

April 22, 2014

Dear PCM Clients and Friends:

This year Minnesota lived up to its reputation as the nation's "ice box," reporting that we had temperatures of zero or below for 53 days of the 93-day span from December 1, 2013 to March 3, 2014, a tie with the winter of 1977-78 for 5th place. The first four were all years

SUBZERO DAYS		
Rank	Winter	Subzero Days
1.	1874-75	68
2.	1886-87	58
3.	1887-88	57
4.	1872-73	56
T5.	1977-78	53
T5.	2013-14	53
7.	1916-17	51
8.	1935-36	50

Source: Minnesota DNR

in the late 1800s, as shown in the table. This was more than twice the average. Uff da. All of which reminds us of an old Ole and Lena joke. Last fall, as the story goes, a government survey crew came to Ole's farm and asked permission to enter his property to do some survey work. Ole agreed, and when they were finished Lena offered the usual Norwegian hospitality of coffee and cookies. Now in mid-April after the bitterly cold winter, the survey crew foreman returned and told Ole that because he and Lena were so kind to the crew last fall he wanted to come and give the bad news to Ole in person. He said that after reviewing their work they had concluded that Ole's farm was in

Wisconsin and not in Minnesota after all. Ole replied, that was not bad news, but good news because "I vas yus telling Lena dis morning dat I don't tink I can take anudder vinter like dis von in Minnesota!" That well worn joke pretty much sums up how we all feel about another winter in Minnesota.

Fishermen are lamenting the toll on fish, as thick ice and lowered oxygen levels have caused significant winterkill of game fish. It has been tough on the birds and critters too. All of us have spent more on bird food than normal and keeping a path open to the bird feeder has been a big task to deal with. Likewise, the deer have had a tough winter to forage for food. The Minnesota DNR, taking pity, has authorized the feeding of deer in northern Minnesota. Perk has a herd of six deer that live in the nearby nature preserve, but come to his backyard each evening for a handout of corn. He thinks he should be able to take them as dependents on his tax return.



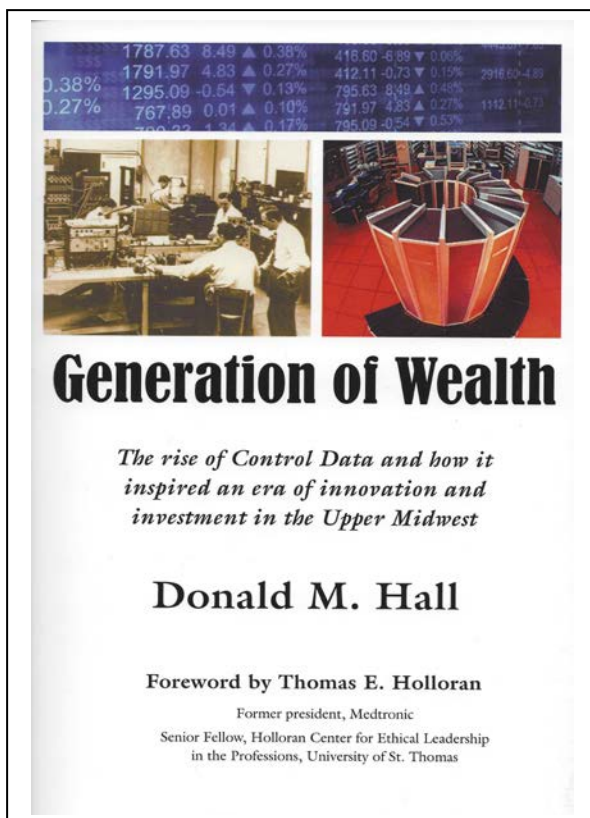
And, as a result of the severe winter we have a bumper crop of potholes, with some deep enough to reach the bumper! We read that there are twice as many to be filled this spring as normal. But it seems to us that estimate is way too low, as it feels like we are driving on the moon, reportedly a crater-filled wasteland. But we are not suffering alone; this winter has been brutal throughout most of the United States reaching further south with ice and snow than any of us can remember. Global warming indeed! The major metropolitan areas of Chicago, Philadelphia, Washington DC, New York and Boston have all had their share; it's just that here in Minneapolis it's supposed to be like this.

