

# Wasatch Small Cap Growth Strategy

DECEMBER 31, 2025

## OVERVIEW

A relatively strong earnings season and Federal Reserve interest rate cuts supported stock prices in the fourth quarter. Within the small cap market, biotechnology was one of the strongest segments, as the biotech component of the Russell 2000® Growth Index soared nearly 27%.

In this environment, the benchmark Russell 2000 Growth Index ended the period with a gain of 1.22%, the Wasatch Small Cap Growth strategy did not keep pace and finished the period in negative territory.

The strategy's underperformance was largely due to one factor—its lack of exposure to biotechnology stocks. While that lack of exposure hurt during the quarter, we're comfortable with our positioning. With many nascent, small cap biotech companies, the success of the stock is based almost solely on the company making a new scientific discovery that may, or may not, pass clinical trials. We don't feel we have expertise in predicting that binary outcome. Instead, we prefer to invest in health-care companies with proven earnings track records and commercially viable products. Over longer time horizons, we believe the stock performance of those types of health-care companies has more than made up for our lack of exposure to biotech companies.

## ANNUAL OVERVIEW

As part of our fourth quarter commentary, we also wanted to provide an update on performance for the 2025 calendar year. For the year, the Russell 2000 Growth Index was up 13.01%, while the strategy had a loss. In terms of performance relative to the benchmark, it was the single worst year for the strategy in more than 25 years. We acknowledge that these results were well short of our clients' expectations—and our own. As significant shareholders in the strategy, we feel that disappointment as well.

One of the most frustrating elements of the year was that the underlying fundamentals of the portfolio remained solid. Return on assets (ROA) and

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return on equity (ROE) both remained well ahead of these metrics in the benchmark, indicating no degradation in the overall quality of the portfolio. Earnings growth was also consistent and exceeded that of the benchmark. Over the long term, we would expect the strategy's higher quality and better earnings growth to translate into outperformance of the benchmark. But it's disappointing when outstanding fundamentals aren't rewarded with higher stock prices over a shorter horizon.

For much of the year, the small cap market was led by companies we perceive as low quality, often with speculative business models and little or no earnings. Many of the stocks that were top performers for the year were tied to popular investment themes such as artificial intelligence (AI), quantum computing, cryptocurrency, nuclear power, aerospace and defense.

This was a direct headwind to the strategy's relative performance, as our focus on high-quality businesses—those with high ROAs and ROEs, and track records of durable earnings growth—led us to avoid investing in many of the more speculative small cap companies whose stocks performed exceedingly well over the past year.

While performance suffered in 2025, we're not overreacting by moving into market-leading stocks we perceive as low-quality. Instead, we remain patient. As we explain more in the Outlook section of this commentary, we believe the strategy is well positioned for an environment in which high-quality stocks return to favor.

## DETAILS OF THE QUARTER

**Shift4 Payments, Inc. (FOUR)** was the largest detractor from strategy performance for the fourth quarter. A longtime holding in many of our small cap strategies, Shift4 is a U.S. company that provides payment processing solutions for hospitality, retail and e-commerce businesses. Fundamentals for the company remain solid, in our view. But the stock was down after a competitor reported disappointing results, raising concerns for the industry. While there are concerns that consumer spending could soften and affect some of Shift4's end markets, we still like the firm's long-term growth potential.

Another large detractor was **Vital Farms, Inc. (VITL)**. The company produces and distributes eggs and butter from pasture-raised chickens and cows, emphasizing ethical sourcing and transparency. The stock likely fell due to the drop in egg prices in recent months. Back when egg prices were higher, Vital gained market share by maintaining a relatively steady price for its eggs when other producers raised prices. With prices now falling, some investors were likely concerned that Vital could lose a little share. We believe these concerns are overdone. We think many customers will continue to purchase Vital's eggs, due to their preference for pasture-raised and ethically sourced food products. Additionally, we believe investors are overlooking the potential for Vital to improve margins as some costs associated with egg production come down.

**Trex Co., Inc. (TREX)** also detracted. Trex manufactures high-performance, low-maintenance composite decking, railing, and related outdoor living products. The stock was down sharply in November after the company reported third quarter earnings that were short of market expectations. In addition, management offered disappointing guidance for the fourth quarter, pointing to a weaker housing market and softer consumer spending on home improvement as the reasons. While the company is facing some current challenges, we still view Trex as a high-quality business. We're doing more due diligence on the company, but we still like its position as the largest company in a market that is largely a duopoly.

**JFrog Ltd. (FROG)** was the top contributor to strategy performance for the quarter. The company provides a software-supply-chain platform, delivering tools like package repositories, continuous-delivery pipelines and security



scanning that help companies manage, build and secure their software delivery lifecycle. JFrog's stock rallied in November, driven by a strong third-quarter earnings report that included 26% revenue growth and earnings growth that came in ahead of consensus expectations. Cloud revenue reaccelerated during the reported period, with security, governance, and AI driving product adoption.

**Fabrinet (FN)** was also a significant contributor. Fabrinet is a contract manufacturer of laser-based communication hardware. The company's optical transceivers are noted for their ability to maintain precise thermal control and alignment of internal components during high-speed transmission of data. Fabrinet is seeing increased demand as data centers upgrade their networks to faster and lower-latency communication standards capable of handling complex AI workloads. Favorable trends in telecommunications end markets have added to investor optimism.

Another contributor was **RBC Bearings, Inc. (RBC)**, a global manufacturer of highly engineered, precision bearings, components and systems for critical aerospace, defense, and industrial applications. There has been no change to our thesis on this longtime holding. In our view, the company's management continues to execute at a high level and has done a phenomenal job of improving the companies it acquires. We believe RBC is poised for another year of steady growth in 2026.

## OUTLOOK AND POSITIONING

We know 2025 has been a difficult time to invest with Wasatch, and we greatly appreciate our clients' patience. As we look ahead, we remain confident in our ability to outperform the benchmark over a full market cycle.

While 2025 was a painful year, we're not making knee-jerk reactions in response to recent performance. Throughout Wasatch's history, we've faced other challenging periods when market behavior didn't seem rational. Those experiences taught us the value of sticking to our discipline, adhering to fundamentals and staying laser focused on finding high-quality growth businesses. The strategy has historically been rewarded for this discipline after periods of underperformance.

Looking back at other periods when the strategy underperformed the most, such as the lead up to the tech bubble, we didn't succumb to market euphoria and continued to focus on company fundamentals. We felt we were generally rewarded for that discipline, as the period after the bursting of the tech bubble was the strategy's greatest period of outperformance in the past 25 years.

Heading into 2026, the quality of the portfolio—as measured by items such as ROA and ROE—remains well above that of the benchmark. Earnings growth has also been consistent and exceeds this metric in the benchmark.

But while the portfolio's fundamentals haven't changed, one thing has. When looking at the valuations of our companies relative to the broader Index, they're more attractive on a relative basis than they've been in a very long time. When you compare the earnings yield of the portfolio to the earnings yield of the broad Index, our relative earnings yield is hovering near its most attractive level in at least a decade.

Given solid fundamentals and valuations that now look more attractive relative to the broader small cap universe, we're quite excited about the strategy's return potential from here.

Thank you for the opportunity to manage your assets.

Sincerely,

Ryan Snow, Ken Korngiebel and Natalie Pesqué



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