Diamond Hill Short Duration Securitized Bond Fund Commentary

As of March 31, 2021

The portfolio held up better than the Bloomberg Barclays U.S. 1-3 Year Government/Credit Index in Q1 and has outpaced the index since its inception. As always, our goal is to outperform the index over a full market cycle, while generating a yield advantage relative to the index.

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As we turned the calendar on a full year of an unprecedented global pandemic and financial market uncertainty, climbing interest rates became the main story in Q1. Dashing the country's hopes of a fresh start after a surreal year of toilet paper hoarding, mask wearing, lockdowns and virus surges, the country began the new year witnessing an assault on the nation's capital that left the world shaken. But even as the political world found its stability with an uneventful inauguration of a new administration, fixed income markets delivered a sharp blow to investors.

Fueled by a euphoric mix of accelerated vaccine distribution, expectations for an end to quarantines, two stimulus packages and a re-opening of the national economy, markets began to rotate in anticipation of a juggernaut economy. With those expectations came a meteoric increase in longer term interest rates, as the 10-year Treasury increased 83 basis points (bps) and the 30-year Treasury increased 77 bps. From a historic standpoint, the absolute shift in yield for the 10-year Treasury ties as the ninth largest quarterly move higher since the early 1980s. While the anticipation of a surging economy was partially due to the aforementioned developments, there were some technical aspects to consider as well:

- Banks and insurers in Japan and Korea were selling longer dated U.S. Treasuries as they prepared for their new fiscal year, which begins in April. In February, the biggest moves higher in longer-dated Treasury yields occurred during Asia trading hours.

- February's 7-year Treasury auction was the worst received auction of that tenor on record. The auction delivered the longest tail for a 7-year auction on record (since 2009). The tail is the difference between the average yield (1.151% in February) and the high yield (1.195%) for the bond being auctioned. A wide, or long, tail means there was diminished interest in the bond at the initial level, forcing the yield higher to attract interest. The dramatic shift that occurred on auction day (February 25) was felt across the long end of the curve, with the 10-year Treasury reaching a high-low spread of 23.6 bps intraday before settling higher by 10.4 bps. The belly of the curve, the 5-year and 7-year, took the biggest hit with the 5-year higher by 21.9 bps and the 7-year higher by 19.3 bps.

- Duration hedging. As interest rates climb higher, mortgage duration (sensitivity to interest rate movements) increases, as lower coupon mortgages become less likely to prepay or refinance, which would expose borrowers to higher borrowing costs. Investors holding these mortgages often sell longer duration Treasuries to lower their overall portfolio duration, thus creating a vicious circle that pushes Treasury rates higher which in turn causes mortgage durations to extend.

- Supplemental leverage ratio expiration. During the early days of the crisis, the Office of the Comptroller of the Currency (OCC), Board of Governors of the Federal Reserve System and the FDIC issued rule 85 FR 32980, an 11-page document that permitted global systemically important banks (G-SIBs) to increase their U.S. Treasury holdings without concern for violating the supplementary leverage ratio (SLR) to be considered well capitalized. This was one of many steps taken by the U.S. government to help stabilize the financial markets during the pandemic. As consumers and businesses raised cash through the sale of securities, accessed credit lines/debt to build cash reserves, or the reception of stimulus, deposit levels at financial institutions continued to grow, increasing the size of institutions' balance sheets. Without adjusting the SLR, the resulting increase in the size of the depository institutions' balance sheets could have caused a sudden and significant increase in the regulatory capital needed to meet a depository institution's leverage ratio requirement. Having served its purpose during the crisis, the government allowed the SLR exemption to expire on March 31 of this year. As financial institutions adjusted their balance sheets by liquidating Treasury positions in anticipation of the expiration, this could have contributed to the increase in longer duration Treasury rates.

