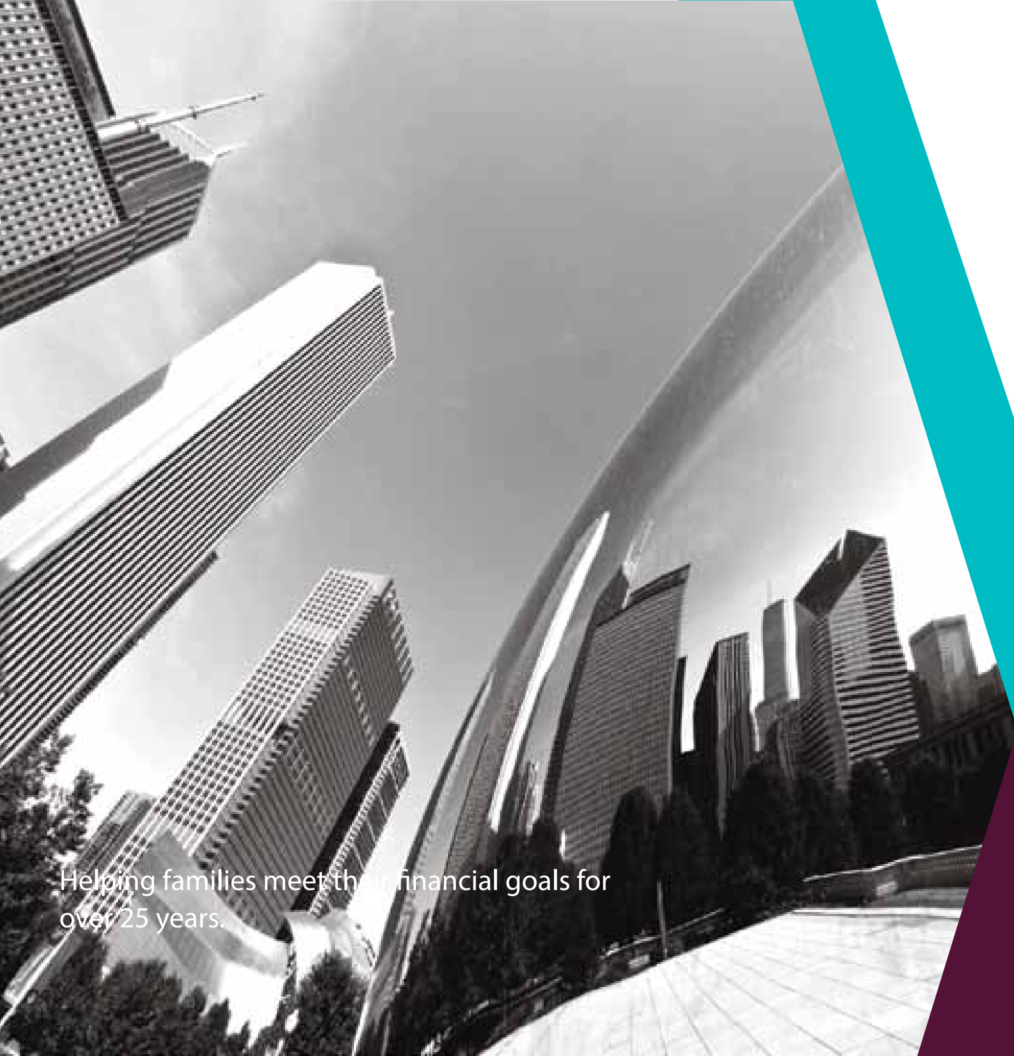
REFLECTIONS

4th Quarter Newsletter 2013



WINDGATE

WEALTH MANAGEMENT

INTRODUCING WINDGATE WEALTH MANAGEMENT

Perritt Capital Management is excited to launch our new website and rebrand of our Private Wealth relationships: Windgate Wealth Management.

