Mid-Year Outlook
Weitz Investment Management

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Jenna: Hello and welcome to Asset TV's Midyear Outlook Series. I'm joined now by two special guests from Weitz Investments. Tom Carney, director of fixed income research and portfolio manager, as well as Nolan Anderson, portfolio manager.

To set the stage for where we find ourselves today, Tom, can you quickly frame the turbulence that we've experienced during the first half of this year?

Tom: I'll start off by using a word that's, I think, well, overused, so it'll be the only time I use it, I hope, during this interview, and it is unprecedented.

Jenna: I've heard that word a few times Tom.

Tom: Hopefully it won’t be said again, at least by me. I would say that it's a very interesting first half that we've experienced, and I used the analogy to investors at the end of the second quarter to describe a character from the 1800s from an American novelist, Washington Irving, his name's Rip Van Winkle, who fell asleep and totally missed the Revolutionary War in the story. Well, had you been Rip Van Winkle in the 1st 6 months of this year and going to sleep at the end of 19 and woke up at June 30 and saw that the S&P was only down 3%, you might have said, “What's the big deal? What happened?” And yet what you would have missed is all-time highs in the stock market, a global pandemic that resulted and led to near worldwide economic lockdowns, the deepest recession since the 1930s and more than 20 million Americans that became unemployed. And that's just six months. So overall although the tale of these 2 quarters, the first quarter and the second quarter, are almost near inversions of each other, we were arguably hit by multiple black swans in the first quarter as a result of the economic lockdowns that were implemented to kind of combat this hidden, this hard to detect, enemy. And so it led to lockdowns around the globe that caused markets to enter bear market territory in the first quarter.

Jenna: At record speed too.

Tom: At record speed, absolutely. But there's a lot of history in the making in the first quarter. Liquidity, because of that speed nearly disappeared and price discovery, particularly in some segments of the fixed income marketplace, became almost nonexistent or very difficult at best. Volatility, certainly even in the equity markets, skyrocketed to historic levels. The 10-year Treasury fell below 1% and remains there today. Investment grade credit spreads that began the year pretty low, somewhere around 100 basis points for high quality investment grade credit spreads, spiked to as high as 400 in late March. High yield was 3- mid-300s at the end of 19 and rose almost 700 basis points before ending somewhere around 600 at June 30th. Crude prices fell dramatically from $60 to $20 a barrel in six months, even trading in negative territory at one point during the first quarter. And, of course, what happened, though, to kind of rectify this, is government intervention, arguably, and the fastest. As fast as the markets fell, government intervention was equally fast. Whether it's at Congress or at the Fed, the reaction was swift and large. The Cares Act, which many are aware of, was implemented, $2 Trillion in economic stimulus to kind of help the economy and the Fed stepped in and lowered interest rates to zero and dusted off the playbook from 08 and 09 and implemented many of those programs that helped stabilize the market and even implemented new ones that have them now buying ETFs, exchange traded funds, corporate bonds and corporate bonds directly. And so that led to a pretty, pretty dramatic easing of the pressures in the marketplace. And the second quarter was almost a near mirror image of the first quarter in terms of stock prices rising rapidly, bond yields declining as low as they seemed to be at the end of 19. There even lower now. And Nolan will speak a little bit more about that in a little bit. And so we're left with an environment for fixed income investors today that seems quite challenging in terms of forward returns, given where credit spreads are, where base rates are, given where Treasury rates are themselves.

Jenna: Yeah, certainly a challenging environment. Anything that you'd like to add here Nolan.

Nolan: The thing about fixed income returns is it's a function of the contract that you have and the price you pay. Whereas in the equity market you can change the discount rate, the growth rate of the company can change. When you buy a fixed income instrument, you get a coupon payment and you get paid back par at maturity. And the yield you get to maturity is simply a function of that contract and the price you pay so you can’t augment the return. If you buy a bond that has a 1% yield to maturity and you hold it to maturity, that's what you're gonna get. You can get lucky and trade that bond and hope that someone else is willing to pay a higher price, but low fixed income returns in the future seem pretty much baked in the cake.

Jenna: Going back to your point on government intervention and speaking of the Fed's involvement, the Fed last cut rates to near zero in December 2008, of course during the great financial crisis, and kept them at that historic low until the end of 2015. During that time, the Weitz Short Duration Income Fund posted a cumulative total return of 29.29% resulting in an average annual return of 3.76% versus the 1-3 year AGGs return of 1.99% and the funds Morningstar category return of 3.42%. That experience must be invaluable for today. So what lessons are you pulling forward to today from how you navigated that time period?

