

Ariel Focused Value

Quarter Ended March 31, 2024

U.S. indices continued to exceed expectations in the first quarter. Investor enthusiasm around artificial intelligence (AI), resilient corporate earnings growth, falling inflation and expectations for interest rate cuts this year drove a broad-based rally. While momentum was the largest driver of performance across size and style, all sectors in the S&P 500, except real estate, posted gains. Fears of a recession have been replaced with optimism and bullish market sentiment. Such turns in market psychology and economic forecasts highlight the challenges of market timing and the importance of taking a long-term view. Although exuberance, particularly for AI-themed mega-cap stocks may eventually prove to be excessive, the patient investor knows stock prices trade on fundamentals. Against this backdrop, the Ariel Focused Value Composite earned +7.52% gross of fees (+7.35% net of fees) in the quarter, underperforming both the Russell 1000 Value Index and the S&P 500 Index, which returned +8.99% and +10.56%, respectively.

Manufacturer and distributor of floorcovering products, **Mohawk Industries Inc. (MHK)** advanced during the quarter. Although consumer demand and pricing remains muted due to a challenging macro backdrop, cost savings and productivity initiatives, along with lower input costs more than offset these difficulties. In our view, MHK's healthy balance sheet and success managing through economic cycles position the company to benefit from long-term growth in residential remodeling, new home construction and commercial projects. At current levels, MHK is trading at compelling discount to our estimate of private market value.

Manufacturer of premium fuel and electrical systems, **Phinia Inc. (PHIN)** also traded up in the period on solid earnings results and a positive full year 2024 outlook. Healthy consumer pricing, new business wins across all end markets, ongoing weakness in electric vehicles, growth in light vehicle original equipment and strong cost controls, more than offset disappointing commercial vehicle sales in China. Meanwhile, management continues to prioritize capital returns to shareholders via buybacks and dividends. Looking ahead, we expect PHIN to deliver sustainable, profitable growth and significant cash generation as it captures operational efficiencies, exits agreements with its former parent company BorgWarner Inc. and also expands its industrial and aftermarket customer base.

Additionally, supplier of residential thermal, comfort and security solutions, **Resideo Technologies, Inc. (REZI)**

advanced following a top- and bottom-line quarterly earnings beat. Despite a challenging macro environment and slower turnover in the housing market, stabilizing order rates and gross margin expansion aided share price appreciation. Additionally, management continues to return capital to shareholders through buybacks. In our view, the company's best-in-class brand and vast distribution network create a narrow moat around the business resulting in high market share across its product portfolio. We believe REZI's earnings potential is underappreciated and will be driven by a secular preference for more connected smart home solutions.

Alternatively, several positions weighed on performance. Oil and natural gas explorer, **APA Corporation (APA)**, declined in the quarter following an earnings miss. Weaker than expected production guidance and an upcoming increase in capital investment weighed on investor sentiment. Additionally, the company's pending acquisition of Callon Petroleum Company, which stands to enhance the scale of APA's existing Delaware Basin assets and appears accretive to key financial metrics in late 2024 and beyond, is still being digested by investors. Nonetheless, APA continues to deliver strong well performance in the Permian Basin and express confidence in its Suriname development, as it continues to work with TotalEnergies to complete a plan for the oil hub. Management remains focused on free cash flow generation and returning capital to shareholders.

Shares of producer and marketer of crop nutrients, **Mosaic Co. (MOS)**, also fell in the period, as weaker than expected phosphates and fertilizer volumes as well as higher raw material and production costs weighed on the bottom-line. Management reiterated expectations for tight global grain and oilseed markets in 2024 and believe growers will continue to be incentivized to maximize yields by applying fertilizers. Meanwhile, MOS is focused on cost discipline, free cash flow generation and paying down debt, while continuing to return significant capital to shareholders through buybacks. Given management's disciplined approach towards capital allocation, we continue to believe the company is well positioned from a risk/reward standpoint.

