Davis All-Cap SMA Portfolio

Winter Update 2024

Davis ADVISORS

The Equity Specialists

Davis ADVISORS

Portfolio Commentary

Key Takeaways

- The S&P 1500 Index gained 25.47% in 2023 despite headwinds that included rising interest rates, high equity valuations and geopolitical uncertainty.
- Mega-cap tech companies created valuation distortions in the index, but there were many attractive opportunities elsewhere across a wide swath of stocks for active managers willing to depart from the benchmarks.
- Our portfolio of companies remains significantly undervalued even after last year's strong market performance, and we point out that value can be its own performance catalyst as long as investors are patient.

Market Perspectives:
Climbing the Wall of Worry

In 2023 the S&P 1500 Index returned 25.47%. This was a strong result given the number of material headwinds and uncertainties investors faced during the year. These included the regional bank crisis in the early part of the year, rising interest rates, two overseas wars, and relatively elevated valuations for major stock indexes.

While there were indeed challenges, there have been favorable factors at work as well. These include a rather full employment picture with the unemployment rate down to historic lows (3.7%), the economy still expanding at a rate of about 5% on an annualized basis, and immensely greater financial stability than in past decades owing to strict regulations, more disciplined underwriting practices by the largest financial institutions in the country, and relatively low leverage.

"The Magnificent Seven represent a very large percentage of the market's total value today which means that they lend their high valuations to the overall index."

While the so-called Magnificent Seven mega-cap tech companies dominated the financial headlines last year, contributing an outsized portion of index performance, many stocks traded at much more reasonable valuations than those particular technology giants. The Seven represent a very large percentage of the index's total value today which means that they lend their high valuations to the overall index as well. They have caused distortions such that the weighted average price-to-earnings (P/E) multiple on the S&P 1500 Index is over 21x while the average valuation excluding the Magnificent Seven is much lower in our estimation. Davis All-Cap SMA portfolio is truly actively managed—we handpick the companies in the portfolio and set the weightings of each position based on its risk and reward profile—the portfolio has a P/E multiple of only 12x.

In short, despite all predictions to the contrary, the U.S. stock market managed to climb the "wall of worry" standing in its way and delivered returns in 2023 that were far above the long-term average return for equities and on par with a number of record historical years. ■

Portfolio Review:
Cross-Sectional Drivers

It was a strong year for Davis All-Cap SMA performance-wise in absolute terms, and its results were driven by a broad cross-section of holdings. As such, despite a high market multiple due to weightings distortions within the index, there were many attractive opportunities available across a wide swath of stocks and sectors to active managers willing to depart from benchmarks.

The portfolio holds 32 different investments with the largest sector exposures being healthcare, technology, industrials and financial services.

Healthcare: Cost Efficiency in a High-Cost System

Healthcare was a relative laggard in the portfolio. Still, we are excited about our investments in the sector, each of which we believe plays an important role in bringing efficiencies to a system burdened with high costs. Healthcare spending now represents roughly 20% of U.S. gross domestic product, and the U.S. population is only getting older on average. In our minds, this means that demographics and budgetary considerations will drive efforts to curb the rate of healthcare inflation in this country.

Our healthcare investments deliver drugs and services with comparatively greater cost efficiency. We are avoiding companies that may be perceived as overcharging the system, meaning branded pharmaceuticals manufacturers as well as certain biotech companies. This is reflected in the margins of such businesses. The largest branded pharmaceuticals companies in America have gross profit margins of more than 60%. That is effectively their "mark-up" on the products they manufacture. While we want to invest in companies that enjoy attractive margins, in this instance such high margins can make those businesses very vulnerable, especially as we are entering a period of price negotiations between the drug manufacturers and the U.S. government.

Thematically, our healthcare investments share in common the fact that they aim to drive cost efficiencies through the system relative to the alternatives. In addition, they have margin structures that we feel are more sustainable than the peak margins we see in the more expensive pharma companies.

One of our largest positions in the portfolio manufactures mostly generic pharmaceuticals, which is an important way to contain healthcare costs. This company is one of the cheapest in our universe on a free cash flow basis and is both underestimated and misunderstood, partly because its management's strategy for creating value is very rare among large corporations. The approach in this case involves effectively "shrinking to greatness"—that is, seeking to achieve better per-share economics by shedding certain assets, paying down debt, and returning capital. It is a highly management-intensive strategy and depends very much on the effectiveness of capital allocation decisions. We believe the right conditions are in place and that the value in the company can be effectively unlocked.

