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THE START OF A NEW MICRO-CAP BULL MARKET?

The extreme market swings within the small- and micro-cap equities in the second quarter of 2016 sent investors a clear message. Volatility is here to stay in our opinion, but a new bull market for small stocks started earlier this year. As we discussed in our last quarterly commentary, small- and micro-cap equities hit a bear market low on February 11, and equity prices rose dramatically in March and April. However, the poor May jobs report and the surprise Brexit news sent stocks lower quickly. To us, the real surprise was the resilience the market showed post-Brexit. Just days after the Brexit vote, small- and micro-cap equities resumed their strength. When markets face big negative news as well as get hit by a big surprise, such as the Brexit news, and equities still trade higher, that is significant! The second quarter performance results are listed below, but what is not reported is the bull market performance. As of June 30, the Russell 2000 Index is up 20.78% from the February 11 low, which is a bull market to us, but the Russell Microcap Index was up 19.16% for that same period, just short of a 20% bull return. It only took one more day in the third quarter for the Russell Microcap Index to hit the official bull market definition of up more than 20%.

ANNUALIZED TOTAL RETURNS AS OF JUNE 30, 2016

| | Second Quarter | YTD | 1-YR | 3-YR | 5-YR | 10-YR | 20-YR |
|----------------------------------|-------------------|-------|--------|-------|-------|-------|-------|
| Russell 2000 Index | 3.79% | 2.22% | -6.73% | 7.09% | 8.35% | 6.20% | 7.61% |
| Russell Microcap Index | 3.97 | -1.69 | -12.05 | 5.95 | 8.20 | 4.31 | - |
| Perritt Ultra MicroCap (PREOX) | 4.18 | 0.98 | -1.05 | 7.56 | 6.24 | 3.90 | - |
| Perritt MicroCap (PRCGX) | 2.34 | -0.70 | -7.20 | 4.58 | 6.81 | 4.57 | 9.51 |
| Perritt Low Priced Stock (PLOWX) | 0.81 | -1.19 | -9.50 | 8.41 | - | - | - |

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. [Click here](#) for standardized performance. 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 800-331-8936. The funds impose a 2% exchange and redemption fee for shares held 90 days or less. Performance data quoted does not reflect the redemption or exchange fee. If reflected, total return would be reduced.



In our opinion, the obvious question now is how long and how far will the bull market take us. Unfortunately, my crystal ball does not lend itself well to those types of predictions, but I thought it would be useful to examine some of the quality investments we have made within our Funds.

Let's start with how our Fund's portfolios are different from the broader markets, such as the Russell 2000 Index and the Russell Microcap Index. Each of the Russell Indexes have investments of more than 25% in financial services. While our funds have a respectable weight in financial services,** each of the indexes have significant exposure to banks. Our financial services weights include more niche insurance companies and asset managers. We believe our financial companies are more attractive investments. For example, one of our largest holdings that we own in all three Funds is Atlas Financial (AFH). Atlas is the largest independent provider of insurance for transportation companies, primarily taxicabs. The company has grown its business well in excess of 20% in the past three years, but yet trades only at 11.6x 2016 earnings.

Healthcare is another large weight within the Russell Indexes. The Russell Microcap Index has approximately 20% invested in healthcare companies. Nearly half of those healthcare companies are biotechnology companies. These biotechnology companies and many of the other healthcare companies don't meet our strict quality measurements. As a result, our healthcare weights are well below than that of the Russell Indexes. To us, the opportunities lie in companies that have strong recurring business models and above average earnings power. We see a great deal of value in industrial and technology companies today. Each of our Funds have greater weights in these two industries than the two Russell Indexes. Some of these industrial companies are construction related, such as NCI Building (NSC) and USG Corporation (USG).

Within our Ultra MicroCap Fund, we feel there are plenty of pockets of value. For example, U.S. Auto Part (PRTS) is a truly misunderstood story in our opinion. PRTS is a leader in the pure-play internet aftermarket auto part space. Investors are not giving management any credit for this pure-play and margins that are just starting to show drastic improvement. PRTS gross margins could improve from the low 20% to 30% level within the next few years. In addition, the company's equity only trades at less than half of revenue. Another example is MCFT Holdings (MCFT). MCFT designs, manufactures, and markets recreational sport boats primarily under the MasterCraft brand. Our analysis and due diligence shows that there is a great deal of pent-up demand in MCFT's business. These are just a couple examples of some potential quality investments within the Ultra MicroCap Fund.

