WASATCH GLOBAL INVESTORS

Quarterly Commentary

Investor WAAEX / Institutional WIAEX

# Wasatch Small Cap Growth Fund

MARCH 31, 2023

## Now That the Clouds Over The Banking Industry Have Parted, We're Beginning to See Some Silver Linings

### OVERVIEW

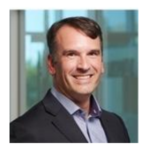
The Wasatch Small Cap Growth Fund—Investor Class logged a total return of 7.47% in what was a positive first quarter for stocks of small U.S. growth companies. The Fund outgained its benchmark, the Russell 2000® Growth Index, which rose 6.07%. The broader Russell 2000 Index of small-cap stocks added 2.74%.

Following 2022's market weakness, which was driven by macro forces that indiscriminately punished most stocks (excluding energy names), it was a welcome reversal to see company fundamentals once again drive stock prices in the first quarter of 2023. While we can't accurately predict trends in interest rates, employment or economic growth, we have confidence that our bottom-up, fundamental research process can help us identify high-quality companies that can thrive regardless of the macro environment. Our companies posted strong operating results in 2022 and entered 2023 with their stocks trading at some of the most attractive valuations we've seen in several years.


FUND MANAGERS

**JB Taylor**
Lead Portfolio Manager
10 YEARS ON FUND / 26 YEARS AT WASATCH

**Ken Korngiebel, CFA**
Portfolio Manager
5 YEARS ON FUND / 7 YEARS AT WASATCH



**Ryan Snow**
Portfolio Manager
5 YEARS ON FUND / 23 YEARS AT WASATCH


*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—1.15% / Institutional Class—Gross 1.06%, Net 1.05%. The Advisor has contractually agreed to limit certain expenses to 1.50% for the Investor Class and 1.05% for the Institutional Class through at least 1/31/2024.***

Energy and banking were the main laggards during the first quarter. Energy was the worst-performing sector of the benchmark as the price of U.S. crude oil ticked lower. Meanwhile, failures of three regional banks in the U.S., and the government-brokered sale of troubled Swiss firm Credit Suisse Group AG, dragged down bank stocks and rattled investors.

The broad U.S. equity market weathered the turmoil well, shrugging off talk from the White House and Capitol Hill about tighter regulation of banks and rallying into the end of the quarter. Hopes that the crisis would push the Federal Reserve closer to the end of its tightening cycle appeared to outweigh concerns about fallout to the general economy. Investors also seemed to gain confidence that the efforts of regulators to contain the crisis had warded off contagion within the banking system.

The consumer-discretionary sector was the Fund's biggest source of outperformance in the quarter. Our retailers tend to have strong brand names and typically operate in well-established niches. Several also specialize in competitively priced, low-priced or discounted items that help consumers stretch their dollars. We believe the retail companies owned in the Fund are positioned better than most of their peers to navigate inflationary and recessionary environments.

Other significant sources of outperformance included financials, industrials and the Fund's lack of investments in energy. Health care was the primary source of weakness in the Fund.

## DETAILS OF THE QUARTER

The strongest contributor to Fund performance for the quarter was Nova Ltd. (NVMI). The company is a key provider of process-control systems used to manufacture semiconductor chips. Nova's stock price rose throughout the quarter amid signs that the semiconductor cycle may be bottoming. Rather than try to pinpoint the cycle's exact turning point, we bought additional shares of Nova for the Fund last year while investors fearful of recession were selling the stock down to attractive valuations. We were more than happy to take the other side of that trade, given our long investment horizon and strong conviction that Nova is a high-quality business. Also, the semiconductor industry is of strategic importance to the U.S., and the need to build additional capacity is a meaningful tailwind for the company in our view.

Focus Financial Partners, Inc. (FOCS) was also a top contributor. The company's stock price jumped in February after Focus announced it was in talks to sell itself to a private-equity firm. Later that month, the company entered into a definitive agreement to be acquired in an all-cash deal expected to close in the third quarter of 2023. We then liquidated the position to lock in gains. Focus is a leading partnership of independent, fiduciary wealth-management firms.

Another strong stock in the Fund was Floor & Decor Holdings, Inc., (FND). A multi-channel specialty retailer of hard-surface flooring, Floor & Decor has become a "category killer" among the big-box home centers. Because the company cuts out middlemen and buys in large quantities, it can offer its customers a wider selection of flooring at lower prices than most of its competitors. Floor & Decor's expanding retail footprint, strong cash flows and solid balance sheet provide the company with what we consider a built-in engine for self-funded growth.

The greatest detractor from Fund performance for the quarter was Pinnacle Financial Partners, Inc. (PNFP). Based in Nashville, Tennessee, Pinnacle is the bank holding company for Pinnacle Bank. Although Pinnacle's stock declined in sympathy with other bank stocks during March, we believe the company's strong fundamentals set it apart from the banks making headlines in the press. It follows a conventional banking model, with a well-diversified customer base, appropriate levels of loans and deposits, and a small securities portfolio. Despite liquidity pressures at a number of other banks, our research found no significant uptick in withdrawals at Pinnacle. Moreover, we believe Pinnacle is a well-managed bank serving a geographical area with a healthy real-estate market, favorable demographics and above-average economic growth.

