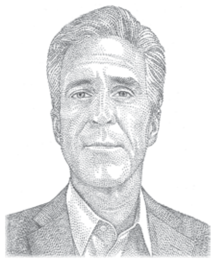

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Update from Portfolio Managers

Andrew A. Davis and Chandler Spears

Davis Real Estate Fund

Annual Review 2024

Key Takeaways

- In 2023 Davis Real Estate Fund returned 10.46% compared to 16.19% for the Wilshire U.S. Real Estate Securities Index.
- The fund is currently navigating a period of underperformance due to our out-of-consensus stance on the future of office demand. We are often early to take advantage when market valuations unmoor from probable outcomes, and we believe this nuanced contrarian call will make a meaningful contribution to performance over time.
- As we enter 2024 the fund maintains its asymmetric barbell strategy, with an overweight tilt in steadily growing sectors where valuations are reasonable relative to growth, and smaller though meaningful investments in sectors where we think valuations are simply too depressed.

Davis Real Estate Fund's Class A shares provided a total return on net asset value of 10.46% for the 12 months ended December 31, 2023. Over the same time period, the Wilshire U.S. Real Estate Securities Index returned 16.19%. During the most recent one-, five- and ten-year periods, a $10,000 investment in Davis Real Estate Fund would have returned $11,046, $13,339 and $19,648, respectively. ■

The average annual total returns for Davis Real Estate Fund's Class A shares for periods ending December 31, 2023, including a maximum 4.75% sales charge, are: 1 year, 5.21%; 5 years, 4.91%; and 10 years, 6.47%. 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. For most recent month-end performance, visit davisfunds.com or call 800-279-0279. Current performance may be lower or higher than the performance quoted. The total annual operating expense ratio for Class A shares as of the most recent prospectus was 0.95%. The total annual operating expense ratio may vary in future years. Returns and expenses for other classes of shares will vary.*

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. All fund performance discussed within this material refers to Class A shares without a sales charge and are as of 12/31/23 unless otherwise noted. This is not a recommendation to buy, sell or hold any specific security. **Past performance is not a guarantee of future results. There is no guarantee that the Fund performance will be positive as equity markets are volatile and an investor may lose money.**

Performance: Challenging Common Assumptions

Current fund management has been at the helm of Davis Real Estate Fund since August of 2002. As we lap our twenty-third year together we marvel at how much has changed in the world of publicly traded real estate securities. Equally striking is what hasn't changed. Real estate investing is inherently a long-term proposition. And while stock prices follow a varied path based on changing expectations, it often seems that real estate possesses a temporal dynamism it simply doesn't have.

The reality is that planning, permitting, constructing and leasing any sort of building is a multiyear process. Some of the most successful commercial real estate developments have been decades in the making. During a year when the fund has performed below expectations, we remind ourselves we are in this for the long haul.

The investment world is intently focused on performance periods that we consider too short. It's not that annual performance doesn't matter. Events can indeed instantly change the outlook for an investment, necessitating some sort of reaction. However, our underwriting takes a much longer-dated approach meaning that over periods of time, sometimes long periods of time, our performance can appear to be out-of-sync with market sentiment. The reason is that we are often early in taking advantage of market fears that unmoor valuation from probable future outcomes. In 2001 we challenged the assumption that the 9/11 attacks would materially impact travel when we made a significant investment in Starwood Hotels & Resorts. Likewise, when many believed that bricks-and-mortar retail would crumble beneath the heft of Amazon's e-commerce push, we selectively invested in retail property. In both cases the Davis Real Estate Fund endured a protracted period of underperformance, but was eventually vindicated by subsequent outperformance.

"Near-daily reports of office's demise gave the appearance that all office space was destined for the waste bin. Without repeating too much of what we have written in the past, we take exception to that position."

The fund is currently navigating a similar period of underperformance given our stance on the future of office demand, among other reasons we will discuss below. In late 2022 we began accumulating positions in certain office REITs using proceeds from the sale of those sectors that had significantly outperformed over the past several years, particularly industrial REITs. The false dawn that office REITs experienced in 2021 had been quickly clouded by the reality that return-to-office (RTO) efforts would be much slower than hoped. More importantly, employer positions on in-office requirements kept shifting as they walked a fine line between satisfying employee preferences and encouraging robust social interaction that most believe is necessary in high-performing businesses. The struggle quickly became the well of eternal life for news reporters of all stripes. Near-daily reports of office's demise gave the appearance that all office space was destined for the waste bin. Without repeating too much of what we have written in the past, we take exception to that position. Unfortunately, for 2023 we have nothing to show for our contrarian stance, but believe that will eventually change.

