Davis Advisors
Davis New York Venture Fund
Fall 2008 Review

Market Perspectives

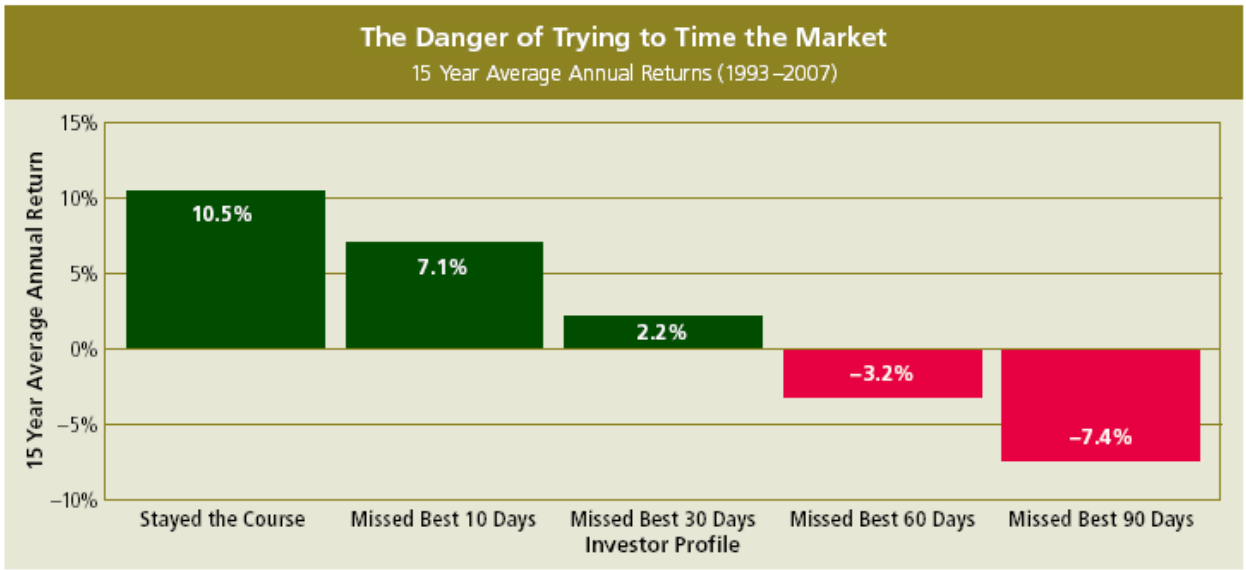
Davis Advisors has managed money for clients since 1969. Since our inception nearly 40 years ago we have adhered steadfastly to the same investment discipline of seeking to buy durable businesses at value prices and hold them for the long term. We have applied this investment discipline decade after decade and through many different market environments. As a sign of our commitment to and conviction in the Davis investment discipline, the Davis family, employees and directors have more than $2 billion of their own money invested side by side with clients.

Over many decades equities have generally produced attractive returns and economic expansion has been the rule not the exception. Over shorter intervals, which can span years, markets and economies move in cycles, with bull markets invariably followed by bear markets (and vice versa) and periods of economic growth alternating with recessions. We are now in a bear market caused by the excesses that occurred in recent years in U.S. residential real estate, the deleveraging of the global financial system and a severe credit crunch among other factors. How long could these volatile conditions persist? Nobody really knows. What we do know is that the capital markets are remarkably resilient, that while there have been casualties in this environment there will also be survivors who will get much stronger through the dislocation and that in time the tide will turn.

History provides a crucial insight regarding market crises: They are inevitable, painful, and ultimately surmountable. None to date has permanently derailed the market's ability to compound over the long term. For the better part of the last century the U.S. economy has grown over every decade and the market in the long run has managed to produce double-digit returns despite setbacks such as prolonged bear markets; wars; recessions; an oil crisis; a hostage crisis; periods of double-digit interest rates, inflation and unemployment; political scandals; stock market crashes; the September 11th attacks; and much more. We believe individuals and institutions focused on long-term objectives will be rewarded for their patience through the current environment, but we recognize the challenge of staying the course in times of great fear and pessimism.[1]

