



**Diamond Hill Capital Management, Inc.  
Form ADV Part 2A - Disclosure Brochure  
January 20, 2011**

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This brochure provides information about the qualifications and business practices of Diamond Hill Capital Management, Inc. If you have any questions about the contents of this brochure, please contact us at 614-255-3333. The information in this brochure has not been approved or verified by the United States Securities and Exchange Commission (SEC) or by any state securities authority.

Additional information about Diamond Hill Capital Management, Inc. is also available on the SEC's website at [www.adviserinfo.sec.gov](http://www.adviserinfo.sec.gov).

## Item 2: Material Changes

This brochure is a new document prepared in response to the 2010 amendments to SEC Form ADV. It is materially different from previous Diamond Hill Capital Management, Inc. filings and includes certain new information that our previous filings did not require.

In the future, Item 2 will be used to provide clients with a summary of material changes that are made to this brochure since the last annual update.

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## Item 4: Advisory Business

### THE COMPANY

Diamond Hill Capital Management, Inc. (“Diamond Hill” or “the firm” or “we”) is a wholly owned subsidiary of Diamond Hill Investment Group, Inc. (“DHIL”, “the parent” or “the parent company”), a publicly traded company listed on NASDAQ and trading under the symbol DHIL.

The firm dates back to 1976 and was originally organized as a broker/dealer and investment advisor focused on small community bank stocks. The firm registered as an investment adviser with the SEC in 1988. The parent was incorporated in 1990 and became a publicly traded company in 1993 under the name Bank Stock Group. In 2000, the parent changed its name to Diamond Hill Investment Group, Inc. as part of a reorganization intended to create a broad investment management firm.

As of December 31, 2010, employees and directors of DHIL and its affiliates owned approximately 28% of the shares outstanding, while outside investors owned the remaining 72% of the shares. As a publicly traded company, the ownership changes on a regular basis.

### INVESTMENT SERVICES

Diamond Hill provides investment management services to individuals and institutional investors, through mutual funds, separate accounts, and private investment funds. Diamond Hill offers six equity investment strategies and one fixed income investment strategy. (Item 8 provides more information about our investment strategies). We do not provide financial planning services, and we do not advise our clients in the selection of other investment advisers or mutual funds not managed by Diamond Hill. Our clients choose one of our seven investment strategies to meet their needs. Upon request, Diamond Hill will often work with clients to accommodate client-specific restrictions on any of our investment strategies.

Our portfolio strategies may include investments in common stocks, preferred stocks, investment-grade and non-investment grade corporate bonds (including private placements), U.S. Government and agency securities, convertible securities (including stocks and convertible corporate bonds), real estate investment trusts, structured instruments, open and closed-end investment companies, hedge funds and master limited partnerships.

### WRAP FEE PROGRAMS

Diamond Hill participates in programs commonly referred to as “wrap fee” programs.<sup>1</sup> In these programs, a third party offers a Diamond Hill strategy to its clients. Diamond Hill receives a fee from the third party as an investment adviser in these wrap fee programs. Wrap fee accounts are considered directed brokerage accounts. (See Item 12 for a discussion of directed brokerage.).

### ASSETS UNDER MANAGEMENT

As of December 31, 2010 Diamond Hill had \$8.6 billion in assets under management. All of these assets were discretionary assets.

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<sup>1</sup>A “wrap” fee program is an advisory program under which specified fees not based directly upon transactions in a client’s account are charged for investment advisory services and the execution of client transactions.

## Item 5: Fees and Compensation

### SEPARATE ACCOUNTS

Our fees for separate accounts are based on the value that we expect to add over rolling five-year periods and will vary by investment strategy. The fees for our separate accounts are payable quarterly in arrears and are calculated based on the value of the assets in the account at the end of each calendar quarter. Diamond Hill provides clients fee invoices which contain the amount of the fee, the value of the assets in the account on which the fee was based, and the specific manner in which the fee was calculated. Fees for partial periods are pro-rated. Below are our standard fee schedules:

SEPARATE ACCOUNTS					
Tier	Small Cap	Small-Mid Cap	Large Cap	Select	Strategic Income
First \$20 million	1.00%	0.95%	0.70%	0.85%	0.55%
Above \$20 million	0.80%	0.75%	0.60%	0.70%	0.50%
Minimum separate account size is \$5 million; minimum quarterly fee is \$8,750 for equity accounts and \$6,875 for strategic income accounts.					

(A description of the investment strategies that are available in separate accounts are set out in Item 8.).

Diamond Hill reserves the right to negotiate fees. Some clients pay more or less than others depending on certain factors, including but not limited to, the type and size of the account, the range of additional services provided to the client, and the total amount of assets managed for a single client. The fees that we charge for investment advisory services are specified in agreement between Diamond Hill and each individual client.

