Dodge & Cox Funds®

# International Stock Fund

## TO OUR SHAREHOLDERS

The Dodge & Cox International Stock Fund had a total return of 8.3% for the year ended December 31, 2016, compared to a return of 1.0% for the MSCI EAFE (Europe, Australasia, Far East) Index.

## AN EXTRAORDINARY YEAR

The Fund's strong absolute and relative performance in 2016 was achieved with largely the same portfolio that produced weak results in 2015. In fact, many of the biggest contributors in 2016 were some of the largest detractors in 2015. The past year's strong performance also improved the Fund's longer-term relative results. The Fund's annualized total return for the past five years was 8.0% versus 6.5% for the MSCI EAFE.

We would like to express sincere appreciation to our fellow shareholders for your patience and confidence in Dodge & Cox. These results serve as a reminder that a single quarter or year is too short an interval over which to judge the success of our strategy. Our bottom-up, value-oriented, active investment approach requires independent thinking to build the level of conviction essential to invest in companies that are out of favor. Stock prices can move dramatically in response to the headlines of the day, but it often takes time for a company's results to improve and for positive change to be recognized by other investors. Accordingly, maintaining a long-term investment horizon and staying the course when markets move against us are essential for our investment team, as well as for our fellow shareholders. We would be the first to acknowledge this is not easy to do, but our persistence to stick with our convictions in the face of market volatility was rewarded during this past year.

Since its inception on May 1, 2001, the Fund has had an average annualized total return of 7.1% versus 4.0% for the MSCI EAFE. This period encompassed large swings in Fund performance, market prices, and equity valuations, including the 2008-09 global financial crisis and subsequent recovery. More recently, investor concerns have been around global economic growth, lower commodity prices, Brexit, and the U.S. presidential election. Uncertainty is a constant, but it can create compelling opportunities for patient, long-term, value-oriented, active investors. Our recent insight paper, "Understanding the Case for Active Management," is summarized at the end of the letter and is available in its entirety on our website.

## MARKET COMMENTARY

The major driver of the Fund's relative results was the significant outperformance of the "value" portion of the market compared to the "growth" segment. Value stocks are those that have lower valuations than growth stocks. Recently, the more economically sensitive, cyclical sectors of the market (e.g., Energy, Financials) have accounted for a larger portion of the value category than stocks in the more defensive, stable sectors (e.g., Consumer Staples, Telecommunication Services, Utilities).

In our 2015 annual letter, we discussed the widening valuation gap between these two segments of the market and noted that we were finding increasingly attractive opportunities in the value segment. That gap widened further in the first half of 2016, marking eight consecutive quarters of value underperforming growth. As prices declined in the value areas of the market, we added to several holdings, including those in Energy, Materials, and European and UK Financials. While we did not know when the market might move in the Fund's favor, our in-depth research, valuation discipline, and three- to five-year investment horizon were critical pillars in building and maintaining our investment conviction. Value stocks staged a significant rally in the second half of 2016, driving much of the Fund's outperformance for the year.

Similarly, as emerging markets lagged developed markets on a multi-year basis through 2015, valuations became increasingly attractive, and the Fund found more investment opportunities. After a dramatic 15% drop in 2015, the MSCI Emerging Markets Index was up 11% in 2016, significantly outpacing the 1% return for developed markets stocks. Many of the Fund's largest emerging market detractors in 2015 turned out to be the biggest contributors in 2016. For example, Petrobras[a] and Itau Unibanco in Brazil were down 55% and 41%, respectively, in 2015, but were up 159% and 81% in 2016. We added to both holdings as their valuations declined in 2015, which later benefited the Fund.

Overall, international equity valuations remain reasonable: the MSCI EAFE trades at 14.8 times forward earnings (compared to a 20-year average of 15.7 times).[b] And while valuations for the cheaper parts of the market rose in relation to more expensive market segments, the valuation spread remains compelling.

## INVESTMENT STRATEGY

In our experience, the best investment opportunities can frequently be found in areas of greatest skepticism and uncertainty. We search in these areas, which are often characterized by discounted valuations, and attempt to discern which companies have the competitive position and management talent to grow earnings and cash flow over the next three to five years. Just as important, we attempt to avoid

a The use of specific examples does not imply that they are more attractive investments than the Fund's other holdings.

b Unless otherwise specified, all weightings and characteristics are as of December 31, 2016.

those companies whose valuations reflect optimism that current conditions will remain intact or significantly improve and thus do not sufficiently compensate us for potential disappointment. Two areas where we currently see attractive investment opportunities amidst investor skepticism are Health Care (13% of the Fund) and European and UK Financials (20% of the Fund).

