

Curb your enthusiasm (for market innovations)

June 20, 2025

"They make everything so hard now. Lights, locks, toilet – you need a PhD to flush!"

-Larry David, *Curb Your Enthusiasm*

Almost every market cycle comes with its fair share of product "innovations." Most of the time, these amount to a repackaging of something that already exists (and works), but with a catchy new twist and higher price tag. "Portfolio insurance" was all the rage until Black Monday. "SPACs" (Special Purpose Acquisition Companies) were lauded as the new IPO until the bubble burst in 2022. Unfortunately for investors, these "innovations" often take something that worked and make it worse.

To us, these situations are the financial market equivalent of a *Curb Your Enthusiasm* episode. We can't help but picture Larry David, an older man often befuddled by new technology, struggling to turn on hotel room lights via an iPad app when a simple light switch would have sufficed, or getting locked out of a "smart house" because the facial recognition can't recognize his squinting. "Why does everything have to be a screen now? Just give me a knob. I like knobs!"

This market cycle, of course, has also come with its fair share of financial product innovations. Defined outcome products – or "buffered ETFs" – are perhaps the most popular. These products pair equity holdings with options to "buffer" against potential drawdowns. The marketing message of "equity-like returns with reduced risk" has certainly struck a chord. The products have grown from a standing start one decade ago to about \$70B of investor assets today.¹

When we see these trends, we ask ourselves: Are these innovations the new smartphone or the new smart toilet? In this case, our intuition suggests the

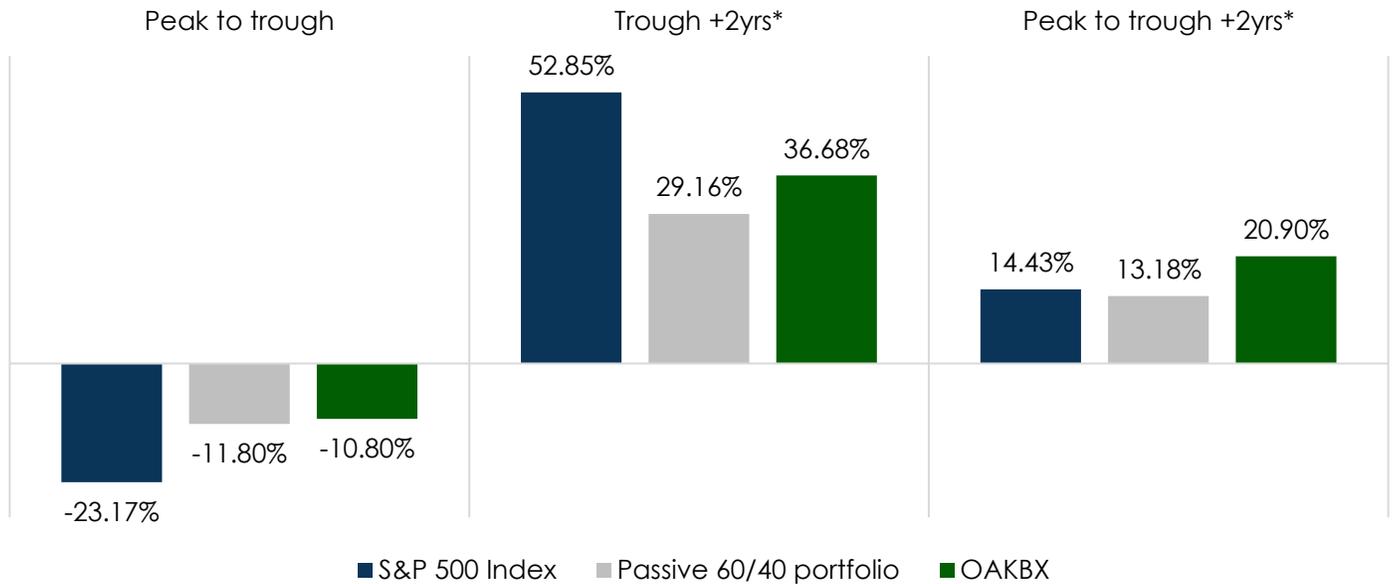
latter. After all, there is no free lunch. In a reasonably efficient market, these products are simply selling fairly priced options to buy other fairly priced options. Blindly buying and selling options (without a view on attractiveness) will alter the shape of returns, but shouldn't be expected to improve the cumulative results. The primary "defined outcome" may be extra trading costs and higher fees.

