

Update from Portfolio Managers
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Davis Select U.S. Equity ETF (DUSA)

Semi-Annual Review 2023

Executive Summary

- Davis Select U.S. Equity ETF (DUSA) returned 17.76% in the year-to-date period ended June 30, 2023. The fund's recent performance coincides with the burst of the easy-money bubble that began during the financial crisis and accelerated during the pandemic.
- The portfolio posted strong recent absolute returns, yet remains attractively valued compared to market averages. Over the past-five years, our portfolio companies in aggregate have grown earnings faster than the market averages and yet currently trade at less than 12 times forward earnings—a more than 40% discount to the S&P 500 Index (Figure 4).
- In spring 2023, a number of high-profile regional banks, none of which we owned, collapsed over the course of a few weeks. In contrast, the select, large banks we own, including Capital One Financial, JP Morgan Chase, Wells Fargo, and U.S. Bancorp, saw deposit inflows and increasing profits, reinforcing our thesis that high-quality financial companies remain among the most misunderstood and attractive sectors of the market.
- In July 2023, all the banks held in DUSA passed the Fed's notably stringent stress test, which simulates a meaningfully worse scenario than the great financial crisis of 2008-2009. The resilience required to endure such conditions, along with proven economies of scale in branding and technology, suggest to us that these institutions are safer than they have been and we believe deserve to be revalued upwards in the years ahead.
- In big technology, the huge price volatility of leaders like Alphabet, Meta and Amazon can come with opportunity—trimming when prices are high and adding when they are low. For example, we added significantly to Meta last year at less than half of today's price and have recently trimmed our position in Alphabet as share prices swung back into favor.
- In the attractive healthcare sector, we look beyond the obvious to identify businesses that simultaneously have exposure to this growth industry and also trade at low prices. We're especially drawn to companies like Cigna Group, Viatrix and Quest Diagnostics, whose products or services play a part in helping to mitigate healthcare's constantly rising costs.



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The average annual total returns for Davis Select U.S. Equity ETF periods ending June 30, 2023, are: NAV Return, 1 year, 18.53%; 5 years, 7.29%; Inception (1/11/17), 8.68%; Market Price Return, 1 year, 18.55%; 5 years, 7.23%; Inception, 8.69%. 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 0.61%. The total annual operating expense ratio may vary in future years.

This material 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. All fund performance discussed within this material are at NAV and are as of 6/30/23 unless otherwise noted. This is not a recommendation to buy, sell or hold any specific security. **Past performance is not a guarantee of future results. The Attractive Growth and Undervalued reference in this material relates to underlying characteristics of the portfolio holdings. There is no guarantee that the Fund performance will be positive as equity markets are volatile and an investor may lose money.**

Results

Davis Select U.S. Equity ETF (DUSA) returned 17.76% in the year-to-date period ended June 30, 2023, outperforming the S&P 500 Index return of 16.89%. ■

Return to Rationality After a Decade of Distortion

The fund's recent performance coincides with the burst of the easy-money bubble that began

during the financial crisis and accelerated during the pandemic. Through this unprecedented period, the cost of money as measured by long-term interest rates fell to the lowest level in recorded history as shown in Figure 1. In turn, this created enormous financial distortions, the consequences of which are only now becoming broadly apparent.

Near-zero interest rates fueled high leverage; provided cheap capital for speculative business models; led to absurdly high valuations for remote earnings potential and provided easy funding for companies that promised to disrupt whole sectors of the economy. As Figure 2 summarizes, this

