Oakmark Fund: Q1 2022 Commentary

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Summary

- We are value investors. In constructing portfolios for our clients, we seek out companies that we believe are trading in the market at significant discounts to their underlying value. These businesses must offer significant profit potential and be run by managers who think and act as owners.
- We believe in the importance of intensive, fundamental research. Our research process is based on a disciplined quantitative and qualitative screening process.
- The Oakmark Fund generated a -3% return during the first quarter, outperforming the S&P 500 Index's return of -5%.
- When other investors believe our companies are substantially riskier than we do, options prices will be higher than our estimate of their intrinsic value.

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Oakmark Fund - Investor Class

Average Annual Total Returns 03/31/22

Since Inception 08/05/91 12.94%

10-year 13.80%

5-year 13.73%

1-year 13.12%

3-month -2.63%

Gross Expense Ratio: 0.93%

Net Expense Ratio: 0.91%

Expense ratios are based on estimated amounts for the current fiscal year; actual expenses may vary.

The net expense ratio reflects a contractual advisory fee waiver agreement through January 27, 2023.

Past performance is no guarantee of future results. The performance data quoted represents past performance. Current performance may be lower or higher than the performance data quoted. The investment return and principal value vary so that an investor's shares when redeemed may be worth more or less than the original cost. To obtain the most recent month-end performance data, view it here.

The Oakmark Fund generated a -3% return during the first quarter, outperforming the S&P 500 Index's return of -5%. Our holdings in the energy sector were the biggest contributor to our outperformance during the period, whereas our holdings in the communication services sector detracted the most. Our highest contributing securities during the period were EOG Resources (EOG) and APA Corp (APA), while our largest detractors were Netflix (NFLX) and Meta Platforms (FB). We continue to own each of these investments given their significant discounts to our estimates of business value, and we added exposure to both Meta Platforms and Netflix.

We took advantage of the market's heightened volatility during the quarter by adding six new positions to the portfolio. (See descriptions below.) We also eliminated our holdings in ADP (ADP), Mastercard (MA), and S&P Global (SPGI). Each of these successful investments approached our estimate of intrinsic value and was sold to pursue more attractive alternatives.

A close look at the portfolio shows an increase in options positions. We use options for two reasons. We frequently use them as part of our tax-loss selling to reduce taxable capital gain distributions. What you see this quarter, however, is different. When other investors believe our companies are substantially riskier than we do, options prices will be higher than our estimate of their intrinsic value. When opportunities like this surface, we'll sell puts or calls as an alternative to purchasing or selling shares, respectively. During the quarter, we took advantage of elevated volatility by selling calls against a small portion of our energy holdings instead of trimming them. We also sold puts on Meta Platforms (rather than adding to it) and Amazon (AMZN) (to initiate a new position).

The following is a brief description of our new holdings:

Amazon is the leading e-commerce and cloud-computing provider in the world. In e-commerce, two-thirds of U.S. households are Amazon Prime subscribers, and over half of all online product searches now start on Amazon. We believe the company's strong customer loyalty and massive infrastructure are significant barriers to entry in a growing e-commerce market. Separately, Amazon Web Services (AWS) controls nearly half of the market in cloud computing. We believe AWS has become utility-like in nature and scale, and we expect healthy growth moving forward as IT workloads continue moving to the cloud. More recently, concerns about rising investment spending have weighed on the stock-as they have in times past-providing us another opportunity to purchase shares at an attractive multiple of normalized earnings and a discount to its peer-weighted enterprise value-to-sales multiple.

Equifax (EFX) is one of the leading U.S. credit bureaus. The company competes in a triopoly with TransUnion and Experian, all of which are great businesses due to their entrenched competitive position, valuable data sets, deep client integration and pricing power. In our view, what separates Equifax from its peers is its proprietary Workforce Solutions database, which is now its largest and most differentiated business. Workforce Solutions is an income and employment database used to evaluate the creditworthiness of a consumer in real-time. Furthermore, Equifax's collection of alternative data is becoming increasingly important to lenders so they can assess the creditworthiness of consumers with thin or even nonexistent credit files. We were able to purchase this well-managed company at an attractive valuation due to concerns that rising interest rates would adversely affect credit inquiries. Despite these near-term headwinds, Equifax recently reiterated full-year guidance and continues to expect significant market outgrowth. Longer term, the company anticipates 7-10% organic sales growth, an outlook that we believe is not properly reflected in today's stock price.

