WASATCH
GLOBAL INVESTORS

Quarterly Commentary

Investor
WHOSX

Wasatch-Hoisington U.S. Treasury Fund

SEPTEMBER 30, 2023

Impending Recession

The views expressed in this commentary are those of Hoisington Investment Management Company (HIMCo), the sub-advisor to the Fund, and may differ from the views of Wasatch Global Investors.

DETAILS OF THE QUARTER

Thirty-year Treasury bond yields increased to 4.77% at the close of the third quarter, versus 3.85% on June 30. The upper bound of the Federal Reserve's (Fed's) policy rate rose 25 basis points to 5.50% in July. Although there were no further increases for the rest of the quarter, forecasts from the Federal Open Market Committee's September meeting indicated that the policy rate would likely stay higher for longer. The negative implications of this policy stance dominated a continuing fall in the inflation signs and tangible weakness, including a 3% rate of decline in vehicle sales in the third quarter, indications of recessionary conditions in Europe and a continued drop in world trade volume.

The Wasatch-Hoisington U.S. Treasury Fund, which is invested in long-dated U.S. Treasury securities (bonds with maturities longer than 20 years), returned -14.16% for the third calendar quarter, compared with -3.23% for the Bloomberg US Aggregate Bond Index.

OVERVIEW

The long history of business cycles illustrates that inflations lead recessions. Inflations don't just happen, they are caused. A varying mix of idiosyncratic elements is always at play from cycle to cycle, but one

FUND MANAGERS

Van R. Hoisington
Lead Portfolio Manager
27
YEARS ON FUND

V.R. Hoisington Jr.
Portfolio Manager
7
YEARS ON FUND

David Hoisington
Portfolio Manager
7
YEARS ON FUND

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: 0.67% The Advisor has contractually agreed to limit certain expenses to 0.75% through at least 1/31/2024.***

abiding constant is monetary excess. This, in turn, must be reversed in order to address the drop in the standard of living and the increase in unaffordability that are essential to consumer well-being. Accordingly, a more complete description of these aggregate fluctuations is that monetary accelerations precede inflations, which then require monetary decelerations that inevitably lead to recessions.

The process of monetary reversal to the 2020–22 inflation is presently at an advanced stage, suggesting a repeat of the standard business-cycle process. To be sure, the quick spread of inflation in this cycle was abetted by massive fiscal stimulation, unprecedentedly coordinated with central bank operations—with the Fed financing the budget deficit outside the normal channels outlined in the Federal Reserve Act of 1913. These combined monetary and fiscal actions have resulted in negative net national saving, a condition that will impair economic growth well after the Fed reverses the severe monetary restraint currently in place. Indeed, the coming downturn is likely to send net national saving even more deeply negative.

Monetary Policy

As a result of the Fed's engineered reduction in permanent reserves of depository institutions by $1.0 trillion from the peak in early 2022, other deposit liabilities (ODL) have fallen by $1.5 trillion. The de facto deposit multiplier averaged 1.5, meaning that for each $1 loss in the reserve measure, ODL fell $2. Combined with inflation, the bank balance sheet contracted unprecedentedly. Further evidence of monetary restraint is that in September, the real federal-funds rate (the nominal rate less one-year inflationary expectations in the University of Michigan Consumer Sentiment Index) rose to the highest level since 2007. In inflation-adjusted terms, ODL decreased over the latest 12-, 24- and 36-month intervals, resulting in an unprecedented swing from acceleration to contraction. This is the same type of central bank monetary policy that has repeatedly exacerbated business-cycle swings, as was so carefully documented by Nobel Laureate Milton Friedman and reinforced by the scholarly work of John Taylor, a preeminent economist at Stanford University. Thus, once again the Fed in responding to one crisis has created another crisis, which is a process of booming the booms and slumping slumps.

In order to deal with the pandemic, policymakers over-played their hand and caused the inflation rate to accelerate from a 2% trend rate of increase in the 2010s to nearly double digits in 2022. The rapid inflation robbed almost everyone but as typical, the greatest burden fell upon modest- and low-income households. U.S. inflation-adjusted median household income fell 4.7% from 2019 to 2022, bringing it back to 2018's level. Real average weekly earnings of salaried and full-time hourly workers (approximately 120 million Americans) fell at a 2.4% annual rate over the latest 12 quarters of the expansion from the second quarter of 2020 through the third quarter of this year, the only such decline to occur when the economy was experiencing rising real GDP.

These income measures demonstrate the depth of the damage caused by the inflationary surge as well as the severe impact at the middle of the income spectrum. As a consequence of these income losses, a respected gauge of housing affordability is at an all-time low, and Cox Automotive calculates that new cars are so expensive that they are not affordable for one-half of the households. Restoring affordability is likely to be a slow process that is only likely to be achieved when real per capita GDP growth is returned to above the historical norm.

