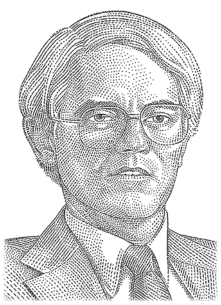
The Wisdom of Great Investors

Insights from Some of History's Greatest Investment Minds



Davis ADVISORS

Over 45 Years of Reliable Investing™

A Collection of Wisdom

We hope this collection of wisdom serves as a valuable guide as you navigate an ever-changing market environment and build long-term wealth.

1. Past performance is not a guarantee of future results.

The Wisdom of Great Investors

During extreme periods for the market, investors often make decisions that can undermine their ability to build long-term wealth.

When faced with such periods, it can be very valuable to look back in history and study closely the timeless principles that have guided the investment decisions of some of history's greatest investors through both good and bad markets. By studying these great investors, we can learn many important lessons about the mindset required to build long-term wealth.

With this goal in mind, the following pages offer the wisdom of many of history's most successful investment minds, including, but not limited to Warren Buffett, Chairman of Berkshire Hathaway and one of the most successful investors in history; Benjamin Graham, recognized as the "Father of Value Investing" and one of the most influential figures in the investment industry; Peter Lynch, portfolio manager and author, and Shelby Cullom Davis, a legendary investor who turned a $100,000 investment in stocks in 1947 into over $800 million at the time of his death in 1994.[2]

Though each of these great investors offers perspective on a distinct topic, the common theme is that a disciplined, patient, unemotional investment approach is required to reach your long-term financial goals. We hope this collection of wisdom serves as a valuable guide as you navigate an ever-changing market environment and build long-term wealth.

Equity markets are volatile and an investor may lose money. Past performance is not a guarantee of future results. 2. Shelby Cullom Davis borrowed $100,000 in 1947 and turned it into an $800 million fortune by the year 1994. While Shelby Cullom Davis' success forms the basis of the Davis Investment Discipline, this was an extraordinary achievement and other investors may not enjoy the same success.

"Individuals who cannot master their emotions are ill-suited to profit from the investment process."

Benjamin Graham
Father of Value Investing

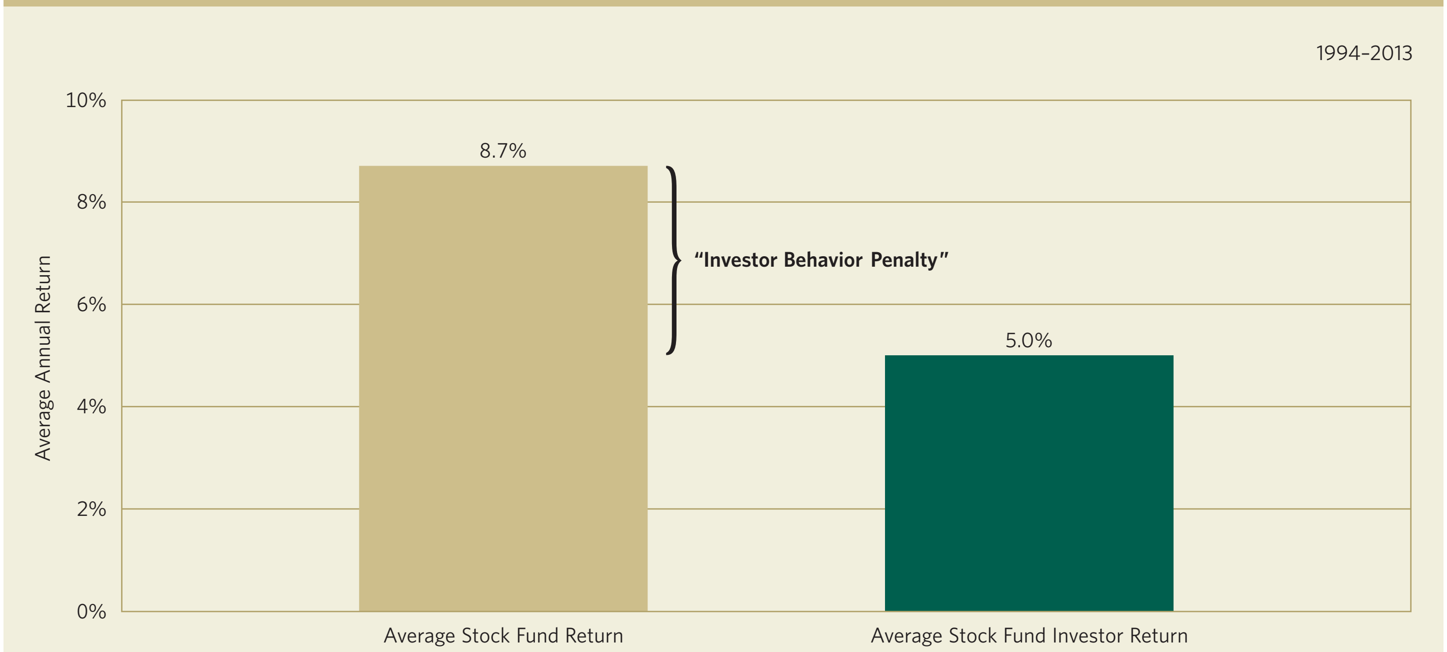
Avoid Self-Destructive Investor Behavior

