DIAMOND HILL

INVESTED IN THE LONG RUN

Long-Short Fund

As of 31 Mar 2024

Market Commentary

Markets moved sharply higher during the first quarter of 2024, delivering positive returns across most regions and countries. US stocks rose +10% (as measured by the Russell 3000 Index), led by large-cap stocks, which were likewise up just over +10%, followed by mid caps (+9%) and small caps (+5%), as measured by their respective Russell indices. From a style perspective, growth continued leading — as it has for the last several quarters. Large-cap growth rose more than +11%, while value was up just shy of +9%; mid-cap growth gained over +9% versus mid-cap value up +8%; and small-cap growth delivered shy of +8%, while small-cap value rose less than +3% (all returns as measured by the respective Russell indices).

From a sector perspective, communication services (+15%), energy (+13%) and financials (+13%) led the way. Technology (+12%) and industrials (+11%) were also nicely positive, highlighting the growth-oriented nature of current market leadership. Relatedly, utilities, (+5%), consumer discretionary (+6%) and consumer staples (+8%) delivered more moderate (though still nicely positive) returns in the quarter as economic activity has generally remained robust, even against a tight monetary policy backdrop. Conversely, real estate was the only sector in the red (-1%).

Team

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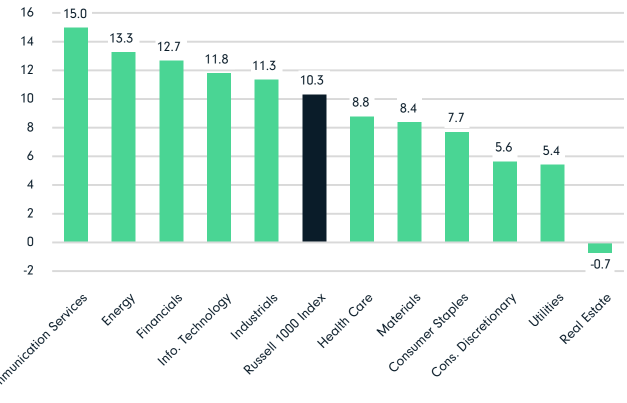
1Q24 Russell 1000 Index Sector Returns (%)



Source: FactSet, as of 31 Mar 2024.

As has been the case in recent quarters, markets-related headlines in Q1 seemed to focus narrowly on global monetary policy and its future direction — though the degree to which monetary policy is the dominant influencer of markets' direction may finally be diminishing. As some evidence of this, in mid-March, US inflation data were higher than analysts' expectations — yet markets largely shrugged in the wake of the news. A quarter or two ago, such a headline would've likely prompted a rather sharp selloff as investors concluded rates would need to remain higher for longer. Then, too, investors may be increasingly convinced central bank heads have achieved the proverbial soft landing, with economic data remaining relatively robust even as inflation data moderate more slowly.

Of note on the monetary policy front was the long-awaited conclusion of Japan's ultra-loose monetary policy. After decades of deflation, Japan's economy is showing signs of mild inflation in the form of higher wages — which presumably lent the Bank of Japan (BOJ) confidence in its decision to end its ultra-loose policy regime. Accordingly, the BOJ made several noteworthy shifts, including raising its benchmark interest rate from -0.1% to +0.1%, ending its yield curve control policy (whereby it capped the 10-year Japanese government bond yield) and ending government purchases of exchange-traded funds and Japanese real estate investment trusts. However, it will continue purchasing roughly $40 billion monthly of Japanese government bonds — so there certainly is still room for monetary policy to tighten in the period ahead, should the inflationary and economic environment remain on their current paths.

Another country being closely watched is China, whose economy has been sluggish over the last year or so as the government struggles to lift it out of the malaise that started amid the pandemic and accompanying lockdowns. The backdrop is challenging: the real estate sector remains in crisis, foreign direct investment has plummeted and the country faces the prospect of trade wars with the US and Europe. Though government leadership is targeting 5% GDP growth in 2024, it remains to be seen whether they will be able to effect sufficient economic activity to hit their goal.

The calendar year began with a similar narrow focus on monetary policy as has prevailed over the past several quarters. Now, one quarter into 2024, it seems as though investors may finally be shifting their focus. Whether this proves beneficial for markets — or certain sectors of markets — will play out over the course of the year and beyond. Though valuations are above average, we believe it is still possible to identify compelling investing opportunities trading at reasonable discounts, and we will maintain our rigorous adherence to our bottom-up, fundamental research process that aims to identify them.

Performance Discussion

The portfolio delivered positive returns in Q1, trailing the Russell 1000 Index but outpacing 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 financials and communication services holdings were also a source of relative strength. Conversely, our long health care and industrials holdings, while positive on an absolute basis, trailed benchmark peers, creating a relative performance headwind in Q1.

On an individual holdings' basis, top contributors to return in Q1 were all from our long book, including KKR and American International Group (AIG). Shares of private equity firm KKR rose amid accelerating key fundamental drivers. Importantly, the fundraising environment remains nicely positive and should continue accelerating over the course of 2024 and into 2025 as flagship funds start raising capital.

Property and casualty insurance company AIG made more progress selling its stake in life insurer Corebridge in the quarter while repositioning its portfolio via several divestitures — lending support to our thesis that the high-quality management team will continue executing a turnaround in the business.

