Ariel Focused Value

As of June 30, 2023

Charles K. Bobrinskoy
Vice Chairman
Portfolio Manager

Performance (%)

				Annualized			
	QTD	YTD	1-Year	3-Year	5-Year	10-Year	Since Inception
Ariel Focused Value							03/31/2005
Gross of Fees	**2.25**	**2.88**	**6.33**	**13.49**	**6.00**	**8.02**	**6.92**
Net of Fees	**2.08**	**2.54**	**5.64**	**12.76**	**5.31**	**7.30**	**6.06**
Russell 1000® Value Index	4.07	5.12	11.54	14.31	8.11	9.22	7.53
S&P 500® Index	8.74	16.89	19.59	14.61	12.31	12.86	9.71

In the second quarter of 2023, US growth stocks significantly outperformed value shares. The Russell 1000 Growth Index surged +14.5% in the quarter versus +4.07% for the Russell 1000 Value Index. Year-to-date, the growth index also outperformed the value index by nearly +25%. Given our bias toward trading at low multiples of expected earnings, this massive performance disparity remained a headwind for Ariel Focused Value. The Ariel Focused Value Composite earned +2.25% gross of fees (+2.08% net of fees) in the second quarter versus +4.07% for the Russell 1000 Value Index and +8.74% for the S&P 500. Our emphasis on low PE stocks is core to our approach. We believe we are well positioned for a market nearing the end of focusing on Federal Reserve tightening and a possible Fed-induced recession.

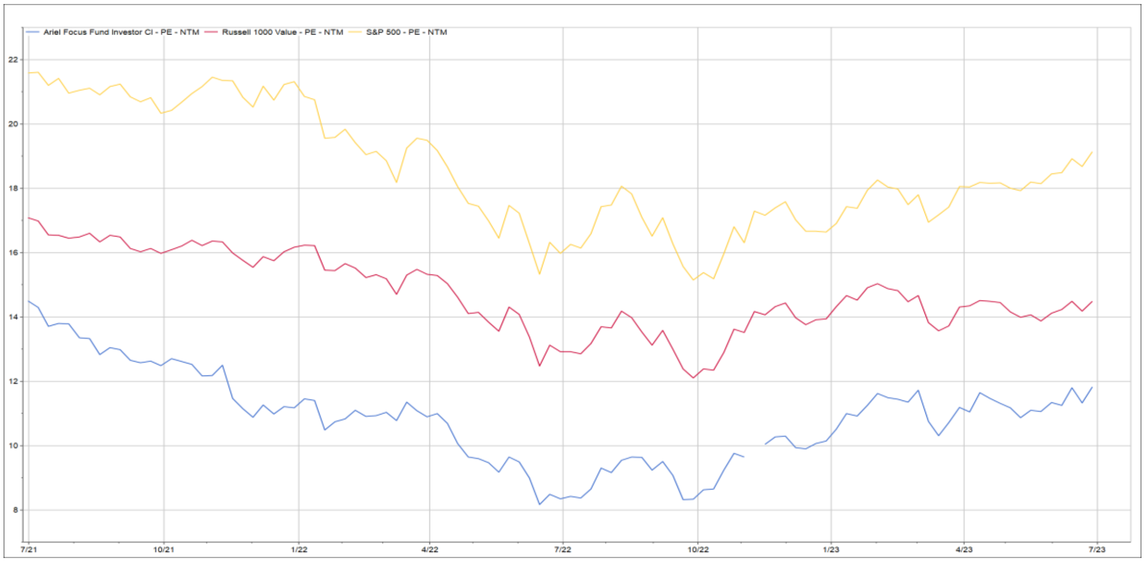
Value on the Horizon

Wall Street's confident prediction of an economic downturn has led participants to penalize companies deemed to be economically sensitive. At Ariel, we like to buy when others are selling. Currently, many industry-leading companies considered cyclical are trading at significant discounts to their intrinsic worth. By contrast, sectors considered non-cyclical such as Information Technology and Consumer Staples, are in vogue. As is often the case, the market is excessively focused on the short term and overconfident in its recession prediction. We believe the value of each of our holdings is the present value of its future cash flows into perpetuity. The next twelve months' earnings, which may or may not include a recession, often represent less than 15% of that value. As we go to press, the US Bureau of Labor Statistics announced inflation, as measured by the Consumer Price Index, dropped to 3.0%, less than a third of the recent high of 9.1%. More evidence shows we are nearing the end of Fed tightening and increasing the probability of an economic soft landing.

