Investing in International Equities

Long-Term Trends, Advantages of Active Management and Themes Driving Returns

Summary

- International stocks look attractive today based on valuation and growth metrics, potentially positioning this asset class to, in our opinion, generate more competitive returns in the decade ahead than in the past decade.[1]
- Actively managed investment strategies have outperformed passive approaches in international equities: The majority of actively managed international stock funds have beaten the MSCI ACWI (All Country World Index) ex US over the five and 10 year trailing periods.[2]
- A willingness to look different from the index is a key requirement for outperforming the benchmark over the long term.
- Long-term secular themes include the rise of online consumers worldwide, the expansion of global transportation and the boom in global education.

Why International Equities?

Investing Around the World to Take Advantage of Long-Term Global Trends

We believe international equities should be a natural and perennial part of a broadly diversified portfolio.[3] The U.S. and international markets are not perfectly correlated and tend to move in different performance cycles, with each offering diversification benefits while also presenting ample opportunities to build wealth over the long term in our experience.

We also believe now is an appropriate time to revisit international equities as foreign markets have evolved and grown, far surpassing the United States in scale and offering a far greater number of investment opportunities. Today, approximately 95% of the world's population, nearly 76% of world gross domestic product (GDP) and 90% of all listed equity securities can be found outside the United States. Many of the best businesses in the world today are located outside the United States.

International equities are also attractive in terms of valuations, in our view. The forward price/earnings (P/E) ratio of the MSCI ACWI ex US stands at only 14.4 times earnings versus 20.0 times earnings for the S&P 500 Index, which translates into approximately 7% earnings yield at a time when interest rates around the world range from zero to 2% in major economies.[4] Meanwhile, earnings per share for international companies have grown an average of more than 10% over the last five years. While these are market averages, the figures support our view that many opportunities for compounding capital exist beyond U.S. borders today looking both at valuations and growth rates.

Foreign markets are considerably cheaper than the U.S. market in part because they have generally lagged the U.S. stock market in recovering from the 2008–2009 financial crisis. Since 2008 the S&P 500 Index has returned 9.1% per year on average while the MSCI ACWI ex US delivered annualized returns of only 1.9% over the same period.[2]

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.** Foreign investments, particularly those in emerging markets, involve greater risk than U.S. investments. Some of these risks are foreign country risk, currency risk, market risk, and emerging market risk. See endnotes for a complete description of these risks. **2.** As of 12/31/19. **Past performance is not a guarantee of future results. 3.** Diversification does not ensure against loss. **4.** The Forward P/E ratio is the Forward P/E ratios of the relevant index's holdings. The ratio is not a forecast of the relevant index's performance and is calculated for each security by dividing the current ending price of the stock by a forecast of its projected Earnings Per Share (EPS).

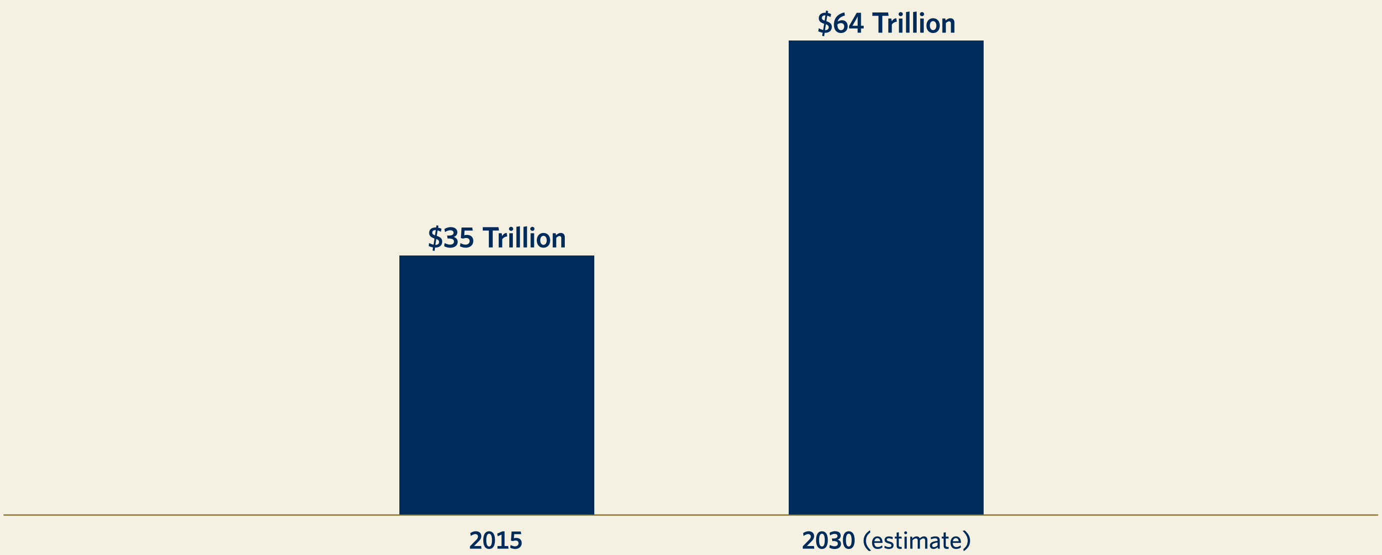
However, U.S. and international markets tend to move in cycles. This fact argues in favor of maintaining exposure to both U.S. and foreign stocks to provide a degree of diversification as well as different sources of returns.

