DIAMOND HILL

INVESTED IN THE LONG RUN

Long-Short Fund

As of 30 Jun 2024

Market Commentary

Markets moved modestly higher in Q2, delivering positive returns across most regions and countries. US stocks rose +3% (as measured by the Russell 3000 Index) — though gains were primarily thanks to large-cap stocks, which were up nearly +4%. Down the cap spectrum, returns were negative, with mid caps and small caps each down roughly -3%, as measured by their respective Russell indices. From a style perspective, growth maintained its sizeable lead over value, with large-cap growth up +8%, while large value was down -2%; mid-cap growth and value each fell roughly -3%, while small-cap growth fell -3% and small-cap value fell nearly -4% (all returns as measured by the respective Russell indices).

From a sector perspective, technology (+13%), communication services (+9%), utilities (+5%) and consumer staples (+1%) were in the black in Q2 — the first three tied partly to meaningful momentum around AI-related technologies and the implied energy demand, which helped boost utilities. The relative resilience of utilities and staples is also likely due somewhat to a growing preference among investors for more defensive sectors as the economic and market cycles get increasingly long in the tooth. Conversely, materials (-5%), industrials (-3%) and financials (-2%) led the way down. Energy (-2%), real estate (-2%), health care (-1%) and consumer discretionary (<-1%) were also in the red.

Team

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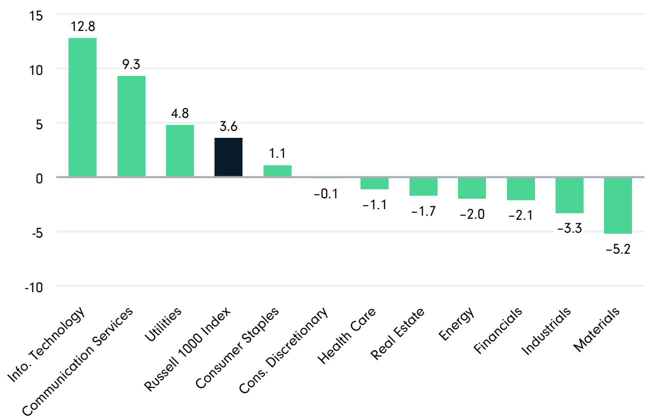
2Q24 Russell 1000 Index Sector Returns (%)



Source: FactSet, as of 30 Jun 2024.

As has been expected for several months, monetary policy among major central banks diverged in Q2 as the European Central Bank cut rates while the Bank of England and the Federal Reserve held. Further, Fed chair Jerome Powell maintained his position that US rates are likely to remain higher for longer, signaling that there is expected to be only one or two rate cuts before the end of the calendar year. Given the US's economic resilience — exemplified by resilient employment numbers — and inflation's ongoing stickiness, Powell's commitment is not particularly surprising. What naturally remains to be seen is how durable the economic data prove to be in the coming months.

Meanwhile, the ongoing global monetary policy and macroeconomic mix continues complicating the picture for a Chinese government which is seeking to boost its economy while facing growing trade tensions with Western countries — especially the US and the European Union, both of which have been ratcheting up restrictions related to electric vehicles and technology more broadly. Positively, Chinese GDP grew 5.3% year over year in Q1 — beating expectations and incrementally better than Q4's 5.2%. However, much of the growth has been attributable to the economy's supply side, for which the government has provided ample support, while the demand side and the country's consumers continue struggling to recover from a deep real estate crisis that has crimped wealth and led many to cut back on spending.

It's been hard to miss the recent performance of AI-related stocks — which has contributed to an increasingly narrow market as a small number of massive technology stocks drive the majority of index returns. Against this market backdrop, it's natural to question whether and how long the bull market can continue. However, this affords us an opportunity to add value for our clients as we avoid the temptations of swimming with the tide and maintain our disciplined adherence to our philosophy, which looks out past the latest trends to the longer term. We also believe it offers an increasingly interesting environment to deploy our time-tested, fundamental approach to identifying high-quality, underappreciated companies that may be easy to miss when they aren't necessarily on the obvious front lines of the latest fad.

Performance Discussion

The portfolio delivered positive returns in Q2 but trailed the Russell 1000 Index and the blended benchmark (60% Russell 1000 Index/40% Bloomberg US Treasury Bills 1-3 Month Index). Our short book trailed the index, providing a relative tailwind to performance. Our long industrials, materials and real estate holdings were also sources of relative strength. Conversely, our long technology holdings, while positive on an absolute basis, and our underweight exposure to the index's top-performing sector posed a relative performance headwind in Q2. Our long health care holdings also trailed benchmark peers, weighing on relative results.

