



**DIAMOND
HILL** | CAPITAL
MANAGEMENT

Quarterly Commentary: Fixed Income Composites

March 31, 2018

Core Bond

High Yield

Corporate Credit

Our Mission

At Diamond Hill, *we serve* our clients by providing investment strategies that deliver lasting value through a shared commitment to our intrinsic value-based investment philosophy, long-term perspective, disciplined approach and alignment with our clients' interests.

VALUE

We believe market price and intrinsic value are independent in the short-term but tend to converge over time.

LONG-TERM

We maintain a long-term focus both in investment analysis and management of our business.

DISCIPLINE

We invest with discipline to increase potential return and protect capital.

PARTNERSHIP

We align our interests with those of our clients through significant personal investment in our strategies.

Fixed Income Markets

Much as it did in the preceding quarter, the yield curve continued to flatten during the first three months of 2018. Fueled by continued speculation surrounding the Federal Open Market Committee's (FOMC) plans to continue raising interest rates this year, the curve shifted higher throughout the quarter despite high levels of volatility.

In early February, we witnessed the end of one era and the beginning of another at the FOMC as Janet Yellen ended her run as chairwoman and Jerome Powell assumed leadership of the committee. Shortly after Yellen's final meeting as chair, year-over-year inflation in wages rose 2.9%, which began a period of market volatility that continued into March. During its March meeting, the FOMC raised the federal funds rate from 1.50% to 1.75%, and Chairman Powell was both transparent and concise in his first press conference as head of the FOMC.

In the Treasury market, the increase in yield resulted in negative performance across the majority of Treasury notes, with the Bloomberg Barclays U.S. Treasury Index declining 1.18% during the first quarter. The shorter end of the curve (1-year and 2-year notes) performed better than the longer end, with the 30-year Treasury delivering the biggest decline (down 3.89% following a strong fourth-quarter 2017).

As with every segment of the investment grade fixed income market, the securitized segment delivered negative returns during the first quarter of the year. Though the securitized sectors held up better than other areas of the market from an excess return standpoint (return over comparable-duration Treasuries), they were negative from an absolute standpoint. Within the securitized market, asset-backed securities delivered the strongest absolute performance, while commercial mortgage-backed securities delivered the best excess return.

After delivering the strongest returns in the investment grade universe in 2017, the investment grade credit market finally pulled back, with the Bloomberg Barclays U.S. Corporate Index declining 2.32% during the quarter. Utilities was the worst-performing sector, followed closely by industrials and financials. The ICE Bank of America Merrill Lynch U.S. High Yield Index returned -0.91% during the first quarter. The one positive aspect of the high yield market came from the CCC-rated segment, which delivered a 0.36% return. BB-rated high yield bonds were hit the hardest, declining 1.65% during the quarter.

The index data referenced herein is the property of ICE Data Indices, LLC, its affiliates ("ICE Data") and/or its third party suppliers and has been licensed for use by Diamond Hill Capital Management, Inc. ICE Data and its third party suppliers accept no liability in connection with its use. See diamond-hill.com for a full copy of the disclaimer.

The views expressed are those of Diamond Hill as of March 31, 2018 and are subject to change. These opinions are not intended to be a forecast of future events, a guarantee of results, or investment advice. Fixed income portfolio holdings are subject to change and will generally be posted monthly on a 60-day lag at diamond-hill.com.

All Composite returns are net of fees.

The Composite* generated a -0.74% total return during the first quarter, compared to -1.46% for the Bloomberg Barclays U.S. Aggregate Index. Since its inception on July 31, 2016, the Composite has generated a total return of 0.55% compared to -0.71% for the Index. The goal of the Diamond Hill Core Bond strategy is to outperform the Index over a market cycle. We are pleased with how the Composite has performed on a relative basis, both in the most recent quarter and since its inception.

Volatility returned to the markets with a vengeance during the first quarter of 2018, spurred first by higher-than-expected wage growth reported for January (a 2.9% year-over-year increase compared to expectations of 2.6%) and then by on-and-off-again trade war rhetoric driven by statements from China and the United States. The quarter also saw the end of Janet Yellen's term as Federal Reserve chairwoman and the beginning of Jerome Powell's term, a transition that occurred smoothly. Chairman Powell continued the tradition of transparency from the Fed during his inaugural Humphrey Hawkins testimony to Congress. The Fed communicated its reluctance to infer that there would be any kind of "Powell Put"*** as volatility spiked during the quarter. Both New York Fed President William Dudley and Chairman Powell made it clear that equity volatility would not influence federal funds rate management. First-quarter 2018 marks the first negative quarter for the Bloomberg Barclays U.S. Aggregate Index since the final quarter of 2016, when the markets were digesting the implications of the results of the U.S. election.

