# Davis Large Cap Value SMA Portfolio

Spring Update 2020

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50 YEARS DAVIS ADVISORS

Davis ADVISORS

THE EQUITY SPECIALISTS

# Portfolio Commentary

## Special Update from Portfolio Managers

### To Our Advisors, Clients and Friends,

For more than 50 years, we at Davis Advisors have served as stewards and fiduciaries for our clients' savings. In doing so, our goal is to help them achieve their financial aspirations, whether a comfortable retirement, a child's education, a dream home, or gifts to charity. At this challenging time, our first thoughts are for their safety and well-being.

We also want to make clear that our firm and client portfolios seek to weather any kind of financial storm, including this one. While past performance does not guarantee future results, over the decades, we have withstood countless market dislocations, natural disasters, and other unforeseeable calamities, from the oil embargo and stagflation to the S&L crisis, 9/11, and the Great Recession. Rest assured, we are well-prepared at every level for the storm at hand. Our firm is financially strong and extremely liquid. Our portfolios are filled with well-capitalized, durable businesses that we believe have the potential to ride out this period with their franchises and earnings power intact. We have the best research team we have ever had and have been diligently evaluating every individual company across our portfolios. We are in regular contact with corporate management teams around the globe. We have a robust and time-tested business-continuity plan and will continue to provide clients and advisors with the first-class support they have come to expect from us, in good times and bad.

## Investment Thoughts

To build generational wealth, successful long-term investors must have the discipline to keep their emotions in check. In normal times, such discipline is not difficult. However, in times of fear, prices gyrate wildly, headlines blare bad news, and panic trumps rationality. In such extreme periods, self-discipline becomes both more difficult and more essential.

Today, with the market, the economy, and country in the grip of panic, rationality and perspective are more important than ever. The purpose of this note is not to make short-term predictions regarding spread of the COVID-19 virus nor on the timing of its containment. Instead, our goal is to provide a longer-term perspective that can serve as a framework for navigating the turbulence and uncertainty of the current environment. Armed with such a framework, investors will be prepared to unemotionally distinguish between the short-term volatility and potential long-term opportunities presented in the current market.

As human beings, we do not welcome times of fear and panic. However, as investors, we welcome the bargain prices such emotions produce. While we are in a volatile period and do not know what the future will look like, today, many wonderful businesses are on sale. The opportunity to buy such businesses at bargain prices is both rare and potentially valuable.

After more than 50 years of successful investing, we can think of no better advice for navigating today's market than the timeless words of our founder, Shelby Davis, who famously said, "You make most of your money in a bear market. You just don't realize it at the time." With many high-quality, durable businesses trading more than 50% below the prices they traded at just a few months ago, investors have the opportunity to make decisions today that may build wealth tomorrow. ■

## Short-Term Predictions Versus Long-Term Probabilities

Today, investors are bombarded by a wide range of short-term predictions regarding the course of the current pandemic over the next 3–12 months, though we would suggest that the containment of the virus in countries such as South Korea, Singapore, and China should lead us to question the most extreme predictions, which seem more based on fearmongering and publicity than data and analysis. While the wide range of short-term predictions may be unsettling, longer-term probabilities fall into a much tighter range. Though there is limited knowledge and uncertainty about the impact of the disease, as we get out 12–24 months, it is possible that the virus will have run its course, a vaccine will be available, and, as a result of the lessons learned from this first modern pandemic, we should be far better prepared for future pandemics. In other words, while we don't know the precise timing, we do believe this period of uncertainty will come to an end, infection rates will fall, venues will reopen, businesses restart, and normal life resume. As a result, while there may be a powerful emotional cost, we believe there may be little lasting economic cost. ■

## Portfolio Update

With the short-term cloudy but the long-term clearer, we have analyzed our Portfolio through three lenses to distinguish which companies to avoid, which to hold, and which to buy.

First, investors should avoid those companies whose business model or precarious financial structure create the risk that they may not be able to survive short-term dislocation. In particular, industries with high fixed costs, plummeting revenue, and high levels of debt are especially vulnerable. While it is likely that many of these will receive some sort of government support to get them through the short term, the availability of such aid is uncertain, and its terms may be punitive. While we recognize that a favorable intervention could lead to a snap back in the shares of some of these companies, buying before the terms are made clear is a speculative gamble, not a long-term investment.

