DIAMOND HILL
INVESTED IN THE LONG RUN

Long-Short Fund

As of 30 Sep 2024

Market Commentary

Markets added to solid year-to-date gains in Q3, though not without their fair share of volatility. US stocks rose 6% (as measured by the Russell 3000 Index), with gains primarily attributable to small- and mid-cap stocks — a noteworthy shift. Large-cap stocks were up 6% in Q3 while down the cap spectrum, mid caps and small caps each delivered north of 9% returns, as measured by their respective Russell indices. From a style perspective, value narrowed the gap relative to growth stocks, outperforming up and down the cap spectrum. Large-cap value was up 9%, while mid- and small-cap value stocks gained 10%. Their growth counterparts were up 3%, 6% and 8%, respectively (all returns as measured by the respective Russell indices).

From a sector perspective, utilities and real estate were the clear leaders in the Russell 1000 Index, as the apparent end of the rate-hiking cycle sent investors into the most interest rate-sensitive sectors. Industrials, financials and materials were also nicely positive, as were consumer staples and consumer discretionary. While only energy was in the red (-2.6%), information technology and communication services delivered more tepid returns as investors turned to more defensive sectors as the bull market continued aging.

Team

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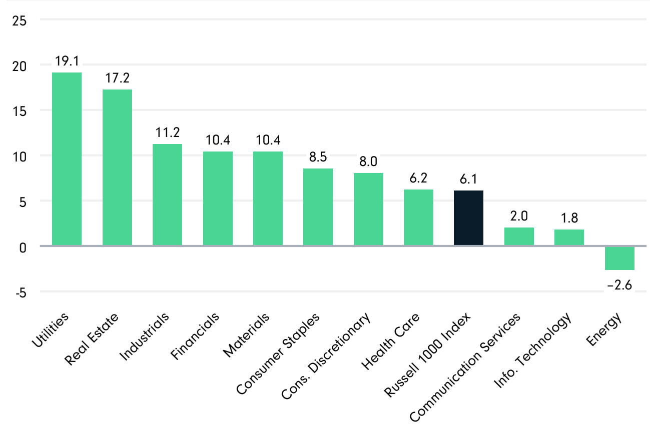
3Q24 Russell 1000 Index Sector Returns (%)



Source: FactSet, as of 30 Sep 2024.

The long-awaited shift of the interest-rate cycle is here, with the Federal Reserve cutting US rates 50 basis points (bps) in September and signaling several more rate cuts are on the table. In the Fed's wake, several other major global central banks cut rates, too, including the European Central Bank, Swiss National Bank and, notably, the People's Bank of China, which not only lowered rates, but banks' reserve requirements (more on China momentarily). The Bank of Japan, which has only recently lifted the country out of its long-standing negative rates regime, held rates steady at a modest 0.25% in September as it attempts to balance nascent inflation after years of deflation with a markedly weaker yen — the byproduct of the yen carry trade's unwinding as higher interest rates in other developed countries (particularly the US) begin declining.

The apparent end of the higher interest-rate cycle helped spur markets higher in September, as did some noteworthy policy shifts in China, which has been struggling to lift its economy out of relative malaise since roughly the pandemic. Late in September, the government announced not only a raft of monetary policy shifts (including the aforementioned rate and reserve requirement cuts) but also a forthcoming fiscal policy package aimed at spurring domestic demand — which surprised investors and seemingly boosted sentiment significantly, as China's market made a meaningful jump thereafter. However, details of the fiscal stimulus are yet to be announced, so whether this proves a true game-changer, which finally lifts the country out of its property sector-induced swoon or not, remains to be seen.

Ample sources of extreme uncertainty remain — including the ongoing (and potentially significantly escalating) hot wars in the Middle East and between Russia and Ukraine. Whether global central banks can achieve the proverbial soft landing remains to be seen — though markets seem fairly unconcerned about the likelihood of imminent economic slowdown — and of course, the US is on the cusp of what will undoubtedly be another highly contentious national election. Regardless, markets have continued climbing the wall of worry — and though valuations are particularly stretched in some sectors, we believe there are still attractive opportunities for diligent investors willing to do the rigorous, bottom-up research necessary to identify them.

