Value Matters

April 2, 2019

Dear Fellow Investor,

It Was a Good Quarter

In 2018, business values generally rose, but a nearly 20% decline in the fourth quarter brought stock market indices into negative territory for the year and made stock valuations much more attractive. We thought the stage was set for good returns going forward, but we would not have guessed that a rebound would be immediate.

Market sentiment changed dramatically as the new year began, and the S&P 500 charged ahead by 13.65% in the first quarter. Our stocks participated and all four stock funds earned double-digit gains that outpaced the S&P 500. The Balanced Fund, with less than 50% of assets currently invested in stocks, earned a very strong return as well. Our bond funds also turned in very solid results for the quarter and fiscal year. Tom and Nolan elaborate in their separate Fixed Income Letter. March 31 is the fiscal year end for all our funds, so this quarter's Portfolio Manager Commentaries will include detailed analysis of results for both the three- and twelve-month periods.

The first-quarter equity numbers would make for good ***annual*** returns, so we will not expect this pace to continue. But the year is off to a good start, and it would seem fair for shareholders to celebrate a little. The performance **table** on our website (weitzinvestments.com) shows year-to-date returns as well as the annualized returns for longer periods. As usual, we suggest investors focus on much longer time frames. Ten-, twenty- and thirty-year compounded returns don't guarantee future success, but we believe they support the idea that our version of value investing works over time.

> It was a good quarter. We look forward to an interesting year and hope to build on the first quarter's results.

Interest Rates Matter and Won't Always Be This Low

The buyer of a business focuses on two key questions: How much cash will the business generate in the future for its owners? And how much should she pay today for that stream of cash? The first is about earnings (E). The second is about valuation or price in relation to earnings (P/E).

Choosing the appropriate P/E involves comparisons among investment alternatives, ***current and future***. One of the choices available to a prospective business (or stock) buyer is an investment in "safe" bonds such as Treasury securities. If interest rates on these bonds are relatively low (as they are today), they pose little competition to stocks, and stock buyers will feel tempted (or compelled) to "pay up" for a company's earnings. Thus, the P/E rises. But if interest rates rise substantially, a dollar of stock earnings becomes less attractive ***relative*** to the return available from the safer bond. Thus, some shareholders sell stocks to buy bonds, and P/E ratios decline. Since long-term investors generally plan to hold their shares over a period of years, the ***average*** level of interest rates ***over time*** is more important to them than the ***current*** level. Hence, investors' fascination with "Fed watching" and other strategies to try to predict the future path of interest rates.

A combination of factors has produced historically low interest rates over the past ten years, the Fed's monetary policy being the most visible. The tepid recovery from the last recession and the deflationary forces unleashed by the Internet (Amazon, Uber, Airbnb, etc.) also help explain why rates have remained low. Many believe that today's rates represent a new normal in which low rates are relatively permanent and historically high stock valuations are justified. Skeptics (including us) suspect that cheap and widely available credit produced by the Fed's quantitative easing, along with stimulative fiscal policy in the form of tax cuts and increased deficit spending, will eventually lead to increases in the price of credit, i.e., higher interest rates. We are not predicting hyper-inflation or even a return to the double-digit rates of the 1980s. Rather, we expect modestly higher rates, on average, that would act as a bit of a headwind for stock valuations.

We Don't Know What the Economy Will Do Next, But We Don't NEED to Know

The current slowdown in the U.S. economy may turn into a recession and cause interest rates to move even lower. Or the economy could regain momentum, continue to grow for several more years and set off inflationary forces that lead to higher rates. We believe that ***both*** will happen, possibly multiple times, over the next 10-20 years. We cannot predict how these changes will unfold, but the nice thing about investing in good businesses is that we do not ***need*** to know. Companies with strong competitive positions, able management and liquid balance sheets will take advantage of whatever opportunities come along.

In fact, periods of economic adversity can ***accelerate*** a company's business value growth. The mortgage crisis and recession in 2007-09 allowed Berkshire Hathaway to make some very high-return investments in companies such as Goldman Sachs and Bank of America. When SiriusXM was facing bankruptcy in 2009, Liberty Media came to its rescue with a loan of about $430 million that not only bore a double-digit interest rate but came with virtually free shares of a preferred stock convertible into 40% of the company. Their stake in SiriusXM is worth over $18 ***billion*** today. Comcast and Danaher were able to help GE with its periodic need to shore up its balance sheet by buying businesses from GE on favorable terms.

Further, when uncertainty over economic growth, Fed policy, etc. plagues nervous investors, the resulting volatility often creates opportunities for us to

sell the expensive and buy the cheap. Price moves of individual stocks and of the market in general often carry much further in both directions than is justified by changes in underlying business values. We welcome the volatility.

