Davis FUNDS

50 YEARS DAVIS ADVISORS

Davis Opportunity Fund

Fall Review 2021

Update from Portfolio Managers

Market Perspectives

For the first seven months of 2021, the broader equity markets delivered solid positive performance, with the S&P 1500 Index returning 18.07%. The financial resiliency and health of most major economies have been tested, but one by one, they are beginning to show the green shoots of recovery. Meanwhile, unlike the financial crisis of 2008–2009, the recent recessionary conditions did not stem from, nor cause, excessive leverage or other balance sheet problems for the U.S. economy. With relatively healthy credit conditions (which are rare after most recessions) and the important support of both fiscal and monetary stimulus, we are seeing evidence that the U.S. economy is healing and even growing again.

Aiding the resumption of economic activity and expansion is the fact that the major banking institutions in the U.S. are, by and large, holding excess capital with which, as COVID subsides, they can increase return of capital through higher dividends and share buybacks; they can also redeploy large amounts of money into loans at significantly higher net interest margins than what they endured in the recent years of compressed spreads. The main point is that we have a relatively strong foundation underpinning this economy from a balance sheet and financing perspective, coupled with signs of stirring economic activity, significant spend at both the consumer and business levels and a healing employment picture.

In certain spots, speculative valuations have bubbled up. That does not describe the whole market. The stock market is just a market of individual stocks, and when we sift through the landscape of hundreds of companies, we believe there are well-priced investment opportunities. On the subject of hype and manias in the markets, our more than 50-year history as a firm has taught us not to be lured into such risky situations.

We are not optimists nor are we pessimists. We try to be realists, and our sense of reality is grounded in history. Every decade has its iconic examples of excessively priced, speculation-driven momentum stocks. Relatively few of those stocks, from their peak levels, delivered competitive returns against the broader market over subsequent periods that in many cases lasted a half decade or more.

In short, the existence of some overvalued situations in the market is commonplace, but does not mean there is a dearth of things to buy. On the contrary, we own today some of the finest businesses in the world, and through true active management and stock-picking, we are concentrating on a portfolio of stocks that we believe are well-priced. Every business we hold presently has the potential in our estimation to generate, over a business cycle, attractive returns on capital, which is an important input when our investment discipline relies to a large degree on compounding shareholder wealth through the businesses we own. It is not always necessary nor advisable, in our opinion, to jettison good businesses in the short term in search of all-new businesses. If the businesses we have identified can compound their internal free cash flow at high rates, then theoretically we could do well by simply holding these financial locomotives, with some changes at the margin as truly warranted. ■

Portfolio Review

In the year-to-date period through July 31, Davis Opportunity Fund returned 23.32%, outperforming the S&P 1500 Index's 18.07% return. We are invested across a wide range of businesses and industries as distinct from one another as financial services, technology, industrials, healthcare and consumer-oriented businesses. The drivers of performance this year include many businesses that had negative stock price trends just a year or so ago, as the effects of COVID were being felt much more.

Key themes represented in the portfolio today are:

- Durable, high-grade financials—leading U.S. and foreign banks, best-in-class insurers and diversified holding companies with significant financials exposure
- Semiconductor-related businesses serving large, increasingly numerous and fast-expanding end markets such as Artificial Intelligence (AI), cloud computing, e-commerce, electric vehicles and 5G, among other areas of emerging growth
- Dominant giants engaged directly in e-commerce, social media, online search and advertising
- Select industrials with scale advantages and sticky customers
- Select healthcare companies

The average annual total returns for Davis Opportunity Fund's Class A shares for periods ending June 30, 2021, including a maximum 4.75% sales charge, are: 1 year, 46.91%; 5 years, 14.55%; and 10 years, 13.11%. The performance presented represents past performance and is not a guarantee of future results. *Total return assumes reinvestment of dividends and capital gain distributions. Investment return and principal value will vary so that, when redeemed, an investor's shares may be worth more or less than their original cost. The total annual operating expense ratio for Class A shares as of the most recent prospectus was 0.94%. The total annual operating expense ratio may vary in future years. Returns and expenses for other classes of shares will vary. Current performance may be lower or higher than the performance quoted. For most recent month-end performance, visit davisfunds.com or call 800-279-0279. The Fund's performance benefited from IPO purchases in 2013 and 2014. After purchase, the IPOs rapidly increased in value. Davis Advisors purchases shares intending to benefit from long-term growth of the underlying company; the rapid appreciation of the IPOs were unusual occurrences.*

One of the Fund's largest sectors—a byproduct of individually chosen stocks that each have their own merits in our analysis—is financial services, which saw performance hurt in 2020, but has been a tailwind this year. Rather than jump to a conclusion that this is synonymous with concentration risk, we note that some of our largest positions include:

Holdings	Business Description
Berkshire Hathaway Inc.	Conglomerate whose earnings are diversified across more than 100 different underlying businesses spanning industrials, utilities, retail, manufacturing and financial services, among others.
Capital One	Possesses the hallmarks that we like to see in a financial services company—a pathway towards potential growth and above-average returns on equity coupled with a culture that focuses intensely on managing credit risk.
AIA	Hong Kong-listed Life and Health Insurer. Operates in nearly 20 countries throughout Asia-Pacific. 100% Asia facing. 2nd largest life insurer in China. Benefits from strong regional demand and rising standards of living. Financial products and services are still in the early stages of development throughout developing Asia including China and India.

