



## MUHLENKAMP & COMPANY, INC.

INTELLIGENT INVESTMENT MANAGEMENT

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### QUARTERLY LETTER

**A**t year-end, we wrote, “Stock and bond prices are fair, the long and intermediate trends are positive, and the short-term trends are neutral.” The price actions of various markets since then have diverged widely.

In early 1996, stock prices moved up 8-10%, giving us an equivalent of twelve months of returns in five months. In this same time period, bond prices moved down 10%. Our judgment in late June was that this stock-bond spread was as wide as it was likely to get. (Some dividend discount models, which showed stocks fairly priced relative to bonds at year-end, showed stocks overpriced relative to bonds by 30% in late June.) This made stock prices vulnerable to any continued weakness or any accident in the bond market.

Our readers know that we believe prices in any market can swing plus or minus 10% at any time for any reason. Moves within a 10% range are psychological “noise”. We believe the recent decline in bond prices has been mostly “noise”, abetted by fears of increased inflation. These fears are aided by some economists who are predicting higher inflation and higher interest rates. Specifically, the chief economist of Morgan Stanley is predicting treasury rates as high as 8 ½% by year-end 1997. While we don’t (yet) believe this prediction, we must respect the possibility (and the author). The real point today is that with bond prices already down 10%, any bond market “accident” could trigger another 10% decline, whether the fundamentals justify it or not. In 1994, the Orange County bankruptcy was such an accident. While we think such an accident is less likely to happen today (largely because a big one happened just two years ago), the nature of accidents is such that they are hard to predict. To sum the above in one sentence – the price moves of the stock and bond markets since year-end have made stocks vulnerable to any further decline in bond prices. The 2% price declines in the bond and stock markets, in response to the strong

#### MUHLENKAMP MONEY HOUR HITS THE AIRWAVES

If you live in the Pittsburgh area, make sure to tune in to the Muhlenkamp Money Hour, every third Monday of the month. The show airs on KQV News Radio 1410 AM at 7:00 p.m.

Each month’s show will feature Ron Muhlenkamp in a discussion of various topics relating to money and investing. The next Muhlenkamp Money Hour will be broadcast on August 19.

If you have investment questions for the show, please send them to our office at the address on this newsletter, or click here to e-mail us.

#### SHAREHOLDERS RESPOND TO AUTOMATIC INVESTMENT PLAN

July marked the initiation of the Muhlenkamp Fund Automatic Investment Plan. To date, over 6% of Fund shareholders have enrolled in the Plan, and more are signing up each day. The Plan easily allows shareholders to put themselves on a regular investment schedule, and at the same time take advantage of the benefits of Dollar Cost Averaging.

To learn more about the Automatic Investment Plan, please call us at 800-860-3863.

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## THE MUHLENKAMP MEMORANDUM

employment numbers released on July 5, demonstrated this thought process and the resulting vulnerability.

Meanwhile, on a short-term basis, stock prices were widely dispersed around the 8-10% gain in the averages. Recent focus on small capitalization and technology stocks has highlighted a speculative bent in the marketplace. This was reinforced by the recent tendency to consider a move of a few weeks duration as a trend and a counter move of a few days as a correction. Our judgment was that a correction which dampened these speculative juices would be the best thing that could happen. And, since early June, we have been witnessing such a correction. The problem is that such corrections seldom confine themselves to the areas of concern – they often spread to the rest of the market. If we are about to get a broader based correction, the current weakness in the high-tech stocks, aided by weakness in the bond market such as occurred on July 5, should trigger it.

