Harris | Oakmark

QUARTERLY MANAGER COMMENTARY

Global All Cap Strategy

September 30, 2024

MARKET ENVIRONMENT

Global equities finished higher during the third quarter, with 10 of 11 GICS sectors posting positive returns. The financials and industrials sectors contributed most to market performance, while energy was the sole detractor. By country, the U.S. and Canada were the strongest contributors to global market returns, and Denmark and the Netherlands were the only two detractors.

Performance highlights

Contributors

- St. James's Place
- Alibaba Group
- Bayer

Detractors

- Kering
- Samsung Electronics Pfd
- Alphabet Cl A

PORTFOLIO PERFORMANCE

The portfolio's return was 7.77% (net) for the reporting period. This compares to the MSCI World Index that returned 6.36% for the same period.

Top contributors:

- St. James's Place was a contributor during the quarter. After several months of negative news flow relating to Consumer Duty regulation fee changes and levied penalties from the Financial Conduct Authority, the U.K. wealth manager's stock price rose materially based on first half of 2024 earnings that included a reaffirmed view of the near-term fees and penalty provisioning for the business as well as medium-term ambitions to double company earnings through a combination of a strong cost savings program and gradual migration of non-fee generating gestation assets to fee-paying assets. We met with CEO Mark Fitzpatrick after the earnings and found the company's outlook credible. We have also spoken to several large St. James's Place wealth management shops to gain conviction on the company's growth ambitions. In our view, its strong growth prospects after its fee reset, low valuation and strong wealth management franchise make the business an attractive investment.
- Alibaba Group was a contributor during the quarter. The China-headquartered consumer discretionary company's stock price rallied following the announcement of a multi-pronged stimulus package by the Chinese government. Despite the stock's strong performance for the quarter, we continue to believe there is upside in the name and that the market is not fully pricing in the turnaround potential for the e-commerce business or other optionality the company possesses.
- Bayer was a contributor during the quarter. The Germany-headquartered pharmaceutical, consumer health and crop science company's stock price rose after a favorable ruling from the U.S. Court of Appeals in the RoundUp case. The Third Circuit Court of Appeals ruled in favor of Bayer on its core preemption argument that the federal regulations around the pesticide's

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warning label supersede state law. During the quarter, we had the opportunity to meet with CFO Wolfgang Nickl who provided an update on Bayer's Dynamic Shared Ownership (DSO) reorganization. The DSO is a company-wide effort to streamline operations and reduce bureaucracy. We are pleased with the DSO momentum so far, with more than 900 teams already on the program and delivering tangible success in their respective business units. We continue to believe Bayer's focus on cost and execution can benefit shareholders in the long term.

Top detractors:

- Kering was a detractor during the quarter. The France-headquartered luxury goods company reported first half of 2024 results largely in line with expectations but issued weak guidance for the remainder of 2024 as revenue trends deteriorated in the final weeks of the second quarter. While new Gucci creative director Sabato de Sarno's collections have resonated with the existing customer base and customer conversion is holding up, store traffic was hurt by a lack of new client recruitment which was amplified by the challenging macro environment, particularly in China. We moderately decreased our sell price after meeting with management, but continue to believe they are making the correct decisions for the long-term health of the brands and see attractive upside for the investment.
- Samsung Electronics was a detractor during the quarter. The South Korea-headquartered technology company's stock price declined amid weaker than expected demand for memory semiconductors as a result of weaker PC and mobile industry sales. While the weaker memory sales in the short term are disappointing, we remain optimistic about memory demand over the medium and long term.
- Alphabet was a detractor during the quarter. The U.S.-based communication services company's stock price fell following a disappointing ruling in the Department of Justice's (DOJ) antitrust lawsuit targeting Google Search. The DOJ found that Google violated Section 2 of the Sherman Act by maintaining a monopoly in general search engine services via exclusive distribution agreements. Although the outcome is uncertain, we believe the most logical remedy would be for the court to require mobile device manufacturers to allow users to select their default search engine themselves. We do not believe this solution will have a material impact on Google's valuation over the long-term as similar regulations in the European Union have not materially impacted Google's market share. We continue to believe Alphabet represents a portfolio of great businesses that are collectively worth more than the market currently recognizes and the company remains an attractive holding.

PORTFOLIO POSITIONING

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

- Akzo Nobel is among the largest paint and coatings manufacturers in the world. We think Akzo Nobel is poised to benefit from a combination of strong pricing power that is inherent to coatings companies as well as company-specific self-help initiatives. Coatings businesses typically have strong pricing power, especially in the decorative market, but pricing tends to lag. In 2022, a spike in raw materials costs put downward pressure on operating margins. With Akzo's price increases now landing, the group reported significant margin improvement in 2023, and we expect another year of margin growth in 2024 to return margins to historical levels. Over the mid-term, we believe Akzo's margins will increase above historical level as the benefits of its recent industrial efficiency plan materialize, which the market is underestimating. Additionally, as profitability and cash generation improves, there is opportunity for increased shareholder returns. We see value at Akzo as its currently trading at a discount to historical multiples despite our belief that margins, return and cash flow are likely to be above historical levels.

- Diageo is a global producer, distributor and marketer of premium drinks with more than 200 brands and sales in nearly 180 countries. The U.K.-based holding company's portfolio includes leading brands, such as Johnnie Walker, Guinness, Don Julio, Crown Royal, Smirnoff, Baileys, Casamigos and Captain Morgan. As the market leader, Diageo's scale provides meaningful competitive advantages in terms of distribution and marketing, which enables the company to invest more than its peers while still generating superior returns on capital. In addition, we like that the company's portfolio is well diversified by geography and category, which helps mitigate against earnings volatility related to economic cyclicality and shifting consumer preferences. Industry de-stocking and rising agave prices impacting tequila margins have weighed on the share price recently, which provided an attractive re-entry point to invest in this dominant beverage company at a below-average price.
- TIS, Inc. is one of Japan's largest IT services companies. It is a business we currently own in our International Small Cap Strategy and are familiar with. We previously owned it as a firm, but sold it as the stock price reached our estimate of intrinsic value. More recently, the stock has underperformed as growth this year is likely to slow due to the completion of several large scale projects, which makes for a difficult comparison base. However, excluding these large projects, the company's fundamental results remain robust as IT spending in Japan continues to be very strong. In our view, Japan lags behind most developed nations in terms of digitizing its economy. This fact, combined with the country's shortage of IT engineering talent, should bode well for Japanese IT spending in the future. In addition to long-term structural demand for IT services, we like that TIS is led by a strong management team with a good track record of creating shareholder value through smart capital allocation decisions. We were happy to purchase shares in an above-average business trading at a discount to our perception of its intrinsic value.

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

- Cisco Systems
- SAP
- Travis Perkins

OUTLOOK

In the short term, traders analyze news flow to predict price movement, whereas investors, like ourselves, attempt to determine the price of an asset using fundamental analysis, then buy low and sell high. We believe traders have greatly influenced current market conditions leading to a disconnect between price and fundamental business value. The result is an opportunity for investors who can identify businesses with strong, durable cash flow streams. Though we are frustrated with our recent performance, based on today's valuations, we remain confident in our time-tested investment approach.

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The MSCI World Index (Net) is a free float-adjusted, market capitalization-weighted index that is designed to measure the global equity market performance of developed markets. The index covers approximately 85% of the free float-adjusted market capitalization in each country. This benchmark calculates reinvested dividends net of withholding taxes. This index is unmanaged and investors cannot invest directly in this index.