Harris Associates

PRIVATE WEALTH MANAGEMENT

Learning from the Greats

March 2025

This quarterly letter was written on March 31st. Tariff announcements have led to a significant increase in volatility in the first few trading days of the second quarter, but the message in this letter still applies. For further insight into our view on tariffs, please find the following article on our website: "Markets in turmoil: Our view on the tariffs".

The 2025 market environment has been challenged by economic and political uncertainty, which has led to a spike in volatility and a negative shift in investor sentiment. Continued inflation, whipsaw economic policies, and geopolitical conflicts are stoking investors' fears. With consumer confidence at a 12-year low, companies and their investors are worried that consumers will pump the brakes on spending, potentially further exacerbating economic issues.

Big tech and AI-related stocks – industries that drove a strong market in 2024 – have felt the effects of policy and economic uncertainty, generating significant day-to-day volatility. Policy uncertainty on tariffs – a common theme of fourth-quarter earnings calls – will continue to be an important focus of upcoming first-quarter earnings calls. Management teams have been hard-pressed to evaluate and communicate how their companies will be affected. More clarity on tariff policy and implementation plans will be helpful for those, like us, who are aiming to quantify their impacts on a company's value.

The first quarter may have felt like a never-ending stream of worrying news to plugged-in investors, marked by massive single-day drops in market value, a market correction, and fears of a global recession. Despite these challenges, the "hard" data has not yet reached concerning levels in our view. Although it is slightly weaker than expected, consumer spending has stayed strong, while unemployment levels remain historically low and corporate profits have been resilient. Fourth-quarter results exceeded the market's expectations, and earnings-per-share growth is expected to be in the low double-digits in 2025[1].

While daily fluctuations can feel unsettling, it is important to put a single trading day's return into perspective. Over the past 50 years, the S&P 500 has been up on only 54% of trading days. Yet over that period, annual returns were positive 82% of the time, or 41 years, leading to double-digit annualized returns. As an avid tennis player and spectator, I was instantly struck by that 54% statistic. Roger Federer, a true winner and tennis superstar, only won 54% of the points played in his singles career[2]. Yet he won 82% of matches, including 20 grand slam titles. Rafael Nadal[3] and Novak Djokovic[4], Federer's legendary rivals, also both won 54% of their points played.

We believe that long-term success in investing, like tennis, is not achieved by winning every point, but by staying consistent and executing a sound strategy over time. Tennis greats can help us understand how to be successful over the long-term despite winning just over half the time.

> *"When you lose every second point, on average, you learn not to dwell on every shot."*
> *-- Roger Federer, 2024 Dartmouth Commencement[2]*

For long-term investors like Harris Associates, maintaining perspective is crucial. Just as tennis icons earned their spots in history by focusing on winning when it matters most, rather than dwelling on individual points lost, investors should maintain a broad view of market performance rather than react emotionally to daily fluctuations. In the end, success is not about perfection – it is about resiliency and consistency. During times like these, it is crucial to stay grounded in our investment philosophy.

Buy businesses trading at a discount to our estimate of intrinsic value

As always, we are trying to buy "a dollar's worth of value for only sixty cents". Such opportunities often present themselves during times of increased market volatility. Sharp market swings can lead to dislocations between stock price and our assessment of a company's value, enabling us to invest in high-quality companies at what we believe are discounted prices. When we invest in discounted stocks, we believe that the upside is greater and the risk of loss of investor capital is mitigated. With clients who are aligned with our long-term philosophy, we can look past short-term noise and focus on the potential for strong performance *through* full economic cycles.

While short-term noise often only affects specific industries rather than the entire market, we remain disciplined in our bottoms-up approach. This approach focuses on identifying the cheapest stocks in the entire market, rather than a specific industry, and it also can uncover clusters of attractive names within specific industries that we believe are underpriced due to short-term fears.

A recent example was in 2022 when mega-cap technology stocks were under pressure in a rising interest rate environment. These fears led the tech-heavy Nasdaq Composite Index to decline 33% that year. We capitalized on this key moment by creating or bolstering positions in high-quality stocks such as Alphabet, which despite its lackluster 2025 performance to-date, is up 79% since its 2022 low. For the first time since 2022, mega-cap stocks like Alphabet are starting to look relatively attractive again.