On an individual holdings' basis, top contributors to return in Q2 included our long positions in Alphabet, Taiwan Semiconductor and Microsoft. Media and technology company Alphabet continued delivering strong results in its search, YouTube advertising, YouTube subscription and cloud businesses. Shares rose amid an environment that continues favoring mega-cap technology companies.

Semiconductor manufacturer Taiwan Semiconductor's (TSMC) fundamentals remain solid as demand for its chips continues growing — particularly as the machine learning and cloud computing trends gain more traction. Software and information technology services provider Microsoft's Azure, its cloud-computing platform, saw growth reaccelerate in the quarter, contributing to higher revenue and operating profit growth.

Other top contributors included our short positions in WD-40 and Alarm.com. Shares of WD-40, which develops and sells homecare, cleaning and maintenance products, declined as the company's quarterly earnings seemingly disappointed investors — whose expectations (and the stock's corresponding valuation) have exceeded what we believed were reasonable.

Alarm.com sells software-as-a-service (SaaS)-based operating systems to third parties that integrate them into their home security hardware systems. We believe the competitive environment is getting more difficult for the company: ADT is one of Alarm.com's large customers and has recently launched its own software platform, which ADT is adding to new users instead of Alarm.com's products. Further, ADT is prioritizing its partnership with Google Nest, which should challenge Alarm.com's future revenue growth. In the wake of these growing competitive forces, shares have been pressured.

Among our bottom Q2 contributors were our short position in GameStop, as well as our long position in Enovis Corporation. Shares of electronics retailer GameStop got a boost in Q2 as trader Keith Gill again made headlines and reinvigorated retail investors in the stock — which allowed the company to issue new stock and raise more capital.

Shares of innovative medical technology company Enovis were pressured amid some short-term headwinds related to the integration of a recent acquisition. While some were quick to conclude the boost Enovis and the medical technology industry overall received from a COVID-era backlog of surgeries is winding down, we believe Enovis remains well-positioned to continue taking share as it cross-sells new products. Further, we believe the market is undervaluing the company's ability to use its continuous improvement-focused business system to drive above-market organic growth, make accretive acquisitions and meaningfully expand margins over the long term.

Other bottom individual contributors in Q2 included our long positions in Lear Corporation, Target and Walt Disney. Leading global automotive seating manufacturer Lear underperformed in Q2 as slowing electric vehicle (EV) adoption weighed on the company's E-Systems segment in the near term. Further, rising dealer inventories are contributing to some concerns about the near-term demand outlook — though it's worth noting dealer inventories remain below pre-COVID levels.

US-based mass retailer Target faces concerns about a slowing consumer discretionary spending environment, which weighed on shares in the quarter. Shares of media and entertainment company Walt Disney declined as the company set expectations for a normalizing parks' environment as the post-COVID boost fades.

Portfolio Activity

Still-rising valuations have made identifying attractively valued, long ideas increasingly challenging — though we still found a few in Q2 that we believe the market is overlooking amid its increasingly narrow focus on the mega-cap technology stocks dominating the major indices. We established new long positions in VeriSign, Ulta Beauty, Sysco Corporation and Lamb Weston Holdings during the quarter.

VeriSign provides registry services for .com and .net top-level domains, as well as infrastructure essential to the internet's functioning. The company's services are mission-critical in supporting the internet's domain name system (DNS). We initiated a position in the company based on our belief it has a unique position and competitive advantages thanks to high switching costs and proprietary technology. We believe the market is narrowly focused on short-term concerns as post-COVID demand normalizes and capitalized on an attractive valuation entry point to initiate a position.

Ulta is a leading US specialty beauty retailer. As inflation has remained relatively elevated and consumers have found ways to economize and moderate discretionary spending, we believe Ulta is well-positioned to take share given its compelling portfolio of beauty brands across a range of price points, including its own private-label brand. We believe the current share price fails to account for an attractive outlook for the company and capitalized on a low valuation to initiate a position in Q2.

Sysco is the US's leading food service distributor. We believe it is a high-quality business and have followed it for many years. As investors' concerns about slowing quick-service restaurant traffic have pressured shares, we capitalized on what we believe to be a temporary headwind to initiate a position at an attractive valuation.

Lamb Weston is the US's leading supplier of frozen French fries. Shares have been pressured amid a slowdown in quick-service restaurant traffic — which gave us a compelling opportunity to capitalize on what we consider a large dislocation in price and intrinsic value.

We also initiated two new short positions in the quarter: Deckers Outdoor Corporation and Doximity. We initiated a short position in footwear and apparel manufacturer Deckers as we believe growing competition in running footwear will weigh on growth in the company's HOKA brand. Additionally, we believe the company's UGG brand is subject to unpredictable fashion trends, which we believe are unlikely to persist.

