



## QUARTERLY COMMENTARY

# Ariel Appreciation Fund

• Value • Deep value • Global



**Investing in mid-cap stocks is riskier and more volatile than investing in large-cap stocks. The intrinsic value of the stocks in which the Fund invests may never be recognized by the broader market. Ariel Appreciation 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, 2016, the average annual total returns of Ariel Appreciation Fund (Investor Class) for the 1-, 5- and 10-year periods were +13.66%, +16.72% and +8.04%, respectively. The Fund's Investor Class shares had an annual expense ratio of 1.12% for the year ended September 30, 2015. Performance data current to the most recent month-end for Ariel Appreciation Fund may be obtained by visiting our website, [arielinvestments.com](http://arielinvestments.com).**

### Quarter Ended September 30, 2016

Equity markets shook off the malaise that took hold at the end of the second quarter—remember Brexit?—to post a strong quarter all around. Returns were especially good in domestic small caps and international stocks. While the S&P 500 Index advanced +3.85%; the Russell 2000 Index jumped +9.05%; and the MSCI EAFE Index rose +6.43%. The third quarter was the best period for the MSCI EAFE Index in nearly three years, and the best for the Russell 2000 Index in almost two years. We do not believe much changed to drive this result: we simply think people recognized the economy is sound and interest rates remain low—a good environment for equities. This quarter, Ariel Appreciation Fund rose +7.00%, outperforming the Russell Midcap Value Index's +4.45% rise, as well as the +4.52% return of the Russell Midcap Index.

Some of our holdings rose nicely during the quarter. Cutting tools maker Kennametal Inc. (KMT) jumped +32.19% as its modernization efforts started to gain traction. To a large extent this means more automation, which increases efficiency and slashes costs. The company is also focusing on its more profitable, large customers and shedding smaller ones. We see these moves as an essential part of making its moat wider and better; we think the financial benefits will be significant and long lasting. Also, asset manager and financial advisory firm

Lazard Ltd. (LAZ) surged +23.46% after beating earnings expectations. Asset management revenues were above consensus numbers, largely the result of \$453 million in net inflows. Lazard also had strong restructuring revenues, which offset weaker advisory revenue. The market, which often extrapolates short-term problems, projected summer outflows would continue.

Other holdings fell back a bit. Jam, peanut butter and coffee company J.M. Smucker Co. (SJM) retreated -10.64% due to a recent acquisition that has not met expectations. In 2015, the company moved into pet food as a part of its "center of the store" strategy with the purchase of Big Heart Pet Brands. That unit did not deliver the revenues or profits analysts expected. We believe the shortfall is mainly due to pet food cost deflation and a price war from its chief competitors. We think the management team will get things moving in the right direction and are content to own the stock at a cheaper multiple in the meantime. In addition, media firm Viacom, Inc. (VIAB) declined -7.61% amidst its management shuffle. As you may know, the company ousted CEO Philippe Dauman in August and temporarily replaced him with Chief Operations Officer Tom Dooley. In late September, Dooley announced he was resigning, effective mid-November. Amidst the turbulence, the company declared a 50% cut in its quarterly dividend—a move we felt was prudent. Clearly in the short term the news from

Viacom is unsettling, but we continue to believe in the company's assets and competitive positioning long term.

In the third quarter, we added new firm-wide holding BOK Financial Corp. (BOKF) to Ariel Appreciation Fund. BOK Financial is a leading bank holding company that provides services to businesses and individuals located in the middle-south. Skilled underwriting capabilities and an experienced management differentiate BOK Financial from its competitors. Recent macroeconomic headwinds in the energy industry caused by depressed oil and natural gas prices have created significant pressure on the stock price. As a result, we see this as an opportunity to own a conservatively managed bank with a geographic niche. We sold all of our shares of St. Jude Medical, Inc. (STJ) on the news of it being acquired by Abbott Laboratories (ABT), as well as PrivateBancorp, Inc. (PVTB) on the news of its acquisition by Canadian Imperial Bank of Commerce or CIBC (CM).

Looking ahead, we are optimistic. That is, most of our companies have been doing well. Management teams are making rational decisions, revenues and profits look good, and the holdings in need of changes are making them. Plus we think fundamentals, broadly, are sound. True, concerns about valuation are growing, and we agree some areas of the market have questionable valuations. So we have steered clear of those areas as well as specific stocks priced for perfection. In short, we believe our own portfolios are in good shape.

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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 9/30/16, Kennametal Inc. constituted 4.6% of Ariel Appreciation Fund; Lazard Ltd. 3.5%; J.M. Smucker Co. 3.4%; Viacom, Inc. 2.7%; BOK Financial Corp. 0.3%; St. Jude Medical, Inc. 0.0%; Abbott Laboratories 0.0%; PrivateBancorp, Inc. 0.0%; and Canadian Imperial Bank of Commerce 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 Appreciation Fund.

The Russell Midcap<sup>®</sup> Value Index measures the performance of the mid-cap value segment of the U.S. equity universe. It includes those Russell Midcap Index companies with lower price-to-book ratios and lower forecasted growth values. The Russell Midcap<sup>®</sup> Index measures the performance of the mid-cap segment of the U.S. equity universe. The Russell Midcap Index is a subset of the Russell 1000<sup>®</sup> Index. It includes approximately 800 of the smallest securities based on a combination of their market cap and current index membership. Russell<sup>®</sup> is a trademark of Russell Investment Group, which is the source and owner of the Russell Indexes' trademarks, service marks and copyrights. Index returns reflect the reinvestment of income and other earnings. Indexes are unmanaged, and investors cannot invest directly in an index.

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