Fiscal Policy

An analysis of the National Income and Product Accounts (NIPA) as well as financial market flows demonstrates the serious problems posed by fiscal policy, which is contractionary, contrary to the widely held view.

THE CIRCULAR FLOW

The circular flow is a basic element in economics. The concept is that an economy's spending equals its earnings and its production. In short, GDP equals GDI. By algebraic substitution, GDP = GDI is also the same as I = S, where I is physical investment and S is total saving. For economists, the term net saving or investment means that depreciation is excluded. As such, for a country's capital stock to increase (which is necessary to raise productivity), there must be an increase in net saving. Net saving has three components: private saving (household and business), foreign saving and government saving. Foreign saving is the inverse of the current account, meaning that a country with a current account deficit, like the U.S., has foreign saving and vice versa. In the second quarter, S was -$59 billion. The negative reading resulted from a government dissaving that was greater than the combined saving of the private and foreign sectors. An imperative for positive S is that absolute and relative budget deficits must be reduced substantially in economic expansions. But, in fiscal years 2022 and 2023 the deficits totaled a massive $3 trillion or an estimated 5% of GDP per year. Previously, such huge deficits were relegated to recessions.

Without saving, the capital stock does not rise on a sustained basis and neither does the standard of living. When the downturn hits, private saving will fall, and government dissaving will rise as spending for built-in stabilizers surge and tax collections drop. S will turn even more negative, thus worsening potential economic growth. Theoretically, the problem is addressable but not in the context of the current political situation and the beleaguered status of three-fifths of U.S. households that are living from paycheck to paycheck.

Since 1947, S was negative only during and immediately after the recession of the Global Financial Crisis (GFC) in the mid-2000s. While remaining positive, all of the significant, multi-quarter decreases in S prior to the GFC were only associated with slumping real GDP and prior recessions.

Financial Flows

The current widely held view that fiscal policy has remained stimulative and inflationary is not supported by scholarly research. The fiscal multiplier is positive for the first four to six quarters after deficit spending by the government. Estimates from econometric studies of highly indebted industrialized economies indicate the multiplier is negative after three years. The deficit for fiscal year (FY) 2023, which ended September 30, was approximately $1 trillion greater than FY 2022 (student loans that were forgiven in 2022 and then reinstated in 2023 are excluded from the calculation). Such a substantial increase could have generated at least a small positive multiplier, but that was negated by the way in which the deficit was financed. Over the first 11 months of FY 2023, the private domestic nonbank sector funded the entire budget deficit and then purchased almost another $1 trillion of previously issued federal debt. Thus, private sector funds for productive use in the positive multiplier private sector were crowded out by negative multiplier governmental spending. Furthermore, increasing government spending to reverse poor economic conditions will be counterproductive.

Contra Normal Cyclical Characteristics

Inflation and real bank credit, historically, have exhibited a virtually unblemished record of lagging the GDP cycle. Yet, over the past four to five quarters they all declined unprecedentedly during a time when real GDP was rising. These divergences suggest that the economy is far weaker than real GDP and employment indicate and that the economy is currently far more susceptible to a downturn than is generally recognized. During the economic growth of the second half of 2022 and the first three quarters of this year, inflation slowed substantially, and real bank credit contracted on a year-over-year basis.

WASATCH GLOBAL INVESTORS

INFLATION

The 12-month percent change of the consumer-price index (CPI) fell about 5.40% from its peak in June 2022 to August 2023. Faster decreases have occurred since 1953, but all of the declines were during and immediately after recessions. Based on historical experience, inflation fell further during recessions. In the eight recessions since 1958 (counting the two recessions of the early 1980s as one), the average low rate of increase in the CPI was 1.3%. If the extreme low is eliminated, the average is 1.7% and if the extreme high and low readings are eliminated, the average trough was 1.2%. This record of the historical business cycle suggests that the Fed's 2% target is easily attainable.

REAL BANK CREDIT

Bank loans and investments have decreased over the latest 12-, 24- and 36-month intervals. This is entirely unprecedented for an economy where GDP is rising. Bank lending standards have risen sharply this year, but this is also a lagging indicator. Increases of this year's size have historically been confined to recessions.

The standard definition of an overall or sectoral recession is that a decline must occur over two consecutive quarters. As measured by bank credit, the commercial banking sector has already been in recession for more than a year. Since money supply or commercial bank checking accounts and consumer-type time and savings deposits lead bank credit, this contraction should continue.

The highest multiplier component of bank credit is commercial and industrial (C&I) loans. In real terms, this is included in the Conference Board's Composite Index of Lagging Indicators. Yet, real C&I loans have contracted almost every month this year. When the recession brings on an even more significant advance of bankruptcies and delinquencies than has already occurred, banks will tighten credit standards even further, thereby sending business lending even lower. This is one of the reasons monetary policy is weak and ineffectual in counteracting recessions, a problem widely referred to as "pushing on a string."

