Large Cap Strategy

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DIAMOND HILL
A First Eagle Investments Company

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Quarterly Snapshot

Summary

The Strategy returned 3.42% (net of fees) compared to a 13.87% return for the Russell 1000 Value Index.

Performance

Stock selection in information technology, along with our underweight to the sector, was responsible for nearly all of the Strategy's underperformance in 2Q26. Stock selection in health care and industrials also detracted from relative performance. Stock selection in consumer staples, materials and consumer discretionary, along with our underweight to utilities, were the most notable contributors to relative performance.

Key Drivers

We believe above-average equity market valuations are likely to lead to below-average returns over the next five years. However, we continue to find attractive opportunities on a bottom-up basis and are confident we can achieve better-than-market returns over the next five years through active portfolio management.

Market and portfolio review

Artificial intelligence (AI), including the companies benefitting from hundreds of billions of dollars being spent to build capacity to support its adoption, continues to be the most notable theme in equity markets. Within the Russell 1000 Value Index, the information technology sector was by far the best performing sector in 2Q26 with an astounding 81% return. Industrials (+12%), real estate (+9%) and financials (+9%) also posted strong returns. Energy (-14%) was the worst-performing sector as an agreement to end the war in Iran led to a significant drop in oil prices.

Similar to recent quarters, the Strategy's technology exposure—companies we do not own, and to a lesser extent, companies we do own—continued to be the most notable detractor from relative performance. However, the magnitude was even greater with the sector driving nearly all the Strategy's underperformance in 2Q26. Not having exposure to a wide range of technology companies benefiting from AI-related capital expenditures, such as Micron, Sandisk, Western Digital and many others, was a very meaningful headwind to relative performance. Our lack of exposure to Micron alone was responsible for approximately 25% of the Strategy's 2Q26 underperformance due to its large weight in the index and enormous return. Texas Instruments provided a modest offset to this headwind, as it is finally seeing a rebound in its key industrial end market. Our software exposure continued to detract from relative performance, as uncertainty around the impact of AI continues to weigh on the industry. While this remains a risk we are monitoring closely, we still believe investors are underestimating the stickiness of Salesforce, Adobe and Microsoft products among enterprise customers, and that current valuations embed too much pessimism about their future prospects. However, we have become more concerned with the slowdown of Wix.com's core business, and we eliminated the position.

There were bright spots among our holdings, though, with a number of sectors contributing to relative performance. Within materials, Nucor is one of our few holdings that is benefitting from data center buildouts, which are driving strong demand for steel and steel-related products. In consumer discretionary, CarMax rebounded as its comparable sales improved, and Starbucks shares were strong as its turnaround is gaining traction. We eliminated Starbucks as it approached our estimate of intrinsic value. While the overall health care sector detracted from relative performance, two newer managed care holdings, Humana and Elevance, were strong contributors on better-than-expected Medicare rate increases announced in early April. These increased rates will be helpful for the industry in closing the gap between pricing and cost trends.

Key contributors

- Semiconductor and processor producer **Texas Instruments** saw shares rise after issuing 2Q26 guidance above market expectations, signaling improving demand trends, particularly in industrial and data center end markets.
- Health care services and insurance company **Humana** is a new holding in 2Q26 and the second-largest Medicare Advantage insurer in the US. Shares outperformed in 2Q26 after the company delivered strong 1Q26 results and on better-than-expected Medicare rate increases announced in early April, which will be helpful for the industry in closing the gap between pricing and cost trends.
- Shares of US steel producer **Nucor** rose as reduced import competition and supportive trade policy strengthened pricing power for domestic producers. The company also benefited from solid shipment volumes, which supported improved earnings, particularly in its steel mills segment.

Key detractors

- Shares of **Zoetis**, an animal health company, underperformed after the company reported flat organic revenue growth and lowered full-year guidance amid softer US companion-animal demand, fewer veterinary visits and a more competitive market. These results heightened concerns that slowing growth in the legacy portfolio could create a near-term earnings gap before newer pipeline products contribute more meaningfully.
- Exploration and production company **ConocoPhillips** saw shares decline after an agreement was reached to end the war between the US and Iran and reopen the Strait of Hormuz. Although the situation in the Middle East remains fragile, the market increasingly viewed the risk of a meaningful supply disruption as diminished, and the war-related risk premium that had supported US exploration and production companies earlier in the year largely dissipated.
- Shares of global information technology services company **Accenture** underperformed after the company reported weaker-than-expected results, noting that near-term demand for its services remained subdued. These results reinforced investor concerns that AI could disrupt portions of its business. However, we believe the company remains well positioned within the broader information technology ecosystem, and its valuation remains attractive relative to its long-term prospects.

New positions

- **Elevance Health** is one of the largest health insurers in the US. Along with the rest of the insurance industry, the company's margins have been pressured due to rising medical costs and lower government reimbursement. Despite these headwinds, we believe the long-term earnings power of the business is positive.
- **FedEx Freight** is a spin-off of shipping company FedEx Corp., creating a standalone less-than-truckload (LTL) carrier that is the industry's largest by revenue. The LTL industry is highly concentrated, with disciplined operators and favorable demand trends. As a standalone company, FedEx Freight should be better positioned to focus on operational execution and improve margins, where it currently trails leading competitors.
- Health care services and insurance company **Humana** is the second-largest Medicare Advantage insurer in the US. Margins have been squeezed in recent years from rising medical costs and lower government reimbursement; however, we believe margins will normalize upward over time as the company prices to reflect higher utilization and as government reimbursement rates improve. Relative to a more normal earnings base, we believe the valuation is very attractive.

Eliminated positions

- **Wix.com** is a website design software and provides "business in a box" back-end functionality to small businesses. The company's core business has experienced slowing growth due to AI-driven vibe coding, and after reporting underwhelming 1Q26 results, the company announced a reduction in force and reduced revenue growth guidance for 2026. Given the fundamental headwinds the company is facing, we exited our position to deploy capital to more attractive opportunities.
- Shares of automaker **General Motors**, electrical product manufacturer **Regal Rexnord**, coffee chain **Starbucks** and **SS&C Technologies**, a diversified provider of tech-enabled services and software to the financial services industry, were sold to allocate funds to more attractive opportunities.

Period and Annualized Total Returns (%)

	Since Inception (30 Jun 2001)	20Y	15Y	10Y	5Y	3Y	1Y	YTD	2Q26
Gross of Fees	9.58	9.21	11.04	10.74	5.74	9.51	2.89	1.26	3.58
Net of Fees	8.84	8.51	10.36	10.07	5.11	8.85	2.27	0.95	3.42
Russell 1000 Value Index	8.41	8.79	11.47	11.52	11.17	17.79	27.12	16.26	13.87
Russell 1000 Index	9.64	11.33	14.15	15.30	12.66	20.47	22.02	10.33	15.14

Calendar Year Returns (%)

	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
Gross of Fees	3.60	13.35	37.79	11.58	-0.17	15.27	21.10	-8.81	32.96	9.99	26.50	-12.83	14.37	12.74	6.19
Net of Fees	2.87	12.61	36.89	10.86	-0.82	14.57	20.37	-9.36	32.16	9.33	25.74	-13.35	13.68	12.06	5.55
Russell 1000 Value Index	0.39	17.51	32.53	13.45	-3.83	17.34	13.66	-8.27	26.54	2.80	25.16	-7.54	11.46	14.37	15.91
Russell 1000 Index	1.50	16.42	33.11	13.24	0.92	12.05	21.69	-4.78	31.43	20.96	26.45	-19.13	26.53	24.51	17.37

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