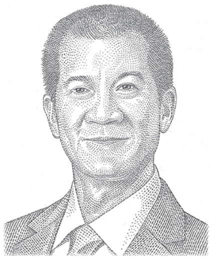

Update from Portfolio Manager

Danton Goei

Davis Select International ETF (DINT)

Annual Review 2023

Executive Summary

- Contributors to performance include international financials such as Denmark's leading bank Danske Bank, Asian life insurer AIA and Singapore's top bank DBS. Rising interest rates bolstered profitability for bank-lending operations. Detractors include Tokyo Electron in Japan and Samsung Electronics in Korea in addition to Chinese consumer internet companies JD.com, Alibaba Group and Baidu, which were affected by the COVID-19 lockdowns that weakened the Chinese economy.

- The year 2022 saw a rapid rise in inflation, which prompted the Fed to raise interest rates to try to rein it in. Inflation peaked in June at more than 9%, as measured by the Consumer Price Index (CPI). Despite the CPI falling steadily to 6.5% in December 2022, it remains elevated; and we expect that the Fed would continue to raise rates beyond the current level of 4.5%, as of this writing.

- The economy appears to be heading back to economic reality after a period of euphoria and speculative excesses. Although the transition to a higher interest-rate environment has been painful, the current context of a 4.5% federal funds rate, as of this writing, and 30-year mortgages costing 6.5% is more in line with long-term historical averages. What was anomalous, in our opinion, was the zero-percent rate environment that we've been experiencing for the past few years.

- The one large country that has not yet moved to a more sustainable post-pandemic milieu is China, which has maintained a highly restrictive COVID policy longer than other countries. This policy had a positive impact on safety and economic growth during the earlier more lethal phase of the pandemic. But it also delayed China's economic recovery and return to normalcy.

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Current Positioning, Long-Term Performance and Recent Results

For the year 2022, Davis Select International ETF (DINT) returned −8.55%, compared with −16.00% for the MSCI ACWI (All Country World Index) ex US—for an outperformance of 7.45%.

Contributors to Performance

Contributors to performance included international financials such as Denmark's leading bank Danske Bank, Asian life insurer AIA and Singapore's leading bank DBS. Rising interest rates bolstered profitability for bank-lending operations. Expectations that the global economy would normalize in a post-COVID-19 world are boosting confidence in the outlook for financials. Chinese industrial automation company, Hollysys Automation was up 19% after receiving multiple takeover offers. Canadian copper and metallurgical (met) coal miner, Teck Resources rose 34% as the outlook for copper demand grows driven by the shift to electric vehicles and renewable energy along with the continued digitization of the economy.[1]

Detractors from Performance

Detractors from performance include Chinese consumer internet companies JD.com, Alibaba Group and Baidu, as they were affected by the COVID-19 lockdowns that weakened the Chinese economy. Semiconductor companies Samsung and Tokyo Electron were down 32% and 47%, respectively, which was no surprise. After several years of strong growth, the industry expects that demand for mobile phones and personal computers would be weak in 2023. French electrical equipment and industrial automation company Schneider Electric was down 27% as COVID lockdowns hurt demand in China and inflation had a negative impact on operating margins. ■

Current Perspective on Global Markets

A Year Marked by Inflation and Interest Rate Increases

In 2022, a rapid rise in inflation prompted the U.S. Federal Reserve Bank to raise interest rates in an effort to bring inflation under control. Inflation, as measured by the year-over-year change in the CPI, peaked in June at more than 9%.[2] Despite the CPI falling steadily to 6.5% in December 2022, it still remains elevated; and we expect that the Fed would continue to raise rates beyond the current level of 4.5%, as of this writing.

Interest rates act as financial gravity for equity valuations weighing on stock prices around the globe. As the cost of debt for leveraged companies rises, bond yields become incrementally more attractive and the rate used to discount future earnings also increases, which lowers the value of these future earnings. The same is true for bonds, as the higher interest rates of today make bonds issued in the past less attractive. As a result, through December the leading bond index,