Emotions can wreak havoc on an investor's ability to build long-term wealth. This phenomenon is illustrated in the study below. Over the period from 1994 to 2013, the average stock fund returned 8.7% annually, while the average stock fund investor earned only 5.0%.

Why did investors sacrifice close to half of their potential return? Driven by emotions like fear and greed, they engaged in such negative behaviors as chasing the hot manager or asset class, avoiding areas of the market that were out of favor, attempting to time the market, or otherwise abandoning their investment plan.

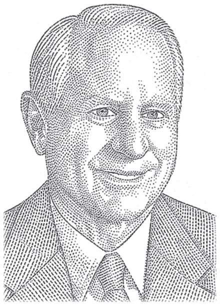
Great investors throughout history have understood that building long-term wealth requires the ability to control one's emotions and avoid self-destructive investor behavior.

Average Stock Fund Return vs. Average Stock Fund Investor Return



Source: *Quantitative Analysis of Investor Behavior* by Dalbar, Inc. (March 2014) and Lipper. Dalbar computed the "average stock fund investor return" by using industry cash flow reports from the Investment Company Institute. The "average stock fund return" figures represent the average return for all funds listed in Lipper's U.S. Diversified Equity fund classification model. Dalbar also measured the behavior of an "asset allocation" investor that uses a mix of equity and fixed income investments. The annualized return for this investor type was 2.5% over the time frame measured. All Dalbar returns were computed using the S&P 500® Index. Returns assume reinvestment of dividends and capital gain distributions. The fact that buy and hold has been a successful strategy in the past does not guarantee that it will continue to be successful in the future. The performance shown is not indicative of any particular Davis investment. **Past performance is not a guarantee of future results.**

There is no guarantee that the average stock fund will continue to outperform the average stock fund investor in the future. Equity markets are volatile and average stock funds and/or average stock fund investors may lose money.



"History provides a crucial insight regarding market crises: They are inevitable, painful and ultimately surmountable."

