DIAMOND HILL

INVESTED IN THE LONG RUN

Large Cap Concentrated Strategy

As of 31 March 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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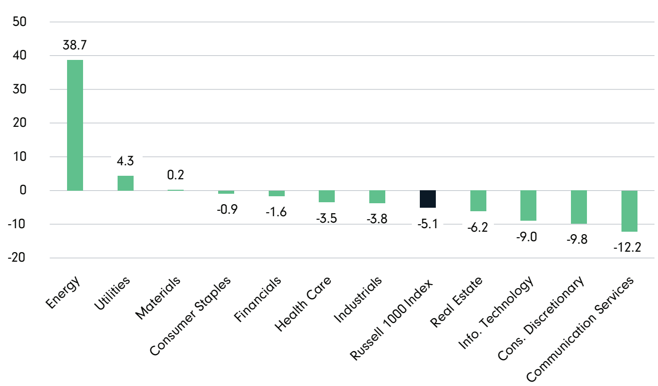
On the downside, the communication services sector fell just over -12% this quarter, driven by declines of some of the largest media companies including Meta (-33%), Netflix (-37%), Disney (-11%) and Alphabet (-3%). The consumer discretionary and technology sectors also posted high single-digit losses 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. (Cl A), Walt Disney Co. and Alphabet, Inc. (Cl A).

Performance Discussion

During a volatile quarter, the portfolio performed roughly in line with the Russell 1000 Index. 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 benefited from the strength of our lone holding in the materials sector, copper-focused mining company Freeport-McMoRan. Offsetting those positives was the underperformance of our holdings in the consumer discretionary, health care, communication services and industrials sectors.

On an individual holdings basis, top contributors to return included Chevron, Conoco Phillips, Berkshire Hathaway, American International Group and the aforementioned Freeport McMoRan. Rising demand for conductive metals and supply risk concerns from Russia lifted copper prices, boosting the shares of Freeport and other copper producers in Q1. Multinational energy companies Chevron and ConocoPhillips benefited from the rise in oil prices. In Chevron's case, 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.

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. American International Group continued to execute on its turnaround of the global property and casualty business, showing underwriting margin improvements during the quarter.

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 diversified healthcare company Abbott Laboratories. 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.

Abbott Labs announced a recall of its infant formula brand Similac® in the US. Though the recall will impact near-term revenues, we are not concerned about any long-term impacts. We remain optimistic about the company's prospects over the long run because, in our view, it is one of the highest quality names in health care with a talented management team that makes smart capital allocation decisions. Abbott also has leading health care and consumer franchises with a particularly strong competitive position in the medical device business. Abbott continues to launch innovative products in key strategic areas (such as diabetes, structural heart and diagnostics), which should help drive not only revenue growth but margin expansion.

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 is one example. 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.

We also initiated a position in Caterpillar, one of the world's leading manufacturers of construction and mining equipment. It's a company we know well, as we have owned it in our large cap portfolio for quite some time. Recent share price weakness provided an opportunity for us to add it to our large cap concentrated portfolio at an attractive discount to our estimate of intrinsic value. We believe Caterpillar stands to benefit from increased capital investment supported by a healthier/recovering end market environment, particularly in construction and mining.

In addition to Chevron, we exited our positions in consumer food and beverage products manufacturer Mondelez International and IT services provider Cognizant Technology Solutions 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.

Period and Annualized Total Returns (%)

	Since Inception (31 Dec 2011)	10Y	5Y	3Y	1Y	YTD	1Q22
Gross of Fees	14.21	13.84	13.10	16.08	9.18	-5.06	-5.06
Net of Fees	13.79	13.41	12.57	15.58	8.72	-5.17	-5.17
Russell 1000 Index	15.51	14.53	15.82	18.71	13.27	-5.13	-5.13
Russell 1000 Value Index	12.55	11.70	10.29	13.02	11.67	-0.74	-0.74

Calendar Year Returns (%)

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Gross of Fees	10.00	38.75	10.70	-0.59	19.17	19.27	-7.16	31.76	10.52	27.42
Net of Fees	9.74	37.22	10.62	-0.46	19.15	18.56	-7.63	31.18	10.03	26.90
Russell 1000 Index	16.42	33.11	13.24	0.92	12.05	21.69	-4.78	31.43	20.96	26.45
Russell 1000 Value Index	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.

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