

April 18, 2013

Dear PCM Clients and Friends:

We always start writing these quarterly letters about three weeks before you receive them, starting with the items that are not time sensitive. At this time, the last weekend in March, we noted with interest that one Mike Gmoser, the prosecutor in Butler County, OH has issued an indictment of Punxsutawney Phil who predicted an early spring when he didn't see his shadow after emerging from his western Pennsylvania lair on February 2. The indictment said "Punxsutawney Phil did purposely, and with prior calculation and design, cause the people to believe that spring would come early," and therefore, constitutes a felony "against the peace and dignity of the state of Ohio." However, Bill Deeley, president of the Punxsutawney Groundhog Club that organizes Groundhog Day, says Phil has a lawyer and would fight any extradition attempt by Ohio authorities. Sounds like a publicity stunt to us, but one thing is certain; more storms are on the way, even this weekend, because he failed in his job.



Recent mail brought the catalog for the Guyette, Schmidt and Deeter decoy auction to be held at the end of April in St. Charles, IL. This is the largest, best attended decoy show and auction in the United States, and one which Perk always attends and has written about in previous letters, especially the July 2010 letter which went into great detail about this event. So when you read this letter, Perk will be in St. Charles, IL, at the decoy auction trying very hard not to spend any money.

A MESSAGE FROM PERK

Among the many publications that we read at Perkins Capital Management, two that I find especially helpful are the *StockInvestor* and the *DividendInvestor*, both from *Morningstar*. One of the tenets espoused by the *StockInvestor* is favoring companies with a wide economic "moat" or competitive advantage which one company may have versus another because of the moat built around it, analogous to the water moat built around the castles of bygone days. In this publication, they try to identify companies with competitive advantage moats as well as those that have negative economic moats or seem to be trending that way. Examples of companies with wide moats are some drug companies which may have a drug under patent which is in demand and unavailable elsewhere (think Pfizer in the early days of Viagra). Another example would certainly be Microsoft, especially at the beginning because of its ubiquitous Windows software or Automatic Data Processing, because of the dominance it had and still has in payroll processing. Even Wal-Mart

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INVESTMENT MANAGEMENT

because of its dominant position in retailing could be considered to have a wide moat; Costco Wholesale is another example of a retailer which is dominant in its particular niche. There are many examples which come to mind in addition to the ones which they rank as having a wide moat. But, of course, competitive advantages can change, just as a moat around a castle could go dry. Therefore, one needs to be on top of the changing fundamentals that can alter a competitive moat advantage. Most likely, it is a change in competition, perhaps directly from companies with similar business models. For example, the competitive edge that Wal-Mart may have because of its size and dominance can be threatened by Target as it chases the same model aggressively, adding stores, and now groceries as well. Likewise, competition can arise from a previously non-competitive firm asserting itself through a dramatically different business model offering an alternative product in a disruptive format. Some companies that have a competitive advantage may suffer an unfavorable change due to government action—some new law or unfavorable decision. Handgun makers come to mind if unfavorable gun ownership laws are passed. *Morningstar* has also mentioned “self-inflicted wounds” as a reason for a moat change, and by that they mean a change in management or management style. We hear frequently that one man or one woman does not run a company, and that is true in the literal sense but not in the philosophical sense. The style of leadership quality ultimately engulfs the other executives often to the point where they think and act as one. That is management leadership, and so it can come to pass that a change in management of one person can significantly alter the course of a company, which may see its management moat disappear.

