SLOW AND STEADY WINS THE RACE

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Investing in small and mid-cap stocks is more risky and more volatile than investing in large cap stocks.
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EXCERPTS FROM THE PATIENT INVESTOR

The Patient Investor is our quarterly newsletter. It provides insight into our conservative and disciplined investment philosophy, offers our view of market conditions and companies to watch — and much more. Excerpts from some of our favorite issues are included in this book.

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IN 1983, when I started Ariel Capital Management, LLC, it was the culmination of my dream to manage money professionally. But even more importantly, it was the beginning of a company, a culture and a community that have grown into a family. Ariel is much more than an investment management firm or a mutual fund company. It is a uniquely talented group of passionate and diverse individuals who share a common mission to become the best small and mid-cap value investment firm in the nation. To us, this goal goes well beyond investment performance and assets under management; it also means fostering an ideal work environment and effecting real, positive changes in our community. Our pursuit of such an ambitious goal is a long process that takes patience — something we practice every day. In fact, the Tortoise is the symbol of our firm, an incarnation of our time-tested philosophy that *Slow and Steady Wins the Race*. We created this book to recognize our longevity, share Ariel’s mission and recount some of the history that has brought us from 1983 to the present. We also feature historic renditions of our beloved Tortoise and Hare fable — as an ongoing reminder that the Tortoise’s story is tied inextricably to our own.

John W. Rogers, Jr.
ONE DAY, A FLEET-FOOTED HARE was making fun of a rather plodding Tortoise. The Hare was surprised when the Tortoise laughed back. “Speedy you may be,” said the Tortoise, “But I challenge you to a race and I bet that I win.”

“Oh, for goodness’ sake,” said the Hare, “It will be no contest at all. In fact, I will dance rings around you all the way.”
WHEN THE TIME CAME, both started off together.

The Hare sped off from the start.

In fact, he ran so quickly that he soon left the Tortoise far behind. He turned circles and flips as he raced ahead, keen and proud of his speed and nimbleness. Once the Hare reached the middle of the course, he was so far ahead, he decided to take a nap.
WHILE THE HARE SLEPT, the Tortoise plodded on and on, straight toward the finish line.

Slowly, steadily, the Tortoise kept focused on his goal.

When the Hare awoke from his nap, he was surprised that the Tortoise was nowhere in sight.

Racing to the finish line with all his proud speed, he saw that it was too late.

The Tortoise was waiting there for him, a smile on his face.
PATIENCE  In earnest pursuit of excellent performance and outstanding client service, this is our overarching virtue. By taking a long-term view, we are able to build our firm around these core values:

FOCUS  As we strive to be the premier small and mid-cap value investment firm, we will continue to grow our company with discipline and rigorous standards.

INDEPENDENT THINKING  Through voracious reading and active listening, we are armed with information that enables us to challenge conventional “wisdom,” and stand out from the investing crowd.

TEAMWORK  Our diverse and experienced professionals work together toward a common goal of excellence in every aspect of our business. We live up to our commitments. Moreover, through significant personal ownership in our firm, as well as in our mutual funds, our interests are squarely aligned with those of our valued clients.

COMMUNITY  We are committed to strengthening the neighborhoods and cities in which we live and work, practicing a hands-on model of corporate responsibility.

These values are in fact more than a corporate mission. They symbolize a way of life that permeates every aspect of our firm and the way we do business. The following pages will help illustrate how these values guide us in all we do.
Illustration by Walter Crane, c. 1887
IN TODAY’S WORLD where money managers, investors and corporate executives are typically focused on the most recent quarter-end earnings, the notion that patience could serve as the underpinning for a credible investment approach, much less a business strategy for an investment management firm, is rare indeed. Yet, at Ariel, patience serves as the core of our corporate philosophy. More than an adage, it sums up our way of evaluating companies, making investment decisions and even running our firm. Given our commitment to identifying and realizing long-term value, it makes perfect sense that we have adopted the Tortoise, the victor in Aesop’s timeless fable, as our symbol, and the fable’s moral — “Slow and Steady Wins the Race”— as our creed.
Ariel began as little more than an idea that wealth can be created by investing in great companies at bargain prices, whose true value would be realized over time.

I began my decades-long study of value investing and contrarian thinking in college. Early on, I discovered Burton Malkiel’s classic, *A Random Walk Down Wall Street*. In the book, Malkiel points out that although markets are largely efficient, there are ample opportunities for contrarians who have the courage to go against the grain. Benjamin Graham and David Dodd, the fathers of value investing, had proved this years before. Warren Buffett, John Templeton and other thoughtful, patient, independent investors were real-life examples of the merits of contrarian thinking.

Although Graham, Dodd, Buffett and Templeton were all original thinkers and successful investors who quickly became my role models, one of my most important role models, aside from my parents, was a man who invested in people rather than markets. He was my Princeton basketball coach Pete Carril, a member of the Basketball Hall of Fame. Coach Carril taught me the power of teamwork. And he demonstrated that intense focus on the fundamentals — which requires discipline and patience — is the key to winning in virtually any competitive setting, whether on a basketball court or Wall Street.

After college, I soon realized I could transform my passion for investing and the philosophies gained from my role models into a profession. So I became a stockbroker. While investing for myself had taught me about risk, investing for others brought a new level of responsibility. I owed it to my clients to recommend only those investment ideas I truly believed in — which, for me, meant only those companies I would want to own myself. Therein lies the difference between *selling stocks* and *managing money*, and my motivation behind founding Ariel.

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I am often asked why I named the firm Ariel and not Rogers Capital Management, LLC. For one thing, I always wanted to build a firm that would belong to all of its employees. But even more importantly, Coach Carril taught me that the power of the team is the best way to leverage the potential of each individual.

Sustaining success takes patience. Twenty years from now, we may have more people and perhaps we will manage more assets, but I do not believe our company will be very different. We will still be running our race our way, creating value through long-term thinking. That said, with another 20 years of practice, we expect to be doing this job even better.

Ariel began as little more than an idea that wealth can be created by investing in great companies at bargain prices, whose true value would be realized over time. In order for people to evaluate our thinking and investment strategy, we started a newsletter, The Patient Investor. Slowly but surely, readers became believers. Believers became investors. Nevertheless, it took over a year to win our first million-dollar institutional account—and another three years to break even. Yet even then, when we were without reputation or clients, I firmly believed that if we remained focused on our goal and consistent in our investment approach, our business would eventually grow.

