Quarterly Commentary

Ariel Small/Mid Cap Value

Quarter Ended December 31, 2024

Markets worldwide defied expectations in 2024 led by the dominating performance of mega-cap technology stocks known as the "magnificent seven.[1]" Even though gains have been concentrated, the results of the U.S. election, strong earnings momentum and a robust labor market drove bullish sentiment. This ebullience extended beyond the equity market: gold delivered its best year since 2010, bitcoin more than doubled and the U.S. dollar neared a 20-year high. Meanwhile, uncertainty surrounding the new U.S. administration's policies and the Federal Reserve signaling slower than anticipated easing in the year ahead drove small cap issues sharply lower in December. Although uncertainty and volatility are likely to remain elevated, the patient investor knows "stock prices trade on fundamentals. And when those solid fundamentals shine through, share prices rise.[2]" Against this backdrop, the Ariel Small/Mid Cap Value Composite advanced +0.76% gross of fees (+0.65% net of fees) in the quarter, ahead of both the Russell 2500 Value Index and Russell 2500 Index, which returned -0.26% and +0.62%, respectively. Over the trailing one-year period, the Ariel Small/Mid Cap Value Composite increased +14.86% (+14.34% net of fees), significantly ahead of both the Russell 2500 Value Index and the Russell 2500 Index, which gained +10.98% and +12.00%, respectively.

Several stocks in the portfolio had strong returns in the quarter. Global cruise vacation company, **Royal Caribbean Group (RCL)**, advanced on another quarterly earnings beat and subsequent raise in full-year guidance. Stronger than anticipated consumer demand, healthy onboard spend, robust pricing and solid cost containment boosted results. Additionally, RCL is benefitting from several new megaships, more island destinations and a growing addressable market, including younger demographics who are "new-to-cruise." The resiliency of the core cruise consumer, in combination with management's superior operational expertise and revised earnings outlook, lays the foundation for RCL to sustain its powerful growth trajectory and strengthen its position as a leader in the global cruise industry.

Alternative asset manager, **Carlyle Group Inc. (CG)**, also traded higher over the quarter with the U.S. election widely viewed as a positive catalyst across the industry. Investors expect the incoming administration to emphasize deregulation and exhibit a greater openness to business combinations compared to the prior regime. Hence, management's positive commentary around the expectation for increased capital market activity, fee-related earnings growth, private equity fund appreciation as well as returning capital to shareholders via buybacks sent shares higher. At current levels, we believe CG trades at a healthy discount to our private market value estimate.

Additionally, shares of global leader in for-profit education, **Adtalem Global Education (ATGE)**, jumped following another robust quarterly earnings beat driven by accelerating new student enrollment growth and a subsequent raise in fiscal year 2025 guidance. Revenue per student at Chamberlain and Walden also came in better than expected on tuition increases. Meanwhile, we remain encouraged by management's solid execution of remediation initiatives at the medical and veterinary schools, where revenue growth outperformed and total enrollment trends are improving. 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.

Alternatively, shares of manufacturer and distributor of floorcovering products, **Mohawk Industries Inc. (MHK)** declined in the period as consumer demand and pricing remain under pressure due to secular headwinds in the housing market. Although quarterly earnings results were in-line with expectations, management lowered near-term guidance to account for losses resulting from recent U.S. hurricanes.

[1] The "Magnificent Seven" are the largest stocks in the S&P 500 Index driving market performance: Apple Inc. (AAPL), Amazon.com, Inc. (AMZN), Alphabet Inc. (GOOGL), Meta Platforms Inc. (META), Microsoft Corp. (MSFT), NVIDIA Corp. (NVDA) and Tesla, Inc. (TSLA).

[2] Hobson, Mellody and John W. Rogers Jr. "What the Stock market Taught Us This Year: Don't Fall for These Investing Traps." *Wall Street Journal*, 5 December 2023.

