

DIAMOND HILL

INVESTED IN THE LONG RUN

Small Cap Monthly Musings

Big World Problems, Small Company Solutions: Thinking about Geopolitical Disruptions from a Business Owner's Mindset

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How do we think about investing in a world of constant disruption and geopolitical tension? The surprise attack of Hamas on Israel has exacerbated tensions in an already unstable region. We now have an active war in Eastern Europe as well as in the Middle East. We've seen steady military disruptions across many African and South American countries. There has been increased tension with China and Taiwan. What opportunities and pitfalls are being created in this environment?



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Our philosophy on investing has us deeply focused on businesses and how they are built – the way cash flows are generated, financial and operating leverage employed, the culture of the company, etc. We seek to identify businesses with the ability to not only traverse challenging and uncertain times but that are built conservatively and can take advantage of drawdowns or cyclical opportunities to make themselves better and stronger over the long term. We refer to this concept as businesses [built with resiliency](#). This also holds at the portfolio level. We are looking to construct a portfolio of unique businesses that collectively should deliver results over the long term regardless of the geopolitical environment. Increasing geopolitical uncertainty and disruptions only increase the importance of these principles.

We've gone through years of de-weaponizing the world. Unfortunately, we are now moving back to needing to replenish stockpiles and armories. This is an area where the US is looking to ramp up investment and manufacturing capacity. In addition to US demand, many suppliers will benefit from heightened demand abroad as numerous countries seek to bolster their arsenals. Not only does escalating geopolitical tension provide direct defense tailwinds, but this environment also increases the likelihood that manufacturing redundancies and friend-shoring/reshoring will occur. In addition, we may see an uptick in heavy machinery investments and demand for steel and armor. Businesses built to take advantage of these opportunities can show up in a variety of places in the portfolio. For example:

- We recently established a position in **Miller Industries**, the world's largest towing and recovery equipment manufacturer. The business is primarily domestic, but the company also has a significant global presence in the military recovery and transport sector, including direct sales relationships with many foreign governments and exports to over 60 countries. Miller's products include heavy-duty towing for military trucks as well as rotators for recovery of vehicles and loading and unloading heavy equipment. While not the primary reason we own the business, these areas present a unique opportunity in the current environment and demonstrate the strength of domestic manufacturing capabilities.

- Another business with interesting exposure is **Graham Corporation**, which builds mission-critical fluid, power, heat transfer, and vacuum technologies for the defense, space, energy, and process industries. Over the past decade, Graham has established itself as a strategic supplier to the US Navy, providing parts on various submarines and naval ships. As the US looks to invest in defense capabilities, Graham is well-suited to benefit and has seen direct investment in capacity expansion to support continued growth in the company's defense pipeline.

As of 31 October 2023, Diamond Hill owned shares of Miller Industries and Graham Corporation.

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