DIAMOND HILL

INVESTED IN THE LONG RUN

All Cap Select Fund

As of 30 Jun 2022

Market Commentary

US stocks ended a tough quarter down more than -16% and closed out one of the worst first halves of a year in decades. While this downturn has its own unique characteristics — a war in Ukraine, inflation and an energy shock — it has followed a fairly typical pattern over the past six to nine months. The initial phase started in mid-2021 when some of the most speculative growth stocks, e.g., those with no earnings, sold off dramatically, providing some early warning signs of cracks in the paradigm that had existed for a full decade — low interest rates and ever-increasing valuations. As we moved through 2022, the market meltdown expanded to include anything within the growth marketplace, including some high-quality companies like Alphabet, Microsoft and Amazon — companies with profits and free cash flow that are operating well but still sold off in sympathy, in our view, likely based more on near-term investor sentiment.

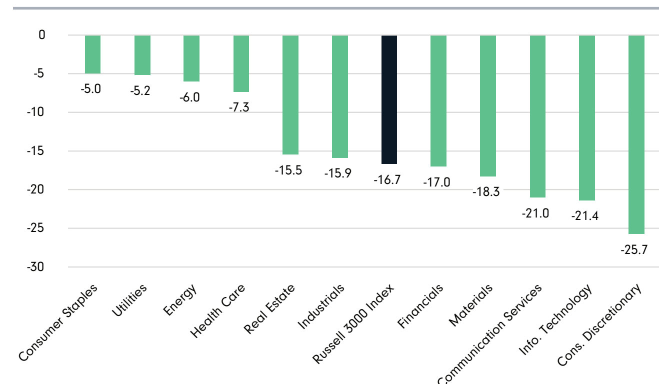
With recession expectations rising, it was no surprise to see more defensive areas of the market hold up better in Q2. In the Russell 3000 Index, the consumer staples and utilities sectors pulled back roughly -5% during the quarter. Energy and health care stocks fell -6% and -7%, respectively. The remaining sectors fell double-digits with the bulk of the pain coming from the consumer discretionary, technology and communication services sectors, all of which declined more than -20%.

Team

Austin Hawley, CFA
Portfolio Manager

Rick Snowdon, CFA
Portfolio Manager

2Q22 Russell 3000 Index Sector Returns (%)



Source: FactSet, as of 30 Jun 2022.

Returns were roughly similar across the market-cap spectrum with the large-cap Russell 1000 Index ending the quarter down -16.7%, the Russell Midcap Index falling -16.9% and the small-cap Russell 2000 Index declining -17.2%. Across the cap spectrum, stocks in the value indices held up better than their growth peers. The Russell 1000 Value Index outperformed its growth counterpart by 871 basis points (bps), while the Russell Midcap Value and Russell 2000 Value Indices outperformed their growth peers by 639 bps and 397 bps, respectively.

After a decade of extraordinary market returns, especially within the growth markets, it can be easy to forget that drawdowns are a part of long-term investing. And while the current environment has been a meaningful one — with a 20%-plus selloff — it is not out of the ordinary for long-term investors. In looking back as recently as November 2021, the Russell 3000 Growth Index compounded annually at approximately 19% during the prior decade. That was an unusual environment with equity returns that simply did not appear sustainable to us. Thus, the current market correction should not come as a shock to market participants with a long-term investment horizon.

As active managers, we believe this type of environment and volatility offers opportunities for us to add value for clients who are able to withstand these types of drawdowns and stay invested over the long run.

Performance Discussion

In a tough quarter where no area of the market was spared, the portfolio performed on par with the Russell 3000 Index. In the technology sector, one of the most challenged areas of the market, as well as in consumer staples, our stock selection was favorable and contributed positively to our relative performance. Partially offsetting those results was the underperformance of our holdings in the consumer discretionary and industrials sectors. Health care was a mixed bag — we benefited from good stock selection, but our underweight exposure to one of the more resilient market sectors this quarter hampered relative results.

On an individual holdings basis, top contributors to return included SunOpta, Post Holdings, BellRing Brands, Humana and Ashland Global Holdings.

SunOpta is focused on the manufacturing of plant-based and fruit-based food (frozen fruit) and beverages for sale to retail customers, foodservice distributors, branded food companies and food manufacturers. Its stock advanced in Q2 after reporting strong operating results and providing a positive business outlook through 2025. We believe SunOpta is well positioned to capitalized on the increasing demand for plant-based alternatives, particularly in environmentally sensitive areas of the food supply chain such as traditional dairy. We are also attracted to the company's national scale in purchasing and transportation, which enables SunOpta to add capacity faster and cheaper than its competition, creating a natural barrier to entry.

