Active May Be Poised to Outperform

A Google search for “the death of active management” produces 1.8 million results. With more than $1 trillion flowing into passive funds and ETFs and $1.1 trillion removed from active managers over the last decade, the tide of investors shifting from active to passive investment strategies has become a tsunami.¹ This wave has been driven by the widespread acceptance of data showing the S&P 500 Index has outperformed the average active manager over the long term. While the data itself is true, we believe the results are misleading in three important ways.

First, active and passive strategies have historically moved in a cycle. During parts of this cycle such as in the last decade or so, passive strategies have tended to outperform active management. However, during other parts of the cycle, even average active managers outperform the index. For example, the chart below tracks the percentage of large cap active managers that outperformed the S&P 500 Index over five-year time periods since 1975. The gold circles represent inflection points where the number of active managers outperforming the market began to increase. If the cycle were to continue, this may point to potential wisdom of moving toward active management.
Active and Passive Outperform in Different Environments

While active managers have historically tended to underperform when the S&P 500 Index has galloped ahead, they have tended to outperform when market returns moderate. In the chart below, each black dot represents a period in which the average manager outperformed the index, while each gold dot represents a period in which the index outperformed. As is clearly shown, the lower the market return, the more active managers outperform.
Funds with Low Fees and High Ownership Outperform the Index

Finally, certain active funds including Davis New York Venture Fund have outperformed in the vast majority of rolling 10 year periods. As a result, while the data shows the average active manager has underperformed, investors need not choose an average manager. In fact, data suggests active managers with certain identifiable characteristics such as low fees, low turnover, proper incentives, an experienced team, and a differentiated portfolio have historically been more likely to outperform both the index and the average active manager. For example, the chart below shows managers with low fees and a high investment in their own funds have outperformed in 89% of all rolling 10 year periods.

Putting these thoughts together, we believe the headwinds active managers have faced in recent years could well become tailwinds in the years ahead. If so, this would not be the first time the herd mentality proved wrong. After all, not so long ago everyone was buying residential real estate based on the then true but ultimately misleading fact single family real estate prices had never declined nationwide.
Davis Funds

We are further encouraged by data indicating identifiable factors such as relatively low expenses, alignment of interest and a willingness to look different from other investment managers, all of which are central to our firm’s investment culture, have historically been durable hallmarks of long-term outperformance. Because these characteristics are shared by all five of the equity strategies managed by our firm, investors should not be surprised that in addition to Davis New York Venture Fund, all of our other equity strategies, including Davis International Fund, Davis Global Fund, Davis Financial Fund, and Davis Opportunity Fund have outperformed their peer category since their inception.⁶

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<th>Outperformed Lipper Peer Category³ (Since Inception)</th>
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This report is authorized for use by existing shareholders. A current Davis Funds prospectus must accompany or precede this material if it is distributed to prospective shareholders. You should carefully consider the Fund’s investment objective, risks, fees, and expenses before investing. Read the prospectus carefully before you invest or send money.


1. Source: Morningstar. Chart plots median actively managed large-cap funds, with manager tenure of greater than 10 years (portfolio manager), annualized three-year rolling returns (with a quarterly frequency) over the 20-year period ending 3/31/16 against the S&P 500 Index returns. Black plot points indicate periods of outperformance and gold plot points represent underperformance. The distance of the points from the diagonal line indicates the degree of over- or underperformance. The fund category used is the Morningstar large-cap fund universe, including, growth, value and blend categories. Performance is net of fees. Past performance is not a guarantee of future results. 2. Since 12/31/78. Class A shares without a sales charge. Past performance is not a guarantee of future results. 5. Source: Capital Group, based on Morningstar data. Based on monthly rolling periods from January 1997 to December 2016. Funds in the “Average Fund” group are those U.S. domestic equity funds in the Morningstar Large Value, Large Blend and Large Growth categories. “Funds with Low Fees and High Ownership” group are those U.S. domestic equity funds in the Morningstar Large Value, Large Blend and Large Growth categories filtered for the quarter with the lowest net expense ratios (NER) and the quartile with the highest manager ownership. U.S. index is S&P 500 Index. The index is unmanaged and, therefore, has no expenses. Investors cannot invest directly in an index. For live funds, only the oldest share class was used. For dead funds with multiple share classes, the median monthly returns were used. Past performance is not a guarantee of future results. 6. Class A shares without a sales charge. 7. As of 6/30/19. Class A shares without a sales charge. Figures will vary in future periods. Lipper Peer Category data is compiled using Lipper, as of 6/30/19. The Lipper Peer Category respectively for each fund are: Davis New York Venture Fund: Large Cap Core; Davis International Fund: International Multi-Cap Growth; Davis Financial Fund: Financial Services; and Davis Opportunity Fund: Multi-Cap Core. Index and Lipper Peer Category average returns are based on the Funds’ inception dates except for Large Cap Core, which is based on 2/28/69. Inception dates for the Funds are: Davis New York Venture Fund: 2/17/69; Davis International Fund: 12/29/06; Davis Global Fund: 12/22/04; Davis Financial Fund: 5/1/19; and Davis Opportunity Fund: 12/1/94. 8. Portfolio is constructed from the bottom up, on a company by company basis, and is not designed to mirror an index. 9. See endnotes for expense ratios. 10. Includes Davis Advisors, the Davis family, our employees, Foundation, and Fund directors. As of 6/30/19.

