2022 Weitz Annual Meeting Transcript
May 25, 2022

Wally Weitz:

It's been a few years. I think this is – it's been… we had a couple of years off because of that thing that happened. But we're back, and we had the meetings the last two years. We did it online. And it turned out there were people around the country that were shareholders that wanted to be here and couldn't. So we're continuing the online thing. So we may have some comments from the ether as we go along.

But I'm glad everybody's here. I want to introduce our board to you. They're down here in front. And our chair, Lorraine Chang, John Hancock. Del Tobin. Our new newest director, Dana Washington. Wally Weitz, oh, yeah, okay. And Justin Wender. And we now have an advisory board and they're here with us, too. Steve Hill, Allie Malloy, and Betsy Sylvester. Betsy and Justin are both Carlton grads. And there is some… there is some rumbling about stacking the deck with Carlton grads, but we thought it was a good idea anyway.

And somebody who's not with us today, I don't think. Right? Is she here? No. A lot of you actually started working with Mary and me in the Chiles Heider days, in the seventies that preceded this fund company. But she retired this year. And I don't know, I expect a lot of you miss her. I miss her. So I did see Bud Light was on the menu and that it was kind of her choice. So think of Mary.

We do have an agenda. This is I think we have a little more prepared stuff this time than you might be used to from the old meetings in person. But we're going to leave plenty of time for questions. And if you're getting restless about getting to the questions, you know, you can make rude noises or whatever. But these six, they're going to talk to you at first. And then there's various ways you can ask a question, wave your hand, fill out an index card and send it up. There's an email address that's on the screen, and I guess you can text them too. I wonder how many of those we'll get.

But anyway, so I'm going to start with talking about the stock market and somebody asked if I was going to give all the answers, and I said, well, you must be a new shareholder. Because that's not what I do. I don't know. But I'm going to give you my opinion of where we are. So, you know, stock prices are down a lot since the first of the year. And the S&P is down almost 20. The Nasdaq's down almost 30. And there's hundreds and hundreds of stocks that are down 50% or more. But what matters to us, and we'll be talking more about it, is our companies are doing fine. And so, I feel great about them. If they're cheaper, we can buy more and that's OK with us.

Just looking at Partners III that I'm closest to, the average stock in Partners III is selling at about two-thirds of the underlying business value, and that value is growing. So, there's plenty of upside potential and the upside is growing along with the business value.

So where did this bear market come from? A lot of factors. Some of them old, some are new. But as far as I'm concerned, the one big one is the Fed changing course. And they went from pumping, pumping up the stock prices and bond prices to deflating them. And I think a lot of that activity was on purpose, to develop a wealth effect, make people feel better and spend more. I think a lot of it was just they kept at it too long. But anyway, the reason for the reversal in their policy was inflation. And everybody knows, everybody has their own examples. The supply chain disruptions, the labor shortages, war in Ukraine, those are triggers that maybe made the CPI bounce up. And, you know, the word transitory has almost gotten to be a punch line. But those factors probably are temporary. Now, temporary might be a year or two. But I think the bigger factor was the zero interest rates and the quantitative easing that the Fed was doing and the emergency spending that we did for COVID. And that created a gigantic increase in the money supply. And if you remember your Milton Friedman, money supply is related, we think, to inflation. So now we're continuing on with trillion-dollar deficits. And it seems like this cause of inflation is going to be harder to turn off than just getting the supply chain figured out.

So the Fed, after years of trying to get inflation up to 2%, now finds itself trying to get it down from 7% or 8%. And if you're - this is probably a pretty narrow interest, But if you happen to be interested in how the Fed and the Treasury really do their stuff from day to day. There's a book called The Trillion Dollar Triage that is day by day, chapter and verse from the Great Financial Crisis. And then again in 2020.

So we have higher interest rates, and higher interest rates… I'm overgeneralizing a little here, but I think this is, you know, a true statement that higher interest rates generally mean lower stock prices and certainly mean lower bond prices. And it comes by way of lower PE ratios. And so, we've known for ten years, and I think we've been a little early getting prepared for it. But when the Fed finally started to show they meant business, everybody raced to the exits and that's why even though they've barely started, interest rates are up and the stock market's down.

So the reason valuations fall just again, to be a little simplistic about it, is that people are less willing to pay today for earnings that are going to come in five or ten years. And when money market funds and CDs start to yield an attractive rate as opposed to nothing, that creates a lot of competition for stocks. It's possible that some of you would have just as soon had a 5% CD the last ten years, but found yourself in the stock market by default. So anyway, I think the outlook is changed. And you know, GDP and corporate earnings go up almost every year. Every once in a while we have a recession. But you can count on them over 10, 20 year periods going up. But what changes is PE ratios go up and down, and they can trend up or down for many years. And so, I drew some pictures of what I think happens with the changing PE ratios there we go.

Now, I drew this. Don't blame Kevin and don't blame Noella, because they could, they could have made them a lot prettier. But if I can get my magic pointer here, it's just in simple terms, when you have this little making a… I don't see it. I guess if I can't see it, there we go. OK, so earnings going up over the years, PE ratios expanding because of the zero interest rates. And so those two things working together make prices go up a bunch. And that gives you a bull market. That’s my picture of the 1982 to 1999. But then, and that's a period when interest rates generally were going down. You know we started with Volcker's 20% and came down, but I think we might be going into is something more like the late sixties and seventies where, oops, I'm rusty from three years off. So we have earnings keep going up, but if the PEs are going down, then the price is more static. And that gives you a market that looks more like that. And that's what it looked like from ‘66 to ‘82. And that's a wide range there. The range was from 600 to a thousand on the Dow. So percentage-wise there were several big round trips, and there was plenty for us to do. It was really a good time for investing, even though the averages didn't really go anywhere. And this is the kind of market where it really actually pays to know your companies and to pick and choose wisely. In the market where it just goes up and everything follows along, the rich get richer. The big stocks attract the most index money and thinking can almost get in the way. So we're hopeful, we're hopeful for a time for thinking is coming.

So it's, we don't know if down 20 is enough for the S&P or down 30 for the Nasdaq, because the, you know, panicky investors and margin calls can make them overshoot. And the Fed may overachieve and send us into a recession, we don't know, but you know it just doesn't - it's not something we have to know I think, because the, you know, a lot of the excesses in prices have already been squeezed out. The prices today are good and will give us good returns over the next five years. If they go lower, we'll buy some more. But it is tempting to try to sidestep all this. But the one thing I know for sure about markets is, bear markets bottom and start going up again long before you know why, or before the news turns good. So, if you - and we've you know, I've tried - I've been doing this 50 years, I tried to find some - guess, some bottoms, and it just turns out it doesn't work.

So we're going to own good companies. Some of the guys will tell you more about which ones we own.

So as I said at the beginning, I feel great. And several people asked me, you know, when's this bad market over? And it's like, it doesn't matter. It's OK. We look out at the horizon.

I have several colleagues that are going to tell you more detail. But first, I have one more thing. Berkshire. There's never been an annual meeting we didn't talk about Berkshire, I'm pretty sure. Or a quarterly letter. It's been in our Funds from day one in 1983, and before that. Many of you have owned it. Great business. We follow it closely, but a few weeks ago I was elected to the board. And I was honored to hear from Warren. He called it an offer I couldn't refuse, and he was right. And I'm excited about being on it. But being on the board of a public company does create some extra complications for a portfolio manager. So we've had to put in some extra procedures and rules around the office, and I won't be able to take questions about Berkshire. In fact, I think we're not going to take questions just to be on the safe side. I think being around Charlie and Warren and the other managers is going to make me a better investor, and I think it'll make our whole team better. So I think it's a good thing.

Anyway, that's all I know and more about stocks. And I'm going to turn it over to Tom, I think, to tell you about the fun subject. Is the bond market.

Tom Carney:

I got to go turn on. I got to go live.

I'm so nervous. Maybe that's it because I haven't been in front of a live audience in over two years. All of us have spent our lives on Zoom or teams or some other form of video conferencing. So to be live like this is pretty cool. So yeah. Welcome, everybody. Yeah. My job next is to talk about really fun topics, fixed income.

