FAIRPOINTE CAPITAL

FAIRPOINTE MID-CAP CORE STRATEGY
2ND QUARTER COMMENTARY 2019

Market Environment

Fears of an impending trade war dominated global capital markets in the second quarter. In April, U.S. equities started the second quarter with strong returns, but investors' optimism evaporated in early May when the U.S. raised tariffs on Chinese imports, sending markets into a tailspin. While we saw markets bounce back in June, investors remain very sensitive to trade news and many fear a full-blown trade war may still develop. Although no sector or region was free from these pressures, stocks in the energy, materials, and technology sectors were hit particularly hard during the May selloff. In June, equity returns improved after central banks in Europe and the U.S. adopted a more dovish tone in response to trade news.

The Fairpointe Mid-Cap Composite mirrored the broader market volatility during the quarter. The Composite increased 1.0%, compared to 3.0% for the S&P MidCap 400 Index and 4.1% for the Russell MidCap Index. Year-to-date, the strategy is up 16.2% versus 17.9% for the S&P MidCap 400 and 21.3% for the Russell MidCap. The Russell MidCap gains were largely driven by continued outperformance of growth-momentum stocks in the index.

Even though our quarterly returns aligned with the overall market's trajectory, there are important differences between our portfolio and its benchmark. Our portfolio remains significantly more attractive than the benchmarks based on a number of valuation criteria. It offers considerable upside potential at a time when many U.S. equities appear historically overvalued. In the past, when the portfolio was similarly positioned, it was on the cusp of significant outperformance, and we expect today's situation offers a comparable opportunity.

Although we cannot predict the future—especially when it comes to political issues such as trade disputes and their disruptive impacts on markets—we can position the portfolio to take advantage of short-term volatility in order to generate long-term gains. We are patient investors and look to invest in good businesses that are trading at attractive valuations.

Second Quarter Review

The top five contributors to performance in the quarter were McDermott International, Inc. (MDR), Owens Corning (OC), Copa Holdings, S.A. (CPA), Jabil, Inc. (JBL) and Cincinnati Financial Corporation (CINF).

McDermott — an integrated provider of engineering, construction and technology solutions to the energy industry — announced several new contracts and positive updates on existing projects. We expect the company to announce the sale of its pipe fabrication and tank business soon, with proceeds used to pay down debt. There remains substantial opportunity for improved earnings as two remaining legacy projects wind down and merger synergies are realized.

Owens Corning — a leading insulation, roofing and composite company — is being pressured by an activist investor to explore strategic alternatives. The news highlights the stock's attractive valuation.

Copa — this leading Latin American provider of airline passenger and cargo services operates a fleet of over 100 aircraft providing service to 80 destinations across 32 countries in North, Central and South America — posted better than expected results due to strong execution. We expect the company will improve operating margins even further by generating more high-margin ancillary revenue from items like seat assignments, baggage fees, and credit card miles. Because of the company's strong quarterly performance, we trimmed our position but continue to hold the stock due to its long-term potential.

The five biggest detractors to performance were Office Depot, Inc. (ODP), Lions Gate Entertainment Corp. (LGF.A and LGF.B), Mattel, Inc. (MAT), Teradata Corporation (TDC) and Cars.com, Inc. (CARS).

Office Depot — a provider of office products and technology solutions — released a disappointing update on its technology service business (CompuCom). The company is continuing to update its retail stores and is expanding its presence in communities through shared workspaces, Web groups and other local activities. Management has been changed at CompuCom with renewed focus on serving current customers and growing the business. The shares are trading at a very low valuation of 1.8x forecasted 2019 EBITDA. This has been a disappointing holding and we have reduced our position.

Lions Gate — a developer and distributer of motion pictures and television programming — remains misunderstood due to the market's short-term focus, which tends to overlook their astute strategic planning. Currently, the company's Starz network has 25 million domestic subscribers through cable providers and streaming services, and the company is building on its domestic success and expanding its international subscriber base. In fiscal 2020, Lions Gate intends to spend $125 to $150 million to attract international Starz subscribers, targeting an increase from 3 million to 20 million over the next five years. This is a new market with substantial potential and the company has a one-time opportunity to get into the market early. The investment being made now will increase the company's value longer term. In addition, the company's unique content makes it an attractive strategic takeover target. Because of these factors, we added to our position in the quarter.

