Wasatch Global Investors

Quarterly Commentary

Investor WALSX / Institutional WGLSX

# Wasatch Long/Short Alpha Fund

MARCH 31, 2023

## The Fund Outpaced the Benchmark Due to Favorable Stock Selections on the Long Side, While Shorts Were Drags On Relative Performance

FUND MANAGER

**Mick Rasmussen, CFA**
Lead Portfolio Manager

1 YEARS ON FUND / 8 YEARS AT WASATCH

### OVERVIEW OF THE QUARTER

During the first quarter of 2023, the Wasatch Long/Short Alpha Fund—Investor Class gained 4.38% and outperformed the benchmark Russell 2500™ Index, which rose 3.39%. The Fund outpaced the benchmark due to favorable stock selections on the long side, while short positions were drags on relative performance. It was encouraging to see that our bottom-up, fundamental approach to selecting long positions generated positive returns in what proved to be a volatile quarter for the market. Moreover, it was gratifying that a sizable portion of the Fund's alpha was driven by some of our largest-weight, highest-conviction positions.

At a broad level, the quarter was characterized by two distinct periods. In the first period, largely during January, the benchmark delivered especially strong returns in what could be characterized as a risk-on environment—one in which many stocks that had been beaten up over the previous year bounced back significantly. During this period, the

*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 3.14%, Net 2.41% / Institutional Class—Gross 3.10%, Net 2.20%. 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 1/31/2024.***

best-performing long positions were stocks characterized by the following factors: high volatility, heavy short-seller interest and reversing momentum. But the second period of the quarter was very different. The benchmark (which is a long-only index) gave back much of its early-quarter increase as investors worried about an overheated economy, elevated inflation, rising interest rates and bank failures.

## 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 March 31, the Fund's long exposure was about 116%, and its short exposure was approximately -36%. 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 that can navigate inevitable challenges, expanding market dynamics, and innovative products, services and business models.

Our short positions are arrived at through a multifactor quantitative model that includes momentum and valuation signals to determine which companies are conducive for short selling. Once short candidates are systematically identified, we leverage our qualitative expertise to further narrow down 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 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 achieve more than 80% of the benchmark's full-cycle return.

We launched the Long/Short Alpha Fund on October 1, 2021. In the 18 months since then, the Fund's average annual total return through March 31, 2023 was 4.81%, which compares very favorably to the benchmark Russell 2500's loss of -8.44%. Moreover, the Fund achieved its return with a beta of about 0.7, which indicates that the Fund's market sensitivity was only a bit higher than we'd like to see over time.

## LONG POSITIONS DURING THE QUARTER

Among long positions, the top contributor to Fund performance for the first quarter was MarketAxess Holdings, Inc. (MKTX), which operates an electronic trading platform that we believe is pivotal for delivering efficiency, liquidity and cost savings to investors trading in global fixed-income markets. The stock appreciated after the company released fourth-quarter earnings growth that exceeded consensus estimates. Looking ahead, our investment thesis for the company remains on track. MarketAxess continues to gain share of global fixed-income trading, and we like the revenue potential of some of the company's new offerings that help clients optimize operations and data flow. That said, we did take the strong run in the stock—and the expansion of its price/earnings multiple—as an opportunity to sell some shares and keep our position size at an appropriate level.

Monolithic Power Systems, Inc. (MPWR) was also a strong contributor. The company offers semiconductor-based power electronics solutions for industrial and consumer markets. Earnings per share jumped 62% in the company's most recent quarter on revenue growth of 37% versus the same quarter a year ago. Revenues from Monolithic's automotive business rose 73% year-over-year, helped by strong sales of highly integrated applications that support automated driver assistance systems. The company's enterprise-data segment grew 69%, driven by increased sales of power-management solutions for cloud-based CPU and GPU server applications. Because Monolithic has a diverse product line serving many different end markets, the stock tends to behave less cyclically than most other semiconductor shares.

