Diamond Hill Long-Short I
DHLSX

Analyst Notes

Diamond Hill Long-Short Equity Loses Manager but Remains Well-Resourced; Ratings Unchanged

Maintain Rating
Apr 03, 2020 | Diamond Hill announced on April 2, 2020, that Jason Downey, a co-portfolio manager on the Diamond Hill Long Short fund, is leaving the firm. He relinquished his portfolio manager position effective immediately.

Downey had been a co-manager on this strategy since 2017 and also covered stocks in the airline sector. The firm promoted associate portfolio manager Nate Palmer to co-portfolio manager, where he joins longtime lead manager Chris Bingaman at the helm of this fund. Palmer’s time as assistant portfolio manager should make for a smooth transition, consistent with Diamond Hill’s history of prudent succession planning.

With the firm’s strong central analyst bench still intact and two experienced managers calling the shots, the fund retains its Above Average People rating and an overall Morningstar Analyst Rating of Bronze for its cheapest share classes.

Diamond Hill Names New CEO; Positive Parent Rating Is Unchanged

Maintain Rating
Jul 10, 2019 | On July 10, 2019, Diamond Hill Investment Group DHIL announced the appointment of its new president and CEO, Heather Brilliant. Additionally, Brilliant will be added to the firm’s board of directors. She will succeed current CEO Chris Bingaman, effective September 2019. Bingaman will remain with the firm and continue in his role as portfolio manager for Diamond Hill Long-Short, which has a Morningstar Analyst Rating of Bronze. The upcoming change does not affect Diamond Hill’s Positive Parent rating.

This is Diamond Hill’s first time hiring a dedicated CEO that does not serve concurrently on its investment team; however, Brilliant’s deep investment experience is consistent with Diamond Hill’s investor-led culture. Brilliant boasts over 20 years of industry experience. Most recently, she served as CEO, Americas, with First State Investments for one year after serving in a managing director role for just under two years. Previously, Brilliant was Morningstar Australasia’s CEO for three years after serving as the global head of equity and credit research for Morningstar for five years. She joined Morningstar in 2005 as an equity analyst, a role she held for over eight years, beginning in July 2005. Brilliant’s prior investment and management experience should serve Diamond Hill well. It is unlikely her appointment shifts the firm’s strategic direction.

Diamond Hill Long-Short Reopens to New Investors

Maintain Rating
Jun 05, 2019 | Following a period of outflows, Diamond Hill Long-Short reopened to new investors on June 1, 2019. The fund retains its Morningstar Analyst Rating of Bronze.

Diamond Hill Long-Short closed to new investors in June 2015. At the time, the strategy had approximately $4.2 billion in assets. The fund has performed well since then, but outflows have brought current assets to around $3.6 billion.

Diamond Hill has responsibly managed capacity across its lineup, and it has indicated that this fund’s capacity is around $4 billion to $5 billion.

Comanager Change at Diamond Hill Long-Short

Immaterial Change
Mar 02, 2017 | In February 2017, Jason Downey was added as a co-manager to Diamond Hill Long-Short DHLSX. Downey is co-director of research and was previously a named manager on Diamond Hill Small Cap DSHSX. He serves as an assistant portfolio manager on this strategy. Portfolio manager Chris Bingaman still serves as the lead portfolio manager for the long-short strategy’s long stocks and Ric Dillon still serves as the lead for the portfolio’s short stock selection. The additional support does not affect this fund’s Morningstar Analyst Rating of Bronze.

