CLIPPER FUND™

An Update from

Christopher C. Davis and Kenneth C. Feinberg Portfolio Managers

Semi-Annual Review 2009

The table below summarizes the results of Clipper Fund compared with the S&P 500® Index against which my co-manager Ken Charles Feinberg, our colleagues and I judge ourselves.

As much as we would like to emphasize the three relatively respectable results in this table, namely the year-to-date return of 7.23% versus 3.16% for the Index, the 10 year return of 0.61% per year versus -2.22% per year for the Index and the inception-to-date results of 10.51% versus 9.95% for the Index, it would be inappropriate to do so, as these numbers may be misleading.[1] Starting with the very short-term results, we have always reminded shareholders that these results are unpredictable and signify little. Furthermore, the year-to-date numbers were materially helped by the proceeds of two legal settlements. These settlements were awarded to Clipper Fund as compensation for losses in our holdings in Tyco and El Paso, both of which were subsequently sold, and amounted to $1.43 per share, or roughly 4.9%. While these payments offset a portion of the investment losses suffered, we consider such payments non-recurring, or at the least highly unusual. Furthermore, as Clipper Fund's asset base is smaller now than it was when the losses were incurred, the positive effect of the settlements is larger than it would have been.

Turning to the satisfactory 10 year and since inception results, because we assumed management of Clipper on January 1, 2006, we deserve no credit for the Fund's success in beating the S&P 500® Index over the very long term. In fact, from the time we assumed management through June 30, 2009, we have lagged the Index by about 17% cumulatively. As it remains our goal to beat this Index after expenses over the long term, we view this 17% deficit as the ground we must make up in order to live up to our commitment to our shareholders. We are dedicated to doing so and will continue to report this figure to you each time we write.

One final comment about our long-term goal: Implicit in this goal of beating the Index after expenses is our expectation that the S&P 500® Index should produce reasonable positive returns over the long run.[2] This has not been the case for the last decade during which the Index actually declined by more than 20%, or -2.2% per year, making the last 10 years some of the worst

Total Returns as of 6/30/09	YTD[3]	1 Year	3 Years	5 Years	10 Years	Inception (2/29/84)
Clipper Fund	7.23%	-31.08%	-14.94%	-7.99%	0.61%	10.51%
S&P 500® Index	3.16%	-26.21%	-8.22%	-2.24%	-2.22%	9.95%

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 0.76%. The total annual operating expense ratio may vary in future years. Current performance may be higher or lower than the performance data quoted. For most recent month-end returns, 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 January 1, 2006 by another advisor. 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, 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 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. Equity markets are volatile and an investor may lose money. [3]Returns for periods less than one year are not annualized.

on record for stock investors. Although Clipper Fund has exceeded the Index by more than 26% cumulatively, or 2.8% per year, over this time period, we would not consider an absolute return of about 6%, or 0.6% per year, satisfactory.[4]

Our focus on both absolute *and* relative returns stems from the simple fact that the two of us, our colleagues, families, and directors are large investors in Clipper Fund with over $40 million invested alongside our shareholders. As co-investors, we eat our own cooking and know the truth of the old saying: "you can't eat relative returns." For reasons outlined below, rather than shake our conviction, this decade of poor absolute returns strengthens our firm belief that in the decades ahead the Index should produce satisfactory absolute returns.[5] As a result, if we are successful in gaining any advantage over this Index after expenses, shareholders should be well rewarded.[5]

Because our objective is to outperform the S&P 500® Index over the long term, which we define as rolling five and rolling 10 year periods, enough time has not yet passed for us to label our results a failure. We are, however, off to an awful start–one that has been bad enough to shake shareholders' confidence. While our firm is well known for managing several other large diversified equity funds, including Selected American Shares, which have produced satisfactory results over the long term, these funds are more diversified and larger than Clipper and thus their results may not be relevant.[6] However, it remains our strong view that Clipper's relatively small size and ability to concentrate its investments should be long-term advantages.[7] This view is supported by the fact that the one concentrated account that we have managed for more than a decade and that should be more analogous to Clipper Fund generated a positive return after fees over the last decade compared with the negative return for the S&P 500® Index.[8] Although we cannot be certain that Clipper would have earned the same results had it been under our management for this period, these results give us some confidence in our ability to manage a concentrated portfolio. A concentrated approach, however, does increase a fund's volatility, meaning that over time the increased opportunity to outperform carries with it the possibility of experiencing worse periods of underperformance, as has been regretfully but clearly demonstrated over the last three and a half years.

It is important to note that if Clipper's results improve in the years ahead as we believe they will, the Fund should be incredibly tax-efficient as the Fund's tax loss carryforward currently stands at $437 million or 44% of net asset value.[9] On top of these realized losses, the Fund has an additional $285 million or 29% of assets in unrealized losses.

In the pages that follow, we will provide perspective and context for our trailing results but we will not try to excuse them. You have a right to expect more from us.

