Harris | Oakmark℠

QUARTERLY MANAGER COMMENTARY

U.S. Large Value Strategy

September 30, 2024

MARKET ENVIRONMENT

U.S. 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 over the period.

PORTFOLIO PERFORMANCE

The portfolio's return was 7.52% (net) for the reporting period. This compares to the Russell 1000 Value Index that returned 9.43% for the same period.

Top contributors:

- CBRE was a contributor during the quarter. The U.S.-headquartered real estate service company's stock price rose following the release of positive second-quarter results, with revenue, earnings per share and free cash flow exceeding consensus expectations and encouraging commentary from management about signs of recovery in commercial real estate activity. Later in the quarter, we met with CEO Bob Sulentic, who was enthusiastic about the company's prospects and the caliber of the current executive team. Sulentic also outlined several avenues for growth at CBRE, including ongoing organic growth in more cyclically resilient business lines. We continue to believe CBRE's strong management team will unlock value for shareholders and appreciate their disciplined approach to managing the business and allocating capital.
- Fiserv was a contributor during the quarter. The U.S.-headquartered data processing and outsourcing services company's stock price rose despite no material fundamental changes. We continue to be impressed with Fiserv's improved business results under CEO Frank Bisignano. We believe Bisignano is a passionate and knowledgeable leader who is focused on leveraging the company's scale and large distribution network to drive continued growth at the company. We believe that Fiserv is well positioned to benefit from the secular trend toward digital payments and banking, and that the stock offers an attractive risk/reward.
- Fortune Brands Innovation was a contributor during the quarter. The U.S.-headquartered building products company's stock price rose following the release of second-quarter earnings. We believe the market's reaction was in response to a combination of macro relief over results as well as a positive update regarding the growth outlook for the company's digital businesses. Notably, management delved into positive developments in digital connected products, which should add a modest amount to total company growth during the second half of 2024. We continue to believe Fortune Brand

Performance highlights

Contributors

- CBRE Group Cl A
- Fiserv
- Fortune Brands Innovations

Detractors

- Alphabet Cl A
- Charles Schwab
- APA

Past performance is no guarantee of future results. The investment return and principal value of this portfolio and any particular holdings may fluctuate. Portfolio holdings are subject to change without notice.

Innovations is a quality, well-managed franchise at an attractive price.

Top detractors:

- 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.
- Charles Schwab was a detractor during the quarter. The U.S.-headquartered brokerage company saw net interest revenue, its biggest top-line contributor, fall year-over-year as deposit balances declined and Schwab was instead forced to use higher cost funding to fund its balance sheet. This was compounded by heightened regulatory scrutiny on the interest rate paid on cash balances at other brokerage firms, which has weighed on share price performance across the sector. We believe Schwab will be less affected by this regulatory scrutiny than peers due to its role as a service provider to independent advisors. Meanwhile, we continue to expect the declines in Schwab deposits to level off with underlying business growth eventually allowing the company to replace its higher cost funding with low-cost deposits, thereby driving a significant increase in earnings. We continue to view Schwab as an excellent business with meaningful scale advantages that should create value for shareholders over the long term.
- APA was a detractor during the quarter. The U.S.-headquartered oil and gas exploration and production company's stock price declined despite reporting, in our view, adequate second-quarter results. APA reported higher than anticipated Permian oil production. In addition, the company increased its synergies guidance with Callon Petroleum Company. APA also returned 317 million dollars to shareholders throughout the first half of the year, which management emphasized was driven by the value they see in APA shares. We continue to believe that management is making disciplined decisions that will unlock shareholder value in the long term.

PORTFOLIO POSITIONING

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

- Genuine Parts Company is a leading global service provider that primarily operates through its subsidiaries Motion Industries and NAPA. Motion Industries operates a hub-and-spoke distribution network for industrial replacement parts used in production plants where customers are generally price insensitive and speed to delivery is critical given the high costs associated with manufacturing downtime. Motion Industries is the largest company within this fragmented industry with nearly twice the revenue base of its closest competitor. However, with an estimated single-digit market share of its addressable market, we believe there is significant scope for it to benefit from organic growth and consolidation. NAPA distributes and sells replacement parts for the automotive aftermarket industry within the U.S. Slowing industry demand and subpar

execution caused NAPA to trail its competitors in 2023, which weighed on Genuine Parts's share price. Since then, we have been impressed by the new NAPA management team and their initiatives to improve store productivity and address underperforming suppliers. Long term, we have confidence in the positive trajectory of the industry and appreciate its history of stable demand with knowledgeable service being prioritized over price. We were able to buy shares in the company at a two-decade trough valuation, which we think is too cheap given Genuine Parts's strong competitive positions, long history of cash flow generation and commitment to shareholder distributions.

- Merck is a global pharmaceutical firm with leading oncology, vaccine and animal health franchises. Premier products in Merck's portfolio include Keytruda, Gardasil, Winrevair and Bravecto. Outsized contributor Keytruda is an immuno-oncology drug that treats several cancers and tumors. Keytruda is an astounding clinical and commercial success that is on track to become one of the best-selling prescription drugs to date. Investor angst surrounding Keytruda's pending U.S. patent expiration in 2028 presented an opportunity to buy shares at a multiple significantly below the broader market. We believe opportunities to extend Keytruda's duration through lifecycle management are underappreciated. More importantly, discounted cash flows from products already on-market cover today's entire stock price, meaning there is minimal value ascribed to a promising pipeline with strong sales potential. We believe Merck is led by a capable management team that will reinvest these cash flows in an accretive manner.

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

- American Express
- Cisco Systems
- Moody's

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 Russell 1000® Value Index measures the performance of the large-cap value segment of the U.S. equity universe. It includes those Russell 1000® companies with lower price-to-book ratios and lower expected growth values. This index is unmanaged and investors cannot invest directly in this index.