FAIRPOINTE CAPITAL

FAIRPOINTE MID-CAP CORE STRATEGY

2ND QUARTER COMMENTARY 2018

2018 has been a bumpy ride for investors as markets returned to normal levels of volatility after years of relative calm and positive returns. Our portfolio has not been immune to these market forces. January started out well (up 5.5%), as several of our well-positioned and undervalued holdings were recognized by the market. For the rest of the first quarter these strong returns evaporated, but in our view, this short-term volatility was not a reflection of our holdings' long-term value. The potential that was realized and rewarded in January has remained in place to date. In fact, there were signs of strength in June when the portfolio outperformed the benchmark. For the second quarter, however, the strategy returned 0.88%, compared to 4.29% for the S&P 400 Midcap Index and 2.82% for the Russell Midcap Index.

As long-term investors, we expect periods of short-term volatility, and we anticipate these dynamics in our process. Looking to the remainder of 2018, we believe this period of volatility will continue due to several factors discussed below. As always, we remain focused on the long-term value of our holdings, rather than the distractions of daily headlines.

Market Commentary

Many of our stocks have been affected by external market forces, even though their long-term value has not changed. The three forces most affecting our portfolio this quarter were: (1) an improved merger and acquisition (M&A) environment; (2) uncertainty over trade policy; and (3) a less accommodative monetary policy.

M&A Environment: The Fog is Clearing

After a prolonged period of uncertainty surrounding regulatory requirements in the U.S. and other countries, M&A activity has finally gained momentum. During the first half of 2018, global M&A activity reached $2.5 trillion, its highest level since the global economic crisis of 2008. This represents a year-over-year increase of almost 65%. After the final regulatory approval of the Time Warner acquisition by AT&T, which had been opposed by the federal government, sentiment surrounding M&A activity improved, and the stock prices of many of the companies involved in potential mergers and acquisitions rebounded. Because our investment process seeks to identify companies with strong balance sheets and attractive valuations, our holdings have often become takeover targets. Increased M&A activity, therefore, should be a positive for our portfolio.

In May, CB&I was acquired by our holding McDermott International. CB&I and McDermott both provide construction and engineering services to oil companies and their stock prices declined due to weakness in the energy sector over the past several years. Uncertainty regarding the merger caused considerable volatility in both companies' shares in the months leading up to the acquisition. Yet, we maintained our investment in CB&I throughout this turbulent period because of its excellent positioning in its critical core product areas. Our understanding of how the merger would work convinced us that the combination of CB&I and McDermott would benefit both companies' shareholders. We have been gratified by the combined company's returns and trimmed our holdings after the acquisition when McDermott's stock rebounded.

Mattel is another top performer for the portfolio whose returns were enhanced by acquisition interest. Like other toy companies, Mattel's share price was hit hard in the fall of 2017 by the news of the Toys R Us bankruptcy. At the time, Mattel was in the midst of a turnaround, spearheaded by the company's new CEO, that was primarily focused on its legacy products, including Barbie and Hot Wheels. In November 2017, Hasbro reportedly approached Mattel with an acquisition offer, which was apparently rebuffed as too low and premature given the company's reinvigorated trajectory. Although we supported the then CEO's long-term strategy, the board became impatient and replaced her in early 2018 with a Mattel director who has a history of deal-making with Disney. With a stabilizing business and an improved M&A environment, Mattel seems well positioned to receive renewed take-over interest. As a result, the stock has gone from being our worst performer in 2017 to our top performer in the past few months—up 25% during the quarter.

Portfolio holding Office Depot has experienced a similar trajectory as Mattel. Another turnaround company and acquisition candidate, the stock was hit hard in 2017. With the M&A environment strengthening, performance was up significantly, inspired by insider buying and an improved strategy. It was one of our best performers in the past quarter, up 20%.

Two other contributors for the quarter include Juniper Networks and Stericycle.

Navigating Unpredictable Trade Policies

Another external factor that has substantially affected our holdings is the on again/off again trade policy of the Trump administration, which has made investors uneasy and increased market volatility around the globe. New tariffs and potential trade wars have also posed challenges to companies' management teams. As a case in point, the management at one of our holdings with operations in China told us that they nervously check the tariff lists every week to see if their products have been added. With this level of uncertainty, it is difficult for global companies to execute long-term strategic plans.