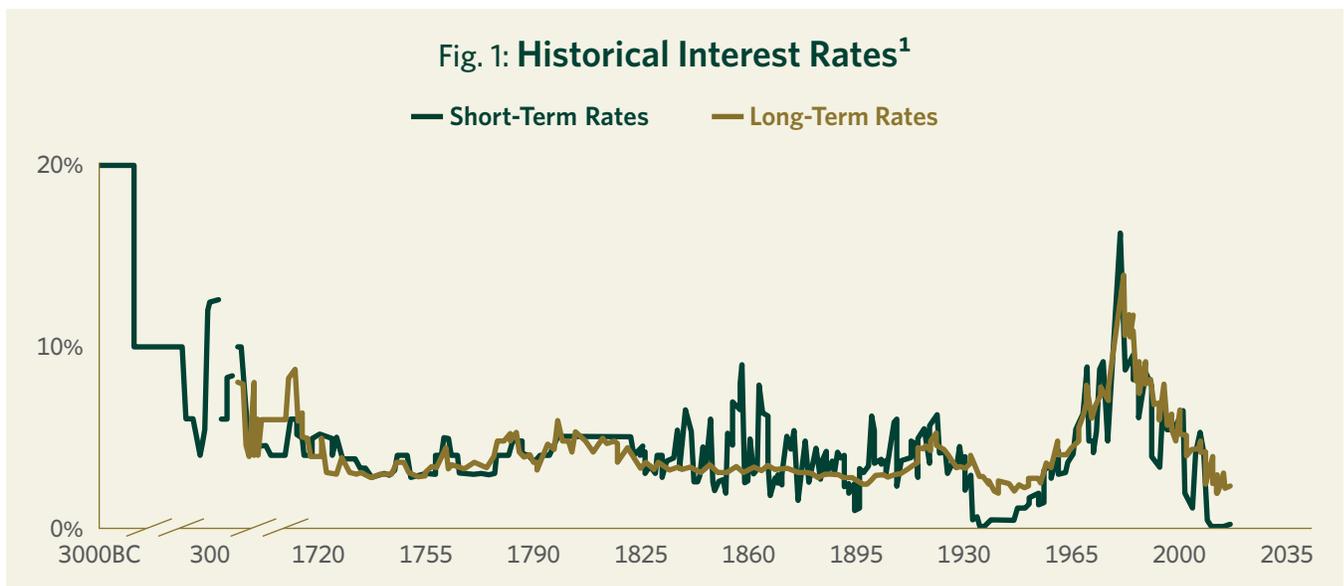


Fig. 2: The Easy Money Era Created Numerous Economic Distortions

Fueled	Penalized
Highly leveraged companies	Companies with conservative balance sheets
Cheap funding for speculative business models	Companies that rely on interest income—e.g., banks/insurers
High valuations for remote earnings potential	Valuations for current vs. future cash flow
Story stocks and possible disruptors	Companies with expense and return discipline
Speculation	

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

environment rewarded just the sort of business models we tend to avoid because they're too risky or too overvalued.

On the other side of the ledger, the speculative frenzy caused by free money led to many companies being relatively undervalued. This includes businesses with attributes like conservative balance sheets, proven long-term business models, a return-on-capital mindset and expense discipline, which are central to our long-term investment discipline. Furthermore, with rates near zero, earnings of financial firms that rely on interest income—e.g., banks and insurers—were thwarted² and current cash flow and dividends became undervalued relative to future promises.

