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 and Portfolio Manager**



Perritt MicroCap Opportunities
 Perritt Ultra MicroCap

An analysis of how small- and micro-cap stocks respond to the rise and fall of inflation expectations provides us added valuable insight. These market-determined expectations have perhaps played a large role in investor behavior during the new, post-crisis/zero rate environment. We will be publishing a white paper early next month, *Observations of Inflation Expectations' Effect on Risk Assets in the Post-Crisis Period*, analyzing the distinct periods of rising and falling inflation expectations over the past four years. We have found that since reaching the zero bound for interest rates the old ways of viewing inflation's effect on stock prices has been turned upside down. In summary, higher inflation expectations have been good for risk assets generally and for small- and micro-cap stocks in particular. **We believe that advisors and shareholders should continue to monitor investor expectations of inflation closely when measuring opportunity in the small and micro-cap sector.** We certainly recommend all of our clients take a look at the white paper when it is released and we encourage your thoughts and feedback.

Q. How Might the Most Recent QE Announcement Affect Micro-cap Equities?

A. As most investors know, part of the underlying goal of continued QE is to push investors toward "riskier assets." Measured by this metric, Bernanke has been somewhat successful despite the fact that investor assets have continued to pour into U.S. Treasuries. As seen in the table below, QE corresponds closely with positive returns for the Russell 2000 index. While QE continues it is reasonable to believe that this trend might persist, indicating a strong environment for small- and micro-cap companies.



Source: Fact Set

The Wall Street Journal 9/15/2012

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Q. With Financials And Biotech Continuing To Drive Index Returns, Why Do You Remain Confident In Cyclical Companies?

A. As we detailed in our previous commentary, the return of the Russell Microcap Index has been concentrated in a small number of Biotech, Regional and Thrift Banking stocks. This trend continued in the third quarter, as can be seen in the table below. Despite this, we are significantly underweight the Financials and Healthcare sectors because of our strong conviction that the greatest upside opportunity in the micro-cap space can currently be found in cyclical companies.

It is not surprising that financial firms have done well in the current economy considering how ultra-low interest rates have provided banks with attractive net interest margins. Within this environment stock prices for regional banks and thrifts have significantly outpaced actual growth in loan value or book value. Median book value of sector has grown approximately 6% this year while stock prices have increased by 28%, in part due to a multiple expansion (price-to-book values have increased from 1.05 to 1.25). It is certainly possible that this type of slow and steady loan growth and expansion of multiples continues, though we question how additional growth may be obtained considering net interest margin is widely predicted to come down. More importantly, we believe that this generally low upside offered by financials is far less compelling than the types of earnings-power opportunities we see in cyclical companies today.

Fast Facts: Russell Microcap Index YTD Performance 19.70% as of 9/30/12

Sector Contribution		Security Contribution	
Biotechnology	3.57%	Parmacyclics Inc.	0.78%
Commercial Banks and Thrifts	3.93%	Arena Pharmaceuticals, Inc.	0.56%
		Inhibitex, Inc.	0.49%
Total:	7.50% (38.1% of return)	Total:	1.83% (9.3% of return)

Source: Capital IQ

YTD Contributions

"We believe that the low upside offered by financials is far less compelling than the earnings-power opportunities we see in cyclical companies today."

To take a closer look at the level of upside potential found in typical cyclical company in our portfolio we point to Integrated Silicon Solutions (ISSI). This company produces semi-conductors for high-margin, customizable electronics products. Annual revenue is \$265 million, the firm holds \$100 million in cash with no debt on the balance sheet, and the market capitalization is \$248 as of 9/30/12. Like many cyclical investments in the small- and micro-cap space, investors have shown no interest in business growth and fundamentals and have failed to do their homework to understand the story. ISSI has been lumped in with more commoditized chip manufactures despite its move towards high margin, more customized products and applications, a classic example of the baby being thrown out with the bath water. What we believe investors will eventually realize is the fact that ISSI trades at a P/E of 6.2 after netting out cash. To demonstrate the potential upside, ISSI would be priced in the mid \$20 range based on forward earnings of \$1.00, a 19.8% ROE and cash on the balance sheet.