Macro Dynamics Favor Treasury Bonds

The peak in the financial cycle occurred in the fourth quarter of 2021, seven quarters from the just-ended third quarter of 2023. This is right in the middle of the five- to nine-quarter lag typical of monetary policy post-World War II. Monetary conditions have steadily tightened through the end of the third quarter, and the process is widely expected to hold through the end of the year and possibly even into 2024. Historically, these more restrictive conditions will expose, through bankruptcy and liquidation, those who took excessive risk during the monetary largess of 2020 until early 2022. Through September of this year, the yield curve between the two- and 10-year Treasury yields has remained inverted for over 12 months. As Duke Professor Campbell Harvey's research has shown, this barometer has, without exception, preceded each of the last eight recessions over the course of 70 years. Such developments point the economy in the direction of an economic downturn and lower inflation.

In past cycles, cost pressures—including increases in oil, other commodities and wages—all rose, but the Fed still won the battle against inflation. Cost pressures in a severely constrained monetary environment serve to reduce economic activity. Oil, for example, is a highly price-inelastic good. Thus, when its price rises, consumers and businesses are forced to reduce discretionary spending. When wages and other costs move higher, businesses are unable to fully pass along the higher costs and corporate profits fall, resulting in weaker economic activity. The concept of a wage-price spiral is flawed. What actually occurs is a money, price and wage spiral. In 2020–21, monetary growth was generating faster wage increases, but money conditions no longer allow them to be passed through. For these costs to result in higher inflation, the Fed would have to undertake a further round of monetary

largess when inflation is still above the Fed's official target, which the FOMC members affirmed again they would not do at their last meeting.

In the past three quarters, real GDI declined at a 0.6% annual rate while real GDP increased at a 2.3% pace. Over the past three quarters, the average of real GDP and GDI was just 0.8%. Given the extent to which these data are revised, this is not significantly different than zero. However, monetary and fiscal restraint intensified during this span, suggesting that the revisions are more likely to take the results lower rather than higher. In addition, the global economy has continued to deteriorate. In the 12 months ended July 2023, the volume of world trade declined 3.2%, a contraction normally associated with recessions. The erosion of this very high multiplier sector indicates that the foreign sector will add to the downward force of the financial cycle. This environment will be favorable for lower U.S. Treasury bond yields.

Thank you for the opportunity to manage your assets.

Sincerely,

Van Hoisington, V.R. Hoisington Jr. and David Hoisington

TOTAL RETURNS

FOR PERIODS ENDED SEPTEMBER 30, 2023

	Quarter*	1 Year	3 Years	5 Years	10 Years
U.S. Treasury Fund	-14.16%	-12.82%	-18.73%	-3.99%	0.34%
Bloomberg US Aggregate Bond Index**	-3.23%	0.64%	-5.21%	0.10%	1.13%

**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 0.75% 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.

Investing in bonds, you are subject, but not limited to, the same interest rate, inflation and credit risk associated with the underlying bonds owned by the Fund. Return of principal is not guaranteed. Interest rate risk is the risk that a debt security's value will decline due to changes in market interest rates. The interest rate is the amount charged, expressed as a percentage of principal, by a lender to a borrower for the use of assets. Even though some interest-bearing securities offer a stable stream of income, their prices will fluctuate with changes in interest rates. Inflation risk is the possibility that inflation will reduce the purchasing power of a currency, and subsequently reduce the value of a security or asset, and may result in rising interest rates. Inflation is the overall upward price movement of goods and services in an economy that causes the value of a dollar to decline. Credit risk is the risk that the issuer of a debt security will fail to repay principal and interest on the security when due. Credit risk is affected by the issuer's credit status, and is generally higher for non-investment grade securities.

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-Hoisington U.S. Treasury Fund's investment objective is to provide a rate of return that exceeds the rate of inflation over a business cycle by investing in U.S. Treasury securities with an emphasis on both income and capital appreciation.

***The Bloomberg US Aggregate Bond Index is a broad-based flagship benchmark that measures the investment grade, U.S. dollar denominated, fixed-rate taxable bond market. The index includes Treasuries, government-related and corporate securities, mortgage-backed securities (MBS) (agency fixed-rate and hybrid adjustable-rate mortgage [ARM] pass-throughs), asset-backed securities (ABS) and commercial mortgage-backed securities (CMBS) (agency and non-agency).*

Indexes are unmanaged. Investors cannot invest directly in this or any index.

Sources: Hoisington Investment Management Co.; Federal Reserve Board; Bureau of Economic Analysis; Haver Analytics; Bureau of Labor Statistics; National Bureau of Economic Research; and St. Louis Federal Reserve.

