

PERKINS  
CAPITAL  
MANAGEMENT, INC.

July 25, 2024

Dear PCM Clients and Friends:

We recently reread an article we saved written by Peter Lynch 27 years ago from the September 1997 issue of *Worth* magazine entitled Small-Cap Carnage. Much of the article read as if it was about today, being written about the past several years; not the mid-1990s. The headline sentence was: "The Dow is reaching new highs, but small-company stocks are in a slump. Sooner or later, this gap has to narrow."

Peter Lynch also wrote:

*Last year the Standard & Poor's 500 Stock index was up 20.3%. Remove the 25 largest companies and the return falls to 12.2 percent... The Nasdaq composite index rose 22.7 percent in 1996. But the median return was only 6 percent. That means half of the stocks in the index didn't even return 6 percent. That's a pretty good working definition of a narrow rally.*

*Through May of this year (1997), the Nasdaq was up 8.5 percent. Just four stocks, however, accounted for more than two-thirds of that gain – Microsoft, Intel, Dell Computer, and Applied Materials.*

This reads much like today. In the second quarter of 2024, the S&P 500 was up 4.28% while the Russell 2500 index – which tracks small and midsize stocks – was down -4.27%. During the first half of the year Nvidia alone accounted for nearly one-third of the S&P 500's total return. If you include Microsoft, Amazon, Meta, and Eli Lilly 55% of the market's return came from just those five companies.

Investors have been willing to pay increasingly higher prices for the same few companies based solely on expectations about their future.

In early July, the top 10 S&P 500 stocks in the market cap-weighted S&P 500 index reached their highest concentration in the index since 1972 with a new record high at 37% of the value of the S&P 500. Also, recently, the market value of Nvidia, by itself, exceeded the entire value of all of the 2,000 companies in the Russell 2000 index.

We believe the best future investment returns can be found in the many undervalued companies who have in recent years been growing and executing on their business' plans; rather than chasing what appears to us to be fully or overvalued investment themes.

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INVESTMENT MANAGEMENT

Over the decades, we have seen this over or under market valuation by investors many times. When momentum investors, often investing in a theme, push the price of individual stocks up parabolically - too far, too fast - it becomes a game of “musical chairs”; which we just do not want to play.

More importantly, from an investment opportunity perspective, when sectors of the economy become undervalued it is normally a multi-year undervaluation and an investment opportunity often presents itself. Today, the energy sector is not as oversold as it was in 2020; but to us it does represent a future investment opportunity. We remember 1980 when this sector was 30% of the value of the S&P 500. Today energy companies represent 3.5% of the S&P 500.

The healthcare sector has seen it's weighting in the S&P 500 drop to below 12%; its lowest weighting since 2012. When you look at healthcare's price deviation from its long-term positive growth trend, you see the lowest valuation since 1993. Some individual healthcare companies are fully valued. Yet, as a group, many are not and opportunities abound. The need for healthcare continues to grow. As active healthcare investors, we know many healthcare companies reached a price peak in early 2021, moved down in price, and have spent 3 ½ years in a sideways price consolidation. We believe they have now grown through this consolidation, are better values, stronger companies, and appear to us to be in the early stages of again resuming their long-term trend of price appreciation. Now is the time to search out new opportunities; especially in genetics, diagnostics and new medical devices.

For conservative income-oriented investors higher-dividend paying stocks are a nice complement – or substitute – for bonds. The utilities sector weight is near a record low of under 2.5% of the S&P 500; yet, with the potential for a decrease in interest rates and a significant increase in the potential demand for electricity to run a myriad of electronic devices, utilities are now again an investment opportunity area for conservative investors.

We continue to meet in our office, at conferences and via zoom calls with attractive small-cap and mid-cap growth companies, particularly in healthcare, computerization enabling technologies, and software, who are still down dramatically from their highs. These are opportunistic companies who have management teams with a vision for their future, are executing focused business plans toward this future, and are appropriately capitalized.

As a group, small-cap companies continue at an extreme multi-decade valuation low. Small-cap stocks have underperformed the S&P 500 for four years in a row. The last time this happened was from 1994 – 1999, a period in the market that was quite similar to now: elevated interest rates, strong economic growth and a technology driven market which left, as Peter Lynch described, small company stocks behind - in a slump. That ended in 1999 and in 2000 the Russell 2000 and small-caps started an 8-year period of outperforming the S&P which ended with the 2008 financial crisis and then resumed again in 2009 until 2021.

We still think 2024 could be a turnaround year where, as we have seen in the past, the “first become last and last become first.”

## THE MARKET SCOREBOARD

Aided by continuing AI-related enthusiasm, expectations for interest rate cuts by the Federal Reserve, solid economic growth and continued strong earnings performance from mega-cap tech companies, the S&P 500 index and the Nasdaq indexes continued to hit multiple new highs in the second quarter.