Why We Do Not Attempt to Time the Market

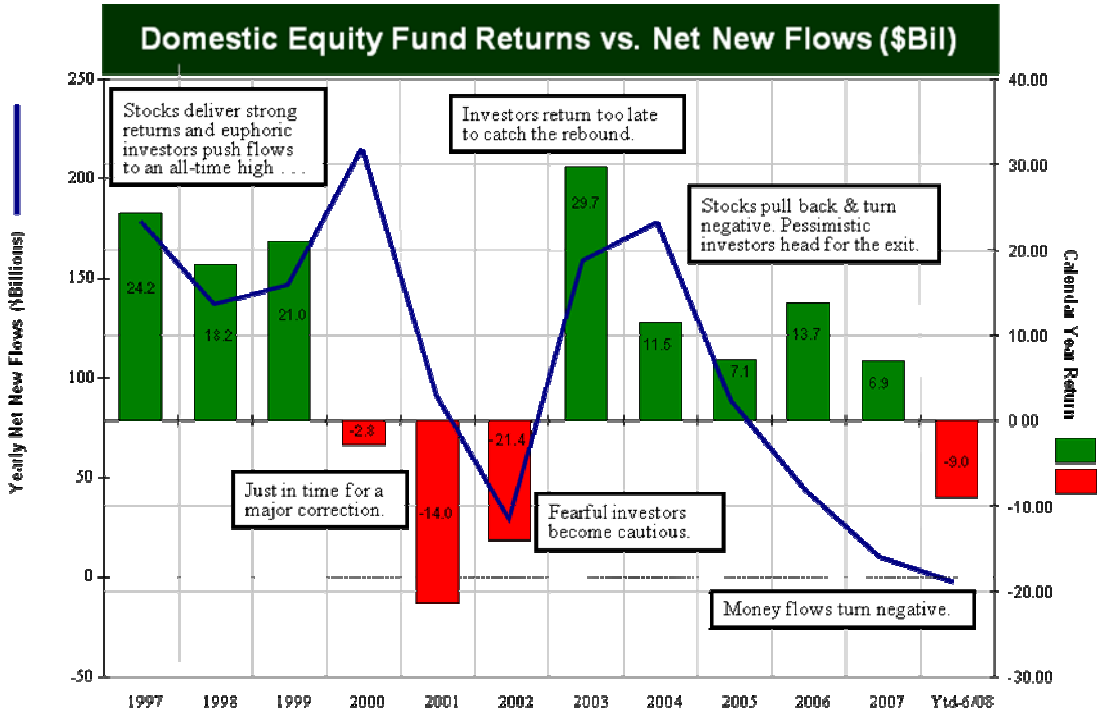
[1] **Past performance is not a guarantee of future results.** Equity markets are volatile and an investor may lose money.



Source: Bloomberg and Davis Advisors. The market is represented by the S&P 500® Index. **Past performance is not a guarantee of future results.**

Recognizing that we are in a difficult environment, it is worth discussing why we do not simply attempt to exit the market and then re-enter when the coast is clear. The first reason is that the danger of mistiming the market in our view poses a far greater risk to our long-term compound return than staying the course. Missing even a few of the best performance days in a year can cost investors the lion's share of that year's returns. Nevertheless, as we go through a bear market, the temptation investors feel to sell after prices have fallen is intense and that feeling is amplified by the media. Each day newspapers across the country outline reasons why the outlook is bleak. Although investors know in their heads that equities should produce satisfactory returns over the long term, particularly if purchased after prolonged periods of poor performance, in their stomachs they want out.