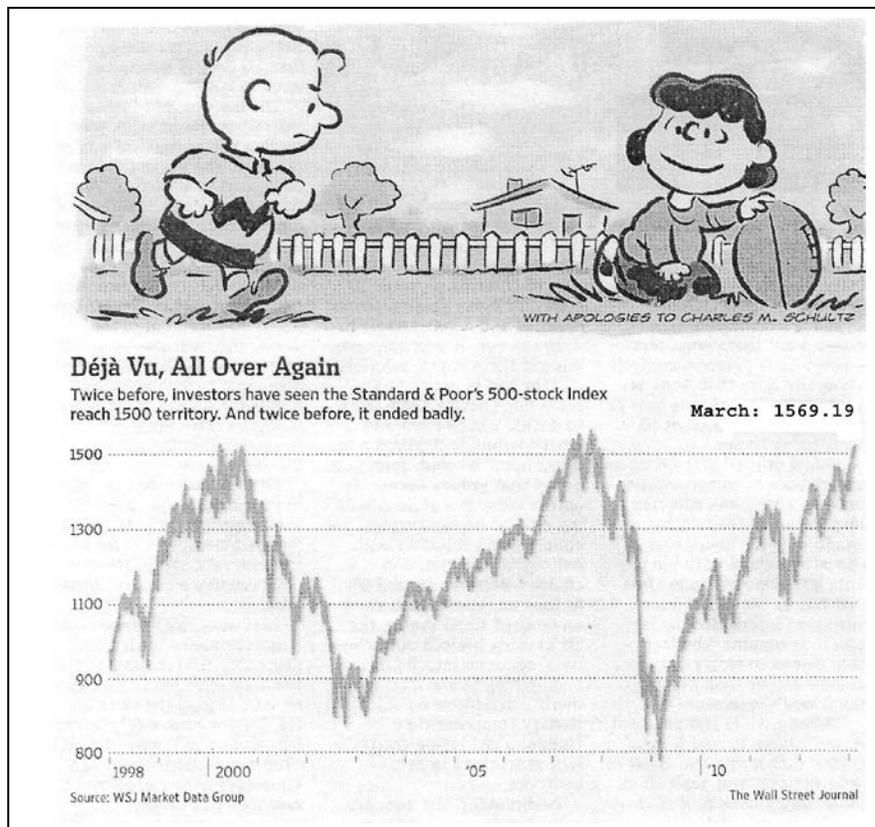
The companion *Morningstar* publication which we also find helpful is the *DividendInvestor*. That sounds simplistic, for we can easily calculate the dividend yield of a stock; in fact, it is shown as part of our quarterly accounting to clients. And we can use many services to sort stocks totally and by industry group showing yield from highest to lowest. But reviewing dividend yield of a stock together with its moat rating is not only helpful, but provides the basis for thought about the companies themselves and the industry that they are in. None of us have a monopoly on investment intelligence, and as Peter Lynch said, “In this business if you are good, you’re right six times out of ten. You are never going to be right nine times out of ten.” Which brings us back to the premise that several sets of eyes or opinions are best—a little “group think,” as it were, when the group think is supplemented by looking at charts, both short-term and long-term, to see what they can tell us. All of this filtering in the process of stock selection hopefully helps us to do our job better and to provide the best results for our clients.

But back to dividends again, which are a reliable measure of a company’s growth and stability; a company’s ability to pay dividends year in and year out is pretty good evidence that it is performing well. Johnson & Johnson, for example, one of America’s premier companies in terms of long-term appreciation, and its wide economic moat in the eyes of *Morningstar*, just announced its 50th annual dividend increase. None of this is meant to turn us away from excellent companies which reinvest profits in the business to grow it, rather than to pay significant dividends, but rather shows that dividend paying wide-moat companies can play an important part in lending stability to a portfolio as well as income in an era of low interest rates.

It is clear from the chart of the NYSE Composite Index vs. the NYSE Common Stock Breadth, that the optimists have been right so far as the advance decline line has now exceeded the 2007 high, while the Index has not done so yet. This chart, therefore, calls for higher prices ahead, perhaps after a minor correction.

The optimists are predominately fundamental analysts, who point to excellent earnings reports resulting in a modest price earnings ratio for the stock market and individual stocks. They cite the Fed's Quantitative Easing—first called QE1, then QE2, and now QE3 or QE Forever, destined to continue until unemployment rates decline to 6% or lower, which may be a long way into the future. So, therefore, the endless liquidity pumped into equities by the Fed provides the fuel for a continued market rise in the view of the optimists. Their rallying cry is "Never fight the Fed." And, indeed, that has been an excellent mantra to follow over the years. Optimists state the most bullish thing that the market can do is to go up, as that creates a "feel good" atmosphere, which continues to push it higher.