Mattel — a leading toy manufacturer — reported better than expected revenue and earnings results in its most recent quarter. Mattel did not raise 2019 guidance, which disappointed investors. The shares also came under pressure due to continued global trade disruptions, which have the potential to raise costs near-term. We have confidence in management's turn-around plan, which is ahead of schedule and should lead to improved performance. We believe additional efficiencies will be gained as the company pivots to a capital-light model by selling owned manufacturing plants. We added to the position in the quarter as we are pleased by the progress the company is making and the long-term potential for margin improvement and brand licensing development.

Portfolio Changes

Agilent Technologies, Inc. (A) — We initiated a position in this leading provider of instruments, software, and consumables for the life sciences, diagnostic, chemical analysis and energy markets. Agilent shares are trading at a discount to peers based on management recently lowering their revenue expectations for China, after the country took steps to lower the price of generic drugs as well as a disruption in the country's food testing market. Despite the near-term weakness in China, we believe the long-term opportunity is strong and expect the food safety testing market to recover, as the Food Ministry is focused on improving the country's food quality. We expect the company to continue to increase the value of its franchise, based on new product introductions and the growing demand from its pharmaceutical and environmental end markets. We are positive on the company's long-term opportunity in China and viewed the step back in the stock price as an opportunity to own a growing, high-quality company in the portfolio.

Perspective and Outlook

The portfolio has a 20-year track record of investing in a concentrated portfolio of midcap stocks. As long-term investors not deterred by short-term price volatility, our portfolio is often inexpensive relative to the benchmark. Due to the market's strong preference for growth and momentum stocks over the past several years, this disparity is about as wide as it's ever been.

The portfolio currently trades at a price-to-earnings multiple of 0.81x relative to the S&P MidCap 400 index. In the past 10 years, the portfolio has reached this level of relative value on only a few occasions, and each time, the portfolio was on the verge of significant outperformance. For example, in the third quarter of 2012, the portfolio's P/E ratio was 0.81x, relative to the index. Then, in 2013, the portfolio returned 44.6%—one of its best relative performance years. The portfolio reached a P/E of 0.80x during the second quarter of 2016 and then went on to return 24.6% for the year, following a second half rebound. In short, value does not stay unrecognized forever. We remain committed to identifying companies that offer the best long-term investment potential through a process that is focused on valuation, but also requires a compelling business model, effective management and financial strength. Our long-term track record demonstrates our success in identifying undervalued companies.

More specific to today's uncertain global backdrop, our commitment to frequent and in-depth conversations with company management teams has become even more critical. We believe it is imperative to understand and assess how tariffs will impact our holdings. While the U.S. and China have restarted trade discussions, the existing 25% tariffs on $250 billion in Chinese imports remain in place. With this in mind, we expect companies to adjust supply chains and production locations over time. Prices for goods and services will rise in the U.S. Companies may decide to reduce capital investment due to the ongoing uncertainty. Under this scenario, we will continue to manage the portfolio—by investing in stocks where short-term concerns offer the highest long-term value appreciation potential.

Thank you for your continued interest and support.

Fairpointe Investment Team

DISCLOSURE

Year End	Total Firm Assets (USD) (millions)	Composite Assets (USD) (millions)	Composite Number of Accounts	Annual Performance Results Composite		S&P MidCap	Russell MidCap	Composite Dispersion
				Gross	Net			
2018	2,935	2,755	Eight	(17.62%)	(18.25%)	(11.08%)	(9.06%)	0.24%
2017	5,415	5,091	Seven	12.87%	12.01%	16.24%	18.52%	0.27%
2016	5,178	4,844	Eight	25.56%	24.59%	20.74%	13.80%	0.41%
2015	5,607	5,308	Eight	(9.74%)	(10.42%)	(2.18%)	(2.44%)	0.81%
2014	7,733	7,389	Seven	10.79%	9.97%	9.77%	13.22%	0.38%
2013	6,999	6,692	Seven	45.67%	44.58%	33.50%	34.76%	1.00%
2012	3,853	3,633	Six	17.76%	16.83%	17.88%	17.28%	N.A.
2011	3,398	3,210	Five or Fewer	(5.36%)	(6.10%)	(1.73%)	(1.55%)	N.A.
2010*	-	2,871	Five or Fewer	24.49%	23.50%	26.64%	25.48%	N.A.
2009*	-	1,493	Five or Fewer	66.28%	65.03%	37.38%	40.48%	N.A.

