

See Our Recent Press

New York Times Sunday Business – Finding Success on Roads Less Traveled

<http://www.nytimes.com/2010/04/11/business/mutfund/11top.html>

Morningstar Advisor Magazine – Undiscovered Managers

<http://advisor.morningstar.com/articles/article.asp?docId=19162>

Follow the Leader

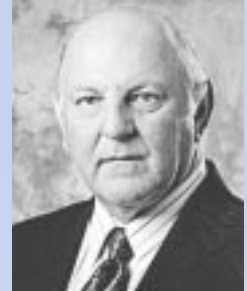
According to the *Ibbotson S&P 500 Classic Yearbook*, which presents a myriad of risk and return statistics for stocks, bonds, bills and inflation over the period 1926-2009, small firm stocks (defined as the bottom quintile of securities ranked by market capitalization from 1926-2009) have provided an 11.9% compound annual return versus a 9.8% compound annual return for the large company S&P 500 Index. While a return differential of 2.1% may not appear to be a significant advantage, the difference in wealth creation over an investment lifetime is astounding. For example, if you invest \$1,000 and earn 9.8% compounded for 40 years, your portfolio would grow to \$42,802. On the other hand, invest the same amount and earn 11.9% compounded annually for 40 years and your portfolio would expand to \$89,785.

Of course, neither portfolio will earn the compound rate each and every year, nor will small firm stocks outperform large firm stocks year-after-year. In fact, during the last 70 years, small firm stocks have provided greater returns relative to large firm stocks during 44 years and they underperformed large firm stocks during 26 years. During that period (1/01/1940 - 12/31/2009), small firm stocks grew at a 14.5% compound annual rate versus a 10.8% compound annual rate for large firm stocks. A hypothetical \$1,000 investment in large firm stocks during that 40-year period would have grown to \$1,312,000 while a similar hypothetical

investment in small firm stocks would have grown to \$13,073,000.

While this is a significant difference in terminal wealth, the value of perfect information is astounding. For example, if you knew in advance which category of stocks would provide the best annual return and directed your investment to that category (i.e., invest in small firm stocks when they perform best and invest in large firm stocks when they are the market leaders), your compound annual rate of return would have expanded to 19.3% and an initial hypothetical investment of \$1,000 would have grown to a whopping \$231,650,000! Of course, if you happened to be star-crossed, and invested in the poorest performing equity class, your compound annual return would have shrunk to 6.3%, and an initial hypothetical investment of \$1,000 would have grown to \$720,000.

Even if you would have made only a few errors during that 70-year period, you could cause irreparable damage to your long-term returns. For example, suppose you had invested your entire investment portfolio in either small firm stocks or large firm stocks at the beginning of each year. If you were correctly invested in the highest return equity class



Dr. Gerald Perritt
CEO & Founder

.....
DR. PERRITT continued on page 4



www.PerrittCap.com

Michael Corbett's 1Q '10 Commentary

President and Portfolio Manager of the Perritt Funds

Q.

How has acquisition activity in the micro-cap space changed this year?

A.

Acquisition activity within the micro-cap space has become extremely robust over the past quarter. Through the first 16 weeks of 2010, we had 8 stocks acquired in the Perritt Emerging Opportunities Fund and 5 stocks acquired in the Perritt MicroCap Opportunities Fund (see detail in table on page 3). The number of companies that were bought out represents 5.4% and 4.7% of the entire portfolios, respectively. That level of merger and acquisition activity in one quarter is impressive: historically, buy-out activity has averaged about 5% of portfolio assets during a calendar year.

One trend that we have witnessed in the recent acquisition activity is that smaller companies are being purchased by public companies as opposed to private equity. Faced with low interest rates, management teams of acquiring companies are potentially receiving pressure from boards and shareholders to find better opportunities to utilize their cash. The result has often been the purchasing of profitable, small companies. On the other side of the equation, we have seen in most instances the companies being acquired have a considerable amount of insider ownership. This is significant because insider owners with a large voting stake can push a decision through if needed, and due to the



Michael Corbett
CIO & Portfolio Manager

Performance as of 3/31/10

	<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)	8.12%	80.72%	-4.61%	3.29%	9.47%	11.27%	9.32% (4/11/88)
Perritt Emerging Opportunities Fund (PREOX)	13.73	93.39%	-9.83%	1.04%	NA	NA	3.29% (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 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.

.....
Commentary continued on page 3

Family Wealth Advisors Since 1988



.....
Commentary continued from page 2

likelihood that taxes may be higher next year, business owners have a motivation to sell their companies now. Added together, we believe that the conditions facing the management teams of acquiring companies and those of companies targeted for purchase have created an environment for acquisition activity in the microcap universe where “the stars are aligned.” This can certainly be a boon to microcap investors: buy-out premiums can be significant; two examples of companies bought out of our portfolios last quarter, Zareba and Global Med, were purchased for premiums of 100% and 80%, respectively.

