

January 24, 2012

Dear PCM Clients and Friends:

“I’m Dreaming of a ~~White~~ Brown Christmas” is how it went this year. There was a little snow here and there which had not melted from our previous, very minor snow, but on Christmas Day it was 45° and, in fact, on Monday, the Christmas holiday, it was 50°. So, our autumn literally stretched through Thanksgiving, and there have been no days below freezing during the daytime, all the way through December. This unusual weather has continued into January, with all-time record highs being recorded for many days, not just here in Minnesota, but throughout much of the Midwest and elsewhere as well. But we knew it would change just as night follows day, and it did abruptly on January 12 with cold weather, and now January is—well—January in Minnesota. The snowbirds are flying south to Florida, Arizona, Cancun, Cabo San Lucas, and Puerto Vallarta. By the time you read this, Perk and Dana will be on their annual trip to San Pedro on Ambergris Caye in Belize to hear Jerry Jeff Walker, as well as the island’s own Dennis Wolfe and The Usual Suspects. More about Dennis later in this letter.

A MESSAGE FROM PERK

We recently had the opportunity to hear the legendary Steve Leuthold speak at a meeting of the MN Chapter of the Market Technicians Association. I have known Steve since we worked together at Piper Jaffray, where I started in May 1966 and Steve joined in 1969. He honed his skills in the fledgling institutional department at Piper, and his insights into the market became very valuable to Piper’s worldwide institutional clients. And so he left the mother ship in 1977 to start the Leuthold Group, which in turn has become a very successful advisory firm to institutions worldwide. Steve has been interviewed countless times by *Barron’s*, and many other prominent financial publications, and is well regarded for his opinions. Over the years, he has gained a reputation as somewhat of a contrarian, and this is because in his view human nature is the prime mover of markets, and thus understanding the investor psychology of greed and fear is critical to investment success. Because greed often coincides with market tops (the greed associated with missing out), and fear with market bottoms (the fear that it will go lower), he says it often pays to be a contrarian—thinking contrary to public opinion. As a result, he says, it is important to know yourself, particularly your weaknesses, in order to defend yourself from crowd thinking. This is, according to Steve, all part of personal discipline which is so essential in making correct investment decisions. One must always consider risk, as well as return, by factoring in the potential downside as well as the upside, and being willing to forgo a tempting investment if the potential risk is as great as the potential reward. And, he says, cash reserves are important, i.e., one does not always have to be fully invested in order to have reserves to employ when an opportunity develops. And, sometimes opportunity

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presents itself in spades when a market crisis develops, and they do seem to come along frequently, and without a cash reserve opportunity can be lost. He made the point in his presentation that stock market “new valuations” have always been temporary. These are times when Wall Street uses the term “new era” saying “it’s really different this time” when that is really a signal that market expectations have gone beyond realism. And the same is true on the downside, when the economy, corporate earnings, and equity valuations are depressed as far as the eye can see. Again the refrain “it’s really different this time” will be heard, and these bearish “new eras” are temporary and thus may very well be the time to build equity positions.

Then Steve emphasized what we already knew: Short Term Trading is a loser’s game. He says it took him 20 years to learn that lesson (about the same for me) as it is a game that gives you courage as you win, until you get enough in the game to go down in flames with a big loss. Another lesson I have learned as well as Steve, is to learn from history. He says that while history is not a Xerox machine, and therefore, does not repeat exactly, it can be similar because history is the past experiences of others and better to learn painful lessons from the experience of others than learn them yourself. Why? Because, as we know, human nature has not, and will not, change. Society may have changed and technology may have advanced, but human nature is still human nature, and after all, the ebb and flow of the market, the total actions of all the players, are reflected there. So fear and greed dominate market forces as they always have. All of this, of course, is vintage Steve Leuthold.

The unanticipated ending to his presentation, however, was that nothing in his view is forever. His question was: “Why not just forget all of the preceding lessons and just buy a portfolio of America’s outstanding companies, then put them away and leave them alone?” His answer, by way of illustration:

- In 1970 the following companies were in the top 50 list of market capitalization:

Eastman Kodak (5)	Polaroid (33)	Xerox (9)
S.S. Kresge (44)	Avon (15)	Burroughs (45)

- So, where are they now? We did some research of our own and found of the six companies listed only Avon (409) and Xerox (286) are in the top 500 (yes 500, not 50). Kresge merged with Sears and Burroughs with Unisys and are both below the market cap of the smallest of the top 500, as is Eastman Kodak at only \$175 million and within sight of bankruptcy. And Polaroid is gone, having been sold as part of the Petters fraud and bankruptcy.
- And 74% of the richest companies ranked by assets in 1945 are no longer on the top 100 list, and 37% of the 100 richest companies in 1995 were not on the top 100 list just six years later in 2001.
- Less than 10% of the companies in the S&P 500 in 1957 are in the index today.

