Davis Appreciation and Income Fund

Update from Portfolio Managers

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Davis FUNDS

THE EQUITY SPECIALISTS™

Davis Appreciation and Income Fund

Semi-Annual Review 2017

Portfolio Results

Davis Appreciation and Income Fund returned 7.16% for the first half of 2017, performing roughly in line with a traditional balanced fund benchmark.[1]

In the year-to-date period ending June 30, 2017, Davis Appreciation and Income Fund returned 7.16%, performing roughly in line with a traditional balanced fund benchmark (60% S&P 500/40% Barclays Aggregate Bond Index). The Fund is designed to participate in equity markets while delivering increasing income over time with a degree of downside protection.[2] While we provide a performance benchmark for purposes of comparison, we do not manage the Portfolio based on the benchmark. Rather, we seek first and foremost to generate satisfactory absolute returns that will preserve and grow our shareholders' purchasing power over the long term. ■

Investment Outlook

Selectivity in both equity and fixed income markets is critical. Avoid overpriced dividend darlings and expensive companies with peak profit margins. Technology and globalization are disrupting industries at an unprecedented rate.

When evaluating the investment landscape, we do not make investment decisions based on short-term forecasts, which history has shown can be unreliable. Instead, we focus on the important and knowable and maintain a long-term perspective.

In today's market, our long-range assumptions include:

- Selectivity is critical when investing in both equity and fixed income markets.
- Opportunities in today's market include global leaders selling at bargain prices, dominant lesser-known businesses in necessary economic niches, blue chips of tomorrow, and beneficiaries of short-term misperceptions.[3]

The average annual total returns for Davis Appreciation and Income Class A shares for periods ending June 30, 2017, including a maximum 4.75% sales charge, are: 1 year, 8.97%; 5 years, 6.85%; and 10 years, 3.18%. 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 0.91%. 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 higher or lower than the performance quoted. For most recent month-end performance, visit davisfunds.com or call 800-279-0279.*

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. Equity markets are volatile and an investor may lose money. **Past performance is not a guarantee of future results. 1.** Class A shares without a sales charge. **Past performance is not a guarantee of future results.** The Combined Index is a composite blend of 60% of the S&P 500 Index and 40% of the Barclays U.S. Aggregate Bond Index and represents a broad measure of the U.S. stock and bond markets, including market sectors in which the fund may invest. **2.** While Davis Advisors attempts to manage risk there is no guarantee that an investor will not lose money. Equity markets are volatile and the investment return and principal value of an investment will vary. Diversification does not ensure against loss. **3.** While we research companies subject to such contingencies, we cannot be correct every time, and a company's stock may never recover.

- Risks in today's market include companies with near peak profit margins and overvalued divided darlings that are riskier than they appear. The 25 most commonly held stocks in the five largest dividend-focused exchange traded funds are valued at 25 times earnings, a P/E ratio significantly higher than the market.
- Technology and globalization are reconfiguring industries at an unprecedented rate. Many long-standing brands and business moats are being disrupted in unexpected ways. For example, in recent years iconic companies in the newspaper, retailing and media industries have become obsolete. At the current rate of change, 75% of the S&P 500 Index may be replaced in the coming decade. To succeed, investors should avoid conventional thinking and remain flexible. ■

The Portfolio

Global leaders trading at bargain prices. Dominant lesser-known businesses. Blue chips of tomorrow. Beneficiaries of short-term misperceptions.

Davis Appreciation and Income Fund seeks to own durable, well-managed businesses that can be purchased at attractive prices and held for the long term.

The Portfolio is well diversified with approximately 70% of assets invested in a broad array of equity positions from a number of different industries. Equity holdings represent businesses that possess both durability and attractive long-term growth prospects in our view. As a general rule, these businesses return significant amounts of capital each year through dividends and share buybacks. In a small number of cases we may invest in companies that do not currently pay a dividend but have demonstrated a capacity to do so based on their free cash flow generation. We believe the balance we have struck between equities and a relatively conservative mix of fixed income securities and cash equivalents is a prudent way to participate in the stock market's appreciation over the years to come while mitigating downside risk.

Global Leaders Trading at Bargain Prices—The Fund's equity positions include some of the strongest and best-known companies in the world. Short-term economic concerns over the past year have reduced the share prices of many global leaders to bargain levels at a time of high valuations for the average company. Buying top-tier businesses at bargain prices should be a goal for long-term investors in any environment.

