

It Is Different This Time

I'm getting a bit tired of hearing financial pundits compare the economic meltdown of 2007-2009 with the Great Depression. Yes, both followed economic bubbles. Yes, both were accompanied by surging unemployment rates. Yes, both were preceded by a stock market meltdown. Yes, both were accompanied by a soaring number of bank failures. However, the severity of the current economic crisis pales in comparison to that of the 1930s. Here are but a few comparative economic statistics.

During the depths of the Great Depression in 1932, one out of every four Americans was unemployed. Today, less than one of ten is unemployed. By 1932, manufacturing output had fallen to 54 percent of its 1929 level. Between 1929 and 1933, real output decreased by 30 percent versus a 7.5 percent decline in real Gross Domestic Product between November 2007 and June 2009. (The preliminary estimate of GDP growth for this year's third quarter recently came in at 3.5 percent, which just about cut the recession's real output decline in half.) During the current recession, 133 banks have failed and some economists estimate that the number will reach nearly 800 before banking stability is finally restored. However, by 1932, 11,000 of the nation's 25,000 banks failed. Furthermore, there was no FDIC around in the 1930s to protect bank depositors. When

a bank closed back then, a depositor's money simply disappeared.

That brings me to the most striking differences between the Great Depression and today's economic recession. During the Great Depression, the nation's central bank actions and inactions increased both the magnitude of the decline in economic activity and forestalled the economy's ultimate recovery.

In their now-classic book, *A Monetary History of the United States*, Milton Friedman and Anna Schwartz identified four major errors made by monetary policymakers during the period shortly before the great stock market crash of 1929 and during the economic collapse that followed. First, the Fed raised interest rates between the spring of 1928 and October 1929 to curb speculative uses of credit, especially in real estate and the stock market. Second, in September and October 1931, the Fed once again raised interest rates to stop the loss of gold reserves (remember, the U.S. and many other countries were on the gold standard at that time) and protect the value of the dollar. Although that tactic



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stabilized the dollar, it also deepened the economic decline. Third, with nominal interest rates near zero, the Fed mistakenly believed that it was following an easy money course and that no more should be done. Finally, the Fed decided not to intervene in the banking crisis, which once again contributed to the precipitous fall in the money supply.

Economic historians have recently identified additional factors that contributed to the economic decline that plagued most industrial nations during the 1930s. First, the gold standard as reconstituted after the end of World War I proved to be both unstable and destabilizing for two reasons. First, the war caused enormous economic destruction, large government debts, battered banking systems and hyperinflation in a number of countries. Second, the Bank of England could no longer maintain its leadership among other central bankers to manage the international monetary system. That job, by default, was left up to the Fed. Given the Fed's decentralized structure, inexperience, and domestically focused leadership, it was not up to the task of fostering international cooperation on monetary matters. As a result, the overall stability of the international system was ignored as central bankers focused instead on conditions within their own borders.

The actions taken by the U.S. Federal Reserve, the U.S. Treasury, and the central bankers around the world during the current financial and economic crisis are far different than those taken nearly eight decades ago. First, and foremost, central banks around the world have adopted easy money policies. They have literally flooded the world with money. Second, without the noose of the gold standard hanging around their necks, central banks have cooperated in an attempt to stabilize the world financial system. This is in complete contrast to the myopic views of central bankers during the 1930s. Finally, most industrialized nations have used fiscal policies to stimulate their local economies.

Today's economic backdrop is much different than it was 75 years ago. Because of the experience of the 1930s, a number of government agencies and programs have been created including: social security, unemployment insurance, federal deposit insurance, and the establishment of the Securities and Exchange Commission.

