

## CONCENTRATED SMALL-CAP GROWTH STRATEGY

3Q 2017

### The Quarter in Review

The Oberweis Concentrated Small-Cap Growth Composite returned 9.19% (9.05% net of fees) during the September quarter versus a 6.22% return for the benchmark Russell 2000 Growth Index. Year-to-date, the Composite returned 21.83% (21.34% net of fees) versus 16.81% for the Russell 2000 Growth Index, an outperformance of 502 basis points (453 basis points net of fees).

Growth stocks again outperformed value stocks during the quarter and have now bested their value cousins by over 1,100 basis points year-to-date, although value stocks did rebound somewhat on a relative basis during the month of September<sup>1</sup>. From a capitalization perspective, small-cap stocks slightly outperformed large-cap stocks during the quarter but continue to lag by nearly 400 basis points year-to-date<sup>2</sup>. Biotech stocks, which returned over 14% during the quarter<sup>3</sup>, remained a headwind and helped drive the healthcare sector to the highest year-to-date return within the Russell 2000 Growth Index. We were underweight the sector and had minimal exposure to biotechs specifically.

Both developed and emerging markets equities continued to exhibit strength globally during the quarter. Chinese stocks have led the way thus far in 2017, followed closely by Brazil and India. Developed European markets – particularly France and Germany – have also performed well, while Russia has been one of the few problematic markets. These positive returns have been supported by accelerating economic growth and earnings growth in 2017, particularly in Europe, where the Global Purchasing Managers' Index for manufacturing has demonstrated consistent strength dating to the end of 2016. In fact, Germany's PMI eclipsed 60 in September for the first time in recent memory, while the PMI in the U.S. continues to post readings in the low-50's, signaling continued expansion.

Against this backdrop, however, are valuations in the U.S. that are above-average for both the S&P 500 Index and for our investable universe of small-cap growth companies, a data point that is discussed frequently on CNBC by those labeling the U.S. equity market as "expensive" or "pricy" or even a "bubble." While the P/E's on an absolute basis are troubling, we would caution that these above-average multiples are against a backdrop of sustained low interest rates. Since 1990, the average yield on a U.S. 10-year Treasury bond is over 4.6%. We closed the third quarter at 2.35% and haven't seen 4.6% in a decade. The Federal Reserve, however, has more recently shifted its monetary stance toward a tightening bias after raising rates four times in 18 months. This bias will soon strengthen as the Fed refrains from purchasing treasuries and mortgage-backed securities with the proceeds from maturing securities on its balance sheet. We expect the balance sheet unwind will become a more pressing topic in 2018 and could help to drive bond yields higher.

The other interesting issue related to P/E resides in the earnings part of the equation, which could experience a meaningful boost should the Congress pass legislation that reduces the corporate tax rate to 20%, as has been telegraphed by President Trump and Republican leadership. Micro-cap and small-cap stocks are seen as more sensitive to corporate tax cut expectations and would stand to disproportionately benefit from an all-encompassing reduction to 20%. Research by Credit Suisse's chief U.S. equity strategist Lori Calvasina estimates that the effective tax rate is currently 32% for the Russell 2000 Index and 26% for the S&P 500 Index. A reduction to 20% would essentially boost earnings for the Russell 2000 Index by over 17% and effectively reduce the index P/E by 15%.

Certainly tax reform expectations are high and are, at a minimum, somewhat priced into micro-cap equities. Now more than ever, the equity rally seems to be based on the promise of tax cuts, both at the corporate and individual levels. Politicians have committed to a resolution by year-end to provide tax clarity heading into 2018, so this represents a risk worth monitoring as the fourth quarter unfolds. Given the Trump administration's multiple failures with healthcare reform, we believe there is a reasonable probability of disappointment that might lead to a short-term disruption in small-cap equity prices.

Longer term, we believe that investing in companies growing sales and earnings beyond consensus expectations drives superior long-term performance. Rather than focus on macro factors or geopolitical events, we instead focus our research effort on a company-by-company basis to identify individual businesses where we believe something is misunderstood or underestimated by the average investor, resulting in proprietary earnings expectations that differ materially from consensus. While the multiple investors are willing to pay may vary in the near-term, we believe such investments will lead to excess performance over the long-term.

<sup>1</sup>The Russell 2000 Growth Index returned 6.22%, 16.81%, and 5.45% for the quarter, year-to-date, and month (ended September 30, 2017), respectively. The Russell 2000 Value Index returned 5.11%, 5.68%, and 7.08% for the quarter, year-to-date, and month (ended September 30, 2017), respectively.

<sup>2</sup>The Russell 1000 Growth Index returned 5.90% during the quarter and 20.72% year-to-date.

<sup>3</sup>The biotechnology industry within the Russell 2000 Growth Index (Russell classifications) returned 14.64% during the quarter.

## Portfolio Highlights

As of September 30, 2017, the portfolio was 93.5% invested in 32 different positions. The portfolio had its largest weightings in technology (36.1% average weighting during the quarter versus 19.7% for the Russell 2000 Growth Index), health care (23.3% versus 24.3%), and consumer discretionary (16.9% versus 15.6%). The portfolio was most underweight producer durables (3.6% versus 15.8%), materials (0.0% versus 8.1%), and financial services (8.2% versus 10.7%).

In the third quarter the portfolio was positively impacted by stock selection in consumer discretionary (where our holdings returned 25.18% versus a 5.82% return for the benchmark's consumer discretionary holdings).

