Diamond Hill Core Bond Strategy

As of September 30, 2020

All Composite returns are net of fees.

The Composite increased 1.32% during the third quarter, compared to a 0.62% increase for the Bloomberg Barclays U.S. Aggregate Index. Since its inception, the strategy has generated a total return of 4.60% compared to 3.72% for the Index. The goal of the Diamond Hill Core Bond strategy is to outperform the Index over a market cycle.

We are entering the final quarter of what has been a historically destructive and disruptive year in the financial markets. Although the third quarter of 2020 provided a brief respite from the volatility and uncertainty of the first two quarters, the relief of nearing the end of this unprecedented year is tempered by the potential for a contested U.S. presidential election, ongoing political maneuvering for additional stimulus from the federal government for both the consumer and various industries and the re-emergence of geopolitical risks like Brexit. Regardless of how long it takes to determine a winner, we should have an idea of who will be running the country over the next four years by the time we put together the next installation of this commentary. But there are expectations for continued volatility as the country sorts through this most unique election. Early in the third quarter, markets moved based on potential resolution to additional stimulus, even as each step forward was followed by two steps back. Near the end of the quarter, daily updates about House Speaker Nancy Pelosi and Treasury Secretary Steve Mnuchin were met with disdain, as expectations faded for agreement on stimulus. Though assumptions were that something would eventually get done, the final composition of stimulus remained unclear. Who would have thought that the future of Brexit would hinge on fishing rights? Obviously, there's much more to the impasse between the European Union and the United Kingdom, but fishing rights have moved to the forefront amongst other issues. U.K. Prime Minister Boris Johnson earmarked October 15 as a deadline for resolution to outstanding issues and the market sees the showdown as just more noise in the ongoing drama that is Brexit.

TEAM

Henry Song, CFA
Portfolio Manager

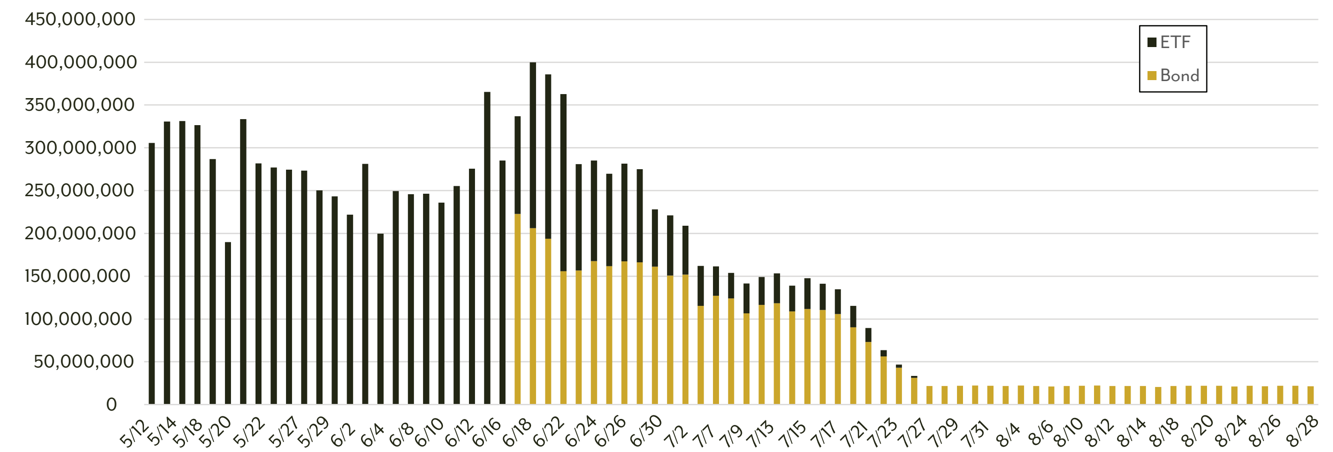
Mark Jackson, CFA
Portfolio Manager

Douglas Gimple
Senior Portfolio Specialist

The jobs market continues its recovery, though the pace has slowed from the significant jump in the second quarter, fueled by 7.5 million jobs added in May and June. In July, August and September, a combined 3.9 million jobs were added, with the three months ranking in the top six non-farm payroll reports since 1980. Since lockdowns began in March and the economy slowly began re-opening gradually over the past several months, the economy is still down a net 10.7 million jobs. Unemployment continues to grind lower, from the historic peak of 22.8% in April to September's report of 12.8%.

