Nebraska Tax-Free Income Fund

4Q 2017 Quarterly Commentary

Investment Style: Municipal-State Bond
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The Nebraska Tax-Free Income Fund returned +1.61% for the 12 months ended December 31 compared to a +3.14% return for the Bloomberg Barclays 5-Year Municipal Bond Index, our Fund's primary benchmark. For the fourth calendar quarter, the Nebraska Tax-Free Income Fund returned -0.18% compared to a -0.70% return for the Bloomberg Barclays 5-Year Municipal Bond Index. The Fund's consistently shorter average life and duration compared to the benchmark hindered full-year results but aided relative results in the fourth quarter.

Overview

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 now 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, long-term municipal bonds (as measured by the Bloomberg Barclays Municipal Long Bond Index) returned over 8 percent, 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 and municipal bond 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 to 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.

Municipal bonds underperformed their taxable government counterparts in the quarter, as the yield relationship between tax-free municipal bonds and taxable alternatives increased. High-quality 5-year municipal bonds, for example, ended the quarter with a yield representing approximately 77% of U.S. Treasuries, up from 71% at September 30. The principal reason for this quarterly underperformance came from increased municipal bond supply related to potential changes to the tax code that was ultimately signed into law late in the year. Municipal bond issuers scrambled to rush deals to the market ahead of the January 1 effective date given the anticipated elimination of the tax exemptions for advanced refunding bonds and possibly, private activity bonds (PAB). Issuance in December was the highest monthly total on record at $64.1 billion, over three times higher than December 2016 (source: sifma). Ultimately, the final version of the Tax Cuts and Jobs Act left PABs tax status unchanged, though the pulling forward of issues in late 2017 is likely to sharply reduce municipal bond supply in early 2018.

Quarterly Contributors

- The higher education segment was the largest contributor to results in the quarter, as strong income returns offset modest (unrealized) price declines. Primary contributors included the revenue bonds issued by Nebraska State College Facilities Corporation and The Board of Regents of the University of Nebraska.
- Primary and secondary education general obligation bonds issued by Papillion-La Vista and Sarpy County (Bellevue) public schools.
- Hospital bond segment led by Douglas County Nebraska Hospital Authority revenue bonds issued for Madonna Rehabilitation Hospital.

Quarterly Detractors

- The electricity and public power segment bonds issued by Lincoln Electric, Loup River and Nebraska Public Power District. Strong income returns were offset by modest (unrealized) price declines.
- General purpose/public improvement segment bonds issued by Sarpy County Nebraska Certificates of Participation. Once again, strong income returns were offset by modest (unrealized) price declines.

Turning to portfolio metrics, the average effective duration of our Fund increased in the quarter to 3.7 years from 3.4 years, and the average effective maturity of our bonds increased to 4.0 years from 3.8 years. Overall asset quality of our portfolio remains high, with approximately 88% rated A or better by one or more credit rating agencies.

Outlook

As mentioned at the outset of this commentary, risk taking (either in the form of interest rate or credit) was the key to outsized returns in 2017. In managing the Nebraska Tax Free Income Fund, we are generally unwilling to assume credit risk unless we view it to be more than appropriately priced. As to interest rate risk, the Fund's long-held strategy has been to avoid or minimize those investments whose success depends on getting the interest-rate "call" right.

Despite the welcome improvement (rise) in short-term "risk-free" (U.S. Treasury) rates, municipal bond yields appear costly or "rich" compared to similar-maturity U.S. Treasury bonds as we enter the new year. Therefore, we expect to continue to position the Fund defensively relative to interest rate exposure while we seek out areas of opportunity. Should interest rates continue to rise, as we saw in the fourth quarter of 2017, our portfolio positioning should prove helpful to results. We remain well-positioned with cash and other short-term securities (approximately 24% of Fund assets) to take advantage of any market weakness.

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

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 December 31, 2017, were 1.61%, 0.87%, 2.29%, 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 December 31, 2017, were 3.14%, 1.83%, and 3.54%. 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.