DIAMOND HILL

INVESTED IN THE LONG RUN

International Strategy

As of 30 Jun 2022

Market Commentary

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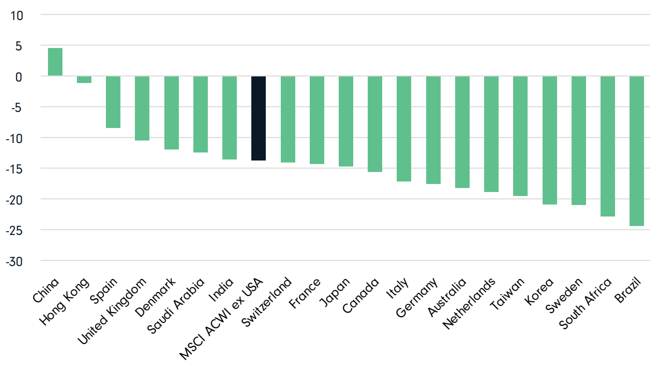
Global stocks ended a tough quarter down more than -15%, as the war in Ukraine and inflation sparked additional concerns about the economic outlook for many countries. Weakness in equity markets was widespread — developed markets were down -16% and emerging markets fell -11%. In Europe, stocks in the UK were down -10% (one of the better performing markets), while stocks in France, Germany, Switzerland and the Netherlands posted declines ranging from -14% to -18%. In Asia Pacific, Japanese stocks declined -14%, stocks in Australia fell -18% and Taiwanese stocks were down -19%. A notable exception was China where stocks advanced roughly 4.5% as the country began to lift some of its strict COVID lockdown policies and the government indicated a gradual easing of regulatory measures on the technology sector.

Brazil was among the worst performing markets with a -24% selloff. In Q1, Brazilian equities advanced more than 35%. However, the market shed a large portion of those gains in April and June as concerns over its presidential election in October, double-digit interest rates and weakness in commodity prices clouded the outlook for the second half of 2022.

In the MSCI ACWI ex USA Index, the energy sector held up the best with a -4% decline. Russia's ongoing war in Ukraine continued to support elevated oil and gas prices, and additional sanctions such as the European Union's agreement on a partial ban of Russian oil imports (plans to ban 90% of Russian oil imports by end of 2022) contributed to the higher prices. Both consumer sectors — staples and discretionary — declined -8%, while the utilities, communication services and health care sectors fell -9%. The remaining sectors posted double-digit declines with the bulk of the pain coming from the technology and materials sectors, both of which were down more than -20%.

2Q22 MSCI ACWI ex USA Index (%)



Source: FactSet, as of 30 Jun 2022.

After a decade of extraordinary market returns, it can be easy to forget that drawdowns are a part of long-term investing. And while the current environment has been a meaningful one — with a 20%-plus selloff in global markets in the 1H 2022 — it is not out of the ordinary for long-term investors. As active managers, we believe this type of environment and volatility offers opportunities for us to add value for clients who are able to withstand these types of drawdowns and stay invested over the long run.

Performance Discussion

Despite a tough quarter where few areas of the market were spared, the portfolio held up slightly better than the MSCI ACWI ex USA Index. We benefited from the outperformance of our holdings in Europe, particularly those in the UK and Switzerland. Relative results were also aided by the outperformance of our stocks in Canada and Japan, and by our lone holding in Brazil (pharmaceutical company Hypera), which held up meaningfully better than other Brazilian stocks. On the downside, weakness in our US holdings hampered relative performance. From a sector perspective, we benefited from positive stock selection in technology, financials and health care. Hindering relative results was the underperformance of our communication services holdings and our lack of investment in the energy sector, which held up the best in Q2.

On an individual holdings basis, top contributors to return included two of our UK holdings, insurance services provider Beazley and multinational consumer goods company Unilever. Beazley is the British parent company of specialist insurance businesses with operations in Europe, the US and Asia. Its shares outperformed in Q2 after the company reported solid quarterly results, which were highlighted by improving pricing and strong underwriting. Shares of Unilever jumped on news that the company appointed American activist investor Nelson Peltz as a non-executive director on its board, as investors expect increasing discipline in capital allocation with his addition.