The Federal Reserve continues to provide support to the financial markets through the Secondary Market Corporate Credit Facility (SMCCF), though the pace of purchases continues to slow. Despite having $250 billion pledged to purchase both corporate bonds and ETFs on the secondary market, available data as of September 8 shows that the SMCCF has only deployed roughly 5.1% of the allotted funds. Purchases have focused in the ETF space, totaling roughly $8.6 billion compared to the bond holdings of $4.0 billion. ETF purchases dominate the total holdings despite the SMCFF's decision to halt purchasing ETFs in late July. The Primary Market Corporate Credit Facility (PMCCF) remains untapped, with the $500 billion pledged to this facility going unused.

CORPORATE BOND PURCHASES BY THE FEDERAL RESERVE



Source: Federal Reserve.

Not only has the Fed extended the perceived support for the corporate market by extending the SMCCF and PMCCF to the end of the year, individual members of the Fed have been delivering speeches at a nearly unprecedented level. Prior to September, the Fed averaged roughly 29 speeches/appearances on a monthly basis but in September, Fed members ramped up their communications to the tune of 49 speeches and appearances, nearly twice the year-to-date run rate. Meeting topics ranged from John Williams discussing the impacts of COVID-19 in a webinar, Raphael Bostic discussing racial injustice or Neel Kashkari addressing "Too Big to Fail." The topics covered throughout the month of September demonstrate the Fed's focus on the impacts of COVID on the U.S. economy as well as its approach to social issues such as racial injustice.

If one were to just look at the yield curve at the beginning of the quarter and the end of the quarter, there wouldn't be much change as the 10-year Treasury moved from 0.71% to 0.69%. and the 30-year Treasury moved from 1.48% to 1.46%. But looking at the movement during the quarter, the 10-year Treasury traded within a range of 0.51% and 0.75% and the 30-year traded within a range of 1.19% to 1.51%. The biggest shift in yields occurred in the middle of August as a result of a less-than-enthusiastic auction of 30-year bonds as the market seemed overwhelmed with the $26 billion issuance followed closely by $25 billion in issuance of the 20-year bond a few days later. Reflecting the clearly communicated 'lower for longer' mandate from the Fed, the shorter end of the curve was unchanged quarter over quarter with the 3-month, 6-month, 1-year, 2-year and 3-year Treasuries finishing at the same yield levels at which they started. Despite the aforementioned volatility in mid-August, the shape of the curve held constant as the volatility was felt all across the curve with some slight steepening with the longer end moving higher.

After whipsawing around over the first two quarters of the year, the fixed income markets stabilized in the third quarter. Credit, both investment grade and high yield, led the fixed income markets as the continued implied support from the federal government kept spreads grinding tighter.

The Treasury market performance during the third quarter illustrated the impact of historically low rates and minimal movement in yields during the quarter. As long as the Treasury curve remains anchored in this historically low trading range, expectations are for minimal returns going forward with minimal principal return and marginal coupon returns. The middle part of the Treasury curve carried the Bloomberg Barclays Treasury Index, with the five-year Treasury (0.18%) leading the way followed by the three-year Treasury (0.12%) and the ten-year Treasury (0.06%) during the quarter. Treasury positioning was slightly additive during the previous quarter.

