



July 18, 2018

Dear PCM Clients and Friends:

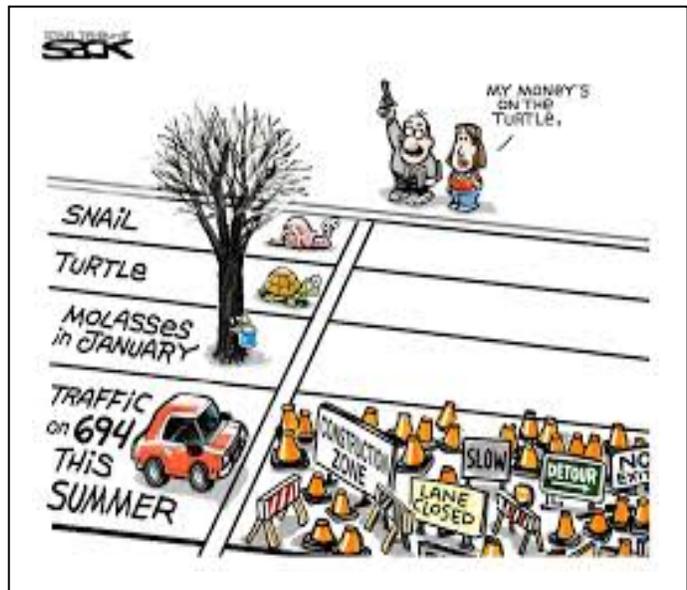
Every few years we feel compelled to complain about road construction during the prime driving season—summer. But, of course, we know there are two seasons in Minnesota,



winter and road repair. We certainly acknowledge that it is difficult to repair roads in the winter—bad enough to just keep the snow plowed. Somehow it seems this year is far worse than the preceding years, which makes us wonder if there isn't a disease in the Department of Transportation which has spread to the City of Minneapolis, which results in a crush putting very old undone programs and new ones into one year. How else could we be in such a predicament? The best way to sum it up is just not go "Because I can't get there from here," which really means the journey will take so long that it is simply not worthwhile and,

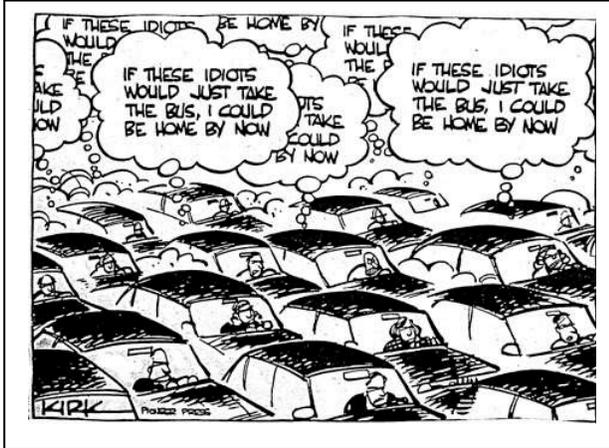
therefore, you should cancel your meeting or dinner engagement. There are several traffic

messes to ponder. First, for many it is the downtowns of Minneapolis and St. Paul where getting about is difficult, and made worse by the bicycle lanes which have proliferated (more on that later) and then the roads and freeways outside the metropolitan area and literally all over the state but worse on the main local freeways, 694, 494, 94 and 35W. The Sack cartoons do a great job depicting everyone's frustrations. The first one shows downtown Minneapolis, the second one the freeway disaster. And get this: MnDOT is advising commuters to use mass transit, form carpools, or work from home during construction.



A MESSAGE FROM PERK

Just having completed the previous page about summer traffic jams, I thought it might be a good idea to talk about traffic congestion in Minnesota, especially around the Twin Cities. Last June, the Center Of The American Experiment (aka Minnesota’s Think Tank) released a white paper titled “Twin Cities Traffic Congestion: It’s No Accident.” Blame for



the congestion getting worse, instead of better, rests squarely on the shoulders of the Metropolitan Council and the Minnesota Department of Transportation (MnDot). Adequate funding is always an issue here as it is in other cities, but there is another reason why we rank higher in congestion than many other cities, at 17th now, vs. 35th thirty-six years ago. The cause evidently comes from MnDot’s strategy of shifting from reducing congestion to prioritizing alternative modes of transportation such as light rail and bicycles, thus diverting money away from

congestion relief. However, light rail and bicycle lanes have actually increased congestion. We have been told by a direct source that Abbott Northwestern Hospital is concerned about bicycle lanes slowing ambulances.