Today, we are a team of 74 individuals managing over $16 billion. We remain true to our original philosophy of patient, bottom-up value investing anchored in focus and fundamentals.

Courtesy of Rev. Gregory I. Carlson, S.J. and Creighton University, Omaha. Photo by Jason K. Bash. c. 1920
People who know me know that my two most favorite interests are stocks and basketball. As I have detailed on many occasions, my father sparked my interest in the stock market by giving me stock certificates in place of toys every birthday and Christmas beginning at the age of 12. Initially, as one might expect, stocks were not my preferred form of gift. But with time (and modest dividend checks!), the stock market became more than a passing interest; it became an obsession. Inevitably, those pieces of paper proved to be the greatest present of all, since my hobby was ultimately transformed into the career I have today. Coincidentally, my love of basketball dates back to almost the same time—and I still play today.

This past April, on the heels of a great season and renowned 29-year career, my college coach, Pete Carril, retired from his job. My recent attendance at his going-away dinner reminded me of my time spent playing for Carril and reinforced my long-standing belief that he was one of the best teachers I ever had. His recitations about the rewards of hard work, teamwork, discipline and patience significantly shaped my views beyond basketball and into life. In fact, I trace the underpinnings of the Ariel investment philosophy and corporate culture to the uncompromising pursuit of excellence I saw in my coach.

In 1967, Carril walked onto Princeton's campus a virtual unknown. In 1996, he left a legend. In spite of the
inherent difficulty of recruiting basketball talent at Princeton each year, Carril’s teams managed to excel on so many occasions and oftentimes against better athletes. With a lifetime coaching record of 525 wins to 273 losses, he is the only active coach to have more than 500 wins without the benefit of athletic scholarships. In order to win, Carril effectively taught team members to play together, using their heads—all the while, being very deliberate.

On the surface, basketball and investment management could not appear to be more different, and yet, the most basic ingredients that made so many Princeton teams win are the exact same ideals we strive to achieve at Ariel. For starters, Coach Carril believed in hard work, plain and simple. His words and his actions prove it. On many occasions, he was known to say, “A player does not play, he works.”

As we believe that a strong work ethic exponentially increases one’s chances of success, we aspire to be the hardest-working investment management firm in the nation. Yet, as Carril taught, hard work is only the beginning; one must also work smart. Working smart means being disciplined. No matter who the Princeton player or what the year, Tiger basketball was always the same, always consistent. Carril liked to say, “We can win with what you can do. Don’t try what you can’t!”

Similarly at Ariel, discipline is reflected in our strict adherence to a unique investment strategy that seeks to identify the very best undervalued small and medium-sized companies—in consistent industries—that offer strong growth potential. Coach Carril always pushed his teams to improve their game and so we, too, must continually work to be better. But just as Carril never altered the fundamentals of Tiger plays to reflect the strengths of varying opponents, our investment disciplines cannot be compromised when we are confronted by trying stock market environments; nor can our standards be relaxed in more agreeable times.

Adhering to discipline often requires patience. Perhaps patience is Coach Carril’s most well-known virtue. Players were taught to pass and pass and pass the ball, until one of them was certain he could make the perfect shot. In our case at Ariel, patience allows us to keep searching until we find the companies we believe to be truly special. Companies with solid fundamentals and strong management teams that offer excellent products or services to customers who come back again and again. When we find these wonderful businesses, patience gives us the fortitude to wait for them to realize their potential.

And so, as Carril moves on, he leaves behind a tremendous legacy that reflects his simple view, “Basketball or life, it’s all the same.”
FOCUS

DO ONE THING AND DO IT WELL

By Timothy Fidler

ONE OF THE MOST SATISFYING ASPECTS of managing investments at Ariel is the opportunity it offers to know more and more about less and less. This may sound like a contradiction, but we believe this type of concentrated effort is what helps us to create value for our customers. As a firm, we maintain an intense concentration on small and mid-cap value investing. Our ambitious goal is to be the best investment manager in these arenas. To us, becoming the best requires a comprehensive understanding of small and mid-cap value investing combined with unparalleled knowledge of the companies that fall within our circle of competence. This extensive company-specific knowledge is critical to our distinct investment style.
In a sense, every company is a riddle. Our analysts unravel the secrets of a company’s performance and prospects.

At Ariel, we purchase companies rather than stocks. We never forget that a share of stock is not just a piece of paper, it is ownership in a business. That simple fact drives our entire bottom-up investment approach and is at the heart of our commitment to exhaustive, investigative research.

In fact, we only buy stocks in companies that we would want to own personally. Making that type of distinction requires a level of scrutiny far deeper than analyzing and modeling a company’s financial statements (where many firms start and end their research process). Of course, we look carefully at the financials, but we also insist on looking far beyond the numbers.

In a sense, every company is a riddle. Our analysts unravel the secrets of a company’s performance and prospects. We begin by determining what we need to know to truly understand a business. We expect our analysts to look where others do not, to seek independent verification and to explore perspectives that often run contrary to the conventional wisdom. We want to learn everything about how management thinks, sells its products and deals with suppliers, employees and customers. Moreover, some of the most important questions we consider are: Would we do business with this company — either as a supplier or a customer? Would we want to work for this company? And ultimately, would we want to own it outright if we could?

Not all investment professionals are prepared to dig this deep. Instead, some are fascinated by the minutiae of the market’s daily ups and downs. Others are motivated

Courtesy of Rev. Gregory I. Carlson, S.J. and Creighton University, Omaha. Photo by Jason K. Bash. c. 1875
Yes, this research-based focus takes time, but we can invest it since each analyst here covers just nine companies on average, compared with 200 at many other firms. In fact, with just six or eight buy/sell opportunities in a year, we often spend more time analyzing a company than other managers might spend owning it.

All investors should expect this kind of due diligence from their money managers—particularly one like Ariel, which counsels patience and long-term returns. Our clients depend on our focus. The more acute our vision, the more effectively we serve them.

primarily by quarterly numbers. At Ariel, we are far more interested in applying the disciplined thinking of Ben Graham and the long-term philosophy of Warren Buffett than in the gyrations of the stock market. For analysts who share those passions, Ariel is an especially rewarding place to work.

