

# Vj g O wj ngpnc o r O go qtc p f w o

O wj ngpnc o r ( 'E q o r c p f . 'K p e 0  
K p v n k i g p v k p x g u o g p v O c p c i g o g p v  
34522 R g t t { ' J k j y c f ' ' C Y g z h t f . ' R C ' 3 7 2 ; 2  
\* 6 3 4 + ; 5 7 / 7 7 4 2 ' ' H C Z \* 6 3 4 + ; 5 7 / 6 9 4 2  
K u m g ' 4 7 . ' H k u v S w e t v g t ' 3 ; ; 5

Y g ' e t g ' r e p p l p i ' e p q v j g t ' u g o l p c t ' v q ' d g ' j g f ' e v ' v j g ' O c t t l k w ' l p ' I t g g p v t g g ' q p ' V j w t u f c { . ' O c t e j ' 3 : . ' e v ' 4 - 5 2 ' ' r 0 b  
c p f ' e i c l p ' e v ' 9 - 5 2 ' r 0 b 0 ' K i { q w ' e p f ' e ' i w g u ' u + y q w f ' h n g ' v q ' e w g p f . ' e c n i ; 5 7 / 7 7 4 2 ' e p f ' b c n g ' { q w t ' t g u t x c v k q p 0 ' Y g  
n q m l h q t y c t f ' v q ' i g g l p i ' { q w ' e v ' v j g ' O c t t l k w 0 V j g ' v q r ' r g t h t o l p i ' O w j n g p n c o r ' H w p f ' j c f ' c ' v q w n t g w t p ' h t ' 3 ; ; 4 ' q h 3 8 ' 0  
C u ' q h L c p w c t { ' 4 3 . ' 3 ; ; 5 ' v j g ' P g v C u u g v X c m g ' q h l j g ' h w p f ' y c u l 3 7 0 8 : ' w r ' 5 0 8 ' ' { g c t ' v q ' f c v g 0 ' C l i c k h e r e ' h t ' v j g ' e w t t g p v P g v  
C u u g v X c m g ' h t ' v j g ' O w j n g p n c o r ' H w p f 0

## S w e t v g t n f ' N g w g t

Vj g ' H q w t v ' S w e t v g t ' q h 3 ; ; 4 ' y k p g u u g f ' c ' u t q p i ' t c m { ' l p ' v j g  
u q e n i o c t n g v ' h g f ' d { ' h p c p e k n i u q e m u . ' e { e r l e c n u ' c p f ' v g e j p q m i { .  
o c p { ' q h i y j k e j ' y g t g ' o k f / u k g 0 ' Y g ' r c t v e k r c v g f ' t c v j g t ' y g m  
t g u w m k p i ' l p ' c ' x g t { ' i q a f { ' g c t 0 Q p e g ' c i c l p . ' v j g ' r w d r e } u  
v p e g t v c l p v ' j c u ' c m q y g f ' w u ' v q ' g c t p ' c ' i q a f ' t g w t p 0 ' Y g ' e a p v k p w g  
v q ' u g g ' u k i p u ' q h i c ' u t g p i v j g p l p i ' g e a p q o { 0 ' V j g ' u j q r r l p i ' r w d r e ' k u  
e q o l p i ' d c e m ' c n d g k v i t c f w e m { ' c p f ' y k j ' c p ' q t l e p v e k p ' v a y c t f  
x c m g 0 ' F w t k p i ' v j g ' E j t k u o c u ' u g c u a p . ' u q o g ' u q t g u ' c p f  
o c p w k e w t g u ' t c p ' q w ' q h o g t e j c p f k u g 0

