WASATCH
GLOBAL INVESTORS

Quarterly Commentary

Investor WALSX / Institutional WGLSX

# Wasatch Long/Short Alpha Fund

MARCH 31, 2024

## Opportunistic Investments in Biotechnology and Health Care Equipment Accounted for Much of the Fund's Outperformance


FUND MANAGER

**Mick Rasmussen, CFA**
Lead Portfolio Manager

2 YEARS ON FUND / 9 YEARS AT WASATCH


### OVERVIEW

During the first quarter of 2024, the Wasatch Long/Short Alpha Fund—Investor Class gained 10.67% and outperformed the benchmark Russell 2500™ Index, which rose 6.92%. As might be expected in an up market, the Fund's long positions drove its positive return. That said, the short positions as a group didn't subtract at all from the return, which was very unusual and fortunate given the euphoric environment for stocks.

On the long side, the Fund's first-quarter return was helped by holdings in several industry groups including health care equipment & services, pharmaceuticals biotechnology & life sciences, energy, consumer discretionary distribution & retail, and capital goods. At the other end of the spectrum, the Fund's return was hurt by holdings in software & services. Among shorts, the Fund benefited from positions in capital goods and suffered from positions in consumer services.

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*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—Gross 2.85%, Net 2.67% / Institutional Class—Gross 2.71%, Net 2.34%. 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 1/31/2025.***

The preceding paragraph discusses industry *groups*. Finer classifications are used to refer to the industries *themselves*. If we look at just two industries, biotechnology and health care equipment, we see that the Fund's long holdings in these industries—despite representing less than 5% of assets—provided almost all of the outperformance relative to the benchmark. Elsewhere, the Fund's holdings were up nicely overall.

Our biotechnology and health care equipment names had particularly large gains as our bottom-up investment thesis (buying oversold shares in a diversified group of companies) played out during the quarter. Two fundamental factors that caused us to increase our weights in these industries were that the company-specific scientific advances appeared solid and the market values of some stocks had fallen to levels below the amount of cash on the balance sheet.

As the market moved up during the quarter, we took advantage of higher stock prices to modestly pare back the Fund's long exposure from about 109% to 104%. At the same time, we turned over several of our short positions but kept the short exposure at approximately -36%. Going forward, we may add some short positions in the near term, especially if the market continues to rally.

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

We want to remind shareholders that the Wasatch Long/Short Alpha Fund takes a *directional* approach, meaning we're always biased toward greater long exposure than short exposure. As mentioned above, the Fund's long exposure was about 104% and its short exposure was approximately -36% on March 31. 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 ideal combination of longs and shorts to 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 expectation 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 30 months since then, the Fund's average annual total return through March 31, 2024 was 16.14%, which compared very favorably to the benchmark Russell 2500's return of 2.51%. Moreover, the Fund achieved its return with a beta of 0.66, 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 FIRST QUARTER

Among longs, the first quarter's top contributor to Fund performance was Viking Therapeutics, Inc. (VKTX), a clinical-stage biopharmaceutical company that develops therapies for metabolic and endocrine disorders. Shares of Viking soared in February after its injectable weight-loss drug demonstrated best-in-class efficacy in a mid-stage clinical trial. A separate, early-stage trial evaluating the safety and tolerability of an orally administered version of the drug also yielded positive data. A successful oral treatment would be a game changer in a multi-billion-dollar industry. We believe these results make Viking a potentially attractive target for acquisition by a larger organization.

UFP Technologies, Inc. (UFPT) was also a strong contributor. The company designs and manufactures a broad range of high-performance cushion packaging and specialty foam as well as plastic products for the industrial and consumer markets. In the past, UFP had made precision-molded fiber packaging primarily from recycled paper but divested from that business due to lower margins. Instead, the company acquired businesses serving the medical industry. We projected that soon after the Covid-19 pandemic, elective medical procedures might ramp up—which we hoped would contribute to fast growth and significant margins for UFP. Our projections were realized as the company reported strong results for both the fourth quarter and the full year of 2023. In addition, UFP made several acquisitions that have helped it significantly increase production capacity and capture synergies by sharing best practices, moving operations to the ideal manufacturing locations, and standardizing systems for information technology, quality and safety. The company has also invested in infrastructure, equipment and talent to serve robotic-surgery businesses, which compose a growing market segment that already accounts for a significant portion of UFP's revenue.

