FAIRPOINTE ESG EQUITY STRATEGY

4TH QUARTER COMMENTARY 2019

In the fourth quarter, the strategy returned 7.24% (net of fees), rebounding from the previous quarter. For the year, the strategy increased 19.13% (net of fees). A high teens annual return would typically be a good year however, the market has experienced an extended period that has favored growth and momentum stocks with less regard for valuation. As active managers with a concentrated portfolio, we will experience periods of both outperformance and underperformance. Recently, we have experienced one of our longer periods of underperformance due to stock selection and the market's favorable view of momentum stocks. However, the recent improved performance of fundamental value stocks, leave us confident about the future. As we write this letter, we are encouraged to see the strategy off to a good start in 2020. As of January 21st, the portfolio has increased approximately 2.6% for the new year.

Digging Deeper into ESG Issues

During the past quarter, no story has captured worldwide attention like the Australian fires. Although in recent days, severe storms have brought relief to many of the fire-ravaged areas, the country has endured tremendous damage since the fires began in September: more than 2000 homes have been destroyed, 10 million hectares of land (larger than the size of Portugal) have been burnt, over 30 people and a staggering one billion animals have died. Not only are the bushfires more likely and intense due to climate change, they actually cause further global warming. Until recently, Australian forests reabsorbed carbon released from fires, but with greater intensity and frequency, the carbon dioxide in the atmosphere continues to rise, creating a powerful negative feedback loop.

The magnitude of the fires has also generated renewed scrutiny of Australia's environmental policies. In particular, Prime Minister Scott Morrison has faced intense criticism, and although he has promised an investigation into the government's response to the fires, he has also continued to defend the country's commitment to supporting—and even expanding—its coal industry!

Yet, as many have pointed out, the problem is not just that Australia is one of the world's largest coal exporters. It is also that the country has embraced thermal coal, which is coal that is burnt to generate energy rather than for manufacturing, and is a major source of carbon-dioxide emissions. Rather than embracing innovative or sustainable practices, Australia has doubled down on an increasingly obsolete industry—one that is propped up by political maneuvering, instead of being subjected to market forces.

Traditionally, the prevailing wisdom has been that the markets don't care about the environment; in fact, market forces have often been seen as driving environmental destruction. Yet, over the past decade, the relationship between markets and sustainability has shifted. Many investors now view sustainable environmental practices as critical for a company's or industry's long-term growth.

Larry Fink, Chairman and CEO of investing behemoth BlackRock, explored the changing relationship between markets and sustainability in his most recent commentary in which he proclaimed: "climate risk is investment risk." Fink went on to argue that environmental concerns "are driving a profound reassessment of risk and asset values…. In the near future—and sooner than most anticipate—there will be a significant reallocation of capital."

While we commend Fink for highlighting how these factors are reshaping investors' understanding of value, we distinguish ourselves from BlackRock's approach, which is strongly rooted in passive investing. In fact, we believe that because risks and values need to be "profoundly reassessed," as Fink claims, we believe that active management is essential for astute ESG investing. The traditional metrics that drive passive investing are not yet capable of adequately assessing and identifying the best ESG practices.

This is at least in part because ESG criteria themselves are not as simple as they seem. This need for a more complex and nuanced analysis arises regularly in our investment process. For example, one of our holdings, Commercial Metals, may not seem like it belongs in a "sustainable" portfolio. After all, steel companies are not known for their strong environmental practices. However, 99% of the company's inputs are recycled from salvaged vehicles, which means that the company does not have to mine ore or use coal-fired furnaces to smelt ore. Commercial Metals uses an electric arc furnace, which is more efficient and requires fewer natural resources to power. It also produces a valuable and essential product—rebar—a necessary ingredient in bridges, infrastructure, buildings, and highways. Although rebar does have a carbon footprint, it is necessary, especially for countries like the U.S. that have aging roads and bridges. Finally, the company is helmed by a female CEO, and, when we initiated our investment, had a female CFO. Looking past its simple sector categorization, Commercial Metals clearly offers many compelling attributes for investors interested in solid ESG practices. It serves as a good example of how we at Fairpointe examine companies with depth and pragmatism not often seen in other ESG managers. We are especially gratified that Commercial Metals was one of our top three performing investments during the fourth quarter of 2019.

Another example of our more in-depth approach can be seen in Mattel, a holding that generated particularly strong returns in December and was our fourth-best performer for the year. Many investors may not consider the environmental impacts of the toy industry, but its products rely on a substantial amount of plastic. Mattel has initiated several innovative and impressive programs to lessen its environmental footprint — the goal to achieve 100% recycled, recyclable or bio-based plastic materials in all products and packaging by 2030—and a Fisher Price toy to be launched this year from sugar-cane based plastic. Recently, we spoke with the company's head of sustainability, who provided compelling information about Mattel's long-term strategies. However, she also indicated that few investors had reached out to her to discuss these issues. One takeaway from this is that, even though professional investors' interest in ESG factors has increased, many do not perform their own due diligence and rely instead on outside ratings.

This raises another interesting advantage of active management. Engaging with company management teams can help investors better understand and assess a company's ESG position. Again, traditional metrics often do not capture these concerns, so talking to company management can provide important insights about innovative programs or policies that are often not widely reported or well understood. We also keep our eyes wide open to green-washing and seek independent verification as well as materiality and context in our process.

Each quarter, we at Fairpointe engage directly with corporate management teams to discuss our concerns and to understand more fully company strategy. This past quarter we held numerous conversations regarding ESG issues.