Attribution Analysis

Performance as of 9/30/12 (Annualized %)	YTD	1 YR	3YR	5YR	10YR	15YR	Since Inception
MicroCap Opportunities Fund (PRCGX)	13.70%	30.18%	9.28%	-1.08%	11.27%	7.2%	8.98% (4/11/88)
Ultra MicroCap Fund (PREOX)	9.70%	11.61%	11.61%	-4.37%	NA	NA	4.17% (8/27/04)
Russell 2000 Index	14.23%	31.91%	12.99%	2.21%	10.17%	5.52%	9.01% (4/11/88)
Russell Microcap	19.70%	36.26%	11.68%	-0.12%	9.23%	NA	4.54% (8/27/04)

Perritt MicroCap Opportunities Fund Expense Ratio: 1.23%
 Perritt Ultra MicroCap Fund Expense Ratio: 1.66%

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 the performance quoted. 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.

Micro Cap Opportunities Fund (PRCGX)

- The MicroCap Opportunities Fund gained 3.99% versus 5.25% for Russell 2000 Index and 5.92% for the Russell MicroCap Index during the second quarter. YTD the fund is up 13.70% versus 14.23% and 19.70% for the Indexes, respectively.
- Strength in both the Financial and Healthcare sectors detracted from our relative performance due to our significant underweight to those two industries as discussed previously. Nearly 40% of the return of the Russell Microcap Index YTD has been concentrated in a small number of Biotech, Regional and Thrift Banking and stocks
- Stock selection in total attributed 4.63% to relative returns versus the Russell 2000 Index YTD and 4.45% for the quarter. Relative to the Russell Microcap Index selection attributed 1.21% YTD and 2.5% for the quarter. Seven of the Fund's nine equity sectors attributed positive stock selection, including strong selection in both the Financials and Healthcare sectors which were in fact the top two sector contributors based on stock selection.

Ultra MicroCap Fund (PREOX)

- The Ultra MicroCap Fund gained 0.96% versus 5.92% for the Russell MicroCap Index during the second quarter. YTD the fund is up 9.70% versus 19.70% for the Index.
- We stress again the difficulty of contrasting this fund to a benchmark as it invests in companies far below the traditional radar, as demonstrated by its average market capitalization of just \$50.6 Million (the lowest of all 8,145 domestic equity Funds, according to Morningstar as of 10/23/12)
- Like the MicroCap Opportunities Fund, the Ultra MicroCap Fund's overweight to cyclical industries such as technology and energy detracted from relative performance.
- Relative performance impact was mixed as five of the Funds ten equity sectors contributed positively to performance. However, negative contributions from Energy, Healthcare and Materials outweighed gains achieved elsewhere.

Small/Micro-Cap Universe* Performance

Market Cap Range	Number of Stocks	Median Return
\$2B+	219	2.10%
\$500-2B	1088	12.48%
\$150-500M	984	12.14%
\$<150M	1185	21.50%



1/1/12- 9/30/12

*Small/Micro-cap universe includes all equities listed in the Russell 2000 & Russell Microcap Indexes plus an approximate 1,000 U.S. listed micro-cap equities not listed in the Indexes.

3Q 2012 Manager Commentary

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 statutory and summary prospectuses contain this and other important information about the investment company, and may be obtained by calling 1-800-331-8936 or by visiting www.perrittmutualfunds.com. Read carefully before investing.

As of 9/30/12, The Perritt MicroCap Opportunities Fund not the Perritt Emerging Opportunities fund held a position in Pharmacyclics Inc. (PCYC), Arena Pharmaceuticals, Inc. (ARNA), or Inhibitex, Inc. (INHX). The Perritt MicroCap Opportunities Fund held a 1.1% position in ISSI and The Perritt Emerging Opportunities Fund held no position in ISSI. Fund holdings and sector allocations are subject to change and are not recommendations to buy or sell any security.

Book Value is the total value of the company's assets that shareholders would theoretically receive if a company were liquidated. Price to Book Value Ratio is calculated by dividing the current price of the stock by the company's book value per share. Price to Earnings Ratio is a valuation ratio of a company's current share price compared to its per-share earnings. 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 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. It is not possible to invest directly in an index.

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 may invest in early stage companies which tend to be more volatile and somewhat more speculative than investments in more established companies.

The Perritt Funds are distributed by Quasar Distributors, LLC



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