DIAMOND HILL

INVESTED IN THE LONG RUN

Large Cap Concentrated Fund

As of 30 Sep 2022

Market Commentary

US stocks closed the quarter down -4.5% (as measured by the Russell 3000 Index), bringing year-to-date losses to -24% and leaving stocks on track for their worst year since the 2008 financial crisis. While hope springs eternal for easing pricing pressures, latest data indicated inflation remained high at 8.3% in August (though a small decline from the July reading).

The current market environment is interesting as it has evolved from the acceleration in inflation, which concerned us starting back in 2019. The pandemic relieved a near-term trend in rising prices, but the subsequent economic recovery served to accelerate cyclical inflationary pressures. The response by the Federal Reserve was, at first, quite timid but has since become aggressive — too aggressive in our opinion. Most leading indicators of inflation, except wage inflation, are pointing to a meaningful decline in inflationary pressures. However, the Federal Reserve remains determined to continue raising interest rates, presumably until reported inflation data is more in line with its long-term targets. Since most inflation data are lagging indicators and Fed tightening impacts the economy with a meaningful delay, we run the risk of a significant economic slowdown caused by an overly restrictive central bank.

As we reflect on this tightening cycle and what it means for investors, we are struck by the relative strength of US financial institutions, particularly in comparison to past tightening cycles. There have been no major financial stresses or calamities. That said, we are concerned about international stresses as the incredible strength of the dollar combined with rising European energy costs may cause meaningful dislocations overseas. Perhaps economic pressures abroad will eventually cause the Fed to relax its strict approach. Fortunately, the current lack of stress in the US reflects the strengthened balance sheets of American financial institutions and the improved asset quality compared to past cycles. We believe this should alleviate the severity of any economic slowdown, but paradoxically it may make it more difficult to quickly slow the economy, assuming that is the Fed's goal.

Finally, we think it is important to emphasize that the magnitude of the recent market selloff has historically been associated with meaningful investment opportunities for long-term investors. To better enable us to understand the long-term opportunity we looked at historical data since 1960. Over the prior 62 years there have been 17 selloffs of 19% or more. The data shows purchasing the market after a 19% decline provides five-year annual returns approximately 200 basis points on average better than the historical average. This historical data is reassuring for investors maintaining a long-term perspective.

In summary, the market selloff has been painful, but at this point, we do not believe the current environment justifies another significant selloff. The financial system is strong, and corporate earnings, while under pressure, should prove more resilient than anticipated. Our expectation is that five years from now we will look back at this period and realize it was a great opportunity for long-term investors — that is why we consistently focus on a five-year time horizon. A short-term perspective too often causes investors to focus only on risk during times of market volatility. However, a five-year focus allows us to see the opportunities available, which have only multiplied with the decline in prices.

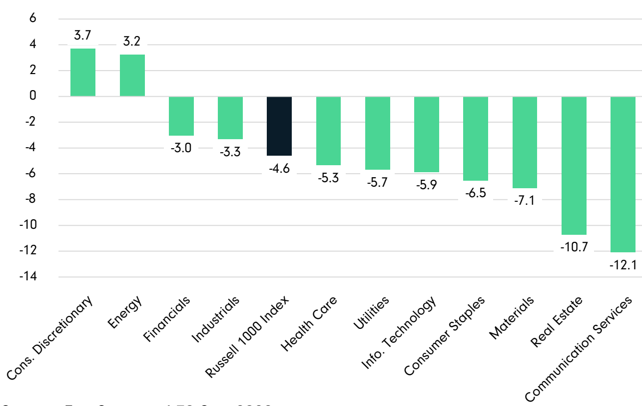
Team

Chuck Bath, CFA
Portfolio Manager

Austin Hawley, CFA
Portfolio Manager

Brian Fontanella, CFA
Portfolio Specialist

3Q22 Russell 1000 Index Sector Returns (%)



Source: FactSet, as of 30 Sep 2022.

Performance Discussion

Our portfolio held up better than the Russell 1000 Index this quarter due in large part to the strength of our holdings in the energy and technology sectors. Partially offsetting those results was the underperformance of our holdings in the health care and financials sectors.

On an individual holdings basis, top contributors to return included oil and gas producer ConocoPhillips and global online retailer Amazon.

The rising price of both oil and natural gas has allowed ConocoPhillips to continue reporting strong earnings and cash flow growth even as the economic outlook becomes more uncertain. We continue to believe the company is an outstanding operator with a strong balance sheet and assets concentrated in well understood jurisdictions. While supply chain tightness has driven input prices higher within the industry, ConocoPhillips has kept its production and capex guidance steady for the full year as its longer-term service contracts help it push costs out into the future as compared to smaller competitors. Amazon reported better-than-expected Q2 results, driven by a step-up in retail consumer demand, solid progress on remedying cost pressures (related to over investment) and strong performance in its web services business.

Other top contributors in Q3 included health insurance company Humana, semiconductor manufacturer Texas Instruments and home improvement retailer Home Depot.

