Get Ready for an Adventurous Year

In the second year of the "COVID era," we're pleased with the results for our stock funds and bond funds. Our fixed income team in particular deserves credit for how they managed through the year, especially considering the challenges that faced the bond markets in 2021, leaving many fixed income indexes in negative territory.

In this uncertain and volatile environment, our focus has been on capital preservation – so to end the year not only protecting capital but with our fair share of black ink is more than welcome. And while our discussion here focuses primarily on the past 12 months, we suggest investors focus on longer periods. We also encourage investors to check our website for Tom and Nolan's **Fixed Income Insights** and portfolio managers' commentaries on each of our funds.

WALLY WEITZ, CFA
Co-Chief Investment Officer
& Portfolio Manager

BRAD HINTON, CFA
Co-Chief Investment Officer
& Portfolio Manager

Market Commentary

The investment environment of 2021 was tricky. The arrival of vaccines to prevent the spread of COVID, along with therapeutics to treat the disease, raised hopes for a return to normalcy. But just as it seemed the world was getting a handle on the pandemic, new virus strains, vaccine hesitancy and mixed levels of COVID protocol compliance led to new waves of infections. Meanwhile, supply chain disruptions and labor shortages caused consumer and producer prices to blow through the Federal Reserve's 2% inflation target. As the year ended, the Fed made it clear that quantitative easing – depressing interest rates by buying bonds – would end soon, and interest rates would be raised in 2022.

Investor sentiment zigged and zagged all year, alternately favoring "reopening" vs. "lockdown" stocks, steady growers vs. cyclical recovery candidates, inflation victims vs. inflation beneficiaries, large-cap stocks vs. small-cap stocks. Thus, different investment "styles" came into, and fell out of, favor at a dizzying pace, and investors who track money managers as if they were horses on a racetrack were probably exhausted by year-end.

> *"...we believe that this mechanical approach to investing distorts relative valuations, and we think that active managers will eventually be able to feast on the resulting bargains."*

"Deep value" had its moments, especially as energy jumped from the performance doghouse to the top of the charts. Innovative new companies threatening to "disrupt" the old guard in a number of industries captured investor imagination. With interest rates near zero, the time value of money was very low, and "birds in the bush" were worth nearly as much as "birds in the hand." Thus, companies that promised robust future flocks (sales and earnings) 5-10 years out were favored investments. For example, electric vehicle maker Rivian Automotive came public in the fall of 2021 and rocketed to a $100 billion market cap before even selling its first vehicle.

In John Maynard Keynes' 1936 *The General Theory of Employment, Interest, and Money*, he wrote about "animal spirits" – the psychological and emotional factors that drive investors to buy and sell securities in times of economic stress and uncertainty. But Keynes likely never imagined the amazing ways those animal spirits would drive speculation in 2021. We've written about the Robin Hood phenomenon that saw traders, many young and inexperienced, driving stocks of questionable value to incredible heights, egging each other on via social media. Margin borrowing and stock options provided extra leverage (and risk). Several thousand (!) new cryptocurrencies were created and have an aggregate market value measured in the trillions of dollars. Regulators are scrambling to find ways to protect investors, but it is still "wild west" days in the crypto market. Blockchain technology is very interesting and is already finding mainstream applications, but the value of a crypto "coin" or "token" is in the eye of the beholder. And as for NFTs – non-fungible tokens – Nike made a considerable investment in this space with their acquisition of RTFKT, a company that makes "virtual tennis shoes" and other digital collectibles. We enjoy watching the spectacle of the crypto phenomenon, but for us, it is an uninvestable "asset class." It seems likely there will be some emperor's new clothes moments.

The trend to "passive" investment in stocks and bonds continued unabated in 2021. New money, created by the Fed and injected into the bond market via quantitative easing (and subsequently leaking into stocks), and "old" money reallocated from active managers to passive, swelled index funds and ETFs. Obviously as active managers you would expect us to lament this trend, but objectively, there are implications that investors should be aware of. Most market indexes are "capitalization-weighted," so new capital is allocated in proportion to the market cap of the index component. This means that the big get bigger, regardless of their attractiveness as investments relative to smaller-cap companies. Some of the mega-cap companies are deserving – we own several of the largest, like Berkshire Hathaway, Alphabet (Google), Amazon, and Meta Platforms (Facebook). However, we believe that this mechanical approach to investing distorts relative valuations, and we think that active managers will eventually be able to feast on the resulting bargains.