These planners ignore people’s preferences and intend to try to change behavior. This reflects an obsolete version of job concentration downtown, whereas jobs are actually dispersed throughout the area. So the congestion problem is ignored in favor of providing alternate modes of travel, which can only be inconvenient for the majority who cannot use an alternative, especially a bicycle! So congestion winds up costing billions more because of the hours Twin City commuters waste sitting in traffic, not to mention the air pollution that results from idling cars consuming gasoline, which in itself is expensive. Supposedly,



we are warned about greenhouse gas emissions, but evidently MnDot feels exempt from any responsibility they may have on this issue. Their excuse is lack of funding, but it is really that the officials have made a decision to try to relieve congestion in favor of a failed attempt at social engineering, believing that people will change if forced to do so. This is flawed reasoning. Do they actually believe bike lanes will be used by commuters? How absurd, especially considering Minnesota weather. In the end, the MnDot

and Met Council policy decisions make congestion worse and fail to help the vast majority of the populace who rely on automobiles for daily transportation. So, we all can thank, once again, government agencies for our misery on the highways in Minnesota.

THE MARKET SCOREBOARD

Small-caps were the leaders in the quarter with all of the gain in the second quarter; S&P Small-Cap 600 was at the top and the Russell 2000 number three. NASDAQ was second,

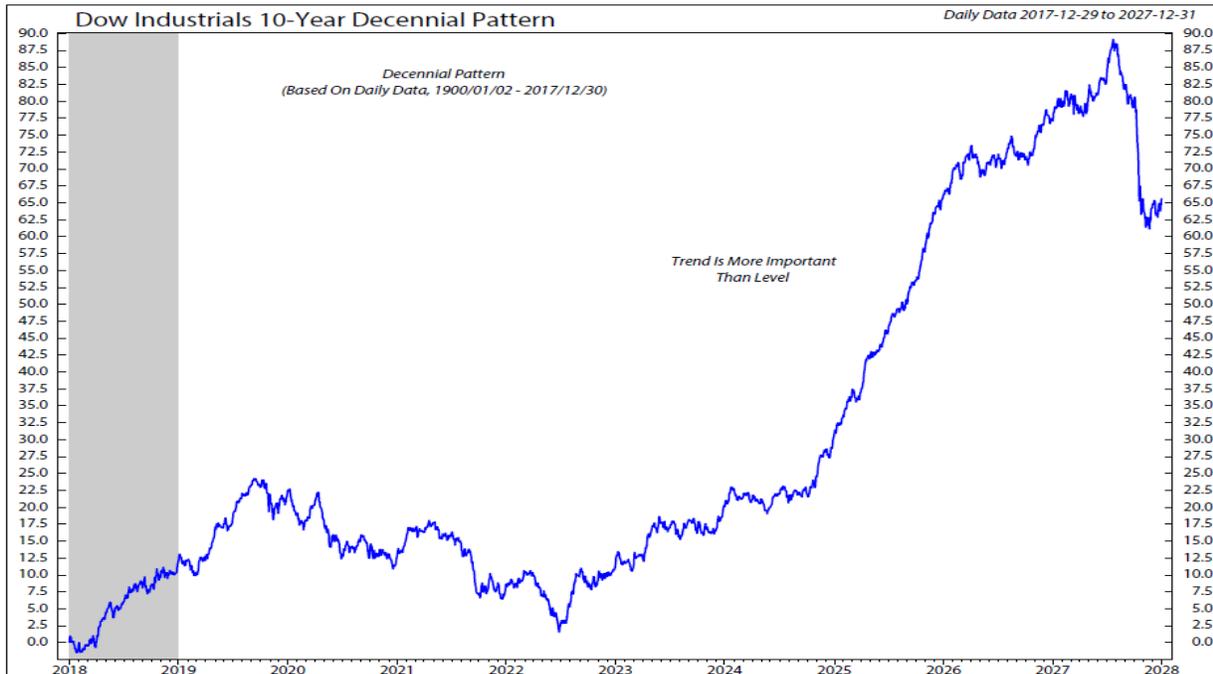
Indexes	% Return YTD 2018	% Return Q2 2018	% Return Q1 2018
S&P Small-Cap 600 Total Return	9.39	8.77	.57
NASDAQ Composite	8.79	6.33	2.32
Russell 2000 Total Return	7.66	7.75	-.08
Value Line Composite	3.59	5.34	-1.66
Russell 3000 Total Return	3.22	3.89	-.64
Russell 1000 Total Return	2.85	3.57	-.69
S&P 500 Total Return	2.65	3.43	-.76
Wilshire 5000	2.16	3.59	-1.38
Dow Jones Industrial Average	-1.81	.70	-2.49
NYSE Composite	-2.38	.42	-2.79

