Views From a Value Manager In a Growth Shop

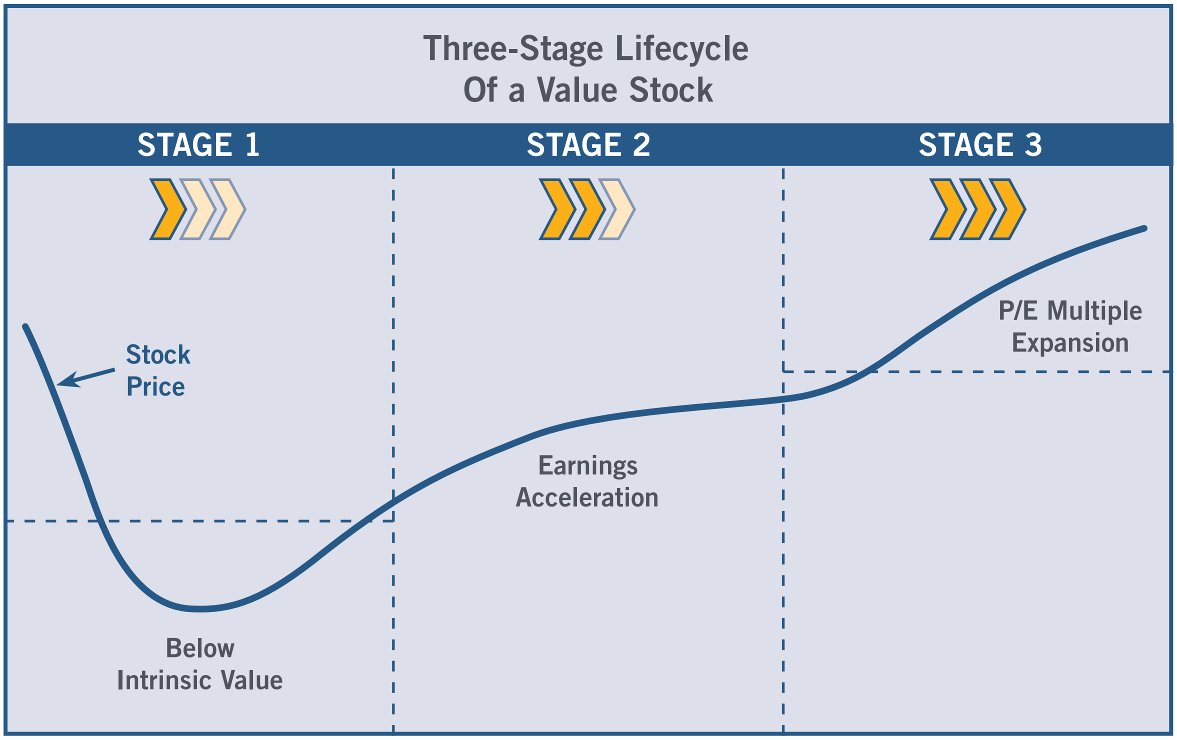
What's it like being a value manager in a growth shop? For Jim Larkins, the Lead Portfolio Manager of the **Wasatch Small Cap Value Fund (WMCVX)**, it's a very natural fit. Indeed, he says the strong growth-oriented research capabilities Wasatch has developed since the firm's founding in 1975 provide him with significant advantages over many other value managers. The small-cap research team at Wasatch seeks to identify the highest-quality growth companies throughout the U.S. Jim is a member of that team. So when stock prices falter due to the volatility inherent in small companies, he's prepared to purchase these same companies as value stocks, often ahead of other portfolio managers. "There's an inefficiency that exists when a growth stock becomes a value stock, and I try to exploit this inefficiency," says Jim.

Jim has been involved with the Wasatch Small Cap Value strategy since before its formal launch as a mutual fund in 1997, having joined the pre-launch investment-management team as a Research Analyst. He became a Portfolio Manager in 1999 and is now the longest-tenured fund manager at Wasatch. As of December 31, 2017, the Wasatch Small Cap Value Fund had more than $394 million in assets invested in about 50 securities. The Fund's edge over much of its competition, says Jim, is its reliance on an investment-research team that's primarily focused on high-quality growth stocks.

LIFECYCLE OF AN INVESTMENT

Jim seeks to exploit this competitive edge throughout what he sees as a three-stage lifecycle of a value stock. In the first stage, he seeks to buy a company at a price below its intrinsic value, which he considers to be its earnings potential. For a company that has experienced a temporary setback, the earnings potential might be defined by the level prior to the setback. In the second and third stages, he seeks to take advantage of earnings acceleration followed by price-to-earnings (P/E) multiple expansion.

