Ariel investments

Quarterly Commentary

Ariel Global Concentrated

Quarter Ended December 31, 2023

Markets worldwide defied expectations in 2023 led by the dominating performance of mega-cap technology stocks known as the "magnificent seven.[1]" Even though gains have been concentrated, improving inflation data and growing excitement central banks will cut interest rates sooner than expected drove a fourth quarter rally and strong finish to the year. Investor sentiment has shifted from fears of a recession towards optimism for a soft landing. Such turns in market psychology and economic forecasts continue to highlight the challenges of market timing and the importance of taking a long-term view. Although uncertainty and volatility are likely to remain elevated, the patient investor knows "stock prices trade on fundamentals. And when those solid fundamentals shine through, share prices rise.[2]" Meanwhile, we remain laser focused on improving upside capture across our international and global portfolios while preserving downside protection. Against this backdrop, the Ariel Global Concentrated Composite advanced +9.36% gross of fees (+9.14% net of fees) in the period, lagging the MSCI ACWI Index's +11.03% increase, but ahead of the MSCI ACWI Value Index which returned +9.17%. Over the trailing one-year period, the Ariel Global Concentrated Composite increased +15.83% gross of fees (+14.91% net of fees), trailing the MSCI ACWI Index's +22.20% gain, but outperforming the +11.81% return of the MSCI ACWI Value Index.

Ariel's non-consensus approach seeks to identify undervalued, out-of-favor, franchises that are misunderstood and therefore mispriced. The Ariel Global Concentrated strategy continues to be significantly overweight Communication Services, Health Care, Real Estate and Financials. The portfolio is underweight Information Technology and Consumer Discretionary, as well as lacks exposure to Industrials, Energy and Materials. At the sector level, our avoidance of Energy and Communication Services holdings were the greatest sources of positive attribution, while our allocation to cash and Health Care were the largest performance detractors in the quarter.

German mobile telecommunications company, **Telefónica Deutschland Holdings AG** was the top performer in the period following Telefónica SA's public tender offer to purchase the remaining 28% it did not own in the German company. We exited the position shortly after the announcement on valuation.

Additionally, a new holding within the portfolio, leading provider of U.S. dialysis services, **DaVita, Inc.** lifted returns following an earnings beat and subsequent raise in full year 2023 guidance. Management indicated a willingness to be "very aggressive" in buying back shares due to the discount between the market's current valuation of the company compared to internal expectations. Shares came under pressure earlier in the period following the release of clinical data on the efficacy of glucagon-like-peptide-1 (GLP-1) weight-loss drugs and their potential to negatively impact the demand for dialysis, providing us an attractive entry point in the name. Even assuming high rates of both uptake and effectiveness, we believe the overall impact on dialysis volumes will be small in the near-to-medium term. We also think the cardio protective effects of the GLP-1 class may enable patients to live longer, thereby increasing the overall size of the end-stage renal disease incidence pool. Meanwhile, we find DaVita's solid financial position, steady cash flow profile and it's share buyback program attractive.

Global communications and technology leader, **Verizon Communications Inc.** also traded higher in the quarter following solid earnings results, highlighted by postpaid consumer net additions and an upward revision to free cash flow guidance. From a competitive and financial standpoint, we view Verizon to be among one of the best positioned telecoms in the world. The company's solid long-term fundamentals are underscored by its predictable, recurring revenue streams and ~7% dividend yield. At current levels, Verizon is trading near an all-time low valuation presenting a compelling total return story for patient investors.

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[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).

[2] Hobson, Mellody and John W. Rogers Jr. "What the Stock market Taught Us This Year: Don't Fall for These Investing Traps." Wall Street Journal, 5 December 2023. https://www.wsj.com/finance/investing/stock-market-2023-lessons-investing-2cedd44f

SLOW AND STEADY WINS THE RACE

By comparison, China's internet search and online community leader, **Baidu, Inc.** traded lower alongside Chinese equities as intensifying problems in China weighed on investor sentiment during the period. The company continues to invest heavily in Artificial Intelligence (AI) and recently launched its generative AI, Ernie Bot, aimed at rivaling Open AI's ChatGPT. While monetization of the new technology is largely dependent on regulatory review, we think Baidu should continue to experience margin improvement with the ongoing implementation of efficiency and profitability initiatives. While some investors remain on the sidelines due to uncertainty surrounding China's economic growth, government regulations, and the political rhetoric towards Taiwan, we remain enthusiastic about Baidu's longer-term opportunity for revenue growth and margin expansion across internet search, cloud, autonomous driving, artificial intelligence and online video.