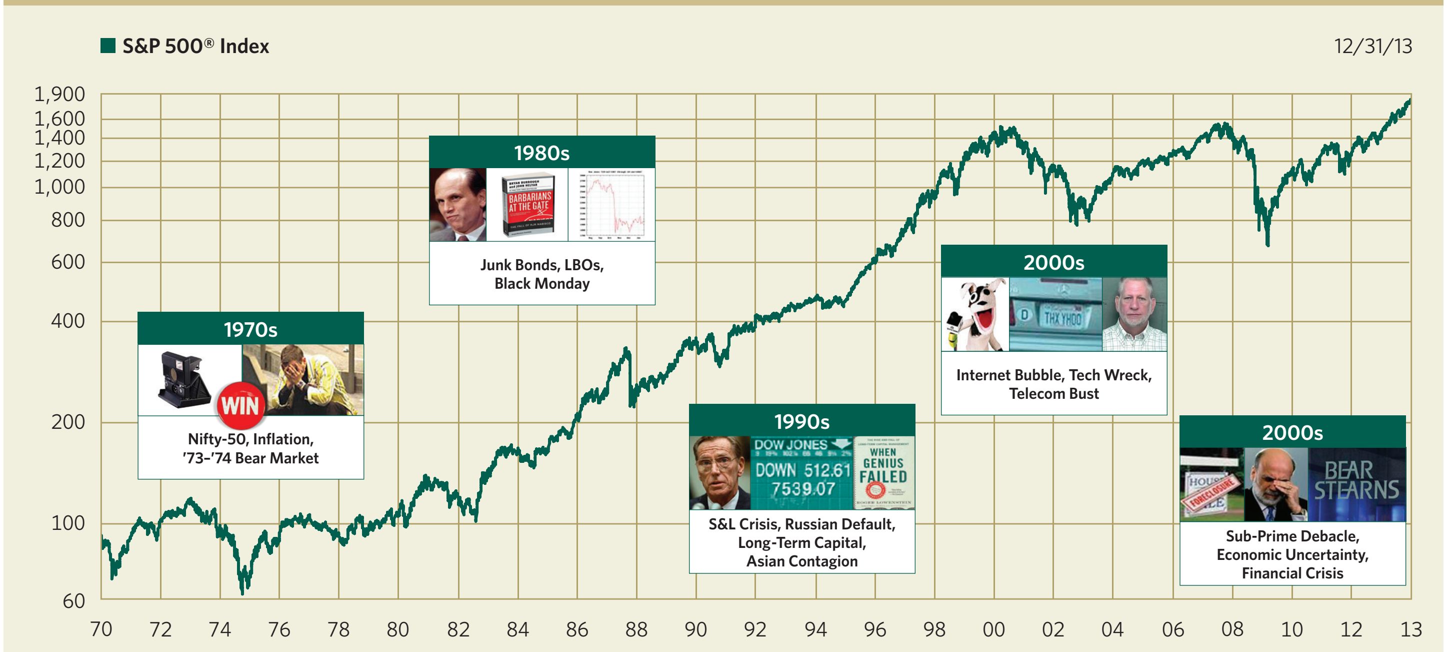
Shelby M.C. Davis
Legendary Investor

Understand That Crises are Inevitable

History has taught that investors in stocks will always encounter crises and uncertainty, yet the market has continued to grow over the long term. The chart below highlights the myriad crises that faced investors over the past four decades, along with the performance of the S&P 500® Index over the same time period. Investors in the 1970s were faced with stagflation, rising energy prices and a stock market that plummeted 44% in two years. Investors in the 1980s dealt with the collapse of the major Wall Street investment bank Drexel Burnham Lambert and Black Monday, when the market crashed over 20% in one day. In the 1990s, investors had to weather the S&L Crisis, the failure and ultimate bailout of hedge fund Long-Term Capital Management and the Asian financial crises. Investors in the beginning of the 2000s experienced the bursting of the technology and telecom bubble, 9/11 and the advent of two wars. Following this, investors were faced with the collapse of residential real estate prices, economic uncertainty and a turmoil in the financial services industry. Through all these crises, the long-term upward progress of the stock market has not been derailed.

Investors who bear in mind that the market has grown despite crises and uncertainty may be less likely to overreact when faced with these events, more likely to avoid making drastic changes to their investment plans and better positioned to benefit from the long-term growth potential of equities.

Despite Decades of Uncertainty, the Historical Trend of the Stock Market Has Been Positive



Source: Yahoo Finance. Graph represents the S&P 500® Index from January 1, 1970 through December 31, 2013. Investments cannot be made directly in an index. **Past performance is not a guarantee of future results.**

"Despite inevitable periods of uncertainty, stocks have rewarded patient, long-term investors."[3]

