



QUARTERLY COMMENTARY

Ariel Fund

• Value • Deep value • Global



Investing in small- and mid-cap stocks is riskier and more 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. Ariel Fund often invests a significant portion of its assets in companies within the financial services and consumer discretionary sectors and its performance may suffer if these sectors underperform the overall stock market.

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. For the period ended September 30, 2014, the average annual total returns of Ariel Fund (Investor Class) for the 1-, 5- and 10-year periods were +15.52%, +16.46% and +7.18%, respectively. Ariel Fund's Investor Class shares had an annual expense ratio of 1.03% for the year ended September 30, 2013. Performance data current to the most recent month-end for Ariel Fund may be obtained by visiting our website, arielinvestments.com.

Quarter Ended September 30, 2014

The third quarter of 2014 experienced a sharp divergence between the major stock market indexes. While domestic large caps inched ahead, foreign stocks fell, and U.S. small caps dropped rather sharply. Specifically, the S&P 500 Index gained +1.13%, the MSCI EAFE Index returned -5.83% and the Russell 2000 Index slid -7.63%. Spreads this wide between large-cap and small-cap returns in just one quarter are rare. The last time the Russell 1000 and Russell 2000 indexes differed by more than this quarter's 801 basis points was in the 2008 crash, and the last time Russell's large-cap bogy outperformed the small-cap one by this much was in 1999. Whether this quarter will be a bump in the road or the beginning of some form of broad dislocation is unclear; we are being opportunistic in the search for any and all values that may arise. Ariel Fund held up well in the quarter's slide, fading -2.96%, finishing ahead of the Russell 2500 Value Index's -6.40% loss and the -8.58% drop of the Russell 2000 Value Index.

Several of our holdings posted strong returns this quarter. Cruise line Royal Caribbean Cruises Ltd. (RCL) sailed to a +21.56% gain, powered by strong earnings. Its \$0.66 earnings per share beat consensus of \$0.53, as well as the \$0.15 mark from the prior year. In addition, management announced a "Double-Double Program" designed to increase return on invested capital (ROIC) to double digits and double the company's earnings per share by 2017.

We think these are ambitious yet sensible goals. In addition, asset manager Janus Capital Group Inc. (JNS) leapt +17.30% in the wake of "Bond King" Bill Gross's arrival. Gross, who founded and was lead investor for PIMCO, unexpectedly joined Janus to manage its unconstrained bond strategy. Neither we nor anyone could have anticipated this development, but we see it as a side benefit of Janus CEO Dick Weil's long tenure at PIMCO.

A few of our holdings struggled throughout the quarter. Oil and gas producer Contango Oil & Gas Co. (MCF) fell -21.44% despite strong earnings. Although Contango has its own results and cash flows, the stock tends to trade with oil prices, which slid from \$102 per barrel to \$91 in the third quarter of 2014. On a fundamental basis, we are pleased that earnings beat expectations, onshore production is up and Contango continues to move toward an even lower-risk production strategy. Also, identification specialist Brady Corp. (BRC) slipped -24.38% as it continues to turn its business around under a new CEO. J. Michael Nauman, who took the reins this summer, says even though recent sales and earnings were better than expected, profitability fell short. The company has certainly had a rough stretch, but we think the situation was temporary and believe improvement has already begun.

During the third quarter, we added Kennametal Inc. (KMT) to Ariel Fund. A current holding in Ariel Appreciation Fund and

Ariel Focus Fund, Kennametal manufactures cutting tools and tooling systems, as well as specialized tools for the oil and gas, mining and road construction industries. These products are precisely engineered to withstand extreme conditions. The company is a number-one or -two player in its geographies and end markets, such as aerospace, defense, transportation, general engineering, energy, and mining. We exited three holdings during the quarter: International Game Technology (IGT), Bally Technologies, Inc. (BYI) and Symmetry Medical Inc. (SMA). We sold the shares of two of our gaming companies on the good news of acquisitions. International Game Technology announced that it was being acquired by GTECH for \$6.4 billion, and Bally Technologies announced that it will be acquired by Scientific Games Corp. (SGMS) in a \$5.1 billion transaction. Lastly, we eliminated Symmetry Medical in order to pursue more compelling opportunities.

At Ariel, we do not let Mr. Market's mercurial nature and occasional gloom whipsaw our own perspective. The market has hummed along for the past few years with relatively little pain, which can lull the crowd into complacency. As independent thinkers, however, we stay focused on valuation levels and become pessimistic when bullishness is widespread rather than when others are nervous. We have been cautiously optimistic for some time. We would not go so far as to welcome negative returns, but we think a slowdown or slight pullback is healthy at this point.

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 reasonably sufficient upon which to base an investment decision and should not be considered a recommendation to purchase or sell any particular security.

As of 9/30/14, Royal Caribbean Cruises Ltd. constituted 3.5% of Ariel Fund; Janus Capital Group Inc. 2.9%; Brady Corp. 2.8%; Contango Oil & Gas Co. 2.8%; Kennametal Inc. 3.0%; International Game Technology 0.0%; Bally Technologies, Inc. 0.0%; Symmetry Medical Inc. 0.0%; and Scientific Games Corp. 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 Fund.

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 lower price/book ratios and lower forecasted growth values. 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/book ratios and lower forecasted growth values. The Russell 1000 Index measures the performance of the large-cap segment of the U.S. equity universe. It is a subset of the Russell 3000® Index, representing approximately 92% of the total market capitalization of that index. It includes approximately 1000 of the largest securities on the basis of a combination of their market cap and current index membership. Russell® is a trademark of Russell Investment Group, which is the source and owner of the Russell Indexes' trademarks, service marks and copyrights.

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