

International equities: Avoiding value traps

August 2024

While our strategy has underperformed – we believe our value investment process is time-tested and built to help us avoid value traps.

KEY TAKEAWAYS:

- When a company doesn't grow per share value at an acceptable rate, we consider the stock to be a value trap.
- To avoid value traps, we seek cheap stocks of companies that are run by an experienced management team committed to creating value for its shareholders.
- We use proprietary analysis to differentiate between changes in company value and stock market price, adding to our positions when the price falls more than is justified.
- Price often reflects short-term, non-fundamental forces rather than long-term impacts on a business' worth.
- Some of our current outperformers were once detractors that we added to at attractive prices.

Long-term success requires the discipline to stick with a solid, time-tested process even if results aren't on target for the short term. Our investment team knows that they won't be rewarded or penalized based on short-term stock price movements, but rather on how well they followed our process. At Harris | Oakmark, we believe our process will result in more stocks that go up than down, and the magnitude of our winners should exceed that of our losers.

Over the last decade, international markets have underperformed U.S. markets and value funds have underperformed growth funds. The U.S. dollar has also appreciated 30%, providing another headwind to returns. For international value funds, absolute returns have been hard to come by. We realize this outcome can invite second-guessing an allocation to the asset class.

We have gone through tough periods before. If we were to stack every monthly factsheet of the Oakmark International Fund (the "Fund") on the table, there would be 371 sheets of paper. A historical analysis of all those factsheets reveals that 35% of them had three-year returns that lagged the MSCI World ex-U.S. Index. They also reveal, however, that across all rolling periods the Fund outperformed the Index by at least 2.5% and posted greater than an 8% return. Without being dogmatic, it's critical that we stick to our investment process during periods of underperformance, rather than make wholesale changes to our process.

The performance data quoted represents past performance. Current performance may be lower or higher than the performance data quoted. All returns reflect the reinvestment of dividends and capital gains and the deduction of transaction costs.

The Fund has outperformed across rolling periods

	1-yr	3-yr	5-yr	10-yr	15-yr	20-yr
Number of rolling periods	371	347	323	263	203	143
% of periods Fund outpaced index	57%	65%	70%	89%	100%	100%
Average annualized Fund net return (%)	10.44	8.28	8.01	8.17	8.10	8.37
Index annualized return (%)*	7.42	5.75	5.32	4.94	4.92	5.17
Outperformance (%)	3.03	2.53	2.68	3.22	3.19	3.21

Source: Harris Associates, as of 6/30/24. Oakmark International Fund (OAKIX) inception date is 9/30/92. Rolling returns analysis based on monthly data for all time periods shown. Oakmark International Fund (OAKIX) vs. *MSCI World EX USA Index. Net Exp. Ratio 1.05%. Expense ratios are from the Fund's most recent prospectus dated January 28, 2024; actual expenses may vary.

A risk is that while the stock appears cheap, it ends up being cheap for a reason. When a company doesn't grow per share value at an acceptable rate, we consider the stock a value trap.

HOW WE AVOID VALUE TRAPS

As value investors, a knee-jerk reaction can be to scoop up stocks when they fall. The risk is a stock that appears cheap may be cheap for a reason. When a company doesn't grow per share value at an acceptable rate, we consider the stock a value trap. The term is primarily applied to structurally disadvantaged companies that currently trade at low multiples. To avoid value traps, we seek cheap stocks of companies that are run by an experienced management team, committed to creating value for its shareholders.

The performance data quoted represents past performance. Past performance does not guarantee future results. The investment return and principal value will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. 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. To obtain most recent month-end performance data, visit Oakmark.com.

When conducting meetings with management teams, we offer the following advice: Run your business to maximize long-term value and invest excess cash in your highest return opportunities, and share repurchase. If you do, the stock price will take care of itself.

After we've purchased a stock, we utilize any new data as it becomes available to see if the stock still fits under our valuation thesis. Our investment team employs several tools and methods to assess value creation and we track estimated business value from the time the stock goes on our approved list. We expect value to grow as time passes, but if we turn out to be wrong, we want the path of least resistance to be selling a stock that isn't meeting our fundamental expectations.

