

# Wasatch Micro Cap Fund

SEPTEMBER 30, 2020

## After Another Strong Quarter, We're Focused on Quality as Uncertainty Is Likely To Increase

### OVERVIEW

The Wasatch Micro Cap Fund—Investor Class increased 12.21% in what was an up-and-down and ultimately positive quarter for U.S. micro caps. The Fund outgained its benchmark, the Russell Microcap Index, which rose 3.69%. Signs of steady economic improvement following the Covid-19 shutdown created a generally positive environment for stocks during most of the quarter. Investors also took heart from progress toward the development of vaccines for the virus.

Despite a spectacular rebound in equities during the previous three months, investors remained somewhat skittish during the third quarter. Stocks of small- and micro-cap companies underperformed large-cap issues as the CBOE Volatility Index, or VIX, remained well above pre-Covid levels. Often referred to as the "Fear Index," the VIX is a widely followed measure of near-term risk in the market. With a high-stakes election rapidly approaching and the coronavirus continuing to pose a threat to economic activity, cautious investors sought the perceived safety of larger companies.

### FUND MANAGERS



**Ken Korngiebel, CFA**  
Lead Portfolio Manager

3 / 5  
YEARS ON FUND / YEARS AT WASATCH



**Dan Chace, CFA**  
Portfolio Manager

16 / 18  
YEARS ON FUND / YEARS AT WASATCH

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*Data show past performance and is not indicative of future performance. Current performance may be lower or higher than the data quoted. For the most recent month-end performance data, visit [wasatchglobal.com](http://wasatchglobal.com). Investment returns and principal value will fluctuate and shares, when redeemed, may be worth more or less than their original cost. The Advisor may absorb certain expenses, leading to higher total shareholder returns. Wasatch Funds will deduct a 2% redemption fee on Fund shares held 60 days or less. Performance data does not reflect this redemption fee or taxes. **Total Expense Ratio: Investor Class 1.66% / Institutional Class 1.59%. The Advisor has contractually agreed to limit certain expenses to 1.95% for the Investor Class and 1.60% for the Institutional Class through at least 1/31/2021.***



Health care was a key area in which we were able to overcome the general headwind to micro caps and outperform the benchmark. The Fund's above-benchmark weight in health care is a natural outgrowth of our bottom-up investment discipline and the importance we place on owning companies that we believe can continue to expand and take market share even in a weak economy. As we scour the micro-cap universe for potential investments, health care has continued to be a source of innovative, disruptive companies with some of the most attractive long-term prospects on our metrics.

The financials sector was another primary source of outperformance. Our underweight position in financials helped the Fund by limiting its exposure to what was one of the worst-performing sectors of the Index during the third quarter. Moreover, the Fund posted a large positive return in the sector due to an outsized gain in a single holding.

Rather than a "bet" against the sector, the Fund's underexposure to financials reflects what we perceive as a scarcity of attractive opportunities in the U.S. banking industry. Although banking currently accounts for about 13% of the Index, it isn't an industry that's dynamic and growing. We actively research and invest in banks that we believe have compelling product strategies and favorable geographic locations. However, we've never been able to find enough of them to get close to the benchmark's weight.

## DETAILS OF THE QUARTER

The top contributor to Fund performance for the quarter was **Open Lending Corp. (LPRO)**. The company provides loan analytics, risk-based pricing and automated-decision technology for automotive lenders. Although Open Lending is classified as a financial company, it incurs no credit risk. Instead, it offers a fee-based platform that enables lenders to assess the creditworthiness of car buyers more accurately. Open Lending's stock price rose steadily

during the third quarter as the company continued to acquire new customers. Because adding customers is neither capital- nor labor-intensive, a high percentage of Open Lending's incremental revenue flows through to the bottom line.

**Silk Road Medical, Inc. (SILK)** was also a top contributor. The company offers implantable devices for the treatment of carotid-artery disease. Investors reacted positively to increases in the number of surgeries using Silk Road's products—from approximately 385 in April to 685 in May and 900 in June. Known as transcatheter artery revascularization, Silk Road's innovative, minimally invasive procedure is likely, in our view, to continue gaining market share at the expense of open surgery and transfemoral stenting, and to eventually become the new standard of care.

