

July 25, 2005

Dear PCM Client:

Rain, rain, oh did it rain! In May we thought we should build an Ark, as the very wet month of May saw 21 days of rain in our area. This delayed crop planting as farmers couldn't get into the fields, and delayed the morel season by a week or more as there was not enough warmth for those little delicacies to pop up. They need moisture, for sure, but also heat. In the end, there was a good season and Perk's morel hunter, Arnold Ward of Rochester, picked 35 pounds for him to give away, eat, and dry for future use. If you have never had



a morel feast with a big steak you are missing one of the rites of spring. Perk has hunted morels since his dad, the first Perk, took him into the woods 65 years ago, when Perk was nine or so. The morels were only part of the training, however, which included finding wild asparagus in the early spring, trout fishing along with the morels in May, walleye and bass fishing in the summer, and harvesting butternuts, walnuts and hazelnuts in the fall. And the little critter season was included in the

training, with ducks and squirrels in the fall, and rabbits in the winter. And yes, today the bounties of the earth are still there for us to find, although perhaps not as abundant as years ago.

As you are reading this July letter, Perk will be in Massachusetts to visit his artist sister, Mary Ann Perkins, and to attend two duck decoy auctions. At the risk of boring you, we will repeat some of what we wrote in April. Perk will head to Cape Cod, for the Ted and Judy Harmon "Ducks Unlimited" auction held annually, this year on Sunday and Monday, July 24 and 25, at the Bourne Best Western. Sunday night, after the auction, he will go to Falmouth where the New Black Eagles Jazz Band will play at the Falmouth Historical Society annual fundraiser. Perk gets the award for traveling the farthest each year. After the auction is finished on Monday, it is off to see Mary Ann for a few days, and then on Thursday, Dana will join him at the Boston Seaport Hotel for the Guyette and Schmidt summer auction, with dealer trading on Thursday and Friday and the auction on Saturday and Sunday, July 30 and 31. There are many fine decoys in both auctions, but Perk has his sights set on a pair of mallards carved by Max Gresser of Blue Earth, MN, which will be sold at the Harmon auction. Perk sells as well as buys, and he will have about 20 decoys for sale in the Guyette and Schmidt auction, which is necessary to provide room for new ones. Over time it is all a matter of upgrading, culling out the less desirable ones that you bought previously, and bringing in new and hopefully better birds.

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INVESTMENT MANAGEMENT

**CONFLICTING MARKET VIEWS**

The quarter ended June 30 was a good one for small-caps, with the Russell 2000 (the 2000 smallest stocks in the Russell 3000) up 4.32%, but still not enough to offset the miserable first quarter when it was off 5.34%, thus resulting in a first six months of -1.25%. The only real winner for the first six months was the S&P Small-Cap 600, which we really consider to be more of a mid-cap index than small-cap.

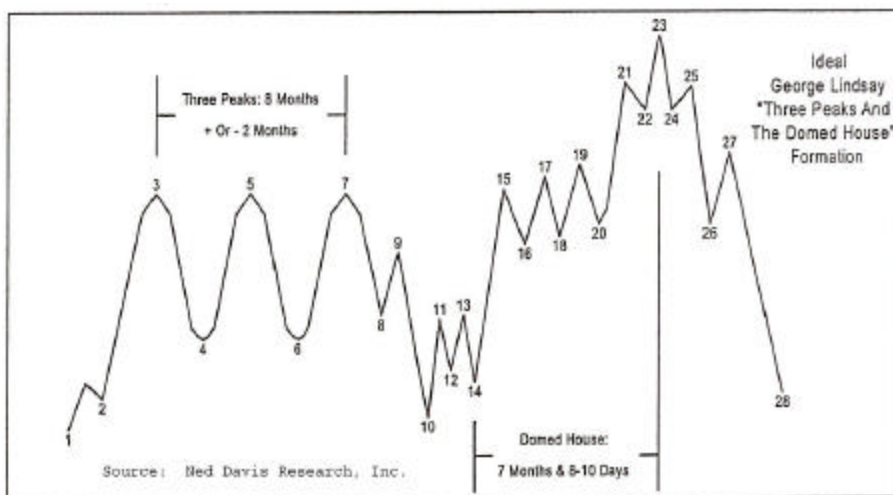
Indexes	% Return 2Q 2005	% Return 12/31/2004 Through 6/30/2005
S&P 500	.91	-1.70
Dow Jones Industrial Average	-2.18	-4.71
NASDAQ Composite	.70	-.50
NYSE Composite	.70	-.45
ValueLine Composite	2.05	-2.32
Wilshire 5000 Index	2.05	-.79
S&P 500 Total Return	1.37	-.81
S&P Small-Cap 600 Total Return	3.94	1.79
Russell 1000 Total Return	2.05	.11
Russell 2000 Total Return	4.32	-1.25

In our January 2005 letter we devoted nearly six pages to the phenomenon of

the fifth year rise, showing charts of each of the fifth years since 1905 which followed a fourth year presidential election, i.e., 1905, 1925, 1945, 1965 and 1985. We showed the history of this repetitive behavior and detailed market statistics suggesting that 2005 would be up just like all the other fifth years following a fourth year presidential election have been. However, we postulated that the rise would be less than the average 26% of the past fifth year rises, but more than the smallest gain of 10.9% in 1965. We are sticking with our forecast, but want our readers to know that there are other credible technical concepts which may derail our fifth year train.

One such negative technical formation is the so-called “three peaks and a domed house,” originally recognized and promulgated by the famous technician, George Lindsay, and now followed by numerous market analysts such as Jerry Favors, Jeffrey Hirsch, Ned Davis, and others.

We wrote about this market pattern in our January 2000 letter at the time of that market top. The chart shown is the “stylized” version of the pattern, and according to its followers the current formation started at the October 2002 bottom, and point 23 was the March high. The theory holds that the subsequent decline will



take the market back, at a minimum, to the level of point 10, which for the Dow would be about 7500. One of the problems with this, however, like all charts and technical formations is the count, i.e., where we are in the formation. We have noticed that the various points are labeled differently by each of the analysts, except that all seem to agree that point 2 was to the October 2002 bottom, and that point 23 may have been seen.