Companies and Industries Evolve, But Basic Investing Principles Still Hold

Our focus on business value growth over the next 5-10 years does ***not*** mean that we ignore changing business models and industry structures. We have owned some companies for long periods. For example, Berkshire has been in our portfolios continuously since our opening day in 1983. However, we have tried to recognize changing business realities in building our portfolios. Newspapers were great businesses at one time. Then they were not. The economics of TV and radio stations have ebbed and flowed. Cable was primarily a video business, but now its broadband services are more important. Traditional advertising agencies were once essentially collectors of royalties on (rising) consumer spending. Now, TV, radio and print advertising sales have been badly eroded by the advent of Google, Facebook and other digital advertisers. These relative newcomers can offer sophisticated targeting of ads and greater clarity as to the return on an advertiser's investment. Software and online commerce and services have changed almost every type of business. Estimating future cash flows in this arena is a challenge, but for companies with superior products and entrenched competitive positions, we believe that the 5-10 year outlook can be predictable enough to make intelligent valuation estimates.

The business plans and accounting for these companies can be very different from those of traditional old economy businesses. Many technology companies spend massive amounts of capital on R&D and customer acquisition, and these costs are written off as they are incurred. This depresses current earnings, and some growing, successful businesses can appear unprofitable and unfit to be considered value stocks. Yet, this is not so different from cable companies in the 1980s and '90s that spent huge amounts of capital up front to build cable and broadband plant while waiting for subscribers to sign up for their services. When the number of customers reached critical mass—paying growing amounts of recurring cable fees—and spending on plant tapered off, these companies gushed free cash flow. We still aspire to buy shares of a company's stock at a significant discount to what an informed investor would pay per share for the whole business. If we can do this, we will have Ben Graham's "margin of safety" to improve our odds of success.

Outlook

Brexit and a fragile EU, trade wars with China, global tensions and shooting wars, and the spectacle of political wrangling at home will undoubtedly cause anxious moments for investors from time to time. The world can be a messy and dangerous place, but from the narrow point of view of stock and bond investors, we think our prospects are good. Economic, political and regulatory changes usually unfold gradually enough that intelligent managements (and investors) can cope with adversity and find ways to take advantage of opportunities. We look forward to an interesting year and hope to build on the first quarter's results.

Thank you again for allowing us to invest for you. We look forward to seeing you at our annual meeting at the Omaha Regency Marriott on May 22. The meeting will begin at 4:30, and there will be plenty of time for Q&A.

Sincerely,

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Performance data represents past performance, which does not guarantee future results. *The investment return and the principal value of an investment in the Funds will fluctuate so that an investor's shares, when redeemed, may be worth more or less than the original cost. Current performance may be higher or lower than the performance data quoted. Performance data current to the most recent month end may be obtained at* ***weitzinvestments.com****.*

As of December 31, 2018, each of the following portfolio companies constituted a portion of the net assets of Value Fund, Partners Value Fund, Partners III Opportunity Fund, Hickory Fund, and Balanced Fund as follows: Alphabet, Inc. (Parent of Google)-Class C: 6.1%, 5.4%, 5.1%, 0%, and 2.0%. Amazon.com, Inc.: 2.1%, 0%, 1.1%, 0%, and 0%. Berkshire Hathaway Inc.-Class B: 7.9%, 5.9%, 14.9%, 0%, and 2.5%. Comcast Corp.-Class A: 3.1%, 2.3%, 0%, 0%, and 1.4%. Danaher Corp.: 2.4%, 0%, 0%, 0%, and 1.3%. Facebook, Inc.-Class A: 3.5%, 3.1%, 3.6%, 0%, and 0%. Liberty Broadband Corp.-Series A & C: 7.1%. 6.0%, 10.0%, 9.1%, and 0%. Liberty Formula One Group-Series A & C: 0%, 0%, 1.1%, 2.5%, and 0%. Liberty SiriusXM Group-Series A & C: 2.0%, 4.1%, 4.0%, 4.5%, and 0%. Portfolio composition is subject to change at any time. Current and future portfolio holdings are subject to risk.

Included is a reference to the term "margin of safety". This term refers to purchasing securities at a price that is less than our estimate of intrinsic value. A potential "margin of safety" may limit downside risk and optimize the potential for growth.

Investors should consider carefully the investment objectives, risks, and charges and expenses of the Funds before investing. The Funds' Prospectus contains this and other information about the Funds and should be read carefully before investing. The Prospectus is available from Weitz Investment Management, Inc. Weitz Securities, Inc. is the distributor of the Weitz Funds.