Looking Ahead to 2020

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We are pleased to report that after a strong fourth quarter, our three long-only stock funds ended 2019 with gains of 34.5% (Value), 33.6% (Partners Value) and 36.1% (Hickory). Partners III, despite its hedges, returned 34.2%. The S&P 500 had a good year as well, rising 31.5%. The Balanced Fund, with less than half the portfolio invested in stocks, shined with an 18.0% return. And while one-year returns are not as important as the long-term record (see performance table), it's all right to celebrate them, just a little.

On the fixed-income front, interest rates remained depressed, and spreads (the extra yield available by taking credit risk) remained thin. Despite a very unattractive opportunity set of potential investments, Short Duration and Core Plus managed to earn solid returns of 4.2% and 7.6%, respectively. For more detail on the fixed income environment, Tom and Nolan elaborate further in their quarterly **Fixed Income Insights**.

	AVERAGE ANNUAL TOTAL RETURNS AS OF 12/31/2019							
	1 Year	5 Year	10 Year	Since Fund Inception	Fund Inception Date	Share Class Inception Date	Net Expense	Gross Expense
Balanced Fund - Institutional (WBAIX)	17.98%	5.80%	7.62%	5.83%	10/1/2003	3/29/2019	0.70%	0.97%
Core Plus Income Fund - Institutional (WCPBX)	7.58%	3.92%	N/A	3.83%	7/31/2014	7/31/2014	0.40%	0.96%
Hickory Fund (WEHIX)	36.06%	5.27%	10.97%	9.60%	4/1/1993	4/1/1993	1.09%	1.27%
Partners III Opportunity Fund - Institutional (WPOPX)	34.22%	5.75%	11.28%	12.29%	6/1/1983	6/1/1983	1.56%	1.56%
Partners Value Fund - Institutional (WPVLX)	33.61%	5.11%	10.78%	11.68%	6/1/1983	7/31/2014	0.89%	1.07%
Short Duration Income Fund - Institutional (WEFIX)	4.22%	2.08%	2.41%	5.00%	12/23/1988	12/23/1988	0.48%	0.63%
Value Fund - Institutional (WVAIX)	34.49%	7.94%	11.79%	10.41%	5/9/1986	7/31/2014	0.89%	1.08%

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. All investments involve risks, including possible loss of principal. Please visit weitzinvestments.com for the most recent month-end performance.

Market Commentary

After a big move up in the stock market, investors tend to get acrophobia. Commentators (whose business depends on raising anxiety levels) bring up various versions of "what goes up, must come down." Stocks ***do*** go down sometimes, but the importance of market swings in both directions is usually exaggerated.

Looking back at the past two years might give some perspective. A one-year gain of 31.5% for the S&P 500 is unusually good. However, in the fourth quarter of 2018, we had a 20% market decline due to fears of further Fed increases in interest rates. As such, much of the 2019 gain merely represented a return to the previous October's highs. A similar exercise would show that the annualized gains off the 2009 extremely depressed market bottom (down approximately 55% from the 2007 peak) are ***much*** less impressive when viewed in a longer time frame. This is not to say that stocks are historically cheap—they are not—but we have experienced expensive markets before, and we do not believe that the current situation is at all dire.

Valuation Cycles—Where Are We Now?

We have written before about how the market has gone through several long stretches of valuation (the price paid for company earnings often measured by price-to-earnings (P/E) ratio) expansion and contraction. Between 1966 and 1982, companies' earnings roughly doubled, but prices, despite some wide interim swings, ended the 16-year period close to where they started. This means that valuations dropped by half. By contrast, from 1982 to 2000, P/E ratios more than quadrupled, and stock prices rose more than tenfold. In this case, valuations skyrocketed. Hence, a major bull market.

These protracted periods of valuation compression and expansion present different opportunities for investors. During a long, choppy sideways market, hopes rise and fall, and individual company performance matters. Understanding what makes businesses tick helps investors distinguish between good long-term compounders and flashes in the pan. We would maintain that this is the environment in which active portfolio management adds the most value.

During a long bull market, investors are compensated for taking more risk. Rising stocks attract more capital, which makes them rise some more. Momentum investing and "trend-following" are rewarded. Value considerations (applying analysis and reasoning, aka thinking) prove counter-productive and passive strategies flourish.

The Role of Interest Rates

The economic and geopolitical backdrops for these two periods (1966-1982 and 1982-2000) were obviously different, and stock markets are moved by a myriad of factors. However, one significant variable at play in both was the level of interest rates. Rates were generally rising during the first period, as inflation was triggered by the Mideast oil crisis of the '70s, and Paul Volker's Fed stamped it out with 20% short-term rates. High yields available on bonds posed serious competition for stocks and helped deflate valuations.

Rates generally fell during the second period as monetary policymakers remained intent on keeping credit cheap and readily available. The financial fuel was plentiful and helped inflate the tech stock bubble that finally popped in 2000.

