FIXED INCOME INSIGHTS

October 1, 2019

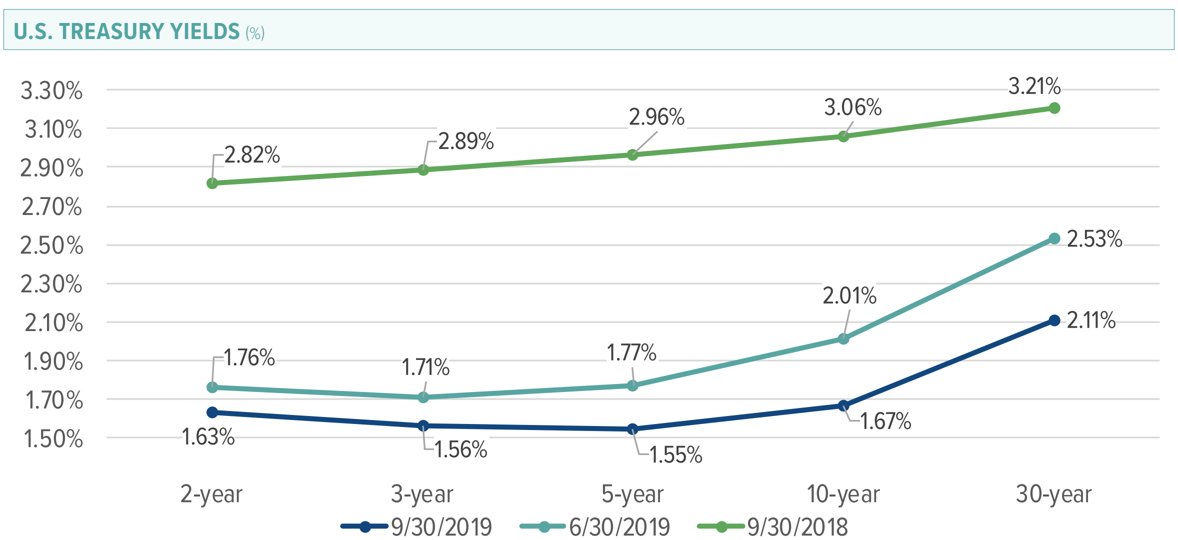
"Be careful when opening the overhead compartments, as items may have shifted during flight."

This familiar phrase by flight attendants upon landing seems a fitting description of market turbulence during the third quarter. An attack on Saudi Arabia's oil refining infrastructure (possibly supported by Iran) heightened geopolitical risk in the region, the on-and-off trade/tariff negotiations between the U.S. and China, decelerating global growth, Brexit, the inverted yield curve's "is it different this time" debate, and the seemingly ever-present Washington political intrigue with the latest impeachment inquiry all contributed to a rocky third quarter. Stocks (as measured by the S&P 500) had a mid-quarter drop of 6%, and the bond market hit the panic button, driving the 30-year Treasury yield below 2% for the first time ever. Fixed-income credit investors, however, were unperturbed by the commotion in the market as continued strong demand left investment-grade[1] credit spreads mostly unchanged—and even spread declines for non-investment-grade borrowers. For the full quarter, stocks recovered their footing and climbed the proverbial wall of worry—producing positive results across all indices. Bond indices delivered solid quarterly returns as well, with year-to-date results (particularly for corporate bonds) near all-time highs.

Weitz equity and balanced funds registered gains in the quarter, and both relative and absolute year-to-date results, are very good. Please see Wally and Brad's **Value Matters Letter** and the equity and balanced funds' Quarterly Commentaries for detailed analysis.

Despite continued relatively low exposure to high yield bonds across our funds and lower duration than our benchmarks (defensive positioning), Weitz fixed income funds delivered good results for the quarter and year to date. Further detail about contributors to performance can be found in the fixed income funds' Quarterly Commentaries.

The graph below illustrates the decline of select Treasury rates over the past quarter and year.



Source: Bloomberg

As mentioned, corporate bonds and other credit-sensitive securities had strong performance during the quarter keeping pace with Treasury bonds as credit spreads were mostly unchanged (except non-investment-grade bonds outperformed investment-grade bonds). A broad measure of investment-grade corporate bond spreads, compiled by ICE BofAML, remained unchanged for the quarter, closing at 122 basis points. Compared to a year ago, these spreads finished the quarter marginally higher (nine basis points).

