Davis Opportunity Fund

Update from Portfolio Managers

50 YEARS DAVIS ADVISORS

Davis FUNDS

THE EQUITY SPECIALISTS

Davis Opportunity Fund

Annual Review 2020

Market Perspectives

Davis Opportunity Fund invests selectively in durable businesses irrespective of market capitalization.

In 2019, the Davis Opportunity Fund generated strong performance, returning 25.49%. The S&P 1500 Index, the Fund's benchmark, returned 30.90% by comparison. Both the Portfolio's results, as well as the broad-based returns of the market, are reflective in our view of relatively strong underlying fundamentals in the U.S. While most of our top holdings generated high double-digit returns during the period, energy as a sector was a detractor, which explains in large part our relative results for the year, during which the Fund participated in the market's advance, but not fully. We believe that given time, the businesses in our portfolio will demonstrate their true worth, however, and that the portfolio is well-positioned to generate competitive returns over the long term.

The strong full-year performance of the U.S. stock market in 2019 occurred against a relatively healthy economic backdrop. With the unemployment rate at an historic low below 4%, a healthy consumer who continues to spend, reasonable Gross Domestic Product (GDP) growth, a foundation of well-capitalized financial institutions, low interest rates, and very modest inflation, we believe that conditions remain favorable in general in the U.S.

Market volatility during the year was rather pronounced. We believe that such gyrations have been driven by and large by shifts in macro sentiment to date, based on uncertainties ranging from trade disputes to geopolitical tensions. However, underlying business fundamentals for most of our holdings have been far less volatile than market prices, and we believe that progress is manifested in higher revenues and earnings power. It is significant that many companies are able to flourish despite (and through) periods of heightened macro concerns of the moment, both in terms of earnings growth as well as share price performance. Historically, there has been no set rule that macro concerns must categorically hold back the progress of businesses or the market as a whole. Quite to the contrary, the market's best years over the last half century—which exceed 30% in a 12-month period—have always coincided with worries and negative headlines of the day. What matters most over the long term in our experience is the longevity and growth of corporate profits.

In other words, however volatile markets may be in the near term, we are more interested in the stability and durability of long-term earnings power rather than swings in short-term market pricing that, in many instances, do not directly or materially impact our businesses' capacity to generate cash earnings. ■

The average annual total returns for Davis Opportunity Fund's Class A shares for periods ending December 31, 2019, including a maximum 4.75% sales charge, are: 1 year, 19.53%; 5 years, 9.00%; and 10 years, 11.19%. 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 0.94%. 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. All fund performance discussions within this piece refer to Class A shares without a sales charge and are as of 12/31/19 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.** Total returns are not annualized for periods of less than one year.

Portfolio Review

Our current portfolio breaks down into various areas that express where, and in what businesses, our highest convictions lie. These areas include:

- Intensely innovative, fast-growing market leaders such as Amazon.com, Alphabet and Microsoft, as well as workhorse technology companies such as Applied Materials, Intel and Texas Instruments. Whether these businesses are engaged in e-commerce, cloud computing, or other large and rapidly expanding end markets tied to semiconductors, our technology holdings are all in leadership positions that we believe will play to their advantage competitively in vast new profitable fields.

- High-grade financials such as Wells Fargo and Capital One Financial that, while mundane, offer some of the best value of any sector, in our view. Wells Fargo, while still re-emerging from its scandal from years past, pays nearly a 4% dividend yield, has repurchased shares at roughly eight times our estimate of normalized earnings, and continues to generate steady cash earnings in excess of $20 billion over the most recent year—all of this despite the headwind of low interest rates, a relatively flat yield curve and a regulatory cap on the company's assets. Taken together, these facts demonstrate the staying power and cash-generative nature of this major financial institution. Capital One Financial, meanwhile, continues to generate high returns on equity, particularly in its core credit card business. The company is benefiting from a relatively healthy credit picture in the U.S. economy, in addition to taking share, based on the competitiveness of its products and services.

- Select industrial companies like United Technologies, whose greatest appeal is the aerospace business, which is poised to benefit for decades, in our estimation, from strong global demand for the company's narrow-body jet engines. The world's logistical networks, the number of airlines, and the number of overall air travelers are all expanding rapidly. The primary global manufacturer of planes that United Technologies serves has an order backlog spanning years, and in addition to selling engines at the point of installation or replacement, United Technologies earns very high-margin revenues from ongoing service and maintenance requirements over the life of the plane—normally more than 20 years, based on today's generation of passenger aircraft. Johnson Controls International, another highly cash-generative industrial company, specializes in building systems such as fire and security solutions. Similar to United Technologies, Johnson Controls International has a strong competitive position with a high degree of recurring revenues and cash flows. The sheer durability and longevity of earnings that can be generated by such industrial leaders—all of which are deeply embedded in large global industries—make these investments attractive long-term positions in the Fund, in our opinion.

- Select managed care and lab diagnostics businesses in the healthcare sector. These include market leaders in the managed care insurance space such as UnitedHealth and Cigna, to which we have been able to add over the past year at what we believe are advantageous prices. We also hold a position in Quest Diagnostics, a leader in independent lab and diagnostics services. We find Quest Diagnostics attractive because its business model centers around the important task of lowering lab testing and analysis expenses for its customers. The company can deliver its services at a fraction of the cost associated with hospital labs, for example. This low-cost value proposition positions the company well, in our opinion, as part of the cost solution in the U.S., where healthcare inflation remains a key long-term issue.

