

## Market Outlook

This month, we had the opportunity to participate in several investor conferences. These events give us a good view of how companies and investors alike are viewing the economy. The tone of presenters at these conferences usually has a decided shift from January through December each year, as hopes turn to reality, and an accounting is made. One recent event was held in New York and had about 40 companies presenting their merits to about 300 investors. The tone of this conference was decidedly – quiet.

A significant majority of the companies we listened to did not sound shell-shocked, as they were in early 2009. But neither were they as optimistic as they sounded in early 2010. Investors were also equally sober, as if the last three years was enough of a ride that they were just trying to make sense of it all. Looking back, it seems the prudent thing to do.

The 4th quarter of 2010 was a good quarter for equity investors. All of the major indexes were up double-digits, and there was a bias for size, as smaller company stocks outperformed large company stocks. To boot, the growth indexes bested the value indexes as the market continues its trend of risk seeking. Of course, these

trends have also poured into the fixed income market as issuance has increased and the bond market continues to relax covenant requirements in pursuit of yield.

With all of the monetary and fiscal lubrication hitting the markets, higher inflation is the odds-on bet in the market right now. Proof of that was evident at the above mentioned investment conference. Every retail company we listened to spoke of impending product price increases, starting in the spring. Investors no doubt have seen the price of cotton, the major component in the textile and apparel industries. Its skyrocketing price during the last year is turning some to focus on man-made fibers as an alternative, but don't bring out your polyester leisure suits just yet. Cotton is a very renewable resource and the current pricing environment is more about transitory supply issues than some new demand component.

However, a more serious issue has been cropping up in China that will reverberate in the pocket books of consumers during the coming years. Back in May of 2010, an executive of Li & Fung Group (a textile and apparel powerhouse based in Hong Kong) made the following statement: "We're paying almost the same

## Composite Performance Tables

### Small Cap Value

	4Q 2010	YTD*
PRCP Small Cap Value, Gross (%)	16.2	20.9
PRCP Small Cap Value, Net	15.9	20.5
Russell 2000® Value	15.4	18.1

\* Composite inception date is August 1, 2010; returns from August 1, 2010

### Micro Cap Value

	4Q 2010	YTD	1 Year	3 Year	Since Inception**
PRCP Micro Cap Value, Gross (%)	22.0	34.2	34.2	8.5	2.2
PRCP Micro Cap Value, Net	21.6	32.3	32.3	6.9	0.7
Russell Microcap® Value	17.9	28.4	28.4	(0.6)	(4.5)

\*\* Composite inception date is April 1, 2007; all returns greater than one year are annualized

The Firm maintains composites on both its strategies. The Small Cap Value Composite was created on August 1, 2010. The Micro Cap Value Composite was created on April 1, 2007. The performance results of the Micro Cap Value strategy includes accounts managed at another advisor. The portfolio characteristics for each strategy are based on a representative account within that strategy. The Firm maintains a complete list and description of composites and a presentation that complies with the requirements of GIPS standards, which is available upon request by contacting Peter Trumbo, Chief Compliance Officer at (503) 886-8972 or Peter.Trumbo@PacRidgeCap.com. This information is shown as supplemental information only and complements the full disclosure presentation (fully compliant GIPS presentation).

## Small Cap Value Portfolio Statistics

	PRCP Small Cap Value	Russell 2000® Value
Number of Holdings	124	1,297
Average Market Cap (\$M)	380.0	665.3
Weighted Average Market Cap (\$M)	398.7	1,117.4
Median Market Cap (\$M)	319.5	466.0
Price/Earnings (FY1)	15.7	15.6
Price/Earnings (FY2)	13.4	14.2
Price/Book	1.46	1.28
Dividend Yield	1.0%	1.9%
Beta (vs Russell 3000)	1.28	1.31
L.T. Growth Forecast Median	14.0%	11.7%

## Micro Cap Value Portfolio Statistics

	PRCP Micro Cap Value	Russell Microcap® Value
Number of Holdings	68	1,062
Average Market Cap (\$M)	278.3	205.9
Weighted Average Market Cap (\$M)	278.6	318.6
Median Market Cap (\$M)	223.4	169.2
Price/Earnings (FY1)	17.5	16.4
Price/Earnings (FY2)	14.0	14.4
Price/Book	1.26	1.01
Dividend Yield	0.5%	2.0%
Beta (vs Russell 3000)	1.24	1.29
L.T. Growth Forecast Median	15.0%	12.3%

amount for T-shirts today as we did in 1980...we believe that is over.”

