Oberweis Asset Management

CHINA OPPORTUNITIES MARKET COMMENTARY

1Q 2025

The Quarter in Review

For the quarter ending March 31, 2025, the Oberweis China Opportunities Composite returned 14.55% (14.28% net of fees) compared to 15.02% for the MSCI China Index. In the quarter, China's capital market staged a remarkable rally, marking the second most robust single-quarter rally in five years. Since the market nadir in mid-January, a confluence of technological breakthroughs, accommodative policies, and improving economic fundamentals has propelled a broad-based rally. Transformative advancements in DeepSeek's AI technology have catalyzed a significant repricing of the tech growth sector. Concurrently, policymakers have spared no effort in implementing targeted measures to bolster the Chinese economy and market liquidity. Moreover, a series of encouraging data points, including three consecutive months of expansion in the manufacturing Purchasing Managers' Index (PMI) and better-than-anticipated retail sales, have affirmed the stabilization of economic recovery. Collectively, these factors have created an improved market environment, characterized by positive policy signals, abundant liquidity, and bottoming fundamentals. As risk appetite resurges, equities have entered a virtuous cycle, with gains fueling further gains.

DeepSeek AI Lab's game-changing breakthrough has completely upended global investors' perceptions of China's tech innovation prowess and catalyzed a powerful rally. In December, the Chinese AI startup made a stunning announcement: its DeepSeek V1 large language model, boasting an impressive 671 billion parameters, could match OpenAI's o1 in handling complex reasoning tasks while drastically reducing inference costs to a mere 1/20th of its competitors' levels, thanks to its proprietary distributed training framework. This news sent ripples throughout the industry. Remarkably, they accomplished this astonishing feat despite facing constraints from U.S. export restrictions on NVIDIA's H100/H200 chips, instead harnessing a custom-designed heterogeneous computing solution powered by domestic technology. With this single stroke, DeepSeek conclusively demonstrated that China can make significant strides in AI even when confronted with severe technological limitations. This pivotal moment entirely reshaped the market's pessimistic outlook on China's capacity to compete in the global AI race. DeepSeek's groundbreaking technological advancement forced investors to consider if productivity improvement estimates for China were too low. Prominent financial institutions' projections for China's potential economic growth rate in 2030 increased by a substantial 20-30 basis points. This reassessment of growth prospects, fueled by the technological revolution, has become the foundational thesis driving the comprehensive compression of risk premiums for Chinese assets this quarter.

AVERAGE ANNUAL TOTAL RETURNS ***(as of March 31, 2025)***

	QTD	1 Yr	3 Yr	5 Yr	10 Yr	Since Inception 10/1/2005
China Opportunities (gross of fees)	**14.55%**	**23.20%**	**1.01%**	**5.34%**	**5.42%**	**11.00%**
China Opportunities (net of fees)	**14.28%**	**21.99%**	**0.01%**	**4.29%**	**4.37%**	**9.90%**
MSCI China Index	15.02%	40.44%	3.53%	1.46%	2.51%	7.27%

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 10-1-05 until 10-1-06 as well as 5-1-08 to present, are derived solely from the performance of the Oberweis China 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 China Net Index is a free float-adjusted market capitalization-weighted Index of Chinese equities that include China-affiliated corporations and H shares listed on the Hong Kong Exchange, and B shares listed on the Shanghai and Shenzhen exchanges and P chips and foreign listings with minimum dividends reinvested net of withholding tax. It is not possible to invest directly in an index.

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The Quarter in Review (continued)

China's economy also showed signs of recovery in Q1 2025, despite facing some persistent challenges. The manufacturing Purchasing Managers' Index (PMI) reached 50.5 in March, remaining above the expansion threshold for two consecutive months, while the non-manufacturing business activity index recorded a healthy 50.8. With the two indicators remaining in the expansion zone for two consecutive months, it is evident that the economic recovery is gaining traction. The primary driver of growth was a surge in high-quality output. High-tech manufacturing's PMI saw a significant increase of 1.4 percentage points, reaching an impressive 52.3, while equipment manufacturing achieved a strong 52.0. Revolutionary AI technology triggered a 19.2% surge in revenue for scientific research and technical services, and an 11.6% increase in IT services. The new energy vehicle manufacturing sector also contributed to the growth, with sales revenue growing by 20.7% year-on-year. Targeted policy measures also began to yield positive results. Equipment upgrade incentives stimulated an 11.6% increase in machinery purchases, while "trade-in" benefits spurred a remarkable 37.3% surge in appliance sales. However, some challenges persisted. Both the Producer Price Index (PPI, -2.2%) and the Consumer Price Index (CPI, -0.7%), along with PMI of small and medium-sized enterprises (SMEs) at 49.6, indicate that falling prices constrained profit growth. Nevertheless, China's economy is regaining its footing, despite these obstacles. While the recovery may not be at full speed yet, the ship is stabilizing.

