Value Matters

October 2, 2018

Dear Fellow Investor,

The 3rd quarter of 2018 was a strong one for the U.S. stock market. As value investors, we focus on the long term and our somewhat defensive posture continued to hold us back from full market participation. Over the last few years, we have refused to join the bandwagon of a "momentum" market in which increasing amounts of investment capital is funneled into the stocks that are going up the most. Eventually, valuation trumps momentum, but in the meantime, disciplined price sensitivity has not been rewarded.

The bond market was "choppy." The Fed continued to slowly unwind its extraordinarily stimulative monetary policy, and despite huge investor demand for even the weakest credits, yields ticked up. This made for rough sledding for bond investors. We feel good that our bond funds held their own, thanks to their conservative positioning. Core Plus, in particular, distinguished itself relative to its peers. We recommend shareholders read the quarterly commentary for Core Plus as well as those of the other funds.

The performance **table** on our website (weitzinvestments.com) shows investment results for all our funds for various intervals over the past 35 years.

In the balance of this letter, we will describe how we are investing in the 10th year of this equity bull market. When asset prices are high and macroeconomic and political forces are mixed, at best, it is especially important to remain focused on what our companies are likely to be worth in 5-10 years. We are confident we can continue to invest successfully in this expensive market without abandoning our principles.

Our Game Plan

U.S. stock investors have many good reasons for enthusiasm. The economy is growing. Corporate tax rates have been cut sharply. The current administration is intent on reducing or eliminating regulations that businesses find burdensome and expensive. Credit is cheap and readily available on easy terms. Psychologically, ten years of bull market gains tend to bolster confidence. The policies that have created these conditions will surely have some unintended consequences, but for now, they are investment positives.

Many stock markets outside the U.S. are suffering from country- and region-specific problems. Europe is dealing with Brexit woes, Italian pushback against EU fiscal rules, and more generally, severe disagreements over refugee policies. Emerging market countries are facing varying degrees of uncertainty over threats of trade wars, and those that have dollar-denominated debt face huge increases in the cost of repaying that debt as their currencies depreciate against the dollar. The woes of these "rest of the world" markets have made U.S. markets all the more (relatively) attractive to global investors.

Our mission is to maximize our clients' wealth over a period of many years. We believe the best way to do that is to acknowledge the inevitability of periodic market corrections and hold a collection of good businesses that can withstand external negatives and continue to grow their business values. To that end, we own several categories of stocks–differing both in business characteristics ***and*** degree of "cheapness"–that we think will serve us well over time.

As a reminder, we believe that a business is worth the value today of all the cash that the business will generate for its owners in the future. We use a discounted cash flow calculation that takes conservative estimates of future cash flows and "discounts" them by 9% per year to reflect the time value of money. We have a high degree of humility as to the accuracy of these estimates, but if a company's value is equal to its current price, we say that its price-to-value (P/V) is 100%. If all our assumptions turn out to be right (including the discounting of future cash flows), if we pay 100% of value, and the stock continues to trade at 100% of value, then we would theoretically earn 9% per year on an investment.

Our mission is to maximize our clients' wealth over a period of many years.

There is no rule that says a stock must eventually trade at 100% of value, but we believe that underlying business value exerts a sort of gravitational pull on stock prices. So, all things being equal, we prefer to buy stocks at a significant discount to 100%. In today's securities markets, however, bargains are few and far between.

We own some ***great*** businesses whose stocks have appreciated significantly from our initial purchases and are now well recognized by investors. A few sell at or even a little above our estimates of their current business values. Given today's opportunity set, we are willing to hold stocks like Mastercard, Visa, Guidewire Software and Thermo Fisher Scientific that have crept up to, and through, 100% P/V on our base case estimates. This may sound like a somewhat heretical statement coming from confirmed value investors, but hear us out. These are companies with significant competitive advantages that we would like to own for a long time. Our conservative appraisals of business value may prove to be just that, and each has a high case with plenty of potential upside. While their stock prices may be a little ahead of themselves for our tastes, these companies are growing very nicely, and even at a modest premium to our base case value estimates, we believe we can earn acceptable positive returns with little risk of permanent loss over the next few years.

There are also some ***very good/great*** businesses for which we have been willing to "pay up" a little, to establish at least starter positions, e.g., CarMax. Stocks like these as well as some long-time holdings like LabCorp (diagnostic testing), Google, Berkshire Hathaway, Oracle (software), Redwood Trust (mortgage investments), Praxair (industrial gases), and Texas Instruments (analog semiconductors) currently sell at 80-95% of our estimated P/V. These do not offer the large margin of safety of cheaper stocks, but we are comfortable holding them for long-term appreciation.

