

Investor  
WHOSX

# Wasatch-Hoisington U.S. Treasury Fund

DECEMBER 31, 2020

## Interest Rates Are Unlikely To Rise in 2021 Despite Fiscal Stimulus and Easy Monetary Policy

*The views expressed in this commentary are those of Hoisington Investment Management Company (HIMCo), the sub-advisor to the Fund, and may differ from the views of Wasatch Global Investors.*

### DETAILS OF THE QUARTER

U.S. Treasury bond yields rose in the fourth quarter, but still ended 2020 substantially below the levels of a year ago. The 30-year Treasury bond yield ended December 2020 at 1.645%, up from 1.452% on September 30, 2020, but well down from 2.388% at the close of 2019. The annual closing level on the 30-year yield in 2020 was the lowest in the recorded history of this bond that started in 1977.

For the three months ended December 31, 2020, the Wasatch-Hoisington U.S. Treasury Fund declined -3.60%, compared to the benchmark Bloomberg Barclays US Aggregate Bond Index's gain of 0.67%. For the full year 2020, the Fund gained 20.07%, outperforming the Index's return of 7.51%.

### FUND MANAGERS



**Van R. Hoisington**  
Lead Portfolio Manager

24  
YEARS ON  
FUND



**V.R. Hoisington Jr.**  
Portfolio Manager

4  
YEARS ON  
FUND



**David Hoisington**  
Portfolio Manager

4  
YEARS ON  
FUND

*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: 0.69%. The Advisor has contractually agreed to limit certain expenses to 0.75% through at least 1/31/2021.***

The decline in yields reflected a contraction in economic activity as well as a slowdown in inflation. The pandemic certainly played an important role in these developments and, in turn, the rally in the Treasury bond market over the course of 2020. However, growth in economic activity and inflation were both slowing before the pandemic hit and Treasury bond yields had fallen significantly in 2019. Due to these conditions, the Federal Open Market Committee (FOMC) cut the target range for the federal-funds rate to 0% to 0.25%.

## OVERVIEW

Investing in a 30-year U.S. Treasury bond at a paltry yield of 2.4% on December 31, 2019 appeared to be a poor investment choice, particularly since it was the lowest year-end yield since the inception of the 30-year bond in 1977. A similar context existed at the end of 2020 as the yield stood 0.75 of a percentage point lower at 1.65%, another record year end low. However, in the short 12-month period ended December 31, 2020, the 30-year U.S. Treasury bond realized a 20% return compared to the 18.4% return of the S&P 500® Index and the 7.5% return for the Bloomberg Barclays US Aggregate Bond Index.

Presently, the overwhelming judgment of market forecasters is that interest rates will rise throughout 2021 owing to the expectation that additional fiscal stimulus coupled with easy monetary policy will create an inflationary cocktail as pandemic-related shutdowns lessen. The essence of the decision at HIMCo, the Fund's sub-advisor, to maintain a bullish stance on long-term U.S. Treasury bonds (maturities longer than 20 years) is not whether rates can rise, since it happens transitorily every year, but whether they can stay elevated. Provided there are no major changes by Congress to the Federal Reserve Act, we believe it's prudent to expect that yields on long-dated U.S. Treasury securities will eventually gravitate to lower levels as inflation continues to recede.

The rationale for our apparently contrary stance is as follows. First, the massive void in economic activity and destruction of wealth created by the virus and related shutdowns of businesses in the U.S. and abroad will take years to fill. Second, U.S. fiscal multipliers are generally negative, rendering much government spending counterproductive in terms of stimulating economic growth. Third, monetary policy will become much less impactful since the debt overhang was massive before the pandemic and is now even worse, not just in the United States but in virtually all parts of the world.

## THE VOID

The U.S. Department of Labor (DOL) reported that the number of people unemployed totaled 10.736 million at the end of 2020. The DOL also noted that individuals working part time because of slack work or business conditions or those who could not find full-time employment totaled nearly 6.170 million. The Economic Policy Institute noted that continuing claims for all unemployment assistance were 17 million above a year ago and that 26.1 million workers are either unemployed or had a drop in hours or pay because of the pandemic lockdowns. The Bureau of Labor Statistics (BLS) job openings and labor turnover survey (JOLTS) report in November 2020 documented that there were only 6.527 million job openings in the U.S. The gap between unemployed workers and available jobs is wide.