Given the tremendous market and economic turmoil as well as the Fund's poor results over the last year, we received many questions from the shareholders who attended our annual gathering in Los Angeles in May. As a result, we thought that it would be useful to elaborate on these topics in this midyear report for the benefit of shareholders who were unable to attend. Thus, we have chosen a somewhat different format for this report, structuring it as a series of answers to these questions. We have organized the questions from the general to the specific and, as always, will

Total Returns as of 6/30/09	1 Year	5 Years	10 Years
Clipper Fund			
return before taxes	-31.08%	-7.99%	0.61%
return after taxes on distributions	-31.30	-8.80	-0.82
return after taxes on distributions and sale of fund shares	-19.94	-6.18	-0.34

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. See endnotes for additional disclosure.*

[4]**Past performance is not a guarantee of future results.** [5]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. Equity markets are volatile and an investor may lose money. [6]This is not a solicitation for Selected American Shares, which is sold under a separate prospectus. [7]Concentrating a fund's portfolio in a select limited number of securities can increase the volatility of the portfolio. [8]Discussion of other concentrated accounts should not be considered a substitute or proxy for Clipper Fund. Holdings and performance will vary. [9]Includes year-to-date realized losses of approximately $401 million.

include a review of our mistakes as well as our successes. We hope you find this format useful and would welcome your feedback.

Q: Has the stock market made a bottom?

A: Questions about the overall market are the most common we receive. Unfortunately, the only answer we can give to such questions is, "We don't know." While hundreds, if not thousands, of people make a living as market and economic forecasters, there is overwhelming evidence that such short-term forecasting is impossible. As John Kenneth Galbraith observed, "The function of economic forecasting is to make astrology look respectable." The chart below illustrates this point by contrasting the top Wall Street economists' forecasts of the direction of interest rates over the following six months with what actually happened. As the chart shows, there is no correlation between their predictions and the outcomes.

The same is true of stock market forecasts. The chart at the top of page 4 shows Wall Street strategists' predictions of the following year's stock market returns, which also appear uncorrelated with what actually happened.

Furthermore, what is true of forecasters as a group is also true of individuals. Although the media is now filled with fawning interviews with those strategists who correctly predicted the bear market, these are not the same strategists who were lionized for predicting the bull market. Reputations for astute forecasting tend to be short-lived. A dramatic example of the ephemeral nature of such reputations came in Alan Greenspan's admission that "I've been in the forecasting business for 50 years, and I'm no better than I ever was, and nobody else is either." (Now he tells us!)

While we cannot predict the short-term direction of the market or economy, we do know that the market is likely to recover well before there are clear signs of the economy improving. As Warren Buffett wrote last fall, "I can't predict the short-term movements of the stock market. . . . What is likely . . . is that the market will move higher, perhaps substantially so, well before either sentiment or the economy turns up. So if you wait for the robins, spring will be over." The same point is illustrated in the chart at the bottom of page 4, which reviews average cyclical patterns since 1970 and shows that the market has tended to bottom months before the economy.

Q: Why should investors be in stocks at all?

A: Given the market's negative return over the last decade, some shareholders have begun to question the wisdom of owning stocks. They particularly highlight the fact that bonds have produced far higher returns over the last decade and with far less risk. However, the very fact that bond

Six Month Average Forecasted Direction vs. Actual Direction of Interest Rates

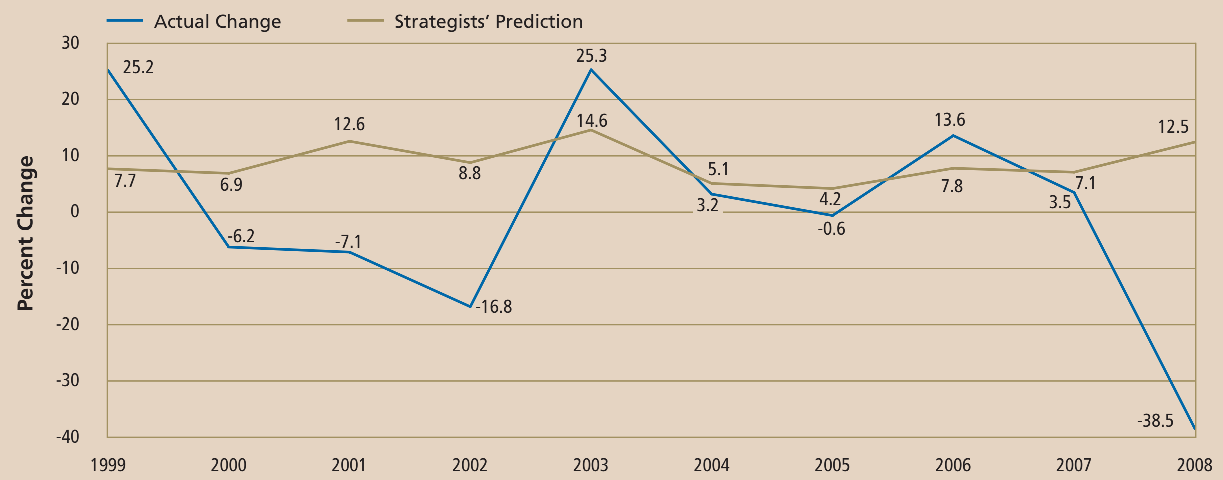
The Wall Street Journal Survey of Economists (12/82–6/09)

