

# Davis International ADR SMA Portfolio

Winter Update 2020

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THE EQUITY SPECIALISTS

# Portfolio Commentary

## Market Perspectives

In 2019, the Davis International ADR SMA strategy generated very competitive double-digit returns, outperforming the MSCI ACWI (All Country World Index) ex US, which returned 21.51%. Both the portfolio's results, as well as the broad-based returns of the market, are reflective of relatively strong underlying fundamentals.

The portfolio is invested very selectively in companies and countries where we feel there are opportunities to own durable businesses with favorable growth prospects trading at value prices. Among the areas of focus currently, we hold a number of high-conviction positions in the domestic consumer-facing sector of China and, to some extent, the greater Asia-Pacific region. In Europe, we hold primarily global multi-nationals with strong balance sheets, enormous geographic reach that are highly cash-generative today, and in our view in a position to generate attractive earnings growth over the next decade. We also hold investments in select European financials based outside of Eurozone such as the Nordics and Switzerland. The rest of the portfolio is diversified across the Americas primarily.

Our positions in Asia-Pacific are largely related to China and specifically companies that face the Chinese consumer (as opposed to exports or manufacturing, which have long been in secular decline relative to services, which has grown considerably). In 2019, shares of numerous Chinese companies in the portfolio rose dramatically, essentially rebounding from late 2018's negative performance, and contributed meaningfully to overall results. It is worth noting that despite this dramatic advance, growth of operating results has justified this revaluation upward in our opinion. Among our investments in this region, we hold both well-known dominant market leaders in

e-commerce and other fast-growing firms, such as for-profit after-school tutoring services. New Oriental Education and Technology, the portfolio's largest holding, is by far the market leader in after-school courses in China.<sup>1</sup> Its services are designed to help students starting as early as kindergarten prepare for college entrance exams in a country where the top universities have an acceptance rate of only 2%.

Europe, which is faced with slow growth and weak consumer demand, has been sluggish as a region, with the Eurozone being particularly challenged (versus the Nordics, for example). We have invested very selectively in a number of industrial multi-nationals with truly global reach, despite their European roots. In the Nordics, we hold a position in Danske Bank, the largest bank in Denmark, whose reputation was dented by an anti-money laundering scandal in recent years, but which, in our view, has taken the appropriate actions to mitigate the potential financial and regulatory consequences that may arise and is trading below book value. The company has sought to rectify its problems by taking decisive steps, including changing management and board and focusing intensely on compliance and controls. Meanwhile, it has very high capital ratios, as well as a very attractive dividend yield, which in essence means that we are being paid to wait in a bank that we believe will eventually return to blue chip status.

Market volatility during the year was rather pronounced. We believe that such gyrations have been driven by and large by shifts in macro sentiment to date, based on uncertainties ranging from trade disputes to geopolitical tensions. However, underlying business fundamentals for most of our holdings have been far less volatile than market prices, and we believe that progress is manifested in higher revenues and earnings power. It is significant that many companies

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. Holdings discussed in this commentary are selected according to objective, non-performance-based criteria. They are chosen each quarter according to a consistent methodology based on their weight in the Davis Advisors International Equity model portfolio as well as recent purchases and recent sales and are intended only as illustrations of the Davis Investment Discipline. They are not recommendations to buy, sell or hold any security. Individual account holdings may vary.

are able to flourish despite (and through) periods of heightened macro concerns of the moment, both in terms of earnings growth as well as share price performance. Historically, there has been no set rule that macro concerns must categorically hold back the progress of businesses or the market as a whole. To the contrary, the market's best years over the last half-century have always coincided with worries and negative headlines of the day. What matters most over the long term, in our experience, is the longevity and growth of corporate profits.

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

## Portfolio Review

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

- Intensely innovative, fast-growing market leaders, particularly in China, engaged in online search, e-commerce, cloud computing, or other large and rapidly expanding end markets. In all cases, our technology holdings are in leadership positions that we believe will play to their advantage competitively in vast new profitable fields. Among our more recent additions to this group is 58.com, a leader within China of classified ads that, if achieved at scale, can be a highly lucrative model.
- Select industrial businesses with competitive advantages. One of our European holdings is a leader in low voltage electrical equipment and solutions globally, a market that serves essential electrical requirements of commercial buildings as well as residential properties and a host of other applications. While its roots are in France the company today serves all major regions—including fast-growing emerging countries—and commands a strong competitive position globally.

