

INTERNATIONAL OPPORTUNITIES MARKET COMMENTARY

3Q 2024

Review

We are pleased to report strong year-to-date performance with the International Opportunities Strategy returning +15.54% (14.78% net of fees) vs. +11.01% for the benchmark, the MSCI World Ex USA Small Cap Growth Index. During the third quarter, the strategy returned +9.72% (9.48% net of fees) vs. +9.98% for the benchmark. Developed equity markets were positive over the quarter, supported by several factors. Monetary policy in global markets pivoted dovish during the period, with the obvious exception of Japan. The Fed lowered the federal funds rate by 50 basis points, more than had been priced in, and China announced a number of monetary and fiscal actions that appear to be both symbolically and substantively important. Eurozone economic data was softer than expected over the quarter, likely linked to the loss of economic momentum hitherto seen in China. This, together with the Fed's actions, has increased the pressure on the ECB to speed up its pace of rate cuts towards consecutive steps, following its initial rate cut in June. September PMIs in the Eurozone showed a deceleration in manufacturing activity, confirming other soft activity data for Q3, including industrial production and some of the forward-looking surveys. Eurozone inflation data at the end of the quarter was also below expectations. While a fall in the price of energy has been a contributing factor, core CPI goods and services inflation also declined more than economists were expecting.

In general, inflation appears to be easing and, with reports that OPEC is planning to raise output, upside risk to the price of oil may be capped. Labor markets largely remained tight across the G10 economies, thus facilitating real income growth over the quarter. With household balance sheets generally remaining strong and consumer confidence recovering, the portents for personal consumption are positive.

The Bank of Japan's posture continued somewhat at odds with the rest of its developed market counterparts. BOJ Governor Kazuo Ueda indicated at the September meeting that the Bank's rate hike stance remains intact. Governor Ueda is focused on wage growth, which accelerated over the period with pass-through to services prices. Additionally, Ueda believes wage growth is likely to continue to increase due to the country's diminishing labor supply. Concurrent with the Fed easing rates in the United States the yen responded accordingly, appreciating materially relative to the U.S. dollar, up approximately 12% over the quarter. Adding to the yen's tailwinds, at the end of September Shigeru Ishiba won the Liberal Democratic Party election, thus effectively winning the Japanese premiership. Ishiba is considered to be a fiscal hawk and in favor of gradually more restrictive monetary policy.

Outlook

For the last twelve months, equity markets have been expecting a soft landing in the economy, disinflation, central bank easing and an AI spending boom. That has largely played out. The global economy now appears well set on the right side of the inflationary cycle, and central banks have begun an easing cycle. In the U.S., the Fed Funds rate is still over 75bps above the two-year yield, a sign that further cuts may be coming. The world's most important central bank is signaling it is more focused on employment than inflation. The data supports this position with the core PCE price index coming in lower than expected for August. The primary remaining inflationary pressures are tied to shelter and auto insurance, both of which should ease in the coming months. In addition, prices of goods are actually deflating, with globalization still exerting a deflationary impulse despite the ongoing trade war with China. Towards the end of the quarter the yield curve steepened notably in the United States, a dynamic that may be replicated in Europe if, as seems increasingly possible, the ECB eventually accelerates the pace of easing into next year thus compressing near-term yields. As referenced in previous letters, we consider it very feasible that longer-term sovereign yields and real rates will remain structurally above where they were in the 2010's. Given demographic trends, ever-expanding fiscal deficits as well as labor market and consumer resilience to tighter financial conditions, it seems likely that the level of real rates will gravitate to a point above the average of the prior decade.

AVERAGE ANNUAL TOTAL RETURNS (as of September 30, 2024)

	QTD	YTD	1 Yr	3 Yr	5 Yr	10 Yr	Since Inception 2/1/2007
International Opportunities (gross of fees)	9.72%	15.54%	25.43%	-8.68%	7.91%	7.35%	9.38%
International Opportunities (net of fees)	9.48%	14.78%	24.33%	-9.50%	6.95%	6.39%	8.40%
MSCI World ex-US Small-Cap Growth Index	9.98%	11.01%	23.42%	-3.58%	5.99%	6.22%	4.51%

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 2-1-07 until 7-31-08, were derived solely from the performance of the Oberweis International Opportunities 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 World ex-US Small-Cap Growth Index (Net) is a free float-adjusted market capitalization weighted index that is designed to measure the performance of small cap growth developed markets excluding the U.S. with minimum dividends reinvested net of withholding tax. It is not possible to invest directly in an index.

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Outlook (continued)

This has potential implications for stock selection. If real rates remain above where they were in the 2010's, we envisage that companies' free cash flow generation and free cash flow growth will maintain prime importance in stock selection. As equity markets have thus far correctly anticipated the disinflationary soft-landing outcome for the global economy, and the environment today shows few visible systemic stresses, there appear to be limited intra-market valuation anomalies. Global intra-sector spreads are close to their long-term averages, almost to the point where what stands out is how little stands out. Value as a factor does not strike us as provocatively attractive and the price of growth is not statistically cheap, but neither does it screen as extreme. Top-down sector opportunities are also not clear cut. In this environment, therefore, what ought to matter most are positive earnings surprises at the stock level. If the wider valuation structure of the market can be characterized as being in a middling grey zone, earnings revisions take on greater importance. This is what we had discussed in our Q4 2023 and Q1 2024 letters, when we noted that the team had significantly increased its personal investments in the strategy amid the trifecta of a cheap asset class valuation, a fundamentally strong portfolio and subsiding style headwinds. We wrote that style headwinds, such as the ones we had seen in recent years, do not tend to persist indefinitely and that we fully expected that some of these headwinds would eventually shift to tailwinds. This is what has happened so far in 2024 and what we expect to continue going forward.

In directional agreement with the consensus macro view, we do not anticipate an impending meaningful deterioration in the economic environment, even though some of the recent economic data has been mixed across the G7 economies. Manufacturing data of late may not have beaten expectations, although looking forward global monetary and fiscal policy responses are cause for optimism. With respect to inflation, the trend is favorable. Except for Japan, wage growth has normalized to a level that is consistent with little to no impact on inflation. The market's overall assumption of disinflation appears to have been validated. Most importantly, consumer confidence indicators are recovering towards their long-term averages, real income growth is ongoing, and employment rates remain resilient.

Valuations in our stock universe are attractive. The United Kingdom, currently the fund's largest geographic overweight, is trading at a discount to its 20-year median PE. On a sector-adjusted basis, relative to global peers, the U.K. is valued near its lows of the last two decades, while offering the highest dividend yield of any of the major developed markets. Similarly, valuations in the Eurozone are at historic lows relative to the U.S. and on an absolute basis look far from constrained given the lower inflation regime in which we are now. When considered through the lens of free cash flow, the disparity of developed markets relative to the U.S. is also clear. Each dollar of free cash flow margin in the United States is accompanied by about 40 cents of free cash yield. In the U.K. this statistic is 80 cents, in Continental Europe 65 cents and in Japan 90 cents.

Portfolio Highlights

At quarter-end, the portfolio was invested in 70 stocks in 14 countries. Our top five country weightings (portfolio weighting versus the MSCI World Ex USA Small Cap Growth Index) at the end of the quarter were Japan (24.2% vs. 32.8%), United Kingdom (23.8% vs. 13.0%), Norway (8.0% vs. 2.2%), Canada (7.2% vs. 9.6%), and Sweden (6.7% vs. 6.5%). On a sector basis, the portfolio was overweight industrials (43.5% vs. 25.9%) and underweight information technology (1.4% vs. 14.8%).

Organization Update

There are no changes to the International team or strategy.

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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