Uh, so I'll start. I figured we'd start with just the basics. Everyone is probably very familiar with this, but fixed income, this is, it's an inverse relationship when it comes to fixed income investing. When interest rates go up, oftentimes your bond prices go down and vice versa. And sometimes we have to remind ourselves of that because we've lived in ten years where it seems like, or longer, 30 years where interest rates have gone, it's been a one-way ticket lower. But we certainly are experiencing so far in ‘22 what happens when interest rates rise and bond prices fall. And I don't mean to necessarily pick on the Fed anymore, but Wally started it, I might as well pile on. Because they've had some great commentary in the last couple of years that have helped in some ways lead to where we're at today. And it is true that we all have to be careful what we wish for. And Wally, he certainly has mentioned the word transitory. We heard it in the press a lot, and that would be that the gentleman at the top Jerome Powell said that quite a bit. And that quote is not as is outlandish as the next two. Both Fed representatives but even as early as September of last year, Mr. Evans commented that he's more uneasy about us not generating enough inflation in ‘23 and ‘24 than the possibility that we will be living with too much. And we always all of us have, I'm sure, say things that “I wish I hadn't said that.” Even Ms. Daly comparably is talking about, we've exercised muscle pushing inflation down so long that changing direction feels unnatural. But that is exactly what we need to do.

Well, they didn't do it. It was a number of things. It was certainly fiscal policy as well. It was the things that Wally mentioned, but we are dealing with multi-decade problems with inflation, and this is the CPI index looking from left to right over many years. And we now sit at a level that is something we haven't seen since the eighties in terms of a CPI inflation number. And we've probably forgotten the wisdom of someone like Reagan who clearly had a much better quote that inflation truly is as violent as a mugger, as frightening as an armed robber and as deadly as a hit man. Because that's what it has really hurt savers in terms of the real returns that they earn on their investments. It has hurt with the lower income as they struggle with the increase in so many different variables, whether it's food or gas on down the line in terms of squeezing that discretionary income. And so it's definitely something as a nation we need to get our arms around broadly, but certainly as investors as well, because it is true that it's hard to put toothpaste back in the tube once you squeeze it out. And that's what we're dealing with now, is inflationary pressures that are percolating all over the place. It's kind of like a Whac-A-Mole. We've got energy going up and then all of a sudden, oh, food prices are a problem, and it's just continues. We certainly see it even in brands that have gone up a lot. That's what goes into the CPI now. It's not our house prices. Those who own a home having their house prices rise a lot, that's not part of the CPI. It's owners' equivalent rent. And that's something once that gets embedded in the economy, it can continue to drive inflation for years to come as those rent prices change and get ratcheted higher.

So on to bonds. Yeah, this hasn't been a great year. So far. Just like stocks, there has been really no safe havens to be an investor. Typically, you would think if stocks are down, bonds are up. But this, again, is a multi-decade sort of experience that investors are living through where stock prices are down, bond prices are down because of this inflationary challenge that we're wrestling with as a country. And so this just highlights through the first quarter how performance across a broad category of fixed income categories were down. And my teammate Nolan's going to even highlight that's only through March 31. It got worse. It is worse. There'll be some good news as I close, but it yeah, that's where we sit today with performance across investment grade corporates, the broad US Aggregate Index, which is a broad index for fixed income investors, to Treasury. Everywhere. It's been a challenge as an investor, at least total returns so far.

And here, we've had some interesting - call it milestones, if you will. April, for example, was only the fourth month since 1973 where the S&P was down more than 5%. It happened to be down 9%, almost 9%. This chart. And Treasuries were down more than 2% in the same month, it actually was down more than 3%. It's only the fourth time since 1973 where it has happened, so we're kind of living through some maybe history we'd rather not repeat. But again it does lead to some potentially better news going forward. In fact, it has been such a tough year for Treasuries that the last time Treasuries had this bad of a performance, George Washington was getting ready to be inaugurated as the first US President. Now this data is a bit, you see by the footnotes that the only way to really track Treasuries well is back to 1941. It's still been the worst start to Treasury since 1941, and then using other surrogates taking us all the way back to the founding of the Republic. So it's been a rough year even for fixed income investors.

What would, what would a Weitz slide be like without including something like Charlie Munger. And despite this change in the interest rate environment, we still have a world that has almost two-and-a-half trillion dollars, dollar-adjusted debt that trades negatively. Switzerland, Japan, and others, there's very few left that still have portions of their capital structure that have negative yields. And this is something that Charlie Munger spoke about in March of 2015 when he used this great phrase, flabbergasted about that. In fact, he said if you find it puzzling your brain is probably working correctly. But yet we still sit here today with countries with negative interest rates. So that has been a factor here, because in a world where capital cross-border flows pretty freely, it has impacted and helped keep our interest rates lower than they probably otherwise would have been.

So where does that leave us today, in the US? A few slides to kind of close out on a little better news. These are pictures of corporate bond spreads which is the incremental return an investor gets for taking credit risk versus what we think of as the safe investment - US Treasuries. The incremental return on the left-hand slide, and then what that yield looks like on the right. A couple of years ago, we were drawing these – if I can do this pointer – yield to worst, this yield slide, t's going uphill now. In 2019, we were going the other way, and we were talking about return-free-risk where returns were so low, we weren't getting paid for the risk we were taking. All of a sudden, kind of to Wally's point about valuations looking much better even in bonds despite the drawdowns, we now have returns as measured by this yield to worst component, that is more than double where it was just a year ago. I chose March 31 of last year. That was the last time we marked it for investors when we had our May shareholder meeting.

And this is investment grade. Pretty broad cross-section of bonds across America. So the risk-reward profile for us as investors has improved. Improved because we're getting paid more in terms of the incremental return on top of a risk-free rate. And then the nominal number, which that is part of, has increased quite dramatically

The same picture can be seen in the high yield market, same kind of, same kind of chart where the returns are much better. We don't manage a full high yield bond fund, but we have portions of our portfolio that we will invest in non-investment grade securities, and in that environment, too, our return profile risk/reward has improved quite a bit.

A couple more slides. We show this in our quarterly correspondence pretty regularly, and it depicts the yield curve, which is a picture of yields across time from really short to really long. And you can see that top one is where we're at very recently. That now, Treasury yields, where'd my blinker go, I lost it. There it is, no. But anyway, the blue line, you can see that we're - just use the two-year as an example, at 260 at the top, whereas a year ago it was all of 0.16. We were very close to being negative a year ago. But that is a - I can do math, you can do math, sixteen-times improvement in return. It's still arguably kind of low, but nevertheless, it really helps in terms of the forward return possibilities that investors have to look forward to. And we see that played out also in investment grade corporate bonds. And this is only through March of this year so it's that top line. The blue line has gone up at least 100 basis points into the four range, which is dramatically better than that bottom chart, which is in the low blue, which is where we were at the end of the year.

So even though there's been dramatic price declines that we've seen, and our Funds, our fixed income funds have experienced some, although we're very pleased, and Nolan will report on relative performance, although it's hard to eat relative performance. But nevertheless, that's - we're in a much, much improved investment environment for our fixed income investors. We're getting paid more for the risks we take. And because of what's happened with Treasury rates that all-in return has improved a lot from where it was a year ago. And having now Nolan and I work together over ten years and having lived through, everyone's probably very familiar with the acronym ZIRP… zero interest rate policy. We've done it twice. I don't want to do it three times. We're finally having the market kind of set interest rates, and that's a good thing ultimately for us and for you as investors.

So with that, I'll turn it over to my teammate Brad to carry on.

Brad Hinton:

Alright. We live here? Yep. Thanks, Tom. You can always count on the bond guy for the big setup. So we'll keep things moving. You know, before we dive into the equity side, I think, you know, Wally in his usual low-key way handled the Berkshire news pretty under the radar. And I think we would just like to say, I mean, it truly is the professional honor of a lifetime and a pretty big deal. So on behalf of everybody with Weitz and hopefully everyone in the audience, congratulations. It's really great.

(Applause)

He's blushing. Alright. So as Tom said, there really have been no safe havens in bonds so far in 2022. And the message is certainly similar in equities. It's - on the heels of several strong years, it's just been a very tough start to 2022 and there's been nowhere to hide. Normally we'd expect quality to hold up a little better than it has so far. But I think a couple of points. First, we were starting from pretty high valuation levels, which we just have to acknowledge. Second, the economy's been pretty strong. And then third, in our view, the value of quality really shines through when times are a lot tougher than they've been. And you know, we'll see if we head there or not.

