

## Wasatch Long/Short Fund

Alternative investments have been gaining favor over the past several years as investors seek to **increase portfolio diversification** and **reduce overall volatility**. While traditional investments such as stocks, bonds and money-market securities have long been accessible to all investors through mutual funds, alternative strategies *had been* accessible mainly to institutions and wealthy individuals through hedge funds and other limited partnerships. “Alternative” strategies include those that employ short-selling or arbitrage and those that invest in commodities, currencies or futures.

Today, these alternative investment strategies are also available through mutual funds, providing shareholders with **more transparency, smaller minimum purchases, lower fees** and **daily liquidity**. In addition, mutual funds are subject to regular audits and greater regulatory scrutiny than hedge funds. This increases the comfort level of shareholders who seek to reduce the volatility of their overall portfolio by adding alternative strategies that may not be as highly correlated with traditional investments. It’s also important to note that, in order for an alternative strategy to make a significant difference in an overall portfolio, **many financial advisors recommend allocations of 20% or more**.

### A DIRECTIONAL LONG/SHORT FUND

The **Wasatch Long/Short Fund (FMLSX)** is an alternative investment that uses short-selling to seek a different source of returns and reduce volatility. Short-selling is a diversifying strategy that until the 1997 repeal of the short-short rule was used mainly by hedge funds that were organized as limited partnerships and some other types of private structures.

Launched on August 1, 2003, the Wasatch Long/Short Fund’s objective is capital appreciation. **The Fund seeks to deliver equity-like returns, but with less volatility and risk than the broad stock market**. Since inception, the Fund has been co-managed by Michael Shinnick, the Lead Portfolio Manager, and Ralph Shive, Portfolio Manager.

The Fund takes a **directional approach** that is also very flexible, meaning it can **vary the size of its long and short positions** to reflect the managers’ view of current market conditions. This flexibility allows the Fund to have 100% of its investments in long positions, or—at the other end of the spectrum—have short positions that outweigh long positions. In contrast, some other long/short funds take a market-neutral approach by roughly balancing their long and short positions. Where a directional long/short fund like Wasatch Long/Short seeks to generate equity-like returns with reduced volatility, a market-neutral fund might seek returns somewhat in excess of Treasury bills with very low volatility.

The Wasatch Long/Short Fund **does not use leverage on the long side**, limiting its long positions to no more than 100% of assets. Other long/short funds might buy stocks with the portfolio’s cash—including the cash generated from short sales—creating an allocation that could be 130% long and 30% short, for example. At Wasatch,

the portfolio managers are not comfortable with such an approach, which they view as more aggressive. Unlike the so-called “130/30 funds” in which long positions almost always outweigh short positions, there are also bear-market funds that might perpetually have short positions that outweigh long positions. Again, the Wasatch managers are not comfortable with a perpetually bearish approach because, over long periods, the stock market has had an upward (bullish) bias.

The sharp market declines following the peak of the dot-com bubble in 2000 and the financial crisis in 2008 and early 2009 provided opportunities for long/short funds and other alternative strategies to demonstrate whether or not they could deliver on their stated goals. For the Wasatch Long/Short Fund, **returns have been consistent with the Fund’s objective** of capital appreciation, and the pursuit of equity-like returns while striving to achieve less volatility and risk than the broad stock market. A look at the Fund’s calendar year total returns (on the next page) reveals that in six of the Fund’s nine full-year periods, its total return either exceeded or was nearly in line with the market as measured by the S&P 500 Index. Indeed, by that measure, the Fund’s two best years of relative returns were in 2008 and 2009, when it significantly outperformed during the market’s sharp decline and subsequent recovery. Furthermore, from its inception on August 1, 2003 through September 30, 2013, the Fund’s **beta was 0.66**, significantly less than the 1.0 beta for the S&P 500. This is consistent with the managers’ goal to keep the Fund’s beta below 0.8 over time.

### Average Annual Total Returns (Net After Expenses)

For Periods Ended September 30, 2013

	1 Year	3 Years	5 Years	10 Years	Since Inception 8/1/2003
<b>Wasatch Long/Short Fund — Investor Class</b>	<b>16.09%</b>	<b>10.56%</b>	<b>8.48%</b>	<b>6.96%</b>	<b>6.88%</b>
S&P 500 Index	19.43%	16.27%	10.02%	7.57%	7.53%
Citigroup U.S. Domestic 3-Mo. T-Bills Index	0.07%	0.08%	0.15%	1.61%	1.60%

Source: Wasatch Funds.

*Data shows past performance. Past performance is not indicative of future performance, and current performance may be lower or higher than the performance quoted. For the most recent month-end performance data, visit [www.WasatchFunds.com](http://www.WasatchFunds.com). Investment returns and principal value will fluctuate; and shares, when redeemed, may be worth more or less than their original cost. **Total Expense Ratio—1.51%**. (1.27% excluding dividend expense on short sales).*

*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, including sales charges, or the taxes you would pay on fund distributions or the redemption of fund shares. These fees and taxes, if reflected, would reduce the performance quoted. Wasatch does not charge any sales fees. For more complete information, including charges, risks and expenses, read the prospectus carefully.*



Source: Wasatch Funds. Past performance is not indicative of future performance, and current performance may be lower or higher than the performance quoted.