### Health Care

Health Care was the worst performing sector (down 12%) of the MSCI EAFE in 2016. Share prices for pharmaceutical companies were hurt by concerns about lower drug pricing in the United States, as pharmacy benefit managers have consolidated their market shares and exerted more pricing power. Since profits generated in the United States represent a substantial share of total profits for the global industry, many believe the outlook for long-term profitability is in question. While we acknowledge this risk, we believe the Fund's pharmaceutical holdings are compelling at recent, lower valuations of 14.2 times forward earnings, which do not appropriately reflect the long-term potential for growth in cash flow and earnings. For example, several companies in the Fund's portfolio have navigated through the most challenging wave of patent expirations, and their intensive research and development efforts are bearing fruit with meaningful new drug launches. We added to several of the Fund's holdings in the latter half of 2016, including AstraZeneca, which is the newest addition to the Fund's Health Care holdings.

AstraZeneca, which is based in the United Kingdom, is a global pharmaceutical company with strengths in treatment for cancer and respiratory, cardiovascular, and infectious diseases. The share price has been under pressure due to recent and upcoming patent expirations for major drugs. Despite this headwind, the long-term growth outlook is favorable because of the company's robust new drug pipeline, particularly in oncology. AstraZeneca has an attractive position in the revolutionary field of cancer immunotherapy, which harnesses the disease-fighting capabilities of the body's immune system to reduce and potentially eliminate cancer tumors. With a 4.6% dividend yield, the current valuation is reasonable and does not appear to reflect the potential success of the immunotherapy drug pipeline.

### European and UK Financials

In our 2016 semi-annual letter, we wrote about adding to several of the Fund's holdings in European and UK Financials during the global equity market swoon in early 2016 and after steep share price declines following the Brexit vote. European and UK Financials outperformed significantly in the second half of the year (up 33% compared to 24% for the MSCI EAFE) and represented 20% of the Fund at year end. We continue to think this industry presents some of the most attractive opportunities in the market.

Valuations remain extremely compelling: the Fund's holdings trade at an average level of 0.7 times book value, reflecting continued doubt in the market that these companies will earn sufficient returns on equity. Over the past five years, the banking industry has been challenged by low interest rates, sluggish global growth, high legal costs, and adverse regulatory changes. Management teams at many institutions have responded by aggressively cutting operating expenses and eliminating underperforming businesses. As a result, many banks are better positioned to expand profitability in an improving environment. For example, in 2012, Switzerland-based UBS Group was early to restructure its investment banking segment and focus on its wealth management business, where it is a global leader. The bank has successfully reduced its cost base, despite facing large litigation costs and new regulatory compliance expenses. Due to its large customer deposit balances, UBS should also be one of the greatest beneficiaries from higher global interest rates as net interest income expands.

## IN CLOSING

Long-term, value-oriented investing is a humbling but hopefully rewarding endeavor. It requires forming independent opinions that may be very different from the consensus view and maintaining mental and emotional discipline in the face of inevitable market fluctuations. It is possible that we will buy shares of a company too early and that business conditions may not improve as we expect. Those challenges are well worth the potential for superior, long-term investment returns.

2016 was a vivid example of these perils and rewards. The significant market swings in the first half of the year highlighted the difficulty in predicting what the markets will do. Fortunately, our discipline paid off as the Fund's strategy did well in the second half of the year. We do not know what the future holds, but we will continue to apply the bottom-up, value-oriented investment approach that has served us well for decades.

We want to express gratitude to the Fund's shareholders for taking the long view and having confidence in Dodge & Cox. Our strategy requires patience and persistence, and we thank you for yours.

As always, we welcome your comments and questions.

For the Board of Trustees,

Charles F. Pohl
Dana M. Emery

Charles F. Pohl,
Chairman

Dana M. Emery,
President

January 31, 2017

## UNDERSTANDING THE CASE FOR ACTIVE MANAGEMENT

One of the fiercest investment debates concerns active versus passive approaches to investing: Should investors actively choose individual investments in the hopes of beating the market, or choose a fund that tracks an index and matches the return of the market, never doing better, but never doing worse?

The most frequently cited evidence against active management is that the majority of active managers fail to beat their benchmark each year. But measuring on a 12-month basis doesn't necessarily capture the results of an active management strategy because it often takes more than a year for a strategy to come to fruition. When measurement intervals are lengthened, the results of the active versus passive comparison are significantly different—a higher percentage of active managers outperform their benchmarks. To be sure, outperformance over the long run is nowhere near a sure thing, but the data suggests active management is an eminently viable choice.