The capital stock of a country indicates the level of production that the country can carry out at any given point in time. It's a measure of a nation's wealth that expectedly increases as a country develops and grows richer.

The Conference Board's Composite Index of Lagging Indicators measures the economic activities of previous months and is used as an after-the-fact way to assess economists' assessments of current economic conditions.

Gross domestic product (GDP) is a basic measure of a country's economic performance and is the market value of all final goods and services made within the borders of a country in a year.

The Cox Automotive/Moody's Analytics Vehicle Affordability Index (VAI) measures the ability of a household earning the median income to afford the purchase of an average-priced new vehicle. The index represents the number of weeks of income that a median-income household would need to pay off a new vehicle.

The current account records a nation's transactions with the rest of the world. It represents a country's imports and exports of goods and services, payments made to foreign investors and transfers such as foreign aid. A country that is a net exporter will have a positive current account (a surplus), and a net importer will have a negative current account (a deficit).

The deposit multiplier represents the highest amount of money a bank can generate based on the bank's level of reserves. It's based on the portion of the deposited funds at the bank available for lending, a figure typically dictated by the reserve requirement established by the Federal Reserve.

The Federal Open Market Committee (FOMC), a component of the Federal Reserve System, is charged under United States law with overseeing the nation's open market operations. Open market operations are the means of implementing monetary policy by which a central bank controls the short-term interest rate and the supply of base money in an economy, and thus indirectly the total money supply.

The Federal Reserve Act of 1913, enacted by President Woodrow Wilson, was landmark legislation that created the central banking system (the Federal Reserve) and thereby laid the foundation of the modern U.S. financial system. Its objectives included prevention of financial panics with the ready availability of cash from a money reserve, an expanding-contracting money supply to match the state of the economy, and a new currency—the Federal Reserve note.

GDP per capita is a measure of the total output of a country that takes the GDP and divides it by the number of people in the country.

The global financial crisis of 2008-09, is considered by many economists to have been the worst financial crisis since the Great Depression of the 1930s.

Real gross domestic product (GDP) is a macroeconomic measure of the value of economic output adjusted for price changes (i.e., inflation or deflation). This adjustment transforms the money-value measure, nominal GDP, into an index for quantity of total output.

Gross domestic income (GDI) is the sum of all income earned while producing goods and services within a nation's borders. GDI is a lesser-known calculation statistic used by the Federal Reserve Bank to gauge economic activity based on income.

Gross domestic product (GDP) is a basic measure of a country's economic performance and is the market value of all final goods and services made within the borders of a country in a year.

The National Income and Product Accounts (NIPA) are part of the national accounts of the United States. They are produced by the Bureau of Economic Analysis of the Department of Commerce and are one of the main sources of data on general economic activity in the United States.

Net national savings is equal to gross national savings less the value of consumption of fixed capital.

Other deposit liabilities (ODL) equal M2 minus currency in circulation and money market mutual fund shares.

The real federal-funds rate is the federal-funds rate (the interest rate that banks with excess reserves at a Federal Reserve district bank charge other banks that need overnight loans) adjusted for inflation.

The consumer-price index (CPI), also called the cost-of-living index, is an inflationary indicator that measures the change in the cost of a fixed basket of products and services, including housing, electricity, food and transportation. The CPI is published monthly. The headline CPI includes volatile food and energy prices, while the core CPI excludes food and energy.

The University of Michigan Consumer Sentiment Index is a consumer confidence index published monthly by the University of Michigan

The yield curve is a line on a graph that plots the interest rates, at a set point in time, of bonds having equal credit quality, but differing maturity dates. The most frequently reported yield curve compares three-month, two-year, five-year and 30-year U.S.

Treasury securities. This yield curve is used as a benchmark for other interest rates, such as mortgage rates or bank lending rates. The curve is also used to predict changes in economic output and growth.

Real per capita GDP is a measure of the total economic output of a country, adjusted for inflation and divided by the number of people.

Real per capita GDP growth measures the rate of change in real GDP per capita from one period to another. It's used to compare the average economic productivity or standard of living between countries and over time.

U.S. TREASURY FUND—TOP 10 HOLDINGS

AS OF JUNE 30, 2023

Security Name		Percent of Net Assets
U.S. Treasury Bond, 1.250%, 5/15/2050		25.7%
U.S. Treasury Bond, 1.375%, 8/15/2050		23.3%
U.S. Treasury Bond, 1.875%, 11/15/2051		15.9%
U.S. Treasury Bond, 2.250%, 8/15/2046		14.2%
U.S. Treasury Bond, 3.000%, 8/15/2048		13.6%
U.S. Treasury Bond, 2.500%, 2/15/2045		6.1%
	Total	98.8%

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.