Christopher C. Davis
Portfolio Manager, Davis Advisors

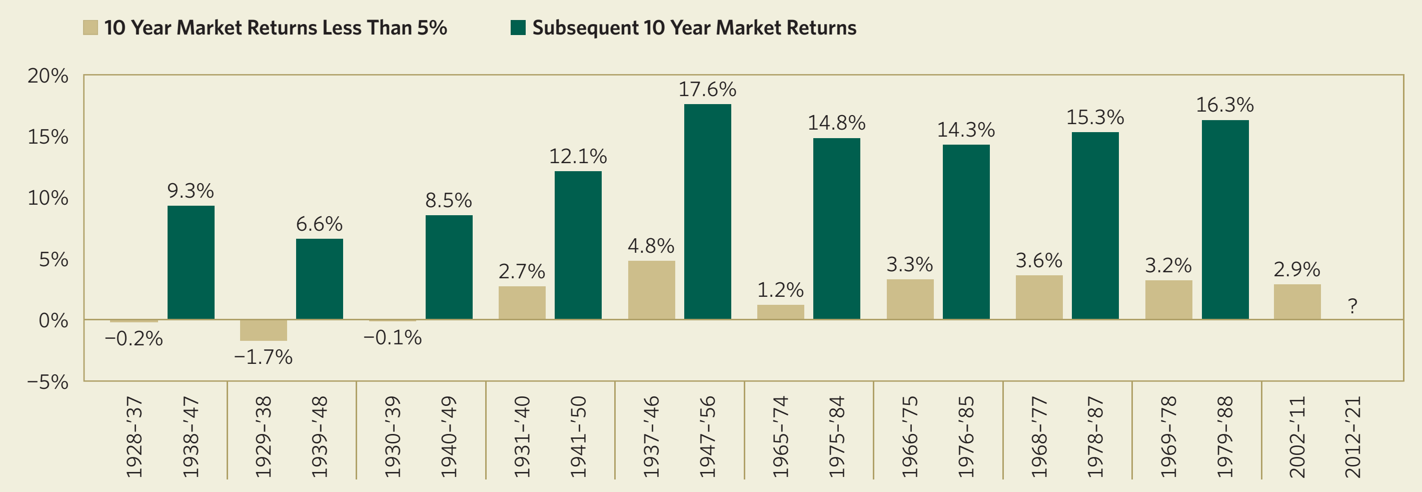
Recognize That Historically, Periods of Low Returns for Stocks Have Been Followed by Periods of Higher Returns[3]

After suffering through a painful period for stocks, investors often reduce their exposure to equities or abandon them altogether. While understandable, such activity often occurs at precisely the wrong time. Though extremely challenging to do, history has shown that investors should feel *confident* about the long-term potential of equities after a prolonged period of disappointment. Why? Because historically, low prices have helped increase future returns and crisis has created opportunity.[4]

Consider the chart below which illustrates the 10 year returns for the market from 1928 to 2013. The tan bars represent 10 year periods where the market returned less than 5%. The green bars represent the 10 year periods that followed these difficult periods. In every case, the 10 year period following each disappointing period produced satisfactory returns. For example, the 1.2% average annual return for the 10 year period ending in 1974 was followed by a 14.8% average annual return for the 10 year period ending in 1984. Furthermore, these periods of recovery averaged 13% per year.

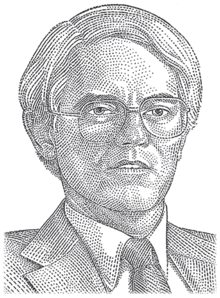
While we cannot know for sure what the next decade will hold, it may be far better than what we have suffered through in the last 10 years. Investors who bear in mind that low prices have helped increase future returns are more likely to endure hard times and be there to benefit from subsequent periods of recovery.[4]

Poor Periods for the Market Have Always Been Followed by Stronger Periods



Source: Thomson Financial, Lipper and Bloomberg. Chart represents when the annualized market returns were less than 5%. Periods where there is not a subsequent 10 year period are not shown. The market is represented by the Dow Jones Industrial Average for the period from 1928 through 1957 and by the S&P 500® Index for the period from 1958 through 2013. Investments cannot be made directly in an index. The performance shown is not indicative of any particular Davis investment. **Past performance is not a guarantee of future results**.

3. Past performance is not a guarantee of future results. 4. There is no guarantee that low-priced securities will appreciate. **Past performance is not a guarantee of future results.**



"Far more money has been lost by investors preparing for corrections or trying to anticipate corrections than has been lost in the corrections themselves."