Our approach has little to do with what is taught in school or even in most training programs. The classroom is an environment where there are always right answers; the student’s job is to find them. Worse still, everyone is expected to find the same answers using the same tools and techniques. At Ariel, we are not interested in consensus answers. We uncover value by looking deeper into companies, asking harder questions and finding different answers.
The German architect Ludwig Mies van der Rohe once characterized his unique style of design with the simple, yet poignant statement, “Less is more.” Although he was referring to office and home design, we would argue the same can be said for building a stock portfolio. Yet, our somewhat simple view appears to run counter to the practices of a vast majority of today’s portfolio managers who seem to believe that, when constructing a stock portfolio, there’s safety in numbers.

With a portfolio potpourri, managers attempt to dampen the potentially negative effects of a lackluster performer or a languishing sector and thereby insulate themselves from being out of sync with the market. Herein lies one of the biggest oxymorons of modern investing. While there has been an indisputable movement toward mitigating investment risk through the ownership of more and more securities, with these growing portfolios, professional fund managers are left to know less and less about their actual holdings.

In our view, this lack of in-depth, company-specific knowledge actually makes for riskier investing. So too, believed Philip Fisher, an often-quoted investment sage who lived to tell tales of his experiences during the 1929 stock market crash. In his book, *Common Stock and Uncommon Profits*, he writes, “Investors have been misled, believing that putting their eggs in several baskets reduces...
risks. [Yet], the disadvantage of purchasing too many stocks is that it becomes impossible to watch all of the eggs in all of the different baskets.”

The famed investor Warren Buffett offers his own critique of this popular phenomenon, calling diversification “a protection against ignorance.” With his usual wit, he goes on to add that owning a little bit of everything is “a Noah’s Ark way of investing [and] you end up with a zoo that way.”

In the execution of his own investment strategy, Buffett emphatically zeros in on those companies in which he has the greatest knowledge and confidence. He has often questioned “why an investor…elects to put money into a business that is his 20th favorite rather than simply adding money to his top choices — the businesses he understands best and that present the least risk, along with the greatest profit potential.” With this perspective, there have been times when Buffett has been known to place over 90% of his multibillion-dollar portfolio in the stock of just three companies.

On many occasions, we have discussed our investigative research effort and how, like Buffett, we go to great lengths to learn everything possible about any candidate for our portfolios. Not only must we develop an intricate network when first considering an investment, in order to stay on top of a company’s prospects, we must perpetuate a useful flow of information for the duration of our ownership of the stock.

This level of detail goes well beyond pure financial analysis. As such, we make no bones about the fact that managing a portfolio can be a daunting task — even in the case of our relatively small 30–35 stock portfolios. This leads us to believe that replicating this process over and over again for dozens and dozens of securities would be a virtual impossibility. We therefore argue that a portfolio concentrated among a relatively smaller number of well-researched stocks actually offers investors greater prospects for above-average long-term investment results by affording them the opportunity to focus their hard-earned investment dollars on truly outstanding businesses.1

In keeping with this sentiment, it is worth noting that in response to a recent Congressional act allowing for increased concentration of mutual fund portfolios, a handful of new funds have been launched as “best of” portfolios. These investments are offshoots of existing funds with focus on the flagship fund’s largest or most promising holdings. Although one would think that every holding in a portfolio would reflect a manager’s highest level of conviction, the trend to diversify has diminished the likelihood of this occurrence. While we have lingering concerns over the composition of the original portfolios, we strongly view this “best of” strategy as a move in the right direction for realizing long-term investment success.

1 Ariel Fund and Ariel Appreciation Fund’s concentrated portfolios mean a fluctuation in the price of one stock could significantly affect the Funds’ overall performance.

Illustration by Félicien Philippe, c. 1921
THE INVESTMENT WORLD IS FILLED WITH SYMBOLS: roaring lions, charging bulls and growling bears. And then there is the Ariel turtle. As in Aesop’s fable, our turtle signifies our determination to run our own race in our own slow and steady way. More importantly and less obviously, however, the turtle signifies that we are not afraid to be different or to think independently. That independence influences everything we do: not only our pace, but the direction we take to the finish line; not only the way we manage our investments, but also the way we manage our business.

People sometimes ask why we didn’t choose an animal that was more aggressive and commanding as our corporate mascot. We realize the turtle may make us appear less forceful — but appearances can be deceiving. While
Ariel is not an aggressive firm, we are a determined and deliberate group of people—in fact, even plodding, just like the turtle. That image is fine with us because our judicious approach enables us to avoid many of the investment mistakes that come from being impatient and overly aggressive. Every decision we make is carefully examined from every angle. Does it move us closer to our investment objective? Is it consistent with our strategy? Do we understand the alternatives and why our chosen course is better?

Our independence helps us to remain steady, focused and patient amidst the noise and glitter of the investment race. Just like the Tortoise, in his competition with the Hare, we often receive unsolicited advice on how to run the race. For example, in the growth-driven, ever-upward market of the '90s, we often heard, “Change now or you’ll be left behind.” Yet we persevered, guided by a culture that provides us with a reliable sense of direction and the stamina we need for the long haul. Ultimately, by not changing course, we served our investors best.

This culture of independence nurtures and sustains the people who work at Ariel. At many companies, culture is a way to enforce sameness. At Ariel, our culture encourages individuality and fresh thinking. We are a diverse group of unique and sometimes quirky individuals—and proud of it. We hold the same core values, but do not necessarily think the same way.
Intellectual diversity and the vigorous discussions it encourages are advantages. Give-and-take forces us to think things through, to broaden our perspectives, to push ourselves.

We realize, however, that independence pursued for its own sake can be its own enemy, and frequently creates risk. At Ariel, we are not rebels out to prove something. We embrace an independent philosophy because we believe—and analysis shows—that it often is the best way to achieve our clients’ investment objectives.