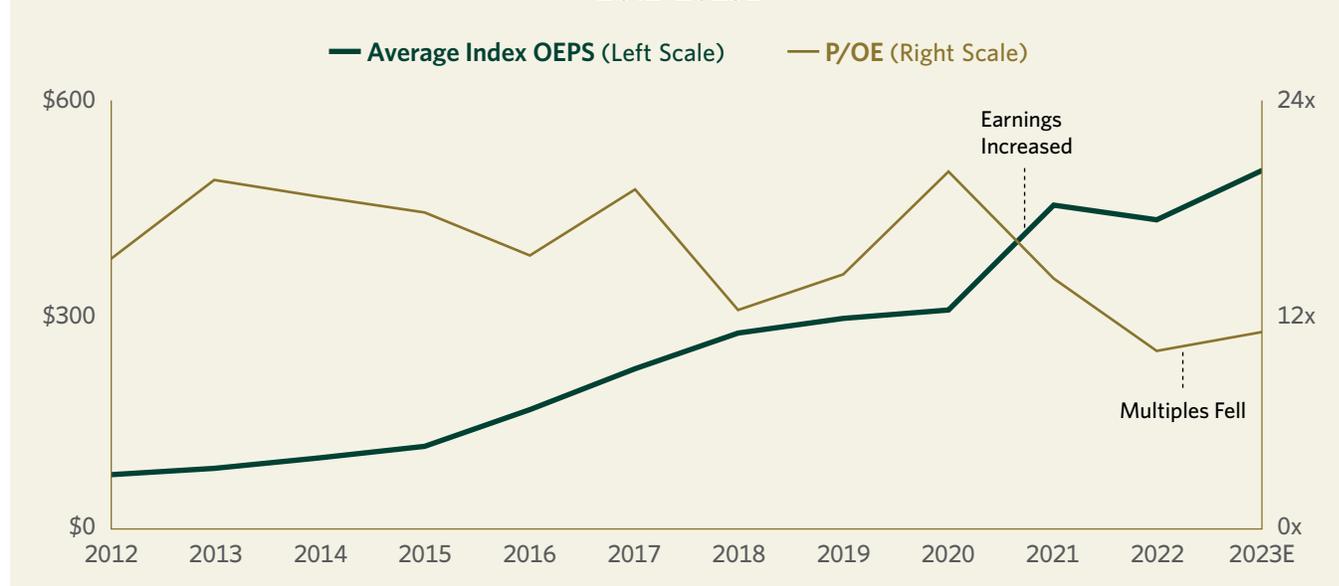
In short, during this decade of distortion, the durable and resilient economic fundamentals of our portfolio companies fell out of fashion. Their fall from favor was reflected in declining relative valuations despite their sound fundamentals. In Figure 3, the rising green line shows the average

earnings over the past decade of the top-15 holdings in our portfolio today, which represent more than 75% of the portfolio. The falling gold line shows the declining valuations that the market placed on these reliable but unspectacular growth companies.

For us, falling valuations and improving fundamentals spell opportunity. As Warren Buffett famously said, "In the short run, the market is a voting machine but in the long run, it is a weighing machine." For more than a decade, our portfolio companies have increased their earnings and become more valuable. With the distortions of the free money era ending, we are encouraged that the fund's results are beginning to reflect the growing value of our portfolio holdings.

While absolute results over the past year have been strong, the portfolio remains significantly undervalued when compared to the market averages. Figure 4 indicates that the carefully selected group

Fig. 3: DUSA Top-15 Holdings OEPS vs. Valuation³
2012-2023E



2. We discuss the opportunity and risks for banks later in this report. 3. Source: Davis Advisors. Not a recommendation to buy, sell or hold any particular security. The information provided is not a sufficient basis upon which to make an investment decision. The securities listed above represent holdings from DUSA as of 6/30/23. The holdings are subject to change. You should review the most recent shareholder report for a full schedule of investments in DUSA. Owner Earnings Per Share (OEPS) reflects discretionary adjustments to reported earnings made by Davis Advisors, including for transaction amortization, any variance between depreciation and estimated maintenance capital expenditures, certain restructuring costs, idiosyncratic gains and losses, and changes to loan loss reserves. P/OE is the ratio of a company's market capitalization to owner earnings.

of companies that comprise DUSA's portfolio trade at less than 12 times forward earnings—a more than 40% discount to the S&P 500 Index—despite having grown their earnings per share significantly faster over the past five years. We believe this rare combination of above-average growth and below-average prices is a value investor's dream that positions us well for the years ahead. ■

Fig. 4: Selective, Attractive Growth, Undervalued⁴

	Fund	S&P 500 Index
Holdings	27	504
EPS Growth (5 Year)	10.9%	9.7%
P/E (Forward)	11.6x	20.2x

■ Outlook

While businesses with decent past records might be expected to trade at low valuations if they face secular challenges or a bleak future, the opposite should be true for the companies in DUSA, which we believe will earn significantly more in the years ahead. We believe the select companies we own have durable competitive advantages and bright prospects.

