WASATCH GLOBAL INVESTORS

Quarterly Commentary

Investor WGROX / Institutional WIGRX

Wasatch Core Growth Fund

SEPTEMBER 30, 2020

Recent Volatility Doesn't Change Our Optimism For Technology Companies

OVERVIEW

During the third quarter of 2020, U.S. small-cap stocks added to their second-quarter gains—albeit at a slower pace. For the three months ended September 30, the benchmark Russell 2000 Index increased 4.93% while the Russell 2000 Growth Index rose 7.16%. The Wasatch Core Growth Fund—Investor Class moved up 6.61%.

U.S. markets showed strong returns even though the coronavirus pandemic continued to impact the economy. While companies have been fairly resilient, no reasonable analyst would minimize the effects on stock prices from support by government fiscal initiatives and Federal Reserve monetary policies. Beyond outright securities purchases and lending backstops, the Fed recently announced its plans to keep interest rates extremely low for at least the next few years and to promote higher employment and inflation. In addition, the Fed stepped outside its monetary mandate by publicly encouraging Congress to do even more on the fiscal front to assist individuals and businesses facing continued hardship.

FUND MANAGERS

JB Taylor
Lead Portfolio Manager
19 YEARS ON FUND / 24 YEARS AT WASATCH

Paul Lambert
Portfolio Manager
15 YEARS ON FUND / 20 YEARS AT WASATCH

Mike Valentine
Portfolio Manager
3 YEARS ON FUND / 3 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, leading to higher total shareholder returns. 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 1.19% / Institutional Class—Gross: 1.09%, 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 1/31/2021.***

Regarding sectors, information technology (IT) and health care were the Fund's largest sources of outperformance relative to the benchmark during the third quarter. In both sectors, favorable stock selection was the key factor. As for the industrials sector, our stocks lagged—which created a drag on the Fund's relative return. The remaining sectors didn't have any major effects on performance against the benchmark.

THE WASATCH PERSPECTIVE ON TECHNOLOGY

Because IT is a large weighting in the Fund—and because our tech and tech-related returns have been so robust for extended periods—we're offering our perspective on the sector and the types of names we hold.

Notwithstanding a temporary pullback during September, IT stocks have continued their strong performance as many tech companies have actually benefited from the pandemic. Tech companies have been the leaders in replacing face-to-face activities with online, virtual alternatives. Additionally, many technology-enabled services have become increasingly important in delivering goods and services during the pandemic. What's more, we don't think these trends will necessarily reverse after the pandemic ends because people have become used to new ways of living and working.

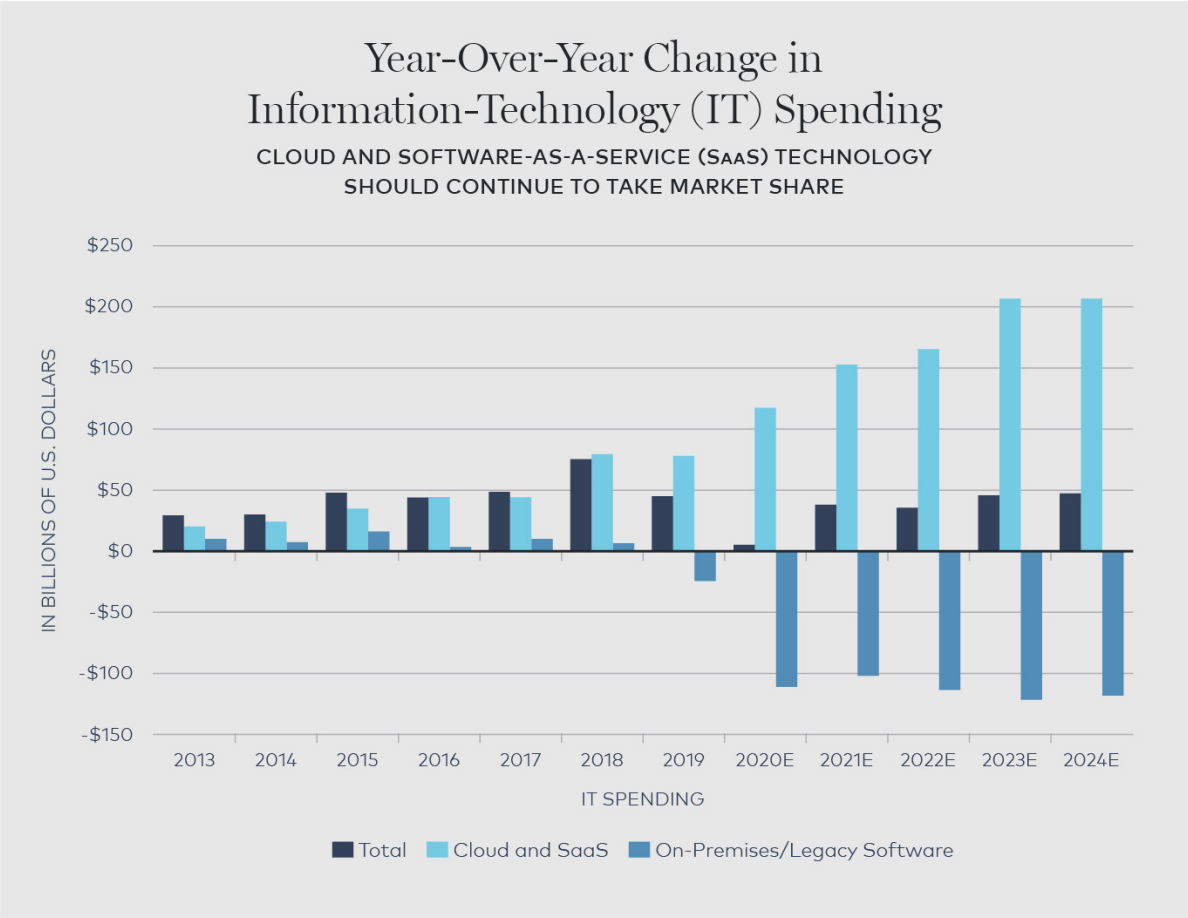
While the Core Growth Fund is significantly overweighted in IT relative to the benchmark, we're very particular about the specific tech and tech-related names we own. First, we invest in what we consider high-quality companies with excellent management teams, innovative business models and expanding markets. Second, we tend to avoid really expensive companies that in our opinion are selling at excessive price-to-sales ratios. This means the Fund may lag some more aggressive portfolios during exceptionally strong upward moves in the market but may also hold up better during major downdrafts. Third, we try to own a balance of some especially fast growers that have been firing on all cylinders and some more moderately priced companies.

