

The Quarter in Review

The Oberweis Emerging Markets strategy fell 2.31% (-2.61% net of fees) during the third quarter of 2023. The MSCI Emerging Markets Small-Cap Index, which serves as our benchmark, climbed 2.93%. For the first three quarters of 2023, the strategy returned 9.19% (8.25% net of fees) versus 13.74% for the index. Looking at a much longer time horizon, we have generated a 41.59% (32.81% net of fees) cumulative return since the strategy's June 2018 inception, which compares favorably to the benchmark's 22.37% cumulative return over that same time period.

Emerging markets small-cap stocks performed relatively well during the quarter. The MSCI Emerging Markets Small-Cap Index's 3.06% return for the quarter substantially beat the negative returns posted by large cap benchmarks like the S&P 500 and MSCI All-country World Indexes (ACWI), as well as the small cap Russell 2000 and MSCI All-country World Small-cap Indexes. The Emerging Markets Small-Cap Index's returns are also the best of the bunch on a year-to-date basis. As we wrote last quarter, most developing world countries and companies have weathered quite well the much-feared rise in interest rates and the continued strength of the US Dollar. With a few exceptions, we think emerging markets are more resilient than they were a generation ago. We also think, with EM small-caps trading at or near 15-year-high valuation discounts relative to the S&P and ACWI indexes, investors have yet to give emerging countries credit for that improved resiliency.

The MSCI Emerging Markets Small-Cap Index outperformed peers but mirrored the timing of their moves up and down during the quarter. The indexes all had a strong July after the soft US Jobs report in late June spurred investors' hopes that the US Federal Reserve was finished hiking interest rates. Then all the indexes turned south at the end of July as the Federal Reserve dashed those hopes and raised rates 25 basis points. Markets turned higher again in mid-August after Nvidia's blowout AI-driven earnings and spectacular sales growth guidance generated enough excitement to lift lots of boats. The indexes slipped again in early September when OPEC+ oil-supply cuts sent petroleum prices higher.

If those third-quarter highlights make you question anyone's ability to succeed as an investor, we hear you. The good news is that macroeconomic headlines may drive short-term gyrations in stock markets, but long-term investment returns are driven by companies' earnings power—their ability to expand sales and margins, and to reinvest capital at attractive rates of return. We spend our time looking for companies with excellent-but-underappreciated earnings power and let the macro-driven swings work themselves out over time.

Even so, it hurts to underperform, even for periods as short as a quarter. The biggest reason for our underperformance was our overweight position in China, which was amongst the worst-performing countries during the quarter. Harsh regulatory actions against Internet, healthcare and education companies, tough Covid restrictions, and a slow property market have taken their toll on the Chinese economy. After several quarters of poor performance, China, the second largest economy in the world, now makes up just 5.4% of the MSCI Emerging Markets Small-Cap Index. However, nearly half of the emerging markets companies in our market-cap range are domiciled in China. From that vast universe, we have selected a handful of companies that we think have the balance sheet strength, growth opportunities, durable competitive advantages, and clean corporate governance that we require. Moreover, we believe our Chinese holdings are irrationally cheap. As investors that prize reason over emotion, process over outcome, and discipline over capriciousness, we remain invested in that select group of Chinese companies.

Looking at the overall portfolio on a country basis, allocation subtracted 181 basis points from relative performance while stock selection subtracted 282 basis points. Our overweight position in China and underweight position in Turkey subtracted 131 basis points and 63 basis points from relative performance, respectively. Breaking down performance attribution by sector presents a different picture, with selection effect generating nearly all the relative underperformance. Most of that negative selection effect came from the Information Technology sector and was largely concentrated in Chinese tech companies and Taiwanese tech companies closely tied to China.

AVERAGE ANNUAL TOTAL RETURNS (as of September 30, 2023)

| | QTD | YTD | 1 YR | 3 YR | 5 YR | Since Inception 6/1/2018 |
|---|---------------|--------------|---------------|--------------|---------------|--------------------------|
| Emerging Markets (gross of fees) | -2.31% | 9.19% | 21.15% | 5.10% | 10.04% | 6.74% |
| Emerging Markets (net of fees) | -2.61% | 8.25% | 19.61% | 3.82% | 8.75% | 5.46% |
| MSCI Emerging Markets Small-Cap Index | 2.93% | 13.74% | 23.06% | 10.61% | 6.45% | 3.86% |

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.

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 15.4 times at the end of the third quarter, which looks attractive relative to the rest of the world. Bloomberg reports that the globe spanning MSCI All Country World Index (ACWI) trades at 16.9 times forward earnings while the S&P 500 trades at 19.7 times. 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 66 stocks domiciled in 21 countries. Our top five country weightings (portfolio versus the MSCI Emerging Markets Small-Cap Index) were India (18.8% vs. 26.2%), Taiwan (15.8% vs. 21.4%), China (15.0% vs. 7.0%), Indonesia (7.5% vs. 2.1%), and South Korea (6.5% vs. 13.8%). The strategy's largest overweight sectors were Information Technology (35.5% vs. 17.9%), Consumer Staples (10.5% vs. 6.3%), and Energy (5.7% vs. 2.1%). The largest underweight sectors were Materials (1.8% vs. 13.3%), Industrials (9.3% vs. 17.1%) and Financials (3.4% vs. 10.2%).

Organization Update

There were no organizational changes 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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