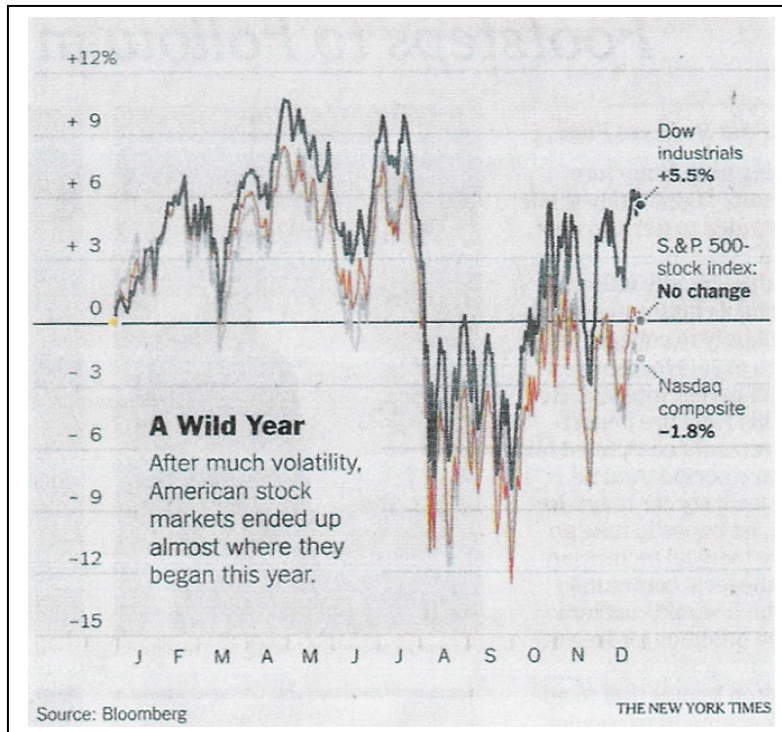
So, history tells us no company's earnings growth is permanent and the rise and fall of corporate fortunes changes constantly and so, therefore, no stock is forever. The exception might be GE which has changed its model and reinvented itself several times!

2011 REPORT CARD

Indexes	% Return Year 2011
S&P 500	0.00
Dow Jones Industrial Average	+5.53
Russell 1000 TR	+1.50
Russell 3000 TR	+1.03
S&P Small-Cap 600 TR	+1.02
Wilshire 5000	-1.27
NASDAQ Composite	-1.80
Russell 2000 TR	-4.18
NYSE Composite	-6.11
Value Line Composite	-11.39

