Oberweis
Asset Management

MICRO-CAP GROWTH MARKET COMMENTARY

3Q 2023

The Quarter in Review

The Oberweis Micro-Cap Growth Composite returned -7.84% (-8.08% net of fees) versus -11.95% for the Russell Microcap Growth Index during the third quarter, an outperformance of 411 basis points (387 basis points net of fees). Our year-to-date performance of +9.96% (+9.21% net of fees) is 1,561 basis points (1,486 basis points net of fees) better than the benchmark return of -5.65%.

It was a mixed backdrop for the strategy as growth stocks lagged value stocks and small-caps once again trailed large-caps during the quarter. On the positive side, higher ROE small-caps outperformed the lowest two ROE quintiles, and non-earners again were relatively weak as higher interest rates disproportionately impacted the valuations of equities devoid of earnings.

Last quarter we poked fun at "macro-focused" investors predicting an imminent recession, and given that real GDP could be as high as 5% in the third quarter, an imminent recession seems less likely than is currently reflected by expectations. We have historically noted in jest the old adage that economists – and the stock market – have predicted 9 of the last 5 recessions, and now it's 10. All is not lost for perma-bear doomsayers, however. They should take solace in the fact that they will ultimately be proven right. Eventually...someday...there will be a recession. We just don't believe there's any value in trying to predict the timing of something so highly unpredictable, and basing investment decisions upon such a guess can be counter-productive. Instead, we focus intently on what we can control – investing in micro-cap companies generating positive earnings surprises because of a significant fundamental change that's misunderstood by other investors. We believe our process uniquely helps us identify and invest in companies with idiosyncratic attributes driving earnings growth that tend to trump macro concerns.

Investors currently seem to be in some sort of "Fed trance," as market pundits and English majors alike feverishly scrutinize the Fed's statements, diagramming sentences, checking for grammatical errors, and debating the meaning of the word "pause." Transcripts of Fed governors giving speeches at rubber-chicken lunches across America are now must-reads. What will the Fed do next? We've been solidly in the "higher for longer" camp for some time now, and believe you need look no further than the Fed's dual mandate to understand why. First, while we are finally experiencing disinflation, current readings are still well above the Fed's long-term 2% inflation target, suggesting more work needs to be done. Second, unemployment hasn't budged at all. Third, and maybe most important, the Fed hasn't broken anything of significance, and we'd wager they're not eager to throw anyone a lifeline this time around. Yes, their hawkish policy helped torch poorly managed Silicon Valley Bank and is making life very uncomfortable for bond fund managers who enjoyed an artificial 20-year bull market. Yes, they are making some commercial real estate investors who overpaid very nervous. Yes, venture investors are looking at huge losses if they ever mark their unicorns to market. It's almost as if the Fed is allowing pain and failure to creep back into the business cycle. It's almost as if the Fed wants there to be a cost of capital again.

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

	QTD	YTD	1 Yr	3 Yr	5 Yr	10 Yr	Since Inception 1/1/1996
Micro-Cap Growth (gross of fees)	**-7.84%**	**9.96%**	**23.36%**	**27.98%**	**13.72%**	**15.47%**	**12.91%**
Micro-Cap Growth (net of fees)	**-8.08%**	**9.21%**	**22.22%**	**26.93%**	**12.70%**	**14.45%**	**11.87%**
Russell Microcap Growth Index	-11.95%	-5.65%	-3.10%	-4.65%	-2.81%	3.12%	N/A

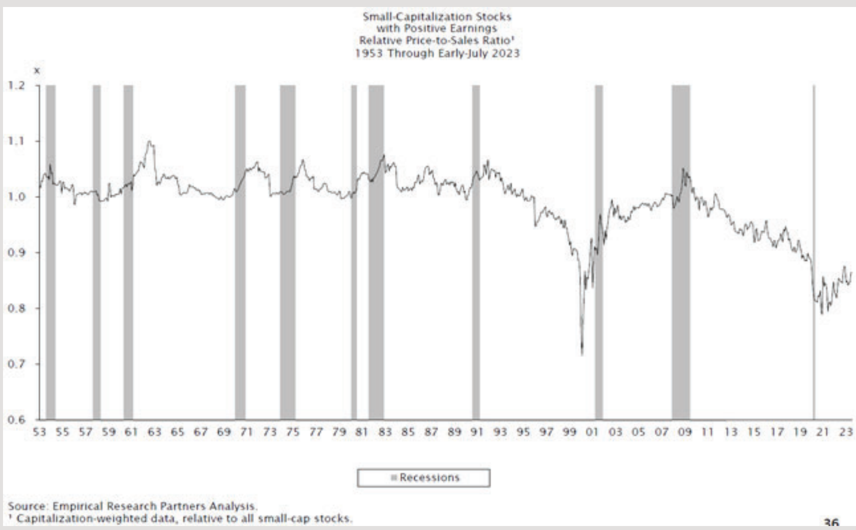
Past performance is not necessarily indicative of future results. Performance is historical and includes the reinvestment of dividends and other income. Unusually high returns may not be sustainable. The strategy invests in rapidly growing smaller and medium-sized companies that may offer greater return 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 1-1-96 until 12-31-03 and 9-1-11 to present were derived solely from the performance of the Oberweis Micro-Cap Fund, a registered, open-end mutual fund, for which OAM serves as investment adviser. Prior to November 4, 2001, James D. Oberweis was the sole portfolio manager for the Micro-Cap Fund during the period of the performance results noted. Accounts are dollar-weighted within the composite and reported in U.S. dollars.

