Mairs & Power Balanced Fund Investor Class MAPOX

Analysis

A diversified, hardy fund despite its regional flavor.
By Tony Thomas 4/7/2017

Mairs & Power Balanced's diversified, lower-risk portfolio has produced competitive returns and a smooth ride for investors, earning a Morningstar Analyst Rating of Silver. Managers Ron Kaliebe and Kevin Earley invest for the long term and keep turnover low. They typically maintain a 60%/40% split between stocks and bonds, preferring dividend-paying stocks and investment-grade corporate bonds. From Kaliebe's appointment as a manager in January 2006 through March 2017, this mix of securities outpaced its allocation--50%-70% equity Morningstar Category peers by 231 basis points.

The managers embrace their firm's preference for companies based near its St. Paul, Minnesota headquarters. They think that maintaining close ties with company management, employees, and the business community gives their fundamental analysis an edge. Almost half of the companies they own are headquartered in the Upper Midwest, but many have diverse, global operations, such as 3M MMM and Ecolab ECL.

The fund's fixed-income holdings have shifted to corporate bonds in recent years as Kaliebe and his team have sought higher yields in a low-rate environment. They dig into issuers' fundamentals just as they do with stocks and look for smaller issuers or companies that can back debt with substantial tangible assets, such as airlines that need to finance their fleets. They are willing to dip below investment-grade occasionally, but only if their research gives them confidence in a company's long-term ability to pay.

The straightforward, prudent approach has generated a solid risk/reward profile with respectable long-term returns and muted risk. Even though it has just 65% invested in equities, the fund's 7.4% annualized return from January 2006 to March 2017 is only 67 basis points below the S&P 500's. And its volatility is well below the market's and its peers'. The fund doesn't fly high in up markets, but it doesn't fall as far in down markets. Its Sortino ratio--a measure of risk-adjusted returns--is 23 basis points higher than the S&P 500's and 39 basis points higher than peers' in the past 11 years.

Process Pillar: Positive

The managers' principled approach to long-term investing earns a Positive Process rating. As is typical for the firm, portfolio turnover is low. Managers Ron Kaliebe and Kevin Earley prefer dividend-paying stocks and businesses that can consistently generate above-average returns on equity. They also favor companies based near their St. Paul office, and over a third of the equity assets are invested in companies headquartered in Minnesota. The equity sleeve is heavy in industrials and healthcare, reflecting Mairs & Power's location in a state known for agriculture, manufacturing, and the Mayo Clinic.

Kaliebe and his team have been paring down fixed-income durations and moving toward higher-yielding corporate bonds because rates have been low. The team evaluates creditworthiness by examining issuers' fundamentals. They favor investment-grade bonds but will dip below-grade if the issuer looks right. They like smaller issuers or debt that is backed by steady cash flows or tangible assets, such as bonds issued by insurance companies or airlines.

Kaliebe and Earley are members of Mairs & Power's 10-person investment committee, which vets current and prospective holdings based on companies' competitive advantages and fundamentals. This collaborative process assists with decision-making and builds a pool of prospective investments.

Managers Ron Kaliebe and Kevin Earley run a moderate-allocation portfolio that targets a 60%/40% mix of stocks and bonds but has leaned more toward equities in recent years owing to low fixed-income rates. The fund currently has 65% of its assets in stocks, a bit above its typical category peer. Most holdings pay a dividend. The equity sleeve usually has 45-60 names. The firm's

Morningstar's Take

Morningstar Analyst Rating: Silver

Morningstar Pillars

Process	Positive
Performance	Positive
People	Positive
Parent	Positive
Price	Positive

Morningstar Analyst Rating

Morningstar evaluates mutual funds based on five key pillars, which its analysts believe lead to funds that are more likely to outperform over the long term on a risk-adjusted basis.

Analyst Rating Spectrum

Gold Silver Bronze Neutral Negative

Fund Performance

	Total Return %	+/- Category
YTD	4.01	-0.95
2016	11.42	4.08
2015	-2.54	-0.61
2014	8.04	1.83
2013	19.02	2.55

Mairs & Power Balanced Fund Investor Class MAPOX

Analysis

regional bias is evident here, with the top holdings dominated by Minnesota-based companies like US Bancorp USB and Medtronic MDT. This bias has also exposed the fund to recent weakness in Target TGT. The team's long-term investing philosophy and their conviction about Target's new strategies are keeping them invested for now.

The managers prefer holding fixed-income securities to maturity, but they are willing to swap for better opportunities. The fund's bond holdings are smaller and more numerous than its equity stakes. It holds 250-plus bond positions, but none are more than 0.5% of total assets. Government bonds made up more than 60% of the fixed-income portfolio in 2007, but low yields have turned Kaliebe's attention to corporate bonds. The fund's bond holdings include securities with insurance companies, energy firms, and airlines. Minnesota-based issuers are less pronounced here, with the exception of firms like Land O'Lakes.

