Ariel investments

Quarterly Commentary

Ariel Small Cap Value Concentrated

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 Cap Value Concentrated Composite declined -0.54% gross of fees (-0.67% net of fees) in the quarter, outpacing the Russell 2000 Value Index's -1.06% return, but shy of the +0.33% gain posted by the Russell 2000 Index. Over the trailing one-year period, the Ariel Small Cap Value Concentrated Composite increased +12.07% (+11.46% net of fees), outperforming the Russell 2000 Value Index's +8.05% gain and the +11.54% return earned by the Russell 2000 Index.

Several stocks in the portfolio had strong returns in the quarter. Provider of wellness services onboard cruise ships and destination resorts, **OneSpaWorld Holdings Ltd. (OSW)**, traded higher as strong consumer trends drove another significant earnings beat and subsequent raise in full year guidance. Meanwhile, management strengthened the balance sheet by paying down and restructuring its expensive first lien term loan as well as ramped up capital returns to shareholders through buybacks and dividends.

Norwegian Cruise Line Holdings Ltd. (NCLH) also advanced over the period following a top- and bottom-line earnings beat and subsequent raise in full-year guidance. Stronger than anticipated consumer demand, healthy onboard spending, robust pricing, solid cost containment and continued progress on leverage reduction boosted results. Looking ahead, NCLH remains focused on right sizing its cost base and improving margins to further strengthen its foundation for sustainable and profitable growth. With a young average fleet and solid liquidity position, we remain enthusiastic about the name.

Additionally, supplier of residential thermal, comfort and security solutions, **Resideo Technologies, Inc. (REZI)** outperformed over the period. Despite a challenging macro environment, positive organic sales growth and structural cost efficiencies drove margin expansion. Encouraging commentary around improving consumer demand trends, new product offerings and cross-selling opportunities further aided share price appreciation. Also in the quarter, President and CEO, Jay Geldmacher, announced his intention to retire from his executive and board roles in 2025. Once a successor is identified, Mr. Geldmacher expects to become a senior advisor to the company to facilitate a smooth transition. In our view, this leadership change is indicative of the successful completion of the transformation plan the team initiated following the spin-out from Honeywell. We believe the company is entering a new phase of sustainable growth which will be driven by a secular preference for more connected smart home solutions and product innovation.

In contrast, logistics and cash management services provider, **Brink's Company (BCO)** underperformed in the period. Despite the delivery of strong organic revenue growth and margin improvement across both the ATM managed services and digital retail solutions segments, currency headwinds and softness in its global services business drove an earnings miss. Although management lowered full year guidance, BCO continues to win margin accretive business, such as its recently announced long-term partnership with Sainsbury's, one of the largest supermarkets in the United Kingdom.

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[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.

SLOW AND STEADY WINS THE RACE

Meanwhile, the company is making substantial investments in its technology platforms and returning capital to shareholders through dividends and share repurchases.

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. 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.

Lastly, U.S. direct-to-consumer pool and spa care services company, **Leslie's Inc. (LESL)** traded lower following another consecutive quarter of disappointing financial and operating results. Soft consumer demand driven by weather-related headwinds and continued price sensitivity on large discretionary purchases weighed on the top-line. Product margins also remained under pressure as the company struggled to unwind its higher-cost inventory. In response, LESL's new executive leadership team introduced three key strategic initiatives focused on personalizing communication and product offerings by leveraging local consumer information and data across different markets while improving existing-store sales and productivity. Although we have been deeply disappointed with this investment, we are optimistic the new efforts will drive meaningful improvements to the business and position the company for long-term success. At today's valuation, LESL appears to have more upside than downside and the company's loyal client base, vertically integrated supply chain, scale advantage and seamless customer experience remain differentiators.

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 companies is more risky and volatile than investing in large cap companies. A concentrated portfolio may be subject to greater volatility than a more diversified portfolio. 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 one-year period ended 12/31/24 and since inception on April 30, 2020, the performance (net of fees) for the Ariel Small Cap Value Concentrated Composite was +11.46% and +14.88%, respectively. For the one-year period ended 12/31/24 and since inception on April 30, 2020 of the Ariel Small Cap Value Concentrated Composite, the performance for the Russell 2000 Value Index was +8.05% and +15.59%, respectively. And over the same periods the Russell 2000 Index delivered +11.54% and +13.56%, respectively. Ariel Composite Net of Fees returns are calculated by deducting the actual monthly advisory fee (on an asset-weighted basis) applicable to all 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 Cap Value Concentrated Composite differs from its primary benchmark in that it has dramatically 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, OneSpaWorld Holdings, Ltd. constituted 11.7% of the Ariel Small Cap Value Concentrated Composite (representative portfolio); Norwegian Cruise Line Holdings, Ltd. 8.4%; Resideo Technologies, Inc. 5.4%; Brink's Company 8.5%; Mohawk Industries, Inc. 3.8%; and Leslie's, Inc. 1.7%. 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 Concentrated 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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