

Selected American Shares is managed according to Davis Advisors' signature investment discipline of purchasing durable businesses at value prices and holding them for the long term. As a sign of our commitment to and conviction in this approach, the Davis family, employees and directors have more than \$2 billion invested side by side with fellow shareholders in the various mutual funds our firm manages.<sup>1</sup>

## Market Perspectives

The year 2007 was a turbulent year for U.S. stocks. Relative to the start of 2007, the S&P 500® Index was down 3% through early March, up more than 10% through early October and ultimately ended the year gaining a modest 5.49%. In retrospect, perhaps most noteworthy is not so much the stock market's volatility in 2007 as the simple fact that the S&P 500® Index finished higher despite tens of billions of dollars of write-downs on Wall Street, declines in residential real estate, the meltdown in certain segments of the credit markets, a slide in the U.S. dollar relative to other major currencies, and the price of oil approaching \$100 per barrel. Given this backdrop, one could have easily imagined a far worse outcome than a sideways trading range market. As for where

developments will lead near term, there is no shortage of speculation and forecasts, but in reality nobody has a crystal ball and the market's direction in any given year is just one of many *important* but *unknowable* variables such as interest rates, inflation, the price of oil, and so forth.

One of our keys to long-term success in the investing business has been our willingness to filter out the important but unknowable and to focus instead on the *important* and *knowable* facts, which are generally company specific. For instance, through persistent, in-depth research, specific business attributes like management quality, the operating leverage of certain profit models over others, the durability of competitive advantages and the valuations paid to own shares in a company can be determined with a reasonable degree of precision. By isolating key drivers of long-term business results and paying careful attention to valuations, we can make informed investment decisions. This bottom-up, fundamentals-driven approach is the key to the Fund's long-term outperformance relative to the broader market, despite the informational noise that is ever present in the background.<sup>3</sup>

(continued)

Total Returns as of December 31, 2007					
	1 Year	3 Years	5 Years	10 Years	Since Inception <sup>2</sup>
<b>Selected American Shares Class S</b>	4.79%	9.88%	14.22%	8.16%	12.58%
<b>S&amp;P 500® Index</b>	5.49%	8.62%	12.82%	5.91%	10.61%

*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 for Selected American Shares Class S shares as of the most recent prospectus was 0.90%. The total annual operating expense ratio may vary in future years. Returns and expenses for other classes of shares will vary. Current performance may be higher or lower than the performance quoted. For most recent month-end returns, visit [selectedfunds.com](http://selectedfunds.com) or call 800-243-1575.*

<sup>1</sup>As of December 31, 2007. <sup>2</sup>Inception is May 1, 1993. <sup>3</sup>Past performance is not a guarantee of future results.

## Building an All-Weather Portfolio<sup>4</sup>

The Fund's investments fall into three major categories, each of which plays a distinct role in the Portfolio:

### ■ **Global leaders with strong balance sheets—**

These companies make up the majority of our holdings and constitute the anchor for the Portfolio. They provide a foundation of stability and based on our research offer what we believe is a high probability of long-term, sustainable returns through capital appreciation and dividends. Altria Group, a leading manufacturer of tobacco products worldwide, is an example of the durable global franchises that form the core of the Fund. With an equity market capitalization of more than \$160 billion and virtually no debt, Altria Group earns more than \$17 billion of pretax earnings annually on close to \$72 billion of revenues that are well-diversified geographically. With its enormous free cash flow, Altria can buy back shares and pay shareholders a dividend yield of 4%. While not the growth company it once was, Altria offers virtually unparalleled stability of earnings, much of which is returned to shareholders, and is highly shock-resistant in times of market turmoil. Its shares returned 22% in 2007. Microsoft, Berkshire Hathaway, Procter & Gamble, and Wal-Mart are other examples of global leaders with strong balance sheets in the Portfolio.