Performance Pillar: Positive

The fund's impressive long-term track record earns it a Positive Performance rating. The portfolio's industrial and energy names faced headwinds in 2015, pushing the fund to its worst calendar-year showing against its peers in the category during the preceding decade. But the managers made adjustments, including exiting ConocoPhillips COP in late 2016 to shift into Chevron CVX, which they believe has a stronger balance sheet and more reliable dividend, and the fund rebounded in 2016.

The fund's industrial and financial names set the pace in 2016, vaulting it to an 11.4% return that was top-decile in its category. Minnesota-based US Bancorp led the charge, followed by recoveries in the stock prices of UPS UPS, Chevron, and J.P. Morgan Chase JPM. Even the fund's healthcare holdings--which focus more on medical devices and diversified drugmakers instead of speculative biotechs--had slight gains in a rough year for the sector.

The fund's long-term performance is impressive. Its trailing one-, three-, five-, 10-, and 15-year returns through March 2017 all rank in its category's top quintile. Since Ron Kaliebe became a manager on the fund in January 2006, the fund's three-year rolling returns have beaten the Morningstar Moderate Target Risk Index in almost two thirds of periods, winning every period from September 2010 through March 2017.

People Pillar: Positive

Mairs & Power's preparations for longtime manager Bill Frels' retirement have led to smooth transitions at this fund. The current team of Ron Kaliebe and Kevin Earley boasts more than 60 years of combined investment industry experience. This stability and veteran leadership merit a Positive People rating.

Kaliebe was named lead manager here on July 1, 2013, after seven years as a comanager alongside Frels. Before arriving at Mairs & Power in 2001, Kaliebe was a portfolio manager at US Bancorp and the chief investment officer at MSI Insurance Companies. While Kaliebe is ultimately responsible for portfolio decisions, he collaborates with Kevin Earley, who joined the firm in 2013 and became comanager here on Jan. 1, 2015. Earley started his investment career at US Bancorp's FAF Advisors, later acquired by Nuveen, and was one of several comanagers on two mid-value funds.

Bob Thompson joined the firm in April 2016 after working with investment-grade and high-yield bonds at Advantage Capital. He is expected to complement Kaliebe's strengths in fixed-income analysis, while Earley focuses on equities.

The firm encourages manager ownership of funds. Kaliebe has more than $1 million invested here, but Earley has not yet built up a substantial stake in his time here.

Parent Pillar: Positive

The success of the Mairs & Power funds reflects the conservative investment philosophy and steady leadership of their advisor, Mairs & Power Inc., earning a Positive Parent rating. The firm's 10 investment professionals form a committee that promotes the core tenets of Mairs & Power's philosophy. They favor buying and holding quality companies that have durable competitive advantages and above-average returns on equity. They prefer companies based near their St. Paul, Minnesota home, believing that ongoing relationships with management and employees give them an edge in fundamental analysis.

The 86-year-old firm had an orderly transition of power when longtime fund manager and CEO Bill Frels ceded his lead manager duties on the Balanced and Growth funds 18 months before his retirement at the end of 2014. Current chairman and CEO Jon Theobald will retire at the end of 2017, with CIO and fund manager Mark Henneman being groomed as his replacement.

There's no rush here to put out new offerings. For more than 50 years, the firm offered just two mutual funds: the flagship Mairs & Power Growth MPGFX, launched in 1958, and Mairs & Power Balanced MAPOX, launched in 1961. The launch of Mairs & Power Small Cap MSCFX in 2011 built upon the team's growing small-cap expertise. Reasonable fees and strong track records add to the attraction of the Mairs & Power lineup.

Price Pillar: Positive

This fund's 0.73% expense ratio is below average for no-load moderate-allocation funds. By comparison, the median fee charged by similarly sold peers was 0.90%. Lower costs give this fund a built-in advantage, an important edge in a category where bonds make up a significant portion of portfolios. The fund earns a Positive Price rating.

Morningstar 2017 Analyst Report: Mairs & Power Balanced Fund (MAPOX)

The Funds' investment objectives, risks, charges and expenses must be considered carefully before investing. The prospectus and summary prospectuses contain this and other important information about the Funds, and may be obtained by calling Shareholder Services at (800) 304-7404 or by visiting www.mairsandpower.com. Read the prospectus and summary prospectuses carefully before investing.

Performance data quoted represents past performance and does not guarantee future results. The investment return and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Current performance of the Funds may be lower or higher than the performance quoted. As of the prospectus dated April 30, 2017, Mairs & Power Growth Fund, Mairs & Power Balanced Fund, and Mairs & Power Small Cap Fund have annual expense ratios of 0.66%, 0.72%, and 1.05%, respectively. For the most recent month-end performance figures, visit the Funds' website at www.mairsandpower.com or call Shareholder Services at (800) 304-7404.

