PERKINS
CAPITAL
MANAGEMENT, INC.

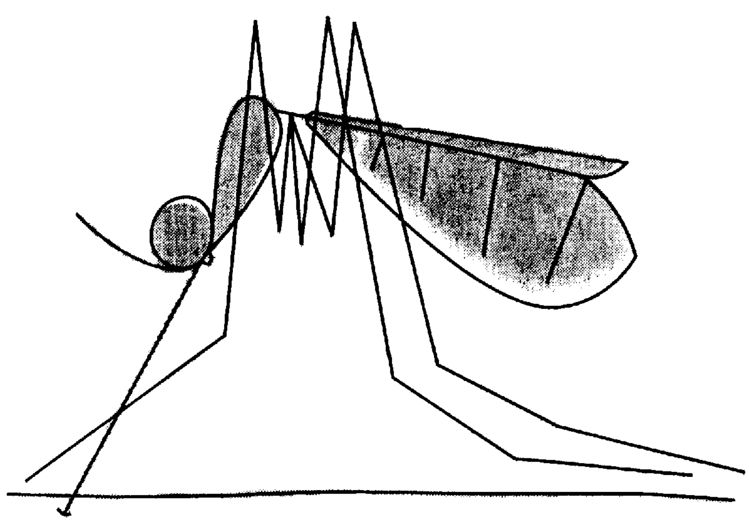
July 26, 2001

Dear PCM Client:

Rain, rain, rain, oh, didn't it rain! That familiar verse told the story for June in Minnesota. We know April showers bring May flowers, but we got very little rain when it was supposed to come in April, and May had some, but gosh, the whole month of June was a soaker. Actually, it rained 17 out of 30 days, a total of 6.35 inches in Minneapolis, well above normal. This has been a great hardship for many people, especially painters, carpenters, gardeners and others who work outside; their schedules were thrown all out-of-whack by the rain. But it was an especially great hardship for the farmers, many of whom were unable to get their crops into the ground until recently. Some crops will never be planted.

Another hardship for the area was the tornadoes. Yes, tornadoes in Minnesota. Most folks think of tornadoes in other Midwestern states, especially Kansas, primarily we suppose because of Dorothy who was swept away in the Wizard of Oz by a great tornado. But here in Minnesota, this year in June alone, there were several reported tornadoes, including the very serious one which cut a wide swath through the town of Benson, located in western Minnesota. On June 20, the small town of Siren, Wisconsin, only a few miles from the Minnesota border, was totally wiped out. But June is gone, and now we're in July with its high temperatures in the 80s and 90s and, of course, no rain. Go figure. But we are still suffering from a surfeit of the Minnesota State Bird, commonly known as a mosquito, a picture of which is shown here in actual size. Because of all the moisture in June, we are experiencing a mosquito invasion far worse than normal. These pesky little critters know no bounds, and will even sneak up on helpless little children. We did some research and found out that there are 50 species of mosquitoes in Minnesota, and a dozen of them bite people. One of the big problems is that mosquito eggs can survive for many

THE ATTACKER



Minnesota State Bird

730 East Lake Street
Wayzata, MN 55391-1769
Telephone (952) 473-8367
Facsimile (952) 473-4702
www.perkinscap.com

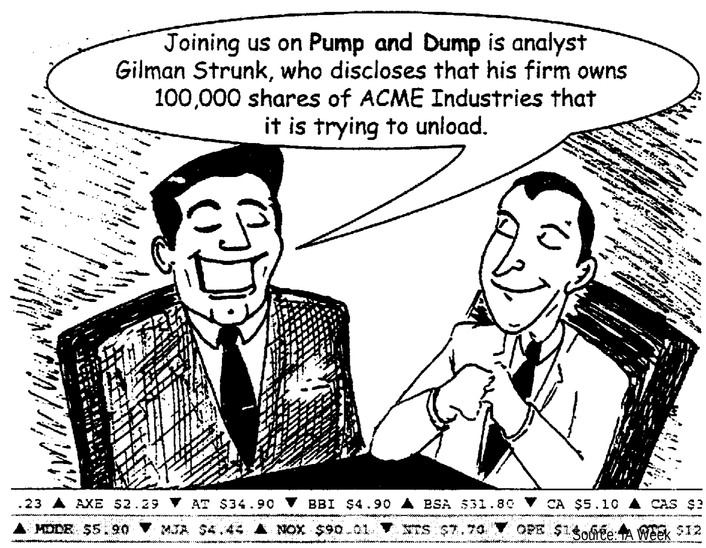
years and all they need is water to hatch. So when we have a huge amount of rain, water gets to places that it hasn't been for awhile and eggs hatch, and hence, this year we have a bumper crop of mosquitoes. It's interesting to note that only the female mosquito bites! Certain mosquitoes transmit LaCrosse encephalitis, and already this season a young boy has been diagnosed with this year's first case. Perk's sister, Mary Ann Perkins, contracted encephalitis when she was five years old, but recovered fully from it. However, there is good news. Scientists have learned why humans are so attractive to mosquitoes, and now a company has developed a device called the "Mosquito Magnet" which mimics a large mammal by emitting a plume of carbon dioxide, heat and moisture, which when combined with Octenol, is irresistible to mosquitoes and other biting insects. This device is portable and can be moved anywhere and located by mosquito breeding areas. It is self-powered by a propane tank, and uses patented counterflow technology to catalytically convert propane into carbon dioxide. We recently saw a news clip on this device on television and were quite impressed. For the modest sum of \$800, you can have a Mosquito Magnet that will cover one half-acre of open space, or for \$1300, you can have one that covers an entire acre. Chris Dahl bought one, but we think we will stick with DEET; it's cheaper.

