Ariel investments

Ariel Focused Value Portfolio Manager Letter

As of September 30, 2023

Performance (%)

	QTD	YTD	1-Year	3-Year (Annualized)	5-Year (Annualized)	10-Year (Annualized)	Since Inception (Annualized)
Ariel Focused Value							03/31/2005
Gross of Fees	**-5.59**	**-2.87**	**8.28**	**9.19**	**3.47**	**6.67**	**6.49**
Net of Fees	**-5.74**	**-3.34**	**7.58**	**8.48**	**2.80**	**5.97**	**5.63**
Russell 1000® Value Index	-3.16	1.79	14.44	11.06	6.23	8.45	7.24
S&P 500® Index	-3.27	13.07	21.62	10.16	9.92	11.92	9.38

Dear Clients and Friends: The third quarter was difficult for financial markets as hawkish signals from the Federal Reserve sent interest rates higher and U.S. stock and bond prices lower. Growth beat value, while small companies underperformed larger ones. Both factors were headwinds for Ariel Focused Value. Our holdings remain cheaper than the broad market as well as the large-cap value index.

To this point, at quarter end, the Ariel Focused Value Composite traded at 10.8x forward earnings, significantly lower than the S&P 500 Index at 17.9x and the Russell 1000 Value Index at 13.7x. This noteworthy discount has persisted for several years now. While we believe our value orientation will generate future returns, it has undoubtedly been a challenge in the face of growth stock outperformance. Our all-cap strategy allows us to purchase companies across the market cap spectrum. Lately, smaller cap names have presented attractive opportunities, causing our market cap to lie well below the indices, creating a headwind this year. As such, the Ariel Focused Value Composite returned -5.59% gross of fees (-5.74% net of fees) for the quarter and -2.87% gross of fees (-3.34% net of fees) year-to-date. The Russell 1000 Value Index lost -3.16% in the quarter and rose +1.79% year-to-date, while the S&P 500 declined -3.27% in the quarter and gained +13.07% year-to-date.

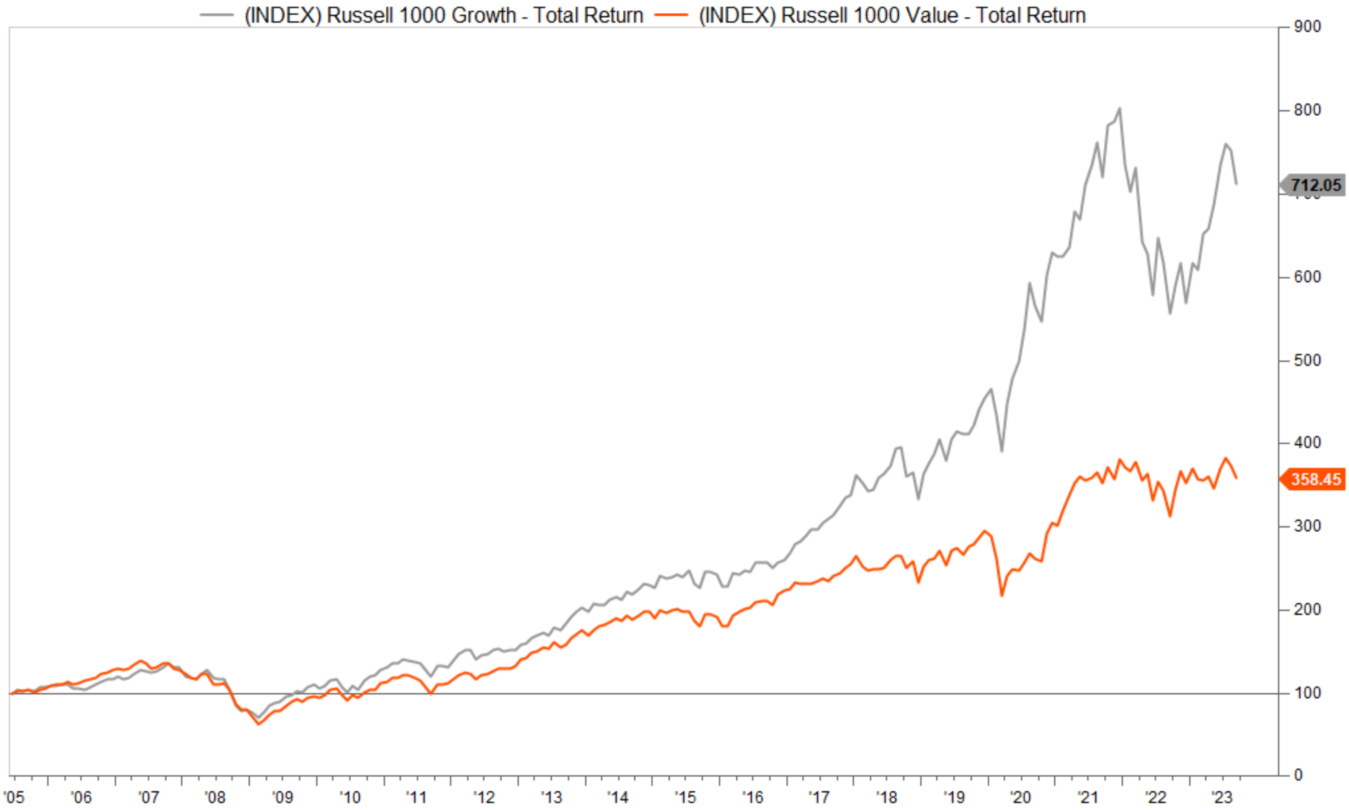
Past letters have discussed the underperformance of value versus growth in U.S. equity markets. Chart 1 on the next page shows the dramatic outperformance of the Russell 1000 Growth Index versus the Russell 1000 Value Index since the inception of Ariel Focused Value in 2005. We believe this growth stock dominance had been driven by low interest rates and, more recently by economic concerns. With growth earnings pushed farther into the future, low interest rates bring these distant cash flows back to the present with a lower discount rate, producing higher present values today. Value stocks, which generate more cash flow in the near term relative to their stock prices, do not benefit as much from lower rates, just as short-term bond prices rise less than long-term bonds when rates fall.

