Transcript

Jenna Dagenhart:

Hello, and welcome to Asset TV. Today we're talking to Weitz Investment Management Founder, co-CIO and portfolio manager Wally Weitz and portfolio manager Drew Weitz. Wally, Drew, thank you for joining us.

Wally Weitz:

Good to be here.

Drew Weitz:

Good to be here.

Jenna:

Wally, your investment career spans five decades, and one of the several areas you're known for is the long-short equity space. I want to ask you about your long-short equity fund, the Weitz Partners III Opportunity Fund. You've been managing it since 1983, and Drew joined as co-PM last year. You've described Partners III as a "long-biased fund with extra tools." What do you mean by that, and what does it mean for you and how you manage the Fund?

Wally:

Well, the main extra tool that we have is short selling, and there are a lot of different ways to use short selling, and we could talk about those later if you want. We've used them different ways over the years. But recently the main purpose has been to hedge against high valuations in general. And we've used index and sector ETFs. So, the core portfolio of Partners III, like our other portfolios, consists of high-quality companies that we bought right, that we want to own for a long time. But for better or worse, the Fed actions since the Great Recession have really pumped up stock and bond prices across the board. So, it's a nice problem because it means our stocks went up, but it leaves us holding stocks that are closer to full value than what we'd really like. So, one option would be to sell them, but if we don't have a great replacement, we hate to take the taxable capital gain and then take the chance of not being able to get back in at lower prices. So, an alternative for us is to short an appropriate index or sector ETF, and this moderates the downside if stocks go down and stay down, but it also gives us a chance to make some trading profits in a correction that's only temporary. So, for example, if we're short an index, that we have a 20% short interest and the index goes down 10% and we cover, we can add 200 basis points to the performance for the year. And we are not traders at heart, but that really came in handy, and well, it really came in handy in 2000, but more recently it was good in the fourth quarter of 2018 and really good in the first quarter of last year.

Jenna:

For a lot of people, when they hear about shorting, the first thing that comes to mind is offensively shorting individual companies, especially with all the news about GameStop and short squeezes over the past quarter. Drew, could you explain some of the circumstances that would lead you to take a short position in an individual company?

Drew:

Sure, absolutely, and yeah, I mean, I agree with you. The sort of GameStop trades that everyone reading about or what we would refer to as the tactical short, or as you said the offensive short. And you know, realistically, there are instances where we will take individual company short positions, although I think both Wally and I would observe that, you know, under the current market environment, some of those trades are just a little bit more dangerous perhaps than they had been in the past. So, we have done individual company shorts of a tactical nature from time to time. You know, examples of that would be shorting Sears prior to them heading into bankruptcy. From time to time, we might have a sector point of view that would lead us to short a specific sector ETF. You know, but in general I think most of ours are individual company shorts that tend to be part of a paired strategy, so that might be looking at, you know, an individual company with two different share classes, and from time to time we've seen those share classes diverge, even though they've had similar economics, we may choose to trade by shorting the more expensive to buy the cheaper class and wait for them to converge. You know, more frequently, I think we tend to sort of think about opportunities where we might be able to harvest a holding company discount. So, an example like that which is in our portfolio today, would be our position in Liberty SiriusXM, and our short position against Sirius itself. So, for those who aren't familiar, Liberty SiriusXM is a holding company controlled by John Malone that owns a controlling interest - almost 80% - of SiriusXM's stock. If you just very briefly do the math and look, every share of Liberty SiriusXM represents just over nine shares of Sirius publicly traded stock. So, you sort of look at that and look at the math and say, well, if Liberty Sirius trades in the mid-40s and the equivalent amount of Sirius shares trade in the high 50s, there's a spread there that creates an opportunity for investors to take advantage of. So, you know, we can effectively monetize a portion of that discount for ourselves by having a short Sirius position against our long Liberty SiriusXM position. One final note on that, I would say is we actually really like the Sirius business. We are effectively net long Sirius through our position and Liberty Sirius. But this is a way for us to sort of generate, while we expect management to close that discount on our behalf over time, it's a way for us to realize some of that value for our shareholders ahead of management actions.

Lastly, there's a couple of other sort of examples we might engage in from time to time, whether it's a merger arbitrage or some sort of industry pair trade, but I think in general what you would see is the bulk of our shorting positions are the index shorts that Wally described and these sort of opportunities for mispriced, holdco. discounts.

Jenna:

And Wally, it goes without saying that the past year has been a wild ride for investors, much of it due to COVID-19 and the pandemic. As of today, vaccines are being distributed and the global economy is moving forward with reopening. But with so much uncertainty about what lies ahead, do you believe stock valuations are overly optimistic, and how does your thinking guide your investment decisions today?