The Emergence of a Global Middle Class

International markets are undergoing a massive and rapid transformation with the emergence of a truly global middle class whose numbers and spending power continue to surge. The global middle class is estimated to include more than two billion people who spend close to $35 trillion in aggregate annually. That population figure is on track to reach 5.4 billion people by 2030 with middle class spending expected to surpass $64 trillion by that time. Much of this growth is occurring in very large and fast-growing emerging markets such as China and India, but also in many other regions as well.[5]

In other words, international investors should not only benefit from enormous opportunities today, but also from the projected growth of their investable universe and the trend in global consumer spending, which in our view should continue to expand substantially in the coming decade.

Global Middle Class Spending Growing[6]



Investors May Be Underweight International Equities Today

Last but not least, now may be an appropriate time for investors to revisit international allocations if their portfolios are underweighted in this important, diversifying asset class. This underweighting may not be solely based on conscious asset allocation decisions but rather result from the difference in relative returns for domestic and foreign stocks over an extended period of time. A portfolio that five years ago had a 60% U.S./40% international weighting in the stock portion of an investor's asset allocation would have a 69% U.S./31% international weighting today, all else being equal and assuming no rebalancing over the period in question. In terms of a recommended weighting for international stocks, nearly half of the world's equity market capitalization is represented by international companies and we believe investors with the appropriate time horizons and risk tolerances may consider that to be a logical starting point in their stock portfolios.

5. Source: *Organisation for Economic Cooperation and Development* (OECD), *The Emerging Middle Class in Developing Countries.* As of 1/10. **6.** Source: The Brookings Institute: Based on a one-time report. As of 2/17.

Active Beats Passive in International Equities

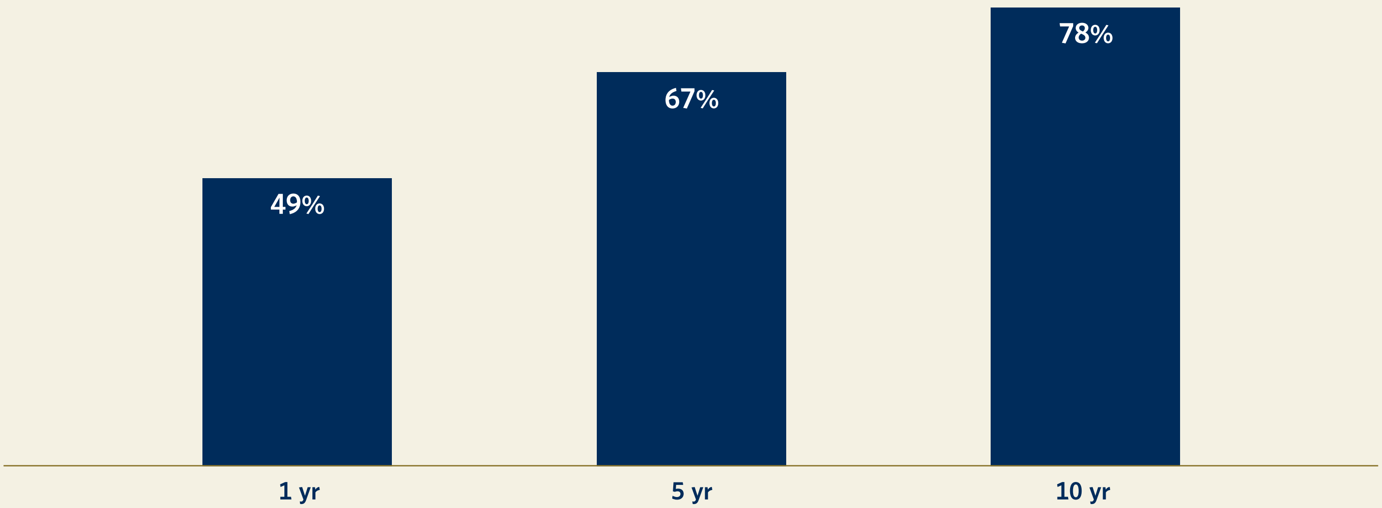
The majority of actively managed international funds have beaten their benchmark over the long term.[7]

