DIAMOND HILL

INVESTED IN THE LONG RUN

Long-Short Fund

As of 30 Sep 2023

Market Commentary

Markets cooled in Q3 2023, with US stocks declining -3% (as measured by the Russell 3000 Index), bringing YTD gains to roughly 12%. Despite rising the most year to date, large-cap stocks held up better than their smaller counterparts in Q3, declining a more modest -3%, while mid-cap stocks fell nearly -5% and small-cap just over -5% (as measured by the Russell indices). Reversing the YTD trend, and as one would generally expect during a downturn, value stocks generally outperformed in Q3 — though large-cap growth and value stocks were effectively even, with both categories declining just over -3%. The Russell Midcap Growth and Russell 2000 Growth Indices declined -5.2% and -7.3%, respectively, while their mid- and small-cap value counterparts held up better, declining a more modest -4.5% and -3.0%, respectively.

From a sector perspective, energy had the best Q3 on the back of rising oil prices, notching a positive quarter (12%). Communication services also managed a positive Q3 (2%), riding the ongoing wave of positive mega-cap stocks' performance, like Alphabet. Conversely, utilities (-9%) and real estate (-9%) were the quarter's worst performers. Consumer staples (-6%), technology (-5%) and industrials (-5%) were also in the red in Q3 as economies globally remain mired in an inflationary battle and some economic data moderated.

Team

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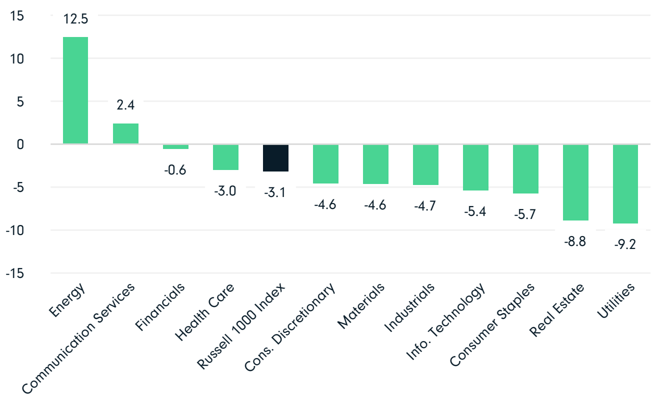
3Q23 Russell 1000 Index Sector Returns (%)



Source: FactSet, as of 30 Sep 2023.

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 in September, while the European Central Bank (ECB) raised its benchmark rate to 4% — the highest level since the euro was launched in 1999.

US Treasury rates, however, were another matter, as long-term rates (10- and 30-year) rose notably, particularly toward the end of the quarter, alongside other long-term government bonds globally. Given most central banks paused rate hikes in September, the move surprised many, prompting various theories about the potential cause. Some see rates reflecting the Fed's "higher for longer" proclamation, while others think markets are pricing in a soft economic landing — i.e., higher rates and ongoing inflation won't ultimately prompt a recession, but the economy will prove resilient enough to continue growing. Naturally, only time will tell which theory (whether one of these or another altogether) provides the best explanation for recent market activity.

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 solid, time-tested and rigorous 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.

Performance Discussion

The portfolio's positive returns led the Russell 1000 Index and the blended benchmark (60% Russell 1000 Index/40% Bloomberg US Treasury Bills 1-3 Month Index) — both of which were negative in Q3. Our short book trailed the index, providing a relative tailwind to performance. Our long financials holdings were also a source of relative strength. Conversely, our long industrials and health care holdings were sources of relative weakness in Q3.

On an individual holdings' basis, top contributors to return in Q3 included long positions in KKR, Ciena Corporation and Alphabet. Alternative asset manager KKR performed well as its most recent earnings were largely in line with expectations, though we believe its Q3 share-price gains were largely driven by improved market sentiment. Networking systems company Ciena's cloud-customer segment reported strong growth in the quarter, lending hope the company's service provider customers may stop pushing out orders and resume more normal ordering behavior in the near term. Shares of media and technology company Alphabet rose in the quarter as its advertising and cloud businesses remain robust and the company delivered results ahead of market expectations.

Other top contributors were from our short book, including Penumbra and Teradata Corporation. Medical device manufacturer Penumbra announced a delay in the launch of one of its new products, weighing on the share price during Q3. Shares of enterprise data warehouse company Teradata declined in the quarter as the company is executing unevenly on its cloud-migration strategy.

Our bottom contributors in Q3 were all from our long book, including HCA Healthcare and SS&C Technologies. Despite solid fundamental performance, health-care facilities operator HCA Healthcare experienced some share-price weakness during Q3. This appears to be more a result of short-term noise and sell-side expectations rather than any significant operational or financial issues.

SS&C Technologies, a provider of software and services to investment firms, brokerages and other financial institutions, has faced slower organic growth in recent quarters as its business units have produced inconsistent results. Further, rising costs have crimped margins — issues we believe will eventually stabilize but which we are monitoring closely. However, we believe the market is overly pessimistic about the company's ability to improve its organic growth rate and its margins and are maintaining our position.

Other bottom contributors included our long positions in Alaska Air Group, Target Corporation and Johnson Controls International (JCI). Shares of regional airline Alaska Air Group and general merchandise retailer Target declined during the quarter amid a weakening consumer and (in Alaska's case) airline pricing environment. Diversified technology and industrial company JCI announced late in Q3 it was impacted by a cyberattack — which contributed to downward pressure on the share price. While we believe the cyberattack was unfortunate, it is also not uncommon and should minimally impact JCI's long-term prospects. We maintain our conviction in the company's position relative to the trend toward smart buildings and expect it to continue shifting to high-margin services — and we believe these possibilities are not reflected in the current valuation, which trades at a steep discount to peers'.

