WASATCH
GLOBAL INVESTORS

Market Scout

APRIL 7, 2021

Market Leadership Shifted as Investors Gained Confidence in a Post-Covid Economic Rebound

During the several years prior to 2021, we were well-rewarded on an absolute and a relative basis for identifying high-quality growth companies. This year, however, we've performed more modestly amid an environment that's favored value-oriented companies.

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DEAR INVESTORS:

At Wasatch, we're mainly growth-oriented investors. Some of our strategies and funds pursue faster growth often in higher-priced companies, while several of our strategies and funds accept somewhat slower growth in lower-priced companies. Broadly speaking, we have a baseline goal of seeking companies that can roughly double their sales and earnings in the coming five years.

Over the long term, we believe sales growth and earnings growth will be reflected in the stock returns of our companies. To give you a sense of how Wasatch has performed over the past few years, let's consider all of the 14 Wasatch funds—including U.S., international, global and emerging markets funds—that have at least five years of performance.

WASATCH PERFORMANCE THROUGH 2020

For the five years ended December 31, 2020, the average Wasatch fund outperformed its benchmark by about 5.7 percentage points per year and the median Wasatch fund outperformed its benchmark by approximately 5.5 percentage points per year. During the three years ended December 31, 2020, the results were even better: about 10.7 percentage points of outperformance per year for the average fund and approximately 10.9 percentage points per year for the median fund.

Moreover, for both periods—the five years and the three years—it's important to note that the percentages weren't skewed by outliers. On an individual basis, 13 of the 14 Wasatch funds outperformed their benchmarks over the five years and the three years.

This discussion isn't meant to imply that our investment horizon is just a few years. In fact, our horizon is much longer—ideally around 10 years or more. We do try to make detailed projections of a company's potential sales and earnings over the next five years. Projections beyond five years are also important but they're much more susceptible to misjudgments. For the purpose of evaluating strategy and fund performance, we think a time period that includes a full market cycle is necessary because stock returns often come in unpredictable fits and starts. You can access all of the standardized performance as of March 31, 2021 for the Wasatch strategies and funds at ***wasatchglobal.com***.

DURING THE PAST SEVERAL YEARS, WE THINK THE STOCK MARKET APPROPRIATELY REWARDED MANY GROWTH-ORIENTED COMPANIES

There's no doubt stocks sometimes reflect company performance trends that later turn out to be unsustainable. And while such disappointments occurred for certain companies in the few years prior to 2021, we think there were many growth-oriented companies that were appropriately rewarded with rising stock prices. In this regard, we explained our approach to growth investing in a previous *Market Scout:*

> "We try to project both the rate and duration of corporate growth. For example, consider hypothetical investments in two different companies at the same valuation today. One company grows 25% annually for 10 years. The other company grows 25% annually for five years and then 10% annually for the next five years. After the full 10 years, the company that maintained its 25% annual growth would be almost

> twice as large as the company that faltered in its growth. This example clearly shows that an investor who made good assessments of the differing growth rates and durations would have been well-rewarded for choosing the company with consistent 25% growth—even if the investor had been willing to pay a somewhat higher starting valuation."

At Wasatch, we tend to focus on technologically advanced companies that operate in areas like services, software, information delivery and health care. When we do venture outside these areas, our companies usually have a unique operating model that's not overly capital-intensive. Moreover, in an environment of higher stock prices, we think in-depth insights into management teams, business models, competitive advantages and the scope for market expansion are particularly important. These insights have always been prime areas of focus for us.

WASATCH PERFORMANCE IN THE FIRST QUARTER OF 2021

Next we turn to the first quarter of 2021. Looking at the same Wasatch funds analyzed above, most saw positive returns but only two of the 14 funds outperformed their benchmarks over this very short period of time.

Still, the funds maintained their longer-term edge. For the five years ended March 31, 2021, the average Wasatch fund outperformed its benchmark by about 5.6 percentage points per year and the median Wasatch fund outperformed its benchmark by approximately 4.9 percentage points per year. Similarly, during the three years ended

*Data show past performance, which is not indicative of future performance. Current performance may be lower or higher than the performance quoted. To obtain the most recent month-end performance available, please visit **wasatchglobal.com**. Investment returns and principal value will fluctuate and shares, when redeemed, may be worth more or less than their original cost.*

March 31, 2021, the results were as follows: about 8.7 percentage points of outperformance per year for the average fund and approximately 8.5 percentage points per year for the median fund. Again, you can access all of the standardized performance for the Wasatch strategies and funds at ***wasatchglobal.com***.