For example, Cars.com has a low ESG rating by MSCI, which we believe does not accurately reflect the company's or the industry's risks. We provided feedback to increase the effectiveness of their ESG disclosures, and they engaged a consultant to provide further guidance. These efforts have proved beneficial. In early January, MSCI increased the company's scores in three different categories: human capital, product liability, and social. We believe that while the ratings still do not accurately reflect the company's ESG policies, we look forward to future upgrades.

Our work in this area is not limited to our holdings. Fairpointe LLC is a signatory on the United Nations Principles for Responsible Investing which allows us to collaborate with other firms to gain a stronger voice and more influence in company decision-making. We recently joined a group of fellow institutional investors to engage with Kellogg's management team, even though we don't currently have a position in the company. We believe an important aspect of the UN PRI is supporting issues and increased disclosures around business risks—especially those that may impact shareholders long term. In this instance, six firms came together to advocate for action relating to plastic packaging and toxic dyes used in printing. After ignoring requests from a single institutional investor, Kellogg felt compelled to respond to the collective group and has now scheduled a meeting for February.

Fourth Quarter Review

In the fourth quarter, the top five contributors to performance were Cars.com, Inc., Bristol-Myers Squibb Company, Commercial Metals Company, Pentair plc, and QUALCOMM Incorporated.

Cars.com reiterated 2019 guidance in the most recent quarter and announced partnerships with GM, Hyundai and Mitsubishi to develop websites for over 5,300 dealers across the US. For perspective, the company currently has a total customer base of 18,635 dealers. There are tailwinds to earnings in 2020 as spending on affiliate conversions was completed last year. We expect the company will grow free cash flow in 2020 and reduce debt. Shares are attractively valued relative to peers and our assessment of private market value.

Bristol-Myers Squibb has reported better than expected results, and performed well, but we continue to see that the market has not fully valued the opportunity from the acquisition of Celgene and its unique pipeline. Its focus on immune-oncology is powerful and offers strong pricing power. With a strong and longstanding commitment to sustainability with goals and metrics in place, this makes Bristol a core holding for our strategy.

Commercial Metals Company, as discussed earlier, might be considered an odd name for our strategy. We have followed this company for many years and believe that there is still upside in the stock as it integrates its Gerdau acquisition and improves its fabrication division.

The five largest detractors to performance were Teradata Corporation, Meredith Corporation, Molson Coors Beverage Company, International Business Machines Corp., and Adtalem Global Education Inc.

Teradata took one step forward and two steps back in the quarter. Our patience has been tested as the company goes through a transition to a software subscription model. In the long term, the software model should be more predictable, profitable and valuable than the company's prior business model based on one-time license fees. Recurring revenue now accounts for 75% of total revenue and this revenue grew 10% year-over-year in the quarter. The other 25% of revenue is generated from hardware and consulting sales and this revenue is in decline due to Teradata's strategy change. While in hindsight our investment was too early in the transition, we expect 2020 to be the year when total revenue grows, and profitability improves.

Meredith did not meet its promised cost synergy targets in 2019. The company continues to digest the Time acquisition, selling non-core assets and reducing debt. In the most recent quarter, the company reiterated fiscal 2020 guidance. We view Meredith's local television business as an underappreciated asset in a consolidating industry. The potential upside, using a sum of the parts valuation, is approximately $43 per share (year-end close of $32.47). It also sports a 7.8% dividend yield.

Molson recently appointed a new CEO, whom we respect greatly and changed its name to Molson Coors Beverage Company (from Molson Coors Brewing Co.) to better reflect its broader product strategy. Fiscal 2020 will be a transition year as the company invests in marketing and new products. The company has new premium light beers, hard coffee and fruit flavored malt beverages coming to market this year, which we expect to improve top-line performance. Shares trade at an attractive absolute and relative valuation and pay a 4.3% dividend yield.

Two new positions, National Instruments Corporation and QIAGEN NV, were initiated in the fourth quarter. **National Instruments** is a leading provider of automated test equipment and virtual instrumentation software. We are attracted to the company's long-term growth opportunities driven by the increasing complexity of autos, airplanes and electronic consumer products. The company generates 20% plus EBITDA* margins and has a debt free balance sheet. The stock under-performed in 2019 due to global uncertainty driven by trade wars. We believe the long-term outlook is currently under-appreciated. **QIAGEN** offers end-to-end advanced molecular testing solutions to navigate the research process faster, better and more efficiently. We view Qiagen as a high-quality company due to its unique, high-margin and growth products, buoyed by stable consumables sales. Investors soured on the stock when management concluded a strategic review without action taken, but the strong underlying fundamentals of the business remain intact. Both companies score extremely high on all ESG factors, although National Instruments could improve on its bord diversity. One small position was eliminated, Dean Foods Inc.

The portfolio is well positioned for the new year. We own great companies with attractive business models and sound ESG practices acquired at attractive valuations relative to their long-term earnings potential. With these companies in our portfolio, we are optimistic about the year ahead and beyond.

Thank you for your interest and support. We wish you a healthy and prosperous 2020.

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EBITDA: Earnings Before Interest, Taxes, Depreciation and Amortization

ESG EQUITY COMPOSITE

Year End	Total Firm Assets (USD) (millions)	Composite Assets (USD) (millions)	Composite Number of Accounts	Annual Performance Results Composite Gross	Net	Russell 1000	Composite Dispersion
2019	1,347	13.0	Five or Fewer	20.12%	19.13%	31.43%	N.A
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.