Ariel investments

Performance (%) as of September 30, 2024	QTD	YTD	1-Year	3-Year (Annualized)	5-Year (Annualized)	10-Year (Annualized)	Since Inception (Annualized)
Ariel Focused Value							03/31/2005
Gross of Fees	**10.46**	**15.22**	**27.79**	**6.05**	**9.93**	**7.62**	**7.49**
Net of Fees	**10.31**	**14.70**	**27.00**	**5.37**	**9.23**	**6.93**	**6.63**
Russell 1000® Value Index	9.43	16.68	27.76	9.02	10.69	9.23	8.21
S&P 500® Index	5.89	22.08	36.35	11.91	15.97	13.38	10.62

Past performance is not indicative of future results. An investment's return and principal value will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Current performance may be lower or higher than the performance data quoted. Performance data as of the most recent month-end may be obtained by visiting our website, arielinvestments.com.

Dear Clients and Friends: In the third quarter, the Ariel Focused Value Composite outperformed its primary benchmark as well as the broad market returning +10.46% gross of fees (+10.31% net of fees) compared to +9.43% for the Russell 1000 Value Index and +5.89% for the S&P 500 Index. During a quarter when value stocks performed well, three of our largest positions moved significantly higher: **Mohawk Industries, Inc. (MHK)**, **Oracle Corporation (ORCL)** and **Lockheed Martin Corporation (LMT)**. Our portfolio was also negatively impacted by our Energy and Basic Materials holdings. **APA Corporation (APA)**, **Core Laboratories, Inc. (CLB)** and **Mosaic Company (MOS)** all declined.

Although value stocks outperformed growth in the quarter, large capitalization growth stocks have significantly upstaged large cap value stocks all year. Year-to-date through September, the Russell 1000 Value Index returned +16.68% while the Russell 1000 Growth Index rose +24.55%. Over the same nine-month period, the Ariel Focused Value Composite gained +15.22% gross of fees (+14.70% net of fees).

Reversion to the Mean

At Ariel, we seek to identify high quality businesses with barriers to entry earning attractive returns on invested capital, trading at discounts to our calculation of intrinsic value. Because we believe equity markets are extremely efficient at incorporating all available information into current stock prices, we must have a clear thesis for discrepancies between today's price and what we believe a company is actually worth. Most often, the market's excessive focus on short-term factors and temporary anomalies that can depress current results, explains the valuation gap. We purchase stocks expecting operating results to normalize when a negative headwind proves transitory.

The Vanguard Group founder, John C. Bogle called this concept of reversion to the mean ("RTTM"), "the iron rule of the financial markets." Observable economic data can have relatively stable quantifiable relationships to other data. For example, over extended periods of time, short-term interest rates tend to be lower than long-term rates producing a positively sloped yield curve. Investors demand a higher rate to commit to a longer investment period. Likewise, value stocks have historically traded at a lower multiple of expected earnings than growth shares. These relationships are represented by observable data that can be measured and tracked. Still, these relationships are not constant. Short-term economic conditions can move these factors away from their long-term averages. For example, the Federal Reserve recently sought to curtail inflation by pushing short-term interest rates well above long-term rates producing an inverted yield curve. Exuberance over developments in Artificial Intelligence (AI) has driven growth stock multiples well above their historic valuations relative to value stocks.

This is where reversion to the mean becomes relevant. Under RTTM, data reverts to norms. To illustrate, a woman flipping 100 coins can be expected to produce 50 Head flips. If she tries her luck and produces 60 Heads, RTTM theory predicts she has a better than 50/50 chance of producing LESS than 60 Heads on her next try. It is probable that the number of Head flips will decline or revert toward the mean of 50.

In applying this theory to equity investing, the Ariel Focused Value strategy looks for companies whose results have been temporarily depressed by an unusual factor that we expect to revert to its mean. A once in a century pandemic might temporarily weaken demand for cruise line vacations. Supply chain snags might reduce cars available on dealer lots. Implementation of an enterprise resource planning (ERP) software system might diminish this year's (but only THIS year's) earnings.

Currently, we expect the relationship between short-term and long-term interest rates to revert to normal (i.e., a positively sloped yield curve). This "more normal" relationship will improve the return on capital of investment banks such as **Goldman Sachs Group, Inc. (GS)** which tend to borrow short and invest long. Goldman Sachs will often fund itself with short-term debt instruments such as federal funds and the cash balances of their wealth management clients. Their investments tend to be more concentrated in longer duration securities like stocks and bonds. A return to the more normal term-structure of interest rates will likely improve Goldman's net interest margin and return on capital.

Similarly, we expect the relationship between value and growth stock multiples to revert to its historic mean. Over the last 20 years, the Russell 1000 Growth Index has traded at an average forward PE multiple of 19.2x compared to 13.8x for the Russell 1000 Value Index. At the end of September, the Russell 1000 Growth Index traded at 28.5x forward earnings compared to 16.7x for the Russell 1000 Value Index. The growth index PE is 11.8 points higher than that of the value index compared to the historical average of 5.4x. This short-term anomaly should revert. Excessive exuberance over the future of AI has lifted growth stock valuations above their intrinsic worth. Fear that a Federal Reserve-induced recession would hit cyclical value stocks has pressured multiples, excessively again, in our opinion. Once the spread between PE ratios of value stocks versus growth stocks eventually narrows, value stocks should outperform.