The Windgate Wealth Management name was born as a nod to Chicago's famous Cloud Gate sculpture and our home in the Windy City. The logo and new design emphasize reflected images to pinpoint how our services and philosophy strive to reflect our clients' individual financial needs.

Our new site will feature regular commentary and insights in addition to your quarterly newsletter. Take a look online at www.windgatewealth.com

We look forward to your feedback.

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You can log-in to your personal financial website at the same address by going to the "see all accounts" tab

"WE CANNOT PREDICT THE FUTURE. WE CAN ONLY INVENT IT."

Dennis Gabor, Nobel Price Winner, Physics

Perritt Capital Management, Inc. is the registered investment advisor for Windgate Wealth Management accounts.

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If you have any questions or comments, or if you know of any friends or family that might benefit from our services, please give us a call at 800.331.8936.

We look forward to continuing the Windgate Wealth Mangement tradition of helping our clients reach their financial goals.

REBALANCING AND REGRESSION TO THE MEAN: A PROFITABLE PAIR

Sean Condon CFP®, Financial Planner, Wealth Advisor

If you are looking to make a New Year's resolutions that you can actually keep, "invest only in the best asset class of 2014" is not a goal we would recommend. The colorful table that follows reveals what a challenge it is to consistently identify the best asset class for the coming year. It also serves as an instructive reminder of why diversification works. Study this chart only briefly and you can see that a New Year's resolution to "invest a portion of my assets in the best asset class of 2014" is actually a goal where the chance of your success is very high.

Each year we like to update the graph on the next page and revisit the idea of regression to the mean. The graph shows how today's winner may be tomorrow's loser. Why? History teaches us that all broad asset classes will eventually revert to the mean. Regression to the mean is a phenomenon in which asset classes will gravitate to their average growth over a course of time. Look at last year, emerging markets were one of the worst performing asset classes, returning investors 1.9%. Yet in 2012 these same investments were one of the best, returning 18.6%. This may not be a coincidence, this is regression to the mean in action.

Want to profit from regression to the mean? Diversifying your investments by rebalancing is an effective tool. For example, take a portfolio of 60% equities 40% bonds (60/40). After a hypothetical strong year for equities and a weak year for bonds (like 2013), your 60/40 portfolio ends up looking more like 65% equities and 35% bonds. The market has caused your portfolio to drift away from your original allocation. Rebalancing means that you are returning back to your original investment stance.

The goal of the rebalance is to take advantage of the short term volatility to move you back towards your model allocations at more advantageous valuations. This process can be applied to more specific asset classes within equity and fixed income (for example emerging markets, small-cap, corporate bonds and government bonds) for maximum effect.

To achieve a diversified investment portfolio, and make sure you're set up for long-term success, you have two goals: 1) invest broadly across assets, 2) invest broadly across markets. Investing broadly across assets is the opposite of doubling down on one company's stock. By spreading your assets out over many industries and companies you save your portfolio from unnecessary risks and volatility. Any stock can go to zero, but an asset class cannot. Asset classes revert to the mean.

Investing broadly across markets is investing your portfolio in several asset classes. It is near impossible to know which asset classes will outperform others from year to year, as we've seen here. But by studying trends in regression to the mean and rebalancing your portfolio, you may increase your odds of investing more in next year's winners.

Best of all, rebalancing saves you from rash investing behavior that results from emotions getting the best of you: begging you to double down recent winners, making you more likely to buy at the top of the markets. And the flipside? Rebalancing actually causes you to invest more of your money in last year's losers, those assets classes that emotion has you staying far away from may offer great investments at bargain prices. This year, make a portfolio New Year's resolution that you can actually keep. Rebalance and diversify and you will see that buy low, sell high is a goal that can be actually achieved.

