WASATCH GLOBAL INVESTORS

Quarterly Commentary

Investor WMICX / Institutional WGICX

# Wasatch Micro Cap Fund

SEPTEMBER 30, 2023

## Our Investment Approach Doesn't Rely on Macro Forecasts, as We Apply Disciplined Risk Management And Select Investments One Stock at a Time


FUND MANAGERS

**Ken Korngiebel, CFA**
Lead Portfolio Manager
6 YEARS ON FUND / 8 YEARS AT WASATCH

**Natalie Pesqué, CFA**
Portfolio Manager
1 YEAR ON FUND / 8 YEARS AT WASATCH


### OVERVIEW

Micro-cap equities struggled during the third quarter of 2023 as hawkish comments from the Federal Reserve (Fed) dashed hopes for an early pivot toward lower interest rates. Labor strikes and the potential impact of a government shutdown added to jitters in financial markets. The Wasatch Micro Cap Fund—Investor Class slipped -7.89% during the quarter. The Fund outperformed the benchmark Russell Microcap® Growth Index, which was down -11.95%. For the year to date, the Fund logged a gain of 8.78%, well ahead of the benchmark's -5.65% decline.

Selloffs in the stock and bond markets deepened in September after the Fed signaled a more aggressive future path for interest rates than investors had been expecting. Fed members also upped their near-term growth forecasts, further contributing to a bias in equity markets toward cyclical sectors such as energy and materials. The benchmark's energy

*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—1.66% / Institutional Class—1.59%. The Advisor has contractually agreed to limit certain expenses to 1.95% for the Investor Class and 1.60% for the Institutional Class through at least 1/31/2024.***

component was the only sector with a positive return in the quarter—it posted a double-digit percentage gain as U.S. crude oil briefly traded above $95 a barrel.

These factors didn't fit especially well with the Fund's sector profile, which naturally arises from our bottom-up focus on growing companies with attractive quality attributes. Along with the benchmark's top-performing energy sector, materials also performed relatively well in the third quarter. The Fund, however, has no holdings in materials and is underweight energy because we think companies in those sectors tend to have less differentiated business models and perform well only when the business cycle is in their favor. In the benchmark, financial stocks did well on a relative basis, but our holdings in the sector underperformed modestly. Consumer discretionary was an additional source of weakness in the Fund.

Despite these headwinds, the Fund held up much better than its benchmark. Industrials and information technology (IT) were the Fund's main sources of outperformance, which we attribute to good stock selection and our preference for high-quality companies. As measured by ROE, the four highest-quality deciles of the Index outperformed the Index as a whole, while the four lowest-quality deciles underperformed. Although IT suffered the worst decline among all sectors of the Index, the Fund's IT stocks generated impressive relative performance across all industry groups.

## DETAILS OF THE QUARTER

The strongest contributor to Fund performance for the quarter was DMC Global, Inc. (BOOM). Trends in revenues and margins have been favorable across all three of DMC's business segments. The company's perforating systems for the oil and gas industry, which are used in fracking, enjoy key advantages over alternative methods. DMC has also experienced strong demand for its explosion-welded metal plates used in industrial applications. And the company's investment in additional capacity for Arcadia, its majority-owned architectural building products business, has fueled optimism that DMC will purchase the remaining minority stake.

Grid Dynamics Holdings, Inc. (GDYN) was also a top contributor. The company provides enterprise-level digital-transformation consulting and implementation services to *Fortune 1000* businesses and other clients. Grid's substantial operations in Ukraine at the outbreak of hostilities there—as well as a temporary slowdown in the global trend toward digitalization—had weighed on the company's stock price since early 2022. Recently, however, an upturn in investor sentiment toward digitalization has boosted shares of Grid and other IT service providers. From a fundamental standpoint, management's ability to navigate inevitable challenges and thrive in the digitalization space has impressed us, and the company's long-term growth prospects remain attractive in our view.

The greatest detractor from Fund performance for the quarter was Silk Road Medical, Inc. (SILK). The company provides medical devices used in its minimally invasive procedure (called Transcarotid Artery Revascularization, or TCAR) to treat blockages in the carotid artery. Silk Road's stock price fell sharply in July after the Centers for Medicare & Medicaid Services (CMS) issued a proposed coverage decision placing traditional carotid stenting at the same reimbursement level as TCAR. The concern is that CMS support for the competitive method could hurt Silk Road's revenues.

We think investors have overreacted. Although CMS has leveled the playing field on reimbursement, we believe outcomes—not reimbursements—will be a more important competitive factor. Silk Road's innovative system to reverse blood flow during TCAR directs any stroke-causing material away from the brain and into a filter, resulting in better outcomes than traditional stenting. Over time, we expect TCAR to continue to take market share and become the new standard of care for treating carotid-artery disease.

Another weak stock in the Fund was Kornit Digital Ltd. (KRNT). The company sells machines and supplies for the digital printing of designs and images on clothing and fabrics. Kornit's share price ran up sharply earlier in the year amid optimism that a pickup in sales of the company's machines was just around the corner. The stock retreated to previous levels during the third quarter as those hopes failed to materialize. We expect growth to resume in 2024 and continue to own the company in the Fund. Kornit's printing technology uses less water than traditional methods and greatly reduces the need for inventory on hand and in supply chains, making consumption and production more sustainable.