Before purchasing a company, Jim looks for metrics that indicate whether the stock is inexpensive relative to where it has been historically. Although potential future earnings are very important, small-cap value companies that have stumbled often have low current earnings. So the current P/E ratio may not be meaningful. Therefore, Jim also looks at the price-to-book value and the EV (enterprise value)-to-sales ratios, which he considers to be more stable measures of worth — with smaller gyrations than those seen in earnings. While earnings can be volatile, book value doesn't usually change rapidly. If a company is selling below a five-year average price-to-book value or EV-to-sales ratio, then Jim might consider the market price to be below the company's intrinsic value. Moreover, since the EV-to-sales ratio takes into account the company's debt load, this ratio is also very helpful because it



Source: Wasatch Advisors. This is a hypothetical representation of the three-stage lifecycle of a value stock. To value investors, a stock's intrinsic value is what is believed to be its "actual" value, based on examination of the company's fundamentals. There is no guarantee that a value stock's price will increase.

provides a window into the company's balance sheet *and* income statement.

When looking at a potential new company, Jim considers whether or not other investors will find it attractive in the future. That's why he considers earnings power and the company's income statement. If the company recovers and earnings return, growth investors probably won't be far behind, pushing the stock price up. In many cases, Jim looks at companies that have been through the complete Wasatch investment process, including initial research, company visits and purchase of the stock in the Wasatch growth portfolios. If a company falls out of favor because it appears that growth prospects are diminished, the stock may drop into value territory and become an attractive candidate for Jim, as long as he sees the possibility that growth will resume within one to two years.

Jim takes full advantage of the investment experience and proprietary research at Wasatch to identify value prospects. This enables him to buy in the first stage of the lifecycle, just after a company stumbles and many investors are running out the door. Other value managers, relying on routine quantitative screens, may not find these prospects until later in the cycle when the stock price has already begun to rise.

In the second stage of the value-stock lifecycle, earnings acceleration may not begin for several quarters after the initial investment. Jim finds it often takes that long before the fundamentals improve and show up on the income statement. He believes this inflection point of improving fundamentals is when there's the best risk/reward potential, and he tries to maximize the capital deployed. As earnings come back, the stock price usually advances.

In the third stage of the lifecycle, a value stock may begin to take on the characteristics of a growth stock, experiencing P/E multiple expansion. While many traditional value investors may exit their positions in the early part of the second stage, Jim prefers to hold his companies a bit longer, and potentially capture the full earnings acceleration and the upside as the stocks trade at premium P/E multiples. He credits the entire Wasatch investment team for helping him navigate this third stage.

"There are two things I do that most other value managers don't," says Jim. "One is that I buy broken growth names earlier than others, due to Wasatch's institutional knowledge of many high-quality small-cap stocks. The second is that I'm willing to own the companies longer than other value managers. If I'm right, I'll capture all three stages of performance in the lifecycle. For shareholders, it's incredibly rewarding to buy a stock that's undervalued, capture the earnings acceleration, and then sell at a premium P/E multiple. I'm not this savvy every time, but the challenge to capture all three stages for shareholders is what really energizes me."

Jim places each of the Small Cap Value Fund's holdings in one of three categories: *Fallen Angels, Undiscovered Gems* and *Quality Value Companies*.

FALLEN ANGELS

Usually making up a sizable category for new investments, Fallen Angels consist of companies that are generally being purchased below intrinsic value. Typically these are former growth companies that have stumbled — companies that have hit a bump in the road, but are not at the end of the road. These companies have often suffered a sharp stock-price decline that Jim believes to be an overreaction by the market to a negative company event.

Using a process he characterizes as *income-statement oriented*, Jim looks at potential earnings growth as the catalyst that will eventually lead to a recovery. Analyzing the company's income statement, he can determine what the company's earnings have been historically and whether he thinks the company can restore those earnings in a reasonable period of time, and then go on to grow to higher levels.

One example of a Fallen Angel is Monro, Inc., an acquisitive, vertically integrated operator of auto-repair shops that service tires, wheels, brakes, suspensions, drivetrains, and exhaust and steering systems. Having invested in the stock three different times over the last two decades, Jim knows the company well and is a fan of its accretive growth model of acquiring local mom-and-pop repair businesses that are already generating solid revenue. Monro then improves the acquired businesses' bottom line by stocking them with proprietary low-cost, high-quality parts sourced from Asia. Because in many cases Monro acquires businesses in geographies where it's already operating, the incremental cost of adding a new outlet in terms of advertising spending and regional management overhead is minimal.