All sectors have struggled. You know, the pain's been very widespread. Virtually everything has been hit this year across the market cap spectrum, large, small, mid, everything in between. The one exception has been energy, which has been making up some ground after several very tough years of its own. They've been benefiting from commodity price inflation, forced capital discipline by the markets over time. But in general, it's been more defensive areas that have held up a little bit better. But it's basically been just tough everywhere out there.

So which leads into the performance review. You can see the year-to-date impact on the left-hand column of this chart. It's been kind of mid-teens to low twenties negative returns through last Friday. As we always say, the longer-term returns are a lot more meaningful. They've also been less painful, although we'd acknowledge they've been a mixed bag as well. There are some really nice stories in here. You know, the Balanced Fund on the bottom part of the slide has held up pretty well on both an absolute and relative basis. Value Fund, which is our large-cap strategy, has had several pretty strong years up until the last six months or so. But I think our story overall is we're not happy with the relative results. We know you're not either, that we're here to add value over what you can get in an index fund and to keep people out of trouble over time. And we just want to state that clearly. I mean, I think we're all invested heavily right alongside you in these strategies. So we're living this experience that you're all having as well. And our approach has been just to try to keep getting better. I mean, we continue to enhance our process. We keep adding tools to improve our decision-making capabilities over time. We're committed to increasing the number of good stories across the firm as we move forward. And as Wally said upfront, you know, I think our view, the most important thing, there are reasons for longer-term optimism. And we'll keep getting into those a little bit more as we go along.

So Quality at a Discount investing - back to the basics. Just a few minutes on philosophy and process. You never can come to a meeting like this without getting a little bit in this area. You know, from day one back in ’83, Wally started the firm, the focus has been the same: think like a business owner and kind of identify and research high-quality durable businesses and try to buy stock or shares of those companies at discounts when we can find them. And in this slide, you'll recognize some of the timeless Weitz hallmarks – long-term approach, patience and discipline, concentrated portfolios, low turnover strategies, none of that's changed

This is our Quality Score matrix, which a lot of you have seen before. We won't go into it in a lot of detail today, but it's really the roadmap that we use to identify companies that we'd like to own. The steadfast elements that we see on the left-hand side, these are the key drivers of value creation for businesses over years and decades. It's what we're really looking to focus on. And that's where we spend most of our research time. You know, we as a team are vetting, evaluating, debating these elements, trying to get to the bottom of how we think, what makes the company great, and what's going to make it stay that way over time. And so just as a quick reminder, a Quality Score one is the best business we look at. We really don't look at Quality Scores five through seven, so you'll hear a lot, a lot of talk about QS 1 and 2 types of businesses as we go through this. And while quality always matters, buying at a discount is equally important. So don't think we've forgotten kind of our value roots. We want to get both pieces right, and that's what's necessary to drive good returns over time.

So here's a visual of the companies that we own. Each bar represents a business that's in one of our five, or more of our five, equity strategies. As you'll see, the heaviest representation is in the higher quality tiers, Quality Scores 1 and 2. You do see slightly more QS 3 and 4 representation, especially in the mid-cap and smaller company universe. And that's kind of to be expected, generally less established businesses that may not have the same depth of moat as some of the other companies that we look at. And while there's some dispersion on the chart, the weighted average Quality Scores across the different portfolios that we manage are actually pretty tight. So it's kind of ranges from mid to high ones in the large-cap strategy to low to mid twos for the mid-cap range. And I think our message would be that we're pretty tightly clustered around good businesses in everything that we do all right.

So this gets hopefully a little more interesting as we move forward here. Here's a look at what we call a price-to-value kind of heat map. This is starting last summer end of second quarter, June 30th of ’21. Setting the stage, the higher-quality companies are at the lower end of the chart. Cheaper valuations are shown on the left. More expensive valuations are to the right. And a few points we'd make from that period of time, it was a fairly fully valued landscape. Weighted average price to values were in the mid-90s. There's a fairly tight spread between cheaper and more expensive, so left-to-right is bunched pretty tightly. And there's also little differentiation between the quality tier. So as you move up and down from one to three, you don't see a lot of spread, which is somewhat unusual. And the thing that we probably would most highlight from this one is on the left side of the chart; a real lack of opportunity is trading at less than $0.80 on the dollar.

So tough landscape, fast forwarding to the end of the calendar year. Look at that nice visual, see Kevin does get credit for that, Wally didn't draw that one. That's good stuff. So still high overall valuation levels, we're well into the 90s at this point in time, but what we've seen is a few more opportunities cropping up as sector performance diverged, and more dispersion to us means more opportunities to sell the expensive than buy the cheap. And in fairness, we've kind of been leaning into that somewhat gently so far. And part of the reason is that it comes with a risk of running into a buzzsaw from a momentum standpoint. And we've seen that already. You know, we've been selling things that have been working to buy things that have been out of favor. And that's kind of continued to - that rubber band is stretched out a little bit over time, and that's kind of part and parcel of what we do. We're investing for the long haul, not for the next three or six months of returns. And we're OK with that. We can live with that. But coming into 2022, our view is that stock price risk was still the biggest concern that we had. Again price-to-values for the portfolios well into the 90s, it's not alarming, and we said so at the time, but there's just not much margin for error in the system. Not a lot can go wrong when you're priced at those levels. And as we've seen, 2022, the tailwinds that we'd enjoyed for many, many years turn pretty violently to headwinds. Inflation spiked, Russian Ukraine went to war, China instituted another round of COVID lockdowns, the Fed tightening conditions, as others have mentioned, have kind of gone from very loose to a lot tighter, and becoming more so probably over the next six to 12 months, and so on. So here's what's happened to the heat map, and if we had kind of one chart from my part it'd probably be this next one. And this is the part that makes Wally feel great. All right. Look at that. Look at it run to the left. Let's do that again one more time. So if you, if you could put that in super slow-mo, you'd see Wally reaching for his buy pad as he sees that happening.

So prices are down materially. At a minimum, it's taking some of the froth out of the top of the market. And I think it's been a lot – it's clearly, I don't think - it's been a lot worse for the more speculative ends of the market. Wally mentioned a lot of companies down 50 to 70%. They don't show up on this map because those are not the kind of things that we're researching or owning. But it's been very, very painful for the more speculative ends. In our portfolio, price-to-value estimates today, Wally talked about two-thirds in Partners III, it's low seventies across most of the Fund, and that's a pretty good starting point, really. The risks, however, I hang around with the bond guys a lot, so I have to talk about the risks a little bit. They've shifted now more to valuations where at the start of the year it was about prices being relatively high. Now it's about business values, which are driven by earnings and forward cash flows more than the stock prices. And that's our team's focus every day. It's what we do all day, every day. And we're laser-focused on it. Jamie Dimon from JPMorgan earlier this week, he's the CEO there – biggest bank in the country, described the current environment pretty well. And what he said, I want to make sure I get this right. He said it's a strong economy with big storm clouds. And he said, I'm calling it storm clouds because they may dissipate. And that's actually a pretty good summary of where we're at now. And our take on that is, there's a few paths that things could unfold. It's not going to be straight up or straight down, obviously. But if the clouds dissipate relatively quickly, there's just plenty of upside potential from these price levels. And that's what I guess the Fed is hoping for, what we call the soft-landing scenario, what might feel to some like the soft-landing dream. But there's a chance that it could work out pretty smoothly. And that's what our valuation work's showing in the low seventies. There's definitely plenty of upside. If things get tougher, you know, the good news, as long-term investors have some margin for error now that wasn't there in late '21. So stocks are not priced for perfection anymore, and we don't have to get everything right from the low seventies price-to-values. But the really exciting news, it's not exciting, but the good news as investors is that if the storm clouds really do turn into heavy rains which would be probably a recession or something deeper over time, that's when the value of durable, resilient companies really shines through. So that's when we're going to be happy we own what we own, that we have clean balance sheets, really great businesses that we think can get through any environment. And none of that means prices can't go lower. But we do own companies that have been designed on purpose to withstand really high winds.

