

## BEST ETFS & MUTUAL FUNDS

# Oberweis Fund Wins Big Gains With Small Stocks

Managers find top stocks other than the megacaps most investors chase

### MUTUAL FUND PROFILE

BY ADAM SHELL  
FOR INVESTOR'S BUSINESS DAILY

**M**egacap stocks are dominating the market. But it's still possible to turn a gargantuan profit buying shares of teeny-tiny companies with the best mutual funds.

Investors are focused this year on the largest, most popular stocks like Nvidia (NVDA) and Facebook parent Meta Platforms (META). These huge tech companies benefit from the AI frenzy. But there's also big opportunity in micro-cap stocks that fly under the radar. These stocks could grow up to become the large-cap superstars of tomorrow.

Oberweis Micro-Cap (OBMCX) proves small stocks most investors have never heard of can deliver jumbo returns. The \$331.1 million fund is up 13.5% this year. That keeps pace with the large-cap S&P 500 stock index's 13.7% gain.

But the small-fry stocks in the portfolio, such as semiconductor testing company Aehr Test Systems (AEHR), green-focused industrial company CECO Environmental (CECO) and electric bus maker Blue Bird (BLBD), have trounced their bigger brethren in the S&P 500 in the past one-, three-, five-, and 10-year time periods, according to fund-tracker Morningstar. In the past year, Oberweis Micro-Cap gained 27.3%, more than double the 12.5% return of the S&P 500. And the fund's 16.7% return handily tops the big-cap benchmark's

12.5% gain in the past 10 years.

What's Oberweis Micro-Cap's secret? And is now a good time to jump on the micro-cap stock bandwagon while the rest of Wall Street is micro-focused on the biggest companies?

To find out, IBD caught up with fund manager Ken Farsalas. He's part of an experienced team of five that has a knack for identifying small growth companies with huge potential that other investors overlook. "We don't get our research ideas from Wall Street," said Farsalas.

Oberweis Micro-Cap initially buys stocks when their market value is less than \$600 million or in the range of market caps of its benchmark, the Russell Microcap Growth Index.


Farsalas is bullish on micro-caps. He says they're compelling investments now. And he ticks off four reasons why.

First, they're under most analysts' microscope. Wall Street pays less attention to small stocks than the big stocks most people know by name, Farsalas says. And that dearth of research means fewer spotlights are shining on these stocks. It also means Oberweis Micro-Cap's team can find undiscovered stocks before the rest of the market does.

"The opportunity for our research team to add value is significantly higher than it is in the large-cap space where you might have hundreds of analysts covering Microsoft (MSFT), for example," said Farsalas.

Second, exposure to micro-caps is shrinking. In the past decade, small-cap fund managers have been buying stocks with larger market values. In 2012, for example, more than half (53%) of small-cap fund portfolios were invested in stocks with market

### Oberweis Micro-Cap



**Kenneth Farsalas**

- Max front load: None
- Expenses: 1.53%
- Symbol: OBMCX

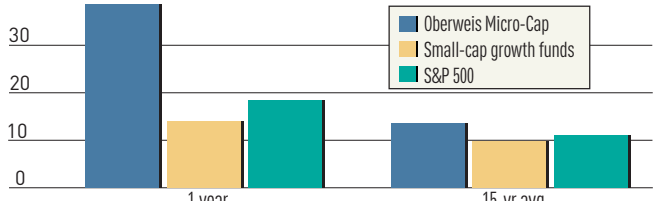
**Total returns** as of 7/3/23  
 2022: -10.61% 3-yr. avg.: 33.31%  
 YTD: 18.55% 5-yr. avg.: 15.36%  
 10-yr. avg.: 16.85%

#### Sector weightings

Fund as of 3/31/23, S&P 500 as of 3/31/23

	% of stock assets	% of S&P 500
<b>Cyclical</b>	<b>18.87%</b>	
Basic materials	0.00	2.28%
Consumer cyclical	11.54	10.82
Financial services	7.33	11.97
Real estate	0.00	2.49
<b>Economically sensitive</b>	<b>60.90</b>	
Communication services	2.85	8.39
Energy	4.41	4.11
Industrials	16.63	8.35
Technology	37.01	28.91
<b>Defensive</b>	<b>20.23</b>	
Consumer defensive	2.93	6.62
Health care	17.29	13.48
Utilities	0.00	2.58

40% Total returns as of 7/3/23



Source: Morningstar Direct

caps of less than \$1.5 billion. Ten years later in 2022 that number fell to 24%, says Farsalas.

That means the average investor's exposure to the smallest small-cap stocks is half of what it was 10 years ago. So, adding micro-cap exposure to a portfolio can help fill that gaping hole and amplify returns.