Japanese auto manufacturer, **Subaru Corporation**, also weighed on results in the period. We believe this recent price action to be primarily driven by appreciation in the Japanese yen and think the weakness in shares runs counter to the company's strong business model. Subaru recently reported healthy earning results driven by robust demand in North America and lower raw materials prices. We remain focused on Subaru's solid business fundamentals and view its EV roadmap as a long-term opportunity to increase market share.

Finally, tobacco maker, **Philip Morris International Inc. (PM)**, declined in the period. We view this price action to run counter to the company's solid fundamentals. PM delivered high-single-digit organic revenue growth and fine-tuned their EPS guidance in an upward direction. We believe the favorable economics and margin expansion associated with market share gains from the IQOS brand and Reduced Risk Products should yield value creation opportunities in the years ahead. Furthermore, at current trading levels, we think the company's operating leverage, pricing power, and free cash flow profile offer a strong margin of safety.

We initiated ten new positions in the quarter.

We added Japanese multinational tire manufacturer, **Bridgestone Corporation**. Shares came under pressure when sales conditions for European and U.S. replacement tires deteriorated as material cost inflation and an influx of Asian products drove dealers to destock their inventories. Although we have begun to see signs of a recovery in Bridgestone's truck, bus and passenger vehicle radial replacement tires, the company is also ramping up its concentration on premium tires (> 18-inch diameter) and deploying ENLITEN technologies, further differentiating itself from tier 2 tire players. In our view, the adoption of electric vehicles should increase the utilization of premium tires due to their heavier weight, continuous torque, and low rolling resistance requirement. At current valuation levels, we believe the market is underappreciating Bridgestone's premium strategy and medium-term opportunity in specialty markets.

We initiated a position in biopharmaceutical company, **Bristol-Myers Squibb Company (BMY)**. Shares came under pressure on news the company would be delaying several new product launches presenting us with an attractive entry point. Although the company's mid- to long-term targets remain intact, management expects a transition period before the company returns to top-tier growth. In our view, many of the new drugs represent either the first-in-class (the first molecule approved by the FDA) or best efficacy opportunities and believe the new product portfolio should outperform expectations over time. Meanwhile, management remains bullish on its maturing pipeline and reaffirmed it will remain continue to seek business development through bolt-on acquisitions and licensing deals.

We added positions in, leading providers of dialysis services, **DaVita, Inc.** and **Fresenius Medical Care AG & Co.** Fresenius Medical Care AG & Co. is the worldwide leader in the treatment of renal disease, while Davita, Inc. administers its services to over 2,700 outpatient dialysis centers across 45+ states and operates over 350 outpatient dialysis centers in 12 total countries. The shares of each company came under pressure following the release of clinical data on the efficacy of glucagon-like-peptide-1 (GLP-1) weight-loss drugs and their potential to negatively impact the demand for dialysis, providing us with attractive entry points in both names. Even assuming high rates of both uptake and effectiveness, we believe the overall impact on dialysis volumes will be small in the near-to-medium term. We also think the cardio protective effects of the GLP-1 class may enable patients to live longer, thereby increasing the overall size of the end-stage renal disease incidence pool. We believed the market misunderstood the actual long-term clinical impact on dialysis and were able to purchase at attractive valuation levels.

We added one of the largest banks in Mexico, **Grupo Financiero Banorte S.A.B. de C.V.**, which is currently experiencing above average growth driven by positive nearshoring effects. The bank continues to see improvements in the quality of its low-cost deposit base and growing consumer loan book. In our view, these factors will allow Banorte to sustain solid net interest margins. We find the company's strong credit quality and attractive return-on-equity to be appealing long-term.

We purchased **Intel Corporation**, one of the world's largest semiconductor chip manufacturers by revenue. We believe Intel is well-positioned to benefit from the near-term rebound in semiconductor demand driven by the cyclical recovery of personal computers (PCs) and central processing units (CPUs). In our view, the market is also overlooking the progress Intel has made towards regaining its manufacturing technology advantage and believe the foundry business will continue to experience strong momentum as it grows its customer base and revenue.

We added Korea's largest financial company in terms of assets and customer base, **KB Financial Group**. 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. At current levels, KB Financial is trading at a significant discount to our estimate of private market value.

We also initiated a position in Korean-based leading manufacturer of mobile phones and smartphones, **Samsung Electronic Company, Ltd**. We see signs of the memory market bottoming driven by supply cuts during a time when demand is near trough levels. Heading into 2024, we expect the company will benefit from a cyclical recovery in memory as well as rising prices as supply/demand stabilizes. We also think replacement demand for smartphones will improve. Longer term, we believe there is upside optionality in Samsung's foundry and display businesses from a fundamental perspective that better transparency and more detailed financial segment reporting would unlock.

