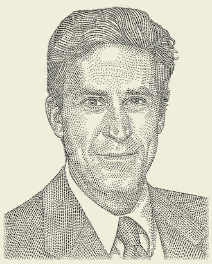

Davis Real Estate Fund

Update from Portfolio Managers

Andrew A. Davis and Chandler Spears

Davis FUNDS

THE EQUITY SPECIALISTS

Davis Real Estate Fund

Annual Review 2018

Investment Results

Davis Real Estate Fund's Class A shares provided a total return on net asset value for the year ended December 31, 2017 of 8.30%. Over the same time period the Wilshire U.S. Real Estate Securities Index returned 4.84%. Over the latest three and five year periods, a $10,000 investment in Davis Real Estate Fund has grown to $12,083 and $15,169, respectively.[1] ■

Investment Overview

Overall 2017 was a great year for the Fund and we are pleased with the profits we have made and the value we have added to the Portfolio. However, we do not plan to pat ourselves on the back and forge ahead into 2018 without further reflection and analysis. We were struck by an op-ed article in *The Wall Street Journal* that suggested we all like to remember success and forget failure. How the author felt confident enough to speak for all is beyond the management of Davis Real Estate Fund, because at the Davis Funds we do not like to forget our mistakes. To us mistakes form the bedrock upon which better decisions are made. That does not mean we will not make mistakes from time to time, but repeating the same mistake is something we never want to do. As we surveyed the landscape of real estate securities in the closing weeks of 2017 we recognized a single issue that vexes all analysts and pundits. This was also the first time since the credit crisis of 2008 that Fund management was in a position to take a stand significantly different from the consensus view. How we build on this new understanding demands that we pay close attention to what we got wrong almost a decade ago.

Longtime investors in the Fund will remember we stuck by our view in early 2007 on enclosed mall real estate investment trust (REIT) General Growth Properties (GGP), only to watch as the company spiraled inexorably into bankruptcy in 2009.[2] At the time we believed a company producing almost $250 million in free cash flow would have adequate resources to weather a credit crunch. Our mistake was underestimating the probability a credit crunch could become a credit freeze, where debt capital was simply not available on any terms at all. Today we are presented with a similar situation that has implications for all of Davis Real Estate Fund's retail real estate holdings. The question is: Are we about to repeat a mistake by underestimating the probability the growth of e-commerce could make bricks-and-mortar real estate irrelevant? While not a perfect parallel with the credit freeze of 2008, we see striking similarity in potential outcomes.

In the past few years the Davis Real Estate Fund has been positioned well. We have maintained significant overweight positions in certain data

The average annual total returns for Davis Real Estate Fund's Class A shares for periods ending December 31, 2017, including a maximum 4.75% sales charge, are: 1 year, 3.16%; 5 years, 7.64%; and 10 years, 4.51%. 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 0.93%. 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. 2.** 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.**

center and industrial real estate companies we thought were best positioned to deal with "last touch" e-commerce distribution, including CyrusOne Inc. (CONE) and Rexford Industrial Realty, Inc. (REXR). Those investments have outperformed significantly. Further adding to performance in 2017 was the Fund's underweight position in malls that performed poorly over the same period. While we can feel good about foreseeing the meteoric growth in e-commerce, our lack of enthusiasm for traditional retail businesses was a valuation call rather than an implicit short on retail real estate, which is so much in vogue these days.

Even though the headwinds facing retail real estate have grown immeasurably over the past couple of years, punctuated perhaps by Amazon's purchase of Whole Foods, Fund management is trying hard not to extend retailer problems to retail real estate. The media and some less thoughtful analysts have assumed a degree of homogeneity regarding retail real estate that simply does not exist. Contrary to the consensus view, we believe some retail real estate will not only survive, but actually thrive. The obvious challenge with that view is determining what sort of real estate can thrive and estimating the cost of making that happen. ■

Portfolio Positioning

During the last half of 2017 we have refined our view and as we enter 2018 we think the Fund is well positioned in those retail real estate companies with assets we consider "must haves." In other words, we want to invest in locations that will be in high demand regardless of the retail landscape. Today we see increasing demand from experienced retailers such as restaurants, entertainment companies and fitness centers. At the same time demand from apparel companies is fast evaporating, which is almost always the result of poor product evolution and bad financial management. As this shakeout continues we believe locations in affluent, densely populated areas will be the winners. For example, businesses that thoughtfully reimagine assets to blend retail, experience and apparel should see accelerating growth. Companies such as Simon Property Group (SPG) and Acadia Realty Trust (AKR) are Fund favorites in that regard.

We have also established significant positions in a few grocery store-anchored shopping center companies that do not have redevelopment opportunities similar to Simon or Acadia, but do have superior locations. Retail Opportunity Investments Corporation (ROIC) and Regency Centers Corporation (REG) both have properties located in areas that should benefit no matter the ultimate winners in the grocery business. Also worth noting is the fact we consider Amazon's purchase of Whole Foods a tacit acknowledgement that well-located real estate is a necessary component of a fully developed multiple-channel grocery business.

Adding to our positive stance on some retail companies is their current low valuation. Almost all of the Fund's retail real estate stocks are trading at multiples we have not seen since the depths of the financial crisis. We believe the valuation for some retail real estate is far too pessimistic. We also see a huge difference in valuation between retail real estate and the sectors that have outperformed over the past two years. Given how significantly we were overweight in some of those winners, we thought it sensible to take some of those gains and reinvest the proceeds in businesses offering better value. As we enter 2018 the Fund has a decidedly barbell look given our stance on e-commerce. Industrial real estate businesses will still have a significant place in the Fund but so will select retail real estate companies, with Acadia Realty Trust (AKR) and Retail Opportunity Investment Corporation (ROIC) being the Fund's two largest overweight investments in this area relative to the Fund's benchmark.

