# Davis Financial Fund—*25th Anniversary*

**Interview with Christopher Davis, Portfolio Manager**

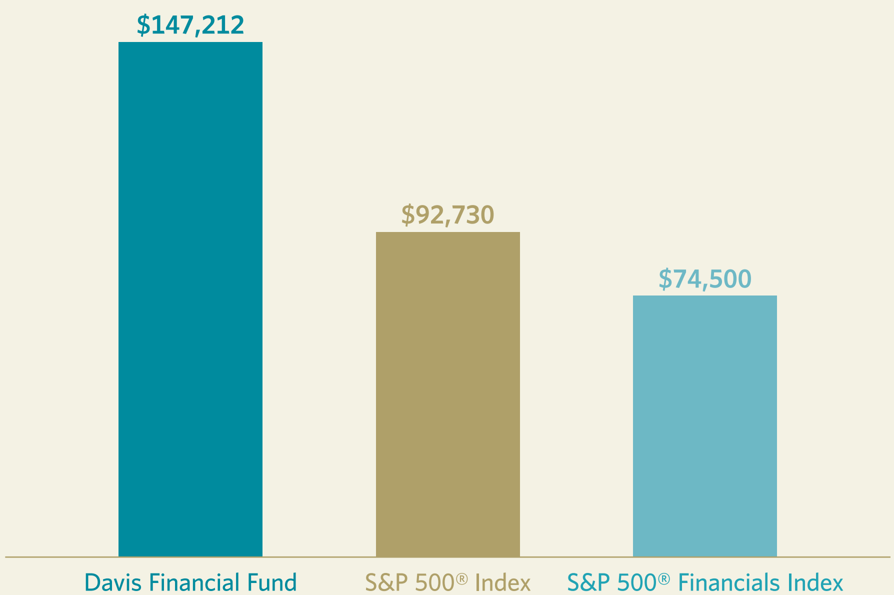
This year marks the 25th anniversary of Davis Financial Fund. Since its inception in 1991, the Fund has outperformed the S&P 500® Index and the S&P 500® Financials Index.[1] Chris Davis started the Fund more than 25 years ago and has almost 30 years of experience investing in financial stocks. Here are Chris's most recent thoughts on why to invest in financial stocks, why active management can add significant value in this vast inefficient sector and why investing in financial stocks offers a unique opportunity today.

## Executive Summary

- Davis Financial Fund has outperformed the S&P 500® Index and S&P 500® Financials Index since inception in 1991.[1]
- Davis Financial Fund has returned more than double the return of the Financial Select Sector SPDR® ETF (XLF) since XLF's inception in 1998.[2]
- Currently, financial stocks are underappreciated and out of favor with investors, offering an attractive long-term investment opportunity.
- Selectivity and active management are the keys to outperformance in the vast, inefficient financial sector. Investing in stronger companies and avoiding weaker ones can make a significant difference in investor returns.
- Davis Financial Fund holdings include: Markel, Chubb, Berkshire Hathaway, JPMorgan Chase, Moody's, BNY Mellon, American Express and Capital One Financial.[3]

### Davis Financial Fund History of Outperformance

**Growth of $10,000 Investment Since Inception[1]**




**Symbols**

A Shares: RPFGX C Shares: DFFCX Y Shares: DVFYX

***The average annual total returns for Davis Financial Fund's Class A shares for periods ending June 30, 2016, including a maximum 4.75% sales charge, are: 1 year, −8.58%; 5 years, 8.22%; and 10 years, 3.99%. 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 0.86%. 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.*

**1.** Class A shares without a sales charge. **Past performance is not a guarantee of future results.** 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. **2.** XLF is the Financial Select Sector SPDR Fund. Its inception is 12/16/1998. **3.** 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.**

## Davis has successfully invested in financial stocks for almost six decades. Why should investors consider this sector now?

In 1947, my grandfather, Shelby Cullom Davis, began investing in financial stocks. Known as the "Dean of Insurance Stocks," he compounded a $100,000 investment into $800 million over his career, largely by investing in financials.[4]

The characteristics my grandfather looked for in financial companies included competitive advantages, experienced management and disciplined capital allocation. We use these same criteria to select all our investments as an equity research boutique. What is interesting and more specific to financials is we can find companies within the sector that have above-average long-term growth prospects but that trade at below-average price/earnings (P/E) multiples. This is the reason my grandfather called financials "growth stocks in disguise."

