

OBERWEIS INTERNATIONAL OPPORTUNITIES INSTITUTIONAL FUND (OBIX) MARKET COMMENTARY

1Q 2023

Review

During the first quarter, the International Opportunities Institutional Fund returned +5.12% vs. +5.45% for the benchmark, the MSCI World Ex USA Small Cap Growth Index. On a 1-year basis, the Fund underperformed its benchmark, with a return of -20.19% vs. -13.02% for the benchmark. On a cumulative 3-year basis, the Fund strongly outperformed its benchmark - by over 800bps - with a return of +45.67% vs. +37.50% for the benchmark.

Both portfolio managers of this strategy took advantage of the recent short-term underperformance to add to their holdings in the strategy. Counter to common investor psychology, which tends to practice “backward-looking”¹ investing through the rearview mirror and tends to chase the most recent short-term performance, we are aware that any investment style can go through favorable and unfavorable style periods, and that – due to mean reversion – often the best time to buy a strategy with high long-term alpha (such as ours) is after underperformance in the very short-term. For example, institutional managers with negative excess returns over the past two years in fact tend to outperform those managers with positive excess returns over the past two years in the subsequent two years.²

Global equity markets moved higher for the second consecutive quarter despite inflation data that continues to prove sticky and banking crises in both the United States and Europe. The resilience of developed market economies and stock markets is impressive. More than a year of monetary tightening has yet to bring economies or labor markets to their knees, and fears of a horrible recession have so far proven misbegotten. Manufacturing activity has shown signs of weakening, with the U.S. March ISM survey falling below 50 on all subcomponents for the first time since 2009, and with softer year-over-year PMI data across most developed markets. However, the service economy remains in growth mode and unemployment claims have not increased in any meaningful way. Concurrently, in the United States wage growth data at the beginning of the quarter looked more innocuous than in preceding months despite the ongoing tightness in the labor market. One can reasonably argue that U.S. service wage inflation, which has helped to drive inflation in services (that constitute almost a third of core CPI), is the most important variable impacting global capital markets today. Ten-year Treasury yields fell by half a point following the December employment report, and longer duration assets have since outperformed. However, the rate of improvement in wage inflation appears to have stalled in the subsequent months, suggesting that it is premature to call for a decisive break lower in inflation. That inflation is down, but not out, has been the message from the recent wider data beyond wages. The Federal Reserve Bank of Atlanta’s Core Sticky Price CPI, made up of a subset of goods and services that change infrequently, and as such is thought to embody information about inflation expectations, peaked at over +7% in June 2022. Its most recent datapoint at the time of writing, namely February, showed an uptick from January to 6.5%. The Core PCE Index is trending lower slowly, +4.6% in February vs prior year, down from a peak of +5.3% twelve months ago. After a year of tightening only a fifth of the distance to the inflation target has been traversed.

¹ Empirical Research Partners, “The Future of the Money Management Industry”, January 3, 2008

² Empirical Research Partners, “The Future of the Money Management Industry”, January 3, 2008, p.7, Exhibit 17

AVERAGE ANNUAL TOTAL RETURNS (as of March 31, 2023)

	QTD	1 Yr	3 Yr	5 Yr	Since Inception 3/10/2014	Gross/Net Expense Ratio*
Oberweis International Opportunities Institutional Fund (OBIX)	5.12%	-20.19%	13.36%	0.36%	4.04%	1.14%/1.10%
MSCI World ex-US Small-Cap Growth Index	5.45%	-13.02%	11.20%	1.47%	4.43%	

Performance data shown represents past performance and is no guarantee of future results. Investment return and principal value will fluctuate, so that you may have gain or loss when shares are sold. Current performance may be higher or lower than quoted. Unusually high returns may not be sustainable. Visit us online at oberweisfunds.com for most recent month end performance.

The Oberweis Funds invest 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. There is no guarantee that the Funds can achieve their objectives.

Before investing, consider the fund’s investment objectives, risks, charges, and expenses. To obtain a copy of the prospectus or summary prospectus containing this and other information, please visit our website at oberweisfunds.com or call 800-323-6166. Read it carefully before investing.

**Audited data as of December 31, 2022. Oberweis Asset Management, Inc. (OAM), the Fund’s investment advisor is contractually obligated through April 30, 2024 to reduce its management fees or reimburse OBIX to the extent that total ordinary operating expenses exceed in any one year 1.10% expressed as a percentage of the Fund’s average daily net assets. Effective May 15, 2023, the adviser may recoup the amount of any expenses reimbursed under the contract within three years following the date of the reimbursement if the recoupment does not cause the Fund’s expenses to exceed the expense limitation in place at the time of the recoupment, or the expense limitation in effect at the time of the initial reimbursement, whichever is lower.*

The Oberweis Funds are distributed by Oberweis Securities, Inc. Member: FINRA & SIPC.