PRICE OR VALUE? HOW WE DEFINE A KEEPER

About 40 years ago, we formalized a process of challenging an analyst's assumptions used to value an approved list company and coined it the Devil's Advocate (DA) review. Our team of 20+ analysts scour the approved list for a company whose value they think the stock selection group should reconsider. They write a Devil's Advocate report on a firm's top holding by researching and presenting reasons to change our valuation assumptions. When a stock is "DA'd", a member of the investment team publishes a bear or a bull case on the company and reprices the business.

After a written rebuttal report is distributed by the defending analyst, the stock selection group meets for a debate and vote to determine the company's fate. It either remains on the approved list or is removed. Though most holdings stick—the bar is high for getting into the portfolio in the first place—the process routinely persuades the defending analyst to take a second look.

In 2023, a period of underperformance for the Oakmark International Fund, the number of Devil's Advocate reports tripled over the previous year. Through this process our team examined company-specific issues at Worldline, Prudential and St. James's Place. The additional rigor applied to the top five detractors for the Fund gave us conviction to add to each on weakness, year to date.

We use discipline and thorough analysis to differentiate between changes in company value and the stock market price. Price often reflects short-term, non-fundamental forces rather than long-term impacts on a business' worth.

When a stock price falls more than our estimate of company value and our team's process reaffirms our conviction in the business, we add to it — often at extremely attractive prices. Though this can cause a blip in short-term performance, we remain convinced this is the correct approach for long-term investment returns.

For example, companies that were once detractors to the Fund — such as Glencore and Mercedes-Benz — have witnessed turnarounds that transformed them into top contributors.

THIS PERIOD REMINDS US OF THE PAST

The last three-year period has landed the Oakmark International Fund performance in historic company alongside the Global Financial Crisis (GFC), the Covid shutdown and the “dotcom” boom. The current three-year period has certainly had macro headlines that caused concern, including Russia's invasion of Ukraine, inflation, the end of lower for longer interest rates and the emergence of artificial intelligence.

The silver lining is that those periods led to strong relative performance. As shown in the chart, after the “dotcom” bubble popped, the economy emerged from the GFC, and Covid fears abated, the Fund was rewarded for its conviction.

In the investment business the line between early and wrong can be blurry, and which side we are on today will only be obvious with hindsight.

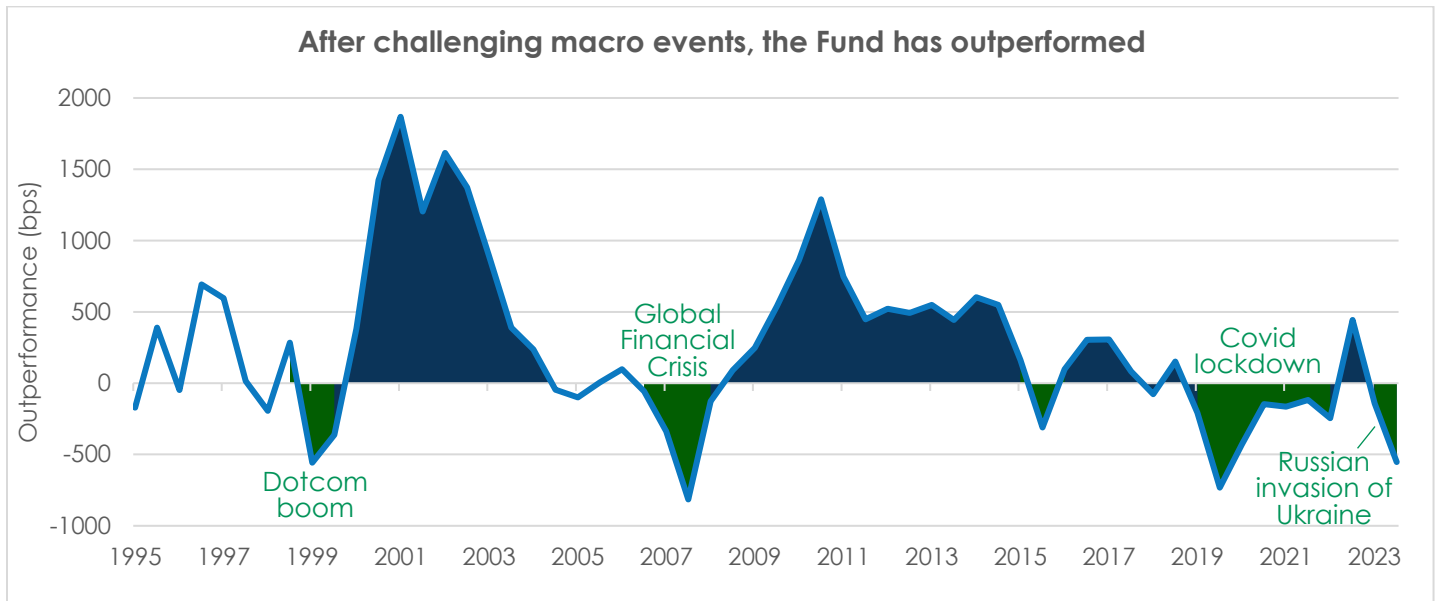
We are deploying the same investment philosophy and process since the Fund was founded in 1992. Today, we're excited by the relative cheapness of the Oakmark International Fund and see similarities with previous periods when our poor relative performance was followed by substantial outperformance of index funds. Thank you for your patience.

