

A Tale of Four Decades

In Seattle, residents tell visitors, "If you don't like the weather, just wait a while and it will change." The same is usually true in the financial markets. Just when you have been conditioned to invest one way, the climate changes. On many occasions, what you have been conditioned to do based on recent history turns out to be exactly contrary to the strategy that ultimately could produce the best returns.

Take the decade of the 1970s for example. Hyperinflation, a falling dollar and economic stagnation wreaked havoc in the stock and bond markets. However, those who placed the bulk of their wealth in real assets such as real estate, gold and silver bullion, collectibles, etc., obtained handsome rewards. Although blue chip stock investors (measured as those who invested in the S&P 500 Index) earned about six percent per year throughout the decade, the average annual return fell 1.5 percent short of the rate of inflation. Those who invested in real assets earned a much greater return, for example the price of gold bullion increased more than 31 percent a year during the decade.

Now jump a decade ahead. Interest rates plummeted, gold investors got burned when the inflation bubble burst, and the nation's hottest real estate markets suddenly turned frigid. On the other hand, common stock prices rocketed skyward. In fact, after 1981, they did not experience a losing year for the remainder of the decade. During the 1980s, the most rewarding invest-

ments were the least rewarding during the 1970s while the most rewarding investments of the 1970s became the laggards of the 1980s.

During the decade of the 1990s, inflation continued to cool, gold bullion prices edged lower, and (except for a small loss in 1990) common stocks (both large and small) posted hefty double-digit average annual returns. By the end of the decade, a vast majority of investors were convinced that common stocks posed little risk and that hefty returns would continue into the foreseeable future.

Of course, we know now the folly of those notions. Two severe bear markets during the twenty-first century's first decade reclaimed most of the wealth accumulated by common stock investors during the previous two decades. Although small company stocks posted modest returns during the last decade, blue chip common stock investors' portfolios declined an average of about 1.0 percent a year. Furthermore, a 2.5 percent decade-long annual rate of inflation resulted in a 30 percent decline in blue chip stock investors' real wealth. Fear of continued terrorist activity and the fear of a collapse of the banking system during the first 10 years of the twenty-first



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century sent investors clamoring for real assets. After two decades of decline, the prices of precious metals such as gold soared during the decade.

That brings us to the present. Today, stock market investors continue to lick the wounds suffered during the previous decade. Gold prices now reside at levels never seen before. A falling dollar and anemic economic growth in the U.S. have sent common stock investors into foreign markets in search of heftier equity returns. The U.S. housing market continues to suffer as waves of residential mortgage foreclosures bash the industry.

Recent historical investment returns suggest that a prudent course of action would be to invest in safe assets such as bonds and Treasury bills and couple those investments with hefty allocations to gold.. However, like decades past, we believe that investors who fall into the trap of projecting the returns of the

recent past into the future could get broadsided by the next shift in investment category returns.

If you can't rely on recent history to guide your investment decisions, what should you do? Before I answer this question, look at the category returns in the accompanying table. Note that despite the financial and economic turbulence experienced during the last four decades, each of the six asset categories not only produced positive returns over the entire period, all posted positive real (i.e., after-inflation) returns. Note also that while some asset categories experienced decade-long losses, at least one asset category produced a double-digit 10-year average return. In other words, an allocation to all asset categories would have ensured that a portion of an investor's capital would have been invested in the decade's best performing asset category. In addition, it is interesting to note that small-cap stocks were never any of the decade's best performing asset, but they were the

The Importance of Diversification

No Telling Which Asset Classes Will be Best Performers

Average Annualized Returns By Decade

<u>1970's</u>	<u>1980's</u>	<u>1990's</u>	<u>2000's</u>
5.9% Large-Cap	17.6% Large-Cap	18.2% Large-Cap	-0.9% Large-Cap
11.5% Small Cap	15.8% Small Cap	15.1% Small Cap	6.3% Small Cap
10.1% International	22.8% International	7.3% International	1.6% International
5.5% Gov't. Bonds	12.7% Gov't. Bonds	8.8% Gov't. Bonds	7.7% Gov't. Bonds
6.3% Treasury Bills	8.8% Treasury Bills	4.9% Treasury Bills	2.8% Treasury Bills
31.3% Gold	-2.1% Gold	-3.7% Gold	17.1% Gold
7.5% Inflation	5.0% Inflation	2.9% Inflation	2.5% Inflation

All data as of 12/31/09

Source: Ibbotson and Associates "Stocks, Bonds, Bills, and Inflation," 2011

Investing In Smaller Companies Since 1988



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best performing asset over the entire forty-year period. Alternatively, Treasury bills were never a decade's worst performing asset, but they were the worst performer during the four-decade period. Finally, note that an equal allocation to all six asset categories would have produced a near double-digit 9.1 percent average annual rate of return during the forty-year period.

So where should you park your money today? If you haven't already guessed, allocating your investment capital across a multitude of asset categories may provide an opportunity for exposure to asset classes that could be performing well at any given time. Your specific allocation to each asset category should be based on your return expectations and ability to assume investment risk. However, when

making allocations, don't ignore any asset category no matter how unappealing it might appear at the present time.

As you formulate your strategy, remember that while the winds of economic change can blow from a number of directions, we believe that the rules of successful investing remain unbroken. Maintain a diversified portfolio, invest for the longer term, avoid the urge to trade frequently, don't let greed steer your portfolio in the direction of today's hottest investments, assess portfolio risk as well as potential return, maintain a level of risk no greater than you can tolerate, and rebalance your portfolio regularly. If followed unwaveringly, we believe that these easy-to-apply rules can provide an opportunity for investment success.

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Past performance does not guarantee future results. Index performance is not illustrative of fund performance and an investment cannot be made directly in an index. For fund performance please call 800-331-8936.

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

Small company stocks defined as the bottom quintile of securities ranked by market capitalization from 1926-2009. Large company stocks are represented by the S&P 500 Index. The S&P 500 Index is a broad based unmanaged index of 500 stocks, which is widely recognized as representative of the equity market in general. Long-term Government Bonds are constructed with data from The Wall Street Journal. To the greatest extent possible, a one-bond portfolio with a term of approximately 20 years and a reasonable coupon was used each year. International equities are represented by the MSCI EAFE® Index. The MSCI EAFE® Index consists of 21 developed equity markets outside of North America. For the U.S. Treasury Bill index, data from The Wall Street Journal are used. Each month a one-bill portfolio containing the shortest-term bill having not less than one month to maturity is constructed. Gold is measured by spot prices of Gold Bullion. The Consumer Price Index for All Urban Consumers is used to measure inflation. You can not invest directly in an index.

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

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