In general, given a choice of whether to invest on an actively managed basis or employ a passive index approach for money allocated to foreign equities, historical data suggests active managers have the edge.[7]

In fact, a large majority of actively managed international funds have outperformed the MSCI ACWI ex US over the trailing five and especially 10 year periods even after adjusting for survivorship bias.[8]

Active managers can draw upon and build a number of key advantages over indexing into their investment process. Highlighted below are a number of advantages that have been critical to building our long-term track record in international equities.

Percent of Large Cap International Stock Fund Managers that Outperformed MSCI ACWI ex US[8]



First, *country selection* can add significant value relative to the index in international markets. These markets encompass almost 50 different countries and more than 2,000 different stocks, using the MSCI ACWI ex US as a proxy. The many countries that make up the index each possess particular attributes. These include different political systems, geopolitical risks, shareholder friendliness, liquidity, rule of law, quality of financial reporting, rigor behind listing requirements, and demographics, as well as different economic growth, interest rate and inflation trends. In other words, country selection is an important advantage available to active managers who seek to outperform not only through security selection but also in terms of the particular countries they choose for their portfolios.

Stock selection is arguably even more important than country selection. As previously noted more than 2,000 different companies are represented in the index. Clearly, there are nowhere near 2,000 superiorly positioned businesses in the world. In the worst instances, a large number of companies in the index are bloated, often debt laden, and highly inefficient state-run enterprises that are not managed for the benefit of minority shareholders. At the other end of the spectrum are independent, entrepreneurially run companies often managed by their founders who operate solely with the aim of creating shareholder value. Our job as active managers is to focus exclusively on exceptional and attractive businesses. We avoid subpar businesses, whether they are state-run enterprises or simply lacking financial strength, management quality and

7. As of 12/31/19. **Past performance is not a guarantee of future results. 8.** Source: Evestment as of 9/30/19 (ACWI ex US Large Cap Universe). Universe consists of managers categorized by Evestment as MSCI ACWI ex US based on holdings. Net of fees. 1 year = 96 managers; 5 year = 79 managers; and 10 year = 55 managers.

competitive position. We believe this focus is an important advantage of active management over passive management when investing in international equities.

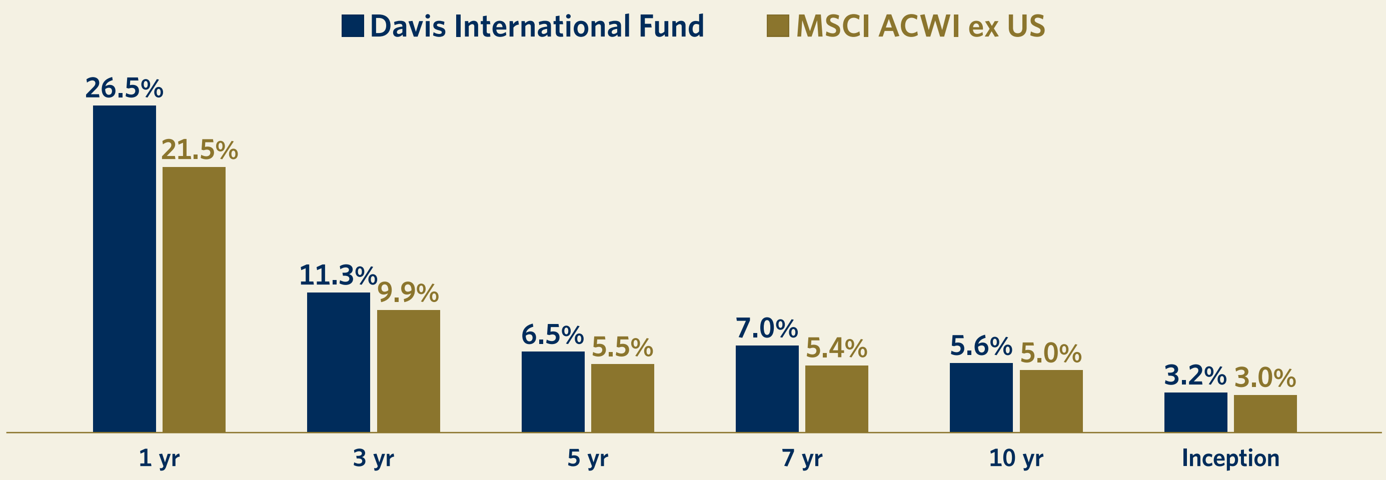
Portfolio construction is another area where active managers can make a difference. The index weights companies according to size with an average position size for each of the more than 2,000 securities in the MSCI ACWI ex US of only 0.04%, meaning even the good businesses in the index can only make a marginal difference in the return of the index. In contrast, we focus on companies in which we have a high degree of convictions so the Fund's average position size is closer to 2.7% (with our largest positions exceeding 5%). In other words, in addition to country and security selection, we have the ability and flexibility to establish larger positions in what we consider the best businesses in foreign markets, whereas the index is limited by its market cap-based weightings approach.

