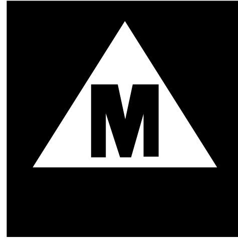

MUHLENKAMP & COMPANY, INC.
INTELLIGENT INVESTMENT MANAGEMENT

(800) 860-3863

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Issue 61 | Published First Quarter | February 2002

On December 31, 2001 the Net Asset Value of the Muhlenkamp Fund was $53.56, up 9.35% year to date.

ANNOUNCEMENTS

COVERDELL EDUCATION SAVINGS ACCOUNT

The Muhlenkamp Fund is pleased to announce that we are now offering the Coverdell Education Savings Account (otherwise known as an "Education IRA"). For more information, please call (800) 860-3863 extension 4, or visit our website at www.muhlenkamp.com

THIRD PARTY CHECKS

Unfortunately, the Muhlenkamp Fund is unable to accept third party checks for deposit into your account. Please call (800) 860-3863 extension 4 if you have any questions regarding this policy.

NAME CHANGE

As of January 2, 2002, our transfer agent, Firstar Mutual Fund Services, has changed its name to U.S. Bancorp Fund Services, LLC and our custodian bank has changed its name to U.S. Bank, N.A. This name change has no effect on the operation of your mutual fund account.

NEWSLETTER AND UPDATES VIA E-MAIL

Enter your name, street address and e-mail address at: newsletter@muhlenkamp.com to receive our quarterly newsletter, the *Muhlenkamp Memorandum*, and various updates via e-mail.

529 COLLEGE SAVINGS PLANS UPDATE

The Wall Street Journal article from Friday, January 25, 2002, Page C 1 captures our skepticism regarding 529 plans with the phrase, "Their generous tax advantages don't mean much if the accounts lose money." See *Muhlenkamp Memorandum* #58 and #60 for our thoughts.

QUARTERLY LETTER

In our quarterly letters to you over the past three years (available on our website at www.muhlenkamp.com), we have spelled out our thoughts on the evolving economic and market pictures.

In 1999, the U.S. Federal Reserve Board (the Fed) began raising interest rates. It did so because many economists feared that continued economic growth would re-ignite inflation (even though this theory was disproved by Paul Volcker and Ronald Reagan twenty years ago).

The Fed's goal was a slowdown and "soft-landing" in the economy much like it engineered in 1994-95. Instead, partly for reasons beyond Fed control, we are in a recession much like the one of 1990-91. This is our tenth recession since WWII. Each of these recessions had been triggered by the Fed raising interest rates, usually for the purpose of combatting inflation or the fear of inflation.

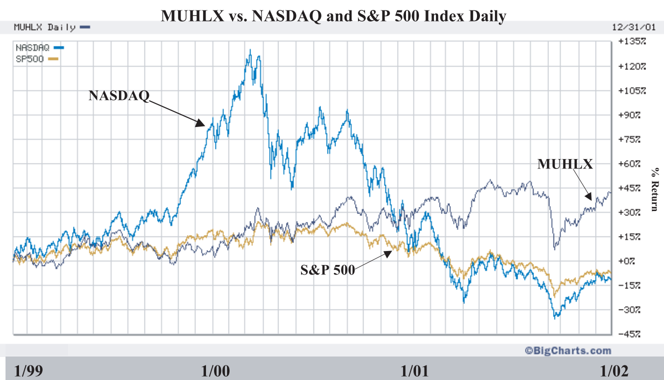
We used to expect a recession every 3-5 years as a normal part of the business cycle. I entered the investment business in 1968. By the mid-1970s I concluded that recessions were inherently self-correcting. In a recession, the typical wage earner works a little harder, saves a little more, and spends a little less. After a few months, when she no longer fears losing her job (though 2-3% of workers have lost theirs), she will have improved her financial position and gradually resume her normal spending pattern. But the fact that recessions are inherently self-correcting doesn't mean they are always self-correcting. In 1930 our government's response to recession was to raise interest rates, raise taxes and raise tariffs, giving us a depression. In the late 1960s our government's response was to print money, giving us inflation. Inflation encourages people to spend more, save less and to speculate making the problem worse. Inflation is not inherently self-correcting. It took a change in government policies to reverse the trend.

