PERKINS
CAPITAL
MANAGEMENT, INC.

October 24, 2022

Dear PCM Clients and Friends:

We hope this letter continues to find you and your family safe and healthy as 2022 comes to an end. Summer in Minnesota this year was dry and very enjoyable. The fall has been spectacular. Though we do not always look forward to winter in Minnesota, this year we are looking forward to enjoying the final weeks of fall, being with family and friends during the holiday months and then moving on into 2023.

We started our August Stock Market Observations section with the comment that “Numerous shocks to the economy had legitimately pressured asset prices and created a complicated investment horizon.” We also stated that we felt this environment would continue. Earlier in May we stated that we felt several “big picture” concerns including Ukraine, the Fed and interest rates, significant price inflation, and other “worries” would continue to affect the markets for the rest of the year and beyond into 2023.

That was the third quarter in spades. Perceived optimism concerning interest rates or inflation caused rallies. Reactions to the “big picture” concerns created declines. Yet, most individual companies and the economy, in general, appear to carry on.

As we start the final quarter of 2022, an honest assessment of the macroeconomic landscape reveals, as we expected, that the markets and the economy are still facing the numerous “big picture” challenges of still-high inflation, ongoing Fed rate hikes, and geopolitical instability. Yet, this reality must be considered in the context of a market that has declined substantially and, presumably, already priced in a lot of “bad news.” Valuations on many quality companies are at levels which, historically speaking, have been attractive over the longer term.

Investor sentiment is extremely pessimistic, at historically bearish extremes, which is positive.

Investors are largely ignoring the reality that there has been some improvement in the macroeconomic outlook over the past several months.

First, inflation has likely peaked. Multiple inflation indicators are showing a peak and decline in price pressures, and while the Consumer Price Index remains far above the Fed’s target of 2%, any deceleration, or even a change in direction, in inflation would likely be a material positive catalyst for both stocks and bonds.

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Second, a less aggressive Fed pivot could still occur. The Fed's last rate hike for this cycle could occur in March 2023 or sooner, after the November FOMC meeting. If that turns out to be the case, and the Fed signals, or even "jawbones" to markets that this rate hike cycle is approaching its end, that will likely be a materially positive catalyst for both stocks and bonds. The July and August rally was driven by hopes of a less aggressive Fed.

Third, geopolitical tensions remain very elevated as Russia has recently escalated the war in Ukraine and the risk of a broader conflict simply can't be ruled out. But most western countries remain united in their opposition to the Russian invasion of Ukraine and that will continue to be a powerful deterrent to Russian President Putin. Additionally, even some of Russia's most important allies, including China and India, have voiced concerns about the escalation of the war over the past month. Any reduction in geopolitical tensions would provide a surprise boost for global risk assets, including U.S. stocks and bonds.

Finally, amidst a difficult macroeconomic backdrop, the U.S. economy and corporate earnings have proven impressively resilient. Most measures of U.S. economic growth remain in solid shape. The widespread earnings declines that were feared back in early 2022 simply have not materialized.

Bottom line, the "macro" outlook for markets and the economy remains challenged, but investors have priced in a lot of "bad" news already, with valuations now at levels that are historically attractive. Sentiment is as pessimistic as it was during the depths of the financial crisis. This is a difficult market and a complicated moment for the world, but history is clear: Positive surprises can and have occurred even in difficult times such as this, and through periods of similar macroeconomic turmoil, markets eventually recouped the losses and moved to meaningful new highs. This is the historical record and there is no reason to think this time will be any different.

THE MARKET SCOREBOARD

Stocks and bonds both extended their declines in the third quarter as inflation remained near multi-decade highs, geopolitical tensions escalated further, and the Federal Reserve continued to aggressively hike interest rates signaling future rate increases will be larger than previously expected.

A month after the mid-June low, in mid-July, a solid rebound off the second quarter lows started in stocks that was driven by resilient corporate earnings, signs of a possible peak in inflation, and hints from the Federal Reserve that the end of the rate hiking cycle may come sooner than markets initially expected. Starting with earnings, corporate results for the second quarter were much better than feared. Despite high inflation and lingering supply chain issues, the majority of Q2 earnings reports beat estimates, and that solid performance by corporate America showed investors that, despite numerous macroeconomic challenges, U.S. earnings were holding up much better than expected. On the inflation front, several survey-based economic reports showed price declines in June and offered hope that inflation pressures were peaking. Finally, in late July the Federal Reserve raised interest rates by another 75 basis points, but at the press conference Fed Chair Powell stated that, at some point in the future, it would likely be necessary for the Fed to slow the pace of interest rate increases. Investors interpreted that comment as a signal that the end of the rate hike cycle may be closer than previously thought. Hope for a less aggressive Fed paired with resilient earnings and a possible peak in inflation fueled a 9.2% gain in the S&P 500 in July, its best monthly return since November 2020.