The ever-insightful economist David Rosenberg recently noted a few more statistics that reflect the magnitude of the devastation over the past 12 months: 1) government benefits now account for nearly 20% of total personal income; 2) one in four households haven't been able to meet their monthly bills since March; 3) one in 15 homeowners are on some sort of loan forbearance relief plan; 4) 75% of the government stimulus went to debt paydown and saving; and 5) one in three

households dipped into savings or retirement accounts over the past year and one in six has borrowed from family or friends to cover bills. Additionally, it should be noted that the National Multifamily Housing Council found that over three-quarters of households made full or partial monthly rent payments by December 6, 2020, down almost 8% versus 2019. Specific industries are reporting catastrophic declines as typified by the National Restaurant Association warning that "more than 500,000 restaurants are in free fall." The same might be said of other entertainment venues and service industries. The severity of the downturn has decimated many small businesses, and they may not survive in their former state. That also appears to be the case for office buildings, shopping centers, convention facilities and airlines.

Gross domestic product (GDP) measures new output, but it has no capability of subtracting from the output measure the destruction of wealth caused by the pandemic and the economic-shutdown response. Achieving the level of pre-crisis activity will in fact require years, owing to the wealth destruction. This economic point was clearly made more than a century ago by French economist Frederic Bastiat (1801–1850) in his essay, which roughly translated from French is entitled, "Things Seen and Things Not Seen." *Economics in One Lesson* (1946), written by Henry Hazlitt (1894–1993), did much to publicize Bastiat's work.

For Hazlitt and Bastiat, the essence of economics consists in looking not merely at the immediate but also at the longer-term effects of any act or policy. It consists of tracing the consequences of that policy not merely for one group but for all groups. One component of this argument is the fallacy of the broken window. If a brick is thrown through the window of a bakery, the baker will have to replace the broken window and, in the process, GDP will be boosted. However,

this argument doesn't consider that the wealth of the baker is reduced because the baker had to reduce other assets or components of wealth to replace the window. Thus, the economy is worse off than if no damage was incurred. If this were not true, then economic prosperity could be achieved by breaking one another's windows. The GDP measure fails to register this loss of wealth.

## GOVERNMENT MULTIPLIERS

During the fiscal year ended September 30, 2020, the federal government ran a deficit of \$3.13 trillion, nearly 218% above the \$984 billion deficit recorded in fiscal year 2019. This percentage increase was nearly identical to the 208% deficit increase in 2009 that was a response to the global financial crisis. Post-election estimates for the 2021 deficit have centered around \$3.1 trillion, similar to the preceding year. Despite the fact that much of the federal government's expenditures are useful to provide a cushion from lost income and output, the size of the outlays has created some concern regarding future inflation. That particular debate can revolve around the macroeconomic effects of fiscal stimuli (fiscal multipliers). The *Journal of Monetary Economics* published an article in 2012 by Ethan Ilsetzki, Enrique Mendoza and Carlos Vegh that has contributed considerable insight and serious scholarly evidence to this debate.

While the work of these economists clearly displays the difficulty of trying to isolate fiscal multipliers, they discovered that the macroeconomic impact of the expenditure shock depends on four key country characteristics. First, industrial countries respond with a positive multiplier. Second, economies operating under flexible exchange rates have a negative multiplier. Third, countries that are open to trade have a negative multiplier. Fourth, the government spending multiplier is sharply negative in highly indebted countries. They point out that the definition of

"highly indebted" is central government debt exceeding 60% of GDP, a condition that is met by most of the major economies of the world. Additionally, the composition of expenditures may play an important role in assessing the effect of fiscal stimulus. The last point regarding the type of expenditure is important, suggesting that not all government spending is created equal. Investment in physical infrastructure, health, education and other similar programs can provide a long-term boost to GDP, according to their work.

Considering the above criteria as it applies to the U.S., it is our conclusion that U.S. fiscal multipliers are in fact negative for non-investment-type spending. First, the United States is obviously a developed country. That is a positive. However, the U.S. meets all of the other three constraining features: The U.S. operates with flexible exchange rates, it's a relatively open economy with respect to trade and it's highly indebted. Note U.S. government debt as a percentage of GDP is not 60% but 127%. On balance, therefore, non-investment expenditure multipliers appear to be negative. This indicates that a sustained strong macroeconomic response from our large federal-government deficits should not be expected. Sizable debt-financed federal fiscal operations in 2009 and 2018 produced only transitory spurts in economic activity. Also, these failed fiscal efforts occurred under the leadership of both major political parties. This indicates that the weak multipliers are not the result of political leadership, but the nature of the debt-financed operations. A government's funding is derived from taxing and borrowing from its citizens. This process reduces the resources available to the private sector, the part of the economy that provides productivity growth and expands the economic "pie." The transfer of resources from the private sector to the federal government can result in misallocation of resources, thereby reducing overall productivity and growth for the entire economic system.

