

MuhlenkampMemorandum

Issue 64

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On September 30, 2002 the Net Asset Value of the Muhlenkamp Fund was \$39.87, down 25.56% year to date.
[Click here to see the current Net Asset Value of the Muhlenkamp Fund.](#)

In the News



Forbes Mutual Fund Honor Roll

For the second year in a row, the Muhlenkamp Fund is among the 10 funds named to "The Honor Roll," *Forbes* magazine's selection of "Standout funds with the mettle to succeed over the long haul—through all kinds of weather." You can read the article at the magazine's website, www.forbes.com/fundsurvey, or in the September 16, 2002 issue.

Kiplinger's Top-10, Large-Cap Performer

The Muhlenkamp Fund is listed in the top ten in the large-company funds category for 3-, 5-, and 10-year performance in *Kiplinger's Personal Finance* magazine's September 2002 issue.

Mutual Funds Top 100 Funds

The Muhlenkamp Fund is listed among the top 100 fund picks in the *Mutual Funds* magazine's "Fund Buyer's Guide" in the August 2002 issue.

Announcements

Minimum Balance Maintenance Fee

The \$15 annual maintenance fee for Muhlenkamp Fund shareholders with account balances *and* net investments below \$1500 will be charged during the first week of December. You have until then to ensure your total *net purchases* are at least \$1500 to avoid the fee.

IRA Account Maintenance Fee

The Annual IRA Maintenance Fee will be deducted from your account on October 25, 2002 unless you have paid the fee by check. The fee is \$10 per account, capped at \$20 per Social Security number.

Quarterly Letter

The economy continues to expand and the markets remain volatile. Several interesting things are going on. Six percent unemployment means that 94% of the people who want to work are working. These people are earning an income. They have only two choices. If they spend their income, the economy comes back fairly strong. If they don't spend their income, the economy remains slow and interest rates decline and they get the chance to refinance their mortgage once again. People are doing some of each, so the expansion is about half-speed and mortgage rates are declining. You may recall that the expansion coming out of the '90 recession was half-speed, and that didn't work out too badly.

Also, as sometimes happens in a recession, consumers are shifting their spending patterns. In this case, they are shifting towards spending on their homes and on autos. So we have the fascinating circumstance of economists lamenting the fact that consumers are spending too little at retail stores and too much on housing, as if consumers should allocate their spending patterns to conform to economists models. Folks, this is backwards. Economists models are useful only to the extent that they conform to the actions of consumers/workers/taxpayers. Over the years, I've learned that when economists say one thing and consumers do something else, watch the consumer.

From January through May of 2002, stock prices reflected the relative values and economic strengths of various industries and companies. In June and July, none of this mattered. Segments of the investing public wanted out of their stocks and out of equity mutual funds and they sold – regardless of price. This emotional sell-off appears to have climaxed in late July. Since then the stocks of good companies at cheap prices have begun to outperform their competitors and overpriced stocks. We expect this to continue. While we cannot say for sure that we won't get another emotional sell-off (we can never say that), the odds decline dramatically after each one. ☞

— Ron Muhlenkamp

Forbes magazine's rating criteria for earning a place on the *Forbes Mutual Fund Honor Roll* include: 1) strong relative performance in up and down markets, 2) a manager tenure of at least six years, 3) diversification, 4) accessibility, and 5) strong long-term, after-tax performance. *Forbes Honor Roll* logo reprinted with permission from *Forbes, Inc.*

Kiplinger's Personal Finance magazine's rating criterion for earning a place in the *Top-10* list is a stock fund earning a positive return for the 12-month period July 1, 2001 through July 31, 2002.

Mutual Funds magazine's rating criteria for earning a place in the *Top 100* were: "sizable stakes of basic-materials stocks," "a global approach to investing," "superior management" demonstrated by a positive alpha, low cost, and "high projected returns" based on the editors' forecast of a healthy economic recovery and benign interest rate environment in the coming year.



