DIAMOND HILL

INVESTED IN THE LONG RUN

Large Cap Concentrated Fund

As of 31 Dec 2022

Market Commentary

US stocks bounced in the quarter just over 7% (as measured by the Russell 3000 Index), bringing year-to-date losses to -19% to conclude stocks' worst year since the 2008 financial crisis. Mid-cap stocks led the way in Q4, up 9%, with large-cap stocks rising 7% and small-cap stocks up 6% (as measured by the Russell indices). From a style perspective, Q4 saw a continuation of the calendar-year trend, with value outperforming growth handily across the cap spectrum. The Russell 1000 Value Index rose 12%, while the Russell 1000 Growth Index rose just 2%. Meanwhile, the Russell Midcap Value Index was up 10% and its growth counterpart rose nearly 7%; the Russell 2000 Value Index was up over 8%, and the Russell 2000 Growth Index advanced 4%.

As they did for the calendar year, energy stocks led the way in the Russell 1000 Index in Q4, rising 21% and bringing total year returns to over 60% — oil prices spiked early in the year as Russia's invaded Ukraine. Industrials (17%) and materials (16%) also turned in a positive Q4, narrowing 2022 losses to -8% and -12%, respectively. Conversely, consumer discretionary and communication services added to calendar year losses, falling -8% and -2% in Q4 and -37% and -41% for the year, respectively.

Team

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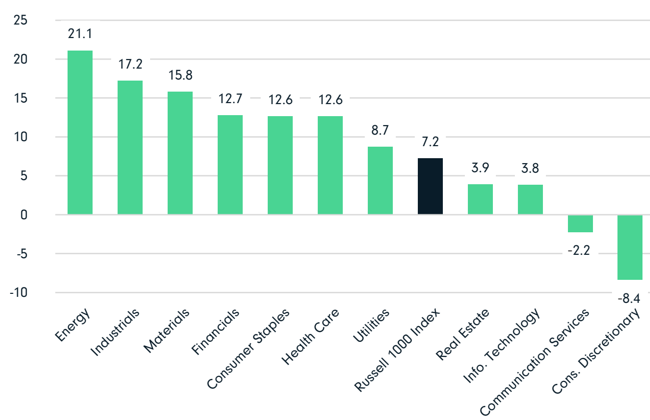
4Q22 Russell 1000 Index Sector Returns (%)



Source: FactSet, as of 31 Dec 2022.

As was the case for much of 2022, market action in Q4 seemed heavily predicated on investors' reading of the Fed tea leaves — with any sign there may soon be reason for easing often accompanied by a market rally. Though December's inflation reading — which, at 7.1% year over year, was the coolest it's been since December 2021 — may have offered reason for such optimism, Fed Chairman Jerome Powell has not indicated he foresees rate cuts in 2023, nor have the major global central bank heads, including the European Central Bank's Christine Lagarde. On the contrary: Rates are expected to rise, albeit at a slower pace, in 2023.

Inflation aside, we cited a positive in Q3 — that US financial institutions remain relatively strong, particularly in comparison with past tightening cycles — while also noting the possibility a particularly strong US dollar and rising European energy costs may cause dislocations overseas. Fortunately, Q4 saw both causes for overseas concern ease with the US dollar and European energy prices moderating, while inflation measures across many individual European countries moderated and economic measures generally remained solid.

This very economic robustness — in the US and overseas — is somewhat of a confounding factor as we enter 2023. By many measures (employment, manufacturing, corporate profit growth, etc.), the US economy particularly seems healthy — but the Fed's apparent determination to wrangle inflation could result in (or even require) overtightening and prompt a recession in the year ahead. Ideally, relative economic health will make any such recession both short-lived and shallow. Meanwhile, 2022's disappointing market returns have broadened the opportunity set for long term-focused investors able to identify compelling investments. Our dedicated focus on a five-year time horizon allows us to see beyond short-term volatility — both economic and market — and help position our clients to capitalize on dislocations like those introduced by 2022.

Performance Discussion

Our portfolio outpaced the Russell 1000 Index in Q4 by a decent margin due in large part to the outperformance of our holdings in the consumer discretionary, industrials and financials sectors. Our overweight exposure to financials and industrials was also beneficial. Partially offsetting those results was the underperformance of our holdings in consumer staples and communication services sectors. For the full calendar year, the portfolio held up meaningfully better than the index but still experienced double-digit declines. The challenging environment pressured equity markets in general as they were severely impacted by volatility and uncertainty created by Russia's war against Ukraine and shifting global macroeconomic conditions. For the full year, the relative strength of our technology holdings and our underweight exposure to the sector were beneficial. We also benefited from our outsized exposure to energy and financials. Weakness among our holdings in the communication services sector and our lack of exposure to utilities worked against us on a relative basis.