Knowing this history, when the Fed sets out to slow the U.S. economy, we always look for signs or actions that would turn a normal cyclical recession into depression or inflation. As we reported in July, we see few signs of either at this time.

We did mention in July that war could have a dramatic effect on this U.S. economy, but we viewed war as unlikely. Obviously September 11 proved us to be wrong. But we have learned some things since September 11. The direct effects of September 11 have lengthened and deepened the slowdown, ensuring a recession. For a period of time, measured in days to a few weeks for most of us, discretionary economic spending was unimportant. "Our heart simply wasn't in it." But when the auto companies offered 0% financing, many consumers responded by buying new cars.

Putting these observations together, our best description is that on September 11 most Americans suffered a "death in the family" resulting in a temporary pause in economic activity, but not necessarily a change in the normal pattern of spending habits.

Further complicating the current economic/market cycle has been the public discovery of, and fascination with, the "game of the stock market." This fascination began in late-1998, and after three years, many of the hyped stock prices are back to where they started. The nearby plot illustrates the round trip of the fad. What remains to be seen is whether the public maintains its fascination with the stock market, either with the same stocks or with new ones.



An additional fear for some people is that the U.S. could go the way of Japan. Most of you know that the Japanese economy has been stagnant for a decade. Folks, we already went the way of Japan; we did it in the 1970s. Our economy was stagnant in the 1970s. The difference was we also had high inflation, which Japan does not.

For a decade the Japanese have been trying to jump start their economy with increased government spending by building more roads, bridges and airports. We tried a similar approach in the 1970s based on economic theories I was taught in the 1960s. Increased government spending didn't work for us in the 1970s, and it hasn't worked for Japan in the 1990s.

Last spring, I had a chance to meet with several economic leaders from Japan representing business and government. They wanted to know how Japan could duplicate the U.S. success in information technology and venture capital. One of them asked, "How can we get grandma to pull her money out of her Post Office Savings Accounts (paying ½% interest) and put it into venture capital?" I replied, "My God, you don't want to. Grandma has no business in venture capital. What you might get grandma to do is the same thing that my grandma was willing to do, lend money to the kids and grandkids in order to buy a house." I asked, "In Japan, how long does it take the average family to buy a house?" They said, "That's a two-generation project." Which means, as a practical matter, it's unavailable to them. The man next to me at lunch was in his late 30s. I asked him, "What would it take to get you to work overtime?" He couldn't think of anything. Folks, when your working population doesn't perceive it in their interest to produce more, your economy will not grow! It is as simple as that. Until Japan learns some of the lessons that Ronald Reagan taught us, their economy will not grow.

So our conclusion remains – the risk in the current economy/market remains that of a normal cyclical recession. The long-term picture for the U.S. remains good. The short-term picture remains one of high stock price volatility.

As we go through this recession, the media will focus on the bad news. It always does; apparently bad news sells. To help your own perspective on the current recession, study the last one. Go to the library and read the business magazines from early 1991.

Ron Muhlenkamp

Past performance does not guarantee future results. The principal value and investment return will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. The S&P 500 Index is a broad based unmanaged index of 500 stocks which is widely recognized as representative of the equity market in general. The NASDAQ Index is a market capitalization-weighted index that is designed to represent the performance of the National Market System which includes over 5,000 stocks traded only over-the-counter and not on an exchange.

UPCOMING APPEARANCES

Muhlenkamp & Company, Inc. will be appearing at the following investment seminars:

The 24th Annual Florida Money Show, February 21-23, 2002 at the Gaylord Palms Resort in Orlando, Florida.

MoneyWatch Expo, March 1-2, 2002 at the Marriott Tech Center in Denver, Colorado.

MoneyWatch Expo, April 19-20, 2002 at the Lloyd Center Doubletree in Portland, Oregon.

For more information, please call (800) 860-3863 extension 4 or visit our website at www.muhlenkamp.com.

