Ariel investments

Quarterly Commentary

Ariel Small Cap Value Concentrated

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 Small Cap Value Concentrated Composite advanced +5.54% gross of fees (+5.28% net of fees) in the quarter, ahead of both the Russell 2000 Value Index and the Russell 2000 Index, which returned +2.90% and +5.18%, respectively.

Financial advisory and asset manager, **Lazard Ltd. (LAZ)** advanced in the period following solid top- and bottom-line results, highlighted by momentum in the advisory business, improving financing markets and early signs of progress on previously articulated cost-savings initiatives. Near-term, management reiterated its cautiously optimistic long-term guidance for the mergers & acquisitions segment given an improving macroeconomic outlook, although LAZ expects geopolitical uncertainty to remain a headwind. Notably, the company aims to increase firm-wide revenue to increase two-fold through double-digit annual revenue growth by 2030. At current levels, we believe the LAZ represents a healthy discount to our private market value estimate.

Shares of global leader in electrical protection and connection solutions, **nVent Electric plc (NVT)** also jumped following strong quarterly earnings results, highlighted by healthy organic revenue growth, margin expansion and robust free cash flow generation. Management also provided a solid full year outlook for 2024, as NVT continues to execute on its global strategy, which is focused on high-growth verticals, new products and innovation. We expect NVT to continue to benefit from secular trends towards increased electrification and data center development, as well as from internal operational improvements.

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.

There were a few notable performance detractors in the quarter. **OneSpaWorld Holdings Ltd. (OSW)**, a provider of wellness services onboard cruise ships and destination resorts, declined over the period. This recent price action runs counter to the company's strong fundamentals. OSW delivered compelling quarterly earnings results, highlighted by robust consumer demand, solid onboard spend levels, strong free cash flow generation and capital returns to shareholders via buybacks. Management also reiterated its expectations for a strong 2024 Wave Season. At today's valuation, we believe OSW's risk/reward is skewed sharply to the upside.

Global dental manufacturing company**, Envista Holdings Corp. (NVST)**, also fell on mixed earnings results and disappointing full year guidance implying a step-down in profitability. The company is navigating heightened investments, sanctions in Russia and pricing pressures in China due to volume-based procurement (VBP) reimbursement, as well as a weakening environment in North America for large dental equipment and implants. Meanwhile, NVST is in search of a new CEO and CFO creating another business distraction and further uncertainty. Shares are likely range bound for the next couple of quarters until a new leadership team is installed and NVST works through its challenges. We are deeply disappointed with this investment. After reassessing the name, we have concluded that the company 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, facility consolidation and previous IT investments. At current levels, we believe the downside is priced in. We are now evaluating the upside return potential with shares trading at a significant discount to our estimate of private market value.

Finally, U.S. direct-to-consumer pool and spa care services company, **Leslie's Inc. (LESL)**, traded lower following several consecutive quarters of earnings declines as well as a significant reduction in fiscal year 2024 guidance, largely driven by a write-down of excess inventory due to supply chain concerns. The weak outlook also reflected soft consumer demand amidst a tough macroeconomic environment. In response to these results, management installed a new CFO, who aims to correct the inventory issues, reduce expenses, implement new processes to enhance internal financial controls and deleverage the balance sheet. Although we have been deeply disappointed with this investment to date, we continue to find LESL's loyal client base, vertically integrated supply chain, scale advantage and seamless customer experience to be differentiated. At today's valuation, we believe LESL's risk/reward is skewed sharply to the upside.

We did not initiate or exit any positions in the quarter.

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 small-cap companies is more risky and volatile than investing in large cap companies. A concentrated portfolio may be subject to greater volatility than a more 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. 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 one-year period ended 3/31/24 and since inception on April 30, 2020, the performance (net of fees) for the Ariel Small Cap Value Concentrated Composite was +15.83% and +15.71%, respectively. For the one-year period ended 3/31/24 and since inception on April 30, 2020 of the Ariel Small Cap Value Concentrated Composite, the performance for the Russell 2000 Value Index was +18.75% and +17.38%, respectively. And over the same periods the Russell 2000 Index delivered +19.71% and +14.64%, 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 Concentrated Composite differs from its primary benchmark in that it has dramatically 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 3/31/24, Lazard Ltd. constituted 5.6% of the Ariel Small Cap Value Concentrated Composite (representative portfolio); nVent Electric plc 3.9%; Resideo Technologies, Inc. 5.4%; OneSpaWorld Holdings Ltd. 10.2%; Envista Holdings Corp. 2.3%; and Leslie's Inc. 4.0%. 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 Concentrated 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

[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).

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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