Average Annual Total Returns for Periods Ending December 31, 2017

	YTD[(1)]	1 Year	3 Years	5 Years	10 Years	20 Years	Since Inception
Mairs & Power Growth Fund[(2)]	16.52	16.52	9.23	13.83	9.21	9.64	11.40
Mairs & Power Balanced Fund[(2)]	11.90	11.90	6.71	9.34	7.60	7.75	9.64
Mairs & Power Small Cap Fund[(2)]	7.64	7.64	9.30	14.10	N/A	N/A	17.69
S&P 500 Total Return (TR) Index[(3)]	21.83	21.83	11.41	15.79	8.50	7.20	N/A
Composite Index[(4)]	14.41	14.41	7.87	10.27	7.02	6.65	N/A
S&P 600 Small Cap Total Return (TR) Index[(5)]	13.23	13.23	12.00	15.99	N/A	N/A	N/A
Morningstar Moderate Target Risk Index[(6)]	14.66	14.66	6.93	7.95	5.81	N/A	N/A

(1) Not annualized

(2) Performance information shown includes the reinvestment of dividend and capital gain distributions, but does not reflect the deduction of taxes that a shareholder would pay on Fund distributions or the redemption of Fund shares.

(3) The S&P 500 TR Index is an unmanaged index of 500 common stocks that is generally considered representative of the U.S. stock market. It tracks both the capital gains of a group of stocks over time and assumes that any cash distributions, such as dividends, are reinvested back into the index. It is not possible to invest directly in an index.

(4) The Composite Index reflects an unmanaged portfolio of 60% of the S&P 500 TR Index and 40% of the Bloomberg Barclays Government/Credit Bond Index. It is not possible to invest in an index.

(5) The S&P SmallCap 600 Total Return Index is an index of small-company stocks managed by Standard & Poor's that covers a broad range of small cap stocks in the United States. The index is weighted according to market capitalization and covers about 3-4% of the total market for equities in the U.S. It tracks both the capital gains of the group of stocks over time and assumes that any cash distributions, such as dividends, are reinvested back into the index. It is not possible to invest directly in an index.

(6) Morningstar Moderate Target Risk Index is designed to benchmark target-date and target-risk investment products. Index is based on well-established asset allocation methodology from Ibboston Associates, a Morningstar company. Index has 60% global equity exposure and 40% global bond exposure. It is not possible to invest directly in an index.

The statements and opinions are those of the author as of the date of this report. All information is historical and not indicative of future results and subject to change. The reader should not assume that an investment in the securities mentioned was or would be profitable in the future. This information is not a recommendation to buy or sell. Past performance is not indicative of future results.

All investments have risks. The Funds are designed for long-term investors. Equity investments are subject to market fluctuations and the Fund's share price can fall because of weakness in the broad market, a particular industry or specific holdings. Investments in small and midcap companies generally are more volatile. International investing risks include among others political, social or economic instability, difficulty in predicting international trade patterns, taxation and foreign trading practices and greater fluctuations in price than U.S. corporations. The Balanced Fund is subject to yield and share price variances with changes in interest rates and market conditions. Investors should note that if interest rates rise significantly from current levels, bond total returns will decline and may even turn negative in the short-term. There is also a chance that some of the Balanced Fund's holdings may have their credit rating downgraded or may default. The Small Cap Fund may invest in initial public offerings by small cap companies, which can involve greater risks than investments in companies that are already publically traded.

The stocks mentioned herein represent the following percentages of the total net assets of the Mairs & Power Balanced Fund as of December 31, 2017: 3M Co. 2.11%, Ecolab, Inc. 2.64%, Chevron Corp 1.61%, Conoco Philips 0.00%, J.P. Morgan Chase & Co. 1.57%, Land O' Lakes 0.00%, Mayo Clinic 0.00%, Medtronic PLC 2.91%, Target Corp. 1.03%, U.S. Bancorp 2.74%, United Parcel Service, Inc. 2.53%. All holdings in the portfolio are subject to change without notice and may or may not represent current or future portfolio composition. The mention of specific securities is not intended as a recommendation or offer for a particular security, nor is it intended to be a solicitation for the purchase or sale of any security.

As of 12/31/2017, the risk adjusted return rank for the Mairs & Power Balanced Fund Rank is 70 for 1-year, 34 for 3-year, 28 for 5-year, 6 for 10-year and 10 for 15-year based on 810, 718, 670, 477 and 252, respectively, in the Moderate Allocation Category.

ALPS Distributors, Inc. is the Distributor for the Mairs & Power Funds.

MNP001009 4/30/2018