

Wasatch Frontier Emerging Small Countries Strategy

DECEMBER 31, 2019

Latin America Drove Solid Fourth Quarter Capping Strategy's Strong Year

OVERVIEW

The Wasatch Frontier Emerging Small Countries strategy finished the fourth quarter of 2019 with a strong gain and outperformed its primary benchmark, the MSCI Frontier Emerging Markets Index, which finished the period up 6.74%.

Following a weak third quarter, both developed and emerging markets bounced back in the fourth quarter to cap off a volatile, but positive year. For the 12 months ended December 31, 2019, the strategy's double-digit return outperformed the benchmark's gain of 14.10%.

Despite the stock-price volatility of our target markets this year, the last couple of quarters have seen strong fundamentals among our portfolio companies. While we have gone through periods during which external factors—from currency issues to commodity prices to national politics—have temporarily overwhelmed fundamental performance in many of the markets in which we invest, we are confident that as those factors come and go, holding a stable of high-quality companies gives the strategy the best chance to weather this volatility successfully.

Much of our focus in frontier- and small emerging-market countries centers on companies meeting large-scale needs for large populations. Just as China and India were thrust onto the global economic stage by the strength of inbuilt consumer demand, other frontier- and emerging-market countries with large populations have found their similarly

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underserved consumers to be positive market forces, while weathering otherwise tumultuous market conditions.

An example of a country with a large consumer population is Brazil, Latin America's largest economy. There was good news for Brazil in the fourth quarter as the central bank cut its Selic rate to a record-low 4.5% in an effort to spur growth. The potent combination of falling interest rates, controlled inflation and firming economic data pushed major stock averages to record highs in Brazil, which was one of the top-performing countries in the MSCI Emerging Markets Index during the fourth quarter. It is unsurprising then, that Brazil added the most to the strategy's return on a country basis and also contributed the most to performance relative to the MSCI Frontier Emerging Markets Index, which does not have a position in Brazil.

Other strong-contributing countries included Mexico, South Africa and Indonesia. These countries also helped the strategy to outperform its benchmark.

Bangladesh subtracted the most from the strategy's return and our holdings underperformed their benchmark counterparts.

The financials sector is the most heavily weighted sector in the strategy at over 40% of assets, and our position size is in line with that of the benchmark. Our financial holdings performed especially well during the quarter, adding significantly to the strategy's return and outperforming the financials in the benchmark. The consumer staples and industrials sectors also performed well, contributing to the strategy's return and adding the most on a sector basis to our outperformance of the benchmark. Our group of consumer-staples holdings produced a double-digit gain, while the benchmark's group suffered a loss. Likewise in the industrials sector, the strategy had a double-digit gain, while the benchmark saw a single-digit return from its industrials holdings.

DETAILS OF THE QUARTER

Raia Drogasil S.A. was the top individual contributor to strategy performance for the quarter. The company operates the leading chain of drug stores in Brazil. Raia Drogasil 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.

Grupo Aeroportuario del Sureste S.A.B. de C.V. was the second-largest contributor. The company operates airports in Mexico, including holding 50-year concessions that began in 1998 to manage airports in Cancun, Cozumel and Merida, among others. During the quarter, the Mexican government clarified regulations pertaining to airport operators. While some questions still remain, we are generally optimistic that the added measure of certainty brought about by the clarification represents a positive long-term indicator for the company.

Weg S.A. was another Brazil-based contributor for the quarter. Weg makes transformers, motors, control panels and other components used to produce and transmit electric power from wind and other sources. With wind energy already the fastest-growing source of power generation in Brazil, we believe Weg is well-positioned to serve the growing demand for wind turbines and other electrical equipment. The company also has been benefiting from a pickup in international markets, particularly China, and from increased demand for its larger, more-profitable electric motors.

Benefiting from a recent rally by Kenyan stocks, **Safaricom plc** contributed during the quarter. The company runs a mobile-to-mobile payments platform, M-Pesa, as well as offering cellular telephone and internet access services in Kenya, which has been the fastest-growing market in sub-Saharan Africa for the past decade. Between 2009 and 2019, the number of internet users in Kenya grew from 3.3 million (or about 9% of the population) to 46.9 million (or about 90% of the population). Although the telecommunications industry in Kenya is young enough that it is likely to see continued changes, Safaricom maintains its dominant position and boasts a strong management team. With the success of its traditional lines of business, as well as its M-Pesa payment platform, we anticipate the company will continue to grow.

