



Quarterly
Commentary

Investor
WAAEX / Institutional
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Wasatch Small Cap Growth Fund

DECEMBER 31, 2021

We Attempt to Determine if Stock Prices Appropriately Reflect Successes and Failures—and Whether Those Successes and Failures Are Transitory or Long-Lasting

OVERVIEW

During the fourth quarter, the benchmark Russell 2000® Growth Index rose 0.01% while the Russell 2000 Index increased 2.14%. Underperforming its benchmark, the Wasatch Small Cap Growth Fund—Investor Class slipped -1.42%. For the one-year period ended December 31, 2021, the Fund's Investor Class gained 8.32% compared to the 2.83% increase in the Russell 2000 Growth Index and the 14.82% rise in the Russell 2000 Index.

One factor that affected stock returns during the quarter was the announcement of revenues and earnings. Whenever a company makes an announcement, the stock price is likely to react. But prices were particularly sensitive in the fourth quarter as investors tended to assume that conditions recently announced would be likely to continue into 2022.

FUND MANAGERS



JB Taylor
Lead Portfolio Manager

8 / 25
YEARS ON FUND / YEARS AT WASATCH



Ken Korngiebel, CFA
Portfolio Manager

4 / 6
YEARS ON FUND / YEARS AT WASATCH



Ryan Snow
Portfolio Manager

4 / 21
YEARS ON FUND / 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 1.16% / Institutional Class—Gross: 1.08%, 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 1/31/2022.*



Other factors that affected stock returns were the emergence of Covid-19's Omicron variant, U.S. inflation at a 39-year high and the Federal Reserve's imminent tapering of monetary stimulus.

Sectors that performed the best during the quarter included industrials, information technology (IT), financials, real estate and consumer staples. The hardest-hit sectors during the quarter included health care, communication services and energy. The Fund benefited relative to its benchmark primarily from favorable stock selections in health care. Stock selections in financials, IT, consumer staples, industrials and communication services were disadvantageous overall.

We're very pleased with the Fund's performance over the past several years. This performance was fueled to a large extent by our fastest-growing companies. During the fourth quarter, we did see the stocks of some of these companies pull back due to valuation, supply-chain and pandemic-related issues. But our research indicates that most of these companies have been improving their competitive positions and are likely to come out of a challenging period as even more powerful market leaders.

A LESSON FROM WASATCH FOUNDER, SAM STEWART

In our most recent firmwide commentary, our *Market Scout*, we mourn the loss of Wasatch founder, Dr. Sam Stewart. While Sam hadn't been with the firm since 2018, he developed the foundation for the research process we still use today, and he personally trained many of us. In our *Market Scout*, we contemplate all he taught us and ask, "What would Sam say about the current environment?" We believe Sam would advise investors that they should pause to contemplate not what seems important today but what will likely be important over the next five to 10 years. He would suggest that investors should focus on companies with superior long-term business models and

significant cash on hand. While such companies may face difficulties during a potential economic downturn, they'll likely gain market share from weaker competitors and emerge from a downturn as even more dominant in their industries.

An example of a company with what we consider a superior long-term business model is **Floor & Decor Holdings, Inc. (FND)**—which is a manufacturer and distributor of tile, wood, laminate and natural-stone flooring as well as related decorations and accessories. Because we believe the company has the potential to open a significant number of new stores and achieve double-digit sales and earnings growth for years on end, we expect Floor & Decor to be a long-term holding. Although the stock can be volatile, we believe the down periods could be great buying opportunities. While investors may fret from time to time over how inflation, interest rates and economic cycles will affect demand for home upgrades, we think Floor & Decor will remain focused on service improvements. And these improvements should turn out to be much more important than periodic macro trends.

Our general view regarding such trends is that if they're truly important, they'll show up in our company-specific fundamental analysis. So while other investors ponder index performance and trends like "growth" versus "value" cycles, we'll stay focused on business-model quality—which tends to influence the long-term power of sales, earnings and cash flows.

