

Wasatch Small Cap Growth Strategy

MARCH 31, 2026

OVERVIEW

U.S. small cap stocks were volatile and finished the first quarter of 2026 lower, as shifting investor sentiment drove sharp rotations within the market. Enthusiasm around artificial intelligence (AI) continued to support companies tied to the infrastructure buildout for these technologies. But each wave of new AI product releases also sparked periodic selloffs of stocks across industries perceived as vulnerable to disruption from AI, including software.

Geopolitical tensions later in the quarter, particularly surrounding conflict involving Iran, added to uncertainty and contributed to market swings amid fears of higher oil prices and their impact on the global economy. We share our views on both issues in the Outlook section of this commentary.

Amid this environment, the benchmark Russell 2000® Growth Index ended the period with a loss of -2.81%. The Wasatch Small Cap Growth strategy finished the period lower than its benchmark.

Within the strategy, stock selection in the financials and consumer-staples sectors detracted the most from performance relative to the benchmark. Lack of exposure to the energy sector also detracted from relative performance, as rising oil prices led to gains for that component of the benchmark. Conversely, stock selection in the information-technology sector and an underweight position in the health-care sector contributed to relative results.

Beyond sector positioning, several of the strategy's holdings were perceived as vulnerable to AI-driven disruption and detracted from performance on both an absolute and relative basis. We believe market participants have taken an increasingly indiscriminate approach toward software companies and other businesses tied to the AI disruption narrative. While we've exited a small number of positions in recent months

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where the implications of AI became less clear to us, we've engaged in considerable research to better understand the potential impact of AI on our software companies. We'll continue to invest in companies in which we have the highest conviction in long-term earnings growth potential.

DETAILS OF THE QUARTER

Shift4 Payments, Inc. (FOUR) was one of the largest detractors from strategy performance during the quarter. Shift4 provides integrated payment processing and commerce software for merchants, specializing in the lodging and restaurant verticals. The stock was an example of one that sold off as part of the AI disruption debate. Additionally, the company made a large acquisition in 2025, and we believe investors are waiting to see evidence of realized synergies.

Given management's track record of realizing high returns on prior acquisitions, we're being patient as the company integrates the newly acquired business. We also believe Shift4's business model is more resilient to AI disruption than investors may appreciate as the company has unique competitive moats across lodging and restaurants. In our view, Shift4's ability to connect its payment rails across a complex ecosystem would be difficult for would-be competitors to replicate.

Another company that saw its stock price decline amid AI disruption concerns was **Agilysys, Inc. (AGYS)**, a provider of property management and point-of-sale software for the hospitality industry. Here, too, we believe the business model is more resilient than market participants anticipate. Property management systems are difficult to replace, and contracts are often long term, frequently extending 10 years or more. Given this contract stickiness and Agilysys' niche expertise, we believe customers will look to the company to incorporate AI functionality into its existing platform rather than develop solutions independently. We also believe Agilysys is positioned to accelerate earnings and free cash flow growth from the implementation of its contract with Marriott International, Inc.

Vital Farms, Inc. (VITL) was another detractor. The company provides specialty eggs and butter sourced from small farms and pasture-raised animals. Heavier promotional activity by some competitors led to concerns about market share shifts and weighed on the stock during the period. Given the more competitive environment, we trimmed our position. We continue to hold the company and view the valuation as attractive but would like to see further evidence that its brand position remains strong.

Nova Ltd. (NVMI) and **Camtek Ltd. (CAMT)** were two of the largest contributors to performance during the quarter. Both companies provide equipment used in semiconductor manufacturing to improve chip performance and reduce defects. AI-driven semiconductor demand contributed to strong returns for both companies during the quarter, extending the momentum seen over the past year.

Everus Construction Group, Inc. (ECG) was another top contributor. The company provides electrical and mechanical contracting services, as well as power transmission and distribution construction. The stock rose following the company's reporting of fourth-quarter and full-year 2025 results, which included a record year-end backlog and profit and revenue growth that exceeded consensus expectations. Management highlighted strong demand and bidding activity across data centers, high-tech, hospitality and utility markets. Looking ahead, we believe demand for the services Everus provides will remain strong, particularly as data centers require increasing energy capacity to support the expansion of AI.

