FUND COMMENTARY

Oakmark Natixis Funds

Harris Associates L.P.

Reporting Period: Q1 2017
Published: April 28, 2017



William C. Nygren, *CFA* Kevin G. Grant, *CFA* Michael J. Mangan, *CFA*

POSITIVE INVESTOR SENTIMENT SENT U.S. EQUITY INDEXES TO ALL-TIME HIGHS IN Q1 2017

THE MARKET ENVIRONMENT

Investor sentiment was notably positive coming into 2017 and U.S. markets built on this momentum in the first quarter, pushing key indexes to reach all-time highs during the period. However, the rally halted late in March after the new administration failed to repeal the Affordable Care Act. The Dow Jones Industrial Average fell for eight consecutive sessions, stemming from investors' skepticism about the Republican Party's ability to get other initiatives passed quickly through the legislature. Even so, benchmarks ended in positive territory for the past three months.

Also in the quarter, the Federal Reserve raised interest rates for only the third time in a decade. We see this move as long overdue, as we believe rates have been artificially low for too long. The Fed cited evidence of broad-based economic improvement over the past several months as its basis for action now. Job gains continued at a brisk pace, and February marked the third-best month for private sector job increases in the past seven years. Housing metrics reflected growth in new construction, and low inventory of existing homes pushed prices to a 31-month high in January. Other measures, including manufacturing output, retail sales and consumer confidence, have all reached healthy growth levels. Furthermore, the CEO Economic Outlook Index (a survey of chief executives from about 200 of the largest U.S. companies) showed that CEO optimism about near-term sales, capital spending and hiring rose to a three-year high in the first quarter. We think mounting positive trends will ultimately benefit investors and companies alike, as business activity accelerates to meet increasing demand.

Investors are constantly looking for what comes next. Hopes are high that the current administration will keep its large- scale pledges pertaining to infrastructure spending, decreased regulation and tax reform. Both the emotions of investors and real economic outcomes hinge on these political actions. Our approach now, as it has always been, is to maintain a rational view. We seek to build portfolios with shares of companies that meet our stringent investment criteria and that will grow shareholder value regardless of the macro environment.

THE PORTFOLIO

Top Performers: Apple reported solid first-quarter results, in our assessment. Total revenues of $78.35* billion and earnings per share of $3.36* exceeded market forecasts. iPhone and Mac unit sales increased 5% and 7% year-over- year, respectively, and both were stronger than market estimates as well. Furthermore, the company's

* in USD

service business rose an impressive 18% and generated $7.2* billion in revenue. Apple also introduced a new version of its iPad along with a red model of the iPhone and a video app, Clips, in March. Although its share price reached a record high level in the quarter, we continue to believe Apple is undervalued relative to its true worth. **Unilever**'s full-year 2016 core operating profit of EUR 8.04 billion led to earnings per share of EUR 1.88, both of which were largely in line with market expectations. In addition, **Kraft Heinz** targeted the company in a takeover attempt, which Unilever rejected and Kraft Heinz ultimately dropped. We spoke with Unilever's CFO Graeme Pitkethly who stated that in response to the bid, management instituted a strategic review (slated for completion in April) to boost near-term shareholder value. In addition to its three-year EUR 1 billion cost savings program already in place, several options are under consideration, including share repurchases. Lastly, Unilever is looking to sell its Flora and Stork brands to generate roughly GBP 6 billion in proceeds. Based on the company's market share gains, supply chain improvements, product innovation and effective use of working capital; we believe Unilever remains an attractive investment. Visa delivered a positive fiscal first- quarter earnings report during the period. We were pleased to see that revenue ($4.46 billion* vs. $4.30 billion*) and earnings per share ($0.86* vs. $0.78*) figures bested market expectations. In addition, reported payment volumes were up 38%, boosted by Visa Europe and Costco, and we like the progression of the Visa Europe integration. We think Visa is a high-quality business that is positioned for secular growth into the future. Overall, we believe the investment in Visa will continue to provide value for our clients.

Bottom Performers: Apache's share price reacted negatively to management's 2017 production guidance that was below market expectations despite higher capital spending. Volumes are expected to decline in the first half of the year stemming from scheduled temporary maintenance as well as the lagging impact of capital expenditure reductions in 2016. However, production is expected to improve in the second half of 2017 primarily due to growth from the new oil and gas discovery (Alpine High) in the Permian basin. Apache's management team remains focused on maximizing shareholder value through lean operations and careful capital allocation. While the near-term operating environment may be challenging, we believe the long-term prospects for Apache are promising and the company is well positioned to benefit from an eventual recovery in oil prices. Even though **Anadarko'**s fourth-quarter revenue was in line with market expectations, the company realized earnings per share loss of $0.50*, which was larger than market forecasts. As the quarter progressed, oil prices weakened, which also pressured Anadarko's share price. This outcome is not surprising to us, as Anadarko's share price is sensitive to moves in energy spot prices. We met with CEO Al Walker last year and discussed the company's strategy to offset low commodity prices by selling certain assets. Late in 2016, Anadarko received more than $1 billion in proceeds from selling its East Texas assets to Castleton Commodities International. In our view, Anadarko remains a quality company and a solid investment. **Qualcomm** was hit early in the quarter with a complaint from the Federal Trade Commission (FTC). The complaint indirectly challenged the company's bundling practices by alleging that its unwillingness to license individual essential patents to chip competitors is anticompetitive. The FTC also alleges that Qualcomm has used licensing discounts to win exclusive chip supply agreements with Apple, and that the company has threatened to withhold chip shipments in order to extract royalty payments. We met with management to discuss the aforementioned matters and learned that there were efforts in place to settle out of court with Apple, who filed a suit of its own against Qualcomm. After the meeting, our assessment of the situation is that

* in USD

there is an enormous range of outcomes in this highly complex and fluid situation. Although we still think Qualcomm is trading below our estimation of its intrinsic value, we are watching the situation closely.

During the quarter we initiated positions in **Chesapeake Energy**, **Delphi Automotive** and **Moody's**. We eliminated **Haliburton** and **Sanofi** from the portfolio.

▶ For more information about **Oakmark Natixis Funds,** please contact your financial advisor.

NGAM Canada LP
145 King Street West, Suite 1500 Ph 866 378 7119 Fax 866 378 7121
Toronto, ON M5H 1J8 Ph 416 775 3700 Fax 416 775 3737
ngam.natixis.ca