Stocks continued higher through the first half of August with the S&P 500 at nearly a four-month high by mid-August. After the worst first half start to a year since 1970, the S&P had rallied 17.4% from its June 16 low to its August 16 high.

Then, while making remarks at the Jackson Hole Economic Symposium, Fed Chair Powell dismissed the idea of a Fed pivot to a less aggressive policy, dashing hopes that the end of the rate hike cycle was in sight. Powell also warned that the U.S. economy would likely feel some "pain" from the Fed's actions. The reiteration of aggressive policy and historically large rate hikes, combined with the warning of looming economic pain, hit stocks late in August.

The markets gave back all the early August gains to end the month solidly lower.

The selling continued in September when at the September FOMC meeting, the Federal Reserve again hiked interest rates by 75 basis points and signaled rates will continue to rise to levels higher than previously expected. The combination of sticky inflation, expectations of numerous future Fed rate hikes, rising geopolitical tensions, and a flight by global investors into U.S. dollars, making currency and bond markets volatile worldwide, weighed heavily on stocks and bonds into the end of September; causing both markets to finish the quarter near their lows for the year. The S&P 500 had its worst first nine months of a year since 2002 and its fourth worst since 1926.

By market capitalization, small-cap and growth stocks modestly outperformed large-cap stocks early in the quarter. This outperformance was temporary and diminished after a sooner-than-expected Fed "hawkish" pivot signaled there was no imminent end to the Fed rate hiking cycle. As interest rates hit new highs, investors rotated back to the perceived safety of large-cap stocks.

Indexes	% Return YTD 2022	% Return Q3 2022	% Return Q2 2022	% Return Q1 2022
S&P 500 Total Return	-20.68	-4.79	-14.36	-2.72
Dow Jones Industrial Average	-20.95	-6.66	-11.25	-4.57
NYSE Composite	-21.51	-7.01	-13.10	-2.87
Wilshire 5000	-26.05	-4.60	-17.63	-5.89
NASDAQ Composite	-32.40	-4.11	-22.44	-9.10

On a sector level, just one of the 11 S&P 500 sectors finished the third quarter with a positive return. Consumer discretionary posted a positive return thanks to strong consumer spending and still-low unemployment. The energy sector finished the quarter with a fractional loss as energy stocks benefitted from solid earnings and strength in natural gas prices. Traditionally, defensive sectors like healthcare began to outperform over the past three months, as investors positioned for slower future economic growth.

Sector laggards in the quarter included communication services, real estate, and materials. Investors continued to shun expensively valued tech companies. In the face of spiking mortgage rates, home price appreciation began to slow and real estate as a broad investment sector declined. There was a sharp drop in several core commodities prices in the third quarter, which was driven by a stronger dollar and growing worries about the global economy.

With rising interest rates, even the traditional “risk-off” bond markets were no place to hide. It was the worst three-quarters in modern history for long-term Treasuries. The Bloomberg Barclays Long U.S Treasury Index was down -9.6% in Q3 bringing 2022 losses to -28.8%.

In sum, the third quarter started with optimism surrounding a resilient corporate earnings outlook, a potential peak in inflation, and a closer-than-expected end to the current Fed rate hiking cycle. But throughout August and September that optimism was eroded by continued rising inflation data and a much more hawkish-than-expected Federal Reserve. At this time, in the fourth quarter, “the markets” remain in search of concrete positive catalysts that signal declining inflation pressures and a less aggressive Federal Reserve.

STOCK MARKET OBSERVATIONS

In August we wrote that we felt the market was in a summer rally and that it had put in “a” bottom on June 16 after ending a selling streak where in five out of seven trading days 90% of S&P 500 stocks closed lower. This was historic one-sided negativity. In August, we also said we felt it was too early to say with any conviction or credibility if the mid-June lows would be the final lows in the averages for this bear market or just “a” low along the way to making a bottom. This is still the case.