Our current bull market, dating back to 2009, has also been characterized by very accommodative monetary policy and record-low interest rates around the world. Freshly printed money by the trillions (literally) has been pumped into global bond markets through quantitative easing in an attempt to stimulate business investment and economic activity. This action would normally be expected to result in price inflation, but trade wars and other uncertainties discouraged capital investments by businesses. As a result, we see inflation in paper assets—stocks and bonds—rather than in the prices of goods and services.

In their "collective wisdom," investors have decided that relatively good economic growth and cheap, abundant credit are the right ingredients for continuing to buy stocks. This is not an unreasonable response, but we would argue that both the monetary policy and investor response to it have been carried too far. Today, stocks are expensive by historical standards. This does not mean that they will go down, but the higher the starting price, the lower the odds of further robust near-term appreciation.

Outlook and Game Plan

We predict that we will see a shift from P/E expansion mode to another period of contraction in which valuations moderate. We would expect that the U.S. and global economies will, on balance, continue to grow and that businesses will do well over time. It would be natural, though, for interest rates to return to levels higher than today's and for P/E ratios to return to more modest levels. The adjustments could be gradual or sharp and dramatic, and history would suggest we will have some periods of each.

This is not terrible news for investors. A relentlessly rising bull market is nice, and we are happy to have benefitted from it. Going forward, though, most of our portfolio returns should once again come from the growth in the value of the businesses we own. Our appraisal of a company's value to its owners is based on estimates of future cash flows, or "owners' earnings," and we use a 9% discount rate. This means that if our estimates are accurate, we could pay 100% of business value and expect to earn a 9% annual return on the investment. We have a healthy degree of humility about our ability to estimate future cash flows, so we try to buy stocks when they sell at a significant discount to full value to add a "margin of safety." Still, with our current estimate of average price-to-value levels in the high-80%, we feel good about our portfolios' return potential.

We have come a long way since a year ago when we felt like kids in a candy store. We were aggressive buyers then, and we appreciate our shareholders' faith in sticking with us through a turbulent period. The path forward will be a bit more complicated, but we welcome the challenge. We believe that our greatest value-added for our investors is our knowledge of the companies we own and our sense of their underlying value. This understanding of value and context makes all the difference when chaotic market conditions arise.

A Final Note

As the holiday season winds down, on the heels of a terrific year, gratitude is the word that naturally comes to mind. All of us at Weitz are grateful for investors who have stuck with us through thick and thin. Without you, our mission loses purpose. We are also thankful, every day, for the chance to invest alongside such a talented, passionate, high-class group of people. The core of our investing team has been together for many moons, and we recently added new voices with fresh perspectives to the mix. While our team-based approach is rooted in bedrock principles, we are continuously enhancing the process. As Gandhi and others have said, it is imperative that we "continue to grow and evolve." We made significant progress during 2019, especially on streamlined work plans, and we are excited to build on that momentum into a new decade.

IMPORTANT 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 1/10/2020, 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.

Included is a reference to the term “margin of safety." This term refers to purchasing securities at a price that is less than our estimate of intrinsic value. A potential “margin of safety” may limit downside risk and optimize the potential for growth.

Investment results assume all distributions are reinvested and reflect applicable fees and expenses. Certain Funds have entered into fee waiver and/or expense reimbursement arrangements with the Investment Advisor. In these cases, 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 Contractual Expiration Date of 7/31/2020.

The Net Expense Ratio reflects the total annual fund operating expenses of the Fund after taking into account any such fee waiver and/or expense reimbursement, if any; total returns would have been lower had there been no waivers or reimbursements.

Performance quoted for the Balanced, Partners Value and Value Funds’ Institutional Class shares before their inception is derived from the historical performance of the Investor Class shares, which have not been adjusted for the expenses of the Institutional Class shares, had they, returns would have been different.

On 12/31/1993, Partners Value Fund succeeded to substantially all of the assets of Weitz Partners II Limited Partnership (the “Partnership”). On 12/30/2005, Partners III Opportunity Fund succeeded to substantially all of the assets of Weitz Partners III Limited Partnership, (the “Partnership”). The investment objectives, policies and restrictions of the Funds are materially equivalent to those of the Partnerships, and the Partnerships were managed at all times with full investment authority by the Investment Adviser. The performance information includes performance for the Partnerships. The Partnerships were not registered under the Investment Company Act of 1940 and, therefore, were not subject to certain investment or other restrictions or requirements imposed by the 1940 Act or the Internal Revenue Code. If the Partnerships had been registered under the 1940 Act, the Partnerships’ performance might have been adversely affected.

Effective 3/29/2019, 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.

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.

Average annual total returns for the S&P 500 index for the one-, five- and ten-year periods ended 12/31/2019, were 31.49%, 11.70% and 13.56%, respectively. 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.

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.