

Ariel Small Cap 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 Small Cap Value Tax-Exempt Composite increased +3.97% gross of fees (+3.71% net of fees) in the quarter, ahead of the +2.90% return posted by the Russell 2000 Value Index but short of the +5.18% gain of the growthier Russell 2000 Index.

Several stocks in the portfolio had strong returns in the quarter. Shares of live entertainment, media and technology company, **Sphere Entertainment Co. (SPHR)** jumped during the period. SPHR's first full quarter of operating results were robust. Revenue and margins beat expectations driven by the strong performance of the Sphere's experience show, Postcard from Earth, sellout crowds at the U2 concerts and a highly profitable takeover of the Sphere by F1. Additionally, events such as the Consumer Electronics Show and Super Bowl in Las Vegas, are expected to aid advertising and sponsorship revenues from the Exosphere (the Sphere's exterior). Meanwhile, the CEO purchased a significant number of shares, underscoring his confidence in the company as well as its ability to secure global franchise partners for future Sphere models. Although the Las Vegas venue will take some time to reach its full potential, the company is well on its way to having events 365 days a year including concert residencies, marquee sporting and corporate events, and Sphere Experience exhibits. In our view, the Sphere's new experiential immersive venue and the company's two regional sports and entertainment networks present a long-term opportunity, which remains meaningfully underappreciated at current trading levels.

Financial advisory and asset manager, **Lazard Ltd. (LAZ)** also 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 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.

Additionally, shares of global leader in electrical protection and connection solutions, **nVent Electric plc (NVT)** 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.

In contrast, shares of luxury adventure travel services company, **Lindblad Expeditions Holdings, Inc. (LIND)** traded sharply lower in the quarter on an earnings miss and cautious full year 2024 outlook, as geopolitical headwinds negatively impact travel itineraries. Importantly, LIND continues to deliver positive performance within its land-based segment, while management remains disciplined in not sacrificing long-term pricing for sea-based voyages to stimulate near-term demand. Looking ahead, we believe LIND's stable land-based segment will continue to anchor the company's profitability. We also expect the enhancement of its strategic relationship with Disney/National Geographic to provide a meaningful tailwind for multiple expansion as the company extends its market share in the expedition tourism niche.

Additionally, **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.



Finally, shares of leading provider of commercial credit data and analytics, **Dun & Bradstreet Corporation (DNB)** also fell in the period on mixed earnings results. New products and consumer demand for DNB's Master Data Management solution, a precursor to generative Artificial Intelligence (AI) and third-party risk and supply chain management solutions, drove strong organic revenue growth. However, this outperformance was offset by higher costs related to data acquisition and processing, personnel expenses and reinvestments in generative AI. We are encouraged by the acceleration in organic growth and expect management to focus on operating efficiencies as newer products scale over the near-to-medium term. In our view, DNB is a wide moat business whose strong brand, market-leading share and excellent free cash flow generation create high barriers to entry.

Also in the quarter, we initiated a new position in leading spirits manufacturer, **MGP Ingredients, Inc. (MGPI)**. After years of successfully developing products for third parties, MGPI entered the branded spirits business. Leveraging its scale and know-how, MGPI is turning existing relationships into growth stories by acquiring and scaling niche premium brands. A recent strategic decision to shut down a distillery in Kansas and concerns around peak whiskey demand amidst a challenging macro environment have placed pressure on the stock. However, we believe the core business is stable and expect branded spirit acquisitions to drive top-line growth and expand margins longer-term.

By comparison, we exited alternative asset manager, **Carlyle Group Inc. (CG)** when its market capitalization grew to be too big for our small cap strategy.

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. 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 3/31/24 the performance (net of fees) for the Ariel Small Cap Value Tax-Exempt Composite for the 1-, 5-, and 10-year periods was +13.38%, +8.74%, and +7.09%, respectively. For the period ended 3/31/24 the performance for the Russell 2000 Value Index and the Russell 2000 Index for the 1-, 5-, and 10-year periods was +18.75%, +8.16%, and +6.87%, and +19.71%, +8.10%, and +7.58%, 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 3/31/24, Sphere Entertainment Co. constituted 2.3% of the Ariel Small Cap Value Tax-Exempt Composite (representative portfolio); Lazard Ltd. 3.1%; nVent Electric plc 2.0%; Lindblad Expeditions Holdings, Inc. 4.2%; OneSpaWorld Holdings Ltd. 5.0%; Dun & Bradstreet

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).



Corporation 2.2%; MGP Ingredients, Inc. 1.0%; and Carlyle Group 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 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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