

DIAMOND HILL

INVESTED IN THE LONG RUN

Large Cap Strategy

(closed to most new investors)

As of 31 Mar 2022

Market Commentary

A wild quarter in equity markets ended in the worst returns since Q1 2020. Rising inflation drove the Federal Reserve to begin its rate hiking cycle, while Putin's invasion of Ukraine sent commodity prices surging (learn more about the war's [agricultural impact](#) in our recent podcast) and an already challenged supply chain system into further disarray. After the Fed raised rates in March, some optimism crept back into markets as investors viewed the sell-off as an opportunity to gobble up stocks that sold off sharply in January and February.

The Russell 1000 Index closed the quarter down -5.13%. Returns were weaker down the market-cap spectrum as the Russell Midcap Index fell -5.68% and the Russell 2000 Index declined -7.53%. Across the cap spectrum, stocks in the value indexes held up far better than their growth index peers. The Russell 1000 Value Index outpaced its growth counterpart by 830 basis points (bps), while the Russell Midcap Value and Russell 2000 Value Indexes outpaced their growth counterparts by more than 1,000 bps each.

In the Russell 1000 Index, the energy sector advanced more than 38% as the Russia/Ukraine war and sanctions on the Russian energy sector sent oil and gas prices skyrocketing in Q1. Brent crude reached a high of \$140 per barrel in early March, a level not seen since the global financial crisis in 2008. In the US, gasoline prices jumped past \$4 per gallon, with expectations that prices could reach \$5 over the next six months. (Learn more about the [state of energy markets](#) in our latest industry perspective.) Utilities and materials stocks also posted small positive returns in Q1.

Team

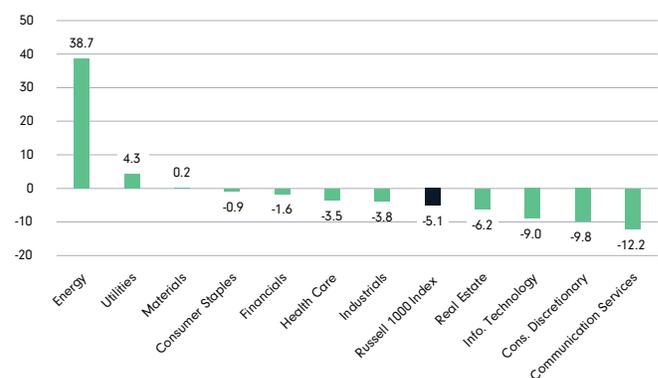
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On the downside, the communication services sector fell just over -12% this quarter, driven by declines of some of the largest media companies including Meta (-33%), Netflix (-37%), Disney (-11%) and Alphabet (-3%). The consumer discretionary and technology sectors also posted high single-digit losses in the -8% to -10% range. The remaining sectors posted declines in the -1% to -6% range.

1Q22 Russell 1000 Index Sector Returns (%)



Source: FactSet, as of 31 Mar 2022.

As of 31 Mar 2022, Diamond Hill owned equity shares of Meta Platforms, Inc. (CI A), Walt Disney Co. and Alphabet, Inc. (CI A).

Performance Discussion

During a volatile quarter, the portfolio held up better than the Russell 1000 Index by a decent margin in Q1. In the technology sector, we benefited from the relative strength of our holdings as well as our underweight exposure to a sector that took a beating in the first half of the quarter. In a similar vein, our outsized investment in the financials sector was beneficial and our stocks held up better than those in the index. We also had positive stock selection in the industrials, consumer staples and communication services sectors. The largest headwind for us in Q1 was the underperformance of our holdings in the consumer discretionary sector.

On an individual holdings basis, top contributors to return included Chevron, Archer-Daniels-Midland and Berkshire Hathaway. Multinational energy company Chevron benefited from the rise in oil prices in Q1. Its share price rose to a level that exceeded our estimate of intrinsic value and we exited our position. We redeployed capital into ConocoPhillips, which was trading at a discount to our estimate of intrinsic value and is well positioned over the long run due to its low-risk asset base.

Archer-Daniels-Midland, more commonly known as ADM, is a leader in global nutrition focused on the development of ingredients and flavors for food and beverages, supplements and more. The company's recent operating results have benefited (unfortunately) from the war in Ukraine as grain prices and agricultural markets globally experienced strong price increases. ADM is positioned well to benefit from the volatility due to its stable North American agricultural base.

Diversified holding company Berkshire Hathaway reported strong earnings during the quarter and benefited from continued share repurchases below intrinsic value. The company also announced significant deployments of excess cash during the quarter, including the acquisition of Alleghany and a large increase in its stake in Occidental Petroleum.

Other top contributors included property and casualty insurance company American International Group and copper-focused mining company Freeport-McMoRan. AIG continued to execute on its turnaround of the global property and casualty business, showing underwriting margin improvements in the quarter, while rising demand for conductive metals and supply risk concerns from Russia lifted copper prices, boosting the shares of Freeport and other copper producers.

Among our weakest stocks were Meta Platforms, General Motors and NVR. The share price of Meta (Facebook's parent company) declined significantly as the company reported a slight miss in earnings and provided guidance for a weak 1Q22. Meta also highlighted that competition from TikTok has been impacting user engagement in its apps. In our view, the company is taking the proper steps and investing heavily in ramping up its "Reels" feature, which competes with TikTok. Meta's stock is trading at a meaningful discount to our estimate of intrinsic value, and we expect the company to retain its attractive network economics and manage competition and user privacy concerns well without impairing the value of the business over the long term.