What accounted for our overall underperformance during the first quarter of 2021? We think there were three main reasons.

First, the stocks of our companies had generally performed extremely well during the previous few years. In fact, some of our tech-oriented companies actually benefited from the virus-induced economic slowdown during which advanced solutions were used to support business and personal activity. Particularly strong performance can create a situation in which stock prices subsequently moderate for a period of time.

Second, optimism for greater economic reopening this year disproportionately benefited the stocks of "cyclical" companies in the consumer, financials, materials and energy sectors. Many of these stocks are considered value stocks, which generally outperformed growth stocks in the first quarter. For example, the Russell 2000® Value Index gained 21.17% during the quarter while the Russell 2000 Growth Index rose only 4.88%.

Third, early 2021 was one of the strangest periods we've seen in our careers. To explain what happened, we need to start with a brief description of a speculative activity called short selling. Participants involved in short selling are usually experienced traders, often at hedge funds, who control relatively large asset bases. Short selling entails borrowing shares of a stock and then selling these shares on the open market.

If the stock falls, the shares can be bought back at a lower price—which nets a profit for the short seller. As you can see, a short seller is hoping that the stock price will fall. But if the stock price rises, the short seller is vulnerable to a theoretically unlimited loss. How could the loss be unlimited? The answer is that stock prices are sometimes unrelated to company fundamentals. So if a stock price rises from $10 to $100 for no fundamental reason, why not $200 or $500 or $1,000?

What happened during the first quarter was that many people on social-media discussion sites decided to attack the short sellers—who are often viewed as wealthy, unscrupulous traders that are normally against the "little guy." Now that brokerage accounts can be opened with small amounts of money and buy orders are often commission-free, the banded-together "little guys" were able to drive up the prices of some of the most heavily shorted stocks in the market. This caused devastating losses—in what's known as a "short squeeze"—for some prominent short sellers.

GameStop Corp. was the most publicized company that experienced a short squeeze because the stock rose about 908% during the quarter even though it is mostly a brick-and-mortar retailer that's been giving up market share and losing money. Additionally, the stocks of many other lower-quality companies also rose indiscriminately on the overall mania.

MONETARY AND FISCAL STIMULUS, INTEREST RATES AND INFLATION

For the past several years, both before and during the pandemic, we think stock prices have been supported by monetary stimulus from central banks and fiscal stimulus from governments around the world. When the economy was expanding slowly, high-quality growth companies were prized the most by investors.

More recently, however, investors have become increasingly optimistic regarding a broader group of companies. Longer-term interest rates, which are under less control by central banks, have risen. This is because there's greater demand for capital by borrowers. And we're starting to see inflation creep higher too—which is evident in the costs of real estate, lumber, copper, nickel and transport services, for example.

Conventional wisdom suggests rising interest rates and inflation will benefit cyclical and value companies. The reason is higher rates make lending more profitable and improve deposits' net interest margins for financial institutions. Similarly, higher inflation tends to enhance the profits of materials and energy companies.

Apart from broad generalizations about cyclical and value companies, we've often found that smaller companies are also well-positioned to cope with inflation because they frequently offer niche products and services in which customers will tolerate price increases. For example, certain

mortgage companies, homebuilders, home-improvement businesses, specialty retailers, cloud-based software companies and internet-security providers are currently thriving.

GROWTH VERSUS VALUE INVESTING: A MUDDLE-THROUGH ENVIRONMENT VERSUS A FULLER ECONOMIC REOPENING

In some ways, the current debate regarding growth investing versus value investing can also be described as investing amid a muddle-through environment during the pandemic versus investing amid a fuller economic reopening. As we've discussed, growth companies were generally better-positioned during a muddle-through environment and value companies are perceived as benefiting more from a fuller economic reopening.