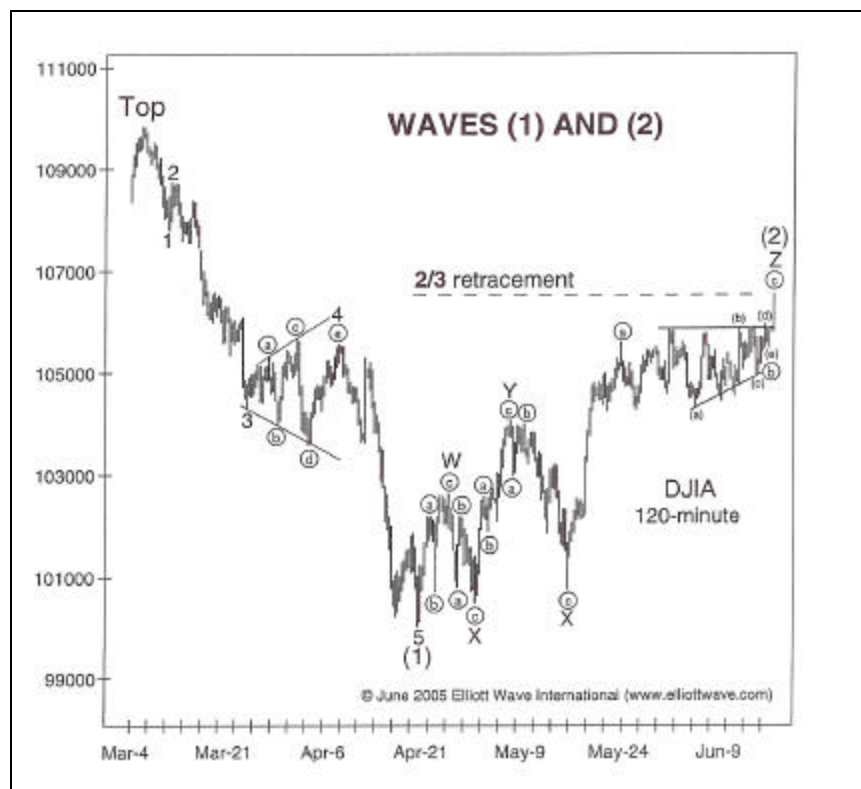
Another technical forecasting tool is the Bradley, a model developed in 1948 by David Bradley, which describes the methodology for market forecasting by using harmonic angles between two-planet pairs.



Source: Crawford Perspectives

At this time, the Bradley forecasting model, pictured here, calls for a July top in the market and a decline until the end of the year. The problem here is that the Bradley, while often right, many times reverses itself, and a projected top becomes a bottom. It is interesting and is worth paying attention to, but certainly not something on which you would bet the farm.

Another negative fly in the ointment is the analysis by Robert Prechter of *The Elliott Wave Theorist* that the Dow has reached its .667 retracement of Wave (1) from the March top, and therefore, would be at the end of Wave (2) where we are faced with Wave (3) to the downside. The problem here is that Prechter has often been wrong and modifies his stance, depending upon what happens in the future. Well, even a broken clock is right twice a day.

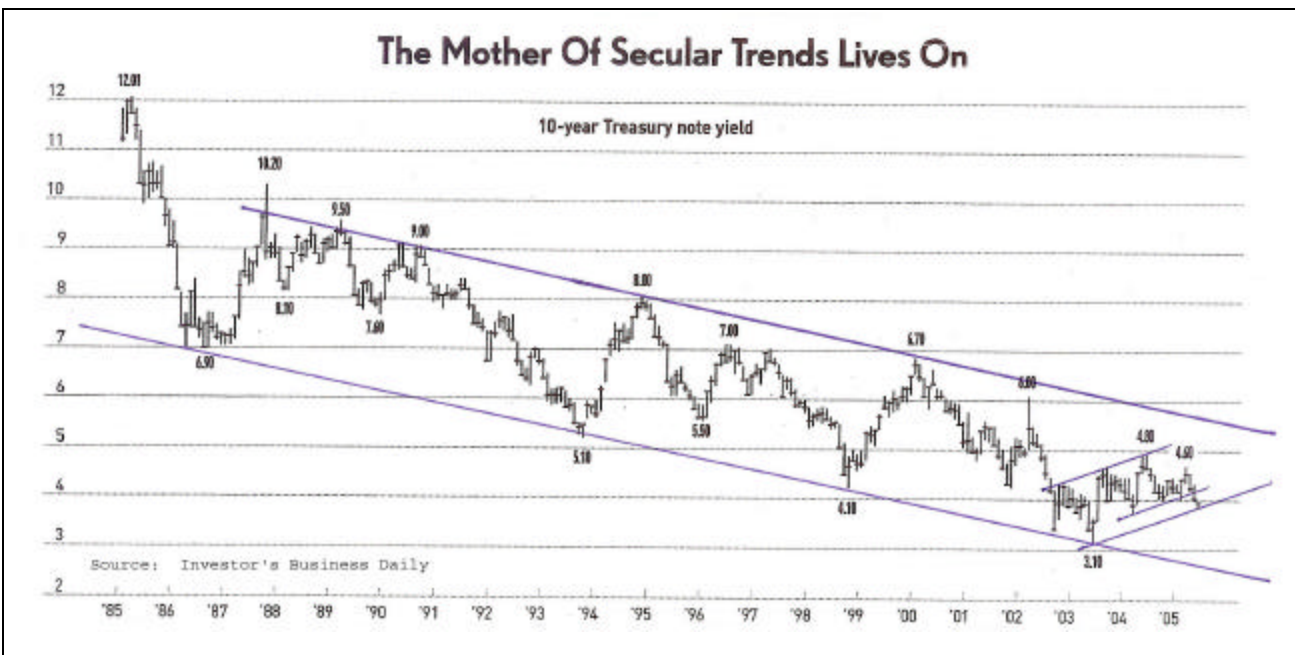


On the other side of the coin, there are equally favorable technical forecasts which are projecting higher markets ahead. Lowry's Advisory, which has been in existence since 1938 currently suggests that there is one more major upside move in the market. In Lowry's 67-year history, their selling pressure index has always turned up at least three months, and usually longer, prior to a major market top, and this has not yet happened.

Furthermore, Lowry's buying power index has tended to decline well before a top, but that index recently advanced to within a few points of its record high. Finally, Lowry's also points out that the advance-decline lines

typically top out months prior to a major top in the stock market, and yet as recently as the end of June their various advance decline lines rose to record highs, which based upon history should extend the life of the present uptrend.

