HARRIS ASSOCIATES

QUARTERLY MANAGER COMMENTARY

U.S. Concentrated Strategy

March 31, 2024

MARKET ENVIRONMENT

U.S. equities showed strength throughout the first quarter of 2024, aided by excitement surrounding artificial intelligence, encouraging economic data and investor expectations for rate cuts from the U.S. Federal Reserve this calendar year. As a result, U.S. market indexes reached new highs. In March, the Federal Reserve Open Market Committee held a meeting and chose to leave interest rates unchanged while it continues to monitor evolving economic data.

PORTFOLIO PERFORMANCE

The portfolio's return was 6.67% (net) for the reporting period. This compares to the S&P 500 that returned 10.56% for the same period.

Top contributors:

- Capital One Financial was a contributor during the quarter. The U.S.-headquartered financials firm's stock price rose following fourth-quarter results that mainly focused on an optimistic outlook on stabilizing credit card and continued elevated marketing costs. Notably, in February, the company announced it would acquire Discover Financial in a $35 billion all-stock deal. We believe the acquisition could be value accretive to shareholders and the potential synergies are significant as it will open Capital One Financial to Discover Financial's network. If approved, it is expected to be completed in late 2024 or early 2025. We continue to think Capital One Financial offers attractive upside.
- KKR was a contributor during the quarter. The U.S.-headquartered financials firm's stock price rose following the release of fourth-quarter results. Notably, private markets fundraising, carried interest revenue and capital markets fee generation saw their best results since mid-2022. We modestly increased our estimate of intrinsic value following the company's fourth-quarter results and management's commentary regarding the outlook and we look forward to investor day in April.
- Phillips 66 was a contributor during the quarter. The U.S.-headquartered energy company's stock price rose following the release of good fourth-quarter results, in our view, with earnings metrics besting consensus expectations, mainly due to outperformance in both the refinery and midstream businesses. We continue to believe Phillips 66 offers attractive upside.

Performance highlights

Contributors

- Capital One Financial
- KKR
- Phillips 66

Detractors

- Charter Communications Cl A
- Warner Bros Discovery
- Lithia Motors Cl A

Top detractors:

- Charter Communications was a top detractor during the quarter. In February, the U.S.-headquartered communication services company's stock price fell when the company reported that broadband subscribers declined 0.2% sequentially. We anticipate that broadband subscriber growth will remain challenging in the near term due to a heightened competitive environment and the likely wind-down of a government subsidy program. However, we expect these competitive forces will abate over the medium term and that Charter's broadband subscriber base will return to normal growth. In the meantime, the company continues to grow earnings, invest in high-return capital projects and repurchase stock. We maintain our belief in the long-term prospects of Charter Communications.
- Warner Bros. Discovery was a detractor during the quarter. The U.S.-headquartered communication services company's stock price fell following the release of mixed fourth-quarter results with earnings metrics falling below consensus expectations, mainly driven by the studio segment. On the positive side, free cash flow came in above our expectations, which allowed for continued debt paydown, which we were glad to see. We continue to believe in the long-term prospects of Warner Bros. Discovery.
- Lithia Motors was a detractor during the quarter. The U.S.-headquartered consumer discretionary company reported mixed fourth-quarter results, in our view, with earnings per share falling short of our expectations, mainly driven by weak unit sales and a continued decline in gross profit per vehicle as margins normalize. We continue to believe in the long-term prospects of Lithia Motors.

PORTFOLIO POSITIONING

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

- Deere & Company is a leading manufacturer of agricultural equipment with dominant market share positions in North America and Brazil. Despite its brand strength, technological capabilities and distribution advantages, the company's stock price has recently come under pressure due to investor fears of a trough in the current agriculture business cycle. Longer term, world population and food demand are expected to increase annually with land and labor devoted to agriculture set to decline each year. As a technological leader, we believe Deere is well-positioned to benefit from this dynamic as farms will need to become more productive. We also like that the company's management team has a strong track record of growing the business organically through cycles, continuously improving returns on invested capital and returning capital to shareholders. We were able to purchase shares in the company at a discount to our estimate of intrinsic value and to other high-quality industrials.

We eliminated our position in Hilton Worldwide during the period.

OUTLOOK

While we keep a watchful eye on the macroeconomic environment, we remain focused on our bottom-up, fundamental analysis at the company level when constructing portfolios. We invest in businesses priced at substantial discounts to our estimate of intrinsic value, that we believe will grow per share value over time, and have management teams that think and act like owners. Our analysts are generalists who remain industry agnostic and focused on finding value, regardless of what is in favor at any given moment. We believe this positions our portfolios for sustainable, long-term success.

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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.