Q.
In conversations with small company managers, are you hearing a different tone over the past few quarters?

A.
 For businesses related to consumer spending (a sector that we remain underweight in), the general discussion continues to be that although sales have been decent, it feels to businesses that they are just restocking shelves. An area where we are beginning

to see more concrete growth however is in companies related to business services. A major focus for managers of all companies seems to be related to finding ways to increase productivity. This is not surprising given that many businesses cut their workforce significantly and now need to find ways to do the same amount of work with less people.

Our conversations with small company management relate to valuations because the big question that all investors are asking is, “when will the revenue growth start to kick in?” While we are not sure about business related to consumer spending, we do have higher confidence in industries related to business services in terms of revenue growth, as mentioned previously. What we have seen and heard from management of these types of companies tells us that they should see growth of revenue, earnings, and lower P/E ratio’s if prices remain stable. A final note on valuations is that although P/E ratios have certainly climbed, they were doing so from severely depressed levels. In our opinion, the P/E ratios of 15 to 16 where the Funds stand now, while well higher than we experienced during the March 2009 lows, are not egregious relative to any metrics.

Acquisition Activity, Jan 1 – Apr 15, 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)	North American Galvanizing (NGA)
International Absorbents	Sports Supply Group (RBI)
North American Galvanizing (NGA)	Techwell (TWLL)
Sports Supply Group (RBI)	Zygo (ZIGO)*
White Electronic Designs	
Zareba (ZRBA)	* deal canceled after our position was sold

.....
Commentary continued on page 4

.....
Commentary continued from page 3

Q.
Discuss attribution analysis – What happened?

A.
 Our attribution analysis shows that in the first quarter of 2010 stock selection added significant value to the performance of The MicroCap Opportunities Fund. Our selection within the Health Care and Information Technology industries were particularly strong, and our relative overweight to those industries contributed to our returns. However, our underweighting in other industries versus the Russell 2000 Index, primarily in financials, caused the Fund to underperform the benchmark. Although the individual financial companies

that we invested in did perform as well as the financial holdings of the benchmark, our large underweight to the sector led to a smaller return overall.

Our attribution analysis shows that in the first quarter of 2010 an underweight in financials hurt performance of the Emerging Opportunities Fund in a similar manner as described for the MicroCap Opportunities Fund.

However, stock selection in the Emerging Opportunities Fund contributed more than 7% to our overall performance during the quarter. Much of this contribution was related to the acquisition activity discussed earlier.

Acquisition Activity as a Percentage of Portfolio*

	<u>2009</u>	<u>2008</u>	<u>2007</u>	<u>2006</u>	<u>2005</u>
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 (1.3%)	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

.....
DR. PERRITT continued from page 1

80% of the time, but happened to make big mistakes when you were invested in the inferior return investment class when it exhibited significant underperformance, your compound annual return could have declined to 13.3%, which is below the return of a small firm stock buy-and-hold strategy and very close to the 12.7% return provided by a portfolio consisting of half small firm stocks and half large firm stocks.

Of course, perfect information about the future course of stock prices does not exist on either Wall Street or Main Street. However, there appears to be enough

information about small company stock returns to potentially improve long term returns. Once again, data in the *Ibbotson SBBI Classic Yearbook* provides a clue. That clue lies in the relatively high serial correlation that appears to exist among small firm risk premia.

Small firm stock premia are created by subtracting large firm stock returns from small firm stock returns. Serial correlation describes the extent to which the return in one period is related to the return in the subsequent period. A correlation of near +1 indicates a

.....
DR. PERRITT continued on page 5

Family Wealth Advisors Since 1988



.....
 DR. PERRITT continued from page 4

trend while a correlation near 0 indicates the absence of any relationship.

Interestingly, small firm stock risk premia exhibit a relatively high positive serial correlation, which indicates the strong possibility of a trend. That is, the excess (deficient) small firm stock returns (relative to large firm stock returns) viewed in a particular year may give a clue to the excess (deficient) returns in a subsequent year.

To test the seemingly persistent trends in small firm stock premia we examined the returns of small firm and large firm stocks over the 70-year period 1940-2009. Our goal was to hypothetically be invested in small firm stocks during years when they produced greater returns than large firm stocks and to be invested in large firm stocks when they provided the higher returns. Our strategy was to follow the leader. That is, the category that produced the greatest return during a given year dictated our allocation in the subsequent year.

We began by observing the returns of large and small firm stocks during 1939. During that year, small firm

stocks outperformed large firm stocks. Thus, we invested in small firm stocks in 1940. Since small firm stock returns topped those of large firms in 1940, we maintained our investment in small firm stocks in 1941, etc. When small firm stocks underperformed in 1946, we switched our allocation to large firm stocks in 1947.

The “follow the leader strategy” produced remarkable results. During the 70-year period, we were invested in the best performing equity class during 48 years or 68.6% of the time. Furthermore, we tended to be invested in the “correct” equity class when that class had the highest return differential. The follow the leader strategy produced a 70-year compound annual return of 16.9%. That amounted to 6.1 percentage points better than a large cap buy-and-hold strategy and a 2.4 percentage point improvement in a small cap buy-and-hold strategy. One dollar invested in a large cap buy-and-hold strategy over this 70-year period would have grown to \$1,312. One dollar invested in a small cap buy-and-hold strategy would have grown to \$13,073. One dollar invested in the follow the leader strategy in 1940 would have grown to \$54,321.