Another important fundamental indicator is the level of interest rates. Despite the continued increases in short rates by the Fed, long-term rates have continued to decline providing fuel for economic growth, the housing boom, and the stock market. We all know that long-term rates represent the rent for money and a premium which is roughly equal to the projected rate of inflation. With long rates at the 4% level, the implication is for inflation of 3%, but that may be high as the numbers seem to indicate that the rate of inflation is less than 3%. If that is the case, rates may very well, once again, move down toward the 3% level, which is exactly what Bill Gross of PIMCO Advisors, the largest bond manager in the world, is suggesting will happen. The chart of bond prices and yields shows this very long downtrend which began in 1985, and which continues to this very day. Yes, of course, at some point it will change, but rather than spiking up dramatically we suspect that interest rates will stay low for quite some time to come. There are many benefits of these low long-term rates, as we said, for the economy, stock market, and housing, but also for the dollar which has been rallying quite dramatically.



The famous Charles H. Dow, founder of *The Wall Street Journal* and inventor of the Dow Theory, said the following many years ago: "There is always a disposition in people's minds to think that existing conditions will be permanent. When the market is down and dull, it is hard to make people believe that this is the prelude to a period of activity and advance. When prices are up and the country is prosperous, it is always said that while preceding booms have not lasted, there are circumstances connected with this one which make it unlike its predecessors and give assurance of permanency. The one fact pertaining to all conditions is that they will change." We feel the same way about the stock market at this juncture. The market has been in the toilet, so to speak, since January 1

and there is a prevalence for people to project the most recent past into the future, and hence, at the moment, a lot of people believe the market has nowhere to go but down. This is very reminiscent of just a few short months ago when the esteemed Warren Buffett, Bill Gates, and others said that the US dollar had nowhere to go but down. Well, those statements were made almost coincidentally with the bottom of the dollar. At the moment, we are wondering if we aren't getting set up with a good old-fashioned bear trap. So despite all the naysayers we are going to stick with our prognostication of an up market in 2005. Meanwhile, of course, as we have stated so frequently, and especially again in our last quarterly letter, stock selection has become paramount, which is why we spend so much time talking to managements, listening to telephone updates, and attending annual meetings and company conferences.

### IN OUR SPARE TIME

There is a perception that investment managers, like those at Perkins Capital Management, pick stock investments by some kind of remote control leaving the manager lots of time to golf with clients or perhaps just take it easy. The reality is that a lot of time is spent visiting company managements, talking to analysts, attending conferences, listening to conference calls, doing research reading, examining charts and market data, and looking at companies via the web. Then there is the time spent actually reviewing portfolios, looking to move from the weaker holdings to those that may be more attractive and have more potential, and there are meetings with existing and prospective clients. We thought it might be of interest to our readers to see the activity at Perkins Capital Management from January 1 to June 30, the first six months of our 21<sup>st</sup> year in business.

First, company meetings. We have met with the following companies, either in our offices, at their facilities or at a group luncheon meeting :

Aastrom Biosciences	EndoCare	Socket Communications
Actel Corp	EZCorp	Sonic Foundry
Affymetrix	Genus/Aixtron, AG	Sonic Solutions
Amer. Superconductor	Globecomm Systems	Sound Surgical Technologies
BottomLine Technologies	HEI, Inc.	Stratex Networks
CABG Medical	Infocrossing	TVI Corp
Cardiogenesis	Isis Pharmaceuticals	3d Systems
Cash Systems	I-Trax	Trintech Group
Casual Male Retail Group	Lakes Entertainment	Urologix
Chroma Vision	LifeCell	Uroplasty
Conmed	MedicalCV	Vasco Data Security
Criticare Systems	Netmanage.com	VioQuest Pharmaceuticals
Curon Medical	OrthoVita	Winland Electronics
Digital Angel	PC Mall	Wipro
EP MedSystems	Parlux Fragrances	Wits Basin Precious Metals
Decode Genetics	ProDex	Workstream
El Capitan Precious Metals	Quinton Cardiology Systems	Youbet.com

We receive numerous telephone calls each day from brokers and analysts as well as company representatives. We don't really keep track of who talked to whom, but usually the information is passed on to the other portfolio managers either via e-mail, memos, our Monday morning research meeting or on the spur of the moment in the hallway. Often however, these messages are either recorded by the recipient and then passed on to the other portfolio managers or if they are voice mail messages to begin with, they are always passed on to the other portfolio managers.

We participate in conference calls with company managements, particularly the calls after the release of earnings. These are reflected in advance on our calendar and, as it turns out, there were 50 such conference calls which we listened to during this first six months.

There are numerous analysts from brokerage firms and other independent research organizations which come to see us; there were 13 such visits in the first six months. Then, there are also the meetings with those independent organizations we pay, and there was one such meeting with the Leuthold Organization and another with *The Institutional Strategist* (Larry Jeddelloh) in the first half of the year. We also attended three Twin City Society of Security Analysts meetings.

Additionally, there are the annual meetings which we attend. We try to go to as many of these as possible, because this affords an opportunity to meet members of management whom we may not have met previously as well as other fellow shareholders. It is often enlightening to hear the questions from the other shareholders. Since most companies have a December 31 year-end, the big annual meeting season begins in March, and this year there were 33 local meetings which we attended or could have attended.

We should also mention that for several accounts, especially one large union portfolio, we invest in private companies, and in that regard we meet frequently with those managements. There were 18 such meetings in the first half.

