

DIAMOND HILL

INVESTED IN THE LONG RUN

International Strategy

As of 30 Jun 2025

Market Commentary

The second quarter saw another strong performance from international stocks, with the MSCI ACWI ex-US Index increasing 12.03%. Despite this solid return, markets experienced notable volatility driven by geopolitical events. Liberation Day initially triggered a sharp sell-off, reflecting investor anxiety over the possibility of severe tariffs. However, markets quickly rebounded as many of the proposed tariffs were delayed or settled at rates much lower than the initial headlines. Meanwhile, tensions stemming from the Israel-Iran conflict had significant humanitarian and geopolitical impacts, causing a brief spike in oil prices; however, markets remained resilient overall.

Europe led the benchmark higher, supported by rate cuts and easing inflation expectations. NATO's collective decision to increase defense spending to 5% of GDP, along with the UK's upcoming infrastructure investment plans, offered optimism despite challenges such as aging infrastructure, as illustrated by recent grid issues in Spain. In Japan, more signs of corporate governance reform were evident through increased share buybacks and the consolidation of parent-child listings, despite ongoing concerns about future GDP growth. Chinese equities mostly stayed flat, reflecting continued uncertainty about the outlook for consumer demand. Improved political stability after South Korea's presidential election boosted its local equity market. Meanwhile, in Latin America, rate cuts and a stronger peso helped lift Mexican stocks, and talks of budget discipline combined with cheap valuations pushed Brazilian stocks higher.

Team

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Performance Discussion

Our portfolio delivered a solid absolute return this quarter, although it slightly underperformed the benchmark. The consumer staples and industrials sectors were positive contributors, while information technology and consumer discretionary detracted on a relative basis. Geographically, holdings in France and Japan boosted relative performance, whereas holdings in Canada and South Korea detracted.

Taiwan Semiconductor Manufacturing Company (TSMC), the world's leading semiconductor foundry, achieved strong financial performance driven by increased demand for its advanced semiconductor technologies from sectors like machine learning and cloud computing.

Tesco, the largest grocery retailer in the UK, reported solid quarterly results, despite recent market concerns sparked by competitor Asda's aggressive pricing strategy. Tesco reaffirmed its position as the leading everyday low-price grocery chain in the UK, which supported its share performance.

Mitsubishi Shokuhin, a major food distributor in Japan, rose sharply following its announced buyout by Mitsubishi Corp., reflecting ongoing improvements in corporate governance and parent-child listing consolidations in Japan, an area of focus for us.

Conversely, Bunzl, a global distributor of non-food consumable products, faced an unexpected quarterly earnings shortfall due to execution issues in its North American operations. Despite this short-term setback, we remain confident in the management team and their proven execution capabilities.

Alibaba, China's largest e-commerce and tech giant, experienced slow consumer spending and weaker-than-expected e-commerce growth, worsened by concerns about China's economic recovery and increased geopolitical tensions.

Gerresheimer, a leading global manufacturer of specialty glass and plastic packaging for pharmaceuticals and cosmetics, lowered its 2025 guidance, citing weak cosmetics demand and temporary softness in medical packaging. We expect organic growth to bounce back later this year, driven by increasing demand for higher-value injectable drug packaging solutions.

Portfolio Activity

The volatility this quarter enabled us to add three new stocks that we had been monitoring closely when their share prices became attractive. At the same time, we decided to exit six positions, choosing to sell two stocks where our investment thesis had been fulfilled and to exit several other positions where our preference was to own other stocks where we had higher conviction.

We initiated a position in Ireland's leading retail bank, Allied Irish Bank (AIB). Ireland has a favorable economic backdrop, and AIB holds a dominant market share in a highly consolidated banking sector. The bank's solid capital position enables the potential for strong returns to shareholders through dividends and buybacks, with further upside expected following the recent sale of the Irish government's final stake in the bank. We believe the market underestimates the bank's market position and its potential for capital returns.

Hindustan Aeronautics is India's leading aerospace and defense company, offering essential services such as the design, manufacturing and maintenance of military aircraft and helicopters. The company's large order backlog is driven by India's strategic move toward defense self-reliance and higher defense spending. Short-term market concerns from operational setbacks created an attractive entry point into this fundamentally strong business with clear long-term earnings prospects.

BAWAG Bank, a leading retail bank in Austria, operates a highly efficient digital banking model that supports sustained profitability and has a proven record of shareholder-friendly capital allocation. The bank maintains a notably low-cost structure and delivers strong returns. We took advantage of temporary market declines related to trade tensions to establish our position at an attractive discount to intrinsic value.

We sold several positions during the quarter. Notably, our exit from Mitsubishi Shokuhin occurred after the company announced a buyout by Mitsubishi Corp. Since Mitsubishi Corp. already held a significant stake in Mitsubishi Shokuhin, acquiring the remaining shares consolidated the parent and subsidiary under the same company. Although this event was not central to our investment thesis, we saw it as a potential source of embedded optionality when we established our position in 2024.

We also exited our position in the Belgian pharmaceutical company UCB S.A. UCB was a notable contributor to performance during our holding period, and its stock price had reached a point where the discount to intrinsic value had narrowed. Additionally, with uncertainty regarding potential pharmaceutical tariffs, we believed it was wise to exit the position given the combination of tariff risks and a narrower discount to intrinsic value. Lastly, we exited positions in Capstone Copper, Prosus NV, Arcos Dorados and Nestlé, where we preferred other positions in the portfolio where conviction was higher.

Market Outlook

International stocks have posted strong returns so far this year, yet they still present attractive relative valuations compared to US equities. While there isn't a single dominant theme across all non-US markets, different regions and countries offer compelling reasons for optimism about their future prospects, potentially unlocking value through economic and corporate developments.

Europe's increased spending on defense and infrastructure, Japan's ongoing corporate governance reforms and China's complex economic and corporate landscape each present unique opportunities and risks. Tariff negotiations have also significantly contributed to market volatility in recent months, and we humbly acknowledge that predicting these outcomes is beyond our skill set. There have been meaningful market swings over just a few months, underscoring the importance of remaining grounded in our investment approach.

In this environment, we continue to follow our disciplined investment philosophy, focusing on companies where a gap exists between the intrinsic value of the business and the current stock price. By staying flexible and nimble in our approach to discovering new ideas, we seek to capture value across diverse international markets while maintaining careful risk management to achieve sustainable, long-term returns for our investors.

Period and Annualized Total Returns (%)	Since Inception (31 Dec 2016)	5Y	3Y	1Y	YTD	2Q25
Gross of Fees	10.41	13.02	14.80	14.44	16.54	11.89
Net of Fees	9.59	12.17	13.94	13.58	16.10	11.68
MSCI ACWI ex USA Index	7.92	10.13	13.99	17.72	17.90	12.03

Calendar Year Returns (%)	2017	2018	2019	2020	2021	2022	2023	2024
Gross of Fees	32.22	-9.62	24.95	7.64	13.73	-12.76	19.18	4.81
Net of Fees	31.23	-10.30	24.01	6.83	12.87	-13.41	18.29	4.03
MSCI ACWI ex USA Index	27.19	-14.20	21.51	10.65	7.82	-16.00	15.62	5.53

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