Second, investors should recognize that for some companies, the current environment may have a favorable short-term impact. Today, for example, services such as online shopping, video conferencing, distance learning, streaming entertainment, and gaming are seeing sharp increases in usage. In many cases, the share prices of such companies have bucked negative trends and risen while the rest of the market has fallen. For long-term investors, the challenge is to distinguish between those companies for whom this effect is likely to reverse as life gets back to normal and those for whom the effect is more likely to be sustained. The former can be a good source of funds in the current environment, while the latter may be long-term holds.

Third, and most importantly, investors must analyze those companies for which a steep, short-term decline in economic activity is an unpleasant but manageable reality. Here, the investment opportunities may be the greatest for the simple reason that investors are more concerned with short-term uncertainty than long-term durability. Whether it is dominant technology leaders, such as Alphabet, high-quality global industrial companies, like Raytheon Technologies, or well-capitalized financial leaders, such as American Express, share prices of select durable businesses can now be purchased at 50–70% off. Energy, similarly, has been deeply discounted. We hold small investments in the energy sector where we believe the liquidity profile and staying power, as well as the production potential in the future, may not be appreciated by the market. Ovintiv is one such holding. To fund new purchases, we sold our position in Adient. In stores, shoppers are quick to respond to such dramatic sales by buying more. In the stock market, emotional investors are more likely to sell or remain on the sidelines. By focusing on facts rather than emotions, rational long-term investors can build wealth for tomorrow by buying these valuable companies at bargain prices. However, it is important to remember that there is no guarantee these share prices will appreciate in the future. ■

## Conclusion

Over 50 years of successful investing, we at Davis Advisors have weathered many storms and crises by being rational when others were fearful. Whether it was the bear market of the 1970s, early 2000s, or the financial crisis, buying after significant price declines have historically rewarded long-term investors who could keep their emotions in check. Although each period differed in its peculiarities, all share a similar pattern to what we see today. Fearful investors sell after prices have gone down, waiting on the sidelines until 'things feel better.' Rational investors buy after prices have gone down, recognizing that prices have the potential to be higher when 'things feel better.' In every case, fearmongers argued that this time was different and that a recovery would never come. And, in every case, our society, our economy, the market, and our portfolios proved resilient, recovered, and went on to new heights. We believe today is no different. Investors who can keep their emotions in check may once again have the opportunity to buy durable and resilient businesses at bargain prices and pursue generational wealth over the long term.

As stewards of our clients' savings, our job is to make rational, long-term decisions and remain dispassionate at all times. However, we are also human beings who understand the stress that fear places on our families, friends and communities. While we know that a period of recovery and healing will follow this difficult stretch, we sincerely hope that, until then, you remain safe and healthy. We thank you for the trust you have placed with us. ■

# Davis Large Cap Value SMA Portfolio

## Selective. Attractive Growth. Undervalued.

Today, the Davis Large Cap Value SMA portfolio holdings can be characterized by three characteristics: selective, attractive growth potential and undervalued. Selectivity allows us to reject the vast majority of companies that make up the index and instead build a portfolio of those few companies that have above-average growth and below-average valuations. This combination of higher growth at below average valuations should create wealth for our shareholders in the years and decades to come.

| | | Davis Large Cap Value SMA Portfolio | S&P 500 Index |
|---|---|---|---|
| **Selective** | Holdings | 25 | 505 |
| **Attractive Growth** | EPS Growth (5 Year)[1] | 24.7% | 18.5% |
| **Undervalued** | P/E (Forward)[2] | 10.9x | 16.2x |

The Attractive Growth and Undervalued reference in this piece relates to underlying characteristics of the portfolio holdings. There is no guarantee that the Porfolio's performance will be positive as equity markets are volatile and an investor may lose money. **Past performance is not a guarantee of future returns.** Performance may vary. **1.** 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. **2.** 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.

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# Davis Large Cap Value SMA Portfolio Holdings