So putting a quick bow on this part of things, two years ago, we wrote that valuation appraisals were more fluid than normal due to the COVID disruptions. And that's still true. I mean, I think if anything, it's probably magnified right now given the uncertainties we face. But those uncertainties call for steady hands at the wheel, and it really underscores the value of having active managers on your side working for you. And we think the Quality at a Discount approach or the QuaD approach, as we call it, is really well-suited for these times, and that we're partnered with companies that can survive and thrive through any market environment.

OK, so last year they said I didn't talk long enough, so they kept giving me more slides. And they may regret that as we as we get going, but this will be quick. So one of the biggest reasons for optimism as we move forward is really the team that ultimately it's all about people in this business, intellectual capital. And it gives us a lot of hope for the future as we move forward. The team, that's a really nice mix. There's a core group of, us seasoned, experienced people who've worked together for 20 years or more. We also have a group of newer analysts that have joined the fold, bringing fresh perspectives, willing to challenge our long-held assumptions, which is really important to making good investment decisions over time. And you see the broad coverage that we've got across the slide. We're covering a lot of ground, and always trying to add to it over time.

Special welcome to Amy and Mo on the right-hand side of the slide. Amy's actually been with us for more than two years now, but this is her first meeting in person since we haven't sat down like this in three years. Hi, Amy. And Mo joined us earlier this year, which you can probably tell because he doesn't have the fancy background on his on his picture. I don't know if Mo owns a tie. I'm sure he does, but he looks good. He's actually traveling today, so he's not with us. He won't join us in person until next year. But he's off to a great start doing a really good job as well.

And then finally, the fixed income team, you guys know I always talk about the dynamic duo of Tom and Nolan, and they've worked together for more than a decade, enviable track record, doing a great job, but also wanted to highlight David Kratz, who's covering corporates for the team. And he's put together a really good list of both owned and target credits, which could become even more valuable as we work through this environment. And then finally, Dan Sullivan, who recently joined fixed income group after more than 20 years with our fund accounting team with Weitz, he'll be doing research in structured and securitized credit, which I think Dan will attest, it's very much like drinking from a fire hose, but there's a lot to learn quickly. And he's got, he's got a good background for it. So great additions to the group, both from a skillset and probably more importantly, the temperament side of things.

So with that, I'm going to stop for now and we'll turn it over to Nolan, who's going to give a little more color on the fixed income markets.

Nolan Anderson:

Thank you, Brad. Let's see. All right. So on the taxable side, which is our primary focus at Weitz, we manage three different strategies, and on the slide here, this is kind of the best way to think about it. There's two primary risks we take every day investing in fixed income: credit risk, which is on the vertical axis here on the left, and then duration risk, so the maturity spectrum in which you can lay out your capital. So our, you know, we've named him pretty well. So it should be pretty obvious. The Ultra Short Fund is a Fund that will invest for a year or less and takes very minimal credit risk. Our flagship product is the Short Duration strategy, which has been around for decades and has done very, very well. That really plays in the core of the short duration, one to three and a half years. And that Fund can do up to 15% in high yield. And then our newest strategy, which is going to be eight years old here soon, is the Core Plus strategy. And that is our longest duration option that invests three and a half years and longer, and that Fund can take additional credit risk relative to the other two – up to 25% of that strategy can be invested in high yield, and we flex that over long periods of time.

As Tom and Brad and Wally alluded to, it has been a very difficult year for fixed income. This is the current performance on the far left through May 20th. We never like to report negative returns as Tom said, you can't eat relative returns. But what we have told investors and we think is very important, when interest rates rise a lot we've had the Funds positioned well to be more durable. So our Core Plus Strategy has outperformed by a couple hundred basis points through the first part of this year, and our Short Duration Strategy is also hanging in there quite well relative to the benchmark and then we are very proud of our longer-term returns, particularly for the Core Plus and Short Duration strategies.

Give a salute to the performance, I'm sorry, the disclosures chart. And then just going on to some basics in the fixed income characteristics. And Tom alluded to this earlier, our average effective duration, starting on the top left for the Core Plus Strategy, has been creeping up here recently as interest rates have risen, while also carrying significantly less interest rate risk, and that's really what we've been trying to do in both the Short Duration and the Core Plus Strategy in this, what has been a very, very long period of low interest rates. If we can out-coupon our competitors and our benchmarks while taking less interest rate risk, we think that's a pretty compelling risk/reward, and over long periods of time we really have been able to do that. And those opportunities really come to fruition when you have volatility and spread widening in the markets. As Tom alluded to earlier, interest rates have risen since quarter-end and spreads have widened. And so forward-looking returns for our strategies, similar to Wally and Brad, we're feeling more optimistic, we don't know what the future holds, obviously, but from a forward-looking yield perspective, which is a pretty solid way to - a very solid forward kind of forecast for returns. We feel pretty, pretty darn good.

Alright. So we developed, kind of this fixed income dashboard several years ago because from whether it's an advisor or a retail client or a consultant, we get asked kind of how we think about the world. And so we have kind of a macro and economic framework that we use. And then we also you know, we do most of our investing based on fundamentals. So this is kind of just a kind of a look behind the curtain of how we kind of think about things. And there is a lot to worry about, which is why you see a preponderance of red and yellow. Certainly from a fiscal and monetary standpoint, as we've talked about, it was like all guns blazing over the last couple of years, which kind of put us in the situation we're in today with high inflation. So we are obviously worried about that, monitoring that. And then, you know, we do a lot of consumer investing. To highlight, we've focused on the consumer debt load, corporate debt health, investor sentiment. And then on the fundamental side, we invest across a very wide variety of assets. And so we're looking at how spreads look relative to the long-term averages, which right now is actually starting to get above the averages. So we're actually thinking about changing these color codes down here on the credit spreads versus long-term trend. That is going to be moving toward a green level just because spreads have continued to widen. And on a relative value basis, we're starting to see a lot of dispersion in the market. I would highlight retail recently as an area where we've continued to find - we've liked some higher quality retail names and they've really widened here based on their own results being maybe a little bit less than what people expected, but still solid. But really just the broader category, it's kind of the baby being thrown out with the bathwater. So that's an example of a relative value opportunity within a certain sector. And then on the securitized products side, again, just recently here in the last month or so, we've started to see large dispersion in the opportunity set there. So thinking about investing in a single-A corporate bond versus a single-A securitized product bond, we're starting to see that basis really move out. So we're allocating more capital there today. So if we were to come back, maybe next time, we might have some movement here. And if spreads, particularly in credit and structured products, continue to move out.

And here's, I mean, we've had other charts about this, too, but really just to kind of highlight the drawdowns we've seen across the different sectors of the fixed income markets, you know, it's kind of the picture's worth a thousand words. You can see the Treasury drawdown that Tom alluded to - the historical context there, but it's also been very, very challenging for investment grade corporate bonds. I mean, to be down 15% through the first several months of the year is historically, you know, pretty challenging. And we've written about this in our letters. We've you know, with the Fed stepping into the market and using quantitative easing, you know, staying behind the corporate bond market during COVID, corporations were able to go out and issue some of the longest maturity debt at some of the lowest coupons that have ever been issued.

And so, you take that and then you throw on some inflation, and you get you know, you get these kind of big drawdowns. Again, we've had, we've taken our lumps too, but we've kind of done what we've told investors we're going to do. We're going to stay safer and shorter and wait for our opportunities, which is what we're kind of doing now. High yield on the bottom left, you know, down 11%. I guess it's been a lot worse, but spreads, if we get into a more challenging environment, obviously things could get a little rougher there. And I also want to talk about leveraged loans because that's really where we've seen a lot of money flowing to. Investors, some investors kind of are always chasing the latest, greatest thing. Well, leveraged loans are floating-rate loans, so they don't have the interest rate sensitivity. So regardless of whether Treasuries go up or down, those don't lose money on a par basis because their interest rate just floats. So it's really, to lose money, it's the spread component. And you can see leveraged loans are only down 3% this year, and that's because spreads just started widening. So we're really keeping a close eye on that market. We do have exposure to leveraged loans through securitized products, where we can kind of pick where we are in the capital structure and play a little bit more safer. So that's an area that we're definitely mindful of, and that that could be kind of the canary in the coal mine in terms of, you know, if investors start selling those funds, you kind of - you get that reverse impact of money coming in and performance being strong if things start moving sideways there, you could see some outflows.

