Ariel investments

Quarterly Commentary

Ariel International Developed Markets

Quarter Ended June 30, 2024

The bull market continued in the second quarter driven primarily by investor enthusiasm for large U.S. companies and artificial intelligence (AI) themed stocks. This narrow, momentum driven, rally helped the MSCI ACWI and MSCI ACWI ex-U.S. indices eke out a modest gain, even as the MSCI EAFE Index posted declines due to its lack of exposure to tech beneficiaries in China and Taiwan. Nonetheless, the global outlook is brightening for the second half of 2024—supported by a recovery in bank lending, a pick-up in global manufacturing, recent structural reforms in Japan, new government policies to stabilize the China property market and boost the economy, as well as the near-term possibility of rate cuts in the U.S. and Europe. Meanwhile, the prospect upcoming elections in the U.S. and Europe may potentially lead to a reshuffling of political power have become a focal point for investors—given the potential economic and market implications. China's support for Russia is also casting an ominous shadow. Although uncertainty is high and volatility will likely remain elevated for now, these risks represent short-term noise within the context of our long-term investment horizon. In what proved to be a tough quarter, the Ariel International DM Composite dropped -1.34% gross of fees (-1.53% net of fees), trailing both its primary and secondary benchmark, the MSCI EAFE and MSCI EAFE Value Indices, which returned -0.42% and +0.01%, respectively.

Ariel's non-consensus approach seeks to identify undervalued, out-of-favor, franchises that are misunderstood and therefore mispriced. The Ariel International DM bottom-up strategy is overweight Consumer Discretionary, Utilities, Financials, Health Care and Information Technology. The portfolio is meaningfully underweight Industrials, Consumer Staples, Energy, Real Estate and Communication Services, as well as lacks exposure to Materials. At the sector level, stock selection within Information Technology and Energy were the largest sources of positive attribution. By comparison, our holdings in the Industrials, Financials and Health Care sectors were the greatest performance detractors during the period.

Taiwan Semiconductor Manufacturing Company, Ltd. (TSMC) traded sharply higher in the quarter, following its annual shareholder meeting where management highlighted robust earnings visibility. The boom in AI investment is driving significant demand for the semiconductor hardware that enables it. TSMC currently holds a dominant position in relevant chip manufacturing and packaging. Additionally, although AI investments have been mostly focused on the datacenter market, Apple's recent announcement on "Apple Intelligence" kickstarted an Edge AI race—which will likely drive greater than expected semiconductor growth in smartphones. TSMC is Apple's sole foundry partner which bodes well for the future. Overall, we continue to view TSMC's scale, technology, business model, customer service and execution favorably. The fact the company remains committed to returning capital to shareholders through both buybacks and dividends is another plus.

Tecnicas Reunidas SA, a Spain-based engineering, procurement and construction company focused on the oil and gas sector, also boosted returns in the period following a well-received Capital Markets Day. Management believes its portfolio, income statement and balance sheet have all normalized in the aftermath of COVID and even despite the ongoing war in Ukraine. They provided guidance for net profit to nearly triple by 2026. In its new five-year strategic plan, Tecnicas Reunidas expects to create a unit to drive the engineering and contract services business and expand its presence in North America with a focus on decarbonization. The company also announced plans to repay its debt in 2026 and to reinstate its shareholder return policy with a 30% dividend payout ratio in the same year.

French multinational tire manufacturer, **Michelin (CDGE)**, also advanced over the period, as strong pricing and sales growth of 18-inch and larger replacement tires within the passenger car business more than offset weaker volumes for industrial tires. Additionally, Michelin held a well-received Capital Markets Day—presenting 2026 financial targets that exceeded consensus expectations. Overall, we believe Michelin remains on track to deliver solid earnings, strong free cash flow generation and attractive shareholder returns through buybacks. We are also enthusiastic about Michelin's strong global competitive position, cyclical resiliency, pricing strategy and cost discipline. Furthermore, we expect the company's "Around Tire" and "Beyond Tire" initiatives to drive profitable growth over the long term.