Also among our top contributors were three of our Chinese holdings — internet commerce and services provider Alibaba, internet search provider Baidu and burial services provider Fu Shou Yuan. Our Chinese holdings in general were boosted by the improved sentiment within the country. And with the easing of the regulatory crackdown on the technology sector, Alibaba and Baidu's shares advanced nicely. Fu Shou Yuan's stock price was also supported by the broad upswing in Chinese equities.

Our bottom contributors in Q2 included Freeport-McMoRan and Spotify Technology. Copper-focused mining company Freeport-McMoRan's stock was up meaningfully in Q1 with other copper producers on rising demand for conductive metals and supply risk concerns from Russia. Despite reporting excellent Q1 results, management raised its cost guidance for the year, attributing it to rising fuel costs and inflation of other materials. Freeport's share price declined in Q2 with other large miners as copper prices declined roughly -22%, and we think the response by market participants is overdone. The company continues to generate strong free cash flow, which it has returned to shareholders in the form of dividends and buybacks. We also remain attracted to Freeport's unique exposure to high-quality copper producing mines, which is a key industrial input, particularly for green technologies, and we believe it's a strong business oriented toward strengthening end markets.

Sweden-based digital music-streaming services provider Spotify continues to execute well, with strong growth and gross margin expansion as benefits of scale and two-sided marketplace investments start to take hold. We see no fundamental reasons for its share price weakness in Q2 and believe shares have been under pressure due to general market factors including rising interest rates and the indiscriminate selloff in technology. We continue to like Spotify's unique network effect business model. More than just a streaming service, Spotify is an online audio network and two-sided marketplace platform with a dominant, and quickly expanding scale advantage. Importantly, growth is 100% company funded with internally generated cash flow, allowing Spotify to avoid the strain of relying on capital markets to invest in growth like other early-stage companies. We continue to believe there is substantial upside under normal operating conditions, as the focus gradually shifts from growth to monetization over time.

Also among our bottom contributors were global entertainment company Disney, South Korean consumer electronics manufacturer Samsung and UK-based spirits maker Diageo.

Portfolio Activity

The market volatility and general selloff has enabled us to seek out new opportunities as well as add to positions where we have the highest conviction as prices become more attractive. In Q2, we added two new positions, SAP and Smith & Nephew, to the portfolio.

SAP is a Germany-based enterprise software provider. The company's enterprise resource planning software is widely used by large businesses throughout the world, and we expect SAP will be a market leader for many years due to the stickiness of the company's software. SAP is slowly transitioning its software portfolio toward cloud-based offerings sold as subscriptions, which should lead to a better user experience over time.

Based in London, Smith & Nephew (S&N) is a global medical technology company specializing in orthopedics, sports medicine and wound healing. The adverse effects of the pandemic on hospitals and higher cost considerations accelerated the trend of elective surgeries moving to ambulatory surgical centers. S&N is uniquely positioned with enabling technologies (e.g., small-footprint, cost-effective, efficient robotics; and improved surgical workflow) to lead in this transition. In addition, the company has developed or acquired new products and technologies that are competitive and will drive at- or above-market growth in its three franchises.

To help fund these purchases and add to existing holdings, we exited our positions in Canadian telecom services provider Rogers Communications, social media company Meta Platforms and UK-based hospitality company InterContinental Hotels Group.

Market Outlook

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

With inflation impacting economies globally, central banks will continue to assess economic developments to determine when and how aggressively to raise interest rates and/or to pull back on pandemic-related stimulus. Different countries are in different phases of their economic cycles, and we expect to continue seeing various monetary policy shifts across geographies.

Non-US equity markets remain more attractive on a relative valuation basis than those in the US, providing international investors a more opportunistic pond to fish in for new investment ideas. 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 2016)	5Y	3Y	1Y	YTD	2Q22
Gross of Fees	8.09	5.56	3.94	-17.26	-16.06	-12.40
Net of Fees	7.71	5.15	3.27	-17.80	-16.33	-12.54
MSCI ACWI ex USA Index	4.75	2.50	1.35	-19.42	-18.42	-13.73

Calendar Year Returns (%)

	2017	2018	2019	2020	2021
Gross of Fees	32.22	-9.62	24.95	7.64	13.73
Net of Fees	32.22	-9.62	24.55	6.94	13.00
MSCI ACWI ex USA Index	27.19	-14.20	21.51	10.65	7.82