Objectives

The Fund seeks a high and stable rate of current income, consistent with long-term preservation of capital. A secondary objective is to take advantage of opportunities to realize capital appreciation.

Strategy

The Fund invests in a diversified portfolio consisting primarily of investment-grade debt securities, including government and government-related obligations, mortgage- and asset-backed securities, corporate and municipal bonds, and other debt securities. To a lesser extent, the Fund may also invest in below investment-grade debt securities.

The proportions held in various debt securities will be revised in light of Dodge & Cox’s appraisal of the economy, the relative yields of securities in the various market sectors, the investment prospects for issuers, and other factors. In selecting securities, Dodge & Cox considers many factors, including yield, credit rating, liquidity, call risk, duration, structure, and capital appreciation potential.

Risks

The Fund invests in individual bonds whose yields and market values fluctuate, so that your investment may be worth more or less than its original cost. Debt securities are subject to interest rate risk, credit risk, and prepayment and call risk, all of which could have adverse effects on the value of the Fund. Please read the prospectus for specific details regarding the Fund’s risk profile.

GENERAL INFORMATION

Net Asset Value Per Share $13.91
Total Net Assets (billions) $59.6
Expense Ratio 0.42%
Portfolio Turnover Rate (1/1/19 to 6/30/19, unannualized) 16%
30-Day SEC Yield 3.08%
Number of Credit Issuers 59
Fund Inception 1989

No sales charges or distribution fees

Investment Manager: Dodge & Cox, San Francisco. Managed by the U.S. Fixed Income Investment Committee, whose nine members’ average tenure at Dodge & Cox is 20 years.

PORTFOLIO CHARACTERISTICS

Effective Duration (years) 4.2

BBG Barclays U.S. Agg 5.7

FIVE LARGEST CREDIT ISSUERS (%) (b)

Charter Communications, Inc. 2.3
Wells Fargo & Co. 1.9
HSBC Holdings PLC 1.8
Petroleos Mexicanos 1.8
Verizon Communications, Inc. 1.7

CREDIT QUALITY (%) (e)(f)

U.S. Treasury/Agency/GSE 44.5
AAA 2.8
AA 5.9
A 6.8
BBB 32.3
BB 6.0
B 0.0
CCC 0.0
Net Cash & Other(e) 1.7

MATURITY DIVERSIFICATION (%)

0-1 Years to Maturity 5.4
1-5 42.4
5-10 34.2
10-15 2.6
15-20 6.1
20-25 2.1
25 and Over 7.3

SECURITY QUALITY (%) (c)

U.S. Treasury 7.1
Government-Related 5.5
Securitized 44.3
Corporate 41.5
Net Cash & Other 1.7

SECTOR DIVERSIFICATION (%)

U.S. Treasury 39.5
Government-Related 5.8
Securitized 29.7
Corporate 25.0
Net Cash & Other 0.0

Net Cash & Other (e) 1.7%
InVESTMENT COMMENTARY

During the second quarter, the broad U.S. investment-grade fixed income market posted its strongest quarterly return in almost eight years, fueled by price gains associated with plunging Treasury yields. The yield on the 10-year Treasury note, for example, has fallen by more than a full percentage point since November 2018. This decline reflects increased worries over trade tensions and slowing economic growth, as well as anticipation that the Federal Reserve will cut interest rates in the second half of the year.

The ongoing U.S.-China trade war has reverberated throughout the global economy, exacerbating the slowdown in China and hurting growth in Europe, which was already suffering from the effects of the Brexit saga. Trade tensions escalated in the second quarter as negotiations between the United States and China collapsed, and President Trump threatened to impose additional tariffs. However, at the end of June both governments agreed to resume trade talks. While the economic expansion in the United States is poised to become the longest on record, signs of deceleration have emerged as recent manufacturing, inflation, and consumer confidence data were weaker than expected.

As widely anticipated, Fed officials held their benchmark interest rate steady in the second quarter. However, policymakers shifted from the patient stance they had adopted earlier in the year to a more dovish outlook. Citing growing risks to the economy from escalating trade tensions as well as below-target inflation, Fed Chairman Jerome Powell strongly suggested the Fed would cut rates as early as July.

