

Market Commentary

After one of history’s sharpest and quickest market declines in Q1, an unprecedented amount of government stimulus and the beginnings of an economic rebound as the world began reopening drove one of the sharpest equity market rebounds ever seen. The Russell 3000 Index returned 22.0% in Q2—its best quarter in history. As of June 30, the index was down just 3.5% for the year.

Technology-related stocks were again the most notable contributors to market returns in Q2. Many of these businesses will likely see minimal long-term impact from COVID-19, with some potentially coming out of it in a better competitive position. Combined with generally strong balance sheets and attractive growth rates, these businesses seem to have safe-haven status in the minds of many investors. Five of these stocks—Apple, Microsoft, Amazon, Facebook and Alphabet—contributed one-quarter of the broader market’s Q2 return. The consumer discretionary sector performed best, driven by Amazon’s 41.5% increase, while 43.8% and 29.4% returns for Apple and Microsoft, respectively, were responsible for a large portion of the information technology sector’s continued outperformance.

After a significant Q1 decline, the energy sector bounced back significantly in Q2. Oil prices plummeted earlier this year as demand cratered, causing producers to take supply offline. As economies started reopening in Q2 and demand slowly began returning, oil prices rebounded 92%—driving the sector 32.4% higher. Still, the sector is by far the worst performing year-to-date, down more than 36%.

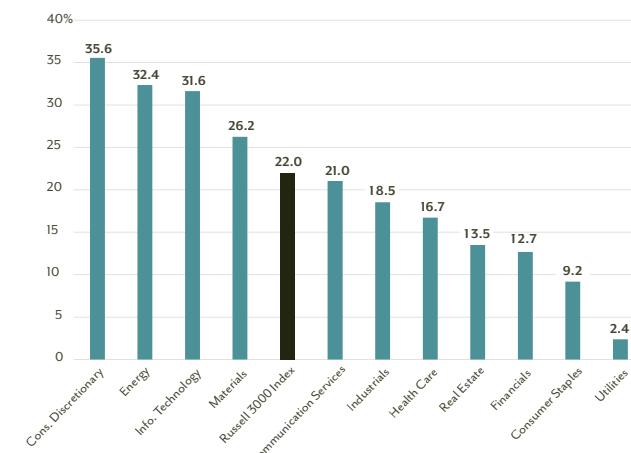
Defensive sectors lagged in Q2, with consumer staples and real estate increasing 9.2% and 13.5%, respectively, and utilities eking out a 2.4% return.

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RUSSELL 3000 INDEX SECTOR RETURNS - 2Q20



Source: FactSet.

Related to the strong performance of technology companies, growth stocks more broadly continued to dominate value stocks, with the Russell 3000 Growth Index’s 28.0% return nearly doubling the value index. Value did have a three-week stretch of outperformance starting May 15, but it didn’t last. Value gave back that outperformance and then some starting in mid-June as COVID-19 cases began to accelerate in many parts of the country. As concerns of a second wave grew, investors reverted back to the perceived safety of large-cap growth stocks.

Small cap stocks, however, reversed their recent trend of underperformance, with the Russell 2000 Index’s 25.4% return beating the Russell 1000 Index return by 360 basis points. This is the largest magnitude by which small caps have outperformed large caps since Q2 2018—though it’s only a small dent in large cap stocks’ multi-year outperformance.

The strength of the market rally has surprised us, since the economic and earnings outlook is still highly uncertain. Stock prices are not far from the levels seen at the beginning of the year, particularly for large caps, and valuations do not appear to discount a meaningful probability of an economic setback from a second wave of COVID-19. That said, the unprecedented amount of government stimulus—and a willingness to do more if necessary—continues to be supportive of markets.



Looking ahead, we anticipate most businesses to report declines in sales and earnings; however, those with a more variable cost structure should be able to protect margins and earnings better than those with greater fixed costs. We have been focused on assessing businesses' cost structures and how the associated operating leverage may impact near-term cash flows. In addition, we have been closely examining companies' balance sheets and liquidity situations to assess their ability to weather the downturn.

We remain focused on individual business analysis, comparing price and value, and prudently using volatility to take advantage of opportunities the market presents, all while attempting to minimize the potential for permanent impairments of client capital.

Small Cap Strategy Review

The Composite increased 16.47%, net of fees, compared to a 25.42% increase in the Russell 2000 Index and an 18.91% increase in the Russell 2000 Value Index.

On an absolute basis, most sectors contributed to return, led by the consumer discretionary and industrials sectors.

The Composite's underperformance relative to the Russell 2000 Index was primarily driven by security selection and an underweight position in the health care sector. Security selection in the consumer discretionary sector and an overweight position in the financials sector were also significant detractors from relative return. Security selection in the energy and utilities sectors contributed to relative return.