© Morningstar 2020. All Rights Reserved. Unless otherwise provided in a separate agreement, you may use this report only in the country in which its original distributor is based. The information, data, analyses and opinions presented herein do not constitute investment advice, are provided solely for informational purposes and therefore are not an offer to buy or sell a security, and are not warranted to be correct, complete or accurate. The opinions expressed are as of the date written and are subject to change without notice. Except as otherwise required by law, Morningstar shall not be responsible for any trading decisions, damages or other losses resulting from, or related to, the information, data, analyses or opinions or their use. The information contained herein is the proprietary property of Morningstar and may not be reproduced, in whole or in part, or used in any manner without the prior written consent of Morningstar. Investment research is produced and issued by subsidiaries of Morningstar, Inc. including, but not limited to, Morningstar Research Services LLC, registered with and governed by the U.S. Securities and Exchange Commission.
Diamond Hill Long-Short I DHLSX
A decent option for fundamentally driven investors.

**Morningstar's Take** DHLSX

**Morningstar Rating** ★★★

**Morningstar Analyst Rating** Bronze

**Morningstar Pillars**

<table>
<thead>
<tr>
<th>Pillar</th>
<th>Rating</th>
</tr>
</thead>
<tbody>
<tr>
<td>Process</td>
<td>Average</td>
</tr>
<tr>
<td>Performance</td>
<td></td>
</tr>
<tr>
<td>People</td>
<td>Above Average</td>
</tr>
<tr>
<td>Parent</td>
<td>High</td>
</tr>
<tr>
<td>Price</td>
<td></td>
</tr>
</tbody>
</table>

**Role In Portfolio**

Supporting Player

**Fund Performance**

<table>
<thead>
<tr>
<th>Year</th>
<th>Total Return (%)</th>
<th>+/- Category</th>
</tr>
</thead>
<tbody>
<tr>
<td>YTD</td>
<td>-23.39</td>
<td>-10.99</td>
</tr>
<tr>
<td>2019</td>
<td>23.11</td>
<td>11.20</td>
</tr>
<tr>
<td>2018</td>
<td>-7.04</td>
<td>-0.75</td>
</tr>
<tr>
<td>2017</td>
<td>5.99</td>
<td>-5.19</td>
</tr>
<tr>
<td>2016</td>
<td>10.55</td>
<td>8.21</td>
</tr>
</tbody>
</table>

Data through 3-31-20

3-03-20 | by Bobby Blue

Experienced managers and a deep analyst bench contribute to Diamond Hill Long-Short. The firm’s steadfast approach to long-term fundamental investing works well for the fund’s long holdings, but has limitations when it comes to shorting stocks. On balance, the fund’s Morningstar Analyst Rating ranges from Bronze to Neutral depending on the share class.

The fund got a boost when Chris Bingaman stepped back from his CEO responsibilities to again focus fully on investing. He has been a manager on the strategy since 2007 and with the firm since 2001. Charles Bath, Jason Downey, and Nate Palmer join him atop the roster, each with more than a decade of experience with Diamond Hill. A strong central analyst team of nearly 30 industry specialists pitches them ideas, both for the fund’s long and short holdings. Dedicated short analysts would boost an already capable team, as short selling can pose unique challenges.

The managers employ the same long-term, fundamentally driven process that characterizes all of the firm’s strategies. The approach has driven excellent results for investors in the long-only funds; three receive Morningstar Analyst Ratings of Gold and one receives a Silver. The approach focuses on forecasting company cash flows out five years to arrive at an intrinsic value. The discount/premium to the company’s current price drives long/short positioning. Applying the same lens to shorting stocks has contributed to some drawn out losses, particularly in financials as the team has held on to some strong performers that have weighed on performance. More consideration to issues unique to short-selling, such as the risk of takeouts and a greater emphasis on momentum, would bolster the fund’s case.

Management intends for the fund’s short book to dampen volatility, which it does to an extent, but not enough to keep pace with the category benchmark S&P 500 on a risk-adjusted basis. The fund’s Sharpe ratio over the trailing 10 years through November 2019 sits at 0.71, a far cry from the 1.03 of the S&P 500. Still, it’s performed notably better than peers; the category average posted just a 0.51 Sharpe ratio.

