

# DIAMOND HILL

INVESTED IN THE LONG RUN

## Mid Cap Strategy

As of 31 Mar 2025

### Market Commentary

Markets were mixed in Q1 as the new presidential administration made repeated waves with an avalanche of activity, which left markets uncertain of the likely path forward. For the quarter, US stocks fell -4.7% (as measured by the Russell 3000 Index), notching markets' first quarterly decline since Q3 2023. Mid-cap stocks held up best, falling a more modest -3.4%, while large caps were down -4.5%. Smaller stocks were hit harder, falling -9.5% — a relatively unsurprising development given smaller companies' shares are generally more volatile as macroeconomic uncertainty increases. From a style perspective, value fared better up and down the cap spectrum, with large-cap value managing a positive gain of +2.1%. Mid-cap value stocks fell -2.1%, compared to -7.1% for their growth counterparts, while small-cap value stocks declined -7.7% versus -11.1% for small growth (all returns as measured by their respective Russell indices). The shift from growth to value was also relatively unsurprising given the flight to safety prompted by tremendous uncertainty around trade and other fiscal policy shifts in the US.

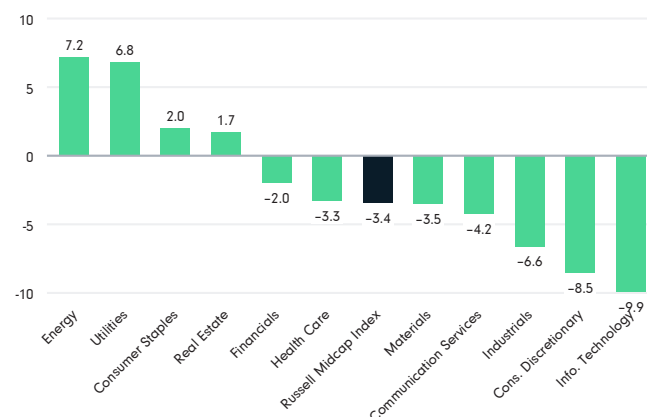
From a sector perspective, likewise, more defensive sectors in the Russell Midcap Index led in the quarter, while cyclical stocks fell out of favor. Energy stocks were the best performers, up +7.2% amid supportive language from President Trump's administration about its willingness to increase US oil production. Utilities also rose nicely, up +6.8%. Conversely, technology stocks were hit hardest, falling -9.9% — which, given the sector's weight in the index, was a major contributor to the index's negative Q1 return. Consumer discretionary stocks also fell -8.2%.

### Team

**Chris Welch, CFA**  
Portfolio Manager

**Kristen Sheffield, CFA, CIPM**  
Portfolio Specialist

### 1Q25 Russell Midcap Index Sector Returns (%)



Source: FactSet, as of 31 Mar 2025.

What began in Q4 — market leadership transitions in anticipation of potential winners and losers from a major shift in executive-level policy direction — vigorously continued in Q1. To some extent, economic data took a backseat in the quarter as investors seemed to focus narrowly on the likeliest implications of major trade policy shifts announced during the quarter by President Trump. Shortly after the quarter concluded, Trump announced a raft of tariffs to go into effect immediately on what he dubbed "Liberation Day." As has been the case since Trump began increasing tariffs, countries are responding in various ways, with some reaching out to the US to negotiate better rates and others — notably, China — choosing to retaliate with their own high tariff rates. Many companies have preemptively announced significant investments in their US operations — ostensibly moves aimed at avoiding tariffs

themselves. Ultimately, whether the “Liberation Day” moniker goes down in history or infamy remains to be seen. What is clear is markets are very nervous about the president’s apparent determination to wholesale (and possibly singlehandedly) rework the global trade landscape, even with countries that have historically been significant trade allies, like Taiwan. We’ll have more thoughts on potential direction from here later in this communication.

Meanwhile, the Federal Reserve held rates in March, citing the likelihood tariffs increase inflationary pressures, while cutting its growth expectations for US GDP in 2025. And the US dollar — which one would generally expect to be bolstered relative to other global currencies as tariffs go up (higher prices for US goods increase demand for US dollars with which to pay for them) — counterintuitively fell as tariff language toughened, perhaps signaling investors’ growing concerns tariffs will contribute to a stagflationary US economic environment with high inflation and low or sluggish growth.

Globally, geopolitical uncertainty remains high, though there have been some signs of modest progress toward ending the war between Russia and Ukraine. Following a dramatic fall-out between President Trump and Ukrainian President Volodymyr Zelenskyy, the US and Ukraine seemed to slowly make their way back toward a minerals and mining deal which would meaningfully increase the US’s economic involvement in Ukraine and potentially pave the way for a broader peace deal between Russia and Ukraine. However, to date, Russian President Vladimir Putin has stymied the US’s attempts to broker a ceasefire between the two countries. War in the Middle East continues, too, as ceasefires between Israel and Hamas and Israel and Lebanon ended and violence across the region re-escalated. The US, too, struck Houthi rebels in Yemen toward the end of the quarter in an attempt to quell attacks on Red Sea shipping lanes.