Other healthcare investments in the portfolio include independent lab and diagnostics company Quest Diagnostics as well as managed care insurance giants such as Humana.

Technology: Five Key Themes

Our positions in technology generally fared well, with many holdings delivering high double-digit returns. Our investments in the broad technology sector span five main areas currently—e-commerce, social media, online search, cloud computing and semiconductors. Our belief is that these industries, while well-established and enormous in size already, are still in the early stages of realizing their full global potential.

In e-commerce, the opportunity set has grown beyond the business of selling products ubiquitously around the globe to include, in addition, revenue-generating opportunities in online advertising and third-party fulfillment and distribution services.

Social media is not always appreciated for its global reach, but the worldwide leader in the space has about 2 billion monthly average users, 90% of which are outside of North America. An opportunity for the company is not only to continue growing its platform and user base, but also to ramp up advertising revenues generated in non-U.S. markets where typical advertising revenue per user is still less than 1/10 of the level in the U.S.

"Cloud computing is the new paradigm for computational data and storage and makes for a seamless experience for end users. The business has a remarkable margin structure and a high barrier to entry."

Online search is still dominated today by a major global technology company which we own. Its hegemony could, in theory, be challenged by new advances in artificial intelligence (AI). That stated, AI is generally smarter and more robust when applied to larger populations of information and data, and this company, by dominating search, boasts more than a 90% market share in many regions of the world. This gives it significantly more data to utilize and process, and a significant competitive advantage over AI newcomers.

Cloud computing is the new paradigm for computational data and storage and makes for a seamless experience for end users. The addition of new cloud services has been somewhat more challenging for the three technology giants that dominate the space, both in terms of new subscriptions and price negotiations. However, the fact remains that cloud is a business with a remarkable margin structure and, based on the amount of capital and technological know-how it requires, a high barrier to entry.

Semiconductors offer a way for investors to access the technology sector, especially if they are seeking to gain exposure to very long-tailed opportunities such as electrification of vehicles, industrial Internet-of-Things (IoT), communications, consumer electronics, and computational processing.

Overall, we believe that the businesses we own in technology are an important facet of the portfolio. We are being disciplined about managing the weightings of companies in this sector as well as the valuations we are willing to pay.

Financials: The Strong Versus the Weak

Financial services surprised many on Wall Street last year, not least because the group defied the notion that the sector must underperform in periods of potential or real economic slowdowns. Our largest financial positions delivered strong returns in 2023 relative to the broader market and other financial stocks. What was perhaps the most remarkable feature of last year's financial stock performance is that the market appeared to make fairly stark distinctions between the stronger and weaker institutions, in sharp contrast to 2008–2009 when we saw a unilateral sell-off across the entire group.

We do not have a monolithic view of the financial sector. We own companies that are multi-industry conglomerates with asset management-like investment practices, what we refer to as "non-financial financials," meaning they are not traditional lenders. They include mega-cap banks, leaders in property casualty insurance and reinsurance, and consumer finance companies, among others. While the group overall performed better than many expected in 2023, regional bank stocks were laggards. A company such as U.S. Bancorp, despite rebounding from its spring 2023 low, still delivered fairly modest performance for the year.

"The general observation that the financial system of the U.S. is stronger and more equipped to handle slowdowns or contractions today holds very true based on the data that we see."

Given the considerable restraints placed on major lending institutions since the last crisis, the companies we favor have been trading roughly at or in some cases below book value. This implies they are set to lose money due to credit losses. We believe the opposite will hold true this time around—specifically that our largest banks and consumer finance companies have the wherewithal to absorb credit costs on their income statements to a much larger extent than before, and may in fact grow earnings and book value, even net of credit costs. These financial businesses are cheap on a price-to-book and P/E basis, setting up the possibility of a "double play" for shareholders if they continue to deliver strong financial results, which has been the case in recent periods.

One should always exercise selectivity in choosing investments, but the general observation that the financial system of the U.S. is stronger and more equipped to handle slowdowns or contractions today holds very true based on the data that we see.

Outside of the above areas, the portfolio's performance last year benefited from its investments in industrial companies such as Eaton Corp.

Newer investments include AGCO, a manufacturer of farm and agricultural equipment. We sold our position in KE Holdings to allocate capital to more attractive opportunities.

