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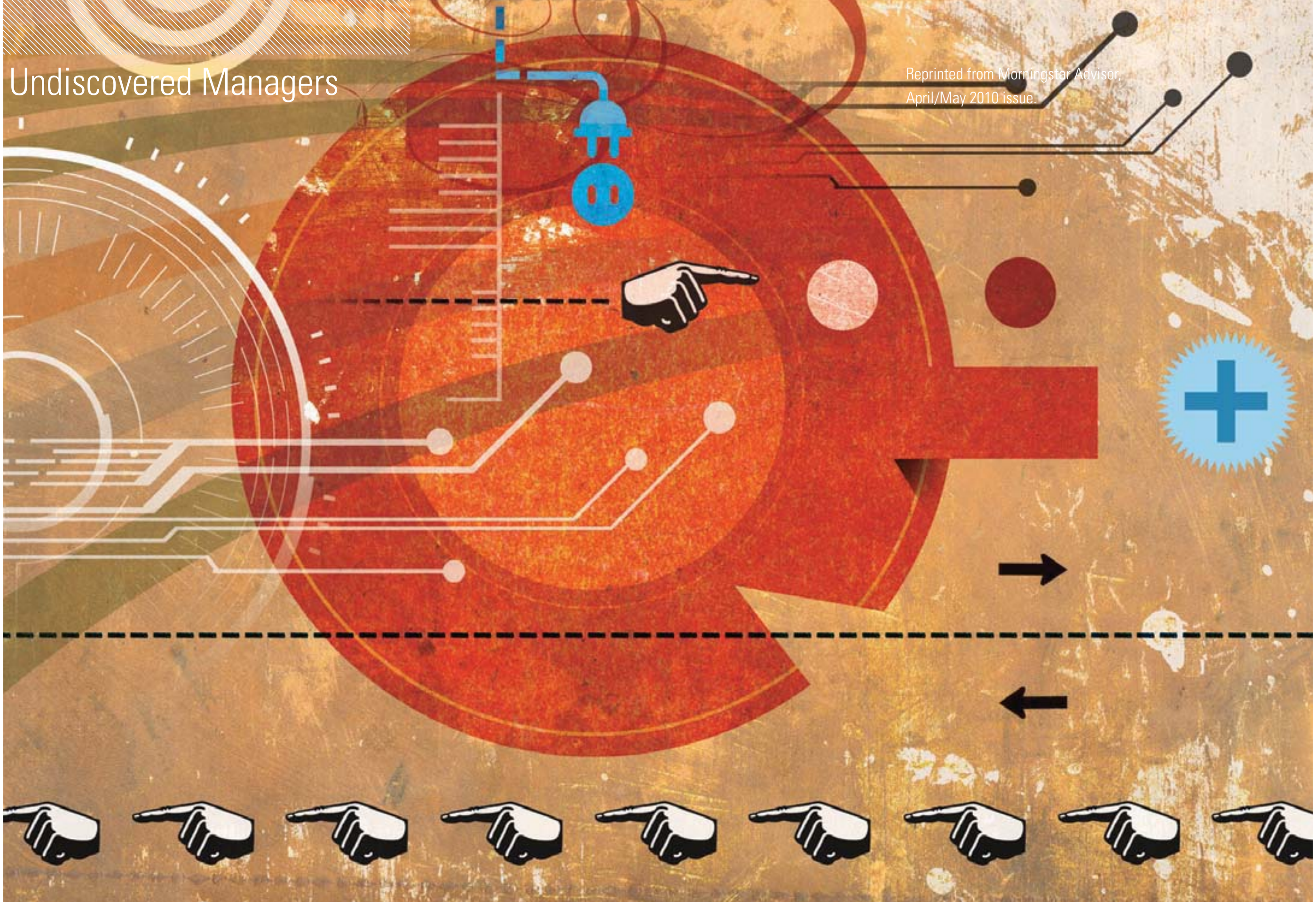


Surviving on Conviction

By Katie Rushkewicz

Since battling against fed-up shareholders and a board that wanted to liquidate his fund, small-cap manager Michael Corbett has thrived.