While volatility is unsettling, it also introduces interesting investing opportunities for those who have been diligent in their research all along. We have no unique insight into how deep this correction will become, whether it will enter bear market territory or how long it will last. However, we know it has helped reset valuations and offered some compelling opportunities to purchase high-quality names at more attractive prices than we’ve seen in some time. Once the trade-related dust settles, time will tell which sectors and individual companies are winners and losers. In the

meantime, we will continue deploying our time-tested approach, which is well-built for uncertain market environments like we’re currently seeing — and which we wouldn’t be surprised to see persist for the foreseeable future.

## Performance Discussion

Our portfolio outperformed the Russell Midcap Index in Q1. Relative strength was heavily concentrated among our financials holdings, which delivered positive returns in a quarter in which benchmark peers were in the red. Our technology holdings — as well as our below-benchmark exposure to the underperforming sector — were also a tailwind. Conversely, our energy holdings, while positive on an absolute basis, trailed benchmark names, weighing on relative performance in Q1. Our below-benchmark exposure to utilities also posed a modest headwind — though our holdings were nicely positive.

On an individual holdings basis, top contributors to return in Q1 included VeriSign and Huntington Ingalls. VeriSign, which provides internet infrastructure and domain name registry services, successfully renewed its .com agreement with the US Department of Commerce in late 2024. It also demonstrated stability in both its .com and .net domain bases. We believe the company is favorably positioned with an attractive business model and management team, which has effectively opportunistically allocated capital.

Shares of US Department of Defense and Navy supplier Huntington Ingalls rose in Q1 following President Trump’s announced formation of a new office of shipbuilding. The president further made comments suggesting the government is working to help Huntington Ingalls address recent supply chain and labor issues, which we anticipate will be resolved over time. We maintain our conviction in Huntington Ingalls’ positioning relative to the Department of Defense’s need to prepare for a potential conflict in the Pacific — which would in turn ensure strong demand for the next 5 to 10 years. Further, we believe resolving the aforementioned supply chain and labor issues will allow Huntington Ingalls to improve its margins — a likelihood which we believe is not yet reflected in the share price.

Other top contributors in Q1 included Mr. Cooper Group, Boston Scientific and American International Group (AIG). Mortgage servicing company Mr. Cooper Group executed well during a particularly challenging mortgage environment as interest rates have remained high relative to historical levels. Importantly, Mr. Cooper's business model is specifically designed to help protect it from just such periods: As rates go up, the value of its mortgage-servicing rights business goes up, giving it the ability to continue generating healthy cash flows even as the mortgage industry overall may slow. Shares of medical device manager Boston Scientific rose in the quarter as it continues capitalizing on demographic tailwinds to drive growth across its businesses.

Property and casualty insurance company AIG is delivering high-quality results: Its most recently reported underlying loss ratio was better than expected, as were catastrophe losses and prior-year development. Further, the company continues generating revenue growth from both its commercial and consumer segments. We are pleased with the progress AIG is making to streamline its business and capitalize on opportunities for earnings growth better than its competitors. We believe it remains well-positioned to scale revenues efficiently and deliver sustainable value as it continues reducing expenses and returning excess capital via share repurchases.

Among our bottom Q1 individual contributors were Regal Rexnord and WESCO. Power transmission components manufacturer Regal Rexnord faced pressure amid growing tariff-related concerns. Generally, its organic growth has held up better than peers', and though its leverage is somewhat elevated, merger synergies and debt paydown rates are beating expectations — factors which should position it well relative to competitors. We believe the recent weakness has been an overreaction and maintain our conviction in our thesis.

Shares of industrial distributor WESCO were pressured amid the company's cyclical exposure and leveraged balance sheet. However, despite recent mixed fundamentals, we believe the company can still leverage its significant scale advantage to take share and improve margins over time. Further, we expect it to benefit from several secular tailwinds, which should contribute to strong free cash-flow generation, allowing it to deleverage over time.

Other bottom individual contributors in Q1 included Ciena, Teleflex and Ashland. Shares of networking systems company Ciena were pressured amid concerns about the durability and timing of cloud customers' orders. Teleflex,

which designs, develops, manufactures and supplies single-use medical devices for common critical care and surgical diagnostic and therapeutic procedures, declined following its announcement that it would spin off some of its underperforming businesses.

Shares of specialty chemical manufacturer Ashland have been pressured by dour sentiment, even as earnings have generally met expectations. The company has indicated that potential tariffs should not particularly affect it, given that most of its production locations and end markets are well-matched within countries. Regardless, investors seem relatively unconvinced and are possibly also factoring in broader economic growth concerns.