### ■ **"Out-of-the-spotlight" businesses—**

These lesser known companies have attractive economics in our opinion and should eventually command higher valuations. Their appeal may take time to gain recognition, often

because these businesses are smaller, headquartered in other countries or operate in a mundane industry. Aggregates companies like Martin Marietta Materials fall into this category as do off-site document storage provider Iron Mountain, the leading worldwide protective packager Sealed Air and reinsurer Transatlantic Holdings. Given the right leadership and attractive reinvestment rates, these low-profile holdings often provide the opportunity for the "double play" of expanding multiples on expanding earnings, which can turn a company with a decent earnings growth rate into a stellar total return vehicle. The Fund's energy holdings are a case in point. We began investing in energy companies in a meaningful way early in this decade. At that time, the sector as a whole was largely neglected by the market following the collapse in oil prices to \$10 per barrel during the 1997–1998 Asian crisis. Over the last five years, in contrast, energy has been a meaningful contributor both to the Fund's performance as well as to the broader market's. Most of our energy holdings were up 25% or more in 2007.

A more recent out-of-the-spotlight investment is Cardinal Health, one of three major drug distribution companies in the United States, which we believe should benefit from the tailwind of an aging American population. Health care expenditures already constitute 16% of our \$13 trillion economy, and we expect that health care spending will continue growing as the U.S. population ages. (The first wave of baby boomers recently turned 60 and the number of medications they take on average is a multiple of the number taken by individuals

<sup>4</sup>Individual security returns are discussed in this piece. The return of a security to a portfolio will vary based on weighting and timing of purchase.

in their 30s.) Given that backdrop, we believe Cardinal Health's margins could expand, partly as a function of the company's scale and partly due to the fact that generic drugs—on which Cardinal earns higher margins than on branded medications—should see their market share grow as more and more branded drugs in big categories like cholesterol and hypertension go off-patent over time.

■ **Headline risk or contrarian investments**<sup>5</sup>—

Around the edges of the Portfolio we selectively make contrarian investments. These often involve controversial situations where the market is discounting a company's share price to reflect a perception of risk that we think is greater than the probable economic risk to the business's long-term fundamentals. Some of the more common headline risk investments we have made over the years involved companies that were tainted by litigation, scandal or other temporary problems that were overblown in the media. Altria Group, for example, was a quintessential headline risk investment in the early part of this decade when it was a high-profile target of many class action and individual lawsuits as well as the subject of a Justice Department probe. At its low, the company traded at five times earnings, which based on our assumptions and models implied that the entire Philip Morris USA unit was worth a large *negative* value—an overly pessimistic assessment, in our view. Early on in our investment we viewed Altria's low valuation as a margin of safety in a highly controversial stock. Since that time, Altria's major legal challenges have been resolved and the company's shares are up more than fourfold (counting the \$22 per

share spin-off of Kraft Foods to Altria shareholders in April 2007).

Headline risk investments are usually a relatively small portion of the Portfolio in percentage terms but they are the most unsettling names for clients to see because they naturally beg the question, "Don't you read the papers?" But it is precisely because so many people automatically sell companies with real (or perceived) problems, however short-term, that the potential for high returns can reside in many such instances. Our job is to ferret out opportunities that represent favorable risk/reward trade-offs and avoid the value traps. We will not be right every time. However, what is important is that we maintain an open mind as investors to controversial companies or companies in transition and that we are willing at times to go "long headline risk." This distinctly contrarian part of our investment discipline has been an important ingredient of our long-term success and can be an effective way to capitalize on herd mentality in the market.

Current headline risk investments in the Portfolio include Citigroup, a money center bank, and Moody's, a credit rating agency. Both companies are suffering from excesses in the credit markets in recent years and their shares were down more than 40% in 2007. As with other important but unknowable factors, we did not predict the timing or the magnitude of the present credit crunch. We did however consider the durability of each business early on, and looking further into the future—possibly several years out—we believe the franchises of both Citigroup and Moody's

<sup>5</sup>While we research companies subject to such contingencies, we cannot be correct every time, and the company's stock may never recover.

will be intact after the current storms have passed and will eventually move forward again. Both businesses have favorable long-term prospects in our view, notwithstanding the current challenging environment. Citigroup's banking franchise outside the United States is a unique asset that should benefit from the globalization of wealth and capital markets activities. In Moody's case we think the long-term secular outlook for debt and securitizations that will require credit ratings to attract widespread institutional ownership is also favorable, despite the headwinds in the credit market presently.