**Process Pillar** Average | Bobby Blue 12/18/2019

The team employs a purely fundamental approach to stock selection. While the firm’s focus on long-term fundamentals has worked well for its long-only funds, this approach can cause issues when shorting stocks. This holds the fund’s Process Pillar at Average.

Diamond Hill’s approach to long-only equity investing remains distinguished, but their long time horizon and lack of specific considerations for shorting stocks holds them back. Management invests in companies trading lower than their estimate of the stock’s intrinsic value, and sells short stocks trading at a premium. When determining intrinsic value, the team models companies’ cash flows using a five-year time horizon; an approach that has excelled on the long side but can lead to drawn-out losses on the short book. Because stocks go up more often than they go down, a shorter time horizon with more defined catalysts for the stocks to lose money can improve outcomes. Other risks unique to shorting, like the risk of a stock being acquired at a premium after losing value, receive less consideration than the premium the stock trades at.

The strength of the long book should not be diminished. The team leverages the same ideas that propel three Diamond Hill long-only funds to Morningstar Analyst Ratings of Gold, and another to Silver. In most environments the fund has a long bias, meaning these ideas have an outsize impact on returns.

Management’s bottom-up research drives net equity exposure, rather than tactical equity market timing. This led them to opportunistically increase exposure in December 2018, when the S&P 500 was in the midst of a nearly 20% drawdown. Net exposure rose to 68%, above the fund’s long run average of 60%. This positioned the fund well for equities’ strong start to 2019. Investors should expect the fund to hew closely to its average weight of about 60% exposure over the long-term, often expressed through a 90% long and 30% short allocation.

The team has made thoughtful changes to the size of their short holdings throughout the years. It decreased the average position size from 90-95 basis points to a smaller 70-75 basis points, and increased the number of names in the short book as a result. The team made these changes recognizing that increased diversification in the riskier short book can dampen volatility. It also tries to avoid shorting names with significant...
headline risk. Tesla, which the team has shorted since September 2018, is a notable exception.

Management will hold on to high-conviction names through difficult stretches, owing to their long time horizon. The team has shorted Cincinnati Financial CINF since June 2012 and First American Financial FAF since March 2013, despite each topping the S&P 500 by at least 400 basis points on an annualized basis since they initiated the position.

Performance Pillar | Bobby Blue 12/18/2019
This fund has posted strong results versus peers, but has failed to best the S&P 500 on an absolute or risk-adjusted basis over the past decade’s bull market. Given its lower equity exposure, evaluation through a risk-adjusted lens makes sense. Its 10-year Sharpe ratio of 0.71 trails the benchmark’s 1.03 mark through November 2019, and its 7.02% annualized return lags by over 600 basis points. Category peers have done worse though, with the average long-short fund returning just 5.30%.

The fund has performed as expected during drawdowns, losing a bit less than the S&P 500. The fund lost 10.47% during the fourth quarter of 2018, while the S&P fell 13.52%. The fund’s beta tends to be around 0.7–high for the category—so it won’t provide as strong of a hedge during pullbacks. More often, the team’s ability to buy underpriced stocks during these drawdowns should drive results when the market recovers. The team positioned the fund well coming out of the 2018 drawdown, increasing equity exposure into 2019. This has contributed to the fund’s top-decile returns in 2019 through November.

Like most long-short equity funds, this fund’s correlation to equity markets is high. It stood at 0.89 over the trailing 10 years through November 2019, a high number for an alternative fund. With correlation so high, it would make more sense to slot this into a portfolio as an equity hedge rather than a return diversifier.

The veteran managers on this strategy receive support from an esteemed central analyst bench, supporting an Above Average People rating.

Four managers sit atop this strategy, all with over a decade of experience at Diamond Hill. Chris Bringaman leads the group, and has taken on a more active role after stepping back from CEO responsibilities in early 2019. He has been a manager on the strategy since 2007, and has shaped the fund’s process. The firm added Jason Downey and Nate Palmer more recently, in 2017 and 2018, respectively. Both have more than 10 years at the firm. Charles Bath takes a less active role on this strategy, as he contributes more actively to several long-only Diamond Hill funds. Ric Dillon, the longtime lead manager on this strategy, retired in 2018, though he had transitioned his responsibilities as lead on the short book to the broader analyst group in 2015.