The portfolio is currently invested across approximately 32 holdings that in our view represent exceptional businesses trading at attractive prices with an average forward P/E multiple of 12x versus 21x for the benchmark. ■

Outlook:
Building Value Over Time

A key takeaway from 2023's strong stock performance is that what matters is not whether the news flow is positive or negative but what the market is *discounting* in prices. Our portfolio of companies remains significantly undervalued even after last year's strong performance, in many cases because these investments by and large started at very depressed valuations. If asked what the catalyst is for those securities, we would point out that value can be its own catalyst as long as investors are patient.

Whatever the market environment, our goal is to have a portfolio that we believe is well-prepared and resilient through inevitable challenges. We maintain our discipline of looking at the changing landscape of businesses and valuations as objectively as possible, and with fresh eyes each day, in order to build value over time.

In conclusion, as stewards of our clients' savings our most important job is growing the value of the funds entrusted to us. With more than $2 billion of our own money invested alongside that of our clients, we are on this journey together.[1] This alignment with our clients is uncommon in our industry; our conviction in our portfolio of carefully selected companies is more than just words. ■

1. As of 12/31/23, Davis Advisors, the Davis family and Foundation, and our employees have more than $2 billion invested alongside clients in similarly managed accounts and strategies.

Davis All-Cap SMA Portfolio

Selective. Attractive Growth. Undervalued.

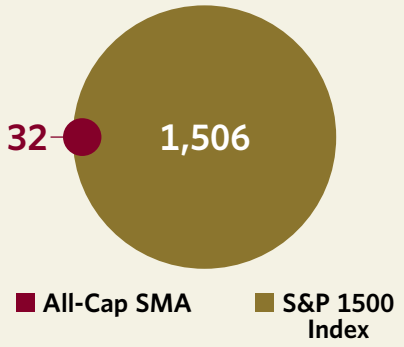
What gives us confidence that Davis All-Cap SMA may build wealth for our shareholders in the years and decades to come? The compelling attributes of our businesses.

By being highly selective and rejecting the vast majority of companies in the index, the companies of Davis All-Cap SMA Portfolio have grown more than the companies in the index, yet are 43% less expensive. In fact, this gap between price and value is among the widest we have ever seen. We believe this sets the stage for attractive returns in the years ahead.

Selective

All-Cap SMA invests in only a select group of well-researched companies

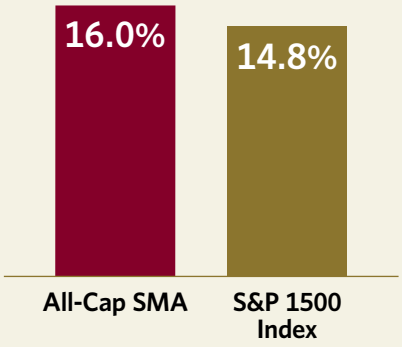
Holdings



Attractive Growth

All-Cap SMA portfolio companies have grown more than the index

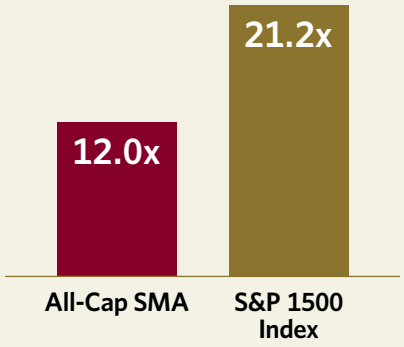
EPS Growth (5 Year)[1]



Undervalued

All-Cap SMA portfolio companies are 43% less expensive than the index

P/E (Forward)[2]



As of 12/31/23. 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. **Past performance is not a guarantee of future returns.** Performance may vary. **1.** Five-year EPS Growth Rate (5-year EPS) is the average annualized earnings per share growth for a company over the past 5 years. The values shown are the weighted average of the 5-year EPS of the stocks in the Portfolio or Index. Approximately 5.20% of the assets of the Portfolio are not accounted for in the calculation of 5-year EPS as relevant information on certain companies is not available to the Advisor's data provider. **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 All-Cap SMA Portfolio Holdings

December 31, 2023

High Conviction. Different from the Index.

