Perritt Funds

MicroCap Opportunities Fund, Inc.
Emerging Opportunities Fund, Inc.

An Interview With Michael Corbett,

President and Portfolio Manager of the Perritt Funds

Michael Corbett
CIO & Portfolio Manager

Q.

How have changes made to the portfolio during the worst of the market's downturn contributed to the Funds recent out-performance?

A.

Much of the Funds' recent performance was a result of our taking advantage of the extreme valuations that we saw in the microcap space at the beginning of this year. In March, the selling became so irrational that half of the companies in our portfolios were trading at levels below tangible book value. We took this opportunity to add to some of our positions. One example of this is Bioscrip, Inc (BIOS). This health care company acts as a middle man between pharmacies to provide services that help consumers get less expensive prices for the prescriptions they need. In early March, there was one particular seller with a significant position in the stock that needed to be unloaded because they were receiving redemption requests. We took advantage of this opportunity by taking a significant portion of the shares when the stock was trading at less than $2.00. The stock has since rebounded to nearly $6.00. These types of examples certainly added significant value to the portfolio and have helped the Funds' performance so far this year. According to Morningstar, for the period January 1 through June 30, 2009, both PRCGX and PREOX ranked in the top 2% among 570 funds in the small-blend funds category, based on total returns.

Morningstar ranked the MicroCap Opportunities Fund (PRCGX) in the top 31%, 24% and 3% out of 661, 465 and 231 small-blend funds for the one-, five- and ten-year periods ending 6/30/2009. Morningstar ranked the Emerging Opportunities Fund (PREOX) in the top 95% and 91% out of 661 and 570 small-blend funds for the one- and three-year periods ending 6/30/2009.

Performance as of 6/30/09

	YTD	1 Yr.	3 Yr.	5 Yr.	10 Yr.	15 Yr.
Perritt MicroCap Opportunities Fund (PRCGX)	27.57%	-23.35%	-9.46%	0.05%	9.81%	10.16%
Perritt Emerging Opportunities Fund (PREOX)	27.94%	-37.13%	-16.26%	NA	NA	NA

Perritt MicroCap Opportunities Fund Expense Ratio: 1.37%
Perritt Emerging Opportunities Fund Expense Ratio: 1.87%

Performance data quoted represents past performance; past performance does not guarantee future results. The investment return and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Current performance of the fund may be lower or higher than their original cost. Performance data current to the most recent month end may be obtained by calling 1-800-331-8936. The funds impose a 2% redemption fee for shares held less than 90 days. Performance data quoted does not reflect the redemption fee. If reflected, total return would be reduced.

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Q.

Now that we've experienced a significant rally, are small company stocks still undervalued?

A.

There is good news and bad news that comes with any significant rally. Obviously the good news for investors is that they have made money. The bad news is the idea that the market may have gone too far, too fast. While this statement may be true, it is clearly a short run view. Over the long run, what ultimately determines the future level of stock prices are valuations. There are several ways to look at valuations. Given the fact that we are currently in a recession, valuation measures such as price-to-earnings ratios and price-to-cash flow ratios become less important. This is because earnings and cash flow levels are likely to become depressed during a recession. In our opinion, one of the most important tools to use when determining a company's value during a recession is the price-to-sales ratio and the quality of the balance sheet. As can be seen in the table that we've provided, The Emerging Opportunities Fund currently trades at 0.4 times sales and The Microcap Opportunities Fund trades at 0.5 times sales. In addition, the balance sheets of the companies in both Funds remain in pristine condition. For more details on the cash and debt levels of the Funds, please see the table at the end of this commentary. It is important to note that historically, in a recession, small companies have been able to move quickly to cut costs. As a result, any improvement in future sales due to a strengthening economy should lead to an even greater increase in the earnings.

Q.

Has the downturn in the economy had an effect on the number of analysts that cover small cap stocks, and if so, what does this mean for you portfolios?

A.

To answer this question it is important to understand why a company receives coverage from analysts in the first place. There are actually two types of firms that cover equities, sell-side firms and firms related to investment banking. A sell-side firm wishes to recommend a company in order to generate trading and subsequently earn commissions. On the other hand, firms related to the investment banking business engage in secondary offerings or other types of banking services. According to The Wall Street Journal, there were more than 2,200 cases of analysts formally dropping coverage of small cap stocks between last September and Mid-May of this year. It is not surprising that due to the recession the overall coverage has decreased. With less money available and less business activity, both sell-side firms and firms related to investment banking have suffered.

The table below compares the level of analyst coverage within the small-cap and large-cap space, as well as the coverage levels for companies in our portfolios. The number of small-cap companies being followed by analysts has always been less than that of large-cap companies. This is one of the key factors in the inefficiencies that we believe exist within the small-cap sector. Therefore, in our opinion, the recent drop in the level of analyst coverage is actually a positive for micro-cap investors because stocks become more inefficiently priced. In other words, the stocks become more undervalued. This is an area where we believe our in-house research has added significant value uncovering mispriced securities. Our research team believes that the entry point for small-cap and micro-cap stocks continues to be attractive right now, as an abundance of these stocks remain inefficiently priced when evaluated on a three to five year time horizon.

Analyst Coverage as of 6/30/09

	Perritt Microcap PRCGX	Perritt Emerging PREOX	Russell 2000 Index	S&P 500 500 Index
Number of stocks	127	145	2019	500
Zero analyst coverage	25	74	299	2
One analyst coverage	24	36	262	7
Average # Analyst	2.75	1.00	4.01	10.03

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Q.