"We believe this is a bull market for small- and micro-cap equities, and we are confident the markets will recognize the high quality companies within each of our portfolios."



Overall valuations are very compelling in our Funds, too. The majority of the companies in the Low Priced Stock Fund are valued at a lower multiple of revenue, book value, and earnings versus that of the Russell 2000 Index.¹ Our MicroCap Opportunities Fund and Ultra MicroCap Fund also have lower valuations relative the Russell Microcap Index.¹ We often tell our investors that the MicroCap Opportunities Fund may offer higher quality and better valuations relative to that of the Russell Microcap Index. As an example of high quality, the average company in this fund has a return on invested capital of 12% versus only a slight positive for the average company within the Russell Microcap Index.² Despite those attractive returns, companies in the MicroCap Opportunities trade at less than one times revenue versus 1.4 times revenue for the Russell Microcap Index. As said earlier, we believe this is a bull market for small- and micro-cap equities, and we are confident the markets will recognize the high quality companies within each of our portfolios.

**As of 6/30/16, the weighting in the financial services sector in the each of the funds was: MicroCap Opportunities Fund - 24.10%, Ultra MicroCap Fund - 12.70%, Low Priced Stock Fund - 12.36%.

¹ **Price/Revenue** is a valuation ratio that compares a company's stock price to its revenues. **Price/Book** is a financial ratio used to compare a company's stock price to its book value. **P/E** is short for the ratio of a company's share price to its per-share earnings.

In addition to our opportunistic view of small-cap equities, please contact **Mark Oberrotman** (mark@perrittcap.com) to receive a third party report that outlines the argument for small-caps.

| As of 6/30/16 | Market Cap | Price/Revenue | Price/Book | P/E |
|------------------|------------|---------------|------------|------|
| Russell Microcap | 191.1 | 1.6 | 1.5 | 17.1 |
| PLOWX | 611.8 | 1.5 | 1.8 | 18.3 |
| PRCGX | 276.8 | 1.0 | 1.6 | 17.3 |
| PREOX | 71.7 | 0.9 | 1.6 | 19.9 |

² Based on the average, Return on Invested Capital of the securities in the fund and in the index as of 6/30/2016.

The Fund's investment objectives, risks, charges and expenses must be considered carefully before investing. The statutory and summary prospectus contain this and other important information about the investment company and may be obtained by calling 1-800-331-8936 or by visiting www.perrittcap.com/index 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 Ultra MicroCap Fund and Low Priced Stock Fund may invest in early stage companies, which tend to be more volatile and somewhat more speculative than investments in more established companies. Low Priced stocks are generally more volatile than higher priced securities.



Russell 2000 Index is an index that measures the performance of approximately 2,000 small-cap companies in the Russell 3000 Index, which is made up of 3,000 of the biggest U.S. stocks. **Russell Microcap Index** is a capitalization weighted index of 2,000 small-cap and micro-cap stocks that captures the smallest 1,000 companies in the Russell 2000, plus 1,000 smaller U.S.-based listed stocks. **Bull market** is group of securities in which prices are rising or are expected to rise. **Return on Invested Capital (ROIC)** is a calculation used to determine the amount of return that a firm could earn on additional contributed capital. The calculation measures the return generated when a company converts its capital into capital expenditures, which generate revenues from core operations. **Multiple of revenue** is a company's valuation divided by its revenue. **Book Value** is the value at which an asset is carried on a balance sheet.

Fund holdings and sector allocations are subject to change at any time and should not be considered a recommendation to buy or sell any security. Click here for the Funds' top 10 holdings: [PLOWX](#), [PREOX](#), and [PRCGX](#).

Earnings growth is not representative of the fund's future performance.

Past Performance does not guarantee future results. The Perritt Funds are distributed by Quasar Distributors, LLC.

Perritt
CAPITAL MANAGEMENT

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Small is passionate.