Alright. And this is one of our tried-and-true slides. You know, I joined over ten years ago, and over that time, I've really been afforded the opportunity to spend a lot of time outside of the primary areas of the investment grade corporate bond market, the Treasury market, and the mortgage-backed market. Those are great markets. There's a lot of opportunity there. But there is this really big multitrillion-dollar market. If I can get my… This asset-backed market, it's very large. It's trillions of dollars, and they're assets that are backed by every aspect of the US economy that you can think of, whether it's credit cards, consumer loans, commercial real estate, housing, small business, medium and large-sized corporate loans, automobiles, equipment, really anything you kind of touch on a daily basis in some format is, it can be securitized and financed in the asset-backed market. And if you invest in an index fund or an ETF, you just can't get exposure to it. And so there are huge opportunities to invest outside of the benchmarks and the index funds that we think are very attractive and over long periods of time we think can be very additive to portfolios. They diversify your risk, some of them are floating-rate so you can get that diversification as well. And those are areas clearly that we have a lot of exposure, and over large periods of time we've continued to expand our circle of competence. We've built out relationships and being able to access these securities and these assets, again, we think is a big advantage and can set us apart.

And the most important slide for fixed income investors and certainly for us is this, and this is something that Tom has alluded to and spoken about. And we've really, you know, focused on is, you can't lose money in fixed income. Right. You lend out a dollar you get back a dollar. If you don't get that dollar back, it takes a lot of additional investing to get that money back. So every investment we make, we're going to make mistakes, too. But every investment we make, we really - this is kind of the top of our checklist just, really do really solid fundamental work and make sure that you're giving yourself the highest probability of getting every dollar you lend out back.

Alright. With that, I'll turn it over to Drew.

Drew Weitz:

Thank you, Nolan.

OK, good evening, everybody. I am excited to talk to you a little bit about some of the Quality at a Discount companies that we are currently invested in. And I know we are coming up toward the end of the prepared remarks. So I'm going to offer you a sort of a lightning round, if you will, of investments. But first, we did a version of this kind of conversation last year in our Zoom-based meeting. And I want to start off by just revisiting one of the companies we talked about last year, which is AutoZone. So last year we talked about AutoZone having a mature but still growing retail business, a faster-growing but smaller commercial accounts business. And at the time, investors were applying a discounted PE multiple, believing again, this was sort of in early 2021 that stimulus checks and COVID-related demand spikes were likely in the rearview mirror, which we've discovered is not the case. But at that time we shared our view that even if sales were trending ahead of schedule, we thought those cash flows that were coming in were very real and that management could turn around and use those cash flows to buy in their own stock at discounted prices and really accelerate the growth of business value. We produced this chart, the left half of which is the carryover from last year trying to graphically depict sort of how that scenario might play out in terms of a theoretical base case. And so we'll fast forward to today and see how that turned out. The chart on the right shows those same elements, but sort of what they added or what they detracted. And what I'm hoping to show is that we ended up with two of the elements of our thesis working out better than planned and one that added less value than we anticipated.

Growth was better than we thought. As we all know, auto supply chains remain disrupted, and that's forced owners of vehicles to keep them longer, but also to invest back into those vehicles for maintenance, and also to maintain the used car value prices. As we've seen, used car values have come up dramatically. Investors also have lately awarded a higher PE multiple given AutoZone's historical reputation for being able to manage through inflationary periods. All of that led to a higher stock price, which just by definition, when you're buying in your own shares at higher prices, that creates a little bit less value for shareholders. But I think we'll all agree that's a good problem to have. So overall, that's sort of where we've been with AutoZone.

I'll turn next to another auto-related business, which is CarMax, the largest retailer of used cars in the United States. So the used vehicle market is huge. 41 million vehicles traded hands last year. And even though CarMax is the largest, they only have about a 2% share, a little more than 2%. The company's size and scale gives it advantages that local independents or smaller dealer network simply can't match. You know, they can ship and source vehicles from any of their 230 stores nationwide. To illustrate that point, before the meeting, I went on to CarMax's website and found that there were almost 200 vehicles on-site at the local store here in Omaha. But because I can source a vehicle from anywhere in the country, I had access to over 50,000 different vehicles. And so if you're in the market for a used car, being able to search and source the vehicle that matches your needs as well as your budget, that breadth of inventory is simply unmatched. In recent years, CarMax has been investing to press some of these advantages with new initiatives like moving into online capabilities, allowing buyers to shop, buy and finance these vehicles online, and also to get instant quotes to let them know the trade-in value or what CarMax is willing to purchase their existing vehicle for. Another advantage of its nationwide footprint is that it can efficiently market nationwide, and management plans to do that and educate consumers about all of these new offerings. While these investments do create near-term profit headwinds, we think they'll pay long-term dividends. Lately, though, as I mentioned earlier, CarMax and the rest of the industry has been forced to navigate the headwinds of surging used car prices and very tight supply environments. We expect these dynamics to moderate over time, particularly as new car supply chains heal, freeing up additional inventory back into the used marketplace. But by maintaining their long-term focus throughout this period and continuing these investments, we think CarMax can emerge a stronger competitor and able to take even more market share.

Next up, I'm going to touch briefly on Costar Group, which may sound familiar to some shareholders familiar with our colleague Jon Baker's excellent writeup in our Analyst Corner back in May of 2020. Costar is the leading provider of data and analytics software for the commercial real estate sector. And they also operate marketplaces that allow buyers and sellers to list assets, to list these properties, and to transact them. Costar also owns Apartments.com, which is the leading online marketplace for the US rental market. The chart at right, this is a little bit different than the previous ones. The chart at right is simply trying to illustrate for you the size… what management estimates the size of their core businesses to be across the four commercial real estate businesses. Additionally, we show sort of what we think their existing market share is within that, and then potential for growth in the coming years. Together, these businesses have delivered terrific growth, high profit margins and generate substantial free cash flow for the founder-led management team to reinvest back into the business to fuel future growth or to potentially acquire new and complementary businesses. To that point, management has launched a new multi-year investment into the residential real estate market. As you can see depicted in the furthest right bar, management believes this market opportunity is potentially greater than its existing four businesses combined. Of course, investors in this environment, as Wally and others have mentioned, haven't been particularly constructive on long-term investment projects these days. Compounding investor frustration has been record-low vacancy for US apartments, slowing growth at Apartments.com simply at the wrong time. We think this phenomenon is temporary, there's new supply coming online that will alleviate some of that vacancy and occupancy pressure and force landlords back into the marketplace to advertise their listings. And importantly, while our models incorporate significant residential investment going after and chasing that opportunity, our base case value actually only contemplates pretty modest success in that arena. So we believe the core businesses remain highly valuable, and when you combine them with a debt-free balance sheet, healthy cash flows and a management team with a highly successful track record, we think we have an option on potential upside from that residential investment.

And then lastly, I'll touch on Liberty Broadband, which is another business we touched on last year, and it probably wouldn't be a Weitz Investment meeting if we did not talk about something Liberty-related. As a reminder, Liberty Broadband owns 26% of Charter Communications, the cable company, but its stock perpetually trades at a discount to that market value of its holdings. Over time, as we said last year, Broadband should benefit from the growth in the underlying Charter business, as well as the eventual closing of the discount of its own shares. Since last we've met, it's been a challenging market for every cable company, including Charter and consequently Liberty Broadband. As you can see on this chart, the bottom line is Liberty Broadband’s stock price. Broadband subscriber growth has moderated from the COVID-related above-trend demand levels, and investors are trying to figure out how competition from fiber providers and wireless alternatives will impact growth across the industry moving forward. It's important to keep in mind, however, that subscriber growth has moderated, not gone negative, and the company continues to add customers and from a competitive standpoint, customer disconnects are at an all-time low. So Charter's actual financial and operating results have remained quite strong and have continued to produce strong cash flows. We'll be happy to touch more on industry specifics in the Q&A, as well as why we remain pretty bullish on the industry. And while the stock price declines have been frustrating, we're encouraged by the potential value creation opportunity that their existing buyback programs can provide at these new lower stock prices as depicted in the chart on the top line. So that top line there is an estimate based on a number of assumptions of what their base case value could be. And this is an example of what Wally was talking about earlier, where when we see one of our businesses that we have a lot of conviction in growing its business value per share while the stock price goes down, we think that's pretty exciting, and we'll look forward to your questions.