Much as it did in the preceding quarter, the yield curve continued to flatten during the first three months of 2018. Fueled by continued speculation surrounding the Federal Open Market Committee's (FOMC) plans to continue raising interest rates this year, the curve shifted higher throughout the quarter despite high levels of volatility. Specifically, the 1-year and 2-year Treasuries moved higher by 35 basis points and 28 basis points, respectively, while the longer end moved higher but at a reduced pace with the 10-year and 30-year increasing 33 basis points and 23 basis points, respectively. The strategy's underweight allocation to Treasuries relative to the benchmark was a positive contributor; however, the longer duration posture of the Treasury allocation within the strategy detracted on a relative basis as rates moved higher throughout the quarter.

The Core Bond strategy's duration has been maintained within our targeted range of +/-10% of the benchmark's duration. At the end of the first quarter, the strategy's duration was roughly 89% of the benchmark's duration (5.40 versus 6.08), reflecting the long-term

PORTFOLIO MANAGEMENT



Henry Song, CFA
Portfolio Manager



Mark Jackson, CFA
Portfolio Manager

viewpoint that interest rates have a greater chance of moving higher over the coming months and quarters. During the quarter, both the duration of the benchmark and the strategy extended as rates moved higher, from 5.98 to 6.08 for the benchmark and from 5.25 to 5.40 for the strategy. The strategy's overall shorter duration positioning relative to the benchmark contributed to performance during the quarter.

After delivering the strongest returns by a sector in the investment grade universe in 2017, the Bloomberg Barclays U.S. Corporate Index finally pulled back, losing 232 basis points during the quarter. Utilities were the worst performing sector, dropping 2.87% during the quarter followed closely by industrials (-2.31%) and financials (-2.21%). The strategy's underweight allocation to investment grade corporate, as well as a shorter duration posture relative to the benchmark, contributed to relative performance. Financials and utilities were essentially a wash relative to the benchmark while the underweight position in industrials contributed to relative performance as this sector was hit rather hard during the quarter.

The sector with the most substantial impact on the strategy during the quarter was the securitized sector, with strong security selection and sector positioning driving the majority of absolute return. A fast start to the year for issuance in the asset-backed securities (ABS) market provided opportunities, especially in the auto ABS sector, which was up 11% year over year. Agency mortgage-backed securities (MBS) delivered the strongest relative performance, followed by ABS. The strategy's MBS allocation performed well during a volatile quarter as plain vanilla pass-through mortgages in the Index extended to a greater degree than the mortgage allocation in the strategy. The commercial MBS allocation in the strategy was additive relative to the benchmark as the strategy's positions held up better during the volatility of the quarter.

The Core Bond strategy continues to search for opportunities in the marketplace while maintaining a conservative risk profile relative to the Index.

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PERIOD & ANNUALIZED RETURNS (%)

Inception Date: July 31, 2016

	TRAILING				CALENDAR	
	SINCE INCEPTION	1-YR	YTD	1Q18	7-31/16 - 12/31/16	2017
SELECT COMPOSITE						
Gross of Fees	0.85	2.68	-0.65	-0.65	-2.45	4.64
Net of Fees	0.55	2.36	-0.74	-0.74	-2.56	4.33
BENCHMARKS						
Bloomberg Barclays U.S. Aggregate Index	-0.71	1.20	-1.46	-1.46	-3.14	3.54

**This phrase originated with the “Greenspan Put” following the equity market crash in October 1987. Alan Greenspan garnered a reputation of adjusting the federal funds rate whenever the stock market dropped below a certain point, which encouraged movement into equities and created a theoretical floor on equity valuations. The Fed has historically added liquidity to the market in times of stress such as the Asian Financial Crisis, Long-Term Capital Management Crisis, Y2K, the 9/11 terrorist attacks, and the 2008 Financial Crisis. This pattern of providing liquidity created the perception that the Fed would continue to protect asset prices in a stressed environment.

