Oberweis
Asset Management

EMERGING MARKETS MARKET COMMENTARY

1Q 2024

The Quarter in Review

The Oberweis Emerging Markets strategy climbed 1.06% (0.74% net of fees) during the first quarter of 2024, slightly trailing our benchmark, the MSCI Emerging Markets Small Cap Index, by 1 basis point (31 basis points net of fees). Looking at a much longer time horizon, we have generated a total cumulative return of 53.04% (42.80% net of fees) since the strategy's June 2018 inception, which compares favorably to the benchmark's 34.73% total return over that same time period.

Emerging markets' equity returns trailed developed market peers during the quarter. The MSCI Emerging Markets Small Cap and Large Cap indexes were up a bit more than 1% and 2%, respectively. In the United States, the S&P 500 was up nearly 11%, while the small cap index, the Russell 2000, climbed 5 percent. The MSCI EAFE Index, a good proxy for the performance of developed markets excluding the United States, returned 9% during the period.

Paraphrasing an old adage, "to the person with a hammer, every problem looks like a nail." We confess that, when facing the quarterly task of explaining emerging markets small cap's relative performance—whether positive or negative—we wield a hammer, the rise or fall in the U.S. Dollar's value. The mechanism is straightforward. Most of the world's raw materials are priced in U.S. Dollars. As the greenback rises, input costs increase and squeeze developing-market companies' margins, products become less affordable for developing-market consumers, and infrastructure projects become more expensive for developing-market governments. On top of that, some developing countries and companies issue U.S. Dollar-denominated debt that becomes harder to service when the dollar is strong. The reverse is true when the greenback cheapens. Emerging markets small-cap equities react to this currency dynamic quickly and reliably.

When we need to explain our asset class's relative performance, we reach for the dollar hammer because that particular tool gets the job done almost every time. It was useful again this quarter. During the first two weeks of 2024, the various global indexes generally moved together. Following a series of comments from U.S. Federal Reserve officials that investors should temper their expectations for rate cuts, Treasury yields spiked, and the dollar kicked off a strong, month-long rally that opened up a nearly 570 basis point gap in the performance of the S&P 500 and the MSCI Emerging Markets Small Cap Index.

Alas, our trusty hammer does not help us explain emerging markets' relative underperformance later in the quarter. From mid-February to mid-March, the dollar gave back most of its year-to-date gains. Small-cap emerging markets equities, however, lost substantial ground versus peer indexes. We think the slump in Indian small caps explains most of the MSCI Emerging Markets Small Cap Index's relative underperformance even as the dollar fell. In late February, the Security and Exchange Board of India (SEBI) issued a warning about overvaluations in small- and mid-cap Indian equities and ordered local mutual funds to estimate how long it would take them to liquidate certain percentages of their portfolios if they needed to meet redemptions. SEBI's caution spooked the market. Indian small caps, which make up roughly one quarter of the MSCI Emerging Markets Small Cap Index, fell nearly 6% through the end of the quarter. The sharp country-specific decline in such a large part of the benchmark offset much of the benefit that might have been realized from a weaker dollar.

Given all that we have said about the importance of the dollar in explaining the performance of emerging markets small caps relative to other indexes, it would be understandable to wonder if investing in this asset class is nothing more than a bet against the dollar. We think not. A falling dollar has historically been the reason emerging markets small caps outperform other equity asset classes, but a weak dollar has not been necessary for decent absolute returns. Since 2011, the dollar was generally strong and the MSCI Emerging Markets Small Cap Index returned 62 percent. That return trails most other equity indexes, but is better than the usual dollar hedges like gold, oil and other commodities. To us, this highlights the role emerging markets small caps play in portfolios, especially for U.S. investors whose finances are generally positively correlated with the greenback's value. An allocation to EM small caps is a portion of the portfolio that should do well when the dollar declines, but in the meantime is invested in real, flesh-and-blood businesses that are expanding sales, reinvesting cash flows and growing intrinsic value.

AVERAGE ANNUAL TOTAL RETURNS ***(as of March 31, 2024)***

	QTD	1 YR	3 YR	5 YR	Since Inception 6/1/2018
Emerging Markets (gross of fees)	**1.06%**	**8.92%**	**0.01%**	**10.39%**	**7.57%**
Emerging Markets (net of fees)	**0.74%**	**7.73%**	**-1.25%**	**9.14%**	**6.30%**
MSCI Emerging Markets Small-Cap Index	1.05%	20.56%	4.23%	8.51%	5.24%

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)

Over the past 50 years, the dollar has been through several cycles of strength and weakness, typically lasting 5 to 10 years. The current upcycle is almost 13 years old and, if history is a guide, is overdue for a downcycle. Maybe it is imminent. Maybe not. We think, however, investors should have part of their portfolio allocated to something that will do well in absolute and relative terms when a period of dollar weakness arrives. For example, during the last multiyear cycle of relative dollar weakness from 2001 to 2011, the MSCI Emerging Markets Small Cap Index generated a total cumulative return of 367%, trouncing most other global indexes, including the S&P 500, MSCI EAFE Index and Russell 2000, which returned 38%, 78% and 113%, respectively.

Turning now to the portfolio, country allocation subtracted 100 basis points from relative performance, while stock selection added 207 basis points. Taiwan was the biggest drag, reducing relative performance by 63 basis points primarily from country allocation as we were underweight that outperforming country. India was the biggest contributor, adding 187 basis points to relative performance thanks to strong stock selection. Looking at the portfolio by sector, stock selection added 139 basis points to relative performance while sector allocation subtracted 32 basis points. Consumer discretionary holdings contributed the most, generating 103 basis points of outperformance. The Financials sector was the biggest detractor, reducing relative performance by 80 basis points.

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 13.4 times at the end of the quarter, which is meaningfully lower than the average forward multiple of 15 since 2009. The benchmark's forward multiple also compares favorably to other indexes. Bloomberg reports that the globe-spanning MSCI ACWI trades at 18.4 times forward earnings while the S&P 500 trades at 21.7 times, which are material premiums to those indexes' 15-year historical 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 58 stocks domiciled in 17 countries. Our top three country weightings (portfolio versus the MSCI Emerging Markets Small Cap Index) were India (18.4% vs. 24.8%), South Korea (15.0% vs. 13.5%), and China (11.5% vs. 8.2%). The strategy's largest overweight sectors were Consumer Discretionary (18.7% vs. 11.4%) and Consumer Staples (12.8% vs. 6.2%). The largest underweight sectors were Materials (1.0% vs. 11.7%) and Real Estate (1.5% vs. 6.0%).

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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