ARIEL INVESTMENTS

MONTHLY COMMENTARY

• Value • Deep value • Global

Month Ended January 31, 2017

In January, our monthly commentary typically focuses on the prior year's asset flows, since they often a reveal a lot about investor sentiment. As we have noted before, asset flows have followed a different pattern in the wake of the great financial crisis. Specifically, bonds tended to receive inflows, domestic equity saw outflows, and passive management began dominating active management—mainly but not only in equities. More subtly, a long-standing preference for funds with strong short-term performance became even more pronounced.

Over the last year it is fair to say we have been through a lot—including Brexit, an unprecedented presidential election and all-time market highs. And yet, the flow story remains unchanged. In 2016, bonds saw inflows, while equity funds saw outflows. Passively-managed funds gained huge assets, while active funds continued to lose them. On the performance front, new money mainly went to recently strong performers or very new offerings.

More specifically, according to Morningstar data, U.S. Equity lost $152 billion and international equity lost $2 billion in 2016, while taxable bonds and municipal bonds gained $113 billion and $27 billion, respectively. Even more dramatically, across the full universe, actively managed funds had $318 billion in outflows while passive funds gained $226 billion in new assets.

Morningstar also shows flows by star rating, which captures investors' performance sensitivity. Among rated funds (those with more than three years of history), the 10% of funds with 5-star ratings gained $136 billion in new money, while the 22.5% of funds with 4-star ratings added just $146 million in flows. Collectively, the other 67.5% of the rated fund universe, funds with 3-, 2- and 1-star ratings, saw $302 billion fly out the door. Perhaps of greatest concern: funds with less than three years of history gained $73 billion in flows. In other words, new and therefore unrated funds had more than half the inflows 5-star funds had.

Overall, we think this behavior is a bit bewildering and counterproductive. The bond fund boom began in 2008. Since which time the asset class has amassed an incredible $1.3 trillion in inflows over nine years. Meanwhile, U.S. and international equity funds have seen $29 billion depart. This push, which most agree stems from stock market losses during the great financial crisis, has hurt overall investor returns. The Barclays U.S. Aggregate Bond Index (the key benchmark) has trailed the S&P 500 Index in seven of nine calendar years over this stretch.

Bond yields continue to be near all-time lows, and the Federal Reserve has signaled it is likely to raise rates three or more times in 2017. As you know: every rate increase causes bond prices to drop in tandem.

As for the nearly wholesale abandonment of active management in favor of index funds and ETFs, we have been clear on that subject before and will offer another piece of 2016 data. In 2016, Morningstar's Mid-Blend category, home to Ariel Fund and Ariel Appreciation Fund, saw more than $7 billion pour out of actively managed funds and nearly $7 billion flow into passively managed funds. To us, that says investors believe mid-blend managers cannot beat representative indexes. And yet, in 2016, 59% of mid-blend funds topped the Russell Midcap Index's +13.80% gain[1]. And over the 3- and 5-year periods, 25% of the category topped this benchmark for both time periods. To be sure, outperformance is not the norm—but it seems a lot more common than flows suggest.

All told, we continue to believe the best game-plan is to assess one's goals, develop a long-term asset allocation policy to achieve those goals, and stick to it while making few adjustments. We also believe that, with a little work, one can find a solid actively-managed equity fund with a track record showing experience and proficiency.

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[1] **Past performance does not guarantee future results.**

The opinions expressed are current as of the date of this commentary but are subject to change. The details offered in this commentary do 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.

Past performance does not guarantee future results. 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 more volatile than investing in large companies. The intrinsic value of the stocks in which a value portfolio invests may never be recognized by the broader market. Ariel Fund and Ariel Appreciation Fund often invest a significant portion of their assets in companies within the financial services and consumer discretionary sectors and their performance may suffer if these sectors underperform the overall stock market.

An actively managed portfolio is more risky than a passively managed portfolio that replicates an index because it contains fewer stocks than its benchmark index. Indexes are unmanaged, and an investor cannot invest directly in an index. However, investors may invest in an index fund, which mimics the composition of an index. There are lower costs associated with index funds, as compared to actively managed funds.

Bonds are fixed income securities in that at the time of the purchase of a bond, the amount of income and the timing of the payments are known. Risks of bonds include credit risk and interest rate risk, both of which may affect a bond's investment value by resulting in lower bond prices or an eventual decrease in income. Treasury bonds are issued by the government of the United States. Payment of principal and interest is guaranteed by the full faith and credit of the U.S. government, and interest earned is exempt from state and local taxes. Municipal bonds are debt securities issued by state and local governments. Municipal notes mature in one year or less, offer fixed income and are often exempt from income tax at the local, state and/or federal levels.

Index returns do not reflect the deduction of the fees, costs or expenses associated with an actual investment account. Indexes are unmanaged, and an investor cannot invest directly in an index. The Russell Midcap® 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® Index. It includes approximately 800 of the smallest securities based on a combination of their market cap and current index membership. Frank Russell Company ("Russell") is the source and owner of the trademarks, service marks and copyrights related to the Russell Indexes. Russell® is a trademark of Frank Russell Company. 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 the most widely accepted barometer of large cap U.S. equities. It includes 500 leading companies. The U.S. Aggregate Bond Index is a broad-based benchmark that measures the investment grade, U.S. dollar-denominated, fixed-rate taxable bond market, including Treasuries, government-related and corporate securities, MBS (agency fixed-rate and hybrid ARM passthroughs), ABS, and CMBS. The U.S. Aggregate rolls up into other Barclays flagship indices, such as the multi-currency Global Aggregate Index and the U.S. Universal Index, which includes high-yield and emerging markets debt.

The Morningstar Rating™ for funds, or "star rating", is calculated for managed products (including mutual funds, variable annuity and variable life subaccounts, exchange-traded funds, closed-end funds, and separate accounts) with at least a three-year history. Exchange-traded funds and open-ended mutual funds are considered a single population for comparative purposes. It is calculated based on a Morningstar Risk-Adjusted Return measure that accounts for variation in a managed product's monthly excess performance, placing more emphasis on downward variations and rewarding consistent performance. The top 10% of products in each product category receive 5 stars, the next 22.5% receive 4 stars, the next 35% receive 3 stars, the next 22.5% receive 2 stars, and the bottom 10% receive 1 star. The Overall Morningstar Rating for a managed product is derived from a weighted average of the performance figures associated with its three-, five-, and 10-year (if applicable) Morningstar Rating metrics. The weights are:

100% three-year rating for 36-59 months of total returns, 60% five-year rating/40% three-year rating for 60-119 months of total returns, and 50% 10-year rating/30% five-year rating/20% three-year rating for 120 or more months of total returns. While the 10-year overall star rating formula seems to give the most weight to the 10-year period, the most recent three-year period actually has the greatest impact because it is included in all three rating periods.

Investors should consider carefully the investment objectives, risks, and charges and expenses before investing. For a current prospectus or summary prospectus which contains this and other information about the funds offered by Ariel Investment Trust, call us at 800-292-7435 or visit our website, arielinvestments.com. Please read the prospectus or summary prospectus carefully before investing. Distributed by Ariel Distributors LLC, a wholly owned subsidiary of Ariel Investments LLC.