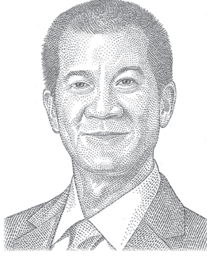

Update from Portfolio Manager

Danton Goei

Davis Select Worldwide ETF (DWLD)

Annual Review 2023

Executive Summary

- For 2022, Davis Select Worldwide ETF (DWLD) returned −14.06%, compared with −18.36% for the MSCI ACWI (All Country World Index)—an outperformance of 4.30%. *Contributing* to the fund's performance were Cigna (up 47%), and international financials such as Singapore's leading bank DBS, Denmark's top bank Danske Bank, Swiss wealth manager Julius Baer, Asian life insurers AIA Group and Ping An Insurance. *Detractors* from performance include Meta (down 64%), Amazon.com (down 50%) and Alphabet (down 39%).
- A rapid rise in inflation in 2022 prompted the Fed to raise interest rates to try to bring it under control. Inflation peaked in June at more than 9%. Despite the Consumer Price Index (CPI) falling steadily to 6.5% in December, inflation remains elevated; and we expect that the Fed will continue to raise rates beyond the current level of 4.5%, as of this writing.
- The selected U.S. companies in our portfolio—including banks, leading internet firms and key high-tech manufacturers are attractive and trading at valuations that bode well for future returns. The Chinese consumer internet companies in the portfolio have some of the lowest valuations and highest expected returns in the fund. On balance, the international indices look relatively more attractive than the S&P 500 Index.
- Since its founding more than 50 years ago, the Davis Investment Discipline has demonstrated that it can generate above-average returns based on the proven principles of in-depth fundamental analysis, a long investment horizon and a strong value discipline.

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The average annual total returns for Davis Select Worldwide ETF for periods ending December 31, 2022 are: NAV Return, 1 year, −14.06%; 5 years, 0.70%; Inception (1/11/17), 5.15%; Market Price Return, 1 year, −14.19%; 5 years, 0.58%; Inception, 5.07%. 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 0.62%. The total annual operating expense ratio may vary in future years.*

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. All fund performance discussed within this piece are at NAV and are as of 12/31/22 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. There is no guarantee that the Fund performance will be positive as equity markets are volatile and an investor may lose money.

Current Positioning, Long-Term Performance and Recent Results

For the year 2022, Davis Select Worldwide ETF (DWLD) returned –14.06%, compared with –18.36% for the MSCI ACWI for an outperformance of 4.30%.

Contributors to Performance

Contributors to performance included United States health insurer, Cigna which was up 47% driven by prudent control of medical costs, strong pricing and timely share repurchases. International financials including Singapore's leading bank DBS, Denmark's top bank Danske Bank, Swiss wealth manager Julius Baer and Asian life insurers AIA Group and Ping An Insurance were all key contributors to 2022 outperformance. 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. 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 U.S. internet leaders Meta (formerly known as Facebook) down 64%, Amazon.com down 50% and Alphabet down 39% following a couple years of very strong performance during the COVID-19-plagued economy. In fact, for the past five years, Amazon is up 44% and Alphabet is up 70%, even factoring in this year's declines. As we look ahead, low starting valuations, continued growth in the base businesses and innovative research and development efforts create promising outlooks. We will discuss Meta in further detail later in the letter. Subdued retail and digital advertising sales slowed revenue growth, and rising inflation led to higher costs and compressed operating margins in 2022.

Earlier-stage high-growth companies including corporate video provider Vimeo and online car retailer Vroom were affected by slower economic growth, increased competition and a more challenging financing environment. We sold out of all these positions in 2022, as the general market downturn offered us other attractive opportunities in more established companies. ■

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,

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.

through December the leading bond index, 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%.