Date	Forecast	Actual	Result	Date	Forecast	Actual	Result	Date	Forecast	Actual	Result
12/82	▼	▼	Right	12/91	▼	▼	Right	12/00	▲	▼	Wrong
6/83	▼	▲	Wrong	6/92	▼	▲	Wrong	6/01	▼	▲	Wrong
12/83	▼	▲	Wrong	12/92	▼	▼	Right	12/01	▼	▼	Right
6/84	▼	▲	Wrong	6/93	▲	▼	Wrong	6/02*	▲	▲	Right
12/84	▲	▼	Wrong	12/93	▲	▼	Wrong	12/02	▲	▼	Wrong
6/85	▲	▼	Wrong	6/94	▼	▲	Wrong	6/03	▲	▼	Wrong
12/85	▲	▼	Wrong	12/94	▼	▲	Wrong	12/03	▲	▲	Right
6/86	▲	▼	Wrong	6/95	▲	▼	Wrong	6/04	▲	▲	Right
12/86	▲	▲	Right	12/95	▼	▼	Right	12/04	▲	▼	Wrong
6/87	▼	▲	Wrong	6/96	▲	▲	Right	6/05	▲	▼	Wrong
12/87	▼	▲	Wrong	12/96	▼	▼	Right	12/05	▲	▲	Right
6/88	▼	▼	Right	6/97	▼	▲	Wrong	6/06	▲	▲	Right
12/88	▲	▲	Right	12/97	▲	▼	Wrong	12/06	▲	▼	Wrong
6/89	▲	▼	Wrong	6/98	▲	▼	Wrong	6/07	▼	▲	Wrong
12/89	▲	▼	Wrong	12/98	▲	▼	Wrong	12/07	▲	▼	Wrong
6/90	▼	▲	Wrong	6/99	▼	▲	Wrong	6/08	▲	▼	Wrong
12/90	▼	▼	Right	12/99	▼	▲	Wrong	12/08	▲	▼	Wrong
6/91	▼	▲	Wrong	6/00	▼	▼	Right	6/09	▲	▲	Right

Source: Legg Mason and *The Wall Street Journal* Survey of Economists. This is a semi-annual survey by *The Wall Street Journal* last updated June 30, 2009. *Benchmark changed from 30 Year Treasury to 10 Year Treasury. **Past performance is not a guarantee of future results.**

Strategists' Average Forecasted Market Change vs. Actual Market Change

(1999 – 2008)

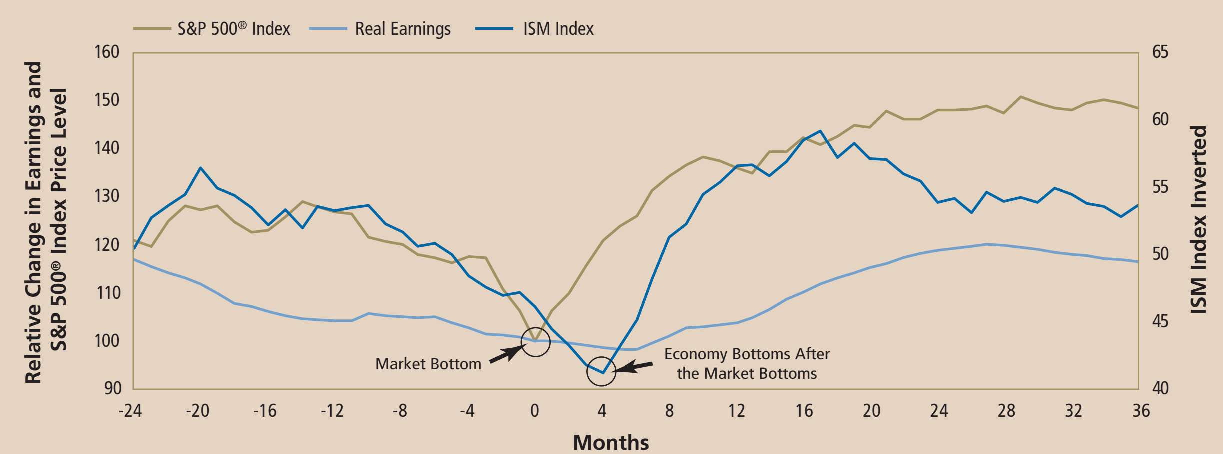


Source: *Barron's*. From 1999 through 2005, numbers reflect Dow Jones Industrial Average forecasts. In 2006, *Barron's* began using the S&P 500® Index exclusively. **Past performance is not a guarantee of future results.**

returns exceeded stock returns over the last decade is exactly why investors should now avoid bonds in favor of equities.[10] Over very long periods of time, but especially those in which interest rates were as low as they are today, stocks have produced better real returns than bonds. As the chart on page 5 shows, there has never been a 20 year period in which stocks produced a negative real return. Please note that this chart is based on data that goes back 200 years. While some credibly argue that the data from before 1920 should not be relied upon, the data since 1920 is more reliable and supports the same conclusion. The fact that we have just come through an anomalous long period in which bonds outperformed stocks is explained by the fact that at the beginning of this period interest rates were very high. Thus, bondholders earned not just a high coupon but also price appreciation from falling interest rates. When interest rates are very low, as they are today, bondholders stand to lose on both fronts. Their starting coupons are low and they face the prospect of price erosion should interest rates rise. Such conditions in the past