Today's deteriorating macroeconomic outlook has led some commentators and pundits to advise selling out of stocks and waiting until economic prospects improve. History teaches us that such market timing is a fool's errand. As famed investor Peter Lynch observed, "Far more money has been lost by investors in preparing for corrections or anticipating corrections than has been lost in the corrections themselves." Corrections are an inevitable but unpredictable part of the investment landscape. Figure 5 shows that on average the market corrects 5% three times per year, 10% once per year and 20% every 3.5 years.

Like market corrections, economic recessions are also an inevitable albeit somewhat less frequent occurrence. In fact, we have navigated through three recessions since the year 2000. More importantly, even if investors had perfect foresight and were able to sit out all recessions, their returns would have been worse, not better, than if they had simply stayed the course.

Figure 6 confirms that if an investor had been able to sell one year before and get back in one year after every economic downturn since 1928, their results would be worse than if they had remained invested.

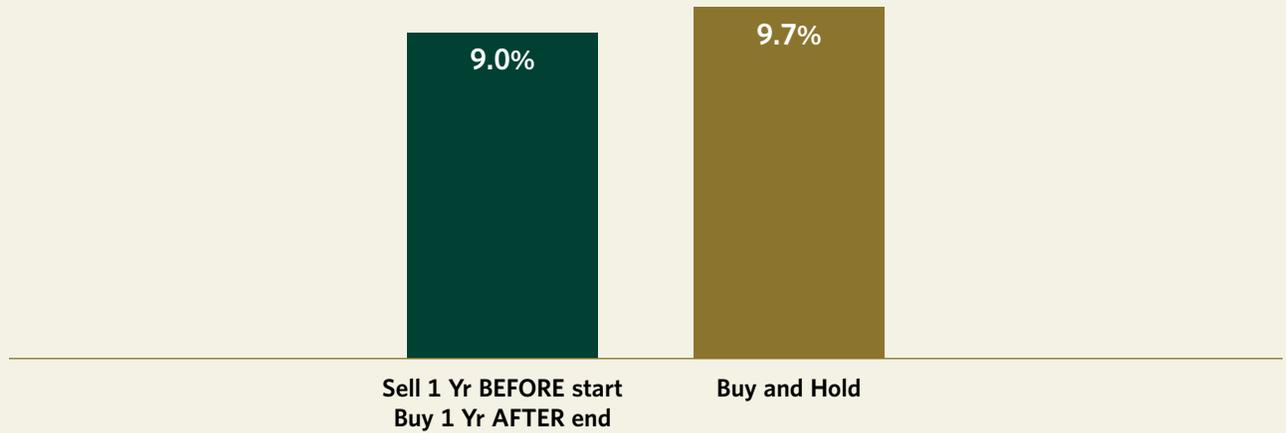
Fig. 5: Accept that Volatility and Market Dips Are Inevitable in Investing⁵

	Occurrences Since 1928	Frequency of Occurrences
5% Correction	310	≈ 3 per year
10% Correction	98	≈ 1 per year
20% Correction	25	≈ 3.5 years

4. The Attractive Growth and Undervalued reference in this material relates to underlying characteristics of the portfolio holdings. There is no guarantee that the Fund'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. Five-year EPS Growth Rate (5-year EPS) is the average annualized earnings per share growth for a company over the past 5 years. The values shown are the weighted average of the 5-year EPS of the stocks in the Fund or Index. Approximately 0.60% of the assets of the Fund are not accounted for in the calculation of 5-year EPS as relevant information on certain companies is not available to the Fund's data provider. Forward Price/Earnings (Forward P/E) Ratio is a stock's price at the date indicated divided by the company's forecasted earnings for the following 12 months based on estimates provided by the Fund's data provider. These values for both the Fund and the Index are the weighted average of the stocks in the portfolio or Index. 5. Source: Ned Davis Research, Inc. Further distribution prohibited without prior permission. All rights reserved.