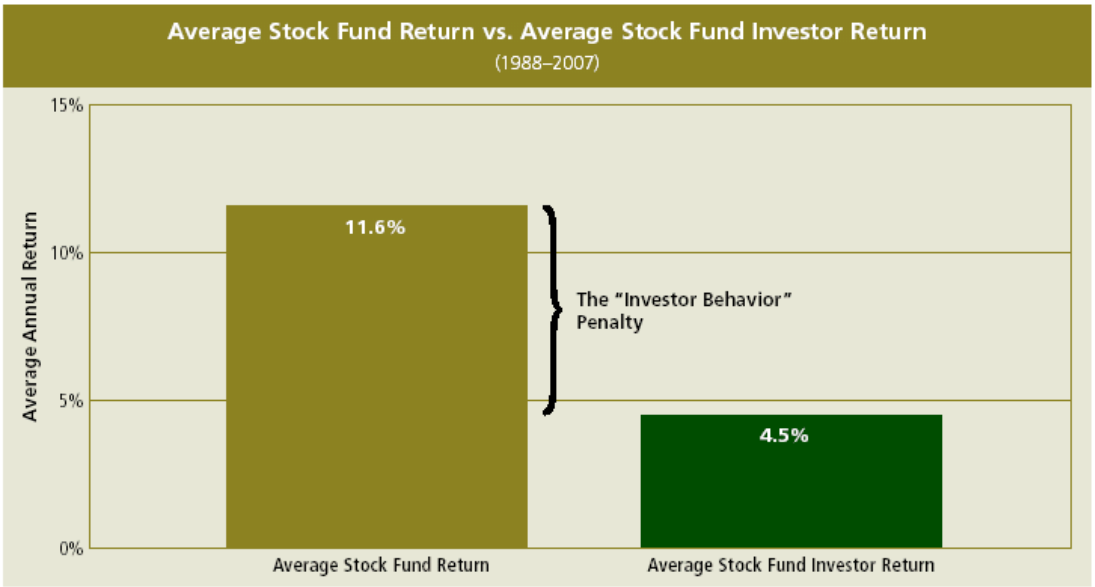
Below is a chart showing the pattern of yearly net flows in and out of domestic equity mutual funds. The pattern suggests that investors overall have a tendency to invest more money in periods of strong performance and to take money out during periods of weak performance. This type of emotionally driven behavior is extremely costly as it essentially amounts to buying high and selling low.



1/1/97 – 6/30/08. Source: Strategic Insight, Investment Company Institute, Lipper, Morningstar and Form N-SAR filed with the SEC.

The costs associated with timing can be dramatic. Over the past 20 calendar years, for instance, Lipper estimates the average stock fund produced an average annual return of 11.6% while the average stock fund investor achieved an average annual return of only 4.5%. The stark difference of 7.1% per year between the two figures is attributable to the investor behavior penalty caused by investors buying high and selling low. On a cumulative basis, those figures really add up: The average stock fund investor achieved a cumulative return of only 140% over the last 20 years versus roughly 800% for the average stock fund.[2]

[2] All returns assume reinvestment of dividends and capital gains distributions. **Past performance is not a guarantee of future results.**



Source: *Quantitative Analysis of Investor Behavior* by Dalbar, Inc. (July 2008) and Lipper. Dalbar computed the "average stock fund investor" returns 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 a "systematic investor" and "asset allocation investor". The annualized return for these investor types was 5.8% and 3.5% respectively 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. **Past performance is not a guarantee of future results.**

The second reason we do not attempt to exit and then to re-enter stocks when the coast is clear is that realistically speaking the coast is never entirely clear of hurdles or obstacles. In other words, the environment always has some degree of uncertainty associated with it. That is true in bull markets as well as bear markets. Our Founder and Advisor Shelby Davis offers a sailing metaphor to describe this fundamental challenge of investing: "To sail across the ocean, you must balance making progress in fair weather with the ability to withstand the inevitable storms. Those who think only of the storms will never leave the shore. Those who think only of fair weather will never reach the other side." Since uncertainty is the rule, not the exception, we believe the key question to ask is not whether or when to invest, but rather how we should invest in order to maximize our chances of achieving a satisfactory long-term compound return. That brings us squarely back to our investment process of seeking to buy durable businesses at value prices and hold them for the long term and to the Portfolio of businesses we own.

Portfolio Positioning[3]

The Portfolio holds three primary categories of investments:

- Market leaders with strong balance sheets
- "Out-of-the-spotlight" businesses
- Headline risk or contrarian investments[4]

[3] Individual securities are discussed in this piece. While we believe we have a reasonable basis for our appraisals and we have confidence in our opinions, actual results may differ materially from those we anticipate. The return of a security to a portfolio will vary based on weighting and timing of purchase. This is not a recommendation to buy or sell any specific security. **Past performance is not a guarantee of future results.**

[4] While we research companies subject to such contingencies, we cannot be correct every time, and a company's stock may never recover.