### PORTFOLIO CHARACTERISTICS

(AS OF SEPTEMBER 30, 2017)

Number of Stocks	32
Weighted Market Capitalization (in millions)	\$3,380
Median Market Capitalization (in millions)	\$2,280
P/E Forward 4 Quarters (estimated)	17.7x
Long-Term Future EPS Growth Rate (estimated)	15.0%
Long-Term Debt to Total Equity	15.0%
Return on Equity	9.0%
Cash Position	6.5%
Portfolio Turnover (2016)	46.9%

Source: Thomson Reuters Eikon

## 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**

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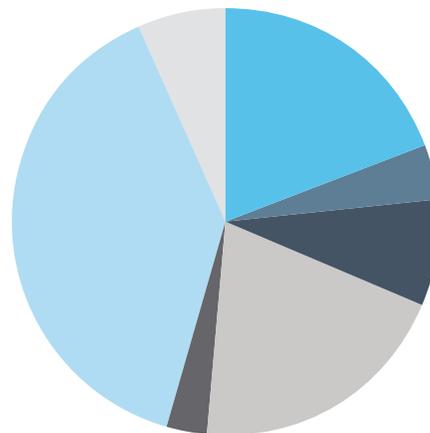
**TOP TEN HOLDINGS (as of September 30, 2017)**

Company		Line of Business
1	Rogers Corp.	4.7% Manufactures specialty materials and components
2	TAL Education Group	4.7% After-school tutoring provider for K-12 in China
3	Inogen, Inc.	4.7% Develops, manufactures and markets portable oxygen concentrators for patients suffering from chronic respiratory conditions
4	LogMeIn, Inc.	4.5% Provides a portfolio of cloud-based service offerings which helps people and businesses to connect to their workplace, colleagues and customers
5	Ceva, Inc.	4.2% Licensor of DSP cores and integrated applications to the semiconductor industry
6	OraSure Technologies	4.1% Develops diagnostic tests used to detect infectious diseases
7	The Children's Place	4.1% Retailer that offers value-priced apparel and accessories for children
8	Burlington Stores, Inc.	3.6% Operates clothing retail stores focused on low prices
9	Eagle Bancorp, Inc.	3.5% Bank holding company that offers commercial banking services to businesses and professional clients and consumer banking to individuals
10	Extreme Networks, Inc.	3.2% Provides soft-ware driven networking solutions

*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 September 30, 2017)**

■ Consumer Discretionary	19.3%
■ Consumer Staples	0.0%
■ Energy	4.2%
■ Financial Services	7.9%
■ Health Care	20.2%
■ Materials & Processing	0.0%
■ Producer Durables	2.9%
■ Technology	39.0%
■ Utilities	0.0%
□ Cash	6.5%
<b>Total</b>	<b>100.0%</b>



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

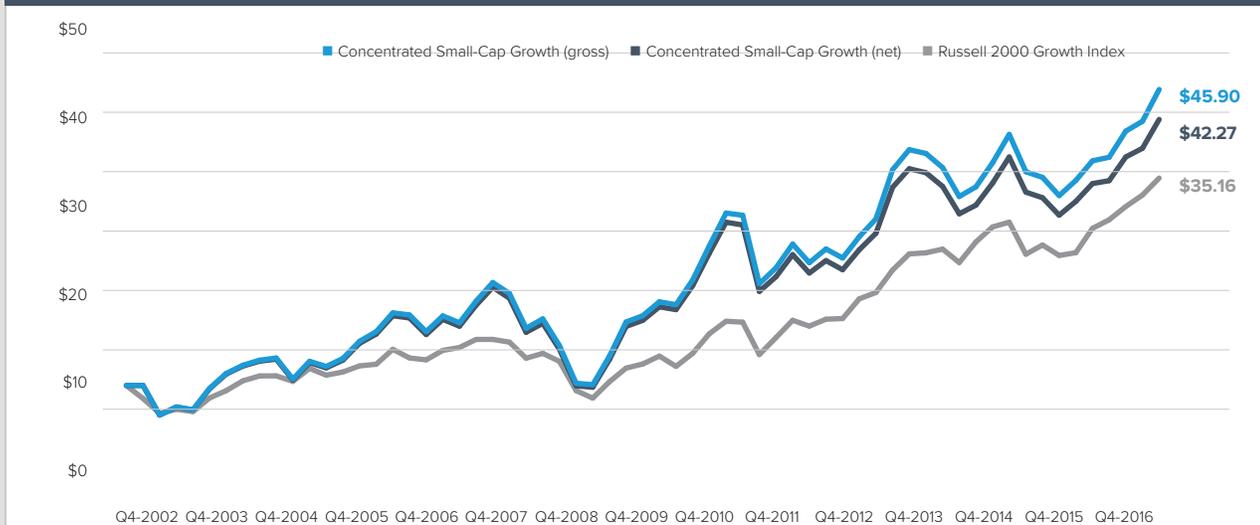
**AVERAGE ANNUAL TOTAL RETURNS (as of September 30, 2017)**

	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>9.19%</b>	<b>21.83%</b>	<b>23.26%</b>	<b>11.72%</b>	<b>11.57%</b>	<b>7.40%</b>	<b>10.39%</b>
<b>Concentrated Small-Cap Growth (net of fees)</b>	<b>9.05%</b>	<b>21.34%</b>	<b>22.59%</b>	<b>11.10%</b>	<b>10.94%</b>	<b>6.79%</b>	<b>9.80%</b>
Russell 2000 Growth Index	6.22%	16.81%	20.98%	12.17%	14.28%	8.47%	8.65%

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– September 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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