The investment objective of Davis New York Venture Fund, Davis International Fund, Davis Global Fund, Davis Financial Fund, and Davis Opportunity Fund is long-term growth of capital. There can be no assurance that a Fund will achieve its objective. Some important risks of investments in Davis New York Venture Fund are stock market risk, manager risk, financial services risk, and foreign country risk. Some important risks of investments in Davis International Fund and Davis Global Fund are stock market risk, manager risk, foreign country risk, and emerging market risk. Some important risks of investments in Davis Financial Fund are stock market risk, manager risk, focused portfolio risk, and financial services risk. Some important risks of investments in Davis Opportunity Fund are stock market risk, manager risk, large-capitalization companies risk, and mid- and small-capitalization companies risk. As of 6/30/19, Davis New York Venture Fund, Davis Financial Fund, and Davis Opportunity Fund had approximately 24.6%, 17.6% and 24.9% of assets invested in foreign securities, respectively. As of 6/30/19, Davis International Fund and Davis Global Fund had approximately 60.0% and 44.7% of assets invested in emerging markets, respectively.

Risks: 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; credit risk: the inability of the issuer of a security (potentially even the U.S. Government) may be unable to make timely payments of interest and principal; depositary receipts risk: depositary receipts involve higher expenses and may trade at a discount (or premium) to the underlying security; emerging market risk: securities in 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; financial services risk: investing a significant portion of assets in the financial services sector may cause the Fund to be more sensitive to problems affecting financial companies; 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; foreign country risk: foreign companies may be subject to greater risk as foreign economies may not be as strong or diversified; 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; 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; interest rate sensitivity risk: interest rates may have a powerful influence on the earnings of financial institutions; 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; stock market risk: stock markets have periods of rising prices and periods of falling prices, including sharp declines. See the prospectus for a complete description of the principal risks.

Large-Cap Core funds invest at least 75% of their equity assets in companies with market capitalizations (on a three-year weighted basis) above Lipper’s USDE large-cap floor. Large-cap core funds have more latitude in the companies in which they invest. These funds typically have an average characteristics compared to the S&P 500 Index. International Multi-Cap Growth funds invest in a variety of market capitalization ranges without concentrating 75% of their equity assets in any one market capitalization range over an extended period of time. International multi-cap growth funds typically have above-average characteristics compared to the MSCI EAFE Index. Global Multi-Cap Growth funds invest in a variety of market capitalization ranges without concentrating 75% of their equity assets in any one market capitalization range over an extended period of time. Global multi-cap growth funds typically have above-average characteristics compared to the MSCI World Index. Financial Service funds invest primarily in equity securities of domestic companies engaged in providing financial services, including but not limited to, banks, finance companies, insurance companies, and securities/brokerage firms. Multi-Cap Core funds invest in a variety of market capitalization ranges without concentrating 75% of their equity assets in any one market capitalization range over an extended period of time. Multi-Cap Core funds typically have average characteristics compared to the S&P SuperComposite 1500 Index. Davis International Fund and Davis Global Fund are subject to a 2% short-term redemption fee for shares held for fewer than 30 days.

The net expense ratio for Class A shares of each fund vs. its respective peer is: Davis New York Venture Fund: 0.88% vs. 0.91%; Davis International Fund: 1.04% vs. 1.12%; Davis Global Fund: 0.96% vs. 1.20%; Davis Financial Fund: 0.94% vs. 1.52%; Davis Opportunity Fund: 0.94% vs. 1.01%.

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 MSCI ACWI (All Country World Index) ex US is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of developed and emerging markets, excluding the United States. The index includes reinvestment of dividends, net of foreign withholding taxes. The MSCI ACWI (All Country World Index) is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of developed and emerging markets throughout the world. The index includes reinvestment of dividends, net foreign withholding taxes. The S&P 1500 Index is comprised of the S&P 500, MidCap 400, and SmallCap 600, which together represent approximately 90% of the U.S. equity market. Investments cannot be made directly in an index.

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.