

## CONCENTRATED SMALL-CAP GROWTH STRATEGY

2Q 2017

### The Quarter in Review

The Oberweis Concentrated Small-Cap Growth Composite returned 2.91% (2.78% net of fees) during the June quarter versus a 4.39% return for the benchmark Russell 2000 Growth Index. Year-to-date, the Composite returned 11.57% (11.28% net of fees) versus 9.97% for the Russell 2000 Growth Index, an outperformance of 160 basis points (131 basis points net of fees).

The portfolio faced numerous performance headwinds over the last three months. Although growth continued to outperform value<sup>1</sup>, lower quality stocks led the way within the benchmark as the lowest ROE quintile and the highest P/E ratio quintile – plus the cohort of companies with no P/E's because they lack earnings – performed best during the quarter. The strength among low-quality stocks was particularly evident in the leadership demonstrated by biotechs, which returned 9.3% over the last three months and are responsible for nearly a quarter of the performance of the Russell 2000 Growth so far this year<sup>2</sup>. The best performing sectors within the Russell 2000 Growth Index during the quarter were Utilities, Healthcare (led by the aforementioned strength in biotech), and Real Estate; we are underweight all three sectors and lack meaningful exposure to biotech.

The strength in equities was broad-based globally during the first half of the year as economic growth and corporate earnings have accelerated world-wide, led by emerging markets such as China and India and developed markets including France and Germany. Manufacturing PMI's remained solidly above 50 in Canada, the Eurozone, Australia, Japan, and most emerging markets, signaling continued economic expansion. In the U.S., the PMI also remained above 50, while consumer confidence is at 10-year highs and wages are showing signs of increasing as unemployment flirts with structural cycle lows. Additionally, year-over-year headline inflation has accelerated globally and in the U.S. is around the Fed's 2% target, likely putting to rest the sustained fears of deflation that dogged global economies – particularly those in Europe – since the Global Financial Crisis.

Outside of equities, there were several notable moves in the second quarter that impacted stocks. Oil declined from nearly \$54 per barrel in early April to nearly \$42 in late June, causing Energy to be the worst-performing sector in the index during the quarter. Although the Federal Reserve increased rates for a fourth time in this tightening cycle in June, the yield on the 10-year U.S. Treasury actually fell since March 31, dragging the U.S. dollar – and financial stocks – lower. Lower yields may be a result of a flight to safety as investors seek shelter in response to rising tensions with North Korea and strained relations with Russia.

Meanwhile, U.S. equity valuations remain somewhat elevated but may be supported by improving corporate earnings. Broader market valuations, such as the S&P 500 P/E, are at above-average levels, although in fairness those P/E's are against a backdrop of sustained low interest rates that remain depressed relative to where they would normally be at this point in the cycle. Our universe P/E, which we've tracked since 2003, remains at average levels and is similar to the P/E's we've seen consistently since 2014. We think the market needs continued strength in economic indicators and corporate earnings and eventually corporate tax reform to justify current valuations, particularly those afforded more expensive large-cap stocks.

While mainstream market commentary is generally focused on those pricey large companies, we believe there are still reasons to be intrigued by small-cap growth stocks. First, evidence suggests that small-cap stocks tend to outperform large-caps during periods when the Federal Reserve is well into a tightening regime. According to research by Jefferies small-cap strategist Steven DeSanctis, small-caps traditionally outperform large-caps by over 300 basis points in the year following the fourth rate hike. Following the fifth hike, which we expect in the second half of 2017, that outperformance expands meaningfully to over 1,000 basis points in the subsequent year. Second, Mr. DeSanctis notes that small-cap growth stocks are still cheap relative to small-cap value stocks on several long-term valuation metrics, most notably price-to-cash flow, price-to-sales, and price-to-book value.

While macro factors can influence shorter time periods, we believe that investing in companies growing earnings beyond expectations results in superior investment performance over the long-term. Rather than ruminate about macro-economic indicators or geopolitical events, we focus on investing in individual businesses in which we believe something misunderstood or under-estimated is likely to drive earnings growth in excess of consensus expectations. While the multiple paid for such companies may oscillate in the short-run, we believe building portfolios populated with such companies leads to portfolio performance in excess of the benchmark over the long-term.

<sup>1</sup>The Russell 2000 Growth Index returned 4.39% for the June quarter and 9.97% year-to-date while the Russell 2000 Value Index returned 0.67% and 0.54%, respectively.

<sup>2</sup>Biotech stocks contributed 236 basis points of performance to the Russell 2000 Growth Index year-to-date. Source: Jefferies.

