

As of March 31, 2023



**Rupal J. Bhansali**  
Chief Investment Officer  
International & Global  
Equities

Performance (%)	Annualized						
	QTD	YTD	1-Year	3-Year	5-Year	10-Year	Since Inception
<b>Ariel International (DM)</b>							<b>12/31/2011</b>
<b>Gross of Fees</b>	<b>6.06</b>	<b>6.06</b>	<b>-4.11</b>	<b>7.77</b>	<b>2.15</b>	<b>5.40</b>	<b>5.82</b>
<b>Net of Fees</b>	<b>5.85</b>	<b>5.85</b>	<b>-4.87</b>	<b>6.91</b>	<b>1.34</b>	<b>4.56</b>	<b>4.95</b>
MSCI EAFE Net Index	8.47	8.47	-1.38	12.99	3.52	5.00	6.40
<b>Additional Indexes</b>							
MSCI EAFE Value Net Index	5.93	5.93	-0.31	14.59	1.75	3.75	5.15
<b>Ariel International (DM/EM)</b>							<b>12/31/2011</b>
<b>Gross of Fees</b>	<b>5.94</b>	<b>5.94</b>	<b>-3.53</b>	<b>9.30</b>	<b>2.88</b>	<b>5.91</b>	<b>6.37</b>
<b>Net of Fees</b>	<b>5.73</b>	<b>5.73</b>	<b>-4.29</b>	<b>8.43</b>	<b>2.06</b>	<b>5.05</b>	<b>5.49</b>
MSCI ACWI ex-US Net Index	6.87	6.87	-5.07	11.81	2.47	4.17	5.43
<b>Additional Indexes</b>							
MSCI ACWI ex-US Value Net Index	5.16	5.16	-4.00	13.83	1.26	3.06	4.32
<b>Ariel Global</b>							<b>12/31/2011</b>
<b>Gross of Fees</b>	<b>4.80</b>	<b>4.80</b>	<b>-0.86</b>	<b>12.49</b>	<b>6.50</b>	<b>8.46</b>	<b>9.17</b>
<b>Net of Fees</b>	<b>4.60</b>	<b>4.60</b>	<b>-1.65</b>	<b>11.59</b>	<b>5.65</b>	<b>7.58</b>	<b>8.26</b>
MSCI ACWI Net Index	7.31	7.31	-7.44	15.37	6.93	8.06	9.18
<b>Additional Indexes</b>							
MSCI ACWI Value Net Index	1.24	1.24	-5.50	15.25	4.27	5.89	7.17
<b>Ariel Global Concentrated</b>							<b>12/31/2019</b>
<b>Gross of Fees</b>	<b>6.64</b>	<b>6.64</b>	<b>0.48</b>	<b>10.71</b>	<b>-</b>	<b>-</b>	<b>5.57</b>
<b>Net of Fees</b>	<b>6.42</b>	<b>6.42</b>	<b>-0.32</b>	<b>9.83</b>	<b>-</b>	<b>-</b>	<b>4.73</b>
MSCI ACWI Net Index	7.31	7.31	-7.44	15.37	-	-	5.97
<b>Additional Indexes</b>							
MSCI ACWI Value Net Index	1.24	1.24	-5.50	15.25	-	-	3.43

This quarter was a disruptive period for the U.S. banking sector. On March 10, 2023, the Federal Deposit Insurance Corporation (FDIC) took over Silicon Valley Bank (SVB) due to a bank run triggered by a sell-off of long-duration assets. SVB's collapse was the second-largest failure of a financial institution in the nation's history. As a result, bank stocks across all market caps slid to multi-year and all-time lows. While the industry has not experienced this level of distress since 2008-2009, we do not believe we are on the verge of another Great Financial Crisis. The U.S. government's decision to increase regulation and guarantee regional bank deposits could have positive long-term effects. However, amid inflationary pressures, it could tighten financial conditions and induce a recession in the near term.

Our distinct focus on risk management aims to eliminate companies that assume outsized risks. We have avoided SVB, Signature Bank, and others with an asset-liability mismatch. In 2007, we witnessed a similar phenomenon called "the run on the Rock." British bank Northern Rock was a darling stock in its heyday. Northern Rock's meltdown was the first United Kingdom bank run in over 140 years, and, like SVB, investors were shocked when the company failed and requested the Bank of England's support. We rejected the company well before the debacle, believing the risks outweighed the rewards. Sixteen years later, we still apply the same approach. Unlike our peers, we do not screen on growth rates or multiples. We screen on risk—even if that means leaving money on the table. We target superior risk-adjusted returns, not high returns at any cost, and believe this distinction serves our clients well.