These three businesses are all lumped into the same sector even though each one is tied to very different drivers and risk factors. In most scenarios, a diverse conglomerate would likely not be directly or immediately correlated with life insurance claims—a function of mortality rates—in many countries, and neither would be strongly correlated with credit card and lending revenue. Hence when we look at the portfolio in detail, we would note the eclectic and diverse business models making up the whole, and that is done intentionally to build in a degree of durability.

Semiconductor-related holdings currently include Applied Materials, Texas Instruments and Intel. While each of these businesses is unique, they serve fast-expanding global end markets ranging from e-commerce and AI to cloud computing, mobile technologies and electric vehicles—a set of market opportunities that dwarf this industry's historical legacy markets in more mature sectors, such as PCs and mobile devices. We are excited by these new, long-tailed areas of future growth for this set of well-resourced, innovative high-technology companies. In our view, best-in-class operators have successfully made the transition from what were historically cyclical businesses to "growth cyclicals" over the coming decades. Products today are harder to design and manufacture, let alone source given a strained supply chain, making chips more valuable today than before—in some cases by multiples of past pricing. In addition, financially savvy managements have created value by retiring large percentages of their companies' shares when their stocks were cheap, with some retiring 20–35% over the last seven years alone.

E-commerce, online search and advertising, social media and software are another component of the portfolio that have proven, attractive businesses. The online portion of the Fund is currently dominated by such market leaders as Amazon.com and Alphabet (the parent company of Google). We are attracted to these names based on the size and rapid expansion of their market opportunities globally, their ability to generate and grow new revenue sources through constant innovation, ample operating leverage as they continue to scale and capable, focused, highly competitive leadership teams. If purchased at sensible prices, these types of businesses in our experience can contribute meaningfully to long-term results.

In the industrial space, we own a select list of well-entrenched market leaders, such as Raytheon Technologies in aerospace and defense and Carrier Global, a global leader in heating, ventilation and air conditioning (HVAC) solutions. These have recovered this year from their lulls in 2020, yet continue to trade at reasonable multiples of subdued earnings, creating a potential setup for the double play of recovering multiples on recovering earnings.

Within healthcare, our largest position is Quest Diagnostics, a leader in independent lab testing and diagnostics. Quest offers its lab services at a fraction of the cost of hospital labs, which constitutes a strong cost-savings value proposition to new and existing customers. It is not surprising that by virtue of the value Quest creates, the company is increasingly serving as an outsource partner to hospitals and healthcare networks across the U.S.

Also within healthcare, we own Viatris, the newly conceived union of Mylan, a generics/specialty pharma company, and Pfizer's Upjohn business, which includes a portfolio of 20 largely off-patent branded Pfizer drugs including Lipitor, Lyrica, Norvasc and Viagra. The combined business is the largest generics/off-patent drug manufacturer in the world and is highly diversified by geography, with 70% of revenue outside the U.S.

Last year around this time, the share prices for many of our holdings declined dramatically in the face of the COVID outbreak. We sharpened our collective pencils, and after some significant investment of time studying the direct and indirect implications of COVID, we took a few notable actions.

The first was to compare the relative opportunities, since prices had changed significantly in virtually every group in the market, with some being buoyed by investors favoring so-called "COVID trades"—i.e., internet-related businesses and food delivery, by and large.

We pared some of our larger technology-related holdings (including, for this purpose, the e-commerce and broader online space), some of which had held up better than other parts of the portfolio.

We exited energy entirely. Despite the rebound that has occurred in oil and gas since our sale, our view was that the longer-term outlook for the fossil fuel industry could become far more difficult both operationally and, even more, financially over the coming decade and perhaps beyond. Between regulation, taxation, and changing social and political attitudes towards drilling, it is yet to be seen whether the recent run in this sector has a sustainable path looking out years, and we have decided for now to avoid the area for fundamental reasons, rather than any outlook on the commodity price.

In terms of what we purchased, we added to a number of our financial positions that, based on both our internal stress tests and the Federal Reserve's years of stress tests for banks, seemed to us like a very attractive risk/reward opportunity set. Our view was that the amount of capital required to foot the bill, even in the case of a deep economic crisis scenario, was in place precisely as a counter-cyclical buffer. Between very high capital ratios going into COVID with a substantial sum of earnings still coming in the door—aided in no small part by stimulus checks—we felt comfortable adding to select financial businesses, and that decision, as noted earlier, has been beneficial to this year's results thus far.