One of the attributes of successful active managers is having a high "active share," meaning their portfolio is significantly different from an index. Another attribute is having low fees and low portfolio turnover, which reduce the drag on performance exerted by expenses. Successful active managers also tend to provide higher risk-adjusted returns, because unlike index funds, they aren't obliged to invest in higher risk companies. Studies also show that active managers do better when they are tightly focused on specific strategies and markets and when they have a significant financial stake in their funds.

Research indicates that the average investor earns two percentage points less per year than the average fund because many investors move in and out of funds too quickly. But if investors have the discipline to stick with good active managers through inevitable periods of underperformance, they can have meaningful prospects of outperforming the market over time.

*A summary from Dodge & Cox's insight paper titled,* "Understanding the Case for Active Management."

Dodge & Cox Funds®

# International Stock Fund

December 31, 2016

*Ticker Symbol*
DODFX

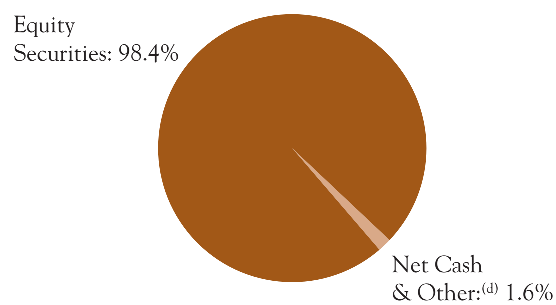
| | |
|---|---|
| *Objectives* | ▪ The Fund seeks long-term growth of principal and income. |
| *Strategy* | ▪ The Fund invests primarily in a diversified portfolio of equity securities issued by non-U.S. companies from at least three different countries, including emerging market countries. The Fund is not required to allocate its investments in set percentages in particular countries. The Fund typically invests in medium-to-large well established companies based on standards of the applicable market. |
| *Risks* | ▪ The Fund is subject to market risk, meaning holdings in the Fund may decline in value for extended periods due to the financial prospects of individual companies or due to general market and economic conditions. Investing in non-U.S. securities may entail risk due to foreign economic and political developments; this risk may be higher when investing in emerging markets. Please read the prospectus for specific details regarding the Fund's risk profile. |

## GENERAL INFORMATION

| | |
|---|---|
| Net Asset Value Per Share | $38.10 |
| Total Net Assets (billions) | $54.2 |
| Expense Ratio | 0.64% |
| Portfolio Turnover Rate | 17% |
| 30-Day SEC Yield[a] | 1.73% |
| Number of Companies | 72 |
| Fund Inception | 2001 |
| *No sales charges or distribution fees* | |

***Investment Manager:*** Dodge & Cox, San Francisco. Managed by the International Investment Policy Committee, whose eight members' average tenure at Dodge & Cox is 22 years.

## ASSET ALLOCATION




## PORTFOLIO CHARACTERISTICS

| | Fund | MSCI EAFE |
|---|---|---|
| Median Market Capitalization (billions) | **$27** | $9 |
| Weighted Average Market Capitalization (billions) | **$59** | $51 |
| Price-to-Earnings Ratio[b] | **14.1x** | 14.8x |
| Countries Represented | **25** | 21 |
| Emerging Markets (Brazil, China, India, Mexico, Russia, South Africa, South Korea, Thailand, Turkey, United Arab Emirates) | **24.9%** | 0.0% |

## REGION DIVERSIFICATION (%)[e]

| | Fund | MSCI EAFE |
|---|---|---|
| Europe (excluding United Kingdom) | **39.7** | 44.8 |
| Pacific (excluding Japan) | **13.5** | 12.1 |
| United Kingdom | **13.2** | 18.3 |
| Japan | **11.9** | 24.1 |
| Latin America | **6.8** | 0.0 |
| United States | **6.0** | 0.0 |
| Africa/Middle East | **5.2** | 0.7 |
| Canada | **2.1** | 0.0 |

## TEN LARGEST HOLDINGS (%)[c]

| | Fund |
|---|---|
| Samsung Electronics Co., Ltd. *(South Korea)* | **4.5** |
| Sanofi *(France)* | **3.7** |
| Naspers, Ltd. *(South Africa)* | **3.4** |
| Schlumberger, Ltd. *(United States)* | **3.2** |
| Novartis AG *(Switzerland)* | **3.2** |
| Barclays PLC *(United Kingdom)* | **2.9** |
| BNP Paribas SA *(France)* | **2.9** |
| Schneider Electric SA *(France)* | **2.6** |
| ICICI Bank, Ltd. *(India)* | **2.5** |
| Itau Unibanco Holding SA *(Brazil)* | **2.5** |

