WASATCH FUNDS

Wasatch-Hoisington U.S. Treasury Fund (WHOSX)

Quarterly Comments from Lead Portfolio Manager Van Hoisington and Portfolio Managers V.R. Hoisington, Jr. and David Hoisington

Open to all investors

Average Annual Total Returns
For Periods Ended December 31, 2018

	Quarter*	1 Year	3 Years	5 Years	10 Years
U.S. Treasury Fund	4.16%	-3.84%	2.19%	6.57%	3.55%
Bloomberg Barclays US Aggregate Bond Index**	1.64%	0.01%	2.06%	2.52%	3.48%

**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 www.WasatchFunds.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: 0.72%**

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 1/31/2019.** See the prospectus for additional information regarding Fund expenses.

Wasatch Funds will deduct a 2.00% redemption proceeds 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.

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 www.WasatchFunds.com or call 800.551.1700. Please read the prospectus carefully before investing.

OVERVIEW

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

The Wasatch-Hoisington U.S. Treasury Fund, which is invested in long-dated U.S. Treasury securities (maturities longer than 20 years), gained 4.16% for the fourth quarter of 2018 and declined -3.84% for the 12 months ended December 31, 2018. The Bloomberg Barclays US Aggregate Bond Index had a return of 1.64% for the quarter and 0.01% for the 12-month period. Since the Fund's inception on December 6, 1986 through December 31, 2018, the average annual return for the Fund was 7.40%, which compared favorably to the 6.04% return of the Index.

The 30-year U.S. Treasury bond yield closed the end of the fourth quarter at 3.02%, down from 3.19% at the close of the prior quarter. The lower yield reflected slower inflation and real growth and had a greater impact on long-term Treasury yields than the ninth increase in the federal-funds rate since late 2016.

SIGNS OF MONETARY RESTRAINT

The fourth quarter marked the second anniversary of a major deceleration in the monetary and credit aggregates, which had peaked in October 2016. One year prior to that deceleration, a contraction in the monetary base and excess reserves commenced.

As a consequence of the contracting reserve and monetary aggregates, there has been a pronounced flattening in the U.S. Treasury yield curve and a retrenchment in world dollar liquidity. The Federal Reserve (Fed) has raised the federal-funds rate nine times (or about 2.25%) since December 2015, which contributed to the shrinkage in the key monetary indicators. It is now evident that the Fed's actions have spread through the financial sector into the broader economy as inflation wanes and the growth rate in interest-sensitive bellwether sectors such as housing, autos and capital spending is either slowing or declining.

PRICING POWER

One of the most consistently reliable indicators of the vibrancy of an economy is pricing power. If business conditions are robust, firms will take advantage of their good fortune and raise prices. Contrarily, if product demand is poor, or overproduction is evident, firms will pull the only lever in their command and that is to lower prices. Based on such diverse items as transportation, apparel and commodities, price weakness was widespread in the fourth quarter, suggesting final demand is weak relative to productive capacity. A fall in inflation is decidedly atypical if not unique for an economy nine-and-a-half years into expansion, suggesting that the economy entering 2019 is noticeably weaker than revealed in the robust coincident and lagging economic indicators.

In the fourth quarter, the gross domestic product (GDP) price deflator is estimated to have eased to the slowest rise since the second quarter of 2017, on par with the headline Consumer Price Index (CPI). For 2018, the CPI increased 1.9%, slower than the 2.1% rise in 2017. In the 12 months ending in November, the headline personal consumption expenditures (PCE) deflator rose less than the Fed's 2% inflation target. Measured by the annualized rate of change, the core PCE deflator has only been above the Fed's target for one month since March 2012. When firms cut prices, they will, at least temporarily, boost demand. But if monetary, fiscal, demographic, indebtedness, and foreign factors are not supportive, lower prices will not be a pathway to a buoyant economy.

The loss of pricing power evident late in 2018 takes on much greater significance since, historically, prices have been very sticky and largely unresponsive to swings in demand during aging expansions. This pattern is one of the reasons that inflation is a lagging indicator. A fall in inflation does not normally occur until the economy is in an actual recession, which was not the case in 2018. As such, the drop in inflation is a notable development that suggests final demand is weaker than volumetric measures imply.

ECONOMIC SECTORS

As 2018 ended, four high-multiplier sectors appear to have either passed their cyclical peaks or are rapidly approaching them. Exports, vehicle sales, and home sales exhibited characteristics of sectors in recession. Capital equipment and oil and gas drilling have also lost considerable momentum and, while remaining positive, their leading indicators are deteriorating.

