

DIAMOND HILL

INVESTED IN THE LONG RUN

Small-Mid Cap 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.

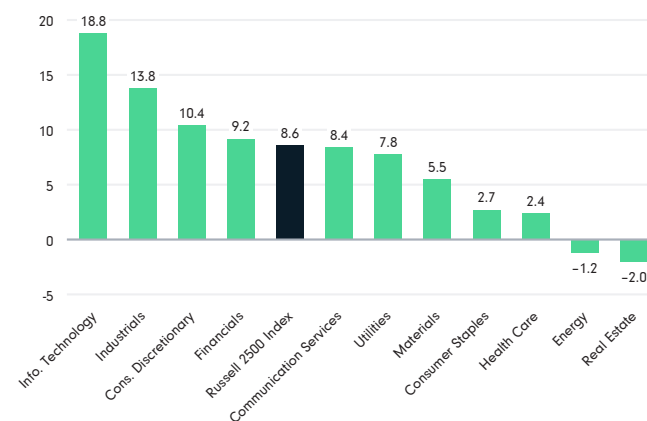
From a sector perspective, investors' risk-on attitude seemed to likewise return, with the growthier sectors in the Russell 2500 Index leading, while defensive sectors fell out of favor. Information technology stocks performed best, rising nearly 19%, followed by industrials, which gained almost 14%. Real estate (-2.0%) and energy (-1.2%) were the index's sole sectors in the red in Q2 – with energy especially hampered by geopolitical upheaval.

Team

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2Q25 Russell 2500 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. However, we remain focused on our investment philosophy, which seeks to identify opportunities to invest in 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 2500 Index in Q2. Relative weakness was concentrated among our technology exposure — both our below-benchmark weight to the index's top performing sector as well as our holdings which, though delivering positive returns, trailed benchmark peers. Our consumer staples holdings also posed a relative headwind in the quarter. Conversely, our financials holdings provided a boost to relative returns.

On an individual holdings' basis, top contributors to return in Q2 included Red Rock Resorts and WESCO. 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. Shares of industrial distributor WESCO rose amid a solid demand environment, particularly among data center customers. Long term, we expect WESCO to leverage its significant scale advantage to capture market share and improve margins. Further, the company is well-positioned to benefit from several secular tailwinds aside from data centers — all factors which the market has not yet fully appreciated.

Other top contributors in Q2 included Regal Rexnord, Mr. Cooper Group and Gates Industrial. 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.

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. Gates Industrial, an engineered power transmission and fluid power solutions provider, benefited as it produces in and for North America — mitigating what otherwise could have been direct tariff impacts. As more production is expected to shift to the US and Mexico, Gates Industrial stands to benefit.

Among our bottom individual Q2 contributors to return were Insperity and Civitas Resources. Insperity provides human resources (HR) and business solutions primarily to US-based small and mid-sized businesses. Shares were pressured in the quarter as higher-than-expected health care costs impacted the company's insurance book, and the company's worksite employee count grew at a tepid rate. Our confidence in the company's execution across multiple fronts — including its Workday partnership, ability to grow worksite employees, manage its health insurance book of business and improve margins — has increasingly weakened. Further, the potential for AI disruption is a longer-term risk to Insperity's worksite employee base. With these factors pressuring the share price and limited visibility into a meaningful turnaround over the course of our investment horizon, we exited our position during the quarter, redeploying the proceeds to more attractive risk-reward opportunities.

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

Other bottom Q2 contributors included ICON, Post Holdings and Ashland. ICON's shares declined during the quarter, as contract research organizations (CROs) broadly underperformed amid ongoing uncertainty around the pace and timing of recovery in biotech and pharmaceutical order volumes. Investor sentiment weakened as visibility into normalized growth trajectories remained limited.

Food products manufacturer Post Holdings has faced weaker volumes in recent quarters, particularly in its cereal category — though management has emphasized volume weakness has been broad-based across the packaged foods industry, so Post is not alone on this front. Importantly, fundamentals in other areas of the business generally remain solid.

Specialty chemical manufacturer Ashland faces the potential for a weaker European macroeconomic environment and Chinese construction industry — sentiment-related factors 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.