## Portfolio Highlights

As of June 30, 2017, the portfolio was 95.3% invested in 36 different positions. The portfolio had its largest weightings in technology (37.7% average weighting during the quarter versus 20.2% for the Russell 2000 Growth Index), health care (24.0% versus 21.9%), and consumer discretionary (15.8% versus 16.0%). The portfolio was most underweight producer durables (3.3% versus 14.0%), materials (0.0% versus 9.7%), and financial services (7.9% versus 12.2%).

In the second quarter the portfolio was negatively impacted by stock selection in technology (where our holdings returned 2.57% versus a 5.71% return for the benchmark's technology holdings) and health care (5.51% versus 9.89%) mainly due to our lack of exposure to biotech stocks.

## Key Benefits

The Concentrated Small-Cap Growth captures and highlights our domestic investment team's stock selection skill over a full market cycle by generally investing in the 25-35 highest conviction ideas from our domestic smaller-cap growth strategies. This strategy helps investors capitalize on the exceptional growth potential of fast-growing emerging companies in the rapid expansion phase of their lifecycle. The Concentrated Small-Cap Growth strategy generally invests in companies with market capitalizations under \$5 billion at the time of purchase.

The key benefits of the Concentrated Small-Cap Growth strategy are:

- Exposure to approximately 25-35 of our team's highest conviction ideas
- Potential for significant alpha over a full market cycle
- Emphasizes rapidly growing smaller-cap companies in the most dynamic phase of their development
- Disciplined and repeatable investment process managed by a passionate and experienced investment team
- Fully invested portfolio - no market timing

**Minimum Account Size: \$5 million for Institutional Account Management**

### PORTFOLIO CHARACTERISTICS

*(AS OF JUNE 30, 2017)*

Number of Stocks	36
Weighted Market Capitalization (in millions)	\$3,269
Median Market Capitalization (in millions)	\$2,049
P/E Forward 4 Quarters (estimated)	24.8x
Long-Term Future EPS Growth Rate (estimated)	18%
Long-Term Debt to Total Equity	30%
Return on Equity	10%
Cash Position	4.7%
Portfolio Turnover (2016)	46.9%

Source: Thomson Reuters Eikon

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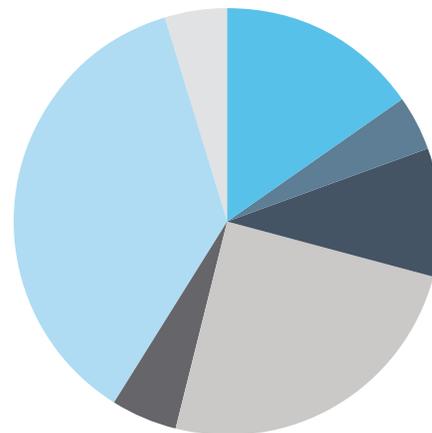
**TOP TEN HOLDINGS (as of June 30, 2017)**

Company		Line of Business
1	Inogen, Inc. 5.1%	Develops, manufactures and markets portable oxygen concentrators for patients suffering from chronic respiratory conditions
2	Ceva, Inc. 4.9%	Licensors of DSP cores and integrated applications to the semiconductor industry
3	LogMeIn, Inc. 4.6%	Provides a portfolio of cloud-based service offerings which helps people and businesses to connect to their workplace, colleagues and customers
4	Applied Optoelectronics, Inc. 4.5%	Manufactures advanced optical semiconductor devices
5	Eagle Bancorp, Inc. 3.6%	Bank holding company that offers commercial banking services to businesses and professional clients and consumer banking to individuals
6	OraSure Technologies 3.5%	Develops diagnostic tests used to detect infectious diseases
7	Monolithic Power Systems 3.1%	Develops high performance power solutions
8	TAL Education Group 3.1%	After-school tutoring provider for K-12 in China
9	Glaukos Corp. 3.0%	Develops treatments for glaucoma
10	Semtech Corp. 3.0%	Manufactures analog and mixed-signal semiconductors

*Top 10 holdings as a percentage of Total Net Assets. Portfolio Holdings are subject to change at any time. References to specific securities should not be construed as a recommendation to buy or sell and should not be assumed profitable. Source: Thomson Reuters Eikon*

**SECTOR WEIGHTINGS (as of June 30, 2017)**

Consumer Discretionary	15.3%
Consumer Staples	0.0%
Energy	4.2%
Financial Services	9.7%
Health Care	24.9%
Materials & Processing	0.0%
Producer Durables	4.8%
Technology	36.4%
Utilities	0.0%
Cash	4.7%
<b>Total</b>	<b>100.0%</b>