In short, 2021 was an unusual year. Interest rate suppression by the Fed and trillions in deficit spending pumped up most segments of the economy, and aggregate corporate earnings numbers were very good. The headlines showed most stock market indices closing the year around all-time highs. Under the surface, though, a considerable proportion of the public company universe have been declining for months and selling at steep discounts from their highs for the year. The explanation for this apparent contradiction is that a shrinking number of mega-cap stocks are supporting the index levels because of the math of cap-weighted indices. This "stealth correction" is welcome as it gives price- and valuation-sensitive investors, like us, raw material for earning future capital gains.

"Sleepers"

Reports to investors usually focus on the winners that prove the worthiness of the managers. It's possible that we've been guilty of that on occasion, despite our best efforts to accurately convey what has worked and what hasn't. This time, though, we are going to celebrate the great businesses we own that "went nowhere" in 2021. In a generally expensive market facing potentially strong headwinds in 2022, we find it very encouraging to own a number of proven winners whose stocks have been "resting" for the last year or so. They will not necessarily save us from markdowns during broad-based corrections, but they are companies that we believe can survive and grow business value through almost anything. They are the kinds of businesses that allow us to sleep well at night and not be tempted to sell at the wrong time. Here are some examples:

Established payments companies have been out of favor recently. Cross-border payments have been depressed with COVID disrupting international travel. These types of payments are particularly lucrative for **Visa** and **Mastercard**, and their absence has impacted earnings. Further, we believe investors have overestimated the negative competitive impact of new fintech companies that have emerged over the past few years. Many of these "disrupters" depend on the Visa and Mastercard "rails" over which electronic payments travel, and these wily incumbents have a way of acquiring, copying or otherwise competing with upstarts. Another in this category, **Fidelity National Information Services**, has a very stable, growing, mission-critical software business serving banks. It entered the payments business a few years ago and is now being painted in the same light as other payment stocks. We think that global spending will eventually revert to its trend line. Further, payments companies' revenues are generally a function of payment volume, so revenues are indexed to inflation while expenses rise more slowly. This is great for profit margins. We expect all three of these companies to be excellent contributors to our results over the next few years.

Software companies and data providers have wonderful economics (write the program/gather the data once and sell it over and over). **Black Knight** (mortgages), **Guidewire** (insurance), and **CoreCard** (payments) offer specialized software that is best-in-class in its niche. **CoStar** is the gold standard for commercial real estate data and has expanded into adjacent markets with great promise. These companies ran up to very full prices last year and deserve a breather, but their competitive positions and pricing power should allow for further upside over time. Another data provider – **Dun and Bradstreet** – provides important business credit information. Previously, it had rested on its laurels and let its moat erode, but new management with a great track record for turnarounds gives us confidence that this "fixer-upper" can become much more valuable. The jury is still out on Dun and Bradstreet's upside potential, but we believe its downside is limited, and if the new management can continue to execute well, we should do well.

> *"So, for all the (realistic) fears of market over-valuation, inflation, rising interest rates, etc., a much-needed "correction" is already well underway."*

Several "platform" companies thrived during COVID and have been very strong stocks. In 2021, their businesses continued to thrive, though their stock prices cooled off. **Amazon** continues to steamroll the competition and grow rapidly, but its stock ended the year about where it began. A different kind of platform, MarketAxess, a bond trading exchange, is rapidly gaining share of global bond trading (our fixed income managers use it, and they swear by it). **MarketAxess** shows promise of rapid growth in business value. It was arguably ahead of itself earlier in 2021 at around $600, but as investor attention strayed to other areas and the stock drifted back under $400, we were able to invest in a company we have long admired.

A couple of other platform companies deserve a mention as well. Meta Platforms and Alphabet have both been under regulatory scrutiny that has affected their valuations. The threats of punitive action are real, but we have tried to be imaginative about how onerous any fines, rule changes or forced divestitures might be, and we believe that the five-year outlook for each is well above average under almost any scenario. So, we include these two in the list of the under-appreciated.