On the long side, the first quarter's greatest detractor from Fund performance was MarketAxess Holdings, Inc. (MKTX), which offers an electronic trading platform that we believe is pivotal for delivering efficiency, liquidity and cost savings to clients operating in global fixed-income markets. After a strong finish in 2023, the stock declined at the beginning of this year due to some concerns about potential market-share losses. Nevertheless, our investment thesis remains on track. We believe MarketAxess has been fine-tuning its services to accommodate clients of various sizes. And we don't think the recent competitive challenges will materially impact the company's ability to grow its global fixed-income trading business over the long term. We're especially excited about the revenue potential of some new services that help clients optimize operations and data flow. That said, MarketAxess is a volatile stock—and we strive to keep our position size at an appropriate level for risk management. During the first quarter, we took advantage of the stock-price weakness to buy more shares.

YETI Holdings, Inc. (YETI) was also a large detractor. The company designs, markets and distributes drinkware, coolers, and other outdoor and recreational gear. Although the company's drinkware segment has performed reasonably well and its rollout of YETI-branded stores has shown promise, strong competitive threats have recently emerged in the drinkware space. So while YETI's stock price is attractive, we're maintaining a small position as we weigh whether the company can offset its slowing U.S. growth by successfully expanding internationally.

Our major sales of long positions included Cannae Holdings, Inc. (CNNE), which invests in restaurants, tech-enabled health-care organizations and financial-services firms. Cannae also helps manage these businesses in an effort to maximize shareholder value. Cannae had been priced in the market at a discount to book value, and we had looked at the stock as an effective offset to some richly priced names that we had shorted. Because we subsequently closed those short positions, we also decided to exit our long position in Cannae.

Our noteworthy buys of long positions included RPC, Inc. (RES), which provides a broad range of specialized services and equipment to independent and major businesses engaged in the exploration, production, and development of oil and gas properties throughout the United States and in select international markets. The stock appears attractively priced relative to the fundamental quality of the business, and the Fund is underweighted in the resources and commodities industries. So adding an inexpensive stock with upside potential is an especially good fit.

## SHORT POSITIONS DURING THE FIRST QUARTER

Turning to short positions, contributors were those names that declined in price. While relatively few stocks fell during the first quarter, we added the most value by shorting Nevro Corp. (NVRO), which makes medical devices for patients suffering from chronic pain. With a questionable business model, decelerating revenue growth and poor gross margins, the company in our view is far from profitability. Moreover, now that investors increasingly favor profitable firms with strong cash flows, we think Nevro may continue to struggle. We consider our short position in Nevro to be part of a basket that helps hedge our long exposure to certain names in the biotechnology and health care equipment industries.

Among shorts, detractors were those stocks that rose in price. The short that hurt us the most was Sweetgreen, Inc. (SG), which manages a restaurant chain that offers salads and other nutritional foods. When we initiated our short position, we recognized Sweetgreen offered high-quality foods and was growing quickly—but we didn't think the company was making sufficient progress in improving margins and returns on capital. More recently, Sweetgreen has unexpectedly refined its business model and has realized some cost efficiencies. As a result, the stock price has risen and we've pared our short position in an effort to control risk. Nevertheless, we remain convinced that Sweetgreen has unfavorable financial characteristics.

Regarding transactions, we initiated a new short in Thryv Holdings, Inc. (THRY), which is a software-as-a-service (SaaS) company providing technology and business-automation tools to small and medium-sized organizations that want to improve time management, marketing, communication with clients, invoicing and accounts receivable. Although Thryv has some legacy operations (e.g., the yellow pages) that generate significant cash flows, we think those cash flows are decelerating and the company's newer initiatives are uninspiring. As a result, we consider Thryv to be a "broken growth company"—a characterization that bodes poorly for the stock, according to our research.

We closed a short position in Alteryx, Inc. (AYX), which provides data storage, retrieval, management, reporting and analytics solutions. Overall, the stock has been a successful short for our full investment period. But the position went against us when Alteryx agreed to be acquired by Clearlake Capital Group and Insight Partners. While we suffered a relatively small near-term loss on Alteryx, the acquisition was actually a vindication for our investment process because the agreed-upon price was much lower than the level where we had initially shorted the stock. *(Current and future holdings are subject to risk and change.)*

## OUTLOOK AND POSITIONING

From the perspective of business fundamentals, we expect the companies we hold on the long side to generate better revenues and margins. These factors should result in earnings growth for 2024 that accelerates to the mid-teens overall. Our companies' earnings growth, therefore, should be a positive force for investment returns. Partially offsetting this force, however, is that valuations have generally become more expensive during the past several months.

