



Needham Small Cap Growth Fund: Review of the Fourth Quarter & Calendar Year 2019

In the fourth quarter of 2019, the Needham Small Cap Growth Fund Institutional and Retail classes returned 16.27% and 16.07%, respectively. The Russell 2000 Index returned 9.94% and the S&P 500 Index returned 9.07%. For the year ending December 31, 2019, the Needham Small Cap Growth Fund Institutional and Retail classes returned 55.31% and 54.45%, respectively. The Russell 2000 Index returned 25.52% and the S&P 500 Index returned 31.49%.

I am very pleased with the Fund's quarterly and annual performance. The Fund was recognized in the [Wall Street Journal](#) and [Investor's Business Daily](#) as the top performing mutual fund in 2019. We are very excited about these recognitions and appreciate the long term support and patience of our investors.

While headline and market volatility continued throughout 2019, we deployed a flexible investment approach that allowed the Fund to take advantage of the market environment. We employed disciplined risk management and continued to evaluate each stock individually as price targets were met and new risks arose. The interest rate curve finally steepened, sparking a market rally from the end of the summer months. I did not believe a recession was looming during the summer, which allowed the Fund an opportunity to deploy substantial capital at reasonable prices.

While global economic growth slowed in 2019, I remain constructive on the overall global economy as it adjusts. With the announcement of the Phase 1 U.S.-China trade deal and an accommodative Federal Reserve, the markets ended the year on a positive note, although the full effects of these developments will not be known until later in 2020.

As I write this letter, we are observing the potential economic impacts that may occur from the spread of the Coronavirus, and expect to see cautious outlook from many companies. Healthcare risk aside, which I believe will be temporary, I expect companies to be generally upbeat on their 2020 outlook, since global economic growth is expected to accelerate. However, will it be enough to support the significant market moves and elevated valuations we enjoyed in 2019? I believe there could be rotation from 2019 stock winners into more value-oriented names. I have adjusted the Fund to harvest some of our gains and look for better entry points to redeploy capital.

While volatility may seem to be a bad word for the overall markets, it is a great chance for active managers to find buying and selling opportunities. In volatile markets, a cash position is truly strategic for small cap fund managers. Many small cap investment opportunities "trade by appointment," and the Needham Small Cap Growth Fund likes to capitalize on these opportunities when liquidity is available to both buy and sell stock positions.

During the month of December, the Fund experienced sizeable inflows of new capital and therefore, we ended the year with a large cash balance that we are actively deploying as we find the right opportunities. Typically, we find these opportunities during and after earnings season, which kicks off more significantly for small cap companies in late January and into February.

The Fund's top holdings as a percentage of net assets at December 31, 2019 included II-VI, Inc. (IIVI), FireEye, Inc. (FEYE), Zuora, Inc. (ZUO), Cambium Networks Corp. (CMBM), and Cohu, Inc. (COHU).

The Fund's top fourth quarter contributors included Cohu, Inc. (COHU), Vicor Corp. (VICR), PDF Solutions, Inc. (PDFS), Photronics, Inc. (PLAB) and Intevac, Inc. (IVAC). The Fund did not have any M&A announcements in the quarter. The Fund's largest fourth quarter detractors were Genmark Diagnostics, Inc. (GNMK), EMCORE Corp. (EMKR), and ChannelAdvisor Corp. (ECOM), Appian Corp. (APPN) and Zuora, Inc. (ZUO).

The Fund's top contributors for the year ending December 31, 2019 included Aspen Aerogels, Inc. (ASPN), PDF Solutions, Inc. (PDFS), Amber Road, Inc. (AMBR), Photronics, Inc. (PLAB) and Ultra Clean Holdings, Inc. (UCTT). The Fund's top detractors for the year ending December 31, 2019 included Zuora, Inc. (ZUO), Genmark Diagnostics, Inc. (GNMK), Emcore Corp. (EMKR), 2U, Inc. (TWOU) and NeoPhotonics Corp. (NPTN).

The markets have recovered nicely from the summer lows of 2019 and it would not surprise me to see a pause in the market recovery. However, my outlook for 2020 remains positive. I look forward to a year of patience rewarded, and I continue to believe that a favorable environment remains for investment in equities.

I am focused on the following three themes: 1) continuation of the growth in the semiconductor capital equipment industry; 2) 5G communication infrastructure build-outs; and 3) military and defense modernization. These three areas of investment impact much of the Fund's portfolio, and I believe that they should create long-term shareholder value.

