Ariel investments

Quarterly Commentary

Ariel Small Cap Value

Quarter Ended December 31, 2023

Markets worldwide defied expectations in 2023 led by the dominating performance of mega-cap technology stocks known as the "magnificent seven.[1]" Even though gains have been concentrated, improving inflation data and dovish comments from the Federal Reserve drove a fourth quarter rally and strong finish to the year. Investor sentiment has shifted from fears of a recession towards optimism for a soft landing. Such turns in market psychology and economic forecasts continue to highlight the challenges of market timing and the importance of taking a long-term view. Although uncertainty and volatility are likely to remain elevated, the patient investor knows "stock prices trade on fundamentals. And when those solid fundamentals shine through, share prices rise.[2]" Against this backdrop, The Ariel Small Cap Value Tax-Exempt Composite increased +13.24% gross of fees (+12.96% net of fees) in the quarter, trailing the returns posted by the Russell 2000 Value Index and the Russell 2000 Index of +15.26% and +14.03%, respectively. Over the trailing one-year period, the Ariel Small Cap Value Tax-Exempt Composite advanced +17.93% gross of fees (+16.76% net of fees), outperforming both the Russell 2000 Value Index and the Russell 2000 Index, which posted gains of +14.65% and +16.93%, respectively.

Shares of luxury adventure travel services company, **Lindblad Expeditions Holdings, Inc. (LIND)**, traded higher in the quarter following a significant bottom-line beat and positive free cash flow generation. Future travel reservations continue to be strong with the company increasing its prices heading into the new year. Although more expensive fuel prices and an uptick in discounting from certain competitors may present short-term headwinds, cancellation rates are slowly improving and should result in higher cruise occupancy. LIND also recently completed its marketing and technology infrastructure upgrades and will enter 2024 with a new website, client relationship management platform and reservation system, which should enable LIND to more effectively target customers. Longer-term, we expect LIND's fundamentals and the extension of its strategic relationship with National Geographic through 2040 will pave the way for multiple expansion as the company extends its market share in the expedition tourism niche. At today's valuation, we believe LIND's risk/reward is skewed sharply to the upside.

Wellness provider onboard cruise ships and destination resorts, **OneSpaWorld Holdings Ltd. (OSW)** was another top contributor in the period, driven by its third consecutive earnings beat and subsequent raise in full year guidance. Looking ahead, we expect OSW's spa services to continue to be met with high demand and spend levels, particularly as OSW continues to launch new higher value spa services and occupancy rates increase over time. Meanwhile, management continues to pay down debt and return capital to shareholders through buybacks. At current levels, we see the risk/reward skewed sharply to the upside.

Shares of real estate expert, **Jones Lang LaSalle (JLL)**, also traded higher during the quarter on solid earnings results. Despite a slowdown in transaction and leasing activity due to higher long-term interest rates, the Property Management and Work Dynamics businesses delivered strong fee revenues and the business continues to prudently manage expenditures. Additionally, management highlighted a positive revenue outlook for 2024 and reiterated its 2025 financial targets. Despite the recent macro-uncertainty, company leadership is highly confident about the medium- and longer-term revenue outlook for both transactional and recurring revenue streams, alongside its efforts to streamline operations and increase efficiencies to generate higher profit over time.

Alternatively, shares of oil services company, **Core Laboratories, Inc. (CLB)**, declined in the period on mixed earnings results. Despite contract delays and lower-than-expected activity in the U.S., CLB maintained solid profitability, delivering operating margin expansion. Although

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[1] The "Magnificent Seven" are the largest stocks in the S&P 500 Index driving market performance: Apple Inc. (AAPL), Amazon.com, Inc. (AMZN), Alphabet Inc. (GOOGL), Meta Platforms Inc. (META), Microsoft Corp. (MSFT), NVIDIA Corp. (NVDA) and Tesla, Inc. (TSLA).

