



Investor / Institutional  
WMICX / WGICX

# Wasatch Micro Cap Fund

JUNE 30, 2020

## Following A Strong Rebound, We Still Like Innovative Micro Caps in Slow-Growth Economy

### OVERVIEW

U.S. equity prices surged during the second quarter of 2020. The benchmark Russell Microcap Index rose 30.54% for the quarter. Surpassing its benchmark by a wide margin, the Wasatch Micro Cap Fund—Investor Class leapt 48.69%.

An upturn in investor sentiment that began in late March continued during the second quarter. Stocks of small companies and micro caps outgained large-cap issues amid growing optimism that the economic impact of the Covid-19 pandemic might be less dire than previously feared. Growth stocks, such as those in which the Fund invests, outperformed stocks of value companies against a backdrop of rapidly improving risk appetite.

With virus-related lockdowns easing and pent-up shoppers making up for lost time, consumer-discretionary stocks were top performers. The Fund's consumer-discretionary holdings were a primary source of outperformance as they outpaced the consumer-discretionary positions in the Index by a wide margin. Other key drivers of Fund performance included health care and information technology (IT).

### FUND MANAGERS



**Ken Korngiebel, CFA**  
Lead Portfolio Manager

3 / 4  
YEARS ON FUND / YEARS AT WASATCH



**Dan Chace, CFA**  
Portfolio Manager

16 / 18  
YEARS ON FUND / YEARS AT WASATCH

*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.***

Our trading activity in March and April was higher than normal, but for good reason. The first quarter's brutal decline in stock prices had at times been driven by waves of indiscriminate sell orders from panicked investors seeking to reduce risk in their portfolios. As the selling intensified, we added a number of companies to the Fund whose stocks we believed were being unfairly punished. Although these businesses typically faced short-term headwinds or possessed other characteristics that caused investors to shun them, we believed their longer-term prospects remained attractive. Moreover, we thought the outsized declines in these stocks may have already factored in most or all of the downside risk.

We also purchased what we considered high-quality growth companies whose market capitalizations had fallen back into our mandated range for micro caps. Having previously owned many of these businesses in the Fund, we were already familiar with them and able to respond quickly to what we regarded as fire-sale prices.

Our disciplined approach and long-term focus were rewarded during the second quarter. As a group, our recent purchases rebounded strongly, significantly boosting the Fund's absolute return and performance relative to the benchmark.

Although stocks of smaller companies have historically recovered more quickly than the broader market after selloffs, their second-quarter rebound was even stronger than we had anticipated. In a process that would ordinarily require much more time to develop, we have already started trimming recently established positions as equity prices begin to reflect expectations for substantial improvements in future business conditions. We used proceeds from these sales to rotate back into Fund holdings with long-term fundamentals that align better with our preferred metrics.

## DETAILS OF THE QUARTER

Concerns about the impact of Covid-19 on company operations and earnings continued to overshadow most other factors driving stock prices during the second quarter.

The strongest contributor to Fund performance was **Kornit Digital Ltd. (KRNT)**. Based in Israel, the company produces digital-printing equipment for the textile industry. Shares of Kornit soared in May after CEO Ronen Samuel said he expected sales growth to reaccelerate during the second half of 2020 as governments begin to lift coronavirus-related restrictions on businesses. Mr. Samuel also noted that disruptions tied to the virus had hastened the shift to e-commerce and exposed inherent supply-chain challenges faced by traditional retail. We believe Kornit is positioned to benefit as the growing need for flexible inventory management drives increased adoption of on-demand digital-production solutions.

**DraftKings, Inc. (DKNG)** was also a top contributor. The company operates as a digital sports-entertainment and gaming company. Having leveraged its fantasy-sports business into a leading position in online sports gambling and internet casino games (iGaming), DraftKings benefited as the pandemic drastically curtailed gaming at physical casinos and hotels. Management issued stronger-than-expected revenue guidance for the second quarter, driven by iGaming and sporting events. These included a high-profile charity golf match between Tiger Woods and Peyton Manning against Phil Mickelson and Tom Brady.

Another strong stock in the Fund was **MacroGenics, Inc. (MGNX)**. A biopharmaceutical company, MacroGenics develops antibody-based therapeutics for the treatment of cancer. The company's stock price soared in May after management said it remains on track to report final

overall-survival data for its breast-cancer drug candidate margetuximab in a head-to-head Phase 3 clinical trial with a top-selling competitor trastuzumab (brand name Herceptin). Last year, MacroGenics presented preliminary data indicating margetuximab was outperforming trastuzumab in the study. Growing optimism about a possible partnership agreement with another drug company also appeared to lift the stock.

