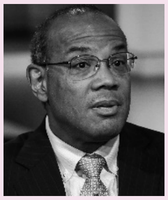
Ariel investments

Ariel Small, Small Concentrated, Small/Mid and Mid Cap Value

As of June 30, 2023



John W. Rogers, Jr.
Chairman & Co-CEO

Mellody Hobson
Co-CEO & President

Performance (%)

				Annualized			
	QTD	YTD	1-Year	3-Year	5-Year	10-Year	Since Inception
Ariel Small Cap Value Tax-Exempt							09/30/1983
Gross of Fees	**5.19**	**12.62**	**17.43**	**18.35**	**7.15**	**9.29**	**12.34**
Net of Fees	**4.93**	**12.06**	**16.27**	**17.18**	**6.09**	**8.20**	**11.22**
Russell 2000™ Value Index	3.18	2.50	6.01	15.44	3.54	7.29	10.03
Russell 2000™ Index	5.21	8.09	12.31	10.83	4.21	8.26	8.88
S&P 500® Index	8.74	16.89	19.59	14.61	12.31	12.86	11.19
Ariel Small Cap Value Concentrated							04/30/2020
Gross of Fees	**7.40**	**14.88**	**17.83**	**16.85**	**-**	**-**	**18.05**
Net of Fees	**7.13**	**14.31**	**16.66**	**15.70**	**-**	**-**	**16.88**
Russell 2000™ Value Index	3.18	2.50	6.01	15.44	-	-	16.64
Russell 2000™ Index	5.21	8.09	12.31	10.83	-	-	13.69
S&P 500® Index	8.74	16.89	19.59	14.61	-	-	16.19
Ariel Small/Mid Cap Value							12/31/2000
Gross of Fees	**3.53**	**10.97**	**15.61**	**17.38**	**7.47**	**10.34**	**9.24**
Net of Fees	**3.27**	**10.42**	**14.47**	**16.22**	**6.40**	**9.25**	**8.16**
Russell 2500™ Value Index	4.37	5.83	10.37	16.09	5.32	8.02	8.68
Russell 2500™ Index	5.22	8.79	13.58	12.30	6.55	9.38	8.59
S&P 500® Index	8.74	16.89	19.59	14.61	12.31	12.86	7.61
Ariel Mid Cap Value							03/31/1990
Gross of Fees	**5.37**	**7.50**	**16.98**	**16.44**	**7.43**	**9.22**	**11.22**
Net of Fees	**5.11**	**6.97**	**15.83**	**15.29**	**6.37**	**8.13**	**10.12**
Russell Midcap® Value Index	3.86	5.23	10.50	15.05	6.84	9.03	10.96
Russell Midcap® Index	4.76	9.01	14.92	12.51	8.46	10.33	11.10
S&P 500® Index	8.74	16.89	19.59	14.61	12.31	12.86	10.29

Last year at this time, the stock market was in free fall. In our second quarter 2022 letter, we wrote, "Like the wildfires sparked by the record-breaking summer heat, the market has been engulfed in its own flames both in the U.S. and abroad." As these "flames" consumed share prices, a bear market was born. Large-cap stocks, as measured by the S&P 500 Index, fell -19.96% for the first six months of 2022, with small and midcap indices down even more. This was the worst first half since 1970.[1] Runaway inflation, post-Covid supply chain bottlenecks and an unexpected Russian war fueled the market mayhem. Aggressive central bankers fixated on subduing inflation with higher interest rates led many to believe a recession was all but guaranteed.

What a difference a year makes.

Twelve months later, the S&P 500 is *up* +19.59% year-to-date, a dramatic turn that has largely defied Wall Street expectations. As *The New York Times International Edition* recently remarked, "The American recession was supposed to have begun by now. But the year is half over, and the recession is nowhere to be found." Although inflation has cooled and is currently hovering at 3%—down from 9.1% last June—it remains above the Federal Reserve's 2% annual target, making a victory lap premature. And yet, the prospect of a deep recession—otherwise known as a "hard landing"—is looking less and less likely. According to the *Times*, "Not, certainly, in the job market, as the unemployment rate at 3.6 percent is hovering near a five-decade low. Not in consumer spending or corporate profits. Not even in the housing market, the industry usually the most sensitive to rising interest rates."[2]

A year ago, our small and mid cap portfolios fell more or less in line with the broad market. Although we hate losing money, we were emboldened by the bargains at hand and said so, writing, "Values are abundant when the investment environment feels the most uncomfortable . . ." Our portfolios were selling at historic lows—not far from the extreme discounts we experienced during the '08-09 financial crisis or the market's precipitous Covid drop. As such, we underscored, ". . . with 39 years of experience, we are trained and battle-tested for these moments." Against that backdrop, we affirmed our time-tested belief that ". . . bear markets and oversold stocks create ripe buying opportunities for long-term, patient investors." So, we bought.