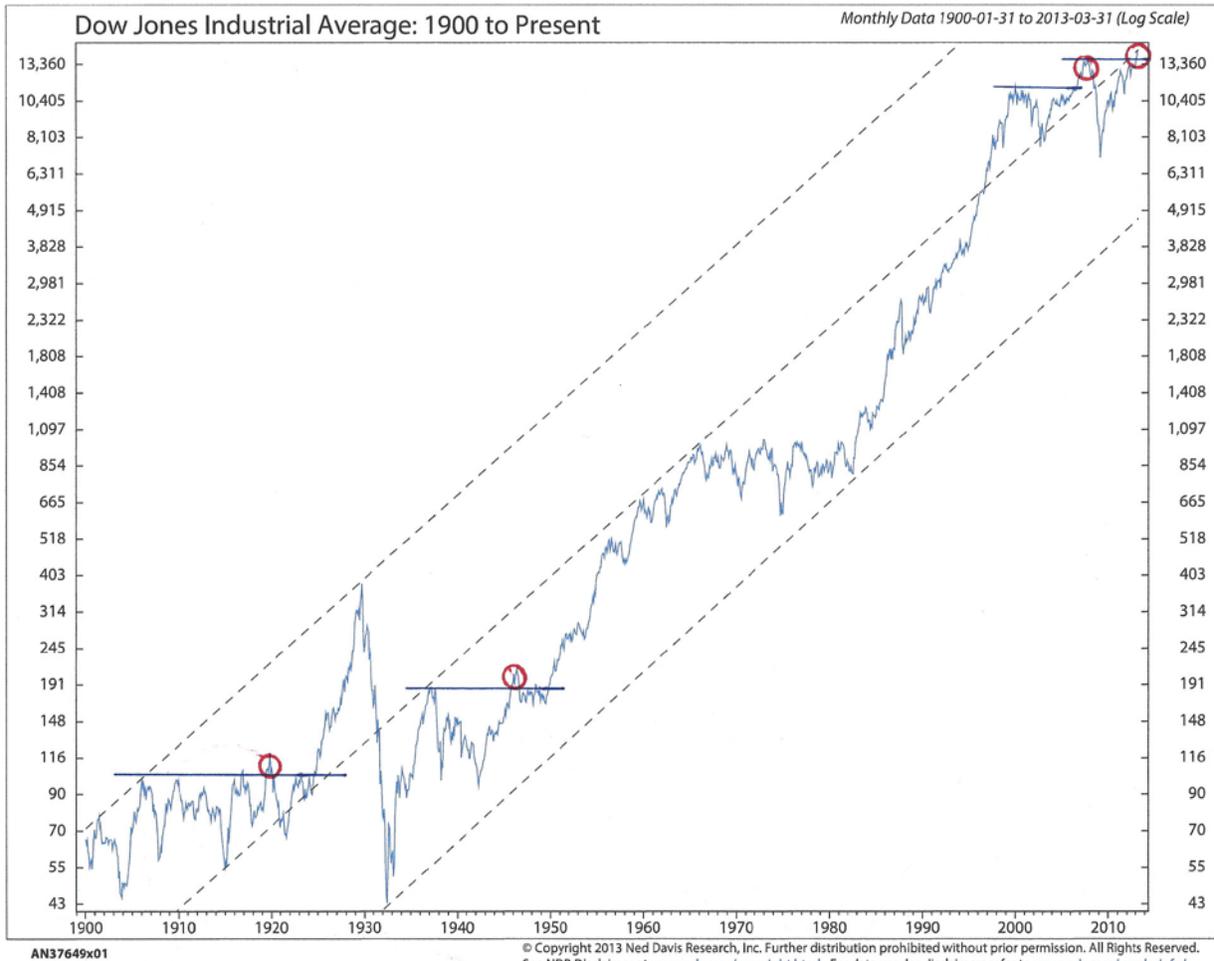
The pessimists, on the other hand, are mostly technical analysts, and others who try to project the market vs. individual stocks by utilizing *Elliott Wave Theory* and Sunspot activity, among other things, all of which have had successful past predictions at one time or another. Another part of what they are saying is that one or more serious corrections in the averages must occur before we can go back to a new bull market, and that the move up from the 2009 lows must be corrected. To explain this, and add a little humor to the explanation, we have inserted a cartoon attached to a chart of the S&P which dates back to 1998.