Berkshire Hathaway, a representative market leader in the Portfolio, is a diversified holding company that owns more than 75 subsidiaries engaged in property and casualty insurance and reinsurance, utilities and energy, finance, manufacturing, retailing, and other services. From 1965 through 2007 Berkshire Hathaway compounded book value at a rate of more than 21% on average. That translates into a cumulative return of more than 400,000%. While prospective returns will be lower, the company nonetheless entered 2008 well positioned to make accretive investments with more than $37 billion in cash and cash equivalents on its balance sheet. Warren Buffett, the company's chairman and chief capital allocator, has deployed more than $20 billion of that capital in various businesses at distressed prices this year alone. Among its recent investments, Berkshire has agreed to acquire Baltimore-based utility Constellation Energy and negotiated stakes in Goldman Sachs and General Electric at very favorable terms.

Comcast, another market leader in the Portfolio, is the nation's largest cable television carrier with roughly 25 million video subscribers. Comcast's strategy has been to leverage the capabilities of its cable infrastructure that passes almost half the households in America to offer other successful services such as broadband and digital phone. Comcast is now launching a fourth service -- commercial services for small businesses -- that will make use of the same cable infrastructure. In addition to its growth prospects, strong competitive position and proven management, we believe Comcast trades at an exceptionally reasonable valuation. Other powerful market leaders in the Portfolio with well-known brands, well-diversified earnings and fortress balance sheets include Johnson & Johnson, Costco Wholesale, Procter & Gamble, and Occidental Petroleum.

Transocean, a representative out-of-the-spotlight holding, is the largest offshore drillship operator in the world controlling roughly half of the world's deepwater rigs. Many of the world's shallow water oil reservoirs have been discovered and exploited. That means to meet growing demand from both developed and fast-growing developing countries oil exploration and production companies must look increasingly to deeper waters for new reserves—for instance in the Gulf of Mexico, offshore West Africa, offshore Brazil or the Arctic. With an order backlog of more than $40 billion, Transocean is exceptionally well positioned in our view to benefit from these long-term tailwinds. Other lesser known out-of-the-spotlight holdings with attractive economics that should eventually command higher valuations in our opinion include CVS Caremark (pharmacy and pharmacy benefits management), Transatlantic Holdings (reinsurance) and Canadian Natural Resources (oil and natural gas exploration and production).

The Bank of New York Mellon is a current example of a headline risk investment in the sense that its share price has declined along with financials in general this year. But share price declines are not the same as declines in intrinsic worth. The Bank of New York Mellon is engaged in such mundane but profitable business activities as global custody, securities processing and asset management and is a leader in almost all of its business lines. Operating in 34 countries, the bank is one of four primary global custodians with more than $23 trillion in custody assets and more than $1 trillion in assets under management. We believe the company is well positioned to be a long-term beneficiary of growth in global custody and asset management. Taking into account cost synergies from the merger of The Bank of New York and Mellon Financial in 2007, the combined company is trading at a very reasonable multiple of owner earnings in our view.

Another way to look at the Portfolio is from the standpoint of individual business types. Roughly 70% of the Portfolio is invested in what we believe are winning business models in industries as diverse as consumer products, oil exploration and production, retail, health care, and technology. Approximately 30% of the Portfolio is invested in a broad array of financial services businesses, the majority of which are diversified holding companies like Berkshire Hathaway, custody and processing businesses like The Bank of New York Mellon or mundane cash compounding machines in such areas as tax preparation, insurance brokerage and personal lines auto insurance. A little more than 10% of the Portfolio is invested in select banks; predominantly in companies that we believe will not only survive the current turmoil but become stronger and more valuable by consolidating competitors in this period of dislocation. (This process is already underway.) Like any investment manager, we will have our share of successes and mistakes, but overall we think that the Portfolio includes an appropriate mix of defense and offense and that the well-diversified mix of businesses we own should produce a satisfactory compound return over full market cycles.[5]

Annualized Total Returns as of September 30, 2008										
Davis New York Venture Fund Class A	YTD[6]	1 Year	3 Years	5 Years	10 Years	15 Years	20 Years	25 Years	30 Years	Since Inception (2/17/1969)
without a sales charge	-20.54%	-22.17%	-0.07%	6.61%	6.17%	9.46%	12.08%	12.62%	14.50%	12.29%
with a maximum 4.75% sales charge	-24.33%	-25.87%	-1.67%	5.58%	5.65%	9.10%	11.80%	12.40%	14.31%	12.15%
S&P 500® Index	-19.29%	-21.98%	0.22%	5.16%	3.06%	8.40%	9.93%	10.88%	11.73%	9.79%