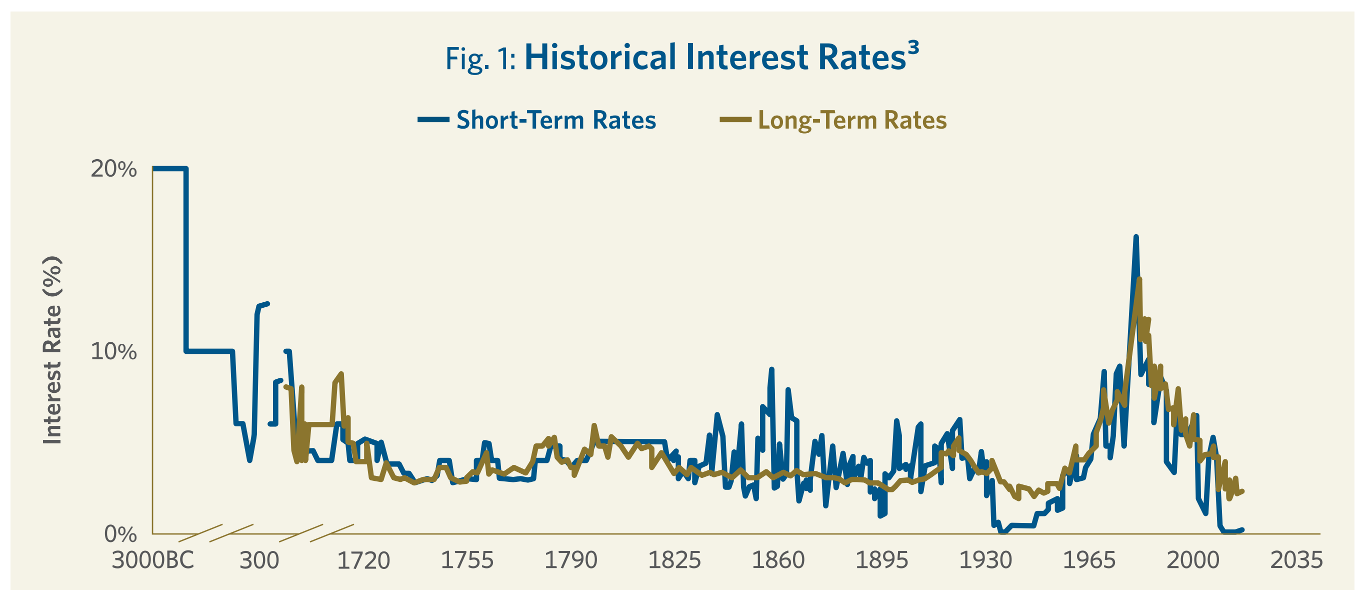
Heading Back to Normal: The Zero-Percent Rate Environment Was a Distortion

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.

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.

Though recent developments—such as the recent 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 global 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]

The select U.S. companies in our portfolio—including banks, leading internet firms and key high-technology manufacturers—are attractive and trading at valuations that bode well for future returns. On balance, however, the international indices look relatively more attractive than the S&P 500 Index. The S&P 500 Index trades at a forward price/earnings multiple of 17.8 times, while the international index MSCI ACWI ex US trades at 12 times—a 32% discount. Not only is their starting multiple much lower, but international stocks on average have more than doubled the dividend return with a 3.9% dividend yield compared to the S&P 500 Index's 1.9% yield. The relative attractiveness of international stocks as well as expectations that international growth will be stronger going forward explains the fund's allocation of 40% to U.S. companies compared to the MSCI ACWI's U.S. weighting of 60%. Our select 20 international industry leaders are currently trading at very attractive valuations, and we anticipate they'll be significant contributors to investor returns in the years to come. ■

Review of Holdings

Ping An Group

DWLD has held Ping An Group since mid-2021, and today it is the fund's second-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

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.

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.

Meta

Meta, formerly known as Facebook, is among the fund's top holdings. Meta owns Facebook, Instagram and WhatsApp (the "family of apps"), which are three of the most popular social media and communications platforms in the world. Nearly half of the world's population (3.7 billion people) use at least one, and often more than one, of these platforms every day. Competition in the social media space is fierce but Meta has continued to innovate and ensure that its applications remain extremely relevant. For example, even in the face of TikTok's massive success, Facebook and Instagram continue to see both robust user engagement and user growth on a global basis.

Meta monetizes the time its users spend on its family of apps primarily via advertising. The company's ad platform is highly sophisticated, and despite some of the privacy headwinds in recent years, Meta still offers best-in-class personalized advertising capabilities at scale; this lets advertisers of all sizes earn attractive returns on its ad spend. Looking beyond near-term macroeconomic uncertainty, we expect that the company's advertising business would continue to grow at a healthy pace—driven by improvements in targeting; advances in machine learning and artificial intelligence (AI); incremental impression growth led by user adoption of Reels, and ongoing monetization efforts at WhatsApp, which today remains largely un-monetized.

The company's very large investments in the metaverse and virtual/augmented reality hardware products—like its Reality Labs business unit—have generated critical headlines in addition to widespread investor concern. Despite our confidence in management and its strong long-term track record, there remains a great deal of uncertainty about the ultimate return on Meta's investment in Reality Labs. However, even including the very large losses in Reality Labs, Meta trades at only 13 times 2023 owner earnings—only 8 times, excluding losses—which is extremely attractive for a very healthy and defensible core business.

