



Davis Financial Fund

Update from Portfolio Manager
Christopher Davis



THE EQUITY SPECIALISTS™

Davis Financial Fund

Annual Review 2016

This year marks the 25th anniversary of Davis Financial Fund, which we launched in May 1991. From the beginning, we set two goals to meet for our fellow shareholders: to grow the value of their savings and to earn results that beat the market averages. Since then, we have achieved both these goals, growing an initial \$10,000 investment to \$151,046 today or about 11.6% per year. This same \$10,000 invested in the S&P 500® Index would be worth \$89,301, about 40% less.¹ The Fund’s results have also exceeded the Morningstar financial peer average in all periods and have earned more than double the returns of the largest financial sector ETF, Financial Select Sector SPDR Fund (XLF) since it was started in 1998.²

In 1991, when we created Davis Financial Fund, financial stocks were deeply unpopular. The scandals of the savings and loan (S&L) crisis and the steep decline in commercial real estate that occurred in the late 1980s and early 1990s were fresh in investors’ memories. However, where others saw bad news, we saw opportunity for the simple reason that even as investors were avoiding financial stocks, many underlying financial businesses were improving. The S&L crisis reduced the number of competitors, eliminated irrational pricing, improved credit standards, lowered the cost of deposits, and led to increased reserves and capital.

If this environment sounds familiar, that is because today’s financial environment is similar. With memories of the financial crisis of 2009 still fresh, investors and market commentators remain leery of financial stocks in general and bank stocks in particular. They assume long-term returns have been poor and business models highly risky. While true for many financial companies, this description is certainly not true for four of our largest and best-known holdings: Wells Fargo, JPMorgan Chase, Bank of New York Mellon, and American Express.³ These four powerhouse companies have each endured for more than a century and have consistently generated strong long-term returns on equity. More important, although hard for many people to believe, none of the four required government assistance and three of the four actually remained profitable even through the worst financial crisis since the 1930s. In fact, bearing in mind Winston Churchill’s advice to “never let a good crisis go to waste,” Wells Fargo and JPMorgan took advantage of the chaos to acquire large competitors at bargain prices.

Despite their outstanding records of success during an incredibly difficult period, these four companies are lumped together with the banking sector as a whole and now sell at a significant discount to the market averages. In fact, by some measures, these institutions are trading at their lowest relative

Average Annual Total Returns as of December 31, 2015

	1 Year	5 Years	10 Years	Since
Davis Financial Fund Class A				5/1/91
without a sales charge	1.74%	10.19%	4.90%	11.63%
with a maximum 4.75% sales charge	-3.09%	9.12%	4.39%	11.41%

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 0.86%. 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.** Investment cannot be made directly in an index. 2. 1, 3, 5, 10, 15, 20 year, and since inception periods, as of 12/31/15. Not a solicitation for Financial Select Sector SPDR Fund (XLF). **Past performance is not a guarantee of future results.** 3. 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.**

valuations in 50 years. This discount is a boon to shareholders as each of these companies is currently repurchasing shares. Looking ahead, although the companies are benefitting from today's benign credit environment, earnings at each should still rise in the years ahead as regulatory, legal and compliance costs moderate and interest rates normalize. The combination of all these factors creates three ways to win: valuations can move higher, earnings can increase and the number of shares outstanding can shrink. Even small improvements in each of these three areas would be magnified by the fact they compound on one another.

In addition to these large banking names, Davis Financial Fund invests in a number of financial businesses that look less like banks and more like growth companies. With almost no credit or interest rate risk, Visa, for example, is not really a financial company at all but rather a global processing firm whose scale advantages and well-known brand should allow it to grow for years and even decades to come. Similarly, although Berkshire Hathaway has long been classified as an insurance company, its growth is as much the result of thoughtful investing as it is outstanding insurance underwriting. Although not as well-known as Berkshire, Market Corporation has followed this same play book with stunning results, having grown its market capitalization 100-fold from \$115 million in 1991 to \$11.5 billion today. These are just a few examples of the variety of financial companies that have contributed to our returns over the years and remain large holdings today.

