

# Wasatch Emerging Markets Small Cap Fund

SEPTEMBER 30, 2023

## Speculative, Indiscriminate Buying Made Reasonably Valued Small Companies More Difficult to Find in India

### OVERVIEW

A jump in U.S. Treasury yields and soft economic data in China undercut sentiment toward developing nations during the third quarter of 2023. The benchmark MSCI Emerging Markets Small Cap Index trimmed earlier gains, finishing up 2.93% for the quarter. The Wasatch Emerging Markets Small Cap Fund—Investor Class underperformed the benchmark with a loss of -3.24%.

Hopes that cooling inflation would allow central banks to transition to easier monetary policy sent world stock markets higher during July. Pledges from the Beijing government to stimulate economic growth in China further underpinned support for emerging markets. Optimism faded during August and September, however, as China's recovery from zero-Covid lockdowns fell short of expectations and fears of a prolonged period of high global interest rates dampened growth prospects in the developing world.

Signals that the U.S. Federal Reserve will likely keep borrowing costs higher for longer bolstered the dollar, impacting dollar-equivalent prices

### FUND MANAGERS



**Ajay Krishnan, CFA**  
Lead Portfolio Manager

4 / 29  
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 / 8  
YEARS ON FUND / YEARS AT WASATCH



**Anh Hoang, CFA**  
Associate Portfolio Manager

1 / 11  
YEAR ON FUND / YEARS AT WASATCH

*The performance data quoted represents past performance. Past performance does not guarantee future results. 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. The performance data does 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.***



of assets denominated in other currencies and lowering the returns of the Index and the Fund. In addition to its direct effects on performance, a stronger dollar makes it more expensive for developing nations to service dollar-denominated debt and issue debt denominated in their own currencies. A firmer greenback and higher interest rates in the U.S. also tend to make riskier investments in emerging markets less appealing in comparison.

China was one of the poorest-performing countries in the Index during the quarter. Official data showed an outflow of \$49 billion in China's capital account during August—the largest monthly exodus since December 2015. Because that figure includes \$29 billion from securities investments, the outflow impacted China's financial markets as well as its currency. Through the end of September, the yuan depreciated -5.0% against the dollar in 2023.

Much of the weakness in Chinese equities spilled over to trading partners such as Taiwan, Korea and the Philippines. Hurt by a -14.1% drop in shipments to China and a sluggish global demand environment, exports from Taiwan registered their 12th straight month of year-over-year declines in August. Taiwan's central bank cut its 2023 forecast for the island's trade-dependent economy to just 1.46% GDP growth, which would be the slowest pace of expansion since 2009. Taiwan was the Fund's biggest source of underperformance in the third quarter, driven largely by holdings tied to exports of industrial components and semiconductor chips.

India accounted for nearly all of the benchmark's positive return in the quarter. Excluding India, the Index would have posted a small quarterly decline. Record inflows from domestic retail clients forced some Indian small-cap stock funds to turn away new investors—a sign that speculative, indiscriminate buying had made reasonably valued small companies difficult to find in India. In that environment, our focus on what we believe are high-quality businesses struggled to gain traction, and our Indian stocks underperformed.

Bright spots in the Fund included Uruguay and Mexico. In these countries, our holdings logged positive returns that helped the Fund's performance.

## DETAILS OF THE QUARTER

One of the strongest contributors to Fund performance for the quarter was **Dlocal Ltd. (DLO)**. Our only holding in Uruguay, the company operates a payment-processing platform for businesses in emerging markets. Investors reacted positively to news that Dlocal had named e-commerce veteran Pedro Arnt as co-chief executive officer. Better-than-expected quarterly results also helped push the stock higher. Revenue rose 59% in the reported quarter on a record-high total payment volume of \$4.4 billion, up 80% from the same quarter a year ago.

**Globant SA (GLOB)** was also a top contributor. An information-technology (IT) services firm headquartered in Luxembourg, Globant operates in over 25 countries. In what were standout financial results among IT outsourcers, revenues grew 15.9% year over year in the company's most recent quarter. Management raised its full-year guidance, citing increased demand in the artificial intelligence (AI) space and Globant's expanded presence in the European market.

Another strong stock in the Fund was **Persistent Systems Ltd.** The company, which is based in India, provides outsourced software development to clients across a range of industries. Uncertainty in the global economic outlook had caused Persistent's revenue growth to slow as customers pushed out spending and took longer to make decisions and sign contracts. The company's share price moved higher during the latter part of the third quarter as the situation improved. Persistent stands to benefit from strategic partnerships with hyperscaler cloud providers, which include AWS, Microsoft and Google Cloud. Persistent is launching a suite of Google Cloud-powered solutions designed to help clients identify and implement opportunities to integrate generative AI technologies into their businesses.



Taiwan accounted for the two biggest detractors from Fund performance for the quarter—**Voltronic Power Technology Corp.** and **Silergy Corp.**, respectively. Voltronic designs and manufactures products that include uninterruptible power supplies and inverters. Earnings growth slowed to 3.3% in the company's most recent quarter as revenues declined -18.1% versus the year-ago quarter. Management cited drop-offs in demand from Italy and South Africa. Drawdowns of customer inventories of uninterruptible power supplies also crimped revenues. Although Voltronic has lowered its near-term guidance, the company's long-term prospects remain attractive in our view.

