



Clipper Fund

Update from Portfolio Managers
Christopher Davis and Danton Goei



Clipper Fund

Annual Review 2017

Summary

- In 2016, Clipper Fund returned 15.62% vs. 11.96% for the S&P 500 Index.¹
- Over the most recent one, three and five year periods, a \$10,000 investment grew to \$11,562, \$13,260, and \$19,988 respectively, exceeding the S&P 500 Index in all periods.¹
- Opportunities in today's market include global leaders selling at bargain prices, dominant lesser-known businesses in necessary economic niches, blue chips of tomorrow, and beneficiaries of short-term misperceptions.²
- Risks in today's market include overvalued dividend darlings and companies with near peak profit margins.³

Average Annual Total Returns as of December 31, 2016

	1 Year	5 Years	10 Years	15 Years	20 Years
Clipper Fund	15.62%	14.86%	5.00%	5.51%	8.55%
S&P 500 Index	11.96%	14.66%	6.95%	6.69%	7.68%

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 as of the most recent prospectus was 0.72%. The total annual operating expense ratio may vary in future years. Current performance may be higher or lower than the performance quoted. For most recent month-end performance, visit clipperfund.com or call 800-432-2504. The Fund received favorable class action settlements from companies that it no longer owns. These settlements had a material impact on the investment performance of the Fund in 2009. This was a one-time event that is unlikely to be repeated. Clipper Fund was managed from inception, February 29, 1984, until December 31, 2005 by another Adviser. Davis Selected Advisers, L.P. took over management of the Fund on January 1, 2006.

This report includes candid statements and observations regarding investment strategies, individual securities, and economic and market conditions; however, there is no guarantee that these statements, opinions or forecasts will prove to be correct. Equity markets are volatile and an investor may lose money. **Past performance is not a guarantee of future results.** **1. Past performance is not a guarantee of future results.** **2.** While we research companies subject to such contingencies, we cannot be correct every time, and a company's stock may never recover. **3.** While Davis Advisors attempts to manage risk there is no guarantee that an investor will not lose money. Equity markets are volatile and the investment return and principal value of an investment will vary. Diversification does not ensure against loss.

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Results of Our Investment Discipline

Clipper Fund results have exceeded the S&P 500 over the latest one, three and five year periods.

Over the latest one, three and five year periods, Clipper Fund has built shareholder wealth at a strong absolute rate and achieved relative results that exceed the S&P 500 Index. While active management has fallen out of fashion in recent years, we believe experience and judgment are valuable strengths in portfolio management and are pleased our results over the last five years bear this out. However, we still have ground to make up since being entrusted with management of the Fund in January 2006 and intend to build on our improved results in the years ahead. Our confidence in our time-tested approach is reflected by our investment of more than \$100 million in Clipper Fund alongside our shareholders.⁴

While our disciplined investment approach will not always be rewarded by the market over shorter periods, this active management strategy has produced positive returns for Clipper shareholders over the most recent 10 year period. The cornerstones of our discipline include rigorous research, focused investing, low expenses, alignment of interests, and a willingness to stand apart from the crowd. ■

Investment Outlook

Equities should outperform bonds over the next decade.⁵ Avoid overpriced dividend darlings. Focus on the important and knowable.

The last five years have been filled with the unexpected. Time and again, professional forecasters and pundits have been proven wrong: from the rise of ISIS to the collapse in energy prices; from Facebook's poorly received initial

public offering to the bankruptcy of Detroit; from Brexit to the election of Donald Trump. Yet through it all, Clipper Fund has grown the value of a dollar invested five years ago by almost 100%, showing that while short-term predictions may be worthless, long-term preparation is invaluable.

The essence of our preparation is a relentless focus on what is both knowable and important. For example, while the short-term outlook for bond markets may not be predictable, we know today's historically low interest rates leave bondholders with less upside potential and more downside potential than at any other time in modern history. With the yield on long-term government bonds now comparable to the dividend yield on stocks, we expect stocks to handily outperform bonds in the decades ahead.

Another fact that is both knowable and important is market dips are inevitable. For example, since 1928 the market has experienced a 10% dip about every eight months and a 20% dip every two and a half years on average. Yet, when we experience such a dip, the media act as if the world is coming to an end. As a result, many investors panic and sell at low prices creating a buying opportunity for those who can keep their heads. Since stocks are one of best ways to build long-term wealth, the years ahead are likely to reward those investors who have a long-term perspective, flexibility and steady nerves and to penalize those investors who are frozen by indecision, committed to passive investment strategies or likely to panic during market downturns.

A final important and knowable fact is investors often feel safest when risks are greatest. From internet mania to the housing boom, what looked like a sure thing in the rear view mirror ended up a speculative bubble. Two sectors where investors feel safe today have risen to levels that appear risky to us. First, many popular dividend-paying stocks, often referred to as dividend darlings, have been bid up to premium valuations that could spell trouble for investors who assume dividends are guaranteed.