Invest in companies expected to grow intrinsic value over time

There is a constant tension between value and growth investors, but we view growth as not the opposite of value, but an integral component of value investing. The difference between us and growth investors is the price we are willing to pay. Just as investor sentiment reflects forward-looking thinking, we model out company financials five years down the road. The question is not whether the company will grow its intrinsic value over time, it's how much and at what speed. What we believe a company will earn and what those earnings are worth today – that is how we identify value.

Even during times of intense volatility, we view growth through the long-term lens of what is "normal." The Covid-19 pandemic is an example of when it was imperative to look *through* a cycle to judge value. Growth went through the roof for companies who supported the pandemic lifestyle – Peloton, Zoom, Chewy, etc. Knowing (and hoping) the pandemic would be temporary, we avoided projecting exponential growth over the long run with early Covid winners.

Invest with management teams that think and act as owners
As shareholders of individual businesses, it is crucial to us that management teams behave in the best interest of shareholder value. A company can be well-positioned financially and in its respective market, but without a strong management team in place, its position can crumble. The most successful teams prioritize sustainable growth, make tough decisions under pressure, and focus on long-term success rather than short-term wins. This approach can help ensure their organizations stay competitive and resilient.

Strong management teams are key to steering companies through times of heightened uncertainty – like the 2023 regional banking crisis. Silicon Valley Bank (SVB) was the first of three small-to-mid-sized banks to collapse during that time. The management team of regional bank, First Citizens (FCNCA), quickly structured a deal to acquire the majority of SVB's distressed assets and liabilities. Although no deals come without risk, management was strategic in its offer, and SVB has grown meaningfully under First Citizen's leadership. Capital allocation decisions like these help us evaluate the quality of a management team.

Executives have plenty of options for allocating earnings and capital. They can return it to shareholders through stock buybacks or dividends, reinvest in their own business, or pursue acquisitions. We evaluate each decision in the full context of the situation, considering both quantitative and qualitative factors. Sometimes it is as straightforward as tracking the value created (like in the case of FCNCA) or destroyed, from an acquisition relative to its purchase price. Other times, the assessment is more nuanced, requiring a deeper understanding of strategic positioning and long-term impact.

Harris Associates' stable investment philosophy has had a profound impact on our nearly 50-year history. It has gotten us through all the ups and downs. As is the case with most periods of downward pressure in the market, investors tend to believe this time will be different (think: dot-com bubble burst, great financial crisis, Covid-19 pandemic). During these times, it's important to remember what all those periods have in common: they are followed by years of disproportionate strength. Although we do not have a crystal ball, we have no reason to believe that the long-term performance of the stock market – or our clients' portfolios – will look different than the careers of tennis greats.

As always, we thank you for entrusting us with your investment assets and for your continued support. Lastly, the best compliment we can receive is a referral from a satisfied client. We appreciate your referrals and handle them with the utmost care.

Emily S. Neumark, CIMA®
Portfolio Manager

[1] https://www.usbank.com/investing/financial-perspectives/market-news/focus-on-corporate-earnings.html
[2] https://home.dartmouth.edu/news/2024/06/2024-commencement-address-roger-federer
[3] https://www.atptour.com/en/players/rafael-nadal/n409/player-stats?year=all&surface=all
[4] https://www.atptour.com/en/players/novak-djokovic/d643/player-stats?year=all&surface=all

The S&P 500 Index is a float-adjusted, capitalization-weighted index of 500 U.S. large-capitalization stocks representing all major industries. It is a widely recognized index of broad, U.S. equity market performance. Returns reflect the reinvestment of dividends. This index is unmanaged and investors cannot invest directly in this index.

The NASDAQ Composite Index is a broad-based market-capitalization weighted index of all common type stocks on the NASDAQ Stock Market, including common stocks, American depositary receipts, ordinary shares, shares of beneficial interest or limited partnership interests, and tracking stocks. The index includes all NASDAQ listed stocks that are not derivatives, preferred shares, funds, exchange-traded funds (ETFs) or debentures. This index is unmanaged and investors cannot invest directly in this index.

All information provided is as of 03/31/2025 unless otherwise specified.

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