DIAMOND HILL INVESTMENT GROUP, INC.
ANNUAL LETTER TO SHAREHOLDERS

March 10, 2017

Dear Fellow Shareholders:

Calendar year 2016 was a productive one for Diamond Hill Investment Group. Our clients benefited from robust domestic capital markets and generally strong results across our various investment strategies. As a firm, we also saw a number of significant developments and achievements. As always, these accomplishments were done within the context of our core values: i*ntrinsic value, long-term orientation, discipline,* and *partnership*.

As a fiduciary and client-centric firm, our foremost priority is generating excellent investment results over sufficiently long time periods (a minimum of five years) in each of our investment strategies. Due to our long-term investment style and disciplined approach toward identifying and holding securities with a margin of safety, we aim to partner with clients who are aligned with both our philosophy and time horizon, as we strive to maintain that alignment through consistent and effective communications.

We expect to accomplish the first critically important part of our mission—generating strong investment returns—by managing relatively concentrated, high-conviction portfolios constructed independent of benchmark weights using detailed research and a long horizon. Our intrinsic value-based philosophy is shared by all of our investment professionals, allowing us to consistently apply this investment discipline across all of our strategies.

Investment Strategy Results for Clients

We achieved strong long-term performance across most of our strategies compared to core benchmarks and peers. Though we accomplished many other things, this is always our most important mandate.

Our clients benefited from healthy U.S. equity markets that rallied sharply in the fourth quarter and posted well above average results for the year. As we witnessed throughout the year, markets around the world clearly reacted to various political developments. Most notably, the domestic equity markets saw sharp increases post the November elections. Financials and other cyclical sectors experienced the biggest gains. Those more economically sensitive areas, despite lagging badly during the first half of the year, ended up leading the market during 2016 while the more defensive sectors generally lagged.

The events of 2016, including the U.S. election, also influenced virtually the entire spectrum of credit markets. The 10-year Treasury yield increased from 1.88% to 2.07% on the day following the election, which represents the largest single-day move since October 2011. In the high yield market, cratering commodities prices and fears about illiquidity, among other issues, priced the market for a high likelihood of recession early in the year. When commodities prices stabilized and liquidity conditions improved, the high yield market began a sharp and sustained recovery.

Clearly, the robust markets provided a tailwind for our firm; however, prospectively we are a bit more cautious. Equity markets in the U.S. appear to be assigning historically elevated multiples to relatively lofty corporate profit margins. On the credit side, markets also enjoyed a significant tightening of spreads—which are now quite narrow by historical measures. No doubt, a meaningful driver of the post-election enthusiasm has been the prospect of corporate tax reform which, if enacted, should increase after-tax profits and nudge valuations back towards long-term averages. Nonetheless, we continue to expect modest market tailwinds over the next five years.

Other Key Developments

- We added to our team by hiring three experienced and accomplished fixed income professionals who had worked together for a number of years within the asset management division of a large financial services firm. These individuals, along with previous hires over the past few years, brought tremendous new skill and expertise to our firm. As a result, we were able to publicly launch three new fixed income strategies (High Yield, Short Duration Total Return, and Core Bond) last year. These new strategies, along with our Corporate Credit Fund, will be the foundation of our growing fixed income efforts. We approach this area of our business with our typical long-term commitment, and we view this effort as very meaningful for all of Diamond Hill's constituents.
- The sale of our Beacon Hill subsidiary was another significant event for the company. After much consideration, we concluded that Diamond Hill was an adequate financial partner for Beacon Hill but not likely an optimal strategic partner. The buyer was a larger service provider with complementary offerings as well as a deep bench of experienced professionals. The resulting combination represents an even stronger organization and a better strategic platform for our former colleagues. We wish them all well and look forward to our continued relationship with their new team as an important service provider to our Fund family.
- As we have communicated in the past, we believe management fees should reflect a fair split of economics between the client and the investment manager. Diamond Hill demonstrated this commitment to clients by reducing the Large Cap, Mid Cap, Research Opportunities, and Financial Long-Short management fees during the past 12 months. In addition, we continued to lower administrative fees across all of our Funds.
- We grew assets under management to $19.4 billion as of December 31, 2016. While stronger markets were clearly a tailwind, we also saw positive flows during the year despite an extremely challenging environment for many active managers. These *net* inflows are likely a result of excellent investment performance as well as our focus on identifying strong prospects, communicating effectively and ultimately collaborating with clients that share our long-term perspective.

Financial Results: Shareholder Value

Diamond Hill Investment Group generated revenue of $136 million in 2016 compared with $124 million in 2015 and $64 million in 2011. Assets under management finished the year at $19.4 billion, up 15% from 2015 and up 123% from 2011 as a result of the strong U.S. equity market along with net inflows into our strategies.

We generated net operating income of $63 million in 2016, an increase of 7% over 2015, and our operating margin of 46% was roughly in line with the 47% operating margin in 2015. By far our largest expense is the compensation of our associates. Included in this line item is a significant amount of variable incentive compensation, which can fluctuate from year to year. A variety of factors influence incentive compensation including the investment results generated for our clients, individual employee contributions, and overall company performance.

Over the past five years, Diamond Hill's tangible book value per share has increased from $6.03 at the end of 2011 to $40.81 at the end of 2016. Additionally, we have paid $26.00 per share in dividends over the past five years ($64.00 per share in total since our initial dividend payment in 2008). The $26.00 per share in dividends plus the $34.78 increase in tangible book value per share equals a total of $60.78 per share, which represents one measure of change in shareholder value during the past five years. While tangible book value is a component of intrinsic value, the percentage of intrinsic value it represents varies considerably between companies.

This analysis is comparable to another popular measure, total shareholder return (TSR), which takes into account both cash returned to shareholders and change in stock price. For Diamond Hill, this equates to approximately 29% annualized over the past five years. While the current stock price represents the market's estimate of a company's intrinsic value, a premise of our investment philosophy is that price and intrinsic value often differ, sometimes substantially. Thus, we believe the relevant measure of value creation, in addition to cash returned to shareholders, is the change in Diamond Hill's intrinsic value.

Outlook

Looking ahead, our top priority is the same as it has always been: meeting our fiduciary duty to clients through our persistent focus on achieving outstanding long-term investment results. Accomplishing that, along with our intentional efforts to identify the right client partners, should allow our investment strategies to grow to capacity. Collectively, our recently expanded lineup of investment strategies has significant room for growth, and despite very healthy inflows since inception, Diamond Hill represents a modest piece of the proverbial pie within the asset management industry.

Undoubtedly, our firm continues to face various industry challenges including what has now become a multi-year trend of assets moving from active to passive management. This market share shift is a consequence of both cyclical and secular forces that will ultimately lead to the demise of many active managers that lack a clear and compelling value proposition for clients. Likely not a surprise to anyone, we strongly believe in the critical role active management plays in our capital markets-based economy. We are quite confident the industry will continue to fulfill this role. Many excellent investment organizations that are committed to serving clients through outstanding investment results and the highest levels of service will thrive going forward. In that regard, we are determined to demonstrate our firm's abilities and the value we bring to our client partnerships.

As I reflect on my first year as CEO, I feel privileged to be part of this team, proud of all that we have accomplished, and excited about our future. I believe Diamond Hill remains well positioned to meet our objectives due to our proven investment philosophy along with a highly skilled, stable team serving increasingly well-aligned clients.

Sincerely,

Chris Bingaman
Chief Executive Officer