- High-grade financials that, while mundane, offer some of the best value of any sector, in our view. As noted earlier, Danske Bank is an example of a well-priced financial trading at an attractive valuation with high capital ratios and an attractive dividend yield. Importantly, it also has the financial strength to absorb even very large potential financial liabilities stemming from penalties or other such expenses that, once satisfied, should prove temporary in nature.
- A relatively minor allocation to energy companies that were detractors to performance in recent periods, but are trading in our view at depressed multiples today. Our thesis in this area rests on an assumption that our specific companies should be able to earn an above-average return on capital over a cycle, which in turn should allow them to grow production and free cash flow at significantly higher rates than most of the sector. With a long-term view that energy prices may eventually stabilize and recover somewhat—owing to supply and demand factors and/or geopolitical developments—the significant “option value” inherent in these North American-contained businesses is meaningful. While the current weak price environment persists, we believe our holdings have staying power, based on a stable funding profile and flexible capital programs. Should the commodity price environment improve from here, we believe these energy-related investments could potentially become a contributor to our results rather than a headwind.

These themes represent the types of investments and the diversification we seek for the portfolio. As to recent changes, we exited our position in Brenntag to allocate the capital to more attractive opportunities. ■

## Portfolio Positioning: Selective, Attractive Growth, Undervalued

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

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

To illustrate our current positioning with data, below we provide three sets of figures for both the Davis International ADR SMA Portfolio and the MSCI ACWI ex US.<sup>2</sup>

#### Selective, Attractive Growth, Undervalued

	Portfolio	Index
Holdings	23	2,412
EPS Growth (5 Year)	26.5%	11.6%
P/E (Forward)	7.2x	14.4x

Specifically, what the table shows is the following:

- We are far more selective than the benchmark with only 23 holdings versus more than 2,000 securities in the MSCI ACWI ex US. The average position size for the portfolio is roughly 4%. In contrast, the benchmark’s average position size is 0.04%. We apply a high bar when selecting individual businesses and believe that our high-conviction, research-driven approach calls for a portfolio structure that allows for individual businesses to make a material contribution to long-term performance and should therefore be weighted as such.
- Our historical earnings growth rate on a per-share basis has been superior to the benchmark on average.
- We believe we own these above-average businesses at below-average starting multiples of earnings, as reflected in the lower forward price-to-earnings ratio of the portfolio versus its benchmark. ■

## Outlook

Looking ahead, we believe selectivity will be a key to generating above-average returns over the coming decade, both at the security and at the sector levels. For this reason, in every holding in the portfolio, we believe there are financial, competitive, and managerial strengths that can allow them to grow, take share, and prosper over the long term.

Beyond selectivity, and even given the past year of strong results, we believe today’s market still offers investors many very attractive individual opportunities. It is possible now to purchase durable, growing businesses at value prices, and we are taking advantage of that opportunity.

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

At Davis Advisors, we seek to purchase durable businesses at value prices and hold them for the long term. The more than \$2 billion Davis Advisors, the Davis family and Foundation, and our employees have invested in similarly managed accounts and strategies remains a true sign of our commitment to and conviction in this enduring philosophy.<sup>3</sup> ■

2. Source: Wilshire Atlas and Davis Advisors. 3. As of 12/31/19.

# Davis International ADR SMA Portfolio

Selective. Attractive Growth. Undervalued.

Today, the Davis International ADR 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 International ADR SMA Portfolio	MSCI ACWI ex US
Selective	Holdings	23	2,412
Attractive Growth	EPS Growth (5 Year) <sup>1</sup>	26.5%	11.6%
Undervalued	P/E (Forward) <sup>2</sup>	7.2x	14.4x

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 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.

# Davis International ADR SMA Portfolio Holdings

December 31, 2019

High Conviction. Different from the Index.