### MUTUAL FUNDS

The investment advisory and administration fees that Diamond Hill receives as a service provider to the Diamond Hill Funds and the Diamond Hill Financial Trends Fund, Inc. are described in the registration statements and/or financial filings of those funds. (Item 10 provides more information about Diamond Hill's involvement with the Diamond Hill Funds and the Diamond Hill Financial Trends Fund, Inc.).

### PRIVATE INVESTMENT FUNDS

The private investment funds pay Diamond Hill a management fee and a performance-based advisory fee. These fees are described in the investment management and investment advisory agreements between Diamond Hill and each of the funds. (Item 6 provides more information about performance-based fees, and Item 10 provides more information about our private investment funds.).

### OTHER FEES OR EXPENSES

Clients may pay other expenses in addition to the fees paid to Diamond Hill. For example, clients may pay costs such as brokerage commissions, transaction fees, custodial fees, transfer taxes, wire transfer fees, and other fees and taxes charged to brokerage accounts and securities transactions, which are unrelated to the fees collected by Diamond Hill. (Item 12 provides more information on our brokerage practices.). Mutual funds and exchange traded funds also charge internal management fees, which are disclosed in a fund's prospectus and/or financial filings. To avoid the duplication of fees and the potential conflicts of interest, we do not charge separate accounts a direct advisory fee on assets

invested in the Diamond Hill Funds or the private investment funds. Fees for client assets invested in Diamond Hill Funds or the private investment funds are charged by the respective fund and reflected in the value of your investment.

### **ADDITIONAL COMPENSATION**

Diamond Hill and its employees do not accept compensation, including sales charges or service fees, from any person for the sale of securities or other investment products.

## **Item 6: Performance-Based Fees and Side-By-Side Management**

We receive performance-based fees from our private investment funds. We will consider performance-based fee arrangements for separate accounts with greater than \$25 million in assets.<sup>2</sup>

### **POTENTIAL CONFLICTS OF INTEREST**

The receipt of performance-based fees from some separate accounts and our private investment funds creates conflicts of interest. Diamond Hill can potentially receive higher fees from accounts with a performance-based compensation structure than from those accounts that pay an asset-based fee as described in Item 5. For example, Diamond Hill may have an incentive to direct the best investment ideas to the account that pays a performance-based fee or to allocate or sequence trades in favor of the performance fee account. To manage these potential conflicts:

- All accounts within a strategy are managed to the strategy's model portfolio.
- Diamond Hill performs a periodic review of each investment strategy's model portfolio versus each client account. In this review, every position size for each client account is compared to our model weights. In addition, portfolios are monitored by our compliance department for consistency with client objectives and restrictions.
- Diamond Hill has implemented policies whereby portfolio manager incentive compensation is based solely upon the performance of the respective strategy that they manage. This policy is intended to incent portfolio managers to act in the best interests of all clients regardless of their fee type.
- Diamond Hill has trade allocation policies and procedures designed to ensure that all clients are treated fairly and equally and to prevent this conflict from influencing the allocation of investment opportunities among clients.

Diamond Hill has another potential conflict of interest, as an adviser to both long-only accounts and accounts that execute short sales. We could sell short securities in a long-short account while causing long-only accounts to hold the same security long. In this case, we could harm the performance of the long-only accounts for the benefit of accounts that execute short sales, which may include performance-based fee accounts. For example, continually selling a position short may depress the stock price which could harm a long-only account if it holds the same security. To manage this conflict, Diamond Hill has a specific policy that prohibits a short position from being held as a long position in any other client account that we manage.

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<sup>2</sup> A performance-based fee is an advisory fee based on a percent of capital gains on or capital appreciation of client assets. Performance-based fees paid to investment advisers may be significantly higher than the asset-based fees paid on traditional accounts.

## Item 7: Types of Clients

Diamond Hill provides investment management services to high net worth individuals and institutional investors, including registered investment companies, private investment funds, financial institutions, annuity funds, charitable institutions, foundations, municipalities, endowment funds, corporations, corporate pension and profit-sharing plans, and Taft-Hartley plans.

The minimum account size for all separate accounts is \$5 million; however Diamond Hill may agree to manage separate accounts below our stated minimum account size. (Item 5 provides a discussion of advisory fees for separate accounts.).

## Item 8: Methods of Analysis, Investment Strategies and Risk of Loss

### DIAMOND HILL INVESTMENT STRATEGIES

We offer six equity investment strategies and one fixed income investment strategy:

#### Equity Strategies

**Small Cap Strategy** – Invests in securities of small capitalization companies selling at prices below our estimate of intrinsic value. We define small capitalization companies as those companies with a market capitalization below \$2.5 billion at the time of purchase or those companies whose market capitalization is generally within the range of securities in the Russell 2000 Index.

