

# Madison Small Cap Fund

## Investment Strategy Letter

### Portfolio Manager Perspective

In the current quarter, small capitalization stocks significantly underperformed large caps, while value indices' returns were below growth across all market caps. The Russell 2000® Index experienced positive absolute performance with returns more muted for the quarter aside from the new GICS communications services sector, which posted a return just above 20%. Health Care and Information Technology were notably strong sectors, while Energy and Real Estate declined during the quarter.

The portfolio experienced positive absolute and relative performance for the quarter, outperforming the Russell 2000 Index, gross of fees, over the period. Throughout different market cycles, the team's focus continues to be on investing in higher quality companies with durable business models, strong balance sheets, leading market positions and seasoned management teams incented to create longer-term shareholder value. We believe that investing in companies with these attributes at a valuation discount provides downside protection and the opportunity for strong absolute returns over longer periods of time. This philosophy has generally supported the portfolio's performance over longer-term investment horizons, consistent with our expectation.

Stock selection was a contributor to relative performance during the quarter. Selection within Industrials most benefitted performance. The Information Technology, Consumer Discretionary, and Real Estate sectors were a partial offset. Allocation among sectors, which is a residual of our stock-by-stock selection process, was negative. This was primarily due to a large underweight in the strongly performing Health Care sector and an underweight in the Information Technology sector.

Albany International was the largest individual relative contributor for the quarter. Albany is a provider of specialty fabric used in the production of paper and engineered composites, predominantly for aerospace applications. The company continues to make significant progress in its role as the sole-source supplier of engine fan blades for the new LEAP engine, which is destined for the next generation of narrow body airplanes. The shares recovered from a slight decline in the previous quarter and appreciated after reporting strong quarterly results in both operating divisions. We slightly trimmed our position, but continue to be highly supportive of our investment thesis and outlook for the company. Luxfer, a manufacturer of high-pressure cylinders and specialty materials used in a broad array of industrial applications, was the second largest relative contributor in the quarter. The shares rose after the company reported better than expected quarterly revenue and earnings. The positive upside was mostly driven by the Elektron segment with particular strength in hurricane meal kits, industrial catalysts and Solumag. Solumag, a well plug made of magnesium that dissolves over time, is growing rapidly by taking share from conventional well plugs that have to be recovered. We maintained our position as we expect management's cost reduction program to materialize over the next couple of years and drive increased earnings.

*Past performance does not predict future results. Please refer to the final two pages of this piece which contain current performance information for the fund, the risks of investing in the fund and a complete list of the fund's individual portfolio holdings as of quarter end. Individual portfolio holdings are identified to illustrate our approach to investing the fund's portfolio and are not intended to represent a recommendation to buy or sell any such security.*

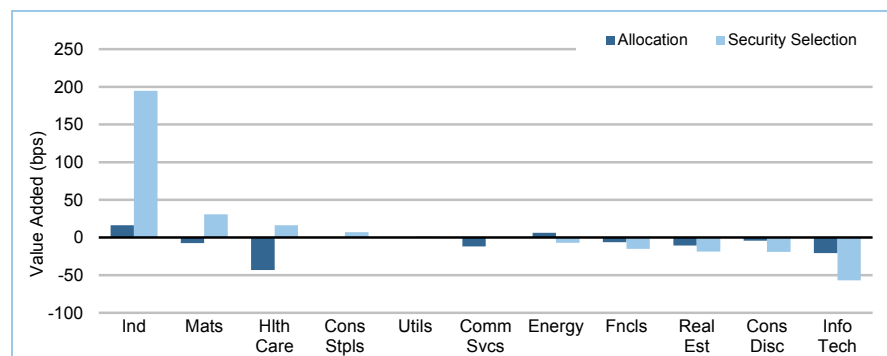
*Performance data shown represents past performance. Investment returns and principal value will fluctuate, so that fund shares, when redeemed, may be worth more or less than the original cost. Past performance does not guarantee future results and current performance may be lower or higher than the performance data shown. Visit [madisonfunds.com](http://madisonfunds.com) or call 800.877.6089 to obtain performance data current to the most recent month-end.*

Diebold Nixdorf, a global provider of automated teller machines (ATMs), point-of-sale (POS) and self-checkout systems, was the top individual relative detractor in the quarter. The shares experienced a significant decline after the company announced another disappointing quarter and outlook. The company has struggled in the execution of the acquisition of Diebold with Wincor Nixdorf and the resulting poor operating results have been exasperated by weak ATM market demand, supply cost increases and disruptions, as well as increased competitive pressure. We eliminated our position in the company during the quarter after determining our investment thesis was no longer supportable with a view that the investment outcome has now become binary. ACCO Brands, a leading branded office products supplier, was the second largest relative detractor in the quarter. The shares declined after the company reported quarterly earnings that were slightly lower than expectations. Although reported revenues were better than expected on good sell-in for back-to-school, a slightly negative product mix and higher costs led to weaker gross margins and the earnings miss. We continue to hold our position, as the shares are very attractively valued and the company continues to grow value through excellent operational management and effective capital allocation.

