

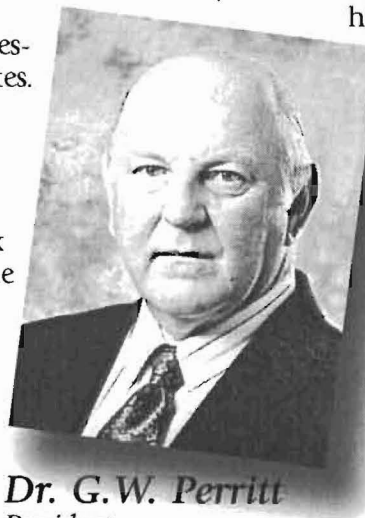


Climbing the Wall of Worry

Most of my life savings are invested in the stock market – and I’m worried. I just paid more than three dollars for a gallon of gasoline. Alan Greenspan has warned of a potential collapse in the Chinese stock market and of a pending economic recession in the United States. U.S. warships are on maneuvers just off the Iranian coast. I worry about the prospect of another terrorist attack on U.S. soil. Hurricane forecasters are telling me to expect an active hurricane season with an above-average number of storms making landfall in the U.S. this summer.

I’m also worried about the geopolitical climate. The U.S. military is bogged down in a nasty war in Iraq with no end in sight. Iran is seeking to expand its uranium enrichment program, which may be a prelude to the construction of a nuclear bomb. China continues to keep a lid on the value of its currency. The result is ballooning trade deficits here at home. Meanwhile, the value of the dollar continues to decline against most of the developed world’s currencies. Could the U.S. economy be headed for another bout of “stagflation?”

My worry list seems to expand every day. With a worry list as long as mine, you are probably wondering why I have so much of my life savings invested in equities. Let me satisfy your curiosity by giving you a brief history lesson.



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Eighty years ago, the U.S. economy and the equity markets were lavishing in the roaring twenties. Life was good and the future never looked brighter. The Dow Jones Industrial Average had more than tripled from its early decade low. At the close of trading April 30, 1927, it stood at a whopping 164.21.

Thirty months later, in October 1929, the U.S. stock market crashed. That initiated the most devastating bear market in history. It also marked the onset of the Great Depression of the 1930s. In the 1940s, the entire world was at war. In the 1950s, the so-called cold war began as the United States and the Soviet Union engaged in an atomic arms race. That sparked fears that someone would push a button and trigger a thermal nuclear holocaust that could reduce the world to a smoldering cinder. I remember donning dog tags and participating in air

raid drills in grammar school. Fallout shelters, not second homes, were the rage of the day. Meanwhile wars were fought in Korea and in Vietnam. A U.S. President was assassinated in the 1960s and another resigned in disgrace in the 1970s. In the late 1970s, hyperinflation sent both interest rates and the unemployment rate soaring. The onset of this century was marked by corporate scandals that rocked the stock market and resulted in the loss of jobs and retirement nest eggs for tens of thousands of bewildered workers.

Now, here's my point. Despite experiencing several stock market crashes, a Great Depression, deflation, several wars, hyperinflation, the assassination and resignation of American presidents, and homeland terrorist attacks, the Dow Jones Industrial Average is currently hovering around the 13,600 level. That's a 13,400-point expansion during a period marked by nearly every catastrophic event imaginable.

A long list of worries is always overhanging the financial markets. Yet, stock prices march to higher ground. The truth is that you can't avoid risk; you have to cope with it. The stock

market, as demonstrated by the S&P 500 Index, has returned an average of 11% a year (8% after inflation) for more than a century. Risk-free Treasury bills have returned 3% (0% after inflation). The difference is payment for the risk assumed by equity investors. The moral of this tale is, if you want to earn meaningful returns you have to accept risk. How much risk you assume is determined by such things as time horizons and inclinations to engage in risk-taking.



Gerald W. Perritt

Past performance is not a guarantee of future results.

Opinions expressed are those of Dr. Perritt and are not intended to be a forecast of future events, a guarantee of future results, nor investment advice.

The Dow Jones Industrial Average is an unmanaged index of common stocks comprised of major industrial companies and assumes reinvestment of dividends. It is not possible to invest directly in this index.

Dr. Perritt received a doctorate in finance and economics from the University of Kentucky in 1974. He has taught courses in investments and finance at a number of colleges and universities and has authored several books on investing. Dr. Gerald W. Perritt shares the portfolio management duties of both the MicroCap and Emerging Opportunities Funds with Michael Corbett.