

Small/Mid-Cap Value

2Q 2017 Quarterly Commentary



Portfolio Managers: Wally Weitz, CFA & Drew Weitz

The Small/Mid-Cap Value Strategy returned +2.93% (gross of fees), +2.61% (net of fees) during the second calendar quarter, compared to +2.13% for the Russell 2500.

The investment landscape of the last few years have been challenging to navigate. We have felt for some time that stock *valuations* appear expensive, although stock *prices* paid little attention as they worked their way still higher. Our estimate of the Strategy's price-to-value (P/V) ratio has remained stubbornly high, in the mid-high 80% range, as we have found few cheap investment opportunities that also meet our qualitative requirements. This implies that, in aggregate, our existing businesses are still modestly undervalued, but that's a far cry from seeing an abundance of bargains. Despite this difficult backdrop, the Strategy notched modest wins versus its benchmark during the first two quarters of the year. While we certainly prefer reporting short-term outperformance to the alternative, our objective is to achieve superior absolute performance over the long term. In our view, any three- or six-month reporting period is an insufficient window for measurement of that goal.

Any discussion of performance, absolute or relative, begins with the actual portfolio itself. The quarter benefited from strong gains by rural telecom provider LICT Corp (+44%), perceived takeover excitement at Interval Leisure (+32%) and signs of operating improvements in QVC Group's (+23%) U.S. operations (where a slowdown previously triggered a significant stock price decline in the second half of 2016). These positives were partially offset by a handful of laggards, most notably National CineMedia (-40%), where a tepid advertising market and lackluster box office receipts combined to raise concerns over the stability of the company's large dividend. To a lesser extent, we experienced modest pressure from Liberty Global's European tracking stock (-11%) following a reduction in management's earnings guidance and further declines in our remaining, small position in Fossil Group (-41%) as it searches for a foothold in its turnaround.

Given the portfolio's P/V level and a generally expensive opportunity set, our trading activity is somewhat predictable. We continue to trim our higher-valued holdings, including exiting our positions in Willis Towers Watson and Interval Leisure Group as both saw their stocks trade above our business value estimates. We looked to redeploy the proceeds into existing holdings, mostly notably by continuing to build our positions in Compass Minerals and Liberty Global's Latin American and Caribbean tracking stock. But, as net sellers during the quarter, the Strategy's cash position rose to nearly 27% (up from 21% at the end of the first quarter).

The raw material for triggering market volatility is in place, and we are looking forward to taking advantage of it.

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Despite the relative performance headwind created by this cash position (sometimes described as the opportunity cost of having "dry powder" for future investments), the Strategy did outpace its benchmark in the quarter, thanks principally to the absolute results described above. Additionally, the Strategy benefited from limited exposure to the Energy sector, as sagging commodity prices depressed that group's stock prices.

With expensive market conditions and elevated levels of residual cash, shareholders may be tempted to ask, "Can this year's run of good *relative* results last?" The answer is, of course, we don't know. We can no more predict future returns (relative or absolute) than we can guess tomorrow's stock prices. That said, we are encouraged by the potential return of volatility in stock prices, specifically in the small- to mid-cap space. We are always wary of any single "explanation" of stock market movements, but it did seem to us that in the months following the November election, investors appeared willing to bid up stocks en masse on the notion that significantly lower taxes and regulatory relief were foregone conclusions. Small- and medium-sized companies appeared to disproportionately participate in the so-called "Trump Bump," presumably due to being less multinational in nature than their large-cap brethren, and thus, larger U.S. tax payers. Confronted with the difficulties of translating a political agenda into actual legislation, however, our impression is that stock prices appear to be moving back toward reacting to individual business fundamentals and outlooks. In such an environment, we are encouraged by owning many good and undervalued businesses and believe that price volatility will create future buying opportunities.

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 Small/Mid-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 index. The Russell 2500™ Index measures the performance of the small to mid-cap segment of the U.S. equity universe, commonly referred to as "SMID" cap. The Russell 2500 Index is a subset of the Russell 3000® Index. It includes approximately 2,500 of the smallest 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.