Cutting to the point, at this time we feel the market is in the process of making a bottom. We still do not know if “the bottom,” in terms of the averages, is in or not. We feel several important pieces toward a bottom have certainly occurred; but major bottoms after a significant decline are a process. Except in “V” bottoms, which is not anticipated here and are often news driven, there is normally not one trading day that makes “the bottom.” We remember the bottom after the financial crisis in 2008-2009. We remember that at that time many of our investments did not go lower after the November 2008 lows. They were down dramatically and had begun building bases; accumulating strength from which to advance. Yet, the bottom in the indexes was not until March of 2009.

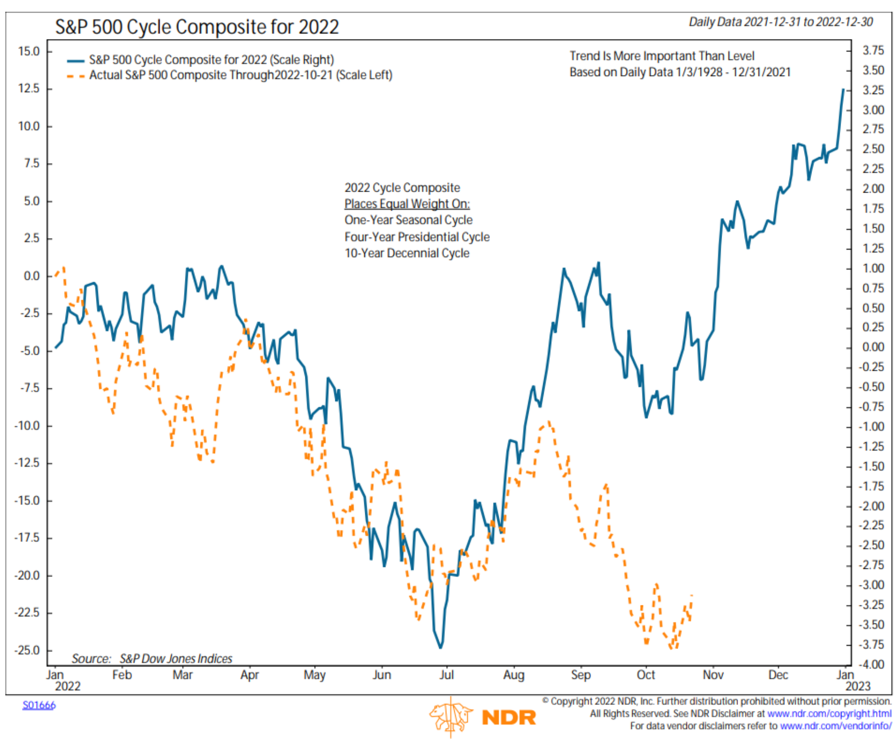
Ned Davis Research and others describe the “making of a bottom” as a four-step process. Simplified, first, after the markets have sold off for a period of time and become deeply over-sold, they then must have a significant rally. What is important is that after the rally the market comes back into the area of the deeply oversold lows and tests that area without going too much lower. After this “test of the bottom” occurs, we need to see the market begin moving up with increasing upside momentum, or what market technicians refer to as "breadth thrusts." This is when 90% or more stocks go up in a strong day or there are several 80% days near to each other; without any intervening "negative breadth thrust" days.

The selloff into June 16 was a historic decline and certainly a sold-out low. In the summer rally, which lasted 30 days to August 16, the S&P 500 rallied 17%, the Dow gained 14%, and the Nasdaq Composite increased 23%; all credible significant rallies. Subsequent to August 16, the markets have come back down into the area of their June 16 lows without breaking much lower. The Russell 2000 came down to its low after a 6-week decline and did not make a new low, staying and testing above the low for the past three weeks. The S&P 500 declined for 5 weeks, spent the sixth week in and around the low, going modestly lower, and is now slightly above its June 16 low. The Nasdaq Composite was down for 6 weeks and has been around its lows for 3 weeks. The Dow's decline was more significant and it spent 7 days below its low. On the 6th day it closed 1,163 points or 4% below its low and acted like it would start a decline the next day. It did not. Instead, it was up and then gapped up higher the next day. At this point, all of the major averages, after declining back into the area of their lows, have had a successful 3-week test of their lows.

What we would like to see now is for the market to "get some legs" and start going up.

We have often included the important cycle work of Ned Davis Research and we again include a copy of their S&P 500 Cycle Composite for 2022, which calls for a year-end rally. Remember, they emphasize their composite is not a forecast; but a historical guide.