Typical Pattern Around Market Bottoms

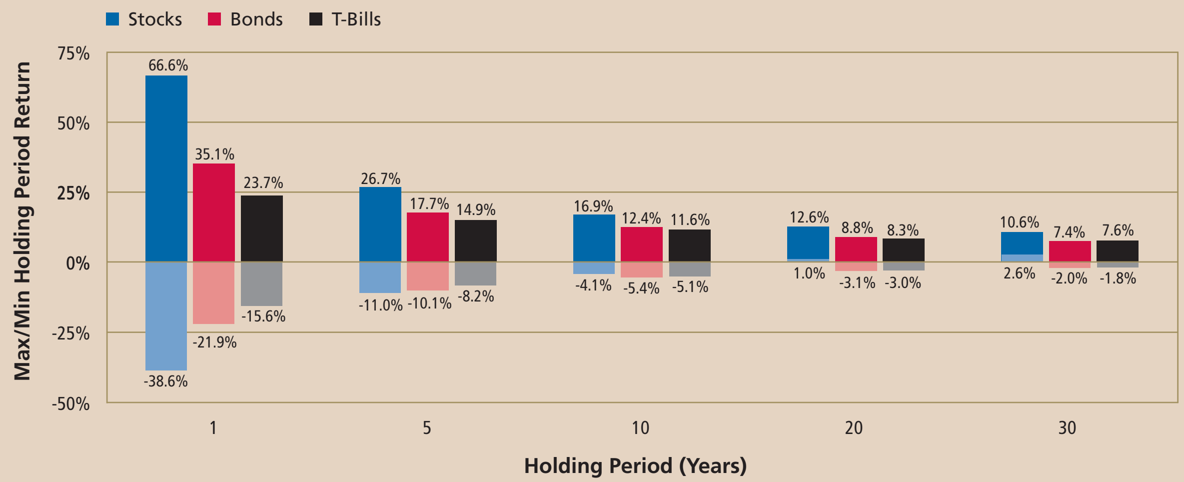
Average Cycle Since 1970



Source: UBS WMR and Datastream as of June 24, 2009. Earnings and S&P 500® Index Price Level equal 100 where Months equal zero. ISM is the Institute of Supply Management. **Past performance is not a guarantee of future results.**

[10]Common stocks and bonds represent different asset classes subject to different risks and rewards. Bonds are considered to have less risk than stocks. Future economic events may favor one asset class over another.

Maximum and Minimum Real Holding Period Returns for Stocks, Bonds and T-Bills
(1802 – 2008)



Source: Siegel, Jeremy. *Stocks for the Long Run*. Common stocks, bonds and T-Bills represent different asset classes subject to different risks and rewards. Bonds and T-Bills are considered to have less risk than stocks. Future economic events may favor one asset class over another. **Past performance is not a guarantee of future results.**

led to 20 and even 30 year periods in which bondholders suffered negative real returns. Thus, if we define risk as the possibility of having a negative real return over a long period of time, then bonds at today's interest rates are far riskier than stocks.[11] While investors may feel safer in bonds, the toxic combination of low coupons and the likely prospect of higher future inflation means bondholders are likely to be more vulnerable to long-term wealth destruction than stockholders.

Q: Why should the next 10 years be better for investors than the last?

A: Although commentators and the public are more pessimistic than ever, it has historically been profitable to invest in the stock market after a decade of poor returns. Specifically, there previously have been 10 rolling 10 year periods since 1928 when the S&P 500® Index (and, before the inception of the S&P 500® Index in the 1950s, the Dow Jones Industrial Average) returned less than 5% per year. In *every* case, the 10 years that followed produced satisfactory returns averaging approximately 13% per year and ranging from a low of 7% per year to a high of 18% per year.[12] While we cannot know for sure what the next decade holds, it is highly likely to be far better than what we have suffered through in the last 10 years.[13] Past market performance is not a guarantee of future results.

The reason that satisfactory decades for investors tend to follow poor ones is that low prices increase future returns. In other words, because stocks represent ownership interests in underlying businesses, investors who buy at lower prices should enjoy better results than if they bought at higher prices. Consider a business that generates $100,000 of income per year. A buyer who pays $2 million for this business should only expect a 5% return on investment. But if a buyer could get that same business for half price, then the buyer's return on investment would double to 10%. This same math applies at the level of the stock market, which is, after all, simply a collection of businesses, the majority of which we believe should earn more money 10 years from now than they do today. Ten years ago, when the S&P 500® Index was trading at 1,372, underlying operating earnings were approximately $47, implying a return of about 3%. With the S&P 500® Index trading at 919, underlying operating earnings should be around $55 this year and $74 next year, implying an earnings yield of 6%

[11]Common stocks and bonds represent different asset classes subject to different risks and rewards. Bonds are considered to have less risk than stocks. Future economic events may favor one asset class over another. [12]Source: Thompson Financial, Lipper and Bloomberg. Based on the S&P 500® Index from inception. Prior to the inception of the S&P 500® Index, returns are based on the Dow Jones Industrial Average. Returns are calculated by computing the 10 year return of the rolling one year periods between 12/31/37 and 12/31/08. **Past performance is not a guarantee of future results.** [13]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. Equity markets are volatile and an investor may lose money.

to 8%, or twice what it was a decade ago.[14] What's more, these earnings figures are cyclically depressed by the weak economy, giving investors additional upside if the global economy recovers as we expect.

Q: What if we are in a new Great Depression?