The strategy's duration has been maintained within our targeted range of +/-10% of the benchmark's duration. The strategy finished the quarter at a slightly shorter duration posture than the benchmark, 5.74 years compared to 6.12 years. Rates remained stagnant from the beginning of the quarter to the end of the quarter, with some volatility throughout the quarter. The strategy's duration positioning relative to the benchmark detracted slightly from performance during the quarter.

Positive performance in the Bloomberg Barclays U.S. Corporate Bond Index was driven by performance in the first month of the quarter as July delivered a 3.25% return followed by back-to-back negative months (August-1.38% and September -0.29%). Issuance has not slowed down in the investment grade corporate space; September marked the sixth time in seven months that issuance broke a monthly record, with September's $162.7 billion pushing past September 2019's $158 billion. July is the only month since March that did not set a new record for the respective month. Year-to-date issuance now stands at $1.5 trillion, on pace to shatter issuance records. From a credit quality standpoint, BBB-rated corporate bonds were the strongest performing, delivering 2.00%, A-rated credit delivered 1.13%, followed by AAA-rated at 1.09% and AA-rated at 0.82%. From an excess return standpoint, the credit quality segments followed nearly the same pattern; BBB (1.86%), AAA (1.03%), A (1.00%) and AA (0.73%). From a sector standpoint, industrials was the strongest performer on a total return basis, gaining 1.63%, followed by financials (1.41%) and utilities (1.38%). Security selection in the corporate bond sector was strong, with performance roughly in line with the corporate allocation in the benchmark. An underweight position relative to the benchmark led to slight detraction in relative performance.

The Bloomberg Barclays U.S. Securitized Index returned 0.24%, the eighth straight quarter of positive returns, dating back to the fourth quarter of 2018. The strategy's overweight in this sector of the market contributed to the majority of excess return during the previous quarter as areas that were under stress in the first quarter, such as asset-backed securities (ABS), continued to rebound during the third quarter. Residential mortgage-backed securities (RMBS) held in the index were the weakest sector, returning 0.11% while commercial mortgage-backed securities (CMBS) returned 1.71% driven by non-agency CMBS which generated 2.55%. Asset-backed securities gained 0.79%, continuing the rebound that began in the latter part of the second quarter as the market thawed and new issuance returned to the market. Issuance in the ABS market continued to recover with July bringing $22.1 billion to market while August felt the traditional summer slowdown with $17.5 billion. September saw the highest level of issuance since the beginning of the year with $30.6 billion in new ABS deals coming to the market, bringing the average issuance per month this year to $17.5 billion. The strategy's focus on differentiating in RMBS through the use of collateralized mortgage obligations in lieu of plain vanilla passthroughs held by the benchmark, as well as diversification beyond index-eligible ABS, contributed significantly to excess return during the quarter.

The strategy continues to search for opportunities in the marketplace while maintaining a conservative risk profile relative to the Index.

Diamond Hill Core Bond Strategy

As of September 30, 2020

PERIOD & ANNUALIZED TOTAL RETURNS (%)

Inception Date: July 31, 2016

	SINCE INCEPTION	3-YR	1-YR	YTD	3Q20
CORE BOND COMPOSITE					
Gross of Fees	4.88	6.31	7.63	7.82	1.37
Net of Fees	4.60	6.04	7.43	7.67	1.32
BENCHMARK					
Bloomberg Barclays U.S. Aggregate Index	3.72	5.24	6.98	6.79	0.62

CALENDAR YEAR RETURNS (%)

	7/31/16 - 12/31/16	2017	2018	2019
CORE BOND COMPOSITE				
Gross of Fees	-2.45	4.64	2.06	8.56
Net of Fees	-2.56	4.33	1.76	8.28
BENCHMARK				
Bloomberg Barclays U.S. Aggregate Index	-3.14	3.54	0.01	8.72