In the quarter, China's policy toolkit delivered a powerful combination of growth-stimulating measures and structural adjustments. The authorities maintained a robust GDP growth target of 5% while increasing the fiscal deficit to 4%. They deployed significant resources, issuing an impressive 1.8 trillion in central government special bonds (vs. 1 trillion in 2024) and authorizing an enhanced 4.4 trillion in local government special bond allocations to strongly support infrastructure investment. However, the most transformative shift occurred in the consumer strategy. "Trade-in" incentives propelled total retail sales by 4%, with smartphone sales experiencing a staggering 26.2% year-on-year growth. Policymakers reinforced the consumer-investment partnership by strengthening social security (including increased fiscal subsidies for pensions and health insurance) and accelerating equipment upgrades (resulting in an 11.6% boost in machinery purchases). In a significant gesture of goodwill toward the private sector, President Xi Jinping's candid discussion with prominent business leaders signaled the conclusion of the stringent regulatory crackdown. This policy combination of macro stabilization and structural fine-tuning aimed to maintain the growth momentum while proactively addressing long-term imbalances.

Outlook

While China's economy made marginal improvements in the first quarter, Sino-US relations remain abysmal, and the impact of Trump's tariffs is likely to manifest in the balance of this year. Trade tensions have reached a new peak, with Trump's reciprocal tariff policy pushing China's overall tariff rate to 145%—significantly higher than other economies—a move that is likely adversely affect demand for Chinese goods. Still, the tariff war is widely anticipated by investors at this point. With policymakers implementing comprehensive support measures and cutting-edge technology providing a boost to the economy, signs of stabilization are emerging and corporate profitability is gradually recovering. Notably, with a net beat of 8%, MSCI China exceeded earnings in both number of companies (11% of index reported), and weighted earnings (50% of market cap reported) for the first time in three and a half years; driven by aggressive estimate cuts, corporate efforts, and tech/AI investment. China now ranks second globally in earnings beat, just after Japan, with an 8% net beat by company numbers, compared to MSCI EM's 0.8% and S&P 500's 1.3%. However, China still faces significant medium-to-long-term challenges. Domestically, deflationary pressures, the property crisis and local government debt remain critical issues.

Valuations are not the deal they were at the end of 2024, with the average-weighted P/E of the Chinese market rebounding close to its ten-year historical average. Further market gains will require clear indications of sustained corporate profit growth to drive upward momentum. Chinese equities are now trading at a forward 12-month price-to-earnings ratio of 11.18x, with projected earnings growth of 8% and 14% in 2025 and 2026 respectively. This is in comparison to the 10-year historical average of 11.35x.

Our investment strategy remains consistent. We continue to focus on companies undergoing positive fundamental changes that we believe have not yet been fully recognized by the market. We seek out niche-oriented companies whose success is driven by factors such as product success, technological innovation, regulatory changes, and the emergence of new markets in China. In the quarter, we identified promising opportunities in the information technology, consumer discretionary, and healthcare sectors. Generally, these companies are leading players in niche markets where growth is more dependent on product acceptance than overall GDP growth. Many of these companies benefit from the ongoing structural economic and social transformations in China. Our approach allows us to uncover undervalued opportunities that are poised for growth due to their unique positioning within evolving market dynamics. By focusing on companies that are beneficiaries of China's ongoing reforms and emerging trends, we aim to generate alpha for our investors.

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Portfolio Highlights

During the quarter, the portfolio was 99.4% invested in 62 companies. The biggest performance contributors were consumer discretionary, financials and energy. On the contrary, our biggest performance detractors were information technology, health care, and communication services.

Organization Update

There was no change to the team 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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