CITYWIRE PRO BUYER

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Vroom, vroom! David Herro is back with cars and banks

The 30-year veteran runs a streaky fund that has delivered big returns over the long haul. Coming off a rough recent run, he is off to a fast start in 2023.

BY JOHN COUMARIANOS

Don't let Oakmark International's (OAKIX) one-star Morningstar rating fool you.

While the fund is firmly in the bottom quintile of the Foreign Large Value category for the five-year period, it's in the top quartile for 10 years and in the top percentile for the 15 years.

Manager David Herro (joined by Michael Manelli in 2016) completed his 30th year on the fund a few months ago, and over those three decades the fund surpassed the MSCI EAFE index by more than 2.5 percentage points on an annualized basis (7.63% compared to 4.92%).

In other words, for three decades, Herro turned an initial $100,000 investment into nearly $908,000, compared to a little more than $422,000 for the index.

We talked to Herro about cars and banks (he's a fan of both), emerging markets (not a fan), and longtime holding Credit Suisse (less of a fan than he used to be). So far in 2023, some of the calls that hurt Herro over the past few years are coming good and it looks like he's back in the driver's seat, with a 13.8% return, landing it in the top 3% of its peer group.

Citywire: You mentioned in a recent investor letter that your portfolio trades at a little more than 50% of your fair value estimate. Is that an all-time low, or close to one?

David Herro: Typically, we've seen it range from high 40s to the high 70s. There have been three outliers to the downside where it was high 30s or low 40s. Outlier one was in March 2009. Outlier two was the pandemic bottom. And oddly enough the third time it was that low was August-September of last year. The other two were huge macro shocks. This one involved us being overweight in Europe because of valuation, and also the decline of European currencies and then the invasion.

Now we're just near a typical bottom. A typical top would be somewhere between 70% and 80%.

This kind of entry point in the past has led to outperformance over the next few years. Extremes are the best, but people are scared to invest in them.

CW: US investors in foreign stocks struggled last year with the rising dollar. How do you deal with currency in the fund?

DH: We employ currency hedging when the dollar is weak and the currencies that we own [are strong]. If that currency is more than 20% overvalued as measured by purchasing power parity we will hedge some of that currency back to US dollar.

For example, the euro hit a high of almost 160 in March 2008, and at that time we would have been 50-60% hedged. But then it began to weaken, [hitting] a 20-year low in September [2022], where it traded just below par.

It's come up since then, but we still have the euro significantly undervalued by purchasing power parity, and it becomes stimulative by increasing exports. My argument towards the end of the summer was not only are the stocks cheap, but you can buy them in weak currencies, so you have a kind of double discount.

CW: Three banks – Intesa Sanpaolo, BNP Paribas, and Lloyds – are at the top of your portfolio. Also Credit Suisse is your 11th-largest holding, having been higher before. What's attractive about these banks right now?

There have been other kinds of macro disturbances after the global financial crisis. We had the Greek crisis, etc… Then came lower [rates] for longer and slower growth. But we thought that couldn't last forever. Banks were building capital.

We thought this would be temporary, and now we're finally starting to see the capital build is over. Lending is going

up, interest rate spreads are going up, and now the thesis is playing out.

Credit Suisse aside, some of the highest-quality banks – Intesa, Lloyds, BNP – are trading at ridiculously [low] price-to-book, low price-to-earnings ratios, and high dividend yields. Every one of those companies has excess capital so that they are increasing dividends and buying back stock. And buying back stock at 60% to 70% of book value is extremely value accretive.

Regarding Credit Suisse – we've owned it for almost two decades, buying back in after the GFC after selling down our position successfully. This was a mistake looking in the rear-view mirror.

We thought they were going to concentrate on the three main businesses – private banking, asset management, and The Swiss Universal Bank. The fourth business – investment banking – unfortunately robbed the other three of earnings. Various chairmen said they were going to come in and derisk the investment bank and focus on the other three areas. We were in agreement with that, but they didn't execute that plan.

So, finally, they sold parts of it. However, the cost of doing this was high. When they sold the securitized products division, with it went deferred tax assets that counted as capital. So they had to raise capital. And we don't know what they got for securitized products, and so our view has changed on Credit Suisse, and that's why you see a much lower position size.

We're hopeful there's value, but they have to turn it around. In the meantime, these other European financials have 10%+ free cash flow yields.

(According to Morningstar data, Herro increased the Credit Suisse position in Oakmark International from nearly 90 million shares at the beginning of 2022 to 94 million shares at the end of September of 2022, but then sold roughly one-third this position, reducing it to 66 million shares by the end of the year.)

CW: You hold both Mercedes Benz and BMW. Despite the luxury cachet of the two automakers, some might say these are capital-intensive businesses in an industry with tough competition. What's your reply?

On Mercedes Benz – it was part of Daimler and a turnaround story – we were about to sell out of the name four years ago. We were disappointed [because] the company was run like a bureaucracy more than a profit-maximizing business.

We thought the new management team was capable and committed (you need both) and they've turned things around.

