FIXED INCOME INSIGHTS / 2Q 2022

Clouds With Silver Linings

Weitz | INVESTMENT MANAGEMENT

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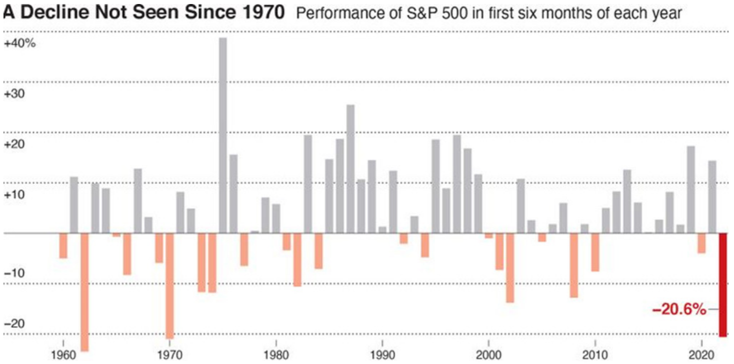
Investors looking for respite from the first quarter's price declines across nearly all asset classes were subjected instead to more turbulence and what may have felt like a bad sequel to a horror movie in the second quarter of 2022. Equity and bond prices declined as inflation remained a persistent problem, serving as a sort of 'boogeyman' that the Fed is now trying to reign in with a more aggressive approach to monetary policy. Short-term interest rates (via the federal funds rate) have been increased at each of the Fed's three meetings in 2022 and in larger increments (50 and 75 basis points) than have been used in over 20 years. With inflation at 40-year highs and more rate hikes forecast for the remainder of 2022 to contain inflation, investors became more concerned about the possibility of an economic contraction (recession). The result was further price declines across the fixed income (and equity markets), particularly in credit-sensitive sectors such as high yield.

The table below provides return data for select Bloomberg U.S. bond indexes for the second quarter and year-to-date. Negative returns were the norm except for ultra-short securities, such as 1-to-3-month Treasury bills, and cash. Given this backdrop, while negative returns are never welcome, we are pleased with the relative results that our investment process and flexible approach have yielded. For details regarding individual fund performance and analysis, see our funds' quarterly commentaries.

Q2 2022 | Fixed Income Returns, Bloomberg Indexes as of 06.30.2022

	Q2 Return (%)	YTD Return (%)
Bloomberg US Aggregate Bond	-4.63	-10.35
Bloomberg US T-Bill 1-3 Mon	0.12	0.16
ICE US T-Bond 7-10 Year	-4.00	-10.53
Bloomberg US MBS (Mortgage-Backed)	-3.98	-8.78
Bloomberg Municipal	-2.77	-8.98
Bloomberg US Corporate Invest Grade	-7.16	-14.39
Bloomberg US Corporate High Yield	-9.78	-14.19

The equity market decline was widespread as well. S&P 500 returns (pre-dividends) for the first half of each year reflect the historical significance of the price declines.



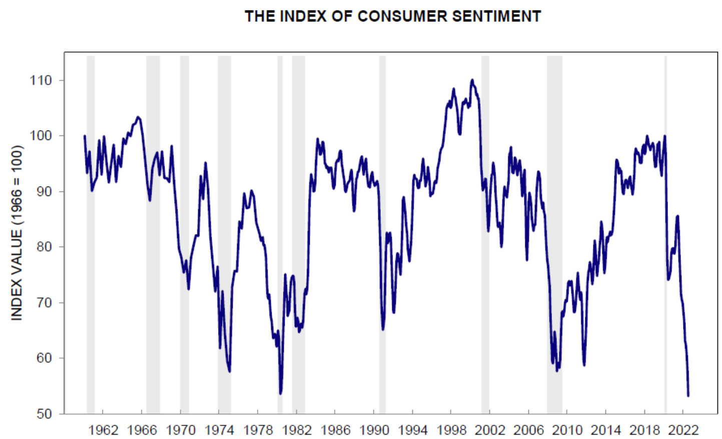
Source: S&P Capital IQ | The New York Times

Not since 1970 has the equity market (using the S&P 500 as a proxy) suffered such a steep decline in the first half of the year. Please see our latest **"Value Matters"** for Wally Weitz's and Brad Hinton's perspectives on the marketplace, particularly the equity market.