## ADJUSTING THE FUND’S LONG AND SHORT EXPOSURE

The Wasatch Long/Short Fund has achieved these results in large part by varying the size of its long and short exposure to reflect the portfolio managers’ assessments of stock valuations and market psychology. While the Fund has maintained short positions in the range of about 5% to 30% of assets, the Fund has the flexibility to allocate a much-larger percentage of assets to short positions. In fact, if market conditions warrant, the Fund has the ability to be temporarily net-short, in which case short positions would outweigh long positions. Such a net-short allocation has not occurred since the Fund began, however.

Over time, the Fund’s long positions have ranged from a low of about 40% of assets up to a high of almost 97%. As described previously, the Fund’s maximum allocation to long positions is 100% of assets, meaning the Fund will not use leverage on the long side. **Since the Fund began, net-long allocations (longs minus shorts) have ranged from about 30% on the conservative end to as much as almost 90% on the aggressive end.**

Not surprisingly, the Fund took its **largest short allocations in the years leading up to the great financial crisis**, enabling the Fund to significantly outperform the overall market (as measured by the S&P 500) in 2008. The main factor that caused the portfolio managers to take a more-conservative approach during this time was the level of imprudent activity in the real-estate markets. While at the University of Notre Dame, Mike Shinnick wrote his senior thesis on the savings and loan crisis of the 1980s. And to him, the pending real-estate crisis looked much worse because it infected the entire banking system in the U.S. and abroad.

Although the portfolio managers had a very negative outlook in 2008, the Fund’s short allocation was *not* overly aggressive. This portfolio-management decision was based on the Securities and Exchange Commission’s (SEC’s) emergency order to halt short-selling of financial stocks. The temporary order imposed by the SEC on September 19, 2008 was intended “to protect the integrity and quality of the securities market and strengthen investor confidence.” **In large part due to shorts on financial stocks, the Wasatch Long/Short Fund’s 2008 year-to-date return was actually positive through the first week of September, which was just prior to when the SEC’s order went into effect.**

Subsequent to the SEC's order, the portfolio managers felt it was prudent to buy back those stocks, and cover the Fund's short positions in the financials sector. It's also important to note that the short-selling ban covered not just traditional financial companies, but also many non-financial companies that had significant financing operations. Mike Shinnick said that being a portfolio manager at the time was analogous to playing a basketball game in which the three-point line was moved in the middle of the game, and could be moved again and again without notice. Because of the uncertainty created by the SEC's short-selling ban on financial stocks, the managers decided to reduce the Fund's overall short exposure rather than attempt to add short positions in other sectors. **Were it not for the ban, it is entirely possible that the Fund would have temporarily had a net-short allocation in late 2008 or early 2009.**

After much of the turmoil in the stock market had passed, the portfolio managers established and maintained a more-bullish allocation in the Wasatch Long/Short Fund. **Since 2009, the Fund's net-long exposure has generally been above 65%.** There have been two main reasons for this bullishness. First, stock valuations have generally been much more reasonable subsequent to the financial crisis. And second, the portfolio managers believed in 2009 that quantitative easing (the Federal Reserve's [Fed's] policy of near-zero interest rates, along with purchases of Treasury securities) would be effective, at least for the time being. While many other professional investors have been skeptical and describe the Fed's actions as "pushing on a string," Mike Shinnick's knowledge of economic history has been particularly helpful. Mike understood that quantitative easing had, in fact, been used with some success to drive stock prices higher in Japan from 2003 to 2007.

Under normal circumstances, the portfolio managers refrain from making overly specific predictions about the direction of the market that could lead to massive changes in the Fund's long, short and net exposure. Instead, the managers take a **flexible approach, starting from a base of about 80% long and 20% short**, and then trimming long exposure (and adding short positions) or reducing short positions (and adding long exposure), depending on valuations and market conditions. It might seem intuitive to think that the managers would always add short exposure when stocks rise because at higher prices they are less attractive, and vice versa. This is often not the case, however. Sometimes the market moves in cycles, and an investor is better off participating in the cycle for a period of time.

As the market climbed in the early months of 2013, for example, and some observers warned that stocks in general might be overvalued, the Fund maintained a relatively small allocation to short positions. In this case, the portfolio managers were still finding some attractively valued companies on the long side, and the shorts simply weren't working. So there was no point in having a large allocation to short positions. However, had the managers become convinced that the cycle was beginning to reverse course, they would have been prepared to increase the Fund's short exposure. **The managers maintain watch lists of companies for potential long and short positions, so that they can quickly respond to changes in market direction or acceleration.** This approach enables the Fund to potentially take advantage of market advances, while still affording the possibility of reducing losses on the downside.

