Investors Looking For "The One" During a Pandemic

Wasatch is "Macro-Aware," Not "Macro-Driven" During Short-Term Crises

AUGUST 5, 2020

FINDING "THE ONE" IN A PANDEMIC

At Wasatch Global Investors, we are well removed from Wall Street. We believe the distance and space better enable us to tune out the buzz and noise stemming from the broader investing world. Our name comes from the Wasatch mountain range situated just outside our offices in Salt Lake City, Utah—a landscape that is a stark counterpoint to Wall Street's Manhattan backdrop and prototypical of the western United States, evocative of innumerable tales of adventurous spirits seeking their fortunes.

Waves of market volatility have followed in the wake of the emergent coronavirus pandemic and, with them, a new form of fortune-seeking, but more in the spirit of Warren Buffett than of Wild Bill. Buffett famously described his method as attempting to "be fearful when others are greedy and greedy when others are fearful."

Certainly, there are few macro developments that could generate as much fear as a global viral pandemic. The connection has not been lost on many investors or analysts. Often, lurking behind the news coverage and dinner-table discussions is the same secret, breathless hope: that one might stumble onto a golden ticket by finding "the chosen one"—the biotechnology company that swoops in with a pandemic-ending panacea, whose stock skyrockets in value and carries its investors to those same new heights.

HEALTH CARE BOOMS

The surge in excitement is evident in how active investors have been in the biotech space in recent months. According to *MarketWatch*, since coronavirus lockdowns began across the U.S. in mid-March, the total stock-market value for the eight biotech companies in the S&P 500® Index has swelled from $130 billion to more than $480 billion, while the total market value of the half-dozen biotech companies that fall just outside the S&P 500 (and are also working on coronavirus treatments or vaccines) has grown to more than $40 billion.

In late June, FTSE Russell went through its annual reconstitution process which sees it modify and rebalance weightings and holdings within the indexes. Incredibly, nearly half of the stocks being promoted to the Russell 1000® Index from the Russell 2000® Index were health-care companies, according to a Reuters piece on the reconstitution. Furthermore, only six initial public offerings were added to the Russell 2000 during the reconstitution. All six came from the health-care sector. As a result of the changes, the health-care weighting in the Russell 2000 Growth Index grew to more than 34%, about 19% of which is now represented by biotech companies, nearly double its weighting compared to a year ago.

This may seem counterintuitive. Many analysts expected the health-care sector to endure a larger sell-off than has thus far transpired. In the early months of the pandemic, it was easy to envision a scenario in which some corners of the health-care sector would face short-term challenges due to stay-at-home orders, supply-chain disruptions, prioritization of Covid-19 over other research areas and similar trends. Instead, health-care stocks have been among the biggest beneficiaries of market rallies in recent months, further fanning the flames of investors hoping to get lucky.

THERE IS NO "THE ONE"

As romantic as the notion may seem, we don't believe there will be just one company that will swoop in with a cure for Covid-19. Moreover, the process of developing and distributing any vaccine will be immensely complex and multi-faceted, encompassing research, development, clinical trials, marketing, manufacturing, transportation and administration. Each of these challenges is multiplied by the pandemic's global nature. In fact, we believe it is possible that manufacturing a vaccine in large enough numbers to satisfy global demand may ultimately eclipse even the difficulty of the vaccine search itself.

More to the immediate point, these challenges will only fully come to bear after the successful development of a proven vaccine. And here is where modern-day speculators hope to strike gold. Yet even if one ignores the significant logistical challenges, focusing solely on those companies directly involved in the search for a vaccine, one will likely find a more expansive universe than anticipated.

Dr. Scott Gottlieb, a former commissioner of the U.S. Food and Drug Administration (FDA) and current board member of pharmaceutical giant Pfizer, claimed in May that there were more than 70 companies and research teams working on a Covid-19 vaccine and more than 270 coronavirus drugs and vaccines in development worldwide.

How these statistics strike a reader is likely to depend on a number of factors. On one hand, it is encouraging that there are a significant number of humanity's "best and brightest" minds working on addressing the pandemic. On the other hand, the context is a sobering reminder of the scope of the challenge before us.

As long-term investors focused on finding excellent companies in the small-cap realm, we do not have to find the metaphorical needle in a haystack, singling out "the winner." Instead, we believe we'll have multiple opportunities to select from a pool of multiple eventual winners.