but only because of the FANG stocks—Facebook, Apple, Netflix and Google, none of which are in the Dow. Most of the NASDAQ gain came in the second quarter also. Nothing else stood out, as being slightly negative or slightly positive. It was basically a small-cap and micro-cap quarter, and year.

OUR VIEW OF THE MARKET

Our minds are full to overflowing with our observations of the market, but we can't get all of our thoughts out at once—so bear with us while we do it in pieces.

First, right now a lot of negative news is rampant—fear of a tariff war, fear of rising interest rates, an immigration problem at our southern border (actually worldwide), Trump's wide-eyed optimism on North Korea and on and on. More negatives are piled on each day. We



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would caution our readers not to get too negative by “throwing the baby out with the bath water,” to use an old phrase. We do need a bit of a correction in the market, which cyclically is called for at this time of the year as summer begins. As Susan Berge points out, this is an off presidential election year, which often results in a summer correction. Furthermore, when this correction is complete (whatever it is) we embark on the rest of the 8th year rise, which lasts well into year nine, as shown in the chart of the 10-year Decennial Pattern on the previous page.

As noted in the scoreboard, small-cap and micro-cap stocks have been big winners, and we think this was foretold in the chart of the Russell 2000 Small Cap Index, which started a consolidation in January, culminating in a breakout in June. So these small-cap stocks have a way to go based on standard chart measurement techniques. We would expect at least 1750 on the RUT, but very likely 1800 or more.



We haven't printed Bob Farrell's Rules to Remember for quite a while now. Bob Farrell was the chief technician for years at Merrill Lynch. Although he started there as a fundamental analyst after graduating from Columbia, he soon realized there was more to the market and so became a “Technical Fundamentalist” and over the years came up with his ten rules to remember. Here they are:

