

DIAMOND HILL

INVESTED IN THE LONG RUN

Select Strategy

As of 30 Jun 2025

Market Commentary

Following a sharp downturn in April in the wake of President Trump's "Liberation Day" tariffs announcement, markets rose relatively uniformly for the rest of the quarter. For the quarter, US stocks rose approximately 11% (as measured by the Russell 3000 Index). Large-cap stocks bounced the most in the quarter, rising just over 11%, while small and mid caps gained roughly 8.5% each. From a style perspective, growth again outperformed value, which, given the sharp market rebound and seeming improvement in investor sentiment, was not particularly surprising. Large-cap growth stocks rose nearly 18% in the quarter as big technology stocks resumed market leadership; in contrast, large-cap value stocks increased by a more modest 3.8%. Likewise, mid-cap growth stocks were up by more than 18% compared to mid-cap value stocks, which rose by a little over 5%. The gap between small-cap growth and value was the smallest, at +12% versus +5%, respectively.

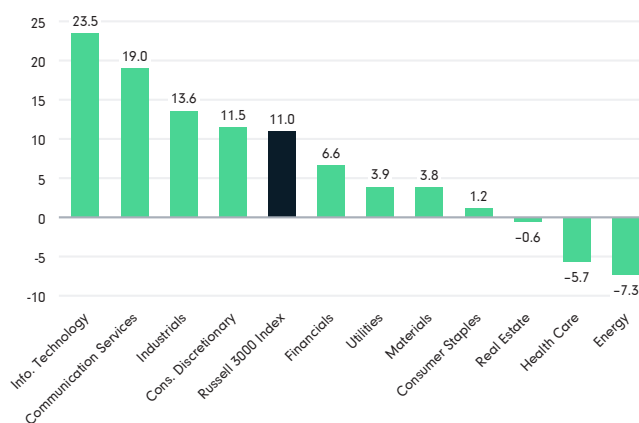
From a sector perspective, investors' risk-on attitude seemed to likewise return, with the growthier sectors in the Russell 3000 Index leading, while defensive sectors fell out of favor. Information technology stocks performed best, rising north of 23%, followed by communication services, which gained 19% and industrials, up nearly 14%. Energy (-7%), health care (-6%) and real estate (-0.6%) were the index's only sectors in the red in Q2 – with energy especially hampered by geopolitical upheaval.

Team

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2Q25 Russell 3000 Index Sector Returns (%)



Source: FactSet, as of 30 Jun 2025.

As has largely been the case since 2025 began, economic data appear to have a minimal impact on market movements, in contrast to headlines surrounding ostensible winners and losers in the ongoing trade upheaval that has prevailed since President Trump took office in January. In Q2, following Trump's announced raft of tariffs, many countries sought new trade deals with the US, and several reached significant new agreements, including the UK and China. The US and China agreed in May to cut tariffs on one another for the ensuing 90 days. Since then, progress with China seems to have largely stalled – likewise, progress on a new US-EU deal. However, neither the US nor China has reverted to the prior threatened tariff rates, which were inarguably exorbitant. Meanwhile, bilateral discussions between other countries – including the UK and India and the UK and the EU – seem to have borne fruit, the

former trade partners reaching an agreement roughly three years after beginning negotiations and the latter agreeing to reset post-Brexit negotiations, ideally clearing the way for tangible progress toward a lasting trade deal.

In contrast to the market's reaction, central banks globally have seemingly remained committed to watching and reacting to economic data, with the Federal Reserve holding rates steady in June even amid pressure from President Trump and growing dissension among its ranks regarding whether a rate cut may be appropriate. The Bank of England likewise held rates steady in June. The European Central Bank (ECB), however, cut rates again in June, even as inflation fell below its 1.9% target, though ECB President Christine Lagarde indicated that rate cuts may be at an end.

If anything could steal headlines from all the quarter's trade developments, it was geopolitics — and indeed, the ongoing Middle East war and the US's increased role in it were front and center in June. Toward the end of the month, following the expiration of a 60-day window during which Iran could have returned to the negotiating table, President Trump authorized military strikes on three nuclear sites in the country. Iran subsequently launched retaliatory missile strikes against Israeli targets and fired several missiles at a US airbase in Qatar, though the latter missiles had little impact and resulted in no US casualties. Shortly after the US strikes, Trump announced a ceasefire between Iran and Israel and attempted to bring the two sides to the table — efforts which are ongoing as we write, though the truce appears to be holding for now. Meanwhile, the war between Russia and Ukraine continues apace, with the two sides currently seeming as far as they've been from either a ceasefire or meaningful progress toward a negotiated peace.