I'll turn it over to Barton to bring us home.

Barton Hooper:

Thank you, Drew. So I'm here to talk about Berkshire. And you know, since Wally… we can't take Q&A about it, I thought I just put together 10 or 20 slides and go through all the footnotes. So I'm sure everybody was waiting for that. Instead, I'll take one slide and just talk about what we're doing, what we're thinking about Berkshire today. And as Wally and Brad have both mentioned, Berkshire is a long-term holding across several of our strategies. And when you think about Berkshire, and Brad referenced it, it's really the original Quality at a Discount company for our firm. It was probably the first one in our portfolio, so by definition it was. But it actually fits with what we do and how we think about researching our businesses. First of all, inside the QuaD framework, you know, what's the quality of the business itself, the competitive positioning? Look at several businesses and we've highlighted them here on the screen that Berkshire owns and that we would love to own separately in our portfolios. BNSF Railways are a tremendous advantage, network businesses. And so we're happy to own that along alongside Berkshire. Benjamin Moore, which does premium residential coatings. It's an area where our colleague Nathan Ritz has done a lot of work on. Again, we love that category. So Berkshire owns Benjamin Moore for us and we're happy to have that. Lubrizol is what I call a hidden gem. Not many people know about it. It's not that large inside Berkshire, but it was one of the companies that was actually on my work list in 2011 when Berkshire took it away from us. But we couldn't buy it. We couldn't spend $11 billion on the thing. So they won. Finally, well next then you have Apple, and I want to highlight that because inside of Berkshire, right, we have wholly owned businesses and then the beauty of Berkshire is it can take its capital and buy publicly owned businesses and buy them in size. And we love Apple. It's a wonderful business and it represents roughly 20% of our estimate of Berkshire's value. So when you think about why doesn't Weitz own Apple? Well, we kind of do. And then the last one I'm going to highlight on here is GEICO. GEICO represents the insurance complex within Berkshire, and GEICO standalone is a great business, but insurance overall inside Berkshire is wonderful. And primarily, one, that we've got a great underwriting culture. But the second reason is that it's contributed the float that really allowed Berkshire to become what it is today. And so we are happy to own all these high-quality businesses sitting inside the company. And that's just one element, right, of our Quality at a Discount framework. The second one we look at often is management, and inside of that is culture. And this is an underappreciated element inside of the company, the business culture that Mr. Buffett and Mr. Munger have established has done wonders to perpetuate the company. And when you look inside of it and you look at the various elements that constitute each one of those businesses in terms of their operating philosophy, you know, just like we talk about think like an owner, behave ethically, those sounds simple, but they've been able to permeate those across the company.

And then the last one, and really importantly because this is a collection of businesses, is capital allocation. Mr. Munger and Mr. Buffett are the gold standard for that, but what encourages us is that the collection of Greg Abel, Todd Combs and Ted Weschler, we think, are positioned to sustain that moving forward and we've seen already their influence on the business and how it operates and how they think.

So when Mr. Munger and Mr. Buffett are no longer running the company, we feel very good about the capital allocation going forward. So what does that all add up to? That adds up to reasonably priced business as we sit here today, but more importantly, it has upside optionality; optionality that comes from the businesses that I talked about, and there's many more underneath that. Then you have capital allocation and float that will allow the company to continue to find reinvestment opportunities and deploy that capital at high rates of return. So in all we feel really good about Berkshire, even though we can't answer your questions about it any longer. So with that, I will now get handed over to Brad for Q&A, and I don't think we have an ending slide. Yeah, we do. Oh, there it goes. All right.

Brad:

All right, thanks Barton. So just a quick reminder for the audience, you can ask a question either on a card or we'll have mics going around if you're here in person. For the virtual audience, thanks for joining us, click on the polling tab to ask a question.

Questions in advance here. Several on inflation. First one will be for Wally. Our generation was a product of the inflationary seventies. Inflation is back in style. Do you think this is a long-term trend or a temporary flashback.

Wally:

Well, I certainly remember the seventies and I remember Paul Volcker taking short-term rates to 20% and crushing inflation. And if you read the Trillion Dollar Triage, there's some brave talk among the Fed governors about how they'll have their Volcker moment, and we'll have to wait and see about that. But you know, as I said in my part, the shortages and the bottlenecks will go, but this money supply thing is, you know, that may be a chronic, chronic thing, especially if we keep on doing trillion-dollar deficits. Hopefully modern monetary theory that says it doesn't matter how much you print and spend is becoming discredited and we'll get some discipline. But I, you know, I wouldn't hold my breath.

Brad:

OK, thanks. And another one was just about the specific asset mix and performance within the Value Fund, the impact of inflation. And just very quickly on that front, I mean, energy has obviously been the primary beneficiary to date of the inflationary environment. We really don't own it directly so that's not been helpful over the last six months or so. We do have companies that are positioned pretty well for an inflationary environment. Some of them are more materials companies. So Vulcan Materials, as transportation costs go up, the value of locally oriented rocks and gravel just continues to go up. And the value of that over long periods of time will become potentially even greater. Linde is another example, an industrial gas company that has really well-structured contracts that will increase with costs over time.

And then, sort of the more basic run-of-the-mill things, would be companies that do better as nominal global GDP growth. So the MasterCards and Visas of the world, things like that. And any company with pricing power, which a lot of the businesses that we own in the portfolios do have that. The area that's been toughest has been the longer duration assets, we would call them more “growthier” companies, where more of the cash flows are way out in the future. CoStar Group, that Drew talked about, would be a prime one like that. And we think that's more price risk in the near term. I mean, if the businesses do what we think they can do, over five, ten, 15 years, that's going to take care of itself over time. But there's certainly some markdown risk along the way. So we'll stop there with that one. Thanks for the question.

Anything from the audience here?

Audience:

Indecipherable

Drew:

Sure. For the benefit of the webcast, I'll repeat the question. The general question was: with the advent of 5G technology for wireless carriers, what is the potential for fixed wireless broadband alternatives to take share from the cable players? I think that was the spirit of the question. It's a great question. I think one of the things that we are seeing today are a lot of announcements from T-Mobile, Verizon, and others talking a lot about fixed wireless alternatives. And when you actually just aggregate and listen to the management companies talk about where they are getting customers, a lot of it is coming from new use cases that weren't really addressed before. So the prime examples of that would be, think about a construction site where there's a construction trailer on top sitting there coordinating all the work that's taking place. You know, historically, you know, the contractors or whomever was in that was sort of operating off of their phones or whatever they might have had when they needed Internet service. Today, now there can be a fixed wireless radio in there to get better broadband, better throughput. COVID testing vans is another example that is often talked about. So there's a lot of use cases that are gaining subscribers, but aren't necessarily taking share.

Another element of that story, and T-Mobile has talked about this, another element of that story has been utilizing fixed wireless alternatives where customers are in rural areas or places where either a cable or fiber architecture is not available, and so it's not very dense. So a wireless drop is a more efficient means of doing that. So they're gaining there. They are gaining some customers in that kind of environment. And then lastly, you know, in cities sort of more, you know, metro areas, companies, the wireless companies are using fixed wireless to gain subscribers, but they're being very targeted about where they do so. They are looking for customers that are living inside of a cell tower's radius that is underutilized.

And the reason that that's really important is that the home, you know, when you're at home using your broadband connection, you are using whatever it is, 20 to 30 times as much data than you would sort of on your mobile device. And so for T-Mobile, just sitting there and thinking about the economics of what they want to do, you know, the ARPU between fixed wireless broadband and a mobile device is, you know, pretty close, it's certainly not 30 times different. And they would rather use that spectrum in a higher value way than fixed wireless alternatives. So they're using it well to sort of maximize latent capacity in their network, but several years from now, as growth and usage continues to rise, that math gets a little more challenging. And so we do see them continuing to take subscribers, but not in a materially disruptive way to the current providers.

Brad:

Okay, another one from the virtual audience. How does portfolio positioning adapt to the ongoing geopolitical uncertainty? Wally, maybe you can talk about just the framework that we how we think about that? And then, Barton, if you want to just have a comment or two maybe about some of the tech supply-chain-related issues, in China?