THE NEMESIS

Mosquito Magnet™

CAVEAT EMPTOR

Let the buyer beware. That is what the SEC recently told investors. In other words, don't rely on what stock analysts say when it comes to picking stocks in which to invest. Evidently, this edict is a result of many complaints which the SEC has received over the past months from citizens about losing large sums of money as a result of following analysts' recommendations. The losses are largely the result of the enormous decline in Internet and other high-tech stocks. Much of this was the irrational exuberance which Greenspan talked so much about. It was a little like the Pied Piper playing his song with all of the rats following him into the sea. And now, this modern Pied Piper has to be paid. So who gets the blame? Not the investors who didn't do any homework or use any common sense with regard to valuations, but the analysts who were paid to write reports for their investment bank employers. Several analysts have been singled out for criticism, most notably, Mary Meeker, Internet analyst at Morgan Stanley, and Henry Blodget, Internet analyst at Merrill Lynch, both of whom endorsed Internet shares at sky-high prices and who now have stopped following many of them. But the fact is that analysts are paid very handsomely (Mary Meeker and Henry Blodget each earned something on the order of $15 million in 1999) to write optimistic reports and make buy recommendations on the shares of companies that their investment bank employers either want to underwrite, or have underwritten, and therefore, need to continue to promote. Investment bankers don't get lucrative underwriting fees from companies whose stocks their analysts either disregard, or disparage by issuing negative reports and opinions. Give us a break! Can the investing public be so naive as to think there is a free lunch hiding there somewhere? Hard to believe, but probably so. Presumably the public must also be unaware of the code which is used for analysts' recommendations; strong buy means "buy" (one you could own), buy means "hold" (ok for your portfolio, but nothing special) and hold means "sell" (get out now while you can). And sell recommendations? A study last December by Thomson Financial reported that 71% of all major analyst recommendations were buy, 28% hold, and only 2% sell. Yes, sell recommendations from brokerages who are also investment banks are as scarce as the proverbial hen's teeth. They can be found much more frequently from those few investment boutiques that have no investment banking axe to grind. But their research is available almost exclusively to institutional clients.



Source: IA Week

There always was supposed to be a "Chinese wall" between underwriting and research, but that concept was always more responsive to the desire to keep inside information, which the investment bankers often got during their due diligence from winding up in the research reports and opinions of analysts. But this wall fell down long ago. There are other conflicts of interest that are also under fire. On June 12, the Securities Industry Association (SIA) adopted a voluntary code for financial analysts to keep them independent from their investment bank employees. These "best practices" guidelines require analysts to clearly disclose their holdings in companies they cover and prohibit them from trading against their own recommendations. Next up at bat was the National Association of Securities Dealers (NASD), which on July 2 proposed a rule requiring analysts at the nation's brokerage firms to disclose "clearly and promptly" any potential conflicts of interest that may influence a stock recommendation. While directed primarily at analysts promoting stocks on television, radio or other public appearances, the same disclaimer of personal holdings also would apply to any sales material prepared by a brokerage firm, including advertisements and research reports. Under this proposed rule, which the industry must comment on by August 15, an analyst making a recommendation would have to divulge any financial interest which he or she holds in the security or whether an account managed by the analyst includes any such holding. Also, the analyst would have to state whether the firm had received compensation from the issuer of the security for investment banking services provided during the previous 12 months.