The market punished Monro's share price—along with those of many of its peers in the auto-service industry—during the past few years because of reverberations from the global financial crisis (GFC). Jim explains that cars tend to start experiencing additional breakdowns around the time of their sixth birthday. There was a significant dropoff in new-car sales during the 2009 - 2010 period right after the GFC, which in turn had a measurable negative effect on repair businesses like Monro roughly six years later. But auto sales came roaring back in the years after 2010. And, predictably, cars of the 2011 - 2013 vintages are now beginning to experience systems failures. As a result, Jim says, what had been a cyclical headwind for Monro should become a tailwind that adds 1% to 2% of same-store sales growth in the next few years. That could be especially important in the near term, Jim notes, because there may well be a temporary pause in Monro's main growth driver—repair-shop acquisitions—as would-be sellers wait to see what impact the recent tax-reform package will have on them.

A second factor that had weighed down Monro's share price was a shakeup in management, with the appointment of a new CEO and the elevation of a sitting board member to chairman. Although Jim had been a supporter of the outgoing leadership, he did meet with the new CEO, Brett Ponton, and was impressed by Mr. Ponton's industry expertise and focus on upgrading Monro's technology platform.

In addition to bringing efficiencies to the existing business, Jim says that tech-focused leadership can position Monro as a preferred partner for Amazon.com, which is coming on strong in the tire market. Monro is already an approved installer for Tire Rack, which sells tires to consumers online and then ships them directly to repair shops for installation. While Monro might prefer to sell its own inventory of tires, such arrangements with Tire Rack and potentially Amazon mean even more on-site customers to whom additional services can be sold.

UNDISCOVERED GEMS

Undiscovered Gems currently make up the Wasatch Small Cap Value Fund's largest category, which includes companies with low valuations due to lack of coverage and interest by analysts and investors. These companies are typically what Jim believes to be good growth companies that have been ignored by the market for any number of reasons. Perhaps the companies are too small for analysts and investors to take note. Or the companies may have come through long recoveries during which the earnings have improved, but not the stock prices.

A good example of an Undiscovered Gem is Ebix, Inc. The company operates specialized and highly profitable data exchanges, primarily for the insurance industry. Recently, Ebix has also branched out with a more consumer-focused initiative to provide payment solutions for the marketplace in India. The Small Cap Value Fund has held the stock since mid-2013.

Jim describes the company's software as a toll road—or more properly a network of toll roads—connecting multiple insurance brokers with multiple carriers. While revenue growth in the business is modest, margins are generous and "moated"—in other words, well-protected by the inherent complexity of the network. Ebix has demonstrated a careful growth strategy and the discipline to walk away from the negotiating table if a deal is too rich. When Ebix does make acquisitions, they tend to be on the smaller side. Moreover, Jim says the company does a good job integrating its acquisitions by leveraging its team in India to upgrade newly acquired firms' technology and reduce their costs.

Although Jim says he'd be happy to own Ebix for its core business alone, the company's presence in India accounts for what he considers the embedded optionality in the stock—its nascent consumer payment-processing business. "Ebix may have something that's really special there," he says. While payment-processing giants such as PayPal and Paytm are also circling the subcontinent's massive consumer market, he explains that Ebix is quietly building out its network by inking deals with small retail-level payment-service providers and with brick-and-mortar shops. So why hasn't Wall Street caught on to the stock yet? Because, Jim explains, the company historically hasn't had much use for investment bankers. Ebix tends to make small acquisitions on its own, without advisors, and doesn't need to tap the equity markets to raise cash. In fact, the company has been buying back its shares—and it remains, at least for now, an Undiscovered Gem in the Small Cap Value Fund.

Together, Fallen Angels and Undiscovered Gems usually account for about 70% to 80% of the Small Cap Value Fund's holdings.

Wasatch Small Cap Value Fund
Top 10 Holdings
As of December 31, 2017

Holding	Sector	% of Net Assets
Altra Industrial Motion Corp.	Industrials	3.3%
Monro, Inc.	Consumer Discretionary	3.3%
Euronet Worldwide, Inc.	Information Technology	3.2%
WESCO International, Inc.	Industrials	3.1%
Knight-Swift Transportation Holdings, Inc.	Industrials	2.8%
Ebix, Inc.	Information Technology	2.7%
Arbor Realty Trust, Inc.	Financials	2.7%
Sleep Number Corp.	Consumer Discretionary	2.7%
Prosperity Bancshares, Inc.	Financials	2.6%
First of Long Island Corp. (The)	Financials	2.6%
	Total	**28.9%**

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.

QUALITY VALUE COMPANIES

Quality Value Companies, which are Jim's version of "traditional" value names, generally comprise the remaining 20% to 30% of the Fund's holdings. These companies usually have been through a sustained turnaround, are experiencing modest growth, or have exposure to deep cyclical or commodity swings. As with Fallen Angels and Undiscovered Gems, Quality Value Companies must have (1) a strong balance sheet or (2) a robust business model. Jim is adamant that companies must possess at least one of these two characteristics. He tries to avoid companies that have both balance-sheet and business-model stresses. Quality Value Companies must, he says, have some redeeming characteristics in these areas.

