

Memorandum

To: Friends of Ariel Investments
From: David M. Maley, Lead Portfolio Manager
Date: January 25, 2021
Re: Ariel Micro-Cap Value and Small Cap Deep Value 4Q20 Client Letter

ARIEL MICRO-CAP VALUE COMPOSITE PERFORMANCE						
As of December 31, 2020						
Inception date: July 31, 2002						
	4Q20	1 Year	3 Years	5 Years	10 Years	Since Inception
Gross of Fees	29.57%	12.84%	3.07%	4.98%	3.90%	7.67%
Net of Fees	29.17%	11.45%	1.79%	3.69%	2.62%	5.69%
Russell Microcap® Value Index	32.76%	6.34%	4.33%	10.50%	9.47%	9.22%
Russell Microcap® Index	31.39%	20.96%	8.78%	11.89%	10.55%	9.75%
S&P 500® Index	12.15%	18.40%	14.18%	15.22%	13.88%	10.20%

ARIEL SMALL CAP DEEP VALUE COMPOSITE PERFORMANCE					
As of December 31, 2020					
Inception date: October 31, 2013			Annualized		
	4Q20	1 Year	3 Years	5 Years	Since Inception
Gross of Fees	31.66%	12.82%	-0.99%	5.64%	-0.46%
Net of Fees	31.34%	11.71%	-1.97%	4.60%	-1.44%
Russell 2000® Value Index	33.36%	4.63%	3.72%	9.65%	6.95%
Russell 2000® Index	31.37%	19.96%	10.25%	13.26%	10.01%
S&P 500® Index	12.15%	18.40%	14.18%	15.22%	13.46%

Start-to-finish 2020 looked like a fairly normal 12 months, with the S&P 500 Index gaining +18.40% and the Russell 2000 Value Index returning +4.63%. Yet, 2020 was anything but typical. With a global pandemic taking hold in March and the subsequent economic shutdown making the first quarter the market's worst since 2008, the aforementioned year-end gains are truly remarkable. Even more noteworthy are the underlying dynamics that fueled them.

On March 18th, small stocks hit their low point after a week of "throw in the towel" panic selling. The S&P 500 bottomed a few days later. The Russell 2000 Index had fallen -40.26% year-to-date, and the Russell 2000 Value was even worse at -43.40%. Our portfolios, which had held up reasonably well in the early stages of the selloff, were briefly pummeled having dropped roughly -45% to -50%.



We wrote the following in our April letter:

The ability to slow down our thought process while working furiously comes from exposure to the best and worst of markets, and allows us to capitalize on the opportunities these difficult times create.

And that is precisely what we did, talking with our company management teams—many of whom were aggressively buying stock with their personal money—assessing staying power for a shutdown of unknown duration, and coming away convinced the destruction in price had far outpaced any decline in long-term intrinsic value. That gave us the confidence to stay the course when things looked the darkest. We also methodically bought a few new names over the year, and have taken advantage of sharp price moves to trim or eliminate stocks that reached full valuation and add to cheaper laggards.

This approach served us quite well, as our portfolios have strongly outperformed since the worst of the downturn. We have benefitted from a return to favor of small value stocks—a move we believe is just getting started.¹ Since the March 18th low, our portfolios have achieved the following, leading to our full year double-digit returns and outperformance of +819 basis points for Small Cap Deep Value and +650 for Micro-Cap:

Returns from March 18, 2020 - December 31, 2020	
Ariel Small Cap Deep Value	118.60%
Russell 2000 Value Index	85.41%
Ariel Micro-Cap Value	104.47%
Russell Micro-Cap Value Index	94.74%
S&P 500 Index	58.82%

Returns are unaudited preliminary composite returns for the period displayed.

Looking to 2021 and Beyond

While small and micro-cap value stocks had an extraordinary fourth quarter, we believe this is merely the beginning of a multi-year run. Discounted valuations, a potentially strong economic recovery boosted by additional stimulus, growing vaccine delivery and uptake, as well as the possibility of rising interest rates from historic lows, all provide fuel for this outcome.

Additionally, we have begun to see an active M&A market in our niche. Four of the 42 stocks we owned across our strategies have agreed to be acquired. They include **Perceptron (PRCP)**, **Rosetta Stone (RST)** and **ZAGG Inc. (ZAGG)** in both strategies, along with **Jernigan Capital (JCAP)** held in Small-Cap Deep Value. We believe the appetite for deals among both strategic and financial buyers remains elevated, and the strong finances and potential accretive nature of our small companies make for a number of enticing targets.