Diamond Hill’s discerning research team provides the managers with well-thought-out ideas. Roughly 30 analysts work in the research group, with each focusing on companies in a specific industry. Their research informs all strategies at the firm. Their approach does not change when reviewing long or short ideas, as the process simply involves looking at the discount/premium to the fair value the analysts arrive at. Analysts with a deeper focus on the short book could provide a boost to an already strong team.

Portfolio managers are aligned with clients through the firm’s long-term-focused compensation structure that is closely tied to its strategies’ results. Employees are not permitted to invest in equities or non-Diamond Hill offerings where the same capability exists internally, making them investors alongside fundholders. The firm also boasts exceptional retention, and its thoughtful approach to succession planning ensures that transitions are seamless and telegraphed well in advance.

Diamond Hill recently appointed its first dedicated CEO in Heather Brilliant, who worked at Morningstar from 2005 to 2017. Brilliant’s priorities include growing brand awareness, but we expect its investor-led focus to stay intact. A mission-driven focus that permeates the firm sets this steward apart.

Price Pillar | Bobby Blue 12/18/2019
There was insufficient cost data available for this investment at time of publication.

People Pillar | Above Average | Bobby Blue 12/18/2019
Diamond Hill has consistently adhered to the intrinsic-value philosophy that drives all its strategies. When it has launched new strategies, the firm has taken a measured approach. For example, the investment team spent the better part of a decade building out global research coverage prior to launching its international and global strategies. It has also proved its willingness to close strategies and err on the side of conservatism when it comes to capacity estimates.
The Fund was long-only from inception through June 2002. 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 Funds’ 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, www.diamond-hill.com.

The Russell 1000 Index is an unmanaged market capitalization-weighted index comprised of the largest 1,000 companies by market capitalization in the Russell 3000 Index, which is comprised of the 3,000 largest U.S. companies by total market capitalization. The blended index represents a 60% weighting of the Russell 1000 Index and a 40% weighting of the ICE BofA U.S. T-Bill 0-3 Month Index. The ICE BofA U.S. T-Bill 0-3 Month Index is comprised of U.S. dollar denominated U.S. Treasury Bills with a term to maturity of less than 3 months. This index does not incur fees and expenses (which would lower the return) and is not available for direct investment. Index data source: London Stock Exchange Group PLC and ICE Data Indicies, LLC. See diamond-hill.com/disclosures for full details.

Risk Disclosure: The Fund uses short selling which incurs significant additional risk. Theoretically, stocks sold short have unlimited risk. Overall equity market risks may affect the value of the fund.

Performance is not guaranteed. Performance returns assume reinvestment of all distributions. Returns for periods less than one year are not annualized. Class C, Class I and Class Y shares include Class A share performance achieved prior to the creation of Class C, Class I and Class Y shares. The returns at POP reflect the maximum sales charge applicable to each class. The maximum sales charge for A shares is 5.00%; C shares have a maximum contingent deferred sales charge (CDSC) of 1.00% for redemptions within the first year of purchase; I shares and Y shares have no sales charge.

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 www.diamond-hill.com or by calling 888-226-5995. 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.

© 2020 Morningstar, Inc. All Rights Reserved. The information contained herein: (1) is proprietary to Morningstar and/or its content providers; (2) may not be copied or distributed; and (3) is not warranted to be accurate, complete or timely. Neither Morningstar nor its content providers are responsible for any damages or losses arising from any use of this information. Past performance is no guarantee of future results.

As of 3/31/20 there were 0 gold rated, 0 silver rated, 4 bronze rated, 4 neutral rated, and 103 not rated funds in the U.S. Long-Short Equity category. Morningstar Analyst ratings relative to the Morningstar Category are based on the cheapest share class for each fund as defined by Morningstar. The cheapest share class does not necessarily equate to the highest rated share class.

