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Michael Corbett's 2Q '10 Commentary

Portfolio Manager of the Perritt Funds

Q.

What did you learn from the recent rebalance of the Russell Indexes?

A.

According to our analysis of the Russell rebalance, the number of investable stocks has declined by 40% since 1999. Each year at the end of June, The Frank Russell Company rebalances its indexes to account for changes in market

size. In 1999 there were nearly 6000 domestic companies listed on the major U.S. stock exchanges. At the time of the Russell rebalance in late June, the number of domestic companies listed on the major stock exchanges was 3633. The reasons for the decline in the number of publicly traded



Michael Corbett
CIO &
Portfolio
Manager

Performance as of 6/30/10

	<u>YTD</u>	<u>1 Yr.</u>	<u>3 Yr.</u>	<u>5 Yr.</u>	<u>10 Yr.</u>	<u>15 Yr.</u>	<u>Since Inception</u>
Perritt MicroCap Opportunities Fund (PRCGX)	-0.46%	19.29%	-9.90%	1.41%	9.07%	10.06%	8.81% (4/11/88)
Perritt Emerging Opportunities Fund (PREOX)	10.41	38.65%	-13.52%	1.05%	NA	NA	2.62% (8/27/04)

Perritt MicroCap Opportunities Fund Expense Ratio: 1.42%

Perritt Emerging Opportunities Fund Expense Ratio: 2.12%

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 the performance quoted. 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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 **Perritt Funds**
MicroCap Opportunities Fund, Inc.
Emerging Opportunities Fund, Inc.

www.PerrittCap.com

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companies include bankruptcies, acquisitions, companies going private, and the decline in the number of IPO's. We feel that the significance of this development can be understood as a simple study of Economics: a shrinking supply of companies to invest in could have a strong impact on rising stock prices in the future.

Q.

Where have you found opportunity as a result of Russell rebalance?

A.

We increased our position in two stocks that were removed from the Russell Indexes as a result of the rebalance, PC Mall (MALL) and NovaMed (NOVA). **In each instance, we felt that institutional selling due to the rebalance caused the stock price to fall to a level that was well-below our valuation of the business.**

PC Mall is a distributor of electronic components. One of the company's larger clients is Apple, Inc. – Apple products such as the iPod and iPhone are distributed through PC Mall's pipeline. Following the Russell rebalance, PC Mall had a market capitalization of \$40 million, a level nearly half of its tangible book value of \$70 million. The company, which trades at approximately \$3.50, earns \$1.1 billion in revenue and has a current P/E ratio of less than 6. We believe that future earnings power translates to a P/E ratio of below 3, which to our minds represents opportunity for significant upside on a long term basis.

NovaMed owns and manages offices for surgeons and other health care providers, an attractive option for doctors who prefer to focus on medicine as opposed to business. Similar to PC Mall, Nova Med's share price declined following the Russell rebalance to a level that we believe is out of touch with fundamentals. Nova Med trades at approximately \$8.00 which corresponds to a market capital-

Acquisition Activity, January 1 – June 30, 2010

Perritt Emerging Opportunities Fund PREOX	Perritt MicroCap Opportunities Fund PRCGX
Boots & Coots (WEL)	Boots & Coots (WEL)
Global Med (GLOB)	Home Diagnostics (HDIX)
Health Fitness (FIT)	Healthtronics (HTRN)
International Absorbents (IAX)	North American Galvanizing (NGA)
North American Galvanizing (NGA)	Sports Supply Group (RBI)
Sports Supply Group (RBI)	Techwell (TWLL)
White Electronic Designs (WEDC)	Virtual Radio Logic (VRAD)
Zareba (ZRBA)	Zygo (ZIGO)*
	*deal canceled after our position was sold

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Investing In Smaller Companies Since 1988



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ization of \$60 million. The company earns \$160 million in revenue but, more significantly, generates an enormous amount of cash flow. The company generates \$45 million annually in cash, which makes today's price equivalent to less than 2 times cash flow and is reason for us to believe that the investment has significant upside.

Q.
Second Quarter Attribution Analysis – What Happened?

A.
 Although the quarter was a down period for our Funds, our attribution analysis shows that stock selection added the largest positive impact in both Funds.

The Emerging Opportunities Fund attribution analysis shows that stock selection impact was driven by several stocks that increased dramatically based on positive news events. One example was Hauppauge (HAUP), a stock that rose more than three-fold over several days after management announced the release

of a new application (app) for the Apple iPod. We felt the stock price appreciated to a level that was unsustainable and as a result, we sold our entire position from The Fund. Over the period, HAUP contributed 1.00% to the Fund's overall performance.

Among portfolio detractors, no single investment reduced the Fund's overall performance by more than 0.40%. We believe this is a testament to the Fund's efforts to reduce stock specific risk by maintaining broad diversification. The Fund holds 100-150 names and initial positions are generally limited to 0.5%-1.5% of the portfolio.

The MicroCap Opportunities Fund attribution analysis shows that the stock selection impact was a result of returns related to four companies that were bought-out of the portfolio during the second quarter, each of which was acquired at a nearly 100% premium. Over the period, these investments added more than 2.0% to the Fund's overall performance. We believe that the environment remains favorable for acquisition activity in the microcap universe, due to number of larger companies searching for a better use of their cash considering the record-low yield it is earning today.

Acquisition Activity as a Percentage of Portfolio*

	2009	2008	2007	2006	2005
Perritt MicroCap Opportunities Fund (PRCGX)	9 of 122 (7.4%)	8 of 135 (5.9%)	14 of 165 (8.5%)	7 of 168 (4.2%)	5 of 164 (3.1%)
Perritt Emerging Opportunities Fund (PREOX)	2 of 151 (1.3%)	8 of 143 (5.6%)	8 of 181 (4.4%)	4 of 150 (2.7%)	3 of 117 (2.6%)

* Based on average # of companies held in portfolio over calendar year

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.

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 than larger companies. 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.

Diversification does not assure a profit or protect against loss in a declining market.

Price to Earnings (P/E) ratio is calculated by dividing current price of the stock by the company's trailing 12 months' earnings per share. Book value is the net asset value of a company, calculated by subtracting total liabilities from total assets. Cash flow measures the cash generating capability of a company by adding non-cash charges (e.g. depreciation) and interest expenses to pretax income. 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 1000 securities in the Russell 2000 Index plus the next 1000 smallest stocks. It is not possible to invest directly in an index.

As of 6/30/10, The MicroCap Opportunities held a 0.66% position in PC Mall and a 1.09% position in Nova Med. The Emerging Opportunities Fund held a 0.67% position in PC Mall and a 0.83% position in Nova Med. Neither Fund held a position in Apple Inc., Boots & Coots, North American Galvanizing, Hauppauge, Global Med, Health Fitness, International Absorbents, Sports Supply Group, White Electronic Designs, Zareba, Home Diagnostics, Techwell, Healthtronics, Virtual Radio Logic or Zygo. Fund holdings and sector allocations are subject to change at any time and are not recommendations to buy or sell any security.

The Perritt Funds are distributed by Quasar Distributors, LLC



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