Weitz Value Investor WVALX

Not getting it done.

Morningstar's Take WVALX

Morningstar Rating	★
Morningstar Analyst Rating	Neutral

Morningstar Pillars

Process	Neutral
Performance	Neutral
People	Neutral
Parent	Positive
Price	Negative

Role In Portfolio
Supporting

Fund Performance WVALX

Year	Total Return (%)	+/- Category
YTD	7.41	-6.65
2016	2.88	-0.35
2015	-4.47	-8.07
2014	9.54	-0.46
2013	31.75	-2.17

Data through 5-31-17

5-16-17 | by Kevin McDevitt, CFA

Weitz Value hasn't produced sufficiently in either its current or former incarnations under its current management. Plus, its high fees create a further hurdle to future success. For these reasons, the fund's Morningstar Analyst Rating is cut to Neutral.

This fund's comanagers, Brad Hinton and David Perkins, officially adopted a strategy embracing high-quality companies in April 2016. But, as they said at that time, this was more an iteration than a sea change. The fund's evolution began when it adopted a large-cap mandate in 2008 and then took a big step away from its value-contrarian roots in 2011, when Perkins became a comanager. In fact, the fund has consistently landed in the large-growth part of the Morningstar Style Box since mid-2011.

As a result of these shifts, the fund's portfolios have migrated from value to blend to, as mentioned, growth. This makes benchmarking the fund's results somewhat problematic. Arguably, the Russell 1000 Index offers the best comparator for the past nine years.

But no matter which index is used, the fund hasn't delivered. Its 8.5% annualized gain since mid-2008 lags the Russell 1000 Index by 1.2 percentage points. The fund has done a bit better on a risk-adjusted basis, but not significantly so. To be sure, not all of this falls on Hinton and Perkins' shoulders. Wally Weitz was a comanager through 2015, and Perkins has only been listed since year-end 2011. Nevertheless, Hinton and Perkins have not created a successful record of their own.

Hindering their efforts is a high expense ratio; what's worse, it has moved in the wrong direction. As of the fund's 2016 annual report, the expense ratio stood at 1.18%, already 28 basis points greater than the large-cap no-load median. But in the December 2016 prospectus, it rose to 1.23%. This higher expense ratio makes the fund's odds of long-term outperformance that much longer. For now, investors are best served looking for cheaper options.

Process Pillar Neutral | Kevin McDevitt, CFA 05/16/2017

This fund is shifting further in the direction of quality; with a less differentiated approach, the Process rating stands at Neutral. The team cut the discount rate it uses to value companies to 9% from 12%. This increases a company's estimated fair value and allows more companies, especially high-quality ones, to enter their target range. Deep-value turnaround plays will be less common and high-quality compounders more so. The team typically looks for stocks that are selling at 70% or so of their estimated fair value. But the required margin of safety also depends on company quality. Distressed or commodity-oriented companies must sell at even deeper discounts to draw the team's interest.

The team looks out as far as 10 years when discounting free cash flows or a company's franchise value, although its investment horizon is usually closer to three to five years. Quality differences between companies are incorporated into valuation estimates through the terminal multiple and the projected return on capital. Companies now receive a 1-7 quality score across metrics such as competitive position, cash flow consistency, reinvestment runway, return on invested capital, and management quality. Financial leverage is also included as a quality component. In the past, the team often tolerated companies with high leverage, but that's less frequently the case these days.

This portfolio has grown a bit more conservative over the years, even as it has become "growthier," especially since 2011. Once known for its all-cap exposure, it adopted a large-cap mandate in June 2008. Since then, the fund has generally stuck to stocks with a market cap greater than the Russell 1000 Index's median. As a result, the fund's mid-cap exposure dropped to 21.6% in March 2017 from 33.4% in June 2008.