1999 was prosperous for mutual funds riding the wave of the bull market, but Perritt Capital Growth Fund struggled. The fund's board wanted to liquidate the fund, which had been limping along with just $9 million in assets after two years of losses. Some shareholders were getting fed up that comanager Michael Corbett wasn't buying the roaring technology stocks that were producing triple-digit gains, stocks that were too speculative and expensive for his liking. As a result, the fund lost 8% in 1999—a year in which the Russell 2000 Index gained 21%.

It would have been easy to shut down the fund, but Corbett refused to give up. He and two operations employees had been working for almost nothing in the late 1990s as they tried to keep the fund afloat. Quitting after a couple of rough years didn't jibe with the fund's long-term investing philosophy. The board reluctantly agreed to keep the fund open. Corbett assumed lead manager duties, and firm founder and figurehead Gerald Perritt stepped back from day-to-day duties but stayed on as an advisor. Corbett would have to work through this rough patch, improve performance in the midst of a burgeoning tech bubble that he didn't buy into, and attract shareholders, all with limited resources.

Those Who Can, Do. Those Who Can't, Teach.
This wasn't the first time the fund had been on shaky ground. The fund badly lagged other small-cap funds after its 1988 inception. News articles even questioned whether Perritt, an author and former finance professor at DePaul University in Chicago, was better suited to explaining investing than actually doing it. Others disagreed. Perritt gained a following

Corbett subscribes to the cockroach theory, a version of which says poor capital expenditures are like the prolific insects—where there's one, there are bound to be many more.

after launching a series of investment newsletters in 1983, including *The Mutual Fund Letter*. But some subscribers wanted Perritt to run their money instead of just giving advice, so in 1987 he founded Perritt Investments (now Perritt Capital Management), a wholly owned subsidiary of his newsletter firm. Soon after, he began managing private client accounts, constructing different asset-allocation portfolios using mutual funds.

In 1988, Perritt used his own money to seed Perritt Capital Growth, a micro-cap mutual fund that changed its name to Perritt Micro Cap Opportunities PRCGX in 1997. Perritt had long been intrigued with academic research showing that small companies had historically outperformed large companies on a risk-adjusted basis. One of his newsletters, *Investment Horizons*, was even dedicated to small-cap stocks. In some ways, Perritt was one of the pioneers of micro-cap investing. Only a handful of micro-cap funds that launched in the 1980s are still around today.

Despite the fund's initial woes, Perritt continued building his investment business, counting family, friends, and former newsletter subscribers as his clients. In 1990, he hired DePaul graduate Corbett to help him with his newsletters. The job gave Corbett valuable training, allowing him to interview renowned managers such as Ralph Wanger of Columbia Acorn and Preston Athey of T. Rowe Price Small-Cap Value PRSVX. Eventually, Corbett assumed more responsibility and became a research analyst.

When Perritt decided to move to Florida in 1996, Corbett, a Chicagoan born and bred, declined offers to follow him. Instead, Corbett became comanager and started picking stocks for the first time, collaborating with Perritt via telephone.

After the Bubble

Corbett made the jump to lead manager at an inauspicious time for the fund—during the late-1990s tech bubble. It was the firm's low point, but the transition gave the fund a chance at a fresh start. Corbett still believed that investing in financially sound micro-cap companies at reasonable prices would work over the long run, but he tweaked the process to better account for company-specific risk. He increased the number of holdings in the portfolio to 100 from 60 and capped positions at 3% of assets, regardless of how much he liked a stock. He also formalized a nine-step research process to grade companies and took a stricter approach to selling stocks that ran up in price, a topic on which he and Perritt occasionally disagreed.

As the tech bubble burst, the fund turned a corner. It made money in 2000 and started attracting interest from investors after landing at the top of the small-blend category from 2001 to 2003. Some of the inflows were from fickle retail investors who poured money in after the fund's big gains in 2001 and yanked it out after a modest return of 0.46% in 2002. The hot money aggravated Corbett, so he pushed for a 2% redemption fee on withdrawals made within the first 90 days. At the same time, Corbett decided to pursue investors through advisors and institutions, which had historically composed just one fifth of the fund's assets. (Today, they make up more than half of the fund's assets.) In 2003, a big investment from an advisor pushed assets past the $50 million mark, and a feature story in *The New York Times* helped the fund exceed $100 million. The fund was on the map.