An example of a market leader in the Portfolio is UnitedHealth Group, which generates close to $200 billion in revenues annually and has established a dominant competitive position in the U.S. health insurance industry.[4] The tailwinds benefiting the company today—and we expect well into the future—include favorable demographic trends (i.e., an aging population), an expanding relationship with Medicare and Medicaid, and a fast-growing health care technology business, all of which have contributed to double-digit earnings growth.

Another market leader in the Portfolio is Texas Instruments, a leading workhorse technology company and one of the world's largest manufacturers of microprocessors. The company focuses on the highly fragmented analog and embedded semiconductor businesses where it has gained significant market share over the years. These types of microprocessors perform specialized functions such as regulating power, dimming or brightening viewing screens, and regulating or boosting performance in a variety of ways. Furthermore, these microprocessors—used in such devices as digital cameras, smart phones, GPS units, and even kitchen appliances—tend to have relatively longer product lives, increasing Texas Instruments' returns on investment. The company benefits from excellent leadership, a strong balance sheet, number one or number two market share positions in its core

4. Individual securities are discussed in this piece. 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. The return of a security to the Fund will vary based on weighting and timing of purchase. This is not a recommendation to buy, sell or hold any specific security. **Past performance is not a guarantee of future results.**

business lines, and also allocates capital well, returning substantial cash to shareholders through dividends and share repurchases.

Out-of-the-spotlight businesses—The next major category of investments in the Portfolio is "out-of-the-spotlight" businesses. These are lesser-known companies from a variety of industries including aerospace, industrial gas production, specialty consumer finance companies, and businesses engaged in energy exploration and production, among others.

An example of an out-of-the-spotlight holding in the Portfolio is Capital One Financial Corporation, a top 10 U.S. bank based on deposits with branches primarily located in the New York to Washington, D.C. corridor as well as Texas and Louisiana. Capital One, which may be best known for its widely advertised and highly competitive credit card offerings, has grown steadily over the years and is now the fourth largest issuer of MasterCard and Visa cards. In our view, Capital One is a highly focused bank with a strong balance sheet and solid capital ratios that is well positioned for future growth.

Blue Chips of Tomorrow—Another theme is fast-moving companies that use innovation to disrupt the economics of larger but less agile competitors. Capitalism is a process of constant change that rewards businesses that can adapt. Over decades, we have seen many examples of today's disrupters emerge as tomorrow's blue chips. Several of Davis Appreciation and Income Fund's core holdings, particularly in the online retailing and social media sectors, currently reflect this theme.

Alphabet, the parent company of Google, globally dominates the business of online search with a market share of more than 80%. The company's Google search engine allows users to search the World Wide Web for free but charges advertisers for placing ads on the search results page. Advertisers gladly pay for this ad placement as their ads are displayed only when searches are relevant to their business. This makes Alphabet a new generation media company in our view with a business model that is exceptionally well positioned to capitalize on the continuing transition from traditional print and television media to Internet-based content and advertising (both desktop and mobile). While Alphabet does not currently pay a dividend, the company generates enough free cash flow to return capital to shareholders if and when that becomes a reasonable choice as a capital allocation decision. For the foreseeable future, we are satisfied with management's decision to continue reinvesting for growth and to expand Alphabet's competitive advantages.

Beneficiaries of Short-Term Misperceptions—
Investors with a very short-term focus often avoid companies that face any type of controversy or a negative near-term outlook, creating an opportunity for long-term investors willing to look beyond today's headlines.

In recent quarters, we opportunistically added to our position in Apache Corporation, an exploration and production company in the energy sector whose primary assets are in the Permian Basin of Texas and New Mexico, one of the lowest cost areas for producing oil in the world. Apache's management is top-notch. Under the leadership of CEO John Christmann, the company has been shedding noncore assets and reinvesting for growth in more productive fields such as the Alpine High project, which has the potential to double the company's cash flow from operations over the next three to five years according to our estimates. We believe Apache's share price does not reflect this expected production growth and as such represents a meaningful discount to the company's true worth. ■

Conclusion

Overall, given the durability, growth prospects and valuations of the companies in Davis Appreciation and Income Fund, we believe the Portfolio is well-positioned to grow shareholder wealth over the long run, all while providing rising income and a degree of downside protection. ■

This report is authorized for use by existing shareholders. A current Davis Appreciation and Income 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.