Finally, we are given the opportunity to go to conferences which are sponsored either by brokerage firms or by other organizations. In any week we could go to several but that, of course, would be impossible. The ones we did attend are shown here:

May 16-18	AEA MicroCap Conference, Monterey, CA	RCP
April 21-22	EdgeWater Conference, Las Vegas, NV	HAL
Feb 22-23	Roth Conference, Laguna, CA	HAL
June 6-9	Pacific Growth Equity Conf., San Francisco, CA	RWP, RCP & HAL
June 9	Craig-Hallum Conference, Minneapolis, MN	RCP & DSP

So, taken all together, we spend much of our time in a research mode of one kind or another. The actual portfolio structure also takes time which means we put in long days, often including Saturdays and stock market holidays. We spend much of each day, and often each evening, reading the written research which we buy or receive from brokers, usually now via e-mail. So, contrary to common opinion, we do not have some kind of remote control equipment to manage the funds which clients have entrusted to us. We do,

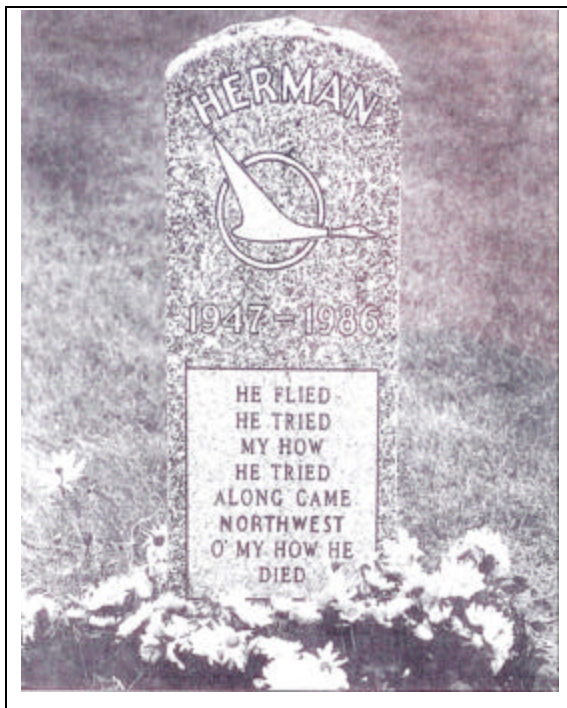


however, use chart analysis as a tool to help us determine the time or price at which to make an investment in a company which we have chosen through our fundamental research. Our technical analyst, Chris Dvorak, is very talented in this regard and gives us a great deal of assistance.

### IT'S DEJA VU ALL OVER AGAIN

If you live in Minnesota, you have come to tolerate Northwest Airlines, or Northworst, as it is unaffectionately known in these parts. Northwest's history is interesting, having started on September 1, 1926, as Northwest Airways, a mail carrier between Minneapolis-St. Paul and Chicago. It carried its first paying passengers in mid-1927 and over the years transformed itself from a fledgling regional carrier to an international airline. Perk remembers when Donald Nyrop, the no-nonsense head of the FAA came to Minneapolis in 1954 as president to "fix" it, and he did. It was no frills for Nyrop who cracked a long whip. Among other things, he built offices without windows (that building is still used) so employees wouldn't fritter away time staring outside. It is also said that he took the doors off the toilet stalls so that employees wouldn't waste time in the biffy. Under his leadership, it grew, prospered, and ultimately became a target for takeover when other airlines were suffering, which is what Gary Wilson and Al Checci did in 1989. In 1986 Northwest had acquired Republic Airlines, which was born in 1979 when Wisconsin based North Central Airlines merged with Southern Airways. This merger was the first of the consolidations after President Jimmy Carter signed the Airline Deregulation Act in 1978.

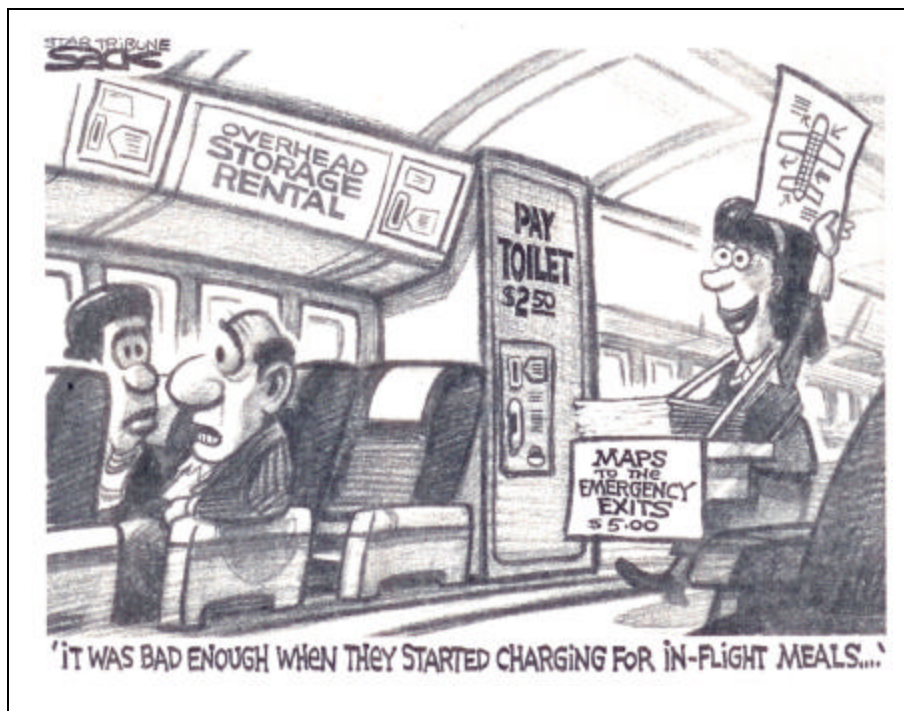
Under the new deregulatory climate, things began to happen and the North Central/Southern Air deal was the first of many. Braniff began route expansion in 1979



and People Express, the first low cost, no frills airline started in 1981. And in 1982, Texas Air took over Continental, and then in 1986 bought Eastern, Frontier, and People Express, folding them all into Continental. The acquisition binge continued with Delta buying Western in 1986, the same year that Northwest acquired Republic. However, the eggs that had been laid in 1978 had hatched, and then the chickens came home to roost 11 years later when both Braniff and Eastern filed Chapter 11. There had been a lot of unhappiness at Northwest after the Republic acquisition, especially by Republic employees and flight attendants. North Central's emblem, Herman the goose (actually a mallard duck), was put to rest with a commemorative tombstone by Republic employees. As Perk recalls, it had to do with the Republic flight attendants and others getting their pay brought up to "parity" with their more

highly paid Northwest counterparts, which was part of the deal, but it didn't happen for several years, and then only partially. The chickens continued to fly home to roost, as Continental went bankrupt in 1990, Pan Am in 1991, and TWA in 1992. Eastern had already closed up shop in 1991, and Braniff died altogether in 1992. Times were tough for the airlines then, just as they are now. Most of us have forgotten that the Minnesota legislature ponied up \$838 million in financial assistance for Northwest in 1991 under the threat that the airline would move its home base, putting thousands of Minnesotans out of work. That threat worked, as did a bankruptcy threat in 1993, when its unions agreed to wage concessions totaling \$886 million. Sound familiar? So here we are today, 13 years later, with the same threats—moving maintenance to a lower cost environment, and bankruptcy if wage concessions totaling at least \$1.1 billion cannot be achieved. And Wilson, Northwest's Chairman, has evidently thrown in the towel after 16 years, having sold 2/3 of his stock so far this year. The Northwest mechanics union, under pressure, recently offered \$143 million per year in pay cuts, which Northwest blew off because it falls short of the \$176 million of labor cost reductions which they had pinpointed for the mechanics as part of the \$1.1 billion savings they are trying to achieve. Watch out, the mechanics vote on a strike in July and the flight attendants are up next. More than likely, we will see a strike this summer or fall.

