Oakmark Select 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 Select Fund declined 6% in the first quarter of 2022 compared to a 5% decline in the S&P 500.

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Oakmark Select Fund - Investor Class

Average Annual Total Returns 03/31/22

Since Inception 11/01/96 **11.95%**

10-year **11.06%**

5-year **8.49%**

1-year **8.47%**

3-month **-6.07%**

Gross Expense Ratio: 1.00%

Net Expense Ratio: 0.98%

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 Select Fund declined 6% in the first quarter of 2022 compared to a 5% decline in the S&P 500. While the portfolio is well positioned for rising interest rates and higher oil prices - both of which were front and center to start the year - two company-specific earnings reports put a damper on what otherwise would have been a solid relative performance quarter. Concentration is a double-edged sword, and we felt the negative side of the blade this quarter.

Netflix (NFLX) (-38%) and Meta Platforms (FB) (-34%) were the most significant detractors in the first quarter - detracting twice as much as the next closest stock. Netflix is experiencing what we would describe as a Covid-19-induced hangover. The pandemic pulled forward subscriber growth while content spend was limited due to health restrictions pushing out production timelines. This led to a perfect storm of accelerated revenue and margin growth, which the Fund benefited from in 2020 and into 2021 when Netflix was one of our top performers. Now the reverse is occurring. Looking at Netflix's business performance with a longer term lens, one hardly sees any disruption in the franchise. We used the price strength in 2021 to reduce our position and have used the current weakness to add to our exposure to Netflix. Meta reported a disappointing outlook for the first quarter of this year as well, but for different reasons. The company's targeted advertising business has been negatively impacted by Apple's (AAPL) new privacy policies, and the franchise also appears to be maturing somewhat. The stock was pummeled on news that the first quarter of 2022 could see revenue growth in the 5-10% plus range. While most companies would kill for an outlook like that, Meta shareholders were accustomed to more. Now shares are valued as if the company won't grow much at all going forward, which we believe is misguided. We sold put options to add to our economic exposure in Meta to take advantage of the price weakness. Please see the Oakmark Fund letter for a more thorough description of why we have elected to use options to increase our exposure to certain names in the Fund.

Our two oil holdings, APA Corporation (APA) (+54%) and EOG Resources (EOG) (+36%), were our top contributors in the quarter as oil prices rallied due to tight supplies, which were then exacerbated by the Russian invasion of Ukraine. Although their share prices have increased considerably, both companies still look quite undervalued even using longer term oil prices in the $65-70 dollar range. Meanwhile, if times are good over the next couple of years, we expect these companies to return significant percentages of their market caps to shareholders.

As is typical during periods of significant volatility, we added a new name to the portfolio. Lithia Motors (LAD) is the largest franchised auto dealer group in the United States. The company has a long history of creating shareholder value through best-in-class operations and consistent acquisitions of smaller dealers at attractive returns. There is a long runway for management to continue creating value through such acquisitions. Management believes this will drive earnings per share to more than $50 by 2025, even as car prices return to pre-pandemic levels. Meanwhile, Lithia has a significant opportunity to further accelerate growth through Driveway, its online auto retailing platform. We believe Lithia's existing nationwide infrastructure provides Driveway with significant competitive advantages in e-commerce, which smaller dealers will struggle to replicate. Driveway is not generating any earnings today, but it could become a major contributor over the next five to seven years. With the stock priced at less than 7x management's 2025 EPS target and with substantial future growth potential from Driveway, we believe Lithia shares are a bargain today.

Humana (HUM) and Hilton (HLT) were reduced to minimal positions in the portfolio as the discount to value narrowed considerably during the quarter. Our CIT shares were converted to First Citizens Bancshares (FCNCA) as the merger was completed.

Thank you, our fellow shareholders, for your continued investment in the 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 Select Fund's total net assets as of 03/31/22: APA Corporation 4.3%, Apple 0%, CIT 0%, EOG Resources 3.7%, First Citizens Bancshares Class A 3.6%, First Citizens Bancshares Class B 0.2%, Hilton 0.6%, Humana 0.8%, Lithia Motors Class A 3.9%, Meta Platforms Class A 3.2%, and Netflix 4.5%. 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 Select 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.

Because the Oakmark Select Fund is non-diversified, the performance of each holding will have a greater impact on the Fund's total return, and may make the Fund's returns more volatile than a more diversified fund.

The stocks of medium-sized companies tend to be more volatile than those of large companies and have underperformed the stocks of small and large companies during some periods.

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