## INVESTMENT PHILOSOPHY

The Wasatch Long/Short Fund's approach to stock selection is driven by a two-part investment philosophy. **First, the portfolio managers believe the market is not fully efficient, and there are always securities that are undervalued or overvalued on an absolute or relative basis.** The Fund can therefore benefit from fundamental and technical analysis of individual securities, industries, sectors and broad markets. The result should be a dynamic portfolio that varies its market exposure over time in an effort to reduce volatility, while still providing the potential for attractive returns. The portfolio managers also believe that as more investors embrace indexing

over active management, the market will become even less efficient because there will be relatively fewer investors seeking to uncover information that's not currently reflected in stock prices.

**The second part of the Fund's investment philosophy is that macro (top-down) analysis matters.** There are three essential components to macro analysis: the business cycle, the cost of money and long-term (secular) themes.

**Business conditions are cyclical**, and correctly recognizing the current point in the cycle provides key information regarding which sectors and industries to emphasize, and which individual positions to establish for the Fund. Furthermore, the portfolio managers believe **the price of money (reflected in interest rates and currencies) is important.** Major events and governmental actions, including fiscal and monetary policies, that affect interest rates also affect the absolute and relative valuations of securities. Finally, the managers think **it is critical to consider secular themes** like the aging population, changes in technology, the growth of industrialization throughout the world, and resource scarcity and shortage.

For example, what Mike Shinnick calls the "intermediate case for peak oil" is a theme that has influenced many of the Fund's investment positions over time. In Mike's view, we are not running out of oil; instead, we are running out of cheap oil. Mike thinks there is plenty of oil out there, but no longer at bargain prices under \$40 per barrel. The current supply/demand curve, in his opinion, favors companies that are providing services for energy exploration and production (E&P). As oil becomes more difficult to extract, companies supplying and operating drilling rigs are likely to have much steadier work than in the past. This steady work should generate high recurring cash flows that are not yet fully reflected in the stock prices. That's why companies such as Halliburton and Patterson-UTI Energy, both suppliers of oilfield services and contract drilling, are among the Fund's top long positions and energy is the Fund's largest sector weighting. Conversely, Exxon Mobil—which has not been able to replace its diminishing energy reserves—is one of the Fund's biggest short positions. Another attractive aspect of Exxon as a short position is that the company is probably too large to be taken over at a higher stock price. And if Exxon takes over a smaller company, such a transaction would likely depress Exxon's shares in the marketplace.

## STOCK-SELECTION PROCESS

The Wasatch Long/Short Fund uses a three-step process to select stocks for both the long and short sides of the portfolio. **The first step is the macro (top-down) analysis.** The portfolio managers generally do not engage in original macroeconomic research. Instead, they rely on publicly and commercially available data and analysis for things like gross domestic product (GDP) growth rates and interest-rate predictions. However, the portfolio managers do make judgments about how to interpret the data and analysis, and how to best allocate the Fund's assets under different scenarios. Helping to assess macro conditions is Ralph Shive's main focus in the management of the Fund.

**The second step in the selection process is individual stock analysis, in which the portfolio managers determine the valuation of a given company.** Here, they draw heavily on Mike Shinnick's prior experience as a business consultant, a role in which he developed a healthy skepticism toward corporate executives and common valuation methods. Mike was often asked to ascertain the worth of a company or part of a business that might be under consideration for sale or purchase. At the time, in 1999 and 2000, Mike says that industry methods of valuing a company led to assessments he considered to be unreasonably high. Textbook discounted-cash-flow analysis based on an irrelevant weighted-average cost of capital and an unrealistic "terminal" value of a company, he says, reflected wildly optimistic assumptions about future growth. This caused businesspeople to overpay for acquisitions, and investors to overpay for stocks. For example, in 1999, the stock of Wal-Mart Stores sold at an outrageous price-to-earnings (P/E) ratio of about 70.

Instead, Mike began using a valuation technique that starts with the worth that exists currently—which takes into account the company’s balance sheet, tangible book value, revenues, operating margins, changes in revenues and margins, and a *modified* discount rate based on a company-specific risk profile. To determine the company’s intrinsic value, the technique then considers how additional worth will be created over time. The Fund typically seeks to take long positions in companies whose stock is trading at least 25% below the company’s intrinsic value. This represents the portfolio managers’ attempt to find a “margin of safety” as described by Benjamin Graham, along with some of the growth characteristics as described by Warren Buffett and Philip Fisher.

Across the different types of stocks in the Fund, **a company’s ability to generate cash** is probably the most-important characteristic they have in common. The portfolio managers prefer companies in which customers continually purchase the products and services, without having to be “resold” each time. Examples of such companies currently held by the Fund include tech companies Apple, Cisco Systems and Microsoft, and pharmacy-benefits manager Express Scripts. Fast-food chain McDonald’s, which was previously owned by the Fund, is another example of a company that generates incredible amounts of cash in good times and bad. McDonald’s is not currently held by the Fund, but it is certainly the type of company that would be owned again at the right level of valuation.