March 31, 2020

## High Conviction. Different from the Index.

| Holding | Portfolio (%) | S&P 500 Index (%) |
|---|---|---|
| Alphabet | 7.0% | 3.3% |
| Berkshire Hathaway | 7.0 | 1.7 |
| Amazon.com | 7.0 | 3.8 |
| Applied Materials | 7.0 | 0.2 |
| United Technologies | 6.1 | 0.4 |
| Capital One Financial | 6.0 | 0.1 |
| Facebook | 5.9 | 1.9 |
| Wells Fargo | 5.8 | 0.5 |
| JPMorgan Chase | 5.6 | 1.3 |
| American Express | 4.4 | 0.3 |
| Alibaba Group Holding | 4.1 | — |
| Bank of New York Mellon | 4.1 | 0.1 |
| New Oriental Education & Technology | 4.1 | — |
| Texas Instruments | 3.7 | 0.4 |
| Intel | 3.3 | 1.1 |
| Quest Diagnostics | 3.1 | 0.1 |
| U.S. Bancorp | 3.0 | 0.2 |
| Microsoft | 1.9 | 5.6 |
| Chubb | 1.7 | 0.2 |
| Apache | 1.3 | 0.0 |
| Raytheon | 1.2 | 0.2 |
| Oracle | 0.9 | 0.5 |
| Loews | 0.7 | 0.0 |
| Ovintiv | 0.1 | — |
| CASH | 5.0 | — |
| | **100.0%** | |

The above listed securities are representative of a model Davis Large Cap Value SMA Portfolio as of the indicated date. Portfolio holdings may change over time. Individual accounts may contain different securities. There is no assurance that any securities listed herein will remain in an individual account at the time you receive this report. The securities listed for the S&P 500 Index are not representative of the entire portfolio, which consists of 505 securities. The information provided should not be considered a recommendation to buy or sell any particular security. There can be no assurance that an investor will earn a profit and not lose money.

# Davis Large Cap Value SMA Portfolio

March 31, 2020

**Davis Large Cap Value is a portfolio of attractive businesses selected using the time-tested Davis Investment Discipline. The Portfolio has outperformed its benchmark since inception. As one of the largest investors in the strategy, we have a unique commitment to client stewardship.[1]**

### Unique Attributes of Davis Large Cap Value SMA Portfolio

- **Equity-Focused Research Firm:** Established in 1969, Davis is a leading specialist in equity investing. Our primary focus on research and unique investment discipline has built wealth for our clients over the long term.
- **Portfolio of Best of Breed Businesses:** Utilizing rigorous independent research, we invest in durable, well-managed businesses with sustainable competitive advantages and attractive long-term growth prospects selling at a discount to their true value.
- **Flexible, Opportunistic Approach:** We believe a bottom-up stock selection process and not mirroring the benchmark index are keys to long-term outperformance. Active Share 82%.
- **We Are One of the Largest Investors:** We have a unique commitment to stewardship, generating attractive long-term results and managing risks.

### Undervalued. Attractive Growth. Selective.[2]

| | | Portfolio | Index |
|---|---|---|---|
| **Undervalued** | P/E (Forward) | 10.9x | 16.2x |
| **Attractive Growth** | EPS Growth (5 Year) | 24.7% | 18.5% |
| **Selective** | Holdings | 25 | 505 |

### Experienced Management

Chris Davis, *31 years with Davis Advisors*
Danton Goei, *21 years with Davis Advisors*

### Our Investment Alongside Our Clients

We have more than $2 billion of our own money invested in Davis strategies and funds.[4]

### Top 10 Holdings[3]

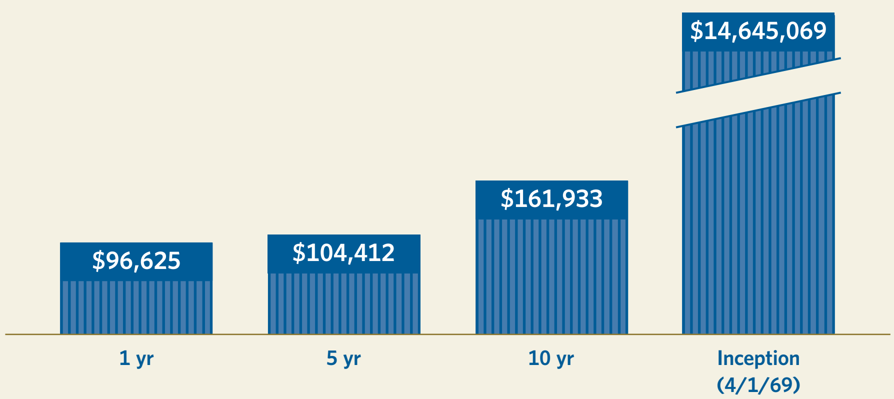
| | Portfolio | Index |
|---|---|---|
| Alphabet | 7.0% | 3.3% |
| Berkshire Hathaway | 7.0 | 1.7 |
| Amazon.com | 7.0 | 3.8 |
| Applied Materials | 7.0 | 0.2 |
| United Technologies | 6.1 | 0.4 |
| Capital One Financial | 6.0 | 0.1 |
| Facebook | 5.9 | 1.9 |
| Wells Fargo | 5.8 | 0.5 |
| JPMorgan Chase | 5.6 | 1.3 |
| American Express | 4.4 | 0.3 |