Collapse in Consumer Confidence

Generational inflationary pressures, a Fed intent on tightening financial conditions by raising short-term interest rates, and fears of a recession have all contributed to a collapse in consumer confidence. The monthly consumer sentiment survey by the University of Michigan reflects the extent of that decline.

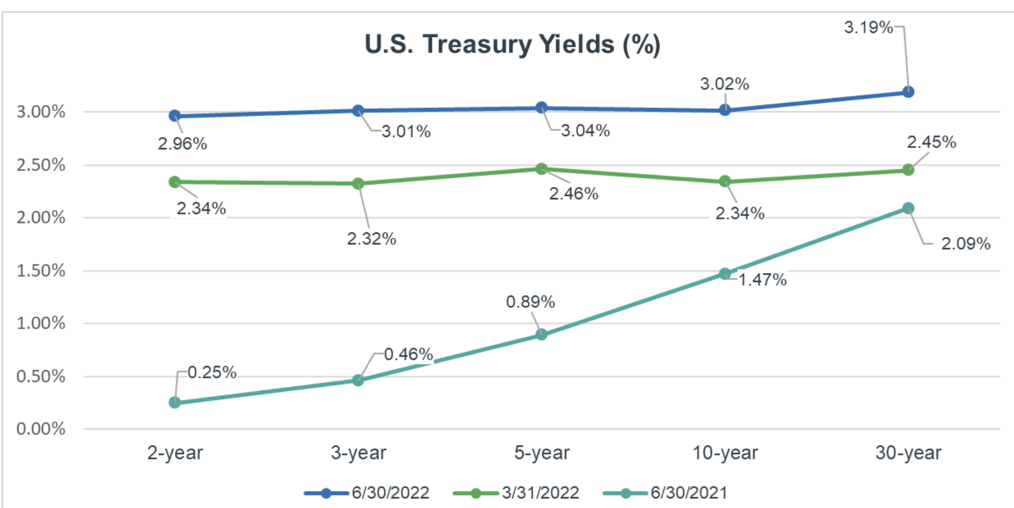
The survey registered an all-time low in June 2022. Consumers appear gloomier than they have been in the last 45 years, including the early days of the COVID-19 pandemic, during the Financial Crisis of 2007-2008, after 9/11, and through the deep recession of the 1980s. Inflation appears to be the driving force behind the decline. Whether the drop in consumer confidence will lead to reduced consumer spending (which has been robust) will be an important factor to monitor in the months ahead.



Source: University of Michigan | Surveys of Consumers

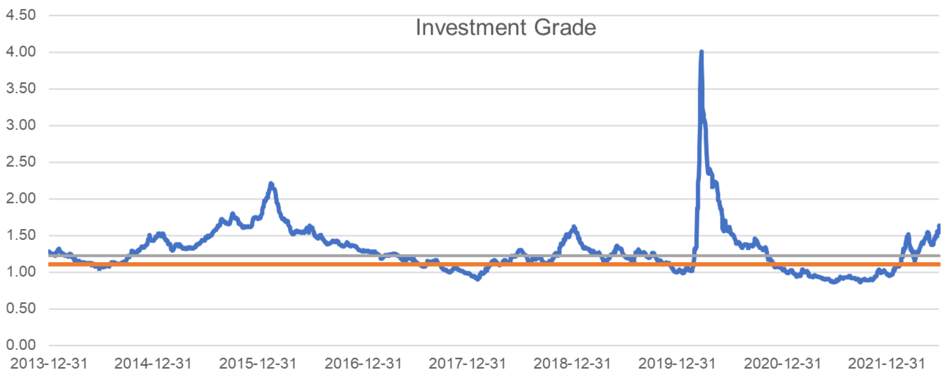
Federal Reserve - from Mr. Rogers to Mr. T

The Federal Reserve, in dealing with various challenges in the past decade, created a favorable 'neighborhood' for investors, in both equity and bonds. Zero interest-rate policy (ZIRP) and an otherwise very low interest rate environment led to high prices for both bonds and stocks. In his June testimony before Congress, Federal Reserve Chairman Jerome Powell resembled professional wrestler/actor Mr. T of Rocky fame when he commented that "the process is likely – highly likely – to involve some pain" as inflation has forced the Fed to pivot from dove to hawk in their role to maintain price stability in the economy. Evidence of that shift can be seen in the increase in U.S. Treasury yields, particularly shorter-term, where sub-one-percent returns on offer a year ago (June 30, 2021) for 2-, 3-, and 5-year Treasuries have increased from three to twelve times as of June 30, 2022.