**Technical analysis, particularly when short-selling, is the third and final step in the stock-selection process.**

Fundamental analysis alone doesn’t give a reliable indication of when to enter a stock trade for a company. From his own personal experience, Mike realized that overvaluation (or undervaluation) can persist for a protracted period of time. As British economist John Maynard Keynes was reported to have said, **“Markets can remain irrational a lot longer than you and I can remain solvent.”**

Mike thinks that market psychology matters and that technical analysis, the evaluation of securities using statistics generated by market activity such as prices and volumes, is an effective way to measure investor behavior. Acknowledging that he had some “painful” shorts in the years prior to launching the Fund, Mike believes it is important to have the additional overlay that technical analysis provides. This assists him in determining when momentum has changed, when there has been an inflection point that indicates it’s time to initiate or exit a short position.

The Fund limits its investments mainly to individual stocks in both the long and short portions of the portfolio. The Fund does write (sell) covered call options on some long stock positions, mainly as a way of generating income. If the stock goes down in price, the premium the Fund receives from writing the option could partially or fully offset the price decline. If the stock goes up, the Fund would likely lose the stock position to the option buyer, but at a price higher than when the option was written. Although the Fund has frequently written covered call options, it has not historically made *other* use of options, futures contracts or similar derivatives. Nor has the Fund historically made use of exchange-traded funds (ETFs), although such use is possible going forward if, for example, the portfolio managers wanted to gain or hedge exposure to a certain sector or to the market as a whole. Overall, the Fund will typically have from **50 to 60 long positions** and from **20 to 30 short positions**.

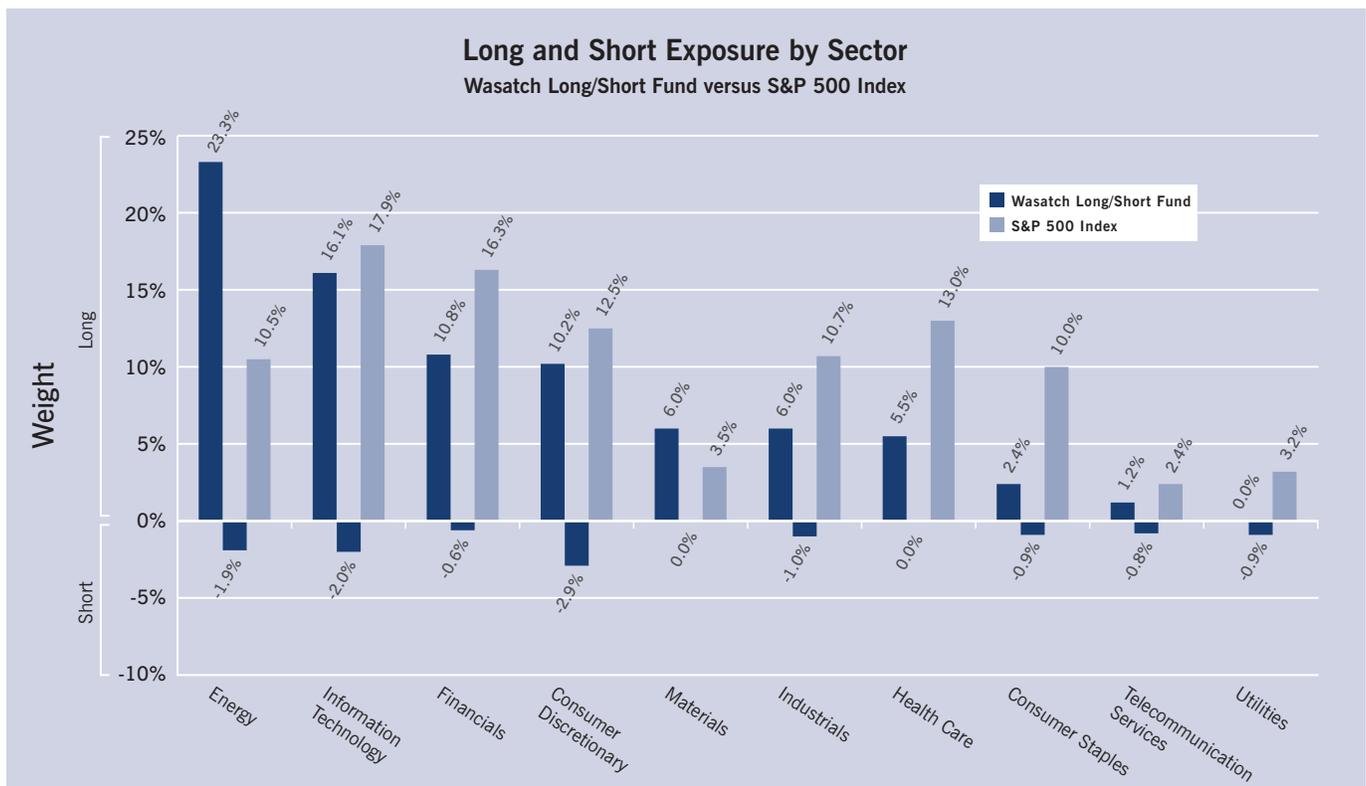
The Wasatch Long/Short Fund will occasionally make a pair trade, which involves going long on one stock in a given sector while simultaneously shorting a second stock in the same sector. Some market-neutral funds do this on a regular basis in an effort to balance their long and short positions. The Wasatch Long/Short Fund makes a pair trade when individual-company research and top-down analysis of a given sector leads to two stocks that are likely to move in different directions or in the same direction at significantly different rates.