[ g v ' v j g ' o g f k c ' h e w e u g u ' q p ' v j g ' r e { q h u ' c p f ' t g t g p e j o g p v c v  
I g p g t c n l O q a q t u \* I O + c p f ' K D O . ' w u w e m { ' e a p e m f l p i ' v j c v ' v j l p i u  
o w u t g e m { ' d g ' d e f ' h i ' t g t g p e j o g p v k u j k w k p i ' v j g ' d k i i g u v c p f ' v j g  
u t q p i g u 0 ' V j g { ' o k u u ' v j g ' r q l p v 0 ' V j g ' e j c p i g u ' q h i y g ' r e u v ' 5 2 ' { g c t u  
j c x g ' c h g e v g f ' c n i e q o r c p l e g u 0 ' O q u v j c x g ' e j c p i g f ' c p f ' l o r t q x g f  
v j g k t ' q r g t c v k a p u ' l p ' t g u r a p u g 0 ' Q p n l ' v j g ' t e j g u v j c x g ' d g g p ' c d n g ' v q  
f g h t ' g u r q p f l p i ' h t ' u q ' h p i 0 ' V j g ' h e v e v j c v l k u ' h p c m l ' j k w k p i  
I O ' c p f ' K D O ' o g c p u ' v j c v ' v j g ' t g t g p e j o g p v l u ' p g c t k p i  
e q o r n g v k p 0 ' E j t { u n g t ' c p f ' H q t f ' i q v ' v j g k t ' c e w ' v q i g v j g t ' \* \* d {  
p g e g u k v { + 3 2 ' { g c t u ' c i q 0 ' V j c v l u ' y j { . ' x g t ' v j g ' r e u v ' v p ' { g c t u .  
y j k g ' v j g ' c x g t c i g ' u q e n i s w e f t w r n g f . ' H q t f ' c p f ' E j t { u n g t ' y g t g ' w r  
p l p g ' k o g u ' y j k g ' I O ' k u ' w r ' h u u ' v j c p ' 3 2 2 ' 0 ' Y j g p ' y g ' d q w i j v  
H q t f ' l p ' 3 ; ; 4 . ' r g q r n g ' h g t g f ' k v y c u i q l p i ' d e p m w v 0 ' Y g ' u q r f ' k v  
v q q ' g c t n { ' c h g t ' k v j c f ' v t k n g f 0

Vj g ' r q l p v k u ' v j c v l k u ' g c u l ' v q ' e j c p i g ' y j g p ' { q w x g ' d g g p  
v p u e e g u u w 0 ' V j g ' o q u v u e e g u u w i c t g ' v j g ' o q u v t g m e c p v v q  
e j c p i g 0 ' C h g t ' E j t { u n g t ' c p f ' H q t f ' p g i q v e v g f ' y c i g ' e a p e g u k q p u .  
v j g ' W C O Y Q u ' e j k g h i p g i q v e v q t ' y k j ' I O ' y c u l p v g t x l g y g f ' q p  
p e v k p y k f g ' v g r x k u k p ' c p f ' y c u ' c u n g f ' y j g v j g t ' v j g ' W C O Y 0 y q w f  
i k g ' I O ' y c i g ' e a p e g u k q p u A ' U j g ' t r i k f . ' S P q ' / ' d g e c w u g ' q w t  
r g q r n g ' f a p ' v j l p n i l O ' k u ' l p ' v t q w d n g 0 ' V j c v y c u ' 3 2 ' { g c t u ' \* c p f  
& 3 4 ' d k n k a p ' l p ' h u u g u + c i q 0 ' V q f c { . ' H q t f ' u ' r e d a t ' e q u v r g t ' e c t ' k u  
& 2 2 ' h u u ' v j c p ' I O u ' c p f ' I O ' u ' D a c t f ' q h F k g e v q t u ' j c x g ' h p c m l  
t g e q i p k g f ' v j g ' r t a d n g o 0 ' I O ' h p c m l ' j c u ' c ' e c t . ' v j g ' U c w t p . ' v j g  
r w d r e ' y c p w 0 ' I g v ' v j g ' W C O Y 0 ' t c v j g t ' v j c p ' x l g y l p i ' c ' u w e e g u u w

## GUUC[

K p ' q w t ' p g y u n g w t ' q h ' C r t k i 3 ; ; 4 . ' y g ' f k u e w u g f ' v j g ' l o r q t v c p e g ' q h t g e q i p k l p i ' v j g ' e w t t g p v l p x g u o g p v e n k o c v g 0 ' Y g ' y q w f ' h n g ' v q  
g z r c p f ' q p ' v j c v ' v j g o g 0