### Sectors[5]

| | Portfolio | Index |
|---|---|---|
| Financials | 40.2% | 12.2% |
| Information Technology | 17.7 | 24.2 |
| Consumer Discretionary | 16.0 | 9.8 |
| Communication Services | 13.6 | 10.7 |
| Industrials | 7.7 | 8.2 |
| Health Care | 3.3 | 15.4 |
| Energy | 1.5 | 2.7 |
| Consumer Staples | — | 7.8 |
| Utilities | — | 3.6 |
| Real Estate | — | 3.0 |
| Materials | — | 2.4 |

## Davis LCV SMA Portfolio Has Grown Client Wealth Over the Long Term[6]

($100,000 Hypothetical Investment)




***Average Annual Total Returns as of March 31, 2020 for Davis Large Cap Value SMA Composite with a 3% maximum wrap fee: 1 year, −14.78%; 5 years, 0.62%; 10 years, 4.57%. The performance presented represents past performance and is not a guarantee of future results.*** *Total return assumes reinvestment of dividends. Investment return and principal value will vary so that an investor may lose money. Current performance may be higher or lower. Total return updates are available quarterly. Please ask your financial advisor to contact Davis Advisors. See endnotes for a description of the Composite.* Portfolio characteristics, holdings and industry groups are subject to change. Davis Advisors classifies its Large Cap Value strategy as such based on its overall investment strategy. At the time of this report, this classification may or may not agree with classifications by other third party information services. **1.** As of 12/31/19. This includes Davis Advisors, the Davis family and Foundation, and our employees. **2.** The Attractive Growth and Undervalued reference in this piece relates to underlying characteristics of the portfolio holdings. There is no guarantee that the Portfolio's performance will be positive as equity markets are volatile and an investor may lose money. **3.** For information purposes only. Not a recommendation to buy or sell any security. **4.** As of 12/31/19. Includes Davis Advisors, Davis Family and Foundation, our employees and Fund Directors. **5.** Sources: Davis Advisors and Wilshire Atlas. **6.** Net of fees. As of 3/31/20.

# Investment Professionals

**Christopher C. Davis** joined Davis Advisors in 1989. He has more than 30 years experience in investment management and securities research. Mr. Davis received his M.A. from the University of St. Andrews in Scotland.

**Danton G. Goei** joined Davis Advisors in 1998. Mr. Goei received his B.A. from Georgetown University and his M.B.A. from The Wharton School. He was previously employed at Bain & Company, Morgan Stanley Asia Ltd. and Citicorp. Mr. Goei speaks multiple languages and has lived in Europe, Asia and currently resides in New York City.

**Dwight C. Blazin** joined Davis Advisors in 1995. He was previously a consultant for IT Consulting and Systems Design. Mr. Blazin received his B.A. from Brigham Young University and his M.A. and Ph.D. from New York University.

**Kent Y. Whitaker** first joined Davis Advisors in 2000. Previously, he worked at Amoco Corporation, British Petroleum, Hunt Energy Corporation, and Asarco. Mr. Whitaker holds a B.A. from Dartmouth College, a M.S. from Miami University and a M.B.A. from the Amos Tuck Business School.

**Darin Prozes** joined Davis Advisors in 2004. He previously worked for the Parthenon Group, a strategy consulting firm. Mr. Prozes received his B.A. from Princeton University and his M.B.A. from Stanford University.

**Pierce B.T. Crosbie, CFA** joined Davis Advisors in 2008. Previously, he worked as a research analyst at Davidson Kempner Capital Management and in mergers and acquisitions at RBC Capital Markets. Mr. Crosbie received his B.A. from McGill University, his M.B.A. from the Harvard Business School and is a CFA charter holder.

**Edward Yen** joined Davis Advisors in 2013. Previously, he worked at Dodge & Cox and Lehman Brothers. Mr. Yen received his B.S. from the University of California, Berkeley and his M.B.A. from Stanford University.

**Benjamin Betcher, CFA** joined Davis Advisors in 2017. Previously, he worked as a research analyst at Sanford Bernstein and as head of finance at Ampush Media. Mr. Betcher received his B.S. from Tufts University and is a CFA charter holder.

**Sobby Arora, CFA** joined Davis Advisors in 2017. Previously, he worked as a research analyst at Federated Global Investment Management and ING Investment Management. Mr. Arora received his B.A. from Colgate University, his M.B.A. from The Stern School of Business and is a CFA charter holder.