ASSET CLASS RETURNS (%)

2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
31.6	34.5	35.1	39.8	5.2	79.0	27.9	8.3	19.7	38.8
26.0	21.4	32.6	16.2	1.8	32.5	26.9	7.8	18.6	32.4
20.7	14.0	26.9	11.6	-33.8	28.0	19.2	2.1	17.9	23.3
18.3	12.2	18.4	7.0	-35.6	27.2	16.8	0.1	16.3	2.9
10.9	4.9	15.8	5.5	-37.0	26.5	15.1	-4.2	16.0	0.0
9.1	4.6	4.8	4.6	-37.7	18.9	8.2	-11.7	4.2	-2.0
4.3	3.0	4.3	-1.6	-43.1	5.9	6.5	-13.3	0.1	-2.3
1.2	2.4	2.1	-15.7	-53.2	0.1	0.1	-18.2	-1.1	-9.5

Small Cap | S&P 500 | International | REIT's
Cash | Fixed Income | Emerging Markets | Commodities

"Rebalancing saves you from rash investing behavior that results from emotion getting the best of you"

See disclosure on last page

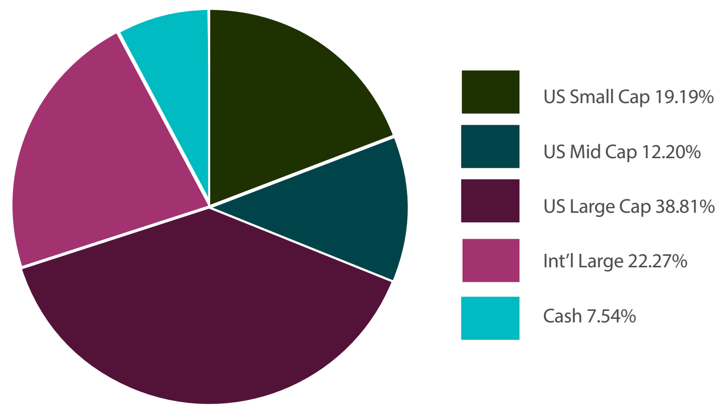
GLOBAL GROWTH PORTFOLIO: YEAR IN REVIEW

The Global Growth Portfolio is an asset allocation model focusing on high growth and international opportunities. It is designed for investors who are seeing capital appreciation and who have an above-average tolerance for risk. At the onset of 2013, we had noted that the Global Growth Portfolio was positioned in one of its most bullish orientations in many years. After starting the year with a fully-invested posture, we took additional exposure in economically sensitive areas by investing in the energy and semi-conductor sectors. This investment turned out to be well-timed and highly beneficial for the 2013 return of the Portfolio. As the year progressed, we trimmed our position in some winning investments and sold others outright in order to take profits off the table. In the third quarter, we liquated our iShares PHLX SOX Semiconductor Sector position and significantly reduced our position in iShares Russell 2000, a US small cap ETF. Each of these positions had provided our clients with positive returns for the year. These changes not only locked in the excess gains we achieved with our previous overweight to US small caps but also freed capital for our longer-term goal of further rotating to international small cap stocks. We believe that there is a noticeable valuation gap between US domestic equities and their international and emerging economy counterparts. Simply put, international stocks look less expensive at the moment in our view.

With that valuation gap in mind, we did take a first small step to increase our exposure to emerging markets at the end of 2013. Fears from the "Tapering" program conducted by the US Federal Reserve have sent emerging economy stocks (and more importantly, currencies) reeling. During 2014, we will look to continue for opportunities to increase our exposure to areas of the market being liquidated by panicked investors. We also enter 2014 with more cash than we did 2013 as we look for better opportunities to redeploy our excess cash position.

> "Fears from the "Tapering" program being conducted by the US Federal Reserve have sent emerging economy stocks (and more importantly, currencies) reeling."