Planting New Seeds

With the fund thriving, Corbett worked with the board to launch a new fund in mid-2004. Perritt Emerging Opportunities PREOX invests in even smaller companies, which Corbett likes because of their high growth potential and their relative obscurity in the investing world. Today, Perritt Emerging Opportunities' average market cap is just $53 million, the smallest in Morningstar's database. By contrast, the average market cap for Perritt Micro Cap Opportunities is $200 million, and the Russell 2000 Index's is $766 million.

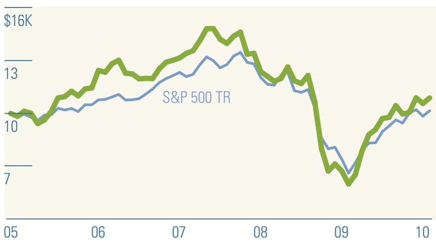
Corbett tries to mitigate the risks of micro-cap investing with independent research. He spends much of his time poring over financial statements and meeting with companies' management teams to make sure they're being responsible with capital. Corbett subscribes to the cockroach theory, a version of which says poor capital expenditures are like the prolific insects—where there's one, there are bound to be many more. A small apparel company the fund owned in the late 1990s bought a Learjet as the stock's price ran up. Red flags like that can prompt Corbett to sell a stock. In retrospect, he says he should have sold the apparel maker sooner because its share price dropped.

Companies with glitzy headquarters aren't appealing investment candidates to Corbett, so it's no surprise that Perritt Capital's own offices in downtown Chicago are pretty basic. Corbett has a private office, but his three analysts, hired in 2004 and 2005, sit in cubicles outside his door. Matthew Brackmann and George Metrou started right out of college,

Michael Corbett

Perritt Micro Cap Opportunities

PRCGX

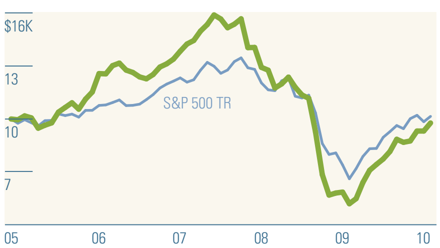


Category Small Blend	**Expense Ratio (%)** 1.42
Morningstar Rating ★★★★	**5-Yr Anl Total Rtn** (%) 1.45
Minimum Investment $1,000	**5-Yr Anl TR % Rank Cat** 43

Data through Feb. 28, 2009

Perritt Emerging Opportunities

PREOX



Category Small Blend	**Expense Ratio (%)** 2.11
Morningstar Rating ★★	**5-Yr Anl Total Rtn** (%) –0.8
Minimum Investment $1,000	**5-Yr Anl TR % Rank Cat** 73

Data through Feb. 28, 2009

which Corbett prefers because he can groom them with his investment philosophy. Although the analysts have gravitated to certain industries over time, they're all generalists, which they say keeps the job interesting. They also like the freedom, flexibility, and back-and-forth banter that come with working at a small firm. Brian Gillespie, who previously worked at a much larger financial institution, says he thinks there are more opportunities to grow at Perritt Capital. The analysts perform their own trades, giving them accountability for their stock picks from start to finish.

All three analysts come from hard-working, entrepreneurial families that gave them exposure to how small companies operate. Corbett, whose own father was a steel worker, thinks that's important. One of his most interesting jobs growing up was working at a family-owned flower shop in suburban Chicago. Corbett was fascinated by the passion the family members had for their trade, and it gave him insight into how a business should be run.

The team at Perritt is like a small, tight-knit family. "We all have our differences but come together to get things done," Corbett says. The atmosphere is open and collegial, although sometimes things get heated when CNBC is on and a reporter is questioning whether small-cap companies can thrive in an environment in which credit has tightened. Corbett says such a claim "simply isn't true," pointing out that he stays away from startups and only buys well-managed firms that have little or no debt. He prefers simple businesses that can thrive without turning to Wall Street for financing, as indicated by both funds' low debt/capital ratios relative to the MSCI U.S. Micro Cap Index and Russell Micro Cap Index.

