

DIAMOND HILL

INVESTED IN THE LONG RUN

Small Company Monthly Musings

Eyes Wide Shut: Risks of Complacency

September 2025

A recent quote of the day came across my Bloomberg terminal that really caught my attention as it is jarringly indicative of some of the current market complacency that can create an environment of irrational extrapolation, pockets of neglect, and, in turn, opportunity for those willing to think ahead and attempt to manage risk:

“How much of my risk management (strategy, structures, institutions) assumes that politics and geopolitics will be stable?” – Dr. Pippa Malmgren

There is an underlying implication in Dr. Malmgren’s question: Are you operating under the assumption that the world will not change? Misplaced assumptions of stability are what fuel the complacency – operating as though forces are not actively in play competing, contradicting, and driving disruption.

The past five years have been punctuated by waves of unforeseen disruptions, illuminating the risks and fragility that can arise from assuming nothing will change. From a global pandemic, to a supply chain not built for surges, to inflation driven by the associated supply chain bottlenecks, to the vulnerability of levered financial institutions, to the realignment of global trade through tariffs. While one’s investment philosophy must remain steadfast throughout turmoil, we are still shaped by and learn from our experience.

While it is not incumbent upon us to be able to predict these events per se, we must be prepared. As investors, we must assess our portfolio for its ability to withstand these challenges. We refer to this as the “capacity to suffer” – the ability to endure – and it has become a paramount attribute of our Small Cap strategy. We want to own businesses built to endure the obscure risk of a global shutdown, such as Red Rock Resorts, whose ownership of its land assets served as a backstop during the pandemic. When it comes to financial institutions operating with leverage, as is the norm for banks in a fractional-reserve banking system, we look to own businesses that are exceptionally prudent in their management, as Bank OZK has illustrated through its highly conservative Real Estate Specialties Group (“RESG”) underwriting. Other businesses we own may build their capacity to suffer by operating with no debt – like Graham Corporation and US Lime & Minerals – allowing them to navigate the cyclicity inherent in some of their end markets. These are the types of companies that prove their mettle through risk management.

Importantly, the capacity to suffer does not necessarily shield us from volatility. However, it does help mitigate our risk of permanent impairment of capital – our definition of true risk. It also gives us the confidence to support our companies during difficult times. That endurance, in turn, creates the flexibility to pursue another trait we value in our businesses – the ability to deploy capital opportunistically, turning others’ complacency and neglect into opportunity.



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As of 31 August 2025, Diamond Hill owned shares of Red Rock Resorts Inc, Bank OZK, Graham Corp and US Lime & Minerals Inc. Securities referenced may not be representative of all portfolio holdings. The reader should not assume that an investment in the securities was or will be profitable.

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