



# Strategic Income Fund Commentary



## Portfolio Management



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The Fund generated a 3.68% total return (Class A without sales charge) during the fourth quarter, outperforming the Merrill Lynch US Corporate, Government and Mortgage Index. The Index return was 0.03%. For the year, the Fund generated a 32.12% total return compared to a 5.24% total return for the Index. For the trailing five-year period, the Fund generated a total return of 3.90% per year compared to 5.08% per year for the Index and 0.81% per year for US stocks, as measured by the Russell 3000 Index.

While credit sensitive sectors – such as corporate bonds and preferred securities – that are the focus of the Fund continued to perform well in the fourth quarter, US Treasury securities came under pressure. During the quarter, the 10-year Treasury yield increased 53 basis points from 3.31% to 3.84%, while the 2-year Treasury yield increased 19 basis points from 0.95% to 1.14%. In contrast, the option-adjusted spread of the Merrill Lynch U.S. Corporates, BBB Rated Index, which began the

year at 784 basis points, declined from 306 basis points to 248 basis points during the fourth quarter. This spread was under 150 basis points from the fourth quarter of 2003 until the third quarter of 2007.

As we have noted throughout the year, corporate credit quality has improved dramatically, but much of that improvement is now reflected in more normal credit spreads. Corporate bonds and preferred securities still seem attractive relative to US government bonds, agency bonds, and agency mortgage-backed securities. We continue to believe, however, that it is increasingly important to monitor interest rate risk. With the declining impact of fiscal stimulus, as well as the potential end to quantitative easing and the near-zero Federal Funds rate ahead, we expect higher levels of volatility as the year progresses.

Over the last several years, the Fund's asset allocation has

## Performance Update

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

	Fourth Quarter	One Year	Three Years	Five Years	Since Inception (9/30/02)	Total Expense Ratio
<b>PERFORMANCE AT NAV</b> <i>without sales charges</i>						
Class A Shares	3.68%	32.13%	2.35%	3.90%	7.07%	1.10%
Class C Shares	3.60%	31.34%	1.62%	3.13%	6.36%	1.85%
Class I Shares	3.78%	32.69%	2.75%	4.30%	7.35%	0.71%
<b>BENCHMARK</b>						
Merrill Lynch US Corporate, Government, & Mortgage Index	0.03%	5.24%	6.19%	5.08%	4.89%	—
<b>PERFORMANCE AT POP</b> <i>includes sales charges</i>						
Class A Shares	0.06%	27.51%	1.15%	3.16%	6.55%	1.10%
Class C Shares	2.60%	30.34%	1.62%	3.13%	6.36%	1.85%



# Strategic Income Fund Commentary *(cont'd)*

evolved. In our current view, the Fund's year-end allocations to investment grade corporate bonds (62% of net assets), non-investment grade corporate bonds (25% of net assets), preferred securities (6% of net assets), and cash (7% of net assets) are close to baseline allocations. (Note that approximately 13 percentage points of the non-investment grade corporate

bond allocation is rated investment grade by one of the major ratings agencies.) We continue to maintain a large position in financial services credits across all sectors in the Fund.

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 Merrill Lynch US Corporate, Government, & Mortgage Index includes a mixture of government bonds, corporate bonds and mortgage pass through securities of investment grade quality, having a maturity greater than or equal to one year. The Merrill Lynch US Corporate, Government, & Mortgage Index does not take into account the deduction of expenses associated with a mutual fund, such as investment management and accounting fees. 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. The Merrill Lynch US Corporate BBB Rated Index tracks the performance of US dollar denominated investment grade debt publicly issued in the US domestic market by US and non-US corporations including all securities rated BBB1 through BBB3 with

qualifying securities having at least one year remaining term to final maturity, a fixed coupon schedule and a minimum amount outstanding of \$250 million. 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.

The maximum sales charge for A shares is 5.00%; C shares have a maximum contingent deferred sales charge (CDSC) of 1.00% for redemptions within the first year of purchase; I shares have no sales charge. Past performance is no guarantee of future results.

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.