Regarding the macroeconomic environment, we think the Federal Reserve has done a good job of normalizing monetary conditions. And if interest rates decline later in the year, that could provide an additional boost for small- and mid-cap companies. But while inflation has cooled, it has remained above the Fed's target level. As a result, Chair Jerome Powell has already walked back the number of Fed interest-rate cuts that are likely to occur in 2024.

This means rates could stay higher for longer than generally anticipated, and it could become more difficult for some companies to execute their business plans and manage their debt.

So which is it? Are interest rates declining? Or are rates staying higher for longer? While we have our views, the truth is that we don't know for sure. And neither does anyone else. That's why we don't let our investment decisions be swayed too much by a definitive interest-rate outlook. Instead, regardless of the outlook, we tend to avoid overindebted businesses because we don't like their risk profiles. We typically prefer high-quality companies with defensible market positions and consistent profitability. We're also biased toward names with strong cash flows from operations and balance sheets that can withstand various economic conditions.

Beyond ruminating about the economy, investors have been pondering the ramifications of artificial intelligence (AI). For our part, we try to avoid force-fitting investments into some preconceived theme. And our normal investment process has led us to only a few companies directly involved in creating AI. We're certainly attracted to companies that will be able to use the technology to strengthen their competitive positions and reduce costs. But an even bigger priority for us is trying to avoid companies whose business models will be materially disrupted.

It's also important to note that we're not complacent with respect to our holdings in biotechnology and health care equipment. Overall, these holdings were up about 80% during the quarter. So we're evaluating our individual names in an attempt to ensure that we don't stick with companies whose stock prices have gotten too far ahead of fundamentals.

Broadly speaking, we don't sense that the wind is completely at our back in the current investment environment. This sense is partially due to some divergences in stock versus bond price action. But we also perceive that the market has been more appropriately rewarding investors who correctly assess the fundamentals and penalizing investors who get the fundamentals wrong. As a result, we're quite comfortable with the opportunities we see on both the long and short sides.

Thank you for the opportunity to manage your assets.

Sincerely,

Mick Rasmussen

## TOTAL RETURNS

FOR PERIODS ENDED MARCH 31, 2024

| | Quarter* | 1 Year | 3 Years | 5 Years | Since Inception** |
|---|---|---|---|---|---|
| Long/Short Alpha Fund—Investor | 10.67% | 35.45% | N/A | N/A | 16.14% |
| Long/Short Alpha Fund—Institutional | 10.70% | 35.72% | N/A | N/A | 16.36% |
| Russell 2500™ Index† | 6.92% | 21.43% | N/A | N/A | 2.51% |
| FTSE 3-Month U.S. Treasury Bill Index†† | 1.37% | 5.52% | N/A | N/A | 3.25% |

**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 1/31/2025.** 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.*

**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.**

**The Fund's investments in long and short equity positions expose it to changes in the value of securities, which exceed the value of the Fund's assets. Investment in the Fund will involve market risks associated with different types of investment decisions than those made for a typical "long only" fund. The Fund relies on quantitative models which entail unique risks, including the risk that a model may be limited or incorrect. These risks are described in more detail in the prospectus.**

**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.**

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

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†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.

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*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.*

*Book value is the value of a security or asset as entered in a company's books.*

*Earnings growth is a measure of growth in a company's net income over a specific period, often one year.*

*Revenue growth is the increase in a company's revenues over a specified period of time, not necessarily one year.*

*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, 2023

| Security Name | | Percent of Net Assets |
|---|---|---|
| HealthEquity, Inc. | | 3.3% |
| ICF International, Inc. | | 3.1% |
| Ensign Group, Inc. | | 3.1% |
| Intra-Cellular Therapies, Inc. | | 3.0% |
| Roper Technologies, Inc. | | 2.9% |
| Pool Corp. | | 2.7% |
| Kadant, Inc. | | 2.7% |
| MarketAxess Holdings, Inc. | | 2.7% |
| Paylocity Holding Corp. | | 2.7% |
| Floor & Decor Holdings, Inc., Class A | | 2.7% |
| | Total | 28.9% |

*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.*