There is a well-known adage that the "market climbs a wall of worry." With worries in abundance, the market has since ascended to unexpected heights. While anything can happen in the world of investing, we are not surprised by the strength of our rebound over the year. To that point, last June, we emphasized, "portfolio dislocations of this magnitude have often served as a prelude to our most robust recoveries . . ."[3]

Cluster of Bargains—Then

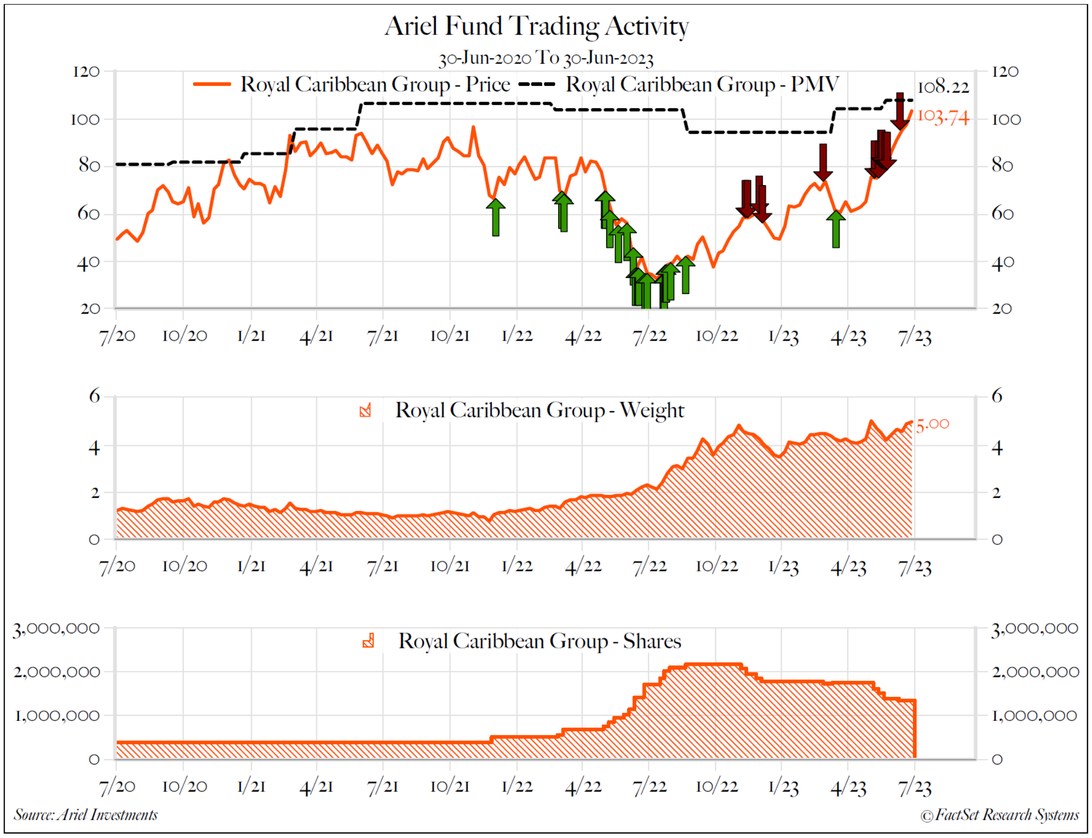
Our biggest winners have been our most contrarian names. Our confidence in doubling down on these holdings—"shopping in our closet"—as we said at the time, was born out of patience, courage and deep expertise. While we could not know when any of our most scorned holdings might turn, we never wavered in our belief that share prices follow fundamentals and the underlying fundamentals of our portfolio companies were—and continue to be—compelling. The question was *when*, not *if*.

Such was the case for one of the most derided areas of the market—a small group of once popular companies with a Covid-ravaged public image—cruise lines. According to *The New York Times*, "At midyear, three of the big cruise companies—Carnival Corporation (CCL), **Royal Caribbean Group (RCL)** and **Norwegian Cruise Line Holdings Ltd (NCLH)—**were among the top 10 stocks in the S&P 500."[4] While we have owned all three of these names in the past, we currently hold Royal Caribbean Group and Norwegian Cruise Line Holdings in our various domestic equity portfolios. Given the rally in their share prices this year with Royal surging +109.9% and Norwegian up +77.9% through June 30th, some might find it hard to believe that three years ago, with no ships at sea, the cruise lines were left to navigate in a near zero-revenue environment. Their share prices were a wreck with Royal off -44% and Norwegian down -56% in the pandemic year. The laws of physics say, "For every action there is an equal and opposite reaction."