The second quarter started with fears of no rate cuts in 2024 (or even a rate hike), which pressured the markets in April, causing the S&P 500 to decline -4.08%, which was its worst month since September.

On the first day of May, Fed Chair Powell essentially shut the door on the possibility of rate hikes, stating that if the Fed was concerned about inflation, it would likely just keep interest rates at current levels for a longer period instead of raising them – “higher for longer.” That comment provided immediate relief for investors. Both stocks and bonds rallied early in May as rate hike fears subsided. The upward momentum continued in June thanks to more positive news on inflation, additional reassuring commentary from the Fed and strong AI-linked tech earnings. The Nasdaq was, by far, the best performing index in the second quarter while the S&P 500, where tech is the largest sector weighting, also logged a solidly

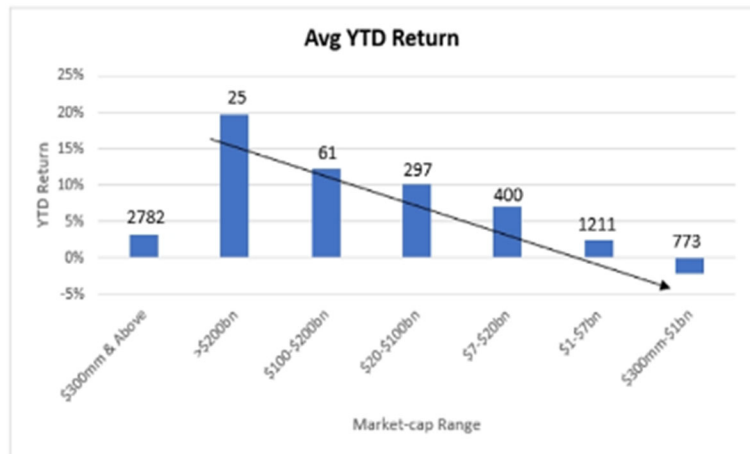
Indexes	% Return YTD 2024	% Return Q2 2024	% Return Q1 2024
NASDAQ Composite	18.13	8.26	9.11
NYSE Composite	6.96	-1.56	8.66
Dow Jones Industrial Average	3.79	-1.73	5.62
S&P 500 Total Return	15.29	4.28	10.56
Wilshire 5000	12.79	2.95	9.56

positive gain. The Wall Street Journal reported that stocks related to the “AI theme gained 14.7% in market value this quarter, whereas the rest lost -1.2%.” The Dow Jones Industrial Average and small-cap focused Russell 2000 posted negative quarterly returns.

By sector, performance was decidedly mixed with only four of the 11 S&P 500 sectors finishing the second quarter with positive returns. The two best performing sectors were the AI-linked technology and communications services sectors. The quarter was primarily driven by robust AI enthusiasm which continued to push the broad tech sector, the Nasdaq indexes and the S&P 500 to over 30 new highs in the quarter. The healthcare, financials, real estate, energy, materials and industrials sectors closed the quarter with negative returns. Their declines reflected growing anxiety about future economic growth as these sectors, along with small-cap stocks, are more sensitive to changes in U.S. and global growth.

By market capitalization, large caps outperformed small caps in Q2, as they did in the first quarter of 2024. Size mattered. In the first two quarters of the year bigger companies outperformed smaller companies. Furey Research Partners, in a study with YTD data as of June 21, 2024, detailed that YTD, in general, the larger a company’s market cap the better it had performed YTD in 2024. Of the 2,782 companies with market caps greater than \$300 million, the best performing group was the very largest 25 companies with market caps greater than \$200 billion who, as a group, were up an average of 19.6%.

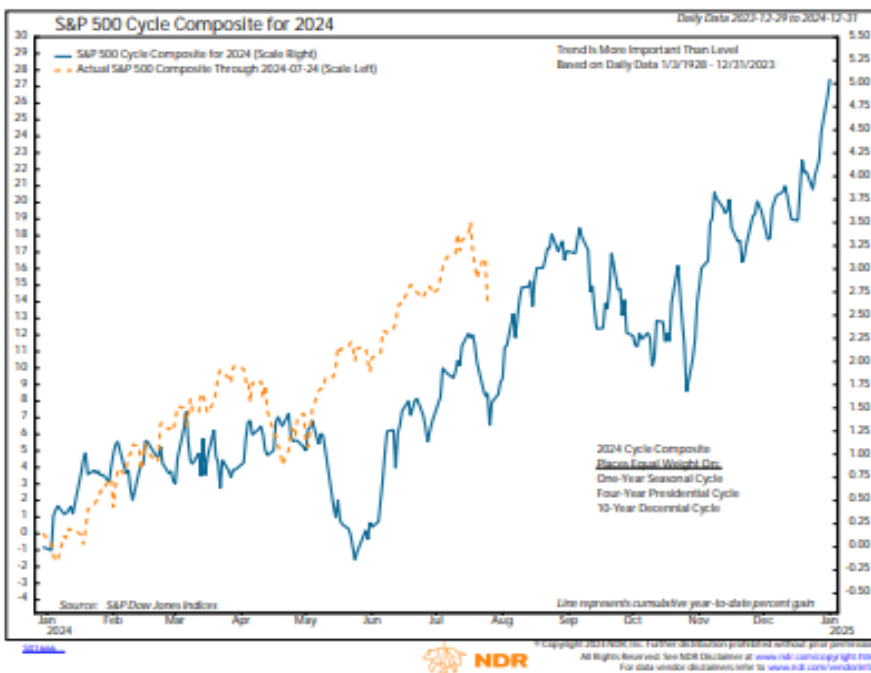
Interestingly, as detailed in the chart to the right, as market cap decreased, so did YTD performance in a declining stair-step from extremely positive to negative. The 1,211 stocks with market caps between \$1 billion and \$7 billion were up a modest 2.5% on average and those with market caps between \$300 million and \$1 billion were down -2% on average. So far, '24 has been a difficult year for small-cap investors and an extremely tough one for micro-cap companies.



