WASATCH GLOBAL INVESTORS

Quarterly Commentary

Wasatch International Select Strategy

DECEMBER 31, 2022

We Believe Our Companies Could Steer Well Through a Potential Recession

OVERVIEW

For the fourth quarter of 2022, the Wasatch International Select strategy produced a gain but trailed the benchmark MSCI EAFE Index, which was up 17.34%.

After losing ground for much of 2022, international equities rallied in the fourth quarter. Gains were driven by signs that inflation may have peaked in some economies, leading to hopes that central banks would slow campaigns of interest-rate increases.

At the sector level, our holdings in the health-care and information-technology (IT) sectors detracted the most from performance relative to the benchmark. However, an underweight position in the consumer-staples sector and stock selections in the industrials sector contributed to relative results.

DETAILS OF THE QUARTER

JMDC, Inc. was the largest detractor from strategy performance in the quarter. While nothing fundamentally changed for the business, many Japanese growth stocks sold off after the Bank of Japan surprised markets with an announcement it would tweak its bond-yield control, which could allow long-term interest rates to rise more. Looking ahead, we continue to believe JMDC will play a vital role in helping Japan's health-care system achieve better patient outcomes through the use of data and analytics.

PORTFOLIO MANAGERS

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Lead Portfolio Manager
6 YEARS ON STRATEGY / 8 YEARS AT WASATCH

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6 YEARS ON STRATEGY / 16 YEARS AT WASATCH

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Another detractor was Kakaku.com, Inc. The company operates a price-comparison website for products and services in Japan and runs a restaurant review site called Tabelog. Weakness in the business for its price-comparison site weighed on the stock this quarter, but we continue to like the company. In our view, management has done a fantastic job innovating and expanding the business over the years. We believe it can repeat the success it has experienced with Kakaku.com and Tabelog in other media segments. Going forward, we continue to like the company's high-margin, cash-generative business model.

M3, Inc. was also a detractor. The Japan-based company provides a range of health-care related services, including a digital sales and marketing business for pharmaceutical and medical-device companies, a doctor and pharmacist placement business, and a consumer-facing health-care business. While the stock drifted lower during the period, we continue to like the company. With nearly 80% of Japan's doctors registered as members on M3's online portal, the company has created a valuable base from which it can launch multiple revenue sources. Further, the lack of investment in digital health-care services in Japan, along with the high cost of developing drugs and delivering health care in the country, all play favorably into M3's various business offerings.

The top contributor to strategy performance for the quarter was Hermes International. The French luxury-design house specializes in handbags, leather goods, jewelry, clothing and lifestyle accessories, and is the maker of the globally famous and highly coveted Birkin bags. Strong financial results in a period of slow economic growth have demonstrated the strength of the brand and helped drive the stock higher in recent months. Anticipation about China reopening, which could spur more demand for Hermes' luxury products, also played a role in driving the stock up. We continue to think Hermes' management team has managed its brands well, helping the company command a relatively high degree of pricing power.

Another large contributor was BayCurrent Consulting, Inc., a Japan-based business management and IT consultant. The stock was up after announcing strong financial results including 32.6% revenue growth. Heading into 2023, we continue to believe BayCurrent has a long runway for growth. Japan is behind many countries when it comes to digitalization. The pandemic and work-from-home environment underscored its need to catch up. As Japanese enterprises undertake large-scale digitalization projects, we believe domestic IT consultants such as BayCurrent have a strong home-country advantage relative to global consulting firms.

CAE, Inc. also contributed. The Canadian company provides training services for civil and defense customers globally. In particular, the company enables airlines to lower their operating costs by outsourcing pilot-training programs. CAE's stock was up substantially after the company posted better-than-expected quarterly revenue and earnings, driven by strong demand for its flight simulators. Going forward, management has made a concerted effort to strengthen the company's long-term competitive position and we expect airlines to rely more heavily on CAE for flight training as a result.

OUTLOOK

While recent data suggests inflation may have peaked for some countries, markets haven't yet climbed a "wall of worry." The potential for a recession continues to loom over international equities, and markets could stay volatile until there is a clearer picture about the global economy.

As bottom-up investors, we tend to spend less time predicting the likelihood or length of a recession, and more time focusing on how our companies can steer through it. On that front, we feel confident for two reasons.

First, the companies in our portfolio provide products and services that are typically critical to the businesses or consumers they serve. Demand for such services could slow marginally during a recession, but given the essential nature of these services, we don't think it would substantially deteriorate.

Second, we believe the high-quality nature of our companies puts them in a good position to weather an economic downturn. We've mentioned it in prior commentaries, but key characteristics we seek in companies include strong balance sheets, high levels of return on invested capital (ROIC) and a long history of steady free-cash-flow growth. In addition, these businesses are typically managed by teams we know well, and who have a history of steering businesses through an economic cycle.

We believe these high-quality traits don't just enable our companies to withstand a downturn. They allow our businesses to go on the offensive when their competitors are back on their heels. We've seen this throughout 2022, in what's been a challenging and uncertain operating environment. Over the course of the year, we've seen our firms make acquisitions to consolidate an industry or grow their sales staff to grab market share. As another example, our industrial distributors absorbed the costs of higher inventory to meet customers' needs amid supply-chain disruptions, which should further establish their reputations as reliable partners.

If the world enters a recession next year, we believe many of our companies would have the strength to stay on the offensive. This should set them up for better growth coming out of the downturn.

Thank you for the opportunity to manage your assets.

Sincerely,

Ken Applegate, Linda Lasater and Derrick Tzau

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