### Portfolio Activity

As volatility picked up sharply in the quarter, we were active in the portfolio — and we anticipate that as volatility continues into Q2, we will likewise attempt to capitalize on compelling opportunities to reposition the portfolio for the period ahead. We initiated four new positions in Q1: Martin Marietta Materials, Ventas, Illumina and TransUnion.

Martin Marietta Materials is a heavy building materials supplier and the second-largest aggregates producer and distributor in the US with competitively positioned cement, ready-mix, asphalt and magnesia specialty businesses. The company has a long-term mindset, which proved effective during the last recession. Generally, the company tries to be the price leader in its markets and has historically successfully passed inflationary prices along to its clients. Given its strategic positioning in markets with strong growth potential and in states with approved multi-year Department of Transportation plans, we believe it is well-positioned for the period ahead. Recent macroeconomic uncertainty has pressured shares, introducing a compelling opportunity for us to invest in a quality aggregates company at a good entry point.

Ventas is a diversified health care real estate investment trust (REIT) focused on private-pay senior housing — primarily independent and assisted living — as well as outpatient medical offices and research/life sciences. The demographics around senior housing are compelling over the medium term: The 80+ age cohort in the US is rapidly growing, while senior housing is limited, which should drive years of strong growth as the industry recovers from oversupply and post-COVID weakness. We anticipate occupancy should improve meaningfully, while pricing is likely to remain solid as senior care is a needs-based business. At approximately 85% occupancy, a facility

generally requires full staffing, making additional tenants beyond that occupancy level significantly higher margin. We also don't anticipate significant new facility development – and even when it starts, it could take some time before annual new construction catches up with demand. Further, recently weaker fundamentals among competitors could create attractive acquisition opportunities for Ventas. Finally, the company's operating platform and pricing software should bring institutional sophistication to a business that has long been tech-averse, giving it a significant and growing competitive advantage. Given we don't believe the valuation adequately reflects these advantages, we initiated a position in Q1.

Illumina provides sequencing- and array-based solutions for genetic and genomic analysis. It has roughly 80% share in its markets, strong fundamentals and a healthy balance sheet. Looking forward, we believe optionality from new tests other companies run using Illumina products, particularly for cancer screening and detection, should create a long-term growth tailwind. Shares have been pressured recently amid weaker end-market demand, combined with concerns about China, new competition from competitor Roche and the potential for National Institutes of Health funding cuts – giving us an opportunity to initiate an investment in a quality business with good long-term growth prospects at the forefront of genetic sequencing.

TransUnion is a global consumer credit reporting agency providing risk and information solutions. Recent concerns about higher interest rates and the risk of recession have weighed on shares, giving us an opportunity to start a position. We believe the market is overly focused on the near term and believe the long-term outlook for this company is solid.

We funded these purchases in part with the proceeds from our sales of regional airline Alaska Air Group, property and casualty insurance provider Loews, welding and cutting equipment and consumables provider ESAB, timberland REIT Rayonier, apartment REIT UDR and electronics component manufacturer Sensata Technologies – all of which we sold in favor of more compelling investment opportunities elsewhere.

We also exited our position in Informatica, a comprehensive data management software company providing an array of solutions that facilitate monitoring, manipulating and moving data assets at large enterprises. Following Q4, we had serious questions about management's ability to execute Informatica's cloud model transition, as well as about the underlying strength of the business's installed base. We consequently sold our position to reallocate our capital to names in which we have greater fundamental conviction.

## Market Outlook

As we start Q2, uncertainty is as high as it has been, arguably since the pandemic's earliest days. While markets struggle to digest the likeliest ramifications of the US's newly announced tariffs – whether they are largely a negotiation tactic whose economic impact will moderate over time as countries and companies reach better terms with the US, or whether they are here to stay for the long term and we will indeed see a significant reshaping of the world trade order – we are watching several factors particularly closely. Foremost, we are monitoring the relationship between the US and China, which is front and center in this trade showdown. As we write, President Trump has threatened a 104% tariff on China in response to its retaliatory increase to 84%. Given the magnitude of the US and Chinese economies, seeing the two countries enter a full-blown trade war would have significant, widespread implications for many US companies, up and down the capitalization spectrum.

Further, the increased uncertainty across a range of macroeconomic policies – trade as well as domestic spending and the administration's ongoing efforts to meaningfully shrink the size of the federal government – is prompting concerns about the consumer. Should tariffs prompt a significant spike in inflation and/or fiscal spending cuts go too far, consumers could rein in their spending. Indeed, companies across various sectors have noted a weakening consumer, suggesting the economy is slowing. With the consumer powering a significant majority of the economy, further weakening may present a risk to the lofty double-digit corporate earnings growth the market had been expecting for 2025.