Another focus over the past year has been refining our perspective on structural capital expenditure, i.e. the costs a company incurs to maintain the competitive position of its properties, which is a key variable in our investment analysis. Our increased investment in retail real estate required us to revisit our assumptions since we believe that the cost of reimagining retail real estate properties will increase in the future. Interestingly, that research changed our perspective on the self-storage sector, which we have underweighted for more than a decade.

Historically self-storage has never really captured our attention. Valuations in this area have always been rich and seemed to depend more on the flow of funds into real estate mutual funds than any other factor because one of the largest real estate companies, Public Storage (PSA), is a self-storage REIT. As new money flowed into the sector, Public Storage's size in most benchmark indexes meant the company attracted new investment dollars regardless of valuation. Now that the flow of funds into real estate strategies has turned into net redemptions and fundamentals in the sector have weakened, Public Storage's valuation is far more reasonable.

What we determined after analyzing almost 20 years of data is that the self-storage business requires almost no structural capital expenditures to keep properties competitive. This is in marked contrast to some sectors that require significant owner investment to keep properties fresh and occupied. Remarkable too is that high margins in the self-storage business have been maintained over the same 20 year time period despite considerable variability in marketing expenses. Based on this research and given much more reasonable valuations, we have become more flexible in our approach to the storage sector. During the past year we maintained our positions in the two largest public storage companies, Public Storage (PSA) and Extra Space Storage Inc. (EXR), and in two smaller storage REITs Life Storage, Inc. (LSI) and CubeSmart (CUBE). We expect investors will be unwilling to reward storage companies for the slowing growth that is likely to occur during 2018, but given that storage is a short duration lease business and is quickly working through pockets of oversupply, we think the sector will begin to look increasingly attractive relative to other sectors as we move into the second half of 2018.

The performance of Fund investments in apartments, another short duration lease sector, also varied in 2017. Our position in Essex Property Trust, Inc. (ESS), an investment we have often called a "forever stock," performed well even though the company entered 2017 facing slowing growth, as did real estate companies in most sectors. That same circumstance dealt another longtime holding a much different hand. American Campus Communities (ACC) reported leasing results for the 2017/2018 academic year that disappointed investors and is finishing the year as one of the single biggest detractors from Fund performance.

Given the nature of its business, American Campus must re-lease the whole of its student housing portfolio over the same time period every year. This pattern has created a detrimental myopia among investors who look for a signal in the current year's leasing results as of a given day versus the exact same day in the prior leasing cycle. For several years in succession American Campus has reported increasing rents and occupancy over the prior year's results and most investors believed that trend would continue. We had no doubt the streak would end at some point. This was the year that happened. What strikes us as the market getting it wrong is that American Campus's valuation suffered far more than other apartment REITs that experienced a similar slowing of core growth. Even more frustrating is the lack of credit the company gets for achieving core growth over long durations with a risk-return profile better than any other apartment company in our investment universe. American Campus is one of the few companies in our investment universe with all the hallmarks of a fantastic business. The company has a defendable franchise in modernizing student housing, is led by an experienced management team deeply aligned with shareholders and is trading at a considerable discount. For these reasons American Campus will remain a significant holding in the Fund and our inclination would be to increase our position should relative and absolute valuation not improve.

Although Davis Real Estate Fund enjoyed another good year in 2017, clouds are forming in a few areas on which we will keenly focus going forward. Interest rates, while beyond our ability to forecast, will continue to be a determining factor affecting the performance of some sectors. Evolving tax reform too will almost surely have unintended consequences for landlords and tenants alike. Finally, late in 2018 new accounting rules will be introduced that govern how lessees recognize and disclose lease obligations. These new rules may result in changing lease terms for public real estate, particularly those properties with long-duration leases, and create choppiness in asset values. These changes and others yet to be known keep the business of investing fun and engaging. We value the trust you have placed in us and look forward to continuing our investment journey together. ■

This report is authorized for use by existing shareholders. A current Davis Real Estate 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 Real Estate 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. Under normal circumstances the Fund invests at least 80% of its net assets, plus any borrowing for investment purposes, in equity, convertible, and debt securities issued by companies principally engaged in the real estate industry. Some important risks of an investment in the Fund are: **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; **fees and expenses risk:** the Fund may not earn enough through income and capital appreciation to offset the operating expenses of the Fund; **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; **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; **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; **real estate risk:** real estate securities are susceptible to the many risks associated with the direct ownership of real estate, such as declines in property values and increases in property taxes; **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. As of December 31, 2017, the Fund had approximately 4.0% 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, 2017, the top ten holdings of Davis Real Estate Fund were: Simon Property Group, Inc., 7.50%; Acadia Realty Trust, 3.47%; Public Storage, Inc., 3.42%; Essex Property Trust, 3.27%; Prologis, Inc., 3.07%; AvalonBay Communities, Inc., 2.92%; Welltower Inc., 2.84%; Boston Properties, Inc., 2.82%; Catchmark Timber Trust Inc.,–A, 2.60%; Alexandria Real Estate Equities, Inc., 2.45%.

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, Thomson Financial, Lipper and index websites.

The Wilshire U.S. Real Estate Securities Index is a broad measure of the performance of publicly traded real estate securities, such as Real Estate Investment Trusts (REITs) and Real Estate Operating Companies (REOCs). The Index is capitalization-weighted. The beginning date was January 1, 1978, and the Index is rebalanced monthly and returns are calculated on a buy and hold basis. Investments cannot be made directly in an index.

After April 30, 2018, 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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