4. As of December 31, 2016. 5. Common stocks and bonds represent different asset classes subject to different risks and rewards. Unlike bonds, the Fund does not offer a fixed rate of return if held to maturity, and the Fund has risks not associated with holding a bond. Bonds are considered to have less risk than equities. Future economic events may favor one asset class over another.

Second, with regulatory encouragement, roughly a trillion dollars has been switched from actively managed funds into passive index funds since 2007. Such huge fund flows create momentum, as more money is automatically invested in those stocks whose prices have already gone up. Unfortunately, momentum-based strategies lead to bubbles and bubbles eventually burst. Moreover, while passive investing may have beaten the *average* manager, a select group of funds have beaten the market over longer periods. Clipper Fund, for example, managed by our predecessor James Gipson until 2005 and by Davis Advisors since, has beaten the benchmarks since its inception in 1984.⁶ Happily, as more money flows into passive index strategies that employ no securities analysis, more investment opportunities are available for investors like us who do. After all, finding undervalued companies is far easier when fewer investors are looking. ■

The Portfolio

Global leaders trading at bargain prices. Dominant lesser-known businesses. Blue chips of tomorrow. Beneficiaries of short-term misperceptions.

While we have individually analyzed each of the 24 companies Clipper Fund holds, four broad themes characterize the majority of these businesses. These themes have allowed us to create a powerful combination of growth and value in Clipper Fund.

Global Leaders Trading at Bargain Prices—Some of the strongest and best-known companies in the world make up the largest portion of the Portfolio. This fact is nothing new. What is unusual though is short-term economic concerns over the past year have reduced the share prices of a handful of global leaders such as Berkshire Hathaway, United Technologies, American Express, and Monsanto to bargain levels at a time of high valuations for the average company.⁷ Buying top tier businesses at bargain prices is a value investor's dream.

Dominant Lesser-Known Businesses—Clipper Fund also invests in a group of lesser-known businesses that dominate dull but necessary niches in the global economy. Whether they participate in unglamorous industries or are headquartered in different countries, these businesses are not household names to U.S. investors. As a result, their shares often trade at a discount to better-known companies despite having the same qualities of market dominance and durability as the global leaders described above. Such companies include Johnson Control's leadership in fire and security, building controls, and car batteries; Liberty Global's strength in European cable TV and broadband; LafargeHolcim's dominance of the world cement industry; and Safran's leadership in jet engines (the company has been an equal but less well-known partner of General Electric for more than 30 years). These companies combine the relevance and resilience of blue chip companies with below-average valuations.

Blue Chips of Tomorrow—Another theme is fast-moving companies that use innovation to disrupt the economics of larger but less agile competitors. Similar to evolution, capitalism is a process of constant change that rewards businesses that can adapt. Over the decades, we have seen many examples of today's disrupters emerging as tomorrow's blue chips. Several of Clipper Fund's core holdings reflect this dynamic. Amazon has not only revolutionized the retail business, but also the information and technology industry through Amazon Web Services (AWS). Alphabet (the parent company of Google) began by making the world's information accessible through the internet and emerged as the largest and most profitable advertising firm in the world, the brains behind the vast majority of all smart phones, a leader in internet video, and the emerging leader in artificial intelligence and self-driving cars.

CarMax, the nation's largest used car retailer, and Didi Chuxing, a ride hailing business comparable to Uber that dominates the Chinese market, are two additional examples of innovators that have been just as disruptive in their industries. Using a

⁶ In the last five years, 59% of actively managed funds underperformed the S&P 500 Index. ⁷ 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 the Fund will vary based on weighting and timing of purchase. This is not a recommendation to buy, sell or hold any specific security. **Past performance is not a guarantee of future results.**

combination of huge selection, no-haggle pricing and long-term warranties, CarMax brings trust, choice and quality into the murky but enormous used car industry. Didi Chuxing is the unquestioned leader in the world's largest ride sharing market, China. With a staggering 85% market share and ride volume still growing nearly 20% a year, this powerhouse business should experience strong growth for years to come. Investors in such disruptive leaders stand to benefit not just from the growth in these companies' underlying businesses, but also from their gradual inclusion in the ranks of blue chip stocks.

Beneficiaries of Short-Term Misperceptions—

Short-sighted investors avoid companies that face short-term misperceptions, creating an opportunity for long-term investors willing to look beyond today's headlines. In banking, for example, memories of the financial crisis of 2008–2009 combined with subsequent anti-banking rhetoric and media coverage have blinded investors to the fact carefully selected banks are both cheap and safe, in our opinion. Contrary to perception, many top tier banks are not only reporting record earnings but are also far better capitalized than at any time in the last 50 years. While unloved now, we believe the leading financial companies we own will be big contributors to Clipper Fund's future returns as the reality of their strong economic fundamentals and rising dividends eclipses current investor perceptions.

