Diamond Hill High Yield Fund Commentary

As of December 31, 2018

All Fund returns based on Class I shares.

The Fund generated a -2.58% total return during the fourth quarter compared to -4.67% for the ICE Bank of America Merrill Lynch U.S. High Yield Index. For the year, the Fund generated a total return of 1.16% compared to -2.26% for the High Yield Index. Since inception on December 4, 2014, the Fund generated an annualized total return of 6.40% compared to 3.93% 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. After generating a -2.26% total return for the year, the High Yield Index ended the year with a 7.95% YTW and OAS of 533 basis points. A YTW close to 8% is a much better starting point for the high yield asset class than 5.84% at the beginning of 2018 or 6.38% at the Fund's inception. The Fund ended the year with a 7.07% YTW and a duration of 4.18, within our typical duration range of plus or minus 10% of the High Yield Index.

We want to hold up better than peers in down markets and then capture our fair share of the upside in strong markets. This should allow us to generate competitive high yield returns over a complete market cycle. Thus, we were gratified to generate a positive total return in a down market during 2018. Further, the Fund was also positive in 2015, the other negative high yield year during the Fund's existence.

Our structural advantages helped immensely. Because of our willingness to look different than the benchmark, we came into the year with much less exposure to the BB-portion of the high yield market which was overvalued with too much interest rate risk. As Treasury yields increased and credit spreads widened, we increased our exposure to that part of the market by 18 percentage points, exiting the year with a much higher credit quality portfolio than we have had since inception. Because we evaluate our performance over rolling five-year periods, we felt no need to chase the strong but overvalued high yield market in the third quarter and we were positioned defensively coming into the fourth quarter. Because we concentrate in our best ideas regardless of their weight in the benchmark, our credit selection outweighed the material spread widening of the High Yield Index in 2018. For example, the Fund generated positive returns in 13 out of 18 industries compared to only four out of 18 in the High Yield Index.

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The first three quarters of 2018 were characterized by rising Treasury yields, yield curve flattening, stable credit spreads and, after April, muted volatility. The Fed hiked three times and was signaling one more hike in the fourth quarter. The Treasury market moved in sync with the Fed although the back end of the curve did not increase as much as the front end so the curve flattened.

Much of this regime changed dramatically in the fourth quarter. Volatility spiked and stayed elevated through the end of the year. Through the November 8 meeting of the Federal Reserve, the volatility was led by a move higher in Treasury yields that seemed to ratify hawkish comments from Fed Chair Powell in early October. Diverging from the move in Treasuries, stocks and high yield bonds were 4-9% off their highs. Oil had declined 20% from its October 3 peak and trade tensions with China were escalating. In its November 8 statement, the Fed did not acknowledge any meaningful change to the environment or to its outlook.

Between the Fed's November 8 and December 19 meetings, Treasury yields came back down and stocks and high yield bonds declined markedly. For example, the 10-year Treasury yield peaked at 3.24% on November 8 but declined by 42 basis points to 2.82% on December 18. The S&P 500 was down 9% between meetings and 13% from the peak, while the Russell 2000 was down 13% between meetings and 20% from the peak. The High Yield Index was down 2.2% between meetings and 3.4% from the peak. (Because high yield bonds are senior to equity in the capital structure, they held up much better than equities in the sell-off, as we would expect.)

This was a treacherous set up for the Fed's December 19 meeting, exacerbated by limited liquidity in financial markets going into the Christmas and New Year holidays. On December 19, the Fed hiked another 25 basis points but its median projections for hikes in 2019 and the long-run neutral Fed Funds rate each came down by 25 basis points. Financial markets initially took this new information

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in stride until the post-statement press conference. In light of the lowered expectations for interest rate hikes, Fed Chair Powell was asked the predictable question of whether the Fed might alter the pace of its balance sheet reduction. The Chair responded by saying that the balance sheet reduction was on “autopilot.” Risk assets, like stocks and high yield bonds, immediately sold off and Treasuries rallied.