**Small-Mid Cap Strategy** – Invests in securities of small and medium capitalization companies selling at prices below our estimate of intrinsic value. We define small and medium capitalization companies as those companies with a market capitalization between \$500 million and \$10 billion at the time of purchase or those companies whose market capitalization is generally within the range of securities in the Russell 2500 Index.

**Large Cap Strategy** – Invests in securities of large capitalization companies selling at prices below our estimate of intrinsic value. We define large capitalization companies as those companies with a market capitalization of \$5 billion or greater or those companies whose market capitalization is generally within the range of securities in the Russell 1000 Index.

**Select Strategy** – Invests in a concentrated portfolio of 30 to 40 securities of companies with market capitalization of \$500 million or greater selling at prices below our estimate of intrinsic value. We anticipate that each of the Select strategy's investments will also be held in the Large Cap, Small-Mid Cap, or Small Cap strategies.

**Long-Short Strategy** – Seeks to buy long or sell short securities of companies at prices below or above our estimate of intrinsic value. The minimum market capitalization of securities purchased for the Long-Short strategy is generally \$2.5 billion at the time of purchase. Investments are sold or shorts covered when the stock price approximates our estimate of intrinsic value.<sup>3</sup>

**Financial Long-Short Strategy** – Seeks to buy long or sell short securities of banks, thrifts, specialty lending institutions, insurance companies, real estate investment trusts, and other financial services companies selling at prices below or above our estimate of intrinsic value. Investments are sold or shorts covered when the stock price approximates our appraised intrinsic value.<sup>4</sup>

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<sup>3</sup> The Long-Short Strategy is available to investors only through the Diamond Hill Long-Short Fund and, to qualified investors, through the private investment funds.

<sup>4</sup> The Financial Long-Short Strategy is available to investors only through the Diamond Hill Financial Long-Short Fund or the Diamond Hill Financial Trends Fund.



## Fixed Income Strategy

**Strategic Income Strategy** – Invests in income producing securities after conducting a risk/reward analysis including an evaluation of interest rate, credit, liquidity, and prepayment risks. Securities are purchased when the compensation received for bearing risk is attractive compared to the risks borne.

## EQUITY INVESTING

The following are the guiding principles for our investment philosophy:

- **Treat every investment as a partial ownership interest in that company.**  
Investing is most intelligent when it is most businesslike.
- **Always invest with a margin of safety.**  
We want to purchase (sell short) securities at a sufficient discount (premium) to our estimate of intrinsic value. If we do this successfully, it will both increase the potential reward and effectively control risk.
- **Possess a long-term investment temperament.**  
In the short term, market prices are driven as much by emotion as economic fundamentals. Over time, the economic performance of the business and the price paid will determine the investment return, not the market.
- **Recognize that market price and intrinsic value tend to converge over a reasonable period of time.**  
The investment opportunity lies in the ability to recognize when the current market price does not reflect our estimate of a company's intrinsic value. By not relying on the market as an indicator of value, we believe the market can be used to our advantage over time.

Investing in securities always involves the risk of loss that investors should understand and be prepared to bear.

Our investment strategy is active and intrinsic-value focused. Our valuation approach is based on a five-year discounted cash flow methodology for both long and short positions. We do not manage to a benchmark or “closet index.” Individual security analysis is of primary importance, followed by a fundamental analysis of industry and sector trends. We are always price conscious. We will only purchase securities that we believe are selling at a discount to our estimate of intrinsic value. We will only sell short securities that we believe are selling at a premium to our estimate of intrinsic value. We estimate the intrinsic value of the business independent of the current stock market price then compare our estimate to the price in order to determine if an opportunity exists. If we do this successfully, it will both increase the potential reward and be the most effective risk control.

Discounted cash flow analysis is the primary methodology used to determine whether there is a discrepancy between the current market price and our estimate of intrinsic value. In order to forecast the amount and timing of cash flows, we concentrate on the fundamental economic drivers of the business and the company's management. We include any knowable and material information that may aid us in forecasting future cash flows. This might encompass the level of industry competition, regulatory factors, the threat of technological obsolescence, and a variety of other factors. Fundamental factors used to estimate the intrinsic value include assumptions for: current earnings, growth of earnings, growth in dividend yield, terminal price to earnings multiple, and required rate of return.

Our research staff consists of dedicated research analysts and portfolio managers. Research analysts focus on a specific sector or a few industries, while portfolio managers function as sector leaders who work closely with the research analysts in their respective sectors. Importantly, all members of our investment team share the same intrinsic value investment philosophy.