The performance presented represents past performance and is not a guarantee of future results. *Total return assumes reinvestment of dividends and capital gain distributions. Investment return and principal value will vary so that, when redeemed, an investor's shares may be worth more or less than their original cost. The total annual operating expense ratio for Class A shares as of the most recent prospectus was 0.85%. The total annual operating expense ratio may vary in future years. Returns and expenses for other classes of shares will vary. Current performance may be higher or lower than the performance quoted. For most recent month-end performance, visit davisfunds.com or call 800-279-0279.*

Performance Review

In the year-to-date period ending September 30, 2008, the S&P 500® Index declined 19.29% and our performance was generally in line with the broader market.[7]

All major sectors of the market are in negative territory this year. The Portfolio's energy investments held up relatively better than most sectors in the year-to-date period and added value over the market's performance. In contrast, our positions in financial services and health care were detractors both on an absolute and a relative basis.

We have sought to position the Portfolio conservatively in high-quality, durable businesses using bottom-up stock selection and to maintain prudent diversification. Over the past year our selective approach helped us avoid a number of ill-fated businesses that appeared dangerously

[5] **Past performance is not a guarantee of future results.**
[6] Returns for periods less than one year are not annualized.

[7] Class A shares, not including a sales charge. **Past performance is not a guarantee of future results.**

leveraged according to our research. For instance, when the mortgage crisis hit, we had consciously steered clear of Countrywide and Washington Mutual. As the crisis spread, we had intentionally avoided Bear Stearns, Lehman Brothers, Fannie Mae, and Freddie Mac. Investing is a batting average business, however, and notwithstanding our successes of omission we did make some mistakes of commission. Specifically, the Portfolio held shares of American International Group (AIG), Merrill Lynch and Wachovia.

AIG was the most significant and most surprising loss among these three positions. In terms of our original thesis, we believed AIG had a strong enough franchise to withstand a down cycle. We based that view on the fact that the company appeared well capitalized with more than $78 billion of shareholder equity (as of the end of second quarter) and estimated pretax earnings power of roughly $20 billion. While we paid careful attention to the company's capital and earnings base, we underestimated the degree of liquidity risk embedded in the company's financial products unit. We knew there was some risk but both the company and we believed it was manageable. For instance, in the event of a credit ratings downgrade AIG expected it would have to post more than $14 billion of collateral to support its credit default swap contracts. Significantly, AIG had already raised $20 billion of additional capital earlier this year, which we believed provided a sufficient cushion when combined with the business's earnings power. We also believed there was some margin of safety in the fact that shares of the company traded at a very low multiple of normalized earnings. However, around the time of Lehman Brothers' collapse conditions in the capital markets deteriorated so suddenly and so dramatically that AIG's collateral requirements skyrocketed well beyond $14 billion and the company was forced to seek an $85 billion loan from the federal government in September. The terms of the loan facility are such that the U.S. government could potentially take as much as 80% of the company at shareholders' expense. As of the quarter's close, AIG represented less than 0.30% of the Portfolio and the company under new CEO Ed Liddy is working to sell businesses in order to pay down the government loan. We continue to hold shares in the belief that new management may be able to unlock some residual value for shareholders above and beyond where the company's shares are trading. However, we recognize that the franchise value has been substantially and permanently reduced by the crisis.

