

October 13, 2004

**Responsible Mutual Fund Governance
Chris Davis at Selected American Points the Way**

About this time a year ago the financial world was abuzz with news about Eliot Spitzer's prosecution of various large mutual fund companies. The "mutual fund scandal" had broken.

Although today we see little in the news about mutual fund governance, the subject continues to be very important for many reasons that go to the core of our model of providing comprehensive financial planning. Identifying and accessing fund managers who provide ethical, affordable, objective and first-rate buy/sell decisions is an ongoing responsibility, while we focus on clients' asset allocations and other aspects of their unique financial profiles.

Independence in choosing investment managers is central to our financial planning philosophy and our ability to make objective decisions on our clients' behalves. We simply can't align ourselves with one manager or one family of funds because we need to retain the ability to "vote with our feet" if we don't like what we see, or if we find better talent elsewhere.

At the same time, it's rewarding when a manager who's had our faith for years shows ethical courage and continues to be an excellent manager. Such is the case for Chris Davis whose team at Davis Selected Advisers offers its stock management expertise through Selected American Funds.

This summer, after negotiating with various custodians like Charles Schwab, Davis pushed through a new class of mutual fund shares that eliminates the ongoing fee paid to those custodians of $\frac{1}{4}$ of 1% (this is called a "12(b)-1 fee" in the financial industry). Davis's initiative required moxie because the big custodians like Schwab effectively control access to a large market of investors; but Davis prevailed. His success, which saves investors millions of dollars per year, may be a breakthrough in reducing mutual fund fees.

It's noteworthy that *Morningstar*, a research service that tracks and rates mutual funds, recently recognized Davis's team for being especially good fiduciaries.

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We're enclosing a copy of the write up. Particularly to the increasing number of our clients who want and expect socially conscious or ethical investments, we recommend reading the section entitled "corporate culture" that summarizes why *Morningstar* recognizes Davis Selected Advisors. We believe ethical investing starts from the top – and is manifested in the corporate cultures of your managers.

Finally, and on a closely-related subject, we've begun moving our clients who own Selected American Shares to the new class of mutual fund shares that are offered by Davis without the ¼ of 1% (12(b)-1) fee. These lower-expense shares are called Selected American Class "D." In most cases we are doing this as part of annual reviews. We've arranged with Davis and your custodian to do this in a way that does not involve capital gains, but there is a one-time cost for the transaction. We think this cost is worth incurring, since we expect Selected American will be one of the managers we prefer for a long time.

As always, I welcome your calls or comments on the subjects raised in our correspondence and periodic newsletters.

Cordially,

A handwritten signature in blue ink, appearing to read "Ted", with a long, sweeping horizontal line above it.

FREDERIC T. KUTSCHER

Fund Company Watch | Kunal Kapoor

Selected American

A look at how this standout's fiduciary grades add up.

In the past few issues of *FundInvestor*, we've walked you through the components of our fiduciary grade. In this issue, we're going to pull it all together and provide an example of a fund that scores highly in our system. The fund in question, **Selected American** SLASX, is run by Davis Selected Advisers, a firm that we've long considered a good fiduciary. Here's a look at the individual components that underlie our opinion of the fund's governance record.

Board Quality

We have confidence in the board of the Selected funds. Seven out of nine members of the board are independent. The chairman of the fund board is James McMonagle, who has served here since 1990. McMonagle draws \$80,000 in annual compensation from the Selected Funds, while the remaining independent directors earn \$44,000 or less for their work here. Importantly, however, all members of the board have more money invested in the Selected Funds than they draw in annual compensation for their work.

Davis Selected Advisers has historically put investors first, and the board has done a good job ensuring that those values are kept alive. It also deserves credit for writing a thoughtful letter to shareholders (a rarity from fund boards) when the fund scandal broke. The letter nicely detailed its efforts in keeping these funds focused on its owners—the shareholders.

Manager Incentives

As part of the bonus structure, payouts to research team members are invested in fund shares. These units only vest based on the performance of the fund over a five-year period. Fifty percent of this weighting is based on outperformance versus the S&P 500, 25% on its relative rankings in its Morningstar category, and 25% on its ranking versus all large-cap funds. Performance below the 40th percentile in the latter two categories results in no payout.

This is a great setup because it closely aligns the interests of fund shareholders with those of the investment team. The fact that there is no payout below the 40th percentile is significant because it shows the importance of being better than average. After all, too many fund managers have enriched themselves by doing no better than average over the long haul.

Finally, manager Chris Davis has more than one third of his liquid net worth invested in the funds, and the Davis family, employees and directors have more than \$2 billion of their own money invested side by side with shareholders in the various mutual funds managed by the firm.

Corporate Culture

It's tough to find fund families that stack up as well on this measure as the Selected Funds. Just recently, the firm began offering shareholders a lower-expense share class if purchased directly from the advisor. That's because investors who buy directly from fund companies effectively end up subsidizing those who may go through a fund supermarket. By splitting the two groups, Selected took a hit to its own profitability but left some shareholders better off.

And that's not where it ends. What little marketing the firm does is focused on its long-term investment strategy, not on any hot returns. Letters to shareholders have also markedly improved in recent years and are supplemented by educational materials, that emphasize the firm's buy-and-hold approach.

More recently, the firm has taken up a fight against companies that make excessive use of options. Moreover, the firm passes on investment opportunities when it feels management has been too liberal with options.

Regulatory Issues & Expenses

The firm paid a small fine because it didn't highlight the effect that IPOs had on the performance of **Davis Opportunity** RPEAX. However, we don't consider it a serious issue. In addition, the firm has a fairly strong compliance function, and this Fund's expenses are below average. ■■■

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This reprint is furnished to you by Davis Distributors, LLC, the distributor of the Selected Funds, and is authorized for use by existing shareholders. Prospective shareholders must receive a current Selected Funds prospectus, which contains more information about investment strategies, risks, fees, and expenses. Please read the prospectus carefully before investing or sending money.

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

As of June 30, 2004, the Davis family, employees and directors have more than \$2 billion of their own money invested side by side with shareholders in the various mutual funds managed by the firm.



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