Lastly, gold mining company, **Barrick Gold Corporation (GOLD)** traded lower in the period. Although GOLD delivered in-line earnings results, as higher prices offset lower gold and copper volumes as well as increased costs, investors were disappointed with management's outlook for full year 2024. GOLD guided to flat production year-over-year driven



by lower-than-expected output due to a delayed permit at the Nevada Gold Mines and mechanical issues at Pueblo Viejo. Management remains laser focused on upgrading its mining operations and broadly improving efficiencies amid today's rising prices for precious metals. The company also continues to prioritize capital returns to shareholders via dividends and a recently announced share repurchase program.

Also in the quarter, we initiated a position in **Core Laboratories NV (CLB)**, which provides reservoir description and production enhancement services to the oil and gas industry. In response to a recently difficult operating environment amplified by geopolitical tensions, management announced prudent enhancements to an existing cost reduction plan, which help CLB achieve its free cash flow targets and reduce debt levels. Longer-term we expect current challenges will continue to abate allowing this asset light business to deliver modest growth in reservoir description. The market's focus on near-term disruptions allowed us to initiate a position in Core Labs at a substantial discount to our calculation of the company's private market value and an attractive multiple of forward earnings.

We also repurchased former holding and leading manufacturer of consumer food products, **J.M. Smucker Co. (SJM)** after the market reacted negatively to the company's recent acquisition of snack-maker Hostess. In our view, iconic brands produce consistent returns on stable consumer demand. After several years of inflationary pressures, SJM's disciplined management team has successfully been able to pass through higher pricing to cover increased costs. Meanwhile, SJM generates relatively high levels of free cash flow, which allows it to deploy cash between business growth initiatives (brand investment, business expansion, and M&A) and shareholder return programs (dividend increases and share repurchases).

By comparison, we successfully exited bar-code manufacturer, **Zebra Technologies (ZBRA)** as shares approached our estimate of private market value. We also eliminated direct-to-consumer pool and spa care services company, **Leslie's Inc. (LESL)**, for more compelling opportunities.

While Wall Street's newly dubbed "fab four"¹ have dominated the rally in recent months, their concentration and elevated valuations remain highly influential on overall market performance. Escalating geopolitical tensions, the potential timing of the Fed pivot, as well as the outcome of the upcoming U.S. Presidential election also pose risks. As the bull market climbs the proverbial "wall of worry," we consider macroeconomic developments and recent headlines within the context of our long-term investment horizon. We

continue to be cautiously optimistic and believe the underlying strength of corporate profits will prove resilient. Consumers are still spending, unemployment remains low and the balance sheets of U.S. financial institutions and households are generally in good shape. As rates begin to subside in 2024 and beyond, we think the gap between mega-cap stocks and their small to mid-cap counterparts will narrow, fortified by consumer confidence, sticky wages, as well as slowing, yet steady long-term economic growth. Meanwhile, we stand ready to take advantage of any pull backs. We strongly believe the disciplined investor that stays the course and consistently owns differentiated, quality business models with robust balance sheets will deliver superior returns over time.

Investing in equity stocks is risky and subject to market volatility. A focused portfolio may be subject to greater volatility than a diversified portfolio. 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.

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 3/31/24, the performance (net of fees) for the Ariel Focused Value Composite for the 1-, 5-, and 10-year periods was +14.37%, +8.38%, and +6.66%, respectively. For the period ended 3/31/24 the performance for the Russell 1000 Value Index and the S&P 500 Index for the 1-, 5-, and 10-year periods was +20.27%, +10.31%, and +9.01%, and +29.88%, +15.04%, and +12.96%, 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 Focused Value Composite differs from its benchmark with dramatically fewer holdings concentrated in fewer sectors.

The opinions 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

¹ The "Fab Four" are the largest stocks in the S&P 500 Index driving market performance: Amazon.com, Inc. (AMZN), Meta Platforms Inc. (META), Microsoft Corp. (MSFT) and NVIDIA Corp. (NVDA).



views expressed will come to fruition or any investment will perform as described.

As of 3/31/24, Mohawk Industries Inc. constituted 5.3% of the Ariel Focused Value Composite (representative portfolio); Phinia Inc. 4.0%; Resideo Technologies, Inc. 5.0%; APA Corporation 4.6%; Mosaic Co. 3.1%; Barrick Gold Corporation 2.9%; Core Laboratories NV 2.7%; J.M. Smucker Co. 1.8%; Zebra Technologies 0.0%; and Leslie's Inc. 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 Focused Value 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 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. 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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