Oberweis
Asset Management

EMERGING MARKETS MARKET COMMENTARY

2Q 2021

The Quarter in Review

The Oberweis Emerging Markets strategy declined 4.60% (-4.89% net of fees) during the third quarter of 2021. The MSCI Emerging Markets Small-Cap Index, which serves as our benchmark, fell 2.16% during the period. Year to date, the strategy has gained 11.62% (10.68% net of fees), while the benchmark index has climbed 17.20%. Since the strategy's June 2018 inception, the strategy has enjoyed an annualized return of 15.70% (14.44% net of fees) versus the benchmark's 8.07% annualized return.

While we focus on emerging markets, we are also cognizant that events and changes in the US and other developed markets can also have a profound influence on those in EM. Changing outlooks on inflation, the related outlook for interest rates, and supply-chain bottlenecks (which also have an impact on the aforementioned inflation outlook) can quickly elevate risks for investors in both developed and emerging market countries. Further, lofty valuation multiples in developed markets leave a smaller-than-normal buffer should growth fail to meet expectations. Global issues can take center stage at a moment's notice, and thus need to be considered by EM investors, in addition to all of the normal innerworkings of each developing country. Those of us who follow developing markets envy the simple life our U.S.-investing colleagues enjoy, having only the one country, and the issues driving it, to follow.

These same big picture factors are also at work in emerging markets, but certainly not uniformly across the entire group. Many emerging markets live with inflation year after year. For some of them, inflation is perhaps currently running a bit higher than normal, but it does not constitute the potential regime change shock to the system that rising inflation might mean for the U.S. Several developing-market central banks have already reacted to higher inflation and have hiked interest rates. In Mexico's case multiple times in the past few months without a remarkable, lasting impact on the equity market. Others, such as Indonesia, are still leaving rates low as they are still recovering from the latest bout with COVID.

Looking at the Big Five emerging markets—Taiwan, India, South Korea, China and Brazil—that comprise a bit more than 70% of the total benchmark, reveals the varied impact, or lack of impact, of inflation and interest rates on domestic equities, and the typically much stronger impact of other local factors. China, the developing world's largest economy, is a good place to start. Instead of raising rates and tightening liquidity as global inflation picked up, China loosened liquidity slightly by reducing the required reserves banks must hold on the balance sheet in an effort to reverse slowing economic growth and support a sagging property market. Even so, the market fell considerably during the quarter as regulatory changes and the potential default of Evergrande, a large property developer, outweighed easing financial conditions.

South Korea and Brazil, on the other hand, both raised rates during the quarter to combat rising inflation. The South Korean market counterintuitively rose after the announcement, although not enough to bring the market into positive territory for the quarter as supply-chain bottlenecks continued to squeeze its manufacturing-heavy economy. Brazilian equities also fell during the quarter, but not noticeably because of rising rates. Brazil's equity-market problems appear to be much more closely tied to falling iron ore and soybean prices—two of the country's top exports—and continuing political chaos.

Neither Taiwan nor India have raised rates in well over a year. The Taiwanese market declined despite keeping financial conditions loose as semiconductor manufacturers fell on signs that the global chip shortage may ease in the near future. Persistent non-semiconductor supply chain issues hit other Taiwanese stocks that serve a variety of sectors, such as computers and telecommunications. The biggest drop for Taiwanese equities during the quarter came after the Biden administration announced arms sales to the country over Chinese objections, which is geopolitically noteworthy, but unrelated to the inflation, interest rate, supply chain and valuation debates that have captured many global investors' attention.

India is the obvious outlier as the only one of the Big Five emerging markets to post a gain during the third quarter. Despite signs of rising inflation, the Reserve Bank of India (RBI) not only left rates unchanged, but also indicated that they were not considering higher rates anytime soon. Indian equities enjoyed an almost uninterrupted rise during the quarter. As in the U.S., the easy financial conditions showed up most noticeably in higher valuation multiples. According to data compiled by Bloomberg, the forward P/E multiple for the MSCI Indian Small Cap Index climbed from just over 28 times to more than 32 times by the end of the quarter as consensus EPS estimates fell during the quarter. The rest of the Big Five saw their forward valuation multiple compress during the quarter. India's current multiple is even more dramatic relative to longer term averages. From 2008 through the second quarter of 2020, when the RBI slashed rates to their current, record lows, the forward multiple for the Indian small cap index averaged 16.9 times. For the past twelve years, actual Indian EPS growth has never met or beat estimates, a streak that Australian investment bank Macquarie calls a world record.

The bottom line to all of the above is this: emerging markets are a diverse basket of countries and, as a group, rarely fit into a neat global macroeconomic or political narrative. In our experience, the one exception to this is a substantial rise or fall in the value of the U.S. Dollar, which is the currency denomination for much of the developing world's corporate and sovereign debt. The dollar rose a bit during the quarter, but stayed within the same range it has been in since early 2020 and below its pre-COVID level. We do not think the dollar played much of a role in developing-market returns during the quarter. Instead, the MSCI Emerging Markets Small Cap Index's decline reflected various country-specific issues, partially offset by equity-market growth in India and a handful of smaller countries.

AVERAGE ANNUAL TOTAL RETURNS ***(as of September 30, 2021)***

	QTD	YTD	1 YR	3 YR	Since Inception 6/1/2018
Emerging Markets (gross of fees)	**-4.60%**	**11.62%**	**33.32%**	**22.82%**	**15.70%**
Emerging Markets (net of fees)	**-4.89%**	**10.68%**	**32.08%**	**21.53%**	**14.44%**
MSCI Emerging Markets Small-Cap Index	-2.16%	17.20%	43.24%	13.11%	8.07%

Past performance is not necessarily indicative of future results. Performance is historical and includes the reinvestment of dividends and other income. Unusually high returns may not be sustainable. The strategy invests in rapidly growing smaller and medium-sized companies that may offer greater return potential. However, these investments often involve greater risks and volatility. Foreign investments involve greater risks than U.S. investments, including political and economic risks and the risk of currency fluctuations. Advisory fees are disclosed in Part II of Form ADV.