Muhlenkamp & Company, Inc.
Intelligent Investment Management

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Investment Insights

Worker Capitalism Triumphs Originally published in October 1987

As reflected in literature and the popular media from Dickens and Marx to Studs Terkel and Jesse Jackson, people have always viewed themselves as workers. As workers, they think of themselves as being in direct competition with owners and managers for a share of the wealth created by business enterprise. They see the return for their efforts in the form of a weekly or semi-monthly paycheck and often conclude that their pay would be greater if only the owners took less. People naturally think in terms of net, "take home" pay, money that is then spent on the day-to-day necessities and luxuries of life. Yet "take home" pay is only a part of the benefits received for work. Other items, whether deducted from gross pay, such as taxes, or those not appearing on the pay stub at all, such as medical insurance or pension benefits, are much less tangible, and are often taken for granted or ignored by the worker. Yet, the least tangible part of the paycheck, the pension benefit, has resulted in American workers owning a major portion of the business assets of the United States. The growth in pension and retirement assets has been so great that Peter Drucker calls wage earners "the only true capitalists in developed countries today."

Today the workers are the owners; they just don't know it yet. According to *Pension & Investments*, in late 1986 the 100 largest U.S. Pension Funds had assets exceeding \$845 billion. Of these 100 funds, only 48 were corporate related. The aggregate market value of the 48 sponsoring companies was \$583 billion. Thus, the 100 largest pension funds could easily own all of the shares of the 48 companies. Individually, the pension funds of the employees of 14 of these companies exceeded the total market value of their respective stocks.

Thus, the employees of General Motors, through their pension plan, could buy all of the stock of their company. So could the employees of AT&T, USX, Alcoa, Lockheed Martin, Union Carbide and Delta Air Lines.

Of the 100 largest pension plans not company related, most are plans for public employees. The California Public Employees Retirement Plan exceeded \$37 billion, an amount sufficient to buy all the stock of General Motors and Ford. Similarly, the Pennsylvania State Employees Retirement Plan could have bought out USX. The Pennsylvania School Employees Retirement Plan, at over \$10 billion, could have bought out USX plus Alcoa. The list goes on and on.

The point is that workers already own a huge chunk of America's capital assets, yet are largely unaware of it. A person retiring from USX with a

"...the least tangible part of the paycheck, the pension benefit, has resulted in American workers owning a major portion of the business assets of the United States."

\$20,000 per year pension and a life expectancy of 15-20 years thinks he's poor, but if he receives the same amount in a lump sum, he thinks he's rich. Same data, different perceptions.

Though the workers seem unaware of their ownership status, managers are rapidly becoming more aware. Directors and managers see huge blocks of "their" stock in the hands of (potentially non-friendly) pension funds and mutual funds, so they try to maintain their positions of power and influence with various "poison pills" and so-called "shareholder rights

plans." Managers sometimes literally buy-off unfriendly holders through greenmail payments or share repurchase. Some do both. When General Motors paid \$700 million in hush money to H. Ross Perot because Perot refused to keep quiet about GM's loss of market share, the firm was besieged by its other larger shareholders, including the Comptroller of the New York City Pension Funds. It seems these other shareholders were not happy with H. Ross being the only beneficiary of the firm's largess, so they made noises about replacing Roger Smith as Chairman. GM announced a share repurchase soon thereafter.

Other firms undermine the shareholder's say in management by creating separate classes of stock, one with the great majority of voting power, the other with very little. The trouble with this strategy is that the New York Stock Exchange has something called the "one share-one vote" rule, and firms opting for this strategy face de-listing of their securities. Opposition to these and other corporate tactics is increasing as institutional shareholders come to recognize their collective power.

Update (1995)

We wrote in 1987 that institutional shareholders and pension plans were beginning "to recognize their collective power." Much has been made of the push in recent years for a greater focus on shareholder values, frequently resulting in corporate cutbacks, including large layoffs. But the public is unaware that the major pension plans have been aggressive drivers of this trend. Specifically, in each of the past several years, Calpers (California Public Employee Retirement System) has targeted a number of major companies, pushing for greater efficiencies and greater profitability. Its targets have included General Motors, Eastman Kodak, Westinghouse, etc., and its pressure has resulted in the firings of chief executives and whole tiers of

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corporate managers, and it was done in the name of, and for the benefit of, workers' pensions.

Update (2002)

The data below and on the following page was reprinted with permission from *Pension and Investments*, January 21, 2002 (Crain Communications, Inc.). It lists the top 200 pension funds and their sponsors in the United States, along with the assets (in millions) in the fund. The largest

fund is Calpers, which is the California Public Employees Retirement System. As of September 30, 2001, the top 100 pension plans aggregate over \$2.9 trillion. The top 200 plans aggregate over \$3.5 trillion. The top 1000 pension plans aggregate over \$4.7 trillion. As you can see, of the top 200 pension plans, 94 have corporate sponsors; of the top 100 plans, 41 have corporate sponsors. We have included a column labeled "Market Value" which shows the market value of the respective corporations, as of September 23, 2002.