There were a few notable performance detractors in the quarter. Multinational automotive manufacturing company, **Stellantis N.V. (STLA)**, underperformed in the period as higher interest rates in the U.S. and tapering demand for high-volume combustion engine models resulted in elevated U.S. inventory levels. Nonetheless, pricing outperformed expectations and management reiterated full-year guidance of double-digit adjusted operating profit margin and positive free

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cash flow. Although we expect discounting to increase as U.S. inventory ages, we maintain a constructive view on the company. We believe STLA's strong global footprint and unwavering dedication to leading the industry in profitability, operational excellence, and strategic foresight will continue to enhance long-term shareholder value.

German-based automotive manufacturing company, **Daimler Truck Holding AG (DTG)**, also declined over the period. Despite delivering solid earnings results, investor sentiment weakened following cautious messaging around increasing economic headwinds in Europe. Management reiterated its full year guidance targets and continues to expect a stable delivery outlook. In our view, DTG is the highest quality trucking equipment manufacturer and we expect it to narrow the current valuation gap versus competitor PACCAR. Its self-help efforts should result in higher margins throughout the cycle, improving DTG's profitability over the medium term and ultimately its share price.

Finally, China's internet search and online community leader, **Baidu, Inc.** traded lower in the quarter as the country's tech giants entered an Artificial Intelligence (AI) price war. Baidu responded by slashing prices across its AI offerings and making its Ernie Bot accessible for free. While the delayed monetization of AI does reflect the volatility of the Chinese technology industry, we are steadfast in our endorsement of Baidu as a leader in the field. Its core business offers downside protection as the company continues to establish its dominance in China's AI scene. Additionally, an improving ad conversion rate indicates a core business advancement from low-single-digit growth to mid-to-high single-digit growth. Our thesis on Baidu remains predicated both on this acceleration and a gradual macro recovery. In success, shares will trade higher with AI Cloud and Autonomous Driving offering long-term optionality.

We initiated four new positions in the quarter.

We purchased multinational insurance and financial services company **AXA SA**, which is currently trading at a significant discount relative to its U.S. peers due to weaker operating performance and its exposure to the European economy. We expect this gap will narrow as AXA prioritizes underwriting within the more predictable non-life business segments including–commercial, protection and health insurance—all of which offer recurring revenues and higher margins. Furthermore, as a stronger cash generator, investors are benefitting from rising dividends as well as opportunistic share repurchases.

We bought bank holding company, **BAWAG Group AG**. In our view, consensus estimates for 2025 and 2026 do not fully appreciate the sustainable growth potential, best-in-class cost efficiency and sector-leading capital returns the business offers. Given the acquisition of Netherlands-based mortgage bank, Knab, as well as recent reports highlighting BAWAG as the leading contender to acquire Barclay's German Consumer Finance business, we believe the company is well-positioned for future growth. In addition to its deal activity, management remains committed to free cash flow generation and returning capital to shareholders via dividends.

We also initiated a position in property investment and development company in the MENA region, **Emaar Properties PJSC**. We believe the company will continue to benefit from the post COVID recovery in Dubai's real estate market, which has been amplified by a large number of expatriates entering the country. Sales in the development, retail, hospitality and entertainment segments have all demonstrated growth. Across these segments, healthy domestic spending as well as a rebound in tourism are driving traffic, occupancy and rates. We expect Emaar Properties valuation discount to regional peers will narrow as it continues to post strong financial results and generate exceptional cash flow.

Lastly, we added **Infineon Technologies AG**, a leading player in power semiconductor and system solutions. In our view, Infineon is well-positioned to gain share from secular tailwinds in both auto and renewable markets. Near-term, the company is benefitting from the shift in battery electric vehicles towards plug-in hybrids given its distinctive manufacturing capabilities. Other notable growth opportunities include increased penetration of Infineon's Advanced Driver Assistance System, enhanced focus on energy efficiency and industrial power applications, and sustainable energy efforts in data centers. At current valuation levels, we do not believe the market fully appreciates Infineon's strong competitive position and growth prospects.

