WASATCH GLOBAL INVESTORS

Quarterly Commentary

Investor
WHOSX

Wasatch-Hoisington U.S. Treasury Fund

JUNE 30, 2020

Massive Debt Buildup, the Collapse in World Trade and The Synchronous Contraction Of Economies Globally May Take Years to Overcome

OVERVIEW

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

Although U.S. Treasury bond yields fell sharply over the first half of 2020, they rose slightly in the three months ended June 30. The 30-year Treasury bond closed the second quarter with a yield of 1.412%, up slightly from 1.310% at the end of the first quarter, but down sharply from the 2.388% recorded at the end of 2019. A year ago, the 30-year Treasury bond yield was 2.531%. Yields declined in 2019 as the U.S. economy slowed and inflation eased, but then fell even more sharply as the economy contracted substantially in the first half of 2020 and inflation dropped further.

FUND MANAGERS

Van R. Hoisington
Lead Portfolio Manager
23
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. 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.***

WASATCH
GLOBAL INVESTORS

DETAILS OF THE QUARTER

For the three months ended June 30, 2020, the Wasatch-Hoisington U.S. Treasury Fund declined -1.34%, compared to the benchmark Bloomberg Barclays US Aggregate Bond Index, which gained 2.90%. For the first half of calendar 2020, the Fund rose 24.47%, outperforming the Index, which returned 6.14%.

ENORMOUS CHALLENGES

Four economic considerations suggest that years will pass before the U.S. economy returns to its prior cyclical 2019 peak performance. These four influences on future economic growth will mean that an extended period of low inflation or deflation will be concurrent with high unemployment rates and sub-par economic performance.

First, with over 90% of the world's economies contracting, the present global recession has no precedent in terms of synchronization. Therefore, no region or country is available to support or offset contracting economies, nor lead a powerful sustained expansion.

Second, a major slump in world trade volume is taking place. This means that one of the historical contributions to advancing global economic performance will be in the highly atypical position of detracting from economic advance as continued disagreements arise over trade barriers and competitive advantages.

Third, additional debt incurred by all countries, and many private entities, to mitigate the worst consequences of the pandemic, while humane, politically popular and in many cases essential, has moved debt-to-gross domestic product (GDP) ratios into uncharted territory. This debt burden virtually ensures that a persistent misallocation of resources will be reinforced, constraining growth as productive resources needed for sustained growth will be unavailable.

Fourth, 2020 global per capita GDP is in the process of registering one of the largest yearly declines in the last century and a half (since 1871) and the largest decline since 1945. The lasting destruction of wealth and income will take time to repair.

SYNCHRONICITY

The World Bank indicated that a record 92.9% of the world's countries are in economic recession in 2020. This level is well above the previous level of 83.8% recorded in the Great Depression. It also exceeds the levels registered in 1914 at 70%, 1918 to 1921 at 70%, and 2008 to 2009 at 61.2%. In the 14 global recessions from 1871 to 2020, the percentage of the world's economies in recession was generally not highly coordinated, with an average of 54.3%. Based on an examination of these four previous periods of high synchronicity, where the economic results are observable, a conclusion might be drawn regarding our present situation.

Based on this history, recessions are either deeper or longer lasting when a high percentage of the world's economies are contracting rather than when a limited number of countries are in recession. The year 1914 is contrary to the rule and is the sole exception as the slump lasted less than a year. It was truncated as World War I started in August of that year, resulting in an immediate upturn in world output. The other three high synchronicities meant deeper and/or longer contractions.

WORLD TRADE VOLUME

For the past nine decades, expanding world trade has been a powerful engine of economic growth. Since 1929, world trade grew by an average 4.8% per annum, three times greater than the 1.6% annual growth in global real GDP. The Organization for Economic Cooperation and Development (OECD) estimates that world trade volume will contract by a dramatic 15% in 2020,

the largest drop since 1945 to 1946 and the third largest fall since 1930.

With so little of the world left untouched by the 2020 world-wide contraction, no meaningful countries appear able to provide a leadership role in moving the world economy forward by expanding trade relationships. It appears that present economic distrust might encourage efforts to erect trade barriers that aim to boost domestic growth.

