WASATCH GLOBAL INVESTORS

Quarterly Commentary

Investor WALSX / Institutional WGLSX

# Wasatch Long/Short Alpha Fund

SEPTEMBER 30, 2022

## Our Shorts Hindered Performance Early in the Third Quarter, But They Were Beneficial as the Market Declined Later On

FUND MANAGER

**Mick Rasmussen, CFA**
Lead Portfolio Manager

1 YEAR ON FUND / 8 YEARS AT WASATCH

### OVERVIEW

During the third quarter of 2022, the Wasatch Long/Short Alpha Fund—Investor Class lost -1.10% but outperformed the benchmark Russell 2500™ Index, which fell -2.82%. The Fund's outperformance of the benchmark came mostly from favorable stock selections on the long side and from advantageous short selling. More specifically, although our shorts hindered performance early in the quarter, they were beneficial as the market declined later on.

On the long side, the Fund benefited from our holdings in several industry groups including banks, technology hardware & equipment, health care equipment & services, commercial & professional services and media & entertainment. At the other end of the spectrum, the Fund was hurt by our holdings in diversified financials, consumer services, semiconductors & semiconductor equipment and consumer durables & apparel.

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*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, without which total returns would have been lower. 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: Investor Class—Gross: 4.96%, Net: 2.50% / Institutional Class—Gross: 4.06%, Net: 2.25%. The Advisor has contractually agreed to limit certain expenses to 1.75% for the Investor Class and 1.50% for the Institutional Class through at least 1/31/2023.***

Among shorts, the Fund was aided by our positions in media & entertainment and household & personal products. In contrast, the Fund was stung by our positions in retailing, food beverage & tobacco, telecommunication services and semiconductors & semiconductor equipment.

## A "DIRECTIONAL APPROACH" TO LONG/SHORT INVESTING

We'd like to remind shareholders that the Wasatch Long/Short Alpha Fund takes a "directional" approach, meaning we always have a bias toward greater long exposure than short exposure. As of September 30, the Fund's long exposure was about 113% and its short exposure was approximately -33%. We primarily hold small- and mid-cap companies, with our longs typically being somewhat bigger in market capitalization than our shorts.

Our long positions consist of companies we've selected based on bottom-up, fundamental research. We pick companies with high-quality characteristics including significant returns on capital, relatively low debt, great management teams, expanding market dynamics, and innovative products, services and business models.

We select our short positions by using a multifactor quantitative model that includes momentum and valuation signals to determine which companies are conducive for short-selling. Once we systematically identify short candidates, we leverage our qualitative expertise to further narrow down our list to companies we believe can best complement our long positions.

In other words, we seek to put together the best combination of longs and shorts that we believe will effectively reduce risk and keep the Fund's volatility much lower than that of the benchmark under most market conditions. In terms of the Fund's beta, our target is approximately 0.5. Over time, we'd consider our approach to be successful if we can keep the Fund's beta close to 0.5 and roughly match the return of the benchmark.

We launched the Long/Short Alpha Fund on October 1, 2021. After exceptional performance in the October-to-December period, the January-to-March period was somewhat disappointing. But the April-to-June and the July-to-September periods met our expectations. One reason for our strong performance relative to the benchmark was that our shorts really did their job amid the market downturns. For the full one-year period from the Fund's inception on October 1, 2021 through September 30, 2022, the Fund was down -9.90% while the benchmark Russell 2500 Index was down more than twice as much at -21.11%. We're especially gratified by the Fund's strong relative performance because the past year was a difficult period for the Wasatch style of growth investing.

## LONG POSITIONS DURING THE QUARTER

Among long positions, a top contributor to Fund performance for the third quarter was **Resolute Forest Products, Inc. (RFP)**, which manufactures newsprint, coated and uncoated ground-wood papers, bleached kraft pulp and lumber products. The company owns and operates pulp and paper mills, coating operations and sawmills in North America. The stock moved higher as Resolute captured the upside in the commodity cycle. We sold our position because the company agreed to be acquired by Paper Excellence Group.

**Paylocity Holding Corp. (PCTY)** was also a contributor. The stock was up substantially after the company reported revenue and earnings that topped consensus expectations. We continue to like the strong, recurring revenue streams associated with the company's cloud-based payroll and human-capital-management software targeted at smaller businesses. Because Paylocity holds significant customer cash on its balance sheet, earnings get a boost in a rising interest-rate environment. While that advantage is an attractive sweetener, it's not a reason why we own the company. Instead, we value Paylocity for its core operations.

Another contributor was Silvergate Capital Corp. (SI), which addresses the specialized banking needs of entrepreneurs and provides a banking platform for innovators, especially in the digital-currency industry. When the stock was lower, we added to our position. More recently, as the stock has risen because Silvergate has benefited from higher interest rates, we've sold some shares.