### Good Deals On Small Caps

Third, small stocks are cheap relative to large caps. You have to go back to 2000 to find a time when the valuation of small stocks was as cheap compared to their larger brethren as they are now, according to data from Jefferies, an investment bank. And today's lower valuations include price-to-sales, price-to-book and trailing price-earnings ratios.

"If you're a contrarian investor, and you want to buy cheap, it's a great time to invest in micro-cap and small-cap stocks," said Farsalas.

Lastly, small stocks fly high when the economy gains speed. Despite talk of a recession, the economy remains resilient. Farsalas isn't in the business of predicting downturns. But he says stocks with small market values shine and outperform larger stocks when the economy is accelerating following uncertainty.

### Different Approach To Growth

Unlike many growth fund managers, Farsalas and his team don't just look for stocks with peppy absolute growth rates. Instead, they use what he calls a "relative to expectations ap-

proach.” They pounce on companies they believe “can grow faster” than the market thinks they can, says Farsalas.

The portfolio team finds names to buy by monitoring stocks that report positive earnings surprises. Then they do their due diligence to make sure the earnings beat isn’t a fluke. They go through a 17-point stock inspection to ensure the reason for the much-better-than-expected results can propel the company to better performance.

“We want to eliminate earnings surprises that are driven by something fleeting in nature,” said Farsalas. “Instead, we want to focus on big, sustainable change. Something really profound and material from a fundamental standpoint.”

Once they’ve identified a stock with staying power that is selling at an attractive valuation, they accumulate shares. And they profit from a behavioral finance phenomenon where other investors underreact to

the new bullish information and don’t buy the stock right away.

Farsalas calls this phenomenon “post-earnings announcement drift,” or PEAD.

#### Four Investment Themes

Typically, when Oberweis Micro-Cap spots a stock with a new catalyst, one of four drivers power the earnings beat.

The first is a new product cycle which can drive sales to a new level. A good example, Farsalas says, is Aehr Test Systems, which has a leading market share in the business of testing silicon carbide semiconductors. Those chips are used in the fast-growing electric vehicle space.

“As EV penetration ramps, the demand for silicon carbide chips will also ramp significantly as will the need to test those semiconductors,” Farsalas said.

#### Another Small Driver

The second driver is a new management team or CEO. New leadership can change the stra-

tegic direction of a company and give it new life. Fund holding CECO Environmental, whose products enable industrial companies help protect the environment, fits the bill.

Since taking over in the summer of 2020, CEO Todd Gleason has restructured the business, cut costs, and created greater shareholder value. “The company is now starting to perform better which has resulted in earnings surprises,” said Farsalas.

The third catalyst is what Farsalas dubs “government-sponsored tailwinds.” That includes new legislation or federal spending that can stimulate sales, profits, and additional business. Electric bus maker Blue Bird is a beneficiary of the government’s push for environmentally friendly green buses with \$5 billion in new capital.

“Blue Bird has the opportunity to perform better than expected,” said Farsalas. “They’ll be selling more of these higher-priced electric buses.” And

with nearly half of the nation’s school-bus fleet over 10 years old, Blue Bird will also benefit from a coming replacement cycle, adds Farsalas.

Another relatively unknown micro-cap company Farsalas likes is Navitas Semiconductor (NVTS). The company’s products are poised to take advantage of demand for more sophisticated computer chips.

The company makes silicon carbide chips used in EVs. But it also makes specialty chips used in so-called power applications. The company’s chips, says Farsalas, are found in “fast chargers” for mobile phones. They also provide power to growth-focused computing areas such as AI and data centers and servers, says Farsalas.

“These are huge secular drivers that we think will enable Navitas to grow its top-line sales growth at 100% per year over the next three to five years,” Farsalas. “That’s how significant the growth is going to be for Navitas.”

**Average Annual Total Returns  
as of 06/30/23**

<b>Fund Name</b>	<b>1 Year</b>	<b>5 Year</b>	<b>10 Year</b>	<b>Gross/Net Expense Ratio*</b>
<i>Oberweis Micro-Cap Fund (OBMCX) – Investor Class</i>	35.71%	15.43%	16.90%	1.53%/1.52%
<i>Oberweis Micro-Cap Fund (OMCIX)- Institutional Class</i>	36.03%	15.74%	17.19%	1.28%/1.27%

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](http://oberweisfunds.com) for most recent month-end performance.

The Oberweis Funds invest in rapidly growing smaller and medium sized companies which 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](http://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 OBMCX to the extent that total ordinary operating expenses, as defined, exceed in any one year the following amounts expressed as a percentage of each Fund’s average daily net assets: 1.8% of the first \$50 million; plus 1.6% of average daily net assets in excess of \$50 million and for OMCIX 1.55% of the first \$50 million; plus 1.35% of average daily net assets in excess of \$50 million.*

*Inception date for OBMCX is 1/1/1996. Institutional Class shares OMCIX performance information was calculated using the historical performance of Investor Class shares for periods prior to 5/1/17.*

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