

# DIAMOND HILL

INVESTED IN THE LONG RUN

## Mid Cap Strategy

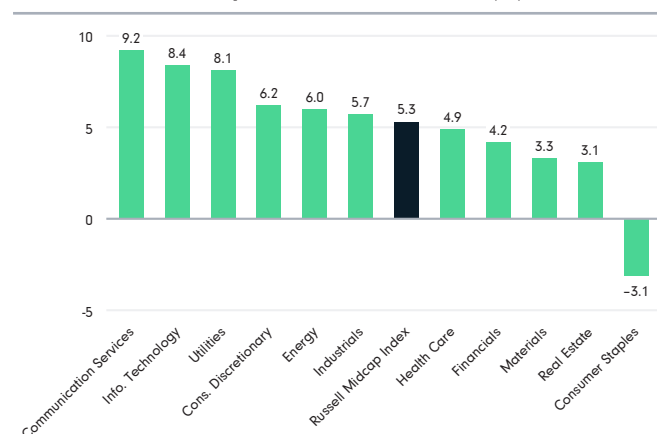
As of 30 Sep 2025

### Market Commentary

Markets continued their year-to-date rise in Q3, with US stocks gaining over 8% (as measured by the Russell 3000 Index) and taking calendar-year gains to over 14%. Small-cap stocks had the best quarter, up over 12%, while large caps gained roughly 8% and mid caps were up 5%. From a style perspective, growth led at the larger end of the cap spectrum, while small-cap growth and value stocks delivered nearly identical returns — with small value slightly ahead (up over 12%).

From a sector perspective, meaningful positive contributors in the Russell Midcap Index were communication services (up 9%) and information technology, fueled by the artificial intelligence (AI) boom, was up nearly 9%. The sole sector in the red in Q3 was consumer staples, which fell just over -3%.

### 3Q25 Russell Midcap Index Sector Returns (%)



Source: FactSet, as of 30 Sep 2025.

### Team

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Portfolio Manager

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Portfolio Specialist

Trade, monetary policy and geopolitics remained the top headlines in Q3, even as markets seemed to shrug off any ongoing concerns and continue their rise (and rebound from late Q1's and early Q2's sharp downturn in the wake of President Trump's initial tariff announcements). Despite the uncertainty stemming from these and other areas, markets plodded along in Q3, with several indices notching new all-time highs. Technology companies have continued their torrid run as sentiment around the potential for AI to radically change life as we know it remains high.

Against such a backdrop, it can be challenging to fight the urge to float with the current — but we believe investors who do the hard work of researching and identifying high-quality companies the markets may be entirely overlooking can ultimately generate attractive long-term returns. As such, we will continue focusing on areas where we believe valuations are disconnected from underlying fundamentals and long-term growth outlooks — an approach we believe will benefit investors regardless of how events continue unfolding in the quarters and years ahead.

### Performance Discussion

Our portfolio trailed the Russell Midcap Index in Q3. Relative weakness was concentrated among our real estate and health care holdings — the latter of which were modestly positive but trailed benchmark peers. Conversely, our industrials holdings provided a relative tailwind. Our financials holdings also provided a boost to relative returns.

On an individual holdings' basis, top contributors to return in Q3 included Mr. Cooper Group and Ciena Corporation. Shares of mortgage servicing company Mr. Cooper Group rose as its acquisition by Rocket Companies closed as the quarter concluded. Investor sentiment has also been buoyed by the Fed's recent rate cut, which should give a boost to housing and refinancing demand in the period ahead.

Strong demand for networking systems company Ciena's hyperscaler offerings has helped drive strong earnings growth. Hyperscaler demand is being fueled by AI-related projects, which Ciena's management team believes should translate to meaningfully elevated and durable demand in the period ahead.

Other top contributors in the quarter included Red Rock Resorts, WESCO and Huntington Ingalls Industries. Red Rock Resorts, a casino operator controlling over half the Las Vegas locals' market, continues to benefit from broad fundamental strength which is underpinning steady and stable growth. Industrial distributor WESCO's data center business is growing rapidly, in turn driving revenue growth. Further, we were encouraged by signs of strong organic growth and nascent signs of improvement in the company's high-margin utility business. We believe over the long term, WESCO can leverage its significant scale advantage to take share and improve margins. It is also well positioned to benefit from several secular tailwinds (aside from data centers), which we don't believe are fully appreciated by the market.

US Department of Defense (DOD) and Navy supplier Huntington Ingalls is seeing early signs of progress from its recent efforts to improve employee attrition. We continue to believe Huntington Ingalls is one of the best positioned defense companies to meet the DOD's need to prepare for a potential conflict in the Pacific — which should ensure strong demand for the next five-plus years. Furthermore, as its recent labor issues abate, the company should be able to improve margins over time.

Among our bottom individual Q3 contributors were American International Group (AIG) and CarMax. Property and casualty insurance company AIG underperformed in sympathy with many industry peers. Over the past several years, property and casualty insurers have enjoyed a healthy margin between pricing and loss costs which now seems to be waning and, in turn, pressuring share prices.

Used car dealer CarMax saw a meaningful slowdown in used retail vehicle sales as well as higher credit-loss provisions in its captive financing arm. We believe consumers likely pulled forward vehicle purchases ahead of tariffs, leading to a recent industry lull. Combined with uncertain consumer sentiment and heightened competition, shares were pressured in the quarter. However, we believe CarMax remains capable of taking share in a fragmented market over the longer term and are confident in the management team, which is focused on finding efficiencies to enable it to spend more on consumer-facing initiatives.