A good friend of mine has explained it best. He owns a company that imports leather gloves from China, and he’s no small fry to his suppliers. About a year ago, he began hearing from his suppliers that workers from the interior of China were becoming less willing to move to the coastal regions, the urbanized centers of manufacturing. This required paying higher wages. But sometimes this wasn’t even enough, and manufacturers had to uproot their plants and move inland – or just plain shut down. This added heavy transportation costs of moving raw materials to plants inland, and then transportation costs to get it back out to the coast for shipping. All of these costs are now making their way to consumers in America. And while the current effect is most pronounced in textiles and apparel, it will seep into every kind of product imported from China into the United States.

In the face of this kind of news, corporate executives appear to be waiting. Not like a punch-drunk fighter who can’t see straight, but like a pedestrian in New York waiting for a crosswalk light to turn green. It’s not a bad sign, but it’s an unusual thing to see. It appears that corporate America is a bit more risk averse than are investors today.

During the coming year, we will continue to search for companies that demonstrate an ability to earn a fair return on capital. As always, we welcome any questions or comments you may have, and thank you for your continued support.

Sincerely,

*Pacific Ridge Capital Partners*

## ***About Pacific Ridge Capital Partners, LLC***

Pacific Ridge Capital Partners is an employee-owned firm. We generate our own investment ideas using fundamental analysis and bottom-up stock picking. The investment team applies a consistent, patient and disciplined process that results in low turnover and stability. Our proven philosophy has performed well over many investment cycles and it is the consistent application of this strategy that makes Pacific Ridge unique.

The principals of Pacific Ridge Capital Partners are invested along with our clients in each of our strategies.

PRCP Small Cap Value – Our Small Cap Value strategy generally purchases stocks in the bottom three-quarters of the Russell 2000® Index. This smaller capitalization segment has a large number of underfollowed companies, providing us the greatest opportunity to exploit market inefficiencies. The typical range of holdings is between 120 and 160.

PRCP Micro Cap Value – Our Micro Cap Value strategy generally purchases stocks in the Russell Microcap® Index. This segment is widely underfollowed, providing us the greatest opportunity to exploit market inefficiencies. The typical range of holdings is between 50 and 80.

For further information about Pacific Ridge Capital Partners and our investment strategies, we invite you to contact Peter Trumbo at (503) 886-8972 or via email at [Peter.Trumbo@PacificRidgeCapital.com](mailto:Peter.Trumbo@PacificRidgeCapital.com).

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### **Disclosures**

Pacific Ridge Capital Partners, LLC (“Pacific Ridge”, “PRCP”, or “the Firm”) is an employee-owned investment advisor registered with the Securities and Exchange Commission under the Investment Advisors Act of 1940. The Firm was established in June 2010, and has one office located in Lake Oswego, Oregon. Pacific Ridge claims compliance with the Global Investment Performance Standards (GIPS®).

Sources: Pacific Ridge; FactSet Research Systems (“FactSet”); and Russell Investment Group (“Russell”) who is the source and owner of the Russell Index data.

The current annual investment advisory fees for the portfolios managed in the Firm’s Small and Micro Cap Value strategies are 1.00% and 1.50% of assets, respectively. Returns for the composites are presented gross and net of management fees and other expenses and includes realized and unrealized gains and losses, cash and cash equivalents and related interest income, and accrued based dividends. The Firm calculates time weighted rates of return by geometrically linking portfolio simple rates of return at least monthly, with adjustments made for significant external cash flows. The composite returns are calculated by asset weighting the individual portfolio returns using beginning of the period values. All returns are calculated after the deduction of the actual trading expenses incurred during the period.

The information provided should not be considered a recommendation to purchase or sell any particular security. There is no assurance that any securities discussed herein will remain in our strategy at the time you receive this report or that securities sold have not been repurchased. It should not be assumed that any of the holdings discussed herein were or will be profitable or that the investment recommendations or decisions we make in the future will be profitable or will equal the investment performance of the securities discussed herein. Past performance is no guarantee of future results.

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