Silergy manufactures integrated-circuit chips used in a wide array of electronic devices. The company's shares have struggled in recent quarters amid competitive pressures and a weak demand environment, which we believe is cyclical and temporary. Lower expectations for the automotive segment of the business may also have dampened enthusiasm for the stock. Even so, Silergy's value proposition and long-term prospects remain attractive in our view.

**Pet Center Comercio e Participacoes SA**, also a significant detractor, was sold on deteriorating fundamentals. The company sells food, medicines, toys, beds and other products for pets in Brazil through its digital platform and retail stores. Increasing competition from online sellers is impacting Pet Center's revenues and margins. With no immediate improvement in sight, we decided to move on. *(Current and future holdings are subject to risk and change.)*

## OUTLOOK

By the end of August, steady deterioration in Chinese economic data had driven sentiment toward China to depressed levels. Defaults in the property sector and China's slide into deflation during July drew comparisons to Japan's "Lost Decades." At a Politburo meeting, Communist Party leaders themselves described the current economic recovery as "torturous." Meanwhile, the government's reluctance to unleash massive stimulus was characterized as a "crisis of confidence" of the type first described by U.S. President Jimmy Carter in his now-famous address of 1979.

Such extreme characterizations often prove unjustified in hindsight. Although China's current situation bears some similarities to Japan in 1990, the differences are at least as great. Unlike Japan, China quickly rebounded from bouts of deflation experienced during 2009 and 2020. In addition, new-economy industries such as electric vehicles, renewable energy and high-speed trains are currently growing in China at double-digit rates. And the Beijing government has good reason to be cautious in its use of economic stimulus—which in previous downturns sent housing prices and debt levels soaring.

Just as it appeared things couldn't get much worse for China, data released in September showed early signs that the government's piecemeal approach to stabilizing the economy was beginning to bear fruit. Industrial production and retail sales for August grew at faster-than-expected rates of 4.5% and 4.6%, respectively, while deflation pressures and the urban jobless rate eased slightly. Meanwhile, factory activity expanded in September for the first time in six months. It's too early to tell whether these improvements are part of a sustained pickup that will usher in a durable rebound in Chinese equities. However, such extremely negative sentiment as was observed during the third quarter often signals a turning point, at least in the short term.

In the meantime, India hopes to attract much of the foreign investment that might otherwise have gone to China. As global firms still smarting from zero-Covid lockdowns in China seek to diversify their supply chains, India is gearing up to significantly expand its export capabilities. Toward that end, the country's network of small and



medium-sized factories has substantial unused capacity and is expected to play a key role in India's efforts to become more tightly integrated with the global economy.

The wave of industrialization sweeping across India has caused us to broaden our investment approach. While we continue to seek high-quality companies with strong cash flows and high returns on equity, we're paying increased attention to firms with more room for fundamental improvement. Because these firms typically trade at less-expensive valuations than the highest-quality companies and stand to benefit more from broad-based improvement in India's economy, we believe a wider approach to India is both justified and desirable.

Changes underway in Saudi Arabia have caught our attention as well. The world's largest exporter of petroleum, Saudi Arabia is benefiting as crude oil fetches higher prices on world markets. More important, the Saudi government is taking steps to diversify the economy away from the oil industry, which currently accounts for about 45% of GDP. Facilitated by other key initiatives designed to improve the investment environment and make the kingdom a more desirable place to live and work, Saudi Arabia may be on the cusp of a major long-term transformation. We've initiated positions in two Saudi companies in the Fund, and a research trip is planned for November.

Thank you for the opportunity to manage your assets.

Sincerely,

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



## TOTAL RETURNS

FOR PERIODS ENDED SEPTEMBER 30, 2023

	Quarter*	1 Year	3 Years	5 Years	10 Years
Emerging Markets Small Cap Fund—Investor	-3.24%	12.39%	1.58%	6.37%	3.80%
Emerging Market Small Cap Fund—Institutional	-2.85%	12.66%	1.82%	6.57%	3.93%
MSCI Emerging Markets Small Cap Index**	2.93%	23.06%	10.61%	6.45%	4.57%
MSCI Emerging Markets Index**	-2.93%	11.70%	-1.73%	0.55%	2.07%

\*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. The 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.

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.**

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.

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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*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.*

*Return on equity (ROE) measures a company's efficiency at generating profits from shareholders' equity.*

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

## EMERGING MARKETS SMALL CAP FUND – TOP 10 HOLDINGS

AS OF JUNE 30, 2023

Security Name	Percent of Net Assets
Voltronic Power Technology Corp.	6.8%
AU Small Finance Bank Ltd.	6.4%
Globant SA	4.7%
Persistent Systems Ltd.	3.8%
Grupo Aeroportuario del Centro Norte SAB de CV	3.7%
LEENO Industrial, Inc.	3.5%
Silergy Corp.	3.1%
Raia Drogasil SA	3.1%
Trent Ltd.	2.9%
Qualitas Controladora SAB de CV	2.8%
Total	40.8%
<i>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.</i>	