To add insult to injury as one final punishment before spring, the weather is still abominable throughout much of the US, especially bad with tornadoes ripping through the Midwest. For our part, we were blessed with a 10"-12" snowfall on April 4, as Mother Nature decided not to let go without one final punch.

A MESSAGE FROM PERK

In the October 2006 client letter, I wrote a lengthy paragraph about the passing of William C. (Bill) Norris, the founder of Control Data here in Minneapolis. I noted that the Twin Cities has three major economic segments which have propelled our growth over the years—food products, medical technology, and computer technology. The food industry, I noted, went back to the Pillsburys and the Bell family of General Mills, medical technology to Earl Bakken of Medtronic, and computer technology to Bill Norris of Control Data. You

could refer to page 9 of that October '06, letter in the client letter archive on our website (www.perkinscapital.com), to read what I said then; having just read it again myself, I find it as interesting as when I wrote it. The founding of Control Data in 1957 really marked the beginning of an era in the Twin Cities that made history as it was unique and probably not duplicated again until the Boston Route 128 or Silicon Valley VC era many years later. All this has been laid out in compelling fashion in a new book titled "Generation of Wealth" by Donald M. Hall. Do yourself a favor and get this book, which will be available from Amazon, Barnes & Noble and most other booksellers by the time you read this. Let Don take you back to that time nearly 60 years ago when a few talented men in search of independence from a large bureaucratic organization called Sperry Rand started Control Data, raising start-up funds without a broker sponsor at \$1 per share, literally door to door and with gatherings of friends like a Tupperware party. It was



indeed the beginning of an era written by a man who lived through much of it. Don Hall, now 76, worked as a young man as an analyst at Control Data and then for 20 years in the local securities industry. Some of you reading this will remember him from the old days of RJ Steichen, a brokerage which he owned part of with the late Jack Feltl.

But let's step back a bit. I was there, too, at that time. Well, almost. I graduated from the University of Wisconsin with an MBA in 1956, and went to work as a securities analyst at the American National Bank and Trust Company on LaSalle Street in Chicago. That is a long story, most suited for my own book someday. In early 1959, I relocated to Rochester, MN as the junior member of a team managing the Mayo Foundation dollars. This was two years after the event referred to as the beginning of an era when Norris and others had raised capital to put Control Data on its way. So also was the stock on its way, a subject of coffee shop talk, even at the Mayo Clinic where the spectacular rise in the price of the stock was discussed almost daily because it was indeed like a rocket ship. By 1961 or so, the stock had gone to \$100, but ultimately, adjusted for splits, that \$1 stock became worth well over \$700 per share. Millions were made, even by those who sold along the way to buy what became a very expensive car or house!

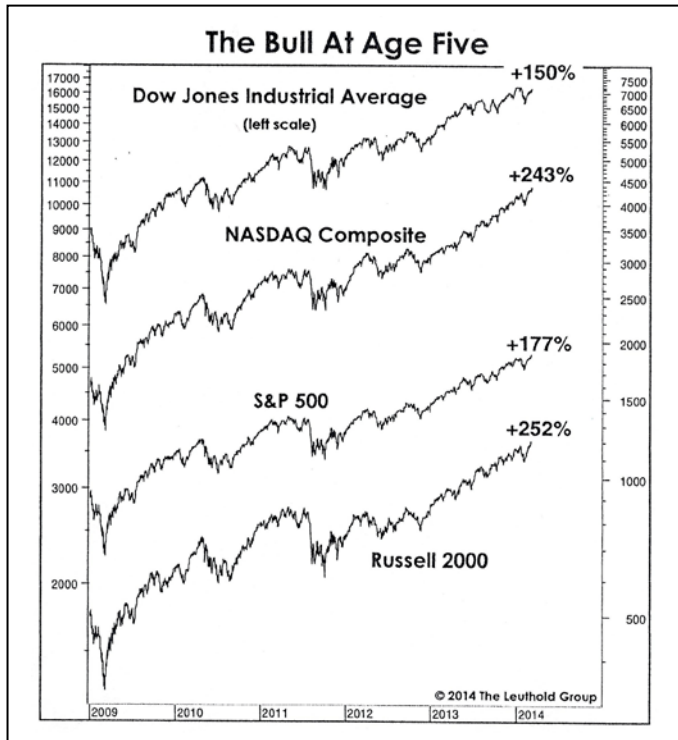
But, I digress too much. As I said, I was there, and lived through most of it. Company after company followed in those footsteps raising capital at \$1 per share or \$1.15 if there was a broker--\$1 for the company and \$0.15 for the broker. They were well paid; imagine a 15% commission today! And on and on it went, some succeeding, some failing, but if you lived through it, as I did, this is a fascinating, well researched and well written book that will bring back memories. Even if you did not live through that period, you will find it captivating if you let Don take you back in time to experience it as if you were there. But this book is not just about Control Data; as the title suggests, you will read the story of Medtronic's beginning as well as many others, such as Cray Research and Possis. You will also read about our one and only Manny Villafana, his successes (St. Jude) and failures (CABG Medical). As George Zimmer said with his signature slogan in the Men's Wearhouse commercial, "I guarantee you will like it."