Holding	Portfolio (%)	S&P 1500 Index (%)
Capital One Financial	7.0%	0.1%
Quest Diagnostics	6.7	0.0
Wells Fargo	6.7	0.4
Viatris	5.5	0.0
Cigna Group	4.9	0.2
Owens Corning	4.8	0.0
Teck Resources	4.4	—
UnitedHealth Group	4.4	1.1
Applied Materials	4.0	0.3
Meta Platforms	3.9	1.8
U.S. Bancorp	3.8	0.2
Markel Group	3.5	—
Amazon.com	3.4	3.2
Berkshire Hathaway	3.0	1.5
Intel	2.5	0.5
Eaton	2.4	0.2
Ferguson	2.4	—
Darling Ingredients	2.3	0.0
Masterbrand	2.3	0.0
Wesco International	2.3	0.0
Carrier Global	2.2	0.1
Johnson Controls International	2.0	0.1
Humana	1.6	0.1
Texas Instruments	1.6	0.4
Alphabet	1.5	3.5
SAP	1.5	—
AGCO	1.4	0.0
CVS Health	1.2	0.2
Microsoft	1.2	6.4
Oracle	1.1	0.4
IAC	0.8	—
Clear Secure	0.5	—
CASH	3.2	—
	100.0%	

The securities listed on the left are representative of a model Davis All-Cap 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 1500 Index are not representative of the entire portfolio, which consists of 1,506 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.

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Davis All-Cap SMA Portfolio

December 31, 2023

Davis All-Cap SMA is a portfolio of small, medium and large companies selected using the time-tested Davis Investment Discipline. As one of the largest investors in the strategy, we have a unique commitment to client stewardship.[1]

Unique Attributes of Davis All-Cap 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:** The portfolio can opportunistically invest across all market caps, sectors and industries. We believe in a bottom-up stock selection process and in not mirroring the benchmark index. Active Share = 87%.
- **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)	12.0x	21.2x
Attractive Growth	EPS Growth (5 Year)	16.0%	14.8%
Selective	Holdings	32	1,506

Experienced Management

The research team has an average of 25 years investment experience.

Top 10 Holdings[3]	Portfolio	Index
Capital One Financial	7.0%	0.1%
Quest Diagnostics	6.7	0.0
Wells Fargo	6.7	0.4
Viatris	5.5	0.0
Cigna Group	4.9	0.2
Owens Corning	4.8	0.0
Teck Resources	4.4	—
UnitedHealth Group	4.4	1.1
Applied Materials	4.0	0.3
Meta Platforms	3.9	1.8

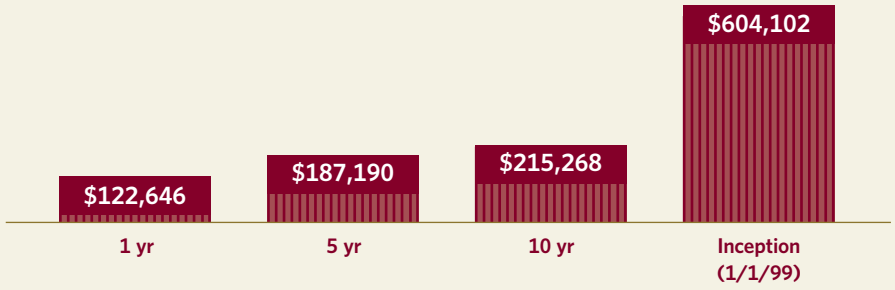
Market Capitalization

Large Cap	90.1%
Mid Cap	7.0
Small Cap	2.9

Sectors[4]	Portfolio	Index
Health Care	25.0%	12.3%
Financials	24.8	13.3
Industrials	20.5	9.8
Information Technology	12.8	27.2
Communication Services	6.4	8.0
Materials	4.6	2.8
Consumer Discretionary	3.5	11.2
Consumer Staples	2.4	6.0
Energy	—	4.0
Real Estate	—	3.0
Utilities	—	2.4

Wealth Over the Long Term[5]

