Oberweis Asset Management

SMALL-CAP OPPORTUNITIES MARKET COMMENTARY

4Q 2023

The Quarter in Review

The Oberweis Small-Cap Opportunities composite returned 6.68% (6.46% net of fees)in the fourth quarter compared to 12.75% for the benchmark Russell 2000 Growth Index, a shortfall of 607 basis points (629 basis points net of fees). For the full year, the composite returned 17.06% (16.08% net of fees) compared to 18.66% for the index, lagging by 160 basis points (258 basis points net of fees).

2024 marks the start of our 10th year since we executed on a leadership, philosophy, and process change at the beginning of 2015. We're thrilled that for the nine years ending December 31, 2023, the Oberweis Small-Cap Opportunities composite returned 14.48% annualized (net of fees) versus 7.33% for the Russell 2000 Growth Index, a healthy outperformance of 715 basis points per year. To frame up the magnitude of the difference, $1 million invested in the strategy on January 1, 2015 would be worth $3.38 million compared to $1.89 million if invested in the index, or $1.49 million better.

The U.S. small-cap market was not particularly favorable in the fourth quarter for our investment style, which mainly focuses on profitable small-cap companies that have recently generated a significant positive earnings surprise. Interestingly, much of the rally in small-caps occurred in the last two months of the year as investors scrambled to increase exposure to the asset class in reaction to an unexpectedly swift decline in interest rates. As a result, the small-cap market was led during the quarter by junky companies, those that are unprofitable and/or have low returns-on-equity (ROE) and are most sensitive to changes in interest rates. In fact, during the final three months the lowest ROE quintile within the Russell 2000 Growth Index performed best and trumped the average return of the top three quintiles by nearly 1,000 basis points. Notably, our portfolio is nearly 80% exposed to those top three ROE quintiles. Additionally, non-earners within the index outperformed small-cap companies with earnings by over 700 basis points during the quarter and represented another strong headwind for our portfolio.

The biggest story as the quarter unfolded was the substantial drop in the 10-year U.S. Treasury yield, which fell from a peak of 4.99% in early October to 3.87% at year-end over euphoric expectations of a "Fed pivot." Fed Funds futures are now predicting six interest rate cuts by the Fed in 2024, beginning in March. For what it's worth, that seems a bit optimistic to us. Real interest rates are still negative and we would remind our readers that the bond market is no better as a predictor of the future than economists, Fed governors, or your hometown psychic. Over longer periods of time, we believe our focus on higher quality companies generating earnings surprises because of misunderstood fundamentals will prove to generate better returns. These firms have idiosyncratic attributes that don't depend as much on macro factors like interest rates and economic growth.

Current economic conditions, though not robust, appear to be steady. We wouldn't be surprised if economic activity cools in 2024 as the impact of the Fed's rate hikes finally take hold, but for now things are stable. The U.S. consumer, which represents nearly 70% of the economy, has about $1 trillion of excess savings and a debt service ratio that remains well below the long-term average. The consumer is also well-employed and is likely to benefit from moderating inflation. Nonfarm payroll gains, while declining, remain positive. The other big economic engine, our government, is still spending hundreds of billions of dollars earmarked during the Covid stimulus period, and we expect the spigot will remain wide open throughout 2024 and into 2025. Afterall, this is an election year.

AVERAGE ANNUAL TOTAL RETURNS *(as of December 31, 2023)*

	QTD	1 Yr	3 Yr	5 Yr	10 Yr	Since Inception (9/15/1996)
Small-Cap Opportunities (gross of fees)	**6.68%**	**17.06%**	**15.25%**	**21.05%**	**13.42%**	**10.58%**
Small-Cap Opportunities (net of fees)	**6.46%**	**16.08%**	**14.28%**	**20.04%**	**12.47%**	**9.65%**
Russell 2000 Growth Index	12.75%	18.66%	-3.50%	9.22%	7.16%	6.80%