AQR Capital Management released a white paper, "Rebuffed: A Closer Look at Options-Based Strategies," in March 2025 that attempted to answer this question with data. In the paper, they compared the returns of various defined outcome strategies to those of a passive 70/30 stock/cash portfolio, concluding that the funds are a "marketing success" but an "investor failure." This inspired us to do our own analysis comparing the performance of defined outcome funds to our own balanced product, the Oakmark Equity & Income Fund (OAKBX), which is typically compared to a blended benchmark comprised of 60% the S&P 500 Index and 40% the Bloomberg U.S. Aggregate Bond Index.

OAKBX has long outperformed a conventional 60/40 portfolio during periods of market turmoil. Since its inception in 1995, the fund has endured 11 S&P 500 drawdowns of greater than 10%. The results during those 11 periods have demonstrated the value proposition of OAKBX. On average, the fund has declined less than the passive 60/40 portfolio during the drawdowns and outperformed the passive 60/40 portfolio in the recoveries that followed. The cumulative result is that OAKBX has, on average, outperformed both the passive 60/40 portfolio and the S&P 500 through those 11 tumultuous periods.

¹ Source: Morningstar Direct, as of 5/31/2025.

Average cumulative return across S&P 500 Index drawdowns >10% over 30 years



Source: Harris Associates, Morningstar, as of 5/15/2025. **Past performance does not guarantee future results.** Performance is shown as daily cumulative returns and is net of fees for OAKBX. Periods where the S&P 500 drawdown was greater than 10% over the last 30 years include the following (period shown is the peak to trough and resulting cumulative return): 10/8/1997 – 10/27/1997 (-10.75%), 7/20/1998 – 8/14/1998 (-10.34%), 7/19/1999 – 10/15/1999 (-11.80%), 3/27/2000 – 10/9/2002 (-47.38%), 10/10/2007 – 3/9/2009 (-55.25%), 5/22/2015 – 2/11/2016 (-12.81%), 1/29/2018 – 2/8/2018 (-10.10%), 9/21/2018 – 12/24/2018 (-19.36%), 2/20/2020 – 3/23/2020 (-33.79%), 1/4/2022 – 10/12/2022 (-24.49%), 2/20/2025 – 4/8/2025 (-18.75%). *For the last drawdown period of 2/20/2025 – 4/8/2025, the trough +2 years and peak to trough +2 years periods only go through 5/15/2025 for illustrative purposes given the recency of the drawdown.

While the performance during drawdowns gets most of the attention (and is the main selling point of defined outcome products), investors shouldn't forget that the rebound is just as important. An all-cash portfolio will protect capital during downturns, but it won't do much to grow purchasing power. Our clients seek to preserve their capital and to grow its value over time. If we achieve the first part but fail at the second, we haven't done our job.

In OAKBX, we aren't just trying to change the shape of the returns. We are also adjusting our asset allocation based on the attractiveness of the opportunity set, as we seek to minimize downside capture and compound capital. We shift our equity allocation between 40% and 75% depending on the attractiveness of equities vis-à-vis fixed income. We also opportunistically shift within asset classes. Our talented fixed income team is constantly searching for the best opportunities across Treasuries, corporate bonds, high-yield bonds and securitized instruments. Likewise, our equity analysts

are always searching for ideas that are more attractive than our existing holdings. If we correctly identify the more attractive asset classes and securities, our investors can "have their cake and eat it too" – protecting capital and compounding over time. Indeed, over the 30-year history of OAKBX, we've done exactly that. We delivered 95% of the cumulative S&P 500 return while minimizing downside capture versus the S&P 500 in 10 of those 11 drawdowns.

Logic would suggest that the defined outcome products will struggle to achieve a similar dual mandate. While it should be relatively easy to protect downside through options, that downside protection isn't free. One way or another, these defined outcome products must sell upside to fund downside protection, which will weigh on the returns through the recovery. Given this dynamic, any assessment of their returns needs to include both the drawdowns and recovery periods.