Fig. 6: **Be Careful Making Investment Decisions Based on Recession Timing**⁶

Annualized Returns for Two Hypothetical Investing Scenarios
During Recessions Since 1928



Knowing that corrections and downturns are unpredictable but inevitable, we prioritize resilience as well as long-term growth potential in our portfolio companies. Importantly, this does not mean that we expect our companies to earn more each year, but rather that we expect earnings power and intrinsic value to compound at a good rate over the long term. With a near recession in the offing, many pundits, strategists and commentators are advising investors to prioritize the short-term predictability of consumer discretionary and consumer staple companies whose slow-growing businesses tend to be less economically sensitive. The problem is that paying a high price for predictable but slow growth can be a recipe for long-term disappointment. It is remarkable that these two relatively slow-growing sectors currently trade at an eye-popping 26 times and 20 times forward earnings, respectively.⁷

By paying high valuations for smooth earnings, investors forget that even a good business can be a bad investment if purchased at an irrational price.

Like Warren Buffett—“We prefer a lumpy 15% return to a smooth 12% return”—and thus focus on long-term rather than linear growth. In today’s environment, we are avoiding overvalued perceived safety and targeting companies with widening competitive positions, ‘lumpy’ growth, significant free cash flow, long-lived assets and durability. ■

■ Fund Holdings

Bearing in mind John Train’s wisdom that “investing is the art of the specific,” we now turn to a detailed review of the themes, sectors and companies that position us to take advantage of the current environment of uncertainty.

Financials—Growth Stocks in Disguise

The financial sector makes up the largest weighting in DUSA—reflecting our belief that since the great financial crisis of 2008-2009, investors have significantly undervalued financial companies in general and banks in particular. This undervaluation

6. Source: Charlie Bilello, Compound Advisors. Past performance is not a guarantee of future results. 7. Ed Yardini Research, accessed last on 7/20/23.

stems from the scars of that crisis and a failure to appreciate that stricter regulations and significantly more capital have made select well-managed large banks far safer and more attractive than ever.

Earlier this year, the importance of the terms “well-managed” and “large” was reinforced by the collapse of three smaller and riskier institutions, Silicon Valley Bank, Signature Bank and First Republic Bank. We owned none of these, not because we hadn’t studied them over the years but rather because our review of their balance sheets showed an interest rate mismatch between their assets (securities and loans) and their liabilities (customer deposits). While we did not predict their collapse, we predicted that they had taken unnecessary risks that would significantly dampen their future earnings power, a clear indication of an aggressive, short-term culture. For example, in a 2022 research memo, we wrote, “At First Republic, [we are] rather startled by their choices. It’s not just that their assets are largely locked into fixed rates, but also that... [we] believe their deposit base is going to be far more rate sensitive than that of a traditional regional bank.”

The collapse of these three poorly managed banks created a panic. While the prices of virtually all banks declined sharply, the value of the large, high-quality banks we own actually increased throughout this period. Despite blaring headlines about bank runs, most of our carefully selected banks are adding new customers and growing profits. Today, their capital ratios are at or near all-time highs; they have benefited from higher interest rates, and most importantly, in July of this year, all passed the stringent stress test overseen by the Federal Reserve.

This stress test models a dramatic recession—one meaningfully worse than the great financial crisis of 2008–2009. It includes a 3.5% decline in gross

domestic product, a 10% unemployment rate, a 37% decline in residential real estate, a 40% decline in commercial real estate and a 55% decline in the stock market. The resilience and strength required to weather such an economic storm combined with proven economies of scale in branding and technology should drive DUSA market share gains and growth for years to come. Trading at some of the lowest valuations in the market, we believe our financial sector holdings—such as Capital One Financial, Wells Fargo, Bank of New York Mellon, JP Morgan Chase and U.S. Bancorp—deserve to be revalued upwards over time. In the meantime, we believe that increasing dividends and a shrinking share base create value while we wait.