The average annual total returns for Davis Select International ETF periods ending December 31, 2022 are: NAV Return, 1 year, −8.55%; Inception (1/11/17), −1.09%; Market Price Return, 1 year, −8.56%; Inception, −1.10%. The performance presented represents past performance and is not a guarantee of future results. 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. For the Fund's most recent month end performance, visit www.davisetfs.com or call 800-279-0279. Current performance may be lower or higher than the performance quoted. *NAV prices are used to calculate market price performance prior to the date when the Fund was first publicly traded. Market performance is determined using the closing price at 4:00 pm Eastern time, when the NAV is typically calculated. Market performance does not represent the returns you would receive if you traded shares at other times. The total annual operating expense ratio as of the most recent prospectus was 0.64%. The total annual operating expense ratio may vary in future years.*

1. https://www.thomasnet.com/insights/the-reasons-why-demand-for-copper-is-growing/. Accessed 1/18/23. **2.** Tradingeconomics.com, as of 1/9/23.

the Bloomberg Aggregate Index, declined 13%. Over the same period the Bloomberg U.S. Long Treasury Bond Index was down 29%, which was far worse than the S&P 500 Index's decline of 18%.

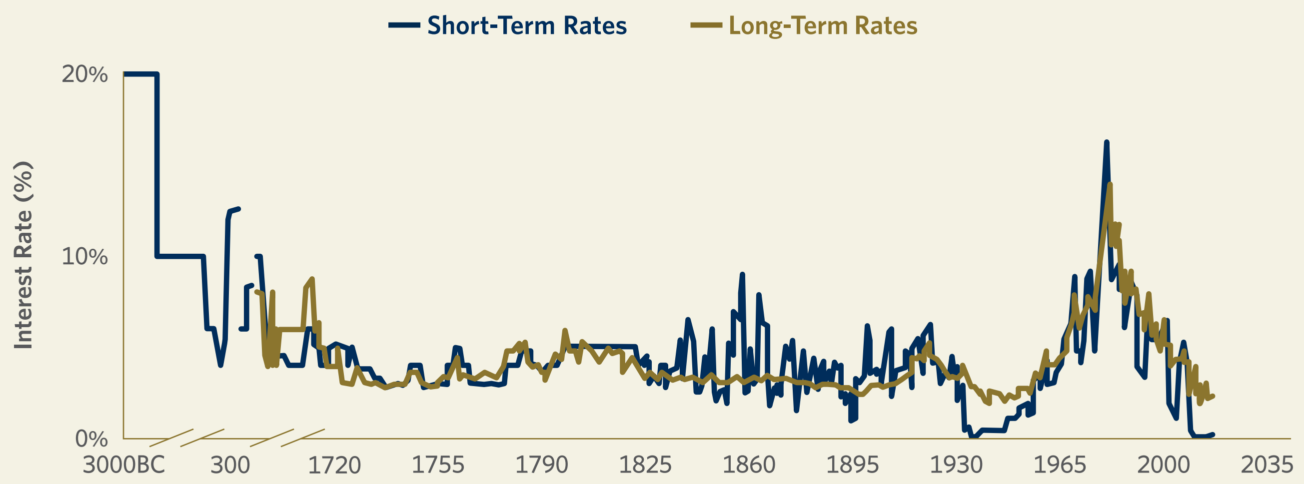
Heading Back to Normal:
The Zero-Percent Rate Environment Was a Distortion

While the transition to this higher interest rate environment has been painful, the current context of a 4.5% federal funds rate, as of this writing, and 30-year mortgages costing 6.5% is much more in line with long-term historical averages. What was anomalous was the zero-percent rate environment that we've been experiencing for the past few years (see Figure 1). Artificially low interest rates have fueled highly leveraged companies, cheap funding for speculative business models and high valuations for remote earnings potential. Examples of recent rampant speculation driven by free financing include meme stock speculation, leveraged crypto bets, sky-high valuations on unproven fintech models and a general reliance on fabricated hopes rather than actual profitability.

In contrast, established companies with conservative balance sheets, banks that generate interest income and companies with strong current earnings suffered in that distorted environment. We expect that conservatively financed leaders with proven competitive advantages who generate strong earnings will benefit from an economy where debt has a cost and competitors will once again need to earn back their cost of capital.

As the interest-rate environment marked a return to more normal levels, a similar pivot was occurring in the global health arena. In March 2022, the COVID-19 Omicron variant quickly spread across the globe and soon established itself as the dominant COVID strain. Omicron proved highly transmittable but also less lethal, which led to office and factory reopenings, increased business travel and a return to a more normal life. Unless there is a big change, the pandemic phase of COVID-19 looks to be behind us and, as an endemic disease, COVID should become predictable and manageable, which in turn would allow the global economy to recover.

