Weitz | FUNDS

Core Plus Income Fund

4Q 2017 Quarterly Commentary

Investment Style: Intermediate-Term Bond
Portfolio Managers: Tom Carney, CFA & Nolan Anderson

Core Plus Income Fund's Institutional Class returned +0.21% for the forth calendar quarter compared to a +0.39% return for the Bloomberg Barclays U.S. Aggregate Bond Index (Bloomberg Barclays U.S. Agg), our primary benchmark. For the 12 months ended December 31, Core Plus Income Fund's Institutional Class returned +3.03% compared to a +3.54% return for the Bloomberg Barclays U.S. Agg. The Fund's performance **table** on our website shows returns over various holding periods.

Market Commentary

U.S. financial markets were strong throughout 2017 as equities rose in each month of the year. Volatility was low, as evidenced by the S&P 500's record run during which the broad market benchmark has not experienced a decline of at least 3% in over a year. Neither a parade of hurricanes nor earthquakes in Mexico nor the threat of nuclear war in the Korean Peninsula nor equity valuations seen as too rich nor anxieties about the White House have disrupted this bull market rally that has entered its ninth year.

The storyline in the bond markets of low volatility and "risk on" was much the same. Despite rising short-term interest rates, the big bond market winners were those who took on the most interest rate and/or credit risk. Thirty-year Treasuries returned over 9 percent on the year while the lowest grade corporate bonds (rated Caa/CCC) returned in excess of 10 percent.

The table below highlights the progression for select U.S. Treasury yields during the last quarter and past 12 months.

U.S. Treasury Yields (%)

	2-year	3-year	5-year	10-year
12/31/2017	1.89	1.97	2.21	2.41
9/30/2017	1.49	1.62	1.94	2.33
12/31/2016	1.19	1.45	1.93	2.45

Source: Bloomberg

Treasury yields rose (prices fell) during the quarter, while a "flattening" yield curve was a key development impacting fixed income returns over the past 12 months. The slope of the Treasury yield curve, the difference between short- and long-term interest rates, flattened meaningfully as the year progressed. For example, the spread difference between the 2-year and 10-year Treasury yield decreased from 126 basis points at the beginning of the year to 52 basis points at year end. The Treasury curve has not been this flat since before the credit crisis of 2007-08. A flattening yield curve can result from investor concerns that the Fed's tightening campaign may lead to a "policy mistake" (leading to slow economic growth, or even a recession) and/or investor expectations that inflation will stay low or even decline.

In December, the Fed increased short-term interest rates for the third time in 2017 and for the fifth time since the end of the Great Recession in 2009–and suggested that short-term rates may be raised further in 2018.

Corporate bonds and other credit-sensitive securities outperformed their Treasury counterparts of comparable maturity as spreads (the incremental return investors demand above U.S. Treasury bonds for owning corporate debt) narrowed. A broad measure of investment-grade corporate bond spreads compiled by ICE Bank of America Merrill Lynch declined 8 basis points in the fourth quarter and 31 basis points for the full year to 99 basis points at December 31.

Portfolio Positioning

The table on the following page highlights the change in allocation to various sectors for the most recent quarter and compared to a year ago. We believe this summary provides a readable view of how we have allocated capital on your (our shareholders') behalf over time.

Net Assets (%)

Sector	12/31/2017	9/30/2017	12/31/2016
Corporate Bonds	28.5	28.9	34.4
Corporate Convertible Bonds	2.4	2.4	2.8
Asset-Backed	25.9	21.2	19.7
CMBS	1.2	2.2	3.8
Agency Mortgage-Backed	0.3	0.3	0.5
Non-Agency Mortgage-Backed	4.3	4.6	1.9
Municipal	1.1	1.0	1.9
U.S. Treasury	33.3	38.0	26.8
Common Stocks	0.8	0.6	1.6
Cash & Equivalents	2.2	0.8	6.6
Total	**100.0**	**100.0**	**100.0**
High Yield*	**13.8**	**7.7**	**9.4**

**High-yield exposure (as of 12/31/2017) consists of investments in the Corporate, Corporate Convertible, ABS and RMBS sectors.*

Material changes to the portfolio during the quarter included: 1) an approximate 500 basis point decrease in our U.S. Treasury holdings, as we continued to find reasonably attractive qualifying investment opportunities in shorter-duration asset-backed securities (ABS), and 2) an approximate 600 basis point increase in our high-yield exposure. As of December 31, our high-yield exposure was approximately 13.8%, up from 7.7% at September 31 (the maximum we are permitted is 25%).