The problem for Northwest and the other major carriers (American, United, Delta and Continental) is the cost structure of their hub-and-spoke modality compared to the



Southwest example of a go and return structure. In the blame-game, the fingers are pointed at the 9/11 disaster and what it did to airline travel, and now the second punch of high fuel costs, but the fact is that the turmoil, and the major carrier bankruptcies, started right after deregulation allowed low cost carriers to take a bite out of the big, inefficient guys and today the low cost boys have 30% or more of the market. The flying public has benefited through lower

fares, but the workers and shareholders (owners) have been hurt. Yes, 9/11 did impact air travel and made the situation worse, and rising fuel prices don't help, but it all goes back to deregulation which puts the major carriers in a position where they can't raise fares.



Here in Minnesota, the cost saving antics of Northwest have become somewhat comical, as depicted by the cartoons on page eight and nine. The first thing to go were the meals, which passengers are now required to pay for, and which weren't any good anyway. Recently, Northwest stopped giving away free pretzels, which will save \$2 million per year. Perk has the same opinion about the pretzels, which were an inexpensive substitute for

peanuts. Later the pillows were pulled to eliminate weight and magazines have now suffered the same fate. The most recent money saving tactic is to charge \$2 for each bag checked curbside. We haven't been able to find out how many bags are checked curbside, so we don't know the potential income to Northwest, but one thing is certain, and that is that this will severely impact the earnings of the skycaps, who earn \$12 per hour,



and thus depend on tips to augment their wages. Most people, including us, tip \$2 per bag (it used to be \$1) which will now go to Northwest, and nothing will go to the skycap, unless an additional tip is provided. This trend will likely continue, with free soda the next thing to go, and with additional charges for any other amenity whatsoever. Over time, the European model where you pay for everything will ultimately prevail; there you pay for your food, your soda, \$5 per pound for luggage in excess of 34 pounds, and a premium for special seats such as the exit row (Virgin Atlantic), and even for just a pre-assigned seat. Get ready. It is just a matter of time.

But in the final analysis, it really boils down to the cost structures, which for the major hub and spoke carriers is out of line with the destination and return carriers such as Southwest, Jet Blue, and others. If the flying public wants no frills, and cheap fares, they are available in most cities, even Minneapolis, where we have Air Tran and Sun Country. Not as convenient as Northwest, with maybe an airplane change in a city along the way or just one stop versus nonstop, but it can be done. In fact, Northwest says that 87% of their Minneapolis-St. Paul travelers have a choice of another airline to get to their destinations. However, we pretty much fly Northwest because they have us hooked on their WorldPerks miles program, and because the choice of flights is significantly greater than with the others.

A little humor is in order at this point and so we thought we would leave you with some announcements made by flight attendants and pilots on actual flights. Here they are:

“Welcome aboard Southwest Flight 245 to Tampa. To operate your seat belt, insert the metal tab into the buckle, and pull tight. It works just like every other seat belt; and, if you don’t know how to operate one, you probably shouldn’t be out in public unsupervised.”

“In the event of a sudden loss of cabin pressure, masks will descend from the ceiling. Stop screaming, grab the mask, and pull it over your face. If you have a small child traveling with you, secure your mask before assisting with theirs. If you are traveling with more than one small child, pick your favorite.”

“Weather at our destination is 50 degrees with some broken clouds, but we’ll try to have them fixed before we arrive. Thank you, and remember nobody loves you, or your money, more than Southwest Airlines.”

“Your seat cushions can be used for flotation; and, in the event of an emergency water landing, please paddle to shore and take them with our compliments.”

“As you exit the plane, make sure to gather all of your belongings. Anything left behind will be distributed evenly among the flight attendants. Please do not leave children or spouses.”

And from the pilot during his welcome message: “Delta Airlines is pleased to have some of the best flight attendants in the industry. Unfortunately, none of them are on this flight.”

After a very hard landing in Salt Lake City, the Southwest flight attendant said on the intercom: “That was quite a bump, and I know what you all are thinking. I’m here to say it wasn’t the airline’s fault, it wasn’t the pilot’s fault, it wasn’t the flight attendant’s fault, it was the asphalt.”

Now that you are warmed up, and in a good mood, read the following titled **‘If Airlines Sold Paint,’** which is a spoof on the three-week advance ticket purchase, the Saturday night stay, and other ridiculous airline rules. Here we go:

**Customer:** Hi, How much is your paint?

**Clerk:** Our lowest price is \$12 a gallon, and we have 60 different prices, up to \$200 a gallon.

**Customer:** What’s the difference in the paint?

**Clerk:** It’s all the same paint.

**Customer:** Then I’d like some of the \$12 paint. And I want to paint tomorrow.

**Clerk:** Sir, the paint for tomorrow is \$200.

**Customer:** How do I get the \$12 paint?

**Clerk:** You buy the paint now, but agree not to paint for three weeks. And you must paint over a Saturday night.

**Customer:** You’ve got to be kidding!

**Clerk:** Oh, the price per gallon just went to \$16.

**Customer:** The price went up as we were talking?

**Clerk:** Yes, sir. We change the prices and rules hundreds of times a day. So I suggest you purchase your paint as soon as possible. How many gallons do you want?

**Customer:** Five gallons. Make that six, so I’ll have enough.

**Clerk:** Well, sir, if you buy paint and don’t use it, there are penalties and possible confiscation of paint you already have.

**Customer:** Forget it! I’ll buy what I need somewhere else.

**Clerk:** I'm sorry, sir. You can buy paint for your bathroom and bedrooms from someone else, but you can only buy paint for your connecting hall from us. That'll be \$300 a gallon.