Excess return indicates the return over comparable duration Treasuries. Analytics provided by The Yield Book® Software. Diamond Hill Capital Management Inc. (DHCM) claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS Standards. Diamond Hill has been independently verified for the period 5/31/00 – 6/30/20. Diamond Hill's current verification firm is ACA Compliance Group. The verification report(s) is/are available upon request. Verification assesses whether (1) the firm has complied with all the composite construction requirements of the GIPS standards on a firm-wide basis and (2) the firm's policies and procedures are designed to calculate and present performance in compliance with the GIPS standards. Verification does not ensure the accuracy of any specific composite presentation. Diamond Hill is a registered investment adviser and wholly owned subsidiary of Diamond Hill Investment Group, Inc.; registration does not imply a certain level of skill or training. Diamond Hill provides investment management services to individuals and institutional investors through mutual funds and separate accounts. A complete list and description of all composites and policies for valuing portfolios, calculating and reporting returns, and preparing compliant presentations are available upon request. The Core Bond Composite is comprised of discretionary non-fee and fee paying non-wrap accounts with a market value over $10M managed according to the firm's Core Bond fixed income strategy. The strategy's investment objective is to maximize total return with the preservation of capital by investing in a diversified portfolio of intermediate and long-term debt securities. The portfolio generally invests at least 80% of its assets in a diversified portfolio of investment grade, fixed income securities and may invest a significant portion or all of its assets in mortgage-related and mortgage-backed securities. The portfolio will typically maintain an average portfolio duration within 20% of the duration of the Bloomberg Barclays U.S. Aggregate Index. The portfolio may invest a significant portion or all of its assets in asset-backed, mortgage-related and mortgage-backed securities at the discretion of DHCM. The Composite results reflect the reinvestment of dividends, capital gains, and other earnings when appropriate. Composite returns and benchmark returns are presented gross of withholding taxes on dividends, interest income and capital gains. Returns are calculated using U.S. Dollars. Net returns are calculated by reducing the gross returns by either the actual client fee paid or the highest stated fee in the Composite fee schedule, depending on the type of client and account, and are reduced by estimated accrued performance based fees where applicable. Only transaction costs are deducted from gross of fees returns. The Bloomberg Barclays U.S. Aggregate Index is an unmanaged index representing the U.S. investment grade fixed rate bond market, with index components for government and corporate securities, mortgage pass-through, and asset-backed securities. Our selection process may lead to portfolios that differ markedly from the benchmarks presented. Returns may be more volatile than, and/ or may not be correlated to these indices, which are for comparative purposes only. The Firm's standard fee schedule for Core Bond separate accounts is as follows: First $50,000,000 = 0.29%; Next $50,000,000 = 0.22%; Above $100 million = 0.18%. The dispersion measure is the asset weighted standard deviation of the annual portfolio returns. Only portfolios represented in the Composite for the entire year are included in the calculation. The calculation is not performed if the Composite contains 5 or fewer accounts for the full year. No alteration of composites as presented here has occurred because of changes in personnel at any time. **Past performance is not a guarantee of future results.** GIPS is a trademark of CFA Institute. CFA Institute has not been involved in the preparation or review of this report/ advertisement. Index data source: Bloomberg Index Services Limited. See diamond-hill.com/disclosures for a full copy of the disclaimer.

AS OF YEAR-END	DHCM	CORE BOND COMPOSITE			3-YR ANNUALIZED STANDARD DEVIATION (GROSS OF FEES)	
	Assets Under Management	Number of Accounts	Assets Under Management	Dispersion (Gross of Fees)	Core Bond Composite	Bloomberg Barclays U.S. Aggregate Index
2019	$23.4B	5 or fewer	$300.2M	NA [1]	2.78%	2.87%
2018	19.1B	5 or fewer	55.3M	NA [1]	NA [2]	NA [2]
2017	22.3B	5 or fewer	43.8M	NA [1]	NA [2]	NA [2]
2016	19.4B	5 or fewer	39.7M	NA [1]	NA [2]	NA [2]

[1] NA = Not Applicable

[2] Statistics are not presented because 36 monthly returns are not available.

This composite was created in July 2016.

Global Investment Performance Standards