The Morningstar Analyst Rating™ is not a credit or risk rating. It is a subjective evaluation performed by Morningstar’s manager research group, which consists of various Morningstar, Inc. subsidiaries (“Manager Research Group”). In the United States, that subsidiary is Morningstar Research Services LLC, which is registered with and governed by the U.S. Securities and Exchange Commission. The Manager Research Group evaluates funds based on five key pillars, which are process, performance, people, parent, and price. The Manager Research Group uses this five-pillar evaluation to determine how they believe funds are likely to perform relative to a benchmark over the long term on a risk adjusted basis. They consider quantitative and qualitative factors in their research. For actively managed strategies, people and process each receive a 45% weighting in their analysis, while parent receives a 10% weighting. For passive strategies, process receives an 80% weighting, while people and parent each receive a 10% weighting. For both active and passive strategies, performance has no explicit weight as it is incorporated into the analysis of people and process; price at the share-class level (where applicable) is directly subtracted from an expected gross alpha estimate derived from the analysis of the other pillars. The impact of the weighted pillar scores for people, process and parent on the final Analyst Rating is further modified by a measure of the dispersion of historical alphas among relevant peers. For certain peer groups where standard benchmarking is not applicable, primarily peer groups of funds.
using alternative investment strategies, the modification by alpha dispersion is not used.

The Analyst Rating scale is Gold, Silver, Bronze, Neutral, and Negative. For active funds, a Morningstar Analyst Rating of Gold, Silver, or Bronze reflects the Manager Research Group’s expectation that an active fund will be able to deliver positive alpha net of fees relative to the standard benchmark index assigned to the Morningstar category. The level of the rating relates to the level of expected positive net alpha relative to Morningstar category peers for active funds. For passive funds, a Morningstar Analyst Rating of Gold, Silver, or Bronze reflects the Manager Research Group’s expectation that a fund will be able to deliver a higher alpha net of fees than the lesser of the relevant Morningstar category median or 0. The level of the rating relates to the level of expected net alpha relative to Morningstar category peers for passive funds. For certain peer groups where standard benchmarking is not applicable, primarily peer groups of funds using alternative investment strategies, a Morningstar Analyst Rating of Gold, Silver, or Bronze reflects the Manager Research Group’s expectation that a fund will deliver a weighted pillar score above a predetermined threshold within its peer group. Analyst Ratings ultimately reflect the Manager Research Group’s overall assessment, are overseen by an Analyst Rating Committee, and are continuously monitored and reevaluated at least every 14 months. For more detailed information about Morningstar’s Analyst Rating, including its methodology, please go to https://shareholders.morningstar.com/investor-relations/governance/Compliance--Disclosure/default.aspx.

The Morningstar Analyst Rating (i) should not be used as the sole basis in evaluating a fund, (ii) involves unknown risks and uncertainties which may cause the Manager Research Group’s expectations not to occur or to differ significantly from what they expected, and (iii) should not be considered an offer or solicitation to buy or sell the fund.

The opinions expressed in this article do not necessarily reflect those of Diamond Hill Capital Management, Inc., Foreside Financial Services, LLC, or the Diamond Hill Funds and are subject to change at any time based on market and other conditions and offer no guarantee of future positive performance for any Diamond Hill Fund or security mentioned. This article is provided for educational and informational purposes only and is not an offer of investment advice or financial products. In addition, the results actual investors might have achieved may vary from those shown. While Diamond Hill Funds believes the information presented in this article to be reliable and current, Diamond Hill Funds was not involved in writing the article and cannot guarantee its accuracy. Further circulation, disclosure or dissemination of all or any part of this material is prohibited. Re-printed with permission from Morningstar, Inc.

For more information about any of the Diamond Hill Funds, please visit our website: www.diamond-hill.com.