The reason we own a balance of companies is that the especially fast growers may be well-positioned for the current environment but may be trading at somewhat expensive valuations. And the more moderately priced companies may be having some challenges at the present time but may be poised to see accelerating growth if the environment changes. By owning a balance, we're positioned for the possibilities of a new environment and a general reset in valuations.

To understand why we're so optimistic regarding growth-oriented tech companies, please refer to the figure below. The figure shows the year-over-year change in information-technology (IT) spending—which is broken down by cloud and Software-as-a-Service (SaaS) spending, on-premises/legacy software spending and total spending.

What you can see from the figure is that total spending has been increasing each year. But cloud and SaaS spending has been increasing at a phenomenal rate, while on-premises/legacy software spending has started to fall dramatically. The coronavirus pandemic and the recession have only accelerated these trends because fewer people are working in the office and companies are looking to save money. The cloud and SaaS are major enablers of remote work and alternative forms of communication and data delivery. Additionally, cloud and SaaS applications should be more cost-effective over the long term.

Another way to think about the development of technology is to visualize a growth curve. Imagine the shape of a successful company's growth curve, which over time goes up and to the right. Now imagine the growth curve is shifted to the left. This means the company's growth comes earlier than



Sources: IDC, Bernstein and Wasatch estimates. As of September 30, 2020. Year-over-year change in IT spending is estimated for years 2020 through 2024.

would otherwise have been the case. And every point on the curve is higher than it would have been. For many of the companies we own, we think the pandemic has in fact caused a leftward shift in the growth curve.

Now let's consider a more concrete example. Suppose the pandemic has already caused a business meeting to take place virtually via a technologically advanced application delivered securely over the internet. The fees to enable this meeting have already gone to the tech company. And the lost fees that may have otherwise gone to airlines, hotels and restaurants will never be recouped. Moreover, after the pandemic ends, people will probably continue to embrace their newfound tech-savvy way of doing business. Beyond the pandemic, there are numerous other reasons why we think many tech and tech-related companies are still very early in their development.

Does this mean we should ignore the exorbitant valuations of some IT stocks? Absolutely not. That's why, as described above, we seek to balance our higher-priced names with more moderately priced holdings. And we keep overall valuations in check by selling positions that move beyond our comfort zone.

For instance, we recently liquidated our shares of **DocuSign, Inc. (DOCU)**, which offers e-signature software that enables businesses and individuals

to digitally prepare and execute agreements. Utilization of the software spiked during the pandemic and the stock was an excellent performer, propelling the company's market capitalization to over $40 billion. While we still like the company, the valuation set a higher bar for the future. With the proceeds of our DocuSign sale, we rotated into what we viewed as more reasonably priced names.

Going forward, it's certainly possible that tech companies may have short-term trouble exceeding their recent success and that other sectors may outpace IT for a period of time. It's also possible that value may temporarily outshine growth. But we don't attempt to navigate such cycles in the market. Instead, we remain focused on the fundamentals: management quality, business-model viability, scope for increased market share and market expansion, returns on capital and balance-sheet health.