Holding	Portfolio (%)	MSCI ACWI ex US (%)
Alibaba Group Holding	7.0%	1.6%
Ferguson	7.0	0.1
JD.com	7.0	0.1
Naspers	7.0	0.3
New Oriental Education & Technology	7.0	0.1
Schneider Electric	7.0	0.3
DBS Group Holdings	6.7	0.2
Julius Baer Group	5.2	0.1
DNB	5.1	0.1
Hollysys Automation Technology	4.9	—
Seven Generations Energy	4.6	—
Bank of N.T. Butterfield & Son	3.9	—
AIA Group	3.5	0.6
Danske Bank	3.4	0.1
Prosus	3.4	0.2
IQIYI	2.3	0.0
Encana	2.1	0.0
Trip.com Group	1.7	0.1
58.COM	1.6	0.0
Noah Holdings	1.6	0.0
China Index Holdings	1.4	—
Baidu	1.1	0.2
Yiren Digital	0.5	—
CASH	5.0	—
	<b>100.0%</b>	

The above listed securities are representative of a model Davis International ADR 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 MSCI ACWI ex US are not representative of the entire portfolio, which consists of 2,412 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 International ADR SMA Portfolio

December 31, 2019

Davis International ADR SMA is a portfolio of attractive businesses from outside of the U.S. 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.

## ► Unique Attributes of Davis International ADR 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 invests in both developed and developing markets. We believe a bottom-up stock selection process and not mirroring the benchmark index are keys to long-term outperformance. Active Share 96%.

### ■ 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.<sup>1</sup>

		Portfolio	Index
Undervalued	P/E (Forward)	7.2x	14.4x
Attractive Growth	EPS Growth (5 Year)	26.5%	11.6%
Selective	Holdings	23	2,412
	Total Countries	12	48

## ► Experienced Management

Danton Goei, 21 years with Davis Advisors

## ► Geographically Diverse Portfolio

Asia	48.7%
Europe	32.7
North & Central America	11.2
Africa	7.4

## ► Top 10 Countries

China	Singapore
France	Switzerland
South Africa	Norway
U.K.	Bermuda
Canada	Hong Kong

## ► Sectors

	Portfolio	Index
Consumer Discretionary	34.7%	11.8%
Financials	31.5	21.3
Industrials	16.2	12.0
Energy	7.1	6.5
Communication Services	5.3	6.7
Information Technology	5.2	9.4
Consumer Staples	0.0	9.4
Health Care	0.0	8.9
Materials	0.0	7.4
Utilities	0.0	3.4
Real Estate	0.0	3.2

## ► Performance

	1 Year	3 Year	5 Year	Inception 10/1/14
International Equity SMA Composite (gross)	26.87%	13.19%	7.54%	6.49%
International Equity SMA Composite (with a 3% max. wrap fee)	23.18	9.87	4.38	3.35
MSCI ACWI ex US	21.51	9.87	5.51	4.44

## ► Attractive International Businesses (Top 10 Holdings)

**Alibaba Group Holding (China):** World's largest and most valuable retailer, with operations in over 200 countries, and dominant position in the e-commerce market

**Ferguson (U.K.):** World's largest distributor of heating and plumbing supplies for professionals, predominantly in the United States

**JD.com (China):** One of the largest e-commerce businesses in mainland China offering consumer electronics and appliances

**Naspers (South Africa):** Media conglomerate that holds interests in a range of e-commerce businesses around the world, including Tencent

**New Oriental Education & Technology (China):** Largest provider of private education services

**Schneider Electric (France):** Global specialist in energy management

**DBS Group Holdings (Singapore):** Largest bank in Singapore and among the largest in developed Asia. Has a strong moat enabled by relatively inexpensive cost of funds, technology leadership, and high market share of retail deposits

**Julius Baer Group (Switzerland):** A premier private bank serving ultrahigh net worth clients

**DNB (Norway):** Largest financial institution and oldest private bank in Norway. Digital leadership and economies of scale are leading drivers of strong and durable moat