Overall portfolio metrics as measured by average effective maturity and average effective duration declined compared to the prior quarter. The average effective maturity decreased to 4.7 years from 5.5 years, and the average effective duration decreased to 4.2 years from 4.8 years. These measures provide a guide to the Fund's interest rate sensitivity. A lower average effective maturity and shorter average effective duration reduce the Fund's price sensitivity to changes in interest rates (either up or down). Consistent with the Fund's positioning since inception, we maintain a significantly lower average effective duration profile than the Bloomberg Barclays U.S. Agg (4.2 years vs. 5.9 years for the U.S. Agg). Despite our lower duration profile, the Fund's current (December 2017) Institutional Class 30-Day SEC Yield of 2.76% compares favorably to the income generation of approximately 2.71% for the Bloomberg Barclays U.S. Agg.

Quarterly Contributors

Security selection was the key driver of performance in the past quarter. Primary contributors included:

- Securitized Products. Our ABS, CMBS and RMBS segments of the Fund continued to perform at or above expectations with respect to credit performance and average life progression[1] while providing steady income and some modest price appreciation during the quarter.
- U.S. Corporate Credit. Corporate credit performance was led by high-yield investments in energy, industrials and consumer cyclicals. Our high-yield investments benefited from solid coupon income and (unrealized) price appreciation as credit spreads continued to move lower. Overall positive investment-grade performance was led by investments in communications and information services.

Quarterly Detractors

- Technology-related corporate bonds. Our single largest detractor to performance during the quarter (and calendar year) was the purchase of 7-year new issue Broadcom Communications (AVGO) bonds. Since the bonds were issued in October, credit spreads have widened approximately 50 bps due to potential large-scale M&A activity and risk of increased corporate leverage. Despite solid long-term business fundamentals, we did not appropriately account for the event risk associated with an acquisition-oriented management team. Given the uncertainty around potential event risk and risk of significantly increased leverage, we trimmed our position and booked a loss.
- Common stock (-7.3%) and convertible bonds of Redwood Trust. Despite solid business results for Redwood in the quarter, tax reform and its potential impact on the mortgage market weighed on investor sentiment. We currently do not expect the new tax law to meaningfully impact the company's core business, but will be monitoring the full impact in the months ahead. For added perspective, Redwood's common stock full year results (+4.5% including dividends) contributed solidly to Fund results.
- U.S. Treasury Bonds. Our U.S. Treasury bonds, with an average duration of approximately 8 years, generated a modest negative total return as rising rates (declining prices) outpaced the quarterly coupon income.

Investment Activity

Portfolio investment allocation was weighted toward shorter-term ABS and high-yield corporate bonds. In ABS, we continued adding to our automobile-backed and consumer loan positions. The Fed's three rate hikes in 2017 enabled us to achieve higher yields on one- to two-year investments without taking significant incremental credit risk. Our focus remains on shorter duration (one- to two-year average life) investments backed by seasoned collateral that has experienced steady or better than expected credit performance. In addition, given the extended nature of the current economic cycle, we are increasingly focused on sponsorship quality, with an emphasis on increasing our exposure to management teams with proven experience through economic and capital markets cycles.

In high yield, a notable new addition to the corporate bond portfolio was the non-investment-grade bonds issued by The Manitowoc Company. Manitowoc is one of the nation's largest manufacturers of engineered lifting equipment (e.g., cranes) for a variety of construction applications globally, including petrochemical and industrial projects, commercial, power/utilities, infrastructure and residential construction. Manitowoc estimates that it has leading global market shares in each of the major crane categories in which it participates. Under new management and the leadership of CEO, Barry Pennypacker, the company has adopted "lean" manufacturing (a systematic method for waste minimization within a manufacturing system without sacrificing productivity), has successfully restructured and refocused the business, and is on a path of meaningful credit improvement/deleveraging. Based on the company's improving fundamentals, we believe the Fund's investment in the company's 12.75% bonds maturing in 2021 are likely to be called at their earliest call date (February of 2019).