Peter Lynch
Legendary Investor and Author

Don't Attempt to Time the Market

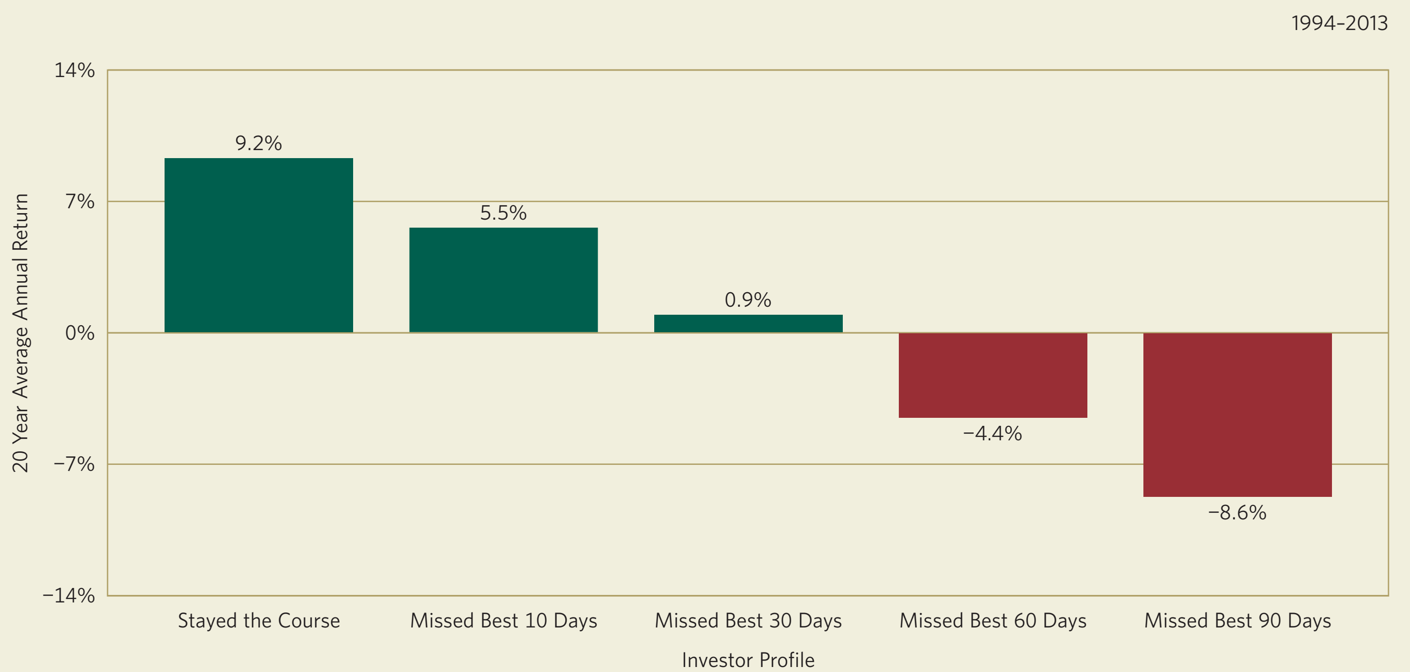
Market corrections often cause investors to abandon their investment plan, moving out of stocks with the intention of moving back in when things seem better—often to disastrous results.

The chart below compares the 20 year returns of equity investors (S&P 500® Index) who remained invested over the entire period to those who missed just the best 10, 30, 60, or 90 trading days:

- The patient investor who remained invested during the entire 20 year period received the highest average annualized return of 9.2% per year.
- The investor who missed the best 30 trading days over this 20 year period experienced an investment that remained flat.
- Amazingly, an investor needed only to miss the best 60 days for his return to plummet.

Investors who understand that timing the market is a loser's game will be less prone to reacting to short-term extremes in the market and more likely to adhere to their long-term investment plan.

Danger of Trying to Time the Market



Source: Bloomberg and Davis Advisors. The market is represented by the S&P 500® Index. Investments cannot be made directly in an index. **Past performance is not a guarantee of future results.**

> "Be fearful when others are greedy. Be greedy when others are fearful."
>
> **Warren Buffett**
> Chairman, Berkshire Hathaway