Portfolio management is a dynamic process and the way we describe a holding at a given time is specific to the moment. Individual companies may move from one category to another. For example, either headline risk or out-of-the-spotlight companies can over time evolve into global leaders. Global leaders can stumble and move into the headline risk category. An important benefit of having several different categories of investments at all times is that each has different payoff characteristics both in terms of time horizon and magnitude, and their interplay is an underappreciated form of "factor" diversification. To use a gardening analogy, in any given year we expect to plant some new ideas, hope to see the benefits of others that are coming into bloom and harvest some of the more mature (or ill-fated) investments. This framework for designing a "perennial" portfolio has the objective and often the benefit of producing a consistent compound return through different market environments.<sup>6</sup> We feel our approach in this regard is distinct in an industry where a

popular belief is that investment managers can optimize their portfolios for next year's market when in fact next year's major developments are simply unknowable. Instead, at Davis, we believe we should concentrate on building the best risk-adjusted portfolio we can for all weather conditions.

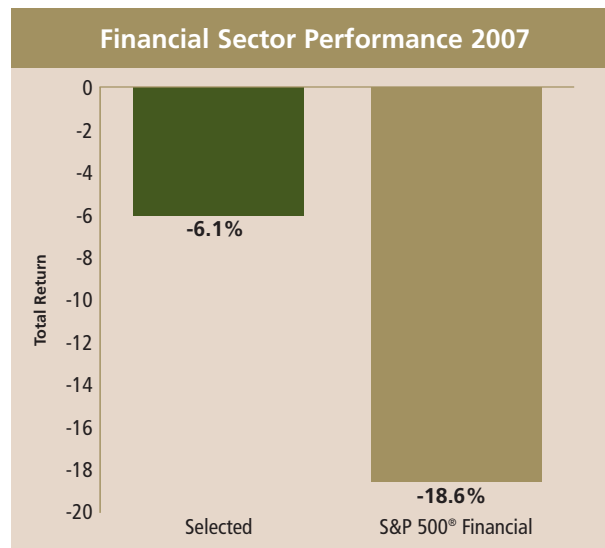
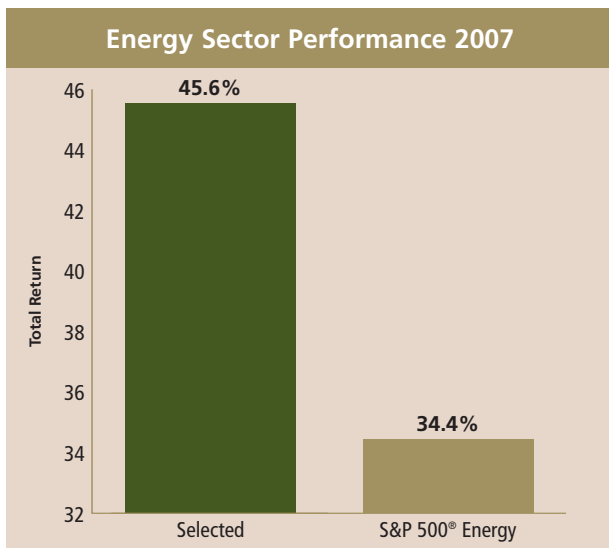
### Portfolio Review

Through December 31, 2007, Selected American Shares outperformed the S&P 500® Index over the trailing three, five and 10 year periods as well as since our firm began managing the Fund in May 1993. In 2007 the Fund was up 4.79%, slightly trailing the S&P 500® Index's 5.49% return.<sup>7</sup>

In any given period, there are factors that help or hurt our performance. Below are some of the prominent contributors and detractors in 2007:

- Energy, which has been an investment theme in the Portfolio for more than half a decade, was a strong contributor to our performance in 2007. Our holdings include major exploration and production companies that specialize in oil and North American natural gas. A relatively new addition to this group is Canadian Natural Resources, which has vast reserves of oil sands. While more expensive to develop than crude oil from the Middle East, extracting these reserves is economically justified at the oil price levels of recent years. The company's reserves, which are located in close proximity to the United States, could become a major source of new incremental supply in years to come.