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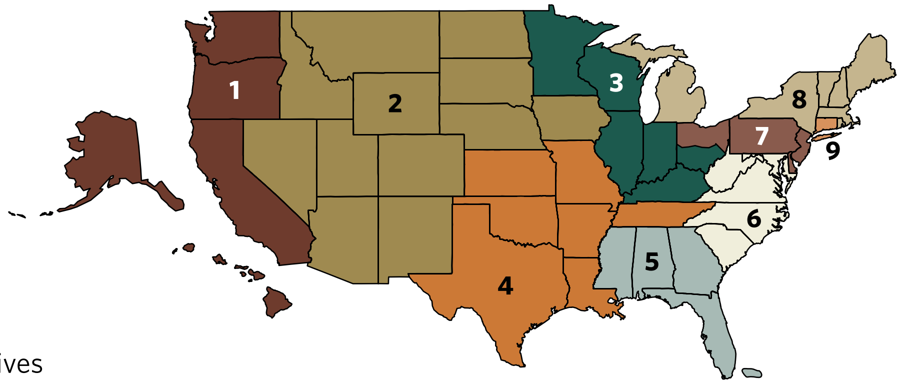
# Contacts

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Contact Regional Directors or Regional Representatives to arrange meetings or for information on our investment process, philosophy and performance.

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*This material may be shared with existing and potential clients to provide information concerning market conditions and the investment strategies and techniques used by Davis Advisors to manage its client accounts. Please refer to Davis Advisors' Form ADV Part 2 for more information regarding investment strategies, risks, fees, and expenses. Clients should also review other relevant material, including a schedule of investments listing securities held in their account.*

Davis Advisors is committed to communicating with our investment partners as candidly as possible because we believe our clients 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," "feel," 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.

This report discusses companies in conformance with Rule 206(4)-1 of the Investment Advisers Act of 1940 and guidance published thereunder. The companies we discuss are chosen in the following manner: starting at the beginning of the year, the holdings from a Large-Cap model portfolio are listed in descending order based on percentage owned. Companies that reflect different weights are then selected. (For the first quarter, holdings numbered 1, 11, 21, and 31 are selected and discussed. For the second quarter, holdings numbered 2, 12, 22, and 32 are selected and discussed. This pattern then repeats itself for the following quarters. No more than two of these holdings can come from the same sector per piece.); one recent purchase and one recent sale are also discussed. A sale is defined as a position that is completely eliminated from the portfolio before the end of the quarter in question. If there were no purchases or sales, the purchases and sales are omitted from the report. If there were multiple purchases and/or sales, the purchase and sale discussed shall be the earliest to occur. If there are multiple purchases and/or sales on the same day, the one that is the largest percentage of assets will be discussed. No holding can be discussed if it was discussed in the previous three quarters.

The information provided in this report does not provide information reasonably sufficient upon which to base an investment decision and should not be considered a recommendation to buy or sell any particular security. There is no assurance that any of the securities discussed herein will remain in an account at the time this report is received or that securities sold have not been repurchased. The securities discussed do not represent an account's entire portfolio and in the aggregate may represent only a small percentage of any account's portfolio holdings. It should not be assumed that any of the securities discussed were or will prove to be profitable, or that the investment recommendations or decisions we make in the future will be profitable or will equal the investment performance of the securities discussed herein. It is possible that a security was profitable over the previous five-year period of time but was not profitable over the last year. In order to determine if a certain security added value to a specific portfolio, it is important to take into consideration at what time that security was added to that specific portfolio. A complete listing of all securities purchased or sold in an account, including the date and execution prices, is available upon request.

The investment objective of a Davis Large Cap Value account is long-term growth of capital. There can be no assurance that Davis will achieve its objective. Davis Advisors uses the Davis Investment Discipline to invest a client's assets principally in common stocks (including indirect holdings of common stock through depositary receipts) issued by large companies with market capitalizations of at least $10 billion. Historically, the Large-Cap Value strategy has invested a significant portion of its assets in financial services companies and in foreign companies, and may also invest in mid- and small-capitalization companies. The principal risks are: common stock risk, depositary receipts risk, emerging markets risk, fees and expenses risk, financial services risk, foreign country risk, foreign currency risk, headline risk, large-capitalization companies risk, manager risk, mid- and small-capitalization companies risk, and stock market risk. See the ADV Part 2 for a description of these principal risks.

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