THE MARKET SCOREBOARD

Taking a quick glance at the first quarter returns, there does not seem to be much of a discernable trend—except that the stock market was up! Well, we knew that. But on closer inspection we can see that small-cap stocks did best, especially when compared to the Dow Industrials which were down as well as the NASDAQ Composite, which was up just a little. All-in-all a mixed bag within a modestly rising trend, just not as much as we had expected for the first quarter when we went to press with our January Letter.

Ranked by Q1 Return Indexes	% Return Q1 2014
Russell 1000 Total Return	2.05
Russell 3000 Total Return	1.97
Wilshire 5000	1.47
S&P 500	1.30
NYSE Composite	1.23
Value Line Composite	1.16
S&P Small-Cap 600 Total Return	1.13
Russell 2000 Total Return	1.12
NASDAQ Composite	.54
Dow Jones Industrial Average	-.72

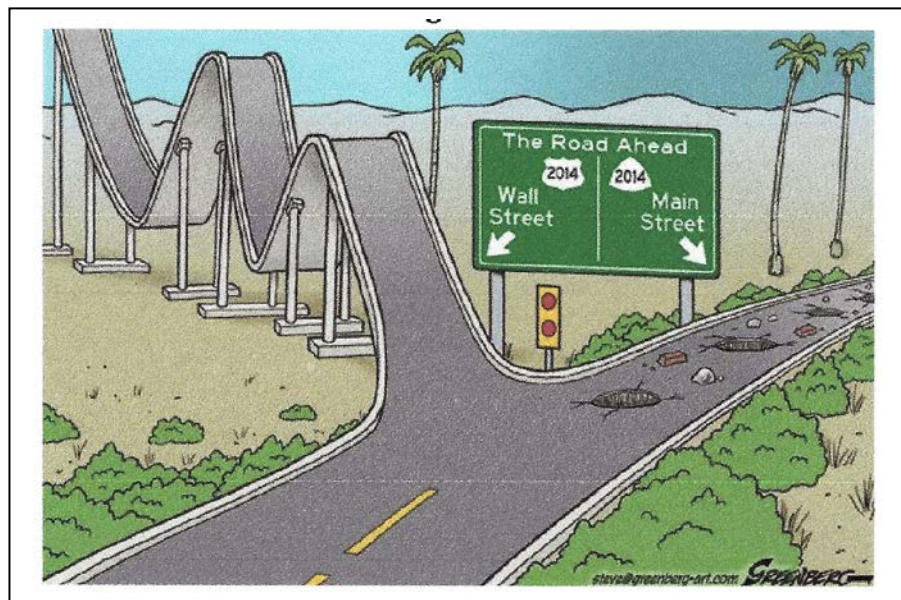
THE ROAD AHEAD



The cyclical bull market is now 5 years old, and as parents we all know that 5-year-olds can be unpredictable in their behavior, but we will take a crack at what this one may be like as he pushes toward age 6. This market now qualifies as only the 6th cyclical bull market since 1900 to last 5 years or more. And, of course, life expectancies at an advanced age are limited, and so only 3 of the 6 previous 5-year-old bulls lived to see a 6th birthday. Yet, the consensus opinion that a new secular bull market has begun is stronger today at age 5, than it was at the bull's 1st, 2nd, 3rd, or 4th birthdays. Of course, that is the way it is supposed to happen—confidence builds more confidence, and a rising market rises on a wall of worry. Until it doesn't. We don't know when this cyclical bull market will end, just that it will at some