Best Performers

- Regional bank **Bank OZK**
- Ski resort operator **Vail Resorts, Inc.**
- Diversified technology company **Colfax Corp.**
- Rental and leasing services company **Aaron's, Inc.**
- Oil and gas exploration and production company **WPX Energy, Inc.**

Worst Performers

- Property and casualty insurance company **ProAssurance Corp.**
- Entertainment company **Live Nation Entertainment, Inc.**
- Property and casualty insurance company **Enstar Group Ltd.**
- Electronic components manufacturer **Sanmina-SCI Corp.**
- Regional bank **First of Long Island Corp.**

New Positions

- Food products manufacturer **Lancaster Colony Corp.**
- Medical device manufacturer **LivaNova PLC**
- Oil and gas exploration and production company **Noble Energy, Inc.**
- Sensor manufacturer **Sensata Technologies Holding PLC**

Eliminated Positions

- Processed and packaged foods manufacturer **B&G Foods, Inc.**
- Real estate investment trust **iStar, Inc.**
- Employment services provider **Kelly Services, Inc. (CI A)**
- Oil and gas exploration and production company **WPX Energy, Inc.**

PERIOD & ANNUALIZED TOTAL RETURNS (%)

Inception Date: December 31, 2000

	SINCE INCEPTION	10-YR	5-YR	3-YR	1-YR	YTD	2Q20
SMALL CAP COMPOSITE							
Gross of Fees	9.30	7.11	-0.68	-4.74	-18.39	-25.30	16.69
Net of Fees	8.44	6.27	-1.48	-5.50	-19.05	-25.61	16.47
BENCHMARKS							
Russell 2000 Index	7.20	10.50	4.29	2.01	-6.63	-12.98	25.42
Russell 2000 Value Index	7.03	7.82	1.26	-4.35	-17.48	-23.50	18.91

CALENDAR YEAR RETURNS (%)

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
SMALL CAP COMPOSITE										
Gross of Fees	24.76	-5.90	14.32	41.64	5.97	-2.44	15.61	12.05	-14.03	22.92
Net of Fees	23.77	-6.63	13.43	40.55	5.17	-3.22	14.70	11.16	-14.73	21.96
BENCHMARKS										
Russell 2000 Index	26.85	-4.18	16.35	38.82	4.89	-4.41	21.31	14.65	-11.01	25.52
Russell 2000 Value Index	24.50	-5.50	18.05	34.52	4.22	-7.47	31.74	7.84	-12.86	22.39

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 – 3/31/20. Diamond Hill's current verification firm is ACA Compliance Group. 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. In addition the Small Cap Composite has received a Performance Examination from 12/31/00 – 3/31/20. The verification and performance exam reports are available upon request. 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 and separate accounts. 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 Small Cap Composite is comprised of discretionary fee paying non-wrap accounts managed according to the firm's Small Cap equity strategy. The strategy's investment objective is to achieve long-term capital appreciation by investing in small capitalization companies selling for less than our estimate of intrinsic value. The Composite typically invests in small capitalization companies with a market capitalization between \$100 million and \$3 billion (or, if greater, the maximum market capitalization of companies generally within the capitalization range of the Russell 2000 Index) at the time of purchase. 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 Russell 2000 Index is the primary benchmark. This index is an unmanaged market-capitalization weighted index measuring the performance of the 2,000 smallest companies, on a market capitalization basis, in the Russell 3000 Index. The Russell 2000 Value Index is shown as additional information. This index is an unmanaged market-capitalization weighted index measuring the performance of the small cap value segment of the U.S. equity universe including those Russell 2000 Index companies with lower expected growth values. The Russell 3000 Index is an unmanaged market-capitalization weighted index measuring the performance of the 3,000 largest U.S. companies based on total market-capitalization. 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 Small Cap separate accounts is as follows: First \$20,000,000 = 0.90%; Over \$20,000,000 = 0.80%. 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.**

AS OF YEAR-END	DHCM	SMALL CAP COMPOSITE			3-YR ANNUALIZED STANDARD DEVIATION (GROSS OF FEES)		
		Assets Under Management	Number of Accounts	Assets Under Management (Gross of Fees)	Dispersion (Gross of Fees)	Small Cap Composite	Russell 2000 Index
2019	\$23.4B	5 or fewer	\$752.9M	NA ¹	14.20%	15.71%	15.68%
2018	19.1B	5 or fewer	1.0B	NA ¹	12.11	15.79	15.76
2017	22.3B	5 or fewer	1.5B	NA ¹	9.44	13.91	13.97
2016	19.4B	5 or fewer	1.8B	NA ¹	10.65	15.76	15.50
2015	16.8B	5 or fewer	1.7B	NA ¹	10.58	13.96	13.46
2014	15.7B	6	1.5B	0.03%	10.62	13.12	12.79
2013	12.2B	7	1.4B	0.74	13.63	16.45	15.82
2012	9.4B	16	911.6M	0.20	15.71	20.20	19.89
2011	8.7B	16	910.2M	0.11	21.46	24.99	26.05
2010	8.6B	19	938.0M	0.24	NA ²	NA ²	NA ²

¹ NA = Not applicable

² Statistics are not presented because the 3-year annualized standard deviations are not required prior to 2011. This composite was created in October 2013.

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. Index data source: London Stock Exchange Group PLC. See diamond-hill.com/disclosures for a full copy of the disclaimer.

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