UNPRODUCTIVE DEBT

Total domestic nonfinancial debt in the U.S., excluding off balance sheet liabilities such as leases and unfunded pension liabilities, surged to a record 259.7% of GDP in the first quarter of this year, 11.4 percentage points higher than the 2009 level when Lehman Brothers failed. Confirming economic research regarding diminishing returns of the overuse of debt, each dollar of debt generated only 38.5 cents of GDP in the first quarter of this year. This result is defined as the marginal revenue product of debt (MRP_D), which was down from 40 cents at the end of 2019. Each dollar of debt generated only 13 cents of GDP growth for the past four quarters, compared with less than one-half of the 26.5 cents generated during the final four quarters immediately before the recession that started in late 2008.

Due to slower reporting of debt in major foreign economies, a comparison between the U.S. total nonfinancial debt situation with that of its major trading partners for 2020 is not yet possible. Anecdotal information, however, indicates that the debt overhang worsened in virtually every major economy, with both Japan and China taking on more total new debt in absolute terms than the larger U.S. economy.

Gross government debt estimates for year-end 2020 are available from the International Monetary Fund. These figures do not include unfunded government liabilities and as such understate the magnitude of the problem. These statistics indicate simultaneous deterioration for the major economies. The gross government debt to GDP ratio for the U.S., Japan, Italy, France and the United Kingdom each are jumping to new all-time records, far above the levels at the end of 2019. China is excluded as the government guarantees provincial and other debt, rendering its series not comparable.

The rising debt levels and subsequent result of falling MRP_D are expected to produce two major macro-economic consequences. First is diminishing returns, a conclusion that is derived from the production function. This idea is that unless offset by the contribution from technology, demographics or natural resources, the overuse of debt will lead to a further weakening of economic growth, thereby placing downward pressure on inflation. When examining each of these categories, one cannot find any optimism for growth. Technological innovation continues to be evolutionary rather than revolutionary in nature. There appears to be limited new sources of raw materials. Recent demographic numbers available from Japan indicate that in 2019 the population declined -0.2%, equaling the all-time low. In view of the adverse effects of the pandemic, other major countries are likely to experience a weakening demographic trend. A recent Brookings Institution study posits that the pandemic will result in 300,000 to 500,000 fewer births next year. For 2019, population growth in the U.S. and the world was already the slowest since 1918 and 1952, respectively.

The second macroeconomic effect of weaker MRP_D will be continued downward pressure on the velocity of money. Many factors influence money velocity, but a strong long-term relationship has been evident between the trend in the MRP_D and velocity since the economy became heavily over-indebted in the late 1990s. Since the peak in velocity in 1997, velocity has fallen 34% as MRP_D has decreased 29%. This is a very close relationship in view of the large number of influences on velocity.

Upcoming developments will be an excellent test of this relationship as M2 has grown at a 23.8% rate in the latest 12 months, the fastest since 1943. We expect velocity to drop sharply in the second quarter, and then rebound in the second half of the year, but not sufficiently to offset the fall in velocity in the first half. In 1934, Irving Fisher wrote that the velocity of money falls in heavily indebted economies. We believe that Fisher's finding will be correct because his view is supported by the evidence and the rationale that the huge additional debt added this year will not generate an income stream to repay principal and interest. Accordingly, we expect the reopening rebound underway in the economy to falter, leaving the economy with a huge output gap. Extreme indebtedness in the corporate sector is a micro-consideration that also supports this view.

CORPORATE DEBT

The U.S. business sector continues to ignore Benjamin Graham's dictum for sound corporate financial management: sell company shares when stock prices are high and use the proceeds to pay off debt and buy shares when stock prices are low by issuing debt. In the first quarter, corporate debt jumped to a record 48.7% of GDP, more than three percentage points higher than during the global financial crisis. Contrary to widespread forecasts for a capital spending boom, year-over-year growth in real private fixed investment peaked in 2012 and since then, the trend has been decelerating significantly. In the first quarter, real private fixed investment was negative for the first time in 10 years. The surge in corporate indebtedness coincided with a profits recession that was evident even before the coronavirus hit. Real corporate profits after tax with IVA and CCAdj, which were unchanged from 2012 at the end of 2019, fell in this year's first quarter to the lowest level in nine years. The situation will be considerably worse after the figures are tabulated for the spring quarter. The stressed corporate income statement and balance sheet circumstances strongly indicate that the reopening rebound in capital spending will simply not have staying power.