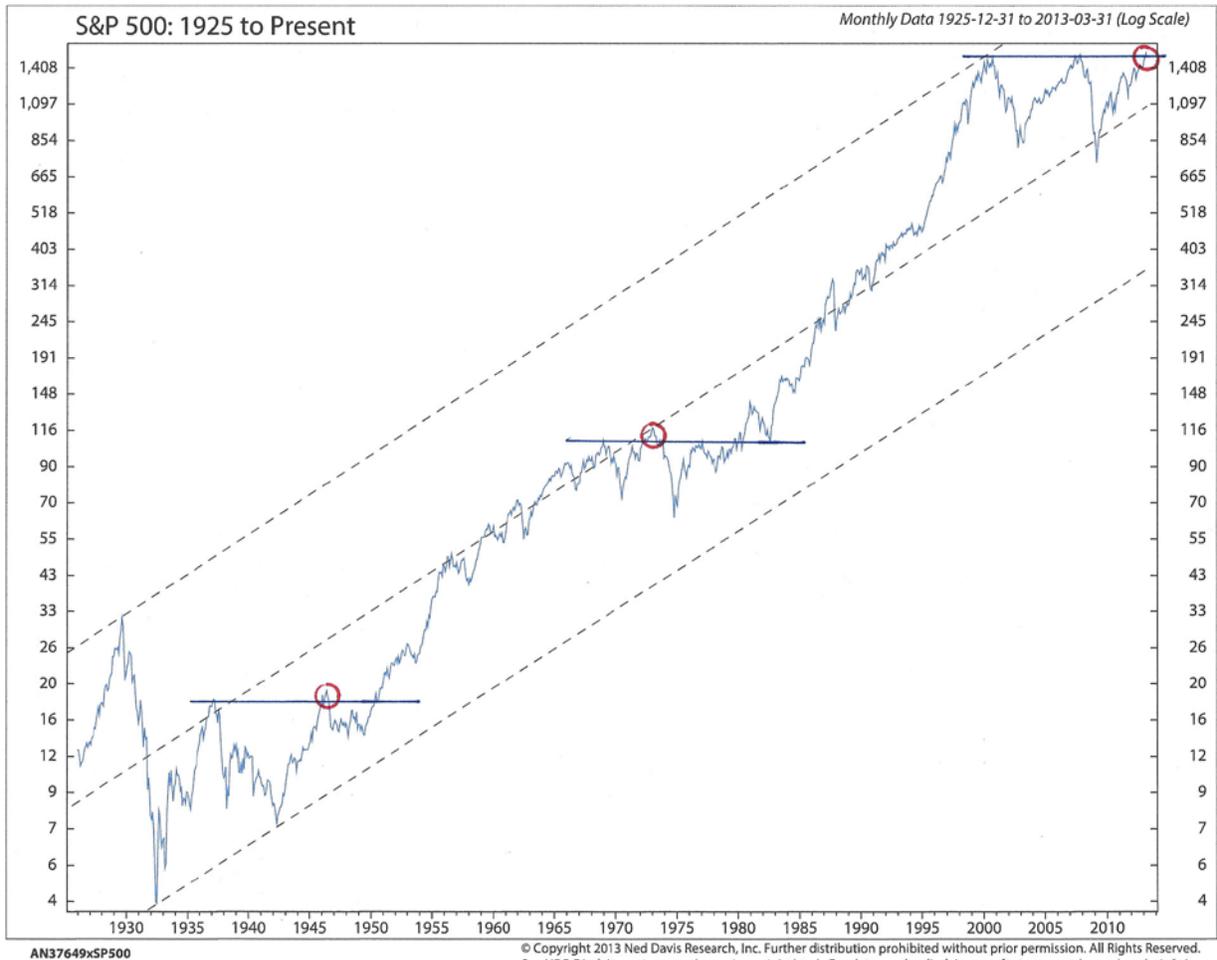
It shows Charlie Brown preparing to kick the football which Lucy is holding, but if you recall the Peanuts comic strip, each time Lucy pulled it away just in time for Charlie Brown to fall on his rear. The message of that cartoon is that with the S&P (and Dow) at new highs the "Price Football" will be moved and serious corrections will ensue. In fact, the late Stan Berge, a prominent technician, always said that "For a new bull market to start, the market (S&P here) must decline back to at least the area of the lows following the first leg up of the rise, which would

imply a price of around 1000 on the S&P average. This certainly seems quite unlikely at this time, just as the current projections of Dow 20000 or S&P 2000 seem preposterous in the near future, although, certainly, sometime down the road those numbers could be reached.

The question we need to ask, therefore, is what does make sense? What is realistic? Probably something in between, perhaps further new highs for a while, and then a correction giving us an opportunity to reposition portfolios for the start of the next bull market. So we asked the Ned Davis Research folks for a “single line chart” for both the Dow and the S&P for the past 100 years or so. In the case of the Dow it’s 113 years from 1900, but the S&P only since 1925 as it didn’t exist before then. Visual inspection of these charts shows that there have been times in the past when both markets have traded in a range, then broken out above that range implying a new rising market, only to fall back one more time before the real launch. For the Dow that happened in 1919, 1946 and again in 2005; for the S&P it was 1946, 1973 and perhaps now in 2013 for both averages. So, realistically, we believe at some point a market correction is necessary, we just don’t know when. We want to stay on the present course and do as we always have by buying shares we think are attractive and selling shares one by one as they may appear to have reached their potential. We don’t play the market by trying to be out when it looks too high as we do not believe that is possible. We prefer having one foot in each ditch, so to speak. We



want to own good stocks and monitor them one by one and to make changes in them as we believe necessary; at the same time, however, we want to be cautious and prepared for some uncomfortable times in the market. It is not possible to predict when the market might be affected by a “Black Swan” unpredictable event. In the end we think realism will prevail and by being realistic in our expectations, we believe we will do well for our clients. To paraphrase our friend, Steve Leuthold, “Market predictions are for show, but stock selections are for dough.”