As a final point, the index by design follows a momentum-type strategy of allocating more capital to the largest businesses in the world, that is weighting its portfolio according to each company's market capitalization without considering whether each company is an attractive investment or not. To the extent size and momentum work in certain environments, indexing can perform well. However, size and momentum are not persistent conditions and are not always the main drivers of market performance internationally.

As the chart below shows, by applying a best ideas, all-cap, contrarian and opportunistic portfolio approach we have demonstrated our ability as an active portfolio manager to beat the index over various time periods.[9]

We are not the only actively managed international mutual fund that can claim this achievement. As noted earlier, the vast majority of actively managed international funds have beaten the benchmark on a fairly consistent basis over various time periods and over the long term.

Attractive Investment Results[10]



The average annual total returns for Davis International Fund's Class A shares for periods ending December 31, 2019, including a maximum 4.75% sales charge, are: 1 year, 20.53%; 5 years; 5.46%; and 10 years, 5.07%. 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 Fund is subject to a 2% short-term redemption fee for shares held for fewer than 30 days. The total annual operating expense ratio for Class A shares as of the most recent prospectus was 1.04%. 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. The Fund's performance benefited from an IPO purchase in 2014. After purchase, the IPO rapidly increased in value. Davis Advisors purchases shares intending to benefit from long-term growth of the underlying company; the rapid appreciation of the IPO was an unusual occurrence.*

9. The fact that our approach has been successful in the past does not guarantee that it will continue to be successful in the future. **10.** Class A shares without a sales charge. As of 12/31/19. **Past performance is not a guarantee of future results.** Inception date of the Fund is 12/29/06.

Three Investment Themes for Long-Term International Equity Investors

Rise of Online Consumers. Expansion of Global Transportation. Boom in Global Education.

Turning to the current market landscape, we are focusing much of our efforts on the following long-term secular themes: the growth of online consumers worldwide, the expansion of global transportation and the boom in global education. These themes generally describe large and growing profit opportunities for leading businesses that are attractive both on their own merits as well as because these companies should enjoy the benefits of multiyear spending tailwinds.

The first theme, the growth of online consumers worldwide, directly relates to the expansion of the global middle class and the growth in middle-class spending worldwide, reflecting a broad "wealth effect" in many parts of the globe. In short, consumers have greater financial ability to make purchases. Increasingly their purchase transactions are occurring on the internet. Global online purchases are growing at 17% per year yet currently account for only 7% of total retail sales worldwide. The number of internet users has doubled since 2010 to 3.5 billion and is growing 10% per year. Three-quarters of global online purchases occur outside the United States. These are powerful trends we expect to continue for many years to come.

The second theme to focus on in our view is the expansion of global transportation. With business and leisure travel on the rise, we believe certain companies including select airlines, aircraft parts manufacturers, logistics providers and ground transport service businesses such as ride-hailing companies are well positioned to benefit from this long-term secular trend.

