

# Wasatch Emerging Markets Small Cap Fund

JUNE 30, 2023

## India's Production-Linked Incentive Scheme Has Contributed to the Recent Surge in Industrial Expansion

### OVERVIEW

Stocks of small companies in developing nations were mostly higher during the second quarter of the year. The benchmark MSCI Emerging Markets Small Cap Index rose 6.39% for the quarter. The Wasatch Emerging Markets Small Cap Fund—Investor Class trailed the benchmark with a total return of 3.35%.

China's economic rebound from zero-Covid lockdowns disappointed investors, intensifying calls for additional stimulus measures. Although sales of consumer goods have risen, the increases thus far have lagged behind the recovery in services. Recent data pointed to a cooling economy, with deflation in producer prices adding to concerns about softening domestic demand and falling exports. Because China was the worst-performing emerging market in the Index, the Fund benefited from underweight positioning relative to the benchmark.

Other below-average performers in the Index included Korea and Thailand. Political uncertainty weighed heavily on investor sentiment in Thailand as an opposition party was unable to form a new government in the aftermath of its May 14 election victory. In both Thailand and Korea,

### FUND MANAGERS



**Ajay Krishnan, CFA**  
Lead Portfolio Manager

4 / 28  
YEARS ON FUND / YEARS AT WASATCH



**Dan Chace, CFA**  
Portfolio Manager

4 / 21  
YEARS ON FUND / YEARS AT WASATCH



**Scott Thomas, CFA**  
Portfolio Manager

8 / 11  
YEARS ON FUND / YEARS AT WASATCH



**Kevin Unger, CFA**  
Associate Portfolio Manager

5 / 7  
YEARS ON FUND / YEARS AT WASATCH



**Anh Hoang, CFA**  
Associate Portfolio Manager

1 / 11  
YEAR ON FUND / YEARS AT WASATCH

*Data show past performance, which 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](http://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 do not reflect this redemption fee or taxes. **Total Expense Ratio: Investor Class—1.91% / Institutional Class—1.78%. The Advisor has contractually agreed to limit certain expenses to 1.95% for the Investor Class and 1.80% for the Institutional Class through at least 1/31/2024.***



our stocks posted returns well ahead of the Index components, making these countries the Fund's main sources of strength against the benchmark.

The Fund's primary source of underperformance was Taiwan. Soft overseas demand for semiconductor chips had sent Taiwan's export-driven economy into recession during the first quarter of 2023. Beginning in May, however, enthusiasm about artificial intelligence (AI) reached a fever pitch, causing shares of technology-hardware manufacturers linked to AI microprocessors to surge. Our Taiwanese stocks performed poorly in comparison and dragged down the Fund's return.

Stocks generally did well in India, the most heavily weighted country in both the Index and the Fund. Easing inflationary pressures in India stoked optimism that the central bank will keep interest rates on hold. Down from 4.70% in April, consumer prices rose 4.25% in May from a year earlier—the smallest increase since April 2021. The Reserve Bank of India (RBI) paused its series of interest-rate hikes for the second straight meeting in June after raising its policy rate by two-and-a-half percentage points since May 2022.

## DETAILS OF THE QUARTER

The greatest contributor to Fund performance for the quarter was **AU Small Finance Bank Ltd.** The company primarily targets unbanked and underbanked low- and middle-income borrowers in India. Net profit in the company's most recent quarter grew 26% compared to the same quarter a year ago, supported by a 37% increase in net interest income. Investors also reacted positively to news that the RBI had approved the reappointment of Sanjay Agarwal as managing director and CEO for a period of three years.

Brazil was one of the highest-returning countries in the Index as a newly proposed fiscal framework designed to shore up the nation's public finances advanced in the legislature. Brazilian holding **Raia Drogasil SA** was among the Fund's top contributors to performance. Already Brazil's leading drugstore operator, the company has continued to gain market share. Raia Drogasil's increased scale now presents enhanced opportunities for growth on both the top and bottom lines. Because costs associated with establishing the company's physical and digital footprints are largely fixed, Raia Drogasil enjoys significant operating leverage to potentially enhance profitability.

Another strong stock in the Fund was **Trent Ltd.** The company operates a leading chain of retail stores in India specializing in fashion apparel, cosmetics, perfumes and toiletries. Trent has done well as falling inflation has allowed consumers to spend more on higher-margin, discretionary items. During one of our recent trips to India, company executives were optimistic that both the fashion format and the similar-to-supermarket format of Trent's stores would remain key drivers of growth going forward.

Taiwan accounted for the two most significant detractors from Fund performance—**Silergy Corp.** and **momo.com, Inc.**, respectively. Silergy produces integrated-circuit chips used in a wide array of electronic devices. The company's shares struggled amid competitive pressures and a weak demand environment, which we believe is cyclical and temporary. Lowered short-term expectations for the automotive segment of the business may also have dampened enthusiasm for the stock. Even so, Silergy's value proposition remains attractive in our view, and we think the company will emerge from the current semiconductor cycle in a stronger competitive position.