OUTLOOK AND POSITIONING

One of the defining investment trends in early 2026 has been investors' intense focus on AI disruption. Software stocks, in particular, sold off sharply in the first quarter as investors have been seeking to understand how AI could reshape or even displace existing business models.

While software has been at the center of this discussion, the debate is broader. Investors are reassessing a wide range of asset-light business models and their long-term value in an AI-driven world.

We don't take the threat AI poses to businesses lightly. AI differs from prior technological innovations in that the breadth of its impact is likely far wider. Given AI's scope, we've taken a holistic approach to evaluating its implications across the strategy and we've been weighing these risks for several years. Our work includes independent research projects, conversations with software end users and direct discussions with management teams—particularly chief technology officers (CTOs)—to understand how companies are deploying AI and how it may affect their existing platforms.

Despite the recent selloff of their stocks, the fundamentals of many of our software holdings remain strong. Revenue growth, customer retention and product adoption continue to track well. However, the focus of market participants has shifted beyond near-term results to long-term outcomes—specifically, the terminal value of these enterprises five to 10 years from now.

Many of our software holdings are long-duration growth companies, with a significant portion of their value tied to cash flows further into the future. As uncertainty around long-term competitive positioning has increased, those future cash flows have been discounted more heavily. Combined with higher starting valuations, this dynamic has driven sharp share price declines for some of our holdings.

However, we believe investors have been undiscerning, repricing long-term uncertainty without consistently distinguishing between individual business models. As a result, the stocks of companies with durable competitive advantages and strong fundamentals have declined alongside those with more challenged outlooks.

Amid market volatility, our investment approach remains grounded in identifying companies with durable competitive moats. History suggests that long-term winners are not defined by superior technology alone, but by advantages that are difficult to replicate. While AI can replicate features and automate workflows, it doesn't easily replicate scale, network effects or deeply embedded positioning within customer ecosystems.

In many cases, we believe AI will reinforce—not erode—these advantages. Companies with proprietary data, established platforms and network effects are often best positioned to benefit. Proprietary data becomes more valuable as AI usage grows, enabling a reinforcing feedback loop in which AI-driven insights expand the platform's utility and deepen its competitive moat.

In recent months, we've refined our positioning within software with this in mind. Our exposure to the software industry is roughly in line with that of the benchmark. During the period, we sold a couple of companies for which the long-term implications of AI were unclear. We've concentrated capital in companies we believe are positioned to potentially benefit from AI—not just avoid disruption. We believe these companies are due for a re-rating as they continue to demonstrate the durability of their earnings power.



THOUGHTS ON THE IRAN CONFLICT

Another issue affecting markets in the first quarter was the U.S. and Israel's attack on Iran, which drove a sharp increase in oil prices. Across the strategy, we don't have many companies that are directly affected by the crisis, either positively or negatively.

We don't own companies in the energy sector that may benefit from rising oil prices. Our view is that it's hard to find companies in the sector that have a durable, long-term competitive advantage. Too often, the stocks of energy companies trade based on the price of an underlying commodity, which we believe is difficult to predict. Over long periods of time, that lack of exposure has helped the strategy, but in times of rising oil prices it can be a headwind to relative performance. However, the energy sector comprises less than 5% of the benchmark, so that headwind is small. While we don't hold many companies that benefit from higher oil prices, the strategy also holds very few companies in which oil is one of the largest input costs.

The strategy does own some consumer-staples and consumer-discretionary companies whose stocks have sold off along with the broader sector amid concerns that rising oil prices may affect consumers' purchasing power. However, we're unlikely to sell any of those positions based on a short-term view of consumer spending. Further, we believe the portfolio is balanced, holding a few consumer companies that may benefit from tougher economic conditions.

The strategy's industrial companies that sell to the aerospace and defense industries may see increased demand because of the conflict. Notably, we don't hold these companies based on a short-term geopolitical view. Regardless of the conflict in Iran, we believe the U.S. and other countries are in the early stages of building out their defense capabilities in a world that has become more geopolitically volatile.

In what could be a volatile market environment ahead, we'll seek to keep the portfolio balanced so that it's not overly exposed to macroeconomic or geopolitical risk.

Thank you for the opportunity to manage your assets.

Sincerely,

Ryan Snow, Ken Korngiebel and Natalie Pesqué



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