Fig. 1: **Historical Interest Rates**[3]



3. Underlying sources: Bank of England; Global Financial Data; Sidney Homer and Richard Sylla. "A History of Interest Rates," 4th ed., Hoboken, NJ: Wiley Finance.

The Case of China

The one large country that has not yet moved to a more sustainable post-pandemic milieu is China, which has maintained a highly restrictive COVID policy longer than other countries. This policy had a positive impact on safety and economic growth during the earlier more lethal phase of the pandemic. But it also delayed China's economic recovery and return to normalcy.

After the 20th Party Congress concluded in October—when Xi Jinping retained the position of president for an unprecedented third term—the government loosened its COVID-19 restrictions. In fact, the loosening in November and December occurred earlier and faster than anticipated, fueled in part by public dissatisfaction with the restrictive policies while the rest of the world had already moved on.

China's rapid transition to a less restrictive policy is going to be bumpy. Already, the number of COVID cases has spiked dramatically in large metropolises such as Beijing and Shanghai and is spreading rapidly around the country. Studies estimate that China could experience as many as one million COVID-related deaths,[4] which is a human toll and should lead to weak economic growth in the first quarter of 2023. The experience of much of the world, however, including countries where governments initially had used restrictive COVID policies—such as New Zealand, Japan, Taiwan and Singapore—is that return to a more normal daily life and level of economic growth is highly probable. In major cities such as Beijing, Tianjin and Chengdu, COVID cases have already peaked. Moreover, traffic congestion in 15 major cities on January 8, 2023, climbed to 116% of the level seen in January 2021 based on an index compiled by BloombergNEF based on Baidu traffic data.[5] Such a rapid rebound in economic activity suggests the economy could recover quickly once the infection wave has passed across the country.

Rebounding from approximately 3% gross domestic product (GDP) growth in 2022, estimates are for China's GDP to grow at 4.7% in 2023 in a slow first half, followed by a very strong recovery in the second half post an initial surge in COVID cases.[6] Consumer spending in 2023 is expected to be particularly strong after weak growth in 2022, which offers a positive outlook for our portfolio's Chinese consumer companies.

In addition to the prospects of an economic rebound led by consumer spending, the government is clearly indicating it is pivoting to support the economy and de-emphasize ideology. He Lifeng—who is widely expected to replace Vice Premier Liu He as the head economic planner in the government—has called for policies to "boost the real-estate sector and re-instill confidence amongst entrepreneurs."[7] Li Qiang, expected to be named Premier in March, has said that the government would "create a favorable environment" for the private sector. And, messaging out of the recent Communist Party's Central Economic Work Conference is that China, "would encourage and support the development and growth of the private economy and private enterprises."[8]

The continued support and pragmatic approach towards economic development is not a surprise, it is after all a continuation of the policies implemented over the past several decades, but it's good to see the government so clearly voice its support for private enterprise and growth initiatives. Geopolitical concerns bear watching. Though recent developments—such as the recent

4. *Nature Magazine*, article by Smitri Mallapaty, 12/19/22. **5.** https://www.bloomberg.com/news/articles/2023-01-09/millions-of-chinese-travel-home-as-holiday-period-kicks-off?utm_source=google&utm_medium=bd&cmpId=google&leadSource=uverify%20wall. Accessed 1/9/23. **6.** *NikkeiAsia*, "China's GDP growth to accelerate to 4.7% in 2023," by Takeshi Kihara and Frances Cheung, 12/28/22. **7.** *Wall Street Journal*, "China's Leaders Plot Pivot Back Toward Boosting Economy," by Keith Zhai, 12/15/22. **8.** *Wall Street Journal*, "China Shows New Pragmatism on Economy," by James Areddy and Keith Zhai, 12/17/22.

G-20 meeting between Presidents Biden and Xi, and the U.S. Securities and Exchange Commission affirming that their audits of U.S.-listed Chinese companies were encouraging—much work needs to be done to create improved relations among the key global players.