A pair-trade example in the information-technology sector involved Cisco Systems and Juniper Networks. Several years ago, there was a perception among many investors that Juniper was taking share from Cisco, which

could lead to Juniper gaining market capitalization at Cisco's expense. Although Juniper was growing more rapidly, it was a much smaller company with fewer long-term competitive advantages. In addition, some negative industry trends had become apparent for Cisco before being recognized for Juniper. As a result, investors were paying P/E multiples for Juniper's stock that seemed unsustainable, leading the Fund to short Juniper and buy Cisco.

In summary, the portfolio managers **keep the Fund's investment process simple**. They are relatively **unconstrained by market cap**. The managers buy and sell short individual stocks, usually of mid- and large-cap companies (and occasionally of small-cap companies). The managers also write (sell) covered call options on stocks held long. No sector may exceed 35% of net assets at the time of purchase. And a relatively large cash position may be used to reduce risk. Typical characteristics of long positions are (1) a **low valuation** relative to the company's sector or industry, (2) a **competitive advantage** based on a global theme or framework, and (3) a **stock price at least 25% below intrinsic value** based on a modified discounted cash-flow analysis. Typical characteristics of short positions are (1) a high valuation relative to the company's sector or industry, (2) a clear thesis for why valuation or earnings will come down, and (3) signs of technical distribution or breakdown.

Regarding sectors, the Wasatch Long/Short Fund has historically had large weightings in **energy, information technology** and **financials**. As discussed previously, within energy, the portfolio managers have tended to prefer service-oriented companies versus those that own actual energy reserves. Within information technology, the managers have found attractive long and short opportunities due to the fast pace of change, the prevalence of irrational (too low and too high) valuations, and the significant level of acquisitions in the sector. Within financials, the largest weightings have typically been in the insurance industry, where Mike Shinnick has a good deal of business-consulting experience. In addition, relative to many other financial companies, Mike believes well-chosen insurance companies tend to have excellent business models with strong tangible book values and steady cash flows.



Source: FactSet, as of September 30, 2013. Current and future holdings are subject to risk and may change at any time.

## CONTINUOUS EVALUATION

Once a stock has been added to the Fund, either on the long or the short side, the portfolio managers continually evaluate the company to ensure that it is providing the desired return characteristics. If the managers have ongoing confidence in the company, they will continue to own the stock. For example, Loews Corp. (insurance, energy and hotels) has been one of the Fund's top long positions since 2009. If the company continues to generate high single-digit compounded growth in earnings, and management continues to act in a responsible way, the stock is likely to remain in the Fund's portfolio because Loews is working according to the investment thesis that prompted the initial purchase of the stock. **The portfolio managers are less concerned with the pace at which a stock goes up. As long as they continue to see limited downside and meaningful upside potential, they are likely to continue holding it.**

**The managers take a similar approach to the Fund's short positions. Rather than look for companies with terrible results, accounting fraud or other corrupt practices, the managers seek companies with limited upside and significant downside.** These are often decent companies that are simply out of their growth phase, have a P/E ratio that's too high, or are poised for an event that's likely to disappoint investors. J.C. Penney Co. is a prime example. The portfolio managers took a short position in J.C. Penney after the announcement that Vornado Realty Trust, one of the department store's biggest shareholders, was selling stock. This followed a large debt issuance in which the majority of J.C. Penney's real-estate assets were pledged. J.C. Penney has a very leveraged balance sheet, has negative cash flow and faces significant operating challenges to return to profitability. So while many professional investors focus more on trying to assess competitive strengths and weaknesses, the portfolio managers of the Wasatch Long/Short Fund place equal emphasis on a company's financial statements.

When the portfolio managers initiate a long position, they typically start with 0.5% to 1% of Fund assets. As they gain additional confidence that their original reason for purchase is correct, they'll often grow the position to 2% to 3% on the long side. For shorts, a full position is typically 1% to 2% of Fund assets, with a maximum of 3%. As is the case on the long side, the managers typically start small with a short position and scale up gradually.

Paradoxically, if a short is working and the stock price declines, the position becomes a *smaller* percentage of the portfolio. So the portfolio managers often "press" the position by shorting more shares to increase its weight in the portfolio. Shorting is inherently very difficult to do successfully. And it is interesting to note that of the Fund's short positions, the majority do not work out profitably. But because the managers frequently press the positions that *are* working and because the market periodically moves down dramatically, the Fund's unsuccessful shorts have been more than offset by the minority of shorts that are profitable. As a result, short positions have contributed to the Wasatch Long/Short Fund's overall performance, while also helping to reduce volatility.