Silk Road Medical, Inc. (SILK) also detracted. The company provides implantable devices to treat blockages in the carotid artery that put patients at risk of a stroke. Although Silk Road posted a narrower-than-expected loss in its most recently reported quarter, the stock sold off after management offered no guidance as to future earnings. On the plus side, revenues rose 42% on the back of increased adoption of the company's Transcarotid Artery Revascularization (TCAR) procedure. In our view, Silk Road's scalable business model, effective sales force and large cash position should give the company an ample runway to profitability.

Another weak stock in the Fund was Medpace Holdings, Inc. (MEDP). Medpace is a contract research organization (CRO) supplying clinical development services to small biotechnology companies. After rising sharply during the fourth quarter of 2022, the company's shares gave back some gains during February in what appeared to be profit-taking. Also weighing on the stock were concerns that Silicon Valley Bank's collapse may make it harder for many of Medpace's customers to fund their research programs. Although short-term risk has increased, we believe the company's underlying fundamentals support attractive long-term growth. Additionally, Medpace generates large amounts of cash, which we believe will enable it to enhance shareholder value by repurchasing its stock. (*Current and future holdings are subject to risk and change.)*

## OUTLOOK AND POSITIONING

According to an old English proverb, "It's an ill wind that blows no one any good." As dark clouds gathered over Silicon Valley Bank and the wind blew it down, it wasn't at all clear what good might be blown our way. But now that the clouds have parted, we're beginning to see some silver linings.

Silicon Valley Bank was at the center of an ecosystem through which many start-ups and other small companies obtained funding. The bank's failure is likely to make it more difficult for small firms in biotechnology, software, and other tech-driven industries to get the money they need to launch and grow their businesses. What does this mean for the companies owned in the Fund? Weaker competition and fewer rivals, mostly.

The Wasatch investment approach seeks high-quality companies with solid business models, strong cash flows and healthy balance sheets. One of the main benefits of having these traits is that the company won't run out of money when business conditions get tough. This is a key advantage in the current environment, when stock prices are down, and interest rates are elevated. We don't want our companies forced to issue new stock at depressed prices or borrow money at high rates.

Competitors might not be as fortunate. While some of them are scrambling to arrange new sources of funding in the wake of Silicon Valley Bank's collapse, our companies can use their cash to make acquisitions, hire new talent, invest in their businesses and take market share. The long-term competitive advantages gained from these actions can be substantial.

Regarding start-ups, a tighter funding environment means there will likely be fewer of them for a while. As investors in technology-driven industries, we're always concerned about innovations that could potentially get funded and disrupt the business models of the companies we own. It appears some of this risk just got taken off the table, at least for now.

Another risk that may be lessening has to do with staffing. The growing companies owned in the Fund often require additional human capital to expand their businesses. Fewer start-ups should mean easing shortages of software engineers and other workers with highly specialized skills. Our companies may also benefit if difficult operating and funding conditions force some competitors to reduce headcounts.

In short, we think our focus on businesses with strong fundamentals may be as important now as ever. While no one wants to see bank runs, financial instability or economic turmoil, we believe the Fund's portfolio of high-quality companies is well-positioned to weather potential storms.

Thank you for the opportunity to manage your assets.

Sincerely,

JB Taylor, Ken Korngiebel and Ryan Snow

## AVERAGE ANNUAL TOTAL RETURNS

FOR PERIODS ENDED MARCH 31, 2023

| | Quarter* | 1 Year | 3 Years | 5 Years | 10 Years |
|---|---|---|---|---|---|
| Small Cap Growth Fund—Investor | 7.47% | -21.55% | 12.01% | 7.63% | 9.33% |
| Small Cap Growth Fund—Institutional | 7.50% | -21.45% | 12.11% | 7.75% | 9.43% |
| Russell 2000® Growth Index** | 6.07% | -10.60% | 13.36% | 4.26% | 8.49% |
| Russell 2000® Index† | 2.74% | -11.61% | 17.51% | 4.71% | 8.04% |

**Returns less than one year are not annualized.*

*Data show past performance, which is not indicative of future performance. 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—1.15% / Institutional Class—Gross 1.06%, Net 1.05%.**

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 1.50% for the Investor Class and 1.05% 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 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 small 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.***

The Small Cap Growth Fund's primary investment objective is long-term growth of capital. Income is a secondary objective, but only when consistent with long-term growth of capital.

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***The Russell 2000 Growth Index measures the performance of Russell 2000 Index companies with higher price-to-book ratios and higher forecasted growth values.*

*†The Russell 2000 Index is an unmanaged total return index of the smallest 2,000 companies in the Russell 3000 Index, as ranked by total market capitalization. The Russell 2000 is widely used in the industry to measure the performance of small company stocks.*

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

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

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

## SMALL CAP GROWTH FUND — TOP 10 HOLDINGS

AS OF DECEMBER 31, 2022

| Security Name | Percent of Net Assets |
|---|---|
| Ensign Group, Inc. | 4.0% |
| Pinnacle Financial Partners, Inc. | 3.5% |
| Medpace Holdings, Inc. | 3.4% |
| BellRing Brands, Inc. | 3.1% |
| HealthEquity, Inc. | 3.0% |
| Nova Ltd. | 2.9% |
| Paylocity Holding Corp. | 2.9% |
| Five Below, Inc. | 2.9% |
| RBC Bearings, Inc. | 2.8% |
| CyberArk Software Ltd. | 2.8% |
| Total | 31.3% |

*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.*