In the face of higher interest rates and inflation, expectations are for subdued economic growth in 2023. The International Monetary Fund forecasts global GDP growth at 3.2% in 2022 but weakening to 2.7% in 2023. Forecasts are that global inflation would rise from 4.7% in 2021 to 8.8% in 2022 before falling—but still would remain at an elevated level of 6.5% in 2023.[9] U.S. GDP growth is forecast to be 1.9% in 2022 with flat growth in 2023.[10] ■

Review of Holdings

Ping An Group

DINT has held Ping An Group since mid-2021, and today it is the fund's third-largest position. Ping An Group is one of the largest financial conglomerates in China with operations across life insurance, property and casualty (P&C) insurance, banking, asset management and fintech. The group is the number-two P&C insurer in the country offering automobile insurance to around 100 million customers. And Ping An serves more than 225 million retail customers in the country.

Ping An's crown jewel is its life and health business, which contributes two-thirds of the company's operating earnings. Ping An is the number-two life insurer in a country where there is a low social safety net for retirement and inadequate public healthcare coverage. Ping An maintains its competitive advantage through its ability to create custom financial solutions for clients and by offering customers access to thousands of in-house doctors at hundreds of top hospitals in the country.

The opportunity to invest in Ping An came after the group had made some poor real estate related investments in their insurance investment portfolio. The incremental investment portfolio risks, however, are marginal and the overall investment portfolio is conservatively managed. The group is also undergoing deep reform in its agency salesforce and product portfolio that has reduced new business sales significantly. We believe that the investment to enhance salesforce productivity will strengthen the group's competitive advantage over time, and consider the current slowdown as temporary.

Ping An Group trades at over 6 times 2023 earnings and offers a 4.6% dividend yield. The Group is a high-teens return on equity business that should grow by high single digits over the medium term. The main risk with Ping An is a prolonged bear market in Chinese equity and debt markets, which would have an impact on both their investment portfolio and sales of new insurance policies.

Delivery Hero

Headquartered in Berlin, Germany, Delivery Hero is one of the largest online food-delivery platforms globally, with market-leading positions in the majority of the more than 70 countries in which it operates. South Korea is the company's largest market, where it comprises nearly half of Gross Merchandise Value (GMV), and enjoys an estimated 75% or greater market share. The company's geographical footprint is well-diversified and predominantly focused on emerging markets. The company has built an efficient network of couriers that has dramatically increased the number of restaurants that offer delivery while also expanding Delivery Hero's competitive moat.

In 2020 and 2021, business grew 68% and 56%, respectively, as demand for food delivery skyrocketed under pandemic restrictions.

9. *CNBC*, "Global economy is headed into a decade of low growth, economist says," by Elliott Smith, 12/28/22. **10.** *The Conference Board,* Economic Forecast for the U.S. Economy, 12/14/22.

However, in the most recent quarter, GMV growth slowed to 8%, leading the market to worry about the company's long-term outlook. Given the still-low user-penetration rates for food delivery across most of the company's footprint, and structural benefits to user frequency as younger generations place greater value on convenience, we believe this period of slower growth likely would be temporary and that the company will return to sustained (if not higher) mid-teens GMV growth over the medium-term.

Although improving quickly, the company still generates aggregate losses today as it invests in earlier stage markets and adjacent business opportunities. Long-term, we think the company will eventually be able to generate earnings before interest and taxes (EBIT) margins of 4.5% on GMV, which this year is expected to reach $49 billion. Trading at just nine times 2022 normalized earnings, the market appears to doubt the long-term profitability potential of Delivery Hero's business model. Factors such as demonstrated profitability by more mature global peers; development of high-margin revenue streams like advertising, and company disclosure citing substantial profitability in Delivery Hero's more mature markets make us confident in the company's profitability trajectory and that its investment in less-developed markets and businesses will pay off over time. ■

Outlook

Market corrections such as what we experienced in 2022, while unpleasant are unfortunately a common part of the investing landscape. For four of the past 10 years, the MSCI ACWI ex US has declined. Although the international MSCI ACWI ex US has had a relatively subdued decade with an annual return of 3.80% a year, the upside is that the starting valuation today, at slightly more than 12 times, is very attractive. Such a low starting multiple bodes well for future returns of international stocks.

Looking ahead, it is also encouraging that following a 20% decline, the S&P 500 Index has on average had a robust return of 23.9% the next year, which demonstrates the benefit of a low starting valuation.[11] We're reminded of Warren Buffett's oft-cited sentiment that the most common cause of low prices is pessimism. We want to do business in such an environment, not because we like pessimism, but because we like the prices it produces. "Optimism is the enemy of the rational buyer," another Buffett axiom, is an apt reminder for today.