**Customer:** You're insane.

**Clerk:** Thanks for painting with us, sir.

Now you know why the major airlines have a problem.

## THE UN-UNITED STATES OF EUROPE

Most Americans are oblivious to news about the rest of the world, except perhaps for the war in Iraq and Afghanistan, and China due to the newsworthiness of the Chinese economy and its exports to America, which exacerbates our balance of trade. But beyond that, we think the average American pays scant attention to what goes on in the rest of the world, despite the fact that they should, because what happens overseas increasingly affects the U.S. and its residents. In Europe, right now, there are events which have taken place which could have a long-term impact on the U.S.

On May 29 and June 1, the French and Dutch rejected the European Union constitution in referendums which brought out a large number of voters. The French voted "non" by a 10% margin, while the Dutch, with the hindsight benefit of the French margin said "nee" with a whopping 24% margin at 62-38%. After years of study and liaison work, twelve countries of Europe finally adopted the Euro on January 1, 2002; the hold out countries were Great Britain, Switzerland, Norway, Sweden, and Denmark. The next thing that was to come was a European Union constitution, one that to come into force required ratification by all 25 members of the EU. Additional referendums are to be held in Denmark, Poland and even in Luxembourg in July. Further rejections are likely, perhaps even in Luxembourg where the prime minister is the current president of the EU. Of course, those who make the rules can change the rules, so it is possible that a coalition of politicians, bureaucrats, and businessmen who badly want to see a constitution adopted may ultimately suggest either that the rules have been misinterpreted or that a referendum does not constitute a repudiation of the entire notion of a European Union. In fact, when the text of the constitution was signed by the EU leaders in Rome last October a declaration was attached which said, in effect, that if in two years four-fifths of the countries had ratified, a EU summit could be held to consider the situation. So, although the dream of a European Union constitution has been flushed down the toilet for now, the fat lady still has probably not sung.

But even so, the reasons for the "non" and "nee" votes are as real as they are different for the French and the Dutch, and as they will be for others. The French, besides not wanting to lose their national identity, were really stating that economic times are difficult, jobs are scarce (10% unemployment) and above all, they do not want to give up any of their numerous social benefits. They are afraid of globalization, and cheap products from Asia, which take French jobs. The Dutch, like the French, are confronted with a problem of their own making, as they have given sanctuary over the years to 1.7 million immigrants, almost none of whom share the Dutch political or religious history. Many are Muslims and, like

France, the Dutch are afraid of losing their sense of history and national identity. Throughout Europe there is the belief that the Euro is the cause of price increases which have made small- and medium-sized companies uncompetitive. In fact, the Italian labor minister is stumping to scrap the Euro and bring back the Lira. We think that is unlikely, but this kind of sentiment virtually assures that Britain will never accept the Euro, for these very dangers were warned about many years ago by Prime Minister Maggie Thatcher, and it is why she and subsequent British officials resisted Britain's entry into the EU and the elimination of the British pound in favor of the Euro.

As we noted earlier, the French want to keep the socialist perks which they have been able to achieve over the years. We are readers of Bill Bonner's *International Living* and in the first issue of volume 25, celebrating the 25<sup>th</sup> anniversary of the publication, he wrote about his family's move to France 10 years ago and gave readers a little insight into French regulation. He said, "France is the most taxed, highly regulated country on earth. For example, they have this rule about the 35-hour work week. Thirty-five hours is crazy, because the French have six weeks of vacation every year, plus lots of paid sick leave. But this law says they can only work 35 hours. There are inspectors to check. Seven o'clock at night they look in buildings to see if lights are on, and if they are, they come into the office. They want to know why the employees are there. If the employee explains that he is trying to catch up on work, he is told he can't do that. I tell the inspector that I didn't ask the employee to stay late, but that's not good enough. You're not allowed to let employees work more than 35 hours. It's crazy." And, as Bill says, if you have problems with an employee that you want to fire, you can't do it. That employee more than likely belongs to a union, and therefore cannot be fired. John Mauldin, author of *Bull's Eye Investing*, produces a weekly dissertation available at [www.frontlinethoughts.com](http://www.frontlinethoughts.com), and in one of his recent issues told his readers about the unions which represent the French National Electric Company and the fantastic deal that the workers have negotiated for themselves over the years. They have guaranteed lifetime employment, a 90% discount on their power bills, free health care, subsidized meals, housing, and vacations as well as a pension of up to 75% of what you made when you retire, plus an option of early retirement. Small wonder then that the French do not want to accept change, for change is always painful, even when it is good change. The *Strategic Forecasting* letter, after the French and Dutch referendums, pointed out that the United States is a lucky country after all, because the internal dynamic of Europe has solved a problem for Washington. The US remains the only large power that is united, relatively secure in its frontiers and possessing a uniformly developed economy. Europe could have been the second, but it is likely not to be. And now circling back to where we started, all of this will have an impact here in the United States, presumably a good one.

## PASSINGS

On April 6, Prince Rainer III of Monaco, born May 31, 1923 into the famed Grimaldi family which had owned the land since 1297, passed on at the age of 81. Today Monaco has its fame as home of the Monte Carlo gambling casino, and a seaport for wandering jet set



playboys and their girls. All this is true today, but once upon a time Monaco was close to bankruptcy when Rainer, not yet 26 years of age, succeeded his grandfather Louis II in 1949. Despite his fascination for fast cars and beautiful women (he was often referred to as Prince Sportif), he found a way to revive it, primarily through the financial support of Aristotle Onassis, who bought into the casino and, therefore, renewed interest in the little principality which, by the way, is only about one square mile in size. But the big news was made nearly 50 years ago, so most Americans don't even remember it. A beautiful American movie star, Grace Kelly, married the Prince in 1956. They had met in 1955 when she was at Cannes for the showing of her film "*The Swan*," where she played a princess and then became a real life princess a year later. This was news that literally took over the Hollywood gossip columns for quite some time—a storybook romance with a prince on the Mediterranean Sea! This publicity also helped Monaco, and soon it was back on its way to prosperity. Prince Rainer and Princess Grace had three children, Princesses Stephanie and Caroline, and Prince Albert. But in the end, it was not the storybook marriage of living "happily forever after," for Princess Grace was killed in an unfortunate auto crash in the mountains in 1982, a loss from which Prince Rainer really never recovered. Their daughters had a series of marriages, divorces, and children with a variety of individuals, some of whom they married, and some of whom they didn't, ranging from a bodyguard to an Austrian prince. But Prince Albert never married, and in 2002 when Rainer's health began to fail, Monaco's succession law was changed to allow power to pass from a reigning prince who has no descendents to his siblings, so as to preserve the continuity of members of the Grimaldi family, the rulers of Monaco. But now there is a new twist to this story about this amazing family. On July 6, Prince Albert declared that he is not childless, and officially recognized paternity to a boy born nearly two years ago to a French-Togolese woman, Nicole Coste, a former flight attendant whom he met in 1997 on an Air France flight to Paris from the French Riviera. This little boy, Alexandre, will now be the principal heir of the Grimaldi family, so a storybook country with a history of storybook romances has just given the world another one. And by the way, we forgot to mention that Prince Rainer's mother was the daughter of Prince Louis Grimaldi, who had fathered her in a liaison with his laundress while stationed with the French Army in Algeria. Even a gifted author could not dream all of this up.