One of the biggest risks in short-selling is the possibility that a company sold short by the Fund will be subject to a takeover bid that results in a significant increase in the stock price. Although the portfolio managers screen investment-research databases in an effort to eliminate possible takeover targets, surprises are always possible.

In 2008, for example, the Fund was short Wrigley when Mars made a takeover bid supported by Berkshire Hathaway. When the Fund shorted Wrigley, the portfolio managers thought it was expensive, trading at about 15 times Enterprise Value/EBITDA. Sugar costs were rising, Wrigley's growth was slow, and the company had just completed an acquisition in Europe that didn't seem to be particularly attractive. So there didn't appear to be any natural buyers of Wrigley, at least not in the near term. But then, privately held Mars, assisted by Warren Buffett's Berkshire Hathaway, launched a takeover bid that pushed the stock up about 20%. Painful as that was, it didn't ruin the Fund's year.

## HOW THE FUND'S INVESTMENT APPROACH WAS DEVELOPED

Mike Shinnick manages the Wasatch Long/Short Fund the same way he managed his own money. Following his education at the University of Notre Dame, which included the study of Philosophy, Politics and Economics (PPE), his professional life began in the business-consulting and technology areas. For someone with a love of learning, particularly about commercial activity and public policy, working in these areas gave him opportunities to explore different companies and industries before selecting a permanent career.

Mike's interest in business consulting grew over time. And in 1994, he was one of the first employees of Diamond Technology Partners, based in Chicago. Working with clients in the information-technology and financials sectors, Mike had a front-row seat as Diamond—fueled by the Internet and capital markets—experienced tremendous growth, went public in 1997 and had a market cap that exceeded \$1 billion in late 1999.

As the late-1990s progressed, Mike became increasingly concerned that market valuations had become significantly inflated. He had to look no further than publicly traded companies in his own industry segment—some of which had stocks selling at prices of more than 10 times revenues—to realize just how unreasonable valuations had become. Concerned for his personal investments that were somewhat illiquid (not readily saleable for tax or other reasons) and that were also highly correlated with technology-stock movements, Mike began to explore ways to protect the overall value of his portfolio. That's when he began using hedging techniques, including short-selling—whereby the short-seller *benefits* from a price decline in a security that is borrowed and sold short.

**The investment approach that drives the Wasatch Long/Short Fund is an outgrowth of the steps Mike took to protect his personal portfolio during the stock-market surge, which ended in March of 2000 when the dot-com bubble finally burst.** He first turned to traditional financial advisors, who talked mainly about diversification. But diversification, Mike knew, meant investing in more stocks at a time when his concern was about the *overall* valuation of the market.

Mike then looked at hedge funds, which were organized mostly as limited partnerships (LPs). And while he understood the strategies that these hedge funds employed, including short-selling, he was wary of being able to select a fund he could trust from among the vast number of relatively unregulated LPs. Instead, Mike became a “student of the markets” and managed his own money over the next few years, buying (“going long”) companies he believed were undervalued, while short-selling (“going short”) those he considered overvalued. Mike successfully navigated the financial markets from the bursting of the dot-com bubble in 2000, through the tragic events of September 11, 2001, and beyond the end of the tech decline in 2002. His long positions during this time were mostly traditional value stocks including some insurance companies that held up relatively well, while his short positions included those that benefited from price declines in some transportation and high-technology stocks. Moreover, Mike's portfolio was periodically net-short, meaning his short positions occasionally outweighed his long positions.

Convinced that a sideways to negative environment might be in store for the stock market, it was then that Mike thought of creating a mutual fund using a long/short investment approach. With the 1997 repeal of the short-short rule, which had previously rendered short-selling impractical for traditional mutual funds, there was no longer any reason that a mutual fund could not duplicate some of the investment strategies that had previously been limited to hedge funds. Based on his personal track record, Mike approached Ralph Shive, a Vice President and Chief Investment Officer of 1st Source Corporation Investment Advisors. In 2003, after intense due diligence of Mike's investment approach, 1st Source launched the Fund, which was co-managed by Mike and Ralph. The Fund became part of the Wasatch family in 2008 and was renamed the Wasatch Long/Short

Fund, with Mike as the Lead Portfolio Manager and Ralph as a Portfolio Manager. More than 10 years since its inception, the Wasatch Long/Short Fund continues to apply the same investment approach that Mike used for his personal portfolio.

## FUND MANAGEMENT—STABLE AND EXPERIENCED PORTFOLIO TEAM

The Wasatch Long/Short Fund has a long track record in the alternative-investments space. Both portfolio managers have been with the Fund since its inception on August 1, 2003, and were involved in crafting the Fund’s stock-selection process prior to launch. Lead Portfolio Manager Mike Shinnick brings unique perspective and experience, and has one of the longest tenures in the mutual-fund marketplace as a long/short manager. Ralph Shive, who co-manages the Wasatch Long/Short Fund, contributes almost four decades of investment experience and proven success.

