The Elephant in the Marketplace

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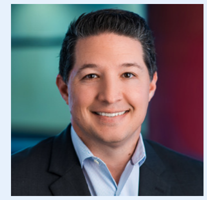

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We once again find ourselves at the midpoint of another year, and what a half-year it has been in the markets. If Rip Van Winkle had gone to sleep on January 1, woke up on July 1 and saw the S&P 500 down only 3% for the first six months, he might have surmised not much had happened so far in 2020. But as we are all aware, that vantage point does not even begin to tell the story of the past six months.

The first half of 2020 contained an all-time high for stocks, a global pandemic that precipitated a near worldwide economic lockdown, the deepest recession since the 1930s, new unemployment of more than 20 million Americans, the sharpest/quickest bear market drop in history, and a subsequent market rally that will also go in the record books. It witnessed unprecedented government (both monetary and fiscal) response to meet the near economic winter caused by the lockdown. And the partial economic reopening in the second quarter has caused some to wonder if the recovery might resemble a V-shape or Nike swoosh (stairstep) instead of an elongated W or a dreaded L.

Overall, the second quarter was a near inversion of the first quarter as stock and bond (particularly corporate and other credit-sensitive) prices recovered.

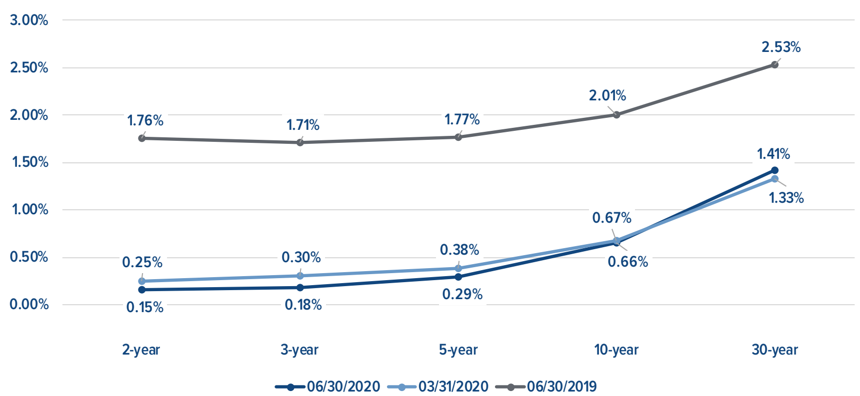
Weitz equity and balanced funds registered strong gains in the second quarter, recovering a large portion of the first quarter's declines. Please see Wally and Brad's ***Value Matters*** and the Portfolio Managers' equity and balanced funds' commentaries for detailed analyses.

Weitz Core Plus Income, Short Duration Income and Nebraska Tax-Free Income Funds also delivered strong returns in the second quarter, more than erasing the first quarter's declines. This has resulted in solid year-to-date investment performance, particularly for our Core Plus Income Fund. More details about contributors to performance can be found in the fixed-income funds' commentaries.

Fixed-Income Market Update

The graph below shows the changes of select Treasury rates over the past quarter and year.

U.S. TREASURY YIELDS

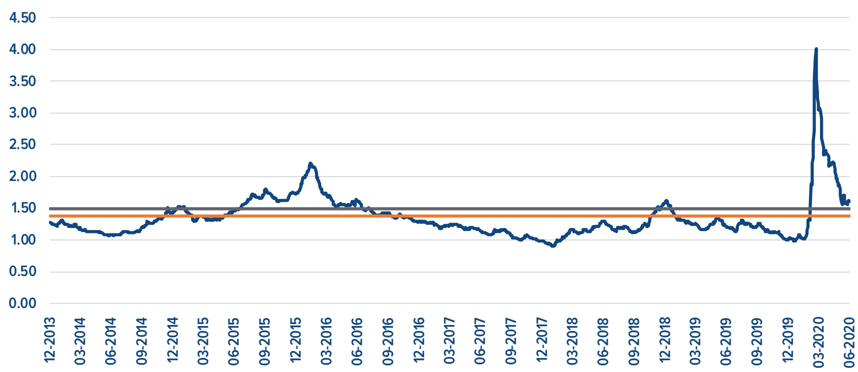


Source: Bloomberg

The Treasury curve steepened in the second quarter as shorter rates (2-, 3- and 5-year) continued their march to zero while longer rates (10- and 30-year) rose modestly. The Federal Reserve (Fed) did not raise the federal funds rate during the quarter (leaving rates near zero) – but in statements and public appearances by Fed chair Jerome Powell and other committee members, the message has been clear. During a June press conference, Powell said "We're not thinking about raising rates. We're not even thinking about thinking about raising rates." The market is growing increasingly comfortable/confident that rates will stay low through 2022 as the "dot plot" of Fed committee members' rate expectations show little dissent about keeping rates anchored at zero for at least that long.

Spreads on corporate bonds rallied (declined) meaningfully in the second quarter, leading to strong outperformance compared to U.S. Treasury bonds. A broad measure of investment-grade corporate bond spreads, compiled by ICE BofAML, declined by nearly half in the quarter – from 305 basis points as of March 31 to 160 basis points on June 30. The chart below depicts the path of investment grade credit spreads for the past five years (blue line) against the one-year (orange) and five-year (gray) averages.

