QUARTERLY COMMENTARY

Ariel Mid Cap Value

• Value • Global

ARIEL INVESTMENTS

Quarter Ended September 30, 2022

All major indices closed out the third quarter at a loss, marking the first time Wall Street posted three consecutive quarters of declines since the aftermath of the global financial crisis. Persistently high inflation, escalating geopolitical tensions in Russia/Ukraine, energy-price shocks and aggressive central-bank tightening have weighed on consumer and business confidence. Recession watch has taken hold as many investors fear a Fed-induced hard landing. While Wall Street sits on edge and markets remain erratic, we are actively leaning into the moment by judiciously acquiring the downtrodden shares of quality companies whose value we believe should be realized over the long term. Against this backdrop, the Ariel Mid Cap Value Composite lost -5.48% gross of fees (-5.71% net of fees) in the quarter, trailing the Russell Midcap Value Index's -4.93% return and the -3.44% loss posted by the Russell Midcap Index.

Several stocks in the portfolio had strong returns in the period. Regional banking services provider **BOK Financial Corporation (BOKF)** advanced in the quarter, as reflation themes in the marketplace raised interest rate expectations, boosting positive net-interest-margin trends. Additionally, the company continued to report solid loan growth along with tight expense controls, providing a tailwind for shares. Looking ahead, we believe BOKF's strong underwriting standards, diversified business model (which includes banking and fee service businesses) and experienced management team continue to present a long-term opportunity.

Financial services provider **Charles Schwab Corporation (SCHW)** traded higher following the delivery of a top and bottom-line earnings beat, an increase in its quarterly dividend and the announcement of a significant stock repurchase program. We believe the company will continue to weather various macro and competitive pressures in a rising rate environment by flexing its scale and customer-centric focus in support of its industry leading cost advantage. We also think the TD Ameritrade acquisition will create incremental value and further enhance SCHW's marketplace standing and long-term growth trajectory.

Additionally, distributor of pharmaceutical and medical products **Cardinal Health, Inc. (CAH)** advanced in the period as leadership changes were viewed to be a positive for shares. Management provided a new profit outlook for Fiscal 2023 and announced an improvement plan for the medical segment. We are encouraged by these changes and think CAH's underlying fundamentals and competitive advantages around preventative maintenance screenings and medication management will continue to improve. We believe valuations of health care companies like CAH that focus on cost optimization and promote technological efficiency across the supply chain will be rewarded over the long term.

Alternatively, premiere oil services company **Core Laboratories NV (CLB)** was the greatest detractor from relative results in the quarter. The ongoing geopolitical conflict between Russian and Ukraine, as well as associated European and U.S. sanctions continue to disrupt the business and create near-term uncertainty. Although headwinds persist, we believe the industry will realign global supply to meet strong demand for oil and natural gas. In our view, this asset light business will deliver modest growth in reservoir description. We also expect to see greater activity in fracturing rock, which should increase output in well completions and fuel longer term growth of the production enhancement sector. We have conviction in the management team's long history of delivering strong operating results, robust free cash flow and returning capital to shareholders.

Shares of **Stanley Black & Decker (SWK)** sharply declined in the period as inflation and rapidly rising rates drove a swift deterioration in consumer demand. In response, SWK is laser-focused on reducing inventory to generate cash flow and re-sizing the cost base through simplifying its corporate structure, optimizing operations and transforming the supply chain. Though the macroeconomic backdrop remains challenging, we have conviction in SWK's experienced executive management team and think the balance sheet is well-positioned to weather the storm. At current levels, SWK is trading at a substantial, historically-high discount to our estimate of private market value.

Used and wholesale vehicle auction operator **CarMax, Inc. (KMX)** also underperformed in the quarter, as inflation, rising interest rates and low consumer confidence led to a sharp decline in pre-owned vehicle sales. Affordability has become a key issue across the industry with the average selling price up nearly 40% relative to the same period pre-pandemic. Wholesale unit sales also declined due to steep market depreciation, resulting in lower offers and buy conversion rates. Despite these near-term headwinds, KMX has continued to post market share gains. In our view, KMX's inventory management expertise, brand and scale are difficult to replicate. Longer-term we believe the company has a long runway for growth as its omni-channel presence and initiatives targeted at personalizing the consumer experience seamlessly combine the company's world-class in-store experience and online offerings. At today's valuation, we believe KMX's risk/reward is skewed sharply to the upside.

We initiated a position in former position **Generac Holdings, Inc. (GNRC)**, a leading global manufacturer of power generation equipment. The company has an unmatched distribution network and product portfolio and enjoys strong brand advantages. We believe this creates a wide moat for this niche business which commands a 75% market share in the North American residential market. Historically, growth has been limited due to a lack of awareness around the benefits of having a home standby generator, as well as its high price point. More recently, however, elevated power outage events, both weather-related and due to aging infrastructure, have tipped the scales of awareness in both the residential and commercial markets, which should result in a long runway of market penetration-led growth, margin expansion and free cash flow generation. The stock was a pandemic darling but has since traded off substantially, giving us an opportunity to acquire shares in this higher quality business.