$100,000 Hypothetical Investment



Net average annual total returns as of December 31, 2023 for Davis Multi-Cap Equity SMA Composite with a 3% maximum wrap fee: 1 year, 22.65%; 5 years, 13.36%; 10 years, 7.97%. 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. For current, quarterly returns, please ask your financial advisor to contact Davis Advisors. Current performance may be higher or lower.* The investment strategies described herein are those of Davis Advisors. These materials are being provided for illustrative and informational purposes only. The information contained herein is obtained from multiple sources that are believed to be reliable. However, such information has not been verified, and may be different from the information included in documents and materials created by the sponsor firm in whose investment program a client participates. Some sponsor firms may require that these materials are preceded or accompanied by investment profiles or other documents or materials prepared by such sponsor firms, which will be provided upon a client's request. For additional information, documents and/or materials, please speak to your Financial Advisor. **1.** As of 12/31/23. 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 performance will be positive as equity markets are volatile and an investor may lose money. **Past performance is not a guarantee of future returns.** Five-year EPS Growth Rate (5-year EPS) is the average annualized earnings per share growth for a company over the past 5 years. The values shown are the weighted average of the 5-year EPS of the stocks in the portfolio or index. Approximately 5.20% of the assets of the Portfolio are not accounted for in the calculation of 5-year EPS as relevant information on certain companies is not available to the data provider. Forward Price/Earnings (Forward P/E) Ratio is a stock's price at the date indicated divided by the company's forecasted earnings for the following 12 months based on estimates provided by the data provider. These values for both the portfolio and the index are the weighted average of the stocks in the portfolio or index. **3.** For information purposes only. Not a recommendation to buy or sell any security. **4.** Sources: Davis Advisors and Wilshire Atlas. **5.** Net of fees. As of 12/31/23.

Investment Professionals

Christopher C. Davis joined Davis Advisors in 1989. He has 35 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.

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.

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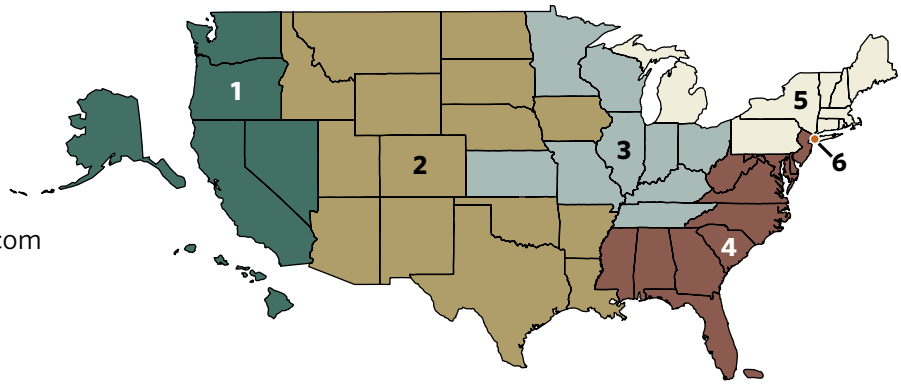

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This material may be shared with existing and potential clients to provide information concerning market conditions and the investment strategies and techniques used by Davis Advisors to manage its client accounts. Please refer to Davis Advisors Form 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," or similar expressions. You should not place undue reliance on forward-looking statements, which are current as of the date of this material. 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 material discusses companies in conformance with Rule 206(4)-1 of the Investment Advisers Act of 1940 and guidance published thereunder. Six companies are discussed and are chosen as follows: (1–4) current holdings based on December 31 holdings; (5) the first new position; and (6) the first position that is completely closed out. Starting at the beginning of the year, the holdings from a Multi-Cap Equity 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, 6, 11, and 16 are selected and discussed. For the second quarter, holdings numbered 2, 7, 12, and 17 are selected and discussed. This pattern then repeats itself for the following quarters. If a holding is no longer in the portfolio then the next holding listed is discussed. No more than two of these holdings can come from the same sector per piece. None of these holdings can be discussed if they were discussed in the previous three quarters. If there were no purchases or sales, the purchases and sales are omitted from the material. If there were multiple purchases and/or sales, the purchase and sale discussed shall be the earliest to occur. Other than the recent buy and sell, any company discussed must constitute at least 1% of the portfolio as of December 31.

The information provided in this material 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 material 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 Multi-Cap Equity 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 portfolio principally in common stocks (including indirect holdings of common stock through depositary receipts). The Multi-Cap Equity strategy may invest in large, medium, or small companies without regard to market capitalization and may invest in issuers in foreign countries, including countries with developed or emerging markets. The principal risks are: common stock risk, depositary receipts risk, emerging markets risk, fees and expenses 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.

Small cap companies have market capitalizations less than $3 billion. Mid cap companies have market capitalizations from $3 billion to $10 billion. Large cap companies have market capitalizations greater than $10 billion. Under normal circumstances, the Multi-Cap Equity Composite invests the majority of its assets in equity securities issued by companies with market capitalizations of less than $20 billion.

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

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.

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