Source: Furey Research Partners, FactSet. Data as of June 21, 2024

## STOCK MARKET OBSERVATIONS

We have often included in our letters a copy of the entire Ned Davis Four-Year Presidential Chart, which we will include again this October. As we have discussed, the Presidential Cycle predicts a trading range market which will last from mid-year in the year prior to the election until mid-year or later in the election year; when the uncertainty of the election outcome is removed. The important point of this cycle is that in the past, in the year leading up to the election, the markets have often been tempered until the markets feel the uncertainty of who is the next President is removed.



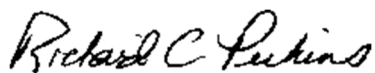
Is the uncertainty of the election removed now? No, not now. With the debate and the past reliable election indicator that during a President's 4-year term the gain or loss in real disposable income often called an election, the markets were beginning to move toward predicting a likely outcome; but not now. At this time, it appears there will be more uncertainty and much more election related news to digest.

The Ned Davis S&P 500 Cycle Composite for 2024, focuses on just this year, the election year. As you can see in the chart on the bottom of the prior page, when you compare the actual YTD S&P 500 composite, in orange, to the NDR S&P 500 Cycle Composite for 2024, in blue, the NDR 2024 Cycle has been reasonably accurate so far this year. Remember that Ned Davis says the predicted cycle trend is more important than a level. In terms of trend, the cycle predicts a correction prior to the election.

We agree and still feel, as we wrote in April, that a 10% or greater correction, which we have not had yet in terms of the averages, should be expected every year and that we should expect one yet in 2024.

As always, we are interested in meeting with you by phone, Zoom, FaceTime, or in person to answer your questions, to have a review of your investments, or for you to update us on your personal investment objectives.

Sincerely,

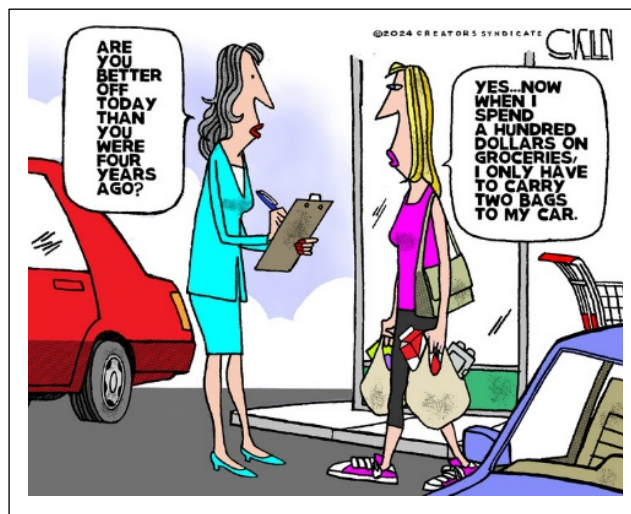


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Sven was checking in at the doctor's office and was asked to fill out a registration form. He was surprised to see that after his address the form inquired about his zip.

He promptly wrote, "Not bad for my age!"

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Pastor Ole and Pastor Sven passed away and, of course, went to heaven. They were greeted by St. Peter. "Your condos are not quite ready," he said. "So, until they are finished, I have arranged for you to return to earth as anything you would like to be." "Vunderful!" Said Pastor Ole. "I've always wanted tew be an eagle soaring over da Grand Canyon." "Your wish is granted, Ole," said St. Peter. "And now, what would you like to be, Pastor Sven?" "Vell, said Pastor Sven. "I've always wanted tew be a real cool stud." Your wish is granted, Sven," said St. Peter.