If we zoom in from the market outlook to DINT's portfolio holdings, we are even more encouraged. The financials sector trades at a significant 28% discount to the market[12] even as these companies' interest income greatly benefits from rising interest rates. For the nine months ended September 30, 2022, net interest income was up 14% at Bank of Butterfield and up 22% at DBS.

Leading semiconductor companies such as Samsung and Tokyo Electron have very attractive long-term characteristics. They are both leaders in an industry with very strong demand driven by the growing digitization of economies and our daily lives. Both companies also have strong market shares and competitive advantages in the semiconductor space. For example, in a sign of its research and development prowess, Samsung owns more patents than any other company in the world,[13] and in 2022, it was the number-one recipient of new patents.[14] Because of fears of weak demand in 2023, following several years of strong semiconductor growth, the company is trading at only 11 times 2022 owner earnings, which makes Samsung particularly attractive as

11. https://www.wsj.com/livecoverage/stock-market-today-dow-jones-bitcoin-fed-rates-06-14-2022/card/how-the-s-p-500-performs-after-closing-in-a-bear-market-yBwgfJwW8HGSNJaKg6LB#:~:text=Since%201950%2C%20the%20S%26P%20500's,year%2C%20it%20was%2023.9%25
12. Bloomberg data. **13.** https://www.banklesstimes.com/news/2022/02/21/samsung-electronics-is-the-worlds-largest-patent-holders-at-90416/. Date accessed: 1/18/23. **14.** https://www.barrons.com/amp/articles/ibm-loses-spot-top-u-s-patent-samsung-51673450575. Date accessed: 1/18/23.

an investment. While 2023 might see inventory destocking based on weak demand, we believe the long-term demand outlook for semiconductors remains extremely solid.

Finally, the Chinese consumer internet companies in the portfolio are among the lowest valuations and highest expected return positions in the fund. Despite a late fourth-quarter rally, when investors realized that a change in China's COVID-19 policy was occurring faster than expected, Chinese internet companies along with life insurance companies Ping An and AIA Group remain very attractive. These companies should benefit greatly from a normalizing economy as their operations will no longer be affected by lockdowns, and consumer demand should rebound. Moreover, the government re-prioritizing support for private enterprises and ending the recent regulatory wave should give investors the confidence that both the long- and short-term outlooks are very positive.

We understand that in uncertain times such as these, it is more important than ever to be able to entrust your savings to an experienced and reliable investment manager with a history of a strong record. During the more than 50 years since the firm's founding, the Davis Investment Discipline has demonstrated our ability to generate above-average returns, based on in-depth fundamental analysis, a long-term investment horizon and a strong value discipline. While the times have changed, these fundamental principles are timeless and proven. We thank you for your continued trust and interest in Davis Select International ETF. ■

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The information provided in this material should not be considered a recommendation to buy, sell or hold any particular security. As of 12/31/22, the top ten holdings of Davis Select International ETF were: DBS Group Holdings, 7.14%; Danske Bank, 6.83%; Ping An Insurance Group, 6.60%; Julius Baer Group, 5.23%; AIA Group, 5.00%; Prosus, 4.93%; Naspers, 4.88%; Bank of N.T. Butterfield & Son, 4.59%; Hollysys Automation Technologies, 4.54%; and Samsung Electronics, 4.46%.

Davis Fundamental ETF Trust has adopted a Portfolio Holdings Disclosure policy that governs the release of non-public portfolio holding information. This policy is described in the prospectus. Holding percentages are subject to change. Visit davisetfs.com or call 800-279-0279 for the most current public portfolio holdings information.

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

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, excluding the United States. The index includes reinvestment of dividends, net of 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. The **Bloomberg Barclays US Aggregate Bond Index** is a broad-based flagship benchmark that measures the investment grade, US dollar-denominated, fixed-rate taxable bond market. The index includes Treasuries, government-related and corporate securities, MBS (agency fixed-rate pass-throughs), ABS and CMBS (agency and non- agency). Investments cannot be made directly in an index. The **Bloomberg U.S. Long Treasury Bond Index** measures US dollar-denominated, fixed-rate, nominal debt issued by the US Treasury with 10 years or more to maturity. Investments cannot be made directly in an index.

After 4/30/23, this material must be accompanied by a supplement containing performance data for the most recent quarter end.

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