Predominantly an e-commerce services company, momo.com operates online-shopping, television-shopping and catalog-based mail-order outlets that mainly serve retail customers in Taiwan. With the island's economy in recession, consumer sentiment in Taiwan remained poor. The company lowered its revenue guidance for 2023 and expects demand to remain soft until the second half of the year. On the plus side, momo.com has continued to gain market share in Taiwan, and our long-term investment thesis remained intact.



**Wilcon Depot, Inc.** also detracted from performance. The company operates the Philippines' leading retail chain for home-improvement products and finishing-construction supplies. A pickup in inflation in the Philippines during 2023 has strained household budgets and crimped spending on home improvement. However, Wilcon Depot appears to be gaining market share in this difficult environment. With inflation already showing signs of easing, we think the company will be well-positioned if the economic backdrop should normalize early next year as we expect. *(Current and future holdings are subject to risk and change.)*

## OUTLOOK

During a recent trip to China, members of our investment-research team got a firsthand look at the modern technology and gleaming infrastructure on display. For example, testing is underway on a vacuum-tube train that will combine aerospace and railway technologies to commute passengers from Shanghai to Hangzhou much more rapidly than currently possible. At a robotics company, a fully automated factory floor uses robots to make other robots.

While such widespread efficiencies and abundant deployment of capital in China have many positive effects, they can sometimes make a market hypercompetitive and drive down a company's profitability, adding challenges to the investment process. For this reason and others, we believe on-the-ground fundamental research is especially important when investing in Chinese businesses.

Around the same time as our China trip, other members of our team visited about 40 companies in India. The growing rivalry between China and the U.S. appears to be working to India's advantage. Exports of electronics from India rose 57% in March from the same month a year ago, official data showed. Most of the increase was attributable to mobile phones produced in India as part of a broader China Plus One strategy adopted by manufacturers seeking to diversify their supply chains.

India's Production-Linked Incentive (PLI) scheme has also contributed to the recent surge in industrial expansion. Through the PLI and other priorities within the Make in India initiative, the Modi government seeks to boost manufacturing to 25% of GDP from around 14% currently. Three Taiwanese suppliers to Apple, Inc. recently secured PLI inducements to increase the production and exports of smartphones. Apple now makes almost 7% of its iPhones in India, up sharply from around 1% in 2021.

For the most part, companies owned in the Fund have been meeting our expectations and continue to be on track for double-digit revenue and earnings growth. With the economic and geopolitical backdrops in heightened states of flux, however, we've become more attuned to short-term developments. These include incremental data points in the U.S., Europe and other developed markets that may significantly impact emerging economies. Rather than overreact, we seek to evaluate company news within its proper long-term context. Our goal in doing so is to determine whether short-term developments will likely impair a company's future outlook.

Thank you for the opportunity to manage your assets.

Sincerely,

Ajay Krishnan, Dan Chace, Scott Thomas, Kevin Unger and Anh Hoang



## AVERAGE ANNUAL TOTAL RETURNS

FOR PERIODS ENDED JUNE 30, 2023

	Quarter*	1 Year	3 Years	5 Years	10 Years
Emerging Markets Small Cap Fund—Investor	3.35%	9.09%	5.45%	5.46%	3.87%
Emerging Market Small Cap Fund—Institutional	3.31%	8.98%	5.54%	5.57%	3.96%
MSCI Emerging Markets Small Cap Index**	6.39%	13.28%	13.72%	4.93%	4.63%
MSCI Emerging Markets Index**	0.90%	1.75%	2.32%	0.93%	2.95%

\*Returns less than one year are not annualized.

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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 1.95% for the Investor Class and 1.80% for the Institutional Class through at least 1/31/2024.** 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 do 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.

Performance for the Institutional Class prior to 2/1/2016 is based on the performance of the Investor Class. Performance of the Fund's Institutional Class prior to 2/1/2016 uses the actual expenses of the Fund's Investor Class without any adjustments. For any such period of time, the performance of the Fund's Institutional Class would have been substantially similar to, yet higher than, the performance of the Fund's Investor Class, because the shares of both classes are invested in the same portfolio of securities, but the classes bear different expenses.

**Investing in foreign securities, especially in emerging markets, entails special risks, such as currency fluctuations and political uncertainties, which are described in more detail in the prospectus. 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. 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.**

**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](http://wasatchglobal.com) or call 800.551.1700. Please read the prospectus carefully before investing.**

The Wasatch Emerging Markets Small Cap Fund's investment objective is long-term growth of capital.

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**\*\*The MSCI Emerging Markets and Emerging Markets Small Cap indexes are free float adjusted market capitalization indexes designed to measure the equity market performance of emerging markets.**

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

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*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.*

## EMERGING MARKETS SMALL CAP FUND – TOP 10 HOLDINGS

AS OF MARCH 31, 2023

Security Name	Percent of Net Assets
Voltronic Power Technology Corp.	6.5%
AU Small Finance Bank Ltd.	5.0%
Globant SA	4.3%
Grupo Aeroportuario del Centro Norte SAB de CV	4.3%
Silergy Corp.	4.0%
momo.com, Inc.	3.6%
LEENO Industrial, Inc.	3.5%
Persistent Systems Ltd.	3.5%
ASPEED Technology, Inc.	3.4%
LTIMindtree Ltd.	3.2%
Total	41.3%

*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.*