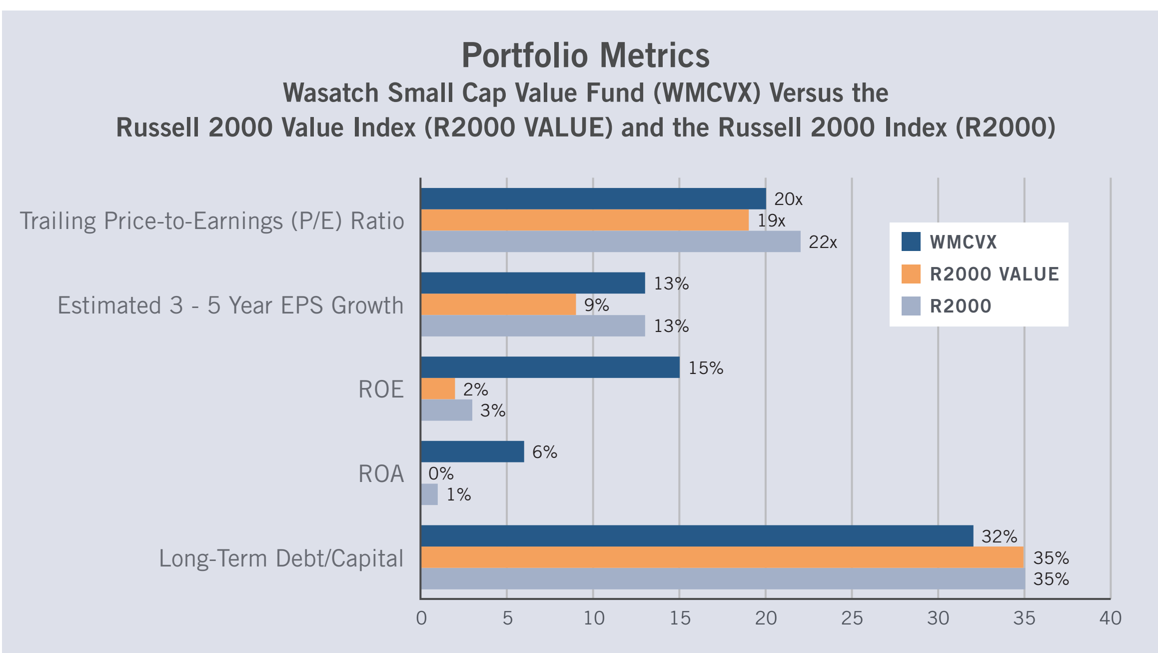
An important feature of the stocks in the Fund's Quality Value category is the extent to which they can add stability to the portfolio, acting as ballast to the Fallen Angels, which tend to be more volatile. Summit Hotel Properties is a great example of a Quality Value stock. Summit is a publicly traded, dividend-paying real estate investment trust (REIT) that owns, develops and operates hotels in the select-service class (think Courtyard by Marriott and Hyatt Place®, of which Summit owns and operates more than a dozen of each). These properties generally lack full-service restaurants and banquet facilities that require big, often unionized staffs. Summit favors "beltway" locations on the outskirts of large cities, but near the campuses of sizable companies that attract business travelers.

The hotel industry is highly competitive, and the healthy economy has resulted in a crowded pipeline of new accommodations becoming available. But to date, much of the focus has been on full-service hotels in the center of big cities, not the outer beltways where Summit prefers to operate. Moreover, Jim says, Summit has a secret weapon: "One of the most exceptional management teams I know." The team's typical pattern is to look for properties it can upgrade—and in some cases, rebrand. When Summit believes it has optimized revenues, it has also demonstrated a readiness to then sell properties at significant premiums to what it paid.

Summit is currently yielding an annual dividend of about 4.4%. Jim considers that a healthy return in its own right for the Quality Value category. But he believes that the REIT's strong management team could lead to dividend compounding over time and that valuation multiples could expand as well when the market discovers this underfollowed stock.

Of the three categories, according to Jim, Undiscovered Gems generally comprise the core, the one that typically generates the best performance. In many cases, Fallen Angels "graduate" to the Undiscovered Gems category if they've been held in the Fund for a year or two and have recovered. Regardless of where they start out, Undiscovered Gems usually experience the most improvement in fundamentals, earnings growth and, eventually, P/E multiple expansion.

Performance aside, Jim generally considers Fallen Angels and Undiscovered Gems to comprise a single large category, and he tries to maintain the combination at 70% to 80% of the Small Cap Value Fund's entire portfolio. If that percentage trends down toward 70%, he views it as a sign that the economy is entering into a more mature phase. Fallen Angels and Undiscovered Gems are the companies that Wasatch's growth managers are most



Sources: FactSet, Russell and Wasatch Advisors, as of December 31, 2017. Past performance is not indicative of future results. Portfolio metrics are subject to change.

likely to find attractive at some point in the companies' lifecycles. These are companies that have the most in common with other Wasatch portfolios, although the timing of purchases and sales may be quite different.