- A relatively minor allocation to energy companies such as Apache and Seven Generations Energy, which have been detractors to performance in recent periods, but are trading, in our view, at depressed multiples today. Our thesis in this area rests on an assumption that our specific companies should be able to earn an above-average return on capital over a cycle, which in turn should allow them to grow production and free cash flow at significantly higher rates than most of the sector. With a long-term view that energy prices may eventually stabilize and recover somewhat—owing to supply and demand factors and/or geopolitical developments—the significant "option value" inherent in these North American-contained businesses is meaningful. While the current weak price environment persists, we believe our holdings have staying power, based on a stable funding profile and flexible capital programs. Should the commodity price environment improve from here, we believe these energy-related investments could potentially become a contributor to our results rather than a headwind.

These themes represent the types of investments and the diversification we seek for the Fund.

Fund Positioning:
Selective, Attractive Growth, Undervalued

At a higher level, the Fund's current positioning starts with our selective, bottom-up approach, which focuses on core, high-conviction investments across different industries where we believe we can identify superior businesses with competitive advantages trading at attractive prices.

In terms of where the best "value" lies in the market today—along the growth-value spectrum, for instance—we believe that it resides, from a risk-and-reward standpoint, in a select list of durable, growing businesses that have above-average prospects that still trade at below-average multiples. In other words, we are combining the best and most effective features of growth and value, which we see as joined at the hip in our ideal investment opportunities.

To illustrate our current positioning with data, below we provide three sets of figures for both the Davis Opportunity Fund and the S&P 1500 Index.[1]

Selective, Attractive Growth, Undervalued

	Fund	Index
Holdings	45	1,506
EPS Growth (5 Year)	17.6%	16.9%
P/E (Forward)	18.1x	19.8x

Specifically, what the table shows is the following:

- We are far more selective than the benchmark with only 45 holdings versus more than 1,500 securities in the S&P 1500 Index. The average position size for the portfolio is roughly 2%. In contrast, the benchmark's average position size is under 0.07%. We apply a high bar when selecting individual businesses and believe that our high-conviction, research-driven approach calls for a portfolio structure that allows for individual businesses to make a material contribution to long-term performance and should therefore be weighted as such.

- Our historical earnings growth rate on a per-share basis has been superior to the benchmark on average.

- In contrast, we believe we are owning these above-average businesses at below-average starting multiples of earnings, as reflected in the lower forward price-to-earnings ratio of the Fund versus its benchmark. ■

1. Source: Wilshire Atlas and Davis Advisors.

Outlook

Looking ahead, we believe selectivity will be a key to generating above-average returns over the coming decade, both at the security and at the sector levels. The future prospects of many businesses are becoming more cloudy—and certainly more challenged—based on the fact that competition continues to intensify, industry by industry, and both at home and abroad.

For this reason, in every holding in the Fund, we believe there are competitive strengths that can allow them to take share and prosper over the long term, even if their "ecosystems" and industries become more difficult for the average player.

Beyond selectivity, we believe today's market offers investors the possibility of owning durable, *growing* businesses at value prices and we are taking advantage of that opportunity.

Taken together, our selective approach to stock selection, the portfolio's growth potential and the opportunity to own powerful, competitively advantaged businesses at such attractive valuations position the Fund well, in our view, for the future.

At Davis Advisors, we seek to purchase durable businesses at value prices and hold them for the long term. The more than $2 billion Davis Advisors, the Davis family and Foundation, our employees, and Fund directors have invested in similarly managed accounts and strategies remains a true sign of our commitment to and conviction in this enduring philosophy.[2] ■

2. As of 12/31/19.

This report 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 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 Opportunity 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 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; **foreign country risk:** foreign companies may be subject to greater risk as foreign economies may not be as strong or diversified. As of 12/31/19, the Fund had approximately 22.1% of assets invested in foreign companies; **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.

Davis Funds 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 Opportunity Fund were: United Technologies, 6.27%; Quest Diagnostics, 6.26%; Alphabet, 5.63%; Wells Fargo, 4.67%; Grab Holdings, 4.59%; UnitedHealth Group, 4.58%; Didi Chuxing, 4.12%; Qorvo, 3.78%; Amazon.com, 3.64%; and Humana, 3.44%.

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, Thomson Financial, Wilshire, Lipper and index websites.

Definitions: Forward Price/Earnings (Forward P/E) Ratio is a stock's current price divided by the company's forecasted earnings for the following 12 months. The values for the portfolio and index are the weighted average of the P/E ratios of the stocks in the portfolio or index. Five-Year EPS Growth Rate is the average annualized earning per share growth for a company over the past five years. The values for the portfolio and index are the weighted average of the five-year EPS Growth Rates of the stocks in the portfolio or index.

The attractive growth reference in this piece relates to underlying characteristics of the portfolio holdings. There is no guarantee that the portfolio performance will be positive as equity markets are volatile and an investor may lose money.

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.

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

Item #4776 12/19