A: More and more, we hear from shareholders who are concerned that we are not in a recession but rather a new Great Depression. While there are many substantial and structural reasons why it is unlikely that the United States economy will contract anywhere near as much as it did in the 1930s, the key question from our perspective as investors, rather than economists, is what happened to the stock market during this bleak period. At first glance, the answer is disheartening. It took 25 years for the stock market to return to the level it reached at the peak in 1929. When we look at what was happening in the world during this period it is no surprise that the market did so badly. After all, this 25 year period included unemployment that rose as high as 25%, a 46% peak-to-trough contraction of GDP and a world war to boot, all three of which we consider unlikely to recur. Nevertheless, rather than debate whether or not the conditions are in place for a similar terrible period, let us just suppose that they are. In other words, let's assume that the market will not reach the highs that it reached in 2000 for 25 years, or until 2025. (Although the S&P 500® Index very slightly exceeded this level in late 2007, few would dispute that the peak of the stock market bubble in terms of valuation and other factors was March of 2000.) Even in granting this horrendous possibility as a worst-case scenario, it should be noted that from 1929–1954, investors did not earn a zero return. After all, the return an investor gets comes from price appreciation plus dividends. Over long periods of time, the returns from dividends can be substantial. In fact, from 1929–1954, although the stock market itself made no headway, investors earned a compound annual return of roughly 5% per year from dividends. It should be noted that this 5% return does not mean that the dividend yield on stocks was 5% throughout this period. In fact, just as today, at the start of the period, the dividend yield was a bit more than 3%.[15] It also does not mean that dividends never get cut. During the early 1930s, dividends were essentially cut in half. Yet from the relatively low starting yield, and even allowing for the cuts, over the entire period dividends grew along with GDP and the result of this growing stream of dividends was a 5% return over this 25 year period.

Importantly, even if we are in the same scenario today, we are not starting at the March 2000 peak but rather well below it. In this example, if we assume that from 2000–2025 the market will perform as badly as it did from 1929–1954, then an investor who started at the 2000 peak should only expect to earn a return of about 5% per year from dividends alone with no price appreciation. (Once again, this 5% return implies that dividends will grow from lower yields at the starting point to much higher yields by the ending point, resulting in a 5% return for the entire period.) However, because the market is currently far below its peak, we would also expect price appreciation from the market simply getting back to the level it started from. This price appreciation from 919 back to the March 2000 high of 1,552 by 2025 would add about 3% per year to the 5% dividend returns, creating a total return of about 8%. While this example is obviously hypothetical, it is interesting to note that even in a scenario in which investor returns are as miserable from March of 2000 to March of 2025 as they were from 1929–1954, the worst period in stock market history, investors would still earn about 8% per year from here.[16]

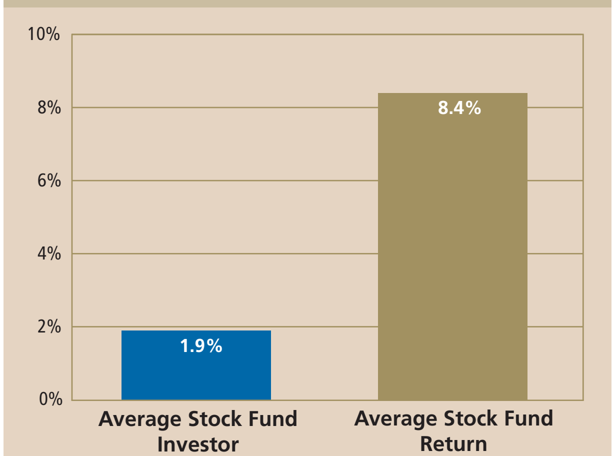
We dwell on such examples in order to provide a counterbalance to the pervasive pessimism that has investors getting out of equities in record numbers at exactly the time we believe they should be getting in. As Warren Buffett notes, "The most common cause of low prices is pessimism–sometimes pervasive, sometimes specific to a company or industry. We want to do business in such an environment, not because we like pessimism but because we like the prices it produces. It's optimism that is the enemy of the rational buyer." Unfortunately, it remains true that people are pessimistic when prices are low and optimistic when prices are high. The result of having sentiment correlated with prices is that investors (aided by stock market promoters and certain financial media commentators) have incurred a significant self-inflicted penalty by getting in *after* prices are up and getting out *after* prices are down. As shown in the chart on page 7, the cost of this penalty over the last 20 years is estimated to be about 6.5% per year, a staggering figure that dwarfs any other investment expenses.

While it may run counter to human nature to suggest that people invest more in times of panic and less in times of euphoria, a simple program of disciplined dollar-cost

[14]Source: Standard & Poor's Index Services and S&P Analytical Services, via standardandpoors.com. Actual results may differ materially from those we anticipate. [15]Source: http://www.econ.yale.edu/~shiller/data/ie_data.xls. As of June 30, 2009. **Past performance is not a guarantee of future results.** [16]This is hypothetical and not a prediction of the future of the stock market.

averaging would greatly improve most investors' results.[17] Looking back at the same bleak period described above provides a staggering example of the effectiveness of just such an approach. Imagine a seemingly unlucky investor started in 1929, investing $10,000 per year each year throughout that terrible bear market until 1954 when the market finally regained its previous high. In other words, this poor investor started investing when the market was at a peak that it would not reach again for 25 years. But amazingly, if this investor had stuck with the discipline of investing $10,000 each year during this bleak 26 year period, the $260,000 invested would have grown to $1.7 million by the end of 1954, a compound annual growth rate of 12% year. The combination of dividends and the return on the investments made each year at lower prices than the first year resulted in this very good performance. But this result was only achieved with the discipline of adding to investments each year, especially when things looked their worst.