## FINI

We usually have more articles which we think would be of interest to our readers than space to print them. We read a lot, probably more than most people, other than Richard Russell. Perk does six newspapers a day and would like to do more, reads numerous magazines, reams of printed e-mails and as many books as he can fit in. We try to balance the inclusion of serious articles with our humorous items in our addendum pages to these letters. This quarter we have only one page of humor, a spoof about Luteran Air, sent in by Peg Strickland, which is on the very back page. The first three pages are a wonderful, thoughtful read for all of you and something to pass on to your spouse, children, other relatives, and those with whom you work. Are you ready? It is the commencement address given a few weeks ago at Stanford University, by Steve Jobs, CEO of Apple

Computer and Pixar Animation Studios. His story gives more credence to our philosophy that things always happen for a reason.

Finally, it is the fishing season in Minnesota, and the cartoon is a wonderful explanation of what happens when we go fishing.

Sincerely,

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RWP:RCP:DSP/jah



## ***Commencement address by Steve Jobs at Stanford on June 12, 2005.***

"I am honored to be with you today at your commencement from one of the finest universities in the world. I never graduated from college. Truth be told, this is the closest I've ever gotten to a college graduation. Today I want to tell you three stories from my life. That's it. No big deal. Just three stories.

The first story is about connecting the dots.

I dropped out of Reed College after the first 6 months, but then stayed around as a drop-in for another 18 months or so before I really quit. So why did I drop out?

It started before I was born. My biological mother was a young, unwed college graduate student, and she decided to put me up for adoption. She felt very strongly that I should be adopted by college graduates, so everything was all set for me to be adopted at birth by a lawyer and his wife. Except that when I popped out they decided at the last minute that they really wanted a girl. So my parents, who were on a waiting list, got a call in the middle of the night asking: "We have an unexpected baby boy; do you want him?" They said: "Of course." My biological mother later found out that my mother had never graduated from college and that my father had never graduated from high school. She refused to sign the final adoption papers. She only relented a few months later when my parents promised that I would someday go to college.

And 17 years later I did go to college. But I naively chose a college that was almost as expensive as Stanford, and all of my working-class parents' savings were being spent on my college tuition. After six months, I couldn't see the value in it. I had no idea what I wanted to do with my life and no idea how college was going to help me figure it out. And here I was spending all of the money my parents had saved their entire life. So I decided to drop out and trust that it would all work out OK. It was pretty scary at the time, but looking back it was one of the best decisions I ever made. The minute I dropped out I could stop taking the required classes that didn't interest me, and begin dropping in on the ones that looked interesting.

It wasn't all romantic. I didn't have a dorm room, so I slept on the floor in friends' rooms, I returned coke bottles for the 5¢ deposits to buy food with, and I would walk the 7 miles across town every Sunday night to get one good meal a week at the Hare Krishna temple. I loved it. And much of what I stumbled into by following my curiosity and intuition turned out to be priceless later on. Let me give you one example:

Reed College at that time offered perhaps the best calligraphy instruction in the country. Throughout the campus every poster, every label on every drawer, was beautifully hand calligraphed. Because I had dropped out and didn't have to take the normal classes, I decided to take a calligraphy class to learn how to do this. I learned about serif and san serif typefaces, about varying the amount of space between different letter combinations, about what makes great typography great. It was beautiful, historical, artistically subtle in a way that science can't capture, and I found it fascinating.

None of this had even a hope of any practical application in my life. But ten years later, when we were designing the first Macintosh computer, it all came back to me. And we designed it all into the Mac. It was the first computer with beautiful typography. If I had never dropped in on that single course in college, the Mac would have never had multiple typefaces or proportionally spaced fonts. And since Windows just copied the Mac, it's likely that no personal computer would have them. If I had never dropped out, I would have never dropped in on this calligraphy class, and personal computers might not have the wonderful typography that they do. Of course it was impossible to connect the dots looking forward when I was in college. But it was very, very clear looking backwards ten years later.

Again, you can't connect the dots looking forward; you can only connect them looking backwards. So you have to trust that the dots will somehow connect in your future. You have to trust in something - your gut,

destiny, life, karma, whatever. This approach has never let me down, and it has made all the difference in my life.

My second story is about love and loss.

I was lucky – I found what I loved to do early in life. Woz and I started Apple in my parent's garage when I was 20. We worked hard, and in 10 years Apple had grown from just the two of us in a garage into a \$2 billion company with over 4000 employees. We had just released our finest creation - the Macintosh - a year earlier, and I had just turned 30. And then I got fired. How can you get fired from a company you started? Well, as Apple grew we hired someone who I thought was very talented to run the company with me, and for the first year or so things went well. But then our visions of the future began to diverge and eventually we had a falling out. When we did, our Board of Directors sided with him. So at 30 I was out. And very publicly out. What had been the focus of my entire adult life was gone, and it was devastating.

I really didn't know what to do for a few months. I felt that I had let the previous generation of entrepreneurs down - that I had dropped the baton as it was being passed to me. I met with David Packard and Bob Noyce and tried to apologize for screwing up so badly. I was a very public failure, and I even thought about running away from the valley. But something slowly began to dawn on me – I still loved what I did. The turn of events at Apple had not changed that one bit. I had been rejected, but I was still in love. And so, I decided to start over.