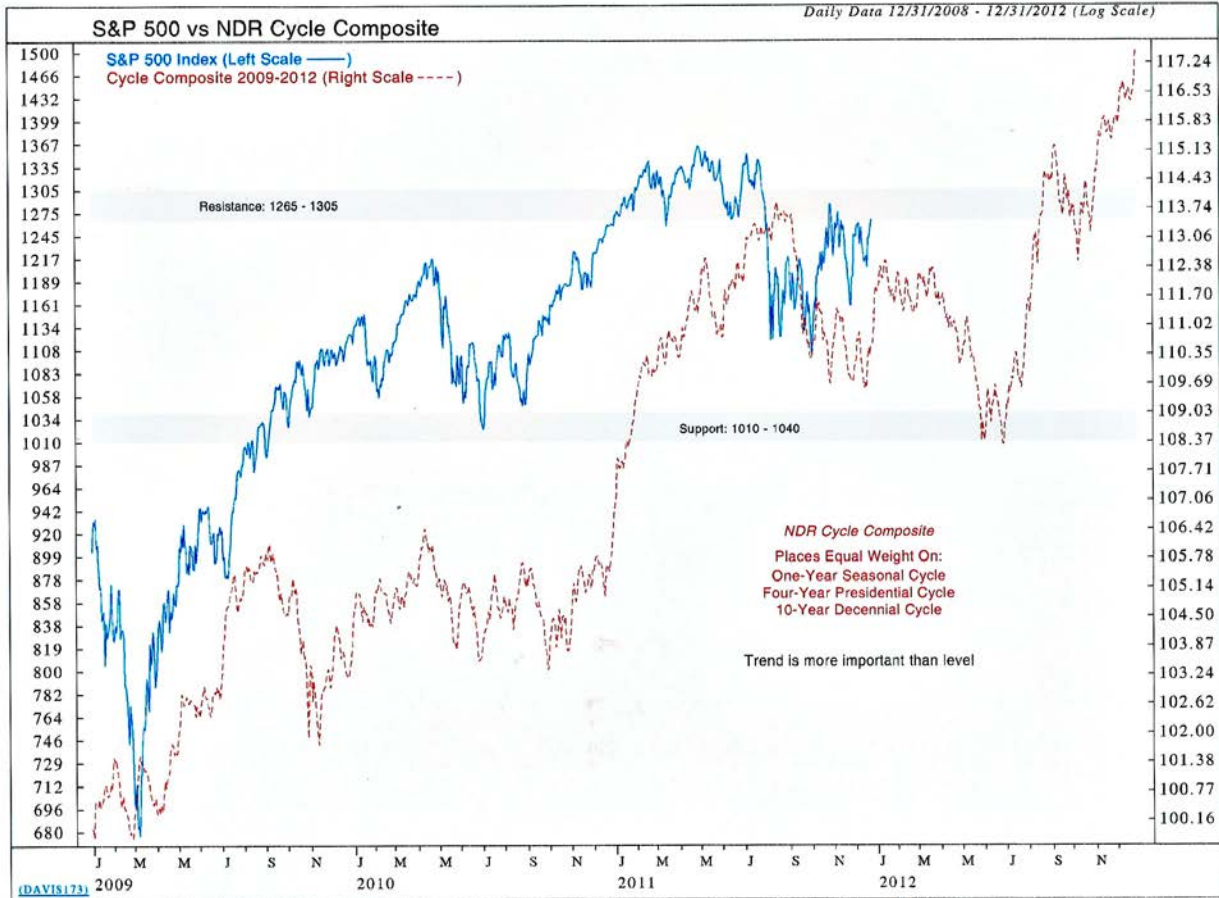
All of the usual statistics for the year are shown in the table. An exceptional year, one with extreme volatility as discussed at length in our last letter (October 2011 The Market's Wild Ride), but yet one that finished the year where it started, at least with the S&P 500 which began the year at 1,257.64 and ended at 1,257.60, if you can believe such a coincidence. On the other hand, the Dow was up 5.5%, which offsets, we guess, the 5.5% decline in the Russell 2000. NASDAQ was basically unchanged also at -1.2%.

In addition, this time, we are displaying a chart that shows the extreme fluctuations throughout the year of the Dow, the S&P, and NASDAQ. We know this may be overkill, but we think it is very important to realize the kind of year that we just went through. Unprecedented, in our view. But 2011 is in the history books and so now we turn the page (literally) to 2012.



LOOKING AHEAD INTO 2012

This is the time of year when we (and others) feel it is our duty to attempt to look ahead into the New Year with some sort of a prediction, notwithstanding C. B. DeMille's admission that "Predictions are very hard to make, especially about the future." Reviewing last January's letter, we were very pleased to see how close the actual 2011 market was to the Ned Davis Cycle Composite, which we presented then and present again here, including their prediction for 2012. Our readers will recall that these chart predictions from



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Ned Davis Research utilize the combination of the One-Year Seasonal Cycle, the Four-Year Presidential Cycle, and the 10-Year Decennial Cycle, giving each equal weight. This projection matches our expectations as stated in the past, namely a year-end 2011 rally carrying into the first quarter, then a declining market until a bottom sometime in the October-November time frame, rather than mid-year, as we believe the political process will have a great impact on the market as time passes. We have stated numerous times that the second year in the decade marks a stock market bottom for the decade, as in the years 1932, 1942, 1952, 1962, 1982 and 2002; not a perfect record, as 1972 and 1992 did not have major decennial bottoms. Not a perfect record, as we said, and not as good as the "0" year bottoms, but close. Our present Congress is dysfunctional, with Christmas vacation the only thing they can agree upon, and this brinkmanship is likely to continue this

year. Congress has been “kicking the can down the road” and will continue to do so, leaving the income tax cuts in limbo. So the second year bottom in our opinion will be pushed to or near election time or until Americans have a clearer indication of what is going to happen.



