Oberweis Asset Management

CHINA OPPORTUNITIES MARKET COMMENTARY

4Q 2022

The Quarter in Review

In the fourth quarter, the China Opportunities Composite returned 5.86% (5.33% net of fees) versus 13.52% for the MSCI China Index. For the year, the Composite returned -35.20% (-36.45% net of fees) versus -21.93 for the Index. It was a tough year for fundamental investors in Chinese equities, as well as for our strategy. Stock prices were driven by primarily by macro factors such as government policies, geopolitical tensions with the USA and interest rate decisions at the US Fed. Micro-level fundamental factors such as individual company competitive advantages and financial performance played a smaller role. Despite a difficult period, the strategy's longer-term track record remains strong, with significant outperformance over trailing 3, 5, 10 and 15-year periods. Over the trailing 10-years, the Oberweis China Opportunities strategy had an average annual return of 8.83% (7.52% net of fees) versus 2.43% for the Index.

Chinese equity markets ended an unusual year with another dramatic quarter. The 20th National Congress of the Chinese Communist Party in October was anticipated to be the most important political event in China this year. It would determine China's core leadership for the next five years, if not longer. As the meeting approached, investors became increasingly concerned that China would gravitate toward a more closed and authoritarian path. The MSCI China Index fell by more than 25% in the two months preceding the end of the meeting. The results of the meeting seemed to justify those concerns, as President Xi Jinping emerged with a complete monopoly on the power of the Politburo, the top decision-making body in China. However, after his successful power consolidation, Xi began to soften his previously tough stance on several core issues, including the Covid-zero policy, property market regulation and anti-monopoly investigations against top internet companies. Encouraged by the swift policy changes, the market rebounded by more than 30% in the two months that followed. Separated by the Congress, we saw two distinct periods distinguished by vastly different policy and stock market performance.

Since the outbreak of Covid-19, China has consistently implemented Covid-zero as its core strategy. Although the strategy sought to ensure minimum infection and the least disturbance to its supply chain, it had become increasingly intolerable with the rise of the more infectious Omicron variant. The policy even triggered social protests, a rare occurrence since the Tiananmen Square Incident in 1989. Facing mounting pressure, Xi quickly abandoned the Covid-zero policy after the Congress and reopened the country. This was much earlier than the market's expectation, which seemed to converge on March's conclusion of the National People's Congress. The poorly-prepared reopening caused a lot of chaos, from shortages of medicine to crowded hospitals to a skyrocketing number of deaths. Economic activity was also disrupted. In December 2022, the official Manufacturing PMI fell to 47.0 and the official Service PMI slumped to 41.6, reflecting the lowest levels for both since February 2020. Those swift policy changes also greatly reduced the time required for herd immunity. In just one month, most of the first batch of cities to reopen reached infection peaks and returned to normal life. It is expected that peak infection and herd immunity will be reached across the country around Chinese New Year, which occurs near the end of January. With the reopening of the country, the Chinese economy is anticipated to return to normal for the first time since the pandemic began.

A declining property sector has also weighed on the Chinese economy for the past two years as China sought to reduce financial leverage. Beginning in late 2020, policymakers launched a series of new policies to control the financing and debt levels of property companies. However, as high leverage businesses, property companies were hit hard by the new financing restrictions. Even some high-quality property companies faced liquidity issues in early 2022. Some deeply-distressed firms could not even finish their existing projects, causing social unrest in some cities. Even faced with these challenges, Chinese regulators stayed on path of austerity despite some small-scale measures in individual cities. However, that policy stance changed significantly after the Congress. Vice Premier Liu He acknowledged the pivotal role of property in the economy for the first time in the past two years. A series of new decisive measures were launched to shore up sector balance sheets and restore confidence in the housing market, including allowing quality companies to restart financing in the bond and equity markets, increasing loan quotas for private developers and relaxing housing purchase restrictions in almost all cities. Although the golden age of this sector has gone, a stable property sector will undoubtedly help support the economy in the coming year.