A large detractor from Fund performance on the long side was YETI Holdings, Inc. (YETI), which designs, markets and distributes coolers, beverage holders, seat cushions, cable locks and other types of outdoor and recreational gear. While the stock got hurt based on fears of a slowdown in consumer spending, we like YETI's competitive position over a full market cycle.

Neogen Corp. (NEOG) was also a detractor. The company provides products to food and animal producers that help keep the world's food supply safe from pathogens and other risks. Although rising costs for freight and supply-chain management have impacted gross margins, we don't think Neogen is any more vulnerable than competitors. Additionally, we believe Neogen's margin erosion is temporary because the company's products are still in strong demand. Another factor that may have impacted the stock was Neogen's acquisition of 3M's food-safety business, which has increased the debt on the balance sheet. In our view, the acquisition was strategically sound, and we see the debt level as reasonable.

Our major sales of long positions included REV Group, Inc. (REVG) and Chefs' Warehouse, Inc. (CHEF). REV is a designer, manufacturer and distributor of specialty vehicles and related parts. Chefs' is a premier distributor of specialty food products. Although we still liked both companies, we thought the proceeds of the sales could be deployed in names with better valuations.

Our noteworthy buys of long positions included fast-growing Workday, Inc. (WDAY) and Axis Capital Holdings Ltd. (AXS). Workday provides cloud-based enterprise applications for human resources, payroll, spending and financial management. Axis Capital offers insurance for property, workers' compensation, professional liability, casualty, marine and aviation coverage.

## SHORT POSITIONS DURING THE QUARTER

Turning to short positions, contributors were those stocks that declined in price. We added the most value by shorting Domo, Inc. (DOMO) and Definitive Healthcare Corp. (DH). Domo provides business information in several industries. The company had a high valuation and was burning cash when we initiated the short position. Definitive Healthcare is a software company that offers data solutions to health-care-related companies. Compared to other software companies, Definitive Healthcare was overvalued when we shorted the stock.

Among shorts, detractors were those stocks that rose in price. We got hit the worst by shorting Xometry, Inc. (XMTR) and Nutanix, Inc. (NTNX). Xometry provides an artificial-intelligence-enabled marketplace for on-demand manufacturing. We incorrectly believed the stock would fall based on the company operating at a significant loss. Nutanix offers a cloud-enabled software and hardware infrastructure for integration, virtualization, storage, disaster recovery, network security and IT management. We underestimated the market's support for Nutanix, which we think operates in a crowded space and lacks enough differentiation.

Regarding transactions in short positions, we covered names like Golar LNG Ltd. (GLNG), 8x8, Inc. (EGHT) and Farfetch Ltd. (FTCH)—which had been expensive when we shorted them but which are now approaching potentially reasonable valuations. New short positions for us are restaurant company Sweetgreen, Inc. (SG) and telehealth company American Well Corp. (AMWL)—which we think are expensive, lower-quality businesses that may need to raise capital on disadvantageous terms. *(Current and future holdings are subject to risk.)*

## OUTLOOK AND POSITIONING

There's no doubt that significant fears still exist among investors. Broadly speaking, these fears relate to persistently high inflation, rising interest rates, the possibility of recessions around the world, the war in Ukraine and ongoing supply-chain challenges—exacerbated by China's zero-Covid policy.

The main offset to these fears is that many of our small-cap companies have stocks trading at some of the best valuations we've seen in more than a decade. As a result, we're very excited about return prospects going forward. While it's true that macro forces can keep a lid on valuations for a period of time, it's impossible to predict the direction of such forces. And even moderately good news on the macro front could trigger unexpected spikes in stock prices.

As portfolio managers, there's nothing we can do to control macro forces or the timing of the returns on our stocks. But, with respect to our long positions, here's what we *can* do:

- Focus on high-quality management. When we look historically at our best-performing stocks, they were generally of companies in which our investment team had reached a consensus that management was top-notch.
- Focus on innovative products, recurring revenues and sustainable business models in markets with headroom for long-duration growth. If we make good assessments in these areas, even relatively pricey companies can go on to be very successful investments for a decade or more.
- Focus on significant returns on capital and relatively low debt. These characteristics often indicate that a company will be able to self-fund its growth, which can be important in preventing the need to raise money and dilute the ownership of existing shareholders.

With respect to our short positions, we're primarily looking for negative stock-price momentum, indications of overvaluation and factors that—when matched with the factors of our long positions—are likely to create favorable portfolio characteristics.

As mentioned above, our target for the Fund's beta is approximately 0.5 with a return that roughly matches the return of the benchmark. In the third quarter, the beta was about 0.6, a bit higher than our ideal. Fortunately, as compensation for the greater volatility we endured, the Fund did outperform the benchmark by over 1.7 percentage points.

