

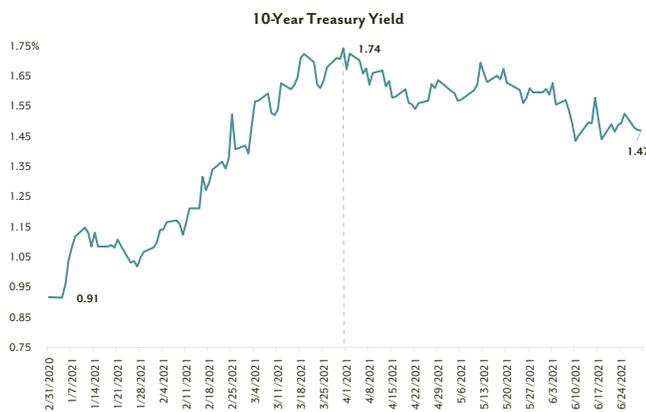
The theme for Q2 was stabilization. Stabilization in the Treasury market—following a near doubling in Q1 (0.91% to 1.74%), the 10-year Treasury yield clawed back 27 bps of yield to finish the quarter at 1.47%. Stabilization in the investment grade corporate bond market—a near-historic collapse in Q1 performance illustrated the risks of longer duration exposure. And stabilization in expectations from the Federal Reserve—who continued to beat the “transitory” and “substantial further progress” drums, albeit with a bit of a hawkish tilt in the Dot Plot.

Our portfolio delivered strong total and relative return during the quarter compared to the Bloomberg Barclays U.S. Aggregate Bond Index and has maintained a strong performance edge since its inception.

Rates

After Q1, which served as a reminder of the risks associated with longer duration assets, the Treasury market recovered some of the loss as yields retraced from the highs at the beginning of Q2 to a range between 1.43% and 1.63% in the final month of the quarter (Exhibit 1).

EXHIBIT 1: VOLATILITY REPLACED WITH STABILITY



Source: Bloomberg.

TEAM

Mark Jackson, CFA
Portfolio Manager

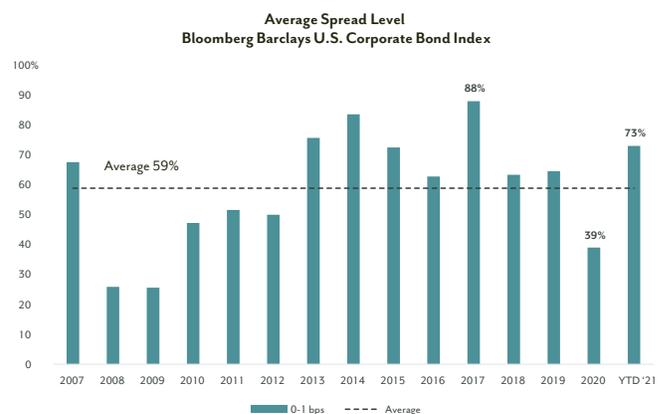
Henry Song, CFA
Portfolio Manager

Douglas Gimple
Senior Portfolio Specialist

Corporate Bond Market

Q1 brought pain to the investment grade credit markets as the Bloomberg Barclays U.S. Corporate Bond Index lost 4.65%, mostly due to the impact from rising rates and the longer duration in the corporate market. Q2 witnessed a near reversal of the damage done in Q1 as rates rallied and spreads stabilized. Further evidence that duration—the sensitivity to a bond’s price based on interest rate movements—was the main culprit for performance volatility is explained through spread movement in the first half of the year. As illustrated in Exhibit 2, the spread level on the Bloomberg Barclays U.S. Corporate Bond Index changed between 0 and 1 basis point daily more than 73% of the time during the first half of the year. This compares to only 39.0% during last year’s pandemic-driven volatility and an average of 59% since 2007. If we break down the first half of this year further, Q2 saw an even more tranquil investment grade corporate market, experiencing a daily change in spread between 0 and 1 basis point 87.7% on trading days (Exhibit 3). So, after all the pain and noise in fixed income markets in Q1, Q2 ground to a halt from a spread standpoint. The past three months of stability are welcome but, as sailors have said since the dawn of time, it is always quietest before the storm.