Wally:

Well, we're really optimistic about the recovery. The economy was doing pretty well before the pandemic struck, and it was thrown into a sort of induced coma by the lockdowns. But as we're coming out of that, as you say, we have vaccines, and there's a, you know, a good pathway to returning to whatever the new normal is going to be. But the problem is, from my point of view, is that the stock prices have already gone up a lot, reflecting that optimism both about the rising earnings and because interest rates are so low. So, we're betting that earnings are going to be going up, but what investors are willing to pay for those earnings might go down. And, so, in short, the E's are going up but the P/E's might come down, and we've seen that sort of phenomenon regularly over the decades. I've been seeing it for you know, 50+ years, but it's been going on longer than that where a time like 1966 to 1982, you had 16 years where earnings were generally rising, but P/E's were dropping because interest rates were so high and because of inflation. So, you had a case where earnings did fine, but stocks stayed in a trading range for 16 years. Then coming out of that, interest rates are coming back down, P/E's, were going back up, and in the 1982 to 2000 period, even though earnings went up, you know, more or less the same as they had in that previous 16-year period, the P/E's more than doubled, so you had a terrific bull market during that period. So, just as a really simple example, if you had two periods of 15 years where earnings double in each of those periods, and that's about what happens, you know 5% a year or so for corporate earnings, but P/E's drop in half in the first period and double in the second period you end up with a stocks staying the same when the earnings are up and the P/E's are down, but the stocks quadrupling when they're both going the right direction, and I think we may be in sort of the situation now where prices are starting high and interest rates are practically zero, and they're not going to stay at zero, so we're expecting a pretty choppy market. Which is just fine, because as long as our companies are doing well and their business values are growing, they'll come out the other end just fine and have their valuations reflected. But if the choppiness makes people scared and they panic out of some of their holdings, that gives us a chance to buy some cheap stocks.

Jenna:

Yeah, and Drew your portfolio management experience has been heavily grounded in the mid-cap space. Is that your primary focus with this Fund, and if so, where are you finding investment opportunities today?

Drew:

Sure, well I would point out that my portfolio management certain experience to date has been focused on the mid-cap space, and I am paying attention to that obviously within Partners III, but it's important that shareholders know that this is, you know, a true all-cap product. There are no set sort of allocations to one market cap space or the other, so we're going to go where we find the opportunities. And it is true, you know, the early parts of this recovery from the pandemic lows were led by some of the largest companies in the market - large-cap tech - and we can see that sort of by the broader indices how that played out. In the last sort of quarter or two, that's reversed somewhat as sort of the vaccine news as well as kind of the reopening trade has taken hold. Some of those smaller and mid-cap companies have done some catching up, but we absolutely have been active in that space, you know, and I think regardless of what market cap spectrum you're talking about, or sort of, what environment we find ourselves in, you know, we're always going to harken back to our Quality at a Discount framework and be looking for high-quality companies that we can acquire at attractive prices.

An example of the recent past has been our recent investment in Dun & Bradstreet. So, this is a long-standing enterprise whose role has been to sell proprietary data to companies trying to evaluate counterparty risk between anyone they may be doing business with. You know, it's a company where we think new management has come in, is modernizing their business practices, reinvigorating their sales, getting them into a position to actually take their contracts into a subscription business model, and then also, you know, this is a management team, again, that's been replaced and led by, you know, famous investor Bill Foley and his CEO Anthony Jabbar with whom we have had a great experience with Black Knight where they hold both of those similar titles. You know, we think they're also in place - looking at inorganic opportunities - to really jumpstart the progress for this business. So, this is a process that's going to take, you know, quarters, not weeks, you know. And given our experience with the management team and our confidence in their ability to execute, you know, we think we have a differentiated point of view and are looking at a slightly different time horizon so that we can build a position while the market is taking a wait-and-see approach.

Jenna:

We mentioned earlier Wally that you've been managing Partners III for almost 40 years. I've read your past comments about investing being a combination of art and science. How big of a role does institutional knowledge play in your investment decisions, and is it only the art side of the equation?

Wally:

Well, I hope art matters because I'm not too good on science, but you know, I've been investing for 60 years, and I've been in the business for 50+. And I've seen a lot, but I'm still learning how to do it. Made lots of mistakes, some of them more than once, but that is how you learn - experiential learning. So, I'm a real believer that value investing not only works, but it always will work because humans let their emotions drive what they do. It's the fear and greed that are timeless, and so I would say that studying behavioral finance, maybe that's the art part, might be just as important as learning to build DCF models - that's the science.

I have several younger colleagues that are much better than I am on the modeling and the technology, and they've got more energy than I do about jumping on planes to go visit companies and dig into the details. But every once in a while, maybe I'm able to point out that some danger lurking that I've noticed you know I've learned before, or if they've found something really good, maybe I can egg him on to take a more aggressive position than they otherwise do. So, I think maybe that's my value added.