Except for the very short run, the Federal Reserve's lending operations for the corporate bond market are a negative for economic growth. The Bank of Japan (BOJ), the European Central Bank (ECB) and the People's Bank of China (PBOC) have all been buying the corporate debt of failing entities for more than a decade, with the BOJ doing so for more than 25 years. These operations have provided a fleeting lift to economic activity, but at the end of the day they have resulted in misallocation of credit, poor economic growth and disinflation/deflation. Keeping failing players in the game prevents the process Joseph Schumpeter called "creative destruction." Delaying failure also causes "moral hazard," thereby eliminating critical factors that make free-market economies successful. When central banks sustain failing businesses, resources are tied up in nonproductive firms and therefore are unavailable for new firms that can contribute to economic growth.

DOMESTIC AND GLOBAL GROWTH SINCE 1871

We calculate that U.S. real per capital GDP will register the largest yearly decline since the recession that occurred immediately after the end of World War II. In the current recession, there is a highly important different initial condition when compared with the decline in the 1940s. As a consequence of the circumstances of World War II, a surge in private saving occurred that enabled the U.S. to pay off the debt overhang of the 1920s and 1930s and also fund huge war related budget deficits of WWII.

There were five yearly contractions that were greater than that of this year, three of which were in the 1930s. Our per capita real GDP 2020 forecast is in line with the median forecast of Federal Open Market Committee participants at the June

2020 meeting for a decline of -5.5% in real GDP from the fourth quarter of 2019 to the fourth quarter of 2020.

The cycle dating committee of the National Bureau of Economic Research (NBER) has determined that the U.S. in 2020 is in its 28th recession since 1870. Recessions in the U.S. have occurred every 5.35 years on average. Reflecting many diverse business cycles for other countries of the world for most of the past 150 years, global recessions have been marked only 14 times and have averaged 10.7 years apart. Thus, the World Bank calculation that the global economy in 2020 is in recession adds a major new dimension to the NBER's calculation about the U.S. and indicates the gravity of economic circumstances.

The World Bank estimates that global real per capita GDP will decline -5.2% this year, on an annual basis, the largest drop since the end of WWII, which, in turn, was greater than any other year in the past 150 years. No single year in the 1930s fell more than in 1945 to 1946 but large back-to-back contractions were not repeated when WWII ended.

RESEARCH

The pandemic will eventually run its course and when that happens economies will register a noticeable improvement. However, the adverse consequences of an unsurpassed increase in new debt will remain for years to come as there currently exists a record domestic and global debt overhang from previous borrowing. Four great past economists—Eugen von Böhm-Bawerk, Irving Fisher, Charles Kindleberger and Hyman Minsky—captured the two-edged nature of debt as being an increase in current spending in exchange for a decline in future spending unless the debt generates an income stream to repay principal and interest. Using rigorous statistical techniques, contemporary economists such as Kenneth Rogoff, Carmen Reinhart, Alan Taylor, Anja Baum, Cristina Checherita-Westphal, Philipp Rother and others have documented the deleterious effects of high debt levels on economic growth. Included in this work is evidence that the detrimental effect of the debt on GDP per capita increases as the debt level rises. Significant research indicates that the adverse consequences start as low as a 67% gross debt to GDP ratio. In other words, the relationship between debt and economic growth is non-linear, just as is the law of diminishing returns.

DEFLATIONARY GAP

Assuming a large percentage gain in economic activity in the second half of this year, the U.S. Federal Reserve, the World Bank and many economists project that there will still be a substantial gap between potential and real GDP. In economic theory, this is called a deflationary gap. At the end of the three worst recessions since the 1940s, the output gap was 4.8% in 1974, 7.9% in 1982 and 6.4% in 2009. The gap that existed after the recession of 2008 to 2009 took nine years to close. This was the longest amount of time to eliminate a deflationary gap. Even when the gap was closing over the last decade, the inflation rate continued to trend downward, remaining below 2%. This indicates that there were even more unutilized/underutilized resources than were captured by the magnitude of the gap. Considering the depth of the decline in global GDP, the massive debt accumulation by all countries, the collapse in world trade and the synchronous nature of the contracting world economies, the task of closing this output gap will be extremely difficult and time consuming. This situation could easily cause aggregate prices to fall, thus putting persistent downward pressure on inflation, which will be reflected in declining long-dated U.S. government bond yields.