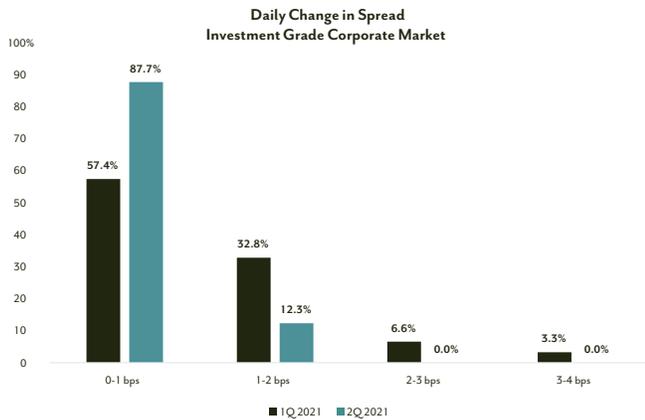
EXHIBIT 2: TRADING LIKE IT’S 2017



Source: Bloomberg.



EXHIBIT 3: Q1 VOLATILITY FOLLOWED BY A SNOOZEFEST IN Q2



Source: Bloomberg.

Issuance in the investment grade corporate market continues to run hot, with \$350 billion in new issuance coming to the market in Q2. This is slightly off the torrid pace set in 2020 (\$401 billion in new issues in Q2 2020) but brings the first half issuance to nearly \$775 billion, which is within shouting distance of last year's first half record of \$786 billion.

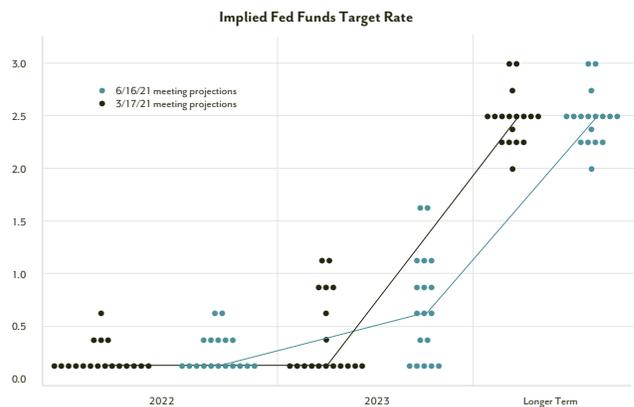
Fed Meeting

The June FOMC meeting was heralded as the most important meeting of the group since...the last meeting that they held on April 28. June's meeting was a quarterly meeting, which meant that outside of the overall rate decision, the Fed would provide its economic projections as well as the Dot Plot outlining any potential changes to the current Fed Funds rate range of 0.00% to 0.25%. While the Fed incorporated changes to its economic outlook due to the continued economic reopening and vaccine distributions, it's still willing to wait on transitory inflation and substantial further progress. Policy projections, including the Dot Plot, continue to evolve and reflect the upbeat outlook for the reemergence of the U.S. economy. GDP expectations for the year increased 50 basis points to 7.0% and the unemployment forecast came in at 4.5%.

The biggest news to come out of the meeting was the hawkish shift of the Dot Plot, the culmination of various members expectations for the future path of interest rates. Seven of the 18 members indicated that they expect rate hikes in 2022, with three members joining the four from the previous quarter's meeting. This shift was not enough to change the median expectations off the 0.125% median level for 2022, but the big news came with the projections for year-end 2023. In the March release, 11 members held fast at 0.125% through year-end 2023 but with the June release, only five participants kept expectations at 0.125% for year-end 2023, as others increased expectations for 0.375%, 0.625%, 1.125% and 1.625%. This shift in sentiment pushed the overall median expectation higher by 0.50%, from 0.125% to 0.625%.

Any discussion of tapering was put on the back burner, though it appears the Fed is finally thinking about thinking about tapering. The waiting game will continue as the markets attempt to discern if inflation is transitory and what the true definition of substantial further progress could be. With the markets already being hit by the summer doldrums, all eyes turn to Jackson Hole, Wyoming, and the Federal Reserve Policy Symposium in late August.

