DIAMOND HILL

INVESTED IN THE LONG RUN

Large Cap Concentrated 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 1000 Value Index leading, while defensive sectors fell out of favor. Information technology stocks performed the best, rising nearly 16%, followed by industrials, which advanced more than 13%. Health care (-8.7%), energy (-7.6%) and real estate (-1.1%) were the only sectors in the red in Q2. Energy was hindered by geopolitical upheaval, about which we'll discuss shortly.

Team

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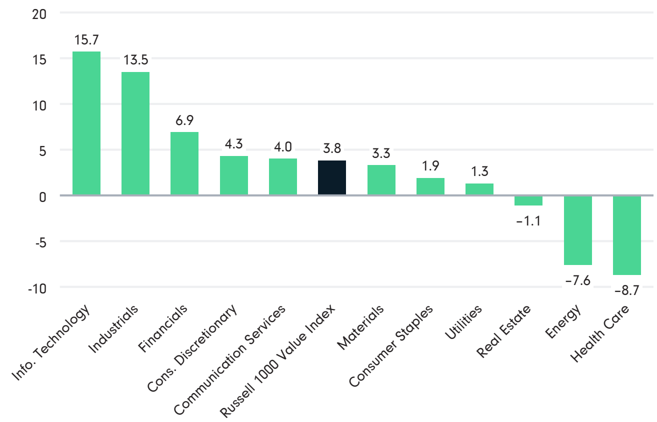
2Q25 Russell 1000 Value Index Sector Returns (%)



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 trailed the Russell 1000 Value Index in Q2. Relative weakness was concentrated among our financials and industrials holdings, both of which delivered positive returns but trailed those of benchmark peers. Conversely, our health care holdings meaningfully outperformed, providing a relative tailwind to performance in the quarter.

Among our top individual contributors in Q2 were Ferguson Enterprises and Capital One. Plumbing and heating products distributor Ferguson Enterprises is capitalizing on its competitive advantages to scale in large projects and the HVAC market. Furthermore, commodity deflation, a recent headwind, diminished in the quarter, providing a boost to shares. Given the still-fragmented industry and Ferguson's status as a high-quality distributor in an industry where scale matters, we believe there is ample room for further margin expansion. Credit card issuer Capital One is benefiting from solid consumer spending, while delinquency trends and credit losses remain well-controlled.

Other top Q2 contributors included new holdings Texas Instruments, Amazon.com and Labcorp. Semiconductor manufacturer Texas Instruments has effectively managed near-term tariff-related uncertainty by capitalizing on its dual-flow manufacturing capability, which enables it to produce the same part in fabrication plants located in different geographical regions. Shares also received a boost as investor sentiment around the semiconductor market improved.

Shares of internet retail and cloud infrastructure company Amazon.com rose in the quarter as the overhang from tariffs — to which Amazon would be considerably exposed — dissolved. Leading diagnostic lab Labcorp announced during the quarter that the FDA's decision to move away from animal models for clinical trials would likely have a modest impact on revenues and an even smaller impact on profitability — giving a boost to shares.

Among our bottom individual contributors in Q2 were ConocoPhillips and Bank of America. Shares of oil and gas producer ConocoPhillips 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, potentially leading to a material increase in supply in a weaker demand environment and weighing on oil prices.

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.

Other bottom Q2 contributors included Berkshire Hathaway, Aon and lululemon athletica. Despite a strong quarter for diversified holding company Berkshire Hathaway, shares declined as investors weighed the implications of Warren Buffett's retirement at the end of the calendar year. Aon is a global leader in insurance brokerage and consulting. Despite good organic revenue growth and margin expansion, investors appeared to be disappointed by the company's medium-term guidance, which in turn weighed on the share price 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.

Portfolio Activity

Despite markets' relatively sharp bounce following April's downward volatility, we were able to initiate three new positions in the quarter at what we consider compelling valuations: the aforementioned Amazon.com and Capital One, as well as Salesforce.com.

Amazon, a leading internet retail and cloud infrastructure company, has grown consistently in line with overall e-commerce growth, while its Amazon Web Services business (AWS) has benefited from improving market-share trends, resulting in faster growth. We capitalized on Q2's tariff-induced downturn to initiate a position at a compelling valuation.

We initiated a position in Capital One Financial, as we anticipate near-term cost savings and longer-term revenue upside potential from customized loyalty and rewards programs, which could attract higher-end customers. We don't believe these possibilities are reflected in the current stock price, and consequently, we initiated a position in the quarter.

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 that 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 what we consider an attractive price relative to our estimate of Salesforce's intrinsic value during the tariff-related downturn to initiate a position.

We funded these purchases in part with the proceeds from the aforementioned Bank of America as well as HCA Healthcare, which we exited in favor of more compelling opportunities.

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 (31 Dec 2011)	10Y	5Y	3Y	1Y	YTD	2Q25
Gross of Fees	13.05	11.66	15.47	16.71	14.50	8.11	2.73
Net of Fees	12.32	10.95	14.77	16.01	13.81	7.78	2.57
Russell 1000 Value Index	11.27	9.19	13.93	12.76	13.70	6.00	3.79
Russell 1000 Index	14.54	13.35	16.30	19.59	15.66	6.12	11.11

Calendar Year Returns (%)

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
Gross of Fees	10.00	38.75	10.70	-0.58	19.17	19.26	-7.17	31.76	10.51	27.43	-12.59	17.32	14.97
Net of Fees	9.23	37.78	9.92	-1.28	18.33	18.48	-7.77	30.90	9.79	26.65	-13.12	16.62	14.28
Russell 1000 Value Index	17.51	32.53	13.45	-3.83	17.34	13.66	-8.27	26.54	2.80	25.16	-7.54	11.46	14.37
Russell 1000 Index	16.42	33.11	13.24	0.92	12.05	21.69	-4.78	31.43	20.96	26.45	-19.13	26.53	24.51