Performance Discussion

The portfolio was in the black in Q3 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 outperformed the index, posing a relative headwind to performance. Our long financials, staples and discretionary holdings, while all positive on an absolute basis, trailed benchmark peers and consequently weighed on results. Conversely, our long technology holdings and our underweight to the underperforming sector were both sources of relative strength in Q3.

On an individual holdings' basis, top contributors to return in Q3 included our long positions in Parker-Hannifin, HCA Healthcare and SS&C Technologies. Diversified industrial and aerospace manufacturer Parker-Hannifin is capitalizing on strength in its aerospace business to drive better-than-expected results against a challenging macroeconomic backdrop that has weighed on peers' results. Health care facilities operator HCA Healthcare is benefiting from strong acute care hospital and outpatient volumes. The payor mix has remained favorable — a byproduct partly of the company's dominance in attractive geographies like Florida and Texas, where populations are growing and unemployment is low.

SS&C Technologies sells a variety of operations and business process software and support services to investment firms, brokerages and other financial institutions. Organic growth has improved over the course of 2024 as its business units have performed better. Further, lower interest rates have decreased the cost of the company's variable-rate debt, contributing to improved operating results and helping boost shares.

Other top contributors in Q3 included our long positions in Meta Platforms and Ciena Corporation. Shares of social media platform Meta rose as advertising growth has been solid and the company's cost-cutting measures have boosted profitability. Meta also released new products in the artificial intelligence space in Q3, lending investors increased confidence about the growth trajectory looking forward. Networking systems company Ciena is benefiting from improving demand in its service provider vertical combined with solid demand from its cloud customers.

Our bottom Q3 contributors included several of our short positions, including Doximity and Mueller Industries. Doximity operates an online platform for medical professionals that generates most of its revenue from digital advertising. The market has remained optimistic about the company's ability to maintain strong revenue growth for years into the future. However, we are skeptical of the level of engagement among medical professionals on Doximity's platform and the sustainability of recent revenue growth trends.

Mueller Industries is a leading producer of copper tubes and pipes for plumbing and heating, ventilating and air conditioning (HVAC) systems. During the quarter, higher copper prices contributed to growing revenues and earnings per share, in turn giving shares a boost. We continue to believe Mueller operates in a cyclical industry with largely commoditized products that have benefited from near-term tailwinds we anticipate will unwind in the coming years. Further, we think the market is failing to account for the secular shift from copper to plastic, which we believe will likely pressure Mueller's profitability in the period ahead.

Our short positions in International Business Machines (IBM) and Sweetgreen were also among our bottom Q3 contributors. Diversified information technology company IBM rose in the quarter as investors seem to believe the company can be a long-term beneficiary of the artificial intelligence trend. However, we maintain our conviction that the company is insufficiently prepared to compete in the highly competitive cloud space and remain skeptical of the outlook from here.

Sweetgreen — a new holding in the quarter — operates a healthy fast-food chain in the US. Shares rose as discussion of its Infinite Kitchen — which is operated by robots — gave a near-term lift to sentiment. However, we believe the market is over-enthusiastic about Sweetgreen's Infinite Kitchen, of which there are currently only four. Further, we believe the company faces growing competition from other fast-casual options — especially those focusing on salads. Given this combination, we believe Sweetgreen will struggle to meaningfully improve growth over the long term and consequently initiated a short position in Q3.

Our long position in Alphabet was also among our bottom Q3 contributors. Shares of the media and technology company were pressured as it received an adverse ruling on the antitrust case brought by the US Department of Justice. Simultaneously, competition is stiffening in the search engine and artificial intelligence spaces, creating a more challenging operating environment for Alphabet.