E j c t v 3 ' k u ' v j g ' d g u v r l e w t g ' y g ' j c x g ' d g g p ' c d n g ' v q ' e a p u t w e v ' v q ' f k u r n e { ' v j g ' l p x g u o g p v e n k o c v g 0 ' O c p { ' q h i { q w y k n i t g e q i p k g ' k ' c u ' c p  
w r f c v g f ' e a r { ' q h i q w t ' S J q w u i F a p v O c n g ' O a p g { ' e j c t v ' q h i L w n { ' 3 ; : 9 0 ' V j g ' e j c t v ' c f l w u v ' v j g ' p q o l p c n l p v g t g u v t c v g u ' q p ' o q t v i c i g u ' h t  
l p h r e v k p ' c p f ' ' v e z g u 0 ' V j w u . ' k v k u ' c ' e j c t v ' q h i ' v j g ' p g v t g e n i c h g t ' l p h r e v k p ' c p f ' v e z g u + e q u v ' q h i d a t t q y l p i ' o a p g { 0 ' Q t . ' v q ' c p ' l p x g u a t . ' k v  
t g r t g u g p u ' v j g ' p g v t g e n i t g w t p ' I t q o ' h g p f l p i ' o a p g { 0 ' V j g ' e j c t v ' h t ' h p i / v g t o ' d a p f u ' k u ' x g t { ' u k o k r e t ' v q ' v j k u ' o q t v i c i g ' e j c t v 0 ' V j g ' e j c t v  
o c n g u ' x k u k d n g ' y j { ' o { ' h e v j g t . ' y k j ' c ' 6 ' ' o q t v i c i g ' l p ' v j g ' 3 ; 7 2 ' u ' u t q x g ' v q ' r c { ' k v ' q h i ' g e t n { 0 ' V j g ' e j c t v o c n g u ' x k u k d n g ' y j { . ' l p ' v j g ' 9 2 ' u .  
d e d { ' d q q o g t u o c f g ' o a p g { ' d w l p i ' g x g t ' d k i i g t ' j q w u g u ' y k j ' g x g t ' d k i i g t ' o q t v i c i g u 0 ' V j g k t ' p g v t g e n i e q u v ' q h i o a p g { ' y c u l t c o c v e c m {  
p g i c v k x g 0 ' V j g ' e j c t v c n q ' o c n g u ' x k u k d n g ' y j { ' y g x g ' d g g p ' v g m k p i ' e n g p u ' v q ' r t g r c { ' o q t v i c i g u l p e w t t g f ' u l p e g ' 3 ; : 3 0

C n g t p e v x g n { . ' I t q o ' c p ' l p x g u a t ' u ' r g t u r g e v k g . ' v j g ' e j c t v o c n g u ' x k u k d n g ' v j g ' 4 / 5 ' ' t g e n i t g w t p u ' q p ' d a p f u ' h t q o ' 3 ; 7 4 ' v q ' v j g ' o k f ' / 8 2 ' u 0  
K i ' r q t v c { u ' h u u g u ' u w h g t g f ' d { ' c p { a p g ' y j q ' q y p g f ' d a p f u ' l p ' v j g ' ' 9 2 ' u 0 ' D ' { ' 3 ; 9 ; . ' c p { a p g ' y j q ' q y p g f ' c ' h p i ' d a p f ' j c f ' c ' h u u 0 ' O c p {  
d a p f u ' u q r f ' c v 7 2 ' e g p u ' q p ' v j g ' g f q m c t 0 ' K i . ' f w t l p i ' v j k u ' r g t k a f . ' { q w ' c x k f g f ' v j g ' h u u g u ' q h i h p i ' d a p f u ' d { ' h n g r l p i ' { q w t ' o a p g { ' l p ' r c u u d q a m  
u c x l p i u . ' { q w t g e g l x g f ' 7 ' 3 1 4 ' ' \* r t g / v z + y j k g ' v j g ' x c m g ' q h i { q w t ' o a p g { ' u j t c p m i d { ' 3 2 ' ' r g t ' { g e t ' f w g ' v q ' l p h r e v k p 0 ' V j g ' e j c t v c n q  
f k u r n e { u ' v j g ' v p w u w e m { ' i q a f ' t g w t p u ' v q ' d a p f j q r f g t u ' l p ' v j g ' ; 2 } u 0