Although the fiscal and monetary actions taken by governments worldwide do not assure a quick resolution to the financial and economic problems facing industrialized nations, the mistakes made during the Great Depression have been avoided this time around. Make no mistake about it, the effects of the financial crisis in the United States and elsewhere are still lingering. Here at home nearly 20 million people are out of work. The nation's unemployment rate is hovering just below 10 percent and most economists believe that the 10 percent threshold will be breached before it will ebb. A large number of American families will lose their homes in the months ahead and hundreds of banks will likely disappear during the next 12 months. Because of a large and growing federal budget deficit, the U.S. dollar should continue to decline against most of the world's major currencies. Finally, the Federal Reserve and the U.S. Treasury will eventually be forced to walk a tightrope while reining in the nation's money supply once the crisis has passed. Tighten too fast and the economy could slip back into a recession. Tighten too slowly and a growing economy awash in money could ignite an inflationary spiral.

The most dangerous phrase ever muttered on Wall Street is "It's different this time." Pundits have dodged this phrase and have replaced it with "a new normal." The new normal has been used to describe an economy marked by higher joblessness and lower standards of living for many Americans, an economy that struggles with anemic growth for years, an economic and social landscape painted in constant change, and a stock market that has produced long-term annual returns closer

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to 5 percent than to the long run 10 percent it has experienced for more than a century.

In a recent editorial, the St. Louis Post-Dispatch opined: "Something is terribly wrong if the new normal means accepting 10,000 Americans a day losing their homes or one out of ten Americans being out of work or the possibility that as many as half of the 7.2 million Americans who have lost their jobs in the recession never will find steady work." I whole heartedly agree!

Things are certainly different today from the way they were during the Great Depression. However, as the saying goes "the more things change the more they stay the same." I believe that the resourcefulness, produc-

tive capacity, innovativeness of Americans and their ability to face and solve problems is undiminished. Although I don't believe that the current economic malaise will disappear overnight, I also don't believe that America and its citizens will continue to suffer for decades to come. Call me optimistic if you will, but I believe that the American dream is still alive. I believe the economy will recover, Americans will be called back to work, standards of living will begin to rise, the financial markets should deliver solid long-term returns, and the host of social and economic problems facing us today will be resolved for the better. To me, the "new normal" is the "old normal" that Americans have been experiencing since 1776.

2009 3rd Quarter Financial Market Statistics

Commodities

Gold	8.5%
Corn	-6.3
Cattle	-5.0
Soybeans	-5.5
Silver	22.1
Wheat	-19.1
Platinum	9.3
Oil	-2.2
Copper	23.4
CRB Index	3.8

Foreign Markets

U.K.	20.8%
Germany	18.0
France	20.9
Japan	1.8
Hong Kong	14.0
India	18.2
China	-6.1
Mexico	18.5
Brazil	27.7
Argentina	30.7

U.S. Sector Performance

Basic Materials	22.5%
Con. Discretionary	21.2
Consumer Services	11.3
Financials	24.5
Health Care	10.2
Industrials	21.5
Energy	12.0
Technology	17.6
Telecomm	6.7
Utilities	6.7

U.S. Stocks

Dow Industrials	15.0%
Nasdaq Composite	15.7
Nasdaq 100	16.4
S&P 500	15.0
Russell 2000	18.9
Wilshire 5000	15.8

Currency - Dollar vs.

Euro	-4.3%
British Pound	2.8
Canadian Dollar	-8.1
Yen	-7.0

Fixed Income Bond Yields (quarter end)

30-yr T-bond	4.0%
10-yr T-bond	3.3
3-mo T-bill	0.1

Source: Yahoo Finance

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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. The Dow Jones Industrial Average is an unmanaged index of common stocks comprised of major industrial companies and assumes reinvestment of dividend. The NASDAQ Composite Index is a market capitalization-weighted index that is designed to represent the performance of the National Market System which includes over 5,000 stocks traded only over-the-counter and not on an exchange. Nasdaq 100 Index an index composed of the 100 largest, most actively traded US companies listed on the Nasdaq stock exchange The Russell 2000 Index consists of the smallest 2,000 companies in a group of 3,000 U.S. companies in the Russell 3000 Index, as ranked by market capitalization. The Wilshire 5000 Stock index consists of more than 5000 companies, representing virtually all of the capitalization of the entire U.S. stock market. FTSE 100 is an index of the share prices of the 100 largest companies in the UK. You cannot invest directly in an index.

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