In such a strong absolute quarter, just a handful of the Fund's holdings detracted from performance, including **ICF International, Inc. (ICFI)**, a provider of consulting and contracting services to government and commercial clients in the U.S. and internationally. Although earnings and revenues exceeded expectations in ICF's most-recent quarter, the stock sold off after the company lowered its full-year guidance for 2020. Noting general uncertainty surrounding the coronavirus pandemic, management cited program cancellations in ICF's commercial marketing-services business and postponements by international government clients in its event-management segment.

We believe these developments represent a temporary setback for ICF. Because the great majority of the company's revenues are derived from government and utility clients under long-term contracts, we continue to view ICF as a stable grower. In addition, we believe the company's IT segment is positioned to benefit from increased government outlays for computer modernization and cybersecurity. Given our positive long-term outlook for ICF and its lower share price, we increased the Fund's position in the stock.

**Exagen, Inc. (XGN)** was also a significant detractor. The company develops diagnostics for diseases such as lupus, rheumatoid arthritis and fibromyalgia. Exagen's shares languished during the second quarter as testing volumes for the company's lead product fell over 56% in April

compared to the year-ago period. Management cited reduced patient flow resulting from stay-at-home orders and related restrictions designed to prevent the spread of the coronavirus and free up hospital capacity for treatment of Covid-19 cases. We're watching developments closely.

Another detractor was **Transcat, Inc. (TRNS)**. The company provides calibration and laboratory-instrument services in the U.S. and other countries. With risk sentiment on the upswing during the second quarter, defensive issues such as Transcat became less attractive to investors. From a longer-term perspective, we think the company's fundamental business trends continue to make its stock a worthwhile holding in the Fund. Transcat has been benefiting from the need for accurate instrumentation in regulated industries. A growing number of companies have been choosing to outsource these services to providers such as Transcat rather than maintain their own instrumentation capabilities. *(Current and future holdings are subject to risk.)*

## OUTLOOK

While the coronavirus pandemic will eventually fade and life will begin to approach some form of normalcy, the impact on America's economy will linger. In particular, massive debts incurred by the government and corporate sectors are likely to restrain U.S. economic growth for at least the next decade.

The primary drivers of economic growth are demographics and productivity—more people producing more goods and services more efficiently. As a larger share of future cash flows are diverted to servicing debt, those resources cannot be used for productive investment. The demographic picture isn't any better, as aging Baby Boomers continue to exit the workforce faster than they are replaced by younger workers and the birthrate decreases.



At the Federal Open Market Committee's June 10 meeting, Fed members submitted their long-term projections for real U.S. economic growth. Following a cyclical rebound in 2021 and 2022 driven by declining unemployment, the Fed expects growth to gradually revert to a long-term rate of just 1.8%. This figure is in line with the Fed's previous long-run median projection of 1.9% published in December 2019.

With structural economic growth in the U.S. likely to remain subdued, we believe it will be the type of environment that tends to favor our active,

bottom-up investment style. As businesses vie for their respective shares of a slowly growing macroeconomic pie, we think innovative micro caps taking market share from their competitors have the potential to generate attractive returns over time.

Thank you for the opportunity to manage your assets.

Sincerely,

Ken Korngiebel and Dan Chace



## AVERAGE ANNUAL TOTAL RETURNS

FOR PERIODS ENDED JUNE 30, 2020

	Quarter*	1 Year	3 Years	5 Years	10 Years
Micro Cap Fund—Investor	48.69%	24.85%	23.84%	17.34%	16.86%
Micro Cap Fund—Institutional	48.52%	24.70%	23.79%	17.31%	16.85%
Russell Microcap® Index**	30.54%	-4.77%	0.85%	2.86%	9.93%

**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.*

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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.*

*The Federal Open Market Committee (FOMC), a component of the Federal Reserve System, is charged under United States law with overseeing the nation's open market operations. Open market operations are the means of implementing monetary policy by which a central bank controls the short-term interest rate and the supply of base money in an economy, and thus indirectly the total money supply.*

*Sales growth is the increase in sales over a specified period of time, not necessarily one year.*

## MICRO CAP FUND – TOP 10 HOLDINGS

AS OF MARCH 31, 2020

Security Name	Percent of Net Assets
Limelight Networks, Inc.	3.0%
Kadant, Inc.	3.0%
Freshpet, Inc.	2.8%
Construction Partners, Inc., Class A	2.7%
Transcat, Inc.	2.7%
Upland Software, Inc.	2.6%
Kornit Digital Ltd. (Israel)	2.5%
Medallia, Inc.	2.5%
Simulations Plus, Inc.	2.5%
ICF International, Inc.	2.5%
Total	26.7%

*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.*