Visitors often say that we do not look or feel like the typical financial firm. Even the design of our office reflects the unique spirit of our company. There is energy here, and a sense of creativity—and there are turtles everywhere! They are a constant reminder that we are not simply a team of patient investors, but independent thinkers as well. This unique balance allows us to grow as professionals and to win this race as a team. And like the Tortoise, to do it at our own steady pace.
I recently read that the Queen of England will be knighting ex-Beatle Paul McCartney. For this music icon, “Sir Paul” certainly does have a funny ring to it. Yet, I must admit that as a huge Beatles fan, I could not have been more pleased to read that such a rare yet curious distinction would be endowed upon such an unusual talent. I use “unusual” because no matter one’s personal bias, history has proven that the Beatles were and continue to be one of the greatest music groups of all time. It’s simply remarkable to think that a band of English rockers that burst onto the American music scene more than 30 years ago still holds the record for the most number-one songs.

I have often thought there are striking similarities between the money management profession and today’s popular music industry. In both cases, performance can be measured. Just as percentages gained and lost are the scorecard of money management, record sales and Billboard ratings measure the results of the modern-day recording artist. Moreover, while technical proficiency is important, like music, money management is an art, not a science.
The artistry is often rooted in one individual or the unique chemistry of a group. As such, inborn talent cannot be passed down and is rarely replicated by others with similar success. Additionally, in both cases, while styles come and go, only a select few prevail over long periods.

THE ART
While New York’s Juilliard School is widely regarded as one of the very best music schools in the world, one can safely say that employing four Juilliard graduates to write, record and play rock songs does not guarantee great music. In a similar vein, academic applications of business fundamentals and investment theory does not exactly ensure long-, or even short-term, investment success. Moreover, though some may say that imitation is the sincerest form of flattery, in matters of artistic genius, mimicry rarely works. The Monkees were not the Beatles. Harry Connick, Jr. will never be Frank Sinatra. And, Robert Hagstrom, Jr. is not Warren Buffett.

THE LEGENDS
For every music legend and every successful long-term investor, there are the dozens and dozens of “one-hit wonders.” These are the hot hands gone cold, where fame is often fast and fleeting. While still said to be popular with today’s students, American Pie was Don McLean’s only hit song. Wall Street, too, has had its own share of short-lived stars.

While some “one-hit wonders” may still be known for their memorable tunes or their short-lived results, in music as well as money management, legends have a unique style all their own and their originality stands the test of time. Although they broke up more than 25 years ago, the Beatles sold 20 million records in 1996 alone — more than any other group or artist.

In the money management industry, the true geniuses are also the exception. Yet, in the wake of the stock market’s unprecedented run, the proliferation of mutual funds (7,000 and counting) and the rock star-like status of today’s hot managers, the definition of genius appears to have been forgotten.

In our view, there are so very few brilliant investors who have withstood the test of time. And of those we most admire, each possesses his own uniqueness, but all are united by Ben Graham’s timeless principal of value investing. Such has been the case with Bill Ruane’s Sequoia Fund and its focus on undervalued large companies, Sir John Templeton’s search for global values and Warren Buffett’s emphasis on dominant business franchises that sell at below-market prices. We, too embrace this principle. And as we overlay our own style of small and medium-sized company investing, we are inspired by the legends and committed to the pursuit of artistic genius.
Illustration by Louis Rhead, c. 1927
I’VE ALWAYS THOUGHT IT ODD THAT MANY INVESTORS do not look particularly deeply into the thought processes of the professionals who will be handling their money. They fail to realize that when investing through a mutual fund, they are really teaming up with an investment manager, a manager who will be making some very important decisions on their behalf. Does that manager share their goals? Does he or she have the resources to pursue their goals in a disciplined, focused way?

As a Certified Public Accountant and the owner of my own firm, I know that building a successful business takes time. From my perspective, Ariel’s investment strategy realistically reflects how companies create long-term value.
for investors and the way I think about investments and risk. Of equal importance, Ariel’s investment analysts are among the most disciplined and thorough in the industry.

When I was asked to serve as a trustee of Ariel Mutual Funds in 1986, I was proud to join the team. Since then, I have had a chance to work closely with Ariel’s professionals, to see what makes this firm so exceptional—and to benefit from my own long-term investment in Ariel Mutual Funds.

In my view, Ariel’s continued success is the result of three factors. The first, of course, is the consistent and disciplined application of Ariel’s patient investment approach—decision after decision, year after year. The firm’s strengths as a value-oriented investment manager are now well known. Time and again, the firm has demonstrated the power of exhaustive research coupled with unswerving diligence. If an investor seeks the opportunity for appreciation over time, Ariel offers key advantages. But if an investor is looking for instantaneous results, or likes to follow the latest fad, Ariel would not be the best choice, and he or she should look elsewhere.

The other two success factors extend beyond the realm of the traditional investment and performance discussions, however, and are easily overlooked. One is the way Ariel is managed. The other is the character of the individuals on Ariel’s team.

The people at Ariel manage their company the same way they think about investing, which is to say, long term. They want to grow, but not at the expense of focus, their culture or their investment principles. Their vision for Ariel reflects their commitment to being the very best small and mid-cap value investing firm, and they are...
willing to pursue a very deliberate and thoughtful course toward that objective.

Achieving that goal requires hiring the best people. Mere academic qualifications are not enough. A candidate—even one who has been recruited—must demonstrate to many people over the course of many interviews maturity, thoughtfulness and intellectual toughness. The people who do best at Ariel are those who understand the importance of discipline, those who welcome accountability and those who realize there is always something new to learn. Ariel people are passionate about investing, and also about their community: They measure personal success not solely by how much money they make as individuals, but also by the difference they make in the world.

That said, there really is no single, ideal Ariel employee. By any measure, the firm is among the most diverse I have ever encountered—a good microcosm of what America can be. Beyond Ariel’s wide racial and ethnic diversity, the range of personalities and interests of Ariel people is both unusual and energizing. It is a place where people are excited to go to work because they are excited to be working together.

The quality of this unique team is a testament to the management skill and personal values of John W. Rogers, Jr. He has created a company where people understand the only expectation is that they strive to be the best in everything they do. At Ariel, everyone has the chance to put their best ideas on the table, to be held accountable and grow professionally, and to share in the rewards and responsibilities of ownership in the firm.

Judging by the commitment of the people to the firm and its mission, Ariel has a management approach that works quite well for its owner/employees. Of even greater significance to me as an individual investor and trustee of Ariel Mutual Funds, the approach works superbly for Ariel’s clients and shareholders.
LES S O N S F R O M L O M BA R D I
THE PATIENT INVESTOR: DECEMBER 31, 1999

At Ariel, reading is the underlying foundation of our research process. We constantly devour magazines, newspapers, books, Wall Street research reports and company-specific literature in order to understand trends, avoid fads, uncover new stock ideas and stay abreast of current holdings. As we strive to continually hone our own skills and get better and better, we also frequently read about leaders and leadership.