Taking the aerospace industry as an indicator of the world's growing transportation needs, today there are approximately 24,000 commercial passenger and cargo aircraft around the world. That is hardly enough to meet today's growing demand for both business and leisure travel as well as logistical needs. The combined order backlog for planes from the two largest manufacturers of jets, Airbus and Boeing, is roughly 20,000 planes over the next five to 10 years, implying nearly a doubling of the existing passenger aircraft fleet over that time frame.[11] Indeed, Boeing has estimated that more than 40,000 planes may be needed by 2030. This figure most likely understates projected demand given that China and India are both ramping up their airline industries rapidly and on a very large scale. In India alone, the government has indicated a need to build at least 100 new airports by 2035 in order to transport as many as one billion people on a regular basis. Currently, India has only 450 passenger jets so just the Indian need for planes suggests the production capacity of original equipment manufacturers may be challenged to keep up with demand.

A third theme we are pursuing, particularly in developing Asia, is the theme of college preparatory and after-school education services. Higher education is an advantage in obtaining higher paying jobs and achieving higher standards of living in virtually any country. However, in Asia the competition for gaining admission to top universities is particularly fierce, making it far more difficult to obtain a place in a top university in China than it is in the United States.

The more developed Asian countries such as South Korea and Japan illustrate the long-term growth potential of this education theme. In South Korea 87% of students take advantage of after-school education services and in Japan that figure is 85%. In China, that percentage is currently only a fraction of those amounts. However, for-profit after-school education services are growing at a double-digit rate. We expect this will continue for years to come as those students either currently vying for or preparing to compete for limited spots at top universities now exceed 200 million students.

In brief, in addition to paying close attention to country selection, stock selection and how a portfolio is constructed, it can also be beneficial for active managers to focus on areas of the market where powerful long-term secular themes can help drive long-term returns.

11. 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.**

Conclusion

In our opinion, International stocks look attractive today based on valuation and growth metrics, positioning this asset class potentially to generate attractive returns in the decade ahead, both in absolute terms as well as relative to the past decade. Active managers have had the advantage in international equities based on historical industry performance data. In our case, the key to our success in international equities is our willingness to look different from the index and to make what we believe are intelligent choices regarding country and stock selection as well as portfolio construction decisions. We believe combining bottom-up research with an awareness of certain powerful long-term secular trends can be a highly effective approach for generating attractive long-term results.

At Davis Advisors, we seek to purchase durable businesses at value prices and hold them for the long term. We have more than $2 billion of our own money invested in Davis Strategies and Funds.[12]

12. Includes Davis Advisors, Davis family and Foundation, our employees, and Fund directors. As of 12/31/19.

This report is authorized for use by existing shareholders. A current Davis International 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 International 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: **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; **depositary receipts risk:** depositary receipts involve higher expenses and may trade at a discount (or premium) to the underlying security; **emerging market risk:** securities of issuers in emerging and developing markets may present risks not found in more mature markets. As of 12/31/19, the Fund had approximately 60.8% of assets invested in securities from emerging markets; **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; **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; **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; and **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.

The Fund is subject to a 2% short-term redemption fee for shares held for fewer than 30 days.

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 12/31/19, the top ten holdings of Davis International Fund were: New Oriental Education & Technology, 10.52%; Alibaba Group Holding, 7.83%; JD.com, 7.55%; Schneider Electric, 5.71%; Naspers, 5.27%; Missfresh Pvt, 5.19%; Ferguson, 4.90%; DBS Group Holdings, 4.75%; DNB, 3.77%; Julius Baer Group, 3.77%.

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.

During the period from inception (12/29/06) through 12/30/09, only the directors, officers and employees of the Fund or its investment adviser and sub-adviser (and the investment adviser itself and affiliated companies) were eligible to purchase Fund shares. Since inception, the Fund's investment strategies and operations have remained substantially the same.

Foreign investments, particularly those in emerging markets, involve greater risk than U.S. investments. Some of these risks are foreign country risk, currency risk, market risk, and emerging market risk. See endnotes for a complete description of these risks.

Forward P/E ratio: Forward price to earnings (forward P/E) is a measure of the price-to earnings (PE) ratio using forecasted earnings for the PE calculation. Davis does not offer an opinion as to the accuracy of, and does not guarantee, the forecasted numbers.

We gather our index data from a combination of reputable sources, including, but not limited to, Thomson Financial, Lipper and index websites.

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. Investments cannot be made directly in an index.

After 4/30/20, 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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