

DIAMOND HILL

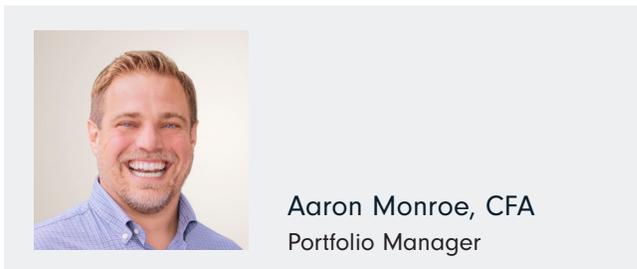
INVESTED IN THE LONG RUN

Small Company Monthly Musings

We Are Living in a Tangible World, and I Am a Tangible Guy

Feb 2026

We may be surrounded by algorithms, but as Madonna famously observed, we are still living in a material world. The contrast between the intangible and the tangible feels particularly relevant today. Few forces have accelerated change as quickly as artificial intelligence (AI). In a matter of months, AI has raised questions around and (in some cases) begun to compress the value of purely intangible work — code, content, analysis — lowering barriers and intensifying competition. But while the digital world may be increasingly replicable, the tangible world remains harder to displace. Physical assets, embedded infrastructure, regulatory barriers and real-world networks still form moats that algorithms alone cannot easily cross.



It is not our role to predict which technologies will ultimately prevail. Innovation is real, and the pace of change is accelerating. In times like these, we return to our foundation: a business-first mentality and a focus on understanding what makes a business resilient. Over time, we have observed that one of our historical edges has been identifying businesses with tangible asset advantages — assets you can see, touch and replicate only at great cost. AI will surely reshape the world, but we are living in a tangible world and I, for one, am a tangible guy. The moats formed by hard assets will prove to be more durable in an ever-changing AI environment.

As we contemplate the world today, we have become increasingly comfortable leaning into businesses where the competitive advantage is rooted in physical scarcity, regulatory barriers or irreplaceable real estate. In an environment where inflation remains non-negligible and capital has been unevenly deployed over the past decade, the cost to recreate physical infrastructure is rising. Tangible assets, particularly those with structural barriers to entry, can provide both resiliency and optionality.

Red Rock Resorts exemplifies this thinking. As a locals-focused Las Vegas casino operator, Red Rock owns a significant land bank in the Las Vegas Valley — a collection of well-positioned parcels that, in combination with SB208, which restricts where casinos can be built, effectively serve as a governor on future competitive supply. These are not assets that can be conjured by software or replicated overnight. This position has allowed the company to produce approximately 20% cash-on-cash returns on new developments — compelling economics supported by a localized network effect and meaningful regulatory constraints.

For much of the period from 2009 to 2020, markets rewarded asset-light models. Owning something tangible seemed less important in a world drifting toward the virtual. Yet the past five years — from supply chain disruptions to inflationary pressures — have underscored the consequences of underinvestment in the physical world. We still live in a world that requires land, buildings, infrastructure and production capacity. Dollars in the ground matter.

We have also selectively leaned into other forms of real estate. Alexandria Real Estate, for example, owns and develops marquee life science research campuses in markets such as Boston and San Diego. While biotech funding has experienced a cyclical trough and legislative uncertainty has weighed on sentiment, the underlying need for specialized laboratory space remains intact. These are mission-critical assets embedded within research ecosystems that are not easily replicated.

This type of franchise is rarely accessible within small-cap investing. Despite stretching our typical market-cap parameters, we initiated a position because we believe the opportunity was unique and differentiated. In our view, owning premier life science real estate during a period of cyclical uncertainty represents a prudent use of capital.

More broadly, real estate has become an increasingly meaningful component of our portfolio. We are not inclined to assume inflation has been fully extinguished. At the same time, there is a growing administrative narrative advocating for lower interest rates. Owning moat-protected real estate offers what we view as a favorable asymmetry across those scenarios. If inflation persists, the cost to build competing assets rises, strengthening the economics for existing owners. If policy becomes more accommodative and rates decline, cap rates should compress, supporting asset values and multiples. In either case, we see optionality for these assets.

This is not an environment in which we are swinging for home runs. We are looking for singles and doubles — businesses with strong franchises, reasonable leverage and the ability to deploy capital opportunistically when others cannot.

Markets may continue to reprice perceived disruption risk from week to week. A new industry may fall under scrutiny each month. Yet the principles that underpin durable value creation remain remarkably consistent. We continue to seek businesses with the capacity to suffer, the ability to deploy capital opportunistically, run by management teams with an ownership mindset that use leverage prudently. Anchoring the portfolio in businesses that own something real and difficult to replicate gives us confidence — not because we can predict every disruption, but because we are positioned to withstand it.

As of 31 January 2025, Diamond Hill owned shares of Red Rock Resorts, Inc and Alexandria Real Estate Equities, Inc.

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