[2] Hobson, Mellody and John W. Rogers Jr. "What the Stock market Taught Us This Year: Don't Fall for These Investing Traps." *Wall Street Journal*, 5 December 2023. https://www.wsj.com/finance/investing/stock-market-2023-lessons-investing-2cedd44f

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the ongoing geopolitical conflict between Russia and Ukraine, as well as associated European and U.S. sanctions, continue to disrupt the business and create near-term uncertainty, CLB is seeing progress in both onshore and offshore activity across its global operations. We have conviction in the management team's long history of delivering strong operating results, robust free cash flow and returning capital to shareholders.

Toy manufacturer, **Mattel, Inc. (MAT)**, also traded lower in the period. Despite delivering a significant earnings beat, management maintained full-year guidance signaling a lighter-than-expected holiday outlook to investors. Nonetheless, we continue to expect MAT will gain share, improve profitability and generate higher levels of cash flow in this weaker retail environment. In our view, MAT remains an undervalued company with resilient consumer demand for toys such as Barbie, Hot Wheels and Disney Princesses, as well as an attractive opportunity for future film and TV projects.

Lastly, leading global dental manufacturing company**, Envista Holdings Corp. (NVST)**, declined on disappointing earnings results. Challenges with sanctions in Russia and China due to volume-based procurement (VBP) reimbursement, as well as a weakening environment in North America for large dental equipment and implants resulted in management reducing its sales and profitability guidance for the year. While shares may be range bound for the next couple of quarters as NVST works through these headwinds and invests in future growth, we think NVST has multiple opportunities to drive upside over the long-term. We believe NVST will benefit from its rich research and development pipeline, several new products in high-growth dental segments, successful execution from recent M&A, facility consolidation and previous IT investments. We anticipate a re-rating of the stock and multiple expansion relative to peers.

We did not initiate any new positions in the quarter, however we did exit asset manager, **Janus Henderson Group PLC (JHG)** to deploy the cash into higher conviction opportunities.

As the pendulum of worry swings from one scenario to another, our focus on recent headlines and macroeconomic developments is to consider their effect on the long-term intrinsic worth of our holdings over the next five-to-ten years. As rates begin to subside in 2024 and beyond, we believe the gap between mega-cap stocks and their small to mid-cap counterparts will begin to narrow, fortified by consumer confidence, wages that are not likely to go down, as well as slowing, yet steady long-term economic growth. Despite the continued concentration of the U.S. equity market, our 41 years of patient investing spanning five market cycles–the crash of 1987, the dot-com era, the global financial crisis, the U.S. debt downgrade and the Covid plunge–have taught us the fundamental principles of investing are resilient. We believe the disciplined investor that stays the course and consistently owns differentiated, quality business models with robust balance sheets will outperform in the long run.

Investing in small-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. The portfolio is often concentrated in fewer sectors than its benchmarks, and its 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 shown net of the highest management fee charged to any client in the Composite during the performance period. Net returns reflect performance returns after the deduction of advisory fees and transaction costs and assume the reinvestment of dividends and other earnings. For the period ended 12/31/23 the performance (net of fees) for the Ariel Small Cap Value Tax-Exempt Composite for the 1-, 5-, and 10-year periods was +16.75%, +11.29%, and +6.53%, respectively. For the period ended 12/31/23 the performance for the Russell 2000 Value Index and the Russell 2000 Index for the 1-, 5-, and 10-year periods was +14.65%, +10.00%, and +6.76, and +16.93%, +9.97%, and +7.16%, respectively. 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 Small Cap Value Tax-Exempt Composite differs from its primary benchmark in that it has fewer holdings and more concentration 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. There is no guarantee that any of the views expressed will come to fruition or any investment will perform as described.

As of 12/31/23, Lindblad Expeditions Holdings, Inc. constituted 5.1% of the Ariel Small Cap Value Tax-Exempt Composite (representative portfolio); OneSpaWorld Holdings, Ltd. 5.8%; Jones Lang LaSalle, Inc. 3.4%; Core Laboratories, Inc. 2.3%; Mattel, Inc. 3.5%; Envista Holdings Corporation 1.6%; and Janus Henderson Group PLC 0.0%. 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 Small Cap Value Tax-Exempt Composite.

A glossary of financial terms provided herein may be found on our website at www.arielinvestments.com.

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. 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.

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