Objective and Risks. Davis Appreciation and Income Fund's investment objective is total return through a combination of growth and income. There can be no assurance that the Fund will achieve its objective. The Fund is subject to both equity and debt risk. Some important risks of an investment in the Fund are: **bonds and other debt securities risk:** Bonds and other debt securities generally are subject to credit risk and interest rate risk; **changes in debt rating risk:** if a rating agency gives a fixed income security a low rating, the value of the security will decline; **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; **convertible securities risk:** convertible securities are often lower-quality debt securities; **credit risk:** The issuer of a fixed income security (potentially even the U.S. Government) may be unable to make timely payments of interest and principal; **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; **difficult to resell risk:** many investors do not want high-yield, high-risk debt securities, and others are prohibited from buying them; **extension and prepayment risk:** the pace at which borrowers prepay affects the yield and the cash flow to holders of securities and the market value of those securities; **fees and expenses risk:** the Fund may not earn enough through income and capital appreciation to offset the operating expenses of the Fund; **foreign country risk:** foreign companies may be subject to greater risk as foreign economies may not be as strong or diversified; **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; **interest rate risk:** interest rate increases can cause the price of a debt security to decrease; **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; **manager risk:** poor security selection may cause the Fund to underperform relevant benchmarks; **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; **overburdened issuers risk:** issuers of high-yield, high-risk debt securities are unlikely to have a cushion from which to make their payments when their earnings are poor or when the economy in general is in decline; **preferred stock risk:** preferred stock is a form of equity security and is generally ranked behind an issuer's debt securities in claims for dividends and assets of an issuer in a liquidation or bankruptcy. An adverse event may have a negative impact on a company and could result in a decline in the price of its preferred stock; **priority risk:** issuers of high-yield, high-risk debt securities are likely to have a substantial amount of other debt which it must be current on before it can pay bondholders; **stock market risk:** stock markets have periods of rising prices and periods of falling prices, including sharp declines; and **variable current income risk:** the income which the Fund pays to investors is not stable. See the prospectus for a complete description of the principal risks.

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.

The information provided in this material should not be considered a recommendation to buy, sell or hold any particular security. As of June 30, 2017, the top ten holdings, not including cash and equivalents, of Davis Appreciation and Income Fund were: Berkshire Hathaway Inc., Class B, 4.19%; United Technologies Corp., 3.71%; LafargeHolcim Ltd., 3.62%; EQT Midstream Partners LP, 3.52%; Safran S.A., 3.44%; Capital One Financial Corp., 3.21%; American Express Co., 3.18%; Bank of New York Mellon Corp., 3.10%; Wells Fargo & Co., 3.09%; Occidental Petroleum Corp., 2.95%.

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.

Broker-dealers and other financial intermediaries may charge Davis Advisors substantial fees for selling its funds and providing continuing support to clients and shareholders. For example, broker-dealers and other financial intermediaries may charge: sales commissions; distribution and service fees; and record-keeping fees. In addition, payments or reimbursements may be requested for: marketing support concerning Davis Advisors' products; placement on a list of offered products; access to sales meetings, sales representatives and management representatives; and participation in conferences or seminars, sales or training programs for invited registered representatives and other employees, client and investor events, and other dealer-sponsored events. Financial advisors should not consider Davis Advisors' payment(s) to a financial intermediary as a basis for recommending Davis Advisors.

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

The Fund can invest in a variety of derivative investments to pursue its investment objective or for hedging purposes. The Adviser and the Fund have claimed exclusions from the definition of the term "commodity pool operator" under the Commodities Exchange Act and, therefore, are not subject to registration or regulation as a pool operator under the Commodities Exchange Act.

The **Combined Index** reflects an unmanaged portfolio (rebalanced monthly) of 60% of the S&P 500 Index and 40% of the Barclays U.S. Aggregate Bond Index. The **S&P 500 Index** is an unmanaged index of 500 selected common stocks, most of which are listed on the New York Stock Exchange. The Index is adjusted for dividends, weighted towards stocks with large market capitalizations and represents approximately two-thirds of the total market value of all domestic common stocks. Investments cannot be made directly in an index.

Trailing Price/Earnings (P/E) Ratio is the weighted average of the price/earnings ratios of the stocks in a portfolio. The P/E ratio of a stock is calculated by dividing the current price of the stock by its trailing 12 months' earnings per share. Portfolio totals are computed using an inverse harmonic methodology.

After October 31, 2017, 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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