Jenna:

A nice combo of both. Now finally, we'll end with a question for both of you. If you had an optimism/pessimism barometer that you could gauge short-term, medium-term, and long-term, what would your gauge be telling you today. Drew, why don't you go first?

Drew:

Sure, you know, I would say for the long term, you know, when we talk about the long term, you know, we really are focused on five, ten, fifteen, twenty-five, fifty years. And so, for the long term, you know, I think we're you know, absolutely sort of optimistic about the future. Warren Buffett always reminds us never to bet against America. And so, I think you know, all of our investment sort of behavior is rooted in that long-term optimism.

Over the medium term, you know that's a little bit tougher question to answer. I think Wally has alluded to a number of the factors that we see in the markets that could create, you know, a different return stream than we've seen in the last 12 to 15 months. And you know, the only way that I know how to sort of evaluate that question is to look at the valuations of the businesses we own, because we're not market forecasters, we don't know what that's going to bring. But as we look at the individual company valuations and sort of see our whole portfolio trading somewhere in the low 90s portfolio-to-value ratio, you know, what that suggests to us is that, you know, forward returns can still be pretty reasonable. You know, again, these are - this is a portfolio of businesses that are growing their per-share value, so while 90 P-to-V might sound a little full, you know, we think there's growth opportunities in front of these businesses. And so again, you know, over the medium term, you know, we think reasonable returns absolutely can happen.

Over the very short term, and I think that's probably on my personal too-hard pile. Anything can happen in the short term, but we feel pretty good about the businesses we own for the medium and long.

Jenna:

Anything can happen indeed. Wally, what about you?

Wally:

Well, yeah, as Drew said, and as I said earlier, I think we're starting from high valuation levels, and we have some headwinds that very likely to crop up in the form of higher interest rates. So, in the short run, choppiness is, think it's the name of the game. But that gives us a chance to take advantage of our shorts, maybe, with some trading profits, and to buy some great companies really cheaply. So, it doesn't look good on the performance charts, but it really sets up the portfolio for what really matters, and that's the long-term performance. And we think that, yeah maybe I've been whining about this for too long, but, you know the Fed flooding the stock and bond markets with cash for 11 or 12 years now has really swamped the securities markets and sort of raised all boats together without regard to valuation, really. And I think it's plausible to think that Congress and the Fed will, for one reason or another, will stop trying to manipulate the securities markets. And if we can get back to the point where businesses, you know, stocks reflect business values instead of just, you know, instead of people just being able to buy whatever is going up and doing momentum investing, actually doing research and analysis, understanding your companies, thinking about their real values. And that's where we'll be able to earn our keep.

Jenna:

It'll be interesting to see how everything plays out. Wally, Drew, thanks for joining us.

Drew:

Thanks for having us.

Wally:

Thanks.

Jenna:

And thank you for watching, that was Weitz Investment Management's founder co-CIO, and portfolio manager Wally Weitz and portfolio manager Drew Weitz.

DISCLOSURES

The opinions expressed are those of Weitz Investment Management and are not meant as investment advice or to predict or project the future performance of any investment product. The opinions are current through the date of publication, are subject to change at any time based on market and other current conditions, and no forecasts can be guaranteed. This commentary is being provided as a general source of information and is not intended as a recommendation to purchase, sell, or hold any specific security or to engage in any investment strategy. Investment decisions should always be made based on an investor's specific objectives, financial needs, risk tolerance and time horizon.

Holdings are subject to change and may not be representative of a Fund's current or future investments.

Past performance is not a guarantee of future results.

Consider these risks before investing: All investments involve risks, including possible loss of principal. The Weitz equity funds may invest in undervalued securities, which by definition are out of favor with investors, and there is no way to predict when, if ever, such securities may return to favor. Because the Fund(s) may have a more concentrated portfolio than certain other mutual funds, the performance of each holding in the Fund(s) has a greater impact upon the overall portfolio, which increases risk. See the Fund's prospectus for a further discussion of risks related to the Fund(s).

As of 03/31/2021, the following portfolio companies constituted a portion of the net assets of the Partners III Opportunity Fund.

- Black Knight: 1.8%
- Dun & Bradstreet Holdings, Inc.: 1.2%
- GameStop Corp: 0.0%
- Liberty SiriusXM Group – Series A & C: 5.7%
- Sears Holdings Corp.: 0.0%
- SiriusXM Holdings, Inc.†: -0.4%

†Denotes short position

Investors should consider carefully the investment objectives, risks, and charges and expenses of a fund before investing. This and other important information is contained in the prospectus and summary prospectus, which may be obtained at weitzinvestments.com/resources/product-literature or from a financial advisor. Please read the prospectus carefully before investing.

Weitz Securities, Inc. is the distributor of the Weitz Funds.