Large-Cap Value

2Q 2017 Quarterly Commentary

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The Large-Cap Value Strategy returned +2.36% (gross of fees), +2.07% (net of fees) during the second calendar quarter, compared to +3.09% for the S&P 500 and +3.06% for the Russell 1000.

With both the equity and bond markets continuing to drift higher, there has been growing interest in the longevity of the now eight-plus-year-old rally. Respected value investor Jeremy Grantham recently grabbed headlines by suggesting higher P/E ratios are likely here to stay, stating matter-of-factly that this upward shift in valuations is in fact "very, very different" (read: sustainable). "The world has changed." Predictably, Grantham has taken his share of flack for making such a bold claim. But Berkshire Hathaway Chairman & CEO Warren Buffett, too, has suggested he doesn't see widespread evidence of overextended valuations within the context of today's long-term interest rate environment. In a February interview Buffett stated "…we are not in bubble territory or anything of the sort…if the 10-year [Treasury Bond yield] stays at 2.3%...for ten years…you would regret very much not having bought stocks now." What will long term interest rates average over the next 10 years? 0%, 2%, 6%? And where will they be in 2027? No one, of course, knows the answer to these questions.

What we do know is today's ultra-low interest rates have generally resulted in a less compelling opportunity set. Earnings streams that were routinely offered at P/E multiples of 12-15x over much of the last 20 years now mostly trade for 18-22x. When the typical investor's alternative is 2-3% 10-year Treasuries or high-grade corporate bonds yielding 3-4%, a broad basket of stocks offering 7-8% hypothetical long-term returns looks attractive (and all the more so when the Federal Reserve stands at the ready with monetary assistance, or promises thereof, at the first sign of equity markets beginning to wane).

In early 2016, we made the decision to lower our hurdle rate for assuming equity risk from 12% to 9%. This was not a decision we took lightly. Cognizant of the risks of skating to where the puck was as opposed to where it may eventually be, we concluded that we had been asking too much of both existing and prospective investments. We had sold a fair number of quality businesses–Texas Instruments, Fidelity National Information Services, Microsoft and Anheuser Busch-InBev, to name a few–at prices we believed still offered low double-digit forward return potential at the time of sale. We also found ourselves passing on prospects we thought likely to produce mid-teens annual returns. These decisions made less and less sense with cash piling up in the portfolio. The goals of adjusting our "ask" were (and are) to: 1) allow us to hold onto stocks we ought to longer (ideally capturing more return, delaying tax realization and lessening the burden of finding qualifying replacements); 2) encourage us to more regularly consider high-quality businesses offering mid-teen return profiles (recent additions Comcast, Oracle, Amazon, Visa and Thermo Fisher Scientific fit this profile); and 3) gradually lead us toward being sustainably more fully invested. We'd like residual cash to eventually average less than 10% of the Strategy's assets, but we are resolved not to "force it."

Importantly, while we believe these process tweaks will be additive to the Strategy's performance over time, our underlying investment philosophy has not changed. We continue to spend our time searching for competitively advantaged businesses, studying the industries in which they live, evaluating the quality of their management teams and framing their ability to generate excess cash flow under a host of different scenarios. We demand a healthy margin of safety upon initial purchase and will sell when prospective returns no longer compensate us for the risks we must bear to earn them.

Portfolio activity has been relatively light through the first six months of the year. During the second quarter, we did not purchase any new securities. Dollar Tree remains our lone new purchase during 2017. We added to the position at more attractive prices during the second quarter and see several potential paths to unlocking value at Family Dollar. We exited the remainder of the Strategy's position in Discovery Communications during the quarter as we continue to favor media distributors amid tectonic shifts in how people consume video.

> The raw material for triggering market volatility is in place, and we are looking forward to taking advantage of it.
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Oracle, Liberty Interactive QVC Group and Alphabet were strong contributors during both the second quarter and year-to-date periods. We lightened our position in the QVC Group tracker during the quarter, using the proceeds to fund the above additions to Dollar Tree. Long-term holdings Aon and Praxair also enjoyed strong second quarter performance. Liberty Broadband, Allergan and LabCorp together have driven roughly a third of the Strategy's gains during 2017.

Liberty Global, Twenty-First Century Fox and Dollar Tree were the three largest detractors to second quarter performance. Liberty Global has struggled executing the initial phases of its ambitious seven million new home buildout across Europe. Despite these setbacks, we continue to see healthy growth in free cash flow per share over the next several years. Fox's share price declined following the departures of star host Bill O'Reilly and several other Fox executives amid allegations of sexual harassment and discrimination. While we are hopeful recent purging results in lasting improvement for Fox's culture, we will continue to monitor the company's progress closely. Our three energy stocks (Range Resources, Pioneer Natural Resources and Halliburton) detracted from performance this year as oil and natural gas prices have struggled under the weight of excess supply. We have been waiting for wider discounts before adding back shares sold at higher levels during the fourth quarter last year.

It should not be assumed that recommendations made in the future will be profitable or will equal the performance of the securities in this list. The holdings identified do not represent all of the securities purchased, sold or recommended for Weitz Inc.'s advisory clients. You may reach Weitz Inc. at 1125 S 103rd Street, Suite 200, Omaha NE 68124, at 800-304-9745 or at weitzinvestments.com.

Investors should consider carefully the investment objectives, risks and charges and expenses of the Strategy before investing. ***Performance data represents past performance, which does not guarantee future results.*** *Portfolio composition is subject to change at any time. Current and future portfolio holdings are subject to risk.*

Performance information in this letter is the weighted-average performance of accounts managed by Weitz Investment, Inc. ("Weitz Inc.") under its Large-Cap Value Strategy (the "Strategy"). All other portfolio holdings information is for a particular "Representative Account" in the Strategy.

Index performance is hypothetical and is shown for illustrative purposes only. Comparative returns are the average returns for the applicable period of the reflected indices. The S&P 500® is an unmanaged index consisting of 500 companies generally representative of the market for the stocks of large-size U.S. companies. The Russell 1000® Index measures the performance of the large-cap segment of the U.S. equity universe. It is a subset of the Russell 3000® Index and includes approximately 1,000 of the largest securities based on a combination of their market cap and current index membership. Russell Investment Group is the source and owner of the trademarks, service marks and copyrights related to the Russell Indices. Russell® is the trademark of Russell Investment Group.

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.