Davis Opportunity Fund

Semi-Annual Review 2024

Update from Portfolio Managers

Key Takeaways

- Despite slowing momentum, the U.S. economy can be seen as a glass that is half full rather than half empty, with strong employment powering personal consumption, the main driver of gross domestic product (GDP).
- The extreme size disparities between the largest companies in the S&P 1500 Index and the rest have produced valuation and concentration risk not seen since the 1990s. Active management offers ways to plot a different course from the benchmark.
- Demonstrating our investment discipline, Davis Opportunity Fund is focused on a relatively small number of positions with an overall earnings growth rate comparable to the S&P 1500 but at a valuation substantially below that of the index.

Market Perspectives: Structural Distortions

This year the U.S. economy has expanded at a slow pace with GDP increasing by an annual rate of 1.4% in the first quarter. U.S. stocks meanwhile continued their advance and the S&P 1500 returned 14.35% in the first half of 2024.

Despite the slowdown in economic momentum, we would still characterize today's economy as a glass that is half full rather than half empty. The jobs market is all-important in this regard because it underpins and powers roughly 70% of our GDP in the form of consumption. We have come a long way since the post-crisis high in unemployment which touched 10% in 2010 and is now 4%, a level that is indicative of a relatively tight jobs market. Inflation remains stubborn but has eased considerably in each of the last two years, falling from a high of 9.1% in 2022 to 3% as of June this year.

We believe that the S&P 1500 today at its current level is vulnerable to bad news, whether it comes in the form of disappointing earnings from certain market darlings at some point or from other factors that could subject the index to multiple contraction.

One path forward in our opinion is to use truly active management. With the freedom and flexibility to own companies at more reasonable valuations and to weight them in a different manner than unmanaged indexes, we believe an actively managed portfolio may hold an advantage over the S&P 1500 portfolio as it is currently structured.

The S&P 1500's valuation today is 22.3 times earnings, which may not be excessive per se, but nor is it cheap. Hence despite the fact that the S&P 1500 is often viewed as a broad proxy for U.S. stocks, it is narrower than usual given the size disparities between the largest companies and the rest of the index. The very largest companies now surpass $3 trillion in total market capitalization, and dwarf the average or median market cap of the index as a whole. In short, the size-based rules of the index's constitution have created vast distortions which introduces a degree of valuation and concentration risk that we have not witnessed since the height of the technology and telecom bubble of the late 1990s.

There is no need to own a market index exclusively. Active management, if approached truly independently from index constitution and structure, may offer ways to plot a different course from the benchmark. In our view, investors should exercise thoughtfulness and prudence in terms of what holdings they select and how an overall portfolio is shaped and structured. ■

Portfolio Review:
Investing on the Merits

Davis Opportunity Fund reflects a very deliberate, research-driven and selective investment process that we have practiced since our Firm's founding in 1969.

The following statistics highlight the differences between our actively managed portfolio and the S&P 1500:

Selective, Attractive Growth, Undervalued[1]

	Fund	Index
Holdings	42	1,506
EPS Growth (5 Year)	16.3%	17.1%
P/E (Forward)	12.7x	22.3x

Presently, Davis Opportunity Fund is allocated such that its largest sector weightings include healthcare, technology-related businesses, industrials, and financials.

Healthcare: Underpriced Potential

Healthcare is a meaningful allocation in the portfolio. In this sector, we hold: Quest Diagnostics, an independent laboratory and diagnostics service provider; managed care insurers Humana, Cigna Health and UnitedHealth; and Viatris, a manufacturer of generic pharmaceuticals. Recently, we also purchased Solventum, a spin-off from 3M that specializes in healthcare supplies primarily.

The opportunity to own such businesses at what we deem attractive prices is based on our expectation that near-term headwinds suppressing growth in their top- and bottom-line results may abate in the foreseeable future. Meanwhile, market pricing seems to suggest a permanence to what have been tepid earnings and compressed margins in recent periods. We are taking the long view and believe the market is underpricing their multiyear potential.

Technology: Growing Ecosystems

Our technology-related investments rather surgically target companies in very large, still fast-growing ecosystems, including e-commerce, cloud computing, social media, online search and the semiconductor complex. To the extent possible, given our valuation parameters and constraints, we have sought to own leaders in their respective fields but at what we believe represent justifiable valuations. In instances where we cannot justify the valuations of certain market darlings, those have been omitted from our portfolio. Amazon.com,

1. Five-year EPS Growth Rate (5-year EPS) is the average annualized earnings per share growth for a company over the past 5 years. The values shown are the weighted average of the 5-year EPS of the stocks in the Fund or Index. Approximately 7.73% of the assets of the Fund are not accounted for in the calculation of 5-year EPS as relevant information on certain companies is not available to the Fund's data provider. Forward Price/Earnings (Forward P/E) Ratio is a stock's price at the date indicated divided by the company's forecasted earnings for the following 12 months based on estimates provided by the Fund's data provider. These values for both the Fund and the Index are the weighted average of the stocks in the portfolio or Index.

a dominant leader in e-commerce both at home and abroad, is the type of business we favor. In our estimation, the company has strong, clear-minded management, rather unique competitive advantages and powerful financial features. It is one of the more expensive holdings in the portfolio but on an adjusted basis still trades at a reasonable multiple of owner earnings, according to our models. Other technology-related investments within technology include Alphabet, Applied Materials and Intel Corp.