### ABOUT THE PORTFOLIO MANAGERS

Michael Shinnick has been the Lead Portfolio Manager of the Wasatch Long/Short Fund since its inception on August 1, 2003 and was a co-manager of the Wasatch Large Cap Value Fund until August 19, 2013. Prior to joining Wasatch, he served as a Vice President and Portfolio Manager at 1st Source Corporation Investment Advisors. Before joining 1st Source, Mike was a Partner and Principal at Diamond Technology Partners in Chicago where he worked in the financial-services division, advising clients in the insurance, brokerage and mutual-fund industries. He was also an Officer of Z-Cosm, a global venture-development group at Zurich Financial Services in New York. Mike graduated from the University of Notre Dame, earning a Bachelor of Arts in Economics.



Michael Shinnick  
Lead Portfolio Manager

Ralph Shive has co-managed the Wasatch Long/Short Fund since its inception on August 1, 2003 and was the Lead Portfolio Manager of the Wasatch Large Cap Value Fund from its inception on September 25, 1996 through August 19, 2013. Prior to joining Wasatch, he served as a Vice President and Chief Investment Officer at 1st Source Corporation Investment Advisors, where he was responsible for developing the firm’s investment philosophy in addition to his duties as a Portfolio Manager. Before joining 1st Source, he managed a private family portfolio in Dallas, Texas. Ralph graduated from Southern Methodist University with a Bachelor of Science in Business Administration. He also holds the designation of Chartered Financial Analyst.



Ralph Shive, CFA  
Portfolio Manager

## ABOUT WASATCH ADVISORS®

Wasatch Advisors is the investment manager to Wasatch Funds,® a family of no-load mutual funds, as well as 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 \$17.9 billion in assets under management as of September 30, 2013. Wasatch Advisors, Inc. is registered with the Securities and Exchange Commission under the Investment Advisers Act of 1940.



Overall Rating



## Wasatch Long/Short Fund

(out of 121 long/short equity funds as of September 30, 2013)

Total Return Percentile Rankings (9/30/2013)	1 YEAR	3 YEAR	5 YEAR	10 YEAR
<b>Long/Short Fund</b> FMLSX (Long/Short Equity)	<b>Top 22%</b> (222 funds)	<b>Top 27%</b> (4 stars/121 funds)	<b>Top 14%</b> (4 stars/74 funds)	<b>Top 34%</b> (4 stars/28 funds)

For each fund with at least a three-year history, Morningstar calculates a Morningstar Rating™ based on a Morningstar Risk-Adjusted Return measure that accounts for variation in a fund's monthly performance (including the effects of sales charges, loads, and redemption fees), placing more emphasis on downward variations and rewarding consistent performance. The top 10% of the funds in each category receive 5 stars, the next 22.5% receive 4 stars, the next 35% receive 3 stars, the next 22.5% receive 2 stars, and the bottom 10% receive 1 star. (Each share class is counted as a fraction of one fund within this scale and rated separately, which may cause slight variations in the distribution percentages.)

Morningstar percentile rankings are based on a comparison of a fund's total return performance against its peers over the stated time period. Past performance is no guarantee of future results. © 2013 Morningstar, Inc. All rights reserved. The information contained herein (1) is proprietary to Morningstar and/or its content providers; (2) may not be copied or distributed; and (3) is not warranted to be accurate, complete, or timely. Neither Morningstar nor its content providers are responsible for any damages or losses arising from any use of this information.

Lipper Total Return Rankings among Long/Short funds as of 9/30/2013			Lipper Preservation Rankings among Equity funds as of 9/30/2013		
3 YEAR	5 YEAR	10 YEAR	3 YEAR	5 YEAR	10 YEAR
<b>Top 28%</b> (103 funds)	<b>Top 13%</b> (64 funds)	<b>Top 31%</b> (26 funds)	<b>Top 9%</b> (10,489 funds)	<b>Top 3%</b> (8,866 funds)	<b>Top 1%</b> (5,119 funds)

The Lipper Category Rank is the fund's total-return percentile rank relative to all funds in the Lipper Long/Short Category. The Preservation Ranking is a calculation to determine a fund's ability to preserve capital in a variety of markets when compared with other equity funds. Under no circumstances does information about Lipper rankings constitute a recommendation to buy or sell mutual funds. Lipper rankings measure past fund performance. Past performance is no guarantee of future results.

## Wasatch Contacts

Individual Investors: 800.551.1700 • Financial Advisors: 800.381.1065  
 Institutional Investors: 801.983.4119 • Retirement Plan Solutions: 801.415.5524

### RISKS

The Fund makes short sales of securities which involve the risk that losses may exceed the original amount invested. Equity investing involves risks, including potential loss of the principal amount invested. Being non-diversified, the Wasatch Long/Short Fund can invest a larger portion of its assets in the securities of a limited number of companies than a diversified fund. Non-diversification increases the risk of loss to the Fund if the values of these securities decline.