Tom: One thing I have to say right out of the gate is that this time is definitely different. But there are certain things that always stay the same. And they're different in that I’ll borrow a phrase from Jim Grant from Grant's Interest Rate Observer, who recently penned a line that, “When history provides no precedent, we're all groping in the dark.” There's little precedent for how markets have handled a situation like this because none of us were alive. Can't count even 08-09. None of the recent historical crises really mirror what's happened. But nevertheless, value investing, investing broadly, there's so many base lessons that you can always take away, and for that I would say for us the same lessons rely on the foundational principles that Wally Weitz founded our firm on nearly 40 years ago now and that is, that at the core we are bottoms-up, fundamental, value-oriented investors, whether that is in our equity funds or in our fixed income investments. And we're trying to identify great risk, good to great, risk adjusted returns in fixed income wherever we can find them, we have no specific mandate to invest in a certain industry. And so what allowed us to navigate the previous episode well, is the ability to be patient, to realize that there's no such thing as cold strikes and investing, that's one thing Wally's taught all of us at Weitz quite well, is patience and wait for your pitch. And we've been able to do that in fixed income. Another key lesson for us also is liquidity. We've had investors over the many years of managing this fund, remind me and Nolan as well, that having liquidity to meet clients' needs is paramount. So for us, we were able to navigate this year's first half in a way that didn't impact that in one way, or… We were more beneficiaries than victims of some of the really disruptive liquidity environments of the first quarter, for example, because we were able to be buyers and not forced sellers, like many of our peers, we're pretty sure had to do to meet client needs. And so I'd say, overall, for us, the lessons are very much the same is to kind of stick to our knitting, to follow those foundational principles our firm was founded on by Wally Weitz and just remember that patience is key and wait for the right pitch, the right investment opportunity for your investors.

Jenna: So where does all this leave fixed income investors today knowing there is a nearly insatiable buyer in the marketplace? And how might financial advisors think of fixed income investing today and for the next few years? Nolan want to take that one?

Nolan: Sure. Well the Fed's new QE program has pushed yields to record lows across the major fixed income sectors, like Tom talked about, Treasuries, agency mortgage backed securities, investment grade corporate bonds, these are multiple trillion dollar markets that the Fed has actively participated in and pushed yields to levels that I don't think anyone, any of us, thought would be possible. So these record low yields, you know, have left fixed income investors in a very difficult positions as we talked about. Um, so I think 60/40 portfolios, 70/30 portfolios, that, you know, the fixed income components yielded 3-4-5% over long periods of time, those returns just aren't possible, given the record low starting yields. So you know, and another thing that I think investors are going to really have to pay attention to and we're more mindful of it now than we've ever been is questioning the ballast that high quality fixed income has provided over long periods of time. We're used to bond prices going up when stocks go down, but you look at the 10-year yield today of less than 60 basis points, you take the most widely followed investment grade corporate bond index yields at 1.9%. That is below the Fed's goal of generating 2% inflation. So, to earn a negative real return on a basket of corporate bonds that do carry risk is, it's really unprecedented. So, with that as the backdrop, investors need to determine what kind of risk they want to take with their fixed income portfolios and how much of it. High quality fixed income faces the very real risk of future inflation and decreased purchasing power – erosion of purchasing power. Lower quality, higher yielding investments, obviously face principal risk, and as we experienced in March and Tom alluded to, volatility and liquidity can be very challenging. So, it's, we think, a balance of high quality, mixed with some lower quality investments at opportune times is the right approach. As advisors look for opportunities outside of the sectors being directly influenced by the Fed, we think active managers like Weitz can be helpful. We've developed very strong relationships with the broker/dealer investment banking community over the last several years, and we have access to high quality investment opportunities that are not available on index. Um, a lot of the things we do in securitized products just simply can't be owned in an index. You have to invest with an active manager to get access to those. I'm talking about like asset backed securities. securities backed by auto and consumer loans, commercial fleet vehicles, different types of equipment. Um, and a variety of commercial real estate property types. We believe these kind of investments can provide diversification benefits and can enhance the return profile of a fixed income portfolio without sacrificing quality. And I think we have a very reasonable track record of doing that in this environment. Those opportunities that benefits flexibility could be potentially even more important.

Jenna: Certainly unprecedented times, as you mentioned, and as Tom led with. Tom, Nolan any final thoughts that you'd like to add?