Though they are not individually large positions, American Tower and Crown Castle Inc., tower infrastructure REITs, hampered the fund's performance relative to our benchmark. From a fundamental perspective both companies had to deal with slowing growth and a coincident spike in their cost of capital, courtesy of the Federal Reserve's unprecedented tightening regime. These factors met head-on with relatively high valuations which, if history is any guide, result in a poor environment for any REIT.

The good news is that the fund has small relative positions in both American Tower and Crown Castle for the very reason that valuation did not provide sufficient cushion against the risks posed by slowing growth and escalating capital costs. The bad news is that not a single tower REIT is included in the fund's benchmark. To use industry parlance, investing outside one's benchmark is considered pure alpha investing. Without getting into the weeds on what that means, the result is that small investments of this sort can materially swing relative performance one way or the other. In 2023 the tower REITs worked against us.

It is important to recognize, however, that we are not cavalier about managing your/our wealth (after all, we are also shareholders in the fund). The tower infrastructure REITs are very widely held among U.S. real estate funds and are included in most other benchmarks used by those funds. That's not surprising given that American Tower is the second largest REIT in the U.S. after Prologis, and Crown Castle is the sixth. That the tower companies are operating in a business which has proven itself durable and supported by long-term structural tailwinds only adds to their attractiveness. Including them in the fund, appropriately sized, is prudent investment management as we see things. In fact, on a relative basis, tower REITs are now looking more attractive than they have in a few years. More on that in a bit.

On the positive side of the ledger we had considerable success with our residential holdings. These include investments in coastal REITs AvalonBay Communities and Essex Property Trust. Both companies represented compelling value relative to Sunbelt-focused apartment REITs in 2020/21 as investors crowded into a migration trend that worked against large coastal cities. That trend got overplayed and we considered a boomerang inevitable as employers began to mandate a return to office, even if only for a couple of days per week. (This is consistent with our thoughts on the cadence of office demand.) The boomerang that we foresaw indeed came to pass in 2023 as many longed for the vibrancy of urban locations or areas within easy commute of coastal employment centers. Both AvalonBay and Essex saw improving performance and, because they were at a relative discount coming into the year, performed quite well during the year.

"When pundits talk about data center fundamentals, they often overlook details that fully explain what is actually happening. For us, there are two primary sources of data center demand."

In absolute terms, the fund's data center investments did well too. When pundits talk about data center fundamentals, they often overlook details that fully explain what is actually happening. For us, there are two primary sources of data center demand. First, there is demand for interconnection. In simple terms, this means the private exchange of data between two businesses. Data centers that fulfill this need have unique characteristics such as robust connectivity systems, global reach, and proximity that significantly reduces latency. Demand here has been very strong for a long time and there is little reason to believe there will be material slowing over any reasonable timeframe. This is the business of Equinix whose stock performance over the past several years has mirrored the massive growth in interconnection demand.

The other source of data center demand is wholesale space needed for power and cooling. In these buildings demand is driven by computing needs with lower latency requirements. To put it in a current-day context, it is in these properties that you'll find artificial intelligence (AI) training applications, whereas inferencing applications are most often found in interconnection facilities. Notwithstanding the promise of AI, demand for wholesale space has proven volatile. It's not that it hasn't been good. For the most part wholesale data centers have maintained full occupancy. The governing factor has been supply which until recently has been delivered consistently, muting rent growth.

What has changed in recent months is power availability. Even though many data center projects are shovel-ready, there is insufficient power available. In northern Virginia, the largest data center market in the world by a factor of three times, the power spigot has literally been turned off. No development will be allocated rights to new power until at least 2026. And northern Virginia is not unique. Other large data center markets have similar issues. This means that Digital Realty, a data center company in the fund's portfolio, is benefiting from fewer development deliveries in its markets. That leaves tenants with few if any alternatives when looking at renewal options, and swings negotiating power to the landlords.

