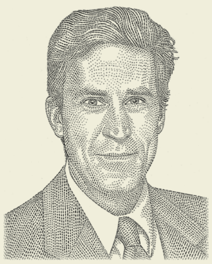
DREF ANNUAL REVIEW 2019



Davis Real Estate Fund

Update from Portfolio Managers

Andrew A. Davis and Chandler Spears

Davis FUNDS

The Equity Specialists

Davis Real Estate Fund

Annual Review 2019

Investment Results

Davis Real Estate Fund's Class A shares provided a total return on net asset value for the year ended December 31, 2018 of –4.52%.[1] Over the same time period the Wilshire U.S. Real Estate Securities Index returned –4.80%. Over the latest three and five year periods, a $10,000 investment in Davis Real Estate Fund has grown to $11,345 and $14,730, respectively.[1] ■

Investment Overview

Davis Real Estate Fund management looks back on 2018 as the year during which investment seeds planted years ago sprouted and flourished. It is perhaps the nature of investing that great investments often look foolish when initiated. The Fund has been willing to take that chance because we believe that our methods work over the long term. While our seed planting strategy has admittedly taken a while to blossom, Fund performance in 2018 was very good and, more importantly, the past few years have really buttressed our long-term record.

No sector has boosted performance more than industrial REITs relative to the index. For years we have positioned the Fund to adapt to structural forces changing the way retailers get goods to customers. Where dated and poorly located bricks-and-mortar mall properties have failed, well located industrial properties have succeeded. Our substantial underweight position in the former and considerable overweight position in the latter has led to significant outperformance over the past few years. A bittersweet acknowledgement of value in the industrial sector occurred in 2018 when DCT Industrial, a longtime industrial holding, agreed to merge with ProLogis, Inc. (PLD).[2] The price ProLogis paid for DCT is, from a historical perspective, rich, but reasonable given growth in the industrial sector is expected to continue for years to come. We take solace in knowing that our ownership of ProLogis means we still own DCT's assets.

While retail real estate has been a net loser as e-commerce powers ahead, our underweight position in the mall sector sends a false signal. We do not think retail real estate is in inexorable decline. Rather, we believe there will be winners

Average Annual Total Returns as of December 31, 2018

Davis Advisors Real Estate Fund Class A	1 Year	5 Years	10 Years
with a maximum 4.75% sales charge	–9.05%	7.01%	10.83%

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 0.97%. 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. 2.** 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.**

and losers. Investors need look no further than the very retailers driving the e-commerce wave to see why. Amazon has endorsed a bricks-and-mortar strategy not only with its purchase of Whole Foods Market, Inc., but also with the opening of its own Amazon-branded stores. These choices tell us that physical stores matter, but it is essential that they be in the best locations. And it is not just Amazon endorsing physical store strategy. We are also seeing demand surface from digitally native retailers and experience-driven tenants. Further, we have witnessed much improved demand and pricing for real estate that is well suited to a more diverse tenant base. Retail centers that once housed only tenants selling products of one form or another are now filling with a multitude of tenant types. The key for Fund management is to identify the companies that own and develop assets best suited to these trends.

For the Fund, that means not only owning the very best mall properties, which in our opinion includes Simon Property Group (SPG), but also investing in shopping centers located in dense urban areas. Federal Realty Investment Trust (FRT) and Acadia Realty Trust (AKR) are both well managed companies possessing exceptionally well located retail properties that have found favor among prosperous retailers, restaurants and other experience-based enterprises. Both were average performers in 2018, but long-term prospects are quite good. Simon performed very well in 2018 and promises to continue performing well in the future. While the success of these companies is due in large part to the fact that their properties are favored locations for thriving retailers, it is important to note that their balance sheets are very strong. We always seek to invest in companies like these with excellent management teams that recognize the value of their assets and capitalize on economic trends to grow their profits and ours.

Fund performance in 2018 also benefited from merger activity beyond the DCT acquisition mentioned earlier. We have always had mixed feelings about M&A. While we appreciate the acknowledgment that we have invested in undervalued companies, typically they are businesses we would rather continue to own. This year we lost to privatization a business we have long considered undervalued: Forest City Realty Trust. While we believe the price paid was a touch below our estimate of terminal value, it is perhaps the best outcome for a business that was maligned for much of its tenure as a public company. The capital returned from this merger and indeed a couple of others mean that the Fund maintained a cash balance higher than we would have liked in 2018. We believe we will have an opportunity to deploy that excess cash early in 2019. ■