Qualitas Controladora S.A.B. de C.V., the largest motor-vehicle insurer in Mexico, was also among the strategy's top contributors in the quarter. Despite slowing growth and policy uncertainty in Mexico, Qualitas has been producing record profitability, with high rates adding a tailwind to investment income at the same time underwriting profitability has been hitting multi-year highs. As the market leader in a very under-penetrated industry in Mexico, we believe Qualitas should continue to post steady revenue growth and strong returns on capital. What's more, the company sits on a significant amount of excess capital that can be used for diversifying the business into adjacent markets or for returning cash to shareholders.

ASA International Group plc, one of our few Bangladeshi holdings, was the strategy's largest individual detractor. ASA operates as a micro-financing company, providing loans and advances to small businesses, with a particular focus on funding for female micro-entrepreneurs. The company group serves clients worldwide. ASA's fundamentals this year have been affected by

currency weakness in a few of the company's larger markets, namely Pakistan. However, our research has indicated that ASA's underlying fundamentals have remained solid. We continue to like the company's valuation, return profile and geographic diversification. Despite the stock's dip, we do not believe there are fundamental reasons for concern.

Another detractor was **Unifin Financiera S.A.B. de C.V.**, which operates as a multiple purpose financial company in Mexico and offers financing products, including leasing, factoring, credit and auto loans, mainly to small and medium-size enterprises in Mexico. The company has recently seen weaker-than-expected demand as a result of heightened government policy uncertainty, which we believe will wane in significance. We expect Unifin's fundamentals to rebound and the company to continue to grow.

OUTLOOK

The final quarter of the year saw a steady stream of positive news. We are heartened by the strategy's strong performance for the quarter and year, especially since the investment climate was marked by volatility and uncertainty. During uncertain times like these, we feel more responsibility, not less, to conduct thorough due diligence as we seek to find companies that have the potential to weather a variety of market environments, come what may.

That South Africa ended the year on a positive note was welcome. In many respects, South Africa is emblematic of the ups-and-downs during the year. The country saw growth plummet in the first quarter, rebound in the second quarter and completely flatten in the third quarter. Nevertheless, our South African holdings turned in strong performance for the fourth quarter.

Mexico also seemingly turned a corner to end the year, but the positive performance comes on



the heels of major currency pressure and reduced capital expenditures in Mexico, along with higher inflation, heightened political uncertainty and a recent economic contraction that has lasted three quarters.

None of these factors necessarily suggest a longer-term downturn in economic growth for the countries in which we're invested. Our hope is that the current positive environment will persist. However, we necessarily balance the positive performance we have been seeing against an unpredictable global environment in which growth has shown signs of slowing.

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 and frontier markets. Weakness in the greenback can become self-reinforcing, as outsized equity gains and stronger economic growth in international markets pull investment away from the U.S., further impacting the dollar. Conversely, a strong U.S. dollar can pose headwinds to emerging- and frontier-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.

Overall, as an asset class, frontier markets have performed well in 2019, with the 17.99% return of the MSCI Frontier Markets Index for the 12 months ended December 31, 2019 keeping pace with the

18.42% return of the MSCI Emerging Markets Index. And while the persistent graduation of frontier-index constituents to emerging-market indexes continues to make the MSCI Frontier Markets benchmark less significant, we remain committed to investing in the broader universe of frontier and emerging small countries that the strategy was founded to address. We believe this universe will offer increasingly unique and attractive investment opportunities in the months and years to come. So even though the indexes continue to shift, our focus on researching and investing in what we see as the highest-quality companies in frontier and emerging small countries will not.

We remain vigilantly aware of developing macro realities, even as our bottom-up approach means we remain solidly focused on finding excellent companies, wherever they may be. As a result of our in-depth due diligence, we believe our holdings are well-positioned to continue on their long-term growth trajectories and to weather the short-term ebbs and flows of frontier- and small emerging-market countries.

Thank you for the opportunity to manage your money.

Sincerely,

Scott Thomas and Jared Whatcott



The MSCI Frontier Emerging Markets and MSCI Frontier Markets indexes are free float-adjusted market capitalization indexes designed to measure equity market performance in the global frontier and emerging markets. You cannot invest in these or any indexes.

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Return on capital is a measure of how effectively a company uses the money, owned or borrowed, that has been invested in its operations.

This commentary is intended to provide you with information about factors affecting the performance of the Wasatch Frontier Emerging Small Countries 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 Frontier Emerging Small Countries 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.

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