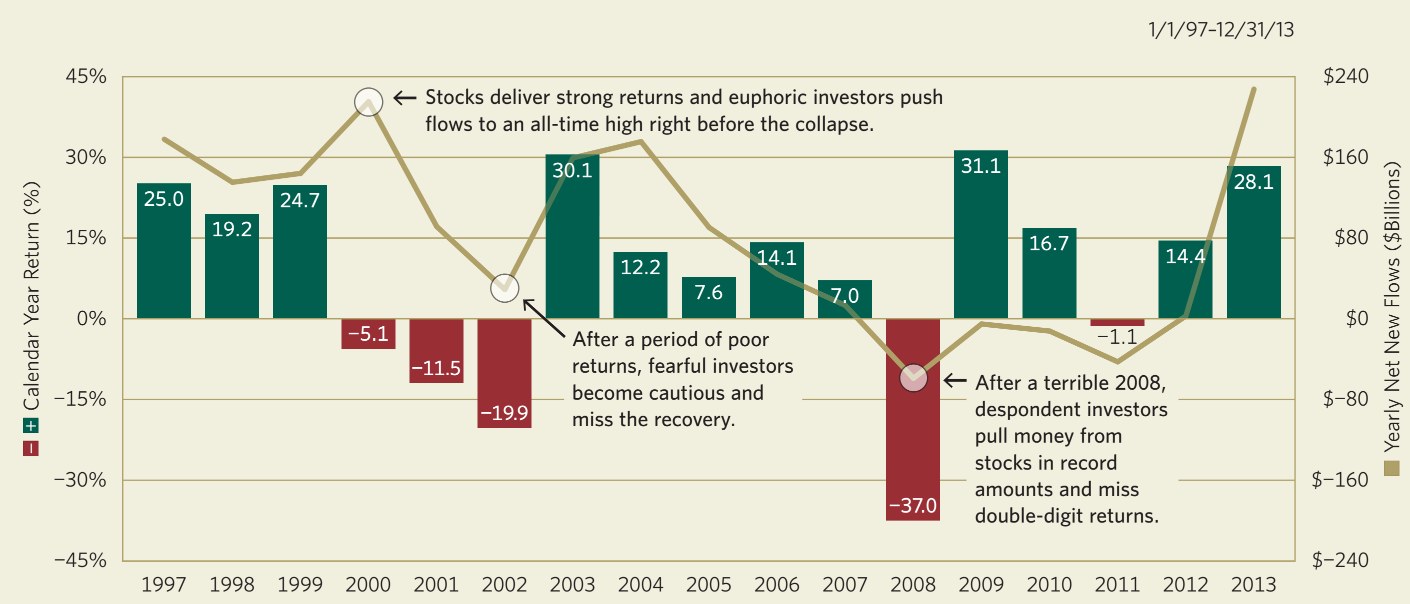
Don't Let Emotions Guide Your Investment Decisions

Building long-term wealth requires counter-emotional investment decisions—like buying at times of maximum pessimism or resisting the euphoria around investments that have recently outperformed. Unfortunately, as the study below shows, investors as a group too often let emotions guide their investment decisions.

The line in the chart below represents the amount of money investors added to domestic stock funds each year from January 1, 1997 to December 31, 2013, while the bars represent the yearly returns for stock funds. Following three years of stellar returns for stock funds from 1997 to 1999, euphoric investors added money in record amounts in 2000, just in time to experience three terrible years of returns from 2000 to 2002. Following these three terrible years, discouraged investors scaled back their contributions to stock funds, just before they delivered one of their best returns ever in 2003 (+30.1%). After stocks delivered a terrible return in 2008, fearful investors became cautious and pulled money from stock funds in record amounts, missing subsequent double-digit returns.

Great investors understand that an unemotional, rational, disciplined investment approach is a key to building long-term wealth.

Stock Fund Net Flows vs. Stock Fund Returns



Source: Strategic Insight and Morningstar as of December 31, 2013. Stock funds are represented by domestic equity funds. **Past performance is not a guarantee of future results.**

"The basic question facing us is whether it's possible for a superior investment manager to underperform.... The assumption widely held is 'no.' And yet if you look at the records, it's not only possible, it's inevitable."