The fund remains highly concentrated. Consumer discretionary stocks, for instance, remain a notable overweighting at 30.2% of assets versus 12.8% for the benchmark, although the Russell 1000 Growth Index has a 21% weighting. It also invests in a limited number of stocks. Top-20 holding MasterCard MA epitomizes the type of high-quality company--rather than contrarian turnaround play--that the managers now look for. There are only 28 stocks in the portfolio, with 48% of assets in the top 10 holdings. Most of the holdings that are covered by Morningstar have a competitive Morningstar Economic Moat Rating.

In the past, the fund often tolerated companies with high leverage, but this has changed as well. The March 2017 portfolio's average debt/capital was 42%, down from 45.5% in April 2016, versus 44.6% for the Russell 1000 Growth Index. This is still much higher in absolute terms than in years past. Such balance-sheet risk is partly offset by a big cash stake, which was recently 16.6%.

Performance Pillar Neutral | Kevin McDevitt, CFA 05/16/2017

After having been an all-cap value offering, this fund adopted a large-cap mandate in June 2008. Since then its portfolios have migrated across the Morningstar Style Box from value to blend to growth. Arguably the best benchmark for the fund for the entire period is the Russell 1000 Index; it lagged that bogy by 1.2 percentage points annualized through April 2017. It has done a bit better on a risk-adjusted basis thanks in part to often large cash stakes, but not significantly so. For this reason, the fund receives a Neutral Performance rating.

The fund's results during downturns are mixed. It turned in a poor showing during the 2007-08 credit crisis. Its 35% financials position in September 2007 was a massive liability. The team subsequently raised the bar on quality, and the fund performed especially well during the mid-2011 correction. But the fund fell nearly 18.1% peak-to-trough (May 21, 2015-Feb. 11, 2016) during the last correction, versus a 14.0% loss for the benchmark.

Furthermore, the fund has endured long dry spells. Its calendar-year returns were in the category's bottom half in seven of eight years from 2001 to 2008. More recently, the fund has trailed its index in each of the past five calendar years. Since 2011, the fund has been mostly in growth territory, and during that nearly 6.5-year stretch, it trailed the Russell 1000 Growth Index by 3.6 percentage points annualized.

People Pillar Neutral | Kevin McDevitt, CFA 05/16/2017

Wally Weitz stepped down as comanager of this fund at the end of 2015, but he remains as CIO. Current comanager Brad Hinton joined Weitz as co-CIO in April 2017, bequeathing his director of equity research role to Drew Weitz. This move freed Hinton from management responsibilities, giving him more time to spend on portfolios and company research.

The fund has not been left in inexperienced hands. Hinton has been a comanager here since August 2006 after joining the firm in 2001. David Perkins became a comanager in 2011, although he has been with the firm since 2004. The two bring different areas of expertise from Wally Weitz, who focused more on financials and media stocks. Hinton was behind the fund's initial foray into technology stocks while Perkins brought familiarity with the energy, materials, and healthcare sectors, areas that were not well-represented in the portfolio before he started as an analyst.

While Hinton and Perkins bring experience to their roles, the fund hasn't done well during their tenures. To be sure, Wally Weitz was at least partly responsible for the fund's results. During the second half of Weitz' tenure from 2001 to 2015, the fund's calendar-year returns landed in the respective categories' bottom half in 11 of 15 years. Nevertheless, the fund has struggled mightily since Hinton and Perkins became comanagers. Without a strong track record of their own, the People rating is cut to Neutral.

Parent Pillar Positive | Kevin McDevitt, CFA 08/13/2015

Weitz Funds gets good marks for stewardship, with the main detractor being the family's slightly above-average overall fees. All of the managers invest in the funds that they run, with firm founder Wally Weitz parking more than $1 million in each of his charges. The independent board members also have significant positions in the funds. As a firm, Weitz has resisted the temptation to introduce trendy funds and has not shown any hint of empire-building. It has a clean regulatory record, too.

Weitz has a strong and established investment culture. Wally Weitz founded the firm in 1983 and is still at the helm, running the advisor and comanaging several portfolios. The equity team is composed of eight portfolio managers and analysts who average about nine years of experience at the firm, excluding Weitz himself.