DETAILS OF THE QUARTER

The top contributor to Fund performance for the fourth quarter was **Boot Barn Holdings, Inc. (BOOT)**—a specialty retailer offering increasingly popular Western and work-related apparel, footwear and accessories. Boots are somewhat resistant to online competition because they often require specialized fitting. The company has benefited from its economies of scale and multi-

channel business model, which have kept revenues flowing during virus-related shutdowns. Stimulus payments by the federal government to consumers have helped as well. Boot Barn's private-label brands, built around well-known personalities in the music business, have enabled the company to convert higher portions of its revenues into bottom-line profits. For most of the period since March 2020, Boot Barn's stock rallied on these positive conditions—and this rally continued in the fourth quarter. We consider Boot Barn's management to be excellent, and we've continually added to our position on periodic price weakness within the context of an overall upward trajectory in the stock.

Intra-Cellular Therapies, Inc. (ITCI) was also a large contributor. The company develops therapeutics for disorders of the central nervous system. Intra-Cellular's stock price jumped in December after the Food and Drug Administration (FDA) approved the company's anti-psychotic drug, Caplyta, for the treatment of depressive episodes associated with bipolar I or II disorder in adults. Previously approved for the treatment of schizophrenia, the drug's appeal for treating bipolar depression is significantly enhanced by its favorable safety and tolerability profile. The FDA's action now sets the stage for Caplyta's possible authorization to treat autism spectrum disorder, certain neurologically based sleep disorders and potentially major depressive disorder as well.

Another significant contributor was **Medpace Holdings, Inc. (MEDP)**—which provides life-sciences services including management and monitoring of clinical trials, regulatory submissions, quality assurance and other services designed to increase the efficiency of organizations' research processes. In its most recent financial announcement, the company reported significant growth in net revenues and a substantial increase in net new business wins compared to the same period a year ago. This was especially welcome news because

Medpace had previously incurred losses as the company laid the groundwork for future success. We believe Medpace should continue to benefit from its role as a facilitator of fundamental research functions. In addition to the company's strong management, we like the fact that Medpace serves small biotechnology companies and gives us some exposure to the biotech industry without the often "all or nothing" nature of the industry.

The greatest detractor from Fund performance for the fourth quarter was **Freshpet, Inc. (FRPT)**. The company is the undisputed leader in refrigerated pet food, which we consider a "growth staple." People seem willing to prioritize the health of their pets under almost any circumstances. Having said that, the stock was down because the company lowered projections for sales and earnings due to rising costs and shortages of labor and materials. Supply-chain challenges have also disrupted Freshpet's ability to expand manufacturing capacity and get food into stores. Marketing activities have been curtailed because the company is having trouble meeting existing demand. We take some comfort in the fact that Freshpet's difficulties are supply-related rather than demand-related. Over time, we believe that supply-chain challenges will be resolved and that Freshpet will resume its growth trajectory. In terms of competition, there are some smaller players that are trying to challenge Freshpet's dominant brand name and footprint in stores. But we think those smaller players are even more vulnerable to today's supply-chain challenges. In fact, the current difficult environment may actually strengthen Freshpet's competitive position and help make the company even more dominant over time. Additionally, we think Freshpet's pricing power and margins will improve substantially as the company becomes larger.

Another significant detractor was **Open Lending Corp. (LPRO)**—which provides loan



analytics, risk-based pricing and automated decision technology for lenders who serve car buyers. Although Open Lending is classified as a financial company, it incurs no credit risk. Instead, Open Lending offers a fee-based platform that enables lenders to assess the creditworthiness of car buyers more accurately. While third-quarter earnings results were strong, management lowered fourth-quarter loan origination guidance due to extremely low inventory levels on dealer lots resulting from supply-chain issues and production slowdowns at auto manufacturers. Also, price increases have been especially tough on car buyers with below-prime credit. While these challenges could persist into 2022, we continue to like the fact that Open Lending has a strong business model and continues to grow its partner network, which should be beneficial as inventory levels normalize. We remain excited about Open Lending's long-run growth opportunity.

HealthEquity, Inc. (HQY) was also a large detractor. The company is a health-savings account (HSA) custodian that provides technology-enabled service platforms, which allow members to make health-care saving and spending decisions. Members have online access to their tax-advantaged health-savings accounts and can compare treatment options, pay medical bills, earn wellness incentives, and receive personalized benefit and clinical information. HealthEquity now oversees almost six million HSAs and continues to grow—including through its April acquisition of Further, a leading HSA provider with about \$1.7 billion in assets under custody. We think HealthEquity's stock was down primarily because new hiring has been slow and because doctor visits and non-urgent medical procedures have been curtailed during the Covid-19 pandemic. Moreover, the company made an ill-timed acquisition of WageWorks—which is a leading facilitator of employer-sponsored commuter benefits. Like discretionary spending on health care, spending on

work-related commuting has been down significantly during the pandemic. Over time, HealthEquity should see some improvement in financial results due to rising interest rates but this improvement will be very gradual. *(Current and future holdings are subject to risk.)*