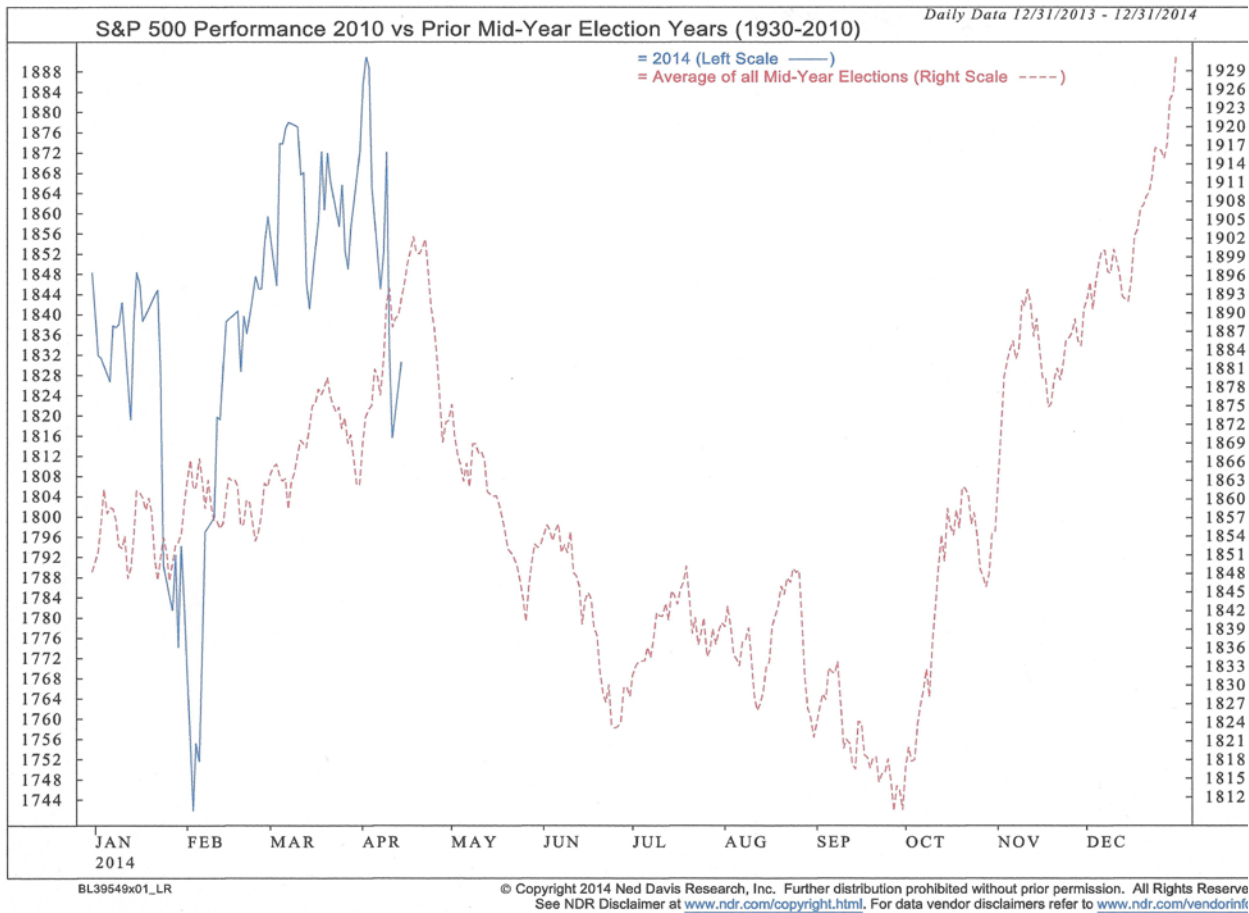
point. The best analogy we can give you is the one from *Lowry's* comparing it to predicting the weather. The daily forecasts are short term, while the analysis of the long term forecast recognizes different signs along the way. And so it is with the end of a bull market and signs of a developing top. As a bull market ends stocks do not fall all at once, but rather as the primary trend matures, more and more stocks fail to participate. Surprising as it may sound, all this creates opportunity—the opportunity to sell those that have