More recently, investors have tended to consider financial companies inextricably linked to the 2008 financial crisis, resulting in a lingering aversion to this out-of-favor group. However, our research shows certain high quality financial companies remained profitable during the worst financial crisis since the Great Depression, are currently trading at a 40% to 50% discount to the market and, most important, are less risky today as they have doubled their capital ratios.[5] In addition, a significant percentage of the assets on these companies' balance sheets have been added since the financial crisis. Moreover, because of limited competition and extremely tight credit standards, these businesses have record earnings. Now, some financial companies are in a position to distribute an increasing percentage of their earnings. Put together, these developments are creating a cyclical opportunity in financial stocks in our view.

In addition to the current cyclical opportunity, we believe a strong case can be made that the right financial company is by its nature a long-term cash-compounding machine. Such a business generates strong current earnings that can be reinvested as well as providing the potential for excellent long-term growth because the industry is so vast and fragmented, and the products and services offered by financial institutions are as long lasting as they are ubiquitous. Almost everyone is a customer of at least one, two or three financial companies. In brief, financial companies offer products that do not become obsolete.

> "Davis Financial Fund has more than doubled the returns of XLF over time."

## Why are financial stocks one of the few areas that can perform well even if we are in a low growth environment as many believe?

We have good reason to think select financial businesses can deliver satisfactory returns to shareholders in a slower growth environment. Suppose a bank grows its net income only 3% per year and trades at a price-earnings multiple of 12. Then assume the bank has to retain 20% of its earnings because of the need to increase capital ratios or strengthen its balance sheet. Further assume the bank's remaining earnings are distributed half as dividends and half as share repurchases. Given this scenario, what is the five year annualized total return to shareholders?[6]

The answer is 9.9%, because despite a somewhat modest growth rate, the number of shares outstanding would decrease due to the share buybacks while earnings per share and dividends per share would rise. Thus, in this scenario, 3% growth in net income growth would result in a highly satisfactory average annual total shareholder return of 9.9%. Of course, if economic growth strengthens, select financial businesses should benefit even more.

## Why have selectivity and active management generated outperformance for Davis Financial Fund?

Davis Financial Fund has delivered more than double the returns of the Financial Select Sector SPDR® ETF (XLF) since the inception of XLF in 1998.

Investing in stronger companies and avoiding weaker ones can make a significant difference over time. Because the returns of financial stocks are widely dispersed, selectivity is key. In fact, since 2005, the average difference between the best and worst performing financial stock in the S&P 500® Index has been about 140%. What accounts for these wide differences in outcomes?

A critical factor to recognize when researching financial companies is they are first and foremost human capital businesses. As a result, management judgment, underwriting practices, and management and employee incentives play a central role in determining which financial companies should perform well through an entire business cycle versus those that might be structured to perform well in a specific environment but not necessarily to endure over time. As bottom-up active managers, we have flexibility to invest more capital in those businesses we believe are best positioned to build long-term wealth while avoiding those with less attractive prospects.

**4.** While Shelby Cullom Davis' success forms the basis of the Davis Investment Discipline, this was an extraordinary achievement and other investors may not enjoy the same success. **5.** 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. **6.** This hypothetical example is for illustrative purposes only and does not represent the performance of any particular investment. Actual results will vary.

| Davis Financial Fund Representative Holdings | |
|---|---|
| MARKEL | Markel, a specialty property and casualty insurer, has generated excellent investment results for decades and grown book value per share more than 16% annually over the last 20 years. |
| VISA | Visa, the largest payments processing company, benefits from a hard-to-replicate business model that includes a secure payments network, trusted brand, large merchant base, and powerful technology. |
| CHUBB | Chubb is a global insurance leader specializing in property and casualty insurance, reinsurance and Asia-focused life insurance. It has a well-regarded management team, strong balance sheet and disciplined underwriting culture. |
| BNY MELLON | BNY Mellon, the world's largest custodian bank with more than $29 trillion of assets under custody, is a durable franchise that benefits from economies of scale. |
| Berkshire Hathaway Inc. | Berkshire Hathaway is a collection of outstanding, profitable businesses. Exceptional world-class capital allocation. |

Contrast our carefully considered approach with many passively managed strategies that indiscriminately allocate the most capital to stocks with the largest market capitalizations. This approach can subject investors to the risk of concentration in the most vulnerable areas of the sector. For instance, many investors may not know XLF has tremendous industry concentration as four of its top five holdings are banks and account for 25% of its assets.