General Motors—and the auto industry in general—continues to face headwinds related to supply chain disruptions and raw material cost inflation. In addition, uncertainty surrounding global energy markets due to inflation and the conflict in Ukraine has created a greater economic burden on consumers, which tends to slow automotive sales.

NVR is a homebuilder and mortgage bank. Its stock, along with other housing stocks, came under pressure in Q1 as mortgage rates rose and concerns that continued interest rate increases will cause a slowdown in new home demand. These near-term headwinds have not impacted our long-term investment thesis, and we believe NVR is well positioned to outperform over the long run.

Other bottom contributors included private equity firm KKR & Co. and home improvement retailer Home Depot. With KKR, investors seemed concerned about the elevated valuations and leverage in private markets, especially during times of equity market volatility. In addition, while KKR's recent quarterly results were solid, the company's AUM growth was modest, and earnings were partially driven by the one-time sale of Origis Energy. In our view, the current share price implies flat AUM growth going forward, which we believe is too pessimistic. We continue to believe KKR is well-positioned to benefit from institutional investors increasing allocations to private markets and concentrating capital with managers who have strong brands and performance.

Home Depot shares underperformed as continued solid fundamental results were outweighed by concerns about the impact rising mortgage rates may have on the housing market and general inflationary pressures potentially leading to a consumer spending slowdown. We view the long-term prospects and multi-year fundamental outlook as unchanged.

Portfolio Activity

The market environment in Q1 provided a meaningful opportunity for us to initiate positions in high-quality names that sold off indiscriminately during the quarter and were trading at prices we haven't seen in quite some time. Alphabet and Amazon are two examples. Alphabet, which owns Google and other products, sold off as the expected rise in interest rates by the Federal Reserve drove what we viewed as excessive investor pessimism. We believe these headwinds are temporary and expect Google's search engine advertising, YouTube advertising and other initiatives to continue driving revenue growth over the long term.

Amazon, one of the leading providers of public cloud services and online retailing, is a rapidly growing business that has been investing heavily in infrastructure and content to improve its customer experience. These investments have obscured the magnitude of sustainable free cash flow as well as the attractive valuation of the business relative to peers.

We also initiated a position in Waste Management, one of the largest providers of waste collection services in the US. We believe it is a high-quality business with ownership of key landfill assets that provide pricing power over the long term. Its stock was trading at a discount to our estimate of intrinsic value due to short-term market concerns over an increase in growth investments—we expect these investments to be value creating over the long term.

In addition to Chevron, we exited our positions in Procter & Gamble and Public Storage as their stock prices approached our estimates of intrinsic value. We also exited our position in First Republic Bank during the quarter in favor of more attractive opportunities.

Market Outlook

After a strong rebound in 2021, global GDP growth is expected to moderate in 2022, with the potential for additional pressure from lingering supply chain disruptions, higher oil prices and other impacts from Russia's invasion of Ukraine. Despite these headwinds, corporate earnings are expected to continue making new highs in 2022.

The sharp economic rebound in the US, along with unprecedented fiscal and monetary stimulus, an uptick in wage growth and instances of supply/demand tightness, has resulted in elevated inflation levels. The Federal Reserve has started to raise interest rates and end quantitative easing but may need to be more aggressive if inflation persists at elevated levels, which could be a headwind for equity markets.

Russia's invasion of Ukraine has the potential to disrupt the flow of exports from these countries, which may impact global supplies and prices for a wide variety of end markets. The potential impact to individual businesses varies, and we are monitoring these risks closely.

While the year-to-date pullback in equity markets has created some investment opportunities, broad market valuations remain above historical averages. From current levels, equity market returns over the next five years are likely to be below historical averages.

Our primary focus is always on achieving value-added results for our existing clients, and we believe we can achieve better-than-market returns over the next five years through active portfolio management.

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Period and Annualized Total Returns (%)	Since Inception (30 Jun 2001)	20Y	15Y	10Y	5Y	3Y	1Y	YTD	1Q22
Gross of Fees	10.46	10.59	10.02	13.72	13.18	16.52	10.49	-3.18	-3.18
Net of Fees	9.87	10.01	9.47	13.16	12.65	15.98	9.98	-3.29	-3.29
Russell 1000 Index	8.79	9.42	10.26	14.53	15.82	18.71	13.27	-5.13	-5.13
Russell 1000 Value Index	7.75	8.08	7.36	11.70	10.29	13.02	11.67	-0.74	-0.74

Calendar Year Returns (%)	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Gross of Fees	6.95	-33.92	31.49	10.61	3.60	13.35	37.79	11.59	-0.18	15.27	21.09	-8.81	32.96	10.00	26.50
Net of Fees	6.37	-34.29	30.79	10.00	3.11	12.79	37.06	10.98	-0.71	14.71	20.50	-9.25	32.35	9.49	25.92
Russell 1000 Index	5.77	-37.60	28.43	16.10	1.50	16.42	33.11	13.24	0.92	12.05	21.69	-4.78	31.43	20.96	26.45
Russell 1000 Value Index	-0.17	-36.85	19.69	15.51	0.39	17.51	32.53	13.45	-3.83	17.34	13.66	-8.27	26.54	2.80	25.16

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Securities referenced may not be representative of all portfolio holdings. Contribution to return is not indicative of whether an investment was or will be profitable. To obtain contribution calculation methodology and a complete list of every holding's contribution to return during the period, contact 855.255.8955 or info@diamond-hill.com.

The views expressed are those of Diamond Hill as of 31 Mar 2022 and are subject to change without notice. These opinions are not intended to be a forecast of future events, a guarantee of future results or investment advice. Investing involves risk, including the possible loss of principal.