The ability and willingness to invest in all different types and sizes of financial companies has served the Fund well over the decades and stands in sharp contrast to the financial index funds and exchange-traded funds (ETFs) such as Financial Select Sector SPDR Fund (XLF) that invests more than 35% of its assets in the five largest financial giants, four of which are mega-cap banks.⁴ We consider our flexibility and diversification an enormous advantage and important contributor to our long-term success versus the financial stock indices.⁵ ■

■ Market Environment

From the lows of 2009 until the middle of 2015, the market raced steadily higher. In fact, by August 2015 the market had enjoyed its longest stretch without a 10% correction in more than 20 years and the third longest stretch since 1928. In short, this was an exceptional period. Since then, market gyrations have reappeared with volatility increasing throughout the remainder of 2015 and so far in 2016. In fact, despite record earnings, many financial companies have led the market lower. Having grown accustomed to a constantly rising market and low volatility, commentators and newspapers are using words such as rout, collapse and turmoil. Such sensational headlines generate considerable excitement compared to statements that might suggest a 10%–20% decline after a 200% gain should not be cause for alarm, though this more sober language is more accurate. While the market generates a positive return in most years, occasional negative years are inevitable. In fact, in one out of four years since 1928, the market has generated a negative one year return.

As an uncommon but inevitable part of the investment landscape, stock market declines present both risks and opportunities. The risks are emotional and the opportunities economic. The emotional risk is that investors become so nervous and fearful they sell their investments at depressed prices. The economic opportunity is that investors recognize the chance to increase future returns by buying more at lower prices.

To avoid the risk and take advantage of the opportunity, investors must remember declining prices are not the same as declining values.⁶ Shoppers understand this difference and generally welcome falling prices as the chance to buy more for less. With stocks, the principle is the same and yet many investors' emotions lead them to react differently. Forgetting the wisdom of the adage "price is what you pay, value is what you get" they dread falling prices instead of welcoming them. Successful long-term investors must keep such irrational emotions in check.

4. As of 12/31/15. 5. Diversification does not ensure against loss. 6. While Davis Advisors attempts to manage risk there is no guarantee that an investor will not lose money. Equity markets are volatile and the investment return and principal value of an investment will vary. Diversification does not ensure against loss.

The most effective way to combat such irrationality is to recognize that stocks represent ownership interests in real businesses and the value of a business is determined by the earnings and cash it produces over the long term. Because we tend to own companies for many years, we already incorporate a range of different economic and political environments into our valuations. After all, as Heraclitus observed more than two thousand years ago, “The only thing constant is change.” Today, for example, commentators cite the risk of falling energy prices, rising interest rates, a weakening Chinese economy, and the strengthening dollar as major concerns. A few short years ago, they worried about the opposite: high energy prices, near zero interest rates, China’s economic strength, and a weak dollar. We use this example not to minimize the importance of economic and political concerns but rather to highlight that such risks are a constant part of the investment landscape. What varies is investors’ perception concerning these risks. When prices are high, investors optimistically focus only on the positives. When prices are low, they pessimistically focus only on the risks.

In managing Davis Financial Fund, we are determined to be neither optimists nor pessimists but realists, focused on facts not emotions. While the macroeconomic factors discussed above can have an impact on earnings in the short run, the key driver of long-term earnings power is the durability of a company’s competitive advantage. In general, the various economic and political factors currently worrying investors and depressing prices have almost no impact on the long-term earnings power of the majority of companies we own. In fact, the earnings of many of our largest holdings could benefit from some of these factors, including rising interest rates.

By focusing on the steady and relentless growth in the earnings power and thus the value of our long-term holdings, we and our investors can tune out unsettling short-term price volatility. After all, eight of our top 10 holdings have survived two world wars, the Great Depression, Vietnam, stagflation,

the Cold War, the S&L crisis, the dot-com bust, and the Great Recession. When the headlines emphasize turmoil and uncertainty, just remember that over the decades, the companies we own have grown more valuable by serving new customers, expanding into new markets and reinforcing their competitive advantages. Over the long term, this growth in value drives shareholder returns. Over the last 25 years, the wonderful companies that make up Davis Financial Fund have more than withstood the test of time. They have grown and prospered. ■