Portfolio Activity

We initiated just one new long position in Q3: internet retail and cloud infrastructure provider Amazon. Shares have been pressured recently against a challenging retail backdrop, given inflation and moderating consumer spending. However, Amazon's retail positioning remains solid, so we capitalized on the share-price weakness to add the high-quality online retailer to our portfolio at what we consider an attractive discount to intrinsic value.

On the other hand, rising valuations have introduced some interesting short opportunities. In addition to Sweetgreen, we also initiated new short positions in Vornado Realty Trust, Samsara, Carvana and Affirm Holdings in Q3.

Vornado is an office real estate investment trust focused primarily on New York City. Though it owns some strong assets, we anticipate it will struggle in the longer term as the office industry continues adapting to a work-from-home oriented environment and still-high vacancy rates. We initiated a short position as shares trade at a premium to our estimate of intrinsic value.

Samsara provides solutions to businesses so they can connect their physical operations data to Samsara's connected operations cloud, allowing them to gather insights from those data. We believe Samsara operates in a competitive industry with an intense rivalry among the players to capture market share, and we consequently capitalized on a rich valuation to initiate a short position.

Carvana is a vertically integrated e-commerce used car dealer. While the company's turnaround has been impressive over the past couple years, we believe the market is over-enthusiastically extrapolating from its current unit-growth recovery and profitability improvement to the company's future size and economics. Management has proven the business model is viable after varying degrees of bankruptcy risk in recent years, but we believe the current valuation underappreciates the economic cyclicality, tail risks, industry competitiveness and capital intensity, considering its current debt load.

Affirm Holdings operates a payment network, including solutions for consumers' point-of-sale payments and merchant commerce as well as a consumer-focused app. We believe its buy-now-pay-later (BNPL) solutions face increasing competition from other vendors and traditional financial services companies. Further, a growing mix of its business comes from a handful of large customers, which could pressure fundamentals over the long term.

We funded these purchases with several sales during Q3, including our long position in electronics component manufacturer Sensata Technologies, which we sold in favor of better opportunities. We also exited our long position in health solutions provider CVS Health Corporation as we lost confidence in management's ability amid several recent operational mishaps, as well as what we saw as questionable capital allocation decisions over the last few years.

We also covered our short positions in omni-channel sporting goods retailer Dick's Sporting Goods; package delivery company United Parcel Service; financial, insurance and advisory services provider CBIZ; and food and beverage company JM Smucker as their share prices converged with our estimates of intrinsic value.

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

Market Outlook

In today's market environment, we observe a pronounced short-term focus among investors, where individual stock performance is heavily influenced by earnings surprises. Stocks that report positive earnings surprises are rewarded, while those with negative surprises face significant penalties. All the while, valuations continue to slowly grind higher, and market participants appear largely unfazed, showing little concern about the sustainability of these elevated valuations. Although supported somewhat by the fall in interest rates since their peak in October 2023, these valuations may still challenge the ability to generate returns that align with historical averages over the next five years.

The broader economic landscape remains healthy, buoyed by strong GDP growth and a healthy labor market. However, there are signs of weakening among consumers, especially those at the lower end of the income spectrum, accompanied by rising unemployment. Given that consumer activity drives a significant portion of the economy, further weakening could pose a risk to the market's expectations of a lofty 15% corporate earnings growth for 2025.

Despite these challenges, we remain committed to identifying attractive opportunities that have the potential to produce above-average returns over the next five years. 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	3Q24	Expense Ratio (%)[1]
Class I (DHLSX)	6.91	6.86	7.25	6.41	7.36	6.11	19.23	11.51	1.18	1.49
Russell 1000 Index	7.94	10.76	14.03	13.10	15.64	10.83	35.68	21.18	6.08	—
60%/40% Blended Index	5.73	7.30	8.97	8.69	10.58	8.26	22.97	14.15	4.18	—
Russell 1000 Value Index	7.88	8.53	11.20	9.23	10.69	9.03	27.76	16.68	9.43	—

Click here for holdings as of 30 September 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 September 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