*The above was written in the first week of July. Since then, the correction in high tech stocks spread to the broader market, and appears to have climaxed on July 16. We believe the correction in high tech stocks was necessary, and a positive development. In fact, we judge the price action of the past month as nearly ideal. (To be truly ideal would require that our stocks go up while all others go down.)*

*We still judge the long-term and intermediate-term trends to be positive. But prices are full enough; and short-term trends are "dicey" enough, that we became more nervous than we have been for some time. Consequently, we culled out some holdings and accumulated some cash. Since July 17, we've been buying selectively. However, we want to see a few more weeks of market response before we are willing to say the correction is over.*

The bigger question is one of economic theory. Most of the people who are now "chief economist" in various places (including Morgan Stanley) studied economics 30-40 years ago. Most of them were taught that growth causes inflation; and consequently fear that good growth in the current economy will cause higher inflation and higher interest rates. We believe the U.S. experience of the past 30 years has proved that growth does not cause inflation. The chief economist at Donaldson Lufkin and Jenrette, based partly on a similar belief, is predicting long-term treasury rates of 4 1/2% by year-end 1997. This is opposite of the prediction of Morgan Stanley. Strange as it may seem, both economists could be right. Financial markets are people, and eighteen months is ample time to reflect first the fears of higher inflation rates and then the (possible) reality of lower inflation rates. It is these con-

flicting prospects that make the current markets so "interesting".

Meanwhile, of course, other concerns that we have been monitoring remain active. So far, our troops in Bosnia remain unwounded; but the bombing in Saudi Arabia marks their vulnerability. The election results in Russia indicate continuing progress towards a freer people and freer markets in that country, albeit often in fits and starts.

Current politics in this country remain more theater than policy, and soap opera theater at that. Two of the more interesting presidential election results in recent history were Carter over Ford in 1976 and Clinton over Bush in 1992. In each of these elections, I believe, the American people chose an unknown promise over a known, dull quantity. Clinton's problem in 1996 is that he's now a known promise, facing a known, dull Dole. The only argument I have heard for re-electing Clinton is that "things are pretty good, why change them." I would respond that things are pretty good largely because Clinton failed in his agenda. The only thing Bill Clinton has accomplished so far is to make Richard Nixon look honest by comparison. □

### WORKER'S CAPITALISM TRIUMPHS; KARL MARX WOULD BE PLEASED?

#### AN UPDATE

(First published in October 1987.)

As reflected in literature and the popular media from Dickens & 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 which 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

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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 Age*, 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 \$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 aware. Directors and managers see huge blocks of “their” stock in the hands of (potentially nonfriendly) 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 delisting of their securities. Opposition to these and other corporate tactics is increasing as institutional shareholders come to recognize their collective power.

### THE UPDATE:

The data on the following page was copied with permission from *Pension and Investments*, January 22, 1996, page 22. 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 TIAA-CREF, which is the Teacher's Insurance Annuity Association - College Retirement Equity Fund. As of September 30, 1995, the top 100 pension plans aggregate over \$2 trillion. The top 200 plans aggregate over \$2.4 trillion. The top 1000 pension plans aggregate over \$3 trillion. As you can see, of the top 200 pension plans, 91 have corporate sponsors; of the top 100 plans, 41 have corporate sponsors. We have included a column labeled “Mkt. Value” which shows the market value of the respective corporations, as of year-end 1995. The asterisks on the table indicates those plans that exceed the market value of the sponsoring companies. Thus, the employees of General Motors, Ford, Boeing, Lockheed, etc., through their pension plans, could purchase their respective companies.

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 corporate managers. And it was done in the name of, and for the benefit of, workers' pensions. In the United States, in 1995, we have worker capitalism. Workers can paraphrase Pogo in saying, “We have met the owners and they are us.”

