Ariel investments

Ariel Emerging Markets Value and Emerging Markets Value ex-China Portfolio Manager Letter

As of September 30, 2023

Performance (%)

				Annualized			
	QTD	YTD	1-Year	3-Year	5-Year	10-Year	Since Inception
Ariel Emerging Markets Value							04/30/2023
Gross of Fees	**0.98**	-	-	-	-	-	**5.34**
Net of Fees	**0.74**	-	-	-	-	-	**4.92**
MSCI EM Net Index	-2.93	-	-	-	-	-	-0.93
MSCI EM Value Net Index	-0.78	-	-	-	-	-	1.32
Ariel Emerging Markets Value ex-China							05/31/2023
Gross of Fees	**1.01**	-	-	-	-	-	**7.12**
Net of Fees	**0.75**	-	-	-	-	-	**6.75**
MSCI EM ex-China Net Index	-3.33	-	-	-	-	-	0.27

Dear Clients and Friends: The third quarter of 2023 was challenging for global markets, but a wide dispersion of returns created lots of stock-picking opportunities. During the three-month period, the MSCI EM Index fell -2.93%, which was in line with the -3.27% drop in the S&P 500—partly reflecting pressure from higher global interest rates but also roiled by local dynamics.

- Still, elevated **inflation** and a stronger-than-expected **job market** drove interest rates up and share prices down in the U.S.
- The pullback in **tech stocks** after the artificial intelligence (AI) craze in the first half of the year weighed on the tech-heavy South Korean and Taiwanese markets.
- **China** underperformed as the pace of the post-pandemic recovery slowed, real estate concerns escalated, and very modest government stimulus measures fell short of market expectations.
- By contrast, **Indian and UAE stocks** benefited from strong economic growth, while the return of more conventional monetary policy buoyed the Turkish market.

The Ariel Emerging Markets Value Composite outperformed both the MSCI EM and S&P 500 Indices during the third quarter as our Korean banks, Taiwanese tech stocks, and ASEAN holdings boosted returns.[1] More specifically, Korean banks rallied as they delivered stronger-than-expected quarterly results while returning more capital to shareholders. Our position in **King Yuan Electronics**, a semiconductor testing company, benefited from a recovery in the semiconductor cycle as well as the company's business with AI market darling **Nvidia Corporation**. Our ASEAN names were helped by strong structural and cyclical tailwinds.

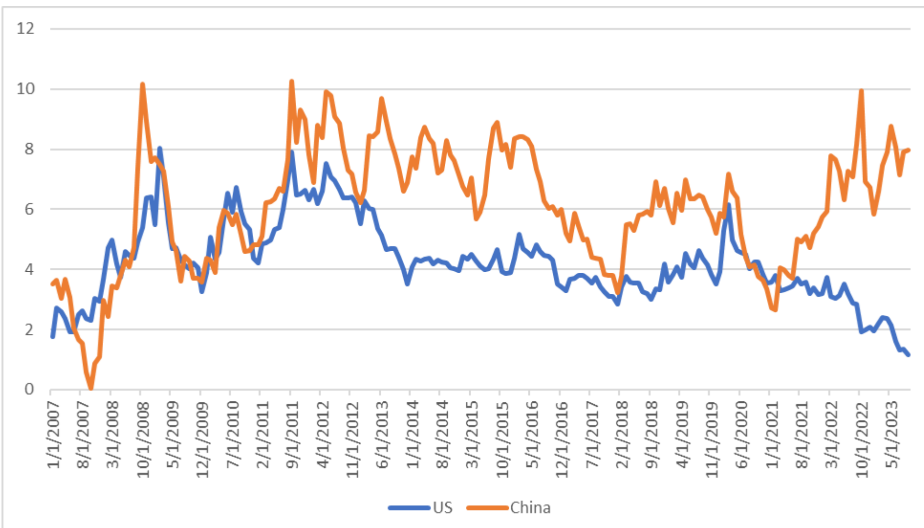
[1] *ASEAN is an intergovernmental organization of ten Southeast Asian Countries: Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Singapore, Thailand and Vietnam.*

Meanwhile, the leading auto dealer and importer of luxury and mid-to-high automobile brands in China, **Zhongsheng Group Holdings,** was our largest detractor this quarter. Pricing pressure amid competition from electric vehicles (EV) and softness in demand for new cars drove a decline in earnings. Despite these near-term headwinds, we believe Zhongsheng will continue to gain market share from fragmented independent dealers, particularly as used car penetration increases, a segment where dealer brand and reputation matter even more relative to the new car segment.

Attractive Valuation Is Not Enough, There Are Catalysts Developing

The 11.2x forward price/earnings multiple for the MSCI EM Index is a bargain compared to 17.9x for the S&P 500. Additionally, the EM benchmark earnings per share (EPS) are expected to grow 20% next year versus just 10% for the S&P 500. Concerns about China's economic outlook—a country which represents approximately 30% of the MSCI EM Index—are likely creating the EM discount. As depicted in the following chart, while today's U.S. equity risk premium is the lowest in a generation, China's equity risk premium is high, resulting in the widest China versus U.S. risk premium spread in the past 15 years.