Digital Realty, with most of its revenue coming from wholesale space leasing, started to realize good topline revenue growth during 2023. In fact, Digital Realty's free cash flow growth would have been impressive had it been possible to avoid the impact of the rising cost of debt on Digital's higher-than-average leverage. We are only at the beginning of the AI revolution and recent regulatory constraints on power availability are setting the stage for promising rent growth for both interconnection and wholesale space. This fact has not been missed by investors if Digital Realty's 2023 stock price performance is any indication. ■

Positioning: Underwriting Credit Risk

If press reports are to be believed there are plenty of reasons to ignore commercial real estate. Office demand is suffering, the supply of new apartments is set to reach unprecedented levels during 2024, and interest rates are higher than they've been since the Great Financial Crisis. As we think about positioning for 2024 and beyond, we return to something we discussed earlier. Real estate is inherently a long-term investment proposition, and tackling it with a value bias means accepting extended periods where building positions can appear difficult. So how do we invest for the long term without exposing our shareholders (including ourselves) to excess risk?

The answer lies in doing things the way we always have, though with a couple of tactical changes. Given the capital-intensive nature of commercial real estate, underwriting credit risk has become mission critical. It has always been a hallmark of what we do, but if we had to point to any one area of our research as being the most important right now, it is credit risk.

Focusing our research on credit risk involves a twofold approach. First, we satisfy ourselves that a fund holding has the financial wherewithal to withstand the vast majority of possible future outcomes. That means having sufficient liquidity and resources to meet all lending obligations for the next several years. Second, we do our best to underwrite tenancy risk. After all, even a debt-free real estate company will fail if all its tenants fail. From there it is a matter of being thoughtful about assessing the potential for earnings growth. For some sectors this is a relatively straightforward exercise. For example, we believe industrial REITs are sure to continue growing earnings even if market rents decline over the next couple of years. For other sectors, particularly office, the analysis has to accommodate a much wider distribution of possible outcomes. Some of those scenarios include situations where occupancy and rents decline for years.

Reasonable (and Unreasonable) Valuations

Consequently, the fund maintains an asymmetric barbell position as it enters 2024, much as it has since late-2022. We are striking an overweight tilt in steadily growing sectors where valuations are reasonable relative to growth while also making smaller though meaningful investments in a few companies in sectors where we think valuations are simply too depressed. To continue with the latter, we've been on record that we believe in the future of office demand as it mutates and transforms along with societal changes.

Cousins Properties is the fund's largest overweight in the conventional office sector, if there is still such a thing. By this we mean that the office of the future, in our view, will start to inherit attributes of other properties, notably residential, retail and hotel. Based on our research, including discussions with multiple brokers in many U.S. cities, the office buildings that are most in demand are those that help employers build a desire among their employees to be in the office. That doesn't necessarily mean a full week, though some companies do mandate a full week in-office. The investment case we make is the leasing getting done (mostly renewal at the moment) consolidates into the best buildings, primarily those with a sense of place.

That is exactly what we are seeing with Cousins Properties. Cousins has been able to grow occupancy through 2023 and at rates higher than passing rents. Tenants seem to prefer the company's updated, amenity-laden properties over other options in the market. This is a dynamic that we believe will play out with all the fund's office holdings. Lest you think we are over our skis, the fund is overweight in Cousins and a few others in the office sector but, at just over 19% of AUM, the office sector is clearly situated at the smaller end of the barbell. Even so, if our out-of-consensus call on office proves correct, it will make a meaningful contribution to the fund's performance over the next couple of years.

"We have also slowly been adding to positions in the tower infrastructure sector … these out-of-benchmark names did us no favors during 2023, but now have relative and absolute valuations that are much more to our liking."

The larger side of the barbell (that is, 81%), which is really everything other than office, includes businesses we have long championed as best of breed. The fund maintains significant investments in selected industrial REITs and coastal apartment REITs that operate in markets where near-term supply is going to be less burdensome. As noted earlier these out-of-benchmark names did us no favors during 2023, but now have relative and absolute valuations that are much more to our liking. Also, in the final quarter of 2023, we began slowly adding to positions in the tower infrastructure sector, particularly American Tower.

We have considerable faith in the shopping center sector as well, and that continues to be a sizable weighting in the fund. Consumption patterns changed during the pandemic. The convenience offered by various forms of order online and pick up in store has proven quite durable, but with pandemic restrictions now a thing of the past, shopping centers are more popular than ever. New supply has been virtually nonexistent for almost a decade, which provides additional support to fundamentals. Results from the shopping center REITs we monitor have been impressive in their consistency, even though the market largely ignored the sector during 2023. While growth rates certainly don't match those of blessed sectors like industrial, discounted valuations mean that we can buy growth at a very reasonable price. Brixmor Property Group and Regency Centers Corporation remain the fund's favorite shopping center investments.

