

# Ariel International Fund

Quarter Ended March 31, 2023

Performance data quoted represents past performance. Past performance does not guarantee future results. All performance assumes the reinvestment of dividends and capital gains, and represents returns of the Investor Class shares. The investment return and principal value of an investment 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 current to the most recent month-end for Ariel International Fund may be obtained by visiting our website, [arielinvestments.com](http://arielinvestments.com). For the period ended March 31, 2023 the average annual total returns of Ariel International Fund (Investor Class) for the 1-, 5, and 10-year periods were -4.61%, +0.89%, and +4.20%, respectively.

Markets worldwide proved resilient in the first quarter, despite a wild ride of volatility. The effects of higher interest rates and tightening financial conditions stressed the banking system spurring a loss of consumer confidence, a run on bank deposits, the closure of three U.S. regional banks and a forced takeover of Credit Suisse. Meanwhile, China is reopening post COVID-19 lockdowns and the Eurozone as well as the United Kingdom are experiencing tailwinds from a mild winter, lower energy costs and a range of economic data that has surprised to the upside. While many hope the worst is over, we do not believe central banks will come to the rescue until inflation falls to targeted levels. Meanwhile, our focus on resilient business models with strong balance sheets and compelling dividend yields remains paramount. Against this backdrop, Ariel International Fund increased +5.40 in the quarter, trailing both the MSCI EAFE and MSCI ACWI ex-US indices, which returned +8.47% and +6.87%, respectively. It also trailed the MSCI EAFE Value Index's return of +5.93% but came in ahead of the MSCI ACWI ex-US Value Index's return of +5.16%.

Ariel's non-consensus approach seeks to identify undervalued, out-of-favor, franchise-quality companies that are misunderstood and mispriced. Ariel International Fund continues to be overweight Utilities, Communication Services, Health Care, Consumer Discretionary, Consumer Staples and Financials. The portfolio is meaningfully underweight Industrials, Information Technology, Energy and Real Estate and continues to lack exposure to Materials. At the sector level, Communication Services holdings were the largest sources of positive attribution. By comparison, stock selection within Information Technology and Consumer Discretionary were the greatest detractors from performance in the quarter.

China's internet search and online community leader **Baidu, Inc.** was the top contributor in the quarter. Shares traded higher following the announcement Baidu plans to launch an AI chatbot similar to ChatGPT. While some investors remain on the sidelines due to uncertainty surrounding Covid, China's economic growth, and the political rhetoric towards Taiwan,

we remain enthusiastic about Baidu's longer-term opportunity for revenue growth and margin expansion across internet search, cloud, autonomous driving, artificial intelligence and online video.

Shares of German mobile telecommunications company **Telefónica Deutschland Holdings AG** also advanced in the quarter, on solid earnings results and stable outlook for 2023. Although short term investor sentiment on the name remains mixed on speculation that competitor Drillisch will gain market share upon the completion of its network build-out, we believe changes to the currently benign competitive environment in Germany are unlikely. Meanwhile, Telefónica Deutschland continues to showcase stable market share, solid average revenue per unit (ARPU), low churn, solid cash generation and a robust dividend yield. And with the peak of 5G capital spending at hand, we think the free cash flow dynamics for Telefónica Deutschland are likely to improve significantly in the years ahead.

Dutch international grocer, **Koninklijke Ahold Delhaize N.V.** was another top performer in the period. The strong value proposition of Ahold's brands are driving incremental market share gains as food-at-home consumption remains sticky. Despite inflationary headwinds and the associated increases in operating expenses, robust sales growth, solid execution on cost-saving initiatives and a material increase in the company's dividend drove earnings ahead of Wall Street's expectations. We continue to believe Ahold's strong market share, stable business model and solid balance sheet has it well positioned to navigate the current market environment.

British home and auto insurer, **Direct Line Insurance Group PLC** weighed on performance following an unexpected profit warning. The announcement was driven by higher claims within the home insurance business due to unusual, below-freezing temperatures in the United Kingdom (UK). Also, price increases in the UK auto insurance market, while improving, continue to lag claims inflation. As a result of near-term profit trends, solvency ratios are at the lower end of management's desired range, causing the company to cancel



their final dividend for 2022. While we expect these adverse factors to normalize if not reverse over the course of 2023, a recovery in earnings will likely be more back-end loaded than we anticipated. Although we are disappointed with these developments, we continue to hold the shares as we believe the stock is materially undervalued relative to its normalized earnings power.

Global pharmaceutical and diagnostics leader, **Roche Holding AG** also traded lower in the quarter on disappointing test results for the company's Alzheimer's drug to treat dementia, as well as a lack of investor enthusiasm for any near-term clinical trial data. Although it is important to remind investors drug trials occasionally have less than favorable outcomes, we remain constructive on the rest of Roche's pharma portfolio. We believe the core oncology franchise remains one of the most important and valuable in the world. The diagnostics segment continues to demonstrate strong growth momentum as it experiences a further normalization of post-pandemic trends. In our view, Roche is a quality defensive name with a rich suite of best-in class pipeline opportunities.