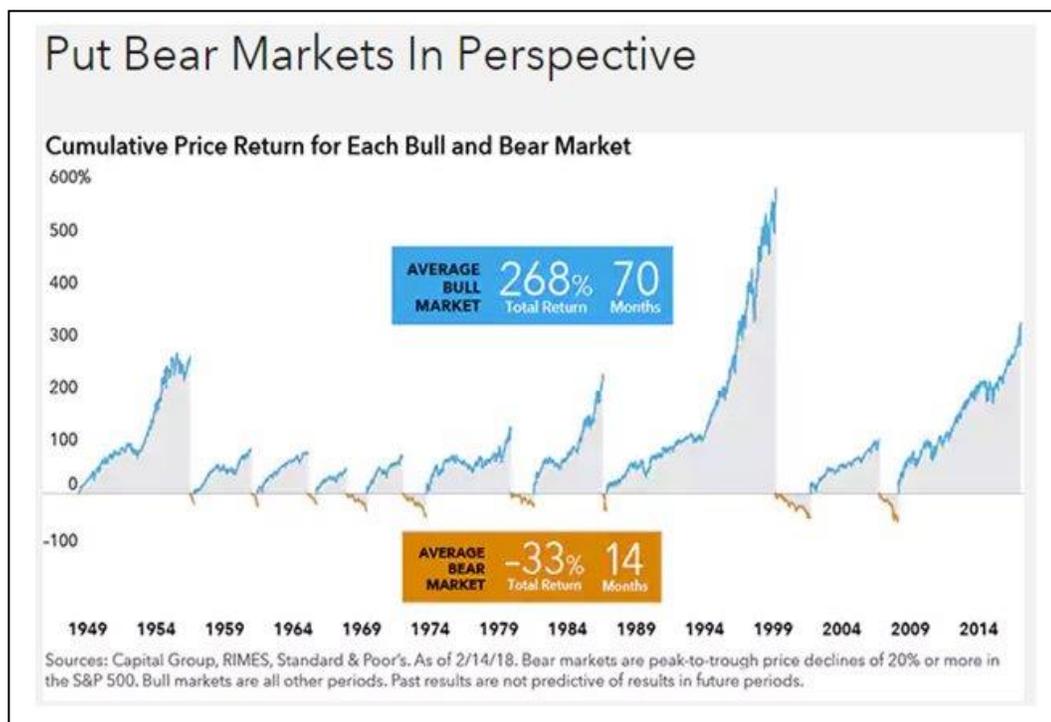
TEN MARKET RULES TO REMEMBER

1. Markets tend to return to the mean over time.
2. Excesses in one direction will lead to an opposite excess in the other direction.
3. There are no new eras--excesses are never permanent.
4. Exponential rapidly rising or falling markets usually go further than you think, but they do not correct by going sideways.

5. The public buys the most at the top and the least at the bottom.
6. Fear and greed are stronger than long-term resolve.
7. Markets are strongest when they are broad and weakest when they narrow to a handful of blue-chip names.
8. Bear markets have three stages: sharp down, reflexive rebound, and a drawn-out fundamental downtrend.
9. When all the experts and forecasts agree—something else is going to happen.
10. Bull markets are more fun than bear markets.

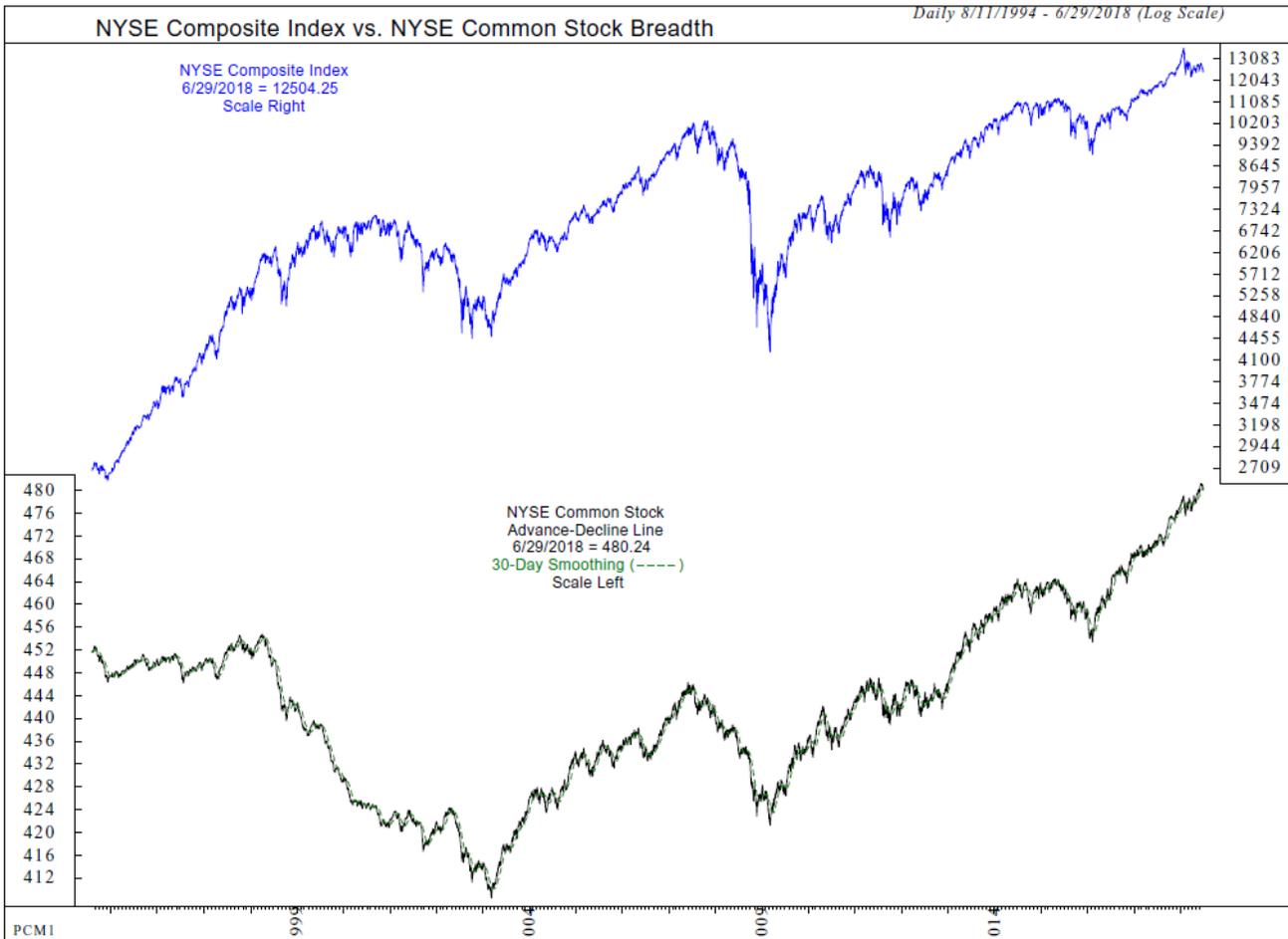
We especially agree with rule number ten, but we can relate to all of them. They are like our observations from years of looking at the market.