Admirably, Weitz has worked hard during the past nine years to build the organization behind him. He has promoted internally and in 2006 began selling 2% of the firm each year to employees. Both practices should motivate the team and keep retention strong. The firm's five-year manager-retention rate through July 2015 is 100%. These moves also show a proactive approach to succession planning.

The fund boards have done a good job closing funds before they get too big. However, they haven't cut fees as much as they could. Several funds have above-average expenses.

Price Pillar Negative | Kevin McDevitt, CFA 05/16/2017

This fund's high fees are a huge drawback. The fund's 1.18% expense ratio is well above the 0.90% large-cap no-load median. Its Morningstar Fee Level is High. What's worse, the latest prospectus shows the expense ratio increasing to 1.23%. Quite simply, this fund isn't cost-competitive. It receives a Negative Price rating.

Past performance is no guarantee of future results. Weitz Value Fund-Investor Class (WVALX) average annual total returns for the one, five, and ten-year periods ended March 31, 2017, were 9.81%, 9.30% and 4.00%. Weitz Value Fund-Institutional Class (WVAIX) average annual total returns for the one, five, and ten-year periods ended March 31, 2017, were 10.06%, 9.42% and 4.06%.The returns above 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% and 1.08% (gross) of the Fund's Investor and Institutional Class net assets, respectively. The Investment Adviser has agreed in writing to limit the total annual operating expenses of Investor Class shares and Institutional Class shares (excluding taxes, interest, brokerage costs, acquired fund fees and expenses and extraordinary expenses) to 1.30% and 0.99% of the respective Classes' average daily net assets through July 31, 2017.

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 www.weitzinvestments.com/funds_and_performance/fund_performance.fs. Effective June 30, 2008, Value Fund adopted its current principal investment strategy of investing the majority of its assets in larger-sized companies. Included is a reference to the term "margin of safety." This term refers to purchasing common stock at a price that is less than what a company is believed to be worth, on a per-share basis. A potential "margin of safety" may limit downside risk and optimize the potential for growth. 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. Institutional Class shares became available for sale on July 31, 2014. For performance prior to that date, this report includes the actual performance of the Fund's Investor Class (and use the actual expenses of the Fund's Investor Class), without adjustment. For any such period of time, the performance of the Fund's Institutional Class would have been similar to the performance of the Fund's Investor Class, because the shares of both classes are invested in the same portfolio of securities, but the classes bear different expenses. 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., 1125 South 103rd Street, Suite 200, Omaha NE 68124-1071, weitzinvestments.com, 800-304-9745 or 402-391-1980. Weitz Securities, Inc. is the distributor of the Weitz Funds.

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 Past performance is no guarantee of future results. For each fund with at least a three-year history, Morningstar calculates a Morningstar Rating™ based on a Morningstar Risk-Adjusted Return measure that accounts for variation in a fund's monthly performance (including the effects of sales charges, loads, and redemption fees), placing more emphasis on downward variations and rewarding consistent performance. The top 10% of funds in each category receive 5 stars, the next 22.5% receive 4 stars, the next 35% receive 3 stars, the next 22.5% receive 2 stars and the bottom 10% receive 1 star. (Each share class is counted as a fraction of one fund within this scale and rated separately, which may cause slight variations in the distribution percentages.) The Overall

Morningstar Rating for a fund is derived from a weighted average of the performance figures associated with its three-, five- and ten-year (if applicable) Morningstar Rating metrics. Weitz Value Fund was rated against the following numbers of U.S.-domiciled Large Growth funds over the following time periods: 1,306 funds in the last three years, 1,154 funds in the last five years, and 800 funds in the last ten years. With respect to these Large Growth funds, Weitz Value Fund-Investor Class received a Morningstar Rating of 1 star, 2 stars and 1 star for the three-, five- and ten-year periods, respectively. With respect to these Large Growth funds, Weitz Value Fund-Institutional Class received a Morningstar Rating of 1 star, 2 stars and 1 star for the three-, five- and ten-year periods, respectively.

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