Charles D. Ellis
Quote from *Wall Street People*

Understand That Short-Term Underperformance is Inevitable

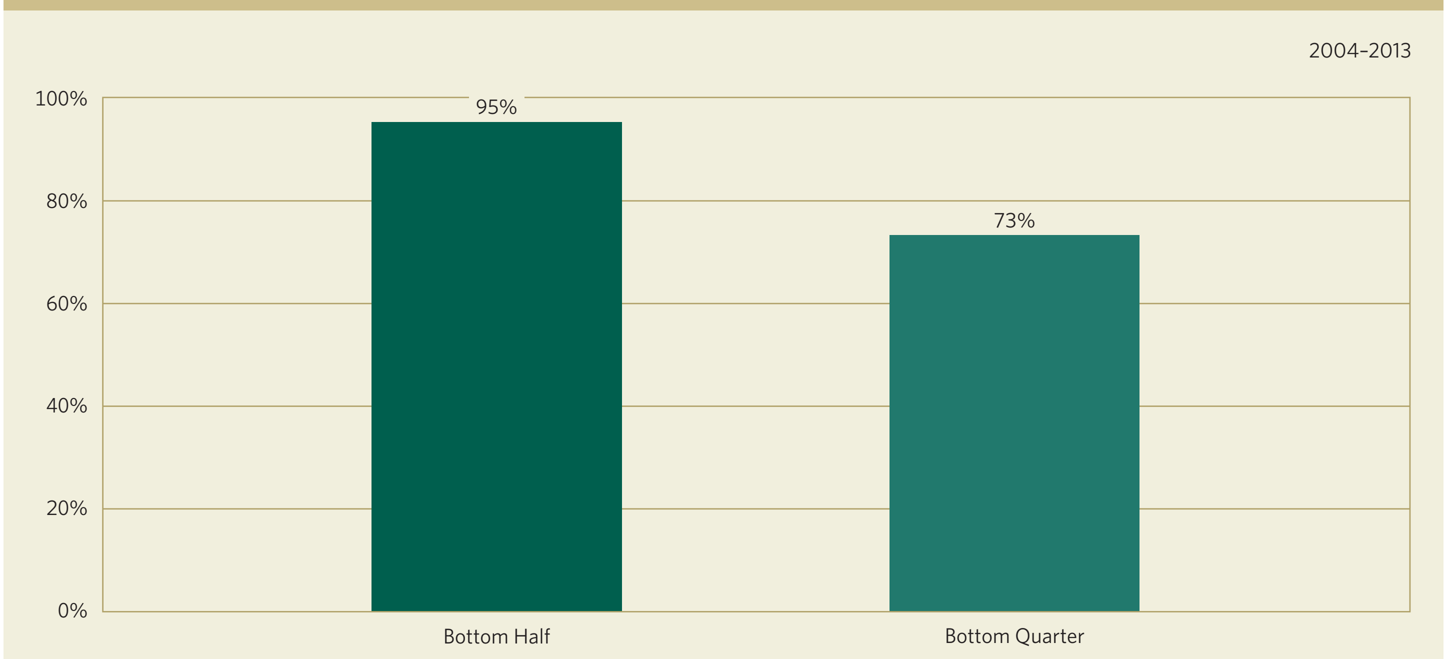
When faced with short-term underperformance from an investment manager, investors may lose conviction and switch to another manager. Unfortunately, when evaluating managers, short-term performance is not a strong indicator of long-term success.

The study below illustrates the percent of top-performing large cap investment managers from January 1, 2004 to December 31, 2013 who suffered through a three year period of underperformance. The results are staggering:

- 95% of these top managers' rankings fell to the bottom half of their peers for at least one three year period, and
- A full 73% ranked among the bottom quarter of their peers for at least one three year period.

Though each of the managers in the study delivered excellent long-term returns, almost all suffered through a difficult period. Investors who recognize and prepare for the fact that short-term underperformance is inevitable—even from the best managers—may be less likely to make unnecessary and often destructive changes to their investment plans.

Percentage of Top Quartile Large Cap Equity Managers Whose Performance Fell Into the Bottom Half or Quarter for at Least One Three Year Period



Source: Davis Advisors. 197 managers from eVestment Alliance's large cap universe whose 10 year gross of fees average annualized performance ranked in the top quartile from January 1, 2004 to December 31, 2013. **Past performance is not a guarantee of future results.**

"The function of economic forecasting is to make astrology look respectable."

John Kenneth Galbraith
Economist and Author

Disregard Short-Term Forecasts and Predictions

During periods of uncertainty, investors often gravitate to the investment media for insights into how to position their portfolios. While these forecasters and prognosticators may be compelling, they usually add no real value.