The investment-grade Corporate sector returned 4.5%\(^3\) for the quarter, outperforming comparable-duration\(^4\) Treasuries by one percentage point. Despite concerns about slowing global growth, credit markets have been supported by generally healthy corporate earnings, the Fed’s dovish tilt, and investors’ reach for yield. Meanwhile, Agency MBS returned 2.0%, underperforming comparable-duration Treasuries by 0.4 percentage points as the pace of prepayments increased with the decline in mortgage rates.

We made a number of modest adjustments to the Fund’s positioning over the period. Within credit, we initiated a position in HCA, a large, for-profit hospital company, and added to Ultrarapid, a leading Brazilian fuel distributor, at attractive valuations; however, the Fund’s overall weighting in credit declined two percentage points as we opportunistically trimmed certain holdings and others matured. Within MBS, we added Agency 30-year 4.5% coupon securities as relative pricing became more compelling. Amid these changes, we maintained the Fund’s defensive duration position, reflecting our longer-term expectations for interest rates to rise more than is implied by current market valuations.

Overall, we remain optimistic about the long-term prospects for the Fund. Thank you for your continued confidence in Dodge & Cox.

SECOND QUARTER PERFORMANCE REVIEW

The Fund underperformed the Bloomberg Barclays U.S. Agg by 0.3 percentage points during the quarter.

KEY DETRACTORS FROM RELATIVE RESULTS

- The Fund’s below benchmark duration position (75% of the Bloomberg Barclays U.S. Agg’s duration) hampered relative returns as Treasury yields plunged.
- The Fund’s Agency MBS holdings underperformed the MBS in the Bloomberg Barclays U.S. Agg after adjusting for duration differences.
- Certain credit issuers underperformed, including Pemex and TC Energy.

KEY CONTRIBUTORS TO RELATIVE RESULTS

- The Fund’s overweight to corporate bonds and underweight to U.S. Treasuries added to relative returns given the outperformance of credit.
- Security selection within credit was positive as several non-U.S. domiciled issuers performed well, including Enel, Petrobras, Rio Oiltanking Trust, and Telecom Italia.
- Despite the overall decline in rates, the Fund’s lower exposure to long-term (10+ years) bonds added to relative returns as the long end of the yield curve declined less than the curve on average.

YEAR-TO-DATE PERFORMANCE REVIEW

The Fund outperformed the Bloomberg Barclays U.S. Agg by 0.5 percentage points year to date.

KEY CONTRIBUTORS TO RELATIVE RESULTS

- Security selection within credit was positive as several issuers performed well, including Citigroup capital securities, Cemex, Enel, Petrobras, and Rio Oiltanking Trust.
- The Fund’s overweight to corporate bonds and underweight to U.S. Treasuries added to relative returns given the outperformance of credit.
- Despite the overall decline in rates, the Fund’s lower exposure to long-term (10+ years) bonds added to relative returns as the long end of the yield curve declined less than the curve on average.

KEY DETRACTORS FROM RELATIVE RESULTS

- The Fund’s below benchmark duration position (74% of the Bloomberg Barclays U.S. Agg’s duration) hampered relative returns as Treasury yields plunged.
- The Fund’s Agency MBS holdings underperformed the MBS in the Bloomberg Barclays U.S. Agg after adjusting for duration differences.

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 and/or interest income but, unlike Fund returns, do not reflect fees or expenses. The Bloomberg Barclays U.S. Aggregate Bond Index is a widely recognized, unmanaged index of U.S. dollar-denominated investment-grade fixed income securities.

2 Sector returns as calculated and reported by Bloomberg.

3 Duration is a measure of a bond’s (or a bond portfolio’s) price sensitivity to changes in interest rates.

4 The U.S. Government does not guarantee the Fund’s shares, yield, or net asset value. The agency guarantee (by, for example, Ginnie Mae, Fannie Mae, or Freddie Mac) does not eliminate market risk.

5 Denotes Fund positioning at the beginning of the period.

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Before investing in any Dodge & Cox Fund, you should carefully consider the Fund’s investment objectives, risks, and charges and expenses. To obtain a Fund’s prospectus and summary prospectus, which contain this and other important information, visit dodgeandcox.com or call 800-621-3979. Please read the prospectus and summary prospectus carefully before investing.

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