



Quarterly Letter

On July 18, 1995 the Net Asset Value of The Muhlenkamp Fund was \$19.67, up 21.21% year to date.

Six months ago, in Muhlenkamp Memorandum #33, we wrote, "We are looking at a 20% off sale." Since year-end bond prices have moved up 16% and stock prices have moved up over 20%. Prices are now back to fair values. The sale is over. Long-term Treasury interest rates have historically equaled inflation plus 2.5-3.0%. Inflation is currently about 3%. So at current interest rates of 6.6%, the bond market is now close to fair value. Stock prices and P/E's are back to levels which imply returns of 8-9% which also match the historic returns of 5-6% over inflation. So we judge current stock prices to be fair. And since we prefer stock returns of 8-9% to bond returns of 6.6%, we currently prefer stocks to bonds. But, with last winter's sale now over, both markets are likely to be more volatile.

Going forward, we expect it to be a stock pickers market and we are spending our time picking stocks. We also find it interesting that, for at least the past 25 years, one of the best signals to buy stocks has been to do so when the Fed lowered short-term interest rates. (That's why Marty Zweig says, "Don't fight the Fed!") The Fed lowered interest rates in the first week of July. For many market timers, this should have signaled the beginning of a bull market.

Meanwhile, other background factors continue to improve. Domestically the odds of the Fed achieving a

"soft landing" are looking better all the time. The US will not solve its deficit problems until it comes to grips with Social Security, but a reduction in government spending is an improvement and, despite their differing agendas, the President and the Congress seem to be driving toward a reduction in government spending. Internationally, Bosnia remains a mess, but it's a known mess. Russia could still implode but each month or quarter that goes by allows her former satellites to progress toward free economies and democratic governments. Mexico seems to be improving after serving as a warning to other emerging countries that relying on international money flows is a risky business.

We do have two major concerns. One is Japan, where the economic situation is not unlike the US in the early '30's. There is still potential for Japan to trigger a worldwide depression (which makes this a particularly foolish time to bash Japan on trade). Should this happen, there would be few safe harbors for our investments. We view the odds of Japan imploding as fairly low, but the consequences are dire enough that it must be monitored.

Our second "concern" is that the undervalued dollar will appreciate, driving down the dollar value of foreign investment. Fortunately, we can avoid this risk by avoiding foreign investments.

Attention:

Muhlenkamp and Company, Inc. is hosting a seminar on August 24, 1995, at the Greentree Marriott. There will be two sessions, the first from 2:00 - 4:00 p.m., and the second from 7:30 - 9:30 p.m. Ron Muhlenkamp will speak on "Growing Your Assets in Today's Investment Climate." Please call 412-935-5520 or 1-800-860-3863 to reserve a seat for yourself and a friend(s) at either session.

Errata: A couple of knowledgeable readers questioned my recommendation to read the works of Irving Fisher in last quarters newsletter. My mistake; I meant to recommend the writing of Phil Fisher, particularly "Common Stocks and Uncommon Profits."

∞ ESSAY ∞

Last quarter, we wrote an essay titled, "How to Retire Wealthy by Driving Used Cars." We could have called it, "How to Get Started on the Road to Wealth." Once started on that road, there is an ongoing need for intelligent investment management, which is a

topic we address in most of our essays. But there is also a need for an intelligent finish, for management of assets you have accumulated but are not likely to spend during your lifetime. This endeavor is called estate planning; and I will explore this topic in the next few essays.

Any useful estate plan must begin with the goals and priorities that you are trying to accomplish with your accumulated assets. We have found that most of our client's goals and priorities approximate the following:

1. Provide for client and spouse during their lifetimes.
2. Allow for disasters.
3. Move assets to heirs.
4. Bequeath assets to charities or other organizations.
5. Buy insurance company products.
6. Pay taxes.

Be aware that you do have an estate plan. It was written for you by the U.S. Congress and the legislature of your resident state. But this plan puts taxes as the first priority. Basically it says that when you go to meet your ancestors, these governments will take as taxes 50% of everything you own over \$600,000. If paying taxes is your first priority, you need no other estate plan. But if you have over \$600,000 in assets (including the death benefit on your insurance policy) and you prefer that a greater portion of your assets go to your heirs or to charities, then you need to take positive actions to accomplish it. The earlier you start to do this, the more options you have.

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