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QUARTERLY LETTER

The story of the first quarter of 1990 was not in the net return, which was slightly negative, but in the pressures absorbed by the U. S. stock market with so little effect. Chief among these pressures was an increase in long-term interest rates. Rates on U.S. Treasury bonds climbed from 8% to 8.6% during the quarter, puffed upward by increased rates in Europe and Japan.

In Europe, rates increased in anticipation of an East German capital shortage, pending reunification with West Germany. The rise in Japanese rates appears to be in response to

somewhat higher consumer inflation in that country, as well as highly inflated real estate and stock prices.

Higher Japanese rates in turn triggered a 30% drop in Japanese stock prices; from three times the world average price/earnings ratio to two times. This was the second major negative absorbed during the quarter by the U.S. market. We, along with many others in the U.S., view the Japanese market decline as a positive, and long overdue. We cannot be sure; however, that the fear it engendered will not spread over here. So far, it hasn't.

Another short-term negative during the quarter was the long expected and widely advertised slowdown in the U.S. economy, which knocked earnings for many companies below year ago levels. The slower economy surprises no one, but weak earnings and higher interest rates combine to create pockets of panic selling in (suddenly) overvalued individual issues. This "earnings mine field" should culminate with the results of the first quarter, which are being reported now. We are trying to avoid the mines and search out firms with good earnings that are reasonably priced.

KILLER BEES

Senator Moynihan's recent proposal to reduce Social Security taxes has reopened a political hornets nest. The hornets are buzzing and the natives are restless, fearing they will be stung once again. We've seen a plethora of articles on the subject, but none which answer two basic questions about the Social Security system: "What did I pay into it?" and "How much can I expect to get?" So here they are:

1. What did I pay? The table shows the maximum Social Security tax paid each year by an employee since the system started in 1937. Equal amounts were paid in by the employer. If you would like the numbers for a self-employed person, give us a call. For the exact numbers in your own account, call Social Security at 1-800-234-5772.

Our regular readers know that historic numbers must be adjusted for inflation. This we have done for you. The 1937 contribution of \$30 represents \$260 of 1990 purchasing power, for example. Totals for each column are shown at the end of the table.

2. How much can I expect to get? A call to Social Security established that a single person retiring in 1990 at age 65 who had always paid the maximum tax would receive annual benefits of \$10,788. A married couple would receive \$16,782 per year. Those who paid less than the maximum would receive less.

Dividing these amounts into the inflation adjusted total for employee and employer (\$127,418) shows that an individual gets all his money back in 11.8 years, a married couple in 7.6 years. But the life expectancy for a male age 65 is 15 years, for a female 20 years, and these benefits are promised for life! The result is that the average person retiring today is promised benefits between 1.3 and 3 times his contribution, regardless of need. That's a problem.

The Social Security problem is a result of two inherently incompatible viewpoints. First, Social Security is considered social insurance -- a way of providing for those in need. Any discussion of benefits is directly related to those who need the money for subsistence living. From this perspective, as in any true insurance plan, the minority who are needy receive more than they paid in because the majority receives less. By definition, the average participant cannot receive more than he paid in, and no one feels "entitled" to the return of his premiums.

But Social Security is also viewed as a pension plan, whereby "I'm entitled" to the benefits because "I paid in all those years." If it were a pension plan, funded in the style of a corporate or employee plan, people would be entitled to receive what they paid in, plus investment gains. But Social Security has never been funded as a pension plan. Promised returns are up to three times contributions, regardless of need.

We can't all expect to get out two or three times what we pay in. The system has worked so far only because earners have outnumbered retirees. We've all heard the phrase "The Social Security Trust Fund." The fact is that the Social Security Trust Fund has never had a significant amount of money in it. Social Security, like most Federal tax and benefit programs, has always been "pay as you go."

In the 1950's, there were over 10 workers per retiree. A retiree could get (and got) ten times what a worker contributed in a given year. Today, there are roughly three workers per retiree, which is why each retiree can receive up to three times what each worker pays.

In twenty years, the ratio will be 2 to 1, so retirees will be able to get the promised benefits only if their children are each willing to pay half. This is why 47 percent of Americans recently surveyed doubted that Social Security will be there to pay benefits when they retire. This is also why Social Security taxes (only politicians call them contributions) have increased dramatically in recent years (see table).

Today, for the first time, these higher taxes have begun to build a sizeable balance in the "Trust Fund." Because by law it must be invested in Treasury Bonds, the Fund has become a source of political rhetoric. Here's why:

The Treasury borrows money (issues bonds) to pay the expenses of the federal government. It does so because the government spends more than it collects in taxes. Any buyer of Treasury bonds (including the Social Security Trust Fund) is therefore loaning money to the federal government to finance the deficit. As the federal accounts are currently kept, increases in the SSTF are netted against the federal deficit, making it look smaller. Senator Heinz of Pennsylvania has introduced a bill to require the government to report the two items separately. This would increase the (reported) deficit and impose further spending discipline on Congress. Senator Moynihan's proposal to cut Social Security taxes would have the same effect.

Like a bee buzzing a spring picnic, mention of changing. Social Security got the public's attention. Each Senator's proposal would also require raising income taxes by an amount equal to the decline in Social Security taxes to avoid further increases in the reported deficit. The hypocrisy of it all is that our politicians speak of Social Security as if it were a pension plan, while continuing to operate it as just another program of taxing one person to benefit another. Until the political hornets are honest about the money flows involved, cover your wallet and be ready for more attacks by the killer bees.

Did you ever figure it out? Taxes are all there is to politics. - Will Rogers

Year	Tax	Adjusted	Year	Tax	Adjusted	Year	Tax	Adjusted
1937	30	260	1956	84	384	1975	825	1904
1938	30	264	1957	95	417	1976	895	1955
1939	30	268	1958	95	406	1977	965	1979
1940	30	266	1959	120	511	1978	1071	2039
1941	30	253	1960	144	604	1979	1404	2402
1942	30	229	1961	144	598	1980	1588	2393
1943	30	215	1962	150	616	1981	1975	2699
1944	30	212	1963	174	706	1982	2171	2793
1945	30	207	1964	174	697	1983	2392	2982
1946	30	191	1965	174	685	1984	2533	3025
1947	30	167	1966	277	1061	1985	2792	3218
1948	30	155	1967	290	1080	1986	3003	3397
1949	30	156	1968	343	1225	1987	3132	3417
1950	45	232	1969	374	1268	1988	3380	3542
1951	54	258	1970	374	1198	1989	3605	3605
1952	54	253	1971	406	1244			
1953	54	251	1972	468	1389	Totals	\$37,772	\$63,709
1954	72	333	1973	632	1766			X2
1955	84	390	1974	772	1945			=\$127,418