VALUE MATTERS / 1Q 2024

Getting Around the Bases

Weitz | INVESTMENT MANAGEMENT

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The first quarter of 2024 was strong for our stock funds and provided a good finish to the one-year period ending March 31. In a market environment where index performance has been skewed by extraordinary performance of a handful of mega-cap stocks, our equity funds delivered strong absolute returns for both the quarter and the past twelve months.

You've probably read more than you care to about the "Magnificent Seven" – Microsoft, Meta Platforms (Facebook parent), Alphabet (Google parent), Amazon.com, Apple, Tesla, and ***especially*** NVIDIA – and their disproportionate impact on the S&P 500 and the Russell 1000 and 3000. For an even more extreme example of a company having an outsized impact on index performance, consider Super Micro Computer (SMCI) which, as of March 31, 2024, accounted for 27% of the year-to-date return of the *entire* Russell 2000 (U.S. small-cap index). Many of these are great businesses, and we own four of them, but the arithmetic of capitalization-weighted indices can distort the story of how "the market" is doing at any given moment.

It would be disingenuous to suggest that we don't care about the *relative* numbers. We do. But what we are after, and what our fixed income teammates are after, is good *risk-adjusted* returns. That is, we want to race as fast as we can around the track while making sure we finish the race safely. (Our co-head of fixed income Tom Carney uses the baseball image of "getting safely around the bases.") Happily, having a healthy respect for risk is **not** inconsistent with winning the long-term race. In fact, **it is a requirement**.

The portfolio managers' commentaries provide portfolio-specific information on our winners and losers and some color on how the funds are positioned. We also recommend reading our *Fixed Income Insights*.

If the economy is okay, and the market is hitting new highs, why does everyone feel so bad?

Over the past five and a half years, the total return for the S&P 500 has been roughly +100%. Yet the mood in the country is subdued, at best. Economists and market commentators are puzzled as to why people are not more upbeat. While key economic indicators such as employment, GDP, and corporate earnings are fairly strong – many polls show that a large proportion of the population has relatively low confidence in the economy and/or their political leaders.

The reasons for the disconnect are complicated, and we do not presume to fully understand them. A lot has happened over the past several years and the crosscurrents of good and bad news have probably been disorienting. Consider, since fall 2018:

- There have been three bear markets – drops of 20% or more in the S&P 500
- Covid caused a shutdown of the economy, creating short-term business winners and losers, and uncertainty as to long-term impacts on the economy
- Covid "safety net" spending provided temporary payments and debt forbearance (not forgiveness), and now those programs have ended
- The Fed expanded the money supply and provided near-zero cost financing in order to *stimulate* inflation, then made a wrenching reversal of policy, raising interest rates dramatically in order to *suppress* the inflation that had been created

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- Shooting wars in Ukraine and the Middle East and trouble in other geopolitical hotspots are causing local suffering and supply chain issues
- Growing tensions with China have widespread implications for a wide range of businesses and raise fears about the future of Taiwan
- Artificial intelligence (AI) is at the heart of the monster rally in tech stocks, but it has also raised troubling questions about its potential misuse

No wonder investors are uneasy! The news media has always understood how to build engagement ("If it bleeds, it leads"), and social media has learned to amplify the noise (and the anxiety). As *citizens*, it's important that we do what we can to address the issues of the day. But from the narrow perspective of *investors*, it is often best to avoid reacting to the scary headlines. Selling all of one's stocks, or worse yet, trying to jump in and out based on the news, would have been **very** expensive. Over the years, we've often suggested that clients turn off CNBC and turn on the History Channel, and we stick by that suggestion.

Focus on the Longer-Term, Bigger Picture

One of Warren Buffett's favorite questions is, "What *one* stock would you buy if you knew the stock market would be closed for the next ***ten*** years?" It's a great question. One is forced to think about the business itself. Will its products and services still be wanted and needed in ten years? Will management be able to adapt to a changing world and avoid being "disrupted?" Is its balance sheet strong enough to withstand recessions and other financial stresses? Is its culture solid and well-entrenched?