Meanwhile, those of us charged with investing on the behalf of clients must assess not only the behavior of markets, but all the things that affect them, and individual stocks as well. *The Economist* had a very negative cover on a recent issue, implying that in the present time there is nowhere to hide. Interest rates (other than the PIIGS countries) are at all time lows, real estate and housing seems to hold no promise, and securities markets in their view have no expectation other than down. But major magazine covers stating an opinion have usually sent the wrong message, with the implication from this one that there is nowhere to invest money safely. We disagree, and believe that there are

segments of our stock market that are attractive. First, we think it is smart to buy high quality companies which provide a good yield. We have been doing this for some time now, investing in the likes of Johnson & Johnson, Bristol-Myers, Lilly and many others that are known growing companies which provide both income and potential capital gains. These companies are not skyrockets, mind you, but stocks that can go up and pay some rent at the same time. We wrote about this subject in our October 2010 letter, when we noted that Johnson & Johnson had sold a 10-year bond at 2.95%, while the stock yielded 3.6% and had grown its dividend for 48 consecutive years. Johnson & Johnson is not a bad place to hide, if indeed you must.

Another area we think represents value, as well as opportunity, are some specific small companies. Yes, we know the Russell 2000 was down last year, and



that some small stocks have been decimated, but something we learned long ago is that “when the cops raid the place they take everyone, including the piano player.” And so, not all small stocks are alike. We can enumerate many whose businesses are stable, and growing, and which have cash on the balance sheet, sometimes lots of it. They are not going out of business just because they have been forsaken in a market climate of uncertainty. We think there are future “diamonds” among them, and are putting our money where our mouth is.

So, don't be like the little bear pictured on the previous page who sold everything because he could not find a place to hide.

THE IRON LADY

When Perk went to see the movie “Iron Lady” he said it was like reliving a piece of his past. When Perk was on the board of The Center of American Experiment, a conservative “Think Tank” here in Minneapolis, the annual fundraiser was always a banquet where a prominent conservative was the speaker. The list of speakers over the years is long and consisted of many of the names that you would expect: George H.W. Bush, Colin Powell, and Rudy Giuliani, among many. In 1997 the board was given the opportunity to host the honorable Lady Margaret Thatcher, who would not fly on a commercial flight, and so part of her stipend was private jet transportation. They needed a private jet airplane to get her from a Chicago speaking engagement to Minneapolis. Since at that time, Perk and Chris Dahl had an interest in a jet, Perk volunteered when asked if he would provide that transportation. And so in May 1997, Perk and Chris flew to Midway International Airport to



fetch the Iron Lady to Minneapolis, and quite a trip it was, with her entourage consisting of her private secretary, Vivian, and two Scotland Yard detectives, whose business cards read "Mrs. Thatcher's protection." This hour-plus trip afforded us ample time for a face-to-face discussion of the political scene, her philosophy, and much, much more. Perk, a great saver of cartoons, political and otherwise, produced one of Bill and Hillary Clinton pushing a baby stroller, carrying twins labeled "Reagan" and "Bush" with the caption, "We decided to adopt." Mrs. Thatcher looked at it, and then said, "How clever. That is exactly what happened in my country," referring, of course, to the election of Tony Blair as Prime Minister just eight days earlier as he adopted many of her conservative policies. And so the conversation began about the British election where Tony Blair won by adopting the basic principles of modern conservatism. Just as Clinton won in a landslide by adopting Reaganism, Blair adopted Thatcherism with the same result. But the real winner was Margaret Thatcher who started it all in the first place. What an experience! Shown on the previous page is a picture taken by Chris Dahl, always to be cherished; he has the one I took of him and the Iron Lady.

So, seeing Meryl Streep in the role of Lady Thatcher was a step back 15 years for Perk. And, what a perfect rendition she has done, especially the coiffed hair. Perk remembers disembarking in Minneapolis in a 30 mph wind, with nary a hair on her head moving; he remarked at the time that it had to be sprayed with shellac.

MUDDLING THROUGH

The phrase "Muddling Through" comes from the pride the British have seeing their bureaucratic processes as a muddle, but still getting the job done, in a somewhat organized way. It looks like we will have to follow the Brit's lead and take a lesson from them this year in view of our dysfunctional Congress and an election that is up for grabs. Frankly, the austerity that will be necessary to deal with imbalances in the U.S. at all levels of government--local, state, and Federal is underestimated in our view. And the same is true in Europe, where not only the PIIGS are in trouble, but many other countries as well. And those that have assets (oil) fight internally and maybe soon with each other. Both here and abroad, the comparison is like putting someone who is anorexic on a diet.