Global Growth Asset Allocation 12/31/2013

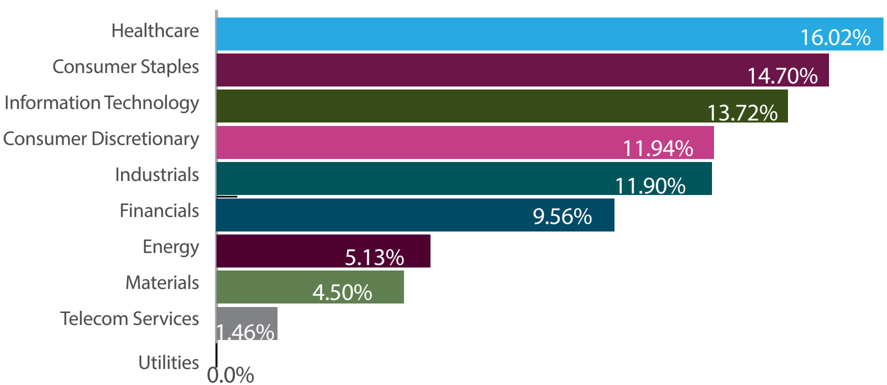


BLUE CHIP YEAR IN REVIEW 2013

The fiestas of San Fermin in Pamplona, Spain have become famous for The Encierro…The Running of the Bulls. The year 2013 was the stock market version of the running of the bulls, with the "bulls" firmly in control. Anyone who positioned themselves against the upward market trend ended up getting run over. Stocks, as measured by the S&P 500, were up over 30% on a total return basis during 2013. From start to finish, the stock market had a tremendous year. Stocks were up over 10% in both Q1 & Q4 and only two months (June & August) had negative returns. In fact, 2013 was the best annual performance for the S&P 500 Index since 1997. During the year, the index posted 45 new all-time closing highs. Finishing the year on a high note, the index reached a new intraday and closing high on the last day of trading. The last time the index closed the year with a new high was in 1999.

Looking ahead to 2014, the key data point to watch might be sales growth, which has been slow in general. Companies have been able to grow earnings in the face of mediocre top line growth by continuing stock buybacks and increasing margins. Eventually investors will need to see top line growth improve to a new level before we can confidently take another step forward in the market. While we are seeing improvements in the economy, many consumers are still nervous. Consumers have been cautious in their spending habits because of uncertainty surrounding home prices, jobs, and changes in health care. The nervousness of consumers trickles down to companies who don't want to get caught over-producing or holding excess inventory. The concern the companies have is partly why we haven't seen job expansion quickly as we had hoped. Until companies become more confident that the consumer is back, it is doubtful we will see a significant increase in employment.

Blue Chip Positions by Sector 12/31/2013



On the back of these tailwinds the Blue Chip portfolio had another solid year in 2013. The Blue Chip portfolio is designed to meet or exceed the return of the S&P 500 index on a risk-adjusted basis. Protecting capital is the main goal, however we also strive to find companies that will generate above average growth for our clients. We continue to look to invest in companies that generate strong cash flows, have high return on equity, and maintain a solid balance sheet. Individual portfolio returns may differ as a result of a number of factors such as desired cash levels, individual positions, and position sizes.

Roughly half of the stocks in the portfolio had returns in excess of 30% during 2013. The best performing stock was Ameriprise Financial Inc (AMP) up over 80% for the year. McKesson Corporation (MCK) was also a stellar performer for us up over 66%. Other positions that performed well include Prudential Financial, Inc (PRU), FedEx Corporation (FDX), and Walgreen Co (WAG) each up over 55%. Every name in the portfolio had a positive year except International Business Machines Corp. (IBM). IBM return -2% during 2013. We don't expect or plan for continued years of 30% growth in the portfolio. Over a full market cycle, with years of decline mixed in with the positive, we feel this type of defensive equity portfolio will perform best.

"Protecting capital is the main goal, however we also strive to find companies that will generate above average growth for our clients."