In our view, the defining characteristics of all leaders — the good ones and the bad ones — are strikingly similar and are often easily translated across a myriad of industries and disciplines. And so, this year it was a book on, of all things, a football coach that presented some of the most compelling insights we have ever read about precision and discipline. While these two ideals are clearly important in the world of competitive sports, they are also two of the most important characteristics of successful investing.

Vince Lombardi said, “Leaders are made, not born,” stressing the importance of preparation and training in life. When Pride Still Mattered describes how he went from an overrated college football player at Fordham University to an assistant coach at West Point and then the New York Giants — by his own account, 20 years of “apprenticeship” before being named head coach of the Green Bay Packers. His two sources of inspiration were St. Ignatius of Loyola and Colonel Red Blaik, the indomitable coach of the West Point football team.
Lombardi’s obsession, like that of his living mentor, was winning — and the pursuit of it required discipline. For him, this discipline was played out with repetition, and repetition begat precision. “He would drill the same play over and over again until it was more than routine and familiar, it was in [the team's] blood, part of their reflexive being.” He said, “They call it coaching, but it’s teaching. You do not just tell them it is so, you show them the reasons why it is so and you repeat and repeat until they are convinced, until they know.”

And so, from Vince Lombardi’s football teachings, we can be better stock pickers. First, there is the idea of apprenticeship. While some people are born with talent, Lombardi’s remarkable career effectively demonstrates that real greatness comes with study. In his case, St. Ignatius and Red Blaik were his subjects, and he mastered and adopted the best of their ideas, mixing in his own along the way. In our own world of investing, we are students of Ben Graham, the father of value investing, and his protégé Warren Buffett, the greatest investor of our era. In our quest to be great investors, our view is that the “apprenticeship” never ends.

Interestingly, “the game itself was the superficial part of coaching for Lombardi. He had already done his work getting his team prepared” before they walked onto the field. In reading this strategy, we are reminded of the importance of our own exhaustive research effort before a stock goes into our portfolios. Once it has passed our high standards, monitoring a holding and watching as it realizes its potential is secondary. We believe this uncompromising due diligence inevitably leads to fewer mistakes.

On the subject of discipline — clearly having a well-defined investment philosophy that is executed with razor-sharp precision is a key ingredient to realizing above-average rates of return. The real challenge is having the resolve to stick with the discipline in difficult periods. To this point, Lombardi would say, “Our greatest glory is not in never falling, but rising every time we fall.”

Lombardi said he always played the game as if the score were “nothing to nothing” — no matter what the team's lead. The same cannot be said of a growing contingent of investment managers who, in an effort to stay in the performance game, build portfolios to perform “in line” with the indices and therefore never have the opportunity to achieve truly exceptional long-term results. These “closet indexers” fear underperformance. Yet, when Lombardi was confronted with a tough challenge like a title-clinching game, he taught his team to manage their nerves. His view, “In football, as in life, excessive fear and anxiety can dim the brightest mind.” Again, the parallels to investing are uncanny as some of the biggest investment mistakes often follow knee-jerk reactions to unfavorable events. And so, we urge our fellow shareholders to let go of those anxieties that may be fueled by short-term setbacks. This game is far from over, and we have our eye on the ball.

Illustration by Félicien Philippe, c. 1921
When I first came to Ariel, I knew very little about investing. Like most young Americans, I did not have the chance to learn about the stock market in school, and it certainly was not a regular topic of conversation at my home. But once immersed in the business, learning about investing opened the door to an entirely new world for me. Research shows how little American children in general—and minority, inner-city children in particular—know about money and investing. From the time they are born, many inner-city kids are left to believe that they lack control of their financial futures. In school, they are not taught even the most basic financial concepts, much less about “wealth creation.” At Ariel, we have
embraced education as the most promising way to change these children’s expectations for themselves. Our efforts to support education take many forms, and clearly, our financial support is important. But most of us see ourselves as hands-on participants, not just spectators or financial benefactors. So there is a roll-up-your-sleeves attitude that energizes and personalizes what we do.

In 1989, we created the Ariel Foundation—now the Ariel Education Initiative—to provide a focal point for our efforts. Its first undertaking, in 1991, was as a participant in the “I Have a Dream Program,” whereby we promised the entire 40-student, sixth-grade class of Chicago’s Shakespeare Elementary School that we would make college affordable for each student who graduated from high school. Beyond this financial guarantee, we provided tutoring, mentoring and moral support along the way. Ultimately, 27 graduated and 22 went on to college—an unheard-of percentage in a Chicago neighborhood with a 70% high school dropout rate. However, for a range of reasons—including patterns developed much earlier in school and in life—several simply could not stick with college, despite our time, attention and money.

As a result, we realized that to really make a difference we needed to remember our patient view. To think longer term and reach kids earlier in their lives. That is the goal behind Ariel Community Academy (ACA), a small Chicago public school that we helped found and now help fund. The ultimate in teamwork, ACA involves students, families, the school, the community, Nuveen Investments—and Ariel—in a partnership focused on the all-around well-being of children. It offers a real-world

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curriculum, including an investment program that begins in the first grade, when each class receives a “class portfolio” of real money — $20,000. Over the years, as the students progress through school, they watch their portfolio and how it performs, taking greater and greater responsibility for its management over time. By the time they enter sixth grade, they begin to make their own investment decisions with a portion of the portfolio. When they graduate, they give $20,000 back to the first grade to make the program self-perpetuating. Then they help decide what to do with the remainder — including how much to direct to scholarships and philanthropy, as well as how much to contribute to the Academy and its endowment.

To help the kids better understand the importance of investing and how it works in practice, we continually seek to offer real-life financial experiences. For example, we held our company’s own 20th anniversary annual meeting at the Academy. It was an exciting day for the students — and for us. The kids were each paired up with an Ariel employee for the duration of the meeting. The kids played a role in the meeting, including calling it to order and adjourning us. During the Q&A session, they asked insightful questions about Ariel’s performance and our investment decisions. For us, it was great to see young people using their investment knowledge and gratifying to realize that they were not the least bit intimidated by the setting, or by us and our other shareholders. It was especially heartening to see that they are becoming comfortable and capable in a world that was effectively “off limits” to them just a short time ago.