We did not exit any positions in the quarter.

Escalating geopolitical tensions, persistently high inflation, slowing economic growth and the potential for excessive Fed tightening continue to fuel recessionary fears. And yet, we view the probability of the most severe "hard landing," or deep recession, to be less likely. Unemployment remains near historic lows and balance sheets of U.S. financial institutions and households are generally in good shape. We continue to be cautiously optimistic these factors will protect against a severe downturn. Meanwhile, values are abundant when the investment environment feels the most uncomfortable. With 39 years of experience, we are trained and battle-tested for these moments. We believe bear markets and oversold stocks create ripe buying opportunities for long-term, patient investors. We are diligently evaluating the collapsing prices of stocks on our watchlist versus our expectations of what these companies and their underlying business fundamentals should be valued at over the long term. In times like these, we believe the worst-case scenario gets priced in giving us a margin of safety[1] to buy and hold our favorite companies with confidence through the uncertainty until the market digests the volatility. Although our portfolios have sold off in recent months, in our view they are statistically cheap—trading at a significant discount to their private market values (PMV)[2]—or what some call intrinsic worth. In the past, portfolio dislocations of this magnitude have often served as a prelude to our most robust recoveries.

Investing in mid-cap companies is more risky and volatile than investing in large cap companies. The intrinsic value of the stocks in which the portfolio invests may never be recognized by the broader market. The portfolio is often concentrated in fewer sectors than its benchmarks, and its performance may suffer if these sectors underperform the overall stock market. Investing in equity stocks is risky and subject to the volatility of the markets.

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[1]Attempting to purchase a stock with a margin of safety does not protect investors from the loss of their investment, volatility associated with stocks, declining fundamentals, external forces, or our incorrect assumptions.

[2]Discount to Private Market Value ("PMV") represents the percentage discount at which the portfolio traded as compared to the portfolio holdings' PMV as determined by Ariel Investments. References to PMV are for the time period: 12/31/07 – 09/30/22.

Past performance does not guarantee future results. Performance results are shown net of the highest management fee charged to any client in the Composite during the performance period. Net returns reflect performance returns after the deduction of advisory fees and transaction costs and assume the reinvestment of dividends and other earnings. For the period ended 9/30/22 the performance (net of fees) for the Ariel Mid Cap Value Composite for the 1-, 5-, and 10-year periods was -18.62%, +3.45%, and +8.13%, respectively. For the period ended 9/30/22 the performance for the Russell Midcap Value Index and the Russell Midcap Index for the 1-, 5-, and 10-year periods was -13.56%, +4.76%, and +9.44%, and -19.39%, +6.48%, and +10.30%, respectively. Actual fees may vary depending on, among other things, the applicable fee schedule and portfolio size. A complete fee schedule is available upon request and may also be found in Ariel Investments LLC's Form ADV, Part 2. Returns are expressed in U.S. dollars. Current performance may be lower or higher than the performance data quoted. The Ariel Mid Cap Value Composite differs from its primary benchmark in that it has fewer holdings and more concentration in fewer sectors.

The opinions expressed are current as of the date of this commentary but are subject to change. The information provided in this commentary does not provide information reasonably sufficient upon which to base an investment decision and should not be considered a recommendation to purchase or sell any particular security.

As of 9/30/22, BOK Financial Corporation constituted 4.57% of the Ariel Mid Cap Value Composite (representative portfolio); Charles Schwab Corp. 4.68%; Cardinal Health, Inc. 2.56%; Core Laboratories 1.74%; Stanley Black & Decker, Inc. 2.36%; CarMax, Inc. 1.87% and Generac Holdings Inc. 1.21%. Portfolio holdings are subject to change. The performance of any single portfolio holding is no indication of the performance of other portfolio holdings of the Ariel Mid Cap Value Composite.

A glossary of financial terms provided herein may be found on our website at www.arielinvestments.com.

Index returns reflect the reinvestment of income and other earnings. Indexes are unmanaged, and investors cannot invest directly in an index. The Russell Midcap® Value Index measures the performance of the mid-cap value segment of the U.S. equity universe. It includes those Russell Midcap Index companies with lower price-to-book ratios, lower forecasted growth values and lower sales per share historical growth. Its inception date is February 1, 1995. The Russell Midcap® Index measures the performance of the mid-cap segment of the U.S. equity universe. The Russell Midcap Index is a subset of the Russell 1000® Index. It includes approximately 800 of the smallest securities based on a combination of their market cap and current index membership. Its inception date is November 1, 1991. Russell® is a trademark of London Stock Exchange Group, which is the source and owner of the Russell Indexes' trademarks, service marks and copyrights. Neither Russell nor its licensors accept any liability for any errors or omissions in the Russell Indexes or underlying data and no party may rely on any Russell Indexes and/or underlying data contained in this communication. No further distribution of Russell data is permitted without Russell's express written consent. Russell does not promote, sponsor or endorse the content of this communication.