WASATCH GLOBAL INVESTORS

Quarterly Commentary

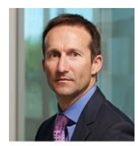
Investor WAIGX / Institutional WIIGX

# Wasatch International Growth Fund

SEPTEMBER 30, 2023

## International Equities Cooled In the Third Quarter, with Several Macroeconomic Issues Weighing on Markets

FUND MANAGERS



**Ken Applegate, CFA, CMT**
Lead Portfolio Manager
7 YEARS ON FUND / 9 YEARS AT WASATCH

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Portfolio Manager
9 YEARS ON FUND / 17 YEARS AT WASATCH

**Derrick Tzau, CFA**
Associate Portfolio Manager
3 YEARS ON FUND / 5 YEARS AT WASATCH

### OVERVIEW

For the third quarter of 2023, the Wasatch International Growth Fund—Investor Class was down -8.40%, underperforming the benchmark MSCI AC (All Country) World ex USA Small Cap Index, which lost -1.70%.

After rallying for much of 2023, global equity markets cooled in the third quarter. Concerns about a weak economy in China and sticky inflation data in Europe both weighed on equity markets during the period. Additionally, stocks came under pressure after central banks indicated they may need to leave interest rates elevated for longer than previously anticipated.

At the sector level, the Fund's stock selection in information technology (IT) and financials weighed most on relative performance. On a geographic basis, stock selection in Japan and Taiwan detracted most from the Fund’s performance relative to its benchmark. Later in this commentary, we share our views on why our Japanese holdings lagged during this quarter and the year-to-date period.

*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. 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—1.44% / Institutional Class—1.33%. The Advisor has contractually agreed to limit certain expenses to 1.75% for the Investor Class and 1.35% for the Institutional Class through at least 1/31/2024.***

## DETAILS OF THE QUARTER

OSB Group PLC, a U.K.-based specialist mortgage lender, was the largest detractor from performance during the quarter. The stock fell after the company announced an effective interest-rate adjustment (accounting charge) that reduced its net income for the first half of 2023 by roughly GBP170 million. The loss was due to a specific loan product that offered clients a five-year fixed rate that rolls over to a higher interest rate more in line with present mortgage interest rates when the five-year period ends. Given the precipitous rise in interest rates over the past 12 months in the U.K., the difference between present mortgage interest rates and the five-year fixed rate is much more dramatic than it used to be. This has caused a significant change in customer behavior—customers are refinancing out of the product much faster once they reach the end of the five-year, fixed-rate period than they have historically. The change in accounting assumption reduced the amount of interest the bank expects to accrue over the life of the product, and the company had to adjust the carrying value of the loan book accordingly. While this causes some short-term pain for OSB Group in 2023, the adjustment is only tied to one product. The bank remains quite profitable and should see profits recover materially beginning in 2024.

Despite the setback, we continue to like OSB Group. The company is a high-quality lender in specialized markets, such as the buy-to-let market, that focuses on consumers who purchase homes to rent out. This specialization and the firm's market leadership position have allowed OSB to command higher rates and produce a strong track record of returns on equity. Looking ahead, we believe the bank is well-provisioned and well-capitalized, and profitability will begin to recover next year. We also expect the company to return more of its excess capital to shareholders over time.

Another detractor was Voltronic Power Technology Corp. A Taiwanese company, Voltronic designs and manufactures power 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 same quarter a year ago. 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.

GMO Payment Gateway, Inc. was another detractor. The Japan-based company provides credit-card transaction services for e-commerce firms. GMO's stock was down after its management team suggested that, as the company becomes a more strategic payment partner to larger companies, its growth rate could become more volatile from period to period—though it should still achieve its mid-term target of a 25% earnings growth rate. We were less concerned about the guidance. As GMO expands its value proposition and works on bigger projects, we're not surprised to see the growth follow a less linear path. We also believe that as the company grows larger, it wouldn't be surprising if the company adjusts its long-term profit growth target to a 20% compound annual growth rate, or slightly higher. That growth is still impressive, in our view.