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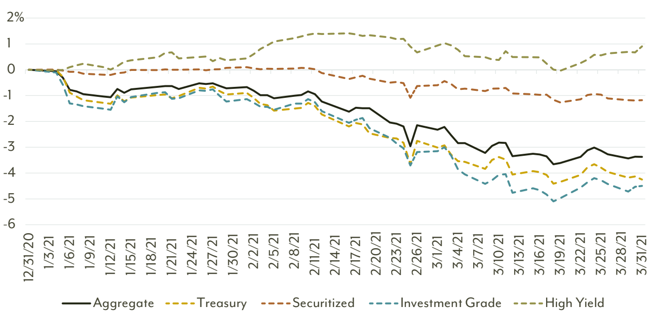
The impact of this historic move higher in interest rates was felt across fixed income markets, as longer duration assets felt the brunt of the impact. Duration is a measure of the sensitivity of the price of a bond or other debt instrument to a change in interest rates—the longer the duration of a bond, the more sensitive that bond is to interest rate movements. Exhibit 1 outlines the return trajectory for a variety of fixed income indices, including the Bloomberg Barclays U.S Aggregate Bond Index, Treasury Index, Securitized Index, Corporate Index and the ICE BofA U.S. High Yield Index. The corporate index delivered the worst performance during the quarter (-4.65%) with a duration at nearly 8.48 years at the end of Q1. The Treasury index lost -4.25% and ended the quarter with a duration of 6.79 years. The shorter duration (4.15 years) securitized index mitigated some of the impact from rising rates, only losing -1.18% quartering Q1. While the ICE BofA U.S. High Yield Index ended the quarter with a duration of 4.05 years, it was able to offset the principal impact of the rate move with higher yield.

EXHIBIT 1: Q1 2021 RETURNS



Source: Bloomberg, as of 3/31/21.

The Federal Reserve continued to hold firm on its outlook for the economy, inflation, quantitative easing, and the future path of interest rates. Despite continued positive news on the employment and vaccine distribution front, the Fed held the line on both short-term rates and its ongoing asset purchase plan. Federal Reserve officials forecast that they will keep the benchmark lending rate near zero until at least 2023 to help the U.S. economy recover from the pandemic. This appears to be a case of erring on the side of caution, maintaining as much accommodation as possible and combining it with ongoing stimulus despite widespread upgrades for growth and employment. Specific to the ongoing asset purchase program, Federal Reserve Chair Powell stated that it was not yet time to start talking about tapering, putting to rest any expectations for a tapering of the monthly purchases of $80 billion in U.S. Treasury debt and $40 billion in mortgage-backed securities. Concerns about inflation were put aside with the Fed continuing to reinforce its comfort with higher than historically average inflation. As year-over-year price comparisons begin to incorporate the beginning of the pandemic last year, expectations for transitory inflation have been well communicated by the Fed.

It is important to note that our portfolio works to provide yield for investors while focusing on the shorter end of fixed income markets. We believe there are opportunities to add incremental yield over the benchmark by investing in structured product across the quality spectrum. The portfolio strives to maintain an average credit quality rating of A/BBB while taking advantage of mispriced opportunities in both unrated securities and an allocation to below investment grade securities.

As of March 31, the portfolio had a yield-to-worst (YTW) of 2.37% with an effective duration of 1.13, compared to the previous quarter end's YTW of 2.44% and effective duration of 1.20. The ongoing decrease in yield can be attributed to the significant rebound in pricing across the asset-backed securities (ABS) and commercial mortgage-backed securities (CMBS) markets that began in the latter part of 2020 and continued into January of this year. The ABS sector remains the largest allocation in the portfolio and was the strongest contributor to performance of the portfolio over the benchmark.

Within the securitized sector, ABS delivered the strongest performance followed by non-agency CMBS. Within the ABS sector, deals backed by small business loans were the strongest performers, as these securities continued to rebound from distressed pricing last year, which was driven by market technicals and not fundamental concerns. Securities backed by unsecured consumer securitizations worked equally as well as small business loans during the quarter. Non-agency CMBS delivered some of the strongest returns in Q1 as these securities carried their late 2020 rally into the beginning of 2021. The portfolio's overweight position relative to the benchmark contributed to performance as the sector delivered strong returns in Q1.

We continue to search for opportunities in the marketplace while maintaining an attractive yield relative to the benchmark.