While the selloff in early Q2 created some interesting and compelling investment opportunities, it was undoubtedly a short window in which to capitalize, given the market's sharp rebound. With equity markets returning to above-average valuations, it is challenging to believe that future returns will match historical averages over the next five years. However, we remain focused on our investment philosophy, which seeks to identify opportunities to invest in high-quality companies trading at valuations we believe are disconnected from their underlying fundamentals and long-term growth outlooks. We believe that by focusing in this way, we can continue to add value for our clients in the period ahead, regardless of how markets evolve from here.

Performance Discussion

Our portfolio, though positive on an absolute basis, trailed the Russell 3000 Index in Q2. Relative weakness was partially attributed to our information technology exposure — both our underweight to the index's top performing sector and our holdings, which, though sharply positive, trailed benchmark peers. Likewise, our consumer discretionary holdings also posed a relative headwind, as did our materials exposure. Conversely, our health care holdings were a source of relative strength, as were our financials holdings.

Among our top individual contributors in Q2 were Regal Rexnord and Coherent. Power transmission components manufacturer Regal Rexnord has held up well against an uncertain macroeconomic backdrop. Merger synergies, its 80/20 growth initiative and continuous improvement efforts are driving strong margin improvement and better-than-expected organic growth. While somewhat elevated leverage could leave the company vulnerable to further near-term macroeconomic weakness, we believe Regal Rexnord's self-help initiatives should contribute to ongoing margin improvement and organic growth faster than peers', which we don't believe the current share price reflects.

Coherent, a global leader in materials, networking and lasers for the industrial, communications, electronics and instrumentation markets, is benefiting from rising data-center demand for optical transceivers.

Other top contributors included Mr. Cooper Group, Capital One and Red Rock Resorts. Shares of mortgage servicing company Mr. Cooper Group rose as investors increasingly appreciate the valuation potential created by Rocket Companies' announced acquisition of Mr. Cooper Group. Credit card issuer Capital One is benefiting from solid consumer spending, while delinquency trends and credit losses remain well-controlled. Red Rock Resorts, a casino operator controlling over half the Las Vegas locals market, has demonstrated the resilience of its business model via a strong start to the year. Coming into Q2, the valuation was attractive, and investors responded accordingly, giving a boost to shares.

Among our bottom individual contributors in Q2 were Ashland and Diamondback Energy. Specialty chemical manufacturer Ashland faces the potential for a weaker European macroeconomic environment and Chinese construction industry — sentiment-related factors which have weighed more on the share price than they have on fundamentals, which have deteriorated more modestly. For now, we are maintaining our position and believe the company could at some point become attractive to potential acquirers given the discount at which it is currently trading.

Shares of oil and gas producer Diamondback Energy were pressured by the combination of growing macroeconomic concerns in the wake of April's tariff announcements and OPEC's announcement it would unwind production cuts early, possibly materially increasing supply in a weaker demand environment and weighing on oil prices.

Other bottom contributors included Bank of America, lululemon athletica and CarMax. Shares of banking and financial services company Bank of America were pressured early in the quarter amid broader macroeconomic concerns. We exited our position to manage our banking exposure and in favor of Capital One, which we believe offers better long-term upside potential — however, the timing of that shift hurt relative performance in Q2. Athletic apparel retailer lululemon faced a softer quarter in the US and internationally as sales slowed. However, we believe the brand remains relevant and shares are trading at an attractive discount to our estimate of intrinsic value. Shares of used car dealer CarMax declined as investors considered whether the company can sustain its recent growth rates, despite some weakness in its captive financing arm.

Portfolio Activity

Despite markets' relatively sharp bounce following April's downward volatility, we were able to initiate two new positions in the quarter at what we consider compelling valuations: Salesforce and Antero Resources Corporation.

Salesforce provides customer relationship management (CRM) technology connecting companies and customers. Revenue growth has recently been pressured as the company has faced an unfavorable cyclical environment, investments in go-to-market enhancements, increased prices and decreased generative AI revenues. We believe as these trends reverse, revenue growth should reaccelerate. Margins should also expand in the period ahead as the company's go-to-market strategy evolves, sales channel mix

shifts, tech stack consolidates and as it transitions to third-party data centers. Given this outlook, we capitalized on the tariff-related downturn by initiating a position at what we consider an attractive price relative to our estimate of Salesforce's intrinsic value.