Regardless of the phase of economic development, Jim views the volatility inherent in small-cap investing as a "perpetual-motion machine" with good companies continually stumbling and falling into one of his three categories.

DEVELOPMENT OF THE PHILOSOPHY AND PROCESS

The investment philosophy and process of the Wasatch Small Cap Value Fund grew out of a challenge inherent in growth-stock investing. The Wasatch growth managers have a captured-earnings philosophy, meaning that they are typically trying to capture 15% or better earnings growth at most times in the companies' lifecycles. Particularly with small companies, which are inherently volatile, this quest for consistent growth can sometimes be elusive. Small companies are often younger. They could have less stable revenue bases, and their product lines might be narrower. All of these characteristics set small companies up for periods in which earnings will be volatile.

For a growth portfolio manager trying to maintain a high overall earnings-growth rate, it can be a problem when a company stumbles. If the portfolio holds too many companies with declining earnings, the portfolio won't meet its growth target. A value portfolio, however, might be the ideal place for some of the companies that no longer meet the qualifications for a growth portfolio. In 1997, the Wasatch team decided to exploit this opportunity in the market and create the firm's first value fund.

Of his own involvement in the Small Cap Value Fund's launch, Jim says, "Honestly, Wasatch had been having a hard time fitting me into a growth team. I was more attracted to contrarian ideas." At the time, Jim had been researching a semiconductor company, which was owned in several Wasatch portfolios. One day in early 1997, he recalls, the company had a big blowup. But rather than dump the stock, a longtime Wasatch portfolio manager bought more. "And I thought, yes, that's how you're supposed to respond," says Jim, who adds that the stock eventually went on to rise by many times the manager's purchase price. Later in 1997, Jim was tapped to work on the new Wasatch Small Cap Value Fund as a Research Analyst. He became a Portfolio Manager two years later, worked with co-managers for several years, and became the sole Portfolio Manager in 2008.

The Fund was created so Wasatch could own companies with attractive long-run growth stories that had temporary earnings issues. These were companies that might not fit in Wasatch's growth portfolios. In addition, Jim found there were companies whose stocks were unjustly oversold because momentum investors were fleeing. In hot growth areas, it isn't unusual to see momentum investors pile in, push stock prices up, and then rapidly head for the exit on a small or short-term disappointment. Indeed, Jim notes that momentum investors fled many high-tech small caps during the second quarter of 2014. While the large-company indexes were relatively stable, the small-cap indexes with significant technology weightings suffered sharp pullbacks.

"My Wasatch colleagues and I have been researching small-cap growth companies for decades," Jim says. "We've already done the work. We've even visited many of them, or had their management teams in our office. But most value managers probably haven't found these companies yet. The companies haven't hit the quantitative value screens. And the value managers haven't been doing the work to understand these companies. So I believe I have an informational edge versus the traditional value managers."

A notable stock in the Fund that falls somewhere between the Fallen Angels and Undiscovered Gems categories is Sleep Number Corp. (formerly known as Select Comfort). The company sells its brand of adjustable, air-filled mattresses through its own stores as well as online. While Jim is wary of retailers operating in crowded markets, he says Sleep Number represents the rare retailer that offers a differentiated product and employs a skilled salesforce that's trained to explain the benefits of a unique product.

While a standard foam mattress is "bought"—a consumer who needs a new mattress visits a store, lies down on a few and makes a choice—Jim explains that a Sleep Number mattress, which is air-filled and adjustable, must be "sold." The combination of a unique product and a specialized salesforce, as well as proprietary technologies such as its trademarked SleepIQ® system that provides feedback to users on how well they slept, represents another moat protecting Sleep Number in a crowded field.

Jim says the company is especially well-positioned to take advantage of the wellness trend and the growing recognition by millennials—who've shown an appetite to spend money on innovative technologies—that sleep is an important aspect of health. He adds that the company is well-managed: It's rolling out a brand-new mattress model and has done a good job of managing its real estate by reducing the number of locations inside dying shopping malls.

With the exception of late 2015 to 2016, when value-oriented stocks staged a modest comeback, growth-oriented stocks have been on a relative tear in the decade following the global financial crisis. Indeed, says Jim, he's benefited from managing a "growthier" value portfolio that—relative to his value peers—has participated more in growth stocks' outperformance. But with the growth rally getting somewhat long-in-the-tooth, he's been focusing more attention on traditional value ideas—including names among industrials and financials. He's also coming back to one industry that's more central to Wasatch's discipline—retail. He was attracted to women's clothing retailer J.Jill, Inc.

