Diamond Hill Core Bond Strategy

As of December 31, 2018

All Composite returns are net of fees.

The Composite* generated a 2.22% total return during the fourth quarter, compared to 1.64% for the Bloomberg Barclays U.S. Aggregate Index. Since inception, the strategy has generated a total return of 1.41% compared to 0.12% 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 strategy has performed on a relative basis, both in the most recent quarter and since its inception.

TEAM

Henry Song, CFA
Portfolio Manager

Mark Jackson, CFA
Portfolio Manager

Douglas Gimple
Sr. Portfolio Specialist

The Federal Open Market Committee (FOMC) became a major force of market volatility during the fourth quarter, straining a market already under stress due to ongoing trade war rhetoric, a global economic slowdown, and the lead up to the most recent government shutdown. Federal Reserve chairman Jerome Powell started the quarter off on October 3 with comments pertaining to the central bank's positioning, stating that, "We're a long way off from neutral at this point." The Treasury market reaction was swift and pronounced, with the yield on the 10-year jumping 12 bps on the day of the speech, from 3.06% to 3.18%. The yield on the 10-year Treasury continued to climb into early November, peaking at 3.24%, before declining heading into the Thanksgiving holiday week as concerns arose around the viability of a cease-fire in the trade war agreed upon between President Trump and Chinese President Xi Jinping. December delivered one of the most volatile months in recent history for all asset classes, as markets and the Fed diverged in their respective outlooks for future interest rate management by the FOMC. As expected, the FOMC raised the target rate 25 bps to a range of 2.25%–2.50%, but the market was much more focused on the outlook delivered by the Dot Plot to better understand the potential for additional rate hikes in 2019. While there was no change to the economic assessment and minimal changes to language in the official statement, the downshift in the Dot Plot from three hikes in 2019 to two hikes was the major news. This meeting could be construed as dovishly hawkish, meaning that the Fed remains hawkish, projecting two increases in 2019, but by reducing from three increases and indicating a more data-dependent approach, there are dovish overtones. Equity markets reacted poorly to the statement and press conference, with the S&P 500 Index finishing December down over 9%. The 10-year Treasury rallied through the final part of the year, finishing the year at 2.68%. On December 22, the federal government partially shut down and remained so as of the end of the year.

Yields in the Treasury market moved dramatically across the curve as the shorter end (one-month to two- to three-year) moved higher and the longer end (five-year to 30-year) collapsed from a year-long high. The yield curve continued the trend of 2018, as spreads between the two-year and 10-year Treasury yields moved from 24.1 bps at the end of the third quarter to 19.5 bps at the end of the fourth quarter. The spread between the two-year and 10-year Treasury surged past its prior low for the year (18.9 bps on August 24), reaching 10.9 bps on December 19 during Jerome Powell's post-FOMC press conference. The short end of the Treasury curve inverted, as the five-year Treasury yield dropped below both the yield on the two-year and three-year Treasury during the first two and a half weeks of December.

The 10-year Treasury began the quarter at 3.06% and peaked in early October at 3.23% before rallying throughout the final weeks of the year to end the year at 2.65%. The shorter end of the curve followed a similar pattern as the two-year Treasury began the quarter at 2.82%, peaked at 2.97% on November 8, and rallied into year-end to finish at 2.49%. The rally across the curve delivered the strongest quarterly performance for the 10-year Treasury (3.87%) since the first quarter of 2016 and the strongest performance for the 30-year since the second quarter of 2017. The Treasury index delivered 2.57% during the final quarter of the year, more than enough to offset the 1.67% lost during the first three quarters of 2018. Despite the strategy's longer duration posture in Treasuries relative to the index, the underweight exposure (19.6% vs. 38.9%) detracted from performance during the quarter.

The strategy's duration has been maintained within our targeted range of +/-10% of the benchmark's duration. At the end of the third quarter, the strategy's duration was 5.42 compared to the index duration of 6.03, reflecting the long-term viewpoint that interest rates have a greater chance of moving higher over the coming months and quarters. Rates rallied throughout the quarter, pushing the duration of the Bloomberg Barclays U.S. Aggregate Index to 5.87 at the end of the fourth quarter. The strategy added duration during the quarter and ended at 5.52, slightly longer than the previous quarter-end but still shorter than the index. The strategy's overall shorter duration positioning relative to the benchmark detracted from performance during the quarter.

DIAMOND HILL | FUNDS

*Investments discussed are based on a representative portfolio and there is no assurance that Diamond Hill will make investments in a new client's portfolio with the same or similar characteristics as the representative portfolio presented. The representative portfolio is presented for discussion purposes only and is not a reliable indicator of the performance or investment profile of the Composite. Excess return indicates the return over comparable duration treasuries.

The Bloomberg Barclays U.S. Corporate Index delivered negative quarterly returns for the third time in 2018, with the third quarter representing the only positive quarter. The index was dragged lower by the industrial sector, which was down 46 bps (negative 350bps excess return) while financials (+27 bps, down 233 bps excess) and utilities (+20 bps, down 325 bps excess) helped to offset some of the negative performance. The significant underperformance from an excess return standpoint reflects the strong quarter for Treasuries combined with the dwindling appetite for risk going into year-end. The strategy's positioning in its corporate allocation contributed to performance as a result of the significant underweight in industrials and slight overweight allocation to financials.

While the investment grade and high yield markets experienced one of the more difficult quarters in recent memory, the securitized market continued to deliver strong absolute returns. Residential mortgage-backed securities (RMBS) delivered the strongest performance during the quarter, with 2.08% return, followed by commercial mortgage-backed securities (CMBS) with 1.72% return and asset-backed securities (ABS) returning 1.25%. Relative to comparable duration Treasuries, which delivered strong performance during the quarter, the shorter duration ABS market trailed by 16 bps, RMBS trailed by 53 bps and CMBS trailed by 112 bps. Within the ABS sector, autos returned 1.12% (-17 bps excess return) and credit cards returned 1.35% (-14 bps excess return). The strategy's overweight in the securitized sector contributed to performance during the quarter, with Residential MBS delivering the strongest contribution.

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

PERIOD & ANNUALIZED RETURNS (%)

Inception Date: July 31, 2016

	TRAILING				CALENDAR		
	SINCE INCEPTION	1-YR	YTD	4Q18	7-31/16 - 12/31/16	2017	2018
CORE BOND COMPOSITE							
Gross of Fees	1.71	2.06	2.06	2.30	-2.45	4.64	2.06
Net of Fees	1.41	1.75	1.75	2.22	-2.56	4.33	1.75
BENCHMARKS							
Bloomberg Barclays U.S. Aggregate Index	0.12	0.01	0.01	1.64	-3.14	3.54	0.01

Analytics provided by The Yield Book® Software. 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 – 9/30/18. 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 DHCM. 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 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. GIPS is a trademark of CFA Institute. CFA Institute has not been involved in the preparation or review of this report/advertisement.

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	Dispersion (Gross of Fees)	Core Bond Composite	Bloomberg Barclays U.S. Aggregate Index
2018	$19.1B	5 or fewer	$55.2M	NA[1]	NA[2]	NA[2]
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.

Global Investment Performance Standards