FAIRPOINTE CAPITAL

FAIRPOINTE ESG EQUITY STRATEGY

3RD QUARTER COMMENTARY 2019

Performance and Our Point of View on ESG

The quarter ended on a positive note, despite market volatility and stock selection which hampered our performance. In September our portfolio returned 4.9%, compared to the benchmark's return of 1.7%. Unfortunately, our strong September performance did not make up for a difficult August environment, and our returns for the quarter were disappointing. The strategy was down 3.0% and underperformed the Russell 1000 Index, which was up 1.4%. This underperformance was largely due to a handful of stocks that lost substantial value based on company specific issues. We discuss these holdings in greater detail on the following pages.

Today, there are numerous databases that provide company ESG data and ratings to asset managers. But the reporting and data collection of this information is challenging. In 2018, the American Council for Capital Formation conducted an independent review of the four largest ESG databases and found "a system that is fraught with problems, from inconsistent metrics, to ratings which continually fail to account for different regulatory regimes across distinct geographies." The report concluded that the most concerning aspect of these databases was their inconsistent use of "proprietary methodologies, metrics, weightings, and even definitions of what constitutes ESG."[1] In other words, managers who rely solely on ESG databases may be getting inaccurate, inconsistent, and highly subjective assessments of the companies they are considering for investment. Most passive ESG funds must utilize these databases and also include as many as 1000 stocks of large cap companies. These large cap companies are owned across multiple passive funds, meaning that the passive ESG funds are typically not very distinct from other large index funds. As a result, these funds have a high correlation to broader stock market performance and a very superficial approach to ESG investing.

Our ESG approach is deep. Our strategy typically includes 35-40 stocks, and the top ten holdings comprise about 30-35% of the total portfolio. Investing in fewer securities may mean greater volatility, as we experienced this quarter. But we believe that it is especially important for an ESG strategy to maintain a high conviction portfolio. This is the best way to ensure that the companies we invest in truly follow the aspirational principles. We strive to select companies that include sustainability in their business practices and have established ESG principles and goals. We do in-depth research to determine which companies adhere to our ESG standards—as well as provide the most attractive investment opportunity. We assess the material risks that the companies are faced with whether they are environmental, social and always governance. Our information is collected through frequent meetings with management teams and review their ESG efforts as well as comb for independent data that is not sourced from the company.

Third Quarter Review – Winners, Losers, New Additions and Eliminations

Winners

The top five contributors to performance in the quarter were Bristol-Myers Squibb Company (BMY), Scholastic Corporation (SCHL), Magna International Inc. (MGA), Smith & Nephew plc (SNN) and Akamai Technologies, Inc. (AKAM).

[1] http://accf.org/2018/07/19/ratings-that-dont-rate-the-subjective-world-of-esg-ratings-agencies/

Bristol-Myers Squibb engages in the discovery, development, licensing, manufacture, marketing, distribution, and sale of biopharmaceutical products. The company's second-quarter earnings beat expectations and they gave positive commentary around their new drug combination, plus the closure of the Celgene deal. This marked a significant improvement over analysts' expectations. The company's revenue surged by 10% for the quarter, which was robust. We see additional catalysts ahead with phase III data on several drugs forthcoming. The company has a strong and comprehensive sustainability effort with good disclosures and articulated targets.

Scholastic publishes and distributes children's books worldwide, operating in three segments: Children's Book Publishing and Distribution, Education, and International. The company's publications include some of the most popular names in children's literature, including Harry Potter, Dog Man, and Wimpy Kid. The stock came under pressure earlier this year, eventually hitting a low of $32 per share in late May. Since then, the stock has rallied impressively, primarily due to a significant surprise in company earnings. The company has been on a profit improvement program for several years which is starting to pay off. We also believe that the company headquarters, a large building in NYC, is an unappreciated/hidden asset. We like their focus on childhood literacy and believe, at its heart, their business is targeted at educating children, a positive impact for our society.

Magna International is a Canadian company that is a major auto parts supplier and assembler. Their results continue to benefit from diversified products and geographic offerings. We admire their commitment to their employees as well as their environmental awareness. Their product mix is not dependent on the growth of the combustion engine, but rather on the use of lighter weight materials, electric vehicles, as well as full automobile assembly. We believe they can generate long term earnings growth and are well positioned to weather any downturn in the auto industry.

Losers

The five largest detractors from performance during the third quarter were Cars.com, Inc. (CARS), Meredith Corporation (MDP), Lions Gate Entertainment Corp. (LGF.A), Patterson Companies, Inc. (PDCO) and General Electric Company (GE).

Cars.com massively stubbed its toe. Cars.com provides an online digital platform that connects consumers with local automobile dealers across the country, with revenues derived from automobile advertising. For almost a year the company's board of directors conducted a strategic review, including the potential sale of the company. In August, this strategic review was completed, and although 29 interested parties came to the table, there was no sale. In addition, the company announced disappointing results for the second quarter. This was certainly not the outcome we anticipated.

We still believe the company has substantial value. Digital automotive advertising is a large and growing market, and Cars.com is a leading player. With the major distraction of putting a company up for sale out of the way, management is now focused on gaining market share. We think the company is poised for improved cash flow generation and we added to our position during the quarter, as did senior management and board members at the company.

CARS is an example of the problems with the ESG database providers rating systems we discussed earlier. CARS scores poorly due to concerns about data privacy, its peer group (which we think is inappropriate), and lack of disclosure. In reality, the data CARS collects is not credit sensitive information, and Facebook amongst others are not appropriate peers. CARS also has been rated poorly on carbon emissions when in reality they have no direct material risks with carbon emissions in their business model.