EXHIBIT 4: DOT PLOT



Source: Bloomberg.

The Treasury curve reversed its Q1 steepening trend as the longer end of the Treasury curve retreated from previous high levels. The Bloomberg Barclays Treasury Index rebounded from a loss of 4.25% in Q1, which was the worst quarterly performance in over 40 years, by delivering 1.75% in the second quarter as rates rallied across the longer end of the curve.

Our portfolio's duration has been maintained within our targeted range of +/- 10% of the benchmark's duration which limited the relative positive impact from the rates move in Q2, much as it limited the relative loss. The portfolio finished the quarter at a shorter duration posture than the benchmark, 5.68 years (down from 6.01 years the previous quarter) compared to 6.58 years (6.40 years the previous quarter), respectively. The portfolio's duration positioning relative to the benchmark detracted slightly from performance in Q2.

The Bloomberg Barclays U.S. Corporate Bond Index delivered strong performance in Q2, recouping some of the losses from Q1 by generating a return of 3.55% (compared to a loss of 4.65% in Q1). Longer duration assets benefitted the most as the longer end of the curve spent most of the quarter rallying lower. Utilities, the longest duration component of the U.S. Corporate Bond Index, returned 4.21%.

From a credit quality perspective, higher quality carried the quarter. The AAA segment delivered 4.74% return while the lower rated segments of the corporate market also provided strong returns—BBB returned 3.75%, AA 3.60% and A 3.23%. The combination of shorter duration in the corporate sector as well as an underweight relative to the benchmark was the strongest detractor from our portfolio's performance during the quarter.

The Bloomberg Barclays U.S. Securitized Index returned 44 bps in Q2, fueled by a rebound in the index-eligible commercial mortgage-backed securities (CMBS) space. Overall, CMBS delivered 1.87% for the quarter, with Agency CMBS (+1.97%) offsetting some of the relative underperformance of the Non-Agency CMBS segment (+1.79%). Index-eligible asset-backed securities (ABS) returned 34 bps during the quarter and outpaced comparable duration Treasuries by 24 bps. Credit cards reversed their trend as the laggard of the group, returning 59 bps in Q2. Index-eligible residential mortgage-backed securities were up 33 bps in Q2. Issuance in the ABS market continues to run hot, with \$82.3 billion in new issuance during Q2, bringing the year-to-date total to over \$150 billion in issuance.

Our portfolio's allocation to areas of the ABS market outside of the index contributed positively to performance as most of these subsectors delivered positive performance in Q2. The portfolio's differentiated focus on residential mortgage-backed securities (RMBS), investing in collateralized mortgage obligations (CMOs) and specified pools in lieu of plain vanilla passthroughs held by the benchmark, contributed to performance during the quarter as plain vanilla mortgages' performance was somewhat muted and CMOs held up well.

The portfolio 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 June 30, 2021

PERIOD AND ANNUALIZED TOTAL RETURNS

Inception Date: July 31, 2016

	SINCE INCEPTION	3-YR	1-YR	YTD	2Q21
CORE BOND COMPOSITE					
Gross of Fees	4.06	6.15	1.06	-0.78	2.07
Net of Fees	3.78	5.90	0.84	-0.90	2.00
BENCHMARK					
Bloomberg Barclays U.S. Aggregate Index	2.95	5.34	-0.33	-1.60	1.83

CALENDAR YEAR RETURNS (%)

	7/31/16 - 12/31/16	2017	2018	2019	2020
CORE BOND COMPOSITE					
Gross of Fees	-2.45	4.64	2.06	8.56	8.34
Net of Fees	-2.56	4.33	1.76	8.28	8.13
BENCHMARK					
Bloomberg Barclays U.S. Aggregate Index	-3.14	3.54	0.01	8.72	7.51

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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 registered trademark of CFA Institute. CFA Institute does not endorse or promote this organization, nor does it warrant the accuracy or quality of the content contained herein. Index data source: Bloomberg Index Services Limited. See diamond-hill.com/disclosures for a full copy of the disclaimer. Analytics provided by The Yield Book® Software.

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
2020	\$26.4B	5 or fewer	\$541.3M	NA ¹	3.71%	3.36%	
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.