

# Long-Short Strategy

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DIAMOND HILL

INVESTED IN THE LONG RUN

**Chris Bingaman, CFA**  
Portfolio Manager

**Nate Palmer, CFA, CPA**  
Portfolio Manager

**Brian Fontanella, CFA**  
Portfolio Specialist

## Quarterly Snapshot

### Performance

The Strategy returned 5.36% (net of fees), the Russell 1000 Index returned 2.41% and the 60/40 Blended Benchmark returned 1.85%.

### Key Drivers

Stock selection in financials, information technology and consumer discretionary contributed to relative performance, while health care stock selection detracted. Our short positions in the consumer discretionary sector contributed the most to performance, while our one short position in the utilities sector detracted modestly.

### Summary

We believe above-average equity market valuations are likely to lead to long-term returns below historical averages, but we remain focused on finding individual businesses that are mispriced. If we are in a lower return equity market, alpha generation in both the long and short books is even more important to achieving satisfactory returns over time.

## Market and portfolio review

Equity markets continued to move higher in Q4, with the Russell 1000 Index increasing 2.41% to end the year up 17.37%. From a sector perspective, health care (+11.2%) was the top-performing sector this quarter, as it seemed to garner renewed investor attention given depressed valuations and several quarters of increased uncertainty. Communication services (+6.1%) was the next-best-performing sector, solely driven by the performance of Alphabet (+29%), which composes approximately 50% of the sector. Sectors that declined tended to lean defensive, including real estate (-2.8%), utilities (-1.5%) and consumer staples (-0.4%).

The strategy outperformed the long-only benchmark in Q4, helped by nearly 9 percentage points of positive long-short spread (the performance of our long positions relative to the performance of our short positions), with both the long and short portfolios adding alpha relative to the Russell 1000 Index. It was a similar story for the full year, with more than 20 percentage points of positive long-short spread, and positive long and short book alpha driving the Fund's outperformance.

While we continue to find compelling long opportunities, it has been a particularly fruitful environment for new short opportunities, as elevated expectations for a range of stocks have pushed valuations higher. In many situations, those elevated expectations have proven unwarranted, which has helped drive significant alpha among our consumer-oriented short positions, in particular.

Net exposure of 57% remains modestly below our 60% long-term average, with long exposure ending the year around 88% and short exposure around 31%. This leaves gross exposure around 120%, a level we would like to modestly increase over time. However, we will be disciplined in doing so.

### Key contributors

#### Long portfolio

- Shares of media and technology company **Alphabet** were strong in Q4 on better-than-expected artificial intelligence (AI)-driven growth, particularly in its Google Search, Google Cloud and YouTube businesses.
- **Ciena**, a networking systems company, saw shares increase meaningfully amid optimism around hyperscaler and AI-related demand. The company has also benefited from growing cloud spending, which has supported its pluggables and data interconnect business.
- **Citigroup**, a diversified global bank, outperformed in Q4 as strong Q3 results showed continued improvement in returns, driven by disciplined expense control and accelerating capital return.

#### Short portfolio

- All key contributors were long positions.

## Key detractors

### Long portfolio

- **Perrigo**, an over-the-counter (OTC) pharmaceuticals manufacturer, saw shares decline following weak results in its infant formula and European OTC businesses. Long term, the company is conducting a strategic review of its infant formula business and will refocus on consumer-oriented operations by expanding the range of products offered alongside its store-brand OTC portfolio, actions which we view positively.
- Social media platform **Meta Platforms** underperformed during the quarter due to a sharp increase in AI-related spending that was viewed unfavorably by the market.
- Shares of software and technology provider **Microsoft** declined as investors became more cautious about funding for large AI investments being made by customers, including OpenAI.

### Short portfolio

- All key contributors were long positions.

## New positions

### Long Portfolio

- **SentinelOne** is a key player in the cybersecurity space, with a strong position in endpoint security software which it has leveraged to expand into cloud data/AI security. After booming during COVID and work-from-home, sentiment is now that the growth in the number of endpoints needing security will continue to slow. While the market will not grow at the rates it had been, the market should still grow high single digits, and we believe the company will continue to take share due to its best-in-class technology.
- Diversified industrial conglomerate **Dover** is in the middle of an underappreciated transition from a merger-and-acquisition-focused holding company to a more execution-focused operating company, which we believe creates a long runway for continued margin expansion. Furthermore, recent portfolio moves have increased its exposure to higher-growth end markets, and after several years of sluggish growth, various cyclical headwinds seem likely to subside. We initiated a position with the stock trading at a significant discount to our estimate of its intrinsic value.

### Short portfolio

- School bus and parts manufacturer **Blue Bird** has seen a strong increase in profits since 2019, driven by outsized profitability on its electric school buses. However, we believe the company's profitability will be pressured moving forward due to the Trump administration's halting of federal funding for electric school buses, recent expirations for electric vehicle tax credits and structural headwinds in public school funding.
- We initiated a short position in **Pure Storage**, a provider of enterprise data storage systems and software, as we believe its recent share gains will be constrained by competitive dynamics within the storage market moving forward. In addition, we view the company's opportunity to capture hyperscaler and AI-related storage demand as limited, which tempers our longer-term growth outlook.
- **Host Hotels & Resorts**, the largest US hotel REIT, operates in an industry where benefits of scale tend to favor franchise brands over asset-heavy owners. The lodging business is also inherently exposed to labor and utility costs and carries high capital requirements. While Host's higher-end consumer is faring well currently, an economic downturn would likely pressure results as we believe franchise brands would outperform in that environment.
- US-focused crypto broker and platform **Coinbase Global** has faced both slowing momentum in its core consumer trading business and increased competition, and the company is also pivoting into more competitive areas, including equity trading and predictive markets. We believe the market is overlooking these structural and cyclical headwinds, so we initiated a short position in Q4.

## Eliminated positions

### Long portfolio

- Business process management company **WNS Holdings** was eliminated from the portfolio after its acquisition by Capgemini closed in an all-cash transaction.
- Shares of apparel retailer **lululemon**, medical supply manufacturer **Teleflex**, and media and technology company **Comcast** were sold to fund more attractive investment opportunities as the fundamentals for each were weaker than we had expected.

### Short portfolio

- All eliminated positions were long positions.

Period and Annualized Total Returns (%)	Since Inception (30 Jun 2000)	20Y	15Y	10Y	5Y	3Y	1Y	YTD	4Q25
Gross of Fees	8.91	8.11	9.74	9.80	11.87	15.75	21.07	21.07	5.62
Net of Fees	7.82	7.03	8.64	8.70	10.76	14.59	19.86	19.86	5.36
Russell 1000 Index	8.33	10.94	13.87	14.59	13.59	22.74	17.37	17.37	2.41
60%/40% Blended Index	6.01	7.45	9.01	9.78	9.64	15.50	12.12	12.12	1.85
Russell 1000 Value Index	8.02	8.32	10.78	10.53	11.33	13.90	15.91	15.91	3.81

Calendar Year Returns (%)	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
Gross of Fees	4.84	10.30	25.03	9.24	0.18	12.34	7.85	-5.46	25.15	1.41	21.40	-6.92	14.27	12.09	21.07
Net of Fees	3.90	9.30	23.91	8.26	-0.72	11.33	6.88	-6.31	24.02	0.50	20.30	-7.75	13.25	10.97	19.86
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
60%/40% Blended Index	1.22	9.75	18.93	7.86	0.75	7.33	12.92	-1.92	19.15	13.30	15.35	-10.86	17.82	16.63	12.12
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

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