Ariel International Developed Markets / Emerging Markets

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 International DM/EM Composite traded up +7.82% gross of fees (+7.61% net of fees) in the period, underperforming both its primary and secondary benchmark, MSCI ACWI ex-US and MSCI ACWI ex-US Value Indices, which returned +9.75% and +8.43%, respectively. Over the trailing one-year period, the Ariel International DM/EM Composite increased +12.53% gross of fees (+11.63% net of fees), underperforming both the MSCI ACWI ex-US Index and the MSCI ACWI ex-US Value Index, which returned +15.62% and +17.30%, respectively.

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, Health Care, Communication Services, Consumer Staples, Financials and Consumer Discretionary. The portfolio is meaningfully underweight Industrials, Energy and Information Technology, and lacks exposure to Materials and Real Estate. At the sector level, our Communication Services holdings were the largest source of positive attribution. By comparison, our avoidance of the outperforming mega-cap technology names in the benchmark and Consumer Staples holdings were the greatest detractors from performance in the quarter.

German mobile telecommunications company, **Telefónica Deutschland Holdings AG** was the top performer in the quarter 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, leading market maker in European derivatives **Deutsche Boerse AG**, which operates the Frankfurt stock exchange, experienced strong stock price performance in the period. As we have noted before, the company's revenue generation and earnings power benefits from high market volatility, rising rates and increased demand for interest rate derivatives. In our view, Deutsche Boerse is well positioned to drive value creation in the year ahead, particularly amidst the current capital market backdrop of high inflation, elevated uncertainty surrounding interest rates and monetary policies around the globe.

French multinational tire manufacturer, **Michelin SCA**, also traded higher over the period. Solid earnings results, highlighted by early signs of a recovery in the replacement tire market and a subsequent raise in full year guidance lifted shares. 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.

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

[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

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.

Dutch international grocer, **Koninklijke Ahold Delhaize N.V.**, also traded lower in the quarter. Despite an increase in free cash flow guidance and the announcement of a new €1 billion buyback authorization, slower sales and margin pressure in the U.S. driven by lower food inflation weighed on shares. We continue to believe Ahold's strong market share, stable business model and solid balance sheet should help the company navigate the current market environment. We also think there is potential for Ahold to unlock additional value through its online channel, bol.com.

Finally, Japanese auto manufacturer, **Subaru Corporation**, 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.

We initiated eight new positions in the quarter.

We added Danish multinational banking and financial services company, **Danske Bank A/S** in the period. Following several years of litigation concerning money-laundering violations, the company recently finalized a settlement, removing the overhang on shares. Meanwhile, the business is demonstrating solid operating momentum, highlighted by the strong credit quality of its customer base as well as improving net interest margin and strong balance sheet. We believe Danske Bank will begin returning capital to shareholders through dividends or buybacks in 2024.

We established a position in Germany-based kidney dialysis services and products provider, **Fresenius Medical Care AG & Co.** Fresenius Kidney Care is the worldwide leader in the treatment of renal disease. Shares 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 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. We believed the market misunderstood the actual long-term clinical impact on dialysis and were able to purchase at attractive valuation levels.

We initiated a position in 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 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 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 bought 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.

Finally, we added Hungarian, ultra-low cost airline provider, **Wizz Air Holdings plc.** An investigation into the Pratt & Whitney (P&W) Geared Turbofan (GTF) engine, which powers the airlines A320 NEO family aircrafts, has grounded 22% of the fleet for 18 months presenting us with an attractive entry point. Although this issue will reduce flight capacity over the near to medium-term, WIZZ has agreed to a cash compensation package with P&W. We anticipate the overall impact on earnings will be further mitigated by the delivery of new planes, lease extensions and more optimal fly routes and schedules. At current levels, WIZZ is trading at a significant discount to our estimate of its intrinsic value and expansion prospects across Western Europe and the Middle East.

Finally, we purchased **iShares MSCI ACWI ex U.S. ETF** as a cash alternative during the month.

By comparison, we exited nine positions in the quarter.

We sold leading domestic producer of infant milk formula in China, **China Feihe, Ltd.**, Brazilian financial services company, **Itau Unibanco Holding SA** and German mobile telecommunications company, **Telefónica Deutschland Holdings AG** on valuation.

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: British multinational consumer healthcare company, **Haleon plc.**, Chilean Bank, **Banco Santander Chile**, Mexico's leading stock exchange, **Bolsa Mexicana de Valores S.A.B. de C.V.**, Swiss multinational food and drink processing conglomerate **Nestle S.A.**, leading long form online video entertainment service in China, **iQIYI Inc.** and multinational pharmaceuticals company, **Novartis AG.**

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 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 12/31/2023, the performance (net of fees) of the Ariel International (DM/EM) Composite for the 1-, 5-, and 10-year periods were +11.63%, +5.54%, and +3.63%, respectively. For the period ended 12/31/2023, 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 +15.62%, +7.08%, +3.83% and +17.30%, +6.34%, and +2.92%, 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 12/31/2023, Telefonica Deutschland Holding AG constituted 0.0% of the Ariel International (DM/EM) Composite (representative portfolio); Deutsche Boerse AG 4.7%; Michelin SCA 6.1%; Baidu, Inc. 5.0%; Koninklijke Ahold Delhaize NV 3.8%; Subaru Corporation 5.0%; Danske Bank A/S 2.3%; Fresenius Medical Care AG 2.5%; Grupo Financiero Banorte S.A.B. de C.V. 1.7%; KB Financial Group 1.9%; Samsung Electronic Company 2.9%; Taiwan Semiconductor Manufacturing Company 1.1%; Wizz Air Holdings Plc 0.4%; iShares MSCI ACWI ex U.S. ETF 0.6%; Banco Santander Chile 0.0%; Bolsa Mexicana de Valores S.A.B. de C.V. 0.0%; China Feihe, Ltd. 0.0%; Haleon plc. 0.0%; Itau Unibanco Holding SA 0.0%; Nestle S.A. 0.0%; Novartis SA 0.0%; and iQIYI 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 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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SLOW AND STEADY WINS THE RACE