Ariel investments

Quarterly Commentary

Ariel International Developed Markets / Emerging Markets

Quarter Ended September 30, 2023

Markets worldwide posted declines in the third quarter, with many developed economies adjusting to the new "higher for longer" rate regime and its implications for slowing global growth. Japan remains an outlier with accommodative policy, while intensifying problems in China have many investors anticipating additional stimulus. As some investors remain cautiously optimistic central banks will engineer a soft-landing, others worry the stress of tight monetary policy will induce a hard landing. Although macroeconomic uncertainty is high and market volatility will likely remain elevated, we view these near-term risks as noise within the context of our long-term investment horizon. The Ariel International DM/EM Composite declined -3.59% gross of fees (-3.78% net of fees) in the period, slightly ahead of the -3.77% loss posted by its primary benchmark, MSCI ACWI ex-US Index, but trailing the -0.07% return posted by the MSCI ACWI ex-US Value Index, its secondary benchmark.

Ariel's non-consensus approach seeks to identify undervalued, out-of-favor, franchises that are misunderstood and therefore mispriced. The Ariel International DM/EM strategy continues to be significantly overweight Utilities, Consumer Staples, Communication Services, Health Care and Financials. The portfolio is meaningfully underweight Industrials, Information Technology, Energy and lacks exposure to Materials and Real Estate. At the sector level, Consumer Discretionary holdings and our underweight Information Technology were the largest sources of positive attribution. By comparison, stock selection within Communication Services and underweight Energy were the greatest detractors from performance in the quarter.

After underperforming during the first half of the year, British home and auto insurer, **Direct Line Insurance Group PLC** was the top contributor to returns in the quarter. The overhang of a potential equity raise was removed following the sale of its brokered commercial business. Additionally, improving pricing conditions, a strengthening in Direct Line's motor reserve, as well as the appointment of a new CEO aided shares. In our view, the stock continues to be undervalued relative to its normalized earnings power.

French multinational tire manufacturer, **Michelin SCA,** also traded higher over the period following an earnings beat and a raise in full year guidance. We remain enthusiastic about Michelin's strong global competitive position, cyclical resiliency, pricing strategy and cost discipline. Furthermore, we expect the company's "Around Tire" and "Beyond Tire" initiatives to drive profitable growth over the long term.

Additionally, global pharmaceutical and healthcare company, **GSK plc.**, advanced in the period following a top- and bottom-line earnings beat and subsequent raise in full-year guidance. Shares were also aided by a successful U.S. and European launch of Arexvy, a respiratory syncytial virus (RSV) vaccine for older adults. Although risks around the Zantac litigation remain a concern, we believe GSK should generate sustainable growth and margin expansion as the company transitions its Pharma pipeline towards specialty medicines and vaccines. Furthermore, the company's robust balance sheet provides the scope for bolt-ons, which has the potential to drive additional growth.

By comparison, shares of German mobile telecommunications company, **Telefónica Deutschland Holdings AG**, sharply declined in the quarter. This underperformance was driven by 1&1's recent announcement it would move its national roaming and spectrum leasing partnership from Telefónica to Vodafone in 2025. Although management expects the decision to meaningfully impact EBITDA and free cash flow over the medium-term, the company reassured investors it will remain a rational player in the market. Telefónica plans to use the now under-utilized network capacity to accommodate new and existing customers. While we remain cautious about these recent developments, we think Telefónica Deutschland can benefit from the relatively stable competitive environment in Germany over the long term.

Peruvian banking franchise, **Credicorp, Ltd.**, also underperformed in the quarter. Although the company delivered solid earnings results, management anticipates slower loan growth and higher provisions in the back half of the year due to an increasingly challenging macro backdrop. Our thesis remains focused on Credicorp's attractive long-term earnings potential. The company holds a dominant position in a highly concentrated banking system with many attractive features including low penetration and high returns on equity. Credicorp also continues to invest in digital transformation and accelerate disruptive innovations. Moreover, it views venture capital and the underdeveloped fintech market in Peru as an opportunity to boost growth and enhance shareholder value.

Lastly, global pharmaceutical and diagnostics leader, **Roche Holding AG**, weighed on returns in the period on mixed earnings. A miss in the diagnostics segment drove sales slightly lower than consensus, but margins came in ahead and EPS was in-line. Importantly, management reiterated full year

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guidance. We remain enthusiastic about Roche's growing pharma portfolio and believe the core oncology franchise remains one of the most valuable in the world. The diagnostics segment also continues to demonstrate momentum following a rise in installed platforms during the pandemic. In our view, Roche is a quality defensive name with a rich suite of pipeline opportunities.

