VALUE MATTERS / 2Q 2024

Investing in a Tech-Driven Market

Weitz | INVESTMENT MANAGEMENT

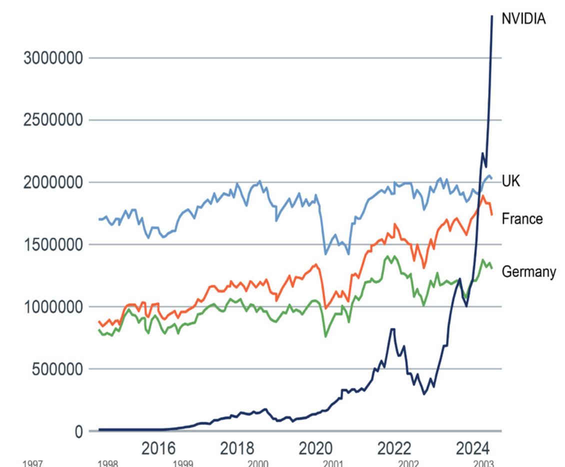
WALLY WEITZ, CFA
Co-Chief Investment Officer & Portfolio Manager

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

After 30 years in our current office space, we are preparing to move to a new historic building in Omaha that happens to be world headquarters for Berkshire Hathaway. For some, this has been light duty, but for one with 50+ years of accumulated files, it has been a much heavier lift.

In the course of packing boxes and digging through the geologic layers of memories, we were reminded of many landmark events – October 19, 1987's 22% market meltdown, 9/11, the Great Financial Crisis (GFC) of 2008-09, and the Covid pandemic of 2020. Another major turning point – and one that reminds us of today's market environment – was the bursting of the dot-com bubble in March of 2000. Back then it was Cisco, providing the plumbing for the internet and briefly reigning as the most valuable public company.

Today Nvidia is the star of the artificial intelligence (AI) mania. The company has seen its stock price increase by over 1,000% over the past 18 months, ending June at $123.54. Nvidia now has a market value of over $3 trillion, the highest of any public company, exceeding the value of the entire UK, French and German stock markets (see graph below). AI is for real, and Nvidia is currently in the catbird seat. But the chip business is cyclical and highly competitive. While Nvidia is not likely to emulate Cisco's subsequent decline of 90% from its high, it seems possible that the last trillion of appreciation may prove harder to sustain.



One side effect of the AI feeding frenzy is that the major market cap-weighted indexes are posting returns that are not representative of stocks in general. We have written about the impact of the "Magnificent Seven" tech stocks – Alphabet, Amazon, Apple, Meta Platforms, Microsoft, Nvidia, and Tesla. Now the story is more like the "Magnificent One."

Nvidia alone accounted for about one third of the S&P 500's year-to-date gain of more than 15%. The **equal-weight** S&P 500 was down in the second quarter and stands at +5% YTD. And the Russell 2000 small-cap index actually lost about 4% in the second quarter and is now up only 1% for the year. Knowing the sad history of the bursting of the dot-com bubble at the start of the century helps only a little as we recall considering Nvidia a couple of years ago. We do believe that "the (business value) truth will out."

Outlook – Continued Market Standoff?

We are in the third year of the Fed's campaign to tame inflation. Jay Powell & Co. have been trying to cool the economy by raising interest rates, and they are succeeding. Earnings growth has moderated in many sectors, and inflation numbers have been declining. Investors seem to be cautiously optimistic about the prospects for a "soft landing" for the economy, but they are obsessed with the timing of a cut in the fed funds rate, as if that were the only factor determining interest rates and stock prices.

We don't have an opinion on near-term Fed moves. They may "over-achieve" and cause a recession. Or they may cut rates prematurely and trigger a resumption of inflation. Maybe they will get policy just right.

Our take, though, is that rates are unlikely to decline to the near-zero depths that drove valuations to very high levels by 2021. Inflation may prove stickier than expected. Climate change is bringing surprises such as higher insurance rates and electricity costs due to wildfires and more extreme storms. Housing shortages and tight labor markets may persist. Deglobalization, "reshoring," and trade wars are expensive. Also, given our rapidly rising national debt, higher interest rates may be required to entice investors to buy the trillions of dollars of freshly printed bonds we are using to pay our bills. (Readers of a certain vintage may remember the term "bond vigilantes," coined in the 1980s.)

The core of our investment philosophy is that (1) the value of a business is the present value of its future cash flows (owners' earnings) and (2) its stock price will ultimately reflect that business value. Interest rates enter the picture because they determine the relative attractiveness of $1 today vs. $1 in the future. So, if interest rate levels **do** remain higher than investors expect, it would be logical to foresee some further valuation compression for stocks (i.e., lower price-earnings ratios) as investors sell stocks to buy current income securities. This transition has been going on for two and a half years and may have a way to go.

We try to invest in a way that does not require accurate macroeconomic predictions. After all, as economist John Kenneth Galbraith quipped, "The only function of economic forecasting is to make astrology look respectable." But as we monitor the prospects for our portfolio companies and look for potential new investments, we need to make some assumptions. We are quite humble about our capacity to do this, but we try to get the big picture **approximately** right. In the current environment, here are some of our working assumptions **(not predictions)**:

> (1) Policymakers will make mistakes and economic surprises will come out of the blue, but business leaders and entrepreneurs, acting in their own self-interests, will generate profits and business value growth **most** years.
>
> (2) Climate change, politics, income inequality and human nature will cause serious problems for large swaths of humanity, but unfair as it may be, changes in the business environment will be slow enough and linear enough for investors to cope.
>
> (3) Fed policy and exogenous shocks aside, "natural causes" will keep benchmark interest rates, e.g. on 10-year Treasuries, from spending much time below today's 4% level.

These assumptions lead us to believe that businesses can do just fine, but that from today's valuation levels, our expectations for near term stock market returns will likely be modest.

We may be in a **single-digit** equity return world for a while, rather than the more optimistic expectations of many investors. We aspire to produce juicier gains, but we think our best way to do that is to stick with our proven businesses and continue to look for new investment ideas that fit our established criteria.

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 07/01/2024, 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 6/30/2024, 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 C.A%, 5.0 L.C%, 7.9 M.C%, and 5.6 P.3%.
- Amazon.com, Inc.: 0.0 C.A%, 3.6 L.C%, 0.0 M.C%, and 4.3 P.3%.
- Apple, Inc.: 0.0 C.A%, 0.0 L.C%, 0.0 M.C%, and 0.0 P.3%.
- Berkshire Hathaway, Inc.: 2.3 C.A%, 4.9 L.C%, 6.7 M.C%, and 10.8 P.3%.
- Cisco Systems, Inc.: 0.0 C.A%, 0.0 L.C%, 0.0 M.C%, and 0.0 P.3%.
- Meta Platforms, Inc.: 0.0 C.A%, 5.0 L.C%, 6.4 M.C%, and 3.7 P.3%.
- Microsoft Corp.: 1.8 C.A%, 0.0 L.C%, 0.0 M.C%, and 3.3 P.3%.
- NVIDIA Corp.: 0.0 C.A%, 0.0 L.C%, 0.0 M.C%, and 0.0 P.3%.
- Tesla, Inc.: 0.0 C.A%, 0.0 L.C%, 0.0 M.C%, and 0.0 P.3%.

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.

Weitz Securities, Inc. is the distributor of the Weitz Funds.