There are other short-term anomalies producing opportunities throughout equity markets. Years of below expected housing starts in the U.S. have reduced demand for the floor covering products of Mohawk Industries. Current operating results have fallen below the company's long-term earnings power. With a forward PE of less than 14x earnings, Mohawk shares are priced as if current depressed housing conditions are the "new normal."

One counter argument to this philosophy of reversion to the mean is, "This time is different." RTTM does not work if the data set moves, taking the mean average with it. Investing in buggy whip companies based on average 19th century horse-drawn buggy sales would have been a mistake after the invention of the Ford Model-T. If things really have changed permanently, this argument is correct. If the new Federal Reserve continues to hold short-term rates high, making an inverted yield curve the new expected term-structure, Goldman Sachs will indeed be less profitable than in the past. If opportunities in AI permanently shift the growth rates of technology companies upward, while leaving non-tech companies with lower growth economics, then the new widened gap in PE ratios will be justified. The slope of the yield curve and the differential between value and growth PEs are more likely to move toward their historic averages.

Contributors and Detractors

The top contributor to the Ariel Focused Value portfolio third quarter performance was Mohawk Industries, Inc. which surged +41.46%. In July, Mohawk repurchased shares for the first time since 2022 and also raised guidance. Despite the recent stock performance, Mohawk continues to trade well below our estimate of its intrinsic value. A normalization in housing construction will increase demand for Mohawk's carpet, ceramic and luxury vinyl tile flooring products.

Oracle Corporation remains one of our favorite misunderstood value stocks. As recently as 2022, Oracle traded at 12x forward earnings with a stock price near $60. After appreciating +21.02% in the third quarter, Oracle now trades above $170 at 26x forward earnings. Oracle's enterprise data software products are well-positioned to assist corporations in utilizing AI capabilities. The data needed to best leverage AI often sits on Oracle's software platform and is expensive to move. The company's recently announced partnerships with Microsoft and Amazon underscore this growth opportunity. Oracle modestly trades below our private market value estimate, but its rising valuation compels us to trim our position.

Lockheed Martin's strong 2024 performance has been less about a reversion to the historical mean, and more about the realization of potential. For the last several years, Lockheed's less than stellar results were caused by delayed shipments of the advanced F-35 fighter jets due to software problems. Given the importance of these aircraft for the company, the U.S. Military, and our allies, we expected these problems to be resolved. Lockheed expects to deliver between 75 and 110 F-35s this year, which remains below the expected annual rate of 150 aircraft. Deliveries of new F-35s are highly profitable on a current cash flow basis as the sale price recoups billions of dollars in past research spending. We expect F-35 sales to represent 30% of company sales going forward.

As already mentioned, our Energy and Basic Materials sectors detracted from our results this quarter. We believe the world's use of petroleum products for transportation, heating and electricity generation will increase rather than decrease over the short and medium-term driving demand for oil in the next decade. And yet, markets are predicting a steady decline in the future price of oil. While demand may fall modestly after 2035, natural gas will continue to be needed to generate electricity.

While our general optimism about the future of the oil and gas exploration industry remains intact, we will acknowledge some disappointment with the operating performance of our largest Energy holding, APA Corporation, which fell -16.25% during the quarter. When APA announced its first oil discovery off the coast of Suriname in South America in early 2020, we would have anticipated first production this year. Instead, APA is estimating first oil production in 2028. Meanwhile, the value of APA's holdings in the North Sea have been reduced by high British tax rates on production off its shores. While APA's results have been disappointing, we believe its current stock price still represents an excellent opportunity. Its shares are currently trading at an enterprise value over EBITDA multiple of 3x and a forward PE ratio of less than 7x.

Sincerely,

Charles K. Bobrinskoy
Vice Chairman

Investing in equity stocks is risky and subject to the volatility of the markets. Investing in small- and mid-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. A focused portfolio may be subject to greater volatility than a more diversified investment.

Past performance does not guarantee future results. Performance results are net of transaction costs and reflect the reinvestment of dividends and other earnings. Ariel Composite Net of Fees returns are calculated by deducting: (1) for the period from inception to August 31, 2024, the maximum advisory fee in effect for the respective period, applied on a monthly basis; and (2) for the period from September 1, 2024 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 Focused Value Composite differs from its benchmark with dramatically fewer holdings concentrated 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. Views and opinions are as of the date of this commentary and can change without notice. There is no guarantee that any expressed views will come to fruition or any investment will perform as described.

As of 9/30/24, the Ariel Focused Value (representative portfolio) held the following positions referenced: Oracle Corporation 6.58%; Mohawk Industries, Inc. 6.38%; Goldman Sachs Group, Inc. 5.64%; Lockheed Martin Corporation 5.15%; APA Corporation 4.07%; Core Laboratories, Inc. 2.78%; and Mosaic Company 2.64%. The 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 Focused Value Composite. Index returns reflect the reinvestment of income and other earnings. Indexes are unmanaged, and investors cannot invest directly in an index.

The Russell 1000 Value Index measures the performance of the large-cap value segment of the U.S. equity universe. It includes those Russell 1000 companies with lower price-to-book ratios, lower forecasted growth values and lower sales per share historical growth. Its inception date is January 1, 1987. The Russell 1000 Growth Index measures the performance of the large-cap growth segment of the US equity universe. It includes those Russell 1000 companies with relatively higher price-to-book ratios, higher I/B/E/S forecast medium term growth and higher sales per share historical growth. The inception date of the Russell 1000® Growth Index is January 1, 1987. 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.