*Sector weightings as a percentage of Total Net Assets. Source: Thomson Reuters Eikon*

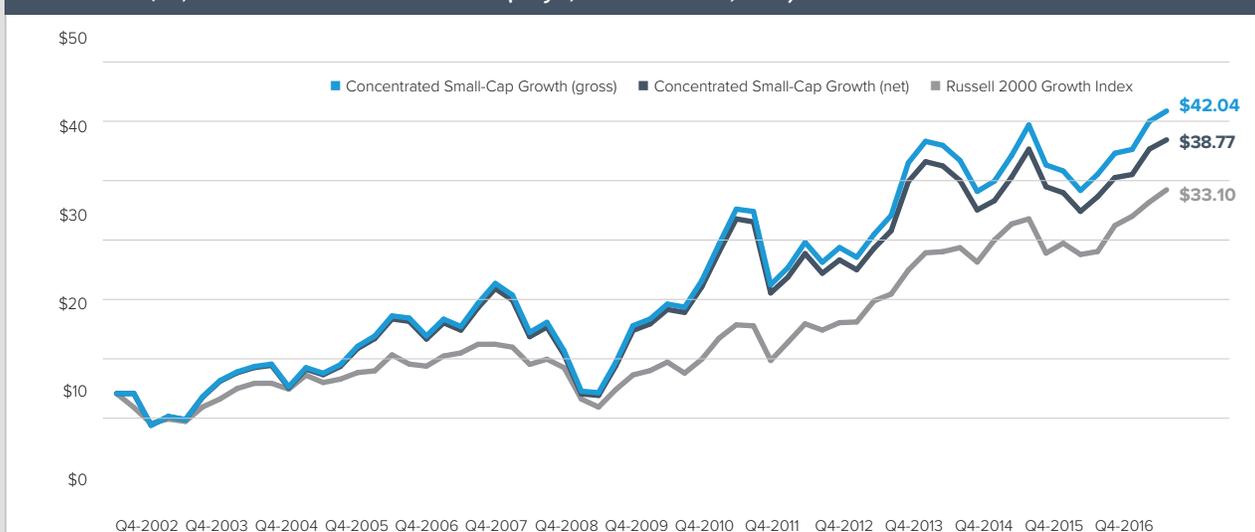
**AVERAGE ANNUAL TOTAL RETURNS (as of June 30, 2017)**

	QTD	YTD	1 Yr	3 Yr	5 Yr	10 Yr	Since Inception 5/1/2002
<b>Concentrated Small-Cap Growth (gross of fees)</b>	<b>2.91%</b>	<b>11.57%</b>	<b>20.57%</b>	<b>4.90%</b>	<b>11.05%</b>	<b>7.58%</b>	<b>9.93%</b>
<b>Concentrated Small-Cap Growth (net of fees)</b>	<b>2.78%</b>	<b>11.28%</b>	<b>19.91%</b>	<b>4.31%</b>	<b>10.40%</b>	<b>6.98%</b>	<b>9.34%</b>
Russell 2000 Growth Index	4.39%	9.97%	24.40%	7.64%	13.98%	7.82%	8.37%

Oberweis Asset Management, Inc. ("OAM") is an independent investment management firm that is not affiliated with any parent organization. The composite includes all fully discretionary accounts which invest at least 70% of their assets in the securities of U.S. traded companies with a market capitalization between \$100 million and \$2.5 billion at the time of investment. Beginning October 2010, the composite includes accounts managed with similar investment objectives that charge a bundled fee for investment advisory and administrative services. Effective January 1, 2008, portfolios with a market value of under \$5 million will be included in the composite. Prior to January 1, 2008, the minimum market value for portfolios to be included in a composite was \$5 million. From inception to 12-31-10, the composite name was Concentrated Smid-Cap Growth Equity. Accounts are dollar-weighted within the composite and reported in U.S. dollars.

The Russell 2000 Growth Index measures the performance of those Russell 2000 companies with higher price-to-book ratios and higher forecasted earnings growth rates. The index is an unmanaged group of stocks, whose performance does not reflect the deduction of fees, expenses or taxes.

Advisory fees are disclosed in Part II of Form ADV. Performance is historical and includes the reinvestment of dividends and other income. Past performance is not necessarily indicative of future results.

**GROWTH OF \$10,000 — WITH INCOME INVESTED (May 1, 2002 – June 30, 2017)**


## The Oberweis Aperture

Our unique, highly disciplined investment approach includes a series of eight criteria to focus our research efforts.


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## Oberweis Asset Management, Inc.

Recognized as a leading small-cap stock specialist, Oberweis has been helping institutional investors manage their assets prudently and effectively for many years.

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