Of course, that doesn't mean the funds are immune to trouble. Both struggled in 2008, especially Perritt Emerging Opportunities, which lost 58%. Yet it has stayed ahead of the MSCI U.S. Micro Cap Index and Russell Micro Cap Index since the fund's 2004 inception. Perritt Micro Cap Opportunities has gained nearly 9% annually since 1988 and roughly 13% per year since Corbett was named lead manager in 1999, topping most small-blend funds. The fund has also outperformed the Russell Micro Cap Index and MSCI U.S. Micro Cap Index since their inceptions in 2000 and 2003, respectively.

The Future

This year is Corbett's 20-year anniversary at Perritt Capital. To financial advisor Rick Bloom, who runs an asset-management firm in Farmington Hills, Mich., that type of management stability is key.

"I feel great about the management team," Bloom says. "There's no big-firm mentality where everything has to be so structured. They've always been extremely helpful with any questions I've had. From an advisor standpoint, the customer service is great."

So where does the firm, which now has more than $400 million in assets, go from here? Corbett says it wouldn't be a stretch to run a small-cap fund that focuses on bigger companies than the other two funds, especially because successful micro-cap companies can grow into small and mid-cap stocks. (One of his first stock picks, International Game Tech IGT, is now a mid-cap.) Yet he wants Perritt Capital to stay true to its core competency of small-cap investing, so it's unlikely the firm would launch anything drastically different. It's also possible that the two funds will close to new investors if assets continue to grow. (Both have been closed in the past.)

A succession plan is being worked out for Perritt, the firm's founder, who is still an advisor to the funds and owns more than half of the firm. (Corbett and Perritt's friends and family own the rest.)

One thing's for certain: The fund that was once fighting for its life is a survivor. M

Katie Rushkewicz is a mutual fund analyst with Morningstar.

Michael Corbett - CIO, Portfolio Manager

Michael Corbett is Chief Investment Officer and Portfolio Manager for all equity portfolios. Perritt Capital Management, Inc. first employed Michael Corbett in 1990 as a research analyst. He assumed portfolio management responsibilities in 1996 and now oversees all portfolios. In 1999 Mr. Corbett became president and Lead manager of the Micro-Cap Opportunities Fund. He became Portfolio Manager of the Perritt Ultra MicroCap Fund in 2004. Mr. Corbett's insight regarding small company investing has been sought after by a variety of financial media outlets, including CNBC and The New York Times. He is a member of the Joliet Diocese Endowment Fund and Board and the St. Mary Gostyn Finance Committee, and has previously served on the St. Mary Gostyn School Board.

AVERAGE ANNUAL TOTAL RETURNS 9/30/15

	YTD	1-YR	3-YR	5-YR	10-YR	INCEPTION
PRCGX	-11.12%	-6.25%	10.23%	9.17%	4.95%	9.12% (4/11/88)
PREOX	-6.88%	-5.40%	12.33%	9.35%	4.79%	6.32% (8/27/04)
Russell 2000	-7.73%	1.25%	11.02%	11.73%	6.55%	7.98% (4/11/88)
Russell Microcap	-8.58%	1.65%	11.34%	12.35%	4.88%	6.34% (8/2004)
MSCI Micro Cap	-10.85%	-4.20%	12.50%	14.63%	7.40%	
S&P 500	-5.29%	-0.61%	12.40%	13.34%	6.80%	7.38% (4/11/88)

PRCGX Expense Ratio 1.19%, PREOX Expense Ratio 1.56%

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 may be obtained by calling 800-331-8926. 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.

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 than larger companies. The Funds invest in micro-cap companies which tend to perform poorly during times of economic stress. The Ultra MicroCap Fund may invest in early stage companies which tend to be more volatile and somewhat more speculative than investments in more established companies.

Median Debt to Assets Ratio is calculated by dividing a company's total liabilities by total assets. It is used to indicate the proportion of a company's assets that is being financed through debt. The S&P 500 is an unmanaged broad based universe of 500 stocks which is widely recognized as the U.S. Equity market. 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. The MSCI U.S. Micro Cap Index represents the micro-cap companies in the U.S. equity market. The index targets for inclusion, approximately the bottom 1.5% of the U.S. equity market capitalization and contains more than 1,400 companies. References to other funds should not be interpreted as an offer of these securities.

As of 9/30/15, the MicroCap Opportunities nor the Ultra MicroCap Fund held a position in International Game Tech. Fund holdings and sector allocations are subject to change at any time and are not recommendations to buy or sell any security.

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