## **DEBT DRAG**

Total public and private debt in the United States jumped to 405.9% of GDP, up from 365.9% in 2019. As of December 31, 2020, total government debt outstanding amounted to nearly \$27 trillion, up from \$23 trillion in December 2019, an approximately 19% increase in the calendar year. Previous studies have indicated that the productivity of debt tends to decline with the overuse of that particular factor of production. When debt capital, like any other factor of production, is overused its marginal revenue product declines. This serves as a persistent drag on economic activity that restrains economic growth despite the best efforts of monetary and fiscal policymakers. The decline in the marginal revenue productivity of debt, due to the pandemic, must now operate with even weaker demographics around the world. The pandemic resulted in considerably lower marriage and birth rates, which will have negative long-term consequences for domestic and global growth. Based upon the universally applicable production function, the capability of achieving historical rates of economic growth will be even more difficult in the years ahead.

## **MONETARY POLICY**

The Federal Reserve responded promptly and aggressively to the downturn in economic activity caused by the virus and economic shutdowns, quickly lowering the federal-funds target rate from 1.5% to a range of 0% to 0.25%. In addition, the Fed began purchasing \$80 billion of Treasury securities and \$40 billion of mortgage-backed securities a month. As a result, the monetary base and Federal Reserve Bank credit jumped by an unprecedented 38.6% and 64%, respectively, resulting in a 19.4% yearly average increase of M2. By comparison in 2019, the monetary base, Federal Reserve Bank credit and M2 registered annual changes of -9.3%, -7.9% and 5.1%, respectively.



The housing sector benefited substantially from policy actions to lower interest rates, with the 30-year conventional mortgage rate dropping to an all-time low in December 2020 of 2.71%, almost a full percentage point below the year-earlier level. The rate decline caused mortgage refinancings to increase about 113% over the year, providing significant funds for consumer spending and investment. However, the lower rate structure reduces the revenue and income of many financial intermediaries.

Despite the benefit from easier monetary policy on the housing sector, the macro-wide effects were contained as the velocity of money fell 17.7% in 2020 with velocity for the year averaging an estimated 1.2, the lowest level since 1946. With velocity falling, funds available for financial investment surged as did prices in many asset markets. The drop in velocity, however, is consistent with the sharp decline in the marginal revenue product of debt and suggests no long-lasting inflationary consequences from the 2020 surge in M2.

In sum, considering the economic destruction visited upon individuals and small businesses by the virus and its resultant shutdowns, the fact that fiscal expenditures have a negative multiplier on macroeconomic conditions, the debilitating impact on economic growth of excessive debt and the restriction of the zero bound (interest rates at 0%) on monetary stimulus, it's our view that a secular inflation cycle is not at hand. Since inflation is the primary determinate of the yield on long-dated U.S. government debt, it remains our judgment that the bull run in 30-year U.S. Treasury securities is likely to continue.

Thank you for the opportunity to manage your assets.

Sincerely,

Van Hoisington, V.R. Hoisington Jr. and  
David Hoisington



## AVERAGE ANNUAL TOTAL RETURNS

FOR PERIODS ENDED DECEMBER 31, 2020

	Quarter*	1 Year	3 Years	5 Years	10 Years
U.S. Treasury Fund	-3.60%	20.07%	10.59%	8.46%	8.86%
Bloomberg Barclays US Aggregate Bond Index**	0.67%	7.51%	5.34%	4.44%	3.84%

*\*Returns less than one year are not annualized.*

*Data show past performance, which is not indicative of future performance. Current performance may be lower or higher than the data quoted. To obtain the most recent month-end performance data available, please visit [wasatchglobal.com](http://wasatchglobal.com). The Advisor may absorb certain Fund expenses, without which total return would have been lower. Investment returns and principal value will fluctuate and shares, when redeemed, may be worth more or less than their original cost. **Total Expense Ratio: 0.69%***

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 0.75% 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.*

**Investing in bonds, you are subject, but not limited to, the same interest rate, inflation and credit risk associated with the underlying bonds owned by the**