Housing and Autos. Home and vehicle sales peaked over a year ago and have declined irregularly since then. New and existing home sales have fallen 23% and 7% from their recent peaks, respectively. Homebuilders have expressed concerns over the considerable weakness, while the layoffs announced by auto manufacturers are tacit confirmation of faltering sales.

International. Constant dollar exports peaked in May and have fallen sharply ever since. Strength in the dollar and poor business conditions for all the major foreign economies have resulted in a significant deterioration in the United States' current-account deficit despite numerous efforts by the Administration to achieve the opposite. The export outlook is not encouraging as global economic growth continues to slow. First, an important indicator of future conditions is money growth, an extensive problem outside the U.S. as we discuss shortly. Second, the productivity of debt around the world has been declining for more than a decade. This additional financial burden will reinforce monetary restraint. Third, growth in the volume of global trade, as measured by the highly regarded Netherlands Bureau of Economic Policy Analysis, eroded significantly after the first quarter of 2018, thereby diminishing international capital flows, which, in turn, further undermines global growth potential.

Capital Equipment. Prior to the fourth quarter, the trend in real producer-durable equipment expenditures was discouraging, with the 3.4% annual rate of increase in the third quarter well below those of 4.6%, 8.5% and 9.9% in the prior three quarters, respectively. Core capital goods orders fell in the three months ending in November and anecdotal evidence from diffusion indexes derived from business surveys indicates that new orders were much weaker in December than for many months prior. That such a considerable shift has occurred makes an important statement in view of the major corporate tax cut in 2018 and the ability of firms to repatriate overseas funds at low tax rates. These fiscal actions were widely anticipated to lead to a capital-spending boom, which has failed to materialize. The prospects for capital equipment spending are bleaker since much manufacturing output is directed to international markets where conditions eroded even further toward the end of 2018. Firms operating commodity businesses are likely to cut back in view of much lower selling prices of their products.

Oil- and gas-related companies are a large segment of capital expenditures. Oil prices in the fourth quarter registered one of the largest three-month declines on record, dropping well below the year's earlier levels, indicating that drilling is poised to move considerably lower. U.S. economic growth is now positively correlated with oil prices. Any boost in consumer spending resulting from a decline in oil prices is far outweighed by the loss in domestic, corporate and household income caused by the oil-price slump. This collinearity was not always the case, but the relationship has changed dramatically as domestic production of oil and related products has surged since 2010. Late in 2018, total supplied petroleum products (an approximation of the amount consumed) were 21 million barrels per day (mbpd), including oil and related products. Imports amounted to about 1.8 mbpd, meaning that domestic sources provided 89% of oil consumed domestically, which approximates the percentage of each dollar's worth of petroleum spending that went to domestic sources. As recently as mid-2010, this amount was 48% and in earlier periods, the domestic content of petroleum usage was even lower. Thus, while consumers may benefit from lower oil prices, the aggregate U.S. economy does not as gross domestic income falls.

CONSUMER

The January 1, 2018 tax reduction boosted consumer cash flows and continues to buoy real consumer spending which constitutes the largest subset (68%) of the economy. However, the personal saving rate (PSR) indicates this boost to the economy has been largely, if not entirely, exhausted. In the final two months of 2017, the PSR was 6.2%. Reflecting a $40 billion dollar drop in personal taxes, the PSR jumped to an average of 7.2% in the first two months of 2018 before ending at 6% in November, slightly less than before the tax cut. November's PSR was near the lowest levels since the expansion began in mid-2009 and was well below the 7% average of the more than nine-year span.

MONETARY RESTRAINT

Going forward, the economy will face past and continuing restraint of monetary actions. First, the flatter yield curve means that financial entities that borrow at short-term interest rates and lend at long-term interest rates will find their activities less profitable and will slow activity or increase risk premiums. Thus, credit will become more expensive or less readily available. Second, world dollar liquidity continues to decline. Third, the velocity of money, following a mild advance over the previous four quarters, fell in the fourth quarter, possibly restarting its multi-year downtrend. Fourth, monetary restraint in the form of Fed balance sheet reduction will tighten financial conditions.