Of importance this year is the influence of the midterm cycle; which has a declining market until before the elections. Also, interestingly, as noted by market technician, Susan Berge, the markets have seen a major bottom in every off-presidential election year since 1960. Ned Davis Research has also noted, and we have discussed previously, that historically from the fall of a midterm year to the summer of the next year is the strongest period of the 4-Year Presidential Cycle.



As we wrote in our last letter, we will continue to review and question what we are invested in for you, rebalancing where needed, doing some selling where we feel businesses have not met our expectations, despite these low prices, and investing in companies which are also now down significantly, have growing businesses, and are attractively priced.

In this environment, we also want to upgrade the quality of your investments. As Philip Carret said: "There is no substitute for buying quality assets and allowing them to compound over time."

As always, if you have any questions about your accounts, any of your specific investments, or any of the companies you are invested in, please give us a call. Or call in and ask to schedule a time to talk.

Also, clients and companies are also coming into the office again to meet with us in person and we welcome this.

Sincerely,

Richard C. Perkins, C.F.A.
President
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Daniel S. Perkins, C.F.A.
Chief Operating Officer
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JUST A MIXTURE TO MAKE YOU SMILE:

Children's Logic: “Give me a sentence about a public servant,” said a teacher. The small boy wrote: “The fireman came down the ladder pregnant.” The teacher took the lad aside to correct him. “Don't you know what pregnant means?” she asked. “Sure," said the young boy confidently. “It means carrying a child.”

A nursery school teacher was delivering a station wagon full of kids home one day when a fire truck zoomed past. Sitting in the front seat of the truck was a Dalmatian dog. The children started discussing the dog’s duties. “They use him to keep crowds back,” said one child. “No,” said another, “he’s just for good luck.” A third child brought the argument to a close. “They use the dogs to find the fire hydrants.”

Out bicycling one day with my eight-year-old granddaughter, Carolyn, I got a little wistful. I said to her that “In ten years you'll want to be with your friends and you won't go walking, biking, and swimming with me like you do now.” Carolyn shrugged, “In ten years you'll be too old to do all those things anyway.”

A woman applying for a job in a Florida lemon grove seemed way too qualified for the job. “Look Miss,” said the foreman, “have you any actual experience in picking lemons?” “Well, as a matter of fact, yes!” she replied. “I’ve been divorced three times."

An old man goes to the Wizard to ask him if he can remove a curse he has been living with for the last 40 years. The Wizard says, “Maybe, but you will have to tell me the exact words that were used to put the curse on you.” The old man says without hesitation, “I now pronounce you man and wife.”

Three friends from the local congregation were asked, “When you’re in your casket, and friends and congregation members are mourning over you, what would you like them to say?” Artie said: “I would like them to say I was a wonderful husband, a fine spiritual leader, and a great family man.” Eugene commented: “I would like them to say I was a wonderful teacher and servant of God who made a huge difference in people's lives.” Al said: “I’d like them to say, “Look, he’s moving!”

Moe: “My wife got me to believe in religion.” Joe: “Really?” Moe: “Yeah. Until I married her - I didn’t believe in hell.”

One day the first grade teacher was reading the story of Chicken Little to her class. She came to the part of the story where Chicken Little tried to warn the farmer. She read, "And so Chicken Little went up to the farmer and said, 'The sky is falling, the sky is falling!'" The teacher paused, then asked the class, "And what do you think that farmer said?” One little girl raised her hand and said, "I think he said: 'Holy Shit! A talking chicken!'" The teacher was unable to teach for the next 10 minutes.

A man is recovering from surgery when the surgical nurse appears and asks him how he is feeling. “I’m ok, but I didn’t like the four-letter-word the doctor used in surgery,” he answered. “What did he say?” asked the nurse. “OOPS!” he replied.

A husband was at his wife’s graveside service which was just barely finished, when there was a massive clap of thunder, followed by a tremendous bolt of lightning, accompanied by even more thunder rumbling in the distance. The little, old man looked at the pastor and calmly said, "Well, she's there."

A little boy was doing his math homework. He said to himself, "Two plus five, that son of a bitch is seven. Three plus six, that son of a bitch is nine." His mother heard what he was saying and gasped, "What are you doing?" The little boy answered, "I'm doing my math homework, Mom." "And this is how your teacher taught you to do it?" the mother asked. "Yes," he answered. Infuriated, the mother asked the teacher the next day, "What are you teaching my son in math?" The teacher replied, "Right now, we are learning addition." The mother asked, "And are you teaching them to say two plus two, that son of a bitch is four?" The teacher answered, "What I taught them was, two plus two, THE SUM OF WHICH, is four."