**Fund. Return of principal is not guaranteed. Interest rate risk is the risk that a debt security's value will decline due to changes in market interest rates. The interest rate is the amount charged, expressed as a percentage of principal, by a lender to a borrower for the use of assets. Even though some interest-bearing securities offer a stable stream of income, their prices will fluctuate with changes in interest rates. Inflation risk is the possibility that inflation will reduce the purchasing power of a currency, and subsequently reduce the value of a security or asset, and may result in rising interest rates. Inflation is the overall upward price movement of goods and services in an economy that causes the value of a dollar to decline. Credit risk is the risk that the issuer of a debt security will fail to repay principal and interest on the security when due. Credit risk is affected by the issuers credit status, and is generally higher for non-investment grade securities.**

***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 Bloomberg Barclays US Aggregate Bond Index is a broad-based flagship benchmark that measures the investment grade, US dollar denominated, fixed-rate taxable bond market. The index includes Treasuries, government-related and corporate securities, mortgage-backed securities (MBS) (agency fixed-rate and hybrid adjustable-rate mortgage [ARM] pass-throughs), asset-backed securities (ABS) and commercial mortgage-backed securities (CMBS) (agency and non-agency). You cannot invest directly in this or any index.*

*The Wasatch-Hoisington U.S. Treasury Fund's investment objective is to provide a rate of return that exceeds the rate of inflation over a business cycle by investing in U.S. Treasury securities with an emphasis on both income and capital appreciation.*

*Sources: Hoisington Investment Management Co., Bureau of Labor Statistics, Bureau of Economic Analysis, U.S. Federal Reserve, U.S. Treasury, Bank for International Settlements, Financial Times, Rosenberg Research, Journal of Monetary Economics, U.S. Department of Labor, Economic Policy Institute, the National Multifamily Housing Council and the National Restaurant Association.*

*A bull market is defined as a prolonged period in which investment prices rise faster than their historical average. Bull markets can happen as the result of an economic recovery, an economic boom, or investor psychology.*

*The Economic Policy Institute is an independent, nonprofit think tank that researches the impact of economic trends and policies on working people in the United States.*

*The federal funds target rate (also known as the fed funds target rate) is set by a committee within the Federal Reserve System called the Federal Open Market Committee (FOMC). The FOMC usually meets every six weeks, and it is at these meetings that the FOMC votes on whether or not to make changes to the federal-funds target rate.*

*The Federal Open Market Committee (FOMC), a component of the Federal Reserve System, is charged under United States law with overseeing the nations 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.*

*The global financial crisis, also known as the 2008-2009 financial crisis, is considered by many economists to have been the worst financial crisis since the Great Depression of the 1930s.*

*Gross domestic product (GDP) is a basic measure of a country's economic performance and is the market value of all final goods and services made within the borders of a country in a year.*

*M2 money supply consists of currency and checking accounts, consumer-type time and savings accounts and equivalent near monies, while M3 money supply consists of M2 plus business-type time deposits and less liquid near monies. Both M2 and M3 exclude monies and near monies owned by the Treasury, depository institutions and foreign banks and official institutions and IRA and Keogh balances owned by consumers.*

*Marginal revenue product (MRP) is the marginal revenue created by the addition of one unit of resource. MRP is calculated by multiplying the marginal physical product (MPP) of the resource by the marginal revenue (MR) generated.*

*The marginal revenue product of debt is the ratio of GDP to debt.*

*The monetary base is the total amount of a currency that is either circulated in the hands of the public or in the commercial bank deposits held in the central bank's reserves. This measure of the money supply typically only includes the most liquid currencies.*

*Mortgage-backed securities are debt issues backed by a pool of mortgages. Investors receive payments from the interest and principal payments made on the underlying mortgages.*

*The S&P 500 Index includes 500 of the United States largest stocks from a broad variety of industries. The Index is unmanaged and is a commonly used measure of common stock total return performance.*

*The velocity of money (V) is defined as the rate at which money circulates, changes hands or turns over in an economy.*



## U.S. TREASURY FUND – TOP 10 HOLDINGS

AS OF SEPTEMBER 30, 2020

Security Name	Percent of Net Assets
U.S. Treasury Bond, 2.250%, 8/15/46	19.1%
U.S. Treasury Strip, principal only, 8/15/45	17.4%
U.S. Treasury Strip, principal only, 5/15/44	12.6%
U.S. Treasury Bond, 1.250%, 5/15/50	11.9%
U.S. Treasury Bond, 3.000%, 8/15/48	11.4%
U.S. Treasury Bond, 2.250%, 8/15/49	10.9%
U.S. Treasury Bond, 2.500%, 2/15/45	5.7%
U.S. Treasury Strip, principal only, 8/15/40	4.8%
U.S. Treasury Bond, 2.875%, 5/15/49	4.7%
Total	98.3%

*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.*