LOWER YOUR TRADING COMMISSIONS - ENROLL IN ELECTRONIC STATEMENTS

Did you know that you can potentially reduce the fee charged by your custodian per trade by as much as half? By enrolling in electronic delivery of statements, we may have the ability to lower your annual cost of investing. Depending on account type, we may be able to reduce the cost per trade from $19.95 (or more) to $8.95.

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Not a recommendation to buy or sell these securities. Past performance does not guarantee future results

ALL WEATHER PORTFOLIO: YEAR IN REVIEW

The All Weather Portfolio is a conservative asset allocation investing in both domestic and international equities and bonds as well as alternative investments such as precious metals. It is designed to provide our clients with participation in stock market gains while also providing downside protection. We made several changes in 2013 to the portfolio based on our interpretation of market signals and valuations.

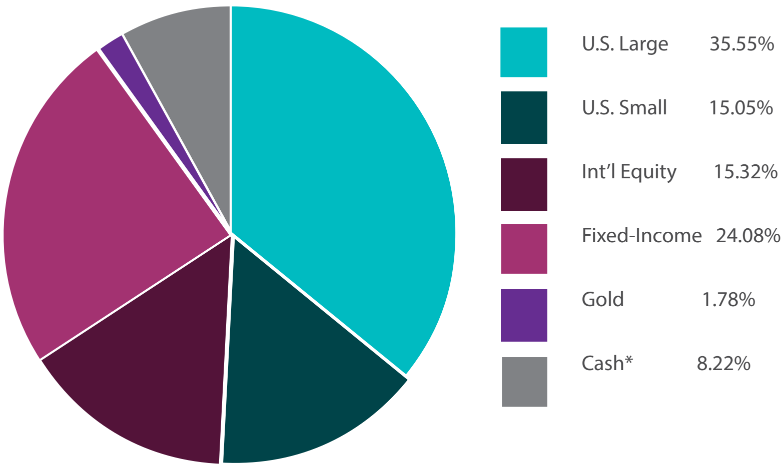
The first change was a purchase of the Vanguard Short Term Bond Fund. We made this purchase to lower the duration risk associated with the fixed income portion of the portfolio. Duration is a measure of the sensitivity of the price (the value of principal) of a bond to a change in interest rates. Imagine for a moment you are holding out your arm parallel to the ground and there is a tiny man resting on your finger. Now move your arm up and down, only slightly. This man's travels at the end of your finger are his duration. If he were to rest not on your finger but nearer to your elbow, for example, his movements wouldn't be nearly as great. That's lower duration. Conversely, imagine if you had fifty foot arms. Make the same slight motion up and down and now that little spec at the edge of your finger is in for a wild ride. That poor fellow is experiencing high duration.

The low duration, Short Term Bonds should be the least sensitive to an increase in interest rates as the Fed moves to taper their monthly bond purchases. Our research has found that longer term duration bonds have occasionally lost their value in a rising interest rate environment. We reduced the risk associated with the previous intermediate-term bond investment by replacing it with selling out of what we view as the most prudent position given the current economic environment.

"By rebalancing the portfolio, we were able to take profits and bring the portfolio closer toward our target allocation.."

Not a recommendation to buy or sell these securities
Past performance does not guarantee future results.

All Weather Asset Allocation 12/31/2013



The second change we made in 2013 was the purchase of the iShares High Yield Bond Fund. We made this purchase to increase the portfolio's yield (interest earned) as we view the interest rate on this product to be large enough to compensate for the higher default risk associated with the underlying companies. High yield bonds also resemble equity investment more than most fixed income investments, so the portfolios offer a chance for capital appreciation along with the attractive interest rate. After monitoring the fixed income space throughout the year we made the investment after what we considered was a selloff in the space from lofty valuations.

Lastly, we also sold half of the position in the iShares Russell 2000 Index Fund. US Small-cap stocks have provided positive returns for several years. As discussed in this newsletter, this led the investments to become slightly overweight relative to other asset categories. By rebalancing the portfolio, we were able to take profits and bring the portfolio closer toward our target allocation. The next step in portfolio rebalancing is to uncover under-performing asset classes and plan on redeploying the cash into an emerging market investment early this year.