OUTLOOK AND POSITIONING

As we begin 2022, we expect to see a tug-of-war between positive forces on one side and negative forces on the other. Positives include strong demand, better wages, customers with cash on hand and companies with increasingly efficient operations. Negatives include somewhat lofty stock valuations, supply-chain challenges, rising inflation and the Omicron variant of Covid-19. Regarding interest rates, history suggests that somewhat higher rates won't necessarily hurt companies and their stock prices.

Partially depending on how the tug-of-war plays out, the market may favor companies that are especially exposed to greater economic reopening or, alternatively, companies that are positioned to thrive regardless of robustness in the economy. As we've communicated repeatedly, we own a balance of both types of companies.

In general, we seek high-quality businesses with unique products and services, market leadership, pricing power, significant margins and operations that aren't overly capital-intensive. Such businesses are typically better able to manage supply chains and cope with rising costs of labor and materials. Moreover, these businesses are usually less vulnerable to a revenue disruption because they tend to have healthy balance sheets with relatively low debt levels. We believe our investments give us a good level of diversification in businesses with varying exposure to Covid-related lockdowns and reopenings.

Going forward, as our companies are tested by market forces, we'll attempt to determine if stock



prices appropriately reflect successes and failures—and whether those successes and failures are transitory or long-lasting. In turn, we'll adjust the portfolio as conditions unfold—rather than attempt to forecast macro events, which we see as more useful in writing newspaper headlines than in making investment decisions. One of the ways we evaluate companies is by studying new-unit productivity. For example, if a company opens a new store, we like to see that store—within a reasonable period of time—generate similar or better sales and earnings compared to existing stores.

Regarding supply chains in particular, we've heard that even with a busy holiday season, transportation delays and backlogs at U.S. ports have been easing to some extent. While this is good news for the overall economy, challenges in the current environment are especially unique from one company to the next. As for our holdings,

we think we're reasonably well-positioned—in areas like industrials, retailers and financials—if businesses surprise investors to the upside. Alternatively, if conditions deteriorate for a period of time, we expect to benefit on a relative basis from our holdings in secular growers like non-capital-intensive IT companies involved in the digital transformation of societies around the world.

As always, we'll pay strict attention to income-statement metrics while we try to capture double-digit earnings growth at rational prices. This was a key tenet from Sam Stewart. And if we stay focused on our investment principles, we believe stock performance will take care of itself.

Thank you for the opportunity to manage your assets.

Sincerely,

JB Taylor, Ken Korngiebel and Ryan Snow



AVERAGE ANNUAL TOTAL RETURNS

FOR PERIODS ENDED DECEMBER 31, 2021

	Quarter*	1 Year	3 Years	5 Years	10 Years
Small Cap Growth Fund—Investor	-1.42%	8.32%	32.86%	24.19%	17.10%
Small Cap Growth Fund—Institutional	-1.42%	8.40%	32.99%	24.34%	17.19%
Russell 2000® Growth Index**	0.01%	2.83%	21.17%	14.53%	14.14%
Russell 2000® Index†	2.14%	14.82%	20.02%	12.02%	13.23%

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 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—1.16% / Institutional Class—Gross: 1.08%, 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 1/31/2022.** 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 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.

You cannot invest directly in these indexes.

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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.

Diversification does not eliminate the risk of experiencing investment losses.

Earnings growth is a measure of growth in a company's net income over a specific period, often one year.

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.

SMALL CAP GROWTH FUND — TOP 10 HOLDINGS

AS OF SEPTEMBER 30, 2021

Security Name	Percent of Net Assets
Kornit Digital Ltd.	4.9%
Medpace Holdings, Inc.	3.3%
Monolithic Power Systems, Inc.	3.2%
Rapid7, Inc.	3.1%
StepStone Group, Inc., Class A	3.1%
CyberArk Software Ltd.	3.0%
Floor & Decor Holdings, Inc., Class A	3.0%
Freshpet, Inc.	2.7%
Pinnacle Financial Partners, Inc.	2.7%
Globant SA	2.6%
Total	31.6%
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.	