AVERAGE ANNUAL TOTAL RETURNS ***(as of December 31, 2022)***

	QTD	1 Yr	3 Yr	5 Yr	10 Yr	Since Inception 10/1/2005
China Opportunities (gross of fees)	**5.86%**	**-35.20%**	**-0.32%**	**0.75%**	**8.83%**	**11.42%**
China Opportunities (net of fees)	**5.33%**	**-36.45%**	**-1.66%**	**-0.57%**	**7.52%**	**10.02%**
MSCI China Index	13.52%	-21.93%	-7.50%	-4.54%	2.43%	7.01%

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 10-1-05 until 10-1-06 as well as 5-1-08 to present, are derived solely from the performance of the Oberweis China Opportunities 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 China Net Index is a free float-adjusted market capitalization-weighted Index of Chinese equities that include China-affiliated corporations and H shares listed on the Hong Kong Exchange, and B shares listed on the Shanghai and Shenzhen exchanges and P chips and foreign listings with minimum dividends reinvested net of withholding tax.

Oberweis Asset Management (Hong Kong) Limited ("OAMHK"), is a subsidiary of OAM and is organized under the laws of Hong Kong and licensed by the Hong Kong Securities and Futures Commission. OAMHK has entered into a sub-advisory agreement with OAM to provide research services and portfolio management with respect to OBCHX.

The Quarter in Review (continued)

Internet was another sector that was negatively impacted by regulations over the past two years but saw swift policy changes after the Congress. China's top regulators released sweeping guidelines on regulation of various aspects of online platform businesses in late 2020, including their investments in financial institutions. The sector has been under persistent regulatory pressure amid accusations of big data-enabled price discrimination and monopolistic practices. The tighter regulation both constrained business expansion and negatively influenced investor sentiment on the sector, putting downward pressure on stock valuations. However, internet companies have proven their value during the pandemic, including providing logistic support during quarantine periods and as efficient communication tools for remote workers. Also, most internet companies have already met the revised antitrust law requirements after two years of business restructuring. Against this background, regulators pivoted once again after the Congress. Internet companies were recognized as an important force in the economy in the latest Politburo meeting in December. Local government officials visited Alibaba for the first time since it was labeled as part of the investigation list. It was also reported that policymakers may soon wrap up previously announced internet company investigations. Ant Finance, the finance arm of Alibaba, got the green light for its first financing plan since the sudden halt of its IPO in October 2020, which marked the beginning of the regulation wave. The PCAOB announced that they were providing complete access from China for the 2022 ADR auditing inspections after their first on-site inspection. This will reduce the delisting risks of Chinese ADRs significantly. After years mired in external challenges, Chinese internet companies may finally return to business, which could become an important driver of the Chinese economy in 2023.

Outlook

Looking forward to the coming year, Chinese equity markets will still face uncertainties under the risk of global recession. However, as most restrictive policies fade, China will return to a more normal track after three years of below-trend growth. The main driver will be domestic consumption. Households have reduced discretionary consumption and increased savings under Covid-zero due to the elevated uncertainty. It is estimated that households have retained more than RMB7.4 trillion in excess savings in the past three years, which will lay a solid foundation for consumption recovery in 2023. Moreover, to restore consumer confidence, the government is likely to maintain supportive monetary and fiscal policies.

After a year of weak performance, valuations of Chinese equities trade for below-average valuations. The forward 12-month price-to-earnings ratio of the MSCI China Index is at 10.6x with estimated earnings growth of 3% and 14% in 2022 and 2023, respectively, compared with a 10-year historical average P/E of 11.3x.

As for our strategy, we continue to focus on misunderstood companies undergoing positive fundamental changes when we believe such changes have not been fully understood by the market yet. We look for niche-oriented companies whose success is more predicted on product success, technological innovation, regulatory changes, and the evolution of new markets in China. In the quarter, we found new ideas in the information technology, consumer discretionary and healthcare sectors. Generally, these companies are leading players in niche markets whose growth is more predicated on product acceptance than on overall GDP growth. Many such ideas are beneficiaries of the ongoing structural economic and social changes occurring in China.

Portfolio Highlights

During the quarter, the portfolio was 99.1% invested in 55 companies. The biggest performance contributors were consumer discretionary, energy and utilities. On the contrary, our biggest performance detractors were information technology, industrials and materials.

Organization Update

We are pleased to announce that Eric Hannemann, our new chief financial officer, and Tom Joyce, our new chief compliance officer, have been named Partners of Oberweis Asset Management, Inc. As we disclosed previously, Eric and Tom have assumed the responsibilities of our former colleague Pat Joyce, who retired on December 31, 2022.

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