Within this context, we'd like to discuss three Covid-related scenarios for companies. (1) Revenues and earnings were pulled from the future into the present. (2) Revenues and earnings were accelerated into the present. (3) Revenues and earnings were postponed to a future in which global economies have begun to approach normalcy.

An example under the first scenario is a non-recurring technology upgrade that was completed sooner than expected because it was needed to support remote work. An example under the second scenario is the new use of software on a subscription basis that was necessary as the pandemic unfolded but that will also be necessary on an ongoing basis. An example under the third scenario is upcoming spending for travel and entertainment that wasn't possible until an end to the pandemic was clearly in sight.

During 2020, the stocks of companies experiencing the first and second scenarios tended to be the best performers. So far in 2021, the stocks of companies experiencing the third scenario have been among the big winners.

POSITIONING PORTFOLIOS THE WASATCH WAY

The Wasatch strategies and funds (hereafter "strategies") can be grouped into a few types: U.S. strategies, international strategies and emerging markets strategies. We also offer global strategies, which combine U.S. stocks with stocks from international developed countries and emerging markets. For our purposes here, we'd like to describe how we're positioning portfolios within the context of the first three strategy types.

For our U.S. strategies, we've trimmed positions in companies where revenues and earnings were pulled from the future into the present because these companies may need some time for their fundamentals to catch up with their stock prices. We're generally more comfortable with companies in which revenues and earnings were accelerated into the present because these companies often saw earlier adoption of their products and services, and likely will continue to see strong purchases going forward.

As for companies in which revenues and earnings were postponed by the pandemic, we're cautious even though many of these companies have had leading stock gains this year. The main reason we're cautious is that we've learned over time not to sacrifice quality for price. The sectors generally viewed as benefiting in the early stages after the pandemic ends are consumer, financials, materials and energy. Of these, we have no trouble finding consumer names we like. We also have some financials. But the unique competitive advantages we seek are much less prevalent in the materials and energy sectors.

The parameters discussed for our U.S. strategies also apply to our international strategies. We've been selling companies where revenues and earnings were pulled from the future into the present. We've also been selling other companies that we believe are overpriced. At the other end of the spectrum, we've been buying companies that are somewhat more economically sensitive. Having said that, we as a firm have been investors in high-quality growth companies for over 45 years. And we don't typically find attractive names in deeply cyclical areas. We're very pleased if we excel in growth-oriented environments even if we just do reasonably well in value-oriented environments.

One country we like in particular is the United Kingdom. Many investors consider the U.K. to be a value market largely due to dislocations stemming from Brexit. But the country has emerged from Brexit reasonably well-positioned, and the British pound has been strengthening. Moreover, the U.K. has handled the vaccine rollout better than most of Europe. On the ground, we've been finding that corporate management teams are allocating resources appropriately and customer demand is strong.

From our perspective, the U.K. provides a powerful combination: reasonable stock prices with many high-quality, long-duration growth companies.

While we wouldn't classify Japan as a value market, it's similar to the U.K. in terms of the increasingly robust business environment. Small-cap companies have strong access to capital, and there's a tendency of small-cap stocks to perform well over time. We especially like Japanese companies that are benefiting from the need to improve the information-technology (IT) infrastructure. These companies include software-as-a-service (SaaS) providers, security consultants, IT integrators and enablers of telemedicine.

Relative to our other strategies, we've made the fewest portfolio changes to our emerging markets strategies. India, Taiwan and China remain three of our favorite countries in which we're finding attractive investments. As for sectors, we like the growth potential of financials in emerging markets more than in developed countries. We also see opportunities based on the domestic demand for information technology, health care, and consumer products and services. Please visit ***wasatchglobal.com*** to access our latest white papers—***The Tide May Be Turning Toward Emerging Markets*** and ***Semiconductors: The "New Oil."***

THE WASATCH OUTLOOK

The environment has certainly changed in 2021. Many people have been receiving coronavirus vaccinations. A timeline for a complete economic reopening has become more clearly defined. Long-term interest rates have risen. Inflation has accelerated. And investors all over the world have begun to favor value stocks over growth stocks.

