Ariel Emerging Markets Value ex-China

Quarter Ended September 30, 2023

The MSCI Emerging Markets (EM) ex-China Index ended the quarter in negative territory, as developing economies adjusted to the new "higher for longer" interest rate regime adopted by many advanced countries and its implications for slowing global growth. All three market regions, Asia/Pacific ex-Japan, Latin America and EMEA (Europe, Middle East and Africa) posted declines. Taiwan and South Korea were notable underperformers due to the global technology sell-off, while India, Turkey and the United Arab Emirates delivered positive gains. Although macroeconomic uncertainty is high and market volatility will likely remain elevated, the valuation discount between developed and emerging markets is wide. In our view, such market inefficiencies present attractive opportunities for meaningful long-term returns. Against this backdrop, the Ariel Emerging Markets Value ex-China Composite increased +1.01% gross of fees (+0.75% net of fees) in the quarter, significantly ahead of the MSCI EM ex-China Index's -3.33% loss.

Some holdings in the portfolio advanced considerably this quarter. Taiwanese testing and packaging solutions company for semiconductors and integrated circuits, **King Yuan Electronics Company, Ltd.** traded up in the period on better than expected earnings results. Management also noted they are seeing an increase in demand for testing chips for artificial intelligence (AI) applications and expect their AI business to nearly double as a percentage of revenues in 2024. We believe King Yuan is at an inflection point as activity levels for testing recover following the cyclical industry downturn. In our view, King Yuan's AI exposure and improved cost structure present an attractive growth opportunity which should lead to a valuation re-rating.

Korea's largest financial company in terms of assets and customer base, **KB Financial Group**, also advanced during the period following strong results as well as the announcement of a share buyback program and subsequent share cancellation. The company is benefitting from higher fee income driven by strong performance in their brokerage and investment banking divisions as well as net interest margin expansion. These factors combined with an improved outlook for Korea's residential real estate market also boosted the share price. Although KB Financial continues to trade at a deeply discounted valuation, we believe the company's strong and stable diversified profit structure and industry leading shareholder returns are well supported by its various business lines and subsidiaries.

During the quarter, shares of United Arab Emirates based property investment and development company in the MENA region, **Emaar Properties PJSC**, rose on strong financial results, highlighted by record quarterly residential sales and steady recurring revenue growth. Healthy domestic spending and a rebound in tourism also drove traffic, occupancy and rates across the company's retail, mall, hospitality and entertainment segments. We believe Emaar Properties will continue to benefit from the post COVID recovery in Dubai's real estate market, which has been amplified by the large number of expatriates recently entering the country. We expect the company's valuation discount to regional peers will narrow as it continues to post strong financial results and improved cash generation.

Alternatively, several positions weighed on performance. Brazilian food distributor, **Sendas Distribuidora SA**, underperformed over the period due to a challenging macro environment. Decelerating food inflation, client inventory cuts, extended cost pressures and weak same-store-sales drove its earnings miss. Additionally, after several quarters of declines, Brazilian interest rates rose in the period creating yet another headwind for shares. While the operating environment will likely remain choppy near-term, we believe Sendas is well-positioned to benefit from a normalization in food inflation and moderating interest rates. Over time, we think the company will experience market share gains, as its cash-and-carry segment benefits from scale-driven price leadership.

Indian financial services conglomerate, **HDFC Bank**, underperformed in the quarter as the market absorbed the negative impact of its recently-completed merger with HDFC Limited. The disclosure of financials for the combined entity took investors by surprise, as the proforma book value came in below consensus due to the adoption of common accounting and credit policies across the businesses. Additionally, management noted the excess liquidity built around the acquisition will weigh on net interest margin. While these factors will pressure shares near-term, we expect their impact on financial results to fade over the next couple years. In time, we believe the merger will enable HDFC to build a more diversified and robust franchise enabling sustainable profit growth driven by its larger customer base, robust distribution network and improved cross-selling capabilities.

Finally, shares of Poland based commercial bank, **Bank Polska Kasa Opieki SA** came under pressure in the quarter following a sharper than expected rate reduction as well as the emergence of new regulatory risks that could negatively impact bank profitability. In light of recent events, we re-evaluated our thesis and exited the name.

We initiated three new positions in the quarter. We added Taiwanese producer of electronic connectors, **Lotes Co., Ltd.**, which manufactures CPU sockets connecting microprocessors to motherboards in servers and personal computers. We expect the CPU socket market to grow, as new generations of these electrical components require more complex and expensive sockets. We believe Lotes should benefit from future roll outs given its leading market position and strong historical relationship with CPU designers Intel and AMD. We also appreciate the company's commitment to return capital to shareholders.

Additionally, during the quarter, we purchased one of the largest retail and corporate banks in Central and Eastern Europe, **OTP Bank Nyrt**. We believe OTP's diversified asset portfolio shields it from excessive fluctuations. We foresee potential upside to shares driven by the gradual elimination of COVID related consumer support policies (interest caps) and the reduction in temporary windfall tax in its core Hungarian market. At 1x book, we believe OTP offers attractive upside given our expectation for mid-to-high-teens returns on tangible equity in 2024-25.