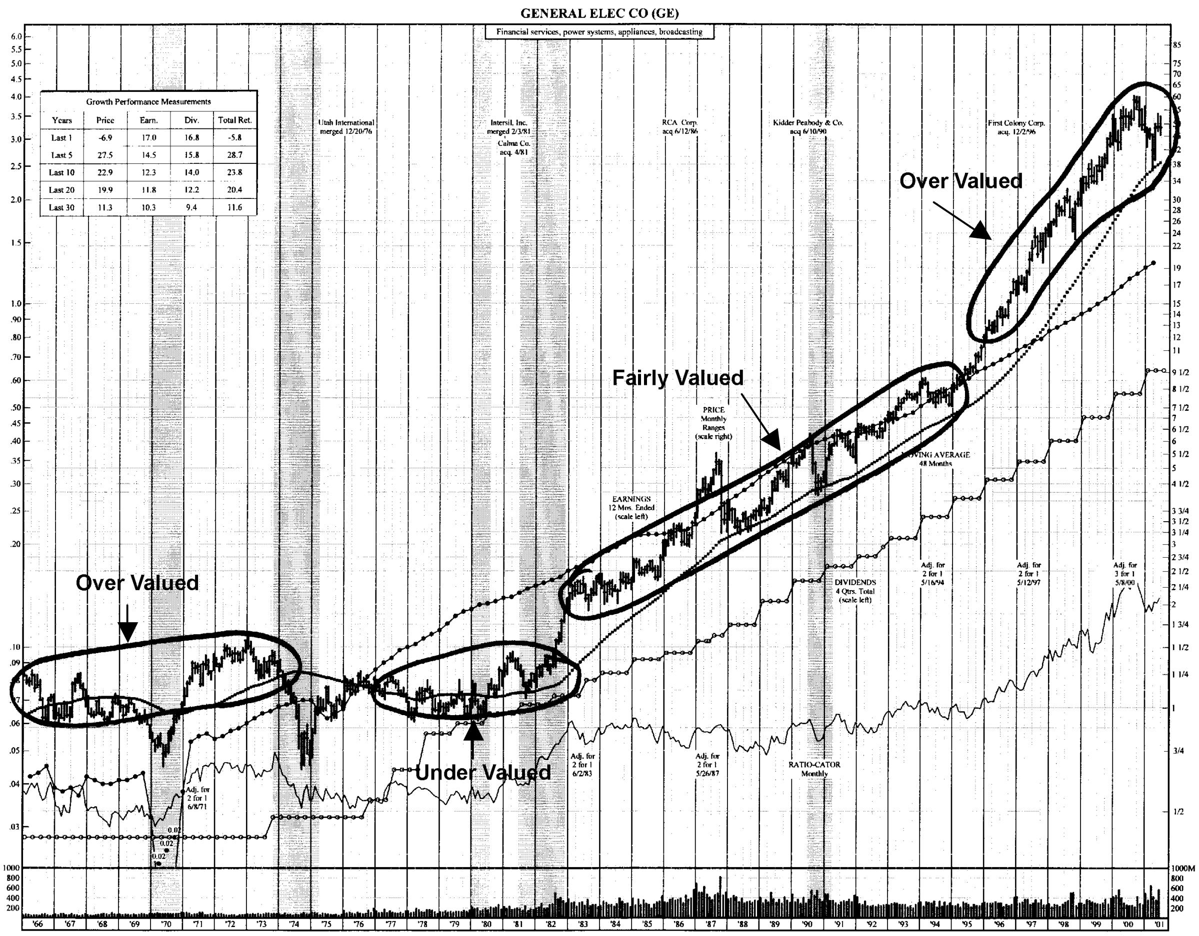
But the more rules there are, the more likely it is that we will continue to get earnings surprises, those startling shortfalls in earnings vs. projections that cause breathtaking drops in stock prices - - free-falls in many cases. Why have there been so many earnings surprises? Well, for one thing, it may go back to the analyst's desire to stay on the good side of investment banking clients, but more likely it is the statistical inevitability of such matters, plus the fact that we are now feeling the effect of regulation Fair Disclosure, commonly called FD. We have discussed the analysts' culpability in the previous paragraphs, but what about statistical probabilities? Like the flip of a coin many times, with heads following heads many times, so it is that there can be a "serial correlation of surprises," i.e., that surprises in a particular direction, either up or down, tend to be followed by more in the same direction. As one wag put it recently, "Earnings surprises are like cockroaches. You rarely see just one." We have been aware of this for years, saying that the first earnings shortfall will not be the last. But now we have Regulation FD, put into effect last fall by the SEC, which requires public companies to announce significant information to everyone at the same time, rather than to a select few. The idea here was to level the playing field by giving the individual investor access to the same information as the institutional investor at the same time. Gone, (maybe) is the familiar practice of giving analysts one-on-one access to top company officers to receive "guidance" with regard to earnings and other corporate secrets. And so, it has come to pass that there should not be any special information given to special people, all of which complicates life for analysts and portfolio managers. Now you cannot get special information as an analyst, you must go out and dig for it. Goodness, what's a poor analyst to do? First, the SEC takes away any special information privileges and now the SIA and the NASD are seeking penalties for making recommendations of stocks where there is a conflict of interest. And to heap insult on top of injury, brokerages such as Merrill Lynch are restricting what stock analysts can own.

All of which brings us around to the long standing caveat, which we have followed at PCM since its beginning and by Perk, during all of his years in the investment business: **Believe what you see**. **Not what you read**, because much of it is written by someone who may actually know less about the subject then you and **not what you hear** because talk is cheap and usually unreliable. Believe only what you can see with your own eyes. For example, if you are visiting a company and the tour of the factory gives a good impression, i.e., it is clean, organized and appears to be functioning smoothly, you may be visiting an efficient company. Perk recalls a visit to the Tennant Company many years ago at which time he had remarked, "Well I think you could actually eat your lunch off this factory floor." What would you think about a plant tour through a dirty and disorganized factory? You would probably reach a different conclusion. Or if you are on a company visit and you find yourself in an opulent headquarters building and the president with whom you are speaking is wearing silk shirts with monogrammed cuffs, and the coffee is served in fancy china, you might just wonder why the dollars were being spent on fancy trappings. Perk remembers so well the time that he and Bill Corneliuson visited Flight Transportation and were confronted by this situation. That company was a fraud! We could go on and on about the warning signs that we see when we visit companies, but also the good things we see, especially management credentials. Usually, if you see that a company president has done a good job once before at a company, you would guess that he might be able to do it again at another company. We think we see this today with Norstan, a company that had truly lost its way, and is now being run by President Jim Granger, who has done it before and can do it again. And speaking of not spending money foolishly, we will never forget our first visit to Zeos Computer Corp, where the founder, Greg Herrick, had a card table for a desk, and boxes on the floor for his files. And, no secretary. He was early on in the computer business and built a very successful model, which he subsequently sold.

This "believe what you see" philosophy is the reason we look at stock charts so that we can see what the market or a particular stock is telling us, as opposed to us trying to tell the market or a particular stock what it is supposed to do, or what we would like it to do. We try to believe what we see, for we know that price action is the summation of all of the knowledge, perceived or real, which investors bring to bear through their buying and selling. A stock price chart is a snapshot of all that knowledge translated into market action. Certain price patterns appear over, and over, and over again, throughout the years. It really doesn't matter if you're looking at a chart of price action last year or 10, 20, or 30 years ago, nor does it matter if you're looking at a chart of a Canadian stock or a Hong Kong stock. In the end, the main difficulty is proper interpretation of all of the information that is contained therein.