Across the portfolio, we are confident in the earnings power, competitive strengths, balance sheets and management teams for each of our 43 positions over the coming decade. We have consciously built a portfolio of relatively dominant businesses that are as durable as they are attractive long-term compounding machines, in our estimation. ■

Conclusion

Given the strong performance enjoyed by many investors this year in stocks, a legitimate question is to ask whether there are still appealing opportunities. We would encourage investors to look very much individually at companies throughout different areas of the economy and markets. A detailed scan should reveal that many fine businesses still represent good value, particularly considering that conditions for most sectors are improving. Owning durable compounding machines with the potential for free cash flow growth over many years is a core part of our discipline. We feel it is a sensible and perennial way to invest as stewards of both our and others' savings—pre-COVID, through COVID and after.

At Davis Advisors, we seek to purchase durable businesses at value prices and hold them for the long term. The more than $2 billion Davis Advisors, the Davis family and Foundation, our employees, and Fund directors have invested in similarly managed accounts and strategies remains a true sign of our commitment to and conviction in this enduring philosophy.[1]

We are grateful for your confidence and trust, and we look forward to continuing our investment journey together. ■

1. As of 6/30/21.

This report is authorized for use by existing shareholders. A current Davis Opportunity Fund prospectus must accompany or precede this material if it is distributed to prospective shareholders. You should carefully consider the Fund's investment objective, risks, charges, and expenses before investing. Read the prospectus carefully before you invest or send money.

This report includes candid statements and observations regarding investment strategies, individual securities, and economic and market conditions; however, there is no guarantee that these statements, opinions or forecasts will prove to be correct. These comments may also include the expression of opinions that are speculative in nature and should not be relied on as statements of fact.

Davis Advisors is committed to communicating with our investment partners as candidly as possible because we believe our investors benefit from understanding our investment philosophy and approach. Our views and opinions include "forward-looking statements" which may or may not be accurate over the long term. Forward-looking statements can be identified by words like "believe," "expect," "anticipate," or similar expressions. You should not place undue reliance on forward-looking statements, which are current as of the date of this report. We disclaim any obligation to update or alter any forward-looking statements, whether as a result of new information, future events, or otherwise. While we believe we have a reasonable basis for our appraisals and we have confidence in our opinions, actual results may differ materially from those we anticipate.

Objective and Risks. Davis Opportunity Fund's investment objective is long-term growth of capital. There can be no assurance that the Fund will achieve its objective. Some important risks of an investment in the Fund are: **stock market risk:** stock markets have periods of rising prices and periods of falling prices, including sharp declines; **common stock risk:** an adverse event may have a negative impact on a company and could result in a decline in the price of its common stock; **foreign country risk:** foreign companies may be subject to greater risk as foreign economies may not be as strong or diversified. As of 6/30/21, the Fund had approximately 19.5% of net assets invested in foreign companies; **headline risk:** the Fund may invest in a company when the company becomes the center of controversy. The company's stock may never recover or may become worthless; **large-capitalization companies risk:** companies with $10 billion or more in market capitalization generally experience slower rates of growth in earnings per share than do mid- and small-capitalization companies; **mid- and small-capitalization companies risk:** companies with less than $10 billion in market capitalization typically have more limited product lines, markets and financial resources than larger companies, and may trade less frequently and in more limited volume; **manager risk:** poor security selection may cause the Fund to underperform relevant benchmarks; **depositary receipts risk:** depositary receipts may trade at a discount (or premium) to the underlying security and may be less liquid than the underlying securities listed on an exchange; **emerging market risk:** securities of issuers in emerging and developing markets may present risks not found in more mature markets; **fees and expenses risk:** the Fund may not earn enough through income and capital appreciation to offset the operating expenses of the Fund; and **foreign currency risk:** the change in value of a foreign currency against the U.S. dollar will result in a change in the U.S. dollar value of securities denominated in that foreign currency. See the prospectus for a complete description of the principal risks.

The information provided in this material should not be considered a recommendation to buy, sell or hold any particular security. As of 6/30/21, the top ten holdings of Davis Opportunity Fund were: Grab Holdings, 6.37%; Wells Fargo, 5.19%; Capital One., 5.01%; Quest Diagnostics, 4.95%; UnitedHealth Group, 4.20%; Cigna, 4.11%; U.S. Bancorp, 4.05%; Alphabet, 3.75%; Owens Corning, 3.68%; DiDi Global, 3.37%.

Davis Funds has adopted a Portfolio Holdings Disclosure policy that governs the release of non-public portfolio holding information. This policy is described in the prospectus. Holding percentages are subject to change. Visit davisfunds.com or call 800-279-0279 for the most current public portfolio holdings information.

We gather our index data from a combination of reputable sources, including, but not limited to, Lipper, Wilshire, and index websites.

The S&P 1500 Index is comprised of the S&P 500, MidCap 400, and SmallCap 600, which together represent approximately 90% of the U.S. equity market. Investments cannot be made directly in an index.

After 10/31/21, this material must be accompanied by a supplement containing performance data for the most recent quarter end.

Shares of the Davis Funds are not deposits or obligations of any bank, are not guaranteed by any bank, are not insured by the FDIC or any other agency, and involve investment risks, including possible loss of the principal amount invested.

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