Oberweis
Asset Management

EMERGING MARKETS MARKET COMMENTARY

2Q 2023

The Quarter in Review

The Oberweis Emerging Markets strategy climbed 3.16% (2.88% net of fees) during the second quarter of 2023. The MSCI Emerging Markets Small-Cap Index, which serves as our benchmark, climbed 6.39%. For the first half of 2023, the strategy returned 11.77% (11.15% net of fees) versus 10.50% for the index. Looking at a much longer time horizon, we have generated a 44.95% (36.37% net of fees) cumulative return since the strategy's June 2018 inception, which compares favorably to the benchmark's 18.89% cumulative return over that same time period.

Before we dive into what happened over the past three months, we would like to highlight what has happened in emerging markets over the past two years. Since July of 2021, the U.S. ten-year yield climbed nearly 400 points from trough to peak, while the U.S. Dollar fell slightly, but stayed close to its twenty-year high as measured by the Bloomberg U.S. Dollar Index. If we traveled back in time and described that macroeconomic backdrop to turn-of-the-century investors, they would have justifiably predicted emerging-markets carnage. In fact, we would not need to travel that far back in time. Less than a year ago we saw headlines like "Embattled emerging markets face fresh pain from U.S. rate hikes" (Reuters), "Rising Inflation and Interest Rates Heap Pressure on Emerging Markets" (Wall Street Journal) and "Rising Rates Evoke Fears of 1990s Asia Crisis for Emerging Markets" (Bloomberg).

The headlines were wrong. The turn-of-the-century investors' predictions would have been incorrect. While we have seen some turmoil in specific countries for country-specific reasons, there has not been a widespread crisis in the developing world. The noteworthy banking crises, in fact, have been in the United States and in Switzerland, bastions of perceived safety. True, the MSCI Emerging Markets Small-cap Index is down roughly 8% over the past two years, which compares unfavorably to the S&P 500's positive return, but developing economies are generally showing resilience. We think that is a testament to the hard work many emerging countries performed over the past two decades to make their economies more shock resistant. Given the circumstances, we believe that most emerging markets have performed remarkably and surprisingly well. We think it is way past time for investors to refresh their risk assessments on emerging markets. When that happens, the valuation gap between EM small caps and their developed-world counterparts won't disappear, but it should narrow, and that narrowing should lead to a period of substantial outperformance for the asset class. We look forward to it.

Turning now to the second quarter of 2023, the MSCI Emerging Markets Small-Cap Index's return was almost entirely driven by India, Taiwan and Brazil. India and Taiwan are the two largest countries in the benchmark, making up nearly 45% of the index. We think slowing inflation in India and the resulting hopes for an interest rate cut drove an 18% rally in that country's shares. Taiwanese small caps rallied more than 9% during the quarter, driven primarily by strong performance of technology shares that we think drafted off the tailwind created by Nvidia and the Artificial Intelligence-motivated tech rally in America. Brazilian shares made up a bit more than 5% of the index and rallied nearly 30% during the quarter. We attribute the strong performance in Brazil to slower inflation and the potential for lower rates.

The portfolio trailed the index for the quarter, but all the underperformance came from the beginning of April through the first week in May. It certainly felt to us at the time like a big rally in "value" stocks. Financials and Materials—sectors that generally have a value bias—led the way and the growthier sectors like technology and communication services trailed. MSCI does not produce growth and value versions of the small-cap index like they do for the large-cap emerging markets index. If we make the reasonable assumption that the growth versus value dynamic amongst the large caps was also present amongst small caps, those five weeks did in fact represent a period of substantial outperformance for value stocks with the MSCI Emerging Markets Value Index up 2.42% while the Growth Index fell 1.96%. We pay considerable attention to valuation and work hard to invest in companies trading at discounts to what we believe is their true value. However, we also insist on strong, durable sales growth and rock-solid balance sheets. As a result, our holdings rarely fall into the traditional "value" bucket, and we may struggle to keep pace with market rallies driven by optically cheaper shares. The portfolio outperformed from the second week in May through the end of the quarter as the value rally petered out, but we were unable to make up all the ground we had previously lost.

AVERAGE ANNUAL TOTAL RETURNS ***(as of June 30, 2023)***

	QTD	YTD	1 YR	3 YR	5 YR	Since Inception 6/1/2018
Emerging Markets (gross of fees)	**3.16%**	**11.77%**	**11.26%**	**9.57%**	**8.50%**	**7.58%**
Emerging Markets (net of fees)	**2.88%**	**11.15%**	**9.73%**	**8.28%**	**7.21%**	**6.29%**
MSCI Emerging Markets Small-Cap Index	6.39%	10.50%	13.28%	13.72%	4.93%	3.46%

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. Net-of-fee composite returns are calculated using the highest model investment advisory fees applicable to portfolios within the composite. 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. It is not possible to invest directly in an index.

The Quarter in Review (continued)

Looking at the overall portfolio on a country basis, allocation subtracted 200 basis points from relative performance while stock selection subtracted 65 basis points. Our overweight position in China and underweight position in India were the two main drivers of underperformance from a country-allocation perspective. Breaking down performance by sector presents very different results, with sector allocation subtracting just 37 basis points from relative performance while stock selection subtracted 228 basis points. Much of that negative selection came from two Chinese stocks in one sector—consumer staples—as the market was disappointed in the recovery of that country's post-Covid consumer spending. In our opinion, both companies continue to show healthy growth and solid margins, as well as increasingly attractive valuations. We also believe that Chinese people will continue to eat food and drink beverages and, as a result, we are more likely to add to those positions after their short-term relative underperformance rather than cut and run.

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 14.1 times at the end of the first quarter, which is lower than the 14.8 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 17.3 times forward earnings while the S&P 500 trades at 20.4 times, which in both cases are premiums to their ten-year averages. 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 69 stocks domiciled in 20 countries. Our top five country weightings (portfolio versus the MSCI Emerging Markets Small-Cap Index) were India (21.4% vs. 24.3%), Taiwan (16.9% vs. 21.9%), China (11.9% vs. 7.5%), Indonesia (8.4% vs. 2.1%), and South Korea (7.9% vs. 15.0%). The strategy's largest overweight sectors were Information Technology (36.6% vs. .3%), Consumer Staples (10.9% vs. 6.1%), and Energy (3.5% vs. 1.8%). The largest underweight sectors were Materials (4.5% vs. 14.0%), Financials (3.3% vs. 11.0%), and Industrials (11.4% vs. 16.9%).

Organization Update

There were no organizational changes 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.

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