But some things haven't changed. Monetary and fiscal stimulus are still providing extraordinary support. The U.S. Federal Reserve plans to maintain short-term interest rates near zero and to continue purchasing at least $120 billion a month of Treasury bonds and mortgage-backed securities. Moreover, Congress has approved nearly $4 trillion in government spending beyond the $1.9 trillion American Rescue Plan. Based largely on this support, U.S. gross domestic product is expected to grow an astounding 6.5% this year. For our part, we'd prefer a situation in which the economy and financial markets could stand on their own.

It's certainly possible that monetary and fiscal stimulus will soon be tapered around the globe and that a self-sustaining economic expansion will take over. Such conditions might also help governments, businesses and individuals dig themselves out of the extreme debt accumulated during the pandemic and prior to that.

If this optimistic case unfolds, we'd expect the stocks of economically sensitive companies to continue as market leaders. And the Wasatch strategies certainly have reasonable exposure to these stocks. But as we've already discussed, we're not willing to sacrifice quality for price. In fact, we consider ourselves quality investors first and growth investors second.

Part of our investment process is to continually stress-test our companies to ensure they still offer outstanding competitive advantages, they still have headroom for significant growth, and their stock prices haven't gotten too far ahead of fundamentals. Where companies haven't passed our stress tests, we've sold positions accordingly and invested the proceeds elsewhere. Our mindset is that every time we sell a company, we want to find a replacement that gets us more excited.

As growth-oriented investors, we don't change our approach. Although different styles can come in and out of favor, switching back and forth is usually unsuccessful. Instead, we believe having a consistent approach is necessary for generating risk-adjusted outperformance ("alpha") versus a benchmark over the long term.

This doesn't mean we only look for opportunities where we've found them before. In the current environment, we've widened our lens to find high-quality, long-duration growth companies wherever they exist. One of our main initiatives now is to understand which trends precipitated or strengthened by the pandemic will stall and which ones will accelerate. This understanding is particularly important in the United States because the U.S. is a leader in vaccine distribution and is likely to enter a post-pandemic phase before most other countries.

With sincere thanks for your continuing investment and for your trust,

Ken Applegate, Brian Bythrow and Ryan Snow

RISKS AND DISCLOSURES

Mutual-fund investing involves risks, and the loss of principal is possible. Investing in micro cap and 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.**

Portfolio holdings are subject to change at any time. References to specific securities should not be construed as recommendations by the Funds or their Advisor. Current and future holdings are subject to risk.

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

As of March 31, 2021, none of the Wasatch strategies or funds were invested in GameStop Corp.

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DEFINITIONS

Alpha *is a risk-adjusted measure of the so-called "excess return" on an investment. It is a common measure of assessing an active manager's performance as it is the return in excess of a benchmark index or "risk-free" investment. The difference between the fair and actually expected rates of return on a stock is called the stock's alpha.*

The American Rescue Plan Act of 2021, also called the **American Rescue Plan**, *is a $1.9 trillion coronavirus rescue package designed to facilitate the United States' recovery from the devastating economic and health effects of the Covid-19 pandemic.*

Brexit *is an abbreviation for "British exit," which refers to the June 23, 2016 referendum whereby British citizens voted to exit the European Union. The referendum roiled global markets, including currencies, causing the British pound to fall to its lowest level in decades.*

The **"cloud"** *is the internet.* **Cloud-computing** *is a model for delivering information-technology services in which resources are retrieved from the internet through web-based tools and applications, rather than from a direct connection to a server.*

Earnings growth *is a measure of growth in a company's net income over a specific period, often one year.*

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.*

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.*

Net interest margin *is typically used for a bank or an investment firm that invests depositors' money, allowing for an interest margin between what is paid to the bank's client and what is made from the borrower of the funds. A positive net interest margin indicates that an entity has invested its funds efficiently, while a negative net interest margin implies that the funds have not been invested efficiently.*

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

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

The **Russell 2000 Index** *is an unmanaged total return index of the smallest 2,000 companies in the Russell 3000 Index, as ranked by total market capitalization. The Russell 2000 is widely used in the industry to measure the performance of small company stocks.*

The **Russell 2000 Growth Index** *measures the performance of Russell 2000 Index companies with higher price-to-book ratios and higher forecasted growth values.*

The **Russell 2000 Value Index** *measures the performance of Russell 2000 Index companies with lower price-to-book ratios and lower forecasted growth values.*

You cannot invest directly in these or any indexes.

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