Other bottom Q3 contributors included GoDaddy, Freeport-McMoRan and Fidelity National Information Services. GoDaddy designs and develops cloud-based products. Shares declined in the quarter as sales slowed and its customer base contracted. Further, investors are weighing whether and to what extent AI may impact GoDaddy's business in the future. Copper-focused mining company Freeport-McMoRan had a significant mudslide in early September at its Grasberg Block Caves mine in Indonesia. Tragically, seven workers have been confirmed dead. The company is still assessing the full extent of the damage and the timeline for repairs — however, it is clear Q3 production will be impacted by the shutdown — though it seems the current best-case scenario is production will ramp back up over 2026 and return to pre-incident levels by 2027.

Shares of financial services technology company Fidelity National Information Services were pressured as revenue growth slowed, and the company made little progress toward improving free cash flow conversion. We exited our position in the quarter given our concerns about the company's longer-term prospects for growth in a changing bank technology environment and as management's ability to execute has become questionable.

## Portfolio Activity

Though markets have continued rising throughout the year, we have continued finding individual companies whose prices we believe are not reflective of their long-term growth outlooks. Accordingly, we initiated several new positions in Q3, including Toro Company, Equitable Holdings, Cooper Companies and Revvity.

Toro Company is a leading provider of equipment for turf and landscape management, snow and ice management and underground construction. It has leading market share and strong distribution and service networks that incentivize customers to replace like for like, generating a strong revenue source for the company. Amid a challenging

macroeconomic environment and bloated channel inventories, recent results have been soft — however, we believe the long-term fundamentals remain intact and expect the company to generate solid results over the next 5 to 10 years.

Equitable Holdings is amid a transition from a life insurance company to a more diversified financial company with a better earnings, profitability and cash-generation profile, which we don't believe is reflected in the current valuation.

Cooper Companies is a medical devices company operating CooperVision, a global leader in contact lenses, and CooperSurgical, a leader in women's health and fertility care. We anticipate the contact lens industry will remain healthy and has an ample runway for growth as customers trade up for higher quality lenses. Further, Cooper Companies has an opportunity to take modest share in the contact lens business. CooperSurgical currently faces cyclical headwinds but operates in an end market that should benefit from several secular tailwinds. The company recently made heavy investments in manufacturing capacity. Given the appealing outlook, we capitalized on slower revenue growth in both CooperSurgical and CooperVision, which we view as transitory, to initiate a position.

Revvity is a life sciences tools and diagnostics company that provides instruments and consumables for preclinical drug research. The company has upgraded its product portfolio to offerings which generate higher margins, and so we took advantage of investors' concerns about biopharmaceuticals policy uncertainty to add a position at a discount to our estimate of intrinsic value.

We funded these purchases in part with the proceeds from several sales in the quarter, including the aforementioned Fidelity National Information Services, as well as medical technology company Enovis and dental products manufacturer Envista Holdings, both of which we sold in favor of better positioned opportunities elsewhere.

## Market Outlook

Amid what could potentially be a bubble (only hindsight will tell), sentiment around AI is driving remarkable equity market returns year to date. In many of these cases, we believe sentiment is at least partially disconnected from reality given AI's potential is yet to be fully borne out. Not only are investors rewarding companies with even minimal

potential exposure to AI, but they are disproportionately punishing companies whose business models may be at any risk from AI disruption or whose businesses are not sufficiently (or at all) exposed to AI — said another way, AI seems to be all many investors care about.

This environment can produce interesting opportunities for discerning investors to unearth companies with attractive business models that markets are either currently ignoring altogether or disproportionately punishing. Over the long term, we believe such high-quality companies could offer solid returns to patient investors.

On the other hand, investors' narrow focus on one major theme is impacting sector and index performance and, in our view, embedding a significant amount of optimism in share prices. Such an investing backdrop can be a challenging one, especially if you are inclined to swim against the tide — which we generally are. However, we are not contrarian for its own sake; rather, we find it hard to justify the valuations of some top-performing companies when much remains to be seen about whether — and how — AI will impact businesses in the future.

Further complicating the macroeconomic picture is the state of the consumer, which is hard to clearly discern. It seems there is a growing divide between those at the top end of the income spectrum who are holding up remarkably well and whose spending levels are either steady or increasing and those in the middle or at the bottom — a share of the population among whom jobs have become increasingly scarce and who are feeling inflation's pinch meaningfully. Given consumers' significant contribution to GDP, overall softening in their spending could pose a risk to the double-digit corporate earnings growth projections expected in 2026.

The selloff in late Q1 and early Q2 started to create some attractive investment opportunities. However, the window to capitalize on those was short given the market's subsequent rebound. Equity markets are back to above-average valuation levels, making it difficult to expect returns that match historical averages over the next five years. 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	3Q25
Gross of Fees	8.56	9.25	14.00	14.48	7.65	10.05	4.68
Net of Fees	7.77	8.47	13.20	13.68	6.90	9.47	4.49
Russell Midcap Index	10.21	11.39	12.66	17.69	11.11	10.42	5.33
Russell Midcap Value Index	8.95	9.96	13.66	15.51	7.58	9.50	6.18

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

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