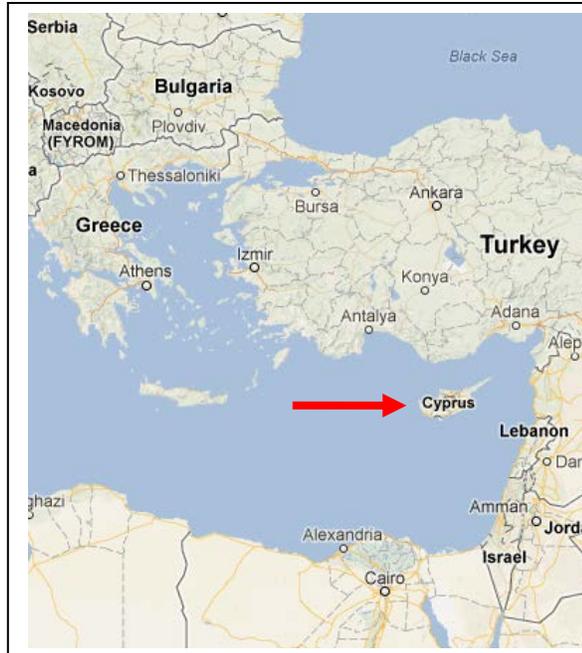


THE BIG BANK HEIST

Until recently, there were many who had no clue where Cyprus was, or knew anything about it. Now they certainly have heard of it, and where it is, and had better pay attention to what has happened there.

This small island in the eastern part of the Mediterranean (actually, just off the coast of Syria and Turkey) has forced the eurozone back into a crisis mode due to its attempts to

secure a bank bailout. Specifically, in mid-March the European Union and the International Monetary Fund demanded that the country of Cyprus needed to find 5.8 billion euros to get the 10 billion of euros offered as a rescue effort. Otherwise, the island would be forced into bankruptcy, but where was the money to come from? Well, it turns

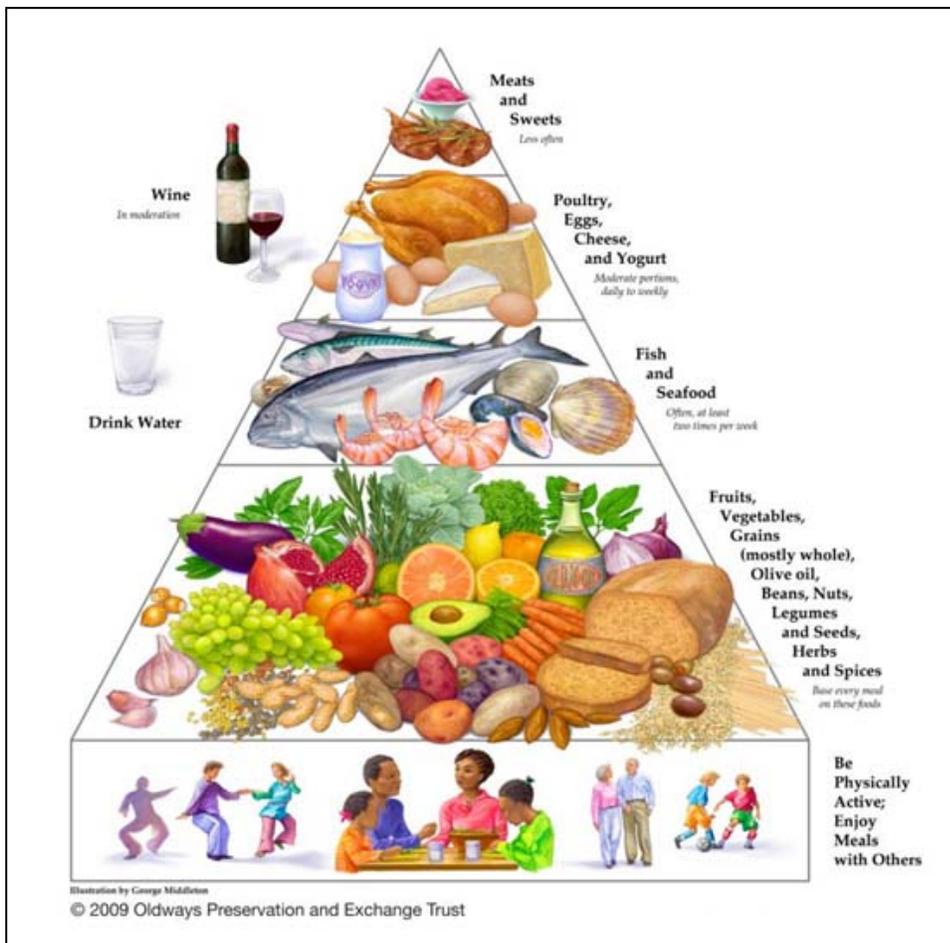


out, from the same place that John Dillinger got his, the banks, because that is where the money is. This time though, the Cypriot Government authorized the stick-up by allowing the seizure of funds directly from depositors' accounts in the Cyprus banks. A smaller percentage would come from accounts under \$100,000 euros, and as much as 5% for accounts over that threshold. Seizing money the depositors put into banks for safekeeping turns out to be an oxymoron, because it is no longer safe in banks. During the depression of the 1930s, here in this country, thousands of banks failed and for years there were people who would never put their money in a bank again, even after the Federal Deposit Insurance Corporation was created to have the Federal Government guarantee accounts when a bank failed. Some people never trusted