Chart 1: China versus U.S. Equity Risk Premium[2]

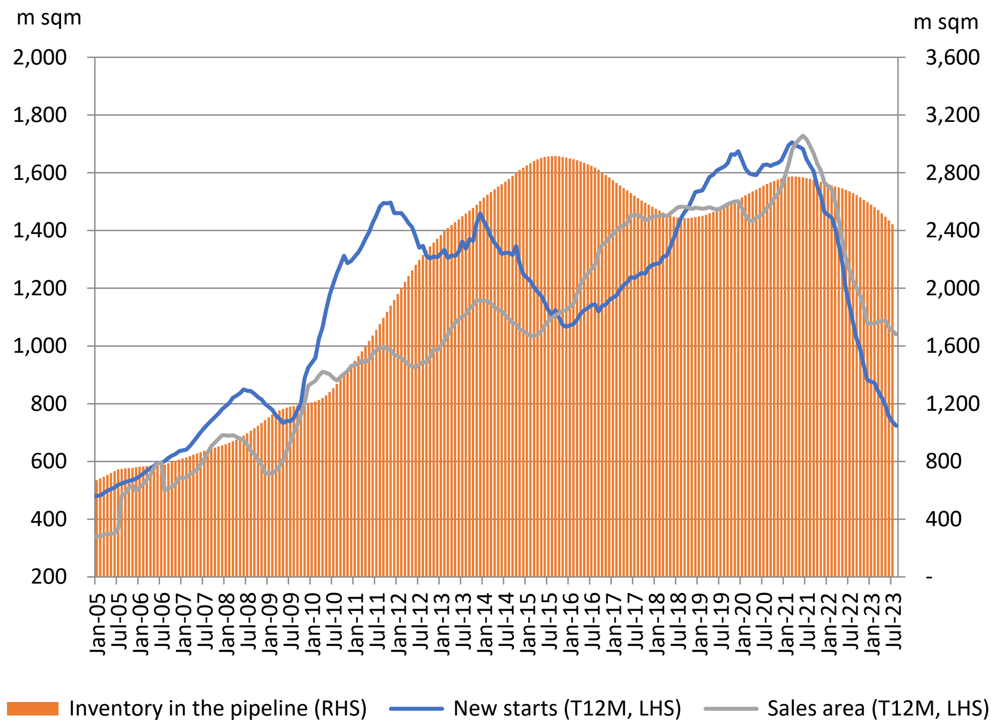


Source: Bloomberg. Ariel Investments analysis.

Investor concern over the China real estate slowdown has only elevated market anxiety. The silver lining in this dark cloud is a massive decline in Chinese new housing starts. More specifically, trailing 12-month starts are down to a level not seen since 2009. While home sales are also off their peak, they are now well above starts, which is pushing unsold inventory down. All of this suggests the worst of the Chinese housing bubble is well behind us, and the market is readjusting to a more sustainable, normalized activity level. Measures such as square meter ownership of residential real estate per capita remain high in China, particularly given its still low income level. At the same time, property growth will be lower going forward. Against this backdrop, we think investors are overestimating the extent of housing price declines from here. We believe the combination of already falling inventories and low loan-to-value ratios for mortgages (estimated at 50-55% per Credit Lyonnais Securities Asia) will lead Chinese housing prices to be more resilient than the market is currently anticipating.

[2] *Equity risk premium is calculated as forward earnings yields less 10-year sovereign bond yield in local currency.*

Chart 2: National new starts, sales area, and cumulative inventory



Source: UBS China Property Sector Database, September 2023

Geopolitics remains the other major China concern and might persist for some time. However, the wide China equity risk premium suggests a high level of uncertainty is already priced into its shares. While it may be in vogue to be bearish on China, it remains one of the fastest-growing economies in the world. Unlike most countries, its government can stimulate its economy. Meanwhile, a high 30%+ savings rate offers abundant consumer spending potential. As demonstrated by the U.S. market's multi-year rise from its March 2009 bottom, stocks begin to rally when news stops getting worse, ahead of an actual economic rebound. We believe China is approaching that inflection point.

Positioning and Outlook

We see a wide variety of opportunities for stock appreciation across countries and sectors. We believe our Chinese holdings can outperform even if it takes time for the country's equity risk premiums to decline. We expect market share gains and improved efficiency to propel strong earnings growth. Outside of China, many other attractive investments exist. Our research indicates considerable upside in Korean banks, memory-focused semiconductor manufacturers, and stocks across ASEAN countries and Brazil. We also see hidden value in Eastern Europe and the UAE that will be boosted by improving growth outlooks. These attractive prospects can be found in the Financials, Information Technology, Consumer Discretionary, Utilities, and Real Estate sectors.

At 7.9x forward earnings, 1.1x price-to-book, and with a 14.9% return on equity, we believe our current portfolio represents one of the most attractive of our careers. In our view, a 50% increase would still leave valuations at reasonable levels given expected profitability, robust growth, and strong balance sheets.

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

Sincerely,

Henry Mallari-D'Auria
Chief Investment Officer
Global and Emerging Markets Equities

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. 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 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.

As of 9/30/23, the Ariel Emerging Markets Value Composite (representative portfolio) held the following positions referenced: King Yuan Electronics Company, Ltd. 2.22% and Zhongsheng Group Holdings, Ltd. 0.63%. As of 9/30/23, the Ariel Emerging Markets Value ex-China Composite (representative portfolio) held the following position referenced: King Yuan Electronics Company, Ltd. 2.83%.

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 Emerging Markets Index captures large and mid cap representation across 24 Emerging Markets (EM) countries. With 1,377 constituents, the index coves approximately 85% of the free float-adjusted market capitalization in each country. Inception of this benchmark was January 1, 2001.

The MSCI Ariel Emerging Markets Value Index captures large and mid cap securities exhibiting overall value style characteristics across 24 Emerging Markets (EM) countries. The value investment style characteristics for index construction are defined using three variables: book value to price, 12-month forward earnings to price and dividend yield. Inception of this benchmark was December 8, 1997. MSCI Emerging Markets ex-China Index captures large and mid cap representation across 23 of the 24 Emerging Markets (EM) countries excluding China. Its inception date is March 9, 2017.

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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