

DIAMOND HILL

INVESTED IN THE LONG RUN

International Fund

As of 30 Sep 2023

Market Commentary

Markets broadly declined in Q3 2023, with global stocks falling over -3% (as measured by the MSCI ACWI Index), bringing YTD gains to roughly 10%. US dollar-based returns were lower than local returns as the USD strengthened slightly during the quarter relative to major global currencies. Developed markets fell slightly more than emerging markets in Q3, declining more than -3% versus just shy of -3%, respectively, and bringing YTD totals to +11% versus +2%, respectively.

With all major regions in the red in Q3, the Middle East markets fell least, declining shy of -2% on the back of strength in Israel and Egypt. As we write, however, Israel is actively at war as Hamas invaded in early October – a development which bears watching and could impact markets in the region and beyond. The Asia Pacific region also held up moderately better than others, tied partly to resilience in India's market, which delivered a rare positive return in the quarter (+3%). Meanwhile, Asian markets generally declined, led down by Hong Kong (-11%), Taiwan (-7%) and Korea (-7%), while China fell a more modest -2% but remains mired in economic malaise. However, during the quarter, the country's government did announce several measures aimed at bolstering the flagging property market and incentivizing economic and trading activity.

In Europe, the biggest economies' markets – France (-7%), Germany (-8%), the UK (-2%) – all fell as the European Central Bank (ECB) and Bank of England (BOE) continue their bids to rein in inflation and economic data show signs of moderating. Meanwhile, investors had effectively the opposite reaction to Turkey's similar battle (its market rose +33% in Q3), given its inflation rate had skyrocketed and the country was in desperate need of higher rates, which its central bank finally started delivering over the last several months. Norway was another positive outlier, its market rising just shy of +12% as oil prices have risen.

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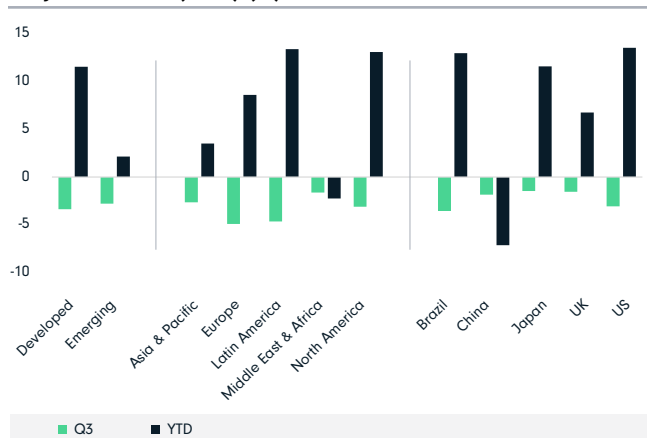
From a sector perspective, energy stocks in the MSCI ACWI ex USA Index were the sole positive performers, rising north of 9%. Conversely, technology stocks gave back some of their YTD gains, declining more than -8%, followed by utilities (-8%), which declined amid a rising rate environment. Consumer staples stocks were also in the red (down more than -6%) as investors weigh concerns about the likelihood of an economic downturn and its likely impact on consumers.

Though Q3 marked the year's first negative quarter, the headlines were substantially similar: Inflation, global monetary policy and geopolitical tensions remain front and center in financial news outlets. If there was a shift in Q3, it was arguably investors' seemingly growing recognition the major developed world central banks are likely to maintain higher interest rates for longer than many thought – with US Federal Reserve head Jerome Powell making that very declaration in September. Yet, the Fed, along with the Bank of England and Bank of Japan, held rates steady in September, while the European Central Bank (ECB) raised its benchmark rate to 4% – the highest level since the euro was launched in 1999.

Another of the major 2023 headlines that persisted in Q3 was concerns about China’s economic malaise – though the Chinese government announced in Q3 measures aimed at boosting growth and bolstering its property market. Among them are relaxed requirements for down payments and interest rates, as well as steps intended to improve sentiment and increase tax allowances for some demographics. These measures’ efficacy remains to be seen, especially in the face of rather stark economic realities, including falling consumer prices and factory activity. Further, China’s proverbial sneeze is prompting something of an Asian cold, with markets in Korea, Taiwan, Hong Kong and, more moderately, Japan declining in Q3 amid faltering Chinese demand.