The asterisks on the table indicate those plans that exceed the market value of the sponsoring companies. Thus, the employees of General Motors, Ford, Boeing, Lockheed Martin, etc., through their pension plans, could purchase their respective companies.

In the United States, in 2002, we have worker capitalism. Workers can paraphrase Pogo in saying, "We have met the owners and they are us." 

—Ron Muhlenkamp

Reprinted with permission from *Pension and Investments*, January 21, 2002 (Crain Communications, Inc.)

Rank	Pension Fund/Sponsor	Assets (MM)	* Market Value (MM 9/23/02)	Rank	Pension Fund/Sponsor	Assets (MM)	* Market Value (MM 9/23/02)
1.	California Public Employees	\$143,887		44.	Illinois Teachers	\$ 21,712	
2.	New York State Common	106,091		45.	DiamlerChrysler	21,490	35,977
3.	California State Teachers	95,553		46.	United Nations Joint Staff	20,806	
4.	Federal Retirement Thrift	93,328		47.	South Carolina Retirement	20,776	
5.	Florida State Board	88,514		48.	Exxon Mobil	20,000	221,103
6.	General Motors	82,500	* 23,299	49.	Raytheon	20,000	* 13,053
7.	Texas Teachers	75,109		50.	Arizona State Retirement	19,641	
8.	New York State Teachers	74,915		51.	Connecticut Retirement	19,142	
9.	General Electric	68,769	262,666	52.	Honeywell	19,000	* 18,819
10.	New Jersey	66,691		53.	Missouri Public Schools	18,809	
11.	Verizon	65,936	81,061	54.	Texas Employees	18,770	
12.	Boeing	57,940	* 28,295	55.	Philip Morris	17,492	91,213
13.	IBM	56,500	107,369	56.	Citigroup	17,408	139,530
14.	Wisconsin Investment Board	55,473		57.	Teamsters, Central States	17,359	
15.	New York City Retirement	54,512		58.	United Technologies	17,258	27,082
16.	Lucent Technologies	52,995	* 3,398	59.	Iowa Employees	15,029	
17.	North Carolina	52,575		60.	Mississippi Employees	14,641	
18.	Ohio Public Employees	50,459		61.	Qwest	14,527	* 4,690
19.	Ford Motor	50,000	* 17,609	62.	Georgia Employees	14,038	
20.	Michigan Retirement	49,266		63.	Illinois Municipal	13,928	
21.	Pennsylvania School Employees	48,000		64.	Alaska Investment Board	13,236	
22.	Ohio State Teachers	47,336		65.	BP America	13,090	153,666
23.	SBC Communications	46,405	75,513	66.	Dow Chemical	13,051	26,220
24.	University of California	41,974		67.	Prudential	12,988	16,243
25.	Washington State Board	41,916		68.	Bank of America	12,900	95,944
26.	New York City Teachers	41,802		69.	Shell Oil	12,842	84,598
27.	Minnesota State Board	39,538		70.	Nevada Public Employees	12,825	
28.	Georgia Teachers	39,230		71.	Utah State Retirement	12,725	
29.	Oregon Employees	35,051		72.	Delta Air Lines	12,392	* 1,393
30.	Virginia Retirement	34,744		73.	State Farm	11,889	
31.	Lockheed Martin	32,289	* 29,888	74.	Kentucky Teachers	11,798	
32.	AT&T	27,601	47,107	75.	Kentucky Retirement	11,784	
33.	Alabama Retirement	27,295		76.	USX	11,715	* 1,112
34.	Colorado Employees	26,928		77.	United Airlines	11,600	* 133
35.	Massachusetts PRIM	26,802		78.	Alcoa	11,506	17,146
36.	Maryland State Retirement	26,608		79.	Eastman Kodak	11,400	* 7,924
37.	Los Angeles County Employees	25,910		80.	American Airlines	11,314	* 657
38.	BellSouth	25,046	40,859	81.	San Francisco City & County	11,230	
39.	Pennsylvania Employees	24,576		82.	United Parcel Service	10,997	69,586
40.	DuPont	24,180	38,123	83.	United Methodist Church	10,931	
41.	Tennessee Consolidated	23,187		84.	Procter & Gamble	10,726	118,007
42.	Western Conference Teamsters	22,604		85.	Louisiana Teachers	10,624	
43.	Northrop Grumman	22,028	* 14,367	86.	3M	10,314	45,822

* Denotes Pension greater than Market Value

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Worker Capitalism...

