Weitz | FUNDS

Nebraska Tax-Free Income Fund

1Q 2018 Quarterly Commentary

Investment Style: Municipal-State Bond
Portfolio Manager: Tom Carney, CFA

Nebraska Tax-Free Income Fund returned -0.89% in the first calendar quarter compared to a -0.57% return for the Bloomberg Barclays 5-Year Municipal Bond Index, our primary benchmark. For the fiscal year ended March 31, 2018, the Nebraska Tax-Free Income Fund's total return was -0.07% compared to a +0.65% return for the benchmark. The Fund's performance **table** on our website (weitzinvestments.com) shows returns over various holding periods.

Fiscal 2018 Review

The low volatility environment that characterized the past year ended abruptly in the first calendar quarter of the new year. Exuberance over the positive economic impact of the newly enacted tax legislation quickly gave way to worries about trade wars and whether the Federal Reserve would raise short-term interest rates more aggressively than previously expected. The municipal bond market started the year off particularly poorly, posting the biggest first-quarter loss in more than two decades.

Since changes in U.S. Treasury yields have an impact on all other fixed-income market segments, included below is a table highlighting the progression for select Treasury yields during the last quarter and past 12 months.

U.S. Treasury Yields (%)

	2-year	3-year	5-year	10-year
3/31/2018	2.27	2.39	2.56	2.74
12/31/2017	1.89	1.97	2.21	2.41
3/31/2017	1.26	1.49	1.92	2.39

Source: Bloomberg

During the past fiscal year, U.S. Treasury bond yields moved higher as the economy continued to exhibit slow but steady strength and the Federal Reserve raised short-term interest rates three times. A flattening yield curve was a key development impacting fixed income returns over the past 12 months. The slope of the Treasury and municipal bond yield curve, the difference between short- and long-term interest rates, flattened meaningfully as the year progressed. For example, while overall yield levels rose year over year, the spread difference between the 2-year and 10-year Treasury yield decreased from 113 basis points at the beginning of the year to 47 basis points at year-end. The Treasury curve has not been this flat since before the credit crisis of 2007-08.

Rising "risk-free" (Treasury) interest rates were a headwind for investor returns in the past year, as bond prices and changes in interest rates are inversely related. Municipal bond performance closely matched its taxable government counterparts, as the yield relationship between tax-free municipal bonds and taxable alternatives was mostly unchanged during the year. High-quality 5-year municipal bonds, for example, ended the current fiscal year (March 31) with a yield representing approximately 81% of U.S. Treasuries, essentially unchanged from 82% a year ago. The net effect is that municipal bond yields generally rose in the past year by about the same amount as their taxable government counterparts.

Our Fund's results in the past year, and particularly in this year's first quarter, were disappointing despite our defensive positioning. Short-term interest rates rose more than longer-term rates, which impacted Fund results due to the Fund's larger concentration in shorter-term investments (e.g., approximately two-thirds of Fund assets mature in under 5 years).

Investment activity in the past year was reasonably active, as we took advantage of improved reinvestment opportunities from the increase in the overall interest rate environment. Over the past year, nearly $15 million new investments (approximately 25% of Fund assets) were made.

An example from this year's first quarter includes a nearly $750,000 investment in the 14-year bonds for Douglas County Hospital Authority #2 (Nebraska Medicine) Revenue Bonds. The bonds are secured by an unconditional promise by Nebraska Medicine (the obligated group) as to timely payment of principal and interest. The obligated group is a clinically integrated health system that includes the Nebraska Medical Center, Bellevue Medical Center and the University of Nebraska Medical Center Physicians. Nebraska Medicine has a number of clinical specialties, including solid organ and bone marrow transplantation, cancer services, heart care, trauma, neurological sciences, rheumatology and infectious disease/bioterrorism. While nearly two-thirds of Fund assets mature in under 5 years, these bonds represent the type of longer-term investment we have added in the past year; namely, those with very high credit quality and that offer returns/yield at the time of purchase that have, in many cases, exceeded the comparable U.S. Treasury yield. For example, the yield to maturity and yield to call (or yield to worst) at purchase of the 14-year Douglas County Hospital *tax-free* municipal bonds were approximately 3.46% and 3.16%, respectively. The yield to maturity was greater than 125% of *fully taxable* U.S. Treasury alternative/comparable, while the yield to call was nearly 120% more than U.S. Treasury bonds of comparable term. Put differently, the taxable equivalent yield for this investment for a Nebraska resident in the highest Federal tax bracket would be approximately 6.2%.