Durable Industrials—Nonlinear Growth

As concern about a looming recession has grown, we have found opportunities in long-term growth companies whose short-term earnings could be affected by an economic downturn. While investors are paying a premium for slow-growing companies that are not economically sensitive in the short term, they are undervaluing companies whose long-term earnings power will grow more substantially over time. As discussed above, the tendency to overweight the pattern of earnings relative to the amount of earnings reflects psychology rather than economics. In today’s market, nervous investors are essentially paying twice as much for a hypothetical business that will earn \$10 million, \$10.5 million, and \$11 million over the next three years than one that will earn \$10 million, \$9 million, and \$13 million even though the second one is worth more. Examples in our portfolio of resilient but nonlinear growth companies with long-lived assets and strong competitive positions include Berkshire Hathaway, Applied Materials, Teck Resources, Samsung and Owens Corning.

Healthcare—Finding Value in a Growth Sector

The healthcare industry has been a growing part of the U.S. economy for decades. As a result, many companies in this sector trade at high valuations reflecting their robust but well-known reputation for growth. For value-conscious investors like us, investing in healthcare requires looking beyond the obvious to identify businesses that have exposure to this growth industry but which trade at low prices. Furthermore, recognizing that the constantly rising cost of healthcare cannot go on forever, we have been particularly drawn to companies whose products or services play some role in managing or reducing the cost of care. As a result, we have positions in Cigna Group, a well-regarded provider of managed care, Viatris, a leading manufacturer of low-cost branded generic drugs and Quest Diagnostics, whose centralized facilities provide diagnostic medical tests at a fraction of the cost of hospitals' in-house labs.

Online Platforms—Controversial Blue Chips

For many years, we have referred to the leading online platforms such as Alphabet, Meta and Amazon as the blue chips of tomorrow. Their economies of scale, network effects, strong competitive positions and profitable business models combine to make them some of the best businesses we have ever seen. Because of this success, these juggernauts have attracted waves of regulatory scrutiny and relentless negative press coverage. As a result of the ebb and flow of these controversies, investor sentiment can swing precipitously from euphoria to disgust, which can provide opportunities for price-conscious investors.

For example, in our last report, we included a detailed review of our investment in Meta, the holding company that includes Facebook, Instagram and WhatsApp, whose shares had recently plunged. We wrote, "Meta currently languishes under a cloud of skepticism... Down more than 65% from its high, we believe all of the risks to be more than discounted and have added to our holding." Since then, Meta shares have soared more than 100%.

While we are not short-term traders, the enormous price volatility of these online tech leaders has led us to be opportunistic, trimming when prices are high and adding when they are low. Recently, as these companies have swung back into favor, we have trimmed our position in Alphabet.

Select International Leaders—Economics Trumps Geography

Finally, because the U.S. stock market has outperformed virtually all international markets over the past decade or more, many investors have given up on international investing and chosen to ignore all companies whose shares trade outside of the U.S. As a result, select companies whose business results, competitive positions and management quality would lead investors to pay a premium if the shares were listed in the United States trade at steep discounts, even allowing for regulatory differences and currency exposure. In each of these investments, our focus is on durability, quality, valuation and management. Examples include DBS, the largest bank in Singapore (also known as the Fort Knox of Asia), Danske Bank, the leading bank of Denmark for more than a century, and Ping An, the largest insurance company in Asia, whose name literally translates as "Safe and Well." ■

Conclusion

The past-12 months mark a complete change in market fundamentals as we move from an era of record-low interest rates and speculative bubbles to a period of higher inflation and recessionary fears. While transitions can be volatile, this transformation represents a long overdue return to normalcy after a decade in which the suppression of interest rates inflated asset prices, rewarded speculation and devalued economic fundamentals. Until roughly one year ago, our focus on durability, resilience and valuation left us out of the hottest areas of the market. Though we grew the value of the assets entrusted to our stewardship, we lagged the S&P 500 Index. However, as the bubble has deflated, our steadfast focus on fundamentals has paid off; the fund is generating strong absolute returns. We are encouraged by this start, but we caution that short-term results are unpredictable and corrections and recessions though painful are inevitable. Instead of trying to predict the timing of such setbacks, we prepare for them by owning companies that can make strong progress in good times and endure through hard times.