QUANTITATIVE TIGHTENING (QT3)

By the end of January 2019, the Fed balance sheet and excess reserves of the depository institutions will decline another $50 billion as a result of QT3 with similar reductions scheduled for each of the remaining 11 months of the year. Excess reserves dropped from a peak of $2.7 trillion to a recent level of $1.5 trillion. Since balance sheet normalization cut excess reserves by $400 billion dollars, the remaining $800 billion dollar decrease in excess reserves may be attributable directly and indirectly to the increases in the Fed's policy interest rate. If QT3 is sustained, by the end of this year, excess reserves will fall to $0.9 trillion, assuming that technical factors are neutralized.

Two equations show the far reach of the changes in the Fed's balance sheet. First, M2 = MB (monetary base) x m (the money multiplier). This equation shows MB is not money but potential or high-powered money. MB is not money since money must be able to serve as a medium of exchange, unit of account and store of value, whereas MB only satisfies the unit of account requirement. Second, world dollar liquidity = MB + Foreign

Official Holdings of U.S. Treasury Securities. Equation #2 holds, reflecting the Fed de facto as the world's central bank.

Equation #1 means that the base is not money but that it can be turned into money by means of the money multiplier (m), which it is unlikely to do given the flat yield curve and the highly indebted economy. The determinants of m are known, unlike those of the velocity of money. Currently, the monetary base is declining and the money multiplier is countervailing to a slight degree, but the drop in the base and the increased federal-funds rate has resulted in a sharp slowdown in the M2 growth rate from a peak of 7.5% per annum in October 2016 to slightly more than 4.0% at the end of 2018.

Accordingly, M2 growth should continue to work irregularly lower even though M2 growth was better in November and December. Late in 2018, surging money market mutual fund shares deposits (MMMFS) boosted M2. While MMMFS are spendable balances, they do not support a sustaining increase in bank credit. The gain in MMMFS apparently resulted from a large movement from stocks rather than motivated by a need for increased transaction balances. This is confirmed by the decreased velocity of money.

The second equation means that world dollar liquidity declines when the monetary base falls unless it is offset by an increase in foreign official holdings of Treasury securities. Both of these components constitute tier one capital and can be leveraged. Thus, the ongoing reduction in world dollar liquidity forces a deleveraging, the tangible signs of which include: a sharp slowdown in M2 growth in Japan, the eurozone (the 19 countries using the euro as their official currency) and China, a drop in world stock and commodity prices, and a synchronized deceleration in major foreign economies. Chinese money growth recently fell to the lowest level in four decades while Japanese money growth dropped below the trough in two of the last three recessions. The Chinese government just announced the fourth reduction in reserve requirements since the start of 2018 in an attempt to reverse the weakness in money and credit growth. European money growth slowed in 2017 and 2018 even though the European Central Bank was, like the Bank of Japan, still engaged in quantitative easing. The velocity of money also fell in Japan, the eurozone and China. Interestingly, velocity was less than one in all three areas, meaning that the stock of money did not completely turn over once during 2018 in these three economic regions.

RETURN TO THE ZERO BOUND

In view of the increasingly restrictive monetary conditions, a change in Federal Reserve policy is in the offing. The historical record indicates that even a quasi-recession would necessitate a significant decrease in the federal-funds rate. However, the Fed will not be able to deliver the same rate cut as historically has been the case since the federal-funds rate would be truncated by the zero bound. Even a quasi-recession would lead to such diminished inflation that the U.S. economy could face zero inflation or outright deflation. Zero inflation would imply that some sectors would be in deflation and that the real burden of the debt levels would become onerous enough to eventually turn a slowdown into a more persistent and/or deeper economic funk.

We looked at three time periods when sufficient economic difficulties arose that a major Fed response was required although a full-fledged recession did not materialize: 1966-67, 1984-86, and 1995-99. All three cases have important similarities. Each period was preceded by a monetary deceleration *and* included a notable bankruptcy, in order: Westec (also known as Western Equities), Continental Illinois National Bank and Trust Company, and Long-Term Capital Management. There are four key differences this time compared to past episodes which cast doubt on the Fed's current capability to turn the economy around given already low current interest rates. First, money velocity was much higher in all three earlier periods and was not in a secular downturn as it is presently. Second, indebtedness was far less. Third, demographics were robust and in stark contrast to the population growth that was only 0.6% in 2018 and at an 81-year low. Fourth, foreign business conditions were far better than the synchronized slowdown currently apparent.

On average, during the three cases we studied, the federal-funds rate and the U.S. inflation rate, decreased by three percentage points and 1.3 percentage points, respectively. Interest rates and inflation were much more elevated during these previous episodes. However, as noted, our current lower rate and inflation circumstances are due to lower velocity of money, higher debt, and poor demographics. Therefore, a larger percentage decline in inflation and interest rates can be expected. Even a mild recession in 2019 would likely put the Fed in an untenable situation.