We always close these letters with a cartoon that we believe speaks to the moment at hand. *TIME Magazine's* man of the year was the protester, a composite of those in the MENA (Middle East and North Africa) countries, as well as Russia, and of course, our own "Occupy Wall Street." We thought the cartoon to be very appropriate, all things considered.

We know that our readers look at the jokes first, and then move on later (maybe) to the rest of the letter. This time both sides of one "joke" page are devoted to some of "Wolfe's Woofers," a humorous column written weekly for the *San Pedro, Belize Visitor Guide*, by Dennis Wolfe, a local musician, whose island band is called The Usual Suspects. Over the years of traveling to Belize to hear Jerry Jeff Walker, we have become friends with Dennis and his wife, Dulce. Dennis came to Belize 23 years ago and never left. He is a

great singer and songwriter--his most famous song is "Just Another Gringo in Belize" about the foreigner who came to Belize and all of his travails there. How Dennis finds time for this weekly column, we are unsure. Tell us if you like them, because there are many more to choose from.

Sincerely,

RW Perkins

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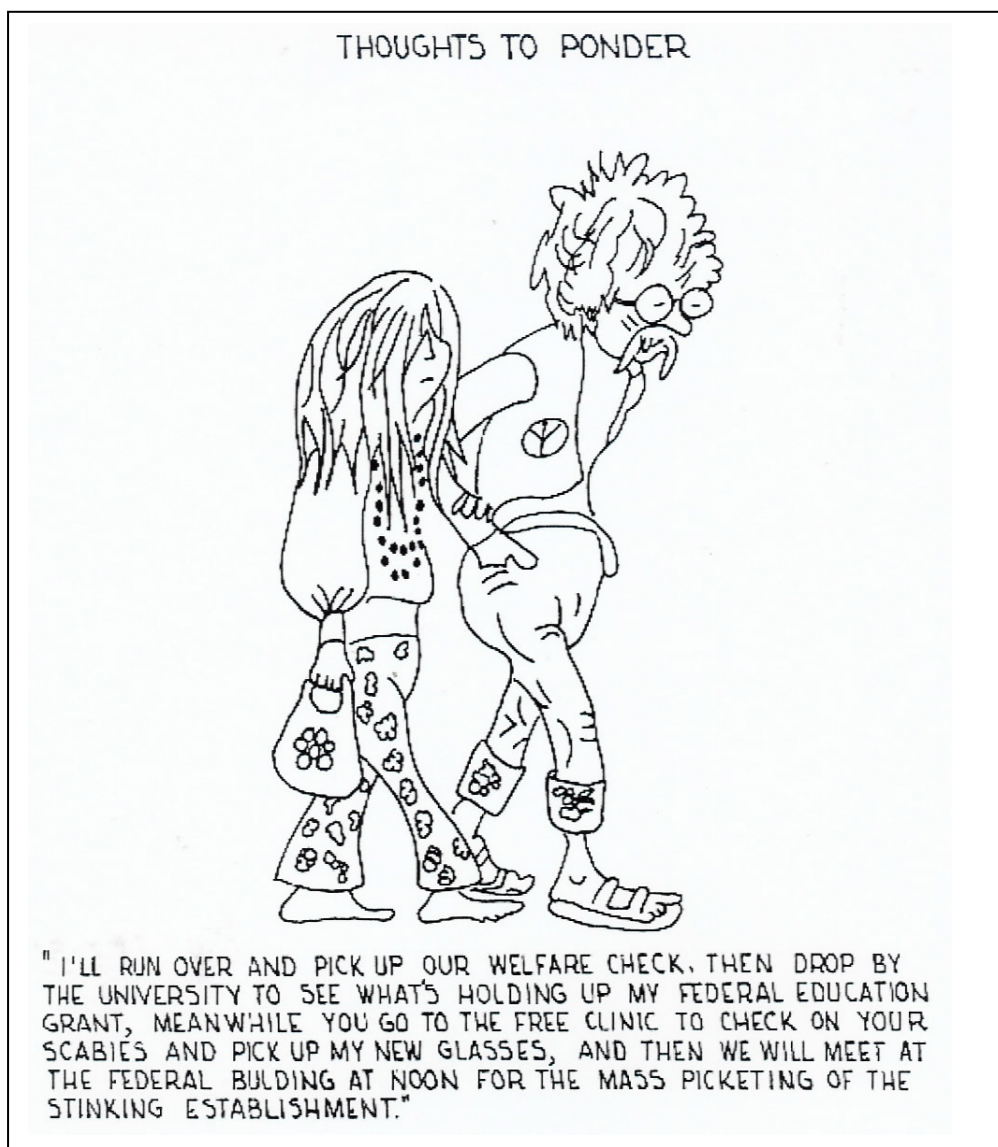
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Wolfe's
Woofers
by
Dennis
Wolfe