THE RACE FOR A CURE LIKELY WON'T BE FAST

The fastest vaccine development on record took about four years, when researchers successfully addressed the mumps virus, starting with the collection of viral samples in 1963 and ending with the vaccine's approval in 1967. Yet despite holding the distinction of being the fastest vaccine to market in history, it still took about four years for the mumps vaccine to be available. Put simply: The development of a coronavirus vaccine is not likely to be fast.

Further consider that the average time from initial FDA application to final approval is roughly 12 years. In short, even allowing for historic human achievement in addressing the pandemic, which is an unironic possibility given the inspiring efforts of the biotech community thus far, we believe it is more likely that true closure is still several years out.

As a result, we believe there may ultimately be different stages of vaccine use given the likely protracted and staggered nature of any vaccine rollout. If that proves true, it may expand the universe of company beneficiaries even further, and it is possible that companies seemingly leading early on may not turn out to be the true winners in the final analysis.

Ultimately, however, we are in uncharted territory. While Covid-19 is occasionally compared to previous viral outbreaks such as MERS and Ebola, these obviously never reached pandemic proportions, gratefully subsiding as serious threats before any potential vaccine made it beyond the second of three rounds of clinical trials. As a result, there is no proven predecessor vaccine for a coronavirus upon which researchers might build their work.

EXPEDITED SOCIETAL TRENDS

The sweeping impact of the coronavirus pandemic is difficult to fully quantify, but among the most immediately noticeable outcomes is an apparent acceleration of secular trends that were otherwise expected to play out over the course of 10 or 20 years.

Among the most significant overarching themes arising from these circumstances is the rapid digital transformation of consumers and organizations. Certainly, this trend was well underway prior to the pandemic, as we have written about in a previous paper, but has been significantly accelerated as vast swaths of the population seek efficient ways of handling tasks from home.

Telemedicine is one theme that we think may benefit. Indeed, the space appears uniquely positioned at the intersection of the trends of consumer digitalization, investor excitement over health care and the emergence of a widespread work-from-home culture. The advantages of being able to address many health-related concerns without the complication of an in-person doctor visit are being highlighted by the current environment, as many consumers are forced to adjust their daily lives.

Moreover, whereas consumers may have been unaware of or uneasy with these capabilities previously, the prospect of performing a medical diagnostics test at home and sending it to a lab for analysis seems less absurd in the current environment. One of our holdings, **Exact Sciences Corp. (EXAS)**, is a good example of a company operating in this space that we believe is well-positioned to benefit from wider acceptance of at-home sample collection. The company developed a non-invasive, at-home, mail-in-screening test for colorectal cancer—one of the least diagnosed, yet most treatable major forms of cancer. The product, called Cologuard,® has a total addressable market of 80 million people and was experiencing a surge in use even before stay-at-home orders dominated the landscape. The simplicity, affordability and broad market base for Cologuard, combined with Exact Sciences's strong financials, helped drive the company's stock price over the past decade.

Also potentially relevant to Exact Sciences: It is likely that many medical providers may have a backlog of routine procedures and screenings, a development that could potentially act as an additional catalyst for the stock as business slowly resumes.

CASE STUDY: INOVIO AND MODERNA

Although Wasatch as a firm does not generally invest heavily in biotech, the industry accounts for just over 16% of invested assets within the Wasatch Small Cap Ultra Growth strategy, more than 11% of assets in the Wasatch Micro Cap Growth strategy and about 6.5% of assets in the Wasatch Small Cap Growth strategy. (These Wasatch strategies are represented by the Wasatch Ultra Growth Fund, the Wasatch Micro Cap Fund and the Wasatch Small Cap Growth Fund, respectively.) And health care, more broadly, has been a primary area of investment in a number of our strategies. As a result, in the process of our ongoing due diligence as a firm, we have incidentally encountered many of the companies being touted of late as potentially holding answers to the current crisis. Two companies that we believe might provide an instructive glimpse into our investment approach are **Inovio Pharmaceuticals, Inc. (INO)** and Moderna, Inc. (MRNA). We hold the former in the three strategies listed above, while we previously researched the latter and decided against investing.

Although our reasoning for those decisions did not hinge upon the companies' involvement in the current search for a vaccine, both companies are involved in that process. To an outside observer, the two companies bear many other similarities. Both companies have been selected to participate in the U.S. Department of Health & Human Services' subtly named "Operation Warp Speed," which has set an extraordinarily optimistic goal of producing 300 million doses of a proven vaccine by January 2021. This has led to considerable news coverage hinting at promising work on coronavirus vaccines from both companies.