Similarly, over the past year, investors fled the energy sector in response to the dramatic (and unsustainable) collapse in oil prices. While oil prices are unknowable in the short term, they must exceed the cost of replacing reserves over time. This simple fact should eventually lead to higher energy prices and should drive future returns for the well-positioned, low-cost producers the Fund holds. As a result, we repositioned the energy portion of the Portfolio, adding to existing holdings and

initiating new investments. We own a select group of innovative and well-positioned energy companies with the capital allocation discipline, management experience and low-cost, long-lived reserves that should allow them to increase production for decades to come. Holdings include Occidental Petroleum, Apache and Encana.

All in all, the carefully selected companies that make up Clipper Fund combine above-average resiliency and growth with below-average prices. ■

Conclusion

Today, as always, when confronted with background noise, investors benefit from tuning out the static of short-term market predictions and company forecasts and focusing instead on long-term opportunities and risks. Today, we see significant opportunity in areas of the markets that are overlooked and risk in popular areas of the market where investors feel safest. This combination creates opportunity for those who can be flexible and independent. At a time when pundits and commentators are making the case that experience and judgment do not matter and that the best investors can hope for is an average result, we strongly disagree. We believe a carefully selected Portfolio of durable, well-managed businesses with competitive advantages, selling at a discount to true value and overseen by a seasoned team with proven results will lead to a better-than-average outcome. In investing, as in any other profession, skill matters. Since our firm's founding more than 47 years ago, we have demonstrated the value of that skill by building wealth for our shareholders. With the vast majority of our net worth invested alongside our shareholders, we have every incentive and intention to build on this record in the years and decades ahead. ■

This report is authorized for use by existing shareholders. A current Clipper Fund prospectus must accompany or precede this material if it is distributed to prospective shareholders. You should carefully consider the Fund's investment objective, risks, fees, 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, 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.

Objective and Risks. Clipper Fund's investment objective is long-term capital growth and capital preservation. There can be no assurance that the Fund will achieve its objective. The 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 the Fund are: stock market risk: stock markets have periods of rising prices and periods of falling prices, including sharp declines; manager risk: poor security selection may cause the Fund to underperform relevant benchmarks; common stock risk: an adverse event may have a negative impact on a company and could result in a decline in the price of its common stock; large-capitalization companies risk: companies with \$10 billion or more in market capitalization generally experience slower rates of growth in earnings per share than do mid- and small-capitalization companies; mid- and small-capitalization companies risk: companies with less than \$10 billion in market capitalization typically have more limited product lines, markets and financial resources than larger companies, and may trade less frequently and in more limited volume; headline risk: the Fund may invest in a company when the company becomes the center of controversy. The company's stock may never recover or may become worthless; 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: investing a significant portion of assets in the financial services sector may cause the Fund to be more sensitive to systemic risk, regulatory actions, changes in interest rates, non-diversified loan portfolios, credit, and competition; foreign country risk: foreign companies may be subject to greater risk as foreign economies may not be as strong or diversified; As of December 31, 2016, the Fund had approximately 11.7% of assets invested in foreign companies; foreign currency risk: the change in value of a foreign currency against the U.S. dollar will result in a change in the U.S. dollar value of securities denominated in that foreign currency; depositary receipts risk: depositary receipts may trade at a discount (or premium) to the underlying security and may be less liquid than the underlying securities listed on an exchange; and fees and expenses risk: the Fund may not earn enough through income and capital appreciation to offset the operating expenses of the Fund. See the prospectus for a complete description 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 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.

The information provided in this material should not be considered a recommendation to buy, sell or hold any particular security. As of December 31, 2016, the top ten holdings of Clipper Fund were: Berkshire Hathaway Inc., Class A, 8.32%; Alphabet Inc., 6.33%; Amazon.com, Inc., 6.31%; United Technologies Corp., 6.09%; American Express Co., 5.53%; Wells Fargo & Co., 5.42%; Apache Corp., 5.41%; Bank of New York Mellon Corp., 5.27%; JPMorgan Chase & Co., 5.07%; Markel Corp., 4.33%.

Clipper Fund 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 clipperfund.com or call 800-432-2504 for the most current public portfolio holdings information.

Broker-dealers and other financial intermediaries may charge Davis Advisors substantial fees for selling its funds and providing continuing support to clients and shareholders. For example, broker-dealers and other financial intermediaries may charge: sales commissions; distribution and service fees; and record-keeping fees. In addition, payments or reimbursements may be requested for: marketing support concerning Davis Advisors' products; placement on a list of offered products; access to sales meetings, sales representatives and management representatives; and participation in conferences or seminars, sales or training programs for invited registered representatives and other employees, client and investor events, and other dealer-sponsored events. Financial advisors should not consider Davis Advisors' payment(s) to a financial intermediary as a basis for recommending Davis Advisors.

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

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 April 30, 2017, this material must be accompanied by a supplement containing performance data for the most recent quarter end.

Shares of the Clipper Fund 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.