As with all pure value stocks, managing downside risk is critical and, in a sense, Jim likes J.Jill for what it's not—an overvalued clothier slugging it out in the cut-throat young women's market, where too much leverage or a flawed business model can quickly turn stocks into classic "value traps." J.Jill, on the other hand, targets more mature women with clothes that include business and casual attire. The retailer has a relatively modest real-estate footprint, or is "understored" as Jim puts it, a factor that is critical given declining foot traffic in many malls. Conversely, J.Jill has a highly developed online business and a successful direct-marketing program that leverages its "right size" store base.

Nonetheless, Jim says he'll be looking for any signs of trouble—trimming positions that run up and selling quickly if the competitive dynamics shift, leverage ratios climb, the next value rally turns out to be limited to a different sector, or if he simply concludes that the catalyst he was expecting when he bought the stock isn't materializing. As the bull market extends its run into historic territory, that discipline applies to the entire portfolio, not just to J.Jill. "I'm faster to sell than I've been in the past," Jim says. "If it turns out I'm wrong, I want to be wrong quickly and move on."

BUY/SELL DISCIPLINE

When William Faulkner said, "In writing, you must kill all your darlings," he might as well have been talking about portfolio management, where studies have shown that investors—even professionals—tend to hold a losing stock for too long as they look for validation of their decision to buy the stock in the first place.

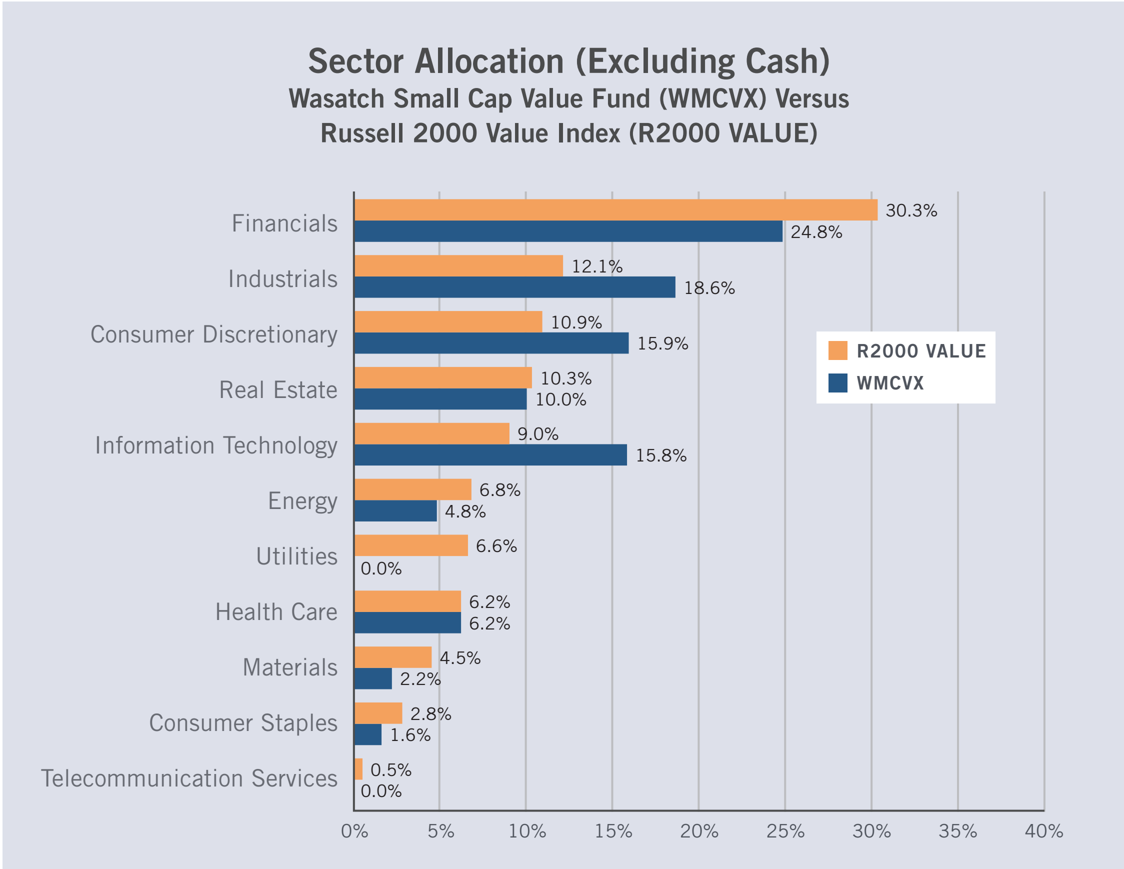
Jim spends a lot of time focusing on his sell discipline, which was shaped by reading about the research of Andrea Frazzini. "That research gave me intellectual permission to sell when I'm wrong," Jim explains. To understand the case for "growthy" value investing, consider the example of an investor who says to himself that if a stock goes up and he thus owns a larger position at a worse price, then surely if the stock goes down he should like it even more at a better price. "That's not always the case in value investing," Jim says, explaining that smart investors should always try to be wrong quickly, recognizing when their original thesis is no longer valid. Conversely, when buying a stock, it's not always necessary to call the bottom. Jim says a stock that's already fundamentally improving can often provide a better risk-adjusted return because there's evidence of success: "While you might originally have had hope or a story, later—even at a higher price—you may have a proven thesis in play that the overall market might not fully appreciate for several months, or perhaps longer."