**Hollysys Automation Technologies (China):** Leading industrial automation company in China

*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. 1. 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.*

## 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.

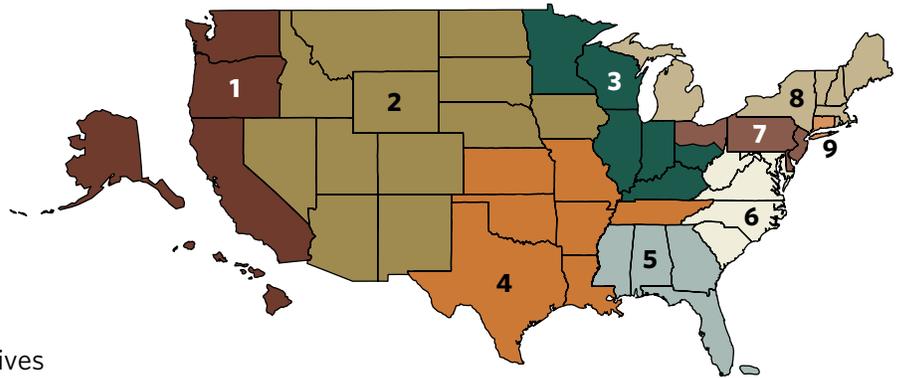
**Sobby Arora, CFA** joined Davis Advisors in 2017. Previously, he worked as a research analyst at Federated Global Investment Management and ING Investment Management. Mr. Arora received his B.A. from Colgate University, his M.B.A. from The Stern School of Business and is a CFA charter holder.

# Contacts

Financial Advisor Support  
and Literature Requests: 800-717-3477  
davisfunds.com

Dodd Kittsley, National Director  
212-891-5578, dkittsley@dsaco.com

Ed Snowden, Manager, Regional Representatives  
800-717-3477 Ext. 2267, esnowden@dsaco.com



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

1	<b>West Coast</b> Alaska, California, Hawaii, Oregon, Washington	Joe Emhof Regional Director	800-717-3477 Ext. 3786	jemhof@dsaco.com
		Jon Franke Senior Regional Representative	800-717-3477 Ext. 2663	jfranke@dsaco.com
2	<b>Central</b> Arizona, Colorado, Idaho, Iowa, Montana, Nebraska, Nevada, New Mexico, North Dakota, South Dakota, Utah, Wyoming	Dan Steichen Regional Director	800-717-3477 Ext. 2262	dsteichen@dsaco.com
		Sean Lynch Senior Regional Representative	800-717-3477 Ext. 2675	slynch@dsaco.com
3	<b>Great Lakes</b> Illinois, Indiana, Kentucky, Minnesota, Southern Ohio, Wisconsin	Bill Coughlin Regional Director	800-717-3477 Ext. 3783	bcoughlin@dsaco.com
		Nancy Brennan Senior Regional Representative	800-717-3477 Ext. 2679	nbrennan@dsaco.com
4	<b>South Central</b> Arkansas, Kansas, Louisiana, Missouri, Oklahoma, Tennessee, Texas	Mark Giles Regional Director	800-717-3477 Ext. 6908	mgiles@dsaco.com
		Marty Smith Regional Representative	800-717-3477 Ext. 2674	marty-smith@dsaco.com
5	<b>Southeast</b> Alabama, Florida, Georgia, Mississippi, Puerto Rico	Peter Yensel Regional Director	800-717-3477 Ext. 3785	pyensel@dsaco.com
		Mike Longoni Senior Regional Representative	800-717-3477 Ext. 2261	mlongoni@dsaco.com
6	<b>Mid-Atlantic</b> Maryland, North Carolina, South Carolina, Virginia, Washington DC, West Virginia	J.P. Raflo Regional Director	800-717-3477 Ext. 6905	jraflo@dsaco.com
		Mari Downey Senior Regional Representative	800-717-3477 Ext. 2665	mdowney@dsaco.com
7	<b>North Atlantic</b> Delaware, New Jersey, Northern Ohio, Pennsylvania	Reed Finley Regional Director	800-717-3477 Ext. 6906	rfinley@dsaco.com
		Ilia Geronov Senior Regional Representative	800-717-3477 Ext. 2677	igeronov@dsaco.com
8	<b>Northeast</b> Maine, Massachusetts, Michigan, New Hampshire, Northern New York, Rhode Island, Vermont	Steve Coyle Regional Director	800-717-3477 Ext. 3790	coyle@dsaco.com
		Danielle Irwin Senior Regional Representative	800-717-3477 Ext. 2682	dirwin@dsaco.com
9	<b>New York City</b> Connecticut, Southern New York	Jim Ambrosio Regional Director	800-717-3477 Ext. 3787	jambrosio@dsaco.com
		Laurel Hardy Senior Regional Representative	800-717-3477 Ext. 2683	lhardy@dsaco.com