Another strong stock in the Fund was **BioLife Solutions, Inc. (BLFS)**, one of our newer holdings. The company provides proprietary biopreservation products used in cell therapy, gene therapy and regenerative medicine. BioLife's flagship product, CryoStor,<sup>®</sup> has garnered increased attention from investors because of its potential use in coronavirus vaccines requiring storage at very cold temperatures. In addition, the company offers thawing products, a cold-chain transport system and high-capacity freezers—all of which also have applications to the prospective distribution programs of certain vaccine candidates for Covid-19.

The greatest detractor from Fund performance for the quarter was **Inovio Pharmaceuticals, Inc. (INO)**. A biotechnology company, Inovio is developing a Covid-19 vaccine candidate, INO-4800. Following an upswell of optimism from March through June, the company's stock price headed lower during the third quarter amid worries that Inovio may be falling behind its competitors in the race to develop a vaccine for the disease. Concerns grew in late September after the company disclosed in a press release that the U.S. Food and

Drug Administration (FDA) had placed a partial hold on a combined Phase 2/3 clinical trial of INO-4800 that Inovio had planned to initiate by the end of the month. According to the company, the FDA had additional questions, including about the vaccine-delivery device to be used in the study.

On the positive side, Inovio stated that the FDA's partial hold did not result from any adverse events in its ongoing Phase 1 trial. Additionally, the hold does not affect the advancement of the company's other pipeline assets. Should INO-4800 eventually gain approval, we think its advantages—especially with respect to safety, storage and administration—would position it as a potentially valuable weapon in the vaccine arsenal that will be needed to quell the pandemic. Inovio's DNA medicines currently in development for various cancers and pre-cancers also offer meaningful upside potential, in our view.

**Paysign, Inc. (PAYS)** was also a significant detractor. The company provides prepaid-card programs and processing services for corporate, consumer and government applications. Total revenues at Paysign slipped -25% in the three months ended June 30 versus the same period a year ago. Management cited a 30% drop in revenue from the blood-plasma industry, as fears of contracting Covid-19 led to steep declines in plasma donations and dollars loaded onto the cards of paid donors. Extended unemployment benefits and stimulus payments from the government also may have impacted donations by lessening the economic imperatives for donors to sell their plasma. We believe these issues are short-term in nature and continue to hold the stock.

Another weak stock in the Fund was **GAN Ltd. (GAN)**. Based in the U.K., the company provides Software-as-a-Service (SaaS) solutions for online casino gaming and online sports betting. Shares of GAN tumbled in August after the company announced that a large customer, FanDuel, had

deployed its own proprietary digital wallet. The news—which meant that GAN would no longer be providing the digital wallet for FanDuel Sportsbook—disappointed investors, who had sent GAN's stock soaring during the first half of 2020 on hopes that the return of professional sports during the pandemic would substantially boost online gambling. While the loss of the FanDuel project was disappointing, GAN remains profitable on a top-line basis and we believe it is well positioned to benefit from future growth in online gambling. *(Current and future holdings are subject to risk.)*

## OUTLOOK

The final quarter of 2020 ushers in an unusually high number of uncertainties, some of which are likely to persist well into the New Year. Factors receiving the most attention from investors will include:

- Upcoming presidential and congressional elections and their effects on the balance of power in Washington
- Policy changes likely to result from the new political landscape—particularly with respect to taxation and health care
- The future course of the Covid-19 pandemic, including its impact on the U.S. and global economies
- The timing and efficacy of vaccines
- Additional economic-stimulus packages

We offer no unique insight into these topics, other than to note an interconnectedness that makes them especially difficult to fathom. For our part, we remain focused on quality as a means of addressing the elevated level of uncertainty. Having reexamined and stress-tested the balance sheets and cash flows of our companies during the early stages of the pandemic, we're comfortable



with the businesses owned in the Fund. At the same time, we believe the Fund is reasonably positioned to benefit from better-than-expected resolutions of uncertainties and other favorable developments that may impact financial markets.

Thank you for the opportunity to manage your assets.

Sincerely,

Ken Korngiebel and Dan Chace

## AVERAGE ANNUAL TOTAL RETURNS

FOR PERIODS ENDED SEPTEMBER 30, 2020

	Quarter*	1 Year	3 Years	5 Years	10 Years
Micro Cap Fund—Investor	12.21%	43.47%	25.10%	23.23%	17.05%
Micro Cap Fund—Institutional	12.22%	43.32%	25.05%	23.21%	17.04%
Russell Microcap® Index**	3.69%	4.44%	-0.09%	6.72%	9.50%

### A fund's performance for very short time periods may not be indicative of future performance.

\*Returns less than one year are not annualized.