Though there are reasons for optimism – both economically and market-wise – there are ample unknowns, as ever, and there are an equal number of reasons for caution. But such market environments, in our opinion, allow for investors with a time-tested and disciplined investing approach to shine. Particularly as market breadth has narrowed meaningfully – i.e., the majority of positive gains are increasingly concentrated in a small handful of market leaders – those bottom-up investors able to continue doing the fundamental work to identify good companies trading at attractive valuations are relatively well positioned. This is particularly relevant in an international context. Amid ongoing global concerns, well-researched investors can often find some of the most attractive long-term investment ideas in overseas markets. This is why we take the approach we do, and why we believe owning a well-curated portfolio of individual companies (as opposed to a benchmark or index) is critical to long-term, non-US investing success.

Exhibit 1 – Q3 2023 Total Returns for Major Markets (USD) (%)



Source: FactSet, as of 30 Sep 2023.

Performance Discussion

Our portfolio trailed the MSCI ACWI ex USA Index in Q3 due largely to our holdings in the UK and Poland, which weighed on relative results. Conversely, we benefited from strength in our Canada holdings, as they handily outpaced benchmark peers. From a sector perspective, our financials and consumer staples holdings underperformed, while our technology and industrials holdings, while still in the red, declined less than index names, benefiting relative performance.

On an individual holdings’ basis, top contributors to return in Q3 included energy names Canadian Natural Resources, Imperial Oil and new holding Japan Petroleum Exploration Company (Japex), all of which benefited from rising oil prices in Q3 as West Texas Intermediate (WTI) crude rose from roughly \$71/barrel at the end of Q2 to roughly \$90/barrel to close Q3. While we anticipate ongoing share-price volatility across energy names tied to oil prices’ volatility, we maintain our conviction in our holdings. Canadian Natural Resources has a solid company culture, balance sheet and management team, as well as an attractive portfolio of long-lived assets which should help the company outperform peers over the long term. Similarly, Imperial Oil has a strong balance sheet, which we anticipate it may utilize to repurchase shares in the coming quarters. Meanwhile, Japex is benefiting from ongoing efforts to improve corporate governance and capital allocation by implementing measures like repurchasing shares, increasing dividends and selling cross-shareholdings, all of which could improve shareholder value over time.

Also among our top Q3 contributors were Fairfax Financial and Howden Joinery Group. Shares of property and casualty insurer Fairfax Financial advanced as its strong underwriting results are contributing to growing book value, giving a boost to shares. Despite the recent share-price appreciation, we believe the franchise is attractively priced given its track record of effective capital allocation and investment performance, as well as the value of the businesses it holds. Howden Joinery, a leading supplier of kitchens in the UK, held up better than generally anticipated given rising interest rates. Notably, the company continues taking share under its capable management team and as peers struggle in the challenging macro environment. Howden Joinery’s strong balance sheet also gives it a leg up as peers pull back and it remains able to invest in the business.

Among our bottom contributors in Q3 were Dino Polska and Compass Group. Polish supermarkets operator Dino Polska has temporarily reduced its intended new store growth rate for the next couple years as it attempts to rein in costs amid a high-inflation environment and as the war in next-door Ukraine continues. Rising costs have also weighed on margins, despite the company's best efforts to contain costs. We believe management is taking the right action in slowing new store growth – avoiding excess strain on the balance sheet until costs normalize – and maintain our conviction in the long-term outlook from here.

Food and support services company Compass continues facing resetting market expectations in the wake of pandemic-induced volatility – first the drop in demand from economic shutdowns and now the demand snapback post-reopening. Volatility aside, however, the company's intrinsic value has remained steady, and it continues taking market share given its scale advantage as food service outsourcing continues growing.

Other bottom contributors in Q3 included Richemont, HDFC Bank and Smith & Nephew. Shares of Richemont, a Switzerland-based luxury goods company, were pressured amid a weakening consumer environment – particularly in China, where the macro environment remains challenging. India-based bank HDFC Bank faces uncertainty tied to its recent merger with HDFC Limited. However, we think the bank is well positioned to benefit from its leading market position in the coming years. UK-based medical devices company Smith & Nephew has faced supply shortages and cost inflation, both of which have impacted the industry broadly. We believe the company is managing pricing well, however, and has seen the worst of cost inflation. Smith & Nephew is investing in key growth areas outside of its orthopedics business, such as in shoulder and advanced wound devices, and we remain confident in its long-term trajectory.