THE WAY WE SEE IT NOW

Reviewing the new Securities Research "Green" 35-year chart book, which came a few weeks ago, made us realize again (we had not really forgotten) how similar the recent period of 1995-2001 is to the 1966-1972 period. That was the era of the Nifty Fifty, a term used to describe the one-decision growth stocks of that time - - American Home Products, Avon Products, General Electric, Johnson & Johnson, McDonald's, Medtronic, Merck, Pfizer and many, many, more. These were companies that had grown consistently at rates of 12 to 20% or more per annum, and could confidently be expected to do so in the future. They were called one-decision stocks, companies you could buy, put away, and not look at again. Of course, some of them faltered (Avon for example), but most of them continued to grow at consistent rates. American Home Products grew its earnings per share at 12% a year from 1966 to 1972, Johnson & Johnson at 20% and McDonald's at 25%. In 1966, American Home Products was selling at a 15 P/E, Johnson & Johnson at 25 and McDonald's at 15, and by the end of 1972, 6 years later, their P/E ratios were 36, 55 and 60 respectively. Why, when their earnings per share growth rate had not changed should their P/E ratios rise so dramatically? A bull market, that's why. Good old price earnings multiple expansion, which is what a bull market is all about. But then a strange thing happened. Cracks began to appear in the economy and we had a short recession in 1970, and these stocks and the market suffered a correction, but then recovered and went back up to a top near the end of 1972.



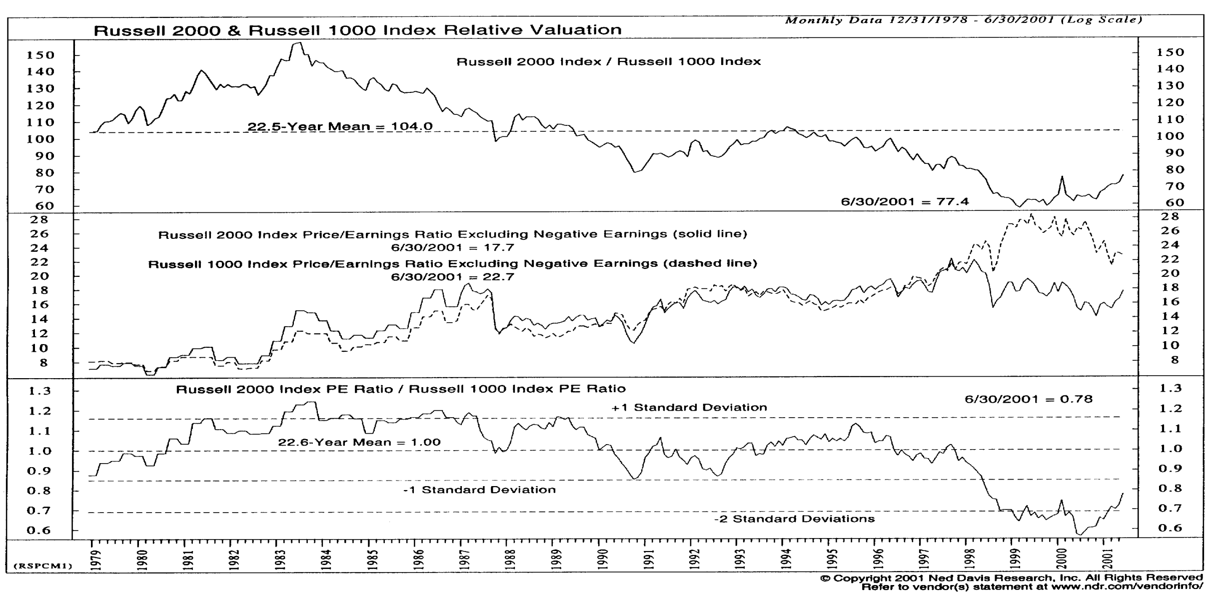
Source: Securities Research Company

The Nifty Fifty also recovered quickly and moved ahead to their lofty 1972 P/E ratios. But then recession worries set in again, and the market collapsed into the 1974 bottom, with the Dow Jones dropping from 1000 to 600, a decline of 40%. The Nifty Fifty stocks which were selling at hefty P/E ratios declined broadly, and although their <u>earnings continued to grow</u>, these shares continued to decline for many years. American Home Products, Johnson & Johnson and McDonald's did not attain their 1972 highs until 1982, 10 years later. Yet, their earnings never faltered. At their 1980 lows their P/E ratios were 10, 14 and 8 respectively, even lower than they were in 1966. Our recent market is very similar as many of these same stocks, and new ones such as Home Depot, Kohl's, Microsoft, Oracle, and many others began to break away from their traditional P/E ratios in 1995 and advanced in price to where their P/E ratios were at the same relative place as they were in 1972. The P/E of the S&P 500 rose from less than 15 to more than 25. One of the best ways to illustrate this for all of these stocks is to show you again the chart of General Electric, which began its ascent in 1995 and peaked in 2000. In 1995 it sold at about 15 times 1994 earnings per share, and at the top in 2000 the P/E was about 50 times 1999 earnings per share, a true bull market performance. GE, you see, has grown its earnings