*(Chart on Next Page)*

# THE MUHLENKAMP MEMORANDUM

## Top 200 Pension Funds (in \$ Millions)

	<u>Pension</u>	<u>Mkt Value</u>		<u>Pension</u>	<u>Mkt Value</u>		<u>Pension</u>
1. TIAA-CREF.....	153,609		68. Prudential Insurance.....	9,381		135. RJR Nabisco.....	4,407
2. California Public Employees.....	92,620		69. Chevron.....	9,353	34,500	136. Aetna Life.....	4,394
3. General Motors..... *	72,000	40,000	70. Mississippi Public Employee	9,002		137. Citibank.....	4,378
4. New York State & Local .....	71,456		71. Sears, Roebuck.....	8,666	15,100	138. TRW.....	4,293
5. California State Teachers.....	58,343		72. Delta Airlines.....*	8,610	3,800	139. Arkansas Teacher.....	4,222
6. AT&T.....	57,097	102,830	73. Utah State Retirement.....	8,591		140. Abbott Laboratories.....	4,200
7. New York State Teachers.....	49,463		74. Iowa Public Employees.....	8,589		141. Tenneco.....	4,125
8. Florida State Board .....	47,726		75. McDonnell Douglas.....	8,500	10,500	142. Eli Lilly.....	4,063
9. Texas Teachers.....	46,054		76. United Airlines.....*	8,345	2,160	143. Honeywell.....	4,027
10. New York City Retirement .....	41,679		77. Illinois Municipal.....	8,264		144. Southern California Edison.....	4,008
11. New Jersey.....	40,974		78. American Airlines.....*	7,900	5,600	145. New Mexico Employees.....	4,008
12. General Electric .....	40,000	122,000	79. Alaska Retirement Systems..	7,873		146. Rhode Island Employees.....	4,006
13. IBM.....	39,159	52,000	80. Georgia Employees.....	7,807		147. Atlantic Richfield.....	3,965
14. Wisconsin Investment Board....	35,586		81. San Francisco City & Cnty...	7,315		148. Sprint.....	3,949
15. Ohio Public Employees .....	34,986		82. Kentucky Teachers.....	7,195		149. Louisiana State Employees.....	3,903
16. Ford Motor.....*	34,900	27,500	83. Westinghouse Electric.....*	7,176	6,100	150. New Mexico Educational.....	3,895
17. Ohio State Teachers .....	33,463		84. Caterpillar.....	7,054	12,000	151. Federal Express.....	3,873
18. Federal Retirement Thrift Board	32,981		85. Nevada Public Employees....	6,929		152. Northwest Airlines.....	3,858
19. North Carolina Retirement.....	32,184		86. Pacific Gas & Electric.....	6,913	12,000	153. Operating Engineers.....	3,808
20. Pennsylvania Public Schools.....	30,806		87. United Methodist Church....	6,727		154. Maine State Retirement.....	3,800
21. Michigan State Retirement.....	28,730		88. 3M.....	6,623	27,700	155. Boilermaker-Blacksmith .....	3,753
22. Boeing.....*	28,529	26,600	89. Xerox.....	6,490	14,200	156. Presbyterian Church (USA)....	3,745
23. New York City Teachers.....	25,943		90. State Farm Insurance.....	6,481		157. Bethlehem Steel.....	3,700
24. E.I. DuPont de Nemours.....	25,817	38,800	91. Los Angeles Fire & Police....	6,443		158. Bristol-Myers Squibb.....	3,694
25. University of California .....	24,327		92. Mobil Oil.....	6,425	45,000	159. National Rural Electric Co-op..	3,685
26. Washington State Board.....	23,701		93. J.C. Penney.....	6,414	10,900	160. Chicago Municipal Employees	3,565
27. Minnesota State Board.....	21,983		94. Illinois State Universities....	6,306		161. PPG Industries.....	3,514
28. Lockheed Martin .....	20,567	16,000	95. Massachusetts PRIM.....	6,275		162. Bakery & Confectionery.....	3,505
29. Los Angeles County Employees	20,358		96. Kansas City Pub. Employees	6,259		163. Los Angeles Water & Power....	3,411
30. Georgia Teachers.....	20,290		97. World Bank.....	6,245		164. Idaho Public Employees.....	3,403
31. NYNEX .....	20,213	23,200	98. Kentucky Retirement.....	6,231		165. Goodyear Tire & Rubber.....	3,359
32. Oregon Public Employees.....	20,000		99. Hawaii Employees.....	6,187		166. Texaco.....	3,339
33. Virginia Retirement System .....	19,916		100. Chicago Public School.....	6,111		167. Oklahoma Teachers.....	3,334