topped, or at least reached a point of diminished potential. At the same time opportunity is created by identifying these that have not participated in the bull run, but now, having not gone up, may be in a position to do so. Right now, despite the age of this bull market, we see only a few signs that it may be topping. Some biotech stocks have gone too far, too fast. The road ahead for 2014, as



depicted in the accompanying picture, shows the Main Street full of potholes like it always is and Wall Street with its roller coaster ups and downs. The Main Street ever present potholes of poor employment reports are combined today with the usual European problems, although the Russia/Ukraine situation and its political repercussions may be more severe than the Spain/Greece problems of last year and the ongoing MENA saga. In comparison, Wall Street's roller coaster looks pretty good to us.

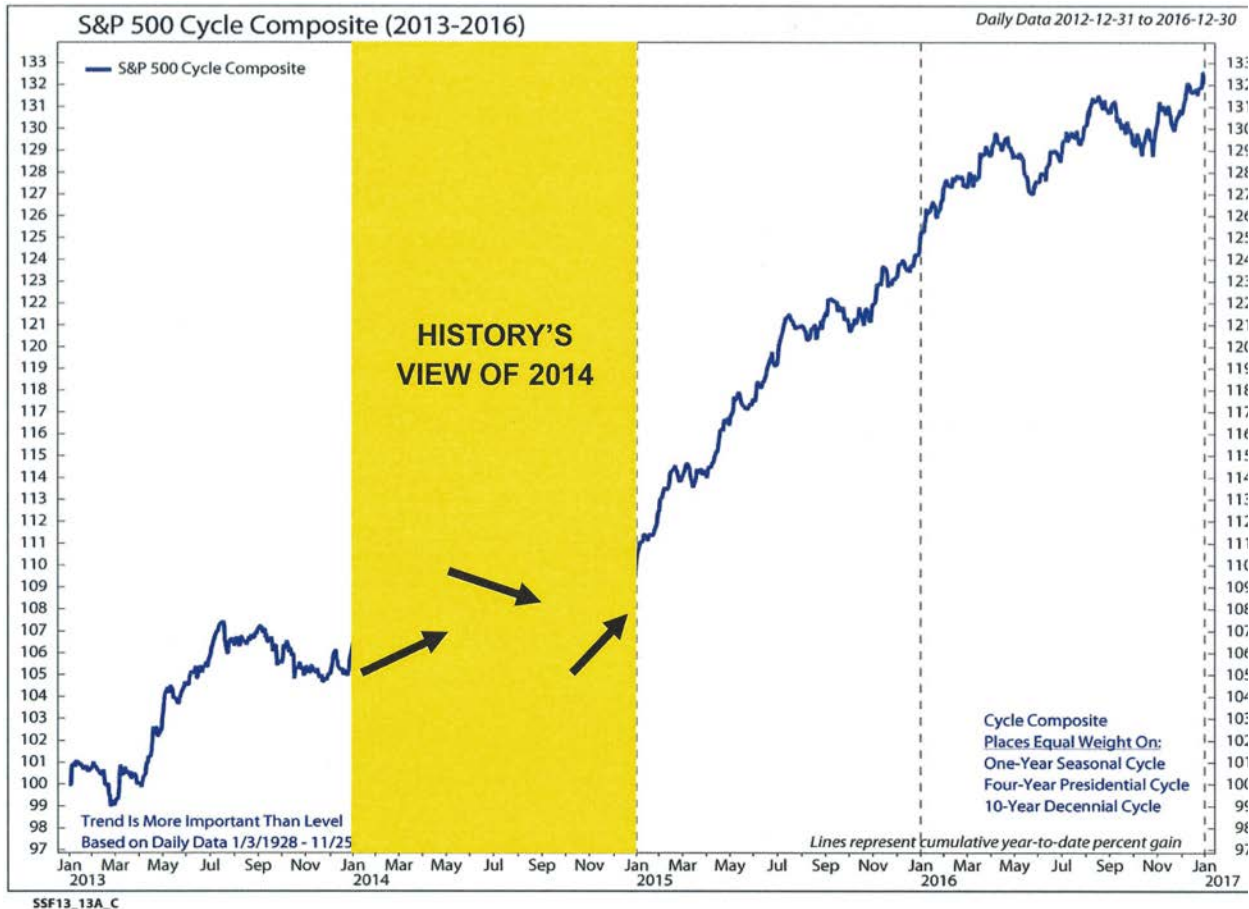
But we can get a clue about the road ahead based on what has happened in previous mid-term election years, such as this one, which of course comes along every 4 years. The chart shows the performance of the S&P 500 so far this year compared to the average