INVESTOR EDUCATION

IRA CHAOS THEORY

Individual Retirement Arrangements (IRAs) are a pain in the advisor. There are Traditional IRAs (with deductible and non-deductible contributions), Roth IRAs, Simple IRAs, SEP IRAs, SAR-SEP IRAs (which are no longer available but you may still see), and Education IRAs (which were never really IRAs because they weren't for retirement, and have now been replaced by Coverdell Education Savings Accounts). The rules, exceptions to the rules, penalties for breaking the rules, and ways to get around the rules fill hundreds of pages in books, magazines, and IRS publications.

Basically, IRAs allow people to defer or avoid taxes on some of their investments. It would be much simpler, easier and cheaper to allow people to avoid taxes on ALL investments. IRAs are moot if taxes on capital gains and investment income are repealed. Until the taxes are repealed, these ideas should be useful:

1. IRAs are a way of owning investments, including stocks, bonds, and mutual funds. IRAs enable you to defer or eliminate paying taxes on the money you make with those investments. How your IRA is invested may (and probably will) differ depending on whether your IRA is with a bank, broker, mutual fund, or annuity. The rules governing IRAs will be the same across each, but the returns and the performance will vary. The rules about IRAs change periodically, so you have to pay attention. Once a year read the first several pages of IRS Publication 590 that highlights changes to IRA accounts.

2. Contribute to an IRA every year. Try to make contributions for your children and non-working spouse. The IRA owner must have compensation for the year, or be married to someone that has compensation. So if your daughter baby-sits, or delivers newspapers or cuts grass, she has compensation. Keep track of her compensation and make an IRA contribution for her each year.

The maximum contribution to an IRA for calendar year 2002 is what you earn during the year or $3,000, whichever is less. The maximum contribution increases to $4,000 in 2005 and $5,000 in 2008. Also, if you are over 50 years old you can add an extra $500 each year because prior to 2002 your contributions were limited to $2,000 per year.

You can still make a $2,000 contribution for calendar year 2001, but you have to make your contribution by April 15, 2002.

3. Choose a Traditional IRA or a Roth IRA. The Traditional IRA is useful if you can take a deduction for the contribution, **and** you think you will be in a lower tax bracket when you retire. You get a tax deduction today, and defer paying taxes until you are in a lower bracket.

Roth IRAs are great if you cannot deduct your contribution, **and** you expect to be in a higher tax bracket when you retire (which is happening more and more often as people utilize 401(k) plans, and other defined contribution plans).

The key differences between the Traditional IRA and the Roth IRA are:

- You may be able to deduct contributions to a Traditional IRA; you can never deduct contributions to a Roth IRA.
- Contributions to a Traditional IRA stop after age 70½; you can continue to contribute to the Roth IRA if you have compensation.
- Qualified distributions from a Traditional IRA are taxed; qualified distributions from a Roth IRA are tax-free.

Refer to Publication 590 for the definitions of qualified distributions, deductibility and eligibility requirements. If you are eligible, then contribute to a Roth IRA. If you aren't eligible for the Roth IRA, then make a contribution to a Traditional IRA. Remember to file Form 8606 with your tax return for every year you make a non-deductible contribution to your Traditional IRA.

4. Invest your IRA in a good no-load mutual fund. If you don't know how to pick a good no-load fund, see my article "Some Criteria to Consider When Selecting A Mutual Fund" in *Muhlenkamp Memorandum* Issue #59.

5. Integrate your IRAs into your estate plan. IRAs are similar to trusts because they have designated beneficiaries, and they are non-probate assets. Typically you want to designate your spouse as your primary beneficiary with your children or grandchildren as contingent beneficiaries. See the article "Understanding the NEW Minimum Distribution Rules" at www.ataxplan.com, and *JK Lasser's How to Pay Less Taxes on your Retirement Savings.*

Clearly there is a lot more that can be said about IRAs and how to use them. The point is to contribute to an IRA every year, and invest your IRA in a good, diversified common stock mutual fund. Start contributing when you are young, and plan to pass the IRA on to your heirs after you die. If you really understand the basics I have outlined here, you should be in good shape. Please call us if you have questions.

Anthony Muhlenkamp

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OF PERSONAL INTEREST...