Tom: I guess I would add a couple quotes by Jerome Powell, who is the Fed chairman, to kind of highlight the difficult position that we as fixed income investors face. And the 1st one was in an interview he talked about saying that the “Fed isn't even thinking about thinking about raising interest rates.” So what that means is, and I'll take him largely at their word that we're likely to be in a zero at least front-end environment for some time and their activity now further out the yield curve is already quite evident and being reported on a periodic basis, so you can see what sort of direct corporate bonds they own and ETFs they own. So you know there's gonna be more activity by the Fed that will make, it’s essentially another buyer in the marketplace that just in some ways can certainly help force yields lower, but it gives us the opportunity to look in areas where they're not directly investing. And Nolan certainly covered some of those areas. And then finally, the last quote is also by Jerome, where he spoke about the Fed, he “didn’t want to see us running through the bond market like an elephant.” Uh, doing things and snuffing out price signals. Uh, and so they may not truly want to be that pachyderm, but any fixed income investor needs to realize they are the elephant in the room, and they're definitely a very big influence in the marketplace. And I think our strategies, our patience, our ability to invest one security at a time outside of indexes, can provide interesting opportunities for investors as we go forward from here.

Jenna: Well, thank you so much for your time and your insights and I really enjoyed those quotes from Chairman Powell.

PMs: Thank you, Jenna. Thanks, Jenna

Jenna: And thank you for watching. That was Tom Carney, director of fixed income research and portfolio manager at Weitz Investments, as well as Nolan Anderson, portfolio manager at Weitz Investments. I'm Jenna Dagenhart with Asset TV.

Disclosures:

Data quoted is past performance and current performance may be lower or higher. Past performance is no guarantee of future results. Investment return and principal value of an investment will fluctuate, and shares, when redeemed, may be worth more or less than their original cost. Please visit weitzinvestments.com for the most recent month-end performance.

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As referenced herein, for the period 12/1/2008 to 12/31/2015 the Weitz Short Duration Income Fund (WEFIX) had a cumulative total return of 29.29% with an average annual return of 3.76% vs. the Bloomberg Barclays 1-3 Year U.S. Aggregate Index average annual return of 1.99% and the Morningstar Short-Term Bond Category average annual return of 3.42%.

Average annual total returns for the Weitz Short Duration Income Fund Institutional Class (WEFIX) for the one-, five- and ten-year periods ended June 30, 2019, were 2.89%, 2.29%, and 2.24%, respectively. Investment results reflect applicable fees and expenses and assume all distributions are reinvested but do not reflect the deduction of taxes an investor would pay on distributions or share redemptions. Net (0.48%) and Gross (0.64%) Expense Ratios are as of the Fund's most recent prospectus. The Fund has entered into fee waiver and/or expense reimbursement arrangements with the Investment Advisor. As such, the Advisor has contractually agreed to waive a portion of the Advisor's fee and reimburse certain expenses (excluding taxes, interest, brokerage costs, acquired fund fees and expenses and extraordinary expenses) to limit the total annual fund operating expenses of the Class's average daily net assets through 07/31/2021.

Average annual total returns for the Bloomberg Barclays 1-3 Year U.S. Aggregate Index for the one-, five- and ten-year periods ended June 30, 2019, were 4.00%, 2.07%, and 1.62%, respectively. Index performance is hypothetical and is shown for illustrative purposes only. You cannot invest directly in an index. The Bloomberg Barclays 1-3 Year U.S. Aggregate is generally representative of the market for investment grade, U.S. dollar denominated, fixed-rate taxable bonds with maturities from one to three years.

Average annual total returns for the Morningstar Short Term Bond Category for the one-, five- and ten-year periods ended June 30, 2019, were 3.34%, 2.18%, and 2.01%, respectively.

Effective 12/16/2016, the Weitz 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.

Holdings are subject to change and may not be representative of a fund's current or future investments. The Fund receives credit quality ratings on portfolio securities when available from credit rating agencies. The Fund itself has not been rated by a credit rating agency. Ratings and portfolio credit quality may change over time. A security is "investment grade" when it has received a credit quality rating of at least BBB. If a security has received different ratings from more than one rating agency, then the highest rating is used.

Definitions: **Investment grade bonds** are those securities rated at least BBB- by one or more credit rating agencies. **Non-investment grade bonds** are those securities (commonly referred to as "high yield" or "junk" bonds) rated below BBB- by two or more credit rating agencies. **Yield-to-worst (YTW)** is the lowest potential yield that can be received on a bond portfolio without the issuers actually defaulting. The views and opinions expressed here are those of Weitz Investment Management as of 07/24/2020, are subject to change with market conditions, and are not meant as investment advice. For informational purposes only. Not an investment recommendation.

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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 or from a financial advisor. Please read the prospectus carefully before investing.

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