The study below tracked the average interest rate forecast from *The Wall Street Journal* Survey of Economists from December 1982 to December 2013. This forecast was then compared to the actual direction of interest rates. Overall, the economists' forecasts were wrong in 40 of the 63 time periods—63% of the time!

Do not waste time and energy focusing on variables that are unknowable and uncontrollable over the short term, like the direction of interest rates or the level of the stock market. Instead, focus your energy on things that you can control, like creating a properly diversified portfolio, determining your true time horizon and setting realistic return expectations.

Six Month Average Forecasted Direction vs. Actual Direction of Interest Rates

Date	Forecast	Actual	Result
12/82	▼	▼	Right
6/83	▼	▲	Wrong
12/83	▼	▲	Wrong
6/84	▼	▲	Wrong
12/84	▲	▼	Wrong
6/85	▲	▼	Wrong
12/85	▲	▼	Wrong
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Source: Legg Mason and *The Wall Street Journal* Survey of Economists. This is a semi-annual survey by *The Wall Street Journal* last updated December 31, 2013.
*Benchmark changed from 30 Year Treasury to 10 Year Treasury. **Past performance is not a guarantee of future results.**

"You make most of your money in a bear market, you just don't realize it at the time."

Shelby Cullom Davis
Legendary Investor, Davis Investment Discipline Founder

Conclusion

It is important to understand that periods of market uncertainty can create wealth-building opportunities for the patient, diligent, long-term investor. Taking advantage of these opportunities, however, requires the willingness to embrace and incorporate the wisdom and insight offered in these pages. History has taught us that investors who have adopted this mindset have met with great success.

Avoid Self-Destructive Investor Behavior

Chasing the hot-performing investment category or making major tweaks to your long-term investment plan can sabotage your ability to build wealth. Instead, work closely with your financial advisor to outline your long-term goals, develop a plan to achieve them and set the expectation that you will stick with that plan when faced with difficult periods for the market.

Understand That Crises are Inevitable

Crises are painful and difficult, but they are also an inevitable part of any long-term investor's journey. Investors who bear this in mind may be less likely to react emotionally, more likely to stay the course and be better positioned to benefit from the long-term growth potential of stocks.

Recognize That Historically, Periods of Low Returns for Stocks Have Been Followed by Periods of Higher Returns

Low prices have helped increase future returns. Investors who bear this in mind are more likely to endure hard times and be there to benefit from the subsequent periods of recovery.

Don't Attempt to Time the Market

Investors who understand that timing the market is a loser's game will be less prone to reacting to short-term extremes in the market and more likely to adhere to their long-term investment plan.

Don't Let Emotions Guide Your Investment Decisions

Great investors throughout history have recognized the value of making decisions that may not feel good at the time but that may potentially bear fruit over the long term—such as investing in areas of the market that investors are avoiding and avoiding areas of the market that investors are embracing.

Understand That Short-Term Underperformance is Inevitable

Almost all great investment managers go through periods of underperformance. Build this expectation into your hiring decisions and also remember it when contemplating a manager change.

Disregard Short-Term Forecasts and Predictions

Don't make decisions based on variables that are impossible to predict or control over the short term. Instead, focus your energy toward creating a diversified portfolio, developing a proper time horizon and setting realistic return expectations.

Past performance is not a guarantee of future results. There is no guarantee that an investor following these strategies will in fact build wealth.

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Dalbar, a Boston-based financial research firm that is independent from Davis Advisors, researched the result of actively trading mutual funds in a report entitled *Quantitative Analysis of Investor Behavior (QAIB)*. The Dalbar report covered the time periods from 1994–2013. The Lipper Equity LANA Universe includes all U.S. registered equity and mixed-equity mutual funds with data available through Lipper. The fact that buy and hold has been a successful strategy in the past does not guarantee that it will continue to be successful in the future.

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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 **Dow Jones Industrial Average** is a price-weighted average of 30 actively traded blue chip stocks. The Dow Jones is calculated by adding the closing prices of the component stocks and using a divisor that is adjusted for splits and stock dividends equal to 10% or more of the market value of an issue as well as substitutions and mergers. The average is quoted in points, not in dollars. Investments cannot be made directly in an index.

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Item #4518 12/13