mid-term year from 1930-2010. Each of these mid-term years had their own characteristics, so of course, none were identical, but taken together they can give a pretty good prognostication of what the year could look like. Bear in mind that the bottom of every other 2nd year in the decade—1942, 1962, 1982 and 2002—may have had a greater downside influence since the prominent 20-year cycle also bottomed in those years, and it is not due again until 2022. So if this is a good template, then we could see a market correction beginning soon with a bottom 6 months or so further out into the fall. That does not necessarily mean the end of this cyclical bull, but perhaps just a correction along the way. If that happened, we would be blessed with a great buying opportunity. Please refer back to the tables in our January 23 letter on page 7, which shows the ensuing gain from

those mid-term bottoms averaging a median gain over the 20 years of 47% to the high the following year and 61% to the election year highs 2 years later.

Also shown here is a chart which clearly shows the rise coming out of that bottom, which we refer to as the 5th year rise, which emanates from the previous year low. If this does turn out to be the case, then the rise in 2015 could be a continuation of this cyclical bull.



A BIT OF AN ENIGMA

What is it? A plane? A bird? No, it's superman. The same question can be asked about the new computer-derived phenomenon, bitcoin. What is it? Is it money? A currency? A store of value? Or a modern day Ponzi scheme? No, it's a digital enigma.

Much has been written about Bitcoin in the recent past—articles in the *Wall Street Journal*, *New York Times*, a cover story in a recent *Business Week* as well as articles in numerous other publications. Each of these articles attempts to find what it is, but falls short in a definition that is easily understood by the average Joe. That includes some of us here at PCM—or at least Perk for sure. Even the highly respected Nouriel Roubini, Chairman of Roubini Global Economics, and Professor of Economics at New York University's Stern

School of Business, speaks unfavorably saying “Bitcoin isn’t a means of payment as there are few transactions in bitcoin. And given its volatility, all who accept it convert it right back into dollars, euros or yen. Bitcoin isn’t a store of value, as little wealth is in bitcoin and there are no assets in it. Also, given price volatility, it is a lousy store of value. So bitcoin isn’t a currency. It is a Ponzi game and a conduit for criminal/illegal activities. And it isn’t safe, given hacking of it.” Nevertheless, digital currencies fascinate the imagination and pocketbooks of venture capital funds. Fortress Capital Group invested \$20 million in bitcoins in 2013, and suffered a \$3.7 million loss according to SEC filings. In December, Andreessen Horowitz invested \$25 million in Coinbase, an international outfit that enables individuals to buy and use bitcoins. In 2014 Fortress has invested again, this time in Xapo, a firm that provides an insured online Bitcoin vault. With names like that laying physical dollars on the line for a currency that does not exist other than digitally, it must have something going for it that we can’t visualize. The best we can do to explain is that a digital currency, such as bitcoin (there are others) is produced by people called “miners” who literally mine the internet using mathematical formulas to solve an equation for which the miners receive bitcoins (essentially numbers known as an address) and then store the bitcoins in a virtual wallet, which saves all of the information until such time as the bitcoin owner wants to use the bitcoin for a purchase. The software behind bitcoin relies on a record of each and every transaction that’s made. When part or all of a bitcoin is spent the change in ownership is recorded on a global network of computers, and posted to a public register which insures that the same bitcoin can’t be used twice. The owners of the computers verifying these transactions are rewarded with new bitcoins for their work.

