

Ariel Focus Fund

Quarter Ended September 30, 2023

Performance data quoted represents past performance. Past performance does not guarantee future results. All performance assumes the reinvestment of dividends and capital gains, and represents returns of the Investor Class shares. The investment return and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Current performance may be lower or higher than the performance data quoted. Performance data current to the most recent month end for Ariel Focus Fund may be obtained by visiting our website, arielinvestments.com. For the period ended September 30, 2023 the average annual returns of Ariel Focus Fund (investor class) for the 1, 5, and 10 year periods were +7.83%, +2.67%, and +5.68%, respectively.

The U.S. stock market posted declines in the third quarter driven by fears of a government shutdown, striking autoworkers, surging oil prices and the prospect of interest rates remaining higher for longer. Against this backdrop, government bond yields soared, equities came under pressure and the richly valued "magnificent seven"¹ lost their shine. As the Federal Reserve attempts to steer the economy, some worry the risks of a hard-landing are growing. Although uncertainty and volatility are likely to remain elevated, we view the recession guessing game as noise within the context of our long-term investment horizon. Ariel Focus Fund fell -5.87% in the quarter, lagging the -3.16% return posted by Russell 1000 Value Index and the -3.27% loss of the S&P 500 Index.

Oil and natural gas explorer, **APA Corporation (APA)**, traded higher over the quarter. APA continues to deliver strong earnings results highlighted by solid production volumes as well as tighter expense controls. The output in the Permian Basin remains solid. APA also has overcome its operational challenges in Egypt and expects to hit its 2H23 oil production guidance in the region. Management also expressed confidence in the Suriname development and is working with TotalEnergies to put together a plan for the oil hub. Looking ahead, APA remains focused on higher-margin oil developments, driving safety and operational improvements, and prioritizing a reduction in carbon intensity. Meanwhile, capital returns through Q2 exceeded APA's minimum 60% return of free cash flow to shareholders through dividends and repurchases, with the potential for more buybacks in the second half of the year. At current valuation levels, APA is trading at a 30% discount to our private market value estimate.

Global leader in money transfer services **Western Union Company (WU)**, also advanced following a top- and bottom-line earnings beat and subsequent raise in full-year guidance. These results were aided by regulatory change in Iraq and margin expansion in the retail business. Meanwhile, management continues to return capital to shareholders through dividends and share repurchases. Although the company anticipates the macroeconomic environment will continue to slow, it reminded investors remittances have proved resilient in prior periods of economic contraction. At current levels, WU is trading at a discount to our estimate of private market value.

Additionally, global investment bank, **Goldman Sachs Group, Inc. (GS)**, increased in the period. Although the company posted mixed earnings results and lowered full-year guidance, GS continues to successfully execute on its strategic initiatives to improve the overall return of the company. It is right sizing headcount and narrowing its ambitions in consumer strategy through divestitures and an enhanced focus on driving profitability in Platform Solutions. GS also noted signs of a recovery in a few investment banking areas, including equity capital markets and mergers & acquisitions. With the stock currently trading near book value, management also announced intentions to return more capital to shareholders via buybacks. Looking ahead, we view the near and long-term outlook for Goldman as attractive at current levels, given favorable business trends, continued positive momentum on strategic initiatives and active expense/capital management programs.

There were a few notable performance detractors in the quarter. Leading direct-to-consumer pool and spa care services company in the U.S., **Leslie's Inc. (LESL)**, declined in the period following a preannounced earnings miss. Unfavorable

¹ The "Magnificent Seven" are the largest stocks in the S&P 500 Index driving market performance: Apple Inc. (AAPL), Amazon.com, Inc. (AMZN), Alphabet Inc. (GOOGL), Meta Platforms Inc. (META), Microsoft Corp. (MSFT), NVIDIA Corp. (NVDA) and Tesla, Inc. (TSLA).



weather across key markets and increased price sensitivity has resulted in weaker than expected store and website traffic trends. Investor concerns regarding the potential deflation on the price of chlorine further weighed on shares. In response to these results, management is reducing inventory, cutting costs and installed a new CFO. We believe our thesis remains intact. In our view, the company continues to differentiate itself through its loyal client base, vertically integrated supply chain, scale advantage and seamless customer experience.

Manufacturer and distributor of floorcovering products, **Mohawk Industries Inc. (MHK)**, detracted from our returns in the period. MHK has historically demonstrated its ability to deliver sales growth and generate strong cash flow despite significant inflation, rising interest rates, and geopolitical instability. However, over the past few quarters, consumer demand has been muted due to a challenging macro environment. Additionally, near-term margin headwinds continue to pressure results, but as channel inventories near the bottom, management is optimistic that volumes will increase as the housing market improves over time. In our view, MHK's healthy balance sheet and success managing through economic cycles have the company well positioned to benefit from long-term growth in residential remodeling, new home construction and commercial projects. At current levels, MHK is trading at a -64% discount to our estimate of private market value.

