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On this week's program: A rare interview with two top global investors: Davis Funds' Chris Davis and Danton Goei explain where they are finding world class growth at value prices.

Christopher Davis
Danton Goei
Co-Portfolio Managers
Davis New York Venture Fund

CONSUELO MACK: This week on WEALTHTRACK, an exclusive interview with the Davis Funds' Chris Davis and Danton Goei. They identify where in the world they are finding growth at value prices. Next on Consuelo Mack WEALTHTRACK.

Hello and welcome to this edition of WEALTHTRACK, I'm Consuelo Mack.
As we all know stock picking is really out of favor right now. Index funds have been garnering most of the headlines because of their low costs and the fact that the S&P 500, the most popular stock market index by far with investors has been outperforming the vast majority of actively managed funds for well over a decade. The giant sucking sound of money leaving traditional mutual funds and pouring into passive index funds has reached an ear splitting crescendo.

If you are a contrarian thinker this almost one directional flood into passive strategies raises some questions. First of all is beating an index or even being in one the "be-all-end-all" of investing? Think back to the red hot NASDAQ Composite Index at the peak of the tech bubble in 2000. Funds that didn't keep up suffered massive outflows. The NASDAQ then proceeded to decline 78% in less than three years.

Many of the funds investors had abandoned proceeded to outperform that index for years.
At any given moment some index somewhere will be outperforming the average manager, and index for that matter. Another key question is can the herd mentality, which is frequently wrong over multi-year periods, be right this time? Or is there now more value and safety to be found among some active strategies?

This week's guests believe there is. It is in their self interest to do so as they are mutual fund managers.

Christopher Davis is a third-generation money manager, Chairman of Davis Advisors and Portfolio Manager of several of the Davis Funds which have a nearly 50 year history of disciplined value investing. Chris took over its flagship New York Venture Fund in 1997 when his dad, Shelby Davis stepped down. Since its 1969 inception New York Venture has beaten the S&P 500 62% of the time in one year periods, 66% of the time in 5 year increments, 86% in ten year periods and 100% in 20, 30 and 40 years. New York Venture and its no load version, Selected American Shares have had a tougher time in recent years. They beat the S&P 500 last year but underperformed it in six of the last ten, although they made money in all but two of those years.

Danton Goei joined New York Venture and Selected American Shares as Co-Manager in 2014. He has been with Davis Advisors for nearly 20 years and singlehandedly runs some of their top performing funds including the Davis Global Fund. Rated 4-star by *Morningstar* Davis Global has beaten its benchmark and category over multiple year periods since its 2004 inception.

I should also add that the Davis Funds are highly regarded for their shareholder friendly policies including reducing expenses and recently introducing actively managed ETFs to give investors more options. I began the interview by asking Davis and Goei a stock picking question: What is the value proposition of one of their largest holdings: Amazon.com

CHRIS DAVIS: Well, this is one of the great misnomers, this idea that growth and value are something different. They're related. Companies that grow and grow profitably are more valuable than companies that don't. So, growth is a component of value. And this is nothing new for us. You know, when my grandfather started investing, he invested in life insurance stocks. And other investors said you're crazy, they have no earnings. And of course, they didn't have earnings because this was the early 1950s, late 1940s. They were growing. The soldiers were coming home, the baby boom was under way. And so, they were paying big commissions out to their salesmen that were selling these life insurance policies and the life insurance policies would generate huge value over the next 30 years. But in the first year of growth, growth costs, right. So, the company invested in its growth. And then you look at my dad investing in the 80s and 90s, cable companies. There's no earnings. But what are they doing? They're investing in growth. Well, Amazon is exactly that model. Amazon, if Amazon chose to stop growing, we think it would be very profitable today, in their core retail businesses. Amazon is investing to grow. And you know, over 15 or 20 years, Wal-Mart invested to grow, and although it produced earnings, if you were to look at the cash flow statement, after capital spending, Wal-Mart generated almost no cash for something like 15 years. So, we measure value based on cash money generated. And if companies aren't generating cash because they're reinvesting for growth, we look at the returns on that investment. And there, Amazon stands alone.