Industrials: Compounding Machines

Within the industrials segment of the portfolio we hold businesses that specialize in industrial automation (Johnson Controls), agricultural machinery and soil testing (AGCO), and biofuel products, among others. Darling Ingredients, which essentially repurposes bio waste into fuel, is representative of the industrial businesses we favor. These are mundane but highly durable businesses, in our estimation, that may be unexciting to describe but are nonetheless very exciting investment ideas for our team given their wide moats and collective earnings power.

Recently, we sold our position in Ferguson plc to allocate more capital to other investment opportunities we have identified.

Financials: Diversified Earnings Power

Within financials, our largest position is Berkshire Hathaway—what we refer to as a "non-financial financial." It is effectively a hybrid between financial services business lines and other, non-financial businesses. The company's economic interests include railroads, utilities, retail, chartered jets and others, in addition to property casualty insurance and reinsurance. All of those business activities reside under the same corporate umbrella and produce combined annual net income of more than $96 billion today on a $1 trillion market cap. It is fairly rare to see a business model that effectively combines under one roof the cash flows produced from so many different industry sources. One could make the argument that this company's earnings may be "internally diversified" to a larger extent than a pure-play, monoline business.

Among more traditional financials, we hold one of the largest lenders in the U.S., Wells Fargo, which has more than $1 trillion in total assets. We have been extremely discerning and selective within this sector and, as such, avoided the banks that failed in the recent regional bank crisis. Our decision to steer clear of those institutions stemmed from their apparent mismatches in assets and liabilities which we regard as a risk for any lender beyond certain reasonable limits.

Lastly, we hold Capital One Financial, a consumer finance leader with a strong market position in credit cards, in particular.

Overall, the financials we hold today are among our best and highest-conviction ideas in a sector that for a long time has offered appealing business choices trading at very attractive prices in general.

Other investments in the portfolio include businesses engaged primarily in copper production (Teck Resources), among other industries. ■

Outlook:
Valuation Discipline

The stock market is in fact a large market of many individual stocks. Our goal is to build wealth for our investors and ideally to add value above and beyond market indexes over the long term. As such, we are utilizing our in-house research insights and flexibility to construct a portfolio that in our minds has a more favorable profile than the S&P 1500 based on selectivity, valuation discipline and demonstrated earnings growth.

In conclusion, as stewards of our clients' savings our most important job is growing the value of the funds entrusted to us. With more than $2 billion of our own money invested alongside that of our clients, we are on this journey together.[2] This alignment with our clients is uncommon in our industry; our conviction in our portfolio of carefully selected companies is more than just words. ■

2. As of 6/30/24 Davis Advisors, the Davis family and Foundation, our employees, and Fund directors have more than $2 billion invested alongside clients in similarly managed accounts and strategies.

This material 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 material 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 material. 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. The investment objective of Davis Opportunity Fund 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 6/30/24, the Fund had approximately 17.6% 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 $18 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 $18 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 involve higher expenses and 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 6/30/24, the top ten holdings of Davis Opportunity Fund were: Capital One Financial, 5.93%; Quest Diagnostics, 5.77%; Viatris, 5.28%; Wells Fargo, 5.19%; Humana, 4.99%; Teck Resources, 4.93%; Cigna Group, 4.58%; Owens Corning, 4.32%; UnitedHealth Group, 3.63%; and Schneider Electric, 3.57%.

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 Statement of Additional Information. Holding percentages are subject to change. Visit davisfunds.com or call 800-279-0279 for the most current public portfolio holdings information.

The ranges reflected for large, mid, and small cap in this document reflect the current ranges utilized by the S&P Composite 1500 Market Cap Guidelines, as may be amended from time to time. The current ranges are reflected here: https://press.spglobal.com/2024-04-01-S-P-Dow-Jones-Indices-Announces-Update-to-S-P-Composite-1500-Market-Cap-Guidelines.

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 includes all stocks in the S&P 500, S&P MidCap 400, and S&P SmallCap 600. This index covers approximately 90% of U.S. market capitalization. Investments cannot be made directly in an index.

After 10/31/24, this material must be accompanied by a supplement containing performance data for the most recent quarter end.

Davis Distributors, LLC
2949 East Elvira Road, Suite 101, Tucson, AZ 85756
800-279-0279, davisfunds.com

Item #4420 6/24