banks again. Unfortunately, this will create a lasting physiological scar on the European banking system, and almost certainly will result in the country of Cyprus departing the European Union. It will set a precedent for other countries as well. Banking, like a reputation, is built on trust and this deposit tax plan breaks that trust. We believe that Cyprus will eventually come to be seen as the beginning of the end for the euro, because trust, once broken, is like a failed reputation and very difficult to repair.

THE MEDITERRANEAN DIET

The *New York Times* recently had a feature article on the Mediterranean diet, which was based on an article published earlier that week by the prestigious *New England Journal of Medicine* on its website. It gained immediate notoriety based on the fact that the results were so impressive after the first five years that the study ended early because "The results were so convincing it was considered unethical to continue." WOW! Quite an endorsement when combined with the fact that all the researchers changed their own diets and are now on the Mediterranean one. The big result of the diet was not loss of weight, but rather a reduction in heart disease risk. The basics of the diet, which actually has been known for years, is an emphasis on olive oil, nuts, poultry, fish, fruits and vegetables, and very little red meat and sweets. And besides water the liquid accompaniment for each meal should be red wine, at least seven glasses a week. Wonderful, for those of us that are red wine affectionados. The illustration shown on the following page depicts in the traditional pyramid form the basics of the diet—which really isn't a diet at all—but rather a



style of eating, which leaves you satisfied and not depressed, because the food is wonderful as well as healthy.

All of what we have written so far is in favor of this eating style, but there are those who think there is more to it. For example, there is far less sugar and salt, two food ingredients used in excess which we have written about previously in these letters. Another factor may be that the style of living in that area of the world is different, with the large meal in the

middle of the day, and then a nap! And they get lots of sun. None of this is mentioned when the press talks about the Mediterranean diet. So, while we agree with the findings of the Mediterranean diet, we think some of its success may very well be a “way of life” and for us here in America who want to utilize this healthy eating and way of life, we should just move to Greece, Italy or Spain. Bon Voyage!

PASSINGS

On Monday, April 8, the world began to mourn the death, at age 87, of the “Iron Lady,” Margaret Thatcher. In May 1997, Perk and his friend, Chris Dahl, were privileged to escort Mrs. Thatcher from Chicago to Minneapolis for a speech she was to give to the American Experiment. Since our letter this time is only nine pages, we decided not to leave page ten blank, but instead to reprint the story from the July 1997 letter recounting Perk’s encounter with Margaret Thatcher a few weeks earlier.

There are two topics of extreme urgent interest which we can cover in this issue with only one cartoon. New York’s mayor, Michael Bloomberg, has been at the front of the obesity dilemma by declaring that large portions of soft drinks should be illegal. But one of our freedoms is to choose whatever size cup we want, and to buy a large version if we wish.

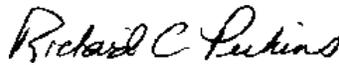
Do we need Mayor Bloomberg to tell us which size container we can have? And now he has piled into the fray over gun control, another highly controversial subject. We all know that people, not guns, kill other people, just as large soft drinks don't cause obesity, the eating and drinking habits of people do. We thought, therefore, that the cartoon is perfect for Mr. Bloomberg, who can outlaw spoons in the fight against obesity as well as large containers.

In the interest of full disclosure, it is our obligation to tell you that some of the jokes came from *Leuthold's Perception* without his permission.

Sincerely,



Richard W. Perkins, C.F.A.
President
Senior Portfolio Manager



Richard C. Perkins, C.F.A.
Executive Vice President
Portfolio Manager



Daniel S. Perkins, C.F.A.
Executive Vice President
Portfolio Manager

RWP:RCP:DSP/jah



July 28, 1997

A VISIT WITH THE IRON LADY

On May 9, Lady Margaret Thatcher, Great Britain's former Prime Minister, also now The Baroness Thatcher, spoke at the annual meeting of the Center of the American Experiment, a conservative "Think Tank" based in Minneapolis. Her speech that evening "The Moral Foundation of Democracy," brought tears to the eyes of some Thatcher fans, and a standing ovation from 2,270 attendees.