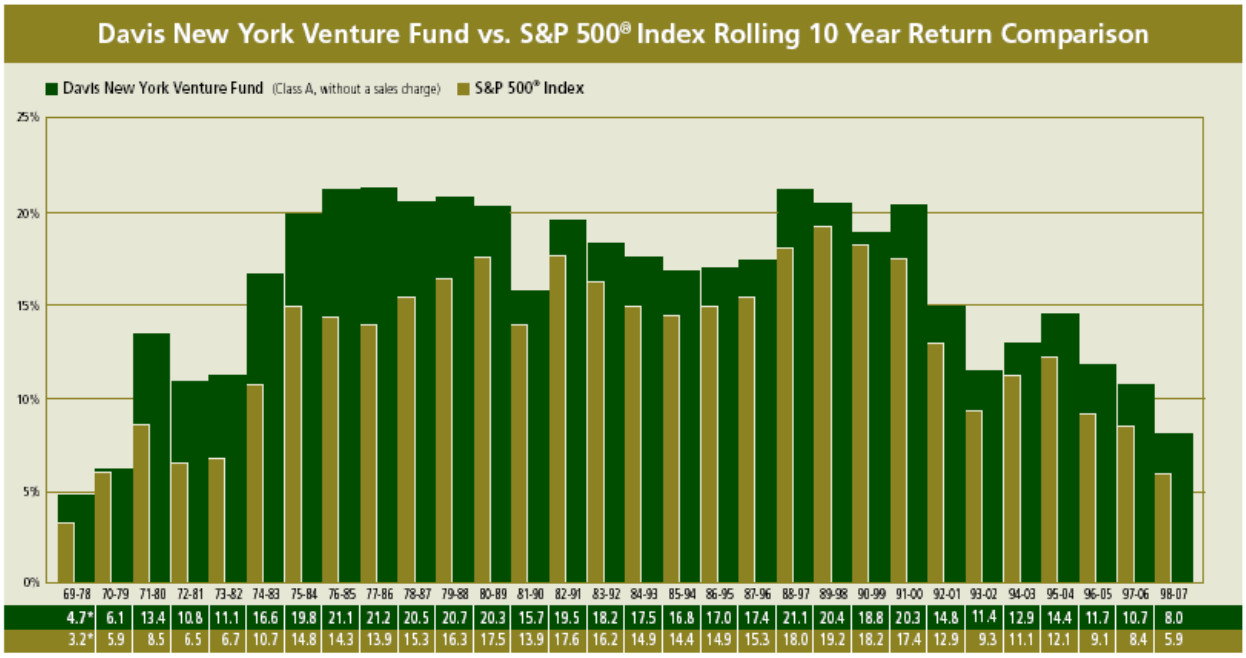
Regarding Merrill Lynch, we initiated a position in December of 2007. At that time we saw significant value in the company's highly coveted global wealth advisory business, believed that the company's new CEO John Thain represented a significant upgrade in the quality of management, and felt Merrill's shares had declined to a very reasonable valuation. Ultimately, both management and we underestimated Merrill's vulnerability in the event of an extremely severe credit crunch. The value we had accorded its global wealth advisory business was a key to the company securing a merger with Bank of America. (This can be contrasted with Lehman Brothers, which declared bankruptcy on the same day that the Merrill/Bank of America deal was announced). However, our future prospects for the Merrill investment have been significantly reduced by the fact that Merrill Lynch was forced recently to raise more capital at distressed prices. At the close of the quarter we were reevaluating the position.

Wachovia began the year as a relatively small weighting in the Portfolio. Heading into the summer the company had Tier 1 capital of more than 8% and more than $400 billion of core deposits, not to mention a strong brand and branch network. Despite these facts, Wachovia was felled by a sudden and massive run on the bank caused more by fear than any other factor. As of

this writing, Wachovia has announced its intention to merge in an all-stock transaction with Wells Fargo and we are reevaluating the position.

As a result of our experience with these three companies we are proceeding in these extraordinary times with a greatly heightened awareness of the liquidity risk that can affect businesses of all types that require short-term funding. Our recent experiences also reinforce a cold hard reality about investing: It is a process involving probabilities, not certainties, and it is a business where getting two out of three investments right can yield exceptional results but where some number of mistakes are inevitable as well. Hence, while we expect the overall Portfolio to produce satisfactory risk-adjusted returns over the long term, we know that this result, if realized, will doubtlessly be the byproduct of some clear investment successes, some marginal successes and mistakes, and some outright mistakes.[8] To the best of our ability we seek to research companies thoroughly; to be a learning organization that admits analyzes and learns from its mistakes -- indeed we maintain a "mistake wall" in our research department -- and to weight the Portfolio in favor of our highest conviction investments.

On the whole, even counting the mistakes of 2008 we have performed roughly in line with the broader market through September 30 and the Davis investment discipline -- a process of research and portfolio management that goes beyond the success or failure of any one holding -- has outperformed the S&P 500® Index over every 10 year rolling period since 1969.[9]



*Returns calculated from 2/17/69 through 12/31/78.