K p ' u j q t v ' v j g ' e j c t v f k u r n e { u ' c ' e j c p i g ' l p ' v j g ' l p x g u o g p v e n k o c v g ' l p ' 3 ; 8 8 ' c p f ' c i c l p ' l p ' 3 ; : 4 0 ' G e e j ' q h i y g u g ' e j c p i g u ' e c w i j v o w e j  
q h i y g ' r w d r e ' c p f ' o c p { ' l p x g u a t u ' d { ' u w r t k u g 0 ' V j t q w i j ' v j g ' 9 2 ' u . ' r g q r n g ' e a p v k p w g f ' v q ' w u g ' u t c v g i k u ' e r r t q r t k e v ' v q ' v j g ' e n k o c v g ' q h i y g  
& 2 ' u . ' w p v k i v j g ' r c l p ' q h i 3 2 ' ' l p h r e v k p ' d g e c o g ' w p d g e t c d n g 0 ' U c x g t u ' n g r v j g k t ' u c x l p i u ' l p ' r c u u d q a n i c e e q w p u ' { l g r f l p i ' 7 ' 3 1 4 ' ' 0

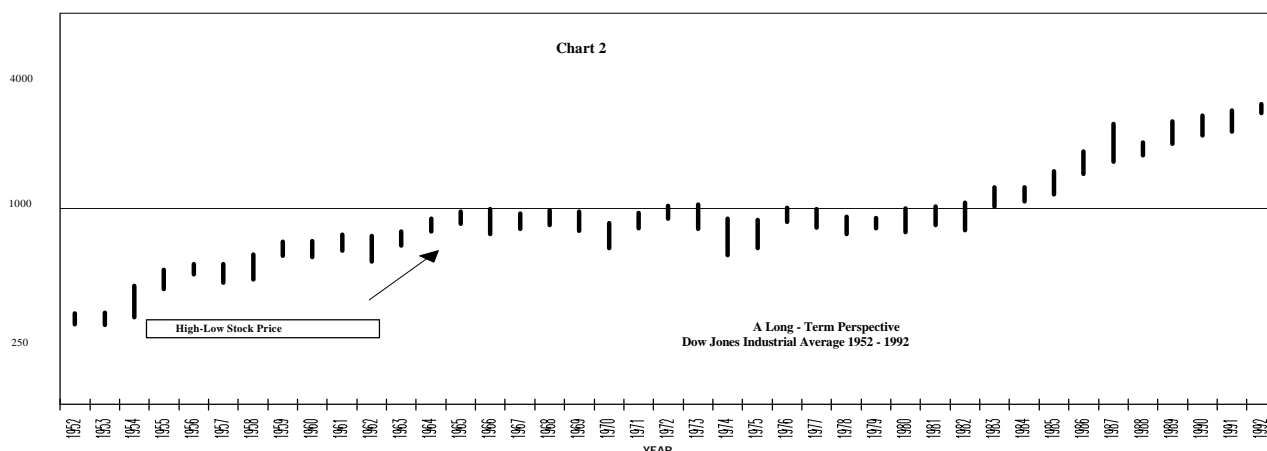
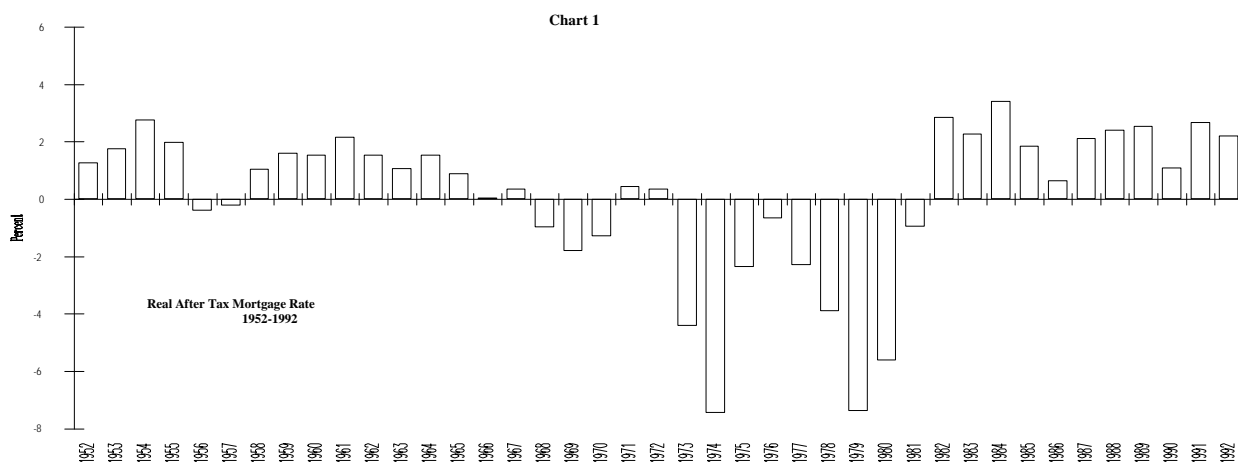
\*E a p v k p w g f ' q p ' v j g t ' u k f g +