Finally, a couple of old favorites. ***Liberty Broadband*** owns 26% of Charter Communications, the second-largest U.S. cable company. Charter finished the year -20.6% from its recent high, and we believe it is a cheap stock in its own right. Liberty Broadband, whose primary asset is its Charter shares, offers Charter ownership at a discount. Another Liberty company, ***Liberty SiriusXM***, owns over 80% of SiriusXM Satellite Radio. We believe that SiriusXM is undervalued and that the Liberty SiriusXM structure allows us to own the company at a discount. Both Charter Communications and SiriusXM are growing nicely, generating prodigious amounts of free cash flow and buying back lots of their own stock. John Malone controls both of these Liberty securities, and we believe he will find ways to close the discounts and extract maximum value for shareholders. Both Liberty securities were stock market duds in 2021, but we expect them to be contributors in 2022 regardless of what the general market does.

In many cases, these stocks borrowed from the future as they outperformed in past years and were just "ahead of themselves." In others, temporarily depressed earnings or overblown fears of competition and regulation put their stocks in the penalty box. So, for all the (realistic) fears of market over-valuation, inflation, rising interest rates, etc., a much-needed "correction" is already well underway.

Outlook

We expect 2022 to be an "adventure" for investors. The list of crosscurrents and transitions that we'll face is long. The world is always an uncertain place. As former Secretary of Defense Donald Rumsfeld characterized it, there are plenty of things that we know we know, plenty of things we know we don't know, and plenty of things we don't know we don't know (and it's the latter category that tends to be the most difficult). More importantly, though, as Mark Twain warned, "It ain't what you don't know that gets you into trouble. It's what you know for sure that just ain't so."

We know that very little in economics, politics and investor psychology is predictable. We do believe, though, that business value is (roughly) measurable and that it (eventually) exerts a gravitational pull on a company's stock price. When confidence is shaken and markets are volatile, active managers have the raw material they need to add value for investors. We're looking forward to an interesting year.

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 01/19/2021, 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.

As of 12/31/2021, the following portfolio company constituted a portion of the net assets of Balanced Fund, Hickory Fund, Partners III Opportunity Fund, Partners Value Fund, and Value Fund as follows:

- Alphabet, Inc. – Class C (GOOG): 2.3%, 0.0%, 7.2%, 7.6%, and 7.5%.
- Amazon.com, Inc. (AMZN): 0.0%, 0.0%, 3.3%, 0.0%, and 2.7%.
- Berkshire Hathaway Inc. – Class B (BRK.B): 2.1%, 0.0%, 10.8%, 5.5%, and 4.7%.
- Black Knight, Inc. (BKI): 0.0%, 2.5%, 2.5%, 2.4%, and 0.0%.
- Charter Communications, Inc. (CHTR): 0.0%, 0.0%, 0.0%, 0.0%, and 0.0%.
- CoreCard Corporation (CCRD): 0.0%, 0.0%, 3.9%, 0.0%, and 0.0%.
- CoStar Group, Inc. (CSGP): 0.0%, 3.2%, 3.2%, 3.2%, and 4.0%.
- Dun & Bradstreet Holdings, Inc. (DNB): 0.0%, 2.9%, 3.4%, 1.9%, and 0.0%.
- Fidelity National Information Services, Inc. (FIS): 1.2%, 0.0%, 4.3%, 0.0%, and 3.3%.
- Guidewire Software, Inc. (GWRE): 0.0%, 2.9%, 0.0%, 2.5%, and 0.0%.
- Liberty Broadband Corp. Class A & C (LBDRA/K): 1.2%, 8.2%, 5.9%, 4.7%, and 4.6%.
- Liberty Media Corp. – Series A&C Liberty SiriusXM (LSXMA/K): 0.0%, 5.2%, 6.7%, 5.2%, and 3.1%.
- MarketAxess Holdings, Inc. (MKTX): 0.0%, 3.3%, 0.0%, 1.8%, and 0.0%.
- Mastercard, Inc. (MA): 1.6%, 0.0%, 4.7%, 3.3%, and 4.0%.
- Meta Platforms, Inc. (FB): 0.0%, 0.0%, 5.5%, 3.4%, and 4.8%.
- Nike, Inc. (NKE): 0.0%, 0.0%, 0.0%, 0.0%, and 0.0%.
- Rivian Automotive, Inc. (RIVN): 0.0%, 0.0%, 0.0%, 0.0%, and 0.0%.
- SiriusXM Holdings, Inc. (SIRI): 0.0%, 0.0%, 0.0%, 0.0%, and 0.0%.
- Visa (V): 1.6%, 0.0%, 5.2%, 3.7%, and 3.8%.

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

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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