The largest contributor to Fund performance in the third quarter was Johns Lyng Group Ltd. The Australia-based company works with the country's insurers to restore properties damaged during insured events. The stock was weak in the second quarter of 2023 but rebounded after the company reported impressive earnings results, which included 43% revenue growth. Management also announced strong expectations for organic growth in 2024. Going forward, we continue to like the company for the unique niche it's carved out serving the insurance industry.

Endava PLC was another top contributor. The British IT-services company specializes in providing digital-transformation consulting, agile software development and various automation solutions to businesses. Digital transformation is a business imperative for most firms over the next several years, and we believe Endava will play a critical role in helping many companies pivot their operations. However, Endava's revenue growth has been disappointing in 2023, as some companies held off on large-scale IT projects due to macroeconomic concerns. However, the stock rose in the quarter after Endava's management team offered guidance suggesting that 2023 was an earnings trough and that management expects the business to start experiencing year-over-year revenue growth in 2024.

Another positive contributor was Globant SA, a global IT-consulting firm. The stock was up sharply after the company announced quarterly results, which included better-than-expected revenue growth of 16%. Management also said it expects 19% revenue growth in the third quarter, which was ahead of consensus expectations. Globant has been a volatile stock in recent quarters, but we continue to take a long-term view of the company. We believe Globant will play an important role in helping businesses stay relevant in a fast-innovating digital age. In the years ahead, we expect strong demand for its services as businesses spend to keep up with digitalization. (*Current and future holdings are subject to risk and change.)*

## OUTLOOK

For the year-to-date period, much of our relative underperformance stems from our holdings in Japan. As part of our quarterly outlook, we want to share why we believe those stocks have underperformed and why we still have conviction in those companies.

Perhaps the most frustrating aspect of our stock performance in Japan is that, by and large, our holdings continue to demonstrate solid fundamentals. Our Japanese companies were growing earnings per share (EPS) at high-teens rates coming into the year, and that growth rate has remained steady—or in many cases edged a little higher—since then. But two market dynamics have worked against the Fund's Japanese stocks in 2023.

First, in the wake of Japan's reopening from the pandemic, the market has rewarded many "middling" Japanese companies whose fundamentals have improved because of that tailwind. Looking across Japan's small- and micro-cap markets year to date, the top performers tended to have below-average earnings growth. Many of the top performers also have a return on equity (ROE) that is near or slightly above the average level in Japan, which suggests they are also middling in terms of business quality.

Many of the companies in this middling camp continue to have ROEs and EPS growth that are lower—and sometimes substantially lower, in our view—than our own holdings. But the stocks were rewarded for having a fairly big improvement in fundamentals. Meanwhile, our own stocks lost ground during the period, despite maintaining solid fundamentals.

A second factor working against us arose when the market began to anticipate that the Bank of Japan would raise interest rates, which resulted in a market rotation from growth to value stocks. Year-to-date, Japanese stocks with the lowest valuations (those with a price-earnings ratio below 9) have experienced returns substantially higher than the average Japanese small- or micro-cap stock.

Many outperforming stocks in both the middling camp and value camp aren't the types of businesses in which we invest. At Wasatch, we're high-quality growth investors. We tend to invest in companies with strong balance sheets, high ROEs, a history of free cash flow generation, and a less economically sensitive business model that allows the company to continue growing earnings through the economic cycle. By and large, our companies in Japan have done just that. This leads to a logical question: When will our companies get credit for the solid fundamentals they continue to produce?

Candidly, we don't have a crystal ball and can't forecast exactly when market sentiment might turn more favorable toward high-quality growth companies. However, the guiding principle that underpins our investment process is that while stocks may move based on macroeconomic issues in the short term, long-term stock performance is primarily dictated by earnings growth. We've seen that principle play out over full market cycles for our entire careers, and we don't think that principle is fundamentally broken in Japan today.

