DIAMOND HILL

INVESTED IN THE LONG RUN

Large Cap Fund

(closed to most new investors)

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 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.

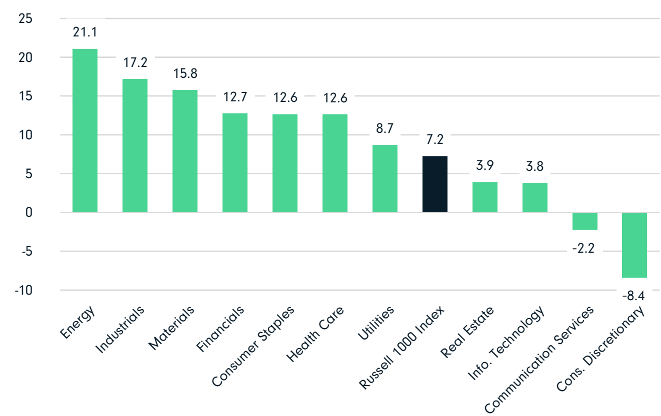
Team

Chuck Bath, CFA
Portfolio Manager

Austin Hawley, CFA
Portfolio Manager

Brian Fontanella, CFA
Portfolio Specialist

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 technology and consumer discretionary sectors, which was a reversal from the prior quarter. Partially offsetting those results was the underperformance of our holdings in the energy, consumer staples and utilities 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 holdings in the technology, industrials and consumer staples sectors was beneficial, as was our underweight to the technology sector, which suffered nearly -30% declines. Conversely, our underweight exposure to the utilities sector, along with our modest overweight to consumer discretionary stocks hampered relative performance.

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 health care facilities operator HCA Healthcare. 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.

HCA's stock price continued to advance in Q4 following a difficult first half of 2022. Fortunately, we did not own shares until the end of Q2. Two major factors that are top of mind for investors right now are volumes and labor constraints, both of which continue to normalize albeit at a relatively slow pace. We remain favorable on the long-term fundamentals of the business and the opportunity for HCA to reinvest the large amounts of cash it generates at attractive returns. That said, the discount to our intrinsic value estimate has narrowed significantly following robust returns in the second half of the year.

Our weakest performers in Q4 were regional bank SVB Financial Group and global online retailer Amazon.com. The rapidly rising interest rate environment has been exerting pressure on SVB's net interest margin as well as impacting the innovation economy, which is the company's primary area of focus. Upon revisiting our long-term thesis, we decided to sell our position in favor of more attractive opportunities.

At Amazon, 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.

Other bottom contributors included media and technology giant Alphabet, apparel and footwear company V.F. Corporation and utility operator Dominion Energy. We believe Alphabet's shares underperformed on 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.

Apparel and footwear company V.F. Corporation's stock declined in Q4 after management lowered guidance based on weaker-than-expected demand in North America, higher promotions and elevated wholesale order cancellations. The company also announced a CEO transition, effective immediately. Following these developments, we sold our shares in favor of higher conviction ideas.

Dominion Energy's stock price weakness was due in part to regulatory concerns surrounding its triennial rate review process and its offshore wind program. Additionally, management highlighted cost pressures, which could hamper growth rates. We believe these headwinds are short-term in nature and continue to hold our position.

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 focused on industrial monopolies (Martin Marietta Materials, Union Pacific, Waste Management) whose shares sold off meaningfully even though their long-term competitive positions made them resilient in the face of a potential economic slowdown. We increased our health care exposure (HCA Healthcare, Stryker) as this economically resilient sector sold off even though the fading pandemic was helping drive a secular improvement in earnings growth. Most recently in Q4, we increased our energy exposure by reinitiating a position in a company we know well and have owned in the past, integrated oil and gas company Chevron. We also initiated positions in used car retailer CarMax and regional bank First Republic Bank.

We previously owned Chevron as recently as February 2022. We sold our position at that time due to heightened risk associated with operations in Kazakhstan, which sends oil through a pipeline that runs through Russia out to the Black Sea. When Russia invaded Ukraine, we believed there was real risk that something would happen to inhibit Chevron's ability to get that oil to the market. We didn't believe that risk was reflected in the stock price, so we sold our position. Today, 10+ months into the Ukraine crisis, more information has become available regarding the Kazakhstan operations, and the associated risks are now well-known. We believe those risks are fully priced into the current stock valuation. Chevron is one of the best operators in its field, with a diversified portfolio and strong management, and we took the opportunity to reinvest when the stock was trading below our estimate of intrinsic value.

CarMax is the largest used vehicle retailer in the United States. The company also operates an in-house wholesale auction and a captive financing arm, both serving as unique and difficult to replicate competitive advantages. We initiated a position with the view that a challenging near-term environment for used car demand presented an opportunity to own a competitively advantaged industry leader with market share opportunity at an attractive discount to our estimate of intrinsic value. We believe the weak near-term external environment should help CarMax solidify its position given its healthy balance sheet and the possibility of a diminished competitive set.

In addition to SVB Financial and V.F. Corporation, we eliminated our positions in financial services technology company Fidelity National Information Services and media and technology company Comcast Corporation. Several reasons factored into our decision to sell Fidelity National

Information Services, including board and leadership changes, a strategic review, and a cooperation agreement with activist shareholder D.E. Shaw (and discussions with JANA Partners). With Comcast, uncertainty surrounding broadband growth due to rising competition and lower market activity, as well as the continued deterioration of the traditional media business, led to a less attractive risk/reward tradeoff and we chose to reallocate that capital to more attractive ideas.

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 (29 Jun 2001)	20Y	15Y	10Y	5Y	3Y	1Y	YTD	4Q22	Expense Ratio (%)
Class I (DHLRX)	8.56	10.47	8.10	11.36	7.23	5.88	-13.38	-13.38	11.01	0.67
Russell 1000 Index	7.66	9.92	8.77	12.37	9.13	7.35	-19.13	-19.13	7.24	—
Russell 1000 Value Index	7.11	8.83	6.96	10.29	6.67	5.96	-7.54	-7.54	12.42	—

Click here for holdings as of 31 December 2022.
Risk disclosure: Overall equity market risks may affect the portfolio's value.
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. 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