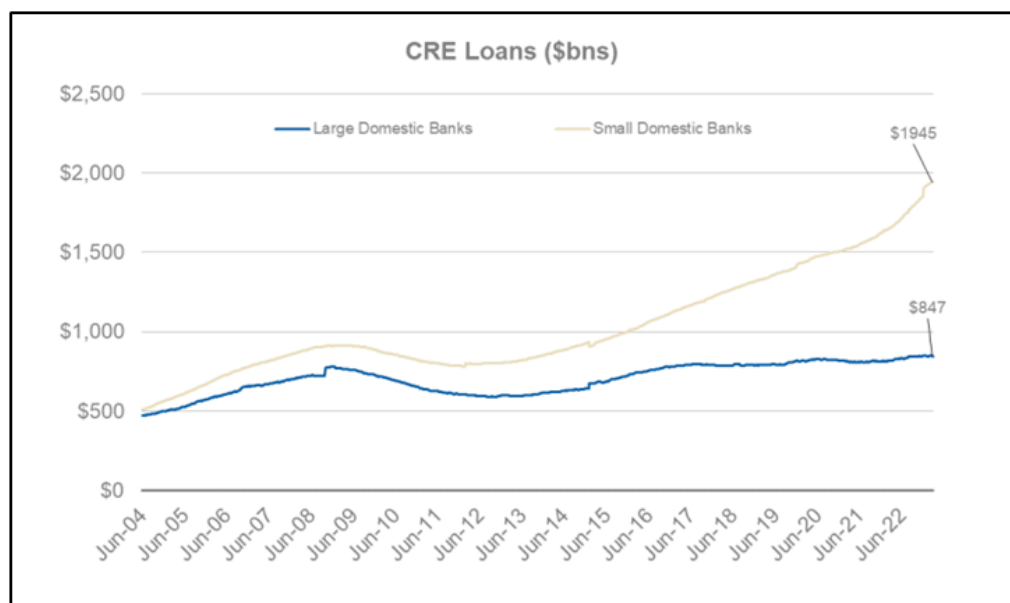
We are highly selective in our Financials exposure. We prefer to own **BNP Paribas**, **KBC Group**, and **U.S. Bancorp**, which we believe offer better profitability and higher capital ratios—albeit with lower growth than the SVBs of the world. In our view, large U.S. and European banks can weather the storm. When the European Union imposed strict capital requirements for all banks under a new regulatory construct called Basel III, they created a resilient system. Meanwhile, American financial institutions under \$250 billion in assets have been exempt from Basel III, making them more vulnerable. While interest rate hikes have stressed Financials, our main concern for small- and mid-size lenders is not deposit flight per se. In our view, the most significant risk is excessive exposure to commercial real estate.

### The Next Challenge for Regional Banks: Commercial Real Estate Loan Exposure

The pivot from in-person work to remote or hybrid has presented significant challenges for commercial real estate. While businesses have reopened at total capacity and the U.S. unemployment rate is at a five-decade low, commercial real estate investors are still grappling with the long-term consequences of virtual employment. The lessened demand for office space has led to vacancies in commercial buildings. In the fourth quarter of 2022, U.S. vacancy and total office availability rates reached 12.5% and 16%, respectively, which resemble the highs of the Great Financial Crisis. Twenty-four percent of the \$11 trillion commercial real estate market represents office space. The industry will likely be pressured should a recession ensue.

U.S. regional banks account for 68% of all commercial real estate loans, putting them at severe risk as loans mature and defaults spike. Over \$1.5 trillion in commercial real estate debt, financed when interest rates were near zero, will mature in the next three years. As property values fall and debt maturities unfold at higher rates, we expect a wave of defaults. Delinquency rates on office mortgages reached 2.4% in February 2023, an increase from 1.5% six months ago. In mid-February, multinational real estate giant Brookfield Corporation defaulted on two of the firm's most prominent skyscrapers in Los Angeles. As noted in Figure 1 on the next page, large banks—with more robust liquidity and regulation—have less loan exposure to commercial real estate than their smaller peers. The market calamity surrounding SVB's failure has subsided, yet the risks to the financial services industry still loom.

