MANAGER POINT OF VIEW

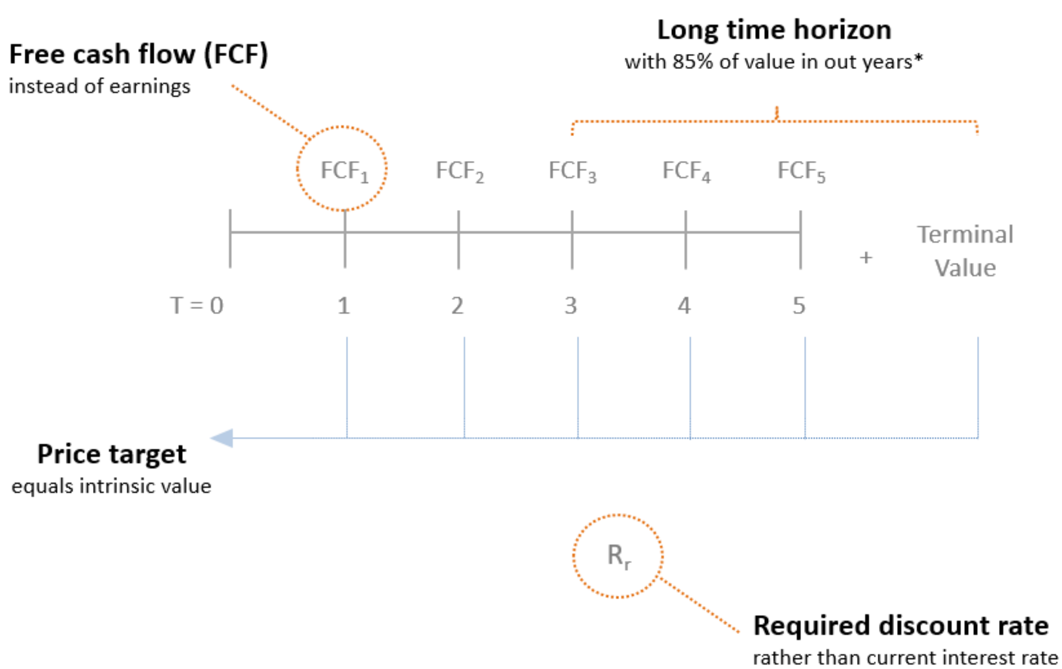
Focus on value, not price

Coronavirus fears have consumed the global equity markets and resulted in a significant increase in volatility. While it is impossible to say how long this issue will disrupt the global economy, this situation has quickly evolved into one that will certainly affect short-term results for many global businesses.

Focus on business value, not price

At Harris Associates, we buy stocks at substantial discounts to our estimates of their intrinsic value, taking the perspective of being the sole owner of a private business. We estimate these intrinsic values by forecasting future cash flows and discounting them to today. Mathematically, most of the total value of a growing company comes from the aggregate cash it will generate in the years 2023-2050 and beyond. We measure the long-term value of a business, not the current market price.

The chart below illustrates how we measure business value and our long-term focus.



Source: Harris Associates as at 28.02.2020. *Forecasted free cash flow calculated for a typical company, defined as a company with a 20% return on equity, a discount rate of 8% and net income growth of 4% for 10 years and 1% into perpetuity.

Harris Associates

Harris Associates manages US, global, and international strategies. The firm employs an intensive, fundamental in-house research process to identify companies trading at a significant discount to managers' estimates of intrinsic business value. Harris Associates uses its experienced team, consistent and pervasive philosophy, repeatable and fundamental process, and long-term investment horizons as the foundation of steadfast conviction.

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Paying attention to fundamentals during periods of volatility has allowed us to successfully navigate past market crises. These periods, as distasteful as they are, often allow our investment teams to purchase stocks at significant discounts, which can lead to sharp rebounds. We are taking advantage of this current volatility to increase our holdings in businesses whose stock prices have declined more than their business values.

We continue to do what we always have: engage with companies and price businesses. Recently, we met with management teams from three of our largest holdings – Glencore, Credit Suisse Group and Lloyds Banking Group.

Glencore – Stock price down 21% through February 29
Glencore was the top holding in the portfolio at the end of 2019. We have held the stock at differing weights since 2015 because its price is very volatile. In 2019, it was down while much of the portfolio was up, so we significantly increased our stake. Weak commodity prices have hurt the company's earnings and share price. Although commodity prices are out of its control, management has done an excellent job of maintaining margins across most of its business. They have repaired the company's balance sheet and the company continues to generate a strong cash flow stream, despite weak commodity prices. We like that management is using the cash generated to repurchase stock at a very attractive price. Further, Glencore mines the commodities required for alternative energy. Copper, cobalt and nickel are all used in batteries for electric vehicles, which are a key component of Glencore's business. At current valuations, we believe Glencore to be extremely attractive and worthy of a top position in the portfolio.

Credit Suisse Group – Stock price down 17.5% through February 29
We met with new Credit Suisse CEO Thomas Gottstein in our offices in Chicago last week. Despite the recent resignation of CEO Tidjane Thiam, we believe changes implemented by him and his team made the company a stronger and vastly improved organization and paved the way for further progress. We believe Gottstein to be a talented and capable leader. We discussed management's intent to keep strategic initiatives intact, despite the leadership change. Gottstein and other members of the executive board were actively involved in setting the strategy and there remains strong collective commitment for its success. Credit Suisse reported fourth-quarter results with revenue that had exceeded market expectations, while net profit and pretax income fell below forecasts. We saw results as mixed as total profit before tax increased 40% from a year earlier, though core operations performance was somewhat disappointing, owing to a number of one-time items that management included in underlying results.

Lloyds Banking Group - Stock price down 22.6% through February 29
The operating environment in 2019 was dominated by uncertainty surrounding Brexit and the formation of a U.K. government, which resulted in both corporate and individual investors postponing investment decisions. This circumstance pressured economic and loan growth and the Bank of England responded with keeping base interest rates low, which put further pressure on bank profitability. Lloyds' management offered a more optimistic view of the U.K. economy going forward. CEO António Horta-Osório noted several indicators of improvement, including evidence of a significant pickup in business confidence throughout the country, spending power of households that continues to rise, and early signs of an upturn in housing market activity and prices. Importantly, management presented 2020 targets that were roughly in line with our expectations.

FOR INVESTMENT PROFESSIONALS ONLY

Outlook

No one knows how long the coronavirus epidemic will last, which is largely why we have recently seen such a dramatic selloff. However, we are witnessing evidence of cases plateauing in China. It seems plausible that the measures taken in China are working to some degree. Further, as of March 4, of the roughly 94,000 confirmed cases, more than 51,000 people have recovered. In addition, while there have been more than 3,000 total deaths, the vast majority of them occurred in the elderly or those with underlying health conditions.

Over the past 25 years, we have seen SARS, the bird flu, Ebola and the West Nile virus cause panic in global stock markets. In each case, the fears were short-lived and did not have a long-term impact on businesses' ability to generate cash. Following brief periods of volatility and stock price weakness, markets eventually recovered and went on to new highs.

As we have seen stock prices drop significantly, the gap between business value and market prices has once again widened. This can be troubling for investors who see the value of their portfolios swing up and down. During these periods, our job is to stick to our investment approach and take advantage of the opportunities presented.

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