Estimating Long-Term Intrinsic Value

ANTHONY P. CONIARIS, CFA, has been a Co-Manager of the Oakmark Select Fund since 2013. He is also an Investment Analyst at Harris Associates. He started at Harris Associates as a Research Associate in 1999 and became an Analyst in 2003. He received an MBA from Northwestern University in 2005 and a B.A. in business/economics from Wheaton College in 1999.

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SECTOR — GENERAL INVESTING
TWST: Could you please give us an overview of Oakmark Select?
Mr. Coniaris: Oakmark Select is a focused mutual fund that typically holds 20 U.S.-based securities, which implements the value philosophy of Harris Associates. As of September 30, 2013, the fund had $4.0 billion in assets under management. We invest in businesses that are trading at significant discounts to intrinsic value, where there is a clear path to that value growing on a per share basis over time, and that are operated by shareholder-oriented management teams. Our team of generalist research analysts uses an intensive, fundamental research process to implement our value philosophy. The fund is focused to allow our best ideas to have a meaningful impact on performance.

TWST: It looks like you had a very strong year with over a 32% return year to date. From your perspective, what factors supported this enviable performance?
Mr. Coniaris: We have to be careful looking at absolute returns in any given year. The market had a fabulous year, and is up roughly 27%. Now, obviously we are very happy to do better than the market. Relatively speaking, we outperformed because of strong stock selection — as we discussed in the last quarter’s letter — as well as from an allocation to more economically sensitive industries. The latter was not some master macro plan, but rather the outcome of our detailed, bottom-up process of estimating business value. We just happened to find the most value in more economically sensitive names in sectors such as financials, industrials and consumer discretionary.

TWST: Looking back over the past year, which sectors or companies outperformed in recent quarters? Did you have any upside surprises and which, if any, disappointed?
Mr. Coniaris: The largest contributors to our performance over the last year were some of the more economically sensitive names in the portfolio, such as TRW (TRW) and TE Connectivity (TEL), and the detractors were Newfield Exploration (NFX) and Cenovus Energy (CVE), both of which are in the energy sector. The positive performers had a combination of improving fundamentals, particularly the auto industry, and a very attractive starting point as they were selling at substantial discounts to intrinsic value.

TWST: Do you see underlying trends continuing; that is, the economic conditions that supported TRW or TE Connectivity’s strong performance? Do you see that in place going forward?
Mr. Coniaris: What we do is estimate the company’s long-term intrinsic value, and then look at the difference between that and the stock price to evaluate the upside of the investment. TRW and TE Connectivity are still very large positions in the fund, because they remain at significant discounts to intrinsic value despite their strong performance this year.

TWST: Do you see any divergent trends emerging that might influence your sector allocations or specific company weightings?
Mr. Coniaris: We do a bottom-up analysis of each company and do not spend time predicting the near-term outlook for the economy. We look at individual businesses and estimate the value in the same way that you and I would, for example, if we were going to buy that business
outright. And then we evaluate the management team and what we think they are likely to do in terms of managing the company as well as allocating free cash flow.

TWST: Do you actually visit the companies that you choose to hold in your portfolio?

Mr. Coniaris: Yes, we do. Management is one of our three criteria for investing in a company, as we mentioned earlier, so we do visit with management teams. We also talk to other third-parties, such as customers, suppliers and competitors to get a well-rounded view of management quality.

TWST: What kinds of things do you find out about a company through visits and investigation of that nuts-and-bolts sort?

Mr. Coniaris: We learn things about the business such as the nature of competition, and why they win with their customers. If you were to own a business outright, you need to understand the economics of the business in order to estimate its value. We also try to understand how managements think. We ask them questions about how they prioritize spending or why they do what they do within the business. Ultimately we are trying to determine whether they are focused on the right sorts of things, like growing the company in a way that maximizes value. We want to see evidence that they are sensitive to return on invested capital and looking at the value of the business on a per-share basis. We want them to understand that just growing for growth’s sake is not a strategy.

TWST: Can you share some more details about your bottom-up approach? What, if anything, differentiates Oakmark’s valuation or screening tools from other funds’?

Mr. Coniaris: I don’t think our screening tools are any different. What is different is our disciplined adherence to the three investment criteria that I mentioned earlier, which is estimating the true long-term value of a business and buying at a significant discount to that, where we see a clear path to value growth and where management is focused on doing the right thing for shareholders. This leads us to be fairly concentrated because those criteria are quite strict.

TWST: Is there anything else you would like investors to know about the fund or would you care to share with us some of your long-term favorite stocks or companies?

Mr. Coniaris: Our favorites are evidenced by the portfolio’s weightings. In general, the larger the discount to our estimate of value, the higher the weight will be in the portfolio.

TWST: What is your turnover rate, what is your average holding time for a company, and what is your sell discipline?

Mr. Coniaris: Our turnover tends to be a fair bit lower than the industry average — we tend to hold companies for three to five years. This year, turnover might be a little lower than that. And as we said in the last quarterly letter, we don’t wear our turnover ratio as a badge of honor — it’s a result of our process. And when you are estimating business value the way that we are and then waiting for that gap to close, it can take years. That’s why our holding period tends to be what it is, but it’s not something we manage to at all.

TWST: Thank you. (VSB)
As of June 30, 2014, the following equities were held as a % of the total net assets:

<table>
<thead>
<tr>
<th>Security Title</th>
<th>Oakmark Select Fund (OAKLX)</th>
</tr>
</thead>
<tbody>
<tr>
<td>TRW Automotive Holdings</td>
<td>7.4%</td>
</tr>
<tr>
<td>TE Connectivity</td>
<td>5.7%</td>
</tr>
<tr>
<td>Newfield Exploration</td>
<td>0%</td>
</tr>
<tr>
<td>Cenovus Energy (US shs)</td>
<td>0%</td>
</tr>
</tbody>
</table>

Portfolio holdings are subject to change without notice and are not intended as recommendations of individual stocks. Current and future portfolio holdings are subject to risk.

To view the full list of Oakmark Select Fund holdings, please visit Oakmark.com.

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 S&P 500 Total Return Index is a market capitalization-weighted index of 500 large-capitalization stocks commonly used to represent the U.S. equity market. All returns reflect reinvested dividends and capital gains distributions. This index is unmanaged and investors cannot invest directly in this index.

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

The discussion of investments and investment strategy of the Fund (including current investment themes, the portfolio manager’s research and investment process and portfolio characteristics) represents the investments of the Fund and the views of Anthony P. Coniaris and Harris Associates L.P., the Fund’s investment adviser, at the time of this interview, and are subject to change without notice.

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 call 1-800-OAKMARK (625-6275).

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