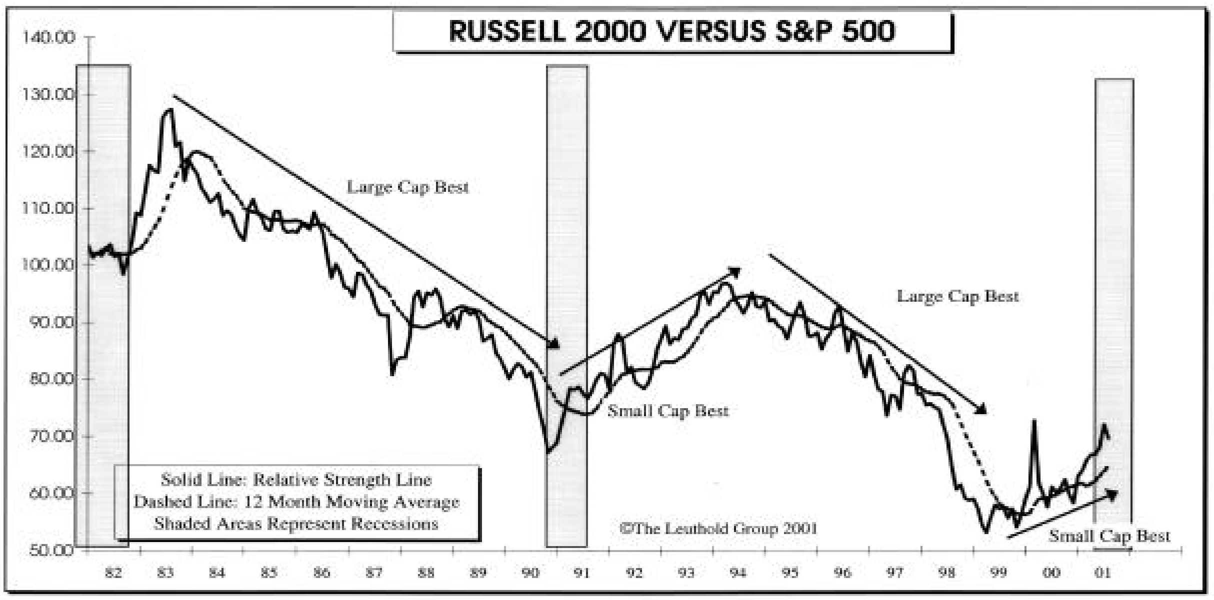
Year	Large U.S. Stocks	Small U.S. Stocks
1972	18.91	4.43
1973	-14.82	-30.90
1974	-26.57	-19.95
1975	37.23	52.82
1976	23.60	57.38
1977	-7.49	25.38
1978	6.36	23.46
1979	18.24	43.46
1980	32.17	39.88
1981	-5.11	13.88
1982	21.44	28.01
1983	22.45	39.67
1984	6.11	-6.67
1985	31.60	24.66
1986	18.57	6.85
1987	5.14	-9.30
1988	16.32	22.87
1989	31.33	10.18
1990	-3.25	-21.56
1991	30.40	44.63
1992	7.59	23.35
1993	10.04	20.98
1994	1.24	3.11
1995	37.45	34.46
1996	22.84	17.62
1997	33.31	22.78
1998	28.54	-7.31
1999	21.02	29.79
2000	-9.08	-3.59
Mean Gain	**14.33**	**16.91**
Risk (SD)	**19.74**	**22.54**
% TimeBest	**13.80**	**37.90**
2001 YTD	**-4.37**	**8.10**

Source: Ned Davis Research, Inc.

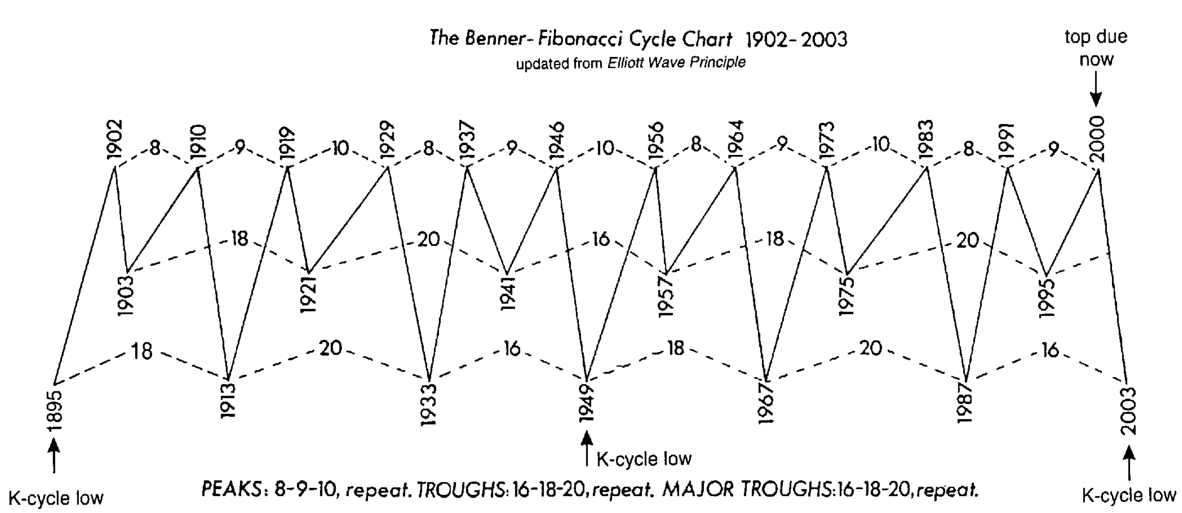
for many, many years at 12% compounded. And based on the theory that a company should sell at about one times its growth rate or maybe a little more, GE over the years sold between 12 and 15 times earnings except, of course, for that 1966 to 1972 period, and then again at its brief overvaluation in 1987. And GE was not alone in its performance as similar acts were performed by American Home Products, American International Group, Anheuser Busch, Bristol-Myers, Colgate, Home Depot, Johnson & Johnson, and a long list of others. So now what is to be deduced from all of this? Our guess is that history will again repeat itself, as it always does, and that we will ultimately see a repeat of what happened in 1972-74. After the initial decline there was a bear market rally (the B wave) and then a final C wave down to the bottom in 1974. During this time the excess P/E ratios began to correct, but that correction was not complete at the end of 1974 and in fact continued until 1980 for American Home Products, Anheuser Busch, Colgate, General Electric, McDonald's, etc., etc., resulting in very low P/E ratios (the old pendulum again going from one extreme to the other) preparing all of them for the great bull market which began in 1982 and has lasted until now. So, if one should not own these large blue chips, then what? Well, the table shows that coming out of the 1974 bottom small stocks were the place to be until the next up leg started in 1982. In fact, today, the relative valuation of small stocks as measured by the Russell 2000 vs. the Russell 1000 is still about as low as it was in 1999-2000. This is shown in the chart below.