We initiated two new positions in the quarter. We added **St. James's Place plc**, a UK wealth management company with about £150bn of funds under management. Through its network of more than 4,700 advisers, the firm offers face-to-face home, insurance, investing and estate planning advice to individuals, trustees and businesses. It does not employ in-house investment managers but offers access to select external managers through its in-house investment funds. While the current macro-backdrop has stalled new business, we find the longer-term business opportunity within the high net worth segment of the advisory market appealing.

We also established a new position in Singapore-based, niche electronics manufacturing service provider, **Venture Corporation Ltd.** The company has a diversified customer base, generates industry leading margins and is consistently recognized for solid execution. Macro headwinds and near-term demand weakness provided us an attractive entry point in the name. In our view, Venture Corporation can attract test & measurement and life-science customers, which are largely underpenetrated due to complex specification and regulatory requirements. We also see upside with Philip Morris, one of the company's key customers, as they roll out their electronic cigarette product, IQOS, in the US. Additionally, we find Venture Corporation's strong financial position, highlighted by its net cash balance sheet to be a plus for a long-term investment opportunity.

To pursue higher conviction opportunities and pair back holdings representing less than 1% of the portfolio so each of our resulting holdings may have more impact, we sold our stakes in the following names: United Kingdom based merchant banking company **Close Brothers Group plc**, Canada based **Element Fleet Management**, international pharmaceutical company **H. Lundbeck A/S**, food distributor and specialized retailer **Jeronimo Martins (JM)**, China's leading after school tutoring program **New Oriental Education & Technology Group, Inc.** and China's leading online travel agency (OTA) **Trip.com Group Ltd**.

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 three-to-five years. While we believe the rise in interest rates is largely behind us, corporate earnings are vulnerable as growth slows and margins face potential compression. We see this environment as conducive for active managers, whose knowledge, expertise and forward thinking enables them to look beyond the short-term noise and identify new opportunities. Accordingly, we are finding many mispriced stocks where valuation is attractive, profitability less vulnerable and balance sheets remain strong. In our view, our international and global portfolios are well-positioned to deliver stronger returns over the long run.

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 International (DM/EM) Composite for the 1-, 5-, and 10-year periods were +17.03%, +1.97%, and +3.34%, respectively. For the period ended 9/30/2023, the performance for the MSCI ACWI ex US Index and the MSCI ACWI ex US Value Index for the 1-, 5-, and 10-year periods were +20.39%, +2.58%, +3.35% and +25.17%, +2.29%, and +2.58%, respectively. Actual fees may vary depending on, among other things, the applicable fee schedule and portfolio size. A complete fee schedule is available upon request and may also be found in Ariel Investments LLC's Form ADV, Part 2. Returns are expressed in U.S. dollars. Current performance may be lower or higher than the performance data quoted. The Ariel International (DM/EM) Composite differs from its benchmark, the MSCI ACWI (All Country World Index) ex US, because: (i) the Composite has fewer holdings than the benchmark and (ii) the Composite will at times invest a portion of its assets in the U.S.

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.

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

As of 9/30/2023, Direct Line Insurance Group Plc constituted 5.6% of the Ariel International (DM/EM) Composite (representative portfolio); Michelin SCA 5.8%; GSK plc 5.4%; Telefonica Deutschland Holding AG 2.1%; Credicorp Ltd. 3.6%; Roche Holding AG 5.5%; St James's Place PLC 0.1%; Venture Corp Ltd 0.2%; Close Brothers Group PLC 0.0%; Element Fleet Management Corp 0.0%; H. Lundbeck A/S 0.0%; Jeronimo Martins SGPS SA 0.0%; New Oriental Education & Technology Group Inc. 0.0%; and Trip.com Group Ltd 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 International (DM/EM) Composite.

Indexes are unmanaged. An investor cannot invest directly in an index. The MSCI ACWI (All Country World Index) ex-US Index is an index of large and mid-cap representation across 22 Developed Markets (DM) and 24 Emerging Markets (EM) countries. Its inception date is January 1, 2001. The MSCI ACWI ex-US Value Index captures large and mid-cap securities exhibiting overall value style characteristics across 22 Developed and 24 Emerging Markets countries. Its inception date is December 8, 1997. 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 company’s 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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