WASATCH GLOBAL INVESTORS

Quarterly Commentary

Wasatch Emerging Markets Small Cap Strategy

DECEMBER 31, 2019

Recent Headwinds for Emerging Markets Have Shown Signs of Reversing

OVERVIEW

Accommodative monetary policy and an apparent breakthrough in the trade impasse between the U.S. and China helped push emerging-market equity prices higher during the fourth quarter. The benchmark MSCI Emerging Markets Small Cap Index rose 9.52%. The Wasatch Emerging Markets Small Cap strategy posted a double-digit gain and outperformed the benchmark. For all of 2019, the strategy performed significantly better than the 11.50% return of the Index.

Central banks around the world maintained a general bias toward easing, with the U.S. Federal Reserve cutting its key lending rate for the third time in 2019. The widely expected move dampened enthusiasm for the U.S. dollar, which slipped -3.0% against a basket of major rivals during the fourth quarter. Emerging markets benefited as the falling greenback and lower U.S. interest rates made riskier assets in developing nations more attractive to international investors. A weaker dollar also makes it easier for emerging markets to issue debt denominated in their own currencies.

Taiwan was the strategy's largest source of outperformance relative to the benchmark. The island's economy has benefited from an influx of manufacturing as global supply chains shifted away from China to avoid tariffs on goods bound for the U.S. Driven by strength in industrials and information technology (IT), the strategy's Taiwanese stocks substantially outgained the Taiwanese positions in the Index.

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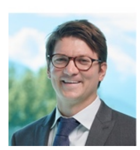

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India and Thailand also were sources of outperformance. With the economies of both countries decelerating, the financials and other growing companies owned in the strategy became more appealing to investors. India's gross domestic product (GDP) rose 4.5% in the September quarter from a year ago—down from 5% in the previous quarter and the slowest pace of expansion in more than six years. In Thailand, the central bank cut its policy interest rate to a record low 1.25% in November to restrain a surging currency that has made the country's exports less competitive overseas.

Korea was the strategy's primary source of weakness against the benchmark. Considered a bellwether for global trade and technology, Korea's equity market moved higher as trade tensions eased during the fourth quarter. Although the strategy's Korean stocks generated a solid gain as a group, declines in two individual holdings dragged down performance.

DETAILS OF THE QUARTER

The strongest contributor to strategy performance for the quarter was **Silergy Corp.** Based in Taiwan, the company manufactures high-performance mixed-signal and analog integrated circuits used in a wide array of electronic devices. Silergy's stock price had languished during the latter half of 2018 and early 2019 as sluggish demand caused a buildup of inventory in semiconductor supply channels. An uptick in sales during May sparked a turnaround in the stock that accelerated during the fourth quarter. In December, Silergy announced that consolidated revenues for November had risen 38.0% in local currency and 39.7% in U.S. dollars versus November 2018.

A pair of Brazilian holdings—**Magazine Luiza S.A.** and **Raia Drogasil S.A.**—represented the second-largest and third-largest contributors, respectively. Magazine Luiza operates a multi-channel retail platform of mobile, website and physical stores in Brazil. Shares of the company logged strong gains amid positive sentiment toward Brazilian equities and optimism that Magazine Luiza will be able to capture a significant slice of Brazil's e-commerce pie.

Raia Drogasil operates the leading chain of drugstores in Brazil. The company had been struggling as competitors used lower-priced, lower-quality generic medicines to lure consumers. Now that the company has begun offering discounted generics of its own, competitive intensity appears to have eased. The stock rose sharply in October after Raia Drogasil reported quarterly same-store sales growth of 11.9% overall and 7.7% for mature stores versus the same quarter a year ago. The company's retail market share increased 1.7 percentage points nationally and 2.5 percentage points in the key São Paulo market compared to the year-ago period.