Conclusion

A quarter of a century ago we launched Davis Financial Fund because we were convinced financial stocks represented a rare opportunity to buy durable, well-managed companies at bargain prices. Today, we see the same opportunity in the select companies that we hold in the Portfolio. At the very time that many of these companies are reporting record profits with the strongest balance sheets they have ever had, their share prices are trading at significant discounts to the market averages. Then as now, our investment case is simple: Over the long term, economic reality trumps market sentiment. As a result, business value and stock prices eventually converge. Over the last 25 years, this convergence has created wealth for our shareholders, growing a \$10,000 investment to more than \$151,000 today, beating the market averages by more than 40% and the Morningstar Financial Fund Category in all periods.⁷

There is no stronger indication of our confidence in Davis Financial Fund than the fact my family and colleagues have more than \$100 million invested in the Fund side by side with our clients.⁸ I began investing my own money in the Fund in 1991 and have never sold a share.

As fellow shareholders, we are as excited about the opportunity we see in financial companies today as we were when we launched Davis Financial Fund a quarter of a century ago. Then, as now, we are mindful of our responsibility and grateful for the trust you have placed in us. Thank you. ■

7. 1, 3, 5, 10, 15, 20 year, and since inception periods, as of 12/31/15. Class A shares without a sales charge. Past performance is not a guarantee of future results. The market is represented by the S&P 500® Index. 8. As of December 31, 2015.

This report is authorized for use by existing shareholders. A current Davis Financial 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 Financial Fund's investment objective is long-term growth of capital. 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 securities issued by companies principally engaged in the financial services sector. 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; manager risk: poor security selection may cause the Fund to underperform relevant benchmarks; 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; 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; 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; 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; financial services risk: investing a significant portion of assets in the financial services sector may cause the Fund to be more sensitive to systemic risk, regulatory actions, changes in interest rates, non-diversified loan portfolios, credit, and competition; foreign country risk: foreign companies may be subject to greater risk as foreign economies may not be as strong or diversified. As of December 31, 2015, the Fund had approximately 9.4% of assets invested in foreign companies; emerging market risk: securities of issuers in emerging and developing markets may present risks not found in more mature markets; 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; depositary receipts risk: depositary receipts may trade at a discount (or premium) to the underlying security and may be less liquid than the underlying securities listed on an exchange; 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; interest rate sensitivity risk: interest rates may have a powerful influence on the earnings of financial institutions; credit risk. The issuer of a fixed income security (potentially even the U.S. Government) may be unable to make timely payments of interest and principal; and fees and expenses risk: the Fund may not earn enough through income and capital appreciation to offset the operating expenses of the Fund. 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, 2015, the top ten holdings of Davis Financial Fund were: Wells Fargo & Co., 7.30%; Markel Corp., 6.50%; Bank of New York Mellon Corp., 5.38%; Visa Inc., Class A, 5.15%; American Express Co., 5.02%; Berkshire Hathaway Inc., Class A, 4.50%; JPMorgan Chase & Co., 4.47%; ACE Ltd., 3.79%; Everest Re Group, Ltd., 3.72%; Citizens Financial Group Inc., 3.37%.

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.

Broker-dealers and other financial intermediaries may charge Davis Advisors substantial fees for selling its funds and providing continuing support to clients and shareholders. For example, broker-dealers and other financial intermediaries may charge: sales commissions; distribution and service fees; and record-keeping fees. In addition, payments or reimbursements may be requested for: marketing support concerning Davis Advisors' products; placement on a list of offered products; access to sales meetings, sales representatives and management representatives; and participation in conferences or seminars, sales or training programs for invited registered representatives and other employees, client and investor events, and other dealer-sponsored events. Financial advisors should not consider Davis Advisors' payment(s) to a financial intermediary as a basis for recommending Davis Advisors.

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

Morningstar financial portfolios focus at least 70% of assets on U.S. stocks of companies that engage in banking, finance, asset management and insurance services. These companies comprise the GICS Financial sector, less the REITs segment.

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. Investments cannot be made directly in an index.

After April 30, 2016, 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.