We have mentioned in previous letters that when the 8th and 9th year rise terminates, as the market eventually becomes less enthusiastic than it has been, and will gradually roll over, we will be looking at a decline that will last probably until the end of 2020, after which we will enjoy a bear market rally into mid-2021, then a final leg down to the forecasted low in 2022, when the 20- and 40-year cycles bottom together as in 1902, 1942, and 1982. Don't be dismayed by this as cycles are always with us, as for example, every day when the 24-hour cycle comes and goes as the earth rotates on its axis. And let's not forget about the 365-day cycle as the earth goes around the sun, which brings the four seasons that we are so used too. But we digress, and we will elaborate on those comments later in another letter. Before we went off on this tangent, we were philosophizing on the next bear market and how it is likely to unfold. But rather than be depressed about a bear market that hasn't even come, remember we have been through many of them as the long-term cycles march on; not everything goes down. In fact, that is when it is possible to



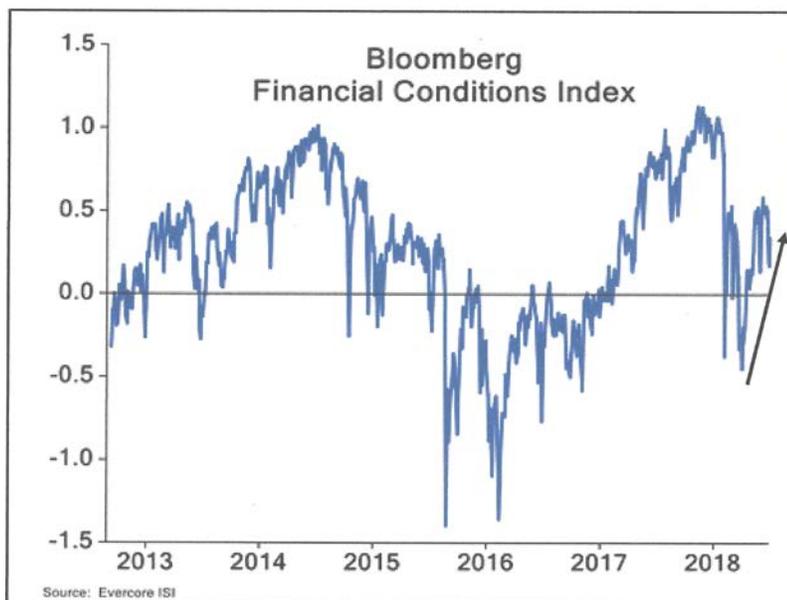
find bargains that are unavailable otherwise. In the market it is somewhat the opposite of real life, as when Macy's has a sale at big markdowns, people stand in line to buy. Not so in the stock market, however, as when prices are marked down everyone gets fearful. The higher prices go, the more people want to buy (fear of missing out) and the lower prices go, the less they want to buy, as human nature brings forth the fear of losses. So use that time to score some real bargains. Thankfully, bear markets are short affairs compared to bulls. The chart on the previous page proves this point by putting bears in perspective relative to bulls. From 1949 to the present, the average bull market was 70 months and the average bear was 14 months. So have faith, as the day will come when bargains will be available just as they are now.