CONSUELO MACK: All right, well, Danton, so I understand that the fundamental analysis, so you know, you just made a compelling case, but what about the price of the stock?

DANTON GOEI: What's interesting that Chris mentioned also is this idea of adapting and growing. And so, what they have done, it's important to also talk about their other business when talking about valuation and price is they built a great retail business as we know, but they've also built this great cloud computing business as well. And I bring that up just because that's a big part of their value proposition as well. And so, Jeff Bezos and his team are very forward thinking and they looked at themselves and say hey, we're beating the competition because of the cloud competing power that we're putting to use, beating Borders, beating Barnes & Noble, beating the corner bookstore. Let's put that cloud computing to the use for third party and other companies because they are also going to be interested in this. And so, they have created this AWS business, Amazon Web Services, which is also very valuable. And when we look at that and see the growth there and how profitable it is, and then look at the retail business where they're also reinvesting in whether it's India or China or PrimeNow, or now we're getting one to two-hour delivery, Fresh, Amazon Fresh and on groceries. When we look at that, and think about the investments they are making there, and adjust for that, we think it is a very compelling and profitable business.

CONSUELO MACK: Let me ask you a couple more questions about some of your major holdings that you share, both in New York Venture, and also in the Davis Global Fund. And Danton, one of them of course, is Alphabet, the parent company of Google. You know, again, value proposition, value and growth, why is Davis investing so heavily in Google?

DANTON GOEI: Well, you know, back in the '90s and 2000 when I joined Davis, we owned a number of newspaper companies and these had been just fabulous businesses for a long period of time. In fact, Chris came to me and said I want you to follow this industry, it's built wealth over decades, if not centuries, families have built fortunes upon it, it's very profitable and it has monopolies in their businesses. And so, they were built on advertising, we were following the trends there, and basically hearing this big sucking sound of add dollars. And we basically followed that sucking sound and it led us to Google.

CONSUELO MACK: Really? Early on?

DANTON GOEI: Early on.

CONSUELO MACK: Right.

DANTON GOEI: And we were trying to figure out at the time, in the early 2000s whether it was the cyclical downturn of the economy or whether it was the secular risk of this thing called the Internet at that time, that was becoming more and more popular. And we settled on the idea that Google and companies like that were actually drawing all these advertising dollars towards them, and were the new newspapers, the new advertising mediums of the future.

CHRIS DAVIS: And they were better. You know, this is the thing. Over 20 years, Danton and I have a few meetings that are really memorable but the one when he came in and said you know, you love these newspapers, but have you heard of this Internet thing? It's better. If you are looking for a house, it is wildly inefficient going through the ads and circling. If you're looking for a job, you know, why are you looking at dog walking jobs if you want to be an accountant. The Internet is better, it's cheaper, it's a much better user experience. That is, people will definitely shift there. And the valuation, I mean one of the things … this goes back, Google may have been one of the deepest valued companies we've ever bought because it may have looked a little bit expensive at the time, but three years later, it was trading at eight times earnings or something from what we had originally paid for it. And so, understanding that nature that you could be instantly global, instantly ubiquitous, I think we would have bought more earlier, if we had understood just how dominant. Remember there was ask Jeeves, there was Yahoo. So, we were thinking of the market as possibly three or four players, like network TV and not realizing. And so over time, our conviction has grown as we've seen that dominance of a winner take all approach.

CONSUELO MACK: So, I'm going to move from kind of the FANG stocks to financial stocks, which has been a hallmark of the Davis Fund since the get go. And I think what, 30 percent of your holdings in New York Venture, for instance are in financial stocks. Wells Fargo, again, another name that is shared by New York Venture Fund and also Davis Global. What's the story with Wells Fargo?