Average Stock Fund Investor Return vs. Average Stock Fund Return
(1989 – 2008)

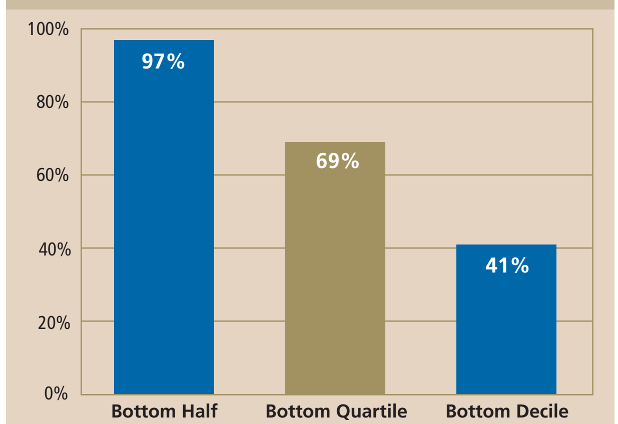


Source: *Quantitative Analysis of Investor Behavior* by Dalbar, Inc. (March 2009) and Lipper. Dalbar computed the "average stock fund investor" returns by using industry cash flow reports from the Investment Company Institute. The "average stock fund return" figures represent the average return for all funds listed in Lipper's U.S. Diversified Equity fund classification model. Dalbar also measured the behavior of a "dollar-cost average" and "asset allocation" investor. The annualized return for these investor types was 2.7% and 1.7% respectively over the time frame measured. All Dalbar returns were computed using the S&P 500® Index. Returns assume reinvestment of dividends and capital gain distributions. **Past performance is not a guarantee of future results.**

Q: If a portfolio manager underperforms for three or more years, isn't it time to switch managers?

A: Although we would far prefer to answer this question at a time when our three year results are good rather than when they are poor, we can promise you that the answer will be the same in both cases. Periods of underperformance are inevitable. As the legendary chairman of Capital Guardian Trust Company Bob Kirby observed, "The basic question facing us is whether it's possible for a superior investment manager to underperform the market three years in a row. The assumption widely held is 'no.' And yet, if you look at the records, it's not only possible, it's inevitable." While we know that making such a statement during a time of underperformance may sound like we are making excuses, the data supporting it is incontrovertible. The vast majority of top-performing managers over a long period of time will experience multi-year stretches of poor performance. Specifically, as the chart below shows, 97% of all of the managers whose results over the last 10 years placed them in the top performance quartile still underperformed for at least a three year stretch during that decade of excellent relative results. More important, in almost half of these cases (41%, to be precise), the three year stretches were bad enough to place them in the bottom decile relative

Percentage of Top Quartile Large Cap Equity Managers Whose Performance Fell Into the Bottom Half, Quartile or Decile for at Least One Three Year Period



Source: Davis Advisors. 176 managers from eVestment Alliance's large cap universe whose 10 year average annualized performance ranked in the top quartile from July 1, 1999–June 30, 2009. **Past performance is not a guarantee of future results.**

[17] Dollar-cost averaging does not assure a profit nor protect against losses in declining markets.

to their peers. While we are clearly in such a trough at the moment, we note that such periods of underperformance are an inevitable part of successful long-term investing rather than a reason for switching. Only time will tell if this period of underperformance will prove to be temporary. But because Clipper is a concentrated fund, it is reasonable to suppose that such periods of underperformance could be more pronounced than they would be in a more diversified fund, as concentration increases volatility. For example, Clipper Fund underperformed by 83% cumulatively over the five year stretch from April 30, 1995 to April 30, 2000. This huge deficit, however, was more than offset in the following almost four year period from April 30, 2000 through February 29, 2004 when the Fund outperformed by a staggering 87%, more than erasing the performance deficit.[18]

While we know that periods of underperformance are inevitable and that concentration increases volatility, it remains our responsibility to ensure that this underperformance is temporary and that the benefits of concentration outweigh the higher volatility.

As for the causes of these periods of underperformance, a portion can be attributed to managers' mistaken appraisals and declines in the value of the underlying businesses they owned. In the recent bear market, this was particularly common in the financial sector. We had our share of such mistakes, which we will discuss later in this report. However, another portion of this underperformance experienced by managers with good long-term results lies in the nature of markets. Because stock prices incorporate investor sentiment, value and price can diverge for long periods of time. In euphoric times, such as during the Internet bubble, the stock prices of many companies exceed their value. In times of panic and dislocation, the value of many companies exceeds their prices.

In such periods, poor reported results may indicate deferred returns rather than permanent losses. For example, a company purchased at $10 per share that has an intrinsic value of $20 is a good investment even if its price falls to $5 for some period of time. In our last report to you, we highlighted the example of RHJ International, which as of this writing has 7.89 euros per share in cash and liquid securities, no outstanding debt or other large liabilities and yet trades for about 4.55 euros per share. In cases such as this, it seems clear that price and value are not the same. Only time will tell what percentage of the recent weak returns were the result of temporary mispricings versus permanent mistakes. In the years ahead, we hope to prove that these poor results do not reflect a flawed investment discipline but rather the fact that prices and values can irrationally diverge for relatively long periods of time.

Although inevitable, such periods of poor results can be doubly costly for clients. After all, as portfolio managers, we can focus on the value of the underlying businesses, but clients can only see the prices. As a result, clients often lose confidence and get out *after* they have already suffered through the period of bad performance but before benefiting from the recovery. This has been especially true for Clipper Fund, which has experienced significant redemptions during this period.

Before turning to the reasons that such divergences can create real opportunities, we must also recognize the cases in which falling stock prices reflect substantial declines in the value of the underlying business. In these cases, we were mistaken in our business appraisals.

Q: What were the Fund's biggest mistakes?