Portfolio Activity

In addition to Japex, we initiated three new positions in Q3, including Wal-Mart de Mexico, Konecranes Oyj and Fusion Micro Finance. Wal-Mart de Mexico (Walmex) is the largest retailer in Mexico, with a significant scale advantage that is amplified in a Mexican market with limited and relatively unsophisticated competition as well as highly price-sensitive consumers. Walmex is earning the highest returns of any grocery retailer globally – including Costco – and is growing faster. Near-term concerns about the macroeconomic environment helped drive down the valuation, giving us an opportunity to initiate a position in a high-quality, fast-growing, stable grocery retailer at a rare discount to our estimate of intrinsic value.

Finland-based Konecranes manufactures, sells and services lifting equipment. While it trades as a cyclical heavy industrial company, it earns more like a staple company as most of its earnings are derived from its steady, high-margin services offering, the majority of which is recurring. The company is a leader on all the equipment it provides and is taking steady share in the services business. However, the share price tends to fluctuate alongside the macroeconomic outlook – which gave us an opportunity to initiate a position in what we believe is a valuable, high-quality business at a compelling valuation.

Fusion Micro Finance is an Indian micro-lender specializing in loans to female entrepreneurs in rural areas. We believe the Indian microfinance industry is well positioned and likely to see good growth and improving profitability. With a geographically diverse book of business and a strong capital position, we anticipate Fusion should benefit from macro tailwinds in the industry.

We exited our positions in Germany-based lubricant manufacturer Fuchs and enterprise application software provider SAP during Q3 in favor of more compelling opportunities. We also sold our position in Japan-based marketing and communication services provider Hakuhodo Dy Holdings in the wake of its Olympics bid-rigging scandal, which will likely impair the brand – though to what extent is hard to assess. Given the near-term headwinds, we chose to conclude our investment and redeploy our capital to higher conviction ideas. We also sold our shares of Japanese video game company Nintendo following the success of its Super Mario Brothers movie and as the company is between video game hardware and software cycles. We capitalized on the attractive share price to fund less cyclical and better risk-adjusted opportunities.

Market Outlook

Market participants have seemingly moved past the year's earlier bank failures; however, the full effects of these failures have not yet been felt. For example, if banks pull back on lending to improve their capital positions, economic growth could be negatively impacted. Balancing the potential economic impact of higher interest rates with elevated inflation levels continues complicating global central banks' monetary policy decision-making calculus.

We expect continued uncertainty and volatility across markets as global economies strive to tame inflation and promote economic progress. As we mentioned, uncertainty creates opportunities, and we are actively searching for opportunities around the globe that can be capitalized upon when the price and time are right. Our team has benefited from a return to more normal travel patterns

post-pandemic and has traveled around the world this year to research potential new investment ideas. The goal of these trips is identifying new businesses that might one day become portfolio holdings, as well as refining our intrinsic value estimates based on what we learn on the ground. Importantly, we also want to eliminate companies or management teams in which we do not want to invest. As always, our primary focus is on achieving value-added results for our existing clients, and we believe we can achieve better-than-market returns over the next five years and beyond through active portfolio management.

Period and Annualized Total Returns (%)	Since Inception (30 Dec 2016)	5Y	3Y	1Y	YTD	3Q23	Expense Ratio (%)
Class I (DHIX)	7.39	4.14	8.84	26.31	7.77	-5.11	0.86
MSCI ACWI ex USA Index	5.11	2.58	3.74	20.39	5.34	-3.77	—

[Click here](#) for holdings as of 30 September 2023.

Risk disclosure: International investments involve special risks, including currency fluctuation, lower liquidity, different accounting methods, tax policies, political systems and higher transaction costs. These risks are typically greater in emerging markets. 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 September 2023 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.

The quoted performance for the Fund reflects the past performance of Diamond Hill International Fund L.P. (the "International Partnership"), a private fund managed with full investment authority by the fund's Adviser. The Fund is managed in all material respects in a manner equivalent to the management of the predecessor unregistered fund. The performance of the International Partnership has been restated to reflect the net expenses and maximum applicable sales charge of the fund for its initial years of investment operations. The International Partnership was not registered under the Investment Company Act of 1940 and therefore was not subject to certain investment restrictions imposed by the 1940 Act. If the International Partnership had been registered under the 1940 Act, its performance may have been adversely affected. Performance is measured from 30 December 2016, the inception of the International Partnership and is not the performance of the fund. The assets of the International Partnership were converted, based on their value on 28 June 2019, into assets of the fund. The International Partnership's past performance is not necessarily an indication of how the fund will perform in the future either before or after taxes.

Fund holdings subject to change without notice.

Index data source: MSCI, Inc. 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