Figure 1: Commercial Real Estate Loans from Small U.S. Banks Exceed Large U.S. Banks<sup>1</sup>



As small domestic banks experience more headwinds, we expect local businesses to face challenges. Following SVB’s crash, approximately \$500 billion flowed out of small lenders and into money-market funds and big banks. Outflows and stricter regulatory guidelines could reduce their capacity to extend credit. Most small businesses rely on community banks or credit unions for financing, as these institutions often leverage soft knowledge of local market conditions to inform a loan decision. Large, highly regulated creditors have more barriers for borrowers than their smaller brethren. Nearly 94% of small firms use credit to cover their expenses, and 52% of that funding comes from community banks. These companies are the fuel of America’s economic engine. We believe more stress on regional banks might lead to a more difficult recession than the market expects.

### A Bright Spot in Emerging Market Banks

Amidst the recent financial services turmoil, emerging markets held up better than their Western peers. EM banks do not face the same mark-to-market fears in securities portfolios, as they distribute loans to individuals and corporates. Likewise, these local institutions have a structural advantage as their clients hold liquid assets such as deposits. The sizeable unbanked population in EM countries can create significant opportunities for growth. Deposits in developing nations tend to be sticky. Therefore, we do not anticipate similar balance sheet issues in these regions. Our EM Financial holdings declined due to macro rather than micro concerns. For instance, Peruvian bank **Credicorp** and Brazilian lender **Itau Bank** have conservative yet progressive management teams prioritizing technology to lower costs and increase revenues. Both companies have experienced a credit cycle but remain profitable and resilient despite high inflation and interest rates. Their stock price underperformance stands in contrast to their improving franchise position. We took advantage of recent market volatility and added to our positions.

### Outlook and Positioning

While we cannot predict the severity of a recession, our stress testing shows that consensus estimates are too optimistic and could disappoint in the coming quarters. We are overweight in recession-resilient sectors, such as Healthcare, Utilities, and Consumer Staples, and underweight in cyclical sectors, including Energy, Materials, and Industrials. We believe low debt and large dividends will be critical in delivering total returns to equity shareholders. As a result, we have positioned our portfolios accordingly.

Our international and global names are paying out more dividends than their peers. Our portfolios also have a lower debt/equity ratio and higher return on equity than their respective benchmarks. In our view, these fundamental characteristics should help reduce risk and preserve capital from adverse outcomes that may still lie ahead.

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

<sup>1</sup> Source: Federal Reserve, Morgan Stanley Research

Investments in foreign securities may underperform and may be more volatile than comparable U.S. stocks because of the risks involving foreign economies and markets, foreign political systems, foreign regulatory standards, and foreign 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. The intrinsic value of the stocks in which the portfolios invest may never be recognized by the broader market. The portfolios are often concentrated in fewer sectors than their benchmarks, and their 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 net of transaction costs and reflect the reinvestment of dividends and other earnings. Net performance of each Composite has been reduced by the amount of the highest fee charged to any client in each 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 International (DM) Composite differs from its benchmark, the MSCI EAFE Index, because: (i) the Composite has fewer holdings than the benchmark, (ii) the Composite will invest in Canada, and (iii) the Composite will at times invest a portion of its assets in the U.S. and emerging markets. 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 Ariel Global Composite differs from its benchmark, the MSCI ACWI (All Country World Index), because the Composite has fewer holdings than the benchmark. 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. 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 3/31/23, the Ariel International (DM) Composite (representative portfolio) held the following positions referenced: BNP Paribas 1.86%; Credicorp, Ltd. 1.13%; KBC Group 0.74% and Itau Unibanco Holding SA ADR 0.55%. As of 3/31/23, the Ariel International (DM/EM) Composite (representative portfolio) held the following positions referenced: Credicorp, Ltd. 3.70%; BNP Paribas 1.22%; Itau Unibanco Holding SA ADR 0.77% and KBC Group 0.59%. As of 3/31/23, the Ariel Global Composite (representative portfolio) held the following positions referenced: Credicorp 3.24%; BNP Paribas 1.10%; Itau Unibanco Holding SA 0.77%; KBC Group 0.30% and U.S. Bancorp 0.25%. As of 3/31/23, the Ariel Global Concentrated Composite (representative portfolio) held the following positions referenced: Credicorp, Ltd. 3.28% and Itau Unibanco Holding SA 0.55%. 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 Composites. Portfolio holdings mentioned do not represent all holdings purchased or sold for the Composites.

Investors cannot invest directly in an index. The MSCI EAFE® Index is an equity index of large and mid-cap representation across 21 Developed Markets (DM) countries around the world, excluding the U.S. and Canada. Its inception date is May 31, 1986. The MSCI EAFE Value Index captures large and mid-cap securities exhibiting overall value style characteristics across Developed Markets countries around the world, excluding the US and Canada. Its inception date is December 8, 1997. 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. 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.