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Total Annual Fund Operating Expenses include operating expenses, including the management fee, before any expense reimbursements by the Advisor. **The Advisor has contractually agreed to limit certain expenses to 1.95% for the Investor Class and 1.60% for the Institutional Class through at least 1/31/2021.** See the prospectus for additional information regarding Fund expenses.

Wasatch Funds will deduct a 2.00% redemption fee on Fund shares held 60 days or less. Performance data does not reflect the deduction of fees or taxes, which if reflected, would reduce the performance quoted. For more complete information including charges, risks and expenses, read the prospectus carefully.

Performance for the Institutional Class prior to 1/31/2020 is based on the performance of the Investor Class. Performance of the Fund's Institutional Class prior to 1/31/2020 uses the actual expenses of the Fund's Investor Class without any adjustments. For any such period of time, the performance of the Fund's Institutional Class would have been substantially similar to, yet higher than, the performance of the Fund's Investor Class, because the shares of both classes are invested in the same portfolio of securities, but the classes bear different expenses.

**Investing in micro cap funds will be more volatile and loss of principal could be greater than investing in large cap or more diversified funds. Investing in foreign securities, especially in emerging markets, entails special risks, such as currency fluctuations and political uncertainties, which are described in more detail in the prospectus.**

**An investor should consider investment objectives, risks, charges and expenses carefully before investing. To obtain a prospectus, containing this and other information, visit [wasatchglobal.com](http://wasatchglobal.com) or call 800.551.1700. Please read the prospectus carefully before investing.**



*\*\*The Russell Microcap Index is an unmanaged total return index of the smallest 1,000 securities in the small-cap Russell 2000 Index along with the next smallest 1,000 companies, based on a ranking of all U.S. equities by market capitalization. The Russell 2000 Index is an unmanaged total return index of the smallest 2,000 companies in the Russell 3000 Index. The Russell 2000 is widely used in the industry to measure the performance of small company stocks.*

*You cannot invest directly in these or any indexes.*

*The Wasatch Micro Cap Fund has been developed solely by Wasatch Global Investors. The Wasatch Micro Cap Fund is not in any way connected to or sponsored, endorsed, sold or promoted by the London Stock Exchange Group plc and its group undertakings (collectively, the "LSE Group"). FTSE Russell is a trading name of certain of the LSE Group companies.*

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*The Index is calculated by or on behalf of FTSE International Limited or its affiliate, agent or partner. The LSE Group does not accept any liability whatsoever to any person arising out of (a) the use of, reliance on or any error in the Index or (b) investment in or operation of the Wasatch Micro Cap Fund or the suitability of the Index for the purpose to which it is being put by Wasatch Global Investors.*

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*The Wasatch Micro Cap Fund's investment objective is long-term growth of capital. Income is an objective only when consistent with long-term growth of capital.*

*VIX is the ticker symbol for the Chicago Board Options Exchange (CBOE) Volatility Index, which shows the market's expectations of 30-day volatility. It is constructed using the implied volatilities of a wide range of S&P 500 Index options. This volatility is meant to be forward looking and is calculated from both calls and puts. The VIX is a widely used measure of market risk and is often referred to as the "investor fear gauge."*

## MICRO CAP FUND – TOP 10 HOLDINGS

AS OF JUNE 30, 2020

Security Name	Percent of Net Assets
Kornit Digital Ltd. (Israel)	2.9%
GenMark Diagnostics, Inc.	2.7%
Freshpet, Inc.	2.2%
Five9, Inc.	2.1%
Medallia, Inc.	2.0%
Open Lending Corp., Class A	2.0%
Bandwidth, Inc., Class A	2.0%
Construction Partners, Inc., Class A	2.0%
Purple Innovation, Inc.	2.0%
Upland Software, Inc.	2.0%
Total	21.9%
<i>Portfolio holdings are subject to change at any time. References to specific securities should not be construed as recommendations by the Fund or its Advisor. Current and future holdings are subject to risk.</i>	