The portfolio manager for each strategy is ultimately responsible for portfolio decision making, including asset allocation, portfolio construction, and security selection. The portfolio manager does not report to an investment committee. Assistant portfolio managers provide significant analytical support and serve as a backup to the portfolio manager. If a portfolio manager is unavailable, assistant portfolio managers have the authority to make investment decisions.

We will sell a holding (cover a short position) under the following circumstances:

- If the price reaches our estimate of intrinsic value, and there is no reason to adjust our assumptions, then we will exit the position.
- If our estimate of intrinsic value is lowered (raised) and the current market price is no longer at a discount (premium) to our estimate of intrinsic value, then we will exit the position.
- If a more attractive investment opportunity is identified, then we may sell (cover) a holding to raise proceeds.
- If a holding reaches our stated limit of the portfolio at market, then we will reduce the position.

We manage risk through our intrinsic value focused investment philosophy and process. Thus, our primary risk control is to regularly compare current market prices to our estimates of intrinsic value. Portfolio guidelines like position size, industry limits, and sector limits provide for diversification, which further reduces risk.

We diversify our portfolios by managing sector, industry, and position size limitations according to the following guidelines:

- For long positions, an individual security cannot be more than 7%, (10% for Financial Long-Short strategy) of the portfolio at market.
- For short positions, an individual security cannot be more than 3% of the portfolio at market.
- Maximum exposure to any one industry is limited to 20% of the portfolio at market.
- Maximum exposure to any one sector is limited to 30% of the portfolio at market.

## Equity Risks

The material risks associated with these strategies are:

**Equity Market Risk** – Overall stock market risks may affect the value of the investments in equity strategies. Factors such as U.S. economic growth and market conditions, interest rates, and political events affect the equity markets.

**Management Risk** - Our judgments about the attractiveness, value and potential appreciation of a particular asset class or individual security may be incorrect and there is no guarantee that individual securities will perform as anticipated. The value of an individual security can be more volatile than the market as a whole or our intrinsic value approach may fail to produce the intended results. Our estimate of intrinsic value may be wrong or even if our estimate of intrinsic value is correct, it may take a long period of time before the price and intrinsic value converge.

**Small and Mid Cap Company Risk** – Investments in small and mid cap companies may be riskier than investments in larger, more established companies. The securities of these companies may trade less frequently and in smaller volumes than securities of larger companies. In addition, small and mid cap companies may be more vulnerable to economic, market and industry changes. Because smaller companies may have limited product lines, markets or financial resources, or may depend on a few key employees, they may be more susceptible to particular economic events or competitive factors than larger capitalization companies.

**Short Sale Risk** – Short sales are speculative transactions and involve special risks. In order to initiate a short position, a security must be borrowed. Strategies that execute short sales may incur a loss if the price of the security sold short increases in value between the date of the short sale and the date when we purchase the security to replace the borrowed security. Losses are potentially unlimited in a short sale transaction.

## **FIXED INCOME INVESTING**

We manage our Strategic Income portfolios with the same fundamental, intrinsic value investment philosophy used to manage our equity portfolios. Our investment time horizon is five years, which affords us the opportunity to seek equity-like returns in the fixed income markets with lower year-to-year volatility and lower risk of a permanent loss of capital.

Our primary objective is to generate a yield greater than the current inflation rate, without bearing undue credit or interest rate risk. We balance our income objective with a focus on total return. We will invest for capital appreciation in addition to income when we believe the market offers an attractive valuation opportunity. When we believe the market is overvalued, we will invest for a fair income return and preservation of capital.

Our entire investment team shares the same intrinsic value investment philosophy and process. As such, our research team, organized by sectors to provide industry specialization, supports our Strategic Income strategy, as well as our equity strategies. We utilize all of our equity research and portfolio management resources to identify attractive income generating securities. We regularly compare the prices available in a market sector to our estimate of its intrinsic value. The outlook for inflation and real interest rates are important factors in the valuation and portfolio construction process. Supply and demand for credit is also taken into consideration.

After the research is complete, we determine whether a security is attractive on a yield basis versus other securities with comparable risk. Expected returns are compared to the relative value available across companies, industries and the capital structure. Finally, we evaluate the quality of a firm's management, as well as their treatment of bondholders and, if relevant, equity holders.

The portfolio manager is ultimately responsible for portfolio decision making, including asset allocation, security selection, portfolio construction, and trading. The portfolio manager does not report to an investment committee. Assistant portfolio managers provide significant analytical support and serve as a backup to the portfolio manager. If the portfolio manager is unavailable, assistant portfolio managers have the authority to make investment decisions.

We will sell a security under the following circumstances:

- If it no longer offers an attractive risk-reward trade-off based on our intrinsic value model assumptions.
- A more attractive investment opportunity is identified.
- If a security reaches our stated issuer limit of 10%.