Credit Spreads

Credit spreads widened meaningfully during the second quarter, pushing above longer-term averages. A broad measure of investment-grade corporate bond spreads, compiled by ICE BofA, increased to 164 basis points on June 30, 2022, from 122 basis points on March 31, 2022. 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.

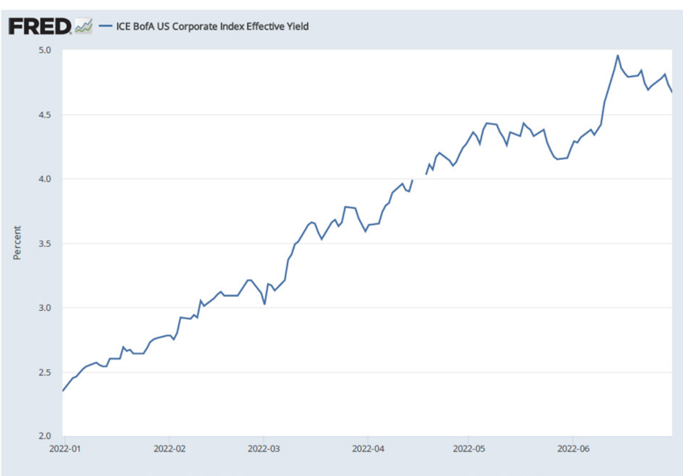


Source: Federal Reserve Economic Data (FRED) – St. Louis Fed

High yield credit spreads experienced similar movement during the first quarter. A broad measure of U.S. high yield corporate bond spreads, compiled by ICE BofA, increased to 587 basis points on June 30, 2022, up from 343 basis points on March 31, 2022.

Silver Linings

Despite the seemingly dour commentary, there is a 'silver lining' – prospects for forward returns have improved meaningfully. In previous commentary we had lamented an environment of return-free risk, where investors had been faced with a double whammy of historically low returns on U.S. Treasury and corporate bonds (as credit spreads had declined meaningfully below long-term averages). That has changed in the first six months of 2022. The charts below reflect that improvement – as they show the increase in effective yield for both investment grade and high yield indexes. Both have approximately doubled year-to-date.



Source: Federal Reserve Economic Data (FRED) – St. Louis Fed | Ice Data Indices, LLC.

The Fed's move away from a seemingly forever zero interest-rate policy has been welcome news for investors in CDs and other shorter-term securities. And the investment opportunity set has improved broadly as rates and spreads have risen across the yield curve.

Like our equity teammates, we would never 'call' a bottom in price or a peak in yields. In fact, we embrace the "Certain Uncertainty" that Wally and Brad reference in the latest "Value Matters," but we welcome the changed investment landscape that we believe can pave the way for better returns in the future. Our overarching investment approach is to remain patient while utilizing our flexible mandate to achieve our long-term investment goals. Namely (a) preserve capital, (b) maintain a strong liquidity position, (c) understand evolving risks and opportunities, (d) conduct consistent/thorough credit surveillance, and (e) selectively take advantage of favorable risk/reward opportunities.

IMPORTANT DISLCOSURES

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 07/15/2022, 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.

One basis point is equal to 0.01 percent.

Portfolio composition is subject to change at any time. Current and future portfolio holdings are subject to risk.

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 BB+ and below by one or more credit ratings agencies.

Consider these risks before investing: All investments involve risks, including possible loss of principal. Market risk includes political, regulatory, economic, social and health risks (including the risks presented by the spread of infectious diseases). Changing interest rates may have sudden and unpredictable effects in the markets and on the Fund’s investments. The Fund may purchase lower-rated and unrated fixed-income securities, which involve an increased possibility that the issuers of these may not be able to make payments of interest and principal. See the Fund’s prospectus for a further discussion of risks.

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 weitzinvestments.com.

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