At Ariel, we believe that, like a great education, investing can change lives. We hope that by teaching the fundamentals of investing, we are helping kids discover a whole new way of looking at the world. If we are successful, we think it will transform not only dinner table conversation in the Black community, but also the future, for generations to come. We know it is an ambitious goal, but what better investment can there be?
While the second quarter of 2002 has certainly been eventful, most investors would probably rather burn newspaper clippings than paste them into scrapbooks. And, while we believe stocks will eventually recover, we are deeply troubled by the fallout of investor trust. In the face of today’s market debacles and rampant corporate duplicity, we are now being asked, “How can investors avoid falling prey to corporate deceit? Where are the warning signs?” Unlike Wall Street analysts and big institutions, individual investors often do not have the luxury of on-site visits to company headquarters, behind-the-scenes plant tours or face-to-face interviews with company CEOs. However, investors do have access to a host of information that we believe is plenty revealing, including conference calls, annual meetings and, most importantly, written communication through annual and quarterly reports.

More specifically, the heart and soul of an institution — its true character — is often revealed in its corporate communications. Annual and quarterly reports present a clear opportunity for CEOs to thoughtfully reflect on their companies and effectively communicate with their shareholders. What company leaders actually do with this opportunity is infinitely telling about their personalities, their priorities and ultimately, their business.

In a shareholder letter, certain ingredients and characteristics differentiate quality management teams from truly mediocre ones. Specifically, as we methodically read through tomes of annual and quarterly letters, we first look for a clear declaration of
a company’s overall vision. Spice company McCormick, Inc. (NYSE: MKC) brings firm-wide focus on core competencies to a new level, demonstrating management’s aim to eat, sleep and breathe spices as each of its annual reports actually smells like a different spice.

The theme of Clorox’s (NYSE: CLX) mission statement is “Great people building great brands around the world.” The 2001 Chairman’s letter opens with this clear, concise core message and then further breaks it down phrase by phrase to explain the immense value of the Clorox team, how its leading brands are the lifeblood of the business, and why the company’s global reach is a key driver of profits. The letter goes on to systematically list company priorities, including goals for the next year as well as a comprehensive, detail-oriented chart presenting last year’s goals and their actual end results. This forthright communication and plain presentation of the facts helps build shareholder trust.

Warren Buffett is widely acclaimed as the master corporate communicator. His annual meetings for Berkshire Hathaway (NYSE: BRK) attract a cult-like attendance and he is lauded for his candor in his thorough yet straightforward annual letters to shareholders. Perhaps most remarkable about Buffett’s annual letters is his willingness to admit mistakes. The first page of his 2001 letter reads, “Though our corporate performance last year was satisfactory, my performance was anything but. I manage most of Berkshire’s equity portfolio, and my results were poor, just as they have been for several years…I’ll tell you more about my mistake later and what we are doing to correct it.” This genuine humility is unusual, and Buffett’s rare attitude of accountability is especially heartening given today’s backdrop of mounting corporate deception.

Conversely, reading inadequate shareholder communications can show investors what to avoid. Enron’s 1998 annual report included a simple two-page document in which the company described itself as a “global energy franchise.” But by 2000, the annual letter was rife with warning signs, from the statement that “Enron hardly resembles the company we were in the early days” to blatant hype and a self-congratulatory tone about the company’s performance, earnings and outlook, declaring, “At a minimum, we see our market opportunities company-wide tripling over the next five years.” Beyond the actual letter, the annual report itself was teeming with long footnotes and muddled legalese — two more red flags for investors, as simple, understandable financial reporting is the cornerstone of an excellent report. But, no matter how straightforward a company’s communications may be, it goes without saying that the onus is on shareholders to read the fine print.

At Ariel, we believe companies that exemplify the qualities of outstanding communicators will ultimately be the most successful, and our job is to seek them out and invest in them. Additionally, we are constantly striving to be counted among them. To that point, we are delighted to have been recognized by Chicago-based mutual fund tracker Morningstar, Inc. as one of 18 fund families who produce “great shareholder letters.” We will continue to work very hard to maintain this distinction.
JOHN W. ROGERS, JR.
Chairman & CEO, Ariel Capital Management, LLC

Founder and Chief Investment Officer of Ariel Capital Management, LLC, John W. Rogers, Jr. manages Ariel's small and mid-cap value portfolios. Prior to founding Ariel, John worked for two and a half years at the investment banking firm of William Blair & Co. in Chicago. John serves on the Boards of Directors of Aon Corporation; Bank One Corporation; Exelon Corporation and McDonald’s Corporation. His civic affiliations include his roles as Chairman of the Chicago Urban League; Director of The University of Chicago; and Board Member of the John S. and James L. Knight Foundation. In addition, he is the former President of the Board of the Chicago Park District; former Director of the National Association of Securities Dealers; and former Trustee of Princeton University. John earned an A.B. in Economics from Princeton University.

DR. JAMES E. BOWMAN
Professor Emeritus, The University of Chicago

Dr. James E. Bowman serves as Professor Emeritus of the Departments of Pathology and Medicine at The University of Chicago as well as on the Committee on Genetics and the Committee on African and African American Studies. He is also Senior Scholar of the MacLean Center for Clinical Medical Ethics at the University. He has authored over 90 scientific publications as well as two books in the fields of general human genetics. He was a member of the U.S. Department of State’s Committee for Science Cooperation between the United States and Iran. Dr. Bowman received both his undergraduate and medical degrees from Howard University. He currently serves on the Monitoring Board for Bone Marrow Transplantation for Thalassemia and Sickle Cell Anemia for the National Heart and Blood Institute of the National Institute of Health.

MELLODY HOBSON
President, Ariel Capital Management, LLC

As President of Ariel Capital Management, LLC, Mellody Hobson has responsibilities related to firm-wide management, strategic planning and marketing. Mellody has worked at Ariel since 1991 after earning her Bachelor of Arts degree from Princeton University’s Woodrow Wilson School of International Relations and Public Policy. She works with a variety of civic and professional organizations, including serving as Director of the Chicago Public Library as well as its foundation; Board Member of the Field Museum; Board Member of the Chicago Public Education Fund; and a Trustee of Princeton University. She also serves as a Director of Tellabs, Inc. Mellody’s extensive media experience includes her role as a regular financial contributor on ABC’s Good Morning America.