We focus on credit risk, interest rate risk, liquidity risk, and prepayment risk when analyzing income-generating securities. Our objective is to avoid a permanent loss of the capital and to earn a sufficient return on capital to grow our purchasing power. We use credit analysis, diversification, and price sensitivity to control risk.

We diversify our portfolios by managing sector, industry, and position size limitations according to the following guidelines:

- Securities of an individual corporate issuer cannot be more than 10% of the portfolio at market.
- Maximum exposure to any one industry is limited to 25% of the portfolio at market.
- Maximum exposure to any one sector is limited to 55% of the portfolio at market.

## **Fixed Income Risks**

The material risks associated with this strategy are:

***Fixed Income Market Risk*** – Fixed income securities increase or decrease in value based on changes in interest rates. If rates increase, the value of fixed income securities generally declines. On the other hand, if rates fall, the value of the fixed income securities generally increases.

***Management Risk*** – Our judgments about the attractiveness, value, and potential appreciation of a particular asset class or individual security may be incorrect and there is no guarantee that individual securities will perform as anticipated. The value of an individual security can be more volatile than the market as a whole, and our intrinsic value approach may fail to produce the intended results.

***Credit Risk*** – There is a risk that issuers and counterparties will not make payments on the securities they issue. In addition, the credit quality of securities may be lowered if an issuer's financial condition changes. Lower credit quality may lead to greater volatility in the price of a security which may affect liquidity and our ability to sell the security.

***Real Estate Risk*** – Real Estate Investment Trusts (REITS), although not a direct investment in real estate, are subject to the risks associated with investing in real estate. The value of these securities will rise and fall in response to many factors including economic conditions, the demand for rental property and changes in interest rates

***Structured Instrument Risk*** – Structured instruments may be less liquid than other debt securities, and the price of structured instruments may be more volatile. Although structured instruments may be sold in the form of a corporate debt obligation, they may not have some of the protection against counterparty default that may be available with publicly traded debt securities.

## **Item 9. Disciplinary History**

Registered investment advisers are required to disclose all material facts regarding any legal or disciplinary events that would be material to your evaluation of firm or the integrity of the firm's management in this item.

Diamond Hill has no legal or disciplinary events to report.<sup>5</sup>

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<sup>5</sup> We note that registered advisers are required to report all disciplinary events regardless of whether they are material in Part 1A of Form ADV. Diamond Hill has no disciplinary events of any kind to report.

## Item 10. Other Financial Industry Activities & Affiliations

As noted in Item 4, Diamond Hill is a wholly owned subsidiary of Diamond Hill Investment Group, Inc. Diamond Hill Investment Group, Inc. is also the parent company of:

- Diamond Hill GP (Cayman) Ltd. An exempt company incorporated in the Cayman Islands. Diamond Hill GP (Cayman) Ltd. acts as the general partner of a Cayman Islands exempted limited partnership.
- Beacon Hill Fund Services, Inc. (“Beacon Hill”). Beacon Hill is an Ohio corporation. Beacon Hill provides compliance, treasury and other fund administration services to mutual fund companies. Beacon Hill provides compliance services to Diamond Hill Funds.
- BHIL Distributors, Inc. (“BHIL”). BHIL is an Ohio corporation and a wholly owned subsidiary of Beacon Hill. BHIL is a limited purpose broker/dealer that provides statutory underwriting services to mutual fund companies, including the Diamond Hill Funds.

### MUTUAL FUNDS

Diamond Hill serves as the investment adviser and administrator to the Diamond Hill Funds, an open-end registered investment company. The following services are supervised by the Board of Trustees of the Diamond Hill Funds, all of whom are independent of DHIL and its affiliates:

- The advisory services and the administrative services agreements between Diamond Hill and the Diamond Hill Funds
- The underwriting agreement between BHIL and the Diamond Hill Funds

Diamond Hill does not believe these services create material conflicts of interest between Diamond Hill and its other clients.

Diamond Hill serves as the investment adviser and administrator to the Diamond Hill Financial Trends Fund, Inc. (the “Financial Trends Fund”), a closed-end registered investment company. The advisory services and the administrative services agreements between Diamond Hill and the Financial Trends Fund are supervised by the Board of Directors of the Financial Trends Fund. A majority of the Board members are independent of DHIL and its affiliates. Diamond Hill does not believe these services create material conflicts of interest between Diamond Hill and its other clients.

Diamond Hill also serves as a sub-adviser to other mutual funds.