How do you explain the wide disparity in performance among the various micro-cap indexes?

A.

The substantial difference in the performance of the various micro-cap indexes is somewhat astounding, as seen in the table below. As of June 30, 2009 there is a difference of nearly 30% between the best and worst performing micro-cap indexes year-to-date, all of which are supposedly tracking the same sector of the market. A closer look reveals that a possible explanation to this irregularity is related to the number of companies being tracked by each index and how they are chosen. In its entirety, the micro-cap universe is made up of approximately 5,000 names. The Russell 2000 and the Russell Microcap Index each track 2000 companies, the Morgan Stanley MicroCap Index tracks 1,300 companies, and the Dow Jones Select Microcap Index and Zacks Microcap Index each track less than 500 companies. The lesson here is that within the micro-cap sector of the market, selecting between the right stock and the wrong stock can have large ramifications on a portfolio's ultimate performance. This is part of the reason why for twenty years we have been such strong advocates of active management within the micro-cap sector of the market. When done correctly we believe it can add a great deal of value in both the short run as well as the long run.

MicroCap Index Performance as of 6/30/09

Russell 2000	2.6%
Russell Microcap	6.0%
MSCI Microcap	22.5%
Dow Jones Select Microcap	-3.2%
Zacks Microcap	-5.0%

Portfolio Characteristics as of 6/30/09

	Perritt MicroCap PRCGX	Perritt Emerging PREOX
Median Market Cap	$145 M	$31 M
Price / Tangible Book	1.0	0.8
Price / Earnings	12.8	13.0
Price / Sales	0.5	0.4
Price / Cash Flow	4.2	3.0

Large Cap vs. Small Cap: Comparison of Debt Levels as of 6/30/09:

	S&P 500 Index	Russell 2000 Index	MicroCap Opportunities Fund (PRCGX)	Emerging Opportunities Fund (PREOX)
Zero Debt: # of companies with zero debt on balance sheet	41 of 500 (8.2%)	575 of 2019 (28.5%)	56 of 127 (44.1%)	64 of 145 (44.1%)
Cash Position: # of companies holding 10% or more of market cap. in cash	208 of 500 (41.6%)	1194 of 2019 (59.1%)	79 of 127 (62.2%)	90 of 145 (62.1%)
Median Debt to Assets Ratio	21%	10%	2%	1%

The information provided herein represents the opinion of Perritt Capital Management and is not intended to be a forecast of future events, a guarantee of future results, nor investment advice.

Past performance does not guarantee future results. Index performance is not illustrative of fund performance. You cannot invest directly in an index. For fund performance please visit www.perrittmutualfunds.com.

The fund's investment objectives, risks, charges and expenses must be considered carefully before investing. The prospectus contains this and other important information about the investment company, and it may be obtained by calling 800-331-8936 or by visiting www.perrittmutualfunds.com. Read it carefully before investing.

Mutual fund investing involves risk. Principal loss is possible. The Funds invest in smaller companies, which involve additional risks such as limited liquidity and greater volatility. The Funds invest in micro cap companies which tend to perform poorly during times of economic stress. The Emerging Opportunities Fund may invest in early stage companies which tend to be more volatile and somewhat more speculative than investments in more established companies.

Price to Sales ratio is a tool for calculating a stock's valuation relative to other companies, calculated by dividing a stock's current price by its revenue per share. Price to Earnings ratio is calculated by dividing current price of the stock by the company's trailing 12 months' earnings per share. Price to Book Value Ratio is calculated by dividing the current price of the stock by the company's book value per share. Price to Cash Flow is calculated by dividing the current price of the stock by the company's cash flow per share. Cash flow measures the cash generating capability of a company by adding non-cash charges (e.g. depreciation) and interest expense to pretax income.

The S&P 500 is an unmanaged broad based universe of 500 stocks which is widely recognized as the US equity market. The Russell 2000 Index consists of the smallest 2000 companies in a group of 3000 companies in the Russell 3000 as ranked by market cap. The Russell Microcap index consists of the smallest 1,000 companies in the Russell 2000, plus 1,000 smaller U.S.-based listed stocks. The MSCI US Micro Cap Index represents the micro cap companies in the U.S. equity market. The index targets for inclusion, approximately the bottom 1.5% of the U.S. equity market capitalization and contains more than 1,400 companies. The Zacks Microcap index is an equal dollar weighted index comprised of between 300 and 500 of the highest-ranking stocks selected quarterly from among the smallest 2,500 U.S. listed companies by market capitalization based on a proprietary multi-factor quantitative selection methodology. The Dow Jones Select MicroCap Index represents the investable portion of U.S. microcap companies. It measures the performance of micro-capitalization stocks traded on the major U.S. exchanges, screening for size, trading volume and fundamentals. It is not possible to invest directly in an index.

As of 6/30/09, The Perritt Funds held Bioscrip (2.62%). Fund holdings and sector allocations are subject to change at any time and are not recommendations to buy or sell any security.

Morningstar rankings represent a fund's total-return percentile rank relative to all funds that have the same Morningstar category. The highest percentile rank is 1 and the lowest is 100. It is based on Morningstar total return, which includes both income and capital gains or losses and is not adjusted for sales charges or redemption fees.

Past performance does not guarantee future results. Both the MicroCap Opportunities Fund and Emerging Opportunities Fund have experienced recent negative returns.

The Perritt Funds are distributed by Quasar Distributors, LLC (7/09)

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