

Davis Opportunity Fund

2012 Portfolio Manager Commentary

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An Update from The Davis Research Team

Since our founding more than 40 years ago in 1969, Davis Advisors' mission as a firm has been to serve our shareholders and to do so with high integrity. Mindful of the enormous responsibility that comes with serving as a steward of others' capital, we are firmly committed to:

- Investment excellence
- Sharing wisdom and perspectives about investor behavior
- Open and honest communications

As a sign of our commitment to and alignment with all those who have entrusted their capital to us, the Davis family, Davis Advisors, employees, and directors have more than \$2 billion of their own money invested side by side with fellow shareholders in the various mutual funds our firm manages.¹

Market Perspectives

During 2011, the U.S. stock market fluctuated in a wide trading range with the S&P 500® Index returning 2.11%. Investors' focus on the macro-economic environment in the past year overshadowed the real progress being made at many high-quality, durable businesses, as evidenced by earnings per share, cash flows, balance sheet strength, dividends, and share repurchases. The market has been acting in other words like a voting machine, reflecting shifts in investor sentiment and indiscriminately penalizing businesses of virtually all types. Longer term, however, we believe the stock market will resume its historical tendency to act more like a weighing machine, valuing businesses based on their individual merits and making proper

distinctions between good and bad businesses. For these reasons we remain steadfastly focused on fundamentals and most important long-term earnings power.

As bottom-up stock pickers with a long-term perspective we look to the future with a degree of optimism that is grounded by two important facts: First, we believe the current wide disparity between stock price performance and the performance of the underlying businesses means many durable businesses are trading at compelling valuations. We refer to this as the price-to-value gap. As just noted many of the businesses we own have made meaningful progress in terms of earnings per share, cash flows, dividends, and balance sheet strength. Based purely on fundamentals, the *intrinsic value* of these businesses is higher today than just a few years ago yet *stock prices* do not fully reflect this reality. Having navigated many different market environments over the past four decades, we believe in time this price-to-value gap should narrow and that may set the stage for higher future returns. This is often overlooked by investors in times of pessimism and uncertainty.

Second, history provides a useful guide for what tends to happen after periods of subpar returns for stocks. Since 1928, there have been 13 decades out of more than 70 (based on rolling 10 year periods) when the market produced what we consider unsatisfactory returns. (For purposes of this discussion, we define unsatisfactory as 5% per annum or less.) *Significantly, in every subsequent*

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.**

¹As of December 31, 2011.

decade the stock market produced far better returns averaging 13% per annum. In other words, based on historical evidence, low prices can set the stage for higher future returns, all other things being equal.²

While we acknowledge the challenges facing the global economy, for the reasons just stated we believe the future for owners of well-managed, durable businesses could well be brighter than the recent past.

Portfolio Positioning

Market conditions may vary from period to period, yet the core tenets of the Davis Investment Discipline and approach remain the same. We start with the premise that stocks represent fractional ownership in real businesses. We seek to purchase durable businesses at value prices and hold them for the long term. We believe that owning shares of well-managed businesses with attractive reinvestment rates, purchased at reasonable valuations and held for years to allow the power of compounding to work, is a reliable method for building capital over long investment horizons. Our Portfolio holds three primary categories of investments:

Market leaders with strong balance sheets—

In many cases these are global companies with universally known brands, earnings that are well diversified from the standpoint of product line and geography, proven management, and fortress balance sheets. These businesses span a broad range of industries from consumer products to technology to financial services to health care, among others. They provide a core foundation of stability within the Portfolio and offer in our view the possibility of long-term sustainable returns through capital appreciation and dividends.

CVS Caremark, the nation's largest provider of prescription drugs, is an example of a market leader in the Portfolio.³ The company was formed through the 2007 merger of the drug store chain CVS with the pharmacy benefit manager Caremark, creating a unique drug distribution business model positioned to benefit from both the aging of the U.S. population as well as the growth in generic drugs as patents on widely used prescription drugs expire. Generic medications tend to be much less expensive for patients than patented medications yet their profitability can be substantially higher for a pharmacy. While combining the retail pharmacy franchise with the pharmacy benefit company has involved a fair share of challenges, we believe CVS Caremark's underlying business is solid and positioned well for potential long-term growth.