### PRIVATE INVESTMENT FUNDS

Diamond Hill is also the Managing Member of Diamond Hill General Partner, LLC. Diamond Hill General Partner, LLC is the general partner of Diamond Hill Investment Partners, L.P., Diamond Hill Investment Partners II, L.P., Diamond Hill Research Partners, L.P., and Diamond Hill Research Partners – International, L.P. Diamond Hill is also the investment adviser and manager of Diamond Hill Offshore Ltd., a Cayman Island Exempted Company. Collectively, these funds are referred to as “private investment funds”.<sup>6</sup> (Items 5 and 6 provide more information relating to the private investment funds.).

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<sup>6</sup> Private investment funds are often referred to as hedge funds and are only offered on a private placement basis to accredited or qualified investors. As discussed in Items 5 and 6, Diamond Hill earns both a management fee and a performance-based incentive fee on the private investment funds.

## **SOLICITOR FEES**

Diamond Hill may enter into an agreement with a broker-dealer or registered investment advisor in which Diamond Hill pays a set percentage of its management fee and/or performance-based fee to the referring broker-dealer or registered investment adviser. These arrangements, often referred to as Solicitor's Agreements, are more specifically discussed in Item 14.

## **Item 11: Code of Ethics, Participation or Interest in Client Transactions and Personal Trading**

### **CODE OF ETHICS & PERSONAL TRADING**

Diamond Hill has adopted a Code of Ethics for all employees of the firm describing our high standards of business conduct, fiduciary duty to our clients, and rules surrounding personal securities trading by our employees.

The Code of Ethics prohibits employees from purchasing individual securities that are also eligible to be held in one of our funds or client portfolios and from purchasing non-Diamond Hill mutual funds that invest primarily in U.S. equity securities. As a result of these prohibitions, substantially all of our employees' equity investments are in the Diamond Hill Funds.

The Code of Ethics also includes guidelines related to gifts and to the reporting of personal securities holdings and trading activity. All Diamond Hill employees must accept in writing the terms of the Code of Ethics upon employment, annually, or as amended.

Diamond Hill clients or prospective clients may request a copy of the firm's Code of Ethics by contacting the firm's Chief Compliance Officer, Mr. Gary Young, at 614-255-3333.

### **PARTICIPATION IN CLIENT TRANSACTIONS**

Diamond Hill recommends to its clients the purchase or sale of our private investment funds. (A discussion of these funds may be found in Item 10 above.). Diamond Hill earns both a management fee and a performance-based fee on the private investment funds. (A discussion of these fees may be found in Items 5 and 6.).

Diamond Hill recommends to its clients the purchase or sale of Diamond Hill Funds. Diamond Hill serves as the investment advisor for and receives fees from the Diamond Hill Funds.

Diamond Hill receives an administrative services fee that is used to pay certain operating expenses of the Diamond Hill Funds.

Therefore, potential conflicts of interest exist. To avoid the duplication of fees and the potential for conflicts of interest, we do not charge an advisory fee to clients on their assets which are invested in the Diamond Hill Funds or the private investment funds.

A portion of Diamond Hill's corporate investment portfolio may be invested in mutual funds or in private investment funds for which Diamond Hill serves as investment adviser, administrator, general partner, or manager. Employees may also own interests in the private investment funds and Diamond Hill Funds. We do not believe that these investments cause a conflict of interest between Diamond Hill and its advisory clients. Diamond Hill does not invest its corporate investment portfolio in any individual securities which are eligible to be held in one of our funds or client portfolios.

## **TRADE ERRORS**

There are two potential types of trade errors, those that are detected after the trade has settled and those that are detected prior to trade settlement. We correct all trade errors so that the client does not suffer a loss and is not harmed.

Trade errors that are detected after the trade has settled in a client account are considered “Client Account Trade Errors.” For Client Account Trade Errors where Diamond Hill is determined to be at fault or where no fault can be determined, Diamond Hill will pay any losses resulting from the error. If it is determined that the client is at fault, Diamond Hill may, in its discretion, pay the loss or charge the loss (in whole or in part) to the client. Net gains incurred when correcting a Client Account Trade Error will be retained by the client.

Trade errors that are detected prior to settlement in a client account are considered “Adviser Account Trade Errors.” Diamond Hill will correct Adviser Account Trade Errors, and any correcting trade, into a separate error account. Net gains realized on a correcting trade will be retained by Diamond Hill and net losses incurred on a correcting trade will be paid by Diamond Hill. Net gains may be retained in the error account and used to offset future net losses.

## **Item 12: Brokerage Practices**

### **BROKER SELECTION & BEST EXECUTION**

Obtaining the best trade execution is an important aspect of every trade that we place in a client account. Diamond Hill has a Best Execution Committee that administers our Best Execution Policy. The Best Execution Committee selects the brokers to use to execute trades and determines the reasonableness of their compensation based on the range and quality of a broker’s services including execution capability, trading expertise, accuracy of execution, commission rates, research, reputation and integrity, fairness in resolving disputes, financial responsibility, and responsiveness.