It is our view that the Fund's investments in long-dated U.S. Treasury bonds (maturities longer

than 20 years) mean that it is appropriately positioned in light of the current circumstances.

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 JUNE 30, 2020

	Quarter*	1 Year	3 Years	5 Years	10 Years
U.S. Treasury Fund	-1.34%	29.59%	13.36%	9.96%	8.53%
Bloomberg Barclays US Aggregate Bond Index**	2.90%	8.74%	5.32%	4.30%	3.82%

**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. 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 issuer's 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 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 Economic Analysis, Congressional Budget Office, Office of Management and Budget, Bureau of Economic Analysis, U.S. Federal Reserve, economists Nathan S. Balke, Robert J. Gordon and Christina D. Romer, www.measuringworth.com, Bureau of Labor Statistics, Haver Analytics, Netherlands Bureau for Economic Policy Analysis, Bank for International Settlements, the Organization for Economic Cooperation and Development, The World Bank, The International Monetary Fund and the Brookings Institution..

The Brookings Institution is a nonprofit public policy organization based in Washington, D.C.

Corporate profits with IVA and CCAdj is the income that arises from current production, measured before income taxes, of organizations treated as corporations in the national income and product accounts. With several differences, this income is measured as receipts less expenses as defined in federal tax law. Among these differences are: Receipts exclude capital gains and dividends received; expenses exclude bad debt, depletion, and capital losses; inventory withdrawals are valued at current cost; and depreciation is on a consistent accounting basis and valued at current replacement cost.

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.

The global financial crisis, also known as the financial crisis of 2008-09 and 2008 financial crisis, is considered by many economists to have been the worst financial crisis since the Great Depression of the 1930s.

The government debt-to-GDP ratio is the ratio of a country's public debt to it gross domestic product (GDP). By comparing what a country owes to what it produces, the debt-to-GDP ratio indicates the country's ability to pay back its debt. Often expressed as a percentage, the ratio can be interpreted as the number of years needed to pay back debt if GDP is dedicated entirely to debt repayment.

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.

The International Monetary Fund (IMF) is an international organization established in 1945 that aims to promote international trade and monetary cooperation, and stabilization of the world's currencies. The IMF maintains a monetary pool from which member nations can draw in order to correct a deficit in their balance of payments. It is a specialized agency of the United Nations.

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.

The marginal revenue product of debt (MRP_D) is the ratio of GDP to debt.

The National Bureau of Economic Research (NBER) is a research organization dedicated to promoting a greater understanding of how the economy works.

The Organization for Economic Cooperation and Development (OECD) is a forum where the governments of 34 democracies with market economies work with each other, as well as with more than 70 non-member economies to promote economic growth, prosperity and sustainable development.

Per capita GDP is a universal measure for gauging the prosperity of nations. It is calculated by dividing GDP by a country's total population.

Real gross domestic product (GDP) is a macroeconomic measure of the value of economic output adjusted for price changes (i.e., inflation or deflation). This adjustment transforms the money-value measure, nominal GDP, into an index for quantity of total output.

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

The World Bank is a collection of international organizations that aid countries in their process of economic development with loans, advice and research. It was founded in the 1940s to aid Western European countries after World War II with capital.

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U.S. TREASURY FUND — TOP 10 HOLDINGS

AS OF MARCH 31, 2020

Security Name	Percent of Net Assets
U.S. Treasury Bond, 2.250%, 8/15/46	25.5%
U.S. Treasury Strip, principal only, 8/15/45	23.2%
U.S. Treasury Strip, principal only, 5/15/44	16.5%
U.S. Treasury Bond, 3.000%, 8/15/48	15.2%
U.S. Treasury Bond, 2.500%, 2/15/45	7.6%
U.S. Treasury Strip, principal only, 8/15/40	6.2%
U.S. Treasury Bond, 2.250%, 8/15/49	2.8%
U.S. Treasury Bond, 2.875%, 5/15/49	1.2%
Total	98.1%

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.