Portfolio Positioning

As we enter 2019 the fundamental backdrop for real estate securities is stable if a bit uninspiring, except in the industrial sector. From a top-line perspective it is hard to envision a year during which we will not see continued growth, although perhaps a bit slower than in years past. What does seem to be changing is the cost of capital and it is proving to be a durable change, unlike recent episodes. For over a year we have been slowly reducing the Fund's exposure to companies with higher than average leverage. We did this because we believed that, although interest rates remained low they could not go any lower, and were more likely to drift higher with a Federal Reserve intent on normalizing rates. Further, redemptions from real estate dedicated mutual funds meant that the most powerful underpinning for stock price valuations was starting to ebb. The resulting upward drift in total capital costs means that investors are likely to favor companies with lower leverage and, if possible, those with good fundamentals. Rising capital costs further set the stage for 2019 guidance that might initially disappoint investors. This is why we say the early part of the New Year might provide an opportunity for us to redeploy cash.

This brings us back to the point we made about Simon Property Group. Certainly Simon has a decent fundamental backdrop if its class-A properties remain among the "winners," but our sense is that performance in 2018 was driven more by a flight to relative balance sheet strength. That has been great for recent Fund performance, but we think it becomes even more important in the years ahead. The Fund today is invested heavily in companies with a conservative capital structure such as Simon, but we have balanced that with opportunity. After all, we can't position the Fund so conservatively that we give up attractive risk-adjusted returns.

We look for those returns in development. Even though it caused a few companies considerable pain during the credit crisis, development yields the best risk-adjusted returns. Even many of the developments that almost failed during the credit crisis are today huge successes. Particularly appealing to us at this point are apartment developers AvalonBay Communities, Inc. (AVB) and office developer Boston Properties (BXP). AvalonBay is developing properties in markets with very strong housing demand and Boston Properties is taking advantage of very strong pre-leasing to deliver new highly amenitized office properties in strong coastal markets.

We are also quite keen on companies redeveloping properties to take advantage of burgeoning e-commerce demand. Our favorites here include Rexford Industrial Realty (REXR) and Terreno Realty (TRNO). Both have capitalized on robust demand for properties that can help a diverse pool of tenants trying to get closer to their customers. Finding that sort of space has proven problematic for many businesses, but Rexford and Terreno have been able to exert a competitive advantage. They are using their acquisition acumen to acquire off-market or lightly-marketed properties at reasonable valuations, then repurpose those buildings to appeal to tenants looking for last-touch distribution. These new tenants typically pay much higher rents than tenants did before redevelopment, which leaves Rexford and Terreno with excellent risk-adjusted returns. Even though both are trading at valuations near the upper end of their historical ranges, our research suggests that earnings growth is going to be better than in any other sector.

Lastly, as we contemplate public real estate companies in a longer dated context, we believe that dealing with complexity will reassert itself as a valuable tool. As the 2008 credit crisis eased there was a massive push to simplify. Not only did companies reduce financial leverage they also shed problematic assets, often focusing on a single type of property and in most instances became very limited in their thinking. Of course there are exceptions, but being too simple can now be a liability, especially for companies that own assets in dense locations. Said differently, seeing a property only as a mall, for example, is often not ideal. Being able to re-envision assets as something different is going to be integral to driving returns in the future. And it is not just malls that need to be reimagined. Smart companies are beginning to transfer offices, apartments and even hotels into multi-use assets that cater to diverse demand. We have invested your money and ours in many companies that we believe are reasserting themselves as managers of complexity, including several of the companies mentioned above. Our hope is that valuations will follow as the broader investment community comes to our way of thinking.

As we approach the Davis Real Estate Fund's 25th anniversary, we thank you for the trust that you have placed in us. As always, rest assured that we back up that confidence with pride and have placed our money alongside yours. We hope that you had a wonderful holiday season. ■

This report 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.

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 Real Estate Fund's investment objective is total return through a combination of growth and income. 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 equity, convertible, and debt securities issued by companies principally engaged in the real estate industry. 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; **fees and expenses risk:** the Fund may not earn enough through income and capital appreciation to offset the operating expenses of the Fund; **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; **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; **stock market risk:** stock markets have periods of rising prices and periods of falling prices, including sharp declines; 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.

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, 2018, the top ten holdings of Davis Real Estate Fund were: Simon Property Group, Inc., 7.78%; Avalonbay Communities, Inc., 6.19%; ProLogis, Inc., 4.56%; Equinix, Inc., 4.25%; Boston Properties Inc., 3.65%; Public Storage, Inc., 3.49%; Essex Property Trust, Inc., 3.29%; Digital Realty Trust, Inc., 3.26%; American Campus Communities, Inc., 3.19%; Hudson Pacific Properties, Inc., 3.17%.

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.

We gather our index data from a combination of reputable sources, including, but not limited to, Thomson Financial, Lipper 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 January 1, 1978, 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 April 30, 2019, 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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