

All Composite returns are net of fees.

The Diamond Hill Core Bond Composite* generated a 1.80% total return during the second quarter, compared to 1.45% for the Bloomberg Barclays U.S. Aggregate Index. Since its inception on July 31, 2016, the Composite has generated a total return of 0.36% compared to -0.94% for the Index. The goal of the Diamond Hill Core Bond strategy is to outperform the Index over a market cycle.

Despite potential economic headwinds that arose during the quarter, the Federal Reserve appears to be fully committed to their plan of gradually increasing the federal funds target rate over time. The Fed opted to maintain rates at their current level after their May 2 meeting and provided clear indication of their plans to continue down the path of normalization. Despite a less-than-stellar jobs report (+138,000) for May and a slight decrease in inflation, the Fed moved forward with their rate hike in June. More importantly, the Fed provided an outline of their plan to wind down the balance sheet over the coming years.

Key points of the proposed Policy Normalization Principles and Plans include:

- ‘Caps’ are defined as the maximum amount per month that will be permitted to roll-off (not reinvested). Proposal is to begin slowly and build up over time.
- ‘Caps’ for Treasuries begin at \$6 billion per month, with an increase of \$6 billion every three months, to a maximum level of \$30 billion per month.
- ‘Caps’ for mortgage-backed securities begin at \$4 billion per month, with an increase of \$4 billion every three months, to a maximum level of \$20 billion per month.
- Fed reserves the right to slow or even reverse the process if the economy struggles to grow or if we hit another recession.

Even as the Fed continues to push the shorter end of the yield curve higher by increasing its target rate, the longer end continues to rally. Lack of yield in the European bond market is one reason why yields on the longer end of the U.S. curve remain so low. However, the flattening of the curve saw some relief near the end of the quarter as the market began anticipating a tightening of the European Central Bank’s policy based on ECB President Mario

PORTFOLIO MANAGEMENT



Henry Song, CFA
Portfolio Manager



Mark Jackson, CFA
Portfolio Manager

Draghi’s comments on June 27. This increased the yield on the German bund, which serves as a bellwether for European interest rates. Longer U.S. Treasury yields moved higher as well.

	3/31/17	6/27/17	6/30/17	QUARTER-OVER-QUARTER CHANGE
2-Year U.S. Treasury	1.26%	1.37%	1.38%	+12 bps
10-Year U.S. Treasury	2.39	2.21	2.30	-9 bps
10-Year German Bund	0.33	0.37	0.46	+13 bps

Source: Bloomberg

The Core Bond strategy’s duration has been maintained within our targeted range of +/- 10% of the benchmark’s duration. At the end of the second quarter, the strategy’s duration was roughly 90% of the benchmark’s duration (5.41 and 6.01, respectively), reflecting the long-term viewpoint that interest rates have a greater chance of moving higher over the coming months and quarters. The strategy’s overall shorter duration positioning relative to the benchmark minimally detracted from performance during the quarter.

The securitized sector was the primary driver of relative return, led by strong security selection and sector positioning. Continued demand in the marketplace drove spreads even tighter across the entire space, even as heavy issuance continued to hit the marketplace. Year-to-date new issuance in the consumer asset-backed securities market is currently at its highest level since the financial crisis, 6.8% ahead of the previous six-month high achieved in 2014. Asset-backed securities, along with commercial mortgage-backed securities, were the primary contributors to relative performance in the securitized sector as spreads tightened due to high demand. With agency mortgage-backed securities still under pressure from the Fed’s involvement in the marketplace, this sector remains overvalued and, relative to other securitized assets, not very attractive.



*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.

Investment grade credit continued its resurgence, with the Bloomberg Barclays U.S. Corporate Index delivering a return of 2.54% in the second quarter. The strategy's underweight allocation to investment grade credit as well as sector allocation within the investment grade space detracted from relative performance. The largest detractor was our underweight position in industrials, which rallied during the quarter. Utilities and financials also slightly detracted from relative performance.

The Core Bond 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	YTD	2Q17	7-31/16 - 12/31/16
SELECT COMPOSITE				
Gross of Fees	0.63	3.16	1.88	-2.45
Net of Fees	0.36	2.99	1.80	-2.56
BENCHMARKS				
Bloomberg Barclays U.S. Aggregate Index	-0.94	2.27	1.45	-3.14

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 – 3/31/17. 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. 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 Diamond Hill Capital Management, Inc. (the "Adviser"). 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. The Global Investment Performance Standards are 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 (Gross of Fees)	Core Bond Composite	Bloomberg Barclays U.S. Aggregate Index
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.