During the past decade of excess, we built a portfolio to ride out the inevitable return to reality. In the years ahead, we expect that our value-investing discipline and patience will be rewarded.

Above all, we never forget that we are stewards of our shareholders' savings and that our most important job is growing the value of the funds entrusted to us. With more than \$2 billion of our own money invested alongside that of our clients, we are on this journey together.⁸ That we stand by our portfolio of carefully selected companies is more than just words. Given that 85% of all funds are overseen by managers who have less than \$1 million invested in tandem with their clients, our alignment with shareholders is an uncommon advantage. While we do not welcome the pessimism and fear that have characterized our world recently, we are well-prepared for it and, more importantly, we are poised for the future.

Thank you for the trust you have placed in us. ■



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- Viewing volatility as a cost of admission to building wealth
- Saving like a pessimist, but investing like an optimist

8. As of 6/30/23 Davis Advisors, the Davis family and Foundation, our employees, and Fund trustees have more than \$2 billion invested alongside clients in similarly managed accounts and strategies.

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Shares of DUSA are bought and sold at market price (not NAV) and are not individually redeemed from the ETF. There can be no guarantee that an active trading market for ETF shares will develop or be maintained, or that their listing will continue or remain unchanged. Buying or selling ETF shares on an exchange may require the payment of brokerage commissions and frequent trading may incur brokerage costs that detract significantly from investment returns.

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Objective and Risks. The investment objective of Davis Select U.S. Equity ETF is long-term capital growth and capital preservation. There can be no assurance that the Fund will achieve its objective. Some important risks of an investment in the Fund are: **stock market risk; common stock risk; market trading risk:** includes the possibility of an inactive market for Fund shares, losses from trading in secondary markets, periods of high volatility, and disruptions in the creation/redemption process. **ONE OR MORE OF THESE FACTORS, AMONG OTHERS, COULD LEAD TO THE FUND'S SHARES TRADING AT A PREMIUM OR DISCOUNT TO NAV; exchange-traded fund risk:** the Fund is subject to the risks of owning the underlying securities as well as the risks of owning an exchange-traded fund generally; **focused portfolio risk:** investing in a limited number of companies causes changes in the value of a single security to have a more significant effect on the value of the Fund's total portfolio; **financial services risk; foreign country risk; headline risk; large-capitalization**

companies risk; manager risk; authorized participant concentration risk: to the extent that Authorized Participants exit the business or are unable or unwilling to proceed with creation and/or redemption orders with respect to the Fund and no other Authorized Participant is able to step forward to create or redeem Creation Units, Fund shares may trade at a discount to NAV and could face delisting; **cybersecurity risk:** a cybersecurity breach may disrupt the business operations of the Fund or its service providers; **depository receipts risk:** depository receipts involve higher expenses and may trade at a discount (or premium) to the underlying security and may be less liquid than the underlying securities listed on an exchange; **fees and expenses risk; foreign currency risk; and mid- and small- capitalization companies risk.** See the prospectus for a complete description of the principal risks.

The information provided in this material should not be considered a recommendation to buy, sell or hold any particular security. As of 6/30/23, the top ten holdings of Davis Select U.S. Equity ETF were: Meta Platforms, 11.61%; Berkshire Hathaway, 10.07%; Capital One Financial, 8.17%; Amazon.com, 7.94%; Wells Fargo, 5.68%; Alphabet, 4.14%; Cigna Group, 3.97%; Viatrix, 3.86%; Owens Corning, 3.74%; and Markel Group, 3.73%.

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 Statement of Additional Information. Holding percentages are subject to change. Visit davisetfs.com or call 800-279-0279 for the most current public portfolio holdings information.

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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 10/31/23, this material must be accompanied by a supplement containing performance data for the most recent quarter end.