

Wasatch Global Value Strategy

DECEMBER 31, 2019

Stocks Gained on Stimulus, Reduced Trade Concerns

OVERVIEW

The Wasatch Global Value strategy produced a solid gain in the fourth quarter of 2019, trailing the benchmark MSCI AC World Index, which returned 8.95%. The strategy also lagged the MSCI AC World Value Index, which returned 7.31%.

The substantial returns for global equities seen in the quarter capped a strong 2019 for the market. Investor sentiment was supported by signs of improving economic growth globally, an apparent de-escalation in the U.S.-China trade war, and substantial monetary policy support in the form of low interest rates from leading central banks.

Within the global equity universe, performance was led for the quarter by information-technology and health-care stocks, while the more defensive utilities, consumer-staples and real-estate sectors were the biggest laggards. The strategy's performance relative to the benchmark was constrained by a relatively conservative stance overall and by underweighting the U.S. market in favor of exposure to emerging markets where we see more value. In terms of sectors, selection within information technology was the biggest constraint on relative performance, while our outperformance in health care benefited results versus the benchmark as did the strategy's overweight position in financials.

DETAILS OF THE QUARTER

Leading contributors for the quarter included consumer electronics and semiconductor company **Samsung Electronics Co. Ltd.** Prior to the fourth quarter, slowing demand for memory chips from smartphone manufacturers and data centers had been weighing on the stock.

PORTFOLIO MANAGER



David Powers, CFA, CAIA, CPA
Lead Portfolio Manager

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YEAR ON STRATEGY / YEARS AT WASATCH

Investor sentiment with respect to Samsung and other semiconductor manufacturers improved over the quarter as signs emerged that the memory chip cycle had bottomed out. We see Samsung as positioned to be a key beneficiary as 5G-capable smartphones are rolled out over the coming quarters. We view the stock as relatively inexpensive within the technology space and maintained the position.

Among large banks, we believe **Citigroup, Inc. (C)** is the most tied to the global economy. Citigroup's share price climbed in the quarter on optimism over the global growth outlook driven by central bank stimulus and improved forward-looking data including stabilization in purchasing-manager indexes. Investor sentiment with respect to the banking industry more broadly benefited from the steepening of the yield curve between two and 10 years, which should help improve net interest margins. We trimmed our Citigroup position on strength but maintained the position.

The stock price of **Centene Corp. (CNC)**, a new name added in the quarter, rose along with those of other managed-care organizations. Concerns over the prospect of "Medicare for all" that have overhung the broader health-care sector receded in the quarter. In addition, Centene management expressed confidence in the timetable for completing the acquisition of WellCare Health Plans which, if approved, will give the provider of government subsidized health care a presence in all 50 states. Finally, Centene was awarded an expanded Medicaid contract in Texas that included two new service areas.

Leading detractors included Korean tobacco company **KT&G Corp.** While KT&G is primarily focused on its domestic market, the company has experienced declining export volumes driven largely by softening demand from the Middle East. In addition, there are concerns about the need to respond to competition from e-cigarettes. While KT&G recently launched a "heat-not-burn" product

it faces significant competition within that segment. In addition, the well-publicized health issues experienced by some users of vaping products have negatively impacted demand globally for tobacco alternatives. Finally, in December Japan Tobacco ended its strategic partnership with KT&G by selling its stake of a little over 2% in the company, sending KT&G's share price lower. We maintained our weighting. KT&G has a strong balance sheet that features more cash than debt and we believe it is positioned to return to topline growth and margin improvement in coming quarters.

Exposure to specialty real-estate investment trust (REIT) **EPR Properties (EPR)** also detracted from strategy performance. EPR owns a range of recreational and entertainment properties including megaplex theaters, amusement parks and ski areas. In addition, EPR has owned properties leased by charter schools, private schools and early education providers. In November, EPR announced the sale of its school-related assets and a tightened focus going forward on "experiential" properties, including a move into casinos. Investors seemed uncertain about this new direction and concerned about earnings dilution pending reinvestment of the asset-sale proceeds.

Utility company **Duke Energy Corp. (DUK)** also detracted. Rising Treasury yields proved to be a headwind for "bond surrogate" sectors such as utilities over the quarter. In addition, there were concerns among some investors over earnings dilution given Duke's plans to raise equity in order to finance capital expenditures. Uncertainty around the timeline for completion of the Atlantic Coast Pipeline also weighed on the stock. The project, which has been mired in legal challenges, is a joint venture of four utility companies designed to better enable the transportation of natural gas extracted from the Marcellus Shale through the Virginias into North Carolina. In our opinion, Duke is



one of the more attractively valued utilities. We added to the position on the view that any concerns were more than fully reflected in the stock price.

OUTLOOK

The global economy is being supported by an enormous amount of stimulus, mostly in the form of central-bank rate cuts. While we would expect to see the impact on growth of this monetary easing most immediately overseas, the U.S. equity market appears to have already discounted this improvement based on current, relatively expensive valuations.

The dollar has held up well despite the U.S. Federal Reserve (Fed) cutting rates three times in 2019. We attribute this to rates being low everywhere and the U.S. dollar's place as a safe-haven asset. With further Fed rate cuts now presumably on hold, companies' earnings growth will have to drive stock price gains rather than price/earnings multiple expansion in our view.

Global trade concerns seem to be receding, manufacturing appears to have bottomed out and the consumer is strong against a backdrop of tight labor markets. These conditions should support modest earnings growth in the mid-single-digit range for large companies in 2020. Geopolitical

developments continue to be a wild card for risk sentiment pertaining to the global equity markets.

The strategy remains tilted toward higher-quality companies within the large-cap value universe, as gauged by strong and sustainable free cash flow, high dividends and solid balance sheets. The strategy has slightly increased its cyclical exposure, finding more value in sectors such as energy and materials. In addition, the strategy's weighting in financials and health care has increased as our holdings have appreciated in value. We're comfortable with our weightings in these sectors given our conviction in our holdings. We continue to overweight international markets relative to the benchmark, on the view that valuations are more attractive outside the U.S. market. This particularly has been the case in emerging markets, where growth has been strong but stock prices have trailed those in developed markets for some time.

Thank you for the opportunity to manage your assets.

Sincerely,

David Powers



The MSCI AC (All Country) World Index captures large- and mid-cap representation across 23 developed market and 24 emerging market countries. With 2,771 constituents, the Index covers approximately 85% of the global investable equity opportunity set. You cannot invest in this or any index.

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Earnings growth is a measure of growth in a company's net income over a specific period, often one year.

The MSCI AC (All Country) World Value Index captures large and mid-cap securities exhibiting overall value style characteristics across 23 developed-market countries and 26 emerging-market countries. You cannot invest directly in this or any index.

The price/earnings (P/E) ratio, also known as the P/E multiple, is the price of a stock divided by its earnings per share.

The yield curve is a line on a graph that plots the interest rates, at a set point in time, of bonds having equal credit quality, but differing maturity dates. The most frequently reported yield curve compares three-month, two-year, five-year and 30-year U.S. Treasury securities. This yield curve is used as a benchmark for other interest rates, such as mortgage rates or bank lending rates. The curve is also used to predict changes in economic output and growth.

Valuation is the process of determining the current worth of an asset or company.

This commentary is intended to provide you with information about factors affecting the performance of the Wasatch Global Value 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 Global Value 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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