So, how does our record stack up versus the defined outcome competition? Unfortunately, the defined outcome products haven't been around long enough to measure performance over the same 30-year period, but many have been around for the last three S&P 500 drawdowns of 10% or

more. Specifically, the COVID-19 recession, the 2022 tech wreck, and the 2025 tariff shock. The following chart illustrates how these new products stack up versus OAKBX through those three periods.

Average cumulative return across last three S&P 500 Index drawdowns >10%



Source: Harris Associates, Morningstar, as of 5/15/2025. **Past performance does not guarantee future results.** Performance is shown as daily cumulative returns and is net of fees for OAKBX and all Defined Outcome Products. The last three S&P 500 drawdown greater than 10% were (period shown is the peak to trough and resulting cumulative return): 2/20/2020 – 3/23/2020 (-33.79%), 1/4/2022 – 10/12/2022 (-24.49%), 2/20/2025 – 4/8/2025 (-18.75%). The sample size for the Defined Outcome Products consists of open-end funds and ETFs in the Morningstar Defined Outcome category that have a track record long enough to participate in the last three S&P 500 drawdowns that were greater than 10%, with the first of those three being from 2/20/2020 – 3/23/2020. The sample size includes 45 products that have existed that long. In the case a product had multiple share classes, the product’s oldest share class was chosen. Returns for the Defined Outcome Products are shown as an average across all 45 products. *For the last drawdown period of 2/20/2025 – 4/8/2025, the trough +2 years and peak to trough +2 years periods only go through 5/15/2025 for illustrative purposes given the recency of the drawdown.

The defined outcome funds have successfully protected capital during downturns, but since they sold upside to do so, they were far less successful in capturing the subsequent rebound. In aggregate, through these three periods of turmoil, the new innovations lagged our balanced fund, OAKBX.

Having lived through enough of these cycles, that outcome isn't particularly surprising to us. In fact, we suspect the performance gap would widen if we could measure the entire 30-year period.² Sadly, our experience is that most financial market

innovations create more value for the firm pitching the product than the end client.

At Harris | Oakmark, we have always said that we only want to offer products that we would like to put our own money in. That is why we launched the Oakmark Bond Fund (OAKCX) in 2020 and the Oakmark U.S. Large Cap ETF (OAKM) in 2024. In both cases, we believe these products offer real value to clients, and we were excited to invest alongside our clients at launch. Across all our

² This is because OAKBX performed somewhat worse during the most recent three downturns compared to the 30-year average, and because the headwind to defined outcome products from transaction costs and fees compounds over time.

There is also reason to suspect these downturns were particularly well timed for defined outcome products.

products, Harris | Oakmark employees, trustees and their families have over \$1 billion invested alongside clients.³

We appreciate that it might sound outdated to be discussing a balanced fund in an era of “defined outcome products.” Sometimes, though, the old solution works best. In OAKBX, we will continue pursuing our dual mandate of protecting client capital and compounding it over time. Our peers will almost certainly continue trying to reinvent the wheel, but we’re going to stick with our tried-and-true approach. As the saying goes, if it ain’t broke, don’t fix it.

**OAKMARK EQUITY AND INCOME FUND
AVERAGE ANNUALIZED TOTAL RETURNS (%) AS OF 3/31/25**

	Inception date	QTD	1 yr	3 yrs	5 yrs	10 yrs	Since inception	Expense ratio
Investor Class OAKBX	11/01/1995	0.91	4.58	5.21	13.69	6.88	9.51	0.85
Advisor Class OAYBX	11/30/2016	0.97	4.80	5.47	13.94	n/a	8.09	0.62
Institutional Class OANBX	11/30/2016	0.98	4.83	5.49	13.97	n/a	8.12	0.59
R6 Class OAZBX	12/15/2020	1.02	4.87	5.52	n/a	n/a	8.09	0.56
60% S&P 500 / 40% Bloomberg U.S. Aggregate Bond Index		-1.45	7.02	5.78	10.88	8.22	7.97	

Expense ratios are as of the Fund’s most recent prospectus dated 1/28/2025, as amended and restated 1/30/2025, 3/14/2025 and 5/19/2025; actual expenses may vary. Returns for periods less than one year are not annualized. Since inception returns for the indexes are calculated based on the Investor Class inception date. See the prospectus for a comparison against the Fund’s regulatory benchmark: S&P 500 Index.

