

# Small Cap Strategy

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**DIAMOND HILL**  
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## Quarterly Snapshot

### Performance

The Strategy declined 6.90% (net of fees) while the Russell 2000 Index declined 7.23%.

### Key Drivers

Stock selection in health care and consumer staples, along with our underweight to information technology, were the largest relative contributors to performance. Industrials, financials and energy were the primary relative headwinds.

### Summary

Small caps pulled back during the quarter as higher interest rates and elevated energy prices weighed on several economically sensitive areas of the market, though strong health care results and continued merger and acquisition (M&A) activity provided meaningful bright spots in the portfolio. We have largely viewed the recent volatility as an opportunity to deploy capital into resilient businesses where we believe durable, long-term demand remains intact.

## Market and portfolio review

Small cap equities declined during the third quarter, with the Russell 2000 falling 7.23% and trailing large cap stocks by roughly 900 basis points. The pullback accelerated in September after the Federal Reserve delivered its first rate hike in three years and Treasury yields moved sharply higher. Additionally, the ongoing conflict with Iran pushed oil and fuel prices higher, increasing concerns around the potential second-order effects on consumer spending and broader economic activity.

From a sector perspective, higher oil prices propelled energy to be the top-performing—and only positive—sector during the quarter. Health care was a distant second, declining 1.5%. Conversely, several cyclical and rate-sensitive areas were pressured as investors digested the potential impact of higher borrowing costs and energy prices. Information technology also weakened during the quarter, making our longstanding underweight to the sector a relative positive after serving as a headwind earlier in the year.

Against this backdrop, we saw several meaningful bright spots in the portfolio. M&A activity continued to be additive, with two additional portfolio holdings announcing takeouts during the quarter. From a sector perspective, health care was particularly strong, with four of our top six contributors coming from the sector. Health care has been an area of increasing opportunity for us over the past two years, and we are encouraged to see

fundamentals continue to deliver across several holdings. Our exposure remains focused largely on businesses providing the tools, services and infrastructure supporting health care delivery rather than more binary areas dependent on a single product or innovation outcome.

Elsewhere, several holdings were pressured by concerns around the knock-on effects of the ongoing conflict with Iran, namely higher fuel prices, and the impact of higher rates. Those concerns rippled across a broad range of end markets, including housing, auto logistics, freight and travel, as investors weighed the potential impact on consumer spending and economic activity. However, we do not believe the underlying long-term fundamentals of these businesses changed materially during the quarter.

Importantly, we have viewed the recent pullback largely as an opportunity to put capital to work, particularly where we believe long-term demand drivers remain durable and, in our view, underappreciated. In fact, part of the competition for capital contributing to higher rates is tied to large, multi-year projects across infrastructure, power-grid investment, reshoring and defense, areas that we believe can support sustained demand for many of the businesses we own.

Our positioning continues to reflect this view, with meaningful exposure to industrial and tangible-asset-oriented businesses. Many of the new opportunities we are finding remain at the lower end of the market cap spectrum, including our three new holdings this quarter that are all below \$1B in market cap. We continue to focus on resilient businesses with the financial strength and competitive position to navigate uncertainty. Where volatility has created a meaningful disconnect between near-term concerns and long-term fundamentals, we have been willing to add to businesses we believe have the capacity to suffer through difficult environments and compound value over time.

### Key contributors

- Shares of snack food company **Utz Brands** rose after entering into an agreement to be acquired by Intersnack, a privately held European leader in savory snacks.
- **Mesa Laboratories**, a provider of quality control products for drug manufacturers and hospitals, saw shares increase as sales returned to organic growth, margins expanded and debt declined. We believe the new CEO's focus on improving execution in the sterilization business supports the long-term value of the company's durable, regulation-driven franchises.
- **UFP Technologies**, a manufacturer of engineered products for leading medical device companies, saw shares rise following strong quarterly results, including broad-based organic growth and margin expansion as new programs gained traction. We believe the company's long-term customer relationships, acquisition pipeline and continued program growth support an attractive long-term outlook.

### Key detractors

- Shares of health care management company **Astrana Health** declined during the quarter as selling pressure emerged following a strong first half of 2026. Company fundamentals remain solid as the management team continues to execute its strategy, and shares are still up meaningfully year to date.
- **Triumph Financial**, a bank and transportation finance company, saw shares decline over concerns that higher diesel prices could weigh on the trucking industry. However, we believe higher prices may benefit Triumph's factory business by increasing average invoice sizes.
- Gaming development and management company **Red Rock Resorts** underperformed amid construction-related disruptions and inflationary concerns tied to elevated oil prices. Despite these near-term pressures, we continue to view the long-term opportunity as attractive, particularly at current valuations.

### New positions

- We initiated a position in **Bank7**, an Oklahoma City-based commercial bank, given the company's highly profitable, branch-light model and recent acquisition of Century Bank, which we believe should meaningfully enhance earnings.
- **Twin Disc** is a manufacturer of marine and industrial propulsion systems. We initiated a position given the company's growing defense exposure, strong backlog and attractive valuation. We believe shares remain undervalued as the market has yet to fully recognize the company's shift away from its historically cyclical oil and gas business.
- **Mayville Engineering**, a leading US contract metal fabricator, was added to the portfolio as we see an attractive opportunity for earnings growth. Several of its legacy end markets remain near cyclical lows, while the company is repurposing underutilized capacity to serve growing demand from data center and critical-power infrastructure. We believe a recovery in core markets, disciplined pricing and new data center demand can drive earnings growth that is underappreciated by the market.

### Eliminated positions

- We exited our position in **Utz Brands** after shares reached our estimate of intrinsic value following its announced acquisition by Intersnack.
- Shares of cell and gene therapy products and services supplier **BioLife Solutions** were sold after the stock price appreciated materially following the acquisition announcement by Regeneron.

| Period and Annualized Total Returns (%) | Since Inception<br>(31 Dec 2000) | 20Y  | 15Y   | 10Y   | 5Y    | 3Y    | 1Y    | YTD   | 3Q26  |
|-----------------------------------------|----------------------------------|------|-------|-------|-------|-------|-------|-------|-------|
| Gross of Fees                           | 11.64                            | 9.66 | 12.31 | 11.16 | 12.45 | 21.59 | 26.37 | 20.22 | -6.69 |
| Net of Fees                             | 10.56                            | 8.61 | 11.25 | 10.14 | 11.44 | 20.50 | 25.24 | 19.41 | -6.90 |
| Russell 2000 Index                      | 8.50                             | 8.45 | 11.80 | 9.84  | 6.34  | 17.72 | 16.20 | 13.71 | -7.23 |
| Russell 2000 Value Index                | 9.01                             | 7.58 | 11.38 | 9.40  | 7.80  | 17.93 | 20.77 | 16.96 | -4.91 |

| 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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