Diversified food company Post Holdings is benefiting from solid organic revenue growth and a recovery in its foodservice business. In general, its management has been a good allocator of capital, creating value while moving away from its legacy cereal business toward faster growing segments like nutrition products.

Post Holdings maintains approximately a 20% stake in BellRing Brands, provider of ready-to-drink protein drinks and other protein-based food items, which it successfully spun off in Q1 2022. The active nutrition space is fast growing, and BellRing is well positioned with a management team skilled in capital allocation. Shares were up following a strong earnings announcement showing solid organic revenue growth.

Health insurance company Humana's stock has experienced higher volatility over the past year, and its 7% advance in Q2 largely reflected a recovery from the strong selloff that followed a disappointing pullback in its Medicare Advantage member enrollment guidance for 2022 back in January. Despite the near-term volatility, we are confident in Humana's long-term value creation plan and its ability to achieve market enrollment growth and improvement in its health care services businesses.

Ashland Global Holdings, manufacturer of specialty chemicals for consumer and industrial markets, is benefiting from strong end-market demand in all segments and a positive mix shift. It has also been proactive in adjusting pricing to recover costs.

Our weakest performers in Q2 included Red Rock Resorts, Cimpress and Freeport-McMoRan. Shares of casino operator Red Rock Resorts traded down on questions about the health of consumers' discretionary income in the face of rising inflation. From a long-term fundamental perspective, we believe Red Rock remains well positioned. It is the market-share leader in the Las Vegas locals' casino market duopoly. Management also has demonstrated an ability to manage well through a challenging backdrop, including improving margins and delivering record cash flows through the pandemic.

Cimpress operates a wide variety of businesses that use mass customization to produce small quantities of individually customized goods. The company's most recent earnings were as anticipated, but its shares continued to come under pressure as widening high-yield spreads impacted the valuation of the enterprise.

Copper-focused mining company Freeport-McMoRan's stock was up meaningfully in Q1 with other copper producers on rising demand for conductive metals and supply risk concerns from Russia. Despite reporting excellent Q1 results, management raised its cost guidance for the year, attributing it to rising fuel costs and inflation of other materials. Freeport's share price declined in Q2 with other large miners as copper prices declined roughly -22%, and we think the response by market participants is overdone. The company continues to generate strong free cash flow, which it has returned to shareholders in the form of dividends and buybacks. We also remain attracted to Freeport's unique exposure to high-quality copper producing mines, which is a key industrial input, particularly for green technologies, and we believe it's a strong business oriented toward strengthening end markets.

Also among our bottom contributors were mortgage servicing company Mr. Cooper Group and WESCO International, a leading distributor of electrical, industrial and communications materials and provider of supply chain management and logistics services. Rapidly rising interest rates in Q2 pushed mortgage rates higher, raising concerns about headwinds for the mortgage industry. Unlike peers, Mr. Cooper has a more balanced business model between mortgage origination and servicing, which should help its business from a fundamental perspective in this environment.

A general selloff among industrials stocks tied to heightened expectations for a recession hit WESCO International particularly hard due to its somewhat elevated leverage. We maintain conviction in WESCO as the largest player in a fragmented market. Its recent merger with a large competitor has given it still more bargaining power in an industry where scale is important, along with significant cost-cutting opportunities. Further, we believe the technical sophistication, customization and high cost of many of the products WESCO supplies, as well as the level of value-added services it provides, should allow the company to remain relatively insulated from e-commerce competition.

Portfolio Activity

In Q2, we initiated positions in Microsoft and SVB Financial. Microsoft's stock price declined amid the broader selloff of technology companies. This presented an opportunity for us to purchase shares at an attractive discount to our estimate of the intrinsic. We expect the business to continue generating strong revenue growth and benefiting from operating leverage. Microsoft's cloud computing services business, Azure, is also generating robust growth, confirming its competitive positioning.

SVB Financial Group is the leading bank for the innovation economy serving early-stage companies and capital providers. It's a company we know well and have followed for several years. SVB has grown tremendously over the years to round out its services to include investment banking and, more recently, wealth management.

ESAB Corp and Enovis Corporation are both new names in the portfolio, but familiar to us through our prior holding in Colfax Corporation, a provider of orthopedic solutions including braces and reconstructive joint products as well as welding equipment and supplies. Early in Q2, Colfax completed a planned split — its fabrication technology business became ESAB and the medical technology business reorganized as Enovis. We continue to hold both, believing the two new companies are in an excellent position to leverage their business systems to continuously improve operations over time and engage in value-creating acquisitions in their respective industries.