Wally:

Well, the question is about the geopolitical impact on positioning the portfolio. That's, that would be an endless answer, I think. And yet, you know, it's a company-by-company proposition. A lot of our companies are domestic only like Sirius XM and Liberty Broadband and Charter and Liberty, you know, so there's no direct impact from that. We don't have a lot of companies that are dealing with oil and materials and food, and you know, I think it's something we watch for overall market impact, but I can't think of too many individual companies where I would act differently. What am I forgetting?

Barton:

Well, I mean, across some of the businesses that we, I mean, Drew talked about one; one of the issues that CarMax has besides inflation, is supply chain and automobiles can't get semiconductors. That's literally a 40-cent part, shutting down their production lines. And some of that's due to the ongoing COVID issues in China. Some of that is just simply it takes a long time to make a semiconductor. It takes six to eight weeks depending on the part that you're making. And when you say, I can't all my orders for a month and then the next month, you say, I need all those orders I had plus three times as much. It's just really difficult to get that back online and going. In the industry, related semiconductors at least, it was short of capacity going into COVID and now we have a big supply chain problem as it relates to that. I don't know Brad, was there something else I…

Wally:

I thought you were focused more on Ukraine and the supply chain certainly impacts all sorts of companies.

Barton:

Ukraine - Russia has impacted some of our companies, MasterCard, and Visa, for instance, they had a shutdown that was roughly 4 to 5% of revenues, which is actually a little surprising to me that Russia, in particular, was so large, but I guess the… those yachts use credit cards.

Brad:

Yet another one from the virtual audience about how much of our portfolio is tied in with the pharmaceutical industries and vaccines. And so the answer to that, effectively, is pharmaceutical companies themselves, it's effectively zero. But pharmaceutical development, we do have exposure to companies that provide what we would call the picks and shovels to the drug development world. So Thermo Fisher Scientific and Danaher Corporation are both involved there. And then LabCorp has been involved in Covid testing and a big beneficiary of cash flows from that. So those three companies together, anywhere from three or 4% of the portfolios to low teens, depending on the strategy and it's only a portion of what they do. The point I would make about both Thermo or really all three of them, but Thermo and Danaher specifically, who are involved both in development of therapeutics and on the testing side, has been their use of the cash flows that have kind of come their way on what is somewhat of a one-time basis. It's been super effective so they've gone out and bought companies that are going to add to the cash flow streams of those businesses on behalf of shareholders for the next ten or 20 years with that excess cash flow that's come their way the last, the last couple of years. And then further, as the pandemic has become more endemic, there is a cash flow stream that is likely to last for a very long period of time on the testing side of things that would be more than just COVID specific. So it's flu testing and other RSV testing along with that. So it's not as though there's a cliff where it goes to zero and it's lasted longer than most people would have thought. So that's kind of the story there.

Wally:

Brad, if I could go back to a few questions ago, about inflation impact. I think the idea of inflation causing higher interest rates that would last for a while really helps our companies that hold tons of cash. In a lot of our, you know, the Googles of the world have tens of billions or hundreds of billions of cash, and there are many companies that we own that have huge cash hoards that if they start making three or four or five percent instead of zero, it'll make a difference to them. And companies like Schwab that hold a trillion-plus of customer balances and they make a spread because they pay you a little bit of interest and make more. If the spreads can widen because of higher interest rates, that's great for them. It's a lot of sort of less obvious ways that we can benefit from inflation.

Brad:

Thanks a lot. And another one for you, a little bit of a tougher question from the virtual audience, but why has Partners III underperformed the broader stock indices for all time periods up to 20 years? And when and why do you think it will ever exceed its benchmarks? Why aren't the hedges you buy helping to hold up on the downside?

Wally:

Well, they left the year 2000 out when we outperformed by about 30 percentage points, but that was 21 years ago. So he picked the wrong period for measuring. And I think since inception it's still ahead of the S&P, but I think, I think the more serious answer is that, you know, when I wrote at the beginning of the year that something's changing finally with the Fed and I talked about it today, it seemed to me that that ought to happen around 2014. And I think being wary and prepared for that way too early has really hurt. And now, in this last six or eight weeks, we've covered shorts and indexes that were down 20% for the S&P and 30% for the Nasdaq, but some of those positions were many years old and had much lower cost basis because of my over caution.

And I think another thing that we've talked about over the years, but maybe it's faded in recent years, the youngsters have convinced me that however good it feels to have, you know, 30 or 40% cash in a portfolio when the market's going down, that that has been an anchor in those eight or nine and years out of ten when it wasn't going down. And so I think in the, you know, up until maybe 2016/17 or so I would say cash was an anchor in Partners III. Since then, between then and the beginning of this year, the shorts have also held it back. So Partners III ought to be able to do better because it has more tools, but you got to use the tools the right way and being overly cautious has been expensive for Partners III.

Brad:

For those of us in our fifties, thanks for calling us youngsters. It's not often I'm called that anyway, and others.

Wally:

You know I'm in a new crowd now, I replaced a 96-year-old on that that board that we can't talk about, but there he was one of four in their nineties. So I think being on that board is sort of maybe, it's a secret way to get to the fountain of youth.

Brad:

I like the sound of that, sounds good. Another good virtual question for Barton, this time as it relates to valuation: how do you think about or account for R&D and a technology business versus capital expenditures in a more traditional capital-intensive business?

Barton:

Yeah, that is a good question. I think the way our research approach and framework is really heavily based around free cash flow, but there is also an element on there, you saw on the slide, of capital efficiency and reinvestment rates. And so when we're doing an analysis of a business, one thing we look at, we say, OK, margins are here today, revenue growth should be this roughly over time, what are some sort of more qualitative elements about a business that we're missing here that should help us think more broadly about valuation? And one can certainly make a lot of estimates about how much research is actually research and how much is actually research and development that they call that for tax purposes, but is actually maintenance. And you get into all these discussions and crosstalk. But the way we approach it is we look at the business, we look at the reinvestment rates, we look at the capital being deployed. And part of all that is looking at R&D, and John Baker is a great person to highlight this, is also sometimes marketing is actually an investment.

If you're spending a lot of money acquiring customers and that customer's lifetime value is seven to ten years, then you know you're expensing something today day that's worth a lot of money tomorrow. And so we always try to break down the elements of the financial statements and understand them in the context of the business in the longer term opportunity. And that's the answer. There's no quantitative way that we look at it specifically because each one of these is sort of a judgment call.

Brad:

Anything else from the audience? We've been pretty heavy on the virtual questions. If not, we can keep we can keep rolling. Ok, we had an interesting question… so I think the gist of it is, what do you think of Apple?

Barton:

Apple is the largest technology company on the planet. It varies at times of being the largest market cap on the planet. It's a really good business. We, if you ask me what are the hard questions, I sometimes wonder how much it can keep growing, how fast it's growing. I've been amazed at the company's ability to turn iPhone customers into subscribers. I believe, and Amy might know, but it's somewhere around 880 million subscribers today as of the last quarter, subscribing to at least one service. That's the largest subscription business on the planet, I believe. So there's many elements of Apple that we like. It's not passive, quite frankly. Our estimate of business value for a while was quite above or quite below where it was, where it was on offer at the market. So if we were wrong about it and it kept going up, we owned it through Berkshire and now it's gotten reasonable and it's moving closer. We have a list of companies that we look at and think about potentially offering to the portfolio managers and you know, it's moving up the list, but I wouldn't say it's anywhere near the top of the list yet.

Brad:

I think the, one portfolio management perspective, is that the services piece and the evolution there is the part that I feel like I missed, at least how strong it was. Not that it wasn't going to be somewhat successful, but it's been crazy good. So credit to Warren for being right again, shocking.

Let's see where we go next, we're running a little bit low on questions.

Wally:

We're running low on time too

Brad:

We are running lower on time. Are we? Is there anything you guys would highlight that we missed?

Audience member raises hand

Brad:

I'm sorry. Yes, thank you. Sorry.

Audience member:

It's been about 20 years or longer since the collapse of Enron. How do you see the risk of major accounting fraud today relative to where it was in the year of 2000? And how does it affect your judgment on companies?

