

# Select Fund Commentary



## Portfolio Management



**Bill Dierker, CFA**  
Manager



**Chuck Bath, CFA**  
Assistant Manager



**Chris Welch, CFA**  
Assistant Manager

The Fund increased 8.54% (Class A, without sales charge) in the fourth quarter, outperforming the Russell 3000 Index, which was up 5.90%.

For the third straight quarter, all sectors provided positive contributions to return, with our investments in the health care, energy, and consumer staples sectors providing the highest contributions to return.

In the health care sector, many positions enjoyed strong performance as it seemed likely that the U.S. Government's reform of the health care system would be less ambitious and less costly than earlier versions of the bill. Our position in medical device maker, Medtronic, Inc., provided the highest contribution to return. During the quarter, Medtronic reported solid earnings with revenue exceeding street expectations. In addition, the company showed gross margin improvement, while maintaining their research and development spending. As a result, Medtronic's management raised their earnings guidance for fiscal year 2010. Our position in health care service provider, UnitedHealth Group, Inc., rose during the quarter, as it became clearer that the new health care legislation would not likely have a government run "public option."

In the energy sector, our positions in exploration and production companies performed well, as commodity prices increased modestly during the quarter. Specifically, our position in Cimarex Energy Co. was a top contributor to performance, as it

continues to see increasing production growth visibility lead by productivity gains in the Cana Shale and Gulf Coast regions. Additionally, our position in Apache Corp. provided positive contribution to return. However, our position in oil and gas equipment maker, Exterran Holdings, Inc., provided negative contribution to results. During the quarter, Exterran reported weaker than expected pricing resulting from reduced activity levels of oil exploration and production companies.

In the consumer staples sector, our position in food wholesaler, Sysco Corp., provided the highest contribution to return. During the quarter, Sysco reported earnings that were better than expected with rising gross profit margins and decreasing operating expenses. In addition, Sysco's management made encouraging comments that deflation is moderating, sales volumes are stabilizing; and, they are focusing on taking market share from weaker, more leveraged competitors.

Other top contributors included software maker, Microsoft Corp., and diversified manufacturer, United Technologies Corp. Microsoft benefited from positive early reviews on its new Windows 7 operating system and greater than expected cost cutting. United Technologies benefited cost cutting, solid earnings, stabilizing order rates for most of its business, and improvement in the Asian markets, including China.

During the quarter, we eliminated our position in drug manufacturer, Schering-Plough Corp., and used the proceeds to initiate a position in drug manufacturer, Merck & Co., Inc. These positions were swapped prior to their merger, because the arbitrage spread between the deal value and market value was extremely narrow, and we saw Merck as an attractive investment. We also eliminated our position in payments and travel company, American Express Co., which was approaching our estimate of intrinsic value, and used the proceeds to initiate a position in insurance company, Prudential Financial, Inc. Dur-

## Performance Update

Period & Average Annual Total Returns as of December 31, 2009

	Fourth Quarter	One Year	Three Years	Five Years	Since Inception (12/30/05)	Total Expense Ratio
<b>PERFORMANCE AT NAV</b> <i>without sales charges</i>						
Class A Shares	8.54%	32.26%	-2.03%	—	1.68%	1.31%
Class C Shares	8.36%	31.86%	-2.78%	—	0.97%	2.06%
Class I Shares	8.67%	33.63%	-1.63%	—	2.08%	0.92%
<b>BENCHMARK</b>						
Russell 3000 Index	5.90%	28.34%	-5.42%	—	-0.53%	—
<b>PERFORMANCE AT POP</b> <i>includes sales charges</i>						
Class A Shares	3.09%	25.63%	-3.69%	—	0.38%	1.31%
Class C Shares	7.36%	30.86%	-2.78%	—	0.97%	2.06%



# Select Fund Commentary (cont'd)



ing the quarter, American Express rose as it reported significant declines in net charge offs and its cardholders began to increase their spending. Early in the quarter, Prudential declined over confusion about their earnings outlook for the fourth quarter and 2010. Viewing this sell off in Prudential as unjustified, we used the opportunity to initiate a position in this name at a significant discount to intrinsic value. Finally, we initiated a position in insurance company, Assured Guaranty Ltd., which completed an equity offering that strengthened its competitive position and was trading at a significant discount to intrinsic value. We eliminated our position in credit services company,

Alliance Data Systems Corp., as its price approached our estimate of intrinsic value.