The performance presented represents past performance and is not a guarantee of future results. *Total return assumes reinvestment of dividends and capital gain distributions. Investment return and principal value will vary so that, when redeemed, an investor's shares may be worth more or less than their original cost. Rolling 10 year*

[8] **Past performance is not a guarantee of future results.** Equity markets are volatile and an investor may lose money.

[9] Class A shares, not including a sales charge as of December 31, 2007. Returns would be lower in some periods if a sales charge were included. See endnotes for a description of our rolling 10 year performance and a definition of the S&P 500® Index. **Past performance is not a guarantee of future results.**

returns would be lower in some periods if a sales charge were included. See the endnotes for a description of this chart and a definition of the S&P 500® Index.

As long-term investors we seek to be realists, not optimists or pessimists, so that we set proper expectations and are capable of making rational decisions through inevitable market and economic cycles. One realistic perspective is that the principles of value investing hold even in markets when returns are poor. Second, a rational approach of investing in well-managed, durable businesses with attractive reinvestment rates has proven an effective method for compounding capital over long holding periods, and that fact has not changed in spite of bear markets, extreme price volatility, credit crunches, recessions, and so forth. Lastly, while we do not know where the bottom of this cycle is, we know we are far from the top, and as Warren Buffett has famously said the key to success in investing is to be "fearful when others are greedy and greedy when others are fearful." We are now in a time of great fear and we know that purchasing shares of compounding machines at lower prices should, all other things being equal, improve the risk/reward trade-off for investors -- a fact that prompted legendary investor Shelby Cullom Davis to remark, "You make most of your money in a bear market, you just don't realize it at the time."

Long-Term Themes

The short term is always filled with important but unanswerable questions. The longer one's perspective the clearer the ultimate destination becomes. For instance, although we do not know the exact timing, we are very confident that home values in the United States will eventually stabilize, that liquidity will eventually return to the credit markets with some government assistance and that durable businesses purchased at lower prices should result in higher prospective returns, all other things being equal.

In the current environment, share price declines suggest almost indiscriminate selling across the market. Such periods of dislocation can result in *security prices* losing their fundamental connection to underlying *business values*. We will seek to capitalize selectively on large disparities that form between price and value in high-quality businesses and we are actively studying situations that fit one of the three categories described above (market leaders, out-of-the-spotlight businesses and headline risk investments).

In addition, we are looking past the current environment to investment tailwinds that we believe could play a role in building our compound return over the next decade or so. These are some of the key themes guiding our search for long-term investment opportunities:

- **High-quality multinationals—**Investing in large corporations today almost necessarily leads to a universe of multinational companies, some of which are based in the United States while others are headquartered elsewhere.[10] Many of these businesses look attractive to us for a number of reasons. Dominant global brands that can raise capital in a wide range of environments, withstand the inevitable but hard-to-anticipate shocks, access fast-growing local markets in developing nations, and enjoy the stability of

[10] Companies operating, incorporated, or principally traded in foreign countries may have more fluctuation as foreign economies may not be as strong or diversified, foreign political systems may not be as stable and foreign financial reporting standards may not be as rigorous as they are in the United States.

geographically diversified earnings should trade at a premium in our view. Instead, many are trading at a discount to the market.

- **Capital spending—**The world's infrastructure needs, from power generation to logistics to water treatment, are significant and rising. We believe a number of global businesses that build jetliners, cranes, highways, turbines for power plants, and locomotives could be beneficiaries of infrastructure spending in the decades ahead.

- **Energy and natural resources—**As developing nations add to worldwide incremental demand for commodities like oil and natural resources, we believe the long-term average price ranges for such resources could climb, notwithstanding the recent pullback in certain commodity prices. Consistent with our energy and natural resource-related investments to date, we will remain on the lookout for disciplined capital allocators who can generate attractive profits for shareholders given a stable price environment and windfall profits under more bullish scenarios.

- **Demographically favored industries (health care and financial services)—**The populations of the United States, Europe and Japan are getting older and we believe that this inexorable trend will direct more nondiscretionary spending, partly from governments and partly from individuals and companies, toward different areas of health care. A rule of thumb in investing is to follow the money and a good deal of money will be flowing into health care equipment, treatments and services. To the extent people are living longer, they will also need to save and invest for retirement, and leading brands in financial services are the logical places where consumers will shop. While the providers may change, the demand for such services should continue to rise over time.