Diamond Hill’s equity traders use various trade execution management systems to ensure proper trade management, including fair order allocation and best execution. The Strategic Income portfolio managers typically execute their own trades with approved brokers who provide closely monitored inventories of fixed income securities on a regular basis.

We have controls in place for monitoring execution in our clients’ portfolio transactions, including reviewing trades for best execution. Certain broker-dealers that Diamond Hill uses to execute client trades are also clients of Diamond Hill and/or refer clients to Diamond Hill creating a conflict of interest. To mitigate this conflict we adopted a policy that prohibits us from considering any factor other than best execution when a client trade is placed with a broker-dealer.

### **RESEARCH AND OTHER SOFT DOLLAR BENEFITS**

Diamond Hill does not have any commitments or understandings to trade with specific brokers or to generate a specified level of brokerage commission with a particular broker in order to receive brokerage or research services. These commitments or understandings are generally known as soft dollar arrangements. Certain brokers through whom Diamond Hill executes trades may provide unsolicited proprietary research (research created or developed by the broker) to us. This research is used for all client accounts, even though certain clients may not have paid direct commissions to the brokers who provided the research. This research could include a wide variety of reports, charts, publications or proprietary data on economic and political strategy, credit analysis, or stock and bond market conditions and projections. In addition to unsolicited research, certain brokers may provide



invitations to attend conferences and meetings with management representatives of issuers or with other analysts and specialists.

Receipt of research from brokers who execute client trades involves conflicts of interest. An adviser that uses client brokerage commissions to obtain research, products, or services receives a benefit because it does not have to produce or pay for the research, products, or services itself. Consequently, the adviser may have an incentive to select or recommend a broker based on its desire to receive research, products, or services rather than a desire to obtain the most favorable execution, which is in the clients' best interest.

Brokers providing research services, even on an unsolicited basis, may charge commissions for executing portfolio transactions that are higher than the amount of commissions that other brokers would charge for effecting the same transactions. Diamond Hill will execute portfolio transactions through these brokers only if it has determined that such brokers provide best execution based on the factors described above.

### **DIRECTED BROKERAGE & AGGREGATED TRADES**

Although we discourage clients from directing trades to a particular broker-dealer (directed brokerage), we do have clients who request directed trades. Transactions for these clients will generally be executed following the execution of portfolio transactions in other client accounts where Diamond Hill has full discretion to execute trades. In the event that we do accommodate a directed brokerage relationship, our standard operating procedure will be to place the trade with an executing broker on our approved broker list with instructions to complete the trade through the client-directed broker. Clients who request directed trades may pay higher brokerage commissions because we may not be able to aggregate orders to reduce transaction costs, and may also receive less favorable prices and execution.

Diamond Hill has a trade allocation policy that allows it to select brokers for accounts where the client has given us full discretion. Trades in discretionary accounts are grouped together and traded first. Directed brokerage accounts, in which the client has directed us to use a specific broker, are grouped together and placed in random order by broker. When a trade is partially completed, the shares are allocated on a pro-rata basis to the appropriate client accounts. All grouped trades are allocated to the participating accounts at average cost.

## **Item 13: Review of Accounts**

Client accounts are monitored by our compliance department daily for consistency with client objectives and restrictions. Portfolio managers perform a periodic review of each client account. In these reviews, every position in each client account is compared to the weights in the appropriate investment strategy model.

Diamond Hill issues periodic written reports to its investment advisory clients. These written reports generally contain a list of assets, investment results, and statistical data related to the client's account. We urge clients to carefully review these reports and compare the statements that they receive from their custodian to the reports that we provide. The information in our reports may vary from custodial statements based on accounting procedures, reporting dates, or valuation methodologies of certain securities.



## Item 14: Client Referrals and Other Compensation

Other than the compensation described in Items 5 and 6, Diamond Hill does not receive an economic benefit from anyone other than its clients. (You may find more information about these relationships in Item 10.).

Diamond Hill may enter into agreements with broker-dealers or investment advisers that are referred to as Solicitor's Agreements. Diamond Hill pays a percentage of the management fee and/or performance-based fee collected from the client to a referring broker-dealer or investment adviser. Clients under these agreements will not be charged fees higher than the standard fees described in Item 5. (See Item 5 for a discussion of Fees and Compensation.). Diamond Hill currently has solicitor's agreements with Barclays Capital, Inc., Synovus Securities, Inc., Morgan Keegan & Co., Stifel Nicolaus and Co., and Far Hills Group, LLC.