As it relates to our largest sector exposures, we still feel very good about our energy and health care holdings based upon the fundamental outlook and adequate margins of safety. While we remain underweighted in financials, we added to certain financial names in the fourth quarter. Our purchases were focused on names where the margin of safety was sufficient in addition to the fact that the positions we added to (or increased) have very strong balance sheets.

## Mentioned Securities and Respective Weights as of December 31, 2009

Alliance Data Systems Corp.	–	Exterran Holdings, Inc.	1.4%	Schering-Plough Corp.	–
American Express Co.	–	Medtronic, Inc.	3.5%	Sysco Corp.	3.3%
Apache Corp.	3.5%	Merck & Co., Inc.	2.0%	United Technologies Corp.	3.3%
Assured Guaranty Ltd.	2.5%	Microsoft Corp.	2.9%	UnitedHealth Group, Inc.	2.4%
Cimarex Energy Co.	2.1%	Prudential Financial, Inc.	1.8%		

Views and opinions regarding the investment prospects of our portfolio holdings and funds are “forward looking statements” which may or may not be accurate over the long term. While we believe we have a reasonable basis for our opinion, actual results may differ materially from those we anticipate. Information provided in this report should not be considered a recommendation to purchase or sell any particular security. We cannot assure future results. You should not place undue reliance on forward-looking statements, which speak only as of the date of this report. We disclaim any obligation to update or alter any forward-looking statements, whether as a result of new information, future events, or otherwise.

The portfolio holdings are subject to change. Performance is not guaranteed. ***The performance data quoted represents past performance; past performance does not guarantee future results. The investment return and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Investors should consider the investment objectives, risks, and charges and expenses of the Diamond Hill Funds carefully before investing. This and other information about the Funds is in the prospectus, which can be obtained at [www.diamond-hill.com](http://www.diamond-hill.com). Read the prospectus carefully before you invest. The Funds' current performance may be lower or higher than the performance data quoted. Investors may obtain performance information current to the last month-end, within 7 business days, at [www.diamond-hill.com](http://www.diamond-hill.com).***

The Russell 3000 is a widely recognized unmanaged market-capitalization weighted index measuring the performance of the 3,000 largest U.S. companies based on total market capitalization. The Russell 3000 does not take into account the deduction of expenses associated with a mutual fund, such as investment management and accounting fees. One cannot invest directly in an index. Unlike mutual funds, the index does not incur expenses. If expenses were deducted, the actual

returns of this index would be lower.

Performance returns assume reinvestment of all distributions. Average annual total returns illustrate the annual compounded returns that would have produced the cumulative total return if the Fund's performance had remained constant throughout the period indicated. Returns for the periods less than one year are not annualized. The total return figures for the Funds do not reflect the applicable sales charge for each class. These total return figures may reflect the waiver of a portion of a Fund's advisory or administrative fees for certain periods. In such instances, and without such waiver of fees, the total returns would have been lower. The investment return and net asset value will fluctuate, so that an investor's shares, when redeemed, may be worth more or less than the original purchase price. Class I and Class C shares include performance based on Class A shares, which was achieved prior to the creation of Class I and Class C shares. Class C returns have been restated for sales charges and for fees applicable to Class C shares, which includes a 1.00% 12b-1 fee.

Investors should consider the investment objectives, risks, and charges and expenses of the Diamond Hill Funds carefully before investing. This and other information about the Funds is in the prospectus, which can be obtained at [www.diamond-hill.com](http://www.diamond-hill.com). Read the prospectus carefully before you invest. Diamond Hill Capital Management, Inc., a registered investment adviser, serves as Investment Adviser to the Diamond Hill Funds and is paid a fee for its services. The Diamond Hill Funds are distributed by BHIL Distributors, Inc. (Member FINRA), an affiliated company. Investors may obtain a copy of the current prospectus at 888-226-5595 or [www.diamond-hill.com](http://www.diamond-hill.com). Like all mutual funds, Diamond Hill Funds are not FDIC insured, may lose value, and have no bank guarantee.