I expect increased volatility to continue into 2020. I also expect the Federal Reserve to remain vigilant in setting interest rate policy that remains a tailwind to risk assets. While global trade negotiations have been painful headlines for many, any resolution to these disagreements should provide a nice tailwind to the global economy as we enter the U.S. general election of 2020. The high-yield markets remain strong, which is also supportive of small cap asset class valuations. I reiterate from past quarterly letters that mergers and acquisitions continued in the small cap universe, and I expect to see increased M&A activity to improve and benefit our portfolio of stocks in 2020.

We welcome our new investors and thank all of our investors for their continued support. If you have any questions, thoughts or concerns, please contact us at (800) 625-7071 or at cretzler@needhamco.com. For information about the funds, please visit our website at www.needhamfunds.com.

Sincerely,



Chris Retzler
Portfolio Manager

AVERAGE ANNUAL RETURNS AS OF 12/31/19

	3 MO	YTD	1YR	3YR	5YR	10YR	SINCE INCEPT.
Needham Small Cap Growth Fund Inst Class**	16.27%	55.31%	55.31%	18.57%	15.02%	12.76%	12.16%
After Taxes on Distributions	13.90%	52.13%	52.13%	14.44%	12.04%	10.84%	10.46%
After Taxes on Distributions & Redemptions	10.91%	34.44%	34.44%	13.03%	10.87%	9.90%	9.91%
Needham Small Cap Growth Fund Retail Class	16.07%	54.45%	54.45%	17.91%	14.39%	12.15%	11.55%
After Taxes on Distributions	13.65%	51.23%	51.23%	13.76%	11.40%	10.23%	9.85%
After Taxes on Distributions and Redemptions	10.81%	33.96%	33.96%	12.50%	10.35%	9.37%	9.37%
Russell 2000 Index	9.94%	25.52%	25.52%	8.59%	8.23%	11.83%	8.61%
S&P 500 Index	9.07%	31.49%	31.49%	15.27%	11.70%	13.56%	8.57%

The Needham Small Cap Growth Fund inception date is 5/22/02.

**Performance for any periods prior to the inception date of Institutional Class Shares are based on the historical performance of the Retail Class Shares adjusted to assume the expenses associated with Institutional Class Shares.

The Needham Small Cap Growth Fund's Gross Expense Ratio is 2.27% for the Retail Class and 2.03% for the Institutional Class. The Needham Small Cap Growth Fund's Net Expense Ratio is 1.93% for the Retail Class and 1.26% for the Institutional Class. The Net Expense Ratio reflects a contractual agreement by the Fund's investment adviser to waive its fee and/or reimburse the Fund through May 1, 2020 to the extent the Gross Expense Ratio exceeds 1.85% and 1.18% of the average daily net assets of Retail Class Shares and Institutional Class Shares (Expense Cap). The Expense Cap excludes taxes, interest, brokerage, dividends on short positions, fees and expenses of "acquired funds," extraordinary items and shareholder redemption fees but includes the management fee.

Fact Sheet Link: [Needham Small Cap Growth Fund](#)

The information presented in this commentary is not intended as personalized investment advice and does not constitute a recommendation to buy or sell a particular security or other investments.

This message is not an offer of the Needham Growth Fund, the Needham Aggressive Growth Fund or the Needham Small Cap Growth Fund. Shares are sold only through the currently effective prospectus. Please read the prospectus or summary prospectus and consider the investment objectives, risks and charges and expenses of the Funds carefully before you invest. The prospectus and summary prospectus contain this and other information about the Funds and can be obtained on our website, www.needhamfunds.com.

Investment returns and principal value will fluctuate, and when redeemed, shares may be worth more or less than their original cost. Performance data quoted represents past performance, and does not guarantee future results. Current performance may be higher or lower than these results. Performance current to the most recent month-end may be obtained by calling our transfer agent at 1-800-625-7071. Total return figures include reinvestment of all dividends and capital gains.

All three of the Needham Funds have substantial exposure to small and micro capitalized companies. Funds holding smaller capitalized companies are subject to greater price fluctuation than those of larger companies.

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Portfolio holdings are subject to change. The Needham Small Cap Growth Fund's ownership as a percentage of net assets in the stated securities as of 12/31/19: IIVI: 3.95%; FEYE: 2.88%; ZUO: 2.82%; CMBM: 2.52%; COHU: 2.38%; VICR: 1.77%; PDFS: 1.53%; PLAB: 0.60%; IVAC: 2.20%; GNMK: 2.18%; EMKR: 1.13%; TWOU: 0.00%; NPTN: 0.00%.