# Patience Truly is a Virtue

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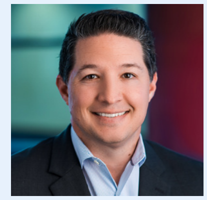

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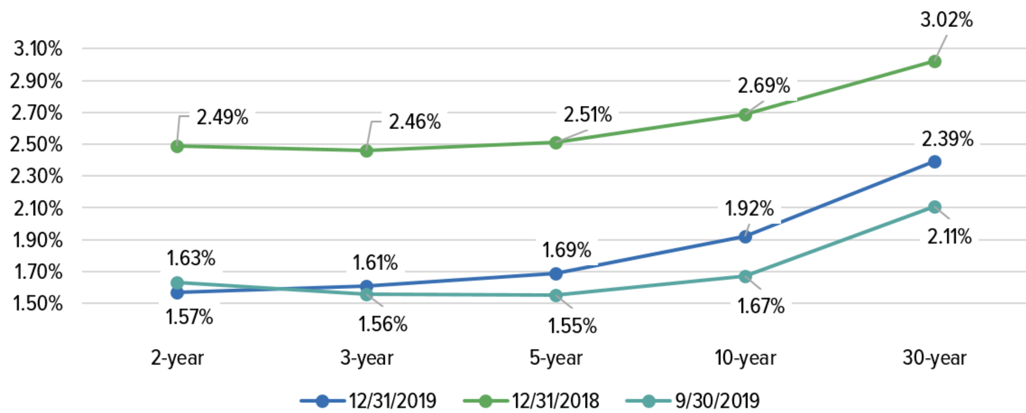
Another decade has come and gone, and it's worth noting that its last year was nearly opposite its predecessor. Where 2018 was a year to forget in terms of lackluster returns across almost all asset classes (bond, stocks, commodities, etc.), 2019 was one for the record books. In 2019, stocks and bonds partied like it was 1998. According to Dow Jones, 2019 marked the first time in over two decades that broad stock market indices jumped at least 20% while benchmark 10-year U.S. Treasury yields declined by three-quarters of a percent or more. Last year's gains were even more extensive as prices of gold and oil rose by more than 10%. The 2019 ascent—across a broad swath of assets from so-called safe to risky—hasn't occurred since 1984. Easing trade tensions, accommodative central banks, tame/low inflation, steady economic growth, solid corporate earnings, a seemingly insatiable thirst for yield, and an overall risk-on mindset were some of the key elixirs that helped drive prices higher in 2019.

Weitz equity and balanced funds registered impressive gains in the fourth quarter, capping year-to-date results that were excellent, both in relative and absolute terms. Please see Wally and Brad's quarterly **Value Matters** commentary and the equity and balanced funds' **Quarterly Commentaries** for detailed analysis.

Despite continued defensive credit and interest rate positioning, Weitz fixed income funds also delivered solid results for the fourth quarter and the year. Further detail about contributors to performance can be found in the fixed-income funds' Quarterly Commentaries.

The graph below shows the changes of select Treasury rates over the past quarter and year. Across the yield curve (a line that plots yields / interest rates of bonds with differing maturity dates) between year-end 2018 and 2019, interest rates have declined approximately three quarters of a percent.

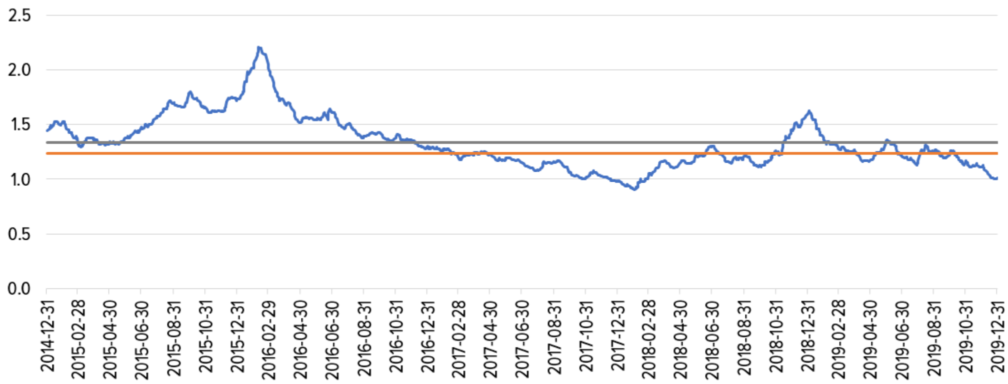
**U.S. TREASURY YIELDS**




*Source: Bloomberg*

Corporate bonds and other credit-sensitive securities had another quarter of strong performance and kept pace with Treasury bonds as credit spreads continued to decline. A broad measure of investment-grade corporate bond spreads, compiled by ICE BofAML, closed at 101 basis points as of December 31, 2019, down 21 basis points during the quarter and down 58 basis points from where they were a year ago. The chart on the next page depicts the path of investment-grade credit spreads for the past five years (blue line) against the one- (orange) and five-year (gray) averages. Overall, corporate bond credit spreads are solidly below recent trends and very near historic lows.