I didn't see it then, but it turned out that getting fired from Apple was the best thing that could have ever happened to me. The heaviness of being successful was replaced by the lightness of being a beginner again, less sure about everything. It freed me to enter one of the most creative periods of my life.

During the next five years, I started a company named NeXT, another company named Pixar, and fell in love with an amazing woman who would become my wife. Pixar went on to create the world's first computer animated feature film, *Toy Story*, and is now the most successful animation studio in the world. In a remarkable turn of events, Apple bought NeXT, I returned to Apple, and the technology we developed at NeXT is at the heart of Apple's current renaissance. And Laurene and I have a wonderful family together.

I'm pretty sure none of this would have happened if I hadn't been fired from Apple. It was awful tasting medicine, but I guess the patient needed it. Sometimes life hits you in the head with a brick. Don't lose faith. I'm convinced that the only thing that kept me going was that I loved what I did. You've got to find what you love. And that is as true for your work as it is for your lovers. Your work is going to fill a large part of your life, and the only way to be truly satisfied is to do what you believe is great work. And the only way to do great work is to love what you do. If you haven't found it yet, keep looking. Don't settle. As with all matters of the heart, you'll know when you find it. And, like any great relationship, it just gets better and better as the years roll on. So keep looking until you find it. Don't settle.

My third story is about death.

When I was 17, I read a quote that went something like: "If you live each day as if it was your last, someday you'll most certainly be right." It made an impression on me, and since then, for the past 33 years, I have looked in the mirror every morning and asked myself: "If today were the last day of my life, would I want to do what I am about to do today?" And whenever the answer has been "No" for too many days in a row, I know I need to change something.

Remembering that I'll be dead soon is the most important tool I've ever encountered to help me make the big choices in life. Because almost everything – all external expectations, all pride, all fear of embarrassment or failure - these things just fall away in the face of death, leaving only what is truly



important. Remembering that you are going to die is the best way I know to avoid the trap of thinking you have something to lose. You are already naked. There is no reason not to follow your heart.

About a year ago I was diagnosed with cancer. I had a scan at 7:30 in the morning, and it clearly showed a tumor on my pancreas. I didn't even know what a pancreas was. The doctors told me this was almost certainly a type of cancer that is incurable, and that I should expect to live no longer than three to six months. My doctor advised me to go home and get my affairs in order, which is doctor's code for prepare to die. It means to try to tell your kids everything you thought you'd have the next 10 years to tell them in just a few months. It means to make sure everything is buttoned up so that it will be as easy as possible for your family. It means to say your goodbyes.

I lived with that diagnosis all day. Later that evening I had a biopsy, where they stuck an endoscope down my throat, through my stomach and into my intestines, put a needle into my pancreas and got a few cells from the tumor. I was sedated, but my wife, who was there, told me that when they viewed the cells under a microscope the doctors started crying because it turned out to be a very rare form of pancreatic cancer that is curable with surgery. I had the surgery and I'm fine now.

This was the closest I've been to facing death, and I hope it's the closest I get for a few more decades. Having lived through it, I can now say this to you with a bit more certainty than when death was a useful but purely intellectual concept:

No one wants to die. Even people who want to go to heaven don't want to die to get there. And yet death is the destination we all share. No one has ever escaped it. And that is as it should be, because Death is very likely the single best invention of Life. It is Life's change agent. It clears out the old to make way for the new. Right now the new is you, but someday not too long from now, you will gradually become the old and be cleared away. Sorry to be so dramatic, but it is quite true.

Your time is limited, so don't waste it living someone else's life. Don't be trapped by dogma - which is living with the results of other people's thinking. Don't let the noise of other's opinions drown out your own inner voice. And most important, have the courage to follow your heart and intuition. They somehow already know what you truly want to become. Everything else is secondary.

When I was young, there was an amazing publication called *The Whole Earth Catalog*, which was one of the bibles of my generation. It was created by a fellow named Stewart Brand not far from here in Menlo Park, and he brought it to life with his poetic touch. This was in the late 1960's, before personal computers and desktop publishing, so it was all made with typewriters, scissors, and Polaroid cameras. It was sort of like Google in paperback form, 35 years before Google came along: it was idealistic, and overflowing with neat tools and great notions.

Stewart and his team put out several issues of *The Whole Earth Catalog*, and then when it had run its course, they put out a final issue. It was the mid-1970s, and I was your age. On the back cover of their final issue was a photograph of an early morning country road, the kind you might find yourself hitchhiking on if you were so adventurous. Beneath it were the words: "Stay Hungry. Stay Foolish." It was their farewell message as they signed off. Stay Hungry. Stay Foolish. And I have always wished that for myself. And now, as you graduate to begin anew, I wish that for you.

Stay Hungry. Stay Foolish.

Thank you all very much."

## "New Lutheran Airline"

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Pay attention to Lena, your flight attendant, who vill acquaint you vit da safety system aboard dis Lutheran Air 599.

Okay den, listen up. I'm only gonna say dis vonce. In da event of a sudden loss of cabin pressure, I am frankly going to be real surprised and so vill Captain Ole Olson, because ve fly right around two tousand feet, so loss of cabin pressure vood probably mean da Second Coming or someting of dat nature, and I vouldn't bodar vit doze liddle masks on da rubber tubes. You're gonna have bigger tings to vorry about den dat. Yust stuff doze back up in dair liddle holes. Probably da masks fell out because of turbulence vich, to be honest vit you, ve're going to have quite a bit of at two tousand feet, sorta like driving across a plowed field, but after a vile you get used to it.

In da event of a vater landing, I'd say forget it. Start saying da Lord's Prayer and yust hope you get to da part about forgive us our sins as ve forgive doze who sin against us, vich some people say "trespass against us," vich isn't right, but vat can you do?

Da use of cell phones on da plane is strictly forbidden, not because day may confuse da plane's navigation system, vich is seat of da pants all da way. No, it's because cell phones are a pain in da vazoo, and if God meant you to use a cell phone, He vould have put your mout on da side of your head.

Ve start lunch right about noon and its buffet style vit da coffee pot up front. Den we'll have da hymn sing; hymnals are in da seat pocket in front of you. Don't take yours vit you ven you go or I am going to be real upset and I am not kiddin!

Right now I'll say Grace. "Come, Lord Jesus, be our guest and let deze gifts to us be blessed. Fadar, Son, and Holy Ghost, may ve land in Dulut or pretty close.

Amen!