Harris | Oakmark℠

QUARTERLY MANAGER COMMENTARY

U.S. Concentrated Strategy

June 30, 2024

MARKET ENVIRONMENT

U.S. equities finished higher quarter-over-quarter. Outsized returns from the Information Technology and Communication Services sectors drove market performance with NVIDIA, Apple and Alphabet each increasing over 20% during the three months. Utilities also posted positive returns as the sector emerged as the latest potential beneficiary of the rise of artificial intelligence. More cyclical sectors, including Financials and Industrials, were the largest detractors from performance, despite only declining approximately 2% and 3%, respectively.

Performance highlights

Contributors

- Alphabet Cl A
- Bank of America
- Charles Schwab

Detractors

- Paycom Software
- IQVIA Holdings
- Brunswick

PORTFOLIO PERFORMANCE

The portfolio's return was -6.49% (net) for the reporting period. This compares to the S&P 500 Total Return Index that returned 4.28% for the same period.

Top contributors:

- Alphabet was a top contributor during the quarter. The stock price rose after the U.S.-based communication services company reported first-quarter operating income growth of 31% versus the prior year. We believe that management's cost reduction initiatives will improve operating efficiency and lead to faster earnings growth. In addition, we expect that the company's new AI-powered features showcased at the recent Google I/O conference will increase the value of its products to users. At the current share price, we continue to see upside to our estimate of Alphabet's intrinsic value.
- Bank of America was a contributor during the quarter. The U.S. bank reported a good set of first quarter results with loan growth slightly positive. Deposits are beginning to stabilize, and the company expects modest deposit growth for the remainder of the year. These points, coupled with an increase in fee revenues and a decline in quarterly expenses, make for an improving outlook during the second half of 2024. As a result of price appreciation, we sold our position in Bank of America during the period.
- Charles Schwab was a contributor during the quarter. The U.S.-based brokerage services firm's stock price rose following good first quarter results, in our view, with net promoter scores at a record high and new account openings that reaccelerated to over 1 million for the first time in several quarters. Management reiterated its expectation for net interest margin to approach 3% by the end of 2025. Further, maturing securities and retained earnings are pushing regulatory capital towards Schwab's target levels, which should allow the company to consider repurchases by the end of 2024. We continue to believe Charles Schwab offers attractive upside.

Top detractors:

- Paycom Software was a detractor during the quarter. The U.S.-based payroll software company's stock underperformed following the release of mixed first quarter results and the resignation of Co-CEO Chris Thomas. We believe Paycom's softer than expected results are largely attributable to a weak macro environment for payroll software and that Paycom is taking the right steps to improve operational performance, which should enable a return to healthy revenue growth when the market improves. And although the Co-CEO's resignation was a negative surprise, we spoke with founder and CEO Chad Richison following the announcement and remain confident in the company's long-term prospects. At the current price, Paycom trades for 4x revenue which we believe is too cheap for a highly profitable, growing software business.
- IQVIA Holdings was a detractor during the quarter. Although the U.S.-headquartered health care company's stock price fell following the release of first quarter results, the fundamentals were in-line with consensus expectations. Forward-looking indicators in the clinical trial business continue to be favorable, and management foresees gradual improvement in the technology and analytics solutions segment in the second half of this year and a stronger rebound next year. We believe IQVIA should sustain above-average long-term growth even though it trades at a discount to other life sciences and data and information services companies.
- Brunswick was a detractor during the quarter. The U.S.-headquartered leisure products company's stock price fell following the release of first-quarter results. Total company sales fell year-over-year, mainly driven by an environment of weak retail sales and cautious dealer and original equipment manufacturer sentiment as well as a tough comparable in 2023 which included channel inventory fill. In our view, there is a disconnect between Brunswick's categorization of the state of the new boat retail market and third-party data, with Brunswick maintaining that industry retail sales are closer to flat rather than down. As such, Brunswick is still forecasting a flat retail market for the full year and we believe that the market is reacting to management's outlook, though this remains immaterial to our estimate of intrinsic value. We continue to believe the stock is attractively priced.

PORTFOLIO POSITIONING

We initiated the following position(s) during the period:

- Centene is one of the largest health insurers in the U.S. The company specializes in three major government-sponsored programs: Medicaid, Marketplace and Medicare Advantage, each of which benefits from long-term secular tailwinds. In Medicaid, states are steadily outsourcing their programs to companies like Centene to reduce costs and improve care quality. Managed Medicaid penetration has increased throughout the past decade and we expect further gains over time. In Marketplace, growth is driven by the trend toward more individuals buying health insurance. Centene holds the #1 market share in both of these programs and is well positioned to capitalize on their continued growth. Finally, we believe management is successfully turning around Centene's Medicare business and expect the division to generate positive earnings over time. After adjusting for losses stemming from Centene's Medicare business, we were able to purchase shares at a single-digit P/E multiple, which we think is too cheap for a leading, secularly growing health insurance company and an improving Medicare business.

- First Citizens BancShares is a leading regional bank with an attractive geographic footprint in the Southeast and West Coast U.S. markets. We like that First Citizens has a low-cost deposit franchise, prudent lending practices, and a history of solid financial results through the economic cycle. Under current CEO Frank Holding's leadership, the company has generated meaningful growth in tangible book value per share driven by strong operating results and accretive acquisitions. A recent example is First Citizens' March 2023 purchase of Silicon Valley Bank out of FDIC receivership, which we believe drove a significant increase in the company's intrinsic value and will continue to be value accretive through cost and funding synergies, and new avenues for growth. In our view, the magnitude of this acquisition and the value of the combined company is not reflected in First Citizens share price, which provided the opportunity to purchase shares at a discount to both traditional and regional banks.

We eliminated the following position(s) during the period:

- American Express
- Bank of America
- EOG Resources
- KKR

OUTLOOK

Whereas investors attempt to determine the price of an asset using fundamental analysis, then buy low and sell high, a trader uses analysis to predict price movement. Although traders have greatly influenced current market conditions, we believe the result has been more opportunity for investors. Though we are frustrated with our recent performance, based on today's valuations, we remain fully confident on what we can deliver in terms of future performance for our clients.

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The S&P 500 Total Return 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.