By comparison, we exited **Grupo Financiero Banorte S.A.B. de C.V.**, one of the largest banks in Mexico, and multinational telecom company, **Vodafone Group PLC** to deploy the cash into more compelling opportunities.

As broad optimism continues to prevail, there are cautious undertones. Although market concentrations have their own peaks and troughs, volatility is near historical lows. The mega-cap technology names—whose rich valuations continue to propel broad market performance—appear vulnerable to a correction. Escalating geopolitical tensions, unpredictable monetary policy, as well as the outcome of elections in the U.S. and Europe also pose risks. As the bull market climbs the proverbial "wall of worry," we expect these uncertainties will likely result in a period of heightened volatility and widening dispersion of returns, creating opportunities for active managers with focused expertise to shine. In our view, higher quality companies with sustainable, profitable growth and robust balance sheets will be the drivers of future outperformance. Accordingly, we continue to improve our upside capture across our international and global portfolios while remaining laser focused on preserving downside protection.

Investments in non-U.S. securities may underperform and may be more volatile than comparable U.S. stocks because of the risks involving non-U.S. economies, markets, political systems, regulatory standards, currencies and taxes. The use of currency derivatives and ETFs may increase investment losses and expenses and create more volatility. Investments in emerging markets present additional risks, such as difficulties in selling on a timely basis and at an acceptable price. The intrinsic value of the stocks within the strategy may never be recognized by the broader market. The strategy 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 6/30/2024, the performance (net of fees) for the Ariel International (DM) Composite for the 1, 5, and 10-year periods were +6.34%, +3.76%, and +2.62%, respectively. For the period ended 6/30/2024 the performance for the MSCI EAFE Index and the MSCI EAFE Value Index for the 1, 5, and 10-year periods were +11.54%, +6.46%, and +4.33% and +13.75%, +6.06%, and +3.01%, respectively. Actual fees may vary depending on, among other things, the applicable fee schedule and portfolio size. Fee information 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 International (DM) Composite differs from its benchmark, the MSCI EAFE Index, because: (i) the Composite has fewer holdings than the benchmark and (ii) the Composite will at times invest a portion of its assets in the U.S. and emerging markets.

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 6/30/2024, Taiwan Semiconductor Manufacturing Co., Ltd. ADR constituted 1.8% of the Ariel International (DM) Composite (representative portfolio); Tecnicas Reunidas SA 0.8%; Michelin (CDGE) 6.3%; Stellantis NV 3.0%; Daimler Truck Holding AG 2.9%; Baidu, Inc. ADR 1.8%; AXA SA 1.2%; BAWAG Group AG. 2.3%; Emaar Properties PJSC 0.5%; Infineon Technologies AG 2.5%; Grupo Financiero Banorte SAB de CV 0.0%; and Vodafone Group PLC 0.0%. The performance of any single portfolio holding is no indication of the performance of other portfolio holdings of the Ariel International (DM) Composite.

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

Indexes are unmanaged. An investor cannot invest directly in an index. The MSCI EAFE® Index is an equity index of large and mid-cap representation across 21 Developed Markets (DM) countries around the world, excluding the U.S. and Canada. Its inception date is May 31, 1986. The MSCI EAFE Value Index captures large and mid-cap securities exhibiting overall value style characteristics across Developed Markets countries around the world, excluding the US and Canada. Its inception date is December 8, 1997. All MSCI Index net returns reflect the reinvestment of income and other earnings, including the dividends net of the maximum withholding tax applicable to non-resident institutional investors that do not benefit from double taxation treaties. MSCI uses the maximum tax rate applicable to institutional investors, as determined by the company’s country of incorporation. MSCI makes no express or implied warranties or representations and shall have no liability whatsoever with respect to any MSCI data contained herein. The MSCI data may not be further redistributed or used to create indices or financial products. This report is not approved or produced by MSCI.

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