Finally, leading global manufacturer of power generation equipment, **Generac Holdings, Inc. (GNRC)**, underperformed in the quarter. Management lowered full-year guidance as a soft consumer environment resulted in weaker-than-expected residential sales, margin contraction and an earnings miss. Subsequently, GNRC held an investor day and issued a new 3-year outlook above consensus driven by grid instability, climate change and accelerating power outages. In our view, GNRC's home standby generator business as well as its commercial and industrial opportunities will benefit from such heightened consumer sensitivities and result in a long runway of penetration across an expanding addressable market, margin expansion and free cash flow generation.

Also in the quarter, we initiated a position in **Chevron Corporation (CVX)**, the second largest integrated energy company in the U.S., operating in exploration, production and refining on a global scale. We view the company as competitively advantaged with a strong balance sheet, sustainable growth pathway and an effective management team. Going forward CVX expects improved cost efficiencies and production growth via its differentiated position in the Permian Basin and recent acquisition of Noble Energy. Additionally, management believes a combination of its new higher-margin projects along with operational improvements will drive a double-digit return of capital employed by 2027. Although oil and gas prices, which lay outside of the company's control, ultimately dictate Chevron's earnings and

cashflow profile, the organization is laser focused on capital discipline. It is this lack of predictability, and potential fear of a global recession which presented us with an opportunity to initiate a position in this high barrier to entry producer at reasonable prices.

We also added consumer health company, **Kenvue, Inc. (KVUE)**, through an exchange offer from our position in Johnson & Johnson (JNJ). We view Kenvue as a beneficiary of current demographic and global economic trends, as demand for and spend on healthcare generally increases as populations age and disposable incomes rise. We expect the company's future earnings growth to be driven by continued innovation within its current product portfolio, robust cash flows and increasing global demand for healthcare, which should increase in both absolute dollars and as a percentage of GDP over the long-term.

Finally, we established a position in manufacturer of premium fuel and electrical systems, **Phinia Inc. (PHIN)**, which was a spinoff from BorgWarner Inc. (BWA). Phinia is focused on the design and development of performance and emissions components of combustion and hybrid vehicles. The remaining BWA business produces components with similar capabilities, however, BWA is focused on electric vehicles. Overall, the market is excited about the longer-term organic growth of BWA at lower margins versus the higher margin Phinia business given questions of how long demand for combustion/hybrid vehicles will continue.

By comparison, we exited four positions during the period. We sold live entertainment, media and technology company, **Sphere Entertainment Co. (SPHR)** and leading designer and manufacturer in the orthopedic marketplace, **Zimmer Biomet Holdings, Inc. (ZBH)** on valuation. We also exited financial advisory and asset manager, **Lazard Ltd. (LAZ)** and global investment company, **The Bank of New York Mellon Corporation (BK)** to pursue other opportunities.

As the pendulum of worry swings from one scenario to another, our focus on recent events and macroeconomic developments is to consider their effect on the long-term intrinsic worth of our holdings over the next five-to-ten years. Although the new "higher for longer" rate regime will likely present headwinds to corporate earnings growth, we remain confident in our portfolio positioning and stand ready to take advantage of market sell offs. We strongly believe the patient investor that stays the course and consistently owns differentiated business models with solid competitive positioning, low leverage and robust balance sheets will deliver stronger returns over the long run.

Investing in equity stocks is risky and subject to the volatility of the markets. Investing in small and mid cap companies is riskier and more volatile than investing in large cap companies. The intrinsic value of the stocks in which the Fund



invests may never be recognized by the broader market. Ariel Focus Fund is a non-diversified fund and therefore may be subject to greater volatility than a more diversified investment. The Fund is often concentrated in few sectors than its benchmarks, and its performance may suffer if these sectors underperform the overall stock market.

Per the Fund's Annual Report for the year ended September 30, 2022, the Fund's Investor Class had an annual net expense ratio of 1.00% and an annual gross expense ratio of 1.13%. Currently, expense ratio cap of 1.00% for the Investor Class is in place to waive fees and reimburse certain expenses that exceed this cap. Ariel Investments, LLC (the Adviser) is contractually obligated to maintain this expense ratio cap through 9/30/24.

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. There is no guarantee that any of the views expressed will come to fruition or any investment will perform as described.

As of 9/30/23, APA Corporation constituted 6.6% of Ariel Focus Fund; Western Union Company 4.1%; Goldman Sachs Group, Inc. 6.0%; Leslie's, Inc. 1.9%; Mohawk Industries, Inc. 4.2%; Generac Holdings Inc. 2.1%; Chevron Corp 1.4%; Kenvue, Inc. 0.9%; PHINIA, Inc. 3.1%; The Bank of New York Mellon Corp. 0.0%; Lazard Ltd 0.0%; Sphere Entertainment Co. 0.0%; and Zimmer Biomet Holdings, Inc. 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 Ariel Focus Fund.

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 1000® Value Index measures the performance of the large-cap value segment of the U.S. equity universe. It includes those Russell 1000 companies with lower price-to-book ratios, lower forecasted growth values and lower sales per share historical growth. Its inception date is January 1, 1987. 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

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