Humana has held up well amid volatile markets given the characteristics of the Medicare Advantage market and expectations that it can return to market growth in the 2023 annual enrollment period. We are confident in Humana's value creation plan and ability to get back to market enrollment growth in addition to an increasing contribution from its health care services businesses. Shares of Texas Instruments outperformed as the COVID lockdowns eased in China, and customers could accept the product shipments leading to an upside in expectations.

Home Depot shares were more resilient in Q3 as the company continues to perform well and reiterated guidance despite increasing market concerns regarding general inflationary pressures and the impact rising mortgage rates may have on the housing market. We view the long-term prospects and multi-year fundamental outlook as unchanged. Home improvement through repair and remodel is likely to be one of more resilient housing-related industries given the relative attractiveness for consumers to renovate existing homes rather than reset their current low fixed mortgage rate to higher rates that we're seeing today.

Two of our weakest performers in Q3 were global pharmaceutical company Pfizer and health care products manufacturer Abbott Labs. Although Pfizer continues to report strong performance of its core drugs, sales of its COVID vaccine and treatment have likely peaked and sales are expected to decline going forward. We remain optimistic about the company long term as we believe management is taking the company in the right direction, focusing R&D, and making strategic acquisitions with profits generated from COVID vaccine sales.

Abbott has been working through a recall of its infant formula brand Similac in the US, which has continued to pressure its share price. Although the recall will impact near-term revenues, we are not concerned about any long-term impacts. We remain optimistic about the company given it is one of the highest quality names in health care, in our view, with a talented management team that makes smart capital allocation decisions. Abbott also has leading health care and consumer franchises with a particularly strong competitive position in its medical device business. The company continues to launch innovative products in key strategic areas (such as diabetes, structural heart, and diagnostics), which should help drive not only revenue growth but margin expansion.

Also among our bottom contributors were media and technology giant Alphabet, software and IT services provider Microsoft and insurance company American International Group (AIG).

Shares of Alphabet underperformed on concerns of a weakening macroeconomic environment. The company also reported weaker-than-expected earnings and revenue for Q2 2022. Longer-term, we expect Google's search engine advertising, YouTube advertising and other initiatives to continue driving revenue growth and attractive margins. Microsoft shares declined in Q3, along with other tech companies, as rising interest rates impacted the near-term outlook. We expect the business to continue to generate strong revenue growth and benefit from operating leverage. Microsoft's cloud computing services business, Azure, is generating robust growth, confirming its competitive positioning. AIG reported strong Q2 earnings, but volatile capital markets led to delays in the IPO of the company's life and retirement business and concerns about the quality of the company's investment portfolio. We continue to believe AIG has one of the best management teams in the industry, and they've been executing well on turning the business around and improving underwriting and expense control.

Portfolio Activity

Throughout 2022, our goal has been to continue taking advantage of the market selloff by focusing on areas of opportunity created by mispriced securities. At first, we recognized an opportunity in a few secular growth companies (Amazon, Alphabet, Microsoft) whose valuations declined due to rising interest rates. Then we identified opportunities in ConocoPhillips, Caterpillar, Union Pacific and Home Depot whose shares sold off meaningfully even though their long-term competitive positions made them resilient in the face of a potential economic slowdown. In Q3, we did not have any new additions or eliminations from the portfolio.

As we examine the market today, we are starting to become intrigued with economically cyclical areas of the market where company valuations have become depressed due to expectations of a near-term economic slowdown while the long-term competitive positions remain intact. These opportunities may be expressed by purchasing new positions in the portfolio or by increasing the position sizes of our current holdings that are cyclical companies. These companies are becoming especially attractive due to the serious price declines their stocks have experienced, and we think this area of the market is providing a great opportunity for long-term investors.

Market Outlook

As the US emerged from the pandemic, a sharp economic rebound, along with unprecedented fiscal and monetary stimulus, an uptick in wage growth and instances of supply/demand tightness, drove inflation to levels not seen in decades. In response, the Federal Reserve has aggressively tightened monetary policy and remains vocal about its commitment to rein in inflation, even if it must accept some economic pain to do so.

While the Federal Reserve continues to tighten monetary policy, a moderation of inflation, along with the sell-off in financial markets, rising mortgage rates and other factors that may slow broader demand could cause the Fed to act less aggressively. We've already seen a moderation in real GDP since its peak in Q4 2021. And while corporate earnings have been rising, a near-term economic slowdown and other factors like a strong US dollar could put pressure on corporate earnings going forward.

This year's decline in equity markets has brought valuations back around historical averages and has created investment opportunities for valuation-disciplined investors in the process. 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.

Period and Annualized Total Returns (%)

	Since Inception (26 Feb 2021)	1Y	YTD	3Q22	Expense Ratio (%)
Class I (DHFIX)	-3.79	-13.17	-22.23	-3.03	0.67
Russell 1000 Index	-4.19	-17.22	-24.59	-4.61	—
Russell 1000 Value Index	-1.29	-11.36	-17.75	-5.62	—

Click here for holdings as of 30 September 2022.

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.

The views expressed are those of Diamond Hill as of 30 September 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.

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.

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