Over the long-term, we believe that market cycles will fade from memory and that growth in sales and earnings will drive the performance of stocks. We also think that in our attempt to capture attractive growth in sales and earnings, tech and tech-related companies will comprise a significant portion of the Fund's holdings. For the most part, the companies we favor are generating significant amounts of cash and are in no danger of having to sell equity or incur debt on unfavorable terms. These companies also tend to show rising trends in gross profit.

TECH AND TECH-RELATED COMPANIES WE LIKE

One of the tech companies we like is **Five9, Inc. (FIVN)**, which provides contact-center software that's managed and hosted from the cloud. The company offers real-time and historical reporting, quality monitoring, and workforce and customer-relationship-management integrations. The stock has benefited from the superiority of cloud-based software over on-premises/legacy software, which has become especially evident during the coronavirus pandemic. Five9's robust software has enabled customers to quickly shift employees from large contact centers to work-from-home environments with limited disruption.

On a longer-term basis, Five9 has a few competitive advantages that make it the dominant growth company in its industry. First, Five9 offers compelling products that address mission-critical customer needs, and the company has been leveraging these products with high research-and-development spending. This has resulted in technological leadership, which has created a barrier to entry that may prevent competitors from gaining a foothold. Second, the company has been enhancing its products for reliability, functionality and scalability at the enterprise level—thereby opening new revenue opportunities. Third, in our estimation, Five9's leadership team has talent and depth at the home office and at the regional levels, and the company has created a culture that attracts and retains best-in-class personnel.

Although Five9 has been extremely successful during the pandemic and the stock price reflects this success, we believe the company and the stock still have considerable upside potential. The market is large and expanding, and Five9's competitive advantages are becoming stronger. Customers, for their part, have every incentive to maintain a long-term, mutually beneficial relationship with Five9 because they receive cost-effective prices, almost zero downtime, easy integration with other software platforms, and reporting systems that help manage full-time and seasonal staff across multiple time zones and geographies.

Another tech company we like is **Avalara, Inc. (AVLR)**, which provides sales-tax management, filing and payment software—including a web-based system to integrate accounting and business applications that span multiple platforms world-

wide. The company also offers consulting, training courses and technical-support services.

At Wasatch, we've had successful investments in software-based human-resources (HR) and payroll companies. One of the reasons for the success is that high-quality HR and payroll companies tend to develop long-term relationships with their customers because the complex nuances of personnel management and recordkeeping are powerful incentives to maintain the status quo.

As for Avalara, we think sales-tax management is even more complex than HR and payroll. Just imagine having to keep track of tax requirements in thousands of international jurisdictions for different industries and for different products and services. If Avalara performs its functions well—and we believe it does—why would a customer leave? And why would a potential competitor think it could catch up with Avalara's detailed local knowledge and already-established software integrations? Also, we believe Avalara's potential growth is enormous because more and more businesses around the world are entering the formal economy and there are many additional jurisdictions for the company to cover.

DETAILS OF THE QUARTER

Falling mortgage interest rates have led to tailwinds in some industries. For example, there's been a spike in U.S. home sales and new-home construction. These trends have been benefiting several of our holdings, including **Floor & Decor Holdings, Inc. (FND)**. The company sells tile, wood, laminate and natural-stone flooring—as well as related decorations and accessories. We think the number of stores may increase by about 20% in 2021 and upcoming same-store sales growth could exceed analysts' expectations. Floor & Decor was among the top contributors to Fund performance for the quarter.

Pool Corp. (POOL) saw its stock price increase as the wholesale distributor of swimming pools and related equipment and supplies benefited from rising demand precipitated by families increasingly favoring activities that can be enjoyed at home. The company also benefited from cost-saving measures put in place at the start of the pandemic. We believe Pool Corp. is on a promising long-term growth trajectory and also has the potential to see more business in the short term from greater use of swimming pools by housing communities and individual households.

The health-care sector—including **Ensign Group, Inc. (ENSG)** and **Pennant Group, Inc. (PNTG)**—produced several companies that were top contributors to the Fund's performance. Pennant was previously a part of Ensign before spinning off into its own operation. Both companies offer senior-care services, with Ensign specializing in assisted-living communities and Pennant focusing on in-home care, including rehabilitative and hospice care. In addition to the secular trend favoring health-care stocks broadly, both companies are benefiting from the Department of Health and Human Services' Provider Relief Fund—which is intended to assist health-care facilities hardest hit by Covid-19.