A large detractor from Fund performance on the long side was Esperion Therapeutics, Inc. (ESPR), which develops oral therapies for people with elevated low-density lipoprotein cholesterol (LDL-C, or "bad cholesterol"). Shares of the company fell sharply in March as investors reacted negatively to data from a cardiovascular outcomes trial of Esperion's cholesterol-lowering drug Nexletol® in statin-intolerant patients. The stock fell again on news that Esperion's partner in the drug was disputing a milestone payment tied to the study's results.

Because this trial isn't directly comparable to trials of competing drugs, we believe investors who failed to look beyond the top-line data may have misinterpreted the results. Our research suggests the trial exceeded clinical expectations of many doctors, who are already prescribing Nexletol to their patients at increasing rates. We expect the milestone dispute will be settled out of court. Moreover, we believe the cardiovascular outcomes trial will lead to expansion of Nexletol's label in the U.S. and Europe, doubling the addressable treatment population and triggering additional milestone payments.

Cactus, Inc. (WHD) was also a detractor on the long side. The company designs, manufactures, and sells a range of wellheads and pressure-control equipment for oil and gas production. Cactus is one of our few energy names, and the decline in the stock price was largely the result of exposure to weakness in commodities—not the result of anything company-specific.

Our major sales of long positions included Silvergate Capital Corp. (SI), Virtu Financial, Inc. (VIRT) and Encore Wire Corp. (WIRE). Silvergate is the holding company for a bank that was largely focused on providing services to the cryptocurrency industry. The bank ran into trouble when depositors started to leave en masse. We exited our position when plummeting deposits came to light. The bank has since announced that it's ceasing operations and winding down. Virtu is a financial company that offers market-making and trade-execution services. The company has been experiencing declining volumes and regulatory pressures, which precipitated our sale. Encore is a commodity-exposed business that was trading at an attractive valuation when we purchased it. But we now see better opportunities elsewhere.

Our noteworthy buys of long positions included Vista Outdoor, Inc. (VSTO), EZCORP, Inc. (EZPW) and Clearwater Paper Corp. (CLW). Vista is going to split itself into two companies, one focused on outdoor products and the other focused on sporting (hunting) products. We think that when the split occurs, the market will place a higher valuation on the outdoor-products company. EZCORP, a provider of pawn services, looks very attractive from a valuation perspective and operates in a recession-resistant industry. Clearwater—which manufactures consumer tissue, bleached paperboard and wood products—is underpriced in our view.

## SHORT POSITIONS DURING THE QUARTER

Turning to short positions, contributors were those stocks that declined in price. We added the most value by shorting Xometry, Inc. (XMTR), which runs an online marketplace that allows customers to purchase custom-manufactured parts in the aerospace, health-care and automotive segments. The company's financials look unattractive to us, and we don't have a great deal of confidence in management. Since we initiated the position, Xometry has been a very successful short for the Fund.

Among shorts, detractors were those stocks that rose in price. Two of the shorts that hurt us the most were Berkshire Grey, Inc. (BGRY) and Luminar Technologies, Inc. (LAZR). Berkshire Grey provides artificial-intelligence-enabled robotic solutions that automate supply-chain operations in the United States and Japan. The company is a cash-burning business that had been a successful short for us in the past. But Berkshire Grey announced that it's being acquired by Softbank, and the stock price shot up as a result. We subsequently closed out our position. Luminar provides sensor technologies and software for passenger cars and commercial trucks. This is another stock that we had successfully shorted in 2022. But it rallied in the early part of 2023 when previously beaten-down names were given a temporary reprieve. Nevertheless, we're maintaining our short position in Luminar.

Regarding transactions in short positions, Affirm Holdings, Inc. (AFRM) is a new short for us. The company offers "buy now, pay later" services for online purchases. Affirm's financial position looks unstable to us, and we're concerned that the company may have trouble collecting accounts receivable in a difficult environment for consumers. *(Current and future holdings are subject to risk.)*

## OUTLOOK

As mentioned above, the quarter could be described in terms of two distinct periods. The first period was exuberant, and the second period was volatile and largely negative. Nevertheless, the quarter ended on a positive note.