Additionally, growth stocks are perceived to be less economically sensitive than the value shares often found in housing, investment and regional banking, and/or energy exploration—industries typically characterized as economically cyclical.

Since the outset of the pandemic in 2020, the market has had a persistent negative outlook on the economy, arising first from a government-mandated shutdown and then from concerns around supply disruption. In 2022, just as economic sentiment (and value stocks!) seemed to be looking up, the Federal Reserve sent Wall Street into "recession watch" with dramatic increases in interest rates designed to slow the economy to cool inflation.

A Light at the End of the Tunnel

Chart 1: Growth Has Dramatically Outperformed Value: Russell 1000 Growth versus Russell 1000 Value Index June 30, 2005 – September 30, 2023



Source: FactSet

While this negative environment has clearly been challenging for Ariel Focused Value, we see a light at the end of this long tunnel. The one-year rise in the Consumer Price Index of 3.7% (through September) is down significantly from its recent 9.1% peak in June 2022. Higher rates from the Fed, combined with a significant slowdown in money supply growth, are working. While one cannot rule out a policy mistake, we believe we are at or near the end of rate hikes. When this becomes apparent to the market, we should see confidence build in the U.S. economy. An end to recession fears should boost value stocks.

Portfolio in Focus

The three companies adding the most to relative performance in the third quarter shared no common traits. By contrast, our three biggest detractors were all housing-related, negatively impacted by increasingly hawkish comments from the Fed and the prospect of “higher for longer” interest rates.

APA Corporation (APA) was our largest contributor, jumping +21.1%. The company benefited from rising oil prices as well as more information on its large South American oil discovery. The contract price for West Texas Intermediate Oil increased from below $70 to above $90 during the quarter. APA and its partner Total Energies announced a successful appraisal of approximately seven hundred million barrels of oil off the coast of Suriname.

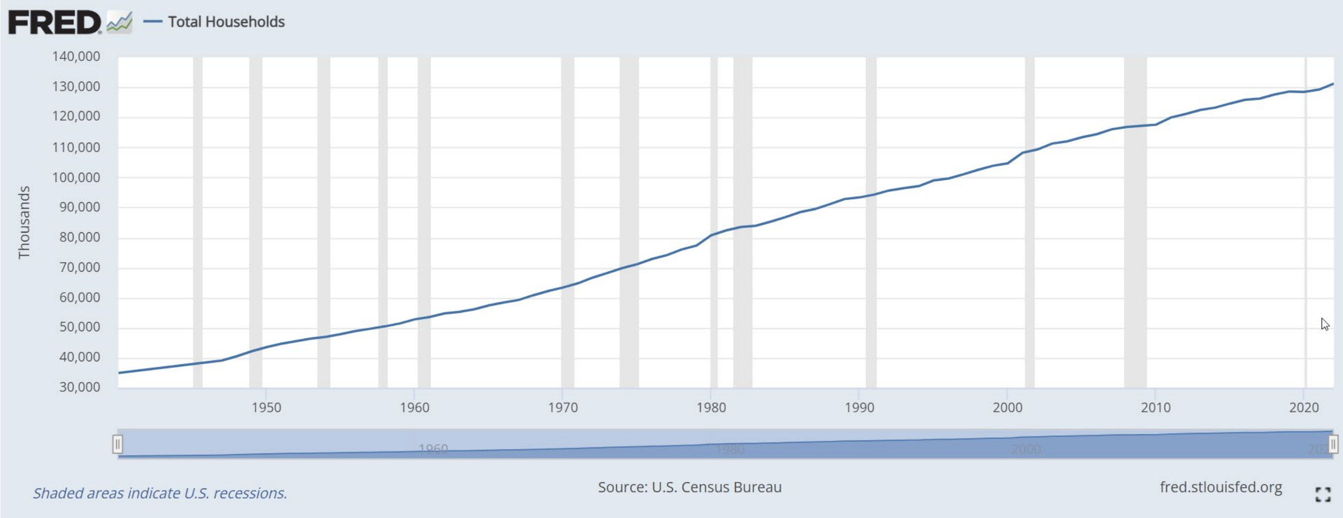
The Western Union Company (WU) was the second largest contributor, returning +14.4%. The company’s results were “better than feared,” as international events have reduced worker movement between countries, in turn reducing cross-border remittance payments. Despite the strong quarter, its shares are down this year. Trading at approximately 7x our estimate of forward earnings, Western Union is a poster child for the markets’ disdain for solid but slower-growing value stocks. We track sell-side ratings of our portfolio companies to measure market sentiment. Western Union has the second-worst rating in our portfolio, which we view as a contrary indicator.