SMALL COMPANY PORTFOLIO: YEAR IN REVIEW

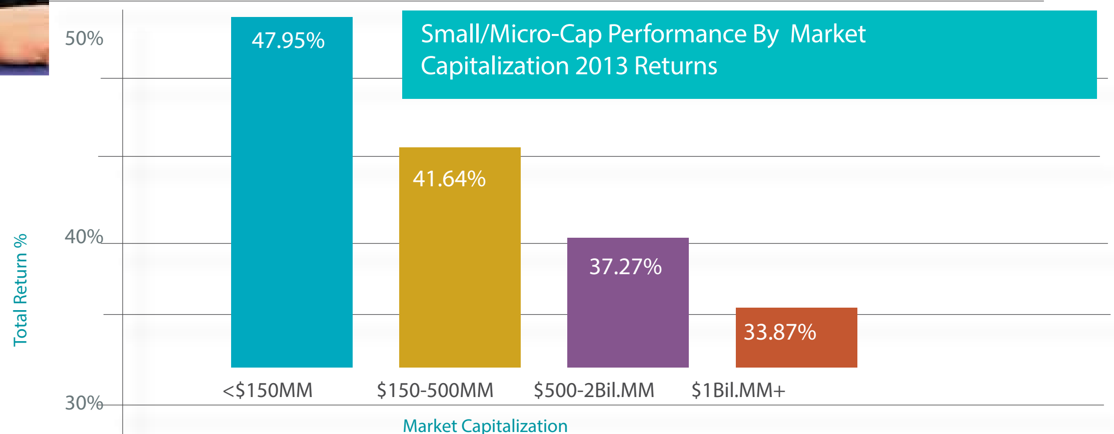
Michael Corbett, Chief Investment Officer/Portfolio Manager

#'s Speak Louder than Words: 2013 Review

"Why should I include micro-cap as part of my small-cap allocation?" It is a question we hear often from investors. The answer is that, since 1926, micro-cap investments have increased the returns and reduced correlation within a diversified portfolio (as documented by Rolf Banz & Ibbotson & Associates[1]). Ask an investor to consider the benefits shown in 87 years of data, however, and you'll quickly see their eyes begin to glaze over. The rewards of investing in micro-cap are easier to understand when you look closely at a period when micro-caps began to perform well. Last year was certainly part of this cycle, as we will see below:

Smaller Was Better: Lowest Market Cap's Provided Best Returns

The below chart illustrates why we believe it makes sense to include micro-cap within a small-cap allocation. As shown, the smaller the size of the company in 2013, the greater the return.



Small/Micro-Cap Universe includes all equities listed in he Russell 2000 Index, Russell Microcap Index, and all other publicly traded companies that are 1) listed on a major US exchange, 2) is a stand-alone operating company, 3) and has a market cap between $25mm-$3,000mm, at the beginning of the calendar year.

80/20 Rule: Big Winners Drive Returns

As is usually the case in micro-cap investing, the investments that worked best accounted for much of the overall return. By the end of the year, we had taken profits on a majority of the names below to reinvest in what we believe could be next year's winners.

Small and micro-cap investing is very volatile and typically accounts for the most risky part of any portfolio. The percentage of an entire portfolio which should be allocated to small companies depends entirely on your financial goals and tolerance for risk. We never recommend investing 100% of an entire portfolio in small companies, despite the outsize returns that can be achieved. However, many are often surprised that a small allocation to these companies can be prudent for many investors despite the risks associated with them. Even retirees, for example, need to potentially fund several more decades of retirement living. As long as there is no short term need to sell the investments and live off cash, the long term rewards can be worth the risk.