* Information presented prior to May 1, 2011 pertains to portfolios managed by the Portfolio Managers while affiliated with prior firms. The presentation conforms to GIPS® guidelines regarding the portability of investment results.
N.A. – Information is not statistically meaningful due to an insufficient number of portfolios in the composite for the entire year.

Mid-Cap Composite contains fully discretionary equity accounts that follow the mid-cap style. Mid-Cap Composite represents portfolios that seek long-term total return through capital appreciation by investing primarily in mid-cap stocks. For comparison purposes the composite is measured against the S&P MidCap and Russell MidCap indices. The S&P MidCap is a market value weighted total return index that represents the performance of the medium-capitalization sector of the U.S. Securities market. The Russell MidCap is a market value weighted total return index that represents the midcap segment which measures the performance of the 800 smallest companies in the Russell 1000 index. Both indices are representative of the types of equity assets invested by Fairpointe Capital. Market indices are unmanaged and do not reflect the deduction of fees. You cannot invest in an Index and the performance of the Index does not represent the performance of any specific investment. The minimum account size for this composite is $2.5 million. Prior to May 1, 2011 the account minimum was $5 million. Effective March 31, 2013, the account minimum has gone back to $5 million.

Fairpointe Capital LLC (Fairpointe) claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS standards. Fairpointe has been independently verified for the periods May 1, 2011 through December 31, 2018.

Verification assesses whether (1) the firm has complied with all the composite construction requirements of the GIPS standards on a firm-wide basis and (2) the firm's policies and procedures are designed to calculate and present performance in compliance with the GIPS standards. The Mid-Cap composite has been examined for the periods May 1, 2011 through December 31, 2018. The verification and performance examination reports are available upon request.

Fairpointe Capital is an independent registered investment adviser. The firm maintains a complete list of composite descriptions which are available upon request. Please send inquiries to mkatauskas@fairpointecapital.com or call 312-477-3300.

Results are based on fully discretionary accounts under management, including those accounts no longer with the firm. Past performance is not indicative of future results. Market, economic, company, and industry specific conditions are considered during the investment selection process. This was a period of generally rising security prices.

The U.S. Dollar is the currency used to express performance. Returns are presented gross and net of management fees and include the reinvestment of all dividends, capital gains, and other earnings. Gross returns will be reduced by investment advisory fees and other expenses that may be incurred in the management of the account. Net of fee performance is calculated using actual fees. The annual composite dispersion is an asset-weighted standard deviation calculated for the accounts in the composite the entire year. Policies for valuing portfolios, calculating performance, and preparing compliant presentations are available upon request.

The investment management fee schedule for the composite was 1.0% on the first $10 million and 0.65% on the remainder. Effective March 31, 2013, the fee schedule is 0.85% on the first $10 million and 0.65% on the remainder. Actual investment advisory fees incurred by clients may vary.

The three-year annualized ex-post standard deviation - December 31, 2018 - composite is 16.63% and 13.32% S&P MidCap and 11.98% Russell MidCap; December 31, 2017 - composite is 15.71% and 10.91% S&P MidCap and 10.36% Russell MidCap; December 31, 2016 - composite is 15.87% and 12.23% S&P MidCap and 11.55% Russell MidCap; December 31, 2015 - composite is 14.30% and 11.70% S&P MidCap and 10.85% Russell MidCap; December 31, 2014- composite is 13.4% and 11.1% S&P MidCap and 10.1% Russell MidCap; December 31, 2013 - composite is 18.4% and 15.0% S&P MidCap and 14.0% Russell MidCap; December 31, 2012 - composite is 20.6% and 17.9% S&P MidCap and 17.2% Russell MidCap; December 31, 2011 - composite is 25.0% and 21.9% S&P MidCap and 21.6% Russell MidCap, respectively.

The Mid-Cap Composite was created May 1, 2011. Performance presented prior to May 1, 2011 occurred while the Portfolio Managers were affiliated with prior firms and the Portfolio Managers were the only individuals responsible for selecting the securities to buy and sell.