Finally, the condos were finished and St. Peter asked his assistant to bring back the two ministers. "How will I find them, Sir?" asked the assistant. "One is soaring as an eagle, over the Grand Canyon," said St. Peter. "The other one may be hard to locate. He is someplace in North Dakota on a snow tire."

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Sven and Ole, two Minnesota engineers were standing at the base of a flagpole, looking up. A woman walks by and asks what they were doing.

"Ve're supposed to find da height of dis flagpole," said Sven, "but ve don't haff a ladder."

The woman took a wrench from her purse, loosened a couple of bolts, and laid the pole down on the ground. Then she took a tape measure from her pocketbook, took a measurement, and announced, "Twenty-one feet, six inches," and walked away.

Ole shook his head and laughed. "Ain't dat yust like a voman! Ve ask fer da height and she gives us da length!"

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Ole was having a lot of trouble balancing the checkbook. Finally, he yelled at Lena, "Vhy in da vorld can't yew learn tew manage money, Lena?" "Vell, Ole!" she hollered back. "It's all your fault because yew never give me enough tew practice vit!"

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Ole is so cheap that after his airplane landed safely, he grumbled, "Vell, dere gose five dollars down da drain for dat flight insurance!"

A little boy was waiting for his mother. As he waited, he was approached by a man who asked, "Son, can you tell me where the post office is?" The little boy replied, "Sure! Just go straight down this street a couple blocks and turn to your right."

The man thanked the boy kindly and said, "I'm the new pastor in town. I'd like you to come to church on Sunday. I'll show you how to get to heaven." The little boy replied with a chuckle, "You're kidding, right? You don't even know the way to the post office."

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One evening, a family brought their frail, elderly mother to a nursing home hoping she would be well cared for. The next morning, the nurses bathed her, fed her a tasty breakfast, and set her in a chair at a window overlooking a lovely flower garden. She seemed ok, but after a while she slowly started to lean over sideways in her chair. The attentive nurses immediately rushed to catch her and straighten her up.

She seemed ok, but after a while she started tilting to the other side. The nurses rushed back and once more brought her back upright. This went on all morning. Later her family arrived to see how their mother was adjusting to her new home.

"So, Mom, how is it here? Are they treating you all right?"

"It's pretty nice," she replied. "Except they won't let you fart."

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A blonde heard that baths in milk would make her beautiful. She left a note for her milkman to leave 25 gallons of milk. When the milkman read the note, he felt there must be a mistake. He thought she probably meant 2.5 gallons. So he knocked on the door to clarify the point.

The blonde came to the door and the milkman said, "I found your note asking me to leave 25 gallons of milk. Did you mean 2.5 gallons?"

The blonde said, "No, I want 25 gallons. I'm going to fill my bathtub up with milk and take a milk bath so I can look young and beautiful again."

The milkman asked, "Do you want it pasteurized?"

The blonde said, "No, just up to my neck. I can splash it on my eyes."

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Just after the funeral services, the undertaker came up to the elderly widow and asked, "How old was your husband?" "98," she replied. "Two years older than me." "So you're 96," the undertaker commented. She responded, "Hardly worth going home, is it?"



A lonely elderly man decided life would be better with a pet. He went to his local pet store in search of an unusual pet. After much consideration, he bought a centipede, and a tiny travel carrier. He decided to start off by stopping at the bar with the centipede for a drink. So, he asked the centipede, "Would you like to go to Frank's Place and have a beer?" But there was no answer from his new pet. He waited a few minutes and asked him again, "Do you want to go have a drink with me?" But again, no answer.

After some time, and a little irritated, he asked him once more. This time, putting his face up against the centipede's carrier, he shouted, "Hey, in there! Would you like to go to Frank's Place and have a beer with me?"

A tiny voice from inside the carrier shouted back, "I heard you the first time! I am putting on my flipping shoes."

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No dictionary has ever been able to satisfactorily define the difference between "complete" and "finished." However, during a recent linguistic conference, held in England, attended by some of the best linguists in the world, Samsundar Balgobin, a Guyanese linguist, was the presenter when he was asked to make that very distinction.

The question put to him by a colleague in the erudite audience was this: Some say there is no difference between complete and finished. Please explain the difference in a way that is easy to understand.

Mr. Balgobin's response: When you marry the right woman, you are complete. If you marry the wrong woman, you are finished. And, if the right one catches you with the wrong one, you are completely finished.

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A husband read an article to his wife about how many words women use a day, 30,000 to a man's 15,000. The wife replied, "The reason has to be because we have to repeat everything to men." The husband then turned to his wife and asked, "What?"

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ASTRONOMER: When you rearrange the letters: MOON STARER

THE EYES: When you rearrange the letters: THEY SEE

DORMITORY: When you rearrange the letters: DIRTY ROOM

ELECTION RESULTS: When you rearrange the letters: LIES – LET'S RECOUNT

