

## When Trends Change - Omnibus and Eno

Several years ago, the writers of *Freakonomics* introduced readers to one of the great crises of the late 1800's: horse manure. Horse manure, based on then existing trends, was projected to choke cities and destroy the very fabric of urban life in the modern world. At about the same time, however, the internal combustion engine was being perfected and a short time later, the horse manure problem was solved. What many people do not remember is that there was another problem brewing, particularly in New York City and other growing urban areas: traffic fatalities.

Up through the 1830's, most intra-city transport was pedestrian, as the cost of hiring a horse and carriage was prohibitively expensive for the average person. A New York businessman named Abraham Brower recognized this. In 1827 he created the omnibus: a horse-drawn wagon that ran on a fixed and scheduled route, carried 12 people at a time, and was cheap. Not only did the omnibus bring more pedestrians and horses downtown, it allowed people to live further away from where they worked. However, with no traffic laws or signaling devices, the omnibus also brought with it clogged streets and an alarming rise in traffic fatalities. What was initially seen as a unique innovation in transportation yielded some very cruel by-products. There was considerable alarm in cities like New York, London, and Paris. How could they continue their growth with innovations like the omnibus—and keep their streets safe at the same time? Fast forward to 1903 and William Phelps Eno, a successful New York businessman tired of the chaos in the streets. Phelps published 100,000 copies of what would be a groundbreaking book: *Rules for Driving*. Thanks to his forward-thinking insights, cities began to introduce traffic calming devices such as stop signs, one-way streets, taxi stands, and rotary interchanges. Pedestrian fatalities declined, congestion eased, and goods began to move freely through city streets.

While Eno's conviction to create "order out of chaos" was implemented during the age of horse-drawn transportation, the real boon from his vision came when the horses were replaced by internal combustion engines, electric trolley, and cable cars. With faster transit devices and more complex routes, his foresight into safety and congestion relief allowed cities across America to grow and accommodate more people, more industry, and more traffic without sacrificing safety. At the same time however, well-planned transit growth led to other negative problems: urban smog, suburban sprawl, and increased congestion, to name a few.

The point of this little ride down memory lane is to illustrate how difficult it is to predict the future based on current circumstances. Trends are only trends until they change. Things that are viewed as good may, with the passage of time, turn out to be terribly bad, such as the government's pursuit of high home ownership rates. Likewise, investing requires the delicate use of inference, despite its tempting allure to be taken at face value. Human behavior can be both unpredictable and unreliable. Individuals who rely solely on trends to make investment decisions can often find themselves on the wrong side of a very bad trade.

At Pacific Ridge Capital Partners, we remain a process-driven investment firm. We look for market pessimism in the companies we buy. Pessimism causes the prices of many good assets to fall and creates great buying opportunities according to our investment "rules of driving." The current market for capital assets, much as it has over the last three years, is being driven by fears of an imploding Europe, a slowing Asia, and an uncertain US economy. As we move through this US election year cycle, there will likely be continued ebbs and flows in stock price trends. We will observe, but not be swayed by, those trends as we continue to seek out companies that have had successful records of navigating through good times and

bad times, in the anticipation that if the public markets do not value their returns, the private markets will.

We would also like to mention that our Micro Cap Value strategy has now reached its five-year milestone. The returns have been quite good and we believe this asset class can be a valuable addition to any portfolio. Please let us know if you would like to learn more about how to invest in either our Small Cap Value or Micro Cap Value strategies.

Sincerely,

*Pacific Ridge Capital Partners*

### Small Cap Value Portfolio Statistics (as of Mar'12)

	PRCP Small Cap Value	Russell 2000® Value
Number of Holdings	120	1,339
Average Market Cap (\$M)	341.8	666.3
Weighted Average Market Cap (\$M)	376.7	1,166.0
Median Market Cap (\$M)	291.8	448.5
Price/Earnings (FY1)	13.5	13.9
Price/Earnings (FY2)	10.8	12.2
Price/Book	1.3	1.3
Dividend Yield	1.2%	2.2%
Beta (vs Russell 3000)	1.5	1.3
L.T. Growth Forecast Median	12.0%	10.5%

### Micro Cap Value Portfolio Statistics (as of Mar'12)

	PRCP Micro Cap Value	Russell Microcap® Value
Number of Holdings	63	1,086
Average Market Cap (\$M)	196.4	201.9
Weighted Average Market Cap (\$M)	210.0	325.1
Median Market Cap (\$M)	172.0	161.8
Price/Earnings (FY1)	14.1	13.7
Price/Earnings (FY2)	11.1	11.8
Price/Book	1.2	1.1
Dividend Yield	0.8%	2.0%
Beta (vs Russell 3000)	1.5	1.3
L.T. Growth Forecast Median	14.0%	11.0%

## Composite Performance Tables

### Small Cap Value

	Q1'12	YTD	1 Year	Since Inception
PRCP Small Cap Value, Gross (%)	14.3	14.3	(4.9)	13.9
PRCP Small Cap Value, Net	14.1	14.1	(5.9)	12.8
Russell 2000® Value	11.6	11.6	(1.1)	14.1

### Micro Cap Value

	Q1'12	YTD	1 Year	3 Year	5 Year	Since Inception
PRCP Micro Cap Value, Gross (%)	18.2	18.2	(1.4)	35.4	3.8	3.8
PRCP Micro Cap Value, Net	17.8	17.8	(2.9)	33.4	2.3	2.3
Russell Microcap® Value	14.6	14.6	(2.9)	24.9	(2.8)	(2.8)

*The Firm maintains composites on both its strategies. The Small Cap Value Composite inceptioned on August 1, 2010. The Micro Cap Value Composite inceptioned on April 1, 2007. All returns greater than one year are annualized. The performance results of the Micro Cap Value strategy includes accounts managed at another advisor. 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@PacificRidgeCapital.com. The portfolio statistics are shown as supplemental information only and complements the full disclosure presentation (fully compliant GIPS presentation).*

## ***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.

Although the statements of fact and data in this report have been obtained from, and are based upon, sources that the Firm believes to be reliable, we do not guarantee their accuracy, and any such information may be incomplete or condensed. All opinions included in this report constitute the Firm’s judgment as of the date of this report and are subject to change without notice. This report is for informational purposes only and is not intended as an offer or solicitation with respect to the purchase or sale of any security.

The Russell 2000® Value Index measures the performance of the Russell 2000 companies with lower price-to-book ratios and lower forecasted growth values. For comparison purposes, the index is fully invested, which includes the reinvestment of income. The return for the index does not include any transaction costs, management fees or other costs.

The Russell Microcap® Value Index measures the performance of the microcap segment of the U.S. equity market. For comparison purposes, the index is fully invested, which includes the reinvestment of income. The return for the index does not include any transaction costs, management fees or other costs.

Returns and asset values are stated in US dollars.