But for the balance of the year and most of 2019, we continue to be very optimistic, especially on small-caps and micro-caps. One key that is very telling is the chart of market breadth which is much stronger than the NYSE Composite Index with which it is compared; thus the market is stronger than it appears.



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Another optimistic sign is the Bloomberg Financial Conditions Index, shown on the next page, and which is pointing up. This is telling us that sentiment is improving.



Two of our respected advisors, Lowry's and Louise Yamada, point out that a major market top is a process and not an event. That is, tops are a process of gradual erosion in market breadth, and the balance of supply and demand. History shows eroding strength typically first begins among small-caps before migrating to mid-caps, and finally large-caps. However, the reverse is the case now which supports our thesis that this bull market has a long way to run if that is going to take place this time.

GE: GONE FROM THE DOW AFTER 111 YEARS

We have written many times in these pages about changes in the composition of the Dow Jones Industrial Average, but a big one that just happened on June 26 makes it worth discussing Dow changes again. The Dow, if you recall, is an arithmetic average and, as such, is price-weighted not capitalization-weighted as all the other averages are. If General Electric had perhaps done a 1-for-10 reverse split it might have been okay, but at \$13 it accounted for only .36% of the Dow, while Boeing contributed 9.5%. So, as a price-weighted average, high price is what counts, although there are others that are just sneaking by, such as Pfizer at 1.01% or even the once mighty Coca-Cola at 1.22%. True, this is called an industrial average, but it is really meant to be a cross section of American industry. General Electric is still representative, but just not enough because of its price, and not what it does. Its replacement was Walgreens Boots Alliance, which will be 1.78% of the adjusted average.

When Charles Dow created the Dow Jones Average in May 1896, it consisted of 12 stocks. One of those stocks was General Electric, but even GE was dropped for a while, in 1898, but put back in 1907 as a replacement for Tennessee Coal, Iron and Railroad. There was also a time when there were 15 stocks and another time when there were 20; it has consisted of 30 stocks since 1928. Some of the large, famous companies came along over time, as General Motors joined in 1915. A latecomer, Disney, was added in 1991. Each time a name was added one had to be eliminated. To calculate the Dow, the prices of all the component stocks are added up and divided by a "divisor," which originally was 30, the number of stocks in the average. However, as changes were made in the composition of the average over the past years, the divisor has been adjusted each time to take price differences into account; the divisor is also adjusted when there is a stock split

or stock dividend in a component company. Today the divisor is less than one (0.14733), so it's actually a multiplier.

The Dow has been reconstituted over 50 times over the years as similar situations have occurred. It is the responsibility of the Index Committee at Dow Jones to keep the average bearing its name as relevant as possible, but there are real people who are responsible for making these changes so not all of them in the past have turned out as intended, and only time will tell if the Walgreens substitution for General Electric will be beneficial. One of the worst changes was the removal of RCA in May 1932, at the low of the market following the great crash, and the substitution of Nash Motors. RCA, which had plunged from \$500 to \$5, ultimately went on to be one of the great electronic companies of this century, whereas Nash Motors went out of business 30 years later. Where would the Dow be today if that substitution had not been made? Higher, obviously. The all-time record for poor timing took place on March 14, 1939 when IBM was taken out of the average and replaced by AT&T. But on June 29, 1979, IBM had become such a success story that it was put back into the average after a 40-year absence. During this period AT&T rose only 104% whereas IBM was up 21,843%. If that 1939 change had not been made, the Dow would now be ??? So much for that exercise. The idea is to own the ones that go up over time, not the ones that go out of business.

REMEMBERING CHARLES KRAUTHAMMER

This country lost one of its greatest patriots on June 21, when Charles Krauthammer died at age 68. His life was amazing; he was the epitome of persistence. Most, if not all, of our readers are familiar with his story. While attending Harvard Medical School, he paused after a tennis game to take a swim, and on his last dive his head hit bottom, leaving him a



paraplegic from then on at age 22. Most of us would have given up, but not Charles, who had a tutor bedside at his long hospitalization, and graduated on time. He never gave up, ultimately becoming a news reporter, and eventually winning a Pulitzer Prize. His 2013 memoir *“Things That Matter”* should be required reading for everyone.

Perk, especially, feels that he knew him as he had appeared twice at banquets for the Center of the American Experiment, here in Minneapolis. He had a chance to meet him personally, talk with him, and have his picture taken with him. Rest in peace, Mr. Krauthammer.