Based on our long-term time horizon, we continue to find opportunities created by the trading and pricing inefficiencies frequently found among small stocks. Driven by our stock-by-stock decisions, we took a number of actions in the portfolio. During the quarter, we initiated a position in Physicians Realty, a medical office building REIT, as shares declined due to concerns surrounding capital allocation and tenant credit quality. We believe management will assess future capital allocation decisions relative to the cost of capital and as long as the shares trade below net asset value (NAV), future acquisitions will be funded with the proceeds of property dispositions. Separately, the tenant credit issues were limited to a small tenant and likely not indicative of the overall health of the portfolio. The REIT's increased exposure over recent years toward investment grade tenants and primary markets improves organic growth and lowers obsolescence risk. The healthy dividend yield and organic earnings growth provide for an attractive total return at today's stock price.

We eliminated two positions during the quarter. As previously discussed, we sold our position in Diebold Nixdorf. In addition, our position in Education Realty Trust, a student housing REIT, was eliminated after the company was acquired by Greystar Real Estate Partners.

## SECTOR ATTRIBUTION



## RELATIVE CONTRIBUTORS

Company	Sector	Stock Return*	Relative Impact	End Weight
Albany International	Industrials	32.3%	56 bps	2.0%
Luxfer Holdings	Industrials	33.4	35	1.5
Belden	Information Technology	16.8	32	2.9
Steelcase	Industrials	38.0	28	1.1
ESCO Technologies	Industrials	18.0	26	2.2

\*Represents return for period held in the Portfolio.  
Table excludes securities not held in the Portfolio during the period.

## RELATIVE DETRACTORS

Company	Sector	Stock Return*	Relative Impact	End Weight
Diebold Nixdorf	Information Technology	-65.6%	- 36 bps	0.0%
ACCO Brands	Industrials	-18.0	- 34	1.3
TRI POINTE GROUP	Consumer Discretionary	-24.0	- 34	1.0
PotlatchDeltic	Real Estate	-12.0	- 28	1.6
Scorpio Tankers	Energy	-28.3	- 24	0.6

\* Represents return for period held in the Portfolio.  
Table excludes securities not held in the Portfolio during the period.

The stocks of smaller companies often involve more risk than the stocks of larger companies. Stocks of small companies tend to be more volatile and have a smaller public market than stocks of larger companies. Small companies may have a shorter history of operations than larger companies, may not have as great an ability to raise additional capital and may have a less diversified product line, making them more susceptible to market pressure. The investment adviser to the fund is Madison Asset Management, LLC ("Madison"). Madison has delegated the day-to-day responsibility of managing the fund to Wellington Management Company LLP.

Information and opinions presented have been obtained or derived from sources believed by Wellington Management Company LLP to be reliable. Wellington makes no representation as to their accuracy or completeness. All opinions expressed herein are as of the published date and are subject to change.

Mention of these securities should not be considered a recommendation or solicitation to purchase or sell the securities. It should not be assumed that any investment in these securities was, or will prove to be, profitable, or that the investment decisions we make in the future will be profitable or equal to the investment performance of securities referenced herein. There is no assurance that any securities referenced herein are currently held in the portfolio or that securities sold have not been repurchased. The securities mentioned may not represent the entire portfolio.

Russell 2000® Index measures the performance of the 2,000 smallest companies in the Russell 3000® Index, which represents approximately 11% of the total market capitalization of the Russell 3000® Index. Russell Investment Group is the source and owner of the trademarks, service marks and copyrights related to the Russell Indexes. Russell® is a trademark of Russell Investment Group.

Madison Asset Management, LLC does not provide investment advice directly to shareholders of the Madison Funds. Opinions stated are informational only and should not be taken as investment recommendation or advice of any kind whatsoever (whether impartial or otherwise).

Madison Funds are distributed by MFD Distributor, LLC. ©Madison Asset Management, LLC. October 15, 2018.