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Rank	Pension Fund/Sponsor	Assets (MM) *	Market Value (MM 9/23/02)	Rank	Pension Fund/Sponsor	Assets (MM) *	Market Value (MM 9/23/02)
				142.	Episcopal Church	\$ 5,978	
				143.	New Mexico Educational	5,948	
				144.	Allstate Insurance	5,925	25,227
				145.	Merrill Lynch	5,900	28,333
87.	Kaiser	\$ 10,162		146.	Bechtel Power	5,864	
88.	Los Angeles Fire & Police	10,082		147.	Wachovia	5,700	45,323
89.	PG&E	10,059	* 4,231	148.	Rhode Island Employees	5,662	
90.	National Electric	10,000		149.	American Electric	5,624	9,020
91.	Illinois State Universities	9,892		150.	Los Angeles Water & Power	5,571	
92.	Indiana Public Employees	9,757		151.	1199 Healthcare Employees	5,550	
93.	International Paper	9,696	16,453	152.	Bethlehem Steel	5,538	* 12
94.	Pfizer	9,552	177,272	153.	Oklahoma Teachers	5,526	
95.	General Dynamics	9,538	17,062	154.	Indiana Teachers	5,519	
96.	Caterpillar	9,406	12,961	155.	Sears, Roebuck	5,481	13,308
97.	World Bank	9,338		156.	Louisiana State Employees	5,472	
98.	Chicago Public School Teachers	9,252		157.	National Rural Electric	5,463	
99.	Delphi Automotive	8,800	* 5,013	158.	Chicago Municipal Employees	5,451	
100.	Texas Municipal Retirement	8,790		159.	Compaq Computer	5,332	39,303
101.	Viacom	8,750	69,897		<i>(Mkt Value includes Hewlett-Packard)</i>		
102.	Kansas Public Employees	8,717		160.	TRW	5,323	7,603
103.	Wells Fargo	8,662	82,593	161.	Bank One	5,299	43,372
104.	FedEx	8,600	14,524	162.	I.A.M. National	5,290	
105.	Chevron	8,500	74,434	163.	Delaware Public Employees	5,281	
106.	Deere	8,421	10,797	164.	Albertson's	5,275	9,872
107.	Motorola	8,375	23,266	165.	Textron	5,274	* 4,834
108.	Texas County & District	8,315		166.	Presbyterian Church	5,243	
109.	Exelon	8,215	14,368	167.	Monsanto	5,217	* 4,060
110.	Federal Reserve Employees	8,119		168.	Cook County Employees	5,200	
111.	Southern Co.	8,016	19,636	169.	Montana Board of Investments	5,143	
112.	Consolidated Edison	7,954	8,347	170.	Merck	5,129	101,793
113.	Hawaii Employees	7,920		171.	Nebraska Investment Council	5,113	
114.	Illinois State Board	7,824		172.	US Airways	5,073	* 38
115.	Ohio Police & Firemen	7,769		173.	Dominion Resources	5,007	13,672
116.	New Mexico Public Employees	7,725		174.	Bakery & Confectionery Union	5,000	
117.	Hewlett-Packard	7,669	39,303	175.	South Dakota Retirement	4,990	
	<i>(Mkt Value includes Compaq)</i>			176.	Duke Energy	4,965	16,505
118.	Abbot Laboratories	7,659	65,146	177.	Oklahoma Public Employees	4,881	
119.	Xerox	7,400	* 4,870	178.	Missouri State Employees	4,866	
120.	Ohio School Employees	7,393		179.	GlaxoSmithKline	4,799	109,755
121.	Georgia-Pacific	7,200	* 3,601	180.	Siemens	4,784	31,793
122.	Idaho Public Employees	7,009		181.	Kimberly-Clark	4,782	29,526
123.	Tennessee Valley Authority	6,992		182.	Intel	4,780	94,190
124.	Chase Manhattan	6,988	38,380	183.	Arizona Public Safety	4,744	
125.	Arkansas Teachers	6,925		184.	Kroger	4,700	11,773
126.	Johnson & Johnson	6,800	157,247	185.	Xcel	4,697	* 3,642
127.	Eli Lilly	6,700	61,904	186.	N.Y. State Deferred Comp.	4,691	
128.	Northwest Airlines	6,669	* 621	187.	Goodyear Tire & Rubber	4,628	* 1,481
129.	MetLife	6,668	16,543	188.	FleetBoston	4,611	21,887
130.	Los Angeles City Employees	6,632		189.	Tribune	4,589	12,568
131.	Bristol-Myers Squibb	6,627	46,954	190.	Electronic Data Systems	4,549	7,935
132.	Maine State Retirement	6,488		191.	CIGNA	4,497	10,311
133.	Operating Engineers	6,456		192.	Philadelphia Municipal	4,476	
134.	Southern Baptist	6,449		193.	Evangelical Lutheran Church	4,383	
135.	AOL Time Warner	6,400	53,604	194.	Orange County	4,361	
136.	Aetna	6,240	* 5,857	195.	Operating Engineers Local 3	4,329	
137.	Unisys	6,221	* 2,276	196.	California Savings Plus	4,301	
138.	Boilermaker-Blacksmith	6,209		197.	ITT Industries	4,300	5,791
139.	Sprint	6,136	11,795	198.	Sandia	4,292	
	<i>(Mkt Value includes PCS and FON)</i>			199.	Halliburton	4,290	5,760
140.	UMWA Health & Retirement	6,130		200.	New Hampshire Retirement	4,234	
141.	J.C. Penney	6,067	* 4,890				
					Total	\$3,560,989	