*Investments in value stocks can perform differently from the market as a whole and other types of stocks and can continue to be undervalued by the market for long periods of time.*

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](http://www.WasatchFunds.com) or call 800.551.1700. Please read it carefully before investing.

*Information in this report regarding market or economic trends or the factors influencing historical or future performance reflects the opinions of management as of the date of this report. 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 investment objective of the Wasatch Long/Short Fund is capital appreciation.*

*The investment objectives of the Wasatch Large Cap Value Fund are to seek capital appreciation and income.*

### DEFINITIONS

**Arbitrage** is the simultaneous buying and selling of securities, currency, or commodities in different markets or in derivative forms in order to take advantage of differing prices for identical or similar assets.

A **Bear Market** is generally defined as a drop of 20% or more in stock prices over at least a two-month period. Someone who is “**Bearish**” or “a bear” is pessimistic with regard to the stock market’s prospects. Someone who is “**Bullish**” or “a bull” is optimistic with regard to the stock market’s prospects.

**Beta** is a measure of the volatility of a fund’s performance relative to the overall market’s performance over a given time period. A beta above 1.0 means the fund was more volatile than the overall market. A beta of less than 1.0 indicates that the fund was less volatile than the overall market.

Writing or selling a **Covered Call** gives the buyer the option of buying a security at a higher, “strike” price in the future. If the security does not achieve that price within the given time frame, the writer of the call keeps both the security and premium paid for the option. If the price of the security does rise to or exceed the “strike” price, then the purchaser of the option will take the security.

**Enterprise Value (EV)** is an industry standard for determining the worth of a company, and is calculated by taking the market value of that company, subtracting its cash and adding its debt. The **Enterprise Value-to-EBITDA (earnings before interest, taxes, depreciation and amortization) Ratio** is enterprise value divided by annual EBITDA.

**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.

**Intrinsic Value** is the actual value of a company based on an underlying perception of its true value including all aspects of the business, in terms of both tangible and intangible factors.

**Leverage**, as the term is used in this report, is defined as borrowing to purchase securities.

*Benjamin Graham and David Dodd coined the term **Margin of Safety**, which is the difference between the intrinsic value of a stock and its market price.*

**Operating Margin** equals operating income divided by revenues, expressed as a percentage.

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

A **Short Sale** is a market transaction involving the sale of borrowed securities in anticipation of a price decline, at which time the securities will be bought back and returned. The short-seller's profit or loss is the difference between the initial sales price and the subsequent buy-back price. The short-seller is also responsible for paying interest on the securities for the duration of the loan.

**Tangible Book Value** is the total net asset value of a company minus intangible assets and goodwill.

The **Taxpayer Relief Act of 1997** included the repeal of the short-short rule, which had prohibited mutual funds from deriving more than 30% of their income from short-term gains. By definition, short-term gains included those on securities held less than three months. Also considered short-term were all gains from short sales and derivatives.

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

The S&P 500 Index represents 500 of the United States' largest stocks from a broad variety of industries. The Index is unmanaged and is a common measure of common stock total return performance.

The Citigroup U.S. Domestic 3-Mo. T-Bills Index tracks the performance of U.S. Treasury bills with a remaining maturity of three months. U.S. Treasury bills, which are short-term loans to the U.S. government, are full-faith-and-credit obligations of the U.S. Treasury and are generally regarded as being free of any risk of default.

*You cannot invest directly in these or any indices.*

*As of September 30, 2013, the Wasatch Long/Short Fund held 4.6% of net assets in Apple, Inc., 1.0% of net assets in Cisco Systems, Inc., 1.5% of net assets in Express Scripts Holding Co., 1.9% of net assets in Halliburton Co., 3.5% of net assets in Loews Corp., 2.4% of net assets in Microsoft Corp., 1.8% of net assets in Patterson-UTI Energy, Inc. and 2.2% of net assets in Wal-Mart Stores, Inc.*

*As of September 30, 2013, the Wasatch Long/Short Fund had sold short -1.7% of net assets in Exxon Mobil Corp. and -0.6% of net assets in J.C. Penney Co., Inc.*

*As of September 30, 2013, the Wasatch Long/Short Fund did not hold Berkshire Hathaway, Inc., Juniper Networks, Inc., Mars, Incorporated, McDonald's Corp., Vornado Realty Trust or Wm. Wrigley Jr. Company.*

*As of September 30, 2013, the Wasatch Large Cap Value Fund held 3.1% of net assets in Apple, Inc., 2.6% of net assets in Cisco Systems, Inc., 3.2% of net assets in Microsoft Corp. and 2.9% of net assets in Wal-Mart Stores, Inc.*

*As of September 30, 2013, the Wasatch Large Cap Value Fund did not hold Berkshire Hathaway, Inc., Express Scripts Holding Co., Exxon Mobil Corp., Halliburton Co., J.C. Penney Co., Inc., Juniper Networks, Inc., Loews Corp., Mars, Incorporated, McDonald's Corp., Patterson-UTI Energy, Inc., Vornado Realty Trust or Wm. Wrigley Jr. Company.*

*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.*

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