In Q4, our top contributors to return included insurance company American International Group (AIG), construction machinery manufacturer Caterpillar and oil and gas producer ConocoPhillips — these stocks were also among our top contributors for the full year. AIG continued to report strong progress in its multi-year turnaround. The company's property and casualty underwriting margin expanded for the 17th straight quarter. In addition, AIG completed the IPO of a portion of its Life and Retirement business, an important step towards a complete separation of the businesses.

In the case of Caterpillar, the company reported a better-than-expected Q3 as demand in mining, non-residential construction and energy remained healthy through the year even as recession fears grew. Caterpillar showed strong pricing power and operating efficiency in the face of supply chain constraints and labor shortages, which in turn contributed to better-than-expected share price performance.

ConocoPhillips' stock performed well in the market largely on the back of continued strong oil prices, even as the economic outlook became more uncertain. We continue to believe the company is one of the best operators in the space, with a diversified portfolio, assets concentrated in well understood jurisdictions, a strong balance sheet and excellent management.

Other top contributors during the quarter were copper producer Freeport-McMoRan and diversified healthcare company Abbott Laboratories. With little fundamental news to report, Freeport-McMoRan's share price advance in Q4 reflected a rebound in copper prices, driven by the recognition that copper inventories are low relative to historical norms. We believe the company continues to have meaningful price and volume leverage in a copper constrained world.

Abbott outperformed during the quarter as investors flocked to safety. Although we are pleased with the stock's performance, we are interested in the company due to its favorable long-term positioning. Abbott is a high-quality company with a talented management team that makes smart capital allocation decisions. The company has leading health care and consumer franchises with a particularly strong competitive position in its medical device business. Abbott 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.

Our weakest performer in Q4 was global online retailer Amazon.com. Recessionary and inflationary headwinds drove weaker demand and higher costs for its AWS (Amazon Web Services) and retail businesses. While overinvestment in the retail business during the pandemic and continued growth of investments in AWS could lead to near-term pressure on profitability, we believe Amazon's competitive advantages will continue to grow and that the business has the potential to grow much faster than the overall economy in the coming years.

Media and technology giant Alphabet's stock also declined in Q4. We believe weakness was driven by concerns of a weakening macroeconomic environment. The company also reported weaker-than-expected earnings and revenue for Q3 2022. Longer-term, we expect Alphabet's search engine advertising, YouTube advertising and other initiatives to continue driving revenue growth. As such, we used the share price weakness this quarter to add to our position.

Other bottom contributors to return included railroad operator Union Pacific, software and IT services provider Microsoft, and banking and financial services company Truist Financial. Union Pacific and Microsoft, though among our bottom contributors, still contributed positively to performance in Q4 as their share prices rose 7% and 3%, respectively. Truist's stock ended flat in Q4.

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 the second half of the year, we did not have any new additions or eliminations from the portfolio.

Market Outlook

After a strong rebound in 2021, global GDP growth moderated in 2022 and could slow further — or contract — in the coming year amid ongoing aggressive monetary policy. As real GDP passed its pre-pandemic peak, corporate earnings also reached new highs in 2022. However, corporate earnings growth is expected to slow in 2023, weighed down in part by an expected decline in energy sector earnings due to the recent decline in commodities prices.

The sharp economic rebound in the US — along with unprecedented pandemic-related fiscal and monetary stimulus, an uptick in wage growth and instances of supply/demand tightness — has resulted in elevated inflation levels. With inflation levels moderating in recent months, the Federal Reserve has started slowing the magnitude of rate increases. However, the Fed has remained vocal about its commitment to reining in inflation and seems willing to accept some economic pain to do so. That may present a risk for equity markets if the Fed continues tightening more than the market expects.

The sharp rise in interest rates has created a very different backdrop for equities. The cheap and abundant capital that had been a tailwind for early stage, high growth, profitless companies has largely evaporated, the effects of which were seen in value stocks' dramatic outperformance relative to growth in 2022.

The calendar year's equity market decline brought valuations back near historical averages and created some investment opportunities in the process. From current levels, it is likelier we see returns in the range of historical averages over the next five years. Our primary focus is always on achieving value-added results for our 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	4Q22	Expense Ratio (%)
Class I (DHFIX)	2.95	-12.75	-12.75	12.19	0.67
Russell 1000 Index	0.12	-19.13	-19.13	7.24	—
Russell 1000 Value Index	5.41	-7.54	-7.54	12.42	—

Click here for holdings as of 31 December 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 31 December 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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