Top 10 Total Returns of 2013	
Anika Therapeutics, Inc. (ANIK)	283.90%
USA Truck Inc. (USAK)	281.45%
Medical Action Industries, Inc. (MDCI)	218.07%
Addus HomeCare Corporation (ADUS)	214.07%
Motorcar Parts of America, Inc. (MPAA)	193.76%
MFRI, Inc. (MFRI)	153.09%
Aceto Corp. (ACET)	152.93%
Atlas Financial Holdings, Inc. (AFH)	147.39%
Barrett Business Services, Inc. (BBSI)	145.76%
Virtusa Corp. (VRTU)	131.83%

Not a recommendation to buy or sell these securities
Past performance does not guarantee future results

"The rewards of investing in micro-cap are easier to understand when you look closely at a period when micro-caps began to perform well."

2013 Q4 FINANCIAL MARKET STATISTICS

Commodities	
Gold	-28.26%
Corn	-39.55%
Cattle	1.76%
Soybeans	-8.30%
Silver	-35.92%
Wheat	-22.22%
Plantinum	-10.89%
Oil	7.19%
Copper	-7.01%
CRB Index	-5.03%

U.S. Industry Performance	
Basic Materials	25.99%
Con Discretionary	42.74%
Consumer Staples	26.31%
Financials	35.53%
Health Care	41.41%
Industrials	40.55%
Energy	26.25%
Technology	26.24%
Telecom	26.18%
Utilities	13.06%

Bond Yields (Change)	Change	Ending Yield
30-Yr T Bond	+1.01	3.96%
10-Yr T Bond	+1.26	3.04%
3-Month T Bill	+0.02	0.07%

U.S. Stocks	
Dow Industrials	29.65%
Nasdaq Composite	40.12%
S&P 500	32.39%
Russell 2000	38.82%
Wilshire 5000	30.45%

Foreign Markets	
UK	18.66%
Germany	25.48%
France	17.99%
Canada	3.30%
Japan	56.72%
Hong Kong	2.87%
India	8.98%
Russia	-2.56%
China	-6.75%
Mexico	-2.24%
Brazil	-15.50%
Argentina	88.87%

US Dollar (Percent Change)	
Euro	-4.26%
British Pound	-1.89%
Canadian Dollar	6.58%
Yen	21.57%

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Call 800-331-8936 to speak with a CFP® about your financial goals and determine if Windgate might be your solution.

Source: J.P. Morgan The S&P 500 Index is widely regarded as the best single gauge of the U.S. equities market. Emerging Markets are defined by The MSCI Emerging MarSkets Index, a free float-adjusted market capitalization index that is designed to measure equity market performance in the global emerging markets. Small-cap stocks are defined as The Russell 2000 Index, an index which measures the performance of the 2,000 smallest companies in the Russell 3000 Index. International stocks are defined as The MSCI® EAFE(Europe, Australia, Far East) Net Index is recognized as the pre-eminent benchmark in the United States to measure international equity performance. It comprises 21 MSCI country indexes, representing the developed markets outside of North America. REITs are defined as The NAREIT EQUITY REIT Index, which is designed to provide the most comprehensive assessment of overall industry performance, and includes all tax-qualified real estate investment trusts (REITs) that are listed on the NYSE, the American Stock Exchange or the NASDAQ National Market List. Fixed income is defined as The Barclays Capital U.S. Aggregate Index, which represents securities that are SEC-registered, taxable, and dollar denominated. The index covers the U.S. investment grade fixed rate bond market, with index components for government and corporate securities, mortgage pass-through securities, and asset-backed securities. Cash is defined as The Barclays U.S. Dollar Floating Rate Note (FRN) Index, which provides a measure of the U.S. dollar denominated floating rate note market. Commodities are defined as The Dow Jones UBS Commodity Index is composed of futures contracts on physical commodities and represents twenty two separate commodities on U.S. exchanges, with the exception of aluminum, nickel, and zinc.