These days, the vacation and leisure spaces are booming in direct response to the isolating Covid lock downs. For many, memories have more value than goods. As a result, cruise operators are posting record revenues and bookings as cruising is seen as "a high-value alternative to land travel" for retirees and younger people alike.[5] With their big share price moves of late, Wall Street has begun to recognize improvements in the business without yet fully realizing the record levels of profitability that remain a few years out.

[1] Nicholas Jasinski, "Stocks Had a Nasty 6 Months. The Second Half Could Be Ugly Too," *Barron's.com,* July 1, 2022.
[2] Ben Casselman and Jeanna Smialek, "The U.S. now appears less likely," *New York Times International Edition,* July 21, 2023, Page 7.
[3] John W. Rogers, Jr. and Mellody Hobson, *The Patient Investor,* June 30, 2022, Page 5.
[4] Jeff Sommer, "Curse of the pandemic ebbs," *The New York Times,* July 10, 2023, Page 8.
[5] Ceylan Yeginsu, "Younger People See Cruises as a Less Costly Travel Option," *The New York Times*, July 24, 2023, Page B2.

The chart below offers an excellent depiction of our flagship Ariel Fund's trading in Royal Caribbean shares leading into and out of the pandemic. The green arrows illustrate our enthusiasm for buying the name as the stock was bottoming last year. By contrast, as the stock rebounded, we lightened up to manage our position size.



Cluster of Bargains—Now

As natural contrarians, we get excited when whole areas of the market are written off because there are often "good stocks in bad neighborhoods." In a higher interest rate environment, widespread disdain for real estate and real estate-related companies is today's "bad neighborhood"—pun intended—offering a bevy of investment opportunities. A recent *BusinessWeek* cover on the commercial real estate sector with the ominous title "SCARY" serves as a case in point—reminding us of the famous 1979 "Death of Equities" cover that coincided with one of the strongest bull markets in stock market history.

As we sift through the current ashes, many names are getting our attention. One that stands out is **Leslie's Inc. (LESL)**, the leading direct-to-consumer U.S. pool and spa care services company. The company went public as the pandemic was hitting in 2020. We like the recurring nature of the business. All pools require long-term cleaning and maintenance—without both, a pool cannot be used and may even need to be replaced over time. Leslie's has increased revenues every year for 59 years in a $15 billion market that continues to grow annually. The company has 5 million users on its platform and operates within 15 minutes of most pools in the United States. This proximity is convenient when homeowners and/or professionals need to load up on product. It also offers a real competitive advantage since some hazardous cleaning chemicals cannot be easily shipped through normal channels. In addition to record summer temperatures driving pool usage, pools also burn through chemicals at a much faster rate when it is hot, requiring more maintenance. After management cut guidance two week ago, shares are trading 60% lower—offering a compelling price point to add to our position on weakness.

Looking Ahead

As the market swings from one scenario to another, our sole consideration of recent events and macroeconomic developments is to consider their effect on the long-term intrinsic worth of our investments over the next five-to-ten years. As we look to the future, higher interest rates will likely present headwinds to corporate earnings growth and dampen the capital return on business investments. Owning high-quality companies with sustainable business models, low debt and robust balance sheets will deliver stronger returns over the long run.

Comings and Goings

During the second quarter, we initiated a new position in alternative asset manager, **Carlyle Group Inc. (CG)** in our small cap and mid cap portfolios. The company's notable 35-year track record, diversified product line and long-tenured client relationships across five continents distinguish it from its private equity peers. In our view, its recent portfolio underperformance presents a unique opportunity to acquire shares of a highly scalable business with attractive fundamentals and healthy fundraising momentum.

In April, **Madison Square Garden Entertainment Corp. (MSGE)** completed its spin-off from **Sphere Entertainment Co. (SPHR)** and we continue to hold both names in our small, small/mid and mid cap portfolios. We like MSGE's unique entertainment assets and are eagerly awaiting the opening of the Sphere as a first-of-its-kind entertainment venue in Las Vegas. We continue to hold MSGE in our small cap concentrated portfolios but parted ways with the newly public SPHR. With such a concentrated 20-stock portfolio, we must be highly selective amongst even our favorite names.