The MSCI World ex-US Small-Cap Growth Index (Net) is a free float-adjusted market capitalization weighted index that is designed to measure the performance of small cap growth developed markets excluding the U.S., with minimum dividends reinvested net of withholding tax.

Outlook

With respect to the earnings outlook over the next twelve months, given the operating leverage in the economy, it is clear that much rests on the central question of whether the United States and other developed markets enter a significant recession. The bond market, as reflected by the yield curve, continues to express near certainty of a downturn. This is also the consensus view held by economists and investors, with sentiment near the lows of the 2008 financial crisis and global fund manager positioning close to as bearish as it has been this century. Our near-term view remains agnostic, in line with recent letters. We are reminded of Charlie Munger's comments at the 2021 Berkshire Hathaway AGM: "if you're not a little confused by what's going on, you don't understand it". The current economic environment is abnormally difficult to diagnose. In particular, as we have referenced previously, the Fed's ability to control the economy appears to be lower than in prior cycles due to the diminished rate sensitivity of the consumer, presenting a potentially double-edged sword. On the one hand, it buys the Fed time, insofar as aggregate demand may feasibly remain durable for long enough until such point that inflation takes a decisive turn for the better. On the other hand, the probability that the Fed makes a policy error and overshoots has likely increased. The difficulties in the banking sector are to some degree symptomatic of this. Credit Suisse, Signature and Silicon Valley Bank are not small banks. Their issues were not necessarily homogenous but it is clear that, in the United States at least, the tighter monetary policy has (along with poor risk management practices) contributed to miscellaneous and significant unrealized losses across the industry. It is possible this will metastasize into a credit downcycle amongst the regional banks and, if so, that has the scope to become a global macroeconomic event. Thus far, markets appear relatively sanguine about the prospect of a credit crunch particularly if accompanied by a less aggressive Fed. However, confidence and contagion are difficult to forecast and the end game here remains to be determined.

The same can be said for inflation. Its underlying trajectory looks slightly constructive but there is still a long way to go to reach the Fed's target. Historically, as the rate of inflation goes up so does its standard deviation and forecasting errors. The unknowns are big, and any predictions here should be accompanied by an appropriate level of humility.

The December labor report showed some weakness in hourly earnings growth, which the market appeared to interpret as a turning point in the quest to lower wage inflation. However, the subsequent data has not, in our view, convincingly supported or repudiated this conclusion. As referenced above, Sticky-Price CPI continues above 6%, representing small progress from 7+% but still far above 2%. It is likely that lower rent-based inflation will provide some relief over the course of this year and services inflation, which is approximately 30% of core CPI, is showing some weakness from a high level. This component has remained stubbornly high due to the tightness in the labor market, but quit rates (a strong lead indicator) rolled over in January providing some hope that services wage growth will subside.

With respect to valuations across our investible universe, free cash flow yields for small cap stocks in developed markets – which we suggested as a highly attractive investment entry point in our Q3 2022 letter – remain near historical highs, even after the subsequent positive quarters:



Further, expectations for forward returns are among the lowest they have ever been. Rarely ever has the consensus opinion been as pessimistic. In March, Empirical Research Partners' investor sentiment index hit its second-lowest level ever, and the lowest level since the global financial crisis. Counter to common investor behavior, which tends to shy away from deploying new capital the more fearful the consensus opinion is, we have found that, historically, attractive valuations and trough expectations have made an excellent set-up for forward-looking long-term returns. As mentioned, both portfolio managers recently added to their holdings in the strategy.



Outlook (continued)

Our primary focus continues to be to own strong companies with great underlying fundamentals, balance sheets and cash flows. Our holdings tend to be niche-oriented firms operating in disruptive markets. GDP matters, but it generally is not the main driver of long-term earnings growth. In that regard, our portfolio companies had in aggregate a solid set of earnings reports with strong underlying fundamentals. We are confident that whether the market goes up or down from here in the short-term, on a relative basis, the underlying fundamentals of our companies will continue to do well.

Fund Highlights

At quarter-end, the Fund was invested in 67 stocks in 15 countries. Our top five country weightings (portfolio weighting vs. the MSCI World Ex USA Small Cap Growth Index) at quarter end were Japan (19.3% vs. 27.9%), Canada (16.1% vs. 10.0%), the UK (13.6% vs. 13.3%), France (11.4% vs. 2.8%), and the Netherlands (6.4% vs. 1.7%). On a sector basis, the Fund was overweight industrials (41.7% vs. 23.3%) and underweight health care (1.2% vs. 10.6%).

Organization Update

There are no changes to the International team or strategy.

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. It also requires the patience and fortitude of a long-term investor and to hold structural winners through the short-term jitters of the stock market.

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