HENRY B. PEARSALL
Former Chairman, Sanford Corporation

From 1969 to 1994, Henry Pearsall worked for Sanford Corporation, a publicly traded company that designed, manufactured and marketed writing instruments and other school and office supplies, in a variety of capacities, including President, Chairman and Chief Executive Officer. Prior to that, Hank was President of Ovaltine Products in the Philippines; former Counsel for The Wander Company in Chicago; and Attorney at the firm of Hopkins and Sutter. Hank serves as a Director and Chairman of the Board of Oak Park River Forest Bankshares, a one-bank holding company; Principal and Director of Pearsall et Pere, a real estate development company in Chicago; and a Trustee of The Morton Arboretum. He earned a B.A. from Amherst College and a J.D. from the University of Michigan Law School.

ROBERT I. SOLOMON
Director, Strategic Accounts, Ariba, Inc.

As Director of Strategic Accounts for Ariba, Inc., Bob Solomon is responsible for strategy, marketing and sales activities for Ariba’s software solutions with key accounts. Prior to joining Ariba, Bob served as Senior Vice President of Corporate Services at Silliker Laboratories Group, Inc. At Silliker, Bob was responsible for corporate marketing,
sales, information technology and human resources. Before Silliker, Bob was Vice President of Sales and Marketing for the Food Ingredients Division of The NutraSweet Company, a division of Monsanto Corporation. Bob also worked in strategy consulting with the Boston Consulting Group. A native Chicagoan, he has an M.B.A. from Stanford University Graduate School of Business, where he was an Arjay Miller Scholar. Bob earned an A.B. in Economics from Princeton University.

**PETER Q. THOMPSON**
*Executive Vice President, Ariel Capital Management, LLC*

Peter Q. Thompson is Executive Vice President of Ariel Capital Management, LLC. As Director of Institutional Marketing & Client Service, he oversees Ariel’s new business development, client service and consultant relations in the institutional marketplace. He joined Ariel in 1994 after spending four years with Aon Corporation. Peter was appointed by Mayor Richard M. Daley to the Mayor’s 21st Century Leadership Council. He also serves on the Boards of the Adler Planetarium & Astronomy Museum, St. Ignatius College Preparatory, the Boys and Girls Clubs of Chicago and Mercy Hospital & Medical Center Foundation. Peter earned his M.B.A. from The University of Chicago Graduate School of Business and has a B.A. in American History from Providence College.

**CHARLES A. TRIBBETT**
*Senior Partner, Russell Reynolds Associates*

Charles A. Tribbett is a Senior Partner of Russell Reynolds Associates and serves as managing director of the Chicago office. He heads the firm’s diversity practice and co-leads the firm’s CEO and board services practice. Prior to Russell Reynolds, Charles served as a corporate securities attorney. Previously, he was a partner with his own private investment management company. Charles is a member of the Dean’s Advisory Board for the Northwestern University J.L. Kellogg School of Management and serves on the boards of the Chicago Urban League, the Chicago Symphony Orchestra and High Jump. He graduated Phi Beta Kappa and Magna Cum Laude from Marquette University and earned a J.D. from the University of Virginia School of Law.

**DAVID J. VITALE**
*Chief Administrative Officer, Chicago Public Schools*

David J. Vitale serves as the Chief Administrative Officer for Chicago Public Schools, overseeing all of the educational support departments, including Finance, Budget, Operations, Human Resources, Technology, Security, Procurement and Business Diversity. David was formerly President and Chief Executive Officer of the Chicago Board of Trade and is a former Vice Chairman and Director of Bank One Corporation. He also serves in the following capacities: Trustee of the Glenwood School for Boys; Trustee of the Museum of Science and Industry; Trustee and Treasurer of the Board of The Art Institute of Chicago; and Member of the Board of Managers of the YMCA of Metropolitan Chicago. David is a graduate of Harvard University and earned an M.B.A. from The University of Chicago.

**PAULA WOLFF**
*Senior Executive, Chicago Metropolis 2020*

Paula Wolff serves as Senior Executive at Chicago Metropolis 2020, a civic organization implementing policy initiatives and programs for regional action. Paula served as President of Governors State University and was a visiting fellow at the John D. and Catherine T. MacArthur Foundation. She taught public policy at Northern Illinois University, Governors State University and the Irving B. Harris School of Public Policy at The University of Chicago. Paula graduated Magna Cum Laude from Smith College, and she earned an M.A. and a Ph.D. from The University of Chicago in Political Science. She serves on numerous boards, including the Johnson Foundation, Harris Insight Funds, the Metropolitan Planning Council and the Joyce Foundation. She also serves as Chair of The University of Chicago Hospitals and as Vice Chair of The University of Chicago Board of Trustees.
BERT N. MITCHELL, C.P.A.
Chairman, Ariel Mutual Funds Board of Trustees
Chairman & CEO, Mitchell & Titus, LLP

Bert N. Mitchell is Chairman and CEO of Mitchell & Titus, LLP, the nation’s largest minority-owned accounting firm. A native of Jamaica, West Indies, he immigrated to the United States in 1958. He holds B.B.A., M.B.A. and Honorary Doctorate degrees from the Baruch School of Business of the City University of New York. Bert is also a graduate of the Owner-President Management Program of the Harvard Business School. He serves on the Boards of The Rouse Company as well as BJ’s Wholesale Club, Inc. Bert’s community activities include directorships of the Greater NY Fund/United Way, One Hundred Black Men, Inc. and several other not-for-profit organizations.

MARIO L. BAEZA
Chairman & CEO, Baeza & Company

Mario L. Baeza is Chairman and CEO of Baeza & Company, an alternative investment firm that specializes in private equities aimed at the U.S. Hispanic market and hedge funds anchored in global macro strategies. In addition, as Chairman of TCW/Latin America Partners, L.L.C., Mario is widely regarded as a preeminent expert in international mergers and acquisitions as well as corporate finance. He received a B.A. from Cornell University and a J.D. from Harvard Law School, where he later taught. Mario also serves on the Boards of Directors of Air Products and Chemicals, Inc. and a number of non-profit organizations, including the Council on Foreign Relations, NAACP Legal Defense and Education Fund as well as the U.S. Cuba Trade and Economic Council, Inc.