Finally, we'd like to comment on the attractiveness of holding growth-oriented companies in the midst of continually elevated interest rates and inflation. While it's true that growth stocks took an outsized hit during the early stages of rate increases, there are other factors to consider. First, our growth companies generally don't have significant debt loads that would be impacted by higher interest rates. Second, quality growth companies should be better able to attract talent and raise prices during an environment of escalating wage and input-cost inflation. Third, in general, we believe the top growth companies are best positioned to navigate especially difficult challenges—ranging from logistical problems amid a booming economy, to the need for increased market share amid a recession. Fourth, the Long/Short Alpha Fund offers shareholders the classic Wasatch growth style of investing—but with what we believe is a lower risk profile.

Thank you for the opportunity to manage your assets.

Sincerely,

Mick Rasmussen

## AVERAGE ANNUAL TOTAL RETURNS

FOR PERIODS ENDED SEPTEMBER 30, 2022

| | Quarter* | 1 Year | 3 Years | 5 Years | Since Inception** |
|---|---|---|---|---|---|
| Long/Short Alpha Fund—Investor | -1.10% | -9.90% | N/A | N/A | -9.90% |
| Long/Short Alpha Fund—Institutional | -1.10% | -9.70% | N/A | N/A | -9.70% |
| Russell 2500™ Index† | -2.82% | -21.11% | N/A | N/A | -21.11% |
| FTSE 3-Month U.S. Treasury Bill Index†† | 0.45% | 0.63% | N/A | N/A | 0.63% |

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

***The Wasatch Long/Short Alpha Fund's inception date was October 1, 2021.*

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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 1.75% for the Investor Class and 1.50% for the Institutional Class through at least 1/31/2023.** 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.*

**Equity investing involves risks, including potential loss of the principal amount invested.**

***Short selling incurs significant unique risks, including potentially unlimited downside risk, high short-sale related expenses, and unavailability of securities to sell short, among others, all of which could negatively impact the performance of the Fund. Additionally, the Fund may not be able to borrow the securities it intends to sell short.***

**Because the Fund invests in both long and short equity positions, the Fund has overall exposure to changes in the value of securities, which far exceeds the value of the Fund's assets. This may magnify gains and losses and increase the volatility of the Fund's returns. Investment in the Fund will involve market risks associated with different types of investment decisions than those made for a typical "long only" fund. There is no guarantee that the use of long and short positions will succeed in limiting the Fund's exposure to market movements, sector swings or other risk factors.**

***Being non-diversified, the Fund can invest a larger portion of its assets in the stocks of a limited number of companies than a diversified fund. Non-diversification increases the risk of loss to the Fund if the values of these securities decline.***

**Portfolio holdings are subject to risk and may change at any time. Securities in the Fund are generally added to the portfolio as long or short positions based upon security rankings provided by multi-factor quantitative models and on fundamental analysis of securities. The reliance on quantitative models entails unique risks, including the risk that a model may be limited or incorrect, that the data on which a model relies may be incorrect or incomplete and the risk that the Advisor may not be successful in selecting companies for investment or determining the weighting of particular stocks in the Fund's portfolio. The Advisor will generally sell a security if, among other things, the rankings provided by the quantitative models decline and/or research analysis reveals deterioration in company fundamentals.**

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 Fund is new and has a limited operating history.*

†The Russell 2500 Index is a market-cap weighted index that includes the smallest 2,500 small- and mid-cap stocks covered in the broad-based Russell 3000 of U.S.-based listed equities.

††The FTSE 3-Month U.S. Treasury Bill Index is intended to track the daily performance of 3-month U.S. Treasury bills.

*Indexes are unmanaged. Investors cannot invest in these or any indexes.*

*The Wasatch Long/Short Alpha Fund has been developed solely by Wasatch Global Investors. The Wasatch Long/Short Alpha Fund is 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.*

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*The Wasatch Long/Short Alpha Fund's investment objective is long-term growth of capital.*

*Beta is a quantitative measure of the volatility of a given stock relative to the overall market. A beta above one is more volatile than the overall market, while a beta below one is less volatile.*

*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.*

*Return on capital is a measure of how effectively a company uses the money, owned or borrowed, that has been invested in its operations.*

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

## LONG/SHORT ALPHA FUND — TOP 10 LONG EQUITY HOLDINGS

AS OF JUNE 30, 2022

| Security Name | | Percent of Net Assets |
|---|---|---|
| Balchem Corp. | | 3.5% |
| Bank OZK | | 3.4% |
| Morningstar, Inc. | | 3.2% |
| Medpace Holdings, Inc. | | 3.2% |
| Ensign Group, Inc. | | 3.0% |
| Roper Technologies, Inc. | | 3.0% |
| Innospec, Inc. | | 2.9% |
| Five9, Inc. | | 2.7% |
| HealthEquity, Inc. | | 2.7% |
| Addus HomeCare Corp. | | 2.6% |
| | Total | 30.2% |

*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.*