Outlook–Plus a New Fixed Income Teammate

While we are pleased with the Fund's absolute and relative performance since inception over three years ago, we are disappointed with our 2017 relative results. As mentioned at the outset of this commentary, risk taking (either in the form of interest rate or credit) were the keys to outsized returns in 2017. We particularly errored on the side of not taking enough credit risk, as measured by the amount, quality and duration of the credit risk in our portfolio. After capitalizing on a target-rich environment in 2016, led by our significant exposure to energy related credits, we shifted too far in the opposite direction after the market's (very) swift recovery. In terms of interest rate risk, the Fund has maintained a lower duration profile since inception than the Bloomberg Barclays U.S. Agg. This has enabled the Fund to better protect capital during periods of rising interest rates (e.g., post election 2016). While credit-sensitive investments appear high priced (as measured by overall credit spreads) as we enter 2018, we are encouraged by the improvement in short-term "risk-free" (U.S. Treasury) rates. The prospect for the Fund's forward returns are enhanced by higher short-term base/risk-free rates, as we will be able to reinvest maturing bonds at short-term Treasury returns that haven't been available in nearly ten years. Should the markets experience any turbulence over the course of the year, we maintain significant capacity to increase our exposure to credit risk. In the meantime, our focus is on capital preservation and seeking out opportunistic shorter-term corporate and securitized investments that provide attractive risk-adjusted returns.

Finally, we are pleased to announce a new member to our fixed income team, David Kratz. David is a 14-year member of the Weitz Investment Management family, most recently serving as a product specialist in our sales and marketing group. Having been with Weitz as long as he has, David meets one of the most important qualitative factors we look for in a Weitz teammate–cultural fit. We believe David has the attributes to be an excellent fixed income analyst by complementing the credit work we are already doing and aiding in the search for future investment opportunities.

We thank you for your continued support, and we will work diligently to maintain your trust.

Performance data represents past performance, which does not guarantee future results. *The investment return and the principal value of an investment in the Fund 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****.*

Average annual total returns for the Fund's Institutional and Investor Class for the one-year and since inception (7/31/14) periods ended December 31, 2017, were 3.03% and 3.39% and 2.83% and 3.19%, respectively. Returns assume reinvestment of dividends and redemption at the end of each period, and reflect the deduction of annual operating expenses, which as stated in the most recent Prospectus are 1.23% (gross) and 1.91% (gross) of the Fund's Institutional and Investor Class net assets, respectively. Returns also include fee waivers and/or expense reimbursements, if any; total returns would have been lower had there been no waivers or reimbursements. The Investment Adviser has agreed in writing to waive its fees and reimburse certain expenses (excluding taxes, interest, brokerage costs, acquired fund fees and expenses and extraordinary expenses) to limit the total annual fund operating expenses for Institutional Class shares and Investor Class shares to 0.40% and 0.60%, respectively, of each Class's average daily net assets through July 31, 2018.

Average annual total returns for the Bloomberg Barclays U.S. Aggregate Bond Index for the one-year and since Fund inception (7/31/14) periods ended December 31, 2017, were 3.54% and 2.62%, respectively. Index performance is hypothetical and is shown for illustrative purposes only. Comparative returns are the average returns for the applicable period of the reflected index. The Bloomberg Barclays U.S. Aggregate Bond is a broad-based benchmark that measures the investment grade, U.S. dollar-denominated, fixed-rate taxable bond market.

Portfolio composition is subject to change at any time. Current and future portfolio holdings are subject to risk.

[1]**Average Life Progression:** A measure of repayment speed for a collateral pool (for example, a collection of mortgages may serve as the collateral pool for an issuance of mortgage-backed securities).

Investors should consider carefully the investment objectives, risks, and charges and expenses of the Fund before investing. The Fund's Prospectus contains this and other information about the Fund 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.