JAMES W. COMPTON
President & CEO, Chicago Urban League

James W. Compton serves as the President and CEO of the Chicago Urban League and the Chicago Urban League Development Corporation, which have worked to eliminate racial discrimination and segregation since 1916. He has a B.A. from Morehouse College and serves on the Boards of Directors of The Field Museum, DePaul University and The Big Shoulders Fund. Additionally, Jim served for 12 years on the board of ComEd and Unicom Corporation.

WILLIAM C. DIETRICH, C.P.A.
Co-Executive Director, Shalem Institute for Spiritual Formation

William C. Dietrich serves as Co-Executive Director and a Senior Faculty Member of the Shalem Institute for Spiritual Formation, an internationally known ecumenical training institute for contemplative living founded in 1973. Previously, Bill served as a financial management consultant and co-founded entrepreneurial ventures in the electronic commerce industry. His experience also includes serving as Chief Financial Officer for a publicly held pharmaceutical manufacturer. Bill’s business career began in public accounting, including nine years with Ernst & Young, where he served as Senior Audit Manager for clients in the mutual fund and aerospace industries. He holds a B.S. from Georgetown University.

ROYCE N. FLIPPIN, JR.
President, Flippin Associates

Royce N. Flippin, Jr. is President of Flippin Associates, a consulting firm for the public and private sectors. Formerly, he was Director of Athletics at Princeton University and was Director of both Athletics and Program Advancement for the Massachusetts Institute of Technology. Additionally, he has held marketing and finance positions with Exxon, General Foods and Salomon Smith Barney. He earned his A.B. from Princeton University and an M.B.A. from Harvard Business School. Royce is on the boards of several corporations and nonprofit institutions, including the Princeton Club, Education and Video Conferencing, Inc., Thorium Power and Lakewood Preparatory School in Hopewell, NJ, which his grandson attends.
JOHN G. GUFFEY, JR.
Director & Treasurer, Silby Guffey & Company, Inc.

John G. Guffey, Jr. is Director and Treasurer of Silby Guffey & Company, Inc., a venture capital firm investing in early stage companies in the health care and environmental industries. John has a B.S. from the University of Pennsylvania’s Wharton School. He does volunteer work and holds directorships with various local and national nonprofit organizations. He was Founder of Calvert Group and its President from 1975 to 1987, and now serves as a Trustee of Calvert mutual funds.

MELLODY HOBSON
President, Ariel Capital Management, LLC

As President of Ariel Capital Management, LLC, Mellody Hobson has responsibilities related to firm-wide management, strategic planning and marketing. Mellody has worked at Ariel since 1991 after earning her Bachelor of Arts degree from Princeton University’s Woodrow Wilson School of International Relations and Public Policy. She works with a variety of civic and professional organizations, including serving as Director of the Chicago Public Library as well as its foundation; Board Member of the Field Museum; Board Member of the Chicago Public Education Fund; and a Trustee of Princeton University. She also serves as a Director of Tellabs, Inc. Mellody’s extensive media experience includes her role as a regular financial contributor on ABC’s Good Morning America.

CHRISTOPHER G. KENNEDY
President, Merchandise Mart Properties, Inc.

Christopher G. Kennedy is President of Merchandise Mart Properties, Inc., which manages, among other prime properties, The Merchandise Mart in Chicago; Market Square in High Point, North Carolina; The Washington Design Center; and the Architects & Designers Building in New York City. He earned his B.A. from Boston College and his M.B.A. from the J.L. Kellogg Graduate School of Management at Northwestern University. Chris serves on a variety of civic and corporate boards, including Interface Floor Covering Company and the Rehabilitation Institute of Chicago.

MERRILLYN J. KOSIER
Executive Vice President, Ariel Capital Management, LLC

Merrillyn J. Kosier serves as Executive Vice President and Director of Mutual Fund Marketing and Investor Services at Ariel Capital Management LLC. In this capacity, she spearheads public relations, advertising, branding and shareholder communications for Ariel Mutual Funds. Merrillyn joined Ariel from the Acorn Family of Funds, where she held the title of Senior Vice President for five years. Prior to Acorn, Merrillyn worked for nearly ten years at Kemper Financial Services, six of which were spent as Vice President of Marketing. She earned a B.B.A. in Marketing from Andrews University and an M.B.A. from Loyola University, where she serves on the advisory board for the School of Business Administration.

JOHN W. ROGERS, JR.
Chairman & CEO, Ariel Capital Management, LLC

Founder and Chief Investment Officer of Ariel Capital Management, LLC, John W. Rogers, Jr. manages Ariel’s small and mid-cap value portfolios. Prior to founding Ariel, John worked for two and a half years at the investment banking firm of William Blair & Co. in Chicago. John serves on the Boards of Directors of Aon Corporation; Bank One Corporation; Exelon Corporation and McDonald’s Corporation. His civic affiliations include his roles as Chairman of the Chicago Urban League; Director of The University of Chicago; and Board Member of the John S. and James L. Knight Foundation. In addition, he is the former President of the Board of the Chicago Park District; former Director of the National Association of Securities Dealers; and former Trustee of Princeton University. John earned an A.B. in Economics from Princeton University.
THE MORAL OF OUR STORY

MORE THAN TWENTY YEARS AGO, Ariel entered the money management race with a strategy based on patience, discipline and focus. Today, we are still moving forward, step by careful step, toward our vision of being the best small and mid-cap value manager in the industry. Every morning, we come to work eager to resume the race. Every evening, we head for home having learned something that gets us closer to our elusive goal. We realize, however, there will always be more to learn, and no matter how much we accomplish, we can always do even better. After all, unlike the race between the Tortoise and the Hare, the investment race has no finish line.
Investors should consider carefully the investment objectives, potential risks, management fees, and charges and expenses of the Ariel Mutual Funds before investing. The current prospectus for the Ariel Mutual Funds contains this and other information about the funds. Investors may obtain a copy of the current prospectus by calling or writing to our distributor, or by logging on to our award winning web site. Please read it carefully before investing or sending money.

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Brochure 2004