Another similar illustration is the Russell 2000 (smaller companies) vs. the S&P 500 (larger companies). We have presented this chart before, the last time in our April 2000 letter. It shows that we entered a period of outperformance for small stocks in 1999, which, if the duration of the expected future outperformance is equal to last time, would carry us to 2003 at a minimum; previous such periods have usually lasted longer than the 1990-1994 period, which is shown in this chart.



The Benner-Fibonacci Cycle from 1885-2003, shown below, called for a top in 2000 and is looking for a bottom in 2003. There are other similar charts. If you still have it, look at our last letter (April 25, 2001) on page 7, where the 3.3-year cycle projects a low in 2003-2004. Likewise, the presidential cycle presented here many times in the past shows an end of



Source: The Elliott Wave Theorist

the cycle low in 2004. So where do we think we are today? Having seen a top in the stock market in March 2000, we are now near completing down wave A, the first corrective wave. When that is complete we will embark on counter trend wave B, the bear market rally wave, which could carry the NASDAQ back to 2800 to 3000 and the Dow back to the old high or possibly even higher. Beginning late next year we will enter down wave C, which will be the third and final corrective wave and which should bottom in 2003 to 2004. During this time, a period of approximately three years, small and mid-cap stocks should outperform large-caps, as the larger companies continue their P/E revaluation to more reasonable levels. This is, by its very nature, a long-term forecast which will contain more then one false or unexpected turn. But the big picture is as outlined. Up from a bottom sometime this year, and then once that rally is complete, a protracted down move into 2003-04, but during this time frame great opportunity exists for small stock investors.

STRAWS IN THE WIND II

In April we wrote about the "Straws In The Wind" that were pointing to an intermediate bottom that would lead to a good, solid B wave bear market rally. They were: TRIN reading of 1.5 or greater; the fourth Fed Rate cut; positive value sentiment indicators; the Fed Market Valuation Model; and the 3.3-year cycle. Three months have passed and the market has not gone up despite those favorable indicators. But there have been continual high TRIN readings; we have just had the sixth discount rate cut; the valuation sentiment indicators are in neutral territory; the Fed Market Valuation Model is still attractive, and the 3.3 year cycle is still intact. **So what is going on here?** The TRIN readings have resulted in market moves with only a small lag in the past, so there is no answer to that riddle other than "there's always an exception to the rule," especially when you are counting on it to work. As far as the rate cuts are concerned, there have been other times when there was a failure of the market to respond. One, of course, was the 1930s when that failure was a major negative clue to a seriously failing economy and maybe that is the answer here, although we hope not. Gary Schilling, for one, states in his July INSIGHT that he doesn't see how the Fed can avoid a US recession that will spread globally even with further cuts. It will be an inevitable winding down of the stock market excesses and the resultant lay-offs and stock market losses. There were, however, two other cycles of Fed easing when the market refused to respond initially. The Fed began easing in November of 1981, but it was August of 1982 before the market took off, and more recently, easing which started in June 1989 didn't have an effect until October of 1990. There were, however, extenuating circumstances in both of these cases. The 1982 bottom was the beginning of the great bull market and stocks were selling at give-away P/E ratios, while in the 1990 situation the market responded to American intervention in Kuwait. So we think the jury is still out and probably waiting for further discount rate cuts. The Federal Funds rate is now 3¾%, and assuming that Greenspan will not go below 3%, we have room for three more ¼% rate cuts. One question that looms large is why the Fed cut by only ¼ point this last time. The explanation that makes the most sense is that the Fed hoped to buoy everyone's confidence by signaling its own confidence in what it has already done, i.e., a ½ point cut would have sent the message that things are really worse than they look.

THE CASE OF THE ERRANT APOSTROPHE

We really love British humor, or if you will, the British frame of mind. Where else but in Great Britain would someone start the Apostrophe Protection Society? But really, it is a true story, faithfully reported by that spectacular newspaper that prints "all the news that is fit to print," the *New York Times*. In Boston, England, John Richards, a retired newspaper copy editor and reporter, founded the Apostrophe Protection Society. Tongue in cheek? No, he is dead serious, and shown in a picture standing in front of the Modern Mans Barber Shop, where the apostrophe is clearly missing from the word Mans. Mr. Richards expressed dismay at a printing shop which offered to print menu's, and a store featuring ladies fashion's, both near his home. "It has irritated me for years," he said, and therefore he took up the war against the absence of apostrophes that are needed and the presence of those that are not. So far, according to the article, only the local library has complied by removing the apostrophe from its CD's sign. Since a newspaper article appeared he has received 450 letters and the society now has 250 members. There were many humorous anecdotes in the Times article. One described a woman's fruitless battle with a local branch of Sainsburys, a supermarket chain that removed the possessive apostrophe in its name but put it in the wrong place in the parking lot, where the sign reads "shopper's car park." She suggested to Sainsburys that they were perhaps being too modest in only expecting only one shopper to turn up, but, the woman recalled "they didn't even reply." Another failure was at Kings Langley, where the campaign to put the apostrophe back into the town's name won 80 to 8 in a villager vote, but was overruled by the council because of cost of stationery and road signs.

This has struck a familiar chord, for the apostrophe is the nemesis of letter writers everywhere, and especially in Wayzata where we are so concerned about punctuation that our letters are reviewed by several people, especially Nancy Lindberg, our resident punctuation expert. Even so, the gremlins occasionally creep in and there are commas where there should be none and vice versa. Ditto for hyphens. But God forbid that we should misuse an apostrophe and find ourselves in trouble with John Richards.