Other examples of market leaders in the Portfolio include ExxonMobil, the world's largest energy company; Coca-Cola, the largest beverage company in the world; Google, a new generation media company that globally dominates Internet search; and Johnson & Johnson, the world's premier consumer health care company.

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 with attractive economics that in our opinion should eventually command higher valuations. Given the right leadership and attractive reinvestment rates, these low-profile holdings have the potential to add meaningfully to results in our estimation.

²The market is represented by the Dow Jones Industrial Average from 1928 through 1957 and the S&P 500® Index from 1958 through 2011. Investments cannot be made directly in an index. There is no guarantee that low-priced securities will appreciate. **Past performance is not a guarantee of future results.** ³Individual 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 or sell any specific security. **Past performance is not a guarantee of future results.**

IDEXX Laboratories, a leader in pet health care, is a representative out-of-the-spotlight holding. Its core business is providing veterinarians around the world with a broad range of diagnostic and information technology-based products and services such as diagnostic tests, laboratory equipment, radiography systems, and software to improve veterinary office productivity and profitability.

Another example of an out-of-the-spotlight holding in the Portfolio is Mexican-based America Movil, a leading wireless operator in Latin America with more than 200 million subscribers. While it operates in 18 countries, America Movil simply dominates the Mexican cellular market with a market share of well over 60%. Controlled by billionaire Carlos Slim, who owns approximately a quarter of the shares, management has demonstrated excellent capital allocation skills and has not historically overpaid to enter new markets or consolidate the company's position in existing markets. We believe America Movil has the opportunity for continued solid growth and should generate high levels of free cash flow for years to come.

Other out-of-the-spotlight holdings in the Portfolio include Agilent Technologies, a leading bio-analytical and electronic measurement company, and PACCAR, a global manufacturer of heavy duty trucks.

Headline risk or contrarian investments⁴—

On a very selective basis we make contrarian investments. These often involve controversial situations where we believe the market has overly discounted a company's shares given the probable economic risk to the business's long-term fundamentals. As with all our investments, underpinning these positions is our internal assessment that the overall risk/reward trade-off is favorable.

An example of a headline risk investment in the Portfolio is Blount International, a manufacturer of power chainsaw and related equipment used by the forestry, yard care and general contractor industries worldwide. Blount's business is so specialized that it operates in a near duopoly, which constitutes in our view a strong and enduring competitive moat. Because demand for its products is housing-related, Blount's business is cyclical and recently has been sluggish due to the global economic slowdown. We believe, however, that secular demand for timber—a key driver for Blount—will eventually resume its long-term growth and that Blount is well positioned to benefit from this trend.

In short, the investments we have made in market leaders, out-of-the-spotlight companies and headline risk businesses combine to create a Portfolio we believe is well diversified with a balance of offensive and defensive characteristics that can produce satisfactory compound returns over full market cycles.⁵

Performance Review

In 2011, the Russell 3000[®] Index returned 1.03%. The Davis Opportunity Fund trailed the broader market over that period.⁶ Relative to the Index, financials and consumer staples holdings performed well on balance, offset primarily by our materials and energy holdings. In the materials sector, a detractor was Sino-Forest, a Canadian-based company that acquires standing timber and leases long-term land usage rights to harvest, sell and replant timber on land owned by provincial cooperatives throughout a number of different provinces in mainland China. As of this writing, it is unclear what developments will unfold at Sino-Forest. We have explored a range of scenarios. As the full story has not yet been written, we will comment further on Sino-Forest in subsequent communications.⁷

⁴While we research companies subject to such contingencies, we cannot be correct every time, and a company's stock may never recover. Diversification does not ensure against loss. ⁵While 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. Equity markets are volatile and an investor may lose money.