Antero Resources is a highly disciplined, independent oil and natural gas company with a particular focus on natural gas. The company is consequently well-positioned to benefit from the second wave of the US's liquid natural gas buildout. Given its transportation capacity, Antero Resources can reliably move its gas to premium-priced Gulf Coast hubs, and its captive midstream system further strengthens its competitive position. Further, Antero's strict capital discipline has enabled it to operate in maintenance mode, prioritizing debt reduction over growth and maximizing free cash flow generation. Looking forward, we believe the company is poised to pivot toward more accretive capital returns, and so we capitalized on the Liberation Day-related market noise to initiate a position at an attractive discount to our estimate of intrinsic value.

We funded these purchases in part with the proceeds from the sale of the aforementioned banking and financial services company, Bank of America, and health care facilities operator, HCA Healthcare, which we exited in favor of more compelling opportunities elsewhere.

Market Outlook

Equity markets have demonstrated remarkable resilience in 2025, navigating a complex environment shaped by shifting policies, economic uncertainty and evolving investor sentiment. As we look ahead, the interplay between these factors will likely continue to influence market dynamics, presenting both challenges and opportunities for investors.

Valuations have returned to elevated levels, and while near-term economic growth projections remain healthy, signs of a weakening consumer have emerged across various sectors. Given the consumer's critical role in driving the economy, further softening could pose risks to the high-single-digit corporate earnings growth currently anticipated for the year. Monitoring these trends will be essential as we assess the sustainability of current market expectations.

Investor preferences have also shifted notably this year, reflecting the broader uncertainty in the economic and policy landscape. While defensive and value stocks gained favor earlier in the year, recent trends have highlighted renewed interest in growth-oriented and economically sensitive sectors. These shifts underscore the importance of

maintaining a flexible and forward-looking approach to portfolio management, as market leadership may continue to evolve in response to changing conditions.

The selloff earlier this year created a brief but compelling window for investment opportunities, though the subsequent market rebound quickly closed that window. As equity markets return to above-average valuation levels, it becomes increasingly challenging to expect returns that align with historical averages over the next five years. However, we remain steadfast in our commitment to delivering value-added results for our clients. By focusing on high-quality companies with strong fundamentals and long-term growth potential, we believe we can achieve returns that exceed the broader market over time.

Looking forward, the path ahead will likely be shaped by a combination of economic resilience, policy developments and shifts in market dynamics. By staying focused on our disciplined investment process, we aim to navigate these complexities and position our portfolio for long-term success.

| Period and Annualized Total Returns (%) | Since Inception (30 Jun 2000) | 20Y | 15Y | 10Y | 5Y | 3Y | 1Y | YTD | 2Q25 |
|---|----------------------------------|-------|-------|-------|-------|-------|-------|------|-------|
| Gross of Fees | 11.50 | 11.15 | 13.90 | 11.47 | 19.74 | 17.21 | 10.64 | 4.08 | 7.53 |
| Net of Fees | 10.55 | 10.22 | 12.96 | 10.56 | 18.78 | 16.27 | 9.76 | 3.66 | 7.31 |
| Russell 3000 Index | 8.04 | 10.53 | 14.46 | 12.96 | 15.96 | 19.08 | 15.30 | 5.75 | 10.99 |
| Russell 3000 Value Index | 7.87 | 8.03 | 11.43 | 9.04 | 13.87 | 12.48 | 13.30 | 5.55 | 3.84 |

| Calendar Year Returns (%) | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 |
|---------------------------|-------|-------|-------|-------|-------|-------|-------|-------|--------|-------|-------|-------|--------|-------|-------|
| Gross of Fees | 11.51 | -0.58 | 12.70 | 45.86 | 12.59 | -0.47 | 10.84 | 21.26 | -11.19 | 31.91 | 15.64 | 34.48 | -16.47 | 31.65 | 14.05 |
| Net of Fees | 10.56 | -1.42 | 11.74 | 44.62 | 11.63 | -1.32 | 9.90 | 20.23 | -11.93 | 30.86 | 14.72 | 33.41 | -17.14 | 30.60 | 13.14 |
| Russell 3000 Index | 16.93 | 1.03 | 16.42 | 33.55 | 12.56 | 0.48 | 12.74 | 21.13 | -5.24 | 31.02 | 20.89 | 25.66 | -19.21 | 25.96 | 23.81 |
| Russell 3000 Value Index | 16.23 | -0.10 | 17.55 | 32.69 | 12.70 | -4.13 | 18.40 | 13.19 | -8.58 | 26.26 | 2.87 | 25.37 | -7.98 | 11.66 | 13.98 |

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