**INVESTMENT GRADE CREDIT SPREADS**



*Source: FRED Economic Data / St. Louis Fed*

### Price is what you pay—value is what you receive

Last quarter, we wrote that lower interest rates and declining credit spreads lead to heightened investment risk. Put another way, price is what you pay while value is what you receive. Continued declines in base interest rates (U.S. Treasury) and credit spreads (corporate bonds) in the fourth quarter have led to investors paying higher prices to receive less in the form of forward return potential.

The table below provides a longer-term view of the trends in the Bloomberg Barclays High-Grade Corporate Bond Index. While the past 10 years have been quite good for fixed-income investors, we begin 2020 increased interest rate risk, as both maturity and option-adjusted duration (OAD) are higher, and higher credit risk, as option-adjusted spread (OAS) is nearly half of its starting point. The overall result is a forward return, yield to worst (YTW), that is much lower than it was a decade ago–and very near its all-time low.

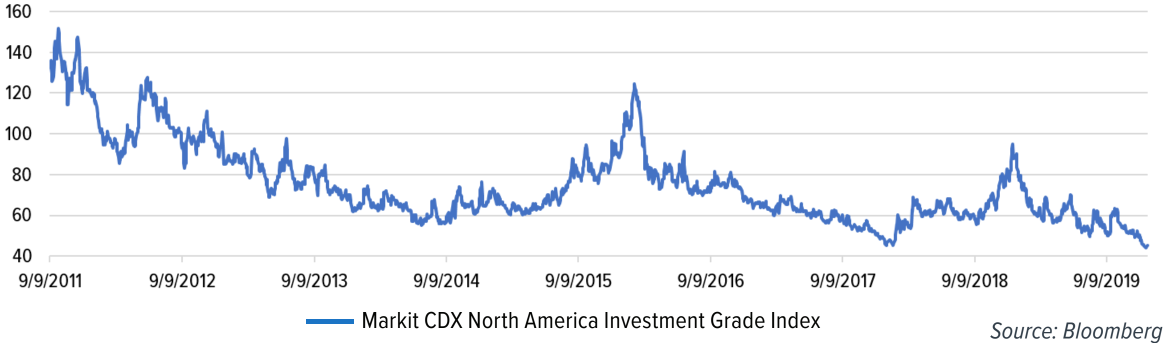
**BLOOMBERG BARCLAYS U.S. CORPORATE INDEX**

| 1/1/2010 | | 1/1/2020 | | Δ |
|---|---|---|---|---|
| Maturity | 10.12 | Maturity | 11.46 | 1.34 |
| OAD | 6.35 | OAD | 7.89 | 1.54 |
| YTW | 4.73% | YTW | 2.84% | -1.89% |
| OAS | 172 bps | OAS | 93 bps | -79 |

*Source: Bloomberg*

The investment dashboard whereby we track macroeconomic risk factors (fiscal, regulatory and monetary policies, inflation expectations, global interest rates, consumer debt load, corporate debt health, and investor sentiment) and fundament factors (credit spreads vs. long-term trends, yield spread to base U.S. Treasury interest-rates, and relative value opportunities across various asset classes) have all been flashing yellow (cautious), with some red, for the past several months. None of this means that recession is imminent or that spreads will become more attractive (wider) tomorrow–but it does inform our process. Borrowing a Warren Buffet morsel of wisdom: "We want to be greedy when others are fearful and fearful when others are greedy." A measure of fear, or *lack* thereof, can be seen in the chart below that tracks the credit default-swap index for investment-grade bonds, which hit a post-credit crisis low in this year's final quarter.

**U.S. CREDIT DEFAULT-SWAP INDEX TRADES AT POST-CREDIT CRISIS LOW**




*Source: Bloomberg*

We intend to be persistent in our hunt for investment opportunities. We've spent 2019 interviewing dozens of new issuers across industries and sectors (corporates, asset-backed, commercial, mortgage), with some leading to meaningful investments for our funds, but all building on the tapestry of information we'll be able to draw from in the future. As we enter a new decade, we will continue to focus on the things we can control—fundamental analysis, security selection, favorable risk-adjusted return profiles, and consistent/thorough credit surveillance. We understand our competition is arguably equally as smart, but we hope to continue building sustainable sources of competitive advantage by learning faster, communicating more effectively, failing less and waiting longer (yes, patience *is* a virtue) for the right opportunity.



Definitions: **Investment Grade Bonds** are those securities rated at least BBB- by one or more credit ratings 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 ratings agencies. **Yield to Worst (YTW)** is the lowest potential yield that can be received on a bond portfolio without the issuers actually defaulting. **Option-Adjusted Duration (OAD)**, also known as Effective Duration, is a duration calculation for bonds that have embedded options. This measure of duration takes into account the fact that expected cash flows will fluctuate as interest rates change. Effective duration can be estimated using modified duration if a bond with embedded options behaves like an option-free bond. **Option-Adjusted Spread (OAS)** measures the spread between a fixed income security and the risk-free rate of return, which considers how the embedded option in the fixed income security is likely to change the expected future cash flows and the present value of the security. An option-adjusted spread converts the difference between the fair price and the market price of a fixed income security, typically a bond or a mortgage-backed security (MBS), into yield and calculates a spread that makes the two prices equal.