Premium automakers earn higher margins than the mass producers. Typically, you'll see margins of 10%. Porsche's are in the high teens, and Ferrari's are low 20s. These makers have learned through the pandemic to focus on profitability more than volume. You can have double-digit margins, and that gives you really good returns on capital.

BMW never had problems with return on capital. Now you see it with double-digit margins; same with Mercedes. They're trading at probably 3x EV/Ebit or cash flow. And this is a sector you want to be in because there's structural growth with the premium producers in emerging markets as people go from lower to middle to upper middle [class].

CW: Quantitative value investors view emerging markets as cheap. Is your stock-by-stock approach uncovering opportunities in EM?

DH: Some of the [EM] index looks undervalued. But you can't [approach] it that way. Take Chinese banks. Bank of China trades at 3.5x earnings; it looks really cheap. [It has the] same yield as European banks. [But] who knows the value of its assets? Also, the corporate governance stinks. So to us these prices are meaningless.

Even take Petrobras, [which] looks cheap on paper. But the government controls the price of gas at the pump, so it's sold at a loss. Especially in EM, it's important to be a bottom-up stock picker. There are landmines out there. You have to go below headline valuation.

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Average Annual Total Returns (%) as of 12/31/22†	1 Month	3 Months	YTD	3 Years	5 Years	10 Years
Oakmark International Fund Class Investor	-1.81	22.96	-15.65	-1.18	-1.70	4.22
MSCI World ex USA Index (Net)	-0.48	16.18	-14.29	1.27	1.79	4.59

Performance data quoted represents past performance and is no guarantee of future results. Total return and value will vary, and you may have a gain or loss when shares are sold. Current performance may be lower or higher than quoted. For most recent month-end performance, visit oakmark.com. Performance for other share classes will be greater or less than shown based on differences in fees and sales charges. You may not invest directly in an index. †Performance for periods less than one year is cumulative, not annualized. Returns reflect changes in share price and reinvestment of dividends and capital gains, if any.

Gross expense ratio 1.07% (Class Investor). Net expense ratio 1.05% (Class Investor). As of the most recent prospectus, the investment advisor has contractually agreed to waive fees and/or reimburse expenses (with certain exceptions) once the expense cap of the fund has been exceeded. This arrangement is set to expire on 01/27/23. When an expense cap has not been exceeded, the gross and net expense ratios may be the same.

[1] **MSCI World ex USA Index (Net)** is an unmanaged index that is designed to measure the equity market performance of developed markets, excluding the United States.

You may not invest directly in an index.

Morningstar Ratings as of 12/31/22	Overall	3-Year	5-Year	10-Year
Oakmark International Fund Class Investor	★ Out of 321	★ Out of 321	★ Out of 298	★ Out of 177

The Morningstar RatingTM for funds, or "star rating", is calculated for managed products (including mutual funds, variable annuity and variable life subaccounts, exchange-traded funds, closed-end funds, and separate accounts) with at least a three-year history. Exchange-traded funds and open-ended mutual funds are considered a single population for comparative purposes. It is calculated based on a Morningstar Risk-Adjusted Return measure that accounts for variation in a managed product's monthly excess performance, placing more emphasis on downward variations and rewarding consistent performance. The Morningstar Rating does not include any adjustment for sales loads. The top 10% of products in each product category receive 5 stars, the next 22.5% receive 4 stars, the next 35% receive 3 stars, the next 22.5% receive 2 stars, and the bottom 10% receive 1 star. The Overall Morningstar Rating for a managed product is derived from a weighted average of the performance figures associated with its three-, five-, and 10-year (if applicable) Morningstar Rating metrics. The weights are: 100% three-year rating for 36-59 months of total returns, 60% five-year rating/40% three-year rating for 60-119 months of total returns, and 50% 10-year rating/30% five-year rating/20% three-year rating for 120 or more months of total returns. While the 10-year overall star rating formula seems to give the most weight to the 10-year period, the most recent three-year period actually has the greatest impact because it is included in all three rating periods.Past performance is no guarantee of future results.

The top ten holdings are presented to illustrate examples of the securities that the fund has bought and the diversity of areas in which the fund may invest and may not be representative of the fund's current or future investments. Portfolio holdings are subject to change without notice and are not intended as recommendations of individual stocks. Current and future portfolio holdings are subject to risk. To view the full list of holdings,

please visit oakmark.com.

Top 10 Holdings as of 12/31/22

Security	% of Net Assets
BNP Paribas	3.32
Intesa Sanpaolo	3.20
Mercedes-Benz Group	3.00
Lloyds Banking Group	2.97
BMW	2.62
Allianz	2.61
Prosus	2.60
Continental	2.57
Fresenius	2.46
Adidas	2.32

Before investing in any Oakmark International Fund, you should carefully consider the Fund's investment objectives, risks, management fees and other expenses. This and other important information is contained in a Fund's prospectus and summary prospectus. Please read the prospectus and summary prospectus carefully before investing. For more information, please call 1-800-OAKMARK (625-6275).

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