Surprise Package

"Hey, Davin. Do you know that today is a special day?"

"It is?"

"It sure is," I said. "Today is your mommy's birthday."

"I didn't know she had birthdays," he said. "How old is she?"

"She's twenty-six."

"Wow! That's really old. I better get her a present."

A few minutes later he came upstairs and said, "Grandpa, I need a little box for my mom's present."

"Here" I said, after rummaging around in the cabinet. "Will this do?"

"That's just right. I got her a present."

"Where did you get it?"

"My friend Lichi that lives next door gave it to me. Will you help me wrap it?"

"Sure."

When Melody got home a half hour later the package was wrapped and had a ribbon and a bow.

"Ooh! This for me?" Melody asked. "What is it?"

"It's a surprise," Davin said. "You have to guess."

"It's kind of heavy. Is it chocolates?"

"No-o-o-o!" Davin laughed. "You have to guess."

"Then it must be jewelry," Melody said. "You know I like jewelry. Is it something made out of gold?"

Davin found this to be hysterical.

"Mom, you'll never guess in a million, gazillion years."

"Aha," Melody said. "I see it has some juice leaking out of this corner of the box."

She caught a few drops on her finger and tasted it.

"I know what it is," she said. "It's a jar of pickles."

"I knew you couldn't guess it," Davin said. "It's a puppy!"

Shopping

"Can I get a ride downtown with you?" Melody asked.

"I'm supposed to meet Bruce and Becky this morning." I told her. "They're staying at Woody's Wharf. You can ride that far with me."

At the hotel Bruce was sitting on the porch sipping iced tea.

"It sure is hot," he said, as he poured me a glass of tea. "It's almost as hot here as it is in Queen City, Texas and it seems to be just as dry."

"It's probably hotter here," I said. "Yesterday, I watched my dog, Muggsy, chasing a cat out of the yard. It was so hot they were both walking."

Bruce said, "It's been so hot in Texas that birds are having to wear gloves to pull worms out of the ground. It's been so dry that the trees have been bribing the dogs."

"That's nothing," I said. "It's been so dry here that the cows have been giving powdered milk."

Becky came out on the porch and said, "Dennis, I thought you were from Georgia."

"I am."

"I can hear you and Bruce lying to each other from inside," she said. "You lie like a Texan.

Bruce, you were going to the store half an hour ago."

I gave him a ride to the store where he bought 6 quarts of milk.

When we got back to the hotel Becky said,

"Bruce, please explain to me why you bought six quarts of milk."

"I did exactly what you told me to do," Bruce said.

"What I said to you was, go buy a quart of milk and if they have eggs, get six. So why did you buy all of this milk?"

Bruce said, "They had eggs."



Wolfe's
Woofers
by
Dennis
Wolfe



Allergies

"Ahh, these allergies are killing me," Dulce said. "I need some sinus medicine. Look at my face." Her eyes were nearly swollen shut.

"I'm going to the bank in a few minutes," I told her. "You want me to pick up something for you?"

"Please do. See if you can stop at the drugstore and pick up some Zyrtec for me."

"O.K."

"While you're at it, will you stop by Fidel's house and ask him to come over and clean the yard?"

"It's a long way to Fidel's. Why can't you just call him?"

"I have been calling but he doesn't answer his phone. Maybe it's not working."

After running my errands at the bank and the drugstore I drove almost to Boca del Rio, searching for Fidel. After knocking on his door several times I finally gave up and started to walk away.

"P-s-s-s-t! Mr. Dennis." I heard a loud whisper.

"I didn't know it was you. Come back."

When the door finally opened a bit. I said,

"Whoa, Fidel, what happened to you?"

His face looked swollen and bruised around the eyes.