PASSINGS

Since our April letter we have lost several famous people whom we loved and respected: Perry Como, May 12; Anthony Quinn, June 3; Jack Lemmon, June 27; and Chet Atkins on June 30. Each was a star to be remembered. But Perry Como, Mr. Easy, who was referred to as "the man who invented casual" by Bing Crosby, was extra special to Perk, for he had also been a barber. Perry had started working at age 10, sweeping out a barbershop for $.50 per week. He soon learned how to strop razors, his boss gave him instructions on haircutting, and by the time he was 14 he owned his own barber shop. He picked up extra money on weekends singing. And it was his intention to remain a barber, but in 1932 he started singing in a band and subsequently was heard by Ted Weems, who gave him his start to fame. By contrast, Perk went to barber college out of high school in 1948 and used his trade to work his way through the University of Wisconsin, by running a haircutting appointment business between classes. He was sought after for his flattops which were popular then. With all deference to successful barbers everywhere, Perk always said that both he and Perry gave the trade the respect it always deserved.

THE CARTOON PAGE

Our little add-on this month consists of some gasoline price related cartoons. We were going to use these last quarter, but thought we should wait until July when gasoline would doubtless be $2.00 or more per gallon. Well, this shows once again that you can't believe everything you read or hear, nor can you always project past price trends into the future. Gasoline never got to those astronomical prices in the Midwest and is now $1.40 in the busy July vacation season, at least here in the Twin Cities. In California, it is closer to $2.00. Oh well, better late than never. The cartoons are still funny.

Finally, we have been amused by the New York law just passed which calls for a $250 fine for using a cell phone while driving. This is wonderful as it gives us a chance to use our cartoon of the month, which we have been saving for such an opportunity since 1998.

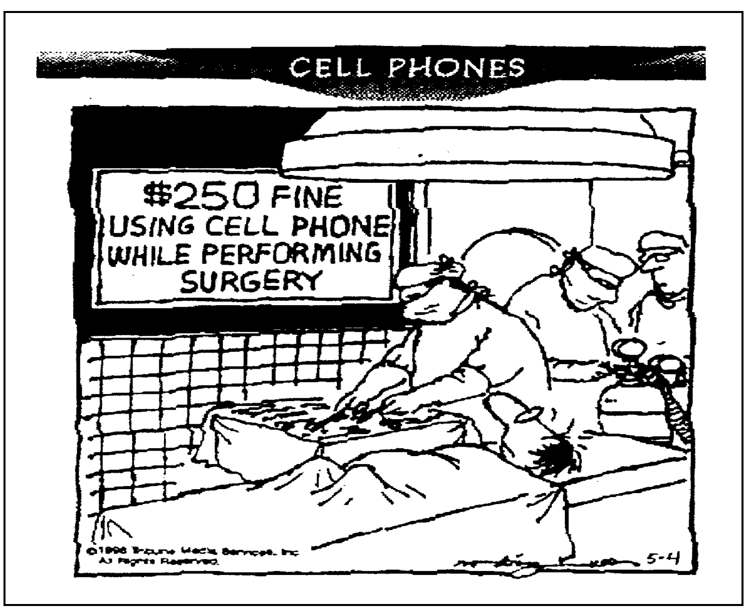
Sincerely,

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

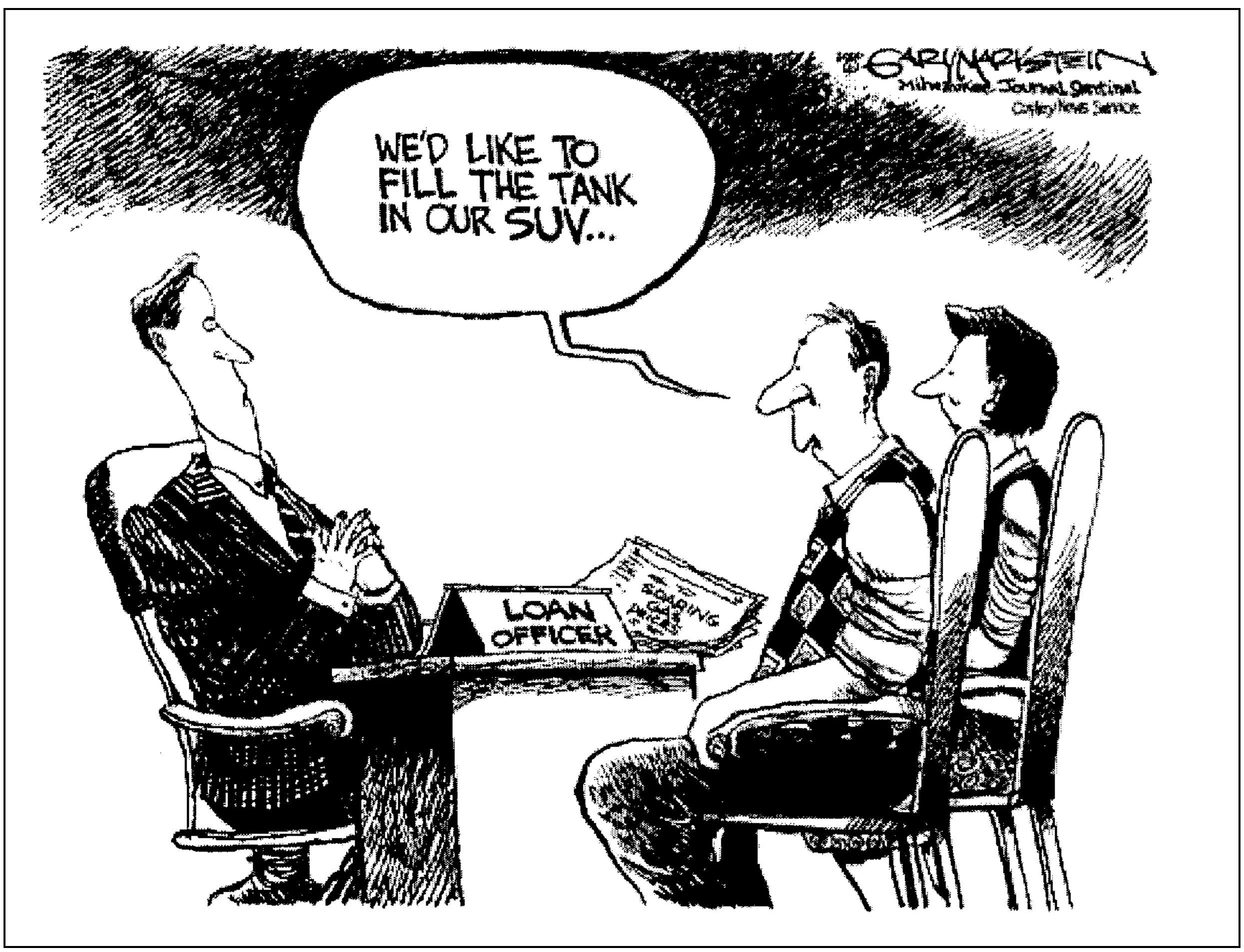
Daniel S. Perkins, C.F.A.
Vice President
Portfolio Manager