The largest detractor from Fund performance for the third quarter was **Monro, Inc. (MNRO)**, a leading chain of automotive-repair shops with more than 1,280 locations spread across 32 states. The company has certainly been impacted in the short term by stay-at-home orders and decreased travel. Also, Monro's CEO recently resigned to become the CEO of a larger company. Board Chairman Robert Mellor has been appointed interim CEO, and the search for a successor has been initiated. We spoke to Mr. Mellor recently and feel comfortable that a sound, long-term business plan remains in place for the company. Given an already-impressive footprint, we believe Monro still has significant headroom for growth over the next few years despite the company's short-term challenges.

HealthEquity, Inc. (HQY), which also declined for the quarter, provides technology-enabled services platforms that allow consumers to make health-care saving and spending decisions. The company's platform gives consumers access to their tax-advantaged health-care-savings accounts, compare treatment options, pay medical bills, earn wellness incentives, and receive personalized benefit and clinical information. We believe the company's acquisition of WageWorks caused some investors to take a wait-and-see attitude toward HealthEquity's stock. But we think the acquisition should be a positive long-term growth driver for HealthEquity despite some associated seasonal risks.

Global investment manager **Cohen & Steers, Inc. (CNS)** was down for the quarter too. The company manages portfolios focused on real-estate assets, as well as preferred securities and other financial products. Cohen & Steers recently reported a decrease in revenue largely related to the coronavirus pandemic. The report wasn't exclusively negative, however, as it also showed a decrease in expenses and an increase in operating margin. Over the long term, we still believe the company has strong growth potential. *(Current and future holdings are subject to risk.)*

OUTLOOK AND POSITIONING

With the success of growth-oriented tech and tech-related stocks over the past several years, many investors are questioning whether there will be a market rotation away from growth stocks and toward value stocks—which are typically in more basic industries like oil drilling, mining and banking. For our part, we don't think it's possible to successfully navigate growth and value cycles. Instead, we prefer to stay invested in growth names that meet our strict quality standards.

More broadly, with the Fed committed to near-zero interest rates (and therefore a low cost of capital) for years on end, cash-generative growth companies should be particularly well-positioned to produce attractive returns on invested capital—especially if the companies' total addressable markets are very large and expanding. Additionally, from a discounted-cash-flow perspective, low interest rates should favor companies that defer profits today in order to achieve large, recurring profits well into the future.

In closing, we'd like to emphasize that our expertise isn't in trying to predict the intricacies of politics, vaccine development, the "reopening trade" or growth versus value cycles. We leave attempts at those predictions to others. For our part, we prefer to stay immersed in analyzing company fundamentals, activities we think actually give us an edge in the very competitive field of investments.

Thank you for the opportunity to manage your assets.

Sincerely,

JB Taylor, Paul Lambert and Mike Valentine

WASATCH GLOBAL INVESTORS

AVERAGE ANNUAL TOTAL RETURNS

FOR PERIODS ENDED SEPTEMBER 30, 2020

	Quarter*	1 Year	3 Years	5 Years	10 Years
Core Growth Fund—Investor	6.61%	17.41%	14.30%	14.43%	14.69%
Core Growth Fund—Institutional	6.65%	17.58%	14.46%	14.59%	14.80%
Russell 2000® Index**	4.93%	0.39%	1.77%	8.00%	9.85%
Russell 2000® Growth Index†	7.16%	15.71%	8.18%	11.42%	12.34%

A fund's performance for very short time periods may not be indicative of future performance.

**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 return 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—1.19% / Institutional Class—Gross: 1.09%, 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 1/31/2021.** 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 1/31/2012 is based on the performance of the Investor Class. Performance of the Fund's Institutional Class prior to 1/31/2012 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.

WASATCH GLOBAL INVESTORS

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

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

You cannot invest directly in these or any indexes.

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The Wasatch Core 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.

The "cloud" is the internet. Cloud-computing is a model for delivering information-technology services in which resources are retrieved from the internet through web-based tools and applications, rather than from a direct connection to a server.

An initial public offering (IPO) is a company's first sale of stock to the public.

The price-to-sales ratio is a stock's capitalization divided by the company's sales over the trailing 12 months. The value is the same whether the calculation is done for the whole company or on a per-share basis.

Return on capital is a measure of how effectively a company uses the money, owned or borrowed, that has been invested in its operations.

Sales growth is the increase in sales over a specified period of time, not necessarily one year.

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

CORE GROWTH FUND — TOP 10 HOLDINGS

AS OF JUNE 30, 2020

Security Name	Percent of Net Assets
Pool Corp.	3.3%
ICON plc (Ireland)	3.0%
Trex Co., Inc.	2.9%
Paylocity Holding Corp.	2.8%
Medpace Holdings, Inc.	2.5%
Monolithic Power Systems, Inc.	2.5%
Hamilton Lane, Inc., Class A	2.5%
Five9, Inc.	2.4%
Proofpoint, Inc.	2.4%
Avalara, Inc.	2.3%
Total	26.5%

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.