Wally:

Well, I think the interest in misbehaving among people has not changed. I do think accounting standards and the Sarbanes-Oxley reporting and all sorts of things probably have made it a lot less likely that somebody can get away with a big one with a mainstream public company. But I think there's tons of larceny going on in in other corners that are not quite so well covered.

You start with crypto, and this is not to say that anything good or bad about Bitcoin or crypto in general, but I think it's pretty clear there's lots of scams going on. So maybe the people who would have done Enron 20 years ago have found greener pastures. The other thing about accounting scandals though, that I've noticed over decades, is a lot of times it seems they don't start out to be an intentional scam or accounting fraud. It's more somebody down in the organization starts feeling pressure to make their numbers and you know, they need to get sales for the quarter up to a certain point. So maybe they ship some things ahead of time and call them sales, even though, you know, a lot of gimmicks that can happen.

But once it gets started, then it's hard to unwind and I think that kind of pressure is still there. And one of the things we're trying to be really careful about is the, you know, the culture of the business and the tone at the top because I can remember talking to a CEO years ago, there were several of us in a meeting and we said, “how do you keep track of all the different subsidiaries and all these different countries?” And he said, “you know, we just tell them to make their numbers. And if they don't make the numbers, we get somebody who will.” And we sold that stock.

Brad:

Well, I think bringing it back around to what we do, the you know, the quality to discount framework helps provide some insulation from that. I mean, we're not perfect in evaluating our companies, but we are looking at businesses that are in the kind of the upper tier, we think, of corporate America for the most part. And that's true both from the businesses they run and hopefully the people that run them from an from an integrity standpoint and from an accounting staff side of things. It's really about following the cash flow ultimately. We own companies, like everybody else, who has adjusted everything you can imagine, adjusted EDITDA, adjusted earnings, adjusted you name it so that's part of the business these days. But a lot of what we're trying to do is just focus on what really matters, and that's free cash flow per share and growth there over long periods of time.

Barton:

And Brad, just one more thing to add to that related to what you were saying, it's really hard to have a fraud when you have net cash on the balance sheet. Usually, those situations happen where there's leverage and people are trying to get something done. And so we're insulated from that because when one of those attributes in the framework is leverage, and when somebody has a lot of leverage that dings that Quality Score pretty heavily.

Wally:

It's all about the people.

Brad:

So thanks everyone for your time and patience. I think we'll turn it over to Wally for closing remarks and we'll be around to the extent that people have anything we didn't get to.

Wally:

Ok, well thank you all. It's good to be back and it's good to see you. We'll do this again.

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Apple, Inc.: 0.0%, 0.0%, 0.0%, 0.0%, and 0.0%.
AutoZone, Inc.: 1.3%, 2.3%, 0.0%, 2.2%, and 3.3%.
Berkshire Hathaway, Inc: 2.5%, 0.0%, 11.7%, 7.1%, and 4.6%.
CarMax, Inc.: 0.0%, 4.3%, 3.4%, 3.1%, and 2.7%.
Charter Communications, Inc.: 0.0%, 0.0%, 0.0%, 0.0%, and 0.0%.
CoStar Group, Inc.: 0.0%, 5.2%, 3.5%, 4.4%, and 4.5%.
Danaher Corporation: 2.1%, 0.0%, 0.0%, 0.0%, and 4.3%.
JPMorgan Chase & Co.: 0.9%, 0.0%, 0.0%, 0.0%, and 0.0%.
Laboratory Corporation of America Holdings: 1.9%, 4.4%, 1.8%, 3.1%, and 3.5%.
Liberty Broadband Corp.: 1.4%, 7.9%, 5.1%, 4.3%, and 4.6%.
Liberty Media Corporation – Liberty Sirius XM: 0.0%, 5.5%, 6.4%, 5.1%, and 3.0%.
Linde PLC: 1.2%, 0.0%, 0.0%, 0.0%, and 2.5%.
MasterCard, Inc.: 1.8%, 0.0%, 5.0%, 3.6%, and 4.3%.
Sirius XM Holdings, Inc.: 0.0%, 0.0%, 0.0%, 0.0%, and 0.0%.
T-Mobile US, Inc.: 0.0%, 0.0%, 0.0%, 0.0%, and 0.0%.
The Charles Schwab Corporation: 1.4%, 0.0%, 2.8%, 2.9%, and 2.9%.
Thermo Fisher Scientific, Inc: 2.0%, 0.0%, 0.0%, 0.0%, and 4.4%.
Verizon Communications, Inc.: 0.0%, 0.0%, 0.0%, 0.0%, and 0.0%.
Visa, Inc.: 1.8%, 0.0%, 5.6%, 4.1%, and 4.3%.
Vulcan Materials Company: 1.9%, 2.8%, 0.0%, 3.1%, and 3.9%.

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Fund expenses, as sated in the most recent Prospectus, are: Hickory Fund 1.14% (Gross), 1.09% (Net); Partners III Opportunity Fund Investor Class 1.88% (Gross/Net); Partners III Opportunity Fund Institutional Class 1.43% (Gross/Net); Partners Value Fund Investor Class 1.07% (Gross/Net); Partners Value Fund Institutional Class 0.89% (Gross/Net); Value Fund Investor Class 1.04% (Gross/Net); Value Fund Institutional Class 0.88% (Gross/Net); Balanced Fund Investor Class 0.99% (Gross), 0.85% (Net); Balanced Fund Institutional Class 0.79% (Gross), 0.70% (Net); Core Plus Income Fund Investor Class 0.93% (Gross), 0.50% (Net); Core Plus Income Fund Institutional Class 0.59% (Gross), 0.40% (Net); Nebraska Tax-Free Income Fund 0.98% (Gross), 0.45% (Net); Short Duration Income Fund Investor Class 0.88%

(Gross), 0.55% (Net); Short Duration Income Fund Institutional Class 0.62% (Gross), 0.48% (Net); Ultra Short Government Fund 0.59% (Gross), 0.20% (Net).

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Performance quoted for the Partners III Opportunity and Short Duration Income Funds' Investor Class shares before their inception is derived from the historical performance of the Institutional Class shares, which have not been adjusted for the expenses of the Institutional Class shares, had they, returns would have been different.

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Effective 12/16/2016, the Short Duration Income Fund revised its principal investment strategies. Since that time the Fund has generally maintained an average effective duration between one to three and a half years. Prior to that date, the Fund maintained a dollar–weighted average maturity of between two to five years. Performance prior to 12/16/2016 reflects the Fund's prior principal investment strategies and may not be indicative of future performance results.

Effective 03/29/2019, the Hickory Fund invests the majority of its assets in the common stock of medium–sized companies, which the Fund considers to be companies with a market capitalization, at the time of initial purchase, of greater than $1 billion and less than or equal to the market capitalization of the largest company in the Russell Midcap Index. Prior to that date, the Fund invested the majority of its assets in the common stock of smaller– and medium–sized companies, which the Fund considered to be companies with a market capitalization, at the time of initial purchase, of less than $10 billion.

Index performance is hypothetical and is shown for illustrative purposes only. You cannot invest directly in an index.

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 Midcap Index tracks the performance of the 800 next-largest U.S. companies, after the 1,000 largest U.S. companies.

The Morningstar Moderately Conservative Target Risk Index is an asset allocation index comprised of constituent Morningstar indices and reflects global equity market exposure of 40% based on an asset allocation methodology derived by Ibbotson Associates, a Morningstar company.

The Bloomberg U.S. Aggregate Bond Index is a broad-based benchmark that measures the investment grade, U.S. dollar-denominated, fixed-rate taxable bond market.

The Bloomberg 1-3 Year U.S. Aggregate Index is generally representative of the market for investment grade, U.S. dollar denominated, fixed-rate taxable bonds with maturities from one to three years.

The Bloomberg 5-Year Municipal Bond Index is a capitalization weighted bond index generally representative of major municipal bonds of all quality ratings with an average maturity of approximately five years.

The ICE BofA 6-Month Treasury Bill Index is generally representative of the market for U.S. Treasury Bills.

All investments involve risks, including possible loss of principal. Market risk includes political, regulatory, economic, social and health risks (including the risks presented by the spread of infectious diseases). See the Fund's Prospectus for discussion of risks.