PORTFOLIO INSIGHTS

Weitz | INVESTMENT MANAGEMENT

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If We May Be So Bold—This Matters to You

Many investors know Weitz to be value-oriented stock investors—and that's true—we are. What some may not realize is that we are also value-oriented bond investors. In fact, over $1 billion of our approximately $4.5 billion in total assets under management is in our bond offerings.

Our bond team patiently seeks out areas of investment opportunity using a fundamental, research-based approach. Instead of managing the portfolios to mirror a particular benchmark, our portfolio managers have the flexibility to invest widely in areas of the bond market where they believe they are being adequately compensated for the risks assumed. Maybe our process sounds pretty standard, but often it is not. Countless bond funds are charged with mimicking a benchmark and, therefore, do not have that same flexibility. Though $1 billion under management may sound like a lot of money (and it is), many well-known bond managers have multiples of that amount under management, limiting their flexibility. Indeed, some bond funds are so large that they have to own nearly everything they can get their hands on.

Below is a broad discussion about what is happening in the bond market (and to some extent the stock market), and why we think it matters how your bond dollars are invested. As you read further, please keep in mind a few bond facts: when interest rates rise, bond prices fall; conversely, when interest rates fall, bond prices rise. All else being equal, the prices of shorter-duration bonds are less sensitive to changes in interest rates than longer-duration bond prices.

We have mostly been in a falling interest rate environment since the 1980s, and especially so since 2008, as worldwide central banks lowered rates to fight the recession. The U.S. Federal Reserve led the way, cutting rates all the way to zero (officially 0.00-0.25%) until December 2015. At that point, the Fed raised the target range for the federal funds rate by 0.25%. In other parts of the world, however, extreme rate cutting is still taking place.

BlackRock data reports that, as of July 5th, approximately 30% of all global sovereign debt yields less than zero. The data also shows that approximately 40% yields 0.00-1.00%. That totals at least 70% of all global sovereign debt—which is unprecedented. With U.S. Treasury debt making up about 60% of the positive-yielding sovereign bonds, investor money is finding its way to the U.S.—more on that later.

Why is this happening today? Central banks, including the U.S. Federal Reserve, have lowered interest rates and engineered multiple money manufacturing programs in an attempt to spur economic growth. They want to encourage borrowing (low rates) and make cash readily available (easy money). Until very recently, however, this attempt had been in vain, as slow to no growth ensued (though it is fair to argue that Fed policies showed merit early on in the recession).

Although U.S. growth is still slow, there are finally some signs of life: consumer spending has increased, supported by wage growth and falling unemployment. In fact, personal spending recently saw its largest increase in seven years. Within this good news, however, lies the dilemma discussed earlier. With the U.S. being one of the only major developed countries having no negative-yielding sovereign debt, U.S. bonds are being sought after. The search for yield has also led many investors to seek dividend-paying stocks as an acceptable option.

Non-U.S. income seekers (pension plans, retirees, etc.), who are being offered negative-yielding domestic bonds, are being all but forced into dividend-paying stocks and U.S. bonds. Domestic income seekers are basically in the same boat. The net effect of all this buying is that stocks and U.S. bond prices are being pushed ever higher. Remember, when demand for bonds is high, those who loan money (governments and corporations) do not have to offer much of an interest rate to find a willing buyer; and as bond yields go lower, bond prices go higher. In this case, it may be that prices are increasing because money is chasing money and not necessarily because economic conditions warrant it. Market distortions that defy conventional investing logic seem unlikely to end well.

We believe that many investors may not be paying enough attention to the inherent interest rate risk and potential credit risk imbedded in bonds (in stocks, valuation risk). While that may sound like the beginning of an excuse for poor performance, it is not. Our bond portfolios—Short Intermediate Income Fund and Core Plus Income Fund—speak for themselves. If you would like an impartial opinion, we invite you to take a closer look at third-party data from reliable sources like Morningstar.com.

At Weitz, our goal is to invest in a portfolio of bonds of varying maturities that we believe represents attractive risk-adjusted returns. We do this while taking into consideration the general level of interest rates and the credit quality of each investment. We have tended to stay mostly shorter in duration, choosing not to take on much interest rate risk. We believe, however, that through careful security selection and reasonable credit risk, it is possible to provide much of the yield of longer-term bonds. Our success is something you can judge for yourself by going to our website and reviewing the data on Weitz Short-Intermediate Income Fund and Weitz Core Plus Income Fund. If you have questions, please contact our client service team at (800) 304-9745 or clientservices@weitzinvestments.com.