## SECTOR DIVERSIFICATION (%)

| | Fund | MSCI EAFE |
|---|---|---|
| Financials | **27.1** | 21.2 |
| Consumer Discretionary | **17.3** | 12.5 |
| Information Technology | **14.3** | 5.5 |
| Health Care | **12.5** | 10.6 |
| Industrials | **8.4** | 14.0 |
| Energy | **7.8** | 5.5 |
| Materials | **5.4** | 7.9 |
| Telecommunication Services | **3.3** | 4.5 |
| Real Estate | **1.3** | 3.7 |
| Consumer Staples | **0.7** | 11.2 |
| Utilities | **0.3** | 3.4 |

(a) SEC Yield is an annualization of the Fund's net investment income for the trailing 30-day period. Dividends paid by the Fund may be higher or lower than implied by the SEC Yield.

(b) Price-to-earnings (P/E) ratios are calculated using 12-month forward earnings estimates from third-party sources.

(c) The Fund's portfolio holdings are subject to change without notice. The mention of specific securities is not a recommendation to buy, sell, or hold any particular security and is not indicative of Dodge & Cox's current or future trading activity.

(d) Net Cash & Other includes cash, short-term investments, receivables, and payables.

(e) The Fund may classify a company in a different category than the MSCI EAFE. The Fund generally classifies a company based on its country of incorporation, but may designate a different country in certain circumstances.

## *Average Annual Total Return*[1]

| For periods ended December 31, 2016 | 1 Year | 3 Years | 5 Years | 10 Years |
|---|---|---|---|---|
| Dodge & Cox International Stock Fund | 8.26% | –1.34% | 7.98% | 2.11% |
| MSCI EAFE Index | 1.00 | –1.60 | 6.53 | 0.75 |

dodgeandcox.com

*Returns represent past performance and do not guarantee future results. Investment return and share price will fluctuate with market conditions, and investors may have a gain or loss when shares are sold. Fund performance changes over time and currently may be significantly lower than stated above. Performance is updated and published monthly. Visit the Fund's website at dodgeandcox.com or call 800-621-3979 for current month-end performance figures.*

The Dodge & Cox International Stock Fund had a total return of 3.4% for the fourth quarter of 2016, compared to –0.7% for the MSCI EAFE (Europe, Australasia, Far East) Index. For 2016, the Fund had a total return of 8.3%, compared to 1.0% for the MSCI EAFE.

### INVESTMENT COMMENTARY

2016 has been an extraordinary year. We would like to express sincere appreciation to our fellow shareholders for your patience and confidence in Dodge & Cox. The Fund's strong performance in 2016, in both absolute and relative terms, was achieved with largely the same portfolio that produced weak results in 2015. In some cases, we leaned even further into areas of investor pessimism as valuations declined. Many of the biggest contributors in 2016 were the largest detractors in 2015. The longer-term results for the Fund have improved significantly with this year's strong performance rebound.

The Fund benefited from two broad market factors. First, after eight consecutive quarters of value stocks underperforming growth stocks across international equities, value stocks significantly outperformed growth in the second half of 2016.[2] As prices declined in the value segment of the market, we added to several holdings, including those in Energy, Materials, and European and UK Financials. Since the portfolio is value-oriented, the market reversal drove much of the Fund's outperformance for the year.

Second, as emerging markets lagged developed markets on a multi-year basis through 2015, valuations had become increasingly attractive, and the Fund found more investment opportunities. After a dramatic 15% drop in 2015, the MSCI Emerging Markets Index was up 11% in 2016, significantly outpacing the 1% return for developed markets stocks. Many of the Fund's largest emerging market detractors in 2015 turned out to be the biggest contributors in 2016. For example, Petrobras and Itau Unibanco in Brazil were down 55% and 41%, respectively, in 2015, but were up 159% and 81% in 2016.

Performance results over the past few years reaffirm that a single quarter or year is too short an interval over which to judge the success of our strategy. Our bottom-up, value-oriented, active investment approach requires independent thinking to build the level of conviction required to invest in companies that are out of favor and the persistence to stick with those convictions in the face of market volatility. It often takes time for a company's operations to improve and to be recognized by the market. Accordingly, maintaining a long-term investment horizon and staying the course are essential for our investment team, as well as for our fellow shareholders.