Figure 1 on the next page is a graph of the forward PE multiple of Ariel Focus Fund over the last two years compared to the Russell 1000 Value Index and the S&P 500. While the portfolio weights of Ariel Focus Fund are not identical to Ariel Focused Value, the companies owned are the same. Ariel Focused Value currently trades at a significantly lower multiple of projected earnings as compared to both the value index and the broad market. This relative relationship has been stable over the last several years. This emphasis on value stocks has been a near-term performance headwind, however we believe it leaves us well-positioned as the market begins to look past Fed tightening.

Figure 1: Price Earnings Multiples for Ariel Focus Fund vs. the Russell 1000 Value Index & S&P 500 Index

July 1, 2021 - June 30, 2023



Source: FactSet

Our Contributors and Detractors

During the second quarter, **Oracle Corporation (ORCL)**, **ZimVie Inc. (ZIMV),** and **Snap-On Inc. (SNA)** were our largest positive contributors to performance. The **Mosaic Company (MOS)**, **Northern Trust Corporation (NTRS)**, and **Barrick Gold Corporation (GOLD)** detracted the most. Oracle jumped +28.7% and became our third biggest position. Our large weighting in Oracle may come as a surprise, given our emphasis on value and wariness of some technology stocks. We have no bias against tech companies with growing earnings, particularly when they trade for low multiples of those earnings.

In October 2022, Oracle traded at 12 times forward earnings, which seemed shockingly low given its leadership position in the database software industry. Many software companies have grown sales by developing “cloud native” products online rather than “on-premise” on a customer’s server. Investors have been skeptical of Oracle’s ability to move its software business to the Cloud. Conventional wisdom argued that the company would not grow sales in the Cloud because customers would be reluctant to give up on-premise control of critical data (Oracle’s specialty) due to security concerns. In actuality, improvements have made data more secure when hosted by Oracle in the Cloud rather than on less sophisticated on-premise servers. In addition, Oracle has quietly developed web-hosting products. In the first quarter of 2023, Oracle’s Cloud services and license support segment grew +14% from the previous year and generated more than $8 billion in revenues, above street estimates. In addition, the market’s recent focus on investment opportunities in artificial intelligence (AI) may have also buoyed the company’s stock price. AI is fundamentally based on analyzing large amounts of data in search of patterns and solutions. Oracle’s leadership in data management software could offer advantages in the developing world of AI software. We should note that this later AI tailwind is highly speculative, and we will be watching closely for signs of unbridled optimism.

ZimVie Inc. surged +55.3% in the second quarter after a tough start to the year. Competitors in dental and orthopedic markets have reported an increase in elective procedures after years of Covid-related softness. ZimVie was created as a stand-alone spin-off from **Zimmer Biomet Holdings (ZBH)** in 2022, with Zimmer Biomet retaining a sizeable stake in the newly formed company. Unfortunately, Zimmer Biomet elected to sell their large position in late 2022, pressuring ZimVie’s share price. With this overhang now behind us, ZimVie has recovered somewhat but trades well below our calculation of its private market value.

Snap-On Inc. was our largest position at quarter end and our third largest contributor to performance in the second quarter, returning +17.4%. Snap-On is the leading manufacturer of tools, tool storage, and diagnostic equipment for the auto mechanic industry. Our research has shown that individual mechanics often take great pride in their collection of Snap-On tools housed in large bright red Snap-On tool storage units. Snap-On operates a proprietary distribution business based on product-carrying “vans” that visit mechanics at work rather than requiring customers to visit a store. These distributors provide financing to mechanics needing credit. Wall Street has historically been skeptical of the investment income from this finance business, which has translated into a lower trading multiple for Snap-On.