Finally, tobacco maker, **Philip Morris International Inc.** declined in the period on concerns related to supply-chain disruptions resulting from the war in Ukraine, which we view as temporary. We believe the favorable economics and margin expansion associated with market share gains from the IQOS brand and Reduced Risk Products should yield value creation opportunities in the years ahead. Furthermore, at current trading levels, we think the company's operating leverage, pricing power, and free cash flow profile offer a margin of safety.<sup>1</sup>

Also in the quarter, we initiated a new position in Brazil-based brewing company, **Ambev SA**. The company produces, distributes and sells beer, carbonated soft drinks and other non-alcoholic and non-carbonated beverages across the Americas. Ambev appointed a new executive leadership team in 2020 focused on transforming the company's culture and operations. Following several consecutive years of margin contraction, we expect 2023 to be a turning point and believe Ambev's commercial strategy will help improve the sales mix resulting in market share, revenue and earnings growth. In addition, we like the net cash balance sheet and high free cashflow generation of the business.

We also purchased a position within Chilean bank, **Banco Santander Chile**. The company has demonstrated stable credit quality across multiple economic cycles and consistently generates risk-adjusted returns with return on equity generally in the range of 18%-20%. We also view management as forward thinking when it comes to strategic initiatives and recently is investing in a new client relationship management system, addressing customer segmentation and exploring omni-channel banking.

By comparison, we exited **Japan Tobacco, Inc. (JT)** on both on price appreciation and increasing questions regarding the capacity of the company to execute on next generation, reduced risk products as effectively as its competitors. In our view, emerging signs of ESG weakness at JT seem unlikely to reverse. We also sold out of multinational biopharmaceutical company, **AstraZeneca Plc** and French manufacturer of stationary products, lighters and shavers **Societe BIC** on price appreciation.

As central banks worldwide navigate the tradeoff between a hard economic landing and runaway inflation, the World Bank warns of a "lost decade" ahead for global growth. As we wrote in our Q2 2021 quarterly letter, "History suggests high trailing valuations presage anemic capital appreciation, as well as a prolonged period of negative returns...interest rates and inflation often move hand-in-hand." We do not believe broad market valuations reflect the impact further monetary tightening will have on corporate profits. Accordingly, we continue to believe defense is likely to be the best offense; and as such, we believe our non-consensus global portfolios are well positioned for downside protection. They are heavily weighted towards undervalued, higher quality defensive holdings which offer higher dividend yields than our relevant respective benchmark holdings.

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Investments in foreign securities may underperform and may be more volatile than comparable U.S. stocks because of the risks involving foreign economies and markets, foreign political systems, foreign regulatory standards, and foreign currencies and taxes. The use of currency derivatives and exchange-traded funds (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 in which the Fund invests may never be recognized by the broader market. The Fund 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.

Per the Fund's Annual Report for the year ended September 30, 2022, Ariel International Fund Investor Class had an annual net expense ratio of 1.13% and an annual gross expense ratio of 1.28%. Currently, an expense ratio cap of 1.13% is in place for the Investor Class to waive fees and reimburse certain expenses that exceed this cap. Ariel Investments LLC (the Advisor) is contractually obligated to maintain this expense ratio cap through 9/30/24.

This commentary candidly discusses a number of individual companies. These opinions are current as of the date of this commentary but are subject to change. The information provided in this commentary does not provide information

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<sup>1</sup> Attempting to purchase a stock with a margin of safety does not protect investors from the loss of their investment, volatility associated with stocks, declining fundamentals, external forces, or our incorrect assumptions.



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 opinion are as of the date of this commentary and can change without notice. There is no guarantee that any of the views expressed will come to fruition or any investment will perform as described.

As of 3/31/2023, Baidu, Inc. ADR constituted 4.8% of Ariel International Fund; Telefónica Deutschland Holdings AG 3.4%; Koninklijke Ahold Delhaize N.V. 5.1%; Direct Line Insurance Group PLC 2.7%; Roche Holding AG 5.9%; Philip Morris International Inc. 5.0%, Ambev SA ADR 0.2%, Banco Santander Chile 0.1%; AstraZeneca Plc 0.0%, Japan Tobacco, Inc. (JT) 0.0%, and Societe BIC 0.0%. Portfolio holdings are subject to change. The performance of any single portfolio holding is no indication of the performance of other portfolio holdings of Ariel International Fund.

A glossary of financial terms provided herein may be found on our website at [www.arielinvestments.com](http://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. The MSCI ACWI (All Country World Index) ex-US Index is an index of large and mid-cap representation across 22 Developed Markets (DM) and 24 Emerging Markets (EM) countries. Its inception date is January 1, 2001. The MSCI ACWI ex-US Value Index captures large and mid-cap securities exhibiting overall value style characteristics across 22 Developed and 24 Emerging Markets countries. 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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