The Russell Microcap Growth Index measures the performance of those Russell Micro Cap companies with higher price-to-book ratios and higher forecasted growth values. The performance data includes reinvested dividends. The Russell Microcap Index is represented by the smallest 1,000 securities in the small cap Russell 2000 Index plus the next 1,000 securities. Each index is an unmanaged group of stocks, whose performance does not reflect the deduction of fees, expenses or taxes. It is not possible to invest directly in an index.

The Quarter in Review (continued)

Speaking of cost of capital, we think a 10-year Treasury yield north of 4% means valuation finally matters again in micro-cap investing. We've been around long enough that we remember when it did, and we couldn't be happier because valuation has always been an important part of our investment process. Yes, higher interest rates generally aren't great for micro-cap growth stocks, but our differentiated focus on "relative-to-expectations growth" means any environment where the price paid for growth is top of mind should actually be a tailwind for our portfolio. For years we've lamented the bubble-like performance of the "non-earners" and other stocks that benefitted from a synthetic low-interest-rate policy. In fact, that dislocation went on for so long that small-cap stocks (micro-caps as a subset) with earnings are historically cheap. According to research by Empirical Research Partners, the relative valuation[1] of small-cap stocks with positive earnings compared to all small-cap stocks[2] is the most attractive in over 20 years. To the extent interest rate policy is more normalized going forward (the 10-year Treasury yield averaged 6.3% in the 1990s and 4.1% in the 2000s), we believe that bodes exceptionally well for our "relative-to-expectations" growth investment style.



Furthermore, we'd bet the farm that micro-cap stocks (as a subset of small-caps) trounce over-loved and over-priced large-caps over the next decade. Frankly it's a pretty obvious call from a statistical and contrarian standpoint. Small-caps are wildly unloved, representing less than 4% of the total U.S. equity market capitalization, the lowest reading since the 1930's. According to Jefferies, the rolling 5-year relative performance of small-caps versus large is in the 7th percentile. Even better, the relative valuations of small-caps compared to large-caps remain at the most attractive levels (using multiple valuation metrics) since the late 1990's. We're not sure when the gun goes off and what the trigger is, but broadly we think it makes sense to tactically bet on small-caps from here, particularly against a backdrop of structurally higher inflation and interest rates. After all, history tells us that small-caps dramatically outperformed during the 1970s and early 1980s when inflation and interest rates were high for a sustained period.

[1] based on price to sales
[2] capitalization-weighted data, relative to all small-cap stocks including the "non-earners"

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Portfolio Highlights

As of September 30, 2023, the portfolio was 96.1% invested in 91 different positions. The portfolio had its largest over-weightings in technology (30.5% average weighting during the quarter versus 17.6% for the Russell Microcap Growth Index) and industrials (21.5% versus 14.7%). The portfolio was most underweight healthcare (18.1% versus 35.4%, primarily due to our significant and perennial biotech underweighting) and financial services (5.3% versus 7.9%).

Overall performance in the third quarter was positively impacted by strong stock selection, particularly in technology (where our holdings returned –9.8% versus a –19.9% return for the benchmark's technology holdings) and industrials (+1.26% versus –8.7%).

Organization Update

We are pleased to announce that Jack Roberts has joined the U.S. Team as an Associate Analyst. He will assist our team with research responsibilities while learning the intricacies of our investment philosophy and process, with the eventual goal of assuming research coverage. Jack was hired by Oberweis in August 2021 and previously worked in other areas of the business before joining the U.S. Team in October 2023. He began his career at Wells Fargo Advisors. Jack is pursuing his CFA and has passed the Level 1 exam. He earned a BA in Economics and History from the University of Illinois.

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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