Perk and Chris Dahl, his friend of many years, were given the opportunity to escort Lady Thatcher from Chicago to Minneapolis in a private jet. This afforded them a once in a lifetime opportunity to speak with the Iron Lady on a one-to-one basis for well over an hour. All of us have admired Lady Thatcher for her courage and wisdom for many years, so this encounter was without equal. She was poised, courteous, impeccably dressed and with well-coifed hair that stayed in place while ours blew around in the breeze. Our meeting was eight days after the May 1 British election which Tony Blair easily won. Margaret Thatcher had been Britain's longest serving Prime Minister (three terms) but lost in 1990 to John Major. We had some trepidation about bringing up the election, but she wasted no time in asking what we thought about it. Perk commented by describing a political cartoon that had appeared in the American press near the time of our election in 1996. It showed Bill and Hillary Clinton wheeling a baby buggy carrying twins labeled "Reagan" and "Bush;" the caption was, "We decided to adopt." Her response was, "How clever. That is exactly what happened in my country." And so the conversation began about the British election where Tony Blair won by adopting the basic principles of modern conservatism. Just as Clinton won in a landslide by adopting Reaganism, Blair adopted Thatcherism with the same result. But the real winner was Margaret Thatcher who started it all in the first place.

The conversation ultimately moved from the election to our love of Great Britain, especially London, and all the wonderful times that both Perk and Chris Dahl have had there. Scotland Yard Inspectors volunteered his assistance should either of us be "in trouble" in London! She admired Perk's Save the Children necktie which brought him to the subject of children and their importance in our adult world. Chris Dahl, President of Children's Broadcasting Corporation, described the company's failed efforts to obtain a radio license to broadcast a children's format in England, which unfortunately was awarded to another company. Later, as we approached Minneapolis and saw the countryside from the air the conversation turned to Minnesota. We were obliged to tell her all the good things about the state leaving out the part about the bitter, cold winters and the hot, humid summers.

Yes, indeed, it was the conversation of a lifetime.



WHAT A COINCIDENCE

A chicken farmer went to the local bar. He sat next to a woman and ordered champagne. The woman said: "How strange, I also just ordered a glass of champagne."

"What a coincidence," said the farmer, who added, "It is a special day for me. I'm celebrating." "It is a special day for me too, I am also celebrating!" said the woman.

"What a coincidence." said the farmer.

While they toasted, the farmer asked, "What are you celebrating?" "My husband and I have been trying to have a child for years, and today, my Gynecologist told me that I am pregnant."

"What a coincidence!" said the man. "I am a chicken farmer and for years all my hens were infertile, but now they are all set to lay fertilized eggs."

"This is awesome," said the woman. "What did you do for your chickens to become fertile?"

"I used a different rooster," he said.

The woman smiled and said, "What a coincidence!"

TWO QUARTERS OR A DOLLAR BILL

A young boy enters a barber shop and the barber whispers to his customer, "This is the dumbest kid in the world. Watch while I prove it to you." The barber puts a dollar bill in one hand and two quarters in the other, then calls the boy over and asks, "Which do you want, son?" The boy takes the quarters and leaves the dollar. "What did I tell you?" said the barber. "That kid never learns!"

Later, the customer sees the same young boy coming out of the ice cream store and says, "Hey, son! May I ask you a question? Why did you take the quarters instead of the dollar bill?" The boy licked his cone and replied, "Because the day I take the dollar, the game's over!"

TOO EXPENSIVE

A very cheap man was looking for a gift for a friend. Everything was too expensive, except for a broken glass vase which he could purchase for almost nothing. He asked the store to send it, hoping his friend would think it had been broken in transit.

In due time, the man received an acknowledgement from his friend. "Thanks for the vase," it read. "It was so thoughtful of you to wrap each piece separately."

LITTLE JOHNNY

A teacher asked little Johnny if he knew his 1 to 10 well. "Yes! Of course! My pop taught me even more than 10!"

"Good. What comes after three?" "Four," answers Johnny. "What comes after six?" "Seven," Johnny replies.

"Very good," says the teacher. "Your dad did a good job. Now...so what comes...after let's say ten?" "A Jack." Johnny replies.

LITTLE PETE

Little Pete came home from the playground with a bloody nose, black eye, and torn clothing. It was obvious he'd been in a bad fight and lost. While his father was patching him up, he asked his son what happened.

"Well, Dad," said Pete. "I challenged Larry to a duel. And, you know, I gave him his choice of weapons."

"Uh-huh," said his father. "That seems fair."

"I know, but I never thought he would choose his sister!"

MEXICAN OYSTERS

A big Texan stopped at a local restaurant after spending a day roaming around in Mexico. While sipping his tequila, he noticed a sizzling, scrumptious looking platter being served at the next table. Not only did it look good, it smelled wonderful. He asked the waiter, "What is that you just served?"

The waiter replied, "Ah Senor, you have excellent taste! Those are called Cojones de Toro, the bull's testicles from the bull fight this morning. A delicacy!"