The third-largest relative contributor was **The Goldman Sachs Group Inc. (GS)**. Of late, Goldman has received a great deal of negative attention for its failed Marcus consumer strategy and the disc-jockey pastime of its CEO. We believe this criticism masks the extraordinary value in the company's investment banking, trading and high net worth asset management businesses. As we go to press, Goldman's shares sell slightly below book value which means Wall Street is placing no value on the company's franchise, brand or relationships. From its founding in 1869 through its initial public offering in 1999, promotion to a Goldman Sachs partnership was one of the most prized achievements in all of finance. A partner could purchase Goldman's shares at book value. Today, all investors have an opportunity to buy Goldman's stock at an even better price. Against this backdrop, Goldman has become our third-largest position.

The three companies detracting most from our relative performance were all housing-related: **Leslie's Inc. (LESL)** in retail pool supply; **Mohawk Industries, Inc. (MHK)** in home flooring products; and **Generac Holdings Inc. (GNRC)** in residential standby power systems. Leslie's dropped -39.7% in the quarter, Mohawk lost -16.8%, and Generac fell -26.9%. As discussed above, the market was disappointed in the Fed's rate guidance, and no industry is more sensitive to changes in interest rates than housing.

This year's housing activity will indeed be suppressed by the rate environment, but longer term, the U.S. continues to suffer from a housing shortage. As seen in Chart 2 below, the number of U.S. households has grown steadily after a pandemic pause in 2020. Over time, growth in demand for housing has been consistent and predictable. With Leslie's, Mohawk, and Generac all trading at significant discounts to our calculation of their intrinsic value, we believe all could outperform when the Fed declares an end to interest rate hikes.

Chart 2: Total U.S. Households
1940-2022



Portfolio Comings and Goings

During 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 the 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.

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 populations age and disposable incomes rise, spending on healthcare should continue to grow.

Finally, we bought shares in premium fuel and electrical systems, **Phinia Inc. (PHIN)**, a spinoff from **BorgWarner Inc. (BWA)** focused on the design and development of performance and emissions components of combustion and hybrid vehicles.

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

As always, we appreciate the opportunity to serve you and welcome any questions or comments you might have.

Sincerely,

Charles K. Bobrinskoy

Charles K. Bobrinskoy
Vice Chairman

Investing in equity stocks is risky and subject to the volatility of the markets. Investing in small- and mid-cap companies is more risky and volatile than investing in large-cap companies. The intrinsic value of the stocks in which the portfolio invests may never be recognized by the broader market. A focused portfolio may be subject to greater volatility than a more diversified investment.

Past performance does not guarantee future results. Performance results are net of transaction costs and reflect the reinvestment of dividends and other earnings. Net performance of the Ariel Focused Value Composite has been reduced by the amount of the highest fee charged to any client in the Composite during the performance period. 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 Focused Value Composite differs from its benchmark with dramatically fewer holdings concentrated in fewer sectors.

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. Views and opinions are as of the date of this commentary and can change without notice. There is no guarantee that any expressed views will come to fruition or any investment will perform as described.

As of 9/30/23, the Ariel Focused Value Composite (representative portfolio) held the following positions referenced: APA Corporation 6.56%; Goldman Sachs Group, Inc. 5.94%; Western Union Company 4.01%; BorgWarner, Inc. 4.04%; Mohawk Industries, Inc. 3.90%; PHINIA, Inc. 3.03%; Generac Holdings, Inc. 2.02%; Leslie's, Inc. 1.88%; Chevron Corporation 1.37% and Kenvue, Inc. 0.91%. The 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 Focused Value Composite.

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. The Russell 1000 Growth Index measures the performance of the large-cap growth segment of the US equity universe. It includes those Russell 1000 companies with relatively higher price-to-book ratios, higher I/B/E/S forecast medium term growth and higher sales per share historical growth. The inception date of the Russell 1000® Growth Index 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 consent. Russell does not promote, sponsor or endorse the content of this communication.

The S&P 500® Index is widely regarded as the best gauge of large-cap U.S. equities. It includes 500 leading companies and covers approximately 80% of available U.S. market capitalization. Its inception date is March 4, 1957.

SLOW AND STEADY WINS THE RACE