Investing in Meta today is reminiscent of our investment in Amazon.com in 2015, when we paid little for a healthy core business and got a free option on Amazon Web Services. If the metaverse investments prove unsuccessful and eventually the Reality Labs segment is shut down, then Meta is too cheap today; and if the metaverse investment ultimately does prove successful, then Meta is even more attractive. The key risk for Meta is stricter antitrust and privacy regulations in the future, but Meta has built a very robust regulatory and government affairs staff and has proven adept at adapting to changing regulations.

Owens Corning

Owens Corning, based in Ohio, specializes in insulation and roofing materials and is one of the leading U.S. building materials companies. The company has been innovating and refining the material science behind glass fibers since the 1930s. This has led to well-known products such as its trademark PINK fiberglass insulation, as well as lesser-known applications—like wind turbine blades, the substrate mat underlying its long-lasting asphalt shingles and structural components for buildings and vehicles. The company continues to find new, high-value applications for this core intellectual property and process know-how—such as a recently introduced fiberglass replacement for steel rebar that is lighter and more corrosion resistant than steel rebar. Owens Corning has also added to its product offering by extending into adjacencies, such as mineral wool insulation and roofing components.

We saw an opportunity to purchase shares in Owens Corning at an attractive single-digit multiple in early 2022, as industrial stock prices swooned on news of the Russia/Ukraine war. The company's primary market is U.S. residential, but it also sells commercial and industrial products in Europe and Asia. Owens Corning has significant end-market exposure to the broad construction sector, which has seen rapidly slowing activity because of the rise in interest rates. This slowing economic activity, and its impact on pricing and volume, is the key risk to consider; and as of this writing it's difficult to estimate how deep and long-lasting the slowdown will be. The company's strong market positions—two times the size of its next-closest competitor in U.S. residential fiberglass insulation—and solid balance sheet are important mitigating factors.

Owens Corning is unique in that, unlike many other construction product suppliers, Owens Corning is a beneficiary of higher energy prices. Many of its products, such as building insulation or wind turbine blades, are used for energy-savings applications or energy production. The company is a long-term beneficiary of building codes ratcheting up to reflect energy scarcity and environmental concerns. ■

Outlook

Market corrections are unfortunately unremarkable. For three of the past 10 years, the MSCI ACWI has declined. Even including this year's −18.36% return, however, the MSCI ACWI has returned 7.97% per year over the past decade.

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 following year. 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 DWLD's portfolio holdings, we are even more encouraged. The financials sector trades at a significant 28% discount to the market[11] 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 12% at Capital One, up 14% at Bank of Butterfield, up 19% at Wells Fargo and up 22% at DBS.

Earlier in the commentary, we noted that, despite a down year in 2022, over a five-year period U.S. total investor returns for internet companies like Alphabet are up 70% and Amazon are up 44%. Yet for the same five-year period, Alphabet earnings and Amazon revenues have about tripled. So, business growth has been much faster than stock returns and as a result the valuation multiples are down substantially. Established profitable U.S. internet companies remain very attractive, as do established semiconductor equipment companies such Applied Materials and Samsung.

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.

11. Bloomberg data.

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 Worldwide ETF. ■

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Davis ETFs

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Shares of DWLD 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.

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. 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 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 include "forward-looking statements" which may or may not be accurate over the long term. Forward-looking statements can be identified by words like "believe," "expect," "anticipate," or similar expressions. You should not place undue reliance on forward-looking statements, which are current as of the date of this 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.

Objective and Risks. The investment objective of Davis Select Worldwide ETF is long-term growth of capital. 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; **foreign country risk; exposure to industry or sector risk:** significant exposure to a particular industry or sector may cause the Fund to be more impacted by risks relating to and developments affecting the industry or sector; **China risk – generally; headline risk; foreign market 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; emerging market risk:** securities of issuers in emerging and developing markets may present risks not found in more mature markets; **depositary receipts risk:** depositary receipts involve higher expenses and may trade at a discount (or premium) to the underlying security; **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 12/31/22, the top ten holdings of Davis Select Worldwide ETF were: Danske Bank, 6.44%, Ping An Insurance, 6.20%, Wells Fargo, 5.78%, DBS Group Holdings, 5.53%, Julius Baer Group, 5.11%, Meta Platforms, 4.98%, Berkshire Hathaway, 4.51%, Hollysys Automation Technologies, 4.35%, AIA Group, 4.21%, and Prosus, 3.92%.

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)** 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. 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). 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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