TOMORROW WILL TAKE CARE OF ITSELF…RIGHT?

I'd like to talk to young, stay-at-home mothers about a future of financial security, independence and knowledge.

In our Muhlenkamp Fund universe, we were studying the types of accounts, and what accounts are held in combination. We discovered over 70% of the people who save money for their kids don't have an IRA for themselves, and women are under represented in the Fund: only 30% of the IRAs are owned by women.

If we assume the numbers for the Muhlenkamp Fund are representative of investors in general, we wondered why so few women own retirement savings accounts. We wondered if Ron's investment style does not appeal to women, or if the educational message is not clear, or if women are not aware of retirement savings opportunities. I decided to conduct an informal survey in an attempt to address these concerns.

I spoke with 5 other mothers in my neighborhood, all of whom participate in the local playgroup. Of the 6 of us in this "study," two work part-time, one works full-time, and the other three have "retired" from their professional careers to stay at home with their children.

Someone said they had funded their IRA off and on while working, but didn't fund it any longer because they no longer worked. I informed the group that every married couple is permitted to fully fund two IRAs—one for each spouse—each year, as long as one spouse has an income. In other words, if you are a full-time, stay-at-home mom, you can (and should) still fund your IRA.

Two of the moms (one of the part-time professionals and the full-time professional) have employer-sponsored pension plans, like a 401k, but don't fund an IRA. I was pleased to learn 50% of us are funding a retirement account in addition to a savings account for our children.

It is natural for a mother to provide for her children. We do it almost without thinking—sometimes to the detriment of other things. In this case the other thing might be our own financial security. Look at the results of the research on UGMA (Uniform Gift to Minors Act)-type accounts: over 70% of these accounts are custodied by a parent who doesn't have his/her own retirement account. Assuming most of these children have mothers, I'm wondering where the moms are saving their money.

A common argument for not saving is, "But we don't have any extra money to save!" Yet each mother has managed to start a savings account for her children, and our husbands have employer-sponsored retirement plans. Why can't we find the little extra to save for ourselves? Maybe you can't save the fully allowable amount, but you can start with what you have. Get in the habit of paying yourself first. The Muhlenkamp Fund allows you to open an account for as little as $200 as long as you automatically invest $50 per month into your account. Start paying the $50 monthly bill now, and put the power of compounding interest to work on your money over the next 20 years.

You say you can't find $50 per month? Do you spend an average $2 a day, each month, on something you can do without (McDonald's Happy Meal? Grande Latte?)? If so, you can probably find $50 per month.

Wouldn't you like to have a nest egg, some financial independence after the children are grown and on their own? Do you **want** to worry about your financial future? Do you want to have to **rely** on your spouse and children for your security?

It is as important for our future to be taken care of as our children's—and it is up to us to ensure that future.

Here's what I believe:

- You will one day rely on your savings and investments to support yourself.
- You don't want to rely on your children to take care of you.
- You like what Ron has to say (since you're reading this newsletter) about the philosophy of investing.

So here is my conclusion:

- If you don't have some form of retirement savings, you should open an IRA account.
- Once you have an IRA account, make the maximum contribution that you can each and every year.

Want to learn more? Give the Muhlenkamp Fund a call at (800) 860-3863. You have until your tax deadline (April 15, 2002 for the majority of readers) to fund your IRA for 2001.

Inger Muhlenkamp

Inger Muhlenkamp is a mother and an independent sub-contractor specializing in custom database design and application software support for end-users. She is married to Tony Muhlenkamp and contributes every year to her IRA.

MUHLENKAMP FUND AVERAGE ANNUAL RETURNS AS OF 12/31/01

One Year	Three Year	Five Year	Ten Year
9.35	*15.14*	*16.00*	*16.51*

For more complete information about the Muhlenkamp Fund, including risks, fees and expenses, please call 1-800-860-3863 to obtain a prospectus. Please read the prospectus carefully before you invest. Past performance does not guarantee future results. Fund shares when redeemed may be worth more or less than their original cost. Please consult your tax advisor for advice concerning your particular situation and for any updates to the tax law. A program of regular investing cannot assure a profit or protect against a loss in a declining market.

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