Portfolio Activity

Despite markets' relatively sharp bounce following April's downward volatility, we were able to initiate several new positions in the quarter at what we consider compelling valuations: Generac Holdings, Alaska Air Group, Knife River Corporation, Taseko Mines, Century Communities and FTI Consulting.

Generac Holdings is a leading energy technology solutions manufacturer with a dominant position in residential home standby power and a diverse offering of energy solutions. We anticipate the combination of increasing electricity usage and electrical grid instability will drive growing demand for Generac's products. While the market seems to have focused on near-term consumer weakness and potential tariff-related headwinds, we believe the long-term outlook is constructive and capitalized on a discounted valuation relative to our estimate of intrinsic value to initiate a position.

Shares of regional airline Alaska Air Group were pressured meaningfully in the quarter following the tariff announcements, which raised questions among investors about the overall macroeconomic outlook. This gave us an attractive opportunity to reestablish a position in a business we know well — and which we had recently exited after it reached our estimate of intrinsic value — at a compelling valuation.

Knife River provides aggregates-led construction materials and contracting services. As the market has softened amid near-term concerns about the macroeconomic environment, shares of Knife River were pressured in sympathy. However, we believe this overlooks Knife River's resilience in the core heavy building materials business. Further, the company's focus on aggregates-led growth and margin expansion could drive meaningful value creation over the course of our investment horizon.

Taseko Mines is a Canada-based copper mining company. Its Florence copper project in Arizona, which is expected to come online at the end of 2025, is expected to generate attractive free cash flows in the period ahead. We capitalized on an attractive share price relative to the outlook to initiate a position.

Century Communities is a homebuilder — an industry that faces near-term challenges amid weaker consumer demand and higher interest rates. However, as shares trade at a sizeable discount to tangible book value, particularly given the company's solid balance sheet and operating model, we capitalized on the opportunity to introduce a position in the quarter.

FTI Consulting provides business advisory services to manage change, mitigate risk and resolve disputes. It has a robust, balanced services lineup spanning procyclical (e.g., M&A advisory work), countercyclical (e.g., restructuring advisory) and acyclical (e.g., forensic accounting and litigation consulting) engagements. The company has improved its scale, geographic reach and service breadth over the past decade or so as the CEO and management team have successfully seeded and grown service areas and geographies while generally reorienting the company's culture toward organic growth. Near-term disruptions over the past several quarters — which we believe will prove to be largely noise in the long term — gave us an opportunity to initiate a position in what we consider a healthy, solid business run by a capable management team at a compelling price.

We funded these purchases in part with the proceeds from the sale of ski resort owner and operator Vail Resorts, which we sold in favor of more compelling opportunities elsewhere, in addition to the aforementioned Insperity.

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.

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. However, we remain steadfast in our commitment to delivering value-added results for our clients. By focusing on 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 (31 Dec 2005)	15Y	10Y	5Y	3Y	1Y	YTD	2Q25
Gross of Fees	9.15	11.22	7.79	13.62	9.16	9.54	1.43	5.60
Net of Fees	8.16	10.22	6.84	12.65	8.23	8.61	0.99	5.37
Russell 2500 Index	8.61	11.45	8.39	11.44	11.31	9.91	0.44	8.59
Russell 2500 Value Index	7.71	10.50	7.73	13.96	10.69	10.47	1.03	7.29

Calendar Year Returns (%)	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
Gross of Fees	24.74	-2.96	16.93	43.32	8.42	2.45	19.30	9.63	-11.71	28.84	2.29	32.34	-12.80	12.45	9.24
Net of Fees	23.55	-3.88	15.82	41.96	7.39	1.47	18.17	8.59	-12.51	27.75	1.42	31.22	-13.54	11.50	8.31
Russell 2500 Index	26.71	-2.51	17.88	36.80	7.07	-2.90	17.59	16.81	-10.00	27.77	19.99	18.18	-18.37	17.42	12.00
Russell 2500 Value Index	24.82	-3.36	19.21	33.32	7.11	-5.49	25.20	10.36	-12.36	23.56	4.88	27.78	-13.08	15.98	10.98

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