However, regardless of how uncomfortable such volatility can be, we are simultaneously encouraged by its impact on the valuations of some companies that we believe are particularly strong and well-positioned to weather the environment ahead — even if it requires further suffering before economic and market growth resume. Accordingly, we have sought to be active in this period, identifying high-quality companies with particularly solid balance sheets whose outlook over the next three to five years is positive in our view. As downward volatility has continued, we have further acted on our research efforts to introduce these names to the portfolio, with the aim of positioning the portfolio well for whatever the environment gives us in the period ahead — whether there is further downside to endure, or whether markets turn around precipitously. We believe, with hindsight, that this period may prove to be one that separates those investors with a rigorous, bottom-up process from those unwilling or unable to see through the near-term volatility to the possibilities beyond.

Our primary focus is always on achieving value-added results for our existing clients, and we believe we can achieve better-than-market returns over the next five years through active portfolio management.

Period and Annualized Total Returns (%)	Since Inception (31 Dec 2013)	10Y	5Y	3Y	1Y	YTD	1Q25
Gross of Fees	7.93	7.60	17.30	2.97	0.40	-1.09	-1.09
Net of Fees	7.14	6.82	16.48	2.25	-0.31	-1.26	-1.26
Russell Midcap Index	9.38	8.82	16.28	4.62	2.59	-3.40	-3.40
Russell Midcap Value Index	8.29	7.62	16.70	3.78	2.27	-2.11	-2.11

Calendar Year Returns (%)	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
Gross of Fees	8.83	1.61	19.62	11.31	-9.55	26.73	-1.00	32.38	-12.50	10.66	11.39
Net of Fees	7.96	0.80	18.66	10.46	-10.21	25.84	-1.69	31.45	-13.12	9.88	10.61
Russell Midcap Index	13.22	-2.44	13.80	18.52	-9.06	30.54	17.10	22.58	-17.32	17.23	15.34
Russell Midcap Value Index	14.75	-4.78	20.00	13.34	-12.29	27.06	4.96	28.34	-12.03	12.71	13.07

Diamond Hill Capital Management, Inc. (DHCM) is an investment adviser registered with the Securities and Exchange Commission and a wholly owned subsidiary of Diamond Hill Investment Group, Inc.; registration does not imply a certain level of skill or training. DHCM provides investment management services to individuals and institutions through mutual funds, separately managed accounts, collective investment trusts, a private fund, a closed-end interval fund and other pooled vehicles including subadvised funds and model delivery programs. A complete list and description of all composites and policies for valuing investments, calculating performance and preparing GIPS reports is available upon request. To receive a complete list and description of all Diamond Hill composites and/or a GIPS® report, contact Scott Stapleton at 614.255.3329, sstapleton@diamond-hill.com or 325 John H. McConnell Blvd., Suite 200, Columbus, OH 43215. A list of broad distribution pooled funds is available upon request. In addition, a list of limited distribution pooled fund descriptions is available upon request. The Mid Cap Composite is comprised of discretionary, fee-paying, non-wrap accounts managed according to the firm's Mid Cap equity strategy. The strategy's investment objective is to achieve long-term capital appreciation by investing in medium market capitalization companies selling for less than our estimate of intrinsic value. Medium market capitalization companies are defined as those companies with a market capitalization between \$1.5 billion and \$20 billion (or, if greater, the maximum market capitalization of companies generally within the capitalization range of the Russell Midcap Index) at the time of purchase. 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 US Dollars. Net returns are calculated by reducing the gross returns by the highest stated fee in the composite fee schedule. Only transaction costs are deducted from gross of fees returns. Prior to 30 September 2022, actual fees were used in calculating net returns. All net returns were changed retroactively to reflect the highest fee in the composite fee schedule. The Russell Midcap Index is the benchmark. This index measures the performance of roughly 800 US mid-cap companies. The Russell Midcap Value Index is shown as additional information. This index measures the performance of US mid-cap companies with lower price/book ratios and forecasted growth values. The indexes are unmanaged, market capitalization weighted, include net reinvested dividends, do not reflect fees or expenses (which would lower the return) and are not available for direct investment. Index data source: London Stock Exchange Group PLC. See [diamond-hill.com/disclosures](https://diamond-hill.com/disclosures) for a full copy of the disclaimer. **The performance data quoted represents past performance; past performance is not a guarantee of future results.** GIPS® is a registered trademark of CFA Institute. CFA Institute does not endorse or promote this organization, nor does it warrant the accuracy or quality of the content contained herein.

Securities referenced may not be representative of all portfolio holdings. The reader should not assume that an investment in the securities was or will be profitable.

**The views expressed are those of Diamond Hill as of 31 March 2025 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.**