⁶Past performance is not a guarantee of future results. ⁷Sino-Forest shares have been suspended from trading by the Ontario Securities Commission.

Returning to the relationship of price to value, the disparity between these two metrics has rarely been wider at any time in the last 20 years, providing the opportunity in our view for higher future returns. In particular, we believe the stock market is overly discounting large cap, liquid, durable businesses to a point where we are finding compelling valuations and the potential for higher future returns across a variety of industries.

Based on current valuations, the companies in the Portfolio today are trading at an estimated owner earnings yield (i.e., the first year return an investor would earn by purchasing the businesses outright) of roughly 7% to 8.5%, approximately four times the prevailing risk-free rate of 2% for 10 year U.S. Treasuries.⁸ By historical measures, that is a very wide disparity and signals in our opinion that high-quality businesses presently offer a great deal of value relative to the alternatives.

Given our businesses' vast sources of earnings power (including in many cases meaningful exposure to fast-growing developing economies), we believe it may be possible for the owner earnings yield to approach 10% or more in the years ahead. The case for equities may be further bolstered by the fact that many of the companies we own are reducing their number of shares outstanding through share repurchases and returning capital to investors through higher dividends. If these trends continue, the total return shareholders could potentially realize starting from today's low levels may well prove quite satisfactory in the long run, a message that seems all too absent from current market debates.⁹

Where We Are Finding Opportunities

Our confidence in our investment approach rests to a large degree on what we view as favorable prospects for the businesses we own. The Portfolio is essentially a group of business models we have researched and consider attractive vehicles that may compound capital over the long term based on their management quality, business durability and competitive advantages, coupled with relatively attractive valuations. In our view the keys to outperforming the market over the next decade, as we have done since Davis Advisors began managing the Fund in 1999,¹⁰ are to:

- Think long term and not get caught up in short-term cycles;
- Continue to exercise a highly selective and disciplined approach with respect to business quality, valuation and risk; and
- Remain focused on in-depth, bottom-up research.

Today we are finding compelling values in many areas of the market that in our view represent attractive avenues for compounding clients' capital over the next decade. Most of these opportunities fit within the following long-term themes:

Globally dominant world leaders—These industry leaders are characterized by strong pricing power, diversified earnings, healthy balance sheets, strong competitive moats, and durable business models. Because these businesses produce excess cash, they are not generally dependent on external funding.

⁸Common stocks and bonds represent different asset classes subject to different risks and rewards. Future economic events may favor one asset class over the others. Owner earnings yield represents a single data point about a company. No such data point can, by itself, guide an investor as to what securities should be bought or sold or when to buy or sell them. We caution our shareholders not to give this calculation undue weight. For a more complete description see the endnotes. ⁹Equity markets are volatile and an investor may lose money. **Past performance is not a guarantee of future results.** ¹⁰Class A shares without a sales charge. **Past performance is not a guarantee of future results.** Davis Advisors began active daily management of the Fund on January 1, 1999. From May 1, 1984 until December 31, 1998, Davis Advisors had a sub-adviser that handled the active daily management of the Fund. The market is represented by the S&P 500[®] Index.

Beneficiaries of crisis—The business model, capital position and management discipline of certain companies allow them to take advantage of dislocations in their industry, the economy or the capital markets. Given strong free cash flow and a conservative balance sheet, these companies may be able to use distressed prices to make investments, arrange acquisitions or buy back their shares at accretive prices. Other companies may significantly decrease their cost structure allowing for potentially increased returns as revenues return to more normal levels.

Select financial companies—Although the future is always uncertain, we believe the financial services industry has much growth ahead of it and its products carry little risk of obsolescence. As a general rule, people will always need basic banking services, insurance products, investment management advice, and other such services. Nonetheless, it is necessary to differentiate between strong and weak players in order to invest successfully in this area of the market.

