

DIAMOND HILL

INVESTED IN THE LONG RUN

Small-Mid 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, i.e., 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 high-quality companies with profits and free cash flow that are operating well but still sold off in sympathy, likely based more on near-term investor sentiment, in our view.

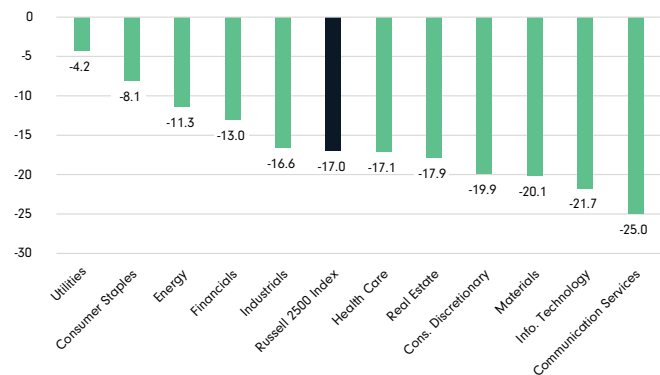
With recession expectations rising, it was no surprise to see the market's more defensive areas hold up better in Q2. In the Russell 2500 Index, the utilities sector fell -4.2% while the consumer staples pulled back -8.1%. The remaining sectors fell in excess of double digits, with the bulk of the pain coming from communication services, technology, materials and consumer discretionary, all of which fell -20% or more.

Team

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Portfolio Manager

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2Q22 Russell 2500 Index Sector Returns (%)



Source: FactSet, as of 30 Jun 2022.

Returns were roughly similar across the market-cap spectrum with the Russell 1000 Index ending the quarter down -16.7%, the Russell Midcap Index falling -16.9%, the Russell 2500 Index down -17.0% and the 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 — the Russell 2500 Index ended Q2 down -27% from its most recent peak — it is not out of the ordinary for long-term investors, particularly when considering the strong gains of the past decade across most equity sizes and styles.

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

Our portfolio's negative returns held up better than the Russell 2500 Index amid Q2's selloff, adding to year-to-date outperformance. Relative performance was aided by our consumer staples and materials holdings, which eked out positive returns overall and outpaced index peers. Our technology holdings, though down overall, also markedly outpaced peers. Conversely, weakness among our industrials and financials weighed on results, as did our overweight exposure to consumer discretionary.

On an individual holdings' basis, top contributors to return in Q2 included Post Holdings, BellRing Brands and UGI Corporation. 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.

UGI Corporation, a natural gas and electric power utility, recovered somewhat from a tough Q1 when share prices were pressured on concerns higher energy prices could lead the company to mismanage commodity risk or erode demand. Looking longer-term, we believe UGI has strategically made significant investments in its renewable fuels business, including renewable natural gas (RNG) and bioLPG—propane produced from renewable sources such as plant and vegetable waste material.

Other top contributors in Q2 included Ashland Global Holdings and First Interstate BancSystem (FIBK). 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. Regional bank FIBK was a standout amid generally weak bank stocks in Q2, as its share price performed well following the closing of its merger with Great Western Bank. FIBK fits well with the types of banks we often seek, having carved out a specialized niche and a strong geographic footprint.

Bottom contributors in Q2 included Red Rock Resorts, Allegiant Airlines and WESCO International. 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.

Similar to Red Rock, shares of leisure-travel focused airline Allegiant Travel were weak along with airlines in general on questions surrounding consumer spending health. Looking forward, we like Allegiant's focus on leisure travel, where customers tend to be stickier. Further, in Q2 Allegiant announced earnings showing the airline has been able to pass along higher fuel costs without eroding demand, which continues to recover from pandemic-related shutdowns.

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 — a leading distributor of electrical, industrial and communications materials and provider of supply chain management and logistics services — as the largest player in a fragmented market. It is executing well on its merger with a large competitor, which 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.

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Other bottom contributors included regional banks Webster Financial and Live Oak Bancshares – both traded down in sympathy with the banking industry on rising expectations for recession. Live Oak is also experiencing net interest margin pressure from rising deposit costs. However, we maintain our conviction in the long-term competitive positioning of our differentiated bank holdings.

Portfolio Activity

With volatility helping valuations broadly look more rational, we were able to identify a few new opportunities in Q2, including SS&C Technologies Holdings and First Advantage.

The broader market selloff gave us an opportunity to initiate a holding in SS&C at what appears to us an attractive discount to intrinsic value. SS&C sells a variety of software/services that support the operations and business processes of investment firms, brokerages and other financial institutions. With a business model focused primarily on recurring revenue, SS&C's business lines collectively have a very high client retention rate. Further, a cost-conscious management team focused on continuous operating improvements and achieving greater scale has resulted in a highly cash generative organization. The management team has also proven to be a good allocator of capital, adding value for shareholders.

First Advantage is one of the largest background screening companies. We believe the largest players in this field stand to benefit disproportionately from increasing technology usage, greater regulatory complexity, consolidation and growth opportunities outside the US. We believe First Advantage is positioned well among peers, having a moderate lead in technology and innovation, a favorable client/end-market mix, a focused strategy with less M&A historically, and a strong management team with good continuity. Largely indiscriminate disinterest toward recent initial public offerings (First Advantage went public in June 2021) along with concerns about a potentially cooling labor market in the near-term gave us an opportunity to purchase shares at what appear to us an attractive discount to long-term intrinsic value.

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 becoming ESAB and the medical technology

business reorganized as Enovis. ESAB has removed Russia from its guidance for 2022, and 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. Our investment in pumping equipment manufacturer SPX Flow concluded upon its acquisition by Lone Star Funds. We exited regional bank Cadence Bank and packaged bakery goods company Flowers Foods to allocate to more attractive opportunities.

Market Outlook

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

The 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.

Russia's invasion of Ukraine has the potential to disrupt the flow of exports from these countries, which may impact 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 the year-to-date pullback in equity markets has created some investment opportunities, broad market valuations remain above historical averages. From current levels, equity market returns over the next five years are 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.

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Mentioned Securities and Respective Weights (%)

Allegiant Travel Co.	1.6	Live Oak Bancshares, Inc.	2.0
Ashland Global Holdings, Inc.	2.7	Post Holdings, Inc.	3.5
BellRing Brands, Inc.	1.3	Red Rock Resorts, Inc. (Cl A)	3.8
Enovis Corp.	2.2	SS&C Technologies Holdings, Inc.	1.8
ESAB Corp.	1.9	UGI Corp.	2.5
First Advantage Corp.	1.0	Webster Financial Corp.	3.3
First Interstate BancSystem, Inc. (Cl A)	1.7	WESCO International, Inc.	4.9

Period and Annualized Total Returns (%)	Since Inception (30 Dec 2005)	15Y	10Y	5Y	3Y	1Y	YTD	2Q22	Expense Ratio (%)	
									Gross	Net ¹
Class I (DHMIX)	8.17	7.84	10.42	5.30	6.19	-9.93	-16.84	-14.21	0.93	0.92
Russell 2500 Index	8.12	7.29	10.49	7.04	5.91	-21.00	-21.81	-16.98	—	—
Russell 2500 Value Index	7.18	6.19	9.54	5.54	6.19	-13.19	-16.66	-15.39	—	—

¹ The Fund may invest in another Diamond Hill Fund. Diamond Hill Capital Management, Inc. is required to permanently waive a portion of its management fee in the pro-rata amount of the management fee charged by the underlying Diamond Hill Fund.

Risk disclosure: 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