Ariel Small/Mid 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/Mid Cap Value Composite advanced +7.53% gross of fees (+7.27% net of fees) in the quarter, outperforming both the Russell 2500 Value Index and Russell 2500 Index, which returned +6.07% and +6.92%, respectively.

Some holdings in the portfolio advanced considerably this 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.

Manufacturer and distributor of floorcovering products, **Mohawk Industries Inc. (MHK)** also increased 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.

Additionally, 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 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.

Alternatively, several positions weighed on performance. Entertainment company, **Paramount Global (PARA)**, traded lower in the quarter as linear Pay TV pressures including shifts in viewership, subscriber erosion, softer ad revenues and continued losses in its streaming business presented headwinds. Despite the negative price action, management expects the consolidated company to deliver significant earnings growth in 2024 and reach Paramount+ domestic profitability in 2025. Meanwhile, PARA remains laser focused on optimizing its cost base while improving monetization for its streaming business, which should drive free cash flow in 2024 and beyond. After many calls with management we have a high degree of confidence that the value of Paramount's proprietary content remains meaningfully underappreciated at current trading levels. However, recent rumors regarding merger talks that forego competitive bidding in favor of an exclusive discussion with Skydance, where the control premium would differentiate the financial position of a single shareholder over all other shareholders is averse to the fair market value of the company. This action along with a new proposal for changes at the board level have heightened our concerns around the company's ability to act on behalf of all shareholders.

Shares of global leader in for-profit education, **Adtalem Global Education (ATGE)**, also tumbled when the publication of a short report accusing the company of being at risk of losing some federal funding was picked up by a major news outlet. Management moved up its earnings release to publicly address the "inaccuracies and misleading conclusions," noting there is "no existential threat" to the business or federal funding. Meanwhile, the fundamentals of the business remain robust, underscored by a top-and bottom-line earnings beat, significant margin expansion and an acceleration in new student enrollment growth. As the number one grantor of nursing degrees in the U.S. and the largest producer of African American MDs, PhDs and nurses in the country, we remain confident ATGE will benefit from the healthcare worker shortage in the U.S.

Finally, global dental manufacturing company, **Envista Holdings Corp. (NVST)**, declined 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.

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.

[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).

Investing in small-cap and mid-cap stocks is more risky and volatile than investing in large-cap stocks. 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/Mid Cap Value Composite for the 1-, 5-, and 10-year periods was +16.80%, +9.32%, and +8.53%, respectively. For the period ended 3/31/24 the performance for the Russell 2500 Value Index and the Russell 2500 Index for the 1-, 5-, and 10-year periods was +21.33% +9.37%, and +7.68%, and +21.43%, +9.90%, and +8.84%, 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/Mid Cap Value 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 4.6% of the Ariel Small/Mid Cap Value Composite (representative portfolio); Mohawk Industries Inc. 4.2%; Lazard Ltd. 3.7%; Paramount Global 2.3%; Adtalem Global Education 2.1%; and Envista Holdings Corp. 2.4%. 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/Mid Cap 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 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. 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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SLOW AND STEADY WINS THE RACE