As mentioned, Colfax Corp is no longer a name in the portfolio, having completed its split and reorganized. We also exited our positions in Meta Platforms, VF Corporation and Alleghany, among others, in favor of more attractive opportunities.

Market Outlook

After a strong rebound in 2021, global GDP growth is moderating in 2022, with the potential for additional pressure from rising interest rates, higher oil prices, lingering supply chain disruptions and other impacts from Russia's invasion of Ukraine. Despite these headwinds, corporate earnings are expected to continue making new highs in 2022.

That sharp economic rebound in the US, along with unprecedented fiscal and monetary stimulus, an uptick in wage growth and instances of supply/demand tightness, has resulted in elevated inflation levels. The Federal Reserve has started to raise interest rates and end quantitative easing but may need to be more aggressive if inflation persists at elevated levels, which could be a headwind for equity markets. However, a moderation of inflation, along with the selloff in financial markets, rising mortgage rates, and other factors that may slow broader demand could cause the Fed to act less aggressively.

Russia's invasion of Ukraine has disrupted the flow of exports from these countries, impacting global supplies and prices for a wide variety of end markets. The potential impact to individual businesses varies, and we are monitoring these risks closely.

While broader equity market valuations have fallen toward historical averages and created some investment opportunities in the process, we do not view the market as glaringly cheap. From current levels, equity market returns over the next five years are still likely to be below historical averages.

Our primary focus is always on achieving value-added results for our existing clients, and we believe we can achieve better-than-market returns over the next five years through active portfolio management.

Mentioned Securities and Respective Weights (%)

Security	Weight	Security	Weight
Alphabet, Inc. (Cl A)	5.5	Humana, Inc.	2.0
Amazon.com, Inc.	5.8	Microsoft Corp.	2.7
Ashland Global Holdings, Inc.	2.7	Mr. Cooper Group, Inc.	7.8
BellRing Brands, Inc.	1.4	Post Holdings, Inc.	1.2
Cimpress PLC	4.1	Red Rock Resorts, Inc. (Cl A)	6.2
Enovis Corp.	2.4	SunOpta, Inc.	3.0
ESAB Corp.	2.6	SVB Financial Group	2.8
Freeport-McMoRan, Inc.	3.1	WESCO International, Inc.	7.4

Period and Annualized Total Returns (%)

	Since Inception (30 Dec 2005)	15Y	10Y	5Y	3Y	1Y	YTD	2Q22	Expense Ratio (%)
Class I (DHLTX)	8.64	8.12	12.33	9.91	11.40	-12.13	-19.28	-17.85	0.87
Russell 3000 Index	8.98	8.36	12.57	10.60	9.77	-13.87	-21.10	-16.70	—
Russell 3000 Value Index	7.17	6.06	10.39	7.01	6.82	-7.46	-13.15	-12.41	—

Risk disclosure: Because the portfolio holds a limited number of securities, a decline in the value of these investments may affect overall performance to a greater degree than a less concentrated portfolio. Small- and mid-capitalization issues tend to be more volatile and less liquid than large-capitalization issues.
The views expressed are those of Diamond Hill as of 30 June 2022 and are subject to change without notice. These opinions are not intended to be a forecast of future events, a guarantee of future results or investment advice. Investing involves risk, including the possible loss of principal.
Past performance is not indicative of future results. Investment returns and principal values 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 quoted. For current to most recent month-end performance, visit diamond-hill.com.
Performance assumes reinvestment of all distributions. Returns for periods less than one year are not annualized. These total return figures may reflect the waiver of a portion of a Fund's advisory or administrative fees for certain periods. Without such waiver of fees, the total returns would have been lower. Class I shares include Investor share performance achieved prior to the creation of Class I shares.
Fund holdings subject to change without notice.
Index data source: London Stock Exchange Group PLC. See diamond-hill.com/disclosures for a full copy of the disclaimer.
Securities referenced may not be representative of all portfolio holdings. Contribution to return is not indicative of whether an investment was or will be profitable. To obtain contribution calculation methodology and a complete list of every holding's contribution to return during the period, contact 855.255.8955 or info@diamond-hill.com.
Carefully consider the Fund's investment objectives, risks and expenses. This and other important information are contained in the Fund's prospectus and summary prospectus, which are available at diamond-hill.com or calling 888.226.5595. Read 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. Not FDIC insured | No bank guarantee | May lose value