INVESTMENT GRADE CREDIT SPREADS



Source: Federal Reserve Economic Data (FRED) – St. Louis Fed

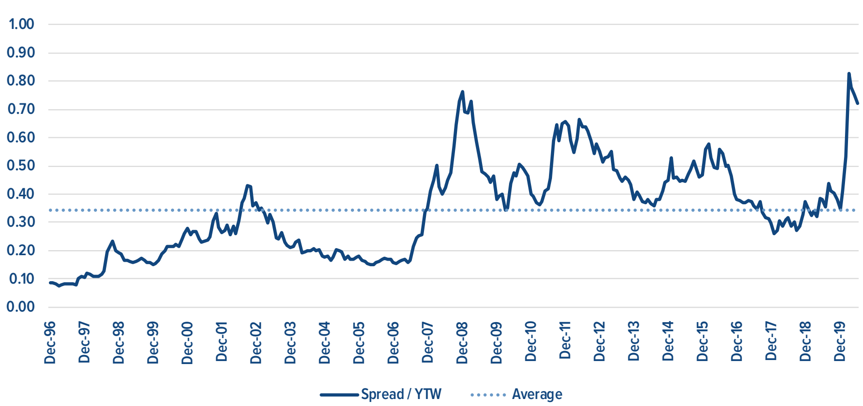
Overall, corporate bond credit spreads have meaningfully retraced the large spike upward that peaked in March of this year. Credit spreads remain above where they have been over the last five years, but coupled with very low 'base' rates (U.S. Treasury) on which nominal returns are set, forward returns on offer for corporate bonds are reaching (or have reached) all-time lows.

An example of the return dilemma fixed-income investors currently face (higher risk with lower returns) can be seen in the Bloomberg Barclays US Aggregate Bond Index (one of the broadest, most widely followed fixed-income indexes) and a few of its key component segments (U.S. Treasuries, mortgage-backed securities, and corporate bonds). As of June 30, the US Aggregate Index's yield-to-worst (a measure of forward returns) of 1.25% and duration (a measure of interest rate sensitivity) of over six years are at/near record levels (i.e. lows for forward returns and high interest rate risk via duration).

	Yield to Worst	Spread	Duration
U.S. Treasuries	0.50%	+0	7.15
Mortgage-Backed Securities	1.36%	+70	2.07
Corporate Bonds	2.15%	+150	8.54
US Aggregate Index	1.25%	+68	6.04

On a slightly more positive note, the chart below provides a near 25-year view of U.S. investment-grade corporate bond spreads when compared against the yield-to-worst. Courtesy of historic ultra-low U.S. Treasury interest rates, the added return for investors to own corporate (or other credit-sensitive) investments relative to "risk-free" U.S. Treasuries is at a multi-year high.

US IG INDEX SPREAD AS A % OF YIELD TO WORST



Source: CreditSights, Inc., ICE BofAML Indecies

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Outlook – crediting the "elephant" in the room

In a June testimony to the Senate Banking Committee, Fed Chair Powell downplayed the significance of the Fed's recent decision to begin buying corporate bonds. "I don't see us as wanting to run through the bond market like an elephant, doing things and snuffing out price signals," said Powell. "We just want to be there if things turn bad in the economy."

The monetary goals of the Fed have always played a key role in credit markets and the economy via its two-fold mission of price stability and full employment. As a result of the economic downturn of 2007 to 2009 ("Great Recession") the Fed took actions to expand its powers/reach through quantitative easing programs (central bank purchases of longer-term securities in the open market). During the COVID-19 crisis, the Fed put its powers on steroids. Besides using programs from the Great Recession, the Fed is now directly involved in buying and accumulating corporate bond exchange-traded funds (ETFs) and individual corporate bonds. The Fed has long jawboned the markets through its press releases and public discourses – but despite its desires to not be ***that*** pachyderm, it has become ***the*** elephant in the room. It has squashed interest rate levels and volatility for the foreseeable future. It has banished the bond market vigilantes – those of us who keep the marketplace functioning by sniffing out prices that are too high or too low – to some sort of financial market Purgatory. And its direct purchases of corporate bonds (via its Primary and Secondary Corporate Credit Facility) may not have snuffed out price signals – but it clearly has given investors the 'all clear' signal.

Where does that leave fixed-income investors today knowing there is a nearly insatiable buyer (elephant) now present in the marketplace? Challenged, for sure, if your investable universe consists primarily of the segments of the marketplace being ***directly*** impacted by the Fed's checkbook.

Our fixed-income funds have broad, flexible mandates that, we believe, allow us to navigate the increasingly lower return environment by identifying investment opportunities less influenced by Fed intervention (such as structured products).

Our goals remain the same. Namely, to preserve capital, maintain a strong liquidity position, understand evolving risks and opportunities, selectively take advantage of favorable risk/reward opportunities, and conduct consistent/thorough credit surveillance.

We remain ready to take advantage of any further valuation disparities that may develop, and we hope to continue to earn your trust.