Fiscal Year Contributors

- The electricity and public power revenue bond segment was the largest contributor to results in the fiscal year, as strong income returns offset modest (unrealized) price declines due to rising interest rates. Nearly every investment in this segment contributed to results. Primary contributors included the revenue bonds issued by Dawson Nebraska Public Power District, Fremont Nebraska Combined Utility System, Lincoln Nebraska Electric System, Municipal Energy System of Nebraska and Nebraska Public Power District.
- General purpose revenue bonds issued by Omaha Nebraska Public Facilities Corporation, Lincoln-Lancaster County Nebraska Public Building Commission and Nebraska State Certificates of Participation.
- Higher education revenue bonds issued by Nebraska State College Facilities Corporation, Lincoln Nebraska Education Facilities (Nebraska Wesleyan University) and University of Nebraska Facilities Corporation (Health Center and College of Nursing Projects).
- Hospital bond segment led by Douglas County Nebraska Hospital Authority revenue bonds issued for Madonna Rehabilitation Hospital.

Fiscal Year Detractors

- The airport segment revenue bonds issued by Greater Orlando FL Aviation Authority, Metropolitan Washington Airport Authority, Miami-Dade County Florida Aviation Authority and San Diego County California Regional Airport. Strong income returns were offset by modest (unrealized) price declines due to rising interest rates.

Turning to portfolio metrics, over the past year the average effective duration of our Fund increased to 3.7 years from 3.0 years, and the average effective maturity of our bonds increased to 4.1 years from 3.4 years. Overall asset quality of our portfolio remains high, with approximately 84% rated A or better by a number of nationally recognized statistical rating organizations, credit rating agencies recognized by the U.S. Securities and Exchange Commission.

Please visit the Fund's **page** on our website (weitzinvestments.com) for additional details regarding the breakdown of our investment holdings by state, sector and rating. Our investments may be wide-ranging, but our analysis is the same. We strive to own only those investments we believe compensate us for the incremental credit risk we assume. Our overall goal is to invest in a portfolio of bonds of varying maturities that we believe represents attractive risk-adjusted returns, taking into consideration the general level of interest rates and the credit quality of each investment. We will invest one security at a time, relying on a fundamental research-based investment approach, and remain well-positioned with cash and other short-term securities (approximately 25% of Fund assets) to take advantage of any market weakness.

The Fund seeks income that is exempt from federal and Nebraska personal income taxes, but income from the Fund may be subject to federal alternative minimum tax and capital gains taxes.

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 one-, five- and ten-year periods ended March 31, 2018, were -0.07%, 0.61% and 2.16%, 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 0.80% of the Fund's net assets. Returns also include fee waivers and/or expense reimbursements, if any; total returns would have been lower had there been no waivers or reimbursements.

On the last business day of 2006, the Fund succeeded to substantially all of the assets of Weitz Income Partners Limited Partnership, (the "Partnership"). The investment objectives, policies and restrictions of the Funds are materially equivalent to those of the Partnership, and the Partnership was managed at all times with full investment authority by the Investment Adviser. The performance information includes performance for the Partnership. The Partnership was not registered under the Investment Company Act of 1940 and, therefore, were not subject to certain investment or other restrictions or requirements imposed by the 1940 Act or the Internal Revenue Code. If the Partnership had been registered under the 1940 Act, the Partnership's performance might have been adversely affected.

Average annual total returns for the Bloomberg Barclays 5-Year Municipal Bond Index for the one-, five- and ten-year periods ended March 31, 2018, were 0.65%, 1.54% and 3.28%. Index performance is hypothetical and is shown for illustrative purposes only. Comparative returns are the average returns for the reflected index. The Bloomberg Barclays 5-Year Municipal Bond Index is a capitalization weighted bond index created by Bloomberg Barclays intended to be representative of major municipal bonds of all quality ratings with an average maturity of approximately five years.

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

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.