Arconic, a holding that was created in 2016 when Alcoa split into two companies, buys aluminum and other lightweight materials, and then transforms them into value-added engineered products, primarily for the aerospace and automotive industries. The threat of various raw material tariffs has hurt Arconic's stock performance, as has fundamental weakness in the aerospace industry. Arconic's long-term fundamentals remain strong. Its highly engineered aluminum products are well positioned to meet new design standards. Despite this attractive long-term position, Arconic's stock will likely face continued short-term disruptions due to the cost of raw materials and the potential of new tariffs. In our view, these short-term issues enable us to own a high-quality business at an attractive price.

Gerdau SA, a Brazilian-based steel company with a large U.S. presence, was also hurt by tariff uncertainty. In May, tariff negotiations between Brazil and the U.S. ended in confusion and some frustration, which inevitably worried investors. In addition, there have been continued concerns about Brazil's economy after high diesel prices sparked an intense truckers' strike, which interrupted the flow of goods into the country for weeks. This raised the specter of another recession in Brazil, which could in turn drive down demand for steel in the country. As a result, Gerdau's stock price dropped in June. We believe, however, that Gerdau's international presence should help buffer it from country-specific downturns. What's more, the company's innovative and distinctive steel production process is much more efficient than its competitors.

Finally, Copa Holdings, one of our top performers last year, has so far experienced a more difficult 2018. Copa is a well-run airline, based in Panama, that maintains a strong presence in Latin America. It controls the majority of gates in both the new and the existing airport terminals of Panama City and has a growing presence in North America. Despite these strengths, Copa's stock price has suffered because of weakness in Latin American currencies and higher fuel prices. We believe this is a temporary setback that does not affect the company's strong long-term prospects.

Two other detractors for the quarter include LKQ Corporation and Cooper Tire & Rubber Company.

Portfolio Changes

New Position: This quarter we added Molson Coors Brewing, a previous holding and the 3rd largest brewer in the world with strong brands such as Coors, Miller, Leinenkugel's and Blue Moon. Currently, its valuation is extremely attractive and at the low end of its historic range, primarily over concerns about U.S. volume growth. With an innovative management team, the company is primed to generate earnings growth through new products, international opportunities and strong cost discipline.

Eliminated Positions: Chicago Bridge & Iron and Adtalem Global Education formerly DeVry. CB&I was acquired by McDermott, as previously discussed. Adtalem Global Education was eliminated based on high valuations and concern for potential near-term disruptions.

Reduced Positions: Akamai, Cree, The New York Times Company and Unisys Corporation rose during the quarter, so we trimmed them significantly. We also reduced our positions in auto suppliers Gentex, BorgWarner and Lear in order to reduce our exposure to the auto industry, which we see as particularly vulnerable to tariff concerns.

Perspective and Outlook

Has the Fed Supported Momentum Investing?

After years of solid returns, the U.S. equity market is poised for a possible short-term correction and a longer-term shift from momentum to value. In the near term, the market may experience a significant downturn during the run up to November's mid-term election due to heightened rhetoric and uncertainty. More extreme trade policy comments intended to stoke voter turnout could increase anxiety among investors.

More broadly, economic trends indicate that value stocks may soon dominate the U.S. market once again. The bull market of the past 10 years was partly fueled by the Fed's very accommodative monetary policy; and unwinding that policy could slow economic growth. With the Fed increasing rates again in June and signaling that two more hikes could be on the horizon this year, it's becoming increasingly clear that a less accommodating monetary policy is likely. If that occurs, investors might take their profits out of their growth holdings and look for stocks with more intrinsic value, such as the holdings in our portfolio. In fact, in the most recent 30-day period ending July 5, the Russell Midcap Value Index rose 0.67% while the Russell Midcap Growth Index declined 0.89%.

With a P/E much lower than the overall market, our portfolio is well positioned for such a turnaround. The difference between our portfolio's P/E and the S&P 500's P/E is the largest it has ever been. Although we do not view ourselves as "textbook" value investors, valuation always plays a critical part in our process. Recently, we have become even more value sensitive, given the length of the economic expansion and the historic levels of corporate earnings growth.

We are long-term investors who look for companies with clear indicators of unrecognized value. During this unique period of a prolonged bull market, paired with extremely accommodative monetary policy, the true value of many of our holdings has not yet been unlocked, but underlying company fundamentals remain solid. While some of our investments have already begun to generate strong returns this year, we believe that many others are poised for higher valuations.

Thank you for your continued interest and support.

Thyra E. Zerhusen, Chief Investment Officer
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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			
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.
2008*	-	722	Five or Fewer	(42.05%)	(42.53%)	(36.23%)	(41.46%)	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 400 and Russell MidCap indices. The S&P MidCap 400 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 March 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 March 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, 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.