Doximity operates an online platform for medical professionals that generates most of its revenue from digital advertising. We believe investors are too optimistic about user engagement and the company's ability to grow its relationships with its largest customers and consequently initiated a short position in the quarter.

We partially funded these purchases by selling our long position in regional airline Alaska Air Group as its price approached our estimate of intrinsic value. We also covered our short positions in consumer electronics retailer Best Buy, alcoholic beverage manufacturer and distributor Brown-Forman and postsecondary education services company Grand Canyon Education as their prices likewise approached our estimates of intrinsic value.

The Fund's net exposure at the end of the quarter was 57%.

Market Outlook

Strong corporate earnings and economic growth continued in Q2, which helped bring the Russell 1000 Index's year-to-date performance to +14.2%. However, the market has narrowed again, with a large portion of returns driven by a small handful of mega-cap tech stocks. Nearly two-thirds of this year's return has been driven by six stocks: NVIDIA, Meta Platforms, Microsoft, Alphabet, Amazon and Apple. Year to date, NVIDIA alone has contributed nearly one-third of equity market returns with its +150% increase.

Over the past 10 years, growth stocks' outperformance relative to value stocks has been astounding at over 8 percentage points annually. However, it is interesting to note this has not been driven by value stocks' poor performance. On the contrary, the Russell 1000 Value Index has increased more than 8% annually over the past 10 years — in the range of long-term equity returns.

Similar to the performance disparity among growth and value stocks, small caps continue to underperform large caps. Year to date, small caps have underperformed by more than 12 percentage points, and over the past 10 years, they have underperformed by about 5.5 percentage points, annualized. By some measures, small caps are trading near a historically low valuation premium relative to large caps.

Corporate earnings are expected to grow at a double-digit rate in 2024, driven by mega-cap tech stocks, a rebound in health care sector earnings after a large decline in 2023 and growth from the financial services sector.

With the continued rally, equity market valuations remain at above-average levels. While this has been somewhat supported by the fall in interest rates since their peak in October 2023, it may still be difficult to generate returns from current levels that match historical averages over the next five years. However, we continue to seek attractive opportunities with the potential to generate above-average returns over that period.

Our primary focus is always on adding value through stock selection by identifying both long and short opportunities. We believe investors who are willing to perform deep research and valuation work to identify individual businesses that are being mispriced by the market will be rewarded with favorable risk-adjusted returns over the long term.

Period and Annualized Total Returns (%)

	Since Inception (30 Jun 2000)	20Y	15Y	10Y	5Y	3Y	1Y	YTD	2Q24	Expense Ratio (%)[1]
Class I (DHLSX)	6.93	7.12	7.73	6.14	7.39	6.12	19.29	10.21	0.58	1.49
Russell 1000 Index	7.76	10.33	14.71	12.51	14.61	8.74	23.88	14.24	3.57	—
60%/40% Blended Index	5.61	7.03	9.34	8.29	9.92	6.85	16.48	9.57	2.73	—
Russell 1000 Value Index	7.56	8.13	11.78	8.23	9.01	5.52	13.06	6.62	-2.17	—

Click here for holdings as of 30 June 2024.

[1] Includes dividend expense relating to short sales. If dividend expenses relating to short sales were excluded, the Expense Ratio for the Long-Short Fund would have been 1.07% for Class I.

Risk disclosure: The portfolio uses short selling which incurs significant additional risk. Theoretically, stocks sold short have the risk of unlimited losses. Overall equity market risks may affect the portfolio's value.

The views expressed are those of Diamond Hill as of 30 June 2024 and are subject to change without notice. These opinions are not intended to be a forecast of future events, a guarantee of future results or investment advice. Investing involves risk, including the possible loss of principal.

Past performance is not indicative of future results. Investment returns and principal values 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 quoted. For current to most recent month-end performance, visit diamond-hill.com.

Performance assumes reinvestment of all distributions. Returns for periods less than one year are not annualized. Class I shares include Investor share performance achieved prior to the creation of Class I shares.

Fund holdings subject to change without notice.

Index data source: Bloomberg Index Services Limited. See diamond-hill.com/disclosures for a full copy of the disclaimer.

Securities referenced may not be representative of all portfolio holdings. Contribution to return is not indicative of whether an investment was or will be profitable. To obtain contribution calculation methodology and a complete list of every holding's contribution to return during the period, contact 855.255.8955 or info@diamond-hill.com.

Carefully consider the Fund's investment objectives, risks and expenses. This and other important information are contained in the Fund's prospectus and summary prospectus, which are available at diamond-hill.com or calling 888.226.5595. Read 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. Not FDIC insured | No bank guarantee | May lose value