We build our Portfolio one company at a time. The Portfolio includes best of breed commercial banks, investment banks, insurance companies, wealth management firms, asset managers, credit card companies, diversified financial conglomerates, and rating agencies.

## What are some of the perceived risks with financial stocks today?

One of the perceived risks with financials has to do with regulation and litigation. While those risks cannot be completely discounted, we believe they are unlikely to have a significant impact.

The potential for energy-related credit losses is another concern among investors. Specifically, some investors wonder whether energy debt will be like subprime mortgage debt was in the past. Our research indicates the exposure to energy-related credit losses in general is not that large. For example, large cap financials' average energy exposure is around 1.9% of loans. Credit losses are a part of doing business for financial companies. What is not normal is having no credit losses.

What matters when investing in bank stocks is that the credit risk exposure is as uncorrelated as possible among a bank's various loans. Energy provides a perfect example of this concept as what is bad for a bank's energy-related loans is actually good for the bank's consumer loans. This is because lower energy prices mean consumers have more disposable income to pay their credit card and mortgage debt.

Regarding the Portfolio's potential energy-related credit losses, three factors are important to consider. One, the potential for energy-related credit losses is relatively small. Two, the potential losses from these loans are not correlated or are slightly inversely correlated with the Portfolio's credit-related investments. Three, reviewing the extent of these losses provides a wonderful opportunity to determine which banks are better loan underwriters. In other words, having information that speaks to the culture of a firm is invaluable.

A final concern about financial stocks for some investors is financial institutions could become so highly regulated they become safe, boring investments that trade like utilities. Although highly unlikely in our view, such a development would mean a 50%–60% increase in these stocks' multiples, which would be a good problem to have.

## With all the positives, why is the opportunity in financial stocks underappreciated and not recognized by the market?

The biggest hurdles to investing in financials in this environment are psychological and emotional as investors still remember the aftermath of the 2008 financial crisis. While the overall market has more than doubled since then, financial stocks have not appreciated as much—even though select financial companies are delivering record earnings and have the strongest balance sheets in decades.

As always, investor fear is correlated with prices. When stock prices go down, people feel more fear and are less interested in buying, and when prices go up they feel reassured. This tends to result in an undesirable outcome.

We take the opposite approach. We search for companies with stock prices that have lagged the companies' true business value. We like to look in unloved or overlooked areas of the market where prices do not reflect true value. In today's environment, the financial sector offers the opportunity we seek.

*This report is authorized for use by existing shareholders. A current Davis Financial 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 Financial Fund's investment objective is long-term growth of capital. There can be no assurance that the Fund will achieve its objective. Under normal circumstances the Fund invests at least 80% of its net assets, plus any borrowing for investment purposes, in securities issued by companies principally engaged in the financial services sector. 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; manager risk: poor security selection may cause the Fund to underperform relevant benchmarks; 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; 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; 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; financial services risk: investing a significant portion of assets in the financial services sector may cause the Fund to be more sensitive to systemic risk, regulatory actions, changes in interest rates, non-diversified loan portfolios, credit, and competition; foreign country risk: foreign companies may be subject to greater risk as foreign economies may not be as strong or diversified. As of June 30, 2016, the Fund had approximately 9.7% of assets invested in foreign companies; emerging market risk: securities of issuers in emerging and developing markets may present risks not found in more mature markets; 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; 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; focused portfolio risk: investing in a limited number of companies causes changes in the value of a single security to have a more significant effect on the value of the Fund's total portfolio; interest rate sensitivity risk: interest rates may have a powerful influence on the earnings of financial institutions; 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; and fees and expenses risk: the Fund may not earn enough through income and capital appreciation to offset the operating expenses of the Fund. 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.

As of June 30, 2016, the top ten holdings of Davis Financial Fund were: Markel Corp., 7.3%; Wells Fargo & Co., 6.6%; Chubb Ltd., 5.7%; Berkshire Hathaway Inc., Class A, 5.4%; Bank of New York Mellon Corp., 5.3%; Visa Inc., Class A, 5.1%; American Express Co., 5.1%; JPMorgan Chase & Co., 5.0%; U.S. Bancorp, 4.5%; Goldman Sachs Group Inc., 4.0%.

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 **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. The **S&P 500® Financials Index** is a capitalization-weighted index that tracks the companies in the financial sector as a subset of the S&P 500® Index. 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, 2016, 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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