Lower interest rates + declining credit spreads = heightened investment risk

The formula above, while true, does not suggest that credit investment risk has reached its maximum, especially since interest rates and credit spreads can conceivably move lower still. It does, however, speak directionally to the "math problem" facing fixed-income investors, as base interest rates (U.S. Treasuries) and corporate spreads have declined since the start of the current economic expansion. The narratives in the marketplace are that domestic inflows into fixed income will continue to be strong; buyers from overseas facing negative returns in their home countries will gravitate to the U.S. (where investment rates are still positive); and open-ended/unending quantitative easing (QE) by global central banks is inevitable. However plausible any of these scenarios are, today's rates and credit spreads leave less and less room for error, for example, from an inflationary shock resulting from massive deficit spending or credit hiccups from economic slowdowns or business failures. Over the long term, bond returns are driven primarily by the coupon returns on offer. Today's low rates and low credit spreads imply low forward returns.

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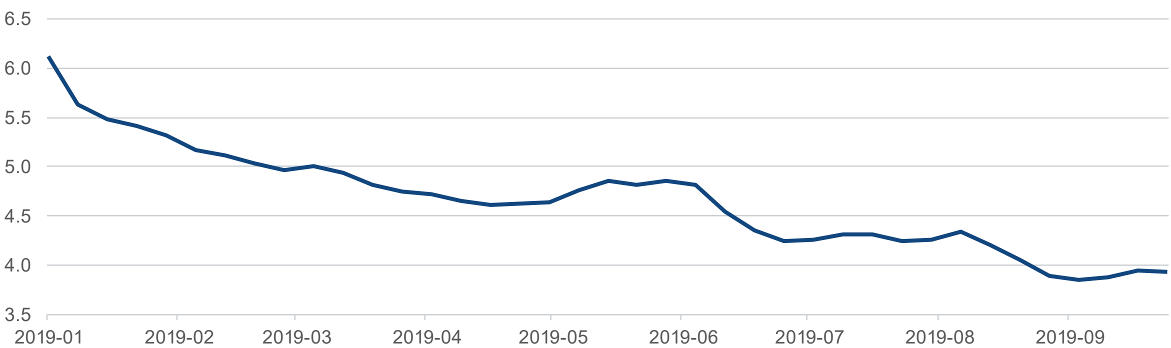
The chart below illustrating the effective yield for the ICE BofAML U.S. High Yield BB index demonstrates the "math problem" investors face. The index yield began the year at above 6 percent and fell below 4 percent, for the first time ever, in the third quarter. That investors would accept less than 4 percent return for highly levered, non-investment-grade bonds might require the bonds to be relabeled "not so high yield" and is reminiscent of Warren Buffett's stock market quote, "You pay a very high price…for a cheery consensus."

ICE BofAML U.S. HIGH YIELD BB EFFECTIVE YIELD



Source: ICE Benchmark Administration Limited (IBA), fred.stlouisfed.org

Outlook

Although the daily news can often shift investor sentiment, we understand that fundamentals matter more than headlines. Our fixed-income investment philosophy is straightforward. We believe the key to winning is not losing. Permanent losses of capital are a bane to long-term compounding—and *especially* so in fixed-income investing. We certainly do not ignore the macro but understand the pitfalls of trying to guess market moves. Caution has arguably always been our calling card in managing fixed-income assets on behalf of clients. We want to be adequately compensated for any risks we assume. We are index agnostic and select assets one at a time. We concentrate in the ideas that we believe best offer attractive risk-adjusted returns, taking into consideration the general level of interest rates and the credit quality of each investment.

We intend to stick to our knitting and be persistent in our hunt for investment opportunities. We may often resemble prospector Yukon Cornelius of 1964's *Rudolph the Red-Nosed Reindeer* when, during his hunt for gold (or was it peppermint?) he regularly exclaimed, "Nothin'!" We know every time we say no ("Nothin'!") to an investment, we enhance our overall understanding, which ultimately leads us closer to the *right* yes. Our version of "life-sustaining supplies" (kudos to those who know Yukon's) are: fundamental analysis, security selection, favorable risk-adjusted return profiles, and consistent and thorough credit surveillance.

Please see all fund commentaries on our website for additional information regarding third-quarter portfolio activity and current positioning. We look forward to taking advantage of any valuation disparities that will invariably develop (the one constant in markets is change) and hope to continue to earn your trust.

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IMPORTANT DISLCOSURES

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.

[1]**Investment Grade:** We consider investment grade to be those securities rated at least BBB- by one or more credit ratings agencies.

Investors should consider carefully the investment objectives, risks, and charges and expenses of the Funds before investing. This and other important information is contained in the prospectus and summary prospectus, which may be obtained at weitzinvesments.com.

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