Finally, there are some ***good*** companies whose stocks actually seem very cheap. Prime examples would start with Liberty Global and the two Liberty plays on Charter Communications (GCI Liberty and Liberty Broadband). We believe they are significantly undervalued, and we would buy more if we did not already hold full positions. Housing and construction-related stocks like Mohawk (flooring), Fortune Brands (home and security products), and Vulcan, Summit and Martin Marietta Materials (aggregates and cement) suffer from uncertainty over rising interest rates, home affordability and barriers to infrastructure spending. Other cyclical companies like Colfax (industrial products) and several of our on-deck stocks are subject to fears of recession and/or trade wars. Stocks that look cheap are sometimes cheap for a reason; that is, they have some obvious flaw that clouds the investment thesis. It is often tricky to distinguish between a permanent impairment of value and a good company with a temporary, fixable impediment. We are mindful of the difficulties of investing in such deep value companies, but with careful research, they can prove to be very profitable investments.

Anything can happen when stocks start to sell off. Whether in response to some startling event or merely a last straw that tips the market into an overdue correction, selling can beget more selling. Prices can overshoot on the downside as well as the upside. However, we do not believe that there is a "tragic flaw" in today's economy that would be analogous to the subprime mortgage meltdown or the late '90s tech bubble. Our thought is that as prices come back into line with business values, we may experience periods of subpar stock market returns but not a financial crisis. Very few of the strong, resilient companies we want to own are available at bargain prices, but we need not stop investing altogether. Corrections will happen–they are normal (though strangely absent over the past several years). In fact, we look forward to the day when true bargains are available again and we are able to take advantage of the opportunities. In the meantime, we thank you again for entrusting your investment capital to us.

Sincerely,

Wally Weitz   Brad Hinton

Wally Weitz
wally@weitzinvestments.com

Brad Hinton
brad@weitzinvestments.com

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 September 30, 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: 5.5%, 4.7%, 4.9%, 0%, and 2.1%. Berkshire Hathaway Inc.-Class B: 7.9%, 5.9%, 13.1%, 0%, and 2.4%. CarMax, Inc.: 2.3%, 2.1%, 2.3%, 0%, and 0%. Charter Communications, Inc.-Class A: 1.3%, 0%, 0%, 0%, and 0%. Colfax Corp.: 0%, 3.3%, 3.9%, 4.9%, and 0%. Fortune Brands Home & Security, Inc.: 0%, 0%, 0%, 1.1%, and 0%. GCI Liberty, Inc.-Class A: 0%, 0%, 1.6%, 4.0%, and 0%. Guidewire Software, Inc.: 0%, 0%, 0%, 2.1%, and 1.6%. Laboratory Corp. of America Holdings: 4.6%, 4.7%, 3.4%, 4.7%, and 2.1%. Liberty Broadband Corp.-Series A & C: 0%, 6.5%, 10.1%, 8.6%, and 0%. Liberty Broadband Corp.-Series C: 6.7%, 0%, 0%, 0%, and 2.2%. Liberty Global plc-Class C: 3.3%, 5.9%, 7.1%, 3.0%, and 0%. Martin Marietta Materials, Inc.: 0%, 0%, 0%, 0%, and 1.1%. Mastercard Inc.-Class A: 3.8%, 4.4%, 5.6%, 0%, and 2.0%. Mohawk Industries, Inc.: 2.0%, 0%, 0%, 0%, and 1.0%. Oracle Corp.: 4.5%, 3.5%, 0%, 0%, and 2.0%. Praxair, Inc.: 3.0%, 0%, 0%, 0%, and 2.0%. Redwood Trust, Inc.: 0%, 3.3%, 2.7%, 4.4%, and 1.5%. Summit Materials, Inc.-Class A: 0%, 1.9%, 1.4%, 2.7%, and 0%. Texas Instruments, Inc.: 0%, 3.1%, 2.8%, 0%, and 1.0%. Thermo Fisher Scientific Inc.: 3.1%, 0%, 0%, 0%, and 2.1%. Visa Inc.-Class A: 3.9%, 4.6%, 4.6%, 0%, and 2.1%. Vulcan Materials Co.: 1.6%, 0%, 0%, 0%, and 1.3%. 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.