The greatest detractor from strategy performance for the quarter was **Vitasoy International Holdings Ltd.** A multinational based in Hong Kong, the company offers soy milk, tofu, rice milk, tea, juices and related food-and-beverage products in China and other countries. Investors reacted negatively to Vitasoy's plans to invest more heavily in its soy-milk business to stave off competitive pressures and pave the way for future growth. We think the company's strategy makes sense, however—especially in view of the large untapped potential for packaged soy milk and Vitasoy's strong brand presence in the markets it serves.

Other detractors included two Korean stocks, **BGF Retail Co. Ltd.** and **Medytox, Inc.** BGF, an operator of convenience stores, has seen competitive pressures impact both the top and bottom lines of its business. In addition, Korea's populist government has raised the country's minimum wage, swelling BGF's labor costs and squeezing margins further. With convenience-store openings in Korea continuing to outstrip demand growth in the industry, we are reevaluating the strategy's position in the stock.

Medytox manufactures neurotoxins for cosmetic applications. Concerns about the pending approval of the company's products for sale in China continued to weigh on the share price of Medytox. Meanwhile, the company's lawsuit against a pair of competitors—which seeks to block U.S. imports of a rival product—have created an additional layer of uncertainty around the stock. On the plus side, a recent inspection of the company's manufacturing facilities by Korea's Ministry of Food and Drug Safety failed to uncover any serious problems, thus removing a potential obstacle to Chinese approval.

OUTLOOK

As was the case during the fourth quarter, a general principle in international investing is that a falling U.S. dollar is helpful to emerging markets. Weakness in the greenback can become self-reinforcing, as outsized equity gains and stronger economic growth in emerging markets pull investment away from the U.S., further impacting the dollar. Conversely, a strong U.S. dollar can pose headwinds to emerging-market investments. Countries with structurally weak currencies are especially vulnerable to dollar strength, which may compel them to adopt overly restrictive monetary and fiscal policies in order to attract and retain foreign capital.

From the dollar's recent low against a basket of major rivals on January 26, 2018, the greenback rose 11.3% through the end of September 2019. When viewed in that light, the difficulties emerging-market investments faced in 2019 and 2018 seem unsurprising. The MSCI Emerging Markets Small Cap Index lost -18.59% in 2018—and was up just 1.81% through the end of 2019's third quarter, lagging more-sizable gains in global equity markets as a whole. The dollar's abrupt reversal during the fourth quarter—in which the greenback declined -3.0% against the same basket of competitive currencies—helped propel the MSCI Emerging Markets Small Cap Index to a 9.52% gain during the final three months of 2019.

Although the dollar's cyclical phases are not actionable for timing purposes, they nevertheless provide us with a rough framework for evaluating the current situation and longer-term probabilities. The dollar's historical tendency to trade within a fairly well-defined band suggests that it cannot continue going up forever. We now seem to be approaching the upper end of that band. If so, the strong-dollar headwind of the past two years may be poised to transform itself into a weak-dollar tailwind for emerging markets.

In the meantime, we think the high-quality companies and innovative disruptors around which we have built the strategy's portfolio are well-positioned to outperform. We look for companies with their own, unique demand drivers that are not tied to macro trends in the global economy. Throughout the dollar's cycles, we believe our fundamental, bottom-up investment approach has the potential to generate attractive returns over time.

Thank you for the opportunity to manage your assets.

Sincerely,

Ajay Krishnan, Roger Edgley, Dan Chace,
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The MSCI Emerging Markets and Emerging Markets Small Cap Indexes are free float-adjusted market capitalization indexes designed to measure the equity market performance of emerging markets. You cannot invest in these or any indexes.

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This commentary is intended to provide you with information about factors affecting the performance of the Wasatch Emerging Markets Small Cap strategy during the period. References to individual companies should not be construed as recommendations to buy or sell shares in those companies. Wasatch analysts closely monitor the companies held in the Emerging Markets Small Cap strategy. If a company's underlying fundamentals or valuation measures change, Wasatch will reevaluate its position and may sell part or all of its holdings.

Past performance is not indicative of future results.