Global Payments (GPN) is a leading provider of merchant acquiring services. The company is also one of the largest providers of payment processing and related technology solutions to credit card issuers. We believe Global Payments' merchant acquiring business is well positioned given its strength in software-driven payments. This is one of the fastest growing parts of the industry as small business customers are increasingly recognizing the efficiency benefits of having payments seamlessly integrated into the software they use to run their businesses. In addition, Global Payments benefits from the broader secular shift away from cash and toward electronic payment methods. Together, these tailwinds have the potential to drive low-double-digit revenue growth and even faster earnings growth. With this strong outlook and with management returning a significant portion of free cash flow to shareholders via repurchase, we think the stock looks attractive at its current valuation of just 12.5x next year's expected EPS.

We previously had an opportunity to own **Pinterest (PINS)** when the stock sold off during the Covid-19-related downturn, and we were pleased to be able to invest in the company once again at an attractive price during the quarter. Pinterest is an online personal discovery tool that people use to find ideas based on their tastes and interests. Unlike most social media companies, the objectives of users and advertisers are fundamentally aligned on Pinterest. Users find a positive and useful product discovery experience, and advertisers find an audience with high commercial intent and the ability to integrate ads naturally. Although Pinterest had more than 430 million global users as of year-end, the company is still in the early days of monetizing its platform. We believe that its shares trade well below fair value on conventional metrics, such as enterprise value to revenue, as well as when we benchmark its ultimate revenue and margin potential against more mature internet companies.

Pulte (PHM) is one of the nation's largest homebuilders. While demographic tailwinds are expected to support healthy housing demand for years to come, more important to our thesis is the company's operational transformation over the past decade. Having adopted a more rigorous, returns-driven approach to land acquisition and manufacturing, Pulte now consistently earns returns on equity near the high end of its peer group. We expect the company to generate approximately 15% of its market cap in free cash flow this year, and management is putting that cash to good use by strengthening its balance sheet and returning capital to shareholders. While we recognize that the recent surge in home prices is producing a level of profitability that's above what we would consider "normal," we still find the stock attractive relative to our more tempered estimate of mid-cycle earnings.

Over the past 20 years, **Salesforce (CRM)** has become a dominant global player in sales, customer service, commerce and marketing software. CRM earns 80% gross margins, grows 20% organically and virtually all of its revenue is recurring. It's a great business that we've admired from afar for a long time. More recently, the organization has made some changes at the top that prompted us to take a closer look at the stock. New CEO Bret Taylor and CFO Amy Weaver are bringing a culture of financial discipline. We believe this renewed focus on profitability, combined with Salesforce's strong underlying business characteristics, will yield strong results. The current valuation of 5x next year's revenues represents a significant discount compared to publicly traded comparables and private market values in the software space. We view this discount as an opportunity to invest in a great business at a good value.

We thank you, our fellow shareholders, for your investment and continued support of the Oakmark Fund.

Original Post

Editor's Note: The summary bullets for this article were chosen by Seeking Alpha editors.

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Additional disclosure: The securities mentioned above comprise the following preliminary percentages of the Oakmark Fund's total net assets as of 03/31/22: ADP 0%, Amazon 0%, APA Corp 3.0%, EOG Resources 3.5%, Equifax 1.1%, Global Payments 1.1%, Mastercard 0%, Meta Platforms Class A 1.6%, Netflix 1.9%, Pinterest Class A 1.4%, Pulte 1.0%, S&P Global 0% and Salesforce 1.2%. Portfolio holdings are subject to change without notice and are not intended as recommendations of individual stocks.

Access the full list of holdings for the Oakmark Fund as of the most recent quarter-end.

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.

EPS refers to Earnings Per Share and is calculated by dividing total earnings by the number of shares outstanding.

The Oakmark Fund's portfolio tends to be invested in a relatively small number of stocks. As a result, the appreciation or depreciation of any one security held by the Fund will have a greater impact on the Fund's net asset value than it would if the Fund invested in a larger number of securities. Although that strategy has the potential to generate attractive returns over time, it also increases the Fund's volatility.

Options may be used for hedging purposes, but also entail risks related to liquidity, market conditions and credit that may increase volatility. The value of the fund's positions in options may fluctuate in response to changes in the value of the underlying asset. Selling call options may limit returns in a rising market.

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All information provided is as of 03/31/2022 unless otherwise specified.