* Denotes Pension greater than Market Value

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Investor Education

We believe a disciplined investment approach is necessary at all times for long-term growth. Following are Frequently Asked Questions (FAQs) with answers from the Muhlenkamp & Company investment team.

Is your investment style value-oriented or growth-oriented?

Both. As Warren Buffet says, "Growth is part of the value calculation." But we consider profitability (return on shareholder equity) more important than growth. We then try to get that profitability at a value price.

Have you changed your style over time?

No, our style hasn't changed in thirty years. But we define style as good investments at good prices. At various times this has included bonds, foreign stocks, real estate and what some people call "growth" stocks. Some people now include size in their definition of style. We think size is irrelevant.

To what extent do you use cash?

We use cash in two ways:

1. As a "parking place" between the sale of one position and the purchase of another.
2. As a portfolio hedge when we see risk in the marketplace.

In 1972, the group I (Ron) was working with saw increasing inflation causing a major negative in the big picture (we would now call it a climate change) and went to 50% cash. At various times, when we've seen the Fed raise interest rates to slow the economy (raising risks in the intermediate term), we've gone to 20-25% cash. The most recent occurrence of this was mid-1998.

When the big picture and intermediate picture look good, but we see psychology risk in the current market, we'll hold 5-15% cash. This was true in January-July of 2002, so we held 6-10% cash.

How do you conduct your research?

We begin with various databases, looking for companies with good return on equity (ROE) and modest price-to-earnings (P/E) ratios. As a working definition, ROE is the rate of return of earnings based on the equity capital. It has averaged roughly 14% since WW II, so that becomes our starting point.

If the numbers look good, we dig deeper by checking financial statements and annual reports. If satisfied, we call the company's management. Our three favorite questions are:

1. Are there analysts on Wall Street who do a good job covering your company? (That saves us time because we can work off their efforts.)
2. What metrics do you use to judge your company's performance? (Some use ROE, some use Discounted Cash Flow, others use Economic Value Added, and so forth; all these are valid, but we want to know what they use.)
3. At what point on that metric do your executives or employees start earning a bonus? We want to know what they're trying to accomplish with shareholder money. (Sometimes they set their hurdles too low, in which case we're not interested. Our job is to figure out whether the company will reach its goals and figure out what we're willing to pay for that.)

Finally, we talk with the company's customers. If the customers are happy, the company is doing something right.

Upcoming Appearances

The New York Money Show
New York Hilton, New York
October 23-26, 2002
Workshops with Ron Muhlenkamp
on Thursday, Friday, and Saturday.
Exhibit Booth #95

Year-End Economic Briefing
with Ron Muhlenkamp
Four Points Sheraton North,
Warrendale, PA
December 5, 2002

**Back to Basics: How to Make
Money in the Current Investment
Climate**
with Ron Muhlenkamp
Location TBD, Atlanta GA
February 18, 2003

The Florida Money Show
Gaylord Palms Resort, Orlando FL
February 19-22, 2003
Workshops with Ron Muhlenkamp
Exhibit Booth #511

Visit www.muhlenkamp.com or call
(800) 860-3863 extension 4 for more
information.