<sup>6</sup>Past performance is not a guarantee of future results. <sup>7</sup>Based on total returns for Class S Shares with the reinvestment of dividends and capital gain distributions. Davis Selected Advisers, L.P., began managing Selected American Shares on May 1, 1993. Prior to that date, the Fund was managed by a different investment adviser. **Past performance is not a guarantee of future results.**



Figures are generated using holdings-based attribution analysis based on Selected American Shares, S&P 500<sup>®</sup> Energy and S&P 500<sup>®</sup> Financial and do not take into consideration any impact of fees or expenses. Returns are from January 1, 2007 through December 31, 2007. The energy or financial holdings contributions to the Fund are dependent on a variety of factors, including weighting and performance of individual companies. These views may not be relied upon as investment advice and are subject to change. **Past performance is not a guarantee of future results.** Source: Wilshire Atlas and Davis Advisors.

- Financials detracted from our performance overall. Still, through careful stock selection and our preference for well-diversified businesses with strong balance sheets in non-correlated areas of financial services, our financial holdings performed better overall on the downside than the S&P 500<sup>®</sup> financial sector in 2007.
- Outside of the above, our performance in the consumer discretionary, materials and information technology sectors detracted from our relative results in the period.

### Long-Term Themes

Looking ahead, the near term is rife with uncertainty. For instance, when will housing declines reach bottom? When will liquidity improve in the credit markets? When will the dollar strengthen? These are important but unknowable developments. Fortunately, the longer one's

investment perspective, the easier it becomes to make at least some meaningful predictions. For instance, although we do not know the exact timing, we are very confident that home values in the United States will eventually stabilize, that liquidity will eventually return to the credit markets (as it has following all major shocks to the financial system in the past), and that the U.S. dollar will see days when it strengthens against other currencies instead of weakening. We just do not know when. That stated, in a framework of investing that spans years and decades, we would argue that the more critical task to get right is understanding the businesses one owns and their ability to weather the inevitable cycles and create value for shareholders through a wide variety of conditions.

A number of key themes suggest where we are currently looking for long-term investment opportunities:

(continued)

■ **Global, high-quality multinationals—**

Investing in large corporations today almost necessarily leads to a universe of global multinationals, some of which are based in the United States while others are headquartered elsewhere.<sup>8</sup> These businesses look attractive to us for a number of reasons. Dominant global brands that can raise capital in any environment, withstand the inevitable shocks, access fast-growing local markets in developing nations, and enjoy the stability of geographically diversified earnings should trade at a premium in our view. Instead many are trading at market or below-market multiples and are one of the few groups that have not participated significantly in the market's last five years of returns.

■ **Capital spending—**The U.S. economy, now 70% driven by the consumer, may be moving into a phase similar to the late 1960s and 1970s where a prolonged capital spending cycle plays a more significant role again. That could mean more profits for infrastructure-related investments both in the United States and abroad—e.g., companies that build jetliners, cranes, highways, locomotives, and port companies.

■ **Energy and natural resources—**As developing nations add to worldwide incremental demand for commodities like oil and natural resources, we believe that the average price ranges for such resources could remain elevated relative to the decade of the 1990s. Consistent with our energy investments to date, we will be on the lookout for disciplined capital allocators who can generate reasonably

attractive profits for shareholders given a stable price environment and generate wind-fall profits under more bullish scenarios.

■ **Demographically favored industries**

**(health care and financial services)—**The populations of the United States, Europe and Japan are getting older and we believe that this inexorable trend will direct more nondiscretionary spending, partly from governments and partly from individuals and companies, toward different areas of health care. A rule of thumb in investing is to follow the money and a good deal of money will be flowing into health care equipment, treatments and services. To the extent people are living longer, they will also need to save and invest for retirement, and leading brands in financial services are the logical places where consumers will shop.

