

DIAMOND HILL

INVESTED IN THE LONG RUN

Large Cap Fund

(closed to most new investors)

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 1000 Index, the consumer staples, energy and utilities sectors pulled back roughly -5% during the quarter. Health care stocks fell -6%. 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%.

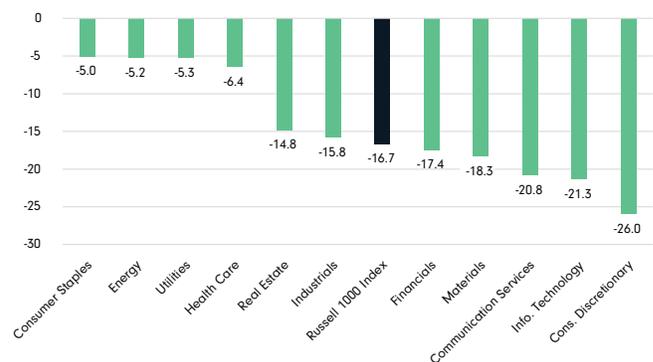
Team

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2Q22 Russell 1000 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.

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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 1000 Growth Index compounded annually at approximately 20% 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

Despite a tough quarter where no area of the market was spared, the portfolio held up better than the Russell 1000 Index. In the two most-challenged areas of the market – technology and consumer discretionary – our stock selection was favorable and contributed positively to our relative results. Stock selection was also positive in a handful of other sectors including industrials, consumer staples, communication services and real estate. Partially offsetting those results was the underperformance of our holdings in the materials and energy sectors. Financials was a mixed bag – we benefited from our exposure to the insurance industry, which held up meaningfully better than the market, but our holdings in the bank industry collectively underperformed.

On an individual holdings basis, top contributors to return included health insurance company Humana and diversified telecom services provider Verizon. 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.

Verizon, alongside other wireless providers, has been increasing plan prices to help offset inflation effects. We've also seen indications that the wireless industry is moving away from the aggressive promotional environment of the last 18 months. A lower level of industry promotional intensity should benefit Verizon's share of quarterly net adds while allowing the company to continue to focus on migrating customers to higher priced unlimited plans.

Other top contributors in Q2 included biopharma company Pfizer, telecom and media company Charter Communications and consumer snacks and beverages manufacturer PepsiCo.

Our weakest performer in Q2 was copper-focused mining company Freeport-McMoRan. In Q1, the stock was up meaningfully 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 a result, 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.

Amazon's shares underperformed as valuations of fast-growing companies continued to compress in Q2. Amazon's growth investments over the past two years have pressured earnings as consumer demand has been weaker than anticipated. However, we believe the company will be able to grow into its infrastructure investments over time. These investments have obscured the magnitude of sustainable free cash flow as well as the attractive valuation of the business relative to peers.

Also among our bottom contributors were insurance company AIG, financial services provider Bank of America and global entertainment company Disney. AIG reported strong Q1 earnings but the selloff in equity markets delayed the IPO of its life and retirement business. Bank of America shares were weak in Q2 as the market became increasingly focused on the possibility of a near-term recession and the potential for credit losses along with current fee revenue pressures. Disney's shares fell on concern over its streaming business as Netflix's recent operating results indicated near-term saturation.

Portfolio Activity

In Q2, we exited our positions in telecom and media company Charter Communications and Archer-Daniels-Midland, an agricultural commodities and products company, in favor of more attractive opportunities. The recent market environment has enabled us to initiate positions in some high-quality names that have sold off indiscriminately and are trading at prices we haven't seen in quite some time. Microsoft is one example. 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 value. 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.

We also initiated positions in HCA Healthcare, Martin Marietta Materials and Union Pacific. HCA is a best-in-class operator of acute care hospitals and other health care facilities, including outpatient surgery centers. It has a strong market presence in highly attractive geographies with growing populations and low unemployment, such as Texas and Florida, which leads to a favorable payor mix. We are further attracted to its strong management team that has a stellar track record of deploying capital, and the founding family continues to own almost a quarter of the business. We initiated a position after HCA reported Q1 earnings — it reduced full year guidance due to increased labor costs and lower-than-expected acuity among COVID admissions, dampening near-term investor sentiment.

Martin Marietta Materials is the second largest aggregates producer and distributor in the US, with competitively positioned cement, ready-mix, asphalt and magnesia specialty businesses. Its share price recently sold off due to concerns about a slowdown in the US residential housing market, giving us the opportunity to initiate a position at an attractive price. We believe Martin Marietta is strategically positioned in markets with strong growth potential, in states that have multi-year department of transportation (DOT) plans approved, and the Infrastructure Investment and Jobs Act (IIJA) will begin distributing funds later this year. Additionally, in the event of an economic downturn, the company has the ability to pull from its prior playbook as a stronger, more geographically diversified player to acquire smaller companies, resulting in better market consolidation.

Union Pacific is a large railroad company that carries freight across the western US and between Canada and Mexico. It transports a variety of industrial goods, raw materials and containerized freight between major US ports, industrial hubs and international gateways. The goods that Union Pacific and other railroads transport are fundamental inputs in the economy and are resilient to long-term trends in the business cycle. We believe Union Pacific offers a compelling investment opportunity as its substantial infrastructure investments, relative cost advantages, limited leverage and the essential nature of the products it delivers provides the company with what we believe is one of the widest moats in the transportation sector. We also like that Union Pacific has a shareholder-oriented management team that is focused on growing earnings while returning capital to shareholders.

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

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.

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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 (%)

| | | | |
|------------------------------------|-----|------------------------------|-----|
| Alphabet, Inc. (CI A) | 2.3 | Microsoft Corp. | 2.2 |
| Amazon.com, Inc. | 2.0 | PepsiCo, Inc. | 3.0 |
| American International Group, Inc. | 4.3 | Pfizer, Inc. | 2.8 |
| Bank of America Corp. | 2.8 | SVB Financial Group | 1.6 |
| Freeport-McMoRan, Inc. | 2.0 | Union Pacific Corp. | 2.1 |
| HCA Healthcare, Inc. | 1.2 | Verizon Communications, Inc. | 1.5 |
| Humana, Inc. | 2.4 | Walt Disney Co. | 1.5 |
| Martin Marietta Materials, Inc. | 1.0 | | |

| Period and Annualized Total Returns (%) | Since Inception (29 Jun 2001) | 20Y | 15Y | 10Y | 5Y | 3Y | 1Y | YTD | 2Q22 | Expense Ratio (%) |
|---|----------------------------------|------|------|-------|-------|-------|--------|--------|--------|----------------------|
| Class I (DHLRX) | 8.51 | 9.57 | 7.74 | 11.71 | 8.17 | 7.23 | -10.16 | -17.62 | -14.81 | 0.67 |
| Russell 1000 Index | 7.74 | 9.21 | 8.51 | 12.82 | 11.00 | 10.17 | -13.04 | -20.94 | -16.67 | — |
| Russell 1000 Value Index | 6.99 | 7.86 | 6.10 | 10.50 | 7.17 | 6.87 | -6.82 | -12.86 | -12.21 | — |

Risk disclosure: Overall equity market risks may affect the portfolio's value.

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. 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