WASATCH GLOBAL INVESTORS

Quarterly Commentary

Investor
WHOSX

Wasatch-Hoisington U.S. Treasury Fund

MARCH 31, 2024

The Long View

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

Long-term Treasury bond yields increased to 4.34% in 2024's first quarter. Various tracking models indicated that growth in real GDP slowed compared to the fourth quarter, and key measures of inflation continued to slow. Typically, such a pattern in these key macro-indicators would have coincided with lower Treasury bond yields. However, U.S. Federal Reserve (Fed) Chair Jerome Powell said that inflation was not close enough to their 2% target to permit an easing of monetary policy. With other Fed officials advocating a similar policy approach, bond market sentiment was negative, and bond yields rose.

The Wasatch-Hoisington U.S. Treasury Fund, which invests in long-dated U.S. Treasury securities, returned -4.62% for the first calendar quarter, compared with -0.78% for the Bloomberg US Aggregate Bond Index.

OVERVIEW

The dynamics of fiscal and monetary policy are now entering a new phase. Due to the emergence of negative net national saving (NNNS), the law of diminishing returns can no longer capture the harmful effect of debt on economic growth. This new analytical framework indicates

FUND MANAGERS

Van R. Hoisington
Lead Portfolio Manager
27
YEARS ON FUND

V.R. Hoisington Jr.
Portfolio Manager
8
YEARS ON FUND

David Hoisington
Portfolio Manager
8
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: 0.70% The Advisor has contractually agreed to limit certain expenses to 0.75% through at least 1/31/2025.***

that the pronounced downward trend in the growth rate of the standard of living, evident since the 1970s, is likely to persist. A redefinition of the monetary base and world dollar liquidity (WDL) is needed to capture the pure impact of central bank actions on business conditions. These new monetary measures, which are more restrictive than the old standards, indicate that the Fed is on the path to reducing inflation to the policy objective.

The aggregate production function, an important economic concept, combines technology with the three production factors (land, labor and capital) to determine real economic growth. From this function, we derive the law of diminishing returns. This law reveals that the overuse of any factor of production will eventually result in lower output, which is a physical concept. Initially, an increase in a production factor will increase output. However, continued inputs of the same factor will result in no new output, and its continued overuse will eventually result in declining output. As such, overuse of one of the factors of production leads to diminishing marginal revenue product, where overuse of a given factor of production will eventually result in a declining amount of output.

For more than a decade, scholars including Reinhart, Reinhart and Rogoff have found that the overuse of debt impedes economic growth when gross government debt as a percentage of GDP generally exceeds 80–90%. While increased indebtedness boosts the economy in the short run, its overuse and the law of diminishing returns prevail over time; thus, increasing the use of debt becomes disinflationary. Now, with debt standing at a more harmful stage in terms of impeding economic growth, another unprecedented economic factor has been adding restraint: The U.S. now has negative net national savings (NNNS). Based on the circular flow principle (where GDI = GDP = Output of Goods and Services), net physical investment (I) = NNS. However, if aggregate saving is negative, then I is negative, meaning that the capital stock will not increase. This will lead to economic stagnation. An often-made presumption is that technology will bail out the economy. Technology boosts economic growth by increasing capital stock and making labor and natural resources more productive. This presumption is rendered moot if NNS is negative. It is probably why Fed Chair Powell stated that "fiscal policy is not sustainable." During periods of NNNS, *ceteris paribus* (all other things being equal), a growth standstill would reinforce disinflationary conditions, pending the actions of the Federal Reserve. The Fed could accelerate money growth, resulting in faster inflation while not eliminating the problem of NNNS. In this case, prices and nominal GDP would rise for a short period of time, but the Fed's actions would not boost the trend rate of growth in real GDP. The burden of higher inflation would fall most significantly on modest- and moderate-income households, thereby worsening the income and wealth divides. Richard Cantillon, who died in 1734 (42 years before Adam Smith's *Wealth of Nations*), wrote that this would result from rapid money growth—and thus was quite prescient. In March, the Federal Open Market Committee (FOMC) reconfirmed a solid resolve to hit its 2% inflation target, a tacit confirmation that the Fed understands what Cantillon did three centuries ago.

A MODERNIZED MONETARY BASE

The monetary base (MB), derived from the consolidated balance sheet of the Fed and the Treasury, has an asset or source side and a liability or use side, comprised of total reserves (TR) and currency. First-quarter increases in MB and TR, based on the historical approach, suggest that the Fed shifted away from restraint with inflation above their target. Former Federal Reserve Board of Governors member Kevin Warsh said in March that the Fed was "goosing" the economy. With the passage of time and more historical observations, a greater understanding of how monetary policy works requires a reinterpretation of these long-existing monetary terms. Based on this alternative view, Fed restraint intensified in the first quarter.