While there is some debate on how the Fed’s balance sheet reduction impacts financial markets, the spike in volatility since the beginning of the fourth quarter coincided with the first month in years that the big four global central banks were not collectively increasing the size of their balance sheets. In our judgment this had a meaningful impact on the willingness of market participants to bear risk and the Fed Chair’s message that the balance sheet reduction was on “autopilot” was not sufficiently sensitive to the market signals leading into the December 19 meeting.

Markets delivered an unequivocal message to the Fed with stocks declining about 8% in the four trading sessions beginning with the December 19 Fed press conference. Since then, the Fed has repeatedly walked back the “autopilot” comment and stocks regained most of the final 8% decline by the end of the year. Still, at the end of the year, the S&P 500 was down about 14% from its September 20 peak while the Russell 2000 was down about 22% from its August 30 peak. The High Yield Index was down about 5% from its October 3 peak.

To engineer a soft landing for the economy, it is appropriate for the Fed to tighten financial conditions. The Fed, as well as other central banks, is also trying to get out of the business of suppressing volatility in financial markets. However, this will not be easy and financial conditions had probably tightened too much at the Christmas Eve lows in stocks. With inflation contained and inflation expectations coming down, there is no need for the Fed to push the economy into recession.

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

	SINCE INCEPTION (12/4/14)	3-YR	1-YR	YTD	4Q18	EXPENSE RATIO
RETURNS AT NAV (WITHOUT SALES CHARGE)						
Class I	6.40%	8.57%	1.16%	1.16%	-2.58%	0.67%
BENCHMARK						
ICE BofAML U.S. High Yield Index	3.93	7.27	-2.26	-2.26	-4.67	—

Must be preceded or accompanied by a prospectus.

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 (i.e.:“High Yield”) securities involve greater risk of default or price changes due to potential changes in the issuer’s credit quality.

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.*

The quoted performance for the Fund reflects the past performance of the Diamond Hill High Yield Fund, L.P. (the “High Yield Partnership”), a private fund managed with full investment authority by the fund’s Adviser. The Fund is managed in all material respects in a manner equivalent to the management of the predecessor unregistered fund. The assets of the High Yield Partnership were converted into assets of the fund prior to commencement of operation of the fund. The performance of the High Yield Partnership has been restated to reflect the net expenses and maximum applicable sales charge of the fund for its initial years of investment operations. The High Yield Partnership was not registered under the Investment Company Act of 1940 and therefore was not subject to certain investment restrictions imposed by the 1940 Act. If the High Yield Partnership had been registered under the 1940 Act, its performance may have been adversely affected. Performance is measured from December 4, 2014, the inception of the High Yield Partnership and is not the performance of the fund. The assets of the High Yield Partnership were converted, based on their value on December 31, 2015, into assets of the fund prior to commencement of operations of the fund. The High Yield Partnership’s past performance is not necessarily an indication of how the fund will perform in the future either before or after taxes.

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 ICE BofA Merrill Lynch U.S. High Yield Index tracks the performance of U.S. dollar denominated below investment grade corporate debt publicly issued in the U.S. domestic market. This index does not incur fees and expenses (which would lower the return) and is not available for direct investment.

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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.

Some part of the decline in risk assets is attributable to the potential of a policy error not just by the Fed, but also by the Trump administration, Congress, or by authorities elsewhere in the world. It is important that authorities pay close attention to significant and sustained market signals. Some part of the decline is attributable to signs that global growth is slowing. Finally, some part of the decline is attributable to a "liquidity recession." One example of this "liquidity recession" in the high yield market is that investors in high yield ETFs expect more liquidity from those ETFs than the underlying high yield market can deliver. All of these factors feed on each other, making it difficult to discern how much each is influencing the financial markets.

We expect volatility to remain elevated for the foreseeable future as is typical late in the economic and market cycles. Over the next three to five years, starting from an 8% YTW, we forecast returns from high yield bonds somewhere between reasonable to good depending on how long the economic cycle is sustained. As always, we are focused on delivering competitive high yield returns over a complete market cycle by holding up better during down cycles and capturing our fair share of up cycles.