Oberweis Asset Management

MICRO-CAP GROWTH MARKET COMMENTARY

3Q 2021

The Quarter in Review

The Oberweis Micro-Cap Growth Strategy posted a favorable relative performance quarter, returning -3.27% (-3.46% net of fees) versus -9.09% for the Russell Microcap Growth Index, an outperformance of 582 basis points (563 basis points net of fees). Year-to-date performance has been strong on both an absolute and relative basis, with the composite returning 35.35% (34.60% net of fees) versus the benchmark return of 9.61%, a delta of nearly 2,600 basis points (2,499 basis points net of fees).

The portfolio performed relatively well despite a mixed market backdrop as capitalization and style were headwinds in the overall market. Smaller cap stocks again underperformed large caps[1] by a wide margin, and value stocks significantly outperformed growth stocks for both the quarter and year-to-date periods[2]. While we are not a value manager, we do pride ourselves on investing in businesses growing faster than expectations at attractive valuations. The vast majority of our portfolio holdings are in companies we consider "high quality," those with strong balance sheets that are generating earnings and cash flow. As we've noted in previous commentaries, investors in 2020 shunned companies with profitability and earnings at a rate we last witnessed in 1999. Instead, the market was driven by investments we avoid: "low-quality" companies with low returns-on-equity (ROE) or "non-earners" that are losing money. This year, those companies are badly lagging and profitable companies with higher ROE's are leading the market, which is helping to drive our strong performance.

Russell 2000 Growth Index Performance by ROE Quintile

	'20 Return	**'21 YTD Return**
Highest ROE Quintile 1	22.79%	14.88%
ROE Quintile 2	10.76%	20.34%
ROE Quintile 3	26.59%	2.67%
ROE Quintile 4	82.74%	--16.30%
Lowest ROE Quintile 5	56.34%	--12.23%

*Source: Jefferies

The overall U.S. equity market chopped around during the third quarter in response to macroeconomic factors that are more mixed today than they were entering the year. On the positive side, global economies continue to re-open as vaccination rates rise and the Covid-19 virus is increasingly under control; the most recent Composite Purchasing Managers' Index readings showed expansionary activity in the U.S., Europe, India, and Brazil. The US consumer, with record household net worth in excess of $140 billion and a household debt service ratio (debt payments as a percentage of disposable personal income) at all-time lows, remains in great shape broadly and seemingly possesses the purchasing firepower to drive further economic growth.

There are, however, some clouds on the horizon that offer cause for concern. The most recent Atlanta Fed forecast for U.S. third quarter GDP has dropped significantly from over 7% in July to a mere 1.3% as of October 5th. Asian economies are lagging, with PMI's in China and Japan at or below 50, signaling deceleration. Elevated inflation endures globally as the debate between the "transitory" and "structural" inflation camps rages on. Record job vacancies are driving wages higher, though we remain hopeful that labor supply will increase now that supplemental unemployment benefits related to the Covid-19 crisis expired in early September.

[1] The proxy for small caps, the Russell 2000 Growth Index, underperformed the large cap Russell 1000 Growth Index by 681 basis points during the quarter and by 1,148 basis points year-to-date.

[2] The Russell 2000 Value Index outperformed the Russell 2000 Growth Index by 267 basis points during the quarter and by over 2,000 basis points year-to-date.

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

	QTD	YTD	1 Yr	3 Yr	5 Yr	10 Yr	Since Inception 1/1/1996
Micro-Cap Growth (gross of fees)	**-3.27%**	**35.35%**	**83.17%**	**18.45%**	**22.35%**	**21.56%**	**13.38%**
Micro-Cap Growth (net of fees)	**-3.46%**	**34.60%**	**82.08%**	**17.42%**	**21.33%**	**20.53%**	**12.34%**
Russell Microcap Growth Index	-9.09%	9.61%	42.11%	12.45%	13.99%	15.02%	N/A

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 1-1-96 until 12-31-03 and 9-1-11 to present were derived solely from the performance of the Oberweis Micro-Cap Fund, a registered, open-end mutual fund, for which OAM serves as investment adviser. Prior to November 4, 2001, James D. Oberweis was the sole portfolio manager for the Micro-Cap Fund during the period of the performance results noted. Accounts are dollar-weighted within the composite and reported in U.S. dollars.

The Russell Microcap Growth Index measures the performance of those Russell Micro Cap companies with higher price-to-book ratios and higher forecasted growth values. The performance data includes reinvested dividends. The Russell Microcap Index is represented by the smallest 1,000 securities in the small cap Russell 2000 Index plus the next 1,000 securities. Each index is an unmanaged group of stocks, whose performance does not reflect the deduction of fees, expenses or taxes.

The Quarter in Review (continued)

Cost pressure and supply constraints are mentioned most often in our conversations with company management teams, and hopes for improvement by year-end now seem to be pushed back to next summer. The global supply chain for goods ranging from appliances to furniture to semiconductors remains surprisingly tight, and potentially worsened during the quarter. Supplier delivery times are the slowest since 2011, and the Baltic Dry Index, a proxy for global shipping costs, is at its highest level since 2008. We are alert to the possibility that some of our investment companies may hit short-term air pockets as they attempt to navigate this challenging environment.

The trade-off between inflation and interest rates is increasingly a conundrum for the Federal Reserve. Interest rates remain purposefully low (the 10-year Treasury Bond yield closed the quarter at 1.53%) with artificial support from the Fed's aggressive bond buying program. Real 10-year rates, which reflect the impact of inflation, now stand at –2.46%, the lowest level since the late 1970's. The Fed has signaled its willingness to begin "tapering" bond purchase amounts as soon as its meeting in November, and other developed market central banks are expected to follow suit. How bond and equity markets respond to a reduction in liquidity will be the subject of much debate until then.

Against this backdrop, there has been consistent discussion about stretched U.S. equity market valuations in the mainstream financial media. While valuations for popular benchmarks like the S&P 500 and Nasdaq 100 are well above normal on valuation metrics like P/E, price/book, and price/cash flow, we believe our investable universe of stocks and our portfolio are actually attractively valued compared to average historical levels. During the latest earnings reporting period, we continued to find a typical number of new investments in companies with the potential for better-than-expected earnings growth trading at what we consider to be attractive valuations based on our proprietary earnings estimates.

It's possible that shifting economic fundamentals around inflation, supply constraints, and interest rates could increase volatility in the market as we move into 2022. Despite potential short-term swings, our bottom-up investment strategy steadfastly focuses on identifying companies with better-than-expected earnings growth prospects driven by structural fundamental changes. While the price the market is willing to pay for these companies may vary from quarter to quarter, we believe over the long-term a diversified portfolio of these investments is likely to outperform the market.

Portfolio Highlights

As of September 30, 2021, the portfolio was 96.0% invested in 81 different positions. The portfolio had its largest over-weightings in technology (27.9% average weighting during the quarter versus 14.3% for the Russell Microcap Growth Index), consumer discretionary (22.7% versus 14.7%), and producer durables (20.6% versus 16.0%). The portfolio was most underweight healthcare (14.9% versus 40.5%, primarily due to our significant biotech underweighting), financial services (1.9% versus 5.0%) and consumer staples (0.3% versus 1.7%).

Overall performance in the third quarter was positively impacted by strong stock selection, particularly in producer durables (where our holdings returned 10.59% versus a -7.58% return for the benchmark's producer durables holdings) and technology (-2.37% versus -8.37%), and materials (16.72% versus 2.01%).

Organization Update

There was no change to the team during the quarter.

Oberweis Asset Management's Investment Philosophy

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.

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