Moderna received considerable attention in mid-March for being the first company with a prospective vaccine to reach the beginning of the clinical trials phase. Inovio submitted its own vaccine applicant to trials three weeks later, having reportedly been delayed by a change to the company's primary manufacturing partner.

Both companies have also earned the support of powerful allies. We liked that the Bill and Melinda Gates Foundation backed Inovio. However, no less than Dr. Anthony Fauci publicly praised Moderna's recent results as "promising." These combined factors no doubt further bolster impressions of a "race for a cure."

Ultimately, our belief that the Gates Foundation's support for Inovio was a positive sign gets more directly at our underlying thesis. As referenced above, because we believe logistical challenges will be more considerable than many may anticipate, any successful offering will ultimately need to be not merely proven, but also feasible on a global scale. To this end, we like that Inovio's platform boasts a stable shelf life of more than a year without any loss of potency. This is often overlooked, but any successful solution must ultimately be deployable to a wide variety of locations and we like that Inovio's vaccine candidate is stable at up to 37 degrees Celsius for at least one year and for five years when stored between 2 and 5 degrees Celsius. By comparison, Moderna's prospective vaccine appears to require storage in specialized freezers—early supplies were reportedly stored at minus 70 degrees Celsius.

We like Inovio's platform, which is simply a segment of DNA in saline solution. Moderna's platform similarly uses a DNA segment, but subsequently requires the creation of in vitro messenger RNA, which must then be packaged into a nanoparticle comprised of five different lipids.

Finally, our respective investment decisions were cemented by lack of conviction that Moderna's high stock valuation was justified. In our separate and unrelated decision to invest in Inovio, we found the valuation more promising and believed the company's research to be more convincing.

MAINTAINING A LONG-TERM VIEW IN SHORT-TERM CRISES

Insofar as these two companies are involved in trying to find solutions to the current pandemic, either, both, or neither of the companies may ultimately be successful in helping to confront the Covid-19 pandemic. Although we decided against investing in Moderna, the company has an impressive operation, including a public-relations team that has proven its value in recent months. Vitally, though, our decision to invest in Inovio was not an attempt to choose a horse in any perceived race. Instead, we applied the same process that has guided Wasatch for more than 40 years. The companies we find attractive share several key attributes: They are well-run by capable management teams, they have strong balance sheets and they offer innovative or otherwise excellent products that we believe can drive long-term growth.

Inovio's participation in the search for a vaccine is ultimately immaterial to our confidence in the company. If a "race for a cure" truly exists, Inovio is among those that might succeed. But the company's future does not hinge upon it, and we believe its platform shows promise in numerous other contexts. This is perhaps the most crucial point. To better understand why, one need only consider that some early vaccine candidates for SARS, also a coronavirus, showed promising results in preliminary trials, but ultimately actually *enhanced* the virus in model experiments.

We believe investors who get overly caught up in the buzz of Wall Street and who view the current crisis as an opportunity to stake their winning claim are likely to end up disappointed, much like many early American fortune-seekers who heard tales of gold so plentiful that it sat in the open in riverbeds, but often quickly learned upon arrival that finding a successful claim would require incredibly hard labor.

In that sense, the Wasatch mountains are a fitting place for our firm to call home. When western states like California and Colorado were in the throes of their gold rushes, regulations in Utah prevented speculation and early settlers largely ignored prospective natural resources, including gold deposits, instead focusing on agriculture, farming, construction and similar forward-looking endeavors. All three states ultimately found great success, but for the purposes of investing, the Wasatch approach is one that prefers long-term cultivation, which we believe to be the best defense against unprecedented and uncertain times.

ABOUT THE INVESTMENT TEAM

John Malooly, CFA

Portfolio Manager

24 Years of Experience / 22 Years at Wasatch

Mr. Malooly is the Portfolio Manager of the U.S. small cap ultra growth strategy. He joined Wasatch Global Investors as an Analyst in 1997.

Prior to joining Wasatch, Mr. Malooly was an investment specialist at UMB Fund Services (formerly Sunstone Financial Group), the transfer agent for Wasatch Funds.

Mr. Malooly graduated from Marquette University, earning a Bachelor of Science in Business Administration. He is also a CFA charterholder.

John is a Wisconsin native. He enjoys skiing, trekking vacations and reading nonfiction. He also admits to having way too many cookbooks.