Another point of differentiation the Wasatch Small Cap Value Fund has versus its peers is that the Fund appears to have more growth-like characteristics. The first reason is that many of the companies in the Fund were growth stocks historically. But the Fund had the opportunity to buy them at value prices. Second, because the Fund tends to hold its positions longer than other value portfolios, a company often will have retaken its growth characteristics by the time the Fund exits the position. And third, the Fund generally seeks higher-quality stocks with better balance sheets and business models than those held in many other value portfolios. These three factors combined give the Wasatch Small Cap Value Fund a somewhat "growthier" feel than its competitors. But the quality orientation of the Fund's investments appears to have helped temper the downside volatility that the broader market has periodically experienced over the past several years.

SECTOR AND INDUSTRY WEIGHTINGS

The Fund is often overweighted in industrials such as distribution and transportation companies, where Jim has identified management teams that can execute well in competitive industries. Health care is another sector in which the Fund typically has been overweighted, based on the proprietary research and investment experience of Wasatch overall. Many of the Fund's Fallen Angels are found in the business-services industry, which is also overweighted.

The Small Cap Value Fund usually has little or no exposure to utilities, which do not lend themselves to the Fallen Angel or Undiscovered Gem approach. Similarly, the Fund is underweighted in materials and heavily cyclical companies. Historically, the Fund also has been underweighted in financials, including banks. Financials comprise about 30% of the Russell 2000 Value Index, a



Sources: Wasatch Funds and FactSet, as of December 31, 2017. Current and future holdings are subject to risk and may change at any time.

reflection of the fragmented U.S. banking system, which includes an enormous number of small banks. Jim finds banking to be a very competitive industry with few barriers to entry and low overall growth. However, given the improving fundamentals for banks recently, he has uncovered some above-average banking companies at attractive prices. The Fund is about equally weighted versus the Index in the real-estate sector, where the Fund's holdings consist entirely of equity real estate investment trusts, including Summit Hotel Properties.

ON THE LOOKOUT FOR OPPORTUNITIES AND PITFALLS

One of the key questions confronting Jim as a value manager is how, when looking for attractive prospects among stocks that have stumbled, to avoid investing in companies that have declined because, in fact, they have truly poor prospects. To begin, Jim stresses that he seeks to buy stocks at historically low valuations. He generally feels comfortable buying a stock at a five-year low valuation based on price-to-book value or EV-to-sales ratios. Conversely, when those same ratios are at historical highs, he will consider selling. Additionally, as noted earlier, he avoids companies that have both balance-sheet and business-model stresses to overcome.

Another consideration that Jim takes into account is competition. If a company is confronted with exceptionally strong competition, what he calls "hyper-competition," he will avoid the company. When a stock is down because of hyper-competition, he says, that's something even the best management team may not be able to overcome. He cites for-profit education as an example of an industry that's much too competitive to be of interest. And although he owns some retailing companies, Jim is very cautious today versus five years ago when he generally would have been investing more aggressively in traditional retail companies. Because of the internet and the decline of mall traffic, he believes retailing has become a very difficult area for value investors.

When buying a new company with both quality and value characteristics, Jim typically starts with a 1% position and usually attempts to get to 2% as he sees fundamentals improve, hopefully before the price moves up. As the stock price appreciates, he may trim the position to keep it below a typical 3% to 5% maximum. When selling, he generally works the same process in reverse, scaling back to about 1% before exiting the position entirely.

As for being a value manager in a growth shop, Jim says it gives him the freedom to buy great high-quality growth companies when they're down and the freedom to own them long enough to more fully harvest the potential gains. "The type of portfolio I manage should have wide appeal," he says. "Many people want to own growth stocks, they just don't want to overpay for them. And that's what I try to offer."

ABOUT THE PORTFOLIO MANAGER

Jim Larkins
Lead Portfolio Manager

Jim Larkins has been the Lead Portfolio Manager for the Wasatch Small Cap Value Fund since 1999. He joined Wasatch Advisors as a Research Analyst in 1995, working on the Micro Cap and Small Cap Growth Funds. He became a Research Analyst on the Small Cap Value Fund at its inception in 1997, and was named as a Portfolio Manager in 1999.