"I got a bad seenus condition," he said. "I'm kind of hiding out because I don't want no one to see me like this."

"It's probably allergies," I told him. "I just got some sinus medicine for Dulce. You want some of it?"

"It won't do me no good," Fidel said. "Ms. Dulce has a sinus condition. I got a seenus condition."

"How did you get a seenus condition?"

"I was out with a married woman and her husband seenus."

GUNS

"How do you like living over here in Cayo?" I asked.

"I like it a lot," my friend Mario said. "It's a lot different from living in the Cayes but it's nice. This is quiet and peaceful."

He pointed to the view from his front porch where we sat. "It is beautiful out there in the mountains."

"When you used to work for me I remember hearing you say that you never wanted to live anywhere but San Pedro," I said.

"Yes, but then my dad died and left me this little farm. Now that I've moved out here I learned to like this country life. I spend a lot of time fishing in the river and hunting."

"What do you hunt?"

"Anything I can eat. My dad left me his shotgun and I learned to use it. I did not want that gun but now I appreciate it."

"Why didn't you want it?"

"I've always hated guns," Mario said. "But when my dad was getting really sick he called me in and said he wanted to leave something special for me so he was giving me his shotgun."

"That was nice of him," I said.

"I told him I didn't want a gun and asked him to leave me his watch instead."

"You really wanted the watch instead of the gun?"

"Yes, but he said I got to have the shotgun. I ask him why and he say, 'Boy, someday maybe you get married. Yes?' and I tell him yes. He say, 'Someday maybe you come home and find your wife with another man. What you gonna do? Point at your watch and say, Time's up?'"

A MATTER OF DEGREE

A mechanic was removing a cylinder head from the engine of a Harley Davidson motorcycle when he spotted a well-know heart surgeon in his workshop. The surgeon was waiting for the Service Manager to come and take a look at his bike.

The mechanic called across the garage, "Hey Doc, can I ask you a question?" The surgeon, a bit surprised, walked over to the mechanic working on the motorcycle. The mechanic straightened up, wiped his hands on a rag and asked, "So Doc, look at this engine. I open its heart, take valves out, fix 'em up, put 'em back in and when I have finished, it works just like new. So how come I get such a small salary and you get the really big bucks?"

The surgeon paused, smiled, leant over and whispered to the mechanic.....
"Try doing it with the engine running."

SAGE ADVICE FOR OLDER GUYS

An old guy decided to finally get back in shape and relive some of his youth, so he decided to start working out again. Upon entering the gym he spotted a beautiful young woman exercising on the treadmill.

He asked the physical trainer that was nearby, "What machine in here should I use to impress that beautiful woman over there?" The trainer looked him up and down and said without any further hesitation, "I would try the ATM in the lobby."

WHAT IS A 710

A few days ago I was having some work done at my local garage. A blonde came in and asked for a seven-hundred-ten.

We all looked at each other and another customer asked, "What is a seven-hundred- ten?"

She replied, "You know, the little piece in the middle of the engine. I have lost it and need a new one."

She replied that she did not know exactly what it was, but this piece had always been there. The mechanic gave her a piece of paper and a pen and asked her to draw what the piece looked like.

She drew a circle and in the middle of it wrote 710. He then took her over to a car just like hers which had its hood up and asked, "Is there a 710 on this car?"

She pointed and said, "Of course, it's right there." The mechanic fainted. Not sure what a 710 is? See picture on the following page.



CLEAN LIVING

A man was walking down the street when he was accosted by a particularly dirty and shabby-looking homeless man who asked him for a couple of dollars for dinner. The man took out his wallet, extracted ten dollars, and asked, "If I give you this money, will you buy some beer with it instead of dinner?"

"No, I had to stop drinking years ago," the homeless man replied.

"Will you use it to gamble instead of buying food?" the man asked.

"No, I don't gamble," the homeless man said. "I need everything I can get just to stay alive."

"Will you spend this on a hunting and fishing license instead of food?" the man asked.

"Are you NUTS!" replied the homeless man. "I haven't hunted or fished in 20 years!"

"Well," said the man, "I'm not going to give you the money. Instead, I'm going to take you home for a terrific dinner cooked by my wife."

The homeless man was astounded. "Won't your wife be furious with you for doing that? I know I'm dirty, and I probably smell pretty disgusting."

The man replied, "That's okay. It's important for her to see what a man looks like after he has given up beer, gambling, hunting, and fishing."