Jill Wahleithner, PhD

Senior Analyst

14 Years of Experience / 6 Years at Wasatch

Dr. Wahleithner joined Wasatch Global Investors in 2013. She was the founder of Type III Research, a biotech-consulting firm, which was under contract with Wasatch Global Investors from 2006 until 2013, when she was brought on at Wasatch full-time.

Some of Dr. Wahleithner's responsibilities with Type III Research included identifying emerging biotech companies, building financial models of private and public companies to assess market capitalization, and interacting with venture capital firm partners to assess company and product potential.

Dr. Wahleithner earned a PhD in Biology from the University of Utah, also where she received a Bachelor of Science. She gained vast experience following her education, which included performing postdoctoral research at CSIRO in Canberra, Australia and the University of California, Davis. She also was a research scientist for Novo Nordisk in Davis, California and a senior research associate for the Department of Biochemistry, Medical School at Dartmouth College.

Jill is a Wisconsin native, and has lived in a dozen states and two foreign countries. She loves gardening and having dogs that outweigh her.

RISKS AND DISCLOSURES

Investing in small 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 unstable currencies, highly volatile securities markets and political and social instability, 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 or call 800.551.1700. Please read the prospectus carefully before investing.

Information in this document regarding market or economic trends or the factors influencing historical or future performance reflects the opinions of management as of the date of this document. These statements should not be relied upon for any other purpose. ***Past performance is no guarantee of future results, and there is no guarantee that the market forecasts discussed will be realized.***

The primary investment objective of the Wasatch Micro Cap Fund, the Wasatch Small Cap Growth Fund and the Wasatch Ultra Growth Fund is long-term growth of capital. Income is a secondary objective, but only when consistent with long-term growth of capital.

References to individual companies should not be construed as recommendations to buy or sell shares in those companies.

As of June 30, 2020, the percentage of net assets invested in Exact Sciences Corp. was 0.00% for the Wasatch Micro Cap Fund, 0.00% for the Wasatch Small Cap Growth Fund and 1.44% for the Wasatch Ultra Growth Fund. As of June 30, 2020, the percentage of net assets invested in Inovio Pharmaceuticals, Inc. was 1.30% for the Wasatch Micro Cap Fund, 0.67% for the Wasatch Small Cap Growth Fund and 1.25% for the Wasatch Ultra Growth Fund. None of these Funds was invested in Moderna, Inc. or Pfizer, Inc. as of June 30, 2020.

ALPS Distributors, Inc. is not affiliated with Wasatch Global Investors.

CFA® is a trademark owned by the CFA Institute.

DEFINITIONS

An **initial public offering (IPO)** *is a company's first sale of stock to the public.*

The **Russell 1000 Index** *is an unmanaged total return index of the largest 1,000 companies in the Russell 3000 Index. The Russell 1000 typically comprises about 92% of the total market capitalization of all listed stocks in the U.S. equity market. It is considered a bellwether index for the performance of large company stocks. You cannot invest directly in this or any index.*

The **Russell 2000 Growth Index** *measures the performance of those Russell 2000 Index companies with higher price-to-book ratios and higher forecasted growth values. You cannot invest directly in this or any index.*

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 this or any index.*

The Wasatch Micro Cap, Wasatch Small Cap Growth and Wasatch Ultra Growth funds have been developed solely by Wasatch Global Investors. These Wasatch funds are 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.*

All rights in the Russell 1000 Index, Russell 2000 Growth Index and Russell 2000 Index vest in the relevant LSE Group company, which owns these indexes. Russell® is a trademark of the relevant LSE Group company and is used by any other LSE Group company under license.

These indexes are 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 these indexes or (b) investment in or operation of the Wasatch Micro Cap, Wasatch Small Cap Growth and Wasatch Ultra Growth funds or the suitability of the indexes for the purpose to which they are being put by Wasatch Global Investors.

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. You cannot invest directly in this or any index.*

The **U.S. Department of Health & Human Services (HHS)** *is the U.S. government's principal agency for protecting the health of all Americans and providing essential human services, especially for those least able to help themselves. HHS accomplishes its mission through programs and initiatives that cover a wide spectrum of activities.*

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

Wasatch Global Investors
505 Wakara Way, 3rd Floor
Salt Lake City, UT 84108

Institutional Investors
p: 800.381.1065
institutionalinfo@wasatchglobal.com

Financial Advisors
p: 800.381.1065
advisorservices@wasatchglobal.com

Individual Investors
p: 800.551.1700
shareholderservice@wasatchfunds.com

 Wasatch Funds are distributed by ALPS Distributors, Inc. WAS005257 7/30/2021