Diamond Hill Core Bond Fund Commentary

As of December 31, 2018

TEAM

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All Fund returns based on Class I shares.

The Fund generated a 2.18% total return during the fourth quarter, compared to 1.64% for the Bloomberg Barclays U.S. Aggregate Index. Since its inception on July 5, 2016, the Fund has generated a total return of 1.41% compared to 0.09% for the Index. The goal of the Diamond Hill Core Bond Fund is to outperform the Index over a market cycle. We are pleased with how the Fund has performed on a relative basis, both in the most recent quarter and since its inception.

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 2-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 Fund's longer duration posture in Treasuries relative to the index, the underweight exposure (19.6% vs. 38.9%) detracted from performance during the quarter.

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The Fund's duration has been maintained within our targeted range of +/-10% of the benchmark's duration. At the end of the third quarter, the Fund'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 Fund added duration during the quarter and ended at 5.52, slightly longer than the previous quarter-end but still shorter than the index. The Fund's overall shorter duration positioning relative to the benchmark detracted from performance during the quarter.

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 Fund'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 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 112bps. Within the ABS sector, autos returned 1.12% (-17 bps excess return) and credit cards returned 1.35% (-14 bps excess return). The Fund's overweight in the securitized sector contributed to performance during the quarter, with Residential MBS delivering the strongest contribution.

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

PERIOD AND AVERAGE ANNUAL TOTAL RETURNS AS OF DECEMBER 31, 2018

	SINCE INCEPTION (7/5/16)	1-YR	YTD	4Q18	EXPENSE RATIO
RETURNS AT NAV (WITHOUT SALES CHARGE)					
Class I	1.41%	1.59%	1.59%	2.18%	0.47%
BENCHMARK					
Bloomberg Barclays U.S. Aggregate Index	0.09	0.01	0.01	1.64	—

*Excess return indicates the return over comparable duration Treasuries.

Risk Disclosure: The value of fixed-income securities varies inversely with interest rates; as interest rates rise, the market value of fixed-income securities will decline. Lower quality debt (ie: "High Yield") securities involve greater risk of default or price changes due to potential changes in the issuer's credit quality. The value of investments in mortgage-related and asset-backed securities will be influenced by the factors affecting the housing market and the assets underlying such securities. The securities may decline in value, face valuation difficulties, become more volatile and/or become illiquid. They are also subject to prepayment risk, which occurs when mortgage holders refinance or otherwise repay their loans sooner than expected, creating an early return of principal to holders of the loans.

The views expressed are those of the portfolio managers as of December 31, 2018, are subject to change and may differ from the views of other portfolio managers or the firm as a whole. These opinions are not intended to be a forecast of future events, a guarantee of results, or investment advice.

The performance data quoted represents past performance; past performance does not guarantee future results. *The investment return and principal value of an investment 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 data quoted. Investors may obtain performance information current to the most recent month-end, within 7 business days, at diamond-hill.com.*

Performance returns assume reinvestment of all distributions. Returns for periods less than one year are not annualized. Class I shares have no sales charge.

Fund holdings subject to change without notice.

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. The Bloomberg Barclays U.S. Corporate Index is an unmanaged index measuring the investment grade, fixed-rate, taxable corporate bond market. It includes USD Denominated securities publicly issued by U.S. and non-U.S. industrial, utility and financial issuers. These indices do not incur fees and expenses (which would lower the return) and are not available for direct investment.

Analytics provided by The Yield Book® Software.

An investor should consider the Fund's investment objectives, risks, and charges and expenses carefully before investing or sending any money. This and other important information about the Fund(s) can be found in the Fund's(s) prospectus or summary prospectus which can be obtained at diamond-hill.com or by calling 888.226.5595. Please read the prospectus or summary prospectus 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. Like all mutual funds, Diamond Hill Funds are not FDIC insured, may lose value, and have no bank guarantee.