*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.*

The performance of mutual funds is included in the Composite. The performance of the mutual funds and other Davis managed accounts may be materially different. For example, the Davis International Fund may be significantly larger than another Davis managed account and may be managed with a view toward different client needs and considerations. The differences that may affect investment performance include, but are not limited to: the timing of cash deposits and withdrawals, the possibility that Davis Advisors may not buy or sell a given security on behalf of all clients pursuing similar strategies, the price and timing differences when buying or selling securities, the size of the account, the differences in expenses and other fees, and the clients pursuing similar investment strategies but imposing different investment restrictions. This is not a solicitation to invest in the Davis International Fund or any other fund.

Effective 9/23/14, Davis Advisors created an International Equity SMA Composite which excludes the institutional accounts and mutual funds. Performance shown from 10/1/14, through the date of this report, the Davis Advisors' International Equity SMA Composite includes all eligible wrap accounts with no account minimum from inception date for the first full month of account management and includes closed accounts through the last day of the month prior to the account's closing.

A time-weighted internal rate of return formula is used to calculate performance for the accounts included in the Composite. The net of fees rate of return formula is calculated based on a hypothetical 3% maximum wrap fee charged by the wrap account sponsor for all account services. For the gross performance results, custodian fees and advisory fees are treated as cash withdrawals.

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.

Davis Advisors' International Equity Composite includes all actual, fee-paying, discretionary International investing style institutional accounts, mutual funds and wrap accounts under management for each investment period from 1/1/05, through the date of this report, including those accounts no longer managed. Effective 1/1/98, a minimum account size of \$3,500,000 was established. Accounts below this minimum are deemed not to be representative of the Composite's intended strategy and as such are not included in the Composite. A time-weighted internal rate of return formula is used to calculate performance for the accounts included in the Composite. For the net of advisory fees performance results, custodian fees are treated as cash withdrawals and advisory fees are treated as a reduction in market value. For mutual funds, the Composite uses the rate of return formula used by the open-end mutual funds calculated in accordance with the SEC guidelines adjusted to treat mutual fund expenses other than advisory fees as cash withdrawals; sales charges are not reflected. Wrap account returns are computed net of a 3% maximum wrap fee. For the gross performance results, custodian fees and advisory fees are treated as cash withdrawals. A list of Davis Advisors' Composites is available upon request.

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 an International 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. Each of these holdings must come from a different country.); 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. If a holding to be discussed (excluding the buys/sells) is no longer in the model portfolio as of quarter end, the next listed holding is selected and discussed.

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 International 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)

issued by both United States and foreign companies, including countries with developed or emerging markets. The global companies' strategy may invest in large, medium, or small companies without regard to market capitalization. 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.

Definitions: Forward Price/Earnings (Forward P/E) Ratio is a stock's current price divided by the company's forecasted earnings for the following

12 months. The values for the portfolio and index are the weighted average of the P/E ratios of the stocks in the portfolio or index. Five-Year EPS Growth Rate is the average annualized earning per share growth for a company over the past five years. The values for the portfolio and index are the weighted average of the five-year EPS Growth Rates of the stocks in the portfolio or index.

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

The **MSCI ACWI (All Country World Index) ex US** is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of developed and emerging markets throughout the world. The Index includes reinvestment of dividends, net foreign withholding taxes. 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. Investments cannot be made directly in an index.