Looking forward, we see reasons for both caution and optimism. Unsurprisingly, many investors are worried about the health of the banking system and are wondering if the troubles that have surfaced thus far represent just the tip of the iceberg. While we wouldn't be surprised to see additional problems at banks and tighter credit conditions, we don't think the economy is headed for a system-wide crisis. The poor management decisions that felled Silvergate Capital, Silicon Valley Bank and Signature Bank were largely bank-specific, so we don't expect broad contagion. Perhaps more important for the Fund is that we don't have significant exposure to the banking industry, as we see better opportunities elsewhere.

We've noticed an increasing consensus among investors that recession is a foregone conclusion. In response to recession fears and higher interest rates, we've recently seen the stocks of economically cyclical and highly indebted companies selling off. The message from the market seems to be clear: If your business model depends on the economy expanding or on easy access to credit, be prepared for a rough ride.

Fortunately, we believe the current environment is one in which the Fund can thrive—with our long and our short positions working in tandem. On the long side, we're focused on identifying companies with reasonable valuations, manageable debt loads, defensible market positions, and the ability to generate strong earnings throughout the inevitable ups and downs of the economic cycle. At the other end of the spectrum, our systematic use of quantitative and qualitative methods to uncover short opportunities should provide ballast to the Fund when stock-market conditions become hostile.

Thank you for the opportunity to manage your assets.

Sincerely,

Mick Rasmussen

## AVERAGE ANNUAL TOTAL RETURNS

FOR PERIODS ENDED MARCH 31, 2023

| | Quarter* | 1 Year | 3 Years | 5 Years | Since Inception** |
|---|---|---|---|---|---|
| Long/Short Alpha Fund—Investor | 4.38% | 6.87% | N/A | N/A | 4.81% |
| Long/Short Alpha Fund—Institutional | 4.37% | 7.17% | N/A | N/A | 5.01% |
| Russell 2500™ Index† | 3.39% | -10.39% | N/A | N/A | -8.44% |
| FTSE 3-Month U.S. Treasury Bill Index†† | 1.12% | 2.61% | N/A | N/A | 1.76% |

**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 1/31/2024.** 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 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 Wasatch Long/Short Alpha Fund's investment objective is long-term growth of capital.

WASATCH
GLOBAL INVESTORS

*[†]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.*

*All rights in the Russell 2500 Index and the FTSE 3-Month U.S. Treasury Bill Index vest in the relevant LSE Group company, which owns these indexes. Russell ® is a trademark of the relevant LSE Group company and is used by any other LSE Group company under license.*

*These indexes are calculated by or on behalf of FTSE International Limited or its affiliate, agent or partner. The LSE Group does not accept any liability whatsoever to any person arising out of (a) the use of, reliance on or any error in these indexes or (b) investment in or operation of the Wasatch Long/Short Alpha Fund or the suitability of these indexes for the purpose to which they are being put by Wasatch Global Investors.*

*Alpha is a risk-adjusted measure of the so-called "excess return" on an investment. It is a common measure of assessing an active manager's performance as it is the return in excess of a benchmark index or "risk-free" investment. The difference between the fair and actually expected rates of return on a stock is called the stock's alpha.*

*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.*

*Earnings per share or 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.*

*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 capital measures 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 DECEMBER 31, 2022

| Security Name | Percent of Net Assets |
|---|---|
| Roper Technologies, Inc. | 3.9% |
| MarketAxess Holdings, Inc. | 3.7% |
| Monolithic Power Systems, Inc. | 3.3% |
| Pool Corp. | 3.0% |
| Ensign Group, Inc. | 2.9% |
| Kadant, Inc. | 2.8% |
| Globant SA | 2.8% |
| ICF International, Inc. | 2.7% |
| Paylocity Holding Corp. | 2.7% |
| Medpace Holdings, Inc. | 2.7% |
| Total | 30.5% |

*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.*