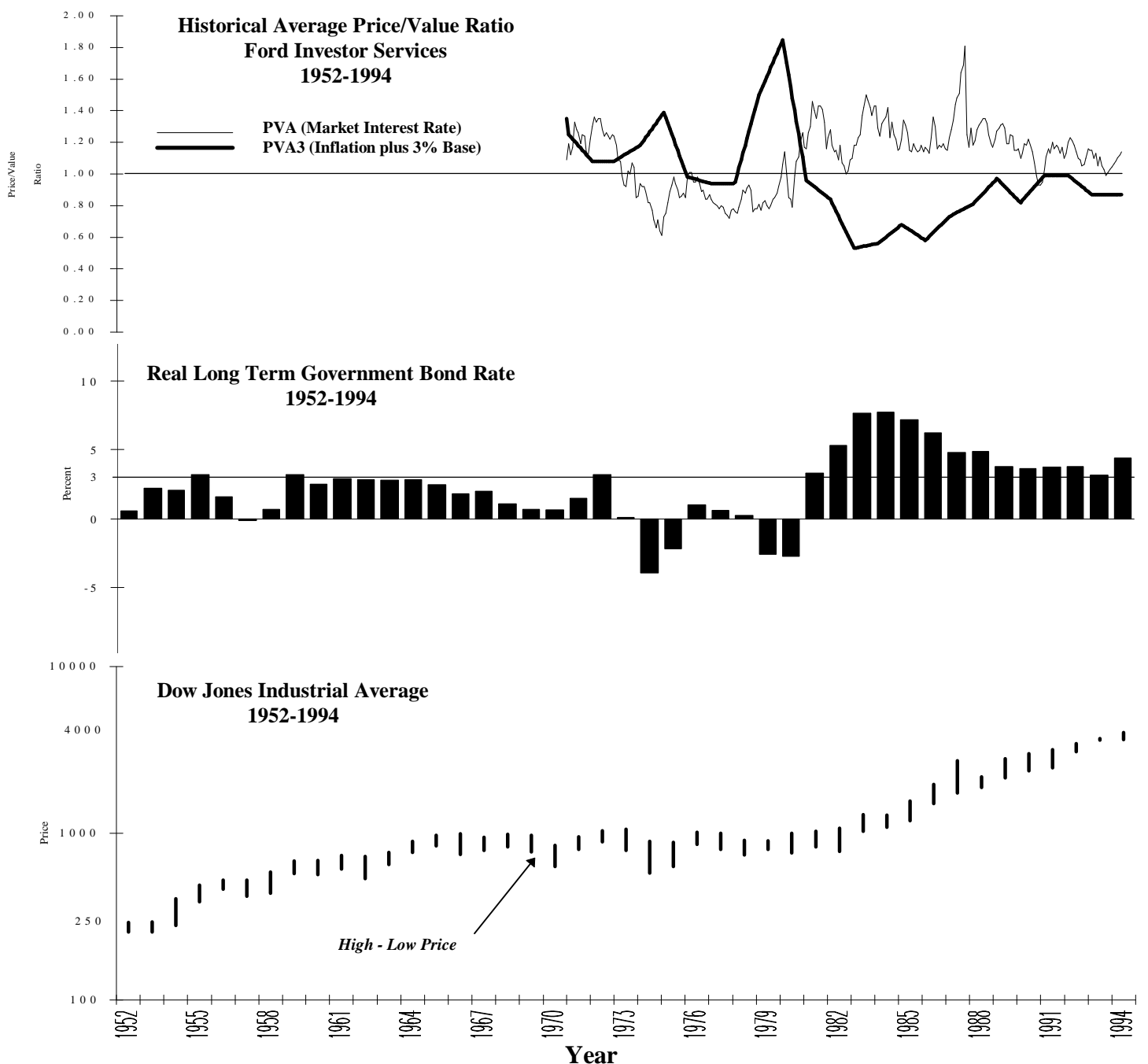


The Muhlenkamp Memorandum

Essay In last quarters essay we printed three charts showing a popular model for valuing stocks along with plots of real interest rates and the Dow Jones Industrial Average (DJIA). We've reprinted those charts below. Comparing the model to the DJIA demonstrates that when PVA indicated that stocks were overvalued, they somehow went up, and that when PVA indicated that stocks were cheap, they somehow went down. PVA has given wrong signals for over 20 years. We attempted to explain why this is so. We believe the model gave wrong signals .because it uses prevailing market interest rates to determine fair values for common stocks. This assumes that current interest rates are always "fair" by definition, as if there were no emotions in the bond market. We think it is more appropriate to use a discount rate based on inflation plus a historically normal real interest rate. Thus after last quarter's essay, we contacted Ford Investor Services and asked them to rerun their model; but instead of using 'prevailing interest rates,' we asked them to substitute numbers equal to annual inflation + 3%. This is equivalent to assuming that real interest rates were at a steady three percent for the period rather than the pattern depicted in the bar chart. For economy we ran the numbers on an annual rather than a monthly basis. No other changes were made to the model. This one change in the assumed interest rate resulted in the line labeled PVA3 which we have overlaid on the earlier plot of PVA. The contrast is apparent. PVA3 indicates that stocks were overvalued for most of the period 1972-1980, when nominal returns were 3%: and that stocks were very cheap in the early 80's and have only recently returned to fair value, after quadrupling in price. PVA3 is a much more profitable model than is PVA. PVA3 approximates the model we've used for valuing stocks for the past 20 years. Note that when real interest rates are 3%, both models give the same values and recently indicated that stock prices are fair.

Charts



Muhlenkamp Fund's NAV is now published in major newspapers around the nation.

As you may know, the Muhlenkamp Fund share price is now published in The Wall Street Journal, Investor's Business Daily, and Baron's. Local newspapers should be able to list us upon your request, as our local Pittsburgh Post Gazette is now doing.

We attracted enough shareholders over the last year to meet NASD's requirements for publication, and can thank Jack Kunkle for his efforts in getting the necessary systems installed and operational. NASD collects price information from us and makes it available to the newspapers, charging us a fee for the service. We think this service is useful and worth having, but please let us know what you think and how useful you find this new availability.