PERIOD AND ANNUALIZED TOTAL RETURNS AS OF MARCH 31, 2021

	SINCE INCEPTION (7/5/16)	3-YR	1-YR	YTD	1Q21	EXPENSE RATIO
SHORT DURATION SECURITIZED BOND FUND						
Class I	3.85%	4.02%	13.30%	1.52%	1.52%	0.53%
BENCHMARK						
Bloomberg Barclays U.S. 1-3 Yr. Gov./Credit Index	1.95	3.04	1.57	-0.04	-0.04	—

Must be preceded or accompanied by a prospectus. The 30-day Yield represents net investment income earned by the fund over the previous 30-day period, expressed as an annual percentage rate based on the Fund's share price at the end of the 30-day period. The 30-day SEC Yield for the Short Duration Securitized Bond Fund (Cl I) is 2.57%.

Risk Disclosure: The value of fixed-income securities varies inversely with interest rates; as interest rates rise, the market value of fixed-income securities will decline. Lower quality debt (ie: "High Yield") securities involve greater risk of default or price changes due to potential changes in the issuer's credit quality. The value of investments in mortgage-related and asset-backed securities will be influenced by the factors affecting the housing market and the assets underlying such securities. The securities may decline in value, face valuation difficulties, become more volatile and/or become illiquid. They are also subject to prepayment risk, which occurs when mortgage holders refinance or otherwise repay their loans sooner than expected, creating an early return of principal to holders of the loans.

The views expressed are those of the portfolio managers as of March 31, 2021, are subject to change and may differ from the views of other portfolio managers or the firm as a whole. These opinions are not intended to be a forecast of future events, a guarantee of results, or investment advice.

The performance data quoted represents past performance; past performance does not guarantee future results. The investment return and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. The Fund's current performance may be lower or higher than the performance data quoted. Investors may obtain performance information current to the most recent month-end, within 7 business days, at diamond-hill.com.

Performance returns assume reinvestment of all distributions. Returns for periods less than one year are not annualized.

Fund holdings subject to change without notice.

The Bloomberg Barclays U.S. 1-3 Yr. Gov./Credit Index is an unmanaged index of investment grade government and corporate bonds with maturities of one to three years. This index does not incur fees and expenses (which would lower the return) and is not available for direct investment.

Index data source: Bloomberg Index Services Limited. See diamond-hill.com/disclosures for a full copy of the disclaimer.

Analytics provided by The Yield Book® Software.

An investor should consider the Fund's investment objectives, risks, and charges and expenses carefully before investing or sending any money. This and other important information about the Fund(s) can be found in the Fund's(s) prospectus or summary prospectus which can be obtained at diamond-hill.com or by calling 888.226.5595. Please read the prospectus or summary prospectus carefully before investing. The Diamond Hill Funds are distributed by Foreside Financial Services, LLC (Member FINRA). Diamond Hill Capital Management, Inc., a registered investment adviser, serves as Investment Adviser to the Diamond Hill Funds and is paid a fee for its services. Like all mutual funds, Diamond Hill Funds are not FDIC insured, may lose value, and have no bank guarantee.

The Bloomberg Barclays U.S. Aggregate Index is an unmanaged index representing the U.S. investment grade fixed rate bond market, with index components for government and corporate securities, mortgage pass-through, and asset-backed securities. The Bloomberg Barclays Treasury Bond Index measures U.S. dollar-denominated, fixed-rate, nominal debt issued by the U.S. Treasury. The Bloomberg Barclays U.S. Securitized Index is an unmanaged index representing the holdings from the securitized sector of the Bloomberg Barclays U.S. Aggregate Index. The Bloomberg Barclays U.S. Corporate Bond Index is an unmanaged index representing the investment grade fixed rate taxable corporate bond market including USD-denominated securities publicly issued by U.S. and non-U.S. industrial, utility, and financial issuers. The ICE BofA U.S. High Yield Index tracks the performance of the U.S. dollar denominated below investment grade corporate debt publicly issued in the U.S. domestic market. The index data referenced herein is the property of ICE Data Indices, LLC, its affiliates ("ICE Data") and/or its third party suppliers and has been licensed for use by Diamond Hill Capital Management, Inc. ICE Data and its third party suppliers accept no liability in connection with its use. See diamond-hill.com/disclosures for a full copy of the disclaimer.