While we can't say exactly when the market will favor higher-quality, higher-earning companies again, we do believe there are a couple of catalysts that could bring about the change. First, valuations for our high-quality companies have come down considerably. This has started to attract strategic buyers. As an example, Omron, a medical-device company, just increased its ownership stake in Japanese medical-data provider JMDC (our second-largest holding in Japan) from 31% to 50%. We believe interest from strategic buyers is an indicator that valuations have become more attractive, and we hope the broader market will soon take notice.

Another reason the market could come to appreciate high-quality growth companies is that growth could prove unsustainable for many companies in the middling camp or value camp. Japan is in the earliest stages of reopening from the pandemic, trailing far behind most countries. In the immediate aftermath of reopening, we can see why investors might gravitate toward a lower-quality or slower-growing company. The economic rebound brings a sudden infusion of growth.

But aging demographics make Japan a slow-growth, muddle-along economy over the long term. As we get a little further from the immediate economic bounce of reopening, we expect investors to reward the companies that aren't dependent on that bounce to thrive.

Thank you for the opportunity to manage your assets.

Sincerely,

Ken Applegate, Linda Lasater and Derrick Tzau

## TOTAL RETURNS

FOR PERIODS ENDED SEPTEMBER 30, 2023

| | Quarter* | 1 Year | 3 Years | 5 Years | 10 Years |
|---|---|---|---|---|---|
| International Growth Fund—Investor | -8.40% | 7.84% | -8.01% | -2.77% | 2.11% |
| International Growth Fund—Institutional | -8.36% | 7.92% | -7.92% | -2.67% | 2.19% |
| MSCI AC World ex USA Small Cap Index** | -1.70% | 19.01% | 4.02% | 2.58% | 4.35% |
| MSCI World ex USA Small Cap Index† | -3.48% | 17.32% | 1.85% | 1.28% | 4.13% |

*Returns less than one year are not annualized.*

*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. To obtain the most recent month-end performance data available, please visit wasatchglobal.com. The Advisor may absorb certain Fund expenses, without which total returns would have been lower. Investment returns and principal value will fluctuate and shares, when redeemed, may be worth more or less than their original cost.* **Total Expense Ratio: Investor Class—1.44% / Institutional Class—1.33%.**

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 1.35% 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 frontier and 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.**

***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.

The Wasatch International Growth Fund's investment objective is long-term growth of capital.

***The MSCI AC (All Country) World ex USA Small Cap Index is an unmanaged index and includes reinvestment of all dividends of issuers located in countries throughout the world representing developed and emerging markets, excluding securities of U.S. issuers. This index is a free float adjusted market capitalization index designed to measure the performance of small capitalization securities.*

*†The MSCI World ex USA Small Cap Index is a free float adjusted market capitalization weighted index designed to measure the equity market performance of developed markets, excluding the United States.*

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

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*Earnings per share (EPS) is the portion of a company's profit allocated to each outstanding share of common stock. EPS growth rates help investors identify companies that are increasing or decreasing in profitability.*

*Free cash flow is a measure of a company's financial performance, calculated as operating cash flow minus capital expenditures. It is the cash a company generates after spending the money required to maintain or expand its asset base.*

*The price/earnings (P/E) ratio, also known as the P/E multiple, is the price of a stock divided by its earnings per share.*

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

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

WASATCH
GLOBAL INVESTORS

## INTERNATIONAL GROWTH FUND — TOP 10 HOLDINGS
AS OF JUNE 30, 2023

| Security Name | Percent of Net Assets |
|---|---|
| BayCurrent Consulting, Inc. | 4.6% |
| Diploma PLC | 3.5% |
| Descartes Systems Group, Inc. | 3.5% |
| Voltronic Power Technology Corp. | 3.3% |
| Kinaxis, Inc. | 3.2% |
| AU Small Finance Bank Ltd. | 2.9% |
| JMDC, Inc. | 2.7% |
| Halma PLC | 2.5% |
| EQB, Inc. | 2.5% |
| CTS Eventim AG & Co. KGaA | 2.5% |
| Total | 31.2% |

*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.*