

Small Cap Strategy

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DIAMOND HILL
A First Eagle Investments Company

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Quarterly Snapshot

Summary

The Strategy returned 24.04% (net of fees) and the Russell 2000 Index returned 21.49%.

Performance

Stock selection in health care and industrials were the largest relative positives while our underweight to information technology served as a relative headwind.

Key Drivers

We continue to find compelling opportunities well beyond the most crowded areas of the market. Our emphasis remains on resilient businesses serving durable, often underappreciated, sources of demand that we believe are well positioned to compound value long term.

Market and portfolio review

Small cap equities continued their strong performance during the second quarter, with the Russell 2000 Index advancing 21.49%, outpacing the Russell 1000 Index by over 6%. Robust corporate earnings, a resilient domestic economy and easing geopolitical concerns all contributed to a constructive backdrop for equities.

Technology (+56%) was by far the strongest-performing sector, driven by continued strength in semiconductors, memory and other businesses directly benefiting from Artificial Intelligence (AI)-related capital spending. Health care (+25%) was also strong as improving trends and increased merger activity supported the sector following an extended period of weakness. Meanwhile, declining oil prices weighed on energy (-10%), making it the only sector to post negative returns during the quarter, while utilities were flat and lagged the broader market.

While the headlines may be heavily dominated by AI-related narratives, outperformance in the quarter was driven by business selection and strong results by holdings that are well outside the AI theme. Health care has been an area of increasing conviction for us over the past several years despite persistent negative sentiment. We have steadily increased our exposure—adding nearly 800 basis points over the past 12 months—as we continue to find businesses supported by durable, long-term demand that we believe the market is underappreciating. That conviction was rewarded during the quarter, with several of our largest contributors coming from health care. Outside of health care, defense-oriented and tangible-asset businesses also drove strong performance in the portfolio.

On the flipside, the largest relative headwind was our underweight to the information technology sector, which was by far the top-performing area during the quarter. Rather than attempting to forecast which technologies or business models ultimately emerge as long-term winners or losers, we have generally preferred to invest where the range of outcomes is narrower, and we feel more comfortable with the individual business risks that we are underwriting. Energy-related holdings also gave back some of their strong first-quarter gains as oil prices retreated alongside easing geopolitical concerns.

Beyond health care, we continue to find attractive opportunities in businesses tied to infrastructure investment, defense modernization and other essential industries where demand remains supported by long-term structural trends. While these businesses may not command the same attention as the latest AI beneficiaries, we believe they offer something equally valuable: durable demand, strong competitive positions, disciplined capital allocation and management teams aligned with long-term owners.

Our positioning continues to reflect this philosophy. We remain focused on resilient businesses capable of navigating a wide range of economic environments while maintaining the flexibility and financial strength to invest through periods of uncertainty. We continue to find an attractive opportunity set among smaller, underfollowed businesses where volatility has created compelling entry points. We believe careful business selection and disciplined ownership remain the best defense against permanent capital impairment and continue to see a compelling opportunity to compound capital through patient, long-term investment in resilient small businesses.

Key contributors

- **Astrana Health**, a leader in value-based health care, outperformed as the company results have continued to demonstrate that it was not taking advantage of loopholes within Medicare coding, the balance sheet is back in good shape after the recent Prospect Health acquisition, which is performing well, and recent Medicare Advantage rates came in better than expected.
- Shares of aerospace and defense manufacturer **Ducommun** rose as both of its primary end markets strengthened simultaneously for the first time in years. Missile revenue increased by nearly a quarter, supported by funded Department of Defense contracts calling for substantial production increases, while commercial aerospace returned to growth following a prolonged period of lower activity.
- **Ryman Hospitality Properties**, a group-lodging focused REIT, saw shares rise in the quarter as the company continues to demonstrate the stability of its cash flow generation. Ryman also reported it had engaged an investment bank to explore the sale of Opry Entertainment Group after receiving multiple inbound inquiries. The plan has always been that Opry Entertainment would not be part of Ryman long term, but this may potentially speed up value realization of that asset.