We purchased manufacturer and marketer of integrated circuits, **Taiwan Semiconductor Manufacturing Company, Ltd**. TSMC has a dominant share of the global foundry market and is an industry leader in terms of scale, technology, customer service and execution. Although demand for smartphones and PCs is stabilizing, we expect the company to benefit from the secular growth trends of Artificial Intelligence (AI) longer-term. A downturn in the foundry industry this year presented us with an attractive entry point, as we think the current forward price-to-earnings ratio does not fully reflect the high-quality nature of the business model.

Lastly, we purchased financial services company, **Truist Financial Corporation**. After the merger of BB&T and SunTrust formed Truist in 2019, management has prioritized simplifying the organization and reducing expenses to optimize profitability. After successfully selling a portion of the insurance business, TFC is now considering selling the remaining stake. While we take no definitive view on the likelihood of a sale, we believe this would be a positive catalyst for the company. TFC could leverage the deal to strengthen its adjusted capital profile, improve margins as well as accelerate its investment in technology. Meanwhile, the company is trading at a significant discount relative to our estimate of its intrinsic value.

By comparison, we exited six positions in the quarter.

To pursue higher conviction opportunities, we sold our stakes in Brazilian insurance company, **BB Seguridade Participacoes SA** and provider of product-driven information system solutions to major telecommunication companies, **Amdocs Limited**.

We also exited leading domestic producer of infant milk formula in China, **China Feihe, Ltd.**, Brazilian financial services company, **Itau Unibanco Holding SA**, leading pharmaceutical, consumer health and medical device company, **Johnson & Johnson**, and German mobile telecommunications company, **Telefónica Deutschland Holdings AG** on valuation.

Despite the recent market rally and consensus for a soft landing in 2024, our outlook is more cautious as geopolitical tensions are high, global growth is slowing and monetary policy remains unpredictable. We expect these uncertainties will likely result in a period of heightened volatility and widening dispersion of returns, creating opportunities for active managers with focused expertise to shine. While market concentrations have their own peaks and troughs, the mega-cap technology names appear vulnerable to a correction. In our view, higher quality companies with robust balance sheets will be the drivers of future outperformance. Accordingly, we are finding many mispriced stocks where valuation is attractive, profitability less vulnerable and balance sheets remain strong.

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, exchange-traded funds (ETFs) and other hedges 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. A concentrated portfolio may be subject to greater volatility than a more diversified portfolio. The intrinsic value of the stocks in which the portfolio invests may never be recognized by the broader market. The portfolio is often concentrated in fewer sectors than its benchmarks, and its performance may suffer if these sectors underperform the overall stock market. Investing in equity stocks is risky and subject to the volatility of the markets.

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 12/31/2023, the performance (net of fees) of the Ariel Global Concentrated Composite for the 1-year and since inception on 12/31/2019 was +14.91% and +5.84%, respectively. For the period ended 12/31/2023, the performance for the MSCI ACWI Index and the MSCI ACWI Value Index over the 1-year and since inception of the Ariel Global Concentrated Composite on 12/31/2019 was +22.20% and +8.28%, and +11.81% and +5.36%, 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 Global Concentrated Composite differs from its benchmark, the MSCI ACWI (All Country World Index), because the Composite has dramatically fewer holdings than the benchmark.

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 12/31/2023, Telefonica Deutschland Holding AG constituted 0.0% of the Ariel Global Concentrated Composite (representative portfolio); DaVita Inc. 2.6%; Verizon Communications Inc. 6.1%; Baidu, Inc. 7.1%; Subaru Corporation 3.6%; Philip Morris International, Inc. 7.8%; Bridgestone Corporation 2.0%; Bristol-Myers Squibb Company 2.0%; Fresenius Medical Care AG 1.5%; Grupo Financiero Banorte S.A.B de C.V. 1.1%; Intel Corporation 1.9%; KB Financial Group 0.9%; Samsung Electronic Company 1.7%; Taiwan Semiconductor Manufacturing Company 0.1%; Truist Financial Corporation 1.1%; Amdocs Limited 0.0%; BB Seguridade Participacoes SA 0.0%; China Feihe, Ltd. 0.0%; Itau Unibanco Holding SA 0.0%; and Johnson & Johnson 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 Global Concentrated Composite.

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

Indexes are unmanaged. An investor cannot invest directly in an index. The MSCI ACWI (All Country World Index) Index is an equity index of large and mid-cap representation across 23 Developed Markets (DM) and 24 Emerging Markets (EM) countries. Its inception date is January 1, 2001. The MSCI ACWI Value Index captures large and mid-cap securities exhibiting overall value style characteristics across 23 Developed Markets countries and 24 Emerging Markets (EM) 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 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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