The objective of the MB was to create an exogenous variable that is not determined within an economic model but plays a role in determining the values of the endogenous variables. The MB was conceptualized by economists

Karl Brunner (1916–1989) and Allan Meltzer (1928–2017) in the 1960s. James Tobin (1918–2002) developed a virtually identical concept called "outside money." The MB and outside money contain endogenous variables, but their volatility has become considerably greater over the past six to seven decades, creating the need for a variable capable of appropriately capturing the Fed's influence on the economy, absent feedback effects.

The exogenous component of the asset side of the Fed's balance sheet is the SOMA (System Open Market Account). Securities held outright at the Fed are what we define as permanent reserves (PR). PR reflects assets that have longer-term maturities. They differ from the Fed's endogenous assets that provide transitory reserves (TR) and are mainly used to offset swings in operating factors like the Treasury General Account, currency in circulation or changes in Fed loans made over the discount window. While Fed assets rose as TR increased more than PR declined in the first quarter, the decline in PR will eventually lead to further contraction of monetary and credit growth, reinforcing the Fed's restraint imposed during the past two years.

A MODERNIZED WORLD DOLLAR LIQUIDITY (MWDL) MEASURE

Four decades ago, Dr. Rod McKnew argued that since the dollar is the world's reserve currency, the Fed is also the world's central banker. To reflect that, he created the concept of WDL, which he defined as the MB plus marketable securities held in custody for foreign official and international accounts at the Federal Reserve Bank of New York. Our modernized measure substitutes MB with PR. MWDL has an outstanding track record, decelerating sharply before all the recessions since 1976. The year-over-year change in MWDL went negative in all recessions except the one in 2000–2001. MWDL has dropped by a record 9% in the twelve months ending February 2024, indicating the effect of the Fed's restraint is intensifying in global markets. For instance, real money growth is negative in the euro area and the United Kingdom, and Japan is experiencing its slowest growth in twelve years. Combined with Japan's recently adopted tighter central bank policy, the risk is that Japanese money growth could turn negative. The record contraction in MWDL will exert additional restraint on a global economy where the euro area, the U.K. and Japan are in either technical or quasi-recessions, and China is in deflation.

CONCLUDING THOUGHTS

The consensus forecast believes the economy is buoyant, supported by robust labor markets and a resilient consumer. In dating business cycles, the National Bureau of Economic Research (NBER) gives equal weight to nonfarm payroll employment and household employment since the two series often diverge as they do now, with payroll up and household down. Following NBER's approach, we created a series that takes the average of payroll and household measures weighted by the weekly hours worked from the payroll survey. This new indicator increased by 0.6% in the first quarter versus a year ago, down from increases of 1.4% in 2023 and 0.9% the year prior to the pandemic.

Some contend fiscal policy will dominate monetary policy in the post-Covid economy. Due to the outlook for many years of large budget deficits, this view means that monetary policy actions will be incapable of containing inflation at a pace close to the Fed's target. But, unless the Fed abandons its inflation mandate, for which the Fed Chair recently said there is "no wiggle room," the vast deficits will have the perverse impact of restraining growth and disinflating the economy as NNNS prevails.

The contractionary effects of monetary policy and the de-facto NNNS policy stance of fiscal policy will serve to place increasing downward pressure on inflation and growth. A sharp 7% rate of decline in vehicle sales in the first quarter is a sign that the deflationary trend in big-ticket consumer-goods prices is more likely to gather speed than reverse.The inflation rate will likely undershoot the Fed's target, and the unemployment rate will move higher than the Fed anticipated. Inflation and unemployment are lagging indicators, and much of their cyclicality occurs after, not before, recessions end. This declining inflation environment will continue to bring down inflationary expectations and long-term 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 MARCH 31, 2024

	Quarter*	1 Year	3 Years	5 Years	10 Years
U.S. Treasury Fund	-4.62%	-8.96%	-10.01%	-4.17%	0.71%
Bloomberg US Aggregate Bond Index**	-0.78%	1.70%	-2.46%	0.36%	1.54%

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

The performance data quoted represents past performance. Past performance does not guarantee future results. 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. 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: 0.70%**

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 1/31/2025.** 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.

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.

Marginal revenue product (MRP) is the marginal revenue created by the addition of one unit of resource. MRP is calculated by multiplying the marginal physical product (MPP) of the resource by the marginal revenue (MR) generated.

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.

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.

The monetary base is the sum of currency in circulation and reserve balances (deposits held by banks and other depository institutions in their accounts at the Federal Reserve).

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

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.

U.S. TREASURY FUND—TOP 10 HOLDINGS

AS OF DECEMBER 31, 2023

Security Name		Percent of Net Assets
U.S. Treasury Bond, 1.375%, 8/15/2050		21.8%
U.S. Treasury Bond, 1.875%, 11/15/2051		19.6%
U.S. Treasury Bond, 2.250%, 8/15/2046		17.7%
U.S. Treasury Bond, 1.250%, 5/15/2050		17.3%
U.S. Treasury Bond, 3.000%, 8/15/2048		16.8%
U.S. Treasury Bond, 2.500%, 2/15/2045		4.7%
	Total	97.9%

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.