Meanwhile, management continues to successfully execute on productivity and cost restructuring initiatives, while also preparing the business for share gains as demand recovers. In our view, MHK's healthy balance sheet and progress managing through economic cycles should help the company benefit from long-term growth in residential remodeling, new home construction and commercial projects.

Madison Square Garden Entertainment Corp. (MSGE) was another underperformer in the quarter. Despite the delivery of strong earnings results, shares traded lower following a reduction to fiscal 2025 adjusted operating income guidance. The revision was driven by unique circumstances surrounding concert tour cancellations and higher costs associated with bringing sponsorship sales in-house. Nonetheless, with marquee assets such as New York's Madison Square Garden, Radio City Music Hall, Beacon Theatre and The Chicago Theater, we believe MSGE is well positioned to capitalize on strong demand for live entertainment. Additionally, new sales and renewal activity in the company's hospitality business remains robust. MSGE recently announced multi-year sponsorship deals with Lenovo, its subsidiary Motorola Mobility, the Department of Culture and Tourism-Abu Dhabi, as well as a multi-year extension of its sponsorship deal with Verizon. In our view, MSGE's portfolio generates stable cash flow that should enable further deleveraging. At current levels, the company is trading at a significant discount to our estimate of private market value.

Lastly, shares of live entertainment, media and technology company, **Sphere Entertainment Co. (SPHR)** traded lower over the period. We view the sell-off as an overreaction given investor's overly-aggressive expectations for a quick MSG Networks debt resolution as well as a third Sphere franchise announcement. Looking ahead, we expect financial results will continue to ramp as the company scales its concert residencies, secures additional marquee sporting events and reaches higher venue utilization across show types. Advertising, sponsorship and suite revenue should provide additional upside. Meanwhile, international expansion beyond Abu Dhabi remains a priority. In our view, the experiential immersive venue in Las Vegas and its franchise opportunities alongside the company's two regional sports and entertainment networks present a long-term opportunity that remains meaningfully underappreciated at current trading levels.

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

We believe the U.S. economy looks healthy and expect corporate profits to prove resilient. Although interest rates will likely settle at a higher structural level compared to the past decade and potential policies around tariffs and immigration present uncertainty, we think market friendly policies such as tax cuts and deregulation should support the broadening of the market beyond the Magnificent Seven. Once the performance gap between mega-cap stocks and smaller company counterparts narrows, our portfolios should be rewarded. We strongly believe the disciplined investor that stays the course and consistently owns differentiated businesses with solid competitive positioning and robust balance sheets will deliver superior returns over time.

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. For the period ended 12/31/24 the performance (net of fees) for the Ariel Small/Mid Cap Value Composite for the 1-, 5-, and 10-year periods was +14.34%, +9.49%, and +8.30%, respectively. For the period ended 12/31/24 the performance for the Russell 2500 Value Index and the Russell 2500 Index for the 1-, 5-, and 10-year periods was +10.98%, +8.43%, and +7.80%, and +12.00%, +8.76%, and +8.85%, respectively. Ariel Composite Net of Fees returns are calculated by deducting: (1) for the period from inception to December 31, 2013, the maximum advisory fee in effect for the respective period, applied on a monthly basis; and (2) for the period from January 1, 2014 onwards, the actual monthly advisory fee (on an asset-weighted basis) accrued for the accounts in the composite, using the fee rates in place as of the most recent calendar quarter-end. Gross returns do not reflect the deduction of advisory fees. Client returns will be reduced by advisory fees and such other expenses as may be incurred in the management of the account. Advisory fees are described in Part 2 of Ariel's Form ADV. Returns assume the reinvestment of dividends and other earnings. 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 12/31/24, Royal Caribbean Cruises, Ltd. constituted 2.6% of the Ariel Small/Mid Cap Value Composite (representative portfolio); Carlyle Group, Inc. 5.0%; Adtalem Global Education, Inc. 3.1%; Mohawk Industries, Inc. 3.3%; Madison Square Garden Entertainment Corporation 4.1%; and

Sphere Entertainment Company 4.3%. 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