Prior to joining Wasatch Advisors, Mr. Larkins worked as a systems consultant for what is now Accenture. He also worked for a start-up company in the technology industry.

Mr. Larkins graduated cum laude with a Bachelor of Arts in Economics from Brigham Young University. He later earned a Master of Business Administration from the Marriott School of Management at BYU. While in the Master's program, he served as president of the MBA Student Association.

Jim is a Utah native. He speaks Spanish and has lived in Argentina and the Middle East. He enjoys water skiing, snow skiing, gardening and traveling.

ABOUT WASATCH ADVISORS

Wasatch Advisors is the investment manager to Wasatch Funds,® a family of no-load mutual funds, as well as to separately managed institutional and individual portfolios. Wasatch Advisors pursues a disciplined approach to investing, focused on bottom-up, fundamental analysis to develop a deep understanding of the investment potential of individual companies. In making investment decisions, the portfolio managers employ a uniquely collaborative process to leverage the knowledge and skill of the entire Wasatch Advisors research team.

Wasatch Advisors is an employee-owned investment advisor founded in 1975 and headquartered in Salt Lake City, Utah. The firm had $16.6 billion in assets under management as of December 31, 2017. Wasatch Advisors, Inc. is registered with the Securities and Exchange Commission under the Investment Advisers Act of 1940.

RISKS AND DISCLOSURES

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. Investments in value stocks can perform differently from the market as a whole and from other types of stocks and can continue to be undervalued by the market for long periods of time. 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. There is no assurance that the investment process will consistently lead to successful investing.

An investor should consider investment objectives, risks, charges, and expenses carefully before investing. To obtain a prospectus, containing this and other information, visit www.WasatchFunds.com or call 800.551.1700. Please read it carefully before investing.

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. ***Past performance is no guarantee of future results, and there is no guarantee that the market forecasts discussed will be realized.***

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

Portfolio holdings are subject to change at any time. References to specific securities should not be construed as recommendations by the Funds or their Advisor. Current and future holdings are subject to risk.

ALPS Distributors, Inc. is not affiliated with Wasatch Advisors.

As of December 31, 2017, the percentage of net assets the Wasatch Small Cap Value Fund had invested in Monro, Inc. was 3.3%, Ebix, Inc. was 2.7%, Sleep Number Corp. was 2.7%, Summit Hotel Properties, Inc. was 2.1% and J.Jill, Inc. was 1.6%.

As of December 31, 2017, the Wasatch Small Cap Value Fund was not invested in Amazon.com, Inc., PayPal Holdings, Inc. or Paytm Mobile Solutions plc. Tire Rack, Inc. is a privately held company.

DEFINITIONS

A **bull market** *is defined as a prolonged period in which investment prices rise faster than their historical average. Bull markets can happen as the result of an economic recovery, an economic boom, or investor psychology.*

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

Earnings-per-share *or* **EPS** *is the portion of a company's profit allocated to each outstanding share of common stock. EPS growth rates help investors identify companies that are increasing or decreasing in profitability.*

Enterprise value (EV) *is a measure of a company's value calculated as market capitalization plus debt, minority interest and preferred shares, minus total cash and cash equivalents. The* **EV (enterprise value)-to-sales ratio** *is enterprise value, as defined above, divided by annual sales. Each ratio is a measure of a company's expensiveness.*

The financial crisis of 2007-08, also known as the **Global Financial Crisis (GFC)** *and 2008 financial crisis, is considered by many economists to have been the worst financial crisis since the Great Depression of the 1930s.*

Intrinsic value *or intrinsic worth is the actual value of a company or an asset based on an underlying perception of its true value including all aspects of the business, taking into account tangible and intangible factors. This value may or may not be the same as the current market value. Value investors use a variety of analytical techniques in order to estimate the intrinsic value of securities in hopes of finding investments where the true value of the investment exceeds its current market value.*

Long-term debt to capital *is a company's debt as a percentage of its total capital. Debt includes all short-term and long-term obligations. Total capital includes the company's debt and shareholders' equity, which includes common stock, preferred stock, minority interest and net debt.*

The **price-to-book value ratio** *is used to compare a company's book value to its current market price.*

The **price-to-earnings (P/E) multiple**, *also known as the P/E ratio, is the price of a stock divided by its earnings per share.*

Return on assets (ROA) *measures a company's profitability by showing how many dollars of earnings a company derives from each dollar of assets it controls.*

Return on equity (ROE) *measures a company's efficiency at generating profits from shareholders' equity.*

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

The **Russell 2000 Value Index** *measures the performance of Russell 2000 Index companies with lower price-to-book ratios and lower 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 3000 Index** *is an unmanaged total return index of the largest 3,000 U.S. companies based on total market capitalization. The Russell 2000 Index is widely used in the industry to measure the performance of small company stocks.*

You cannot invest directly in these or any indexes.

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