We had a tough time finding a relevant cartoon as those we liked were too political. Well, we just found this one, which is a little political too; with many states allowing medical marijuana and some allowing recreational, but either one is still illegal according to our federal government. However, Canada as a country has legalized, so perhaps the U.S. will get in step. Meanwhile, an entirely new industry with many public stocks has been created and some of them are really on fire, so to speak. By our estimate, there are 65 publically held cannabis stocks, just here and Canada alone, although for many it is a small “add-on” business. There are, however, five ETFs specializing in cannabis stocks. They are doing very well in the market, but how much of that is outright speculation, we don’t know. Suffice to say we don’t own any—yet.

Sincerely,

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

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

Daniel S. Perkins, C.F.A.
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JOKE PAGES FOLLOW →

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THE NEW YORKER

A New York attorney representing a wealthy art collector called his client. "Saul, I have some good news, and I have some bad news." The art collector replied, "I've had an awful day. Give me the good news first."

The lawyer said, "Well, I met with your wife today, and she informed me that she just invested \$5,000 in two pictures that she thinks will bring a minimum of \$15 million to \$20 million, and I think she could be right."

Saul replied enthusiastically, "Well done! My wife is a brilliant businesswoman! You've just made my day. Now I know I can handle the bad news. What is it?"

The lawyer replied, "The pictures are of you and your secretary."

OLE THE CONTRACTOR

A couple was picking out wall colors for their house with Ole the contractor. They went into the living room first, said they'd like to have it in a pale green. Ole wrote something down on a pad, then went to the window and yelled, "Gren sida oop!"

They went on into the kitchen, where the couple chose a light clay color for the room. Again Ole wrote something on a pad, went to the window, and yelled "Gren sida oop!"

This continued from room to room, upstairs and downstairs - all through the house until they were finished. Finally, the husband couldn't contain himself any longer; he had to find out what was going on. "I'm confused," he said. "Every room we've gone to, we've picked out a room color, you've written on a pad, then gone to the window and yelled, "Gren sida oop! Now, I know a little Swedish and we didn't choose green in any room. What's going on?"

"Oh!" said Ole, "I've got Sven out der layin' sod for me."

IRISH COMPASSION

Shortly after takeoff on an outbound evening Air Lingus flight from Dublin to Boston, the flight attendant nervously made the following painful announcement in her lovely Irish brogue: "Ladies and gentlemen, I'm so very sorry, but there has been a terrible mix-up by our catering service. I don't know how this has happened, but we have 103 passengers on board, and unfortunately, we received only 40 dinner meals. I truly apologize for this mistake and inconvenience."

When the muttering of the passengers had died down, she continued, "Anyone who is kind enough to give up their meal so that someone else can eat will receive free, unlimited drinks for the duration of our five-hour flight."

Her next announcement came about two hours later: "If anyone is hungry, we still have 40 dinners available."

THE HEARTWARMING LAWYER

One afternoon a lawyer was riding in his limousine when he saw two men along the roadside eating grass. Disturbed, he ordered his driver to stop and got out to investigate. He asked one man, "Why are you eating grass?" "We don't have any money for food," the poor man replied. "We have to eat grass." "Well, then you can come with me to my house and I'll feed you," the lawyer said.

"But sir, I have a wife and two children with me. They are over there, under that tree." "Bring them along," the lawyer replied.

Turning to the other poor man he stated, "You may come with us, also." The second man, in a pitiful voice, then said, "But sir, I also have a wife and six children with me~!" "Bring them all as well," the lawyer answered. They all entered the car, which was no easy task, even for a car as large as the limousine was.

Once under way, one of the poor fellows turned to the lawyer and said, "Sir, you are too kind." "Thank you for taking all of us with you."

The lawyer replied, "Glad to do it. You'll really love my place. The grass is almost a foot high."

THE NEW LAWN MOWER

A priest buys a lawn mower at a yard sale. Back home, he pulls on the starter rope a few times with no results. He storms back to the yard sale and tells the previous owner, "I can't get the mower to start!" "That's because you have to curse to get it started," says the man.

"I'm a man of the cloth. I don't even remember how to curse."

"You keep pulling on that rope, and it'll come back to you."