In addition, we are always looking for the “quality accidents of the day,” or the headline risk situation that becomes a bargain for temporary but surmountable reasons according to our own analysis. Recently, for instance, we initiated a position in Merrill Lynch in the Fund through a private placement. Merrill faces an uphill battle in the short term as it seeks to shore up its balance sheet to offset billions of dollars of losses in investments that are tied directly or indirectly to a deteriorating residential mortgage market. Provided the company can manage the balancing act of raising capital while shrinking credit and lending exposures, we believe Merrill will see better days ahead. The company has an exceptionally strong franchise in global wealth advisory services and investment banking—both of which should be

<sup>8</sup>Companies operating, incorporated or principally traded in foreign countries may have more fluctuation as foreign economies may not be as strong or diversified, foreign political systems may not be as stable and foreign financial reporting standards may not be as rigorous as they are in the United States.

high return on equity, growth businesses in the long run—and a capable new CEO, John Thain, who previously ran NYSE Group and prior to that spent more than two decades at Goldman Sachs in key operations and finance roles.

Ultimately whatever happens in 2008 and whatever styles, industries or market capitalizations move in or out of favor, we remain committed to our signature investment discipline of buying durable businesses at value prices and holding them for the long term. We have seen this

bottom-up, research-driven approach prove highly effective through a wide variety of market conditions. We believe that keen attention to stock selection combined with a sensible framework for building portfolios (global leaders, out-of-the-spotlight holdings and headline risk investments) is a time-tested and reliable way to compound capital over full market cycles.

Thank you for your support. We at Davis Advisors look forward to continuing our investment journey together. ■

*This report is authorized for use by existing shareholders. A current Selected Funds prospectus must accompany or precede this piece if it is distributed to prospective shareholders. You should carefully consider the Fund's investment objectives, risks, fees, and expenses before investing. Read the prospectus carefully before you invest or send money.*

Selected American Shares' investment objective is capital growth and income. In the current market environment, we expect that income will be low. There can be no assurance that the Fund will achieve its objective. Selected American Shares invests primarily in common stock of U.S. companies with market capitalizations of at least \$10 billion. The most important risks of an investment in Selected American Shares are: market risk: the market value of shares of common stock can change rapidly and unpredictably; company risk: the market value of a common stock varies with the success or failure of the company issuing the stock; financial services risk: investing a significant portion of assets in the financial services sector may cause a fund to be more volatile. Securities within the financial services sector are more prone to regulatory action in the financial services industry, more sensitive to interest rate fluctuations and are the target of increased competition, and foreign country risk: companies operating, incorporated, or principally traded in foreign countries may have more fluctuation as foreign economies may not be as strong or diversified, foreign political systems may not be as stable and foreign financial reporting standards may not be as rigorous as they are in the United States. As of December 31, 2007, Selected American Shares had approximately 13.9% of assets invested in foreign companies. See the prospectus for a complete listing 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 regarding the investment prospects of our portfolio holdings include "forward looking statements" which may or may not be accurate over the long term. 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. These opinions are current as of the date of this piece but are subject to change. Market values will vary so that an investor may experience a gain or a loss. The views expressed by the Davis Advisors investment professionals in this report are subject to change, and some of the stocks discussed may no longer be owned. The information provided in this report should not be considered a recommendation to buy, sell, or hold any particular security. As of December 31, 2007, Selected American Shares had invested the following percentages of its assets in the companies listed: Transatlantic Holdings, 0.98%; Martin Marietta Materials, 0.98%; Canadian Natural Resources, 1.27%; Berkshire Hathaway, 4.16%; Wal-Mart, 1.58%; Cardinal Health, 0.74%; Moody's, 0.64%; Altria, 3.61%; Microsoft, 2.46%; Iron Mountain, 1.57%; Procter & Gamble, 1.16%; Sealed Air, 1.45%; Citigroup, 0.85%; Merrill Lynch, 1.32%.

Selected Funds have adopted a Portfolio Holdings Disclosure policy that governs the release of non-public portfolio holding information. This policy is described in detail in the prospectus. Visit [selectedfunds.com](http://selectedfunds.com) or call (800) 243-1575 for the most current public portfolio holdings information.

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 **S&P 500® Energy** tracks the companies in the energy sector as a subset of the S&P 500® Index. The **S&P 500® Financial** tracks the companies in the financial sector as a subset of the S&P 500® Index. Investments cannot be made directly in an Index.

After April 30, 2008, this piece must be accompanied by a supplement containing performance figures through the most recent quarter end.

**Shares of the Selected 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.**