

IGNORING MICRO - CAP STOCKS?



THINK AGAIN!

When reporting on micro-cap stocks, the headlines in financial magazines and investment blogs read something like, “Micro-cap Stocks Often Overlooked,” or some other compelling phrase that infers neglect – much like the headline of this article. It’s true that micro-cap stocks are not as well-known as their small- or large-cap cousins. But one company has been paying very close attention to the micro-cap space for years. In fact, they never take their eyes off it.

Twenty-five years ago, fresh out of college, Michael Corbett joined Perritt Capital Management, Inc. as a research assistant and writer for investment newsletters. Today, he is CEO and CIO of that Chicago-based firm which currently manages \$600 million of client assets. “We are one

of the pioneers in micro-cap investing – only a handful of micro-cap managers launched in the 1980s still exist today,” said Corbett. “Having the patience, the fortitude and the ability to find great companies within this space to make great investments and earn great rewards for our clients is what this firm is built on.”

Perritt Capital Management offers investors two micro-cap investment strategies. The Perritt MicroCap Opportunities Fund (PRCGX) invests in a diversified portfolio of equity securities that have a market capitalization (equity market value) of \$500 million or less. The fund strategy seeks niche-based micro-cap companies with a potential for long-term capital appreciation. Investing in the smallest companies listed on

the exchanges – those equity securities with a market capitalization of \$300 million or less – is the mission of the Perritt Ultra MicroCap Fund (PREOX). It seeks to find the next generation of winners during their earliest growth stage. Companies typically have a significant percentage of stock owned by management, low levels of long-term debt, along with above average revenue and earnings growth rates. Corbett is portfolio manager for both funds.

Perritt Capital Management’s philosophy is built on the research of Rolf Banz, a University of Chicago doctoral student who discovered the first crack in the foundation of the efficient market theory, dubbed “the small firm effect.” The small firm effect” is the tendency of common stocks of small companies to outperform

form the stocks of large companies at equivalent levels of risk. A whitepaper authored by Perritt Capital Management founder Dr. Gerald W. Perritt, *The Micro-Cap Advantage: How MicroCap Equities Have Helped Enhance Return and Lower Correlation in Client Portfolios*, explores this phenomenon in detail and can be found on the firm's website.

Perritt Capital Management has developed a process that helps them wade through over 3,000 micro-cap companies with filings that are often incomplete or which may not tell a business's full story. The firm begins with what they call their Three Quality Measurements analysis. First, they review a company's financial statements based on a 9-factor test evaluating the strength of the data. If the company passes, the Perritt team then examines the quality of the micro-cap company's management team and business plan. Once past this hurdle, they move on to quality of valuations and other assessments. "The risk always lies within management, so we're constantly evaluating through our three-part process," Corbett explained. "We meet with three to five CEO's and CFO's of small companies in our offices every week."

Given the raging popularity of exchange traded funds (ETF's), "The Suit" asked Corbett how or if they fit into his micro-cap investment strategy. While Corbett praised the tax efficiency, low cost and liquidity of ETF's, he stressed that when stocks get to a certain size, liquidity can actually have a negative impact. "ETF's may not be useful in certain markets. As you move into micro-cap spaces, emerging markets or overseas markets, there are certainly big dangers to be aware of," he warned. "But overall, on larger cap and more efficient markets,

ETF's are a wonderful place for investors to get equity or fixed income exposure."

Also under the Perritt Capital Management umbrella is Windgate Wealth Management, a company providing high net worth asset allocation and financial planning, along with comprehensive portfolio management for families. Currently, Windgate manages \$100 million in assets compared to the \$500 million managed by Perritt Capital Management. "We do not chase performance. That's how you get in trouble," explained Corbett. "We're more aware of how to allocate assets properly to establish a solid investing plan. It's about getting to know the client well, fiduciary duty and financial planning for each particular client."

Corbett's passion for investing in small companies is as strong today as it was when he began twenty years ago. "It is rewarding to be able to speak with CEO's and CFO's of small companies every day," he says. "If I were investing in large companies, the CEO of Pepsi probably wouldn't pick up the phone. With small companies, you get executives who are excited to talk about their business success with you."

Corbett has succeeded in his own right. It is not uncommon for executives of the very same companies he was once the first to believe in to invest their own money in his Funds. "Investing is about trust. That goes for buying shares of a small business or working with an advisor to invest your personal portfolio." Corbett continues, "To see our clients have that trust in us is the highest compliment."



MICHAEL CORBETT
CEO, CIO and Portfolio Manager



DR. GERALD W. PERRITT
Founder, Chief Economist



MARK OBERROTMAN
Executive Director of Client Relations



SEAN M. CONDON, CFP®
Financial Planner/Client Relations

Perritt

CAPITAL MANAGEMENT

For more information contact for
Mark mark@perrittcap.com or
Sean scondon@perrittcap.com
(312) 669-1650 300 S. Wacker,
Suite 2880 Chicago IL 60606
www.perrittcap.com

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