Diamond Hill Capital Management Inc. (DHCM) claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS Standards. Diamond Hill has been independently verified for the period 5/31/00 – 12/31/17. Diamond Hill’s current verification firm is ACA Compliance Group. The verification report(s) is/are available upon request. Verification assesses whether (1) the firm has complied with all the composite construction requirements of the GIPS standards on a firm-wide basis and (2) the firm’s policies and procedures are designed to calculate and present performance in compliance with the GIPS standards. Verification does not ensure the accuracy of any specific composite presentation. Diamond Hill is a registered investment adviser and wholly owned subsidiary of Diamond Hill Investment Group, Inc.; registration does not imply a certain level of skill or training. Diamond Hill provides investment management services to individuals and institutional investors through mutual funds, separate accounts, exchange traded funds and private investment funds. A complete list and description of all composites and policies for valuing portfolios, calculating and reporting returns, and preparing compliant presentations are available upon request. The Core Bond Composite is comprised of discretionary non-fee and fee paying non-wrap accounts with a market value over \$10M managed according to the firm’s Core Bond fixed income strategy. The strategy’s investment objective is to maximize total return with the preservation of capital by investing in a diversified portfolio of intermediate and long-term debt securities. The portfolio generally invests at least 80% of its assets in a diversified portfolio of investment grade, fixed income securities and may invest a significant portion or all of its assets in mortgage-related and mortgage-backed securities. The portfolio will typically maintain an average portfolio duration within 20% of the duration of the Bloomberg Barclays U.S. Aggregate Index. The portfolio may invest a significant portion or all of its assets in asset-backed, mortgage-related and mortgage-backed securities at the discretion of Diamond Hill Capital Management, Inc. (the “Adviser”). The Composite results reflect the reinvestment of dividends, capital gains, and other earnings when appropriate. Composite returns and benchmark returns are presented gross of withholding taxes on dividends, interest income and capital gains. Returns are calculated using U.S. Dollars. Net returns are calculated by reducing the gross returns by either the actual client fee paid or the highest stated fee in the Composite fee schedule, depending on the type of client and account, and are reduced by estimated accrued performance based fees where applicable. Only transaction costs are deducted from gross of fees returns. The Bloomberg Barclays U.S. Aggregate Index is an unmanaged index representing the U.S. investment grade fixed rate bond market, with index components for government and corporate securities, mortgage pass-through, and asset-backed securities. Our selection process may lead to portfolios that differ markedly from the benchmarks presented. Returns may be more volatile than, and/ or may not be correlated to these indices, which are for comparative purposes only. The Firm’s standard fee schedule for Core Bond separate accounts is as follows: First \$50,000,000 = 0.29%; Next \$50,000,000 = 0.22%; Balance = 0.18%. The dispersion measure is the asset weighted standard deviation of the annual portfolio returns. Only portfolios represented in the Composite for the entire year are included in the calculation. The calculation is not performed if the Composite contains 5 or fewer accounts for the full year. No alteration of composites as presented here has occurred because of changes in personnel at any time. **Past performance is not a guarantee of future results.** It should not be assumed that an investment in the securities identified was or will be profitable. The holdings identified do not represent all of the securities purchased, sold, or recommended for the adviser’s clients. To obtain

AS OF YEAR-END	DHCM	CORE BOND COMPOSITE			3-YR ANNUALIZED STANDARD DEVIATION (GROSS OF FEES)	
		Assets Under Management	Number of Accounts	Assets Under Management (Gross of Fees)	Core Bond Composite	Bloomberg Barclays U.S. Aggregate Index
2017	\$22.3B	5 or fewer	\$43.8M	NA ¹	NA ²	NA ²
2016	19.4B	5 or fewer	39.7M	NA ¹	NA ²	NA ²

¹ NA = Not Applicable

² Statistics are not presented because 36 monthly returns are not available.

This composite was created in July 2016.

the contribution calculation methodology and a complete list of every holding’s contribution to the overall portfolio’s performance during the measurement period, please contact 855.255.8955 or info@diamond-hill.com. The Global Investment Performance Standards are a trademark of CFA Institute. CFA Institute has not been involved in the preparation or review of this report/advertisement.



All Composite returns are net of fees.

The Composite* generated a 0.38% total return during the first quarter compared to -1.98% for the ICE Bank of America Merrill Lynch U.S. Corporate & High Yield Index. For the trailing five years, the Composite generated an annualized total return of 5.76% compared to 3.39% for the Corporate & High Yield Index.