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. Total return includes change in share prices and, in each case, includes reinvestment of dividends and capital gain distributions. 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.

Open-end mutual funds and Exchange Traded Funds (ETFs) are investment vehicles with both similarities and differences. Investors should read offering documents and consult a financial or tax advisor before investing. Some differences include: ETF Expenses: Expense ratio - Annual fee covering fund management and operations. Commissions - Fees for buying or selling ETFs, though many brokers offer commission-free trades. Mutual Fund Expenses: Sales loads - Commissions paid when buying (front-end load) or selling (back-end

load) fund shares. Redemption fees - Charged when selling shares within a certain time frame. Purchase fees - Fees for buying shares, separate from sales loads. Exchange fees - Fees for switching between funds within the same family. Account fees - Maintenance fees for low balances or inactivity. Annual fund operating expenses - Management fees paid to the fund’s investment advisor, 12b-1 fees for marketing and distribution, and other expenses like legal, custodial, accounting, and administrative costs. Tax Implications: ETFs - Generally tax-efficient due to the in-kind creation/redemption process, with gains or losses realized only when selling an ETF. Mutual Funds - Redemptions can trigger portfolio trading, leading to tax implications for shareholders, including capital gains distributions. Buying and Selling: ETFs - Continuously priced throughout the trading day and traded in the secondary market via brokers, allowing limit, stop-limit, short-sale orders, and margin trading. Mutual Funds - Transacted

³ As of 9/30/2024.

directly with the mutual fund company or via a brokerage account, with orders placed during the business day and filled later using the closing price of securities. Pricing: ETFs - Share prices fluctuate during the day on a stock exchange and can trade at a premium or discount to the net asset value (NAV). Mutual Funds - All shareholder orders receive the same daily price—the NAV—calculated after the market closes. Holdings Disclosure: ETFs - Generally daily disclosure of portfolio holdings and estimated value of underlying holdings throughout trading hours. Mutual Funds - Generally delayed monthly or quarterly disclosure of portfolio holdings with daily disclosure of NAV performance.

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Understanding the Risks

Investing involves risk; principal loss is possible. There is no guarantee the Fund's investment objective will be achieved. Value stocks may fall out of favor with investors and underperform growth stocks during given periods. Medium and lower quality debt securities have higher yield potential but present greater investment and credit risk than higher quality securities, which may result in greater share price volatility. An economic downturn could severely disrupt the market in medium or lower grade debt securities and adversely affect the value of outstanding bonds and the ability of the issuers to repay principal and interest. The 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. Medium-sized companies' stocks tend to be more volatile than those of large companies and have underperformed the stocks of small and large companies during some periods. These and other risk considerations are described in detail in the Fund's prospectus.

Glossary

The **Defined Outcome Morningstar Category** contains funds that deliver investors a predefined range of outcomes over a set period. This range is determined by equity market performance and the derivative contracts that underlie each fund. The funds' features primarily include upside caps and downside buffers. Underlying asset classes tend to be equity-based but may be derived from other asset classes. The products predominantly use options to deliver these outcomes but may also utilize swaps or other derivatives.

The **60% S&P 500 / 40% Bloomberg U.S. Aggregate Bond Index** is comprised of 60% weight given to the S&P 500 Index and 40% weight given to the Bloomberg U.S. Aggregate Bond Index and is rebalanced monthly. The **S&P 500 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. The **Bloomberg U.S. Aggregate Bond Index** is a broad-based benchmark that measures the investment grade, U.S. dollar-denominated, fixed-rate taxable bond market. The index includes Treasuries, government-related and corporate securities, mortgage-backed securities (agency fixed-rate and hybrid ARM pass-throughs), asset-backed securities and commercial mortgage-backed securities (agency and non-agency). These indexes are unmanaged and investors cannot invest directly in them.

Before investing, carefully consider fund investment objectives, risks, charges and other expenses. For this and other information that should be read carefully, please request a prospectus and summary prospectus by calling 1-800-OAKMARK (625-6275) (mutual funds) or 1-800-458-7452 (ETF) or visiting oakmark.com.

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