Energy, commodities and agricultural businesses—Well-managed companies in these areas are positioned to benefit from the inexorable long-term growth of a global middle class, which may result in increasing demand and potentially higher prices for most natural resources. We seek businesses with a history of smart capital allocation that have mostly avoided the pitfalls of rapid expansion and costly acquisitions during periods of relatively high commodity prices. Investing in companies that

can grow the intrinsic value of their business through economic cycles may create the opportunity for long-term growth that is not solely dependent on the pricing of the underlying commodity while also allowing the potential for higher returns should rapid commodity price inflation occur in the future.

Select special situations—We may periodically invest in highly opportunistic companies in diverse industries with unique or not well understood characteristics that may make them compelling long-term investments in our view.

The investment opportunities discussed above combined with the breadth of our other investments create a Portfolio that is broadly diversified with a conscious blend of both offensive and defensive components in our view.¹¹ The common thread running through the Portfolio is each holding has been selected according to the Davis Investment Discipline with an emphasis on management quality, business model strength, durable competitive advantages, and appropriate valuations. The sum total of our investments creates a Portfolio we believe affords our clients the potential to generate satisfactory compound returns over the course of many years.

All of us at Davis Advisors thank you for investing with us. We take our responsibilities to our clients seriously and appreciate your confidence. We look forward to continuing our investment journey together. ■

¹¹Diversification does not ensure against loss.

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.

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; 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; under \$10 billion market capitalization risk: small- and mid-size companies typically involve more risk than larger, more mature companies; 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; trading markets and depositary receipts risk: depositary receipts involve higher expenses and may trade at a discount (or premium) to the underlying security; 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; 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; and emerging market risk: securities of issuers in emerging and developing markets may present risks not found in more mature markets. As of December 31, 2011, the Fund had approximately 9.9% of assets invested in foreign companies. 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 December 31, 2011, Davis Opportunity Fund had invested the following percentages of its assets in the companies listed: Agilent Technologies, 0.38%; America Movil, 0.25%; Blount International, 0.73%; Coca-Cola, 3.71%; CVS Caremark, 3.27%; ExxonMobil, 1.77%; Google, 7.24%; IDEXX Laboratories, 1.46%; Johnson & Johnson, 1.26%; PACCAR, 2.24%; Sino-Forest, 0.13%.

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. 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.

The owner earnings yield is a calculation that estimates how much the owner of an entire company could withdraw from a company (after paying continuing maintenance expenses) divided by the market price of the company. It represents a single data point about a company. No such data point can, by itself, guide an investor as to what securities should be bought or sold or when to buy or sell them. We caution our shareholders not to give this calculation undue weight. The owner earnings yield alone tells nothing about the quality of the businesses we own or the managements that run them, the range or distribution of individual owner earnings yields of individual companies held in the Fund, and the sources of and changes in the owner earnings yield.

When all of the above information is considered, the owner earnings yield is a useful tool to gauge the attractiveness of a Fund's potential opportunity. It does not, however, tell when that opportunity will be realized, nor does it guarantee that any particular company's price will increase. To the extent an investor considers owner earnings yield in assessing a Fund's return opportunity, the limits of this tool should be considered along with other factors relevant to each investor.

We gather our index data from a combination of reputable sources, including, but not limited to, Thomson Financial, Lipper, and index websites. Small-cap companies have market capitalizations less than \$3 billion. Mid-cap companies have market capitalizations from \$3 billion to \$10 billion. Large-cap companies have market capitalizations more than \$10 billion. Under normal circumstances, Davis Opportunity Fund invests the majority of its assets in equity securities issued by companies with market capitalizations of less than \$20 billion.

The **Russell 3000® Index** measures the performance of the 3,000 largest companies incorporated in the United States and its territories and listed on the NYSE, AMEX, or NASDAQ. The companies are ranked by decreased total market capitalizations. 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 **Dow Jones Industrial Average** is a price-weighted average of 30 actively traded blue chip stocks. The Dow Jones is calculated by adding the closing prices of the component stocks and using a divisor that is adjusted for splits and stock dividends equal to 10% or more of the market value of an issue as well as substitutions and mergers. The average is quoted in points, not in dollars. Investments cannot be made directly in an index.

After April 30, 2012, 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.