CHRIS DAVIS: Well, first, I'd start by saying there's a general theme at our place that's played out over probably 70 years, which is we're always interested in investing where headlines are lousy. And so, today, within the financial sector, we get so excited, because the memories of the financial crisis, they've just been seared in and people just refuse to believe that somehow the banks aren't constantly teetering on the brink, even though their capital ratios are higher, they're more profitable, there's less irrational competition.
In a funny way, the regulations have increased the mote around the businesses. So, we think this is an extraordinarily good time to invest in financials with rising dividends, low relative valuation, strong capital ratios, just a great time. Now, within that, of course, Wells Fargo in a sense, checks a lot of boxes, right, because of this scandal, they're in the penalty box, their valuation …

CONSUELO MACK: But it had nothing to do with the financial crisis?

CHRIS DAVIS: No, it was a self-inflicted wound, and it came from something that had worked very well. You know, Well's proposition, going all the way back to when it was run by Dick Kovacevich and was Norwest, he had a simple observation. He said, why is it that people like going to stores, but they hate going to their bank. And the answer was at stores they get great service, things are convenient, and he built a culture there based on the idea that instead of branches, they had stores, the stores look at what customers need, what will help them sell them the product. Including, by the way, having a commissioned sales force instead of a bunch of bureaucrats. Well, of course it worked well for decades and we as consumers liked it because having multiple accounts at one bank is way better than having three or four accounts spread out and Wells did a wonderful job of bundling your accounts. Well, of course, what happened? They went too far on every possible axis.

CONSUELO MACK: Right.

CHRIS DAVIS: And their behavior was absolutely inexcusable. There's no question about it. So, our feeling is over the next decade, of course Wells is solving these problems. In the meantime, they have very high customer satisfaction scores, they have wonderful, wonderful employee retention, they have a dominant franchise in what they do. And we think the remain, especially broadly speaking, one of the great lenders, and one of the great credit cultures. So, to get all that at such a low multiple with rising dividends, excess capital, you know, often crisis creates opportunity. We don't condone their behavior, but we are taking advantage of the valuation discount it created.

CONSUELO MACK: Speaking of headline risks, Danton, 30 percent of your … the Davis

Global Fund I think is in emerging markets. And your Chinese holdings in particular, I mean I looked at some of the figures, have done incredibly well versus the China Index versus the SMP 500. But China is a headline risk. I mean just by its very nature. A lot of investors have been afraid to invest in China because they don't trust it.

DANTON GOEI: You know, very similar to sort of, you know, Wells Fargo, the opportunity is there because people are skeptical because they're doubtful. Now, the track record is also though very strong. If you look about in the last 18 years, the GDP has grown over there over nine percent compounded for close to two decades. And as you say, there are risks in China, and we do aim to mitigate them. For example, we only invest in Hong Kong listed or U.S. ADRs for Chinese companies. So, none of the A shares, you know, the A share market is dominated 80 percent by personal, individual investors. And that's why it's a wild swing up and down. We're not in that casino. We want the listing requirements, the accounting transparency, the custodian requirements, whether it's in the U.S. or in Hong Kong with international accounting standards. The government who built that track record is the same government who is in place now, and there are a lot of things that we would not certainly agree with. You know, as an American, you know, I'd rather live here than over there because of the personal liberties that we have here. But the track record of building strong economy and allowing strong businesses to grow is there. So, we have a really, in fact, even though it's a communist country, it's a very pro-business government. And that's what we're looking for as shareholders. Is it an economy that could thrive over time? It will slow down for sure, but there are a lot of real opportunities there, we believe.

CONSUELO MACK: Right. There is a Chinese company that I think is one of your top ten holdings whose name I'm not going to mispronounce because I'll completely garble it. But tell me about that, and why it's in both New York Venture and in Davis Global.

DANTON GOEI: I believe you are talking about Didi?

CONSUELO MACK: Yes.

DANTON GOEI: Didi Chuxing and that is the equivalent to sort of Uber here in the United States.

CONSUELO MACK: I see.

DANTON GOEI: So, it's a ride sharing, ride-hailing platform over there. Now what's really interesting is that they went head to head with Uber, so Uber is the incumbent, the global competitor. Didi is only in China so far, and they won, Didi won. They beat Uber at its own game there, so they, they have become just very efficient, very technologically savvy and what's really interesting is that even though Didi is only in China, it has more rides per day than Uber has globally. And that just speaks to the size of the Chinese market. Here we've got about ten cities of over a million people. There they have over 100 cities over a million people.