Meanwhile, in our small/mid cap strategy, we acquired shares of Leslie's for the reasons already detailed. In our mid cap portfolio, we re-initiated a position in **Paramount Global (PARA)**, a former name currently held in other Ariel strategies. The stock fell hard following a lackluster earnings report and subsequent dividend cut, presenting a compelling entry point in this leading entertainment company. In our view, Paramount's long-term opportunity in streaming joined with the value of its proprietary content remain meaningfully underappreciated at current trading levels.

During the quarter, we did not eliminate any positions in our small cap strategy. In our small/mid cap strategy, we successfully sold **Bio-Rad Laboratories Inc. (BIO)** on valuation. We also exited pharmaceutical and medical products distributor **Cardinal Health, Inc. (CAH)**, from our mid cap portfolios as its shares approached our private market value estimate.

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

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 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. A concentrated portfolio may be subject to greater volatility than a more diversified portfolio. 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. Fee information 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. Any extraordinary performance shown for short-term periods may not be sustainable and is not representative of the performance over longer periods. Ariel's small, small concentrated, small/mid and mid cap portfolios differ from their primary benchmarks with fewer holdings and more concentration in fewer sectors. Effective August 1, 2010, the Ariel Mid Cap Value Composite was redefined to exclude pooled funds due to differences in performance calculation methods. 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 Small Cap Value Composite (representative portfolio) held the following positions referenced: Norwegian Cruise Line Holdings, Ltd. 4.72%; Leslie's, Inc. 2.89%; Madison Square Garden Entertainment Corporation 2.09%; Carlyle Group, Inc. 1.84% and Sphere Entertainment Company 1.71%. As of 6/30/23, the Ariel Small Cap Value Concentrated Composite (representative portfolio) held the following positions referenced: Norwegian Cruise Line Holdings, Ltd. 9.89%; Leslie's, Inc. 4.22% and Madison Square Garden Entertainment Corporation 3.90%. As of 6/30/23, the Ariel Small/Mid Cap Value Composite (representative portfolio) held the following positions referenced: Royal Caribbean Cruises, Ltd. 5.04%; Paramount Global, Class B 3.49%; Carlyle Group, Inc. 3.42%; Madison Square Garden Entertainment Corporation 3.39%; Sphere Entertainment Company 2.35% and Leslies, Inc. 0.84%.

As of 6/30/23, the Ariel Mid Cap Value Composite (representative portfolio) held the following positions referenced: Madison Square Garden Entertainment Corporation 1.56%; Carlyle Group, Inc. 1.45%; Paramount Global Class B 1.24% and Sphere Entertainment Company 0.92%. 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. The Portfolio holdings mentioned do not represent all holdings purchased or sold for the Composites.

Index returns reflect the reinvestment of income and other earnings. Indexes are unmanaged, and investors cannot invest directly in an index. The Russell 2000® Value Index measures the performance of the small-cap value segment of the U.S. equity universe. It includes those Russell 2000 companies with lower price-to-book ratios, lower forecast growth and lower sales per share historical growth. Its inception date is June 1, 1993. The Russell 2000® Index measures the performance of the small-cap segment of the U.S. equity universe. The Russell 2000 Index is a subset of the Russell 3000® Index representing approximately 10% of the total market capitalization of that index. It includes approximately 2,000 of the smallest securities based on a combination of their market cap and current index membership. Its inception date is January 1, 1984.

The Russell 2500™ Value Index measures the performance of the small to mid-cap value segment of the U.S. equity universe. It includes those Russell 2500 companies with relatively lower price-to-book ratios, lower forecasted growth values and lower sales per share historical growth. Its inception date is July 1, 1995. The Russell 2500™ Index measures the performance of the small to mid-cap segment of the U.S. equity universe, commonly referred to as "smid" cap. The Russell 2500 Index is a subset of the Russell 3000® Index. It includes approximately 2500 of the smallest securities based on a combination of their market cap and current index membership. Its inception date is June 1, 1990. The Russell Midcap® Value Index measures the performance of the mid-cap value segment of the U.S. equity universe. It includes those Russell Midcap Index companies with lower price-to-book ratios, lower forecasted growth values and lower sales per share historical growth. Its inception date is February 1, 1995. The Russell Midcap® Index measures the performance of the mid-cap segment of the U.S. equity universe. The Russell Midcap Index is a subset of the Russell 1000® Index. It includes approximately 800 of the smallest securities based on a combination of their market cap and current index membership. Its inception date is November 1, 1991.

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.