It is conceivable that the Fed, constrained by the zero-bound interest rates and in attempting to raise economic activity, could engage in another untested experiment with unforeseen consequences to boost debt levels. If that occurs, the U.S.'s debt overhang would worsen and the country would follow a path pursued by other heavily indebted countries such as Japan, Europe and China. The risk is rising that the U.S. will not only return to 0% short-term interest rates but, as in Japan, that it might also remain there for several years.

Given our view that the multi-year trend is toward decreasing interest rates and lower inflation, we believe the Fund is appropriately positioned for these conditions with investments in long-term U.S. Treasury bonds.

Thank you for the opportunity to manage your assets.

Sincerely,

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

***The Bloomberg Barclays US Aggregate Bond Index is a broad-based flagship benchmark that measures the investment grade, US 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). You cannot invest directly in this or any index.*

Collinearity, in statistics, is the correlation between predictor variables (or independent variables), such that they express a linear relationship in a regression model.

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.

A credit aggregate measures the stock of bank loans outstanding at a point in time.

The federal-funds rate is the interest rate at which private depository institutions (mostly banks) lend balances (federal funds) at the Federal Reserve to other depository institutions, usually overnight. It is the interest rate banks charge each other for loans.

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.

M2 money supply consists of currency and checking accounts, consumer-type time and savings accounts and equivalent near monies, while M3 money supply consists of M2 plus business-type time deposits and less liquid near monies. Both M2 and M3 exclude monies and near monies owned by the Treasury, depository institutions and foreign banks and official institutions and IRA and Keogh balances owned by consumers.

A monetary aggregate measures the stock of money outstanding within an economy at a point in time.

The monetary base is the total amount of a currency that is either circulated in the hands of the public or in the commercial bank deposits held in the central bank's reserves. This measure of the money supply typically only includes the most liquid currencies.

The money multiplier is the expansion of a country's money supply that results from banks being able to lend. The size of the multiplier effect depends on the percentage of deposits that banks are required to hold as reserves. In other words, it is money used to create more money and is calculated by dividing total bank deposits by the reserve requirement.

The Netherlands Bureau for Economic Policy Analysis (CPB) does scientific research aimed at contributing to the economic decision-making process of politicians and policymakers.

The Personal Consumption Expenditures (PCE) Deflator is part of the National Income and Products Accounts developed by the Bureau of Economic Analysis of the U.S. Commerce Department. The PCE Deflator is a variable weighted index and is widely considered to be the most reliable of all the price indexes.

Quantitative easing is a government monetary policy used to increase the money supply by buying government securities or other securities from the market. Quantitative easing increases the money supply by flooding financial institutions with capital in an effort to promote increased lending and liquidity.

Quantitative tightening (QT) is the reversal of quantitative easing. In the process of quantitative tightening the U.S. Federal Reserve sells the government and other securities it purchased during the period of quantitative easing it embarked upon during and after the financial crisis of 2008.

The velocity of money (V) is defined as the rate at which money circulates, changes hands or turns over in an economy.

The yield curve is a line on a graph that plots the interest rates, at a set point in time, of bonds having equal credit quality, but differing maturity dates. The most frequently reported yield curve compares three-month, two-year, five-year and 30-year U.S. Treasury securities. This yield curve is used as a benchmark for other interest rates, such as mortgage rates or bank lending rates. The curve is also used to predict changes in economic output and growth.

U.S. Treasury Fund Top Holdings as of September 30, 2018 **Security Name**	Percent of Net Assets
U.S. Treasury Bond, 2.250%, 8/15/46	31.8%
U.S. Treasury Strip, principal only, 8/15/45	24.6%
U.S. Treasury Bond, 2.500%, 2/15/45	15.1%
U.S. Treasury Strip, principal only, 5/15/44	11.8%
U.S. Treasury Strip, principal only, 8/15/40	6.5%
U.S. Treasury Bond, 3.750%, 11/15/43	5.1%
U.S. Treasury Bond, 3.125%, 8/15/44	2.6%
U.S. Treasury Bond, 3.000%, 8/15/48	2.2%
Total	99.8%

Portfolio holdings are subject to change at any time. References to specific securities should not be construed as recommendations by the Fund, its Advisor or Sub-Advisor. Current and future holdings are subject to risk.

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