All of us at Davis Advisors thank you for your support and are grateful to have your confidence in challenging market environments like the present. We will continue to work hard on your behalf and look forward to continuing our investment journey together.

This report is authorized for use by existing shareholders. A current Davis New York Venture Fund prospectus must accompany or precede this piece if it is distributed to prospective shareholders. You should carefully consider the Fund's investment objectives, risks, charges and expenses before investing. Read the prospectus carefully before you invest or send money.

This report includes candid statements and observations regarding investment strategies, individual securities, economic and market conditions; however, there is no guarantee that these statements, opinions or forecasts will prove to be correct. These comments may also include the expression of opinions that are speculative in nature and should not be relied on as statements of fact.

Davis New York Venture Fund's investment objective is long-term growth of capital. There can be no assurance that the Fund will achieve its objective. Davis New York Venture Fund invests primarily in equity securities issued by large companies with market capitalizations of at least $10 billion. Some important risks of an investment in Davis New York Venture Fund are: market risk: the market value of shares of common stock can change rapidly and unpredictably; company risk: the market value of a common stock varies with the success or failure of the company issuing the stock; financial services risk: investing a significant portion of assets in the financial services sector may cause a fund to be more volatile as securities within the financial services sector are more prone to regulatory action in the financial services industry, more sensitive to interest rate fluctuations, and are the target of increased competition; foreign country risk: companies operating, incorporated, or principally traded in foreign countries may have more fluctuation as foreign economies may not be as strong or diversified, foreign political systems may not be as stable, and foreign financial reporting standards may not be as rigorous as they are in the United States. As of

September 30, 2008, Davis New York Venture Fund had approximately 13.2% of assets invested in foreign companies. See the prospectus for a complete listing of the principal risks.

Davis Advisors is committed to communicating with our investment partners as candidly as possible because we believe our investors benefit from understanding our investment philosophy and approach. Our views and opinions regarding the investment prospects of our portfolio holdings include "forward looking statements" which may or may not be accurate over the long term. 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. These opinions are current as of the date of this piece but are subject to change. Market values will vary so that an investor may experience a gain or a loss. The information provided in this report should not be considered a recommendation to buy, sell, or hold any particular security. As of September 30, 2008, Davis New York Venture Fund had invested the following percentages of its assets in the companies listed: Berkshire Hathaway, 3.92%; Goldman Sachs, 0.37%; Comcast, 2.33%; Johnson & Johnson, 0.53%; Costco Wholesale, 4.32%; Procter & Gamble, 1.57%; Occidental Petroleum, 2.46%; Transocean, 0.86%; CVS Caremark, 1.45%; Transatlantic Holdings, 0.88%; Canadian Natural Resources, 2.02%; Bank of New York Mellon, 2.23%; American International Group, 0.28%; Merrill Lynch, 2.46%; Wachovia, 0.12%.

Davis Funds has adopted a Portfolio Holdings Disclosure policy that governs the release of non-public portfolio holding information. This policy is described in detail in the prospectus. Visit davisfunds.com or call (800) 279-0279 for the most current public portfolio holdings information.

Over the last five years, the high and low turnover ratio for Davis New York Venture Fund was 16% and 3%, respectively.

Rolling 10 Year Performance Chart. Davis New York Venture Fund's average annual total returns for Class A shares were compared against the returns earned by the S&P 500® Index as of December 31 of each year for all 10 year time periods from 1969 through 2007. The Fund's returns assume an investment in Class A shares on January 1 of each year with all dividends and capital gain distributions reinvested for a 10 year period. The figures are not adjusted for any sales charge that may be imposed. If a sales charge were imposed, the reported figures would be lower. The figures shown reflect past results; past performance is not a guarantee of future results. There can be no guarantee that the Fund will continue to deliver consistent investment performance. The performance presented includes periods of bear markets when performance was negative. Equity markets are volatile. An investor may experience a loss. Returns for other share classes will vary.

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 1988-2007. 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.

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.

After January 31, 2009, this material must be accompanied by a supplement containing performance and/or ranking data for the most recent quarter end.

Shares of the Davis Funds are not deposits or obligations of any bank, are not guaranteed by any bank, are not insured by the FDIC or any other agency, and involve investment risks, including possible loss of the principal amount invested.

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