We believe Snap-On benefits from a series of tailwinds likely to last for years. A combination of less new car availability, plus better-built existing cars, has resulted in the prolonged life of automobiles on the road. These older, higher-mileage cars require more maintenance. The increasing complexity of new automobiles, particularly with the introduction of electric and hybrid vehicles, has also increased the average annual amount car owners spend on maintenance. Our conversations with dealers have shown investment in repair departments, with maintenance making up a larger share of total dealer revenues. All these trends can continue for years to come.

The Mosaic Company declined -23.2% in the quarter and was our largest performance detractor. Our investment in Mosaic is based on a series of long-term trends that support increasing demand for agricultural fertilizers. First, global populations will grow over the next several decades, particularly in the developing world. Second, diets will continue to improve and become more protein-based with higher consumption of cattle, hogs, and chicken, all large grain consumers. Third, climate change and population growth in the future will reduce arable land and put a premium on increasing yields on the remaining acreage. Mosaic's fertilizers increase crop yields with proven return on investment. Mosaic's phosphate and potash mines are predominately located in North America close to Kansas's wheat fields and Iowa's corn fields.

Mosaic was a strong contributor to performance in 2022, and we believe our investment thesis remains intact. However, we acknowledge that the company's stock price is highly volatile and subject to the vagaries of underlying commodity prices. In 2023, the US corn price dropped precipitately from over $6.80 per bushel in January to under $5 as we go to press. Corn prices have been pressured by the USDA's forecast of a record US corn crop of over 15.5 billion bushels. When crop prices are low, fertilizer demand drops as farmers' incentive to maximize yields per acre is reduced. It remains tough to gain permitting approval for new Potash and Phosphate mines in North America, and we believe Mosaic's competitive advantage is as strong as ever. While we remain confident in the long-term growth demand for Mosaic's products, we acknowledge that the business will remain volatile on a quarter-to-quarter basis.

Northern Trust Corporation's stock fell -15.0% in the quarter, in sympathy with a general decline in regional bank stocks after the collapse of Silicon Valley Bank and two other regional competitors. While there has been a tendency among some investors to downplay the impact of Silicon Valley Bank's failure, we take a more balanced view. Deposits remain the lowest cost of funding for almost any regional bank. All but the largest US banks have seen significant withdrawals in 2023. These withdrawals stem from concerns about future bank failures and the pursuit of higher yields. It is inherent to the banking business to borrow short and lend long. An inverted yield curve is fundamentally bad for bank earnings. Northern Trust is no exception to any of these effects.

In July 2022, the mean analyst estimate for Northern Trust 2023 earnings per share was $8.46. Today the mean estimate is $6.31, a nearly 25% decline. The bank's stock has fallen -22% over this year, demonstrating the market's tendency to anchor to short-term challenges. While acknowledging recent headwinds, we believe Northern Trust's world-class franchise remains intact, particularly its business of providing high-touch financial services to some of the wealthiest families.

Barrick Gold Corporation dropped -8.2% in the quarter despite the price of gold reaching $2,000 per ounce. Concerns about a global recession pressured copper prices, while signs of falling inflation may have made gold mining stocks less compelling. We must acknowledge disappointment in Barrick's inability to translate higher gold prices into better earnings. The recent inflationary environment, with many market participants looking for a haven from economic uncertainty, should have been well-suited to Barrick's business. Our investment thesis is currently under review.

We started this letter by acknowledging that our emphasis on value stocks has penalized recent performance. However, we feel we are much closer to the end of the Fed tightening cycle than the beginning. We also believe we are well-positioned for a market less focused on the risk of a near-term recession and more interested in a company's long-term earnings power.

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 6/30/23, the Ariel Focused Value Composite (representative portfolio) held the following positions referenced: : Snap-On, Inc. 6.45%; Oracle Corporation 5.84%; Mosaic Company 3.70%; Barrick Gold Corporation 3.31%; Northern Trust Corporation 3.22%; ZimVie, Inc. 2.61% and Zimmer Biomet Holdings, Inc. 1.09%. 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.