34. Maryland State Retirement .....	19,298		101. Kaiser Permanente.....	5,989		168. CIGNA.....	3,325
35. BellSouth.....	18,798	43,600	102. Louisiana Teachers.....	5,891		169. D.C. Retirement Board.....	3,294
36. Bell Atlantic .....	17,217	28,800	103. Southern Co. Services.....	5,788		170. Chemical Bank.....	3,252
37. Colorado Public Employees.....	16,770		104. UMW.....	5,788		171. American Home Products.....	3,249
38. GTE.....	16,697	42,700	105. National Electrical Benefit...	5,750		172. West Virginia State Board.....	3,217
39. Pennsylvania State Employees..	15,936		106. Raytheon.....	5,630	11,200	173. Healthcare Employees.....	3,200
40. Chrysler.....	15,715	21,000	107. United Parcel Service.....	5,616		174. Johnson & Johnson.....	3,159
41. Tennessee Consolidated.....	15,077		108. Consolidated Edison.....	5,609	7,500	175. Evangelical Lutheran Church...	3,117
42. South Carolina Retirement.....	14,932		109. Unisys.....*	5,550	1,000	176. Oklahoma Public Employees...	3,079
43. United Nations Joint Staff.....	14,707		110. Indiana Public Employees....	5,484		177. Indiana State Teachers.....	3,078
44. Ameritech .....	14,700	32,700	111. Dow Chemical.....	5,474	17,500	178. Travelers Insurance.....	3,074
45. Pacific Telesis Group.....*	14,637	14,400	112. General Dynamics.....*	5,458	3,800	179. Nebraska Investment Council..	3,059
46. Teamsters, Central States.....	14,611		113. Ohio Police & Firemen .....	5,403		180. Halliburton .....	3,025
47. Western Conf. of Teamsters....	14,600		114. Motorola.....	5,353	33,700	181. Cook County Employees.....	3,001
48. Alabama Retirement Systems....	14,098		115. Monsanto .....	5,324	14,100	182. American Stores.....	2,994
49. Illinois Teachers.....	13,512		116. Deere .....	5,208	9,000	183. Montana Board.....	2,963
50. US WEST .....	12,827	17,000	117. Amoco.....	5,200	36,200	184. Commonwealth Edison.....	2,960
51. Arizona State Retirement.....	12,674		118. Tennessee Valley Authority..	5,057		185. Missouri State Employees.....	2,951
52. Rockwell International .....	12,659	9,800	119. Texas Municipal.....	5,024		186. Southern California UFCW.....	2,944
53. Connecticut Trust Funds .....	12,630		120. MetLife Insurance.....	5,002		187. American Electric Power.....	2,919
54. Northrop Grumman.....*	12,374	3,100	121. Detroit Retirement Systems.	4,907		188. Orange County Employees.....	2,917
55. Texas Employees.....	12,257		122. Aluminum Co. of America...	4,896	9,300	189. I.A.M. National.....	2,913
56. United Technologies.....*	11,867	11,700	123. ITT.....	4,878	12,000	190. USAir.....	2,889
57. Philip Morris .....	11,748	77,000	124. Ohio School Employees.....	4,818		191. Phillips Petroleum.....	2,885
58. Shell Oil .....	11,596	44,800	125. Illinois State Board.....	4,790		192. FPL Group.....	2,885
59. Missouri Public School .....	11,193		126. Texas County & District.....	4,721		193. Sandia.....	2,865
60. SBC Communications.....	10,611	35,000	127. Los Angeles City Employees	4,708		194. New England Teamsters.....	2,835
61. Eastman Kodak.....	10,368	22,900	128. Bank of America.....	4,681	23,800	195. Owens-Illinois.....	2,793
62. Exxon.....	10,153	103,100	129. Tectron.....	4,679	5,900	196. Kmart.....	2,750
63. Proctor & Gamble .....	10,042	57,000	130. Southern Baptist Convention	4,646		197. New York Life.....	2,745
64. USX .....	9,824	5,600	131. ICMA Retirement.....	4,592		198. Delaware State Retirement.....	2,733
65. Hughes Aircraft .....	9,591	4,700	132. Union Carbide.....	4,517	4,921	199. Episcopal Church.....	2,711
66. Allied Signal.....	9,500	13,600	133. Hewlett Packard.....	4,432	42,800	200. Sheet Metal Workers.....	2,683
67. Mass. Teachers/Employees.....	9,426		134. International Paper.....	4,419	11,300	<b>TOTAL.....</b>	<b>2,441,717</b>