Manager Commentary

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Manager Commentary, 4th Quarter 2018

Flash Market Update

Investors did not take the news well from the Federal Reserve. While most investors expected the Fed to raise interest rates by 25 basis points last week, most were hoping further increases would be unlikely. Instead, the Fed said two more increases in interest rates would be likely next year. This news sent stocks to new lows for the year.

Despite one of the worst weekly and monthly declines in U.S. stocks and the increased nervousness by investors, there are several indicators that lead us to be more bullish on stocks.

For the past week, the S&P 500 Index lost 7.1%, the Russell 2000 Index lost 8.4%, and the Russell Microcap Index lost 9.0%.

If the December month were to end today, this would be the worst December in stock market history. While large stocks are not officially in bear market territory yet, we might as well call it a bear market since nearly 50% of large stocks are down more than 20% from their highs. Small stocks are officially in bear market territory with a decline of more than 25% for both the Russell 2000 and Russell Microcap Indexes. We also monitor the LD Microcap Index, which is down nearly 35% from its high and down more than 30% for the year. While history has taught us that stocks can go lower in bear markets, this is also an excellent time for long-term investors to consider purchasing more equity holdings.

Unless a huge rally happens in the last week of the year, this will be the first year in more than 100 years that more than 90% of all asset classes finished down for the year. This is also telling us it is a great time for long-term investors. ***I should caution investors, though, that the real leaders of the next bull market will likely be a different group of stocks than we saw in this past bull market.***

- The put/call ratio hit a record reading of 1.82, which is about the same level in the first week of March 2009, which was the bottom of the Great Recession. While there is a great level of uncertainly in this market today, there is no structural economic issues like we had in 2008/2009 market.
- Let's remember that 2017 was one of the least volatile years on record, as the S&P 500 was up each month and never fell more than 3% during the entire year. We believe part of the relentless selling pressure may be related to tax-loss selling. This is the first major decline in stocks in nearly 10 years, which means it could be the first year for investors to realize losses. In addition, investment professionals have been trained to always mine losses for tax efficient reasons. We think there is good chance for a strong bounce in stocks in the beginning of the year.
- According to American Association of Individual Investors (AAII), the bearish sentiment soared last week to nearly a 49% reading. This contrarian indicator reading has not been that high since April 2013, which was a good entry point for stock investors. It may be another great time for long-term investors today as well.
- According to Lipper Analytical, investors redeemed nearly $50 billion of domestic equity funds in the second week of December and purchased more than $80 billion of money market mutual funds. This selling is a new record for weekly outflows, which we believe is another bullish contrarian indicator.

Despite all these contrarian positive indications, the probability of a recession in the future has increased. The only lead indicator pointing to a recession is the stock market. While it is unclear, we could be in a painful transition of stock market leadership, rather than recession.

Each of these indicators show that investors have become very fearful of the equity markets. As Warren Buffet has said many times, "Be fearful when others are greedy, and be greedy when others are fearful." Given all these negative readings, it appears to be a great time for long-term investors to add to their equity holdings. I, for one, will be adding to my equity holdings soon.

I hope everyone has a great holiday season. If you have any questions about my comments, the markets, or the economy, please feel to email me at corbett@perrittcap.com or call 800-331-8936.

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The information provided herein is opinion and is not intended to be a forecast of future events, a guarantee of future results, nor investment advice.

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.

S&P 500 Index is a stock market index that tracks the stocks of 500 large-cap U.S. companies. It represents the stock market's performance by reporting the risks and returns of the biggest companies.

LD Microcap Index is designed to give the most accurate representation of the intraday activity of microcap stocks in North America. The index is market cap weighted and is comprised of approximately 1,014 stocks in the U.S. and Canada.

Sources: American Association of Individual Investors (AAII) and Lipper Analytical.

Earnings Growth is not a measure of the Fund's future performance.

Mutual fund investing involves risk. Principal loss is possible. The fund invests in smaller companies, which involve additional risks, such as limited liquidity and greater volatility. The fund invests in micro-cap companies which tend to perform poorly in times of economic stress.

One cannot invest directly in an index.

Before you invest in the Perritt MicroCap Opportunities Fund or Perritt Ultra MicroCap Fund, please refer to the prospectus for important information about the investment company, including investment objectives, risks, charges and expenses. You may also obtain a hard copy of the prospectus by calling 800-331-8936. The prospectus should be read carefully before you invest.

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