A: As always, we must begin a discussion of mistakes with some definitions. Most important, we do not label an investment as a mistake simply because it trades below our purchase price. In fact, given market volatility, it is probable that every company we buy will trade below our purchase price at some point, especially in a bear market. Rather, we identify an investment as a mistake when our work indicates a significant reduction in our assessment of a company's intrinsic value. In some fortunate cases, especially during bull markets, we are able to identify the mistake before the market does and sell the shares without incurring a substantial loss. However, since being entrusted with the management of Clipper Fund, we have made certain mistakes that resulted in a permanent and substantial loss of capital as we were not ahead of the market in identifying declining intrinsic value. Chief among these mistakes was our investment in American International Group (AIG), which cumulatively detracted almost 13% from returns in the three and a half years that we have managed Clipper. This loss is more than two and a half times the next biggest detractor from our results over the same time period. In our 2008 year-end report, we provided a detailed review of this mistake, which we commend to your attention. (Please visit the Fund Literature section of the Clipper Fund website,

[18]**Past performance is not a guarantee of future results.** Performance is relative to the S&P 500® Index.

www.clipperfund.com, to read this report.) In the first half of this year, we liquidated the position. Though we believe there may be value in the shares that exceeds today's market capitalization, we are not convinced that this value will be permitted to accrue to shareholders given today's charged political environment.

The next two largest detractors from our results over this time period were American Express and Harley-Davidson. However, unlike AIG, we continue to hold these companies. In our view, both companies still maintain very powerful competitive advantages and should weather this storm. As a result, we have not yet labeled them as mistakes though we were mistaken in parts of our analysis. For example, in both cases, the earnings have fallen far more than we would have anticipated as a result of the weakening economy. While cyclically weak earnings are predictable and inevitable if one has a long holding period, this cycle has been far worse than we imagined. Furthermore, in both instances, even when the economy recovers, the companies' profits are unlikely to rebound as much as we would have thought due to unexpected changes in each company's business model. In the case of Harley-Davidson, it is doubtful that the company will be able to profitably provide customer financing for future sales, which will likely result in lost sales and the elimination of what had been a profit center. In the case of American Express, even when the higher rate of charge-offs that one would expect in a recession has abated, a more difficult regulatory environment, higher financing costs and long-term weakness in consumer spending make it likely that the business will not be as profitable as it once was.

One final investment that should be highlighted was our investment in Merrill Lynch, which subtracted about 3.5% cumulatively from our returns.[19] This investment reached its sad conclusion in our fourth quarter 2008 sale of the shares at a substantial loss. Though this investment was a mistake, we remain convinced that Merrill's powerful network of financial advisors combined with decisive management reduced our downside and prevented the sort of catastrophic loss we experienced in AIG and others experienced in firms like Lehman Brothers and Bear Stearns.

Q: Why do you have so much in financials?

A: The Fund continues to have a large weighting in financials relative to the Index, representing approximately 50% for the Fund versus 14% for the S&P 500® Index. Given that the worst carnage of this bear market was centered in the financial sector, this has clearly been a mistake. Importantly, though, the companies that make up the financial category are not monolithic but include a wide range of business models, many of which performed far better than those in the headlines. This wide range of results is understandable when we consider that the category lumps together a conglomerate like Berkshire Hathaway, a securities processing firm like The Bank of New York Mellon and a charge card company like American Express. Also, although we did mistakenly own AIG and Merrill, we did not hold or we sold positions in a number of other financial companies that were wiped out, including Fannie Mae and Freddie Mac, Countrywide, Bear Stearns, Lehman Brothers, and Washington Mutual. As a result, though it is small solace, the stocks that we held within the financial sector outperformed the average financial stock by about 10 percentage points over the past three years.

That said, we must emphasize again that we do not structure the Portfolio on the basis of top-down sector allocations. Rather we construct it from the bottom up, company by company. Furthermore, while it is clear that the financial sector is made up of a very diverse group of companies, we should also mention that financial companies tend to share certain characteristics that we find attractive. For example, most financial business models are not prone to obsolescence. Further, given the collapse of the securitization markets and what has been called the shadow-banking system of non-bank finance companies, traditional financial institutions now face far less competition. In short, having come through a financial hurricane, these companies now face the prospect of greater demand for their products and services with far less competition.

At the same time, we have two main concerns that offset some of the positives just outlined: regulation and leverage. Interestingly, these two concerns could hurt companies in opposite ways. If the economy rebounds strongly, harmful regulation would likely have the effect of reducing the returns many financial firms would otherwise have earned. Conversely, if the economy does not get better, the leverage embedded in most financial firms increases the risk of losses or further dilutive share issuance. Although leverage is lower today, the fact that we continue to face rising credit losses and that these losses are amplified by leverage

[19]Between 1/1/2006 and 6/30/09 Merrill Lynch subtracted 3.5% from cumulative returns.

is a real concern. Put another way, while today's valuations discount a significant increase in credit costs, there is no certainty that actual losses will not exceed even these conservative estimates.

Q: What are the biggest changes in the Portfolio?

A: Because portfolio turnover tends to be low, the Fund's holdings remain quite similar to what we have described in past reports and are divided very roughly into five subjective categories. First are leading companies that we sometimes refer to as stalwarts. These companies include those whose operations are primarily domestic such as Costco and Harley-Davidson as well as global leaders like Merck, Procter & Gamble, Microsoft and Coca-Cola. The second category is made up of companies that are subject to "headline risk," most notably select financials such as American Express, The Bank of New York Mellon, JPMorgan Chase, Goldman Sachs, and Wells Fargo & Company. The third category is made up of companies whose business model and management mindset put them in a position to take advantage of the crisis in the capital markets such as Berkshire Hathaway, Loews Corp., Oaktree Capital, and RHJ International. The fourth category comprises companies that are positioned to benefit if global commodity prices rise as we expect due to growing demand from China, India and Brazil. This category includes energy and commodity companies such as Canadian Natural Resources and ConocoPhillips. (Loews Corp. also has substantial energy operations through its holding of Diamond Offshore.) The fifth category is a catch-all and includes our now reduced holdings in the Japanese insurance sector.