CONSUELO MACK: So why is it in New York Venture, Chris?

CHRIS DAVIS: Well, interestingly, New York Venture, one of the lenses that we look at as a firm is we look for world leaders. And yet, there is something in the minds of U.S. investors that still thinks that somehow China is something different. Now, of course, there are differences, but without question, I would say a company like Didi, and we met with the management of Uber over the years. If we had owned Uber, it would not be surprising. And yet, instead, we chose a company that we believe has far better management, is actually larger, and yet was cheaper.

CONSUELO MACK: Yes, but Uber is not publicly traded.

CHRIS DAVIS: Yes, and actually neither is Didi yet. So, these are investments …

CONSUELO MACK: Oh, so those are private investments that you've made.

CHRIS DAVIS: Yes.

CONSUELO MACK: I see.

CHRIS DAVIS: And that is also, as you know, we invest our own money in the funds that we manage. And we're looking … we're less concerned with labels than we are with building wealth over a long period of time. And so, it's a bit of an unusual holding in New York Venture, but very consistent with our history of, you know, when I first started, we owned Elf Aquitaine. And it was at such a discount to the U.S. oil companies. And then there was a time when we owned companies like Nestle that were such a discount to Coca-Cola and P&G. Now, we're in a world where people would own Google or own Uber but they wouldn't look over at Didi or Alibaba and we think they're missing something very powerful, which is that China is not an emerging market. It has emerged.

CONSUELO MACK: Right, exactly.

CHRIS DAVIS: When you're the second largest, it has emerged. And so, I think that is sort of the mindset that we try to do to be in front of that type of thing.

CONSUELO MACK: The rise of online consumers is one of your global themes. Another one is the emerging middle class. So, tell me about the world leaders, Danton, in those three areas. What would you pick? The online consumer for instance, worldwide.

DANTON GOEI: Yes, I mean, you know, we're seeing something really radical happening here at accelerating pace in the United States. But it's a global phenomenon and that's a transformation of the retail sector. In China, that pace is even faster and in some sense bigger. China, for example, the online commerce is 15 percent of retail versus about eight or nine percent here. And e-commerce market is larger than the U.S. one. So, the Chinese, they've basically, just like the cell phone, skipped to online and not gone to land lines or physical stores. And so, we've invested in a number of those companies, Alibaba or JD.com in China to take advantage of that phenomenon.

CONSUELO MACK: And the rising middle class is another theme.

CHRIS DAVIS: Well, I think they're a great example, as this, you know, when people have some money, what are the sorts of things they want to do? Well, one is travel. And so, when we look at miles flown, we see that as sort of a relentless growth industry, with sort of, if you pardon the pun, wonderful tailwinds. And so, when we look at how to invest in that, we look across the entire industry, from the people that make aircraft engines to airline manufacturers.

CONSUELO MACK: So, you buy United Technologies, for instance?

CHRIS DAVIS: United Technologies in the U.S., maybe Safran outside of the U.S., both dominant engine manufacturers. But we might also look at airlines. Now, here, we've missed this big move in U.S. airlines. Maybe we were over scarred by years in the past. But, you know, you might see it in some emerging market airlines. So, there we might look at airlines. So, we'll look at online travel booking services. So, there are all different ways that when we look at an ecosystem that grows, that's a theme that we're interested in on a global basis, then we go down company by company, what are the best ways to participate, sometimes here in the U.S., sometimes they're international. And in a sense, we have the funds where we can put the best ideas in that theme into either an international, global or domestic fund.

DANTON GOEI: And the scope there, you know, is broad. I mean you can look at Federal Express, which we own as well. You can look at companies like ZTO in China, which is sort of the equivalent there. So, it really is across industries, trying to understand how this theme, such as the middle class, or online retailing or travel really impacts these and it really shows up in the portfolio.