We also established a position in **Saudi National Bank (SNB)** during the period. Over the past three years, SNB has built up its reserves and diversified its loan portfolio, reducing concentration and spreading risk across various economic segments. As of the beginning of the third quarter in 2023, the bank nearly achieved neutrality in its net interest margin (NIM) sensitivity to interest rate fluctuations, which we believe favorably positions SNB for future interest rate cuts. Simultaneously, the bank has been expanding its loan portfolio and gaining market share by leveraging its robust deposit franchise and access to Saudi Arabia's monumental Giga projects. In our view, the current forward price-to-earnings discount relative to the sector does not fully account for its resilient NIM and above-industry market growth, presenting us with an attractive entry price. We believe that SNB will outperform most of the MENA banks in 2024.

By comparison, we sold our stake in in leading designer of display driver integrated circuits (DDICs), **Novatek Microelectronics Corp.** We also exited **Bank Polska Kasa Opieki SA** after re-evaluating our thesis due to the emergence of new regulatory risks that could negatively impact bank profitability. Lastly, we sold **iShares MSCI Saudi Arabia ETF** to pursue better opportunities.

As economic growth potentially slows in the developed world, we are cautiously optimistic corporate earnings growth in emerging markets will exceed the outlook for companies in advanced (and potentially slowing) economies over the near-to-medium term. This is being driven by both cyclical and structural factors. These regions quickly responded to inflationary risks with rate hikes in 2021 and are now benefitting from falling inflation and more accommodative policies, which should strengthen purchasing power and consumer spending. Rising productivity, demographic trends underscored by a burgeoning middle class as well as urbanization also support tailwinds for local demand. Additionally, weaknesses in global trade exposed by the pandemic have broadened the recipients of foreign direct investment in EM countries, as businesses look to nearshore operations as well as realign their global supply chains away from China. Meanwhile, investors remain underweight the asset class. Looking forward, our confidence in our current positioning remains high. In our view, valuations are compelling, particularly with Ariel's Emerging Markets Value ex-China portfolio trading at 9.08x forward price-to-earnings and 1.19x price-to-book – a significant discount to both the indices and our own internal estimates.

Investments in non-U.S. securities may underperform and may be more volatile than comparable U.S. stocks because of the risks involving non-U.S. economies, markets, political systems, regulatory standards, currencies and taxes. The use of currency derivatives and ETFs may increase investment losses and expenses and create more volatility. Investments in emerging markets present additional risks, such as difficulties in selling on a timely basis and at an acceptable price. The intrinsic value of the stocks within the strategy may never be recognized by the broader market. The strategy is often concentrated in fewer sectors than its benchmarks, and its performance may suffer if these sectors underperform the overall stock market.

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 9/30/2023, the performance (net of fees) of the Ariel Emerging Markets Value ex-China Composite since inception on 5/31/2023 was +6.75%. For the four-month period ended 9/30/2023, the performance for the MSCI EM ex-China Net Index was +0.27%. Actual fees may vary depending on, among other things, the applicable fee schedule and portfolio size. A complete fee schedule is available upon request. Returns are expressed in U.S. dollars. Current performance may be lower or higher than the performance data quoted. The Ariel Emerging Markets Value ex-China Composite differs from its benchmark, the MSCI EM ex-China Net Index, because the Composite has fewer holdings than the benchmark.

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As of 9/30/2023, King Yuan Electronics Company, Ltd. constituted 2.8% of the Ariel Emerging Markets Value ex-China Composite (representative portfolio); KB Financial Group, Inc. 5.2%; Emaar Properties PJSC 2.6%; Sendas Distribuidora SA 2.4%; HDFC Bank Ltd. 2.1%; Bank Polska Kasa Opieki SA 0.0%; Lotes Co Ltd 1.4%; OTP Bank Nyrt 1.5%; The Saudi National Bank 0.0%; Novatek Microelectronics Corp. 0.0%; and iShares MSCI Saudi Arabia ETF 0.0%. 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 Emerging Markets Value ex-China Composite.

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

Indexes are unmanaged. Investors cannot invest directly in an index. MSCI Emerging Markets ex-China Index captures large and mid cap representation across 23 of the 24 Emerging Markets (EM) countries excluding China. Its inception date is March 9, 2017. All MSCI Index net returns reflect the reinvestment of income and other earnings, including the dividends net of the maximum withholding tax applicable to non-resident institutional investors that do not benefit from double taxation treaties. MSCI uses the maximum tax rate applicable to institutional investors, as determined by the companies' country of incorporation. MSCI makes no express or implied warranties or representations and shall have no liability whatsoever with respect to any MSCI data contained herein. The MSCI data may not be further redistributed or used to create indices or financial products. This report is not approved or produced by MSCI.

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SLOW AND STEADY WINS THE RACE