Follow The Leader Strategy Uncovers Serial Correlation Trend, 1940-2009

	<u>Follow The Leader</u>	<u>All Small Cap Buy & Hold</u>	<u>All Large Cap Buy & Hold</u>
Years invested in better performing asset class	48 of 70 (68.6%)	44 of 70 (62.9%)	26 of 70 (37.1%)
Annualized return % 1/01/1940 - 12/31/2009	16.9%	14.5%	10.8%
Hypothetical growth of \$1	\$54,321	\$13,073	\$1,312

Source: Ibbotson & Associates, Stocks, Bonds, Bills & Inflation Classic Yearbook, 2010

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

.....
 DR. PERRITT continued on page 7

The Road to Recovery?

Courtesy of dshort.com., the following is a comparison of the market's recovery from the lows of the "Four Bad Bears," including The Dow Crash of 1929 (Dow - recovery beginning 9/3/1929), The 1973 Oil Crisis (S&P 500 - recovery beginning 10/3/1974), The 2000 Tech Crash (S&P 500 - recovery beginning 10/9/2002) and the 2007 financial Crisis (S&P 500 - recovery beginning 3/9/09).



2010 1st Quarter Financial Market Statistics

Commodities

Gold	1.7%
Corn	-16.8
Cattle	8.6
Soybeans	-10.3
Silver	4.0
Wheat	-14.3
Platinum	11.5
Oil	5.5
Copper	6.2
CRB Index	-3.5

Foreign Markets

U.K.	4.8%
Germany	3.3
France	1.6
Japan	5.2
Hong Kong	-2.9
India	0.4
China	-5.1
Mexico	3.6
Brazil	2.6
Argentina	2.3

U.S. Sector Performance

Basic Materials	2.8%
Con. Discretionary	10.3
Consumer Services	5.5
Financials	10.8
Health Care	3.4
Industrials	12.4
Energy	0.9
Technology	0.7
Telecomm	0.0
Utilities	-4.4

U.S. Stocks

Dow Industrials	4.1%
Nasdaq Composite	5.7
Nasdaq 100	5.3
S&P 500	4.9
Russell 2000	8.5
Wilshire 5000	5.7

Currency - Dollar vs.

Euro	5.99%
British Pound	6.46
Canadian Dollar	-2.85
Yen	0.41

Fixed Income Bond Yields (quarter end)

30-yr T-bond	4.72%
10-yr T-bond	3.84
3-mo T-bill	0.16

Source: Yahoo Finance

Family Wealth Advisors Since 1988



.....
DR. PERRITT continued from page 5

Of course, past returns are no guarantee of future results. In addition, we are not advocating an “all or nothing” small cap investment strategy. We have always believed that investors are best served by the maintenance of a well-diversified portfolio consisting of several categories of assets. However, the follow the leader strategy might be incorporated in a diversified portfolio. Here’s a simple example.

Suppose that you have decided to allocate 70% of the equity portion of your portfolio to large cap stocks and 30% to small cap stocks. If small caps outperform

large caps that year, you could increase your allocation to small caps and reduce your allocation to large cap stocks in the subsequent year. When small cap stocks underperform large cap stocks, you could then reverse direction and underweight small cap stocks and overweight large cap stocks in the subsequent year. This strategy keeps you diversified across categories of assets and reduces the risk inherent in an all or nothing strategy. According to the historical record, this strategy should improve the investment return obtained by a static buy-and-hold asset allocation strategy

.....
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.

Past performance is not a guarantee of future results. Index performance is not illustrative of fund or portfolio performance. You cannot invest directly in an index. Please visit www.perrittmutualfunds.com for fund performance.

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.

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

A correlation coefficient is a measure of the interdependence of two random variables that ranges in value from -1 to +1, indicating perfect negative correlation at -1, absence of correlation at zero, and perfect positive correlation at +1. 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. 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. 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 3/31/10, The MicroCap Opportunities held a 0.16% position in Boots & Coots, and a 0.77% position in North American Galvanizing. The Emerging Opportunities Fund held a 1.02% position in Boots & Coots and a 0.81% position in North American Galvanizing. Neither Fund held a position in Global Med, Health Fitness, International Absorbents, Sports Supply Group, White Electronic Designs, Zareba, Home Diagnostics, Techwell, or Zygo. Fund holdings and sector allocations are subject to change at any time and are not recommendations to buy or sell any security.

Perritt Capital Management is the advisor of The Perritt Funds which are distributed by Quasar Distributors, LLC



300 S. Wacker Drive • Suite 2880 • Chicago, IL 60606

Tel: 312-669-1650 • 800-331-8936 • Fax: 312-669-1235

E-mail: PerrittCap@PerrittCap.com • Web Site: www.PerrittCap.com