Looking forward, we continue to see attractive investment opportunities throughout the world. Overall, international equity valuations remain reasonable: the MSCI EAFE trades at 14.8 times forward earnings (compared to a 20-year average of 15.7 times). And while valuations for the cheaper parts of the market rose in relation to more expensive market segments, the valuation spread remains compelling. We believe the Fund is well positioned, and we remain optimistic about the long-term outlook for the portfolio.

### FOURTH QUARTER PERFORMANCE REVIEW

The Fund outperformed the MSCI EAFE by 4.1 percentage points during the quarter.

#### KEY CONTRIBUTORS TO RELATIVE RESULTS

- Strong returns from the Fund's holdings in the Financials sector (up 14% compared to up 10% for the MSCI EAFE sector), particularly in Europe and the United Kingdom, aided performance. AEGON (up 44%), Societe Generale (up 43%), Barclays (up 27%), and BNP Paribas (up 24%) were notable contributors.
- The Fund's average underweight position in the Consumer Staples sector (1% versus 12% for the MSCI EAFE sector) helped results because this was one of the weaker sectors of the market (down 10%).
- Additional contributors included Mitsubishi Electric (up 10%), Schlumberger (up 7%), and Sanofi (up 7%).

#### KEY DETRACTORS FROM RELATIVE RESULTS

- In the Media industry, the Fund's average overweight position (9% versus 1%) and holdings (down 12% compared to down 3% for the MSCI EAFE industry) hindered results. Grupo Televisa (down 19%), Naspers (down 15%), and Liberty Global (down 10%) performed poorly.
- Since Materials was one of the stronger sectors of the market (up 3%), the Fund's underweight position in this sector (5% versus 8% for the MSCI EAFE sector) hurt performance, especially because of the lack of holdings in the Metals & Mining industry.
- Additional detractors included Nintendo (down 20%), LM Ericsson (down 19%), and Baidu (down 10%).

### 2016 PERFORMANCE REVIEW

The Fund outperformed the MSCI EAFE by 7.3 percentage points in 2016.

#### KEY CONTRIBUTORS TO RELATIVE RESULTS

- Strong returns from the Fund's holdings in emerging markets (up 21%), especially in the Financials sector (up 32%), contributed significantly to performance. Petrobras (up 159%), Itau Unibanco (up 81%), and Samsung Electronics (up 41%) were notable contributors.
- The Fund's average overweight position (15% versus 5%) and holdings in the Information Technology sector (up 21% compared to up 4% for the MSCI EAFE sector) enhanced results. Hewlett Packard Enterprise (up 53%) and Nintendo (up 52%) performed well.
- The Fund's holdings in the Industrials sector (up 29% compared to up 7% for the MSCI EAFE sector) aided performance. Johnson Controls (up 40%), Mitsubishi Electric (up 34%), and Schneider Electric (up 25%) were particularly strong.
- Teck Resources (up 201% to date of sale), Schlumberger (up 24%), and Naspers (up 8%) were among the additional contributors.

#### KEY DETRACTORS FROM RELATIVE RESULTS

- The Fund's holdings in European and UK Financials hindered performance, especially UniCredit (down 47%), Credit Suisse Group (down 30%), Lloyds Banking Group (down 25%), and Barclays (down 12%).
- Investments in the Consumer Discretionary sector (down 5% compared to down 2% for the MSCI EAFE sector) hurt results. Grupo Televisa (down 23%), Liberty Global (down 17%), Bayerische Motoren Werke (down 9%), and Honda Motor (down 8%) were particularly weak.
- Additional detractors included Saipem (down 43%), LM Ericsson (down 38%), and Novartis (down 13%).

[1] The Fund's total returns include the reinvestment of dividend and capital gain distributions, but have not been adjusted for any income taxes payable by shareholders on these distributions or on Fund share redemptions. Index returns include dividends but, unlike Fund returns, do not reflect fees or expenses. The MSCI EAFE (Europe, Australasia, Far East) Index is a broad-based, unmanaged equity market index aggregated from 21 developed market country indices, excluding the United States and Canada. MSCI makes no express or implied warranties or representations and shall have no liability whatsoever with respect to any MSCI data contained herein. The MSCI data may not be further redistributed or used as a basis for other indices or any securities or financial products. This report is not approved, reviewed, or produced by MSCI. All returns are stated in U.S. dollars, unless otherwise noted.

[2] The MSCI EAFE Value Index outperformed the MSCI EAFE Growth Index by 13.4 percentage points during the second half of 2016. Generally, stocks that have lower valuations are considered "value" stocks, while those with higher valuations are considered "growth" stocks.