Portfolio Activity

We initiated several new positions in Q3, including one long position: Laboratory Corporation of America Holdings (LabCorp). LabCorp is the leading diagnostic testing laboratory with a strong competitive position and significant scale that is difficult for new industry entrants to replicate. We capitalized on a compelling discount to our estimate of intrinsic value to initiate a position in the quarter.

We also initiated short positions in Mueller Industries, Bank of Hawaii, Alarm.com Holdings and Garmin in Q3. Mueller Industries is a leading producer of copper tubes and pipes for plumbing and HVAC systems — a cyclical industry with largely commoditized products that has seen meaningful margin gains in recent years tied to tailwinds we anticipate will likely reverse in coming years. Further, we expect long-term volume trends will likely remain sluggish as copper piping continues losing share to plastic over time. Given our expectation earnings power will revert to historical levels over time, we initiated a short position during the quarter.

We reinitiated a short position in Bank of Hawaii given the fair value risk in its securities portfolio, as well as its thin capital level — a combination we anticipate will constrain the bank's ability to grow earnings or return capital to shareholders in the period ahead.

Alarm.com Holdings provides various security, monitoring and automation solutions for residential, multifamily, small business and enterprise commercial markets globally. We believe the current share price meaningfully overestimates the company's future earnings power, while underestimating the magnitude of the challenges the company faces in growing its revenue base and expanding operating margins.

Garmin is a consumer electronics company which primarily sells high-end outdoor, fitness and adventure equipment which benefited tremendously from pandemic-related trends — which we believe will normalize. Further, we anticipate the company will face stiffer competition in its core smartwatch market, weighing on fundamentals over the coming years.

In Q3, we exited our long position in information technology services provider Cognizant Technology Solutions as the share price approached our estimate of intrinsic value. We also covered our short position in utility company Consolidated Edison as the share price reached our estimate of intrinsic value. We covered our short position in software-as-a-service (SaaS) information delivery provider Consensus Cloud Solutions in favor of more compelling opportunities.

The Fund's net exposure at the end of the quarter was 57%.

Market Outlook

After a strong start to Q3, equity markets gave back some ground in August and September, with the Russell 1000 Index ending the quarter down -3%. This reversal can, in large part, be attributed to the Fed's September meeting, at which it provided a stronger-than-expected economic outlook — a scenario potentially requiring interest rates at levels that are "higher for longer" than the market had previously expected.

Year to date, a very narrow group of stocks continues driving equity markets, with just seven — Meta Platforms, Apple, NVIDIA, Alphabet, Microsoft, Amazon and Tesla — still contributing a majority of the market's return. However, those stocks have collectively fallen since hitting their July peaks. In the first half of the year, it seemed investors shrugged off rising interest rates and continued buying growth stocks more broadly in anticipation of aggressive Fed easing in 2024. As that scenario began to appear less likely, growth's outperformance relative to value started modestly reversing.

Market participants have seemingly moved past the earlier failures of SVB Financial, First Republic and Signature Bank; 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 the Fed's monetary policy decision-making calculus.

Corporate earnings growth has slowed in 2023, weighed down partly by a decline in energy sector earnings due to commodities prices that remain lower than their mid-2022 peaks. However, energy sector earnings will soon benefit from the recent oil price rally.

Given aggressive monetary policy and much higher interest rates, we have been somewhat surprised at the magnitude by which large-cap growth stocks have outperformed the market thus far in 2023. And although the Fed's recent hawkish message and the subsequent jump in rates have weighed modestly on growth stocks, they have still regained a vast majority of their 2022 underperformance relative to value stocks, with the Russell 1000 Growth Index outperforming the Russell 1000 Value Index by 23 percentage points year to date.

Equity market valuations have fallen slightly to levels modestly above long-term averages (~18X versus ~17X). Given current valuations and interest rate levels, it may be difficult for equity markets to generate returns that match historical averages over the next five years; however, we continue finding attractive opportunities with the potential to generate above-average returns over that time horizon.

Our primary focus is always on adding value through stock selection by identifying both long and short opportunities. We believe investors who are willing to perform deep research and valuation work to identify individual businesses that are being mispriced by the market will be rewarded with favorable risk-adjusted returns over the long term.

Period and Annualized Total Returns (%)	Since Inception (30 Jun 2000)	20Y	15Y	10Y	5Y	3Y	1Y	YTD	3Q23	Expense Ratio (%)
Class I (DHLSX)	6.41	7.07	5.58	5.65	4.78	9.35	11.57	5.13	1.23	1.50
Russell 1000 Index	6.89	9.79	11.26	11.63	9.63	9.53	21.19	13.01	-3.15	—
60%/40% Blended Index	5.05	6.64	7.30	7.60	6.87	6.76	14.62	9.36	-1.33	—
Russell 1000 Value Index	7.10	8.22	8.59	8.45	6.23	11.05	14.44	1.79	-3.16	—

Click here for holdings as of 30 September 2023.

[1] Includes dividend expense relating to short sales. If dividend expenses relating to short sales were excluded, the Expense Ratio for the Long-Short Fund would have been 1.08% for Class I.

Risk disclosure: The portfolio uses short selling which incurs significant additional risk. Theoretically, stocks sold short have the risk of unlimited losses. Overall equity market risks may affect the portfolio's value.

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. 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: Bloomberg Index Services Limited. 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