CONSUELO MACK: So, we have to ask you, all of these really interesting ideas, but we're going to ask you to choose one, Danton. If there's one investment that we should all be making in a long term diversified portfolio, what should we all own some of?

DANTON GOEI: So, if I had to choose one investment to put a large part of my net worth in where I could not trade it, or even see how it's been doing for ten years, I would put it into Safran. Chris mentioned it. It's a jet engine manufacturer, it's a French company. It is one of the leaders. So, the jet engine manufacturing area is a really interesting space. And I would say broadly speaking, the aerospace industry is a very interesting and great pond to fish in. But why have we chosen the jet engine manufacturing space to look at? When you look at who's the players there, there are actually only three players that supply jet engines to all the commercial aircraft manufacturers and that is Safran with their partner GE, Pratt-Whitney, which is owned by United Technologies, which we also own UTX and then Rolls-Royce. And if you look at the market where Safran plays, which is the narrow body market, there they have 75 percent of that space. The narrow body market is really the workforce of fleets across the world. These are the Boeing 737s, the Airbus A320s and it's the fastest growing part of the market as well.

CONSUELO MACK: And with GE as a partner?

DANTON GOEI: And with GE as a partner. It's a 50/50 joint partnership with General Electric. And what's great about the business is that these planes; the median age is 25 years. So, once you are the engine on these planes, you have 25 years of service and parts revenue ahead of you.

CONSUELO MACK: That Safran also gets?

DANTON GOEI: That Safran also gets.

CONSUELO MACK: And it's certainly not a household name for us. That's for sure. So, that's a very interesting idea. Chris?

CHRIS DAVIS: If I was to pick something that I think is particularly cheap today and where I think it is also just being punished by headline risk and misunderstanding, it would be a financial company, Capital One. And I think what is unusual is Capital One, which is one of the largest banks in the country is still run by its founder. We don't really think about that. But Rich Fairbanks, who was the founder of this, it started as a pure, almost virtual company, doing mail order credit cards, created a whole new market of segmenting data, very data driven and only got into branches through an acquisition around the time just before the financial crisis to create more stable funding. Well, think about what that means in a world going electronic, Fintech. Here you have a company where in its DNA they understand that you access customers, you don't wait for them to walk into your branch. And so, I like their positioning, I like their culture and I like the fact that in a world where every other lender is fighting for the super-premium customer, high spending, high rewards sapphire, platinum, gold, you know, black, that Capital One has been left alone on Main Street.

CONSUELO MACK: So, it's great to have you both here. And Danton Goei, this is the first time that I've met you and I know Chris has been talking about you because you've been with Davis Advisors for 19 years. So, thank you so much for joining us.

DANTON GOEI: Thank you so much for having me.

CONSUELO MACK: I really appreciate your being here.

DANTON GOEI: It was a lot of fun.

CONSUELO MACK: And Chris Davis, always a pleasure to have you on Wealth Track as well.

CHRIS DAVIS: Thank you, Consuelo.

CONSUELO MACK: Thanks.

CONSUELO MACK: At the close of every WEALTHTRACK we try to give you one suggestion to help you build and protect your wealth over the long term. This week's action point is: Don't get caught up in the investment craze of the moment. Right now that craze is beating the market, specifically the S&P 500 which has had an exceptional run since 2009.
As they were in the 1990's every fund manager is now being compared to an index- then it was the NASDAQ Composite, in the 1980's it was japan for global investors.

There are other better long term criteria like risk adjusted returns. Does a fund cushion you during market declines? Inflation adjusted returns- does it protect your purchasing power by delivering returns comfortably above the rate of inflation over time?
Consistency of investment style and discipline, diversification of holdings, attention to costs…
All of these considerations matter far more than just beating a hot index that at some point will cool off.

Meanwhile in the EXTRA feature on our website we will ask this week's guests about actively competing in a passive-oriented world. We appreciate how active our audience has been in connecting with us! Keep your thoughts coming with your Facebook messages and Tweets.

Thank you for watching. Have a great weekend and make the week ahead a profitable and a productive one.