Oberweis Asset Management, Inc. ("OAM") is an independent investment management firm that is not affiliated with any parent organization. The composite returns are comprised of all fully discretionary accounts with a minimum value of $5 million. Performance results, from 6-1-18 to present, are derived solely from the performance of the Oberweis Emerging Markets Fund, a registered, open-end mutual fund, for which OAM serves as investment adviser. Accounts are dollar-weighted within the composite and reported in U.S. dollars.

The MSCI Emerging Markets Small Cap Index is a free float-adjusted, market capitalization-weighted index that measures the performance of small-cap stocks in 24 emerging markets.

The Quarter in Review (continued)

The Oberweis Emerging Markets strategy remains focused on company fundamentals. We look for well-managed businesses with durable balance sheets, durable growth and durable competitive advantages. Local economic and political conditions matter as we think about how underlying economic growth may impact sales at a specific company or if changing domestic political conditions alter the risks to a particular business. Under normal circumstances, however, bottom-up company characteristics outweigh top-down factors as we search for investment opportunities.

The strategy invests in select businesses with key quality attributes, but not at any price. We pay careful attention to valuation when making investment decisions. As a result, we found relatively fewer investment opportunities in India, where valuation multiples are high, and relatively more in China and Brazil, where valuation multiples are much cheaper. That relative position was a performance headwind during the quarter as India outperformed, while Brazil and China substantially trailed the benchmark. We have been down this road before. We often find opportunities to invest in outstanding businesses that, because they happened to be in out-of-favor countries, trade at attractive prices. In the short term, those companies may underperform as macroeconomic or political uncertainty proves temporarily stronger than business fundamentals. Over the long term, however, superior company quality gets recognized in rising stock prices and strong relative and absolute investment performance, as has been the case for the Oberweis Emerging Markets strategy's returns since inception.

Looking more closely at portfolio performance during the quarter, and starting with country-level attribution, country allocation had no net impact on relative performance. Issue selection, on the other hand, subtracted 86 basis points from relative performance. Looking at attribution on a sector basis, issue selection added 10 basis points to relative performance and sector allocation trimmed 96 basis points. Communication Services and Consumer Staples, the largest contributors to performance, added 152 basis points and 95 basis points, respectively. On the other side of the ledger, Information Technology reduced relative performance by 293 basis points and Health Care by 58 basis points.

Outlook

We remain excited about the investment potential in emerging markets. We believe the drive of people who live in the developing world to live better, healthier and more productive lives is inexorable. Moreover, we continue to believe that drive will fuel structural growth in spending on consumer goods and healthcare, as well as investments in infrastructure and automation. Our strategy to invest in prudently managed and competitively advantaged companies that are positioned to benefit from that long-term structural growth remains unchanged.

We also continue to believe that emerging markets equities are attractively valued. According to data compiled by Bloomberg, the MSCI Emerging Markets Small Cap Index traded at a forward price-to-earnings multiple of 14.2 times at the end of the third quarter, which is only slightly higher than the 13.8 times average forward earnings that the Index has traded at over the past ten years. Emerging markets small cap equities look attractive relative to the rest of the world. Bloomberg reports that the globe-spanning MSCI All Country World Index (ACWI) trades at a much richer 18.4 times forward multiple. Given the comparatively attractive long-term growth opportunities we see for smaller companies in developing markets, we think the lower valuation multiple is attractive.

Portfolio Highlights

At quarter-end, the portfolio was invested in 67 stocks domiciled in 24 countries. Our top five country weightings (portfolio versus the MSCI Emerging Markets Small-Cap Index) were China (16.0% vs. 8.4%), India (17.1% vs. 20.4%), Taiwan (15.6% vs. 21.2%), South Korea (11.3% vs. 17.3%), and Indonesia (4.5% vs. 1.6%). The strategy's largest overweight sectors were Consumer Discretionary (19.4% vs. 13.0%), Consumer Staples (11.3% vs. 6.9%), and Information Technology (22.9% vs. 23.5%). The largest underweight sectors were Materials (3.1% vs. 12.0%), Real Estate (1.1% vs. 3.1%), and Utilities (0% vs. 1.9%).

Organization Update

There was no change to the team during the quarter.

Oberweis Asset Management's Investment Phillosophy

We believe that investing in smaller companies driving revenue and earnings growth in excess of expectations results in superior investment performance over long periods of time. We believe that innovation is the key to economic growth and wealth creation and are committed to investing in companies at the forefront of innovation – smaller company stocks that offer the potential for extraordinary revenue and earnings growth.

The entrepreneurial spirit is alive and well at these companies. Many are nimble and uniquely address the needs of their customers with patented new products and services. Successful investing, however, demands more than finding companies with good growth prospects. We must also buy these stocks for our clients at prices that make sense. By paying careful attention to companies' valuations in relation to expected earnings growth rates, we seek to purchase stocks when they still have considerable appreciation potential.

For more information please contact:
Brian K. Lee, Director of Marketing & Client Service
(800) 323-6166 | (630) 577-2321 | brian.lee@oberweis.net

Marc Carlson, Director Marketing & Client Service
(800) 323-6166 | (630) 577-2364 | marc.carlson@oberweis.net

Oberweis Asset Management, Inc.
3333 Warrenville Rd., Suite 500, Lisle, IL 60532