Other top Q1 contributors included Meta Platforms, Citigroup and Walt Disney. Shares of social media platform Meta rose in Q1 as advertising revenues rebounded and cost-cutting measures contributed to higher profits and revenues. The company's user base on its apps — including Facebook, Instagram, Messenger and WhatsApp — also grew during the quarter. Banking and financial services company Citigroup's restructuring efforts are ongoing, and it continues remediating regulatory issues and building capital in anticipation of increased requirements. The company expects to see expenses fall meaningfully in the second half of 2024, bolstering the outlook from here. Media and entertainment company Walt Disney faced — and defeated — an activist campaign and proxy battle during the quarter, giving a boost to shares. Profitability has also improved — with the company announcing it expects to reach double-digits profitability in its streaming business — and it announced forthcoming capital returns to shareholders.

Among our bottom Q1 contributors were our long positions in Humana and WNS Holdings, as well as our short positions in Dick's Sporting Goods, International Business Machines (IBM) and Palomar Holdings. Shares of health insurance company Humana were meaningfully pressured in late 2023 against a backdrop of accelerating medical costs among its Medicare population, weighing on health plan profitability. Further, since Medicare Advantage plan pricing is set in June of each year for the following year, Humana is unable to offset increased medical costs with higher pricing — which in turn pressured shares in Q1. Nevertheless, we anticipate Humana will be able to improve margins over the next several years, and we maintain our conviction in our position.

Shares of business process management company WNS Holdings declined in the wake of a large client's decision to part ways with WNS. Though the decision was unrelated to artificial intelligence (AI), the move renewed concerns about how AI will ultimately affect the company. However, we believe WNS's business process management solutions and its ability to implement AI capabilities on clients' behalf are more valuable than is currently reflected in the share price, and we continue to believe the outlook from here is favorable.

Shares of general sporting goods retailer Dick's Sporting Goods rose in the quarter as sales and margin growth have proved more robust than anticipated and have yet to revert to pre-COVID levels. Though we believe the quality and durability of IBM's free cash flow-generating capabilities remain questionable, investor sentiment has improved amid optimism for the company's still-nascent AI product suite. Residential and business property and casualty insurance company Palomar has benefited from solid fundamentals, even amid a difficult reinsurance environment in 2023. However, we believe shares remain overvalued and are maintaining our short position.

Portfolio Activity

As valuations have risen, it has become increasingly challenging to find high-quality companies trading at interesting valuations. Accordingly, we didn't initiate any new long positions during the quarter. However, we did introduce three new short positions, including Powell Industries, Royal Caribbean Group and YETI Holdings.

Powell Industries designs, manufactures and services complex electrical systems for several industries. While recent fundamentals have been solid, we believe the valuation has become stretched for what has historically been a highly cyclical business and accordingly initiated a new short position in Q1.

Royal Caribbean Group (RCL) is the second largest player in a cruise industry in which size and scale matter. While the company has benefited from strong demand since the pandemic's end, we believe the valuation has outpaced the fundamentals and find the risk/reward on the short side attractive.

YETI Holdings (Yeti) designs and sells outdoor and recreational products. We initiated a short position in Q1 as we believe the company faces a combination of existing market saturation and intensifying competition from companies like Stanley and Hydro Flask. We also believe a 2023 product recall obscured a broader demand deceleration for Yeti's products.

We exited our long position in global automotive supplier BorgWarner during the quarter. The company has faced near-term volatility in the ongoing shift to electric vehicles and hybrids, which has, in turn, impacted results and weighed on shares. Given our expectation this volatility will continue for the foreseeable future, we decided to upgrade our capital into more compelling opportunities.

We also covered our short positions in rental car company Avis Budget Group, internet service provider Cogent Communications Holdings and medical technology company CONMED Corporation in Q1 as their share prices converged on our estimates of intrinsic value.

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

Market Outlook

Equity markets continued higher in Q1 as the economy and earnings growth remained robust. The Russell 1000 Index increased 10% in the quarter — despite a 32-basis point increase in the 10-year Treasury and the market now expecting far fewer interest rate cuts in 2024. The rally was fairly broad, with the S&P 500 Equal Weighted Index increasing more than 7%.

Markets were again led by mega-cap tech stocks, with the Magnificent 7 (Microsoft, Apple, Amazon, Alphabet, NVIDIA, Tesla, Meta) collectively increasing about 13%. However, the performance of the Magnificent 7 varied quite a bit, with NVIDIA and Meta up significantly, while Tesla and Apple shares fell meaningfully. Still, as mentioned, growth stocks continued their outperformance over value stocks in Q1.

Small caps continued to underperform large caps, with the Russell 2000 Index's 5.2% gain trailing the Russell 1000 Index's return by more than five percentage points. Interestingly, more than one-quarter of the Russell 2000 Index's return came from one stock, Super Micro Computer, which increased more than 250% and now sports a market cap north of $60 billion.

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 continued strong growth among industrials.

With the continued rally, equity market valuations remain above average. While the fall in interest rates since their peak in October 2023 has somewhat supported this, 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	1Q24	Expense Ratio (%)
Class I (DHLSX)	6.98	7.19	8.57	6.49	8.70	7.36	22.49	9.58	9.58	1.49
Russell 1000 Index	7.69	10.21	15.62	12.68	14.76	10.45	29.87	10.30	10.30	–
60%/40% Blended Index	5.56	6.93	9.82	8.33	9.96	7.66	19.75	6.65	6.65	–
Russell 1000 Value Index	7.74	8.29	13.10	9.01	10.32	8.11	20.27	8.99	8.99	–

Click here for holdings as of 31 March 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 31 March 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