## Item 15: Custody

Diamond Hill does not provide custodial services to its clients. Client assets are held with banks or registered broker-dealers that are "qualified custodians." Clients will receive statements directly from the qualified custodians at least quarterly. We urge clients to carefully review those statements and compare the custodial records to the reports that we provide them. The information in our reports may vary from custodial statements based on accounting procedures, reporting dates or valuation methodologies of certain securities.

## Item 16: Investment Discretion

Diamond Hill accepts discretionary authority to manage the assets in the client's account. We observe investment limitations and restrictions that are outlined in each account's investment management agreement.

## Item 17: Voting Client Securities

We will allow clients to vote the proxies in their account; however, Diamond Hill typically accepts authority to vote proxies for our clients' accounts. When we recognize a conflict of interest that impedes our ability to vote a proxy, we will deliver the proxy to the client to be voted. We do not utilize third party proxy voting services. If a client wishes to direct Diamond Hill to vote in a certain manner for a particular proxy, they should provide such direction in writing to Diamond Hill at least two weeks prior to the shareholder meeting date.

When we vote proxies, our objective is to maximize the value of the securities held in clients' portfolios. We will pay particular attention to the following matters in exercising our proxy voting responsibilities for our clients:

**Accountability.** Each company should have effective controls in place to hold those entrusted with managing a company's business accountable for their actions. Company management should be accountable to its board of directors and the board should be accountable to shareholders.

**Alignment of Management and Shareholder Interests.** Each company should seek to align the

interests of management and the board of directors with the interests of the company's shareholders. For example, we generally believe that compensation should be designed to reward management for creating value for the shareholders of the company.

**Transparency.** Each company should provide timely disclosure of important information about its business operations and financial performance to enable investors to evaluate the company's performance and to make informed decisions about the purchase and sale of the company's securities.

A copy of our proxy voting policies and procedures and/or information regarding the votes cast by Diamond Hill with regard to a client's securities is available upon request mailed to:

**Diamond Hill Capital Management, Inc.**

**Attn: Proxy Voting Requests**

**325 John H. McConnell Blvd.**

**Suite 200**

**Columbus, OH 43215**

## Item 18. Financial Information

In certain circumstances, registered investment advisers are required to provide you with financial information or disclosures about their financial condition in this Item. Diamond Hill has no financial commitment that impairs its ability to meet contractual and fiduciary commitments to clients and has never been the subject of a bankruptcy proceeding. Diamond Hill Investment Group, Inc. files quarterly and annual financial statements with the SEC. These are available through the SEC and on our web site at the following location:

<http://www.diamond-hill.com/cgi-bin/imr/investor-media-relations.pl>

## Voluntary Disclosure of Personal Investments

Our firm's mission states that our interests should be aligned with those of our clients. In order foster this alignment of interests, our Code of Ethics prohibits employees from purchasing individual securities that are eligible for purchase in one of Diamond Hill's strategies. The Code of Ethics also prohibits the purchase of third-party mutual funds that invest primarily in U.S. equity securities. As a result, substantially all of our employees' equity investments are in the same Diamond Hill strategies in which our clients invest.

The tables below represent the dollar range of investments owned by portfolio managers and officers as of December 31, 2010. This table includes shares beneficially owned through the Diamond Hill 401(k) plan.

Fund	Portfolio Manager	DOLLAR RANGE OF INVESTMENTS IN SPECIFIC DIAMOND HILL STRATEGY					
		\$1 - \$10,000	\$10,001 - \$50,000	\$50,001 - \$100,000	\$100,001 - \$500,000	\$500,001 - \$1,000,000	Over - \$1,000,000
Small Cap	Tom Schindler				X		
Small-Mid Cap	Chris Welch					X	
Large Cap	Chuck Bath						X
Select	Bill Dierker				X		
Long-Short	Ric Dillon						X
	Chuck Bath						X
Financial Long-Short	Chris Bingaman					X	
Strategic Income	Bill Zox				X		

Individual	Title	DOLLAR RANGE OF INVESTMENTS IN ALL DIAMOND HILL STRATEGIES					
		\$1 - \$10,000	\$10,001 - \$50,000	\$50,001 - \$100,000	\$100,001 - \$500,000	\$500,001 - \$1,000,000	Over - \$1,000,000
Chuck Bath	Portfolio Manger						X
Chris Bingaman	Portfolio Manger						X
Ric Dillon	Portfolio Manger						X
Bill Dierker	Portfolio Manger					X	
Tom Schindler	Portfolio Manger				X		
Chris Welch	Portfolio Manger						X
Bill Zox	Portfolio Manger					X	
James Laird	Chief Financial Officer						X
Gary Young	Chief Compliance Officer					X	
All other employees of the Advisor (collectively)	N/A						X
Adviser's Corporate Investments	N/A						X