With our portfolios trading at 35% to 45% discounts to our estimates of private market value (PMV), there is plenty of room for upside. We remain convinced our patient approach, which served us so well while the world around us panicked in March, will continue to do so whatever 2021 throws our way.

¹Mellody Hobson and John Rogers, "How to Understand This Crazy Year in Investing—and What to Do Now". *The Wall Street Journal*. December 11, 2020. <https://www.wsj.com/articles/how-to-understand-this-crazy-year-in-investingand-what-to-do-now-11607698800> (Accessed January 11, 2021).



Portfolio Comings and Goings

We added **Alico, Inc. (ALCO)** to both portfolios during the quarter. Based in Tampa, Florida, Alico is the largest US producer of fruit used for orange juice. In addition to over 45,000 Florida acres utilized for citrus, the company owns more than 54,000 acres of ranch and other land which it has been selling. A program known as Alico 2.0 begun in 2017 under then CFO and now CEO John Kiernan has led to improved efficiency along with an emphasis on building and realizing shareholder value. We believe Alico stock is attractive based on either its likely earnings or the value of its Florida acreage.

On the sell side, we said farewell in both strategies to long-time holding **Perceptron (PRCP)**, once its acquisition for \$7.00 per share in cash by Sweden-based Atlas Copco closed in late December. We also eliminated **AXT, Inc. (AXTI)** and **Magnite, Inc. (MGNI)** from the micro-cap portfolio as we believe each became fully valued.

We appreciate your interest and welcome any questions.

Investing in micro-cap and small-cap companies is more risky and volatile than investing in large companies. The intrinsic value of the stocks in which the portfolios invest may never be recognized by the broader market.

Past performance does not guarantee future results. Performance results are net of transaction costs and reflect the reinvestment of dividends and other earnings. Net performance of each Composite has been reduced by the amount of the highest fee charged to any client in each Composite during the performance period. Actual fees may vary depending on, among other things, the applicable fee schedule and portfolio size. Fee information 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 Small Cap Deep Value Composite and the Micro-Cap Value Composite differ from their primary benchmarks with fewer holdings concentrated in fewer sectors.

Net returns of the Ariel Micro-Cap Value Composite beginning May 2009 reflect the deduction of the advisory fee. Net returns of the Ariel Micro-Cap Value Composite prior to May 2009 are net of a 20% incentive fee, other expenses, management fees, and profit allocations. The performance results prior to April 30, 2009 were achieved while David Maley managed the strategy at his prior firm using a substantially similar investment style. Mr. Maley began managing this strategy at Ariel on April 30, 2009. The performance results achieved at Mr. Maley's prior firm are linked to the performance results of the Ariel Micro-Cap Value Composite. The strategy will on occasion hold cash when values are difficult to identify. Also, the strategy at times includes temporary investments in Exchange Traded Funds (ETFs) while seeking other investment opportunities. During June 2004 through January 2008, the investment strategy included periodically holding short positions in certain ETFs. This practice may have had a material effect on returns.

The opinions expressed are current as of the date of this commentary but are subject to change. The information 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 12/31/2020, the Ariel Micro-Cap Value Composite (representative portfolio) held the following positions referenced: Alico, Inc. 2.03% and ZAGG, Inc. 1.12%. As of 12/31/2020, the Ariel Small Cap Deep Value Composite (representative portfolio) held the following positions referenced: Alico, Inc. 2.04% and ZAGG, Inc. 1.12%. Portfolio holdings are subject to change. The performance of any single portfolio holding is no indication of the performance of other portfolio holdings in the Ariel Micro-Cap Value Composite or the Ariel Small Cap Deep Value Composite.



Index returns reflect the reinvestment of income and other earnings. Indexes are unmanaged, and investors cannot invest directly in an index. The Russell Microcap® Value Index measures the performance of the microcap value segment (companies that are considered more value oriented, relative to the overall market) of the U.S. equity market. The Russell Microcap® Index measures the performance of the microcap segment (1,000 of the smallest securities in the small-cap Russell 2000® Index) of the U.S. equity market. The Russell 2000® Value Index measures the performance of the small-cap value segment (companies with lower price-to-book ratios and lower forecasted growth values) of the U. S. equity universe. The Russell 2000® Index measures the performance of the small-cap segment (2000 of the smallest securities of the Russell 3000® Index) of the U.S. equity universe. Frank Russell Company ("Russell") is the source and owner of the trademarks, service marks and copyrights related to the Russell Indexes. Russell® is a trademark of Frank Russell Company. 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. The S&P 500® Index is the most widely accepted barometer of large cap U.S. equities. It includes 500 leading companies.