Unlike most corporate bond strategies, Diamond Hill Corporate Credit is not managed against any index. Instead, the strategy is managed against absolute objectives within a range of inflation plus 3% and 7% nominal, each measured over rolling five-year periods. Our goal is to generate a yield and total return within that range while minimizing the risk of downside volatility over longer time periods. Although the strategy's investable universe (and the Corporate & High Yield Index) includes both investment grade and high yield corporate bonds, since early 2010 we have been largely focused on the high yield portion of the market to achieve these objectives. About 90% of the strategy was in high yield corporate bonds at the end of the first quarter.

The high yield portion of the U.S. corporate bond market, as represented by the ICE Bank of America Merrill Lynch U.S. High Yield Index, began the year with a yield to worst (YTW) of 5.84% and option-adjusted spread (OAS) of 363 basis points. After generating a -0.91% total return in the first quarter, the High Yield Index ended the quarter with a 6.35% YTW and OAS of 372 basis points.

Financial markets have been sensitive to signs of wage inflation as that could ultimately lead to a more aggressive Federal Reserve. Also, markets may test the new Fed chair to get a better sense of when the Fed will try to suppress volatility. Volatility is difficult to forecast but with the aging of the economic and federal funds rate hike cycles and the impending global quantitative tightening, we expect (and always want to be prepared for) more frequent bouts of volatility.

PORTFOLIO MANAGEMENT



Bill Zox, CFA
Portfolio Manager



John McClain, CFA
Portfolio Manager



Suken Patel, CFA
Asst. Portfolio Manager

The high yield market is still priced for low defaults and muted volatility. The strategy's YTW is typically somewhere in the range of our absolute objectives, although it was well below the low end of the range on June 30, 2014 (the peak of that high yield market cycle) and well above the high end of the range on February 11, 2016 (the most recent bottom of the high yield market). At the end of the quarter, the strategy's YTW was 5.42%. The strategy's duration was 3.24, within the typical 2.0-3.5 range and well below the High Yield Index duration of 4.22 and the Corporate & High Yield Index duration of 6.69.

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Diamond Hill Corporate Credit Strategy

As of March 31, 2018

PERIOD & ANNUALIZED RETURNS (%)

Inception Date: September 30, 2002

	SINCE INCEPTION	10-YR	5-YR	3-YR	1-YR	YTD	1Q18
CORPORATE CREDIT COMPOSITE							
Gross of Fees	7.69	7.33	6.25	6.88	5.98	0.49	0.49
Net of Fees	7.19	6.82	5.76	6.41	5.52	0.38	0.38
BENCHMARKS							
ICE BofAML U.S. Corporate & High Yield Index	6.02	5.88	3.39	2.86	2.85	-1.98	-1.98
ICE BofAML U.S. High Yield Index	8.94	8.12	5.01	5.18	3.69	-0.91	-0.91

CALENDAR YEAR RETURNS (%)

	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
CORPORATE CREDIT COMPOSITE										
Gross of Fees	-16.55	30.78	14.52	6.30	10.65	6.12	3.17	2.18	12.90	8.55
Net of Fees	-16.96	30.09	13.96	5.78	10.11	5.60	2.65	1.72	12.40	8.08
BENCHMARKS										
ICE BofAML U.S. Corporate & High Yield Index	-10.93	26.00	10.76	6.80	11.37	0.34	6.43	-1.37	7.97	6.66
ICE BofAML U.S. High Yield Index	-26.39	57.51	15.19	4.38	15.58	7.42	2.50	-4.64	17.49	7.48

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portfolio returns. Only portfolios represented in the Composite for the entire year are included in the calculation. The calculation is not performed if the Composite contains 5 or fewer accounts for the full year. No alteration of composites as presented here has occurred because of changes in personnel at any time. **Past performance is not a guarantee of future results.** It should not be assumed that an investment in the securities identified was or will be profitable. The holdings identified do not represent all of the securities purchased, sold, or recommended for the adviser's clients. To obtain the contribution calculation methodology and a complete list of every holding's contribution to the overall portfolio's performance during the measurement period, please contact 855.255.8955 or info@diamond-hill.com. The Global Investment Performance Standards are a trademark of CFA Institute. CFA Institute has not been involved in the preparation or review of this report/advertisement. The index data referenced herein is the property of ICE Data Indices, LLC, its affiliates ("ICE Data") and/or its third party suppliers and has been licensed for use by Diamond Hill Capital Management, Inc. ICE Data and its third party suppliers accept no liability in connection with its use. See diamond-hill.com for a full copy of the disclaimer.