Fortunately, we ***will*** have a stock market available to allow us to take profits, make new investments and correct mistakes. But if we think about our investment choices as if we would have to live with them for many years, the focus is very different.

Predicting near-term changes in the fed funds rate becomes irrelevant. Balance sheet strength and capital structure flexibility will be more important.

Quarterly earnings become much less important. Investors tend to obsess over the *pattern* of earnings growth and how the results compare to "expectations." Strong, healthy earnings *are* important, and growth in the stream of earnings is desirable. But regular, stairstep earnings growth is *not* necessary (and may be evidence of management's short-term focus and/or dishonest accounting).

Some businesses are highly cyclical. This is okay. Buffett has often said that he "preferred a lumpy 15% [growth] to a smooth 12%." ConAgra Foods CEO Mike Harper said he expected the chicken business to lose money about one in every four years but that it was a welcome part of the product portfolio because it earned very high *average* returns on capital over the cycle.

All companies are cyclical to some extent. Business expansions and contractions tend to overshoot in both directions (the business cycle will always be with us). During the Covid shutdown, some earnings were pulled forward (groceries, home improvement products, broadband service) and others were delayed (travel, hospitality, live entertainment). Capital expenditures can also impact the pattern of reported earnings and can divert cash from one of investors' favorite corporate activities – stock buybacks. In each of these cases, investors are likely to have little tantrums if a company "misses its numbers." What really matters to the long-term investor, though, is the aggregate amount of cash, or owners' earnings, the company is going to produce over a long holding period.

Finally, while it is critical that we do not *overpay* for a stock – with a 10-year frame of reference, it is less important that we buy on the *absolute bottom* tick. We would like to benefit from multiple expansion or valuation "rerating," but over the long run, the bulk of our return will come from growth in the value of the business as the company evolves and reinvests its retained earnings.

Outlook and Game Plan

Stocks have gone up a lot over the past eighteen months. The mega-cap "inflation" of the indices probably overstates the dimensions of the move, but valuations are on the high side by historical standards.

Our stocks have participated. The weighted average price-to-value ratios of our portfolios are higher than they have been in a while. We do not despair at this – most of our stocks are fairly valued, and we have a few "good ideas that have not worked yet" for which we have high hopes.

Our focus is on long-term returns. Our companies are generally doing very well and growing the values of their businesses. The economic news is subject to all sorts of crosscurrents, and the added noise of an election year make the outlook as unpredictable as ever. But we plan to continue to collect great businesses and patiently give them the time to generate and compound investment returns.

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 04/01/2024, 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.

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

Past performance is not a guarantee of future results.

As of 3/31/2024, the following portfolio companies constituted a portion of the net assets of Conservative Allocation Fund, Large Cap Equity Fund, Multi Cap Equity Fund, and Partners III Opportunity Fund as follows:

- Alphabet, Inc.: 1.3%, 5.0%, 6.6%, and 6.1%.
- Amazon.com, Inc.: 0.0%, 4.3%, 0.0%, and 4.9%.
- Apple, Inc.: 0.0%, 0.0%, 0.0%, and 0.0%.
- Berkshire Hathaway, Inc.: 2.7%, 4.9%, 6.6%, and 10.7%.
- Conagra Brands, Inc.: 0.0%, 0.0%, 0.0%, and 0.0%.
- Meta Platforms, Inc.: 0.0%, 5.2%, 5.9%, and 3.5%.
- Microsoft Corp.: 1.8%, 0.0%, 0.0%, and 3.2%.
- NVIDIA Corp.: 0.0%, 0.0%, 0.0%, and 0.0%.
- Tesla, Inc. 0.0%, 0.0%, 0.0%, and 0.0%.
- Super Micro Computer, Inc.: 0.0%, 0.0%, 0.0%, and 0.0%.

The **Russell 3000** measures the performance of the largest 3,000 U.S. companies representing approximately 98% of the investable U.S. equity market. The **Russell 2000** is a subset of the Russell 3000 and measures the performance of the 2,000 smaller companies included in the larger index. The **Russell 1000** is a subset of the Russell 3000 and measures the performance of the largest 1,000 U.S. companies in the larger 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 weitzinvestments.com.

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