Of these categories, we have been adding the most to the global stalwarts, having recently purchased Coca-Cola and Merck. These companies are characterized by healthy balance sheets, strong competitive positions and durable business models. They generally have pricing power and the ability to pass through cost increases. Because such businesses produce excess cash, they are self-funding and have no need to regularly replenish capital. Beyond these factors, we place a particularly high value on the global aspects of these businesses for two reasons. First, only five percent of the world's population now lives in the United States. Further, although we remain bullish on the long-term prospects of our country, it seems likely that a number of other large economies will grow faster in the decades ahead. We consider it the best of both worlds to invest in proven U.S.-based companies that are well positioned to capitalize on these higher growth rates overseas. Second, although not certain, the likely long-term consequence of the dramatic increase in our federal budget and trade deficits will be a weaker dollar. Such an outcome will significantly increase the value of businesses with strong non-dollar earnings streams. It is amazing, for example, that by 2020, 90% to 95% of Coca-Cola's earnings may be generated from overseas.

Q: How have current events affected your firm?

A: Although the turmoil of the last year was dramatic, the fact that this year marks the 40th anniversary of the founding of our firm serves as a useful reminder that tumultuous periods in the market and economy have happened before and will happen again. Not long after our founding, the market declined almost 50% and unemployment soared to double-digit rates while our country remained mired in a deeply unpopular war. We have always managed our firm, like our funds, to get through such difficult periods. We are private, employee-owned, frugal, and well capitalized. We have no debt or derivatives. In this chaotic environment, we have hired three new research analysts. We remain committed to providing clients satisfactory long-term returns after expenses. We also are among the largest investors in Clipper Fund and have continued to add to our holdings throughout this downturn.

Looking ahead, Ken and I feel strongly that our team of analysts is the best we have ever had and we are often given credit for their work. Two that deserve special mention for their long-term contribution to returns are Danton Goei and Stephen Chen. We are proud to have such talented, dedicated and honorable colleagues.

We know we have ground to make up to live up to the commitment we have made to the shareholders of Clipper Fund. We are dedicated to doing so and grateful for the trust you have placed in us. ■

CLIPPER FUND™

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 objectives, 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, 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.

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. Clipper 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: 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; focused portfolio risk: concentrating a fund's portfolio in a select limited number of securities can increase the volatility of the portfolio; financial services risk: investing a significant portion of assets in the financial services sector may cause a fund to be more volatile as 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 June 30, 2009, Clipper Fund had approximately 14.9% 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 report but are subject to change. Market values will vary so that an investor may experience a gain or a loss. The information provided in this material should not be considered a recommendation to buy, sell or hold any particular security. As of June 30, 2009, Clipper Fund had invested the following percentages of its assets in the companies listed: American Express, 6.47%; The Bank of New York Mellon, 7.47%; Berkshire Hathaway, 10.37%; Canadian Natural Resources, 6.90%; Coca-Cola, 0.93%; ConocoPhillips, 4.46%; Costco Wholesale, 10.70%; Goldman Sachs, 1.18%; Harley-Davidson, 4.66%; JPMorgan Chase, 2.89%; Loews Corp., 4.97%; Merck, 1.38%; Microsoft, 3.21%; Oaktree Capital, 4.89%; Procter & Gamble, 6.57%; RHJ International, 3.75%; Wells Fargo & Company, 0.95%.

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

The net expense ratio for Clipper Fund for the fiscal period ended June 30, 2009 was 0.86%.

Effective July 1, 2009 Davis Advisors voluntarily and permanently reduced any management fee breakpoints ABOVE 0.55% to 0.55% for Clipper Fund.

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.

Over the last five years, the high and low turnover ratio for Clipper Fund was 63% and 7%, respectively.

Dalbar, a Boston-based financial research firm that is independent from Davis Advisors, researched the result of actively trading mutual funds in a report entitled *Quantitative Analysis of Investor Behavior (QAIB)*. The Dalbar report covered the time periods from 1989–2008. The Lipper Equity LANA Universe includes all U.S. registered equity and mixed-equity mutual funds with data available through Lipper. Returns assume reinvestment of dividends and capital gain distributions. The fact that buy and hold has been a successful strategy in the past does not guarantee that it will continue to be successful in the future.

After-tax returns show the Fund's annualized after-tax total return for the time period specified. After-tax returns with shares sold show the Fund's annualized after-tax total return for the time period specified plus the tax effect of selling your shares at the end of the period. To determine these figures, distributions are treated as taxed at the maximum tax rate in effect at the time they were paid with the balance reinvested. The maximum rates are currently 35% for non-qualified dividend income and short-term capital gain distributions. Long-term capital gains and qualified dividends currently are taxed at a maximum 15% rate. The tax rate is applied to distributions prior to reinvestment and the after-tax portion is reinvested in the Fund. State and local taxes are ignored.

Broker-dealers and other financial intermediaries may charge Davis Advisors substantial fees for selling its products 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.

After October 31, 2009, 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.

Item #4768 6/09 Davis Distributors, LLC, 2949 East Elvira Road, Suite 101, Tucson, AZ 85756, 800-432-2504, clipperfund.com