GCM Grosvenor, Inc. (GCMG) was a new addition to the Fund. An investment-management firm serving customers world-wide, Grosvenor focuses on private markets, infrastructure investments, real estate, credit finance and absolute return. Wasatch's experience as long-term investors in similar companies enabled us to leverage insights that gave us confidence in adding Grosvenor to the Fund. We especially like the company's private-markets business, which features high growth rates, strong margins and—most importantly—much stickier client capital. In addition, Grosvenor's stock provides an attractive dividend yield supported by the company's substantial cash flows.

We sold Heritage-Crystal Clean, Inc. (HCCI) after the environmental-services company disclosed that it had agreed to be acquired by a private-equity firm in an all-cash deal expected to close in the fourth quarter of 2023. Because the acquisition was priced at a significant premium to Heritage-Crystal Clean's market valuation before the announcement, the stock was a top contributor to third-quarter Fund performance. We had owned the stock with an eye toward growing opportunities tied to the remediation of water contaminated with per- and polyfluoroalkyl substances (PFAS)—so-called "forever chemicals" found in products ranging from firefighting foam to fast-food wrappers, clothing and carpeting. (*Current and future holdings are subject to risk and change.*

## OUTLOOK

With the recent period having lived up to its reputation as a historically poor season for equities, we now approach what's tended to be a better environment. According to data from Ned Davis Research, most of the stock market's gains in the years since 1950 have occurred during the period from November through April. So, based on the calendar and historical averages, there are reasons to be optimistic.

There are also reasons to be cautious. After a strong summer, recent figures from Bank of America showed that spending on credit cards has slowed since Labor Day, especially in discretionary categories such as furniture. Meanwhile, credit-card losses and delinquencies are climbing at their fastest pace since the recession of 2008. Auto-loan delinquencies and Chapter 11 bankruptcy filings are also on the rise. The end of the student-loan moratorium on October 1 will add a new wrinkle for many households already grappling with rising costs for basic items such as groceries and gasoline.

Because consumption accounts for about 70% of U.S. GDP, it makes sense to consider how the mood of consumers may affect the broader economy heading into the holiday shopping season. Recent data on that front has been mixed. Although consumer confidence declined in September, and high interest rates are constraining discretionary purchases, surveys have shown that consumers plan to begin their holiday shopping earlier this year and spend more. Other positive signs include a strong job market and high labor-participation rates.

Whether the final months of 2023 will bring holiday cheer or a lump of coal for the U.S. economy is hard to predict. However, our investment approach doesn't rely on macro forecasts. While we pay close attention to the risk environment—which we strive to navigate through disciplined risk management—we select investments from the bottom up, one stock at a time. In this environment, we're vigilant about the quality of our companies, and we've allocated a larger portion of the Fund to holdings with stable growth. We believe our focus on seeking high-quality micro-caps with strong underlying fundamentals will benefit the Fund through this period of macro uncertainty.

Thank you for the opportunity to manage your assets.

Sincerely,

Ken Korngiebel and Natalie Pesqué

## TOTAL RETURNS

FOR PERIODS ENDED SEPTEMBER 30, 2023

| | Quarter* | 1 Year | 3 Years | 5 Years | 10 Years |
|---|---|---|---|---|---|
| Micro Cap Fund—Investor | -7.89% | 6.12% | -3.72% | 4.82% | 9.93% |
| Micro Cap Fund—Institutional | -7.89% | 6.12% | -3.68% | 4.83% | 9.93% |
| Russell Microcap® Growth Index** | -11.95% | -3.10% | -4.65% | -2.81% | 3.12% |
| Russell Microcap® Index† | -7.93% | -1.35% | 4.85% | 0.23% | 5.25% |

**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 1.60% 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.*

Performance for the Institutional Class prior to 1/31/2020 is based on the performance of the Investor Class. Performance of the Fund's Institutional Class prior to 1/31/2020 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 micro cap funds will be more volatile and loss of principal could be greater than investing in large cap or more diversified funds. 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.**

***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 Micro Cap Fund's investment objective is long-term growth of capital. Income is an objective only when consistent with long-term growth of capital.

***The Russell Microcap Growth Index is an unmanaged total return index measuring the performance of the micro-cap growth segment of the U.S. equity market.*

*†The Russell Microcap Index is an unmanaged total return index of the smallest 1,000 securities in the small-cap Russell 2000 Index along with the next smallest 1,000 companies, based on a ranking of all U.S. equities by market capitalization.*

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

*The Wasatch Micro Cap Fund has been developed solely by Wasatch Global Investors. The Wasatch Micro Cap 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.*



*The Index is 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 the Index or (b) investment in or operation of the Wasatch Micro Cap Fund or the suitability of the Index for the purpose to which it is being put by Wasatch Global Investors.*

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

## MICRO CAP FUND — TOP 10 HOLDINGS

AS OF JUNE 30, 2023

| Security Name | | Percent of Net Assets |
|---|---|---|
| Heritage-Crystal Clean, Inc. | | 3.0% |
| Addus HomeCare Corp. | | 2.8% |
| Esquire Financial Holdings, Inc. | | 2.7% |
| Kadant, Inc. | | 2.6% |
| XPEL, Inc. | | 2.5% |
| Transcat, Inc. | | 2.5% |
| ICF International, Inc. | | 2.4% |
| Veeco Instruments, Inc. | | 2.2% |
| Nova Ltd. | | 2.1% |
| Construction Partners, Inc. Class A | | 2.1% |
| | Total | 24.9% |

*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.*