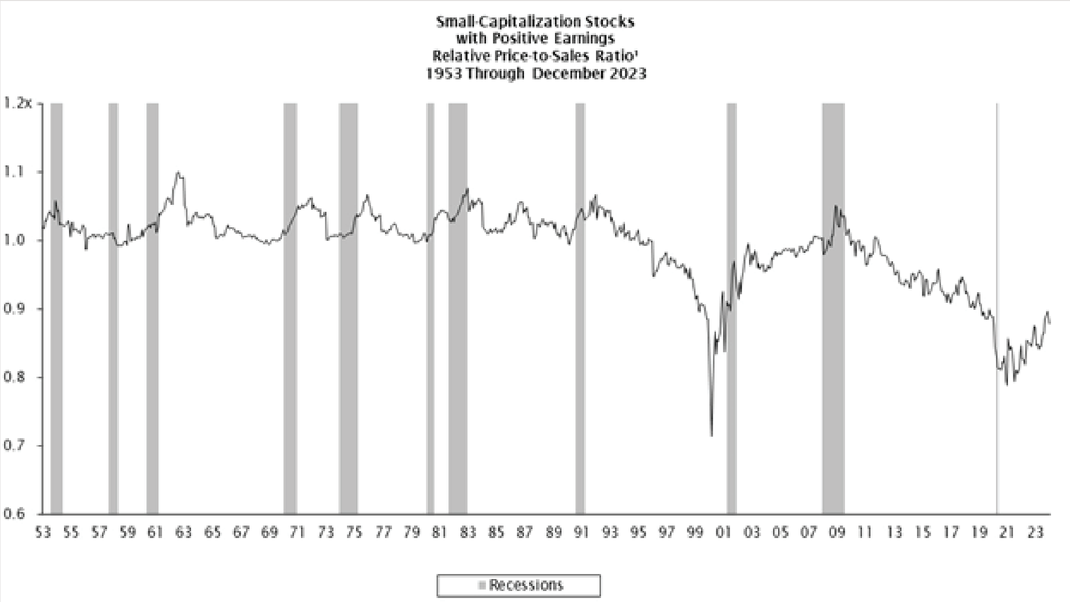
Past performance is not necessarily indicative of future results. Performance is historical and includes the reinvestment of dividends and other income. Unusually high returns may not be sustainable. The strategy invests in rapidly growing smaller and medium-sized companies that may offer greater return 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 $2.5 million. Performance results, from 1-1-97 to 12-31-03 and from 7-1-08 to present, are derived solely from the performance of the Oberweis Small-Cap Opportunities Fund (formerly known as the Oberweis Mid-Cap 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 Russell 2000 Growth Index measures the performance of those Russell 2000 companies with higher price-to-book ratios and higher forecasted earnings growth rates. The 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)

While lower quality companies led the recent small-cap resurgence, we think the entire asset class is overly ripe for a lengthy period of outperformance. We believe small-cap risks are substantially lower following a decade-plus of underperformance for the asset class. Small-caps have lagged large-caps since September 2013 by nearly 500 basis points annualized[1], and importantly, are as cheap as they've been relative to large-caps since the late 1990's. Large-cap stocks are universally loved, with the top 10 holdings in the S&P 500 representing a record 32% of that index. Meanwhile, small-caps are unloved and currently account for less than 4% of the total U.S. equity market, the lowest level in nearly 100 years. While we don't pretend to know exactly when the shift from large to small will begin, we are quite confident that small-caps will materially outperform large-caps over the next 5 to 10 years. It could begin in 2024 or 2025 or 2026, but this type of valuation gap won't persist indefinitely. In our opinion, it's a generational opportunity.



Source: Empirical Research Partners Analysis.
¹ Capitalization-weighted data, relative to all small-cap stocks.

Within small-caps, it's imperative to be a discerning investor. Buyers should beware because there's a lot of rubbish in the space. Non-earners represent just over 40% of the Russell 2000 Index and still trade at a pronounced valuation premium relative to the entire small-cap universe. While they may move higher in the short-term – particularly if interest rates continue to decline – over the intermediate- to long-term we believe investors would be wise to focus on the profitable companies within the small-cap market. In our experience, quality companies outperform over time and are especially compelling right now. Those companies, as shown in the graph above, trade at a significant valuation discount to their long-term average. In our view, a focus on profitable small-cap stocks should pay off very handsomely over the next decade because the starting point here is statistically compelling. We believe our portfolio is well positioned to capture this opportunity.

[1] From September 30, 2013 through December 31, 2023, the S&P 500 returned 12.81% annualized compared to 7.85% annualized for the Russell 2000 Index, a difference of 494 basis points annualized.

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Portfolio Highlights

As of December 31, 2023, the portfolio was 96.3% invested in 87 different positions. The portfolio had its largest over-weightings in industrials (26.4% average weighting during the quarter versus 20.3% for the Russell 2000 Growth Index) and technology (22.5% versus 21.6%). The portfolio was most underweight financial services (3.1% versus 6.5%) and materials (2.1% versus 4.2%).

Performance in the fourth quarter was positively impacted by strong stock selection in energy (where our holdings returned +2.8% versus a -7.6% return for the benchmark's energy holdings) and industrials (14.7% versus 12.5%). Performance was negatively impacted in the quarter by our stock selections in technology (-6.8% versus 13.9%) and healthcare (8.9% versus 15.5%).

Organization Update

There was no change to the team 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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