AS OF YEAR-END	DHCM	CORPORATE CREDIT COMPOSITE			3-YR ANNUALIZED STANDARD DEVIATION (GROSS OF FEES)		
		Assets Under Management	Number of Accounts	Assets Under Management	Dispersion (Gross of Fees)	ICE BofAML U.S. Corporate Credit Composite	Corporate & High Yield Index
2017	\$22.3B	5 or fewer	\$652.4M	NA	3.78%	3.63%	5.60%
2016	19.4B	5 or fewer	533.5M	NA	3.96	3.93	6.03
2015	16.8B	5 or fewer	299.0M	NA	2.91	3.82	5.27
2014	15.7B	5 or fewer	220.0M	NA	2.37	3.79	4.44
2013	12.2B	5 or fewer	186.7M	NA	3.32	4.34	6.42
2012	9.4B	5 or fewer	178.4M	NA	3.80	4.00	7.03
2011	8.7B	5 or fewer	146.0M	NA	7.10	5.73	11.00
2010	8.6B	5 or fewer	145.8M	NA	NA	NA	NA
2009	6.3B	5 or fewer	127.6M	NA	NA	NA	NA
2008	4.5B	5 or fewer	112.8M	NA	NA	NA	NA

NA = Not Applicable

This composite was created in April 2015.

**Global Investment
Performance Standards**

All Composite returns are net of fees.

The Composite* generated a 0.64% total return during the first quarter compared to -0.91% for the ICE Bank of America Merrill Lynch U.S. High Yield Index. Since inception on December 31, 2014, the Composite has generated an annualized total return of 8.18% compared to 5.59% for the High Yield Index.

The High Yield Index began the year with a yield to worst (YTW) of 5.84% and option-adjusted spread (OAS) of 363 basis points and ended the quarter with a 6.35% YTW and OAS of 372 basis points.

Financial markets have been sensitive to signs of wage inflation as that could ultimately lead to a more aggressive Federal Reserve. Also, markets may test the new Fed chair to get a better sense of when the Fed will try to suppress volatility. Volatility is difficult to forecast but with the aging of the economic and federal funds rate hike cycles and the impending global quantitative tightening, we expect (and always want to be prepared for) more frequent bouts of volatility.

The high yield market is still priced for low defaults and muted volatility. We will be patient and wait for our opportunity to purchase bonds at substantial discounts to intrinsic value. For now, it is more important to protect capital in a low yield and spread environment.

PORTFOLIO MANAGEMENT



Bill Zox, CFA
Portfolio Manager



John McClain, CFA
Portfolio Manager



Suken Patel, CFA
Asst. Portfolio Manager

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Diamond Hill High Yield Strategy

As of March 31, 2018

PERIOD & ANNUALIZED RETURNS (%)

Inception Date: December 31, 2014

	SINCE INCEPTION	3-YR	1-YR	YTD	1Q18
HIGH YIELD COMPOSITE					
Gross of Fees	8.55	8.03	7.74	0.76	0.76
Net of Fees	8.18	7.64	7.22	0.64	0.64
BENCHMARKS					
ICE BofAML U.S. High Yield Index	5.59	5.18	3.69	-0.91	-0.91

CALENDAR YEAR RETURNS (%)

	2015	2016	2017
HIGH YIELD COMPOSITE			
Gross of Fees	1.02	15.40	11.12
Net of Fees	1.02	14.82	10.58
BENCHMARKS			
ICE BofAML U.S. High Yield Index	-4.64	17.49	7.48

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AS OF YEAR-END	DHCM	HIGH YIELD COMPOSITE			3-YR ANNUALIZED STANDARD DEVIATION (GROSS OF FEES)	
		Assets Under Management	Number of Accounts	Assets Under Management	Dispersion (Gross of Fees)	High Yield Composite
2017	\$22.3B	5 or fewer	\$31.1M	NA ¹	5.15%	5.60%
2016	19.4B	5 or fewer	31.9M	NA ¹	NA ²	NA ²
2015	16.8B	5 or fewer	10.1M	NA ¹	NA ²	NA ²

¹ NA = Not Applicable

² The three-year annualized ex-post standard deviation of the composite and/or benchmark is not presented because 36 monthly returns are not available.

This composite was created in January 2016.





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