It is worth adding a quick comment on a few areas where we are less enthusiastic. Despite considerable recovery in senior housing fundamentals and the prospect that 2024 could be just as good, certain health care REITs are trading at lofty valuations. The same can be said for the self-storage sector, which benefited tremendously from migration trends during and immediately following the pandemic. Our detailed research shows that some of the performance gained in those sectors had more to do with avoiding other areas of the property market that are more sensitive to interest rates, notably the office sector and any company with higher than average leverage. With the market now expecting a more accommodative Federal Reserve, we are concerned that some of the "fear" premium factored into health care and similar sectors may begin to unwind. To be clear, the fund is invested in several companies in those sectors and benefited this year as a result, but our current underweight stance is likely to persist until relative valuations narrow.

Pushing Against the Negative Narrative

Normally we would wrap up our thoughts here, but we would like to address the "doom speak" surrounding commercial real estate generally. It is hard to counter arguments that rising rates are bad for commercial real estate. Even with the best match funding there are almost always timing differences between changes in the cost of debt and the resetting of asset values or rents. That the Federal Reserve over the past year has pursued financial tightening at unprecedented speed makes it all the more painful for commercial real estate companies, especially those with a poorly structured capital stack.

The good news is that this doesn't apply to the vast majority of publicly traded real estate companies. Even though most have seen their cost of financing increase, maturities are generally well-laddered and refinancing is happening, albeit at higher rates and often with re-margin requirements. The more subtle, important consequence of tighter financial conditions is that it ends a decade of profligate lending. It has been too easy for too long to borrow money. Tighter financial conditions will hasten the demise of some commercial property, but publicly traded real estate will likely benefit.

As we have always done, we carefully monitored lending in 2023 and we are certain that it is going to be highly selective in the future. Over what duration we don't know exactly, but it will be counted in years, not months. This could have several effects. First, lenders are likely to be very particular about borrowers with whom they do business. Most public real estate companies should be favored at the expense of many private real estate entities with challenged balance sheets. Second, we believe lenders would prefer assets to remain in the hands of owners whenever possible. Getting the keys back puts lenders in the position of having to actually operate a property, likely one that needs capital, and that is definitely not the lenders' preferred business. Third, we expect lending on speculative development to all but evaporate. Merchant developers need not apply and even the most well-heeled developers will likely receive deafening silence absent substantial pre-leasing. It is this last point that is most exciting to us. Constrained development lending is laying the groundwork for a massive reduction in supply. Based on our research this could result in market rent recovery for almost all property sectors, even the most beleaguered.

Our long-term optimism should not give the impression we believe waters will be calm. There are considerable risks facing commercial real estate as well as the general economy, and our political system is facing several existential crises. The path forward will be choppy with plenty of individual property failures likely to inflame the debate. We believe that the public real estate model, REITs in particular, has proven itself and care should be taken not to reflexively conflate every instance of property failure with the viability of public real estate companies. To our eye, public real estate companies will end up the long-term winners and the fund's investments in them will prove to be fruitful.

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.[1] This alignment with our clients is uncommon in our industry; our conviction in our portfolio of carefully selected companies is more than just words. While we do not welcome the pessimism that has characterized markets recently, we are prepared for it, and importantly, we are well-positioned for the future. ■

1. As of 12/32/23, 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 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.

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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 Real Estate Fund is total return through a combination of growth and income. 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; **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; **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; **fees and expenses risk:** the Fund may not earn enough through income and capital appreciation to offset the operating expenses of the Fund; **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; 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.

The information provided in this material should not be considered a recommendation to buy, sell or hold any particular security. As of 12/31/23, the top ten holdings of Davis Real Estate Fund were: Prologis, 6.82%; Alexandria Real Estate, 4.97%; Cousins Properties, 4.60%; Brixmor Property Group, 4.59%; Simon Property Group, 4.47%; Public Storage, 4.43%; Ventas, 4.11%; Equinix, 3.98%; Digital Realty Trust, 3.86%; and Essex Property Trust, 3.81%.

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.

We gather our index data from a combination of reputable sources, including, but not limited to, Lipper, Wilshire, 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 1/1/78, 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 4/30/24, this material must be accompanied by a supplement containing performance data for the most recent quarter end.

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