CHILDREN'S SCIENCE EXAM ANSWERS

Q: Explain one of the processes by which water can be made safe to drink.
A: Flirtation makes water safe to drink because it removes large pollutants like grit, sand, dead sheep and canoeists.

Q: How is dew formed?
A: The sun shines down on the leaves and makes them perspire.

Q: How can you delay milk turning sour?
A: Keep it in the cow.

Q: What happens to a boy when he reaches puberty?
A: He says good-bye to his boyhood and looks forward to his adultery.

Q: What is the fibula?
A: A small lie.

Q: What does "varicose" mean?
A: Nearby.

Q: What does the word "benign" mean?
A: Benign is what you will be after you be eight.

GRANDPARENTS AND GRANDCHILDREN

My young grandson called the other day to wish me Happy Birthday. He asked how old I was, and I told him, "62." He was quiet for a moment, and then he asked, "Did you start at one?"

A grandmother was telling her little granddaughter what her own childhood was like: "We used to skate outside on a pond. I had a swing made from a tire; it hung from a tree in our front yard. We rode our pony. We picked wild raspberries in the woods." The little girl was wide-eyed, taking this all in. At last, she said, "I sure wish I'd gotten to know you sooner!"

I didn't know if my granddaughter had learned her colors yet, so I decided to test her. I would point out something and ask what color it was. She would tell me and was always correct. It was fun for me, so I continued. At last, she headed for the door, saying sagely, "Grandma, I think you should try to figure out some of these yourself!"

A second grader came home from school and said to her grandmother, "Grandma, guess what? We learned how to make babies today." The grandmother, more than a little surprised, tried to keep her cool. "That's interesting," she said, "How do you make babies?" "It's simple," replied the girl. "You just change 'y' to 'i' and add 'es'."

WOMEN'S REVENGE

"Cash, check or charge?" I asked, after folding items a woman wished to purchase. As she fumbled for her wallet, I noticed a remote for a television in her purse. "So, do you always carry your TV remote?" I asked. "No," she replied, "but my husband refused to come shopping with me, I figured this was the evilest thing I could do to him legally."

LOOSE LIVING

"A drunk that smelled like a brewery got on a bus one day. He sat down next to a priest. The drunk's shirt was stained, his face was full of bright red lipstick and he had a half-empty bottle of wine sticking out of his pocket. He opened his newspaper and started reading. A couple minutes later, he asked the priest, "Father, what causes arthritis?" "Mister, it's caused by loose living, being with cheap, wicked women, too much alcohol, and contempt for your fellow man," the priest replied.

"Imagine that," the drunk muttered. He returned to reading his paper. The priest, thinking about what he had said, turned to the man and apologized: "I'm sorry, I didn't mean to come on so strong. How long have you had arthritis?"

"I don't have arthritis, Father," the drunk said, "but I just read in the paper that the Pope does."

MEN AND THEIR DOGS

Four men were bragging about how smart their dogs are. The first man was an engineer, the second man was an accountant, the third man was a chemist, and the fourth was a government worker.

To show off, the engineer called to his dog. “T-Square, do your stuff.” T-Square trotted over to the desk, took out some paper and a pen, and promptly drew a circle, a square, and a triangle. Everyone agreed that was pretty smart.

But the accountant said his dog could do better. He called his dog and said, “Slide Rule, do your stuff.” Slide Rule went out into the kitchen and returned with a dozen cookies. He divided them into 4 equal piles of 3 cookies each. Everyone agreed that was good.

But the chemist said his dog could do better. He called his dog and said, “Measure, do your stuff.” Measure got up, walked over to the fridge, took out a quart of milk, got a 10 oz. glass from the cupboard, and poured exactly 8 oz. without spilling a drop. Everyone agreed that was good.

Then the three men turned to the government worker and said, “What can your dog do?” The government worker called to his dog and said, “Coffee Break, do your stuff.” Coffee Break jumped to his feet, ate the cookies, drank the milk, dumped on the paper, assaulted the other three dogs, claimed he injured his back while doing so, filed a grievance report for unsafe working conditions, put in for Worker's Compensation, and went home on sick leave.

“Why do I get the feeling our secret hunting spot is no longer secret.”

"Blah! You have duck breath!"