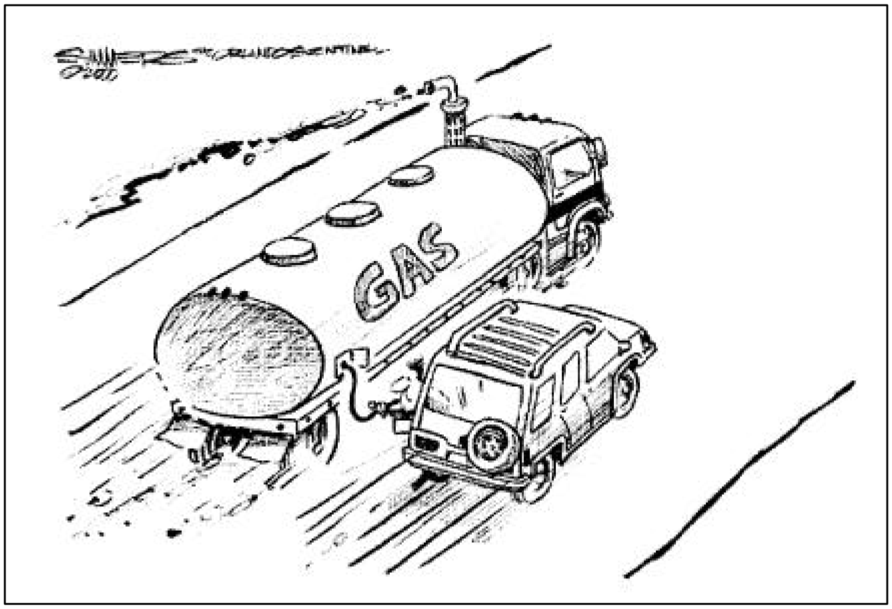
Richard C. Perkins, C.F.A.
Vice President
Portfolio Manager

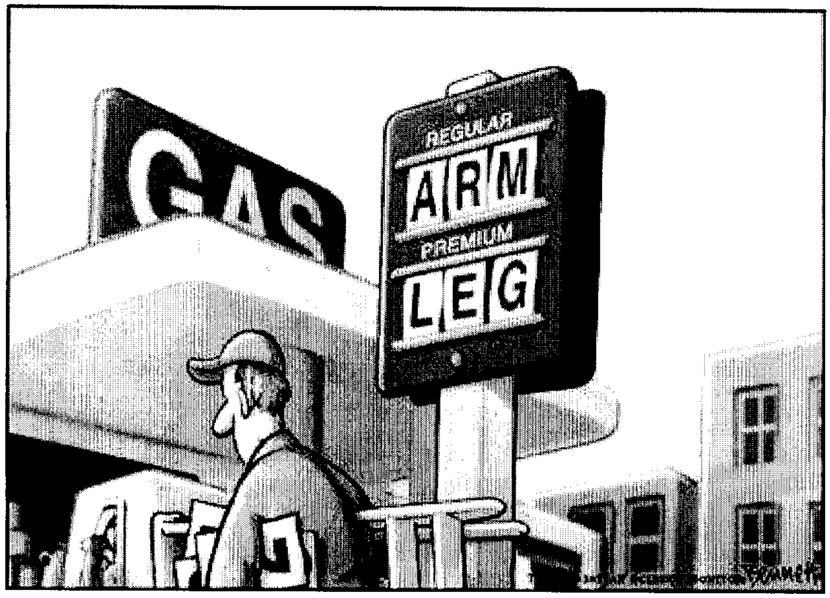
RWP:DSP:RCP/jah




MILK
$2.39
A GALLON
ORANGE
JUICE
$5.90
A GALLON
MAPLE
SYRUP
$48.84
A GALLON
BEER
$9.87
A GALLON
SPRING
WATER
$4.52
A GALLON
FOOD MART
GAS
$1.65
A GALLON
KAL
The Baltimore Sun


GARY MARKSTEIN
Milwaukee Journal Sentinel
Copley News Service
WE'D LIKE TO FILL THE TANK IN OUR SUV...
LOAN OFFICER
SOARING GAS PRICES


GAS


GAS
REGULAR
ARM
PREMIUM
LEG


HAND OVER THE GAS.
STAYSKAL 2000 TAMPA TRIBUNE