# The Muhlenkamp Memorandum

Baby boomers who bought big houses (or farms) with big mortgages were warned by their fathers that they would never be able to pay it off. By the late '70's, we all knew that we didn't want to pay off the mortgage early. And the savers, typically our parents, flocked to get the 14% rates offered by money market funds.

Meanwhile, the same pain that caused people to move their assets to 14% money market funds caused them to demand lower inflation, resulting in a new Fed chairman and a new occupant of 1600 Pennsylvania Avenue. Yet, while demanding and getting lower inflation, the public continued to follow the strategies appropriate to the '70's. Our parents kept their money in CDs and money market funds to avoid any loss of "principal", and were encouraged to do so by the experts. Baby boomers bought ever bigger houses with ever bigger mortgages, comfortable in the belief that doing so was a "good investment" and would make them money. Yet the chart illustrates the heavy net cost of 11% mortgages in a 4% inflation economy. We've been warning our readers about this cost since 1987; but the public has only taken it to heart in the past two years. We had no influence on the timing of the change but we believe the recession, exacerbated by the Gulf War, did. Anyway, it has finally happened. The bottom line is that the mortgaged American public has reversed its actions from "trading up on the equity" to "prepaying the mortgage." Folks, this change is a 180° turnaround; it is a complete reversal. And since a major segment of this public has gone from 30 year mortgages to 15 year mortgages, this new trend is unlikely to be reversed anytime soon.

Chart II is a plot of the DJIA over the same time span. We believe the climatic conditions you see in Chart I drove the prices you see in Chart II. And the perception of the investing public lagged reality just as the perceptions of the mortgaged public did. It's the same public.



In 1934, Ben Graham authored the book, "Security Analysis," which is the definitive work in the field. In the 1951 edition he said the stock market was over priced. In the 1962 edition he upped his valuation criteria by 50% but still concluded that the market was overpriced. As you can see, the market rose for another four years. But by 1972, the public's confidence in the market had become so strong that a group of us working for an insurance company were nearly fired because we sold half of the stockholdings and went to cash. Today people who compare stock prices to the last decade say the market is too high. After the experience of the last ten years, we find it fascinating that there's still faith in real estate, but owning stocks is still considered risky. Yet our evaluation criteria, which flagged stocks as expensive in 1972, indicate that prices are fair today.

We're coming out of a recession. In our weather analogy, while Chart 1 pictures the investment climate, the seasons correspond to cyclicity in the economy and the markets. Since W.W.II these seasons have been determined by cyclical patterns in monetary and fiscal policy emanating from Washington DC. In the 1970's people talked about a four year cycle in the stock market. Such a cycle is visible in Chart II from 1954 to 1982. I believe the cycle was determined politically. After being elected, each President from Eisenhower through Ford (with implicit help from the Fed) squeezed the economy to contain inflation and then goosed it to get reelected. Jimmy Carter didn't read the script. He goosed it early, inflation ran up and he lacked maneuvering room in his final two years. Responding to popular demand, Reagan and the Fed squeezed the economy to lower inflation but did not goose it later, giving us a good economic decade. My advice to Bill Clinton would be to talk about stimulus but to save any action for '95-96. We're already set up for good economic numbers for the next couple years. (No, he hasn't asked.)

Finally, just to complete our picture of investment markets and the analogy to weather, daily stock price fluctuations correspond to daily rainfall. Whether stocks run up or down 30 points today is no more important than whether or not we get 1/2 inch of rain. Today, such fluctuations correspond to human moods and to the passage of weather fronts across the landscape. Such movements give people in the media/entertainment business (and pilots of small planes) something to talk about but have very little importance.