Meredith produces print magazines and digital media, and it operates 17 television stations located throughout the U.S. The company completed the acquisition of Time, Inc. in January 2018. We like the assets, particularly the local television stations, which we think are attractive due to the burgeoning interest in political news, much of which is accessed through local TV stations. Meredith published investor information a quarter ago showing significant cost synergies.

The company announced results in early September and reduced their outlook. We think the long-term outlook for Meredith is positive due to its improving profitability, deleveraging and the unrecognized value of the television stations. However, the timeline has been pushed out. We added to our position in the stock as have several insiders.

While Meredith's board of directors is a diverse group, corporate governance lacks proper independence and the C-suite lacks gender diversity. Considering the company's audience is predominantly female, we have actively engaged with management and have advocated for improvement.

Lions Gate Entertainment's film business has been known for its low risk budgeting approach and high returns. The Starz media network was added in 2016 which diversified the company into TV production and distribution. In 2019 the company decided to invest significant capital to expand Starz internationally. While we believe that this will pay off long term, it will impact near term profitability and cash flow. While there have been rumors of offers to buy the Starz network for more than their purchase price, Lions Gate has turned down offers, believing there is greater enhancement to value that they can make. The stock performance reflects concerns about the longer term returns on this investment.

One ESG issue at Lions Gate is their corporate governance with two classes of stock (one non-voting), and less than ideal independence of directors. We own the voting stock and have actively engaged with management on their corporate governance and compensation.

New Additions

Waters Corporation (WAT) is an analytical laboratory instrument company. Its tools are used for pharmaceutical, industrial, food, and environmental quality testing as well as supplying consumable reagents for use with their tools. Concerns about China's outlook, as well as competition, have created an opportunity for us to add to this high-margin franchise that generates strong cash flow. Waters gets high marks for its community and employee programs as well as a strong focus on safety. Their products are critical and used for testing environmental qualities. Waters has a diverse board as well as programs in place to measure gender pay equity.

Corning Incorporated (GLW) is a multinational technology company specializing in glass, ceramics, and related materials. Much of their business involves advanced optic technology used in industrial and scientific applications, with a significant opportunity in 5G. The stock price fell in mid-September after Corning reduced the outlook for two of its business segments—optical communications and display technologies.

In addition to solid fundamentals, the company is also attractive to us because of its strong, long-term commitment to ESG principles. It has been a leader in clean air technologies, receiving an award for its practices from the European Commission in 2018, as well as the Energy Star Partner of the Year award from the U.S. EPA for each of the past five years. In addition to its environmental commitments, Corning has focused on diversity and inclusivity initiatives for the past fifty years. Women now make up 40% of all of its employees, up from about 20% fifteen years ago. In 2017, the company achieved 100% pay equity between men and women employees in the U.S. Finally, the company has dedicated significant resources to creating a more welcoming workplace, especially for LGBT and disabled employees. Given its strong ESG record and its attractive valuation, we were pleased to add Corning to our portfolio during the quarter.

Eliminations

AGCO Corporation is an agricultural equipment manufacturer with a large presence in Europe. It reported strong second quarter earnings, and over the past year the stock has increased 26.6%, a substantial outperformance compared to their industry, which has shown an average 7.8% price increase. We believe the company was fairly valued and were concerned about future results in Europe and the impact on equipment demand from the African swine flu.

Bank of New York Mellon Corporation is a worldwide banking and financial services company. The company has been engaged in a full-scale overhaul for the past two years, led by CEO Charlie Scharf, who recently announced that he would be leaving the company to helm a turnaround at Wells Fargo. Our exit was also driven by the diminished outlook for banks in a falling interest rate environment.

HP Inc. is a vestige of the company formerly known as Hewlett Packard. Though the restructuring efforts are expected to generate impressive savings over the next several years, we believe the turnaround is taking too long, and we've moved on. And we are glad we did, as in early October 2019, it issued guidance that it would significantly fall short of analysts' expectations for 2020 earnings. In addition, it also reported significantly reduced free cash flow. Management is attributing the company's financial woes on the costs of restructuring the business, and it's planning to lay off 7,000 to 9,000 employees to help reduce costs.

Outlook

We are mindful of the news flow regarding tariffs, elections, and recessions, but our focus continues to be on long term investing in sustainable companies. The news flow on ESG topics has become prolific as has awareness of climate change risks. Today Exxon is being brought forth to Congress and has been sued by the Attorney General of New York for its lack of quantification of the regulatory costs due to climate change. Exxon is an example of a company that did not meet our ESG criteria. Instead, we focus on companies that are attentive and prepared for these risks and ultimately should offer investors excess returns.

Thank you for your continued interest and support.

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ESG EQUITY COMPOSITE

Year End	Total Firm Assets (USD) (millions)	Composite Assets (USD) (millions)	Composite Number of Accounts	Annual Performance Results Composite		Russell 1000	Composite Dispersion
				Gross	Net		
2018	2,935	9.9	Five or Fewer	(15.01%)	(15.72%)	(4.78%)	N.A

The ESG Equity Composite includes all fully discretionary equity accounts that invest in all cap equities with no fixed income exposure. The ESG Composite represents portfolios that seek to invest in companies that adhere to good environmental, social and governance practices. For comparison purposes the composite is measured against the Russell 1000 index. The Russell 1000 is a market capitalization-weighted index made up of 1,000 large cap stocks that account for upwards of 90% of the market capitalization of companies traded in the U.S. The index is 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.

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 verification 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 any accounts that would no longer be 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 is 0.85% on the first $10 million and 0.65% on thereafter. Actual investment advisory fees incurred by clients may vary.

The three-year annualized ex-post standard deviation of the composite and the benchmarks are not presented because the composite did not exist prior to 2015.

The ESG Equity Composite was created January 1, 2018.