Key detractors

- Exploration and production company **Magnolia Oil & Gas** 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.
- **United States Lime & Minerals**, a producer and supplier of limestone products, underperformed as several near-term headwinds—weather disruptions, labor shortages and higher fuel costs—pressured demand and margins. Despite these challenges, the company's scarce limestone reserves in Texas continue to support strong pricing power, and we maintain a constructive long-term view for the business.
- **Silvercrest Asset Management**, an independent asset manager serving high-net worth families and institutional investors, saw shares decline as continued client outflows and elevated compensation costs weighed on profitability and overshadowed the company's strong long-term investment performance and efforts to expand its institutional business.

New positions

- We initiated a position in **Insteel Industries**, the nation's largest manufacturer of steel wire reinforcing products for concrete construction. We believe the company is well positioned to benefit from durable infrastructure and data center spending, as well as the ongoing adoption of labor-saving reinforcing solutions. Recent acquisitions have strengthened Insteel's competitive position and geographic footprint, while its debt-free balance sheet provides flexibility to pursue additional growth opportunities and return capital to shareholders.
- Cell and gene therapy products and services supplier **BioLife Solutions** provides essential materials used to manufacture, store and transport living human cells. The company's biopreservation media are supported by FDA Master Files and embedded across approved therapies and clinical trials. We initiated a position as we believe the company enjoys a distinct advantage over other players in the space, as switching providers can be difficult due to validation requirements, regulatory filings and manufacturing processes.
- **InfuSystem** provides medical device management services, primarily supporting ambulatory infusion pumps used in cancer treatment, handling equipment logistics, maintenance and insurance reimbursement. We initiated a position as we believe the company benefits from a difficult-to-replicate payer network, improving profitability driven by operational efficiencies and a favorable product mix, and a strong balance sheet that supports disciplined capital allocation.
- **FreightCar America** manufactures railcars for the North American freight market. We initiated a position in 2Q26 as we believe the company is well positioned to benefit from an aging railcar fleet that will require replacement as well as improving industry pricing. Additionally, the company's vertically integrated manufacturing operations provide a cost and delivery advantage, while recent margin improvement reflects operational progress.
- We initiated a position in **Daktronics**, a leading provider of LED video displays and digital signage, based on our view that the company has a strong competitive position supported by longstanding customer relationships and proprietary software. We believe new leadership, improved corporate governance and a focus on operational execution create an opportunity to improve profitability, while its debt-free balance sheet and cash generation provide financial flexibility.

Eliminated positions

- **Avanos Medical**, a medical technology company focused on GI tube feeding and non-opioid pain management solutions, was acquired by American Industrial Partners, an operationally focused private equity firm, in an all-cash transaction.
- **Cimpress**, a technology-enabled mass-customization company that makes personalized print and promotional products for small businesses, is a position we had been trimming as the discount to intrinsic value was narrowing and fully exited to initiate our new position in FreightCar America.
- Pressure exchange manufacturer **Energy Recovery** was sold to allocate funds to more attractive opportunities.

Period and Annualized Total Returns (%)	Since Inception (31 Dec 2000)	20Y	15Y	10Y	5Y	3Y	1Y	YTD	2Q26
Gross of Fees	12.07	9.80	11.29	12.35	14.52	22.16	46.51	28.85	24.32
Net of Fees	10.98	8.74	10.23	11.31	13.49	21.06	45.19	28.27	24.04
Russell 2000 Index	8.90	8.88	10.52	11.62	6.98	18.60	40.78	22.57	21.49
Russell 2000 Value Index	9.31	7.98	9.97	10.89	8.23	18.73	43.01	22.99	17.19

Calendar Year Returns (%)	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
Gross of Fees	-5.90	14.32	41.64	5.99	-2.44	15.61	12.05	-14.03	22.92	0.77	34.17	-13.90	24.47	14.32	12.95
Net of Fees	-6.84	13.18	40.22	4.93	-3.42	14.45	10.93	-14.85	21.82	-0.14	32.97	-14.67	23.35	13.29	11.93
Russell 2000 Index	-4.18	16.35	38.82	4.89	-4.41	21.31	14.65	-11.01	25.52	19.96	14.82	-20.44	16.93	11.54	12.81
Russell 2000 Value Index	-5.50	18.05	34.52	4.22	-7.47	31.74	7.84	-12.86	22.39	4.63	28.27	-14.48	14.65	8.05	12.59

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