Sounds crazy, right? And maybe the man who started it all, one Satoshi Nakamoto of Los Angeles was the crazy person who invented it despite his denial. To add more intrigue to this, in February a Tokyo-based Bitcoin exchange named Mt. Gox was hacked and \$425 million of bitcoins were stolen. But in late March the exchange, now in bankruptcy, miraculously found coins worth about \$100 million in “old format wallets” and as the *New York Times* said, that discovery of virtual currency is the equivalent of finding money in another pair of pants. Now there is an explanation for you to digest!

Now what? We would likely not even be writing about this were it not for the fact that our highly respected friend, Mike Moe, devoted most of his recent March 16 newsletter, *A 2 Apple*, to a discussion and tacit recommendation of digital currencies. Mike is the founder and manager of GSV Capital, a public performance fee based fund that invests in internet companies before they go public. His most recognized investments are Facebook and Twitter, as well as Dropbox, to mention a few. Our readers who do not receive *A 2 Apple* each week, as we do, are missing out on an education about all things internet, and this is important, for after all, the internet is this century’s equivalent of the industrial revolution. A subscription to *A 2 Apple* is free; just go to www.gsvcapital.com and sign up; you can also see the fund’s holdings, most of which you likely never heard of, but which you will, just as you had not heard of Facebook or Twitter just a few years ago.

But we digress. In the March 16 issue of *A 2 Apple*, written from Dubai, Mike reviews the different currencies used throughout history, from early bartering to the paper money of today. He opines that since we now live and work in a global society with a global internet

marketplace, we need a global currency that allows more people to share goods and services with each other. He thinks Bitcoin could very well be able to provide such a ubiquitous global currency. Well, this may all sound silly, he says, "But a bitcoin as a currency is no less fictional than fiat money created by governments." An interesting prospect for sure, something that may take years to happen, if it ever does. But things evolve, and if you think about it everything we have today, even life itself, evolved over time. If it is possible to conceive an idea, it often is possible to achieve it and this just may be one of those ideas.

After we wrote all of this, another entity took an interest in bitcoin, namely the Internal Revenue Service. On March 26 it issued guidelines on bitcoin declaring that it is not a currency, nor is it legal tender endorsed by a central bank, and therefore, it is simply property and all rules of property apply. As property any increase in value which bitcoin holders realize is taxable as a capital gain or conversely a tax loss, if a loss is taken. In turn, all the other tax rules apply, including reporting by any vendor that receives more than \$600 of value from any one person. Therefore, the IRS may just have stuck a stick in the spokes of the bitcoin wheels, just as they were beginning to gain momentum. Time will tell how this all plays out, but effectively, this IRS ruling may only turn out to be a bump in the road as there are too many people who already have an invested interest, so there may only be a delay in implementation.

REMEMBERING

Today we mourn the passing of a beloved old friend, **Common Sense**, who had been with us for many years. No one knows for sure how old he was, since his birth records were long ago lost in bureaucratic red tape. He will be remembered as having cultivated such valuable lessons as:

- Knowing when to come in out of the rain;
- Why the early bird gets the worm...
- Life isn't always fair;
- And maybe it WAS my fault.

Common Sense lived by simple, sound financial policies (don't spend more than you earn) and reliable strategies (adults, not children, are in charge).

Common Sense took a beating when you couldn't defend yourself from a burglar in your own home and the burglar could sue you for assault.

Common Sense lost ground when parents attacked teachers for doing the job that they themselves had failed to do in disciplining their unruly children.

Common Sense lost the will to live as the churches became businesses; and criminals received better treatment than their victims.

Common Sense finally gave up the will to live, when well-intentioned but overbearing regulations were set in place.

Common Sense was preceded in death

- by his parents, Truth and Trust,
- by his wife, Discretion,
- by his daughter, Responsibility,
- and by his son, Reason.

Not many attended his funeral because so few realized he was gone.

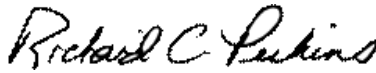
Source: excerpted from an obituary in the *London Times* many years ago.

And that brings us to the cartoon for this month, which we think is perfect in light of what we have just written. A pirate, having opened the treasure chest that was just dug up, mutters that they are bitcoins as they float out into the atmosphere. "It's a pirate currency" the cartoonist says.

Sincerely,



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President
Senior Portfolio Manager



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



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