Periods of the Fund's largest underperformance relative to MSCI World ex USA Index

Start	End	Relative Performance (bps)	Reason
6/30/05	6/30/08	-815	Global Financial Crisis
6/30/17	6/30/20	-732	Covid lockdown
12/31/96	12/31/99	-557	Dotcom boom
6/30/21	6/30/24	-552	Russian invasion of Ukraine
12/31/17	12/31/20	-429	Covid lockdown

Source: Morningstar Direct, 12/31/92-6/30/24. Three-year rolling return analysis for all time periods shown. Chart shows top five largest underperformance periods for the Oakmark International Fund (OAKIX) relative to MSCI World EX USA Index. Net Exp. Ratio 1.05%.

The performance data quoted represents past performance. Current performance may be lower or higher than the performance data quoted. All returns reflect the reinvestment of dividends and capital gains and the deduction of transaction costs.



Source: Morningstar Direct, three-year rolling returns, 12/31/92-6/30/24. Oakmark International Fund (OAKIX) vs. MSCI World EX USA Index. Net Exp. Ratio 1.05%. Expense ratios are from the Fund's most recent prospectus dated January 28, 2024; actual expenses may vary.

ANNUALIZED TOTAL RETURNS (%)

	QTD*	1 yr	3 yrs	5 yrs	10 yrs	Since inception ¹	Expense ratio
Investor Class OAKIX	-4.28	-3.01	-2.70	3.90	2.68	8.34	1.05
MSCI World Index ex USA	-0.60	11.22	2.82	6.55	4.27	6.03	

As of 6/30/24. Expense ratios are from the Fund's most recent prospectus dated January 28, 2024; actual expenses may vary.

*Not annualized

¹ Inception date: Investor Class 09/30/1992

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.

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Market Commentary & Breaking News

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The MSCI World ex USA Index (Net) is a free float-adjusted, market capitalization-weighted index that is designed to measure international developed market equity performance, excluding the U.S. 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.

The securities mentioned above comprise the following percentages of the Oakmark International Fund's total net assets as of 06/30/2024: Glencore 1.9%, Mercedes-Benz Group 2.7%, Prudential 2.8%, St. James's Place 0% and Worldline 0.9%. **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 International Fund as of the most recent quarter-end.](#)

Investing in value stocks presents the risk that value stocks may fall out of favor with investors and underperform growth stocks during given periods.

Investing in foreign securities presents risks which in some ways may be greater than USA investments. Those risks include: currency fluctuation; different regulation, accounting standards, trading practices and levels of available information; generally higher transaction costs; and political risks.

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.

Before investing in any Oakmark Fund, you should carefully consider the Fund's investment objectives, risks, management fees and other expenses. This and other important information is contained in a Fund's prospectus and summary prospectus. Please read the prospectus and summary prospectus carefully before investing. For more information, please visit oakmark.com or call 1-800-OAKMARK (1-800-625-6275).

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