The cowboy said, "What the heck, bring me an order." The waiter replied, "I am so sorry, Senor. There is only one serving per day because there is only one bull fight each morning. If you come early and place your order, we will be sure to save you this delicacy."

The next morning, the cowboy returned, placed his order, and that evening was served the one and only special delicacy of the day. After a few bites, inspecting his platter, he called to the waiter and said, "These are delicious, but they are much, much smaller than the ones I saw you serve yesterday."

The waiter shrugged his shoulders and replied, "Si, Senor. Sometimes the bull wins!"

RALPH AND NORRIS

Ralph and Norris went bear hunting in Montana. While Ralph stayed in the cabin, Norris went out looking for a bear. He soon found a huge bear, shot at it but only wounded it. The enraged bear charged toward him. His rifle jammed, so he dropped it and started running for the cabin as fast as he could.

Now Norris was pretty fleet of foot, but the bear was just a little faster and gained on him with every step. Just as Norris reached the open cabin door, he tripped and fell flat. Too close behind to stop, the bear tripped over him and went rolling into the cabin.

Norris jumped up, closed the cabin door and yelled to Ralph inside, "You skin this one while I go and get another!"

THE ECCENTRIC PROFESSOR

After a semester dealing with a broad array of topics, an eccentric philosophy professor gave a one question final exam. The class was seated and ready to go when the professor picked up his chair, plopped it on his desk and wrote on the board, "Using everything we have learned this semester, prove that this chair does not exist."

Fingers flew, erasers erased, notebooks were filled in a furious fashion, some students wrote over 30 pages in one hour attempting to refute the existence of the chair. But one student was up and finished in less than a minute.

Weeks later, when the grades were posted, the rest of the group wondered how he could have gotten an "A" when he had barely written anything at all.

His answer consisted of two words: What chair?

THINK BEFORE YOU ACT

ArcelorMittal Steel, feeling it was time for a shakeup, hired a new CEO. The new boss was determined to rid the company of all slackers. On a tour of the facilities, the CEO noticed a guy leaning against a wall. The room was full of workers and he wanted to let them know that he meant business. He asked the guy, "How much money do you make a week?" A little surprised, the young man looked at him and said, "I make \$400 a week. Why?" The CEO said, "Wait right here." He walked back to his office, came back in two minutes, and handed the guy \$1,600 in cash and said, "Here's four weeks' pay. Now GET OUT and don't come back." Feeling pretty good about himself, the CEO looked around the room and asked, "Does anyone want to tell me what that goofball did here?"

From across the room a voice said, "Pizza delivery guy from Domino's."

DEPARTMENT OF LABOR

It seemed that the Department of Labor thought that a Texas rancher was in violation in what the rancher was paying his employees. So they sent an official out to meet with the rancher. The Labor official went out to the ranch and said to the owner, "Tell me about your ranch workers and what they get paid."

The rancher said, "Well, I have a ranch hand that has been here 3 years and makes \$200 per week and he gets room and board." "I also have a challenged worker who does about 90% of the work and gets paid \$20 per week and pays his own room and board. I give him a bottle of Bourbon every Saturday to help him cope. He also gets to sleep with my wife occasionally."

"I want to talk to the mentally challenged worker" said the official.

"That would be me." said the rancher.

I'LL BE WAITING ON THE FRONT PORCH

On the first day, God created the dog and said, "Sit all day by the door of your house and bark at anyone who comes in or walks past. For this, I will give you a life span of twenty years." The dog said, "That's a long time to be barking. How about only ten years and I'll give you back the other ten?" And God saw it was good.

On the second day, God created the monkey and said, "Entertain people, do tricks, and make them laugh. For this, I'll give you a twenty-year life span." The monkey said, "Monkey tricks for twenty years? That's a pretty long time to perform. How about I give you back ten like the dog did?" And again, God saw it was good.

On the third day, God created the cow and said, "You must go into the field with the farmer all day long and suffer under the sun, have calves and give milk to support the farmer's family. For this, I will give you a life span of sixty years." The cow said, "That's kind of a tough life you want me to live for sixty years. How about twenty and I'll give back the other forty?" And God agreed it was good.

On the fourth day, God created humans and said, "Eat, sleep, play, marry and enjoy your life. For this, I'll give you twenty years." But, the human said, "Only twenty years? Could you possibly give me my twenty, the forty the cow gave back, the ten the monkey gave back, and the ten the dog gave back; that makes eighty, okay?" "Okay," said God, "You asked for it."

So that is why for our first twenty years, we eat, sleep, play, and enjoy ourselves. For the next forty years, we slave in the sun to support our family. For the next ten years, we do monkey tricks to entertain the grandchildren. And for the last ten years, we sit on the front porch and bark at everyone.

Life has now been explained to you.