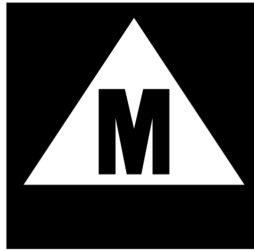

MUHLENKAMP & COMPANY, INC.

INTELLIGENT INVESTMENT MANAGEMENT

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Issue 53 First Quarter 2000

On December 31, 1999 the Net Asset Value of the Muhlenkamp Fund was $41.11, up 11.4% in 1999. Click here to see the current Net Asset Value for the Muhlenkamp Fund.

FUND YOUR 1999 IRA

You have until April 15, 2000 to fund your Traditional IRA or Roth IRA or a combination of the two for the 1999 tax year. Every American with earned income, and their non-working spouse, can contribute up to $2,000 into an IRA each year. Call us for a prospectus and a Muhlenkamp Fund IRA application or download this information from our website. For rules and regulations on IRAs, request Publication 590 from the IRS at 1-800-TAX-FORM or www.irs.gov. If you have already funded your IRA for 1999, get started today on your 2000 contribution.

MUHLENKAMP FUND CORRESPONDENCE

All written Muhlenkamp Fund correspondence (applications, checks, redemption requests, address changes, account registration changes, etc.) must be sent to the following address: **Muhlenkamp Fund, c/o Firstar Mutual Fund Services, PO Box 701, Milwaukee, WI 53201-0701**. Any Fund correspondence of this nature, which is received at our Wexford, PA address, will be forwarded by regular mail to Milwaukee.

MUHLENKAMP FUND STATEMENTS

Some shareholders who invest frequently, especially those enrolled in the Automatic Investment Plan (AIP), have requested the Fund only send them a quarterly statement for their account. Confirmation statements for each individual transaction are suppressed. This option is available to all shareholders on an individual basis by calling the Fund's representatives at 1-800-860-3863 extension 0.

QUARTERLY LETTER

The Fourth Quarter of 1999 continued the patterns we have described to you over the past year. The economy continued strong in nearly all respects with GDP (Gross Domestic Product) up 6.1% for the fourth quarter and 5.5% for the year. Employment remained strong, keeping the unemployment rate at 4.1%.

Inflation remains under control, with the core CPI (Consumer Price Index) up 2.0% for the fourth quarter and up 1.9% for the year. The core PPI (Producer Price Index) was also up for the quarter and 1.9% for the year.

Despite these numbers, economists and the bond market continue to fear that the strong economy must cause increased inflation, even though Reagan and Volcker disproved this theory nearly 20 years ago. This fear drove Long-term Treasury yields from 5.4% at the beginning of the year to 6.7% at the end of the year, driving bond prices down 13% for their worst year ever. (The second worst year was 1994.) This rise in interest rates drove P/E (Price/Earnings) ratios lower for most stocks. Fully one-half of the stocks on both the NYSE and the NASDAQ declined in price, despite healthy increases in sales and earnings.

Despite this background, public enthusiasm for a narrow list of high-tech stocks drove them to dramatic price gains. In the S&P 500 Index, just 30 stocks (of the 500) accounted for all of its gain for the year, and just 7 stocks accounted for one-half of the gain.

I once commented to a friend that most people buy stocks the way teenagers buy clothes, i.e. they buy into current fads. We have seen such behavior in those stocks that caught the fancy of the public in 1999. Until mid-year there was some rationale for the price levels of most stocks, even the most popular. Lately, many prices have lost all relationship to reality. I will cite two examples that came to our attention in December.

The Muhlenkamp Memorandum is a quarterly information service of Muhlenkamp & Company, Inc. ©2000

Quarterly letter (continued)

Freemarkets is a Pittsburgh company that conducts auctions, on the internet, for businesses purchasing parts and supplies from other businesses. Thus, it can be useful in helping a purchasing agent to do his/her job. By September 1999, it had conducted auctions for a total of 21 companies with two, United Technologies and General Motors, accounting for 58% of its revenues. UTX owns 5% of the company and could reasonably be expected to continue as a customer. But GM, at the time of the offering, had invested a sizeable sum in a competitor.

In 1998, Freemarkets had $8 million in revenues. By the fourth quarter of 1999, its revenues were approaching $5 million/quarter. In December 1999, the company sold 3.6 million shares to the public, out of a total 34 million shares. The stock had been filed to come to market at $14/share; but due to high demand it came at $48/share, and it jumped to $350/share in three weeks. At this point the market valued the company at $12 billion ($350 times 34 million shares). This for a company doing $20 million annual rate in revenues and without anything proprietary. On January 3, 2000, GM announced they were canceling their contract with Freemarkets and would henceforth do their business with the competitor in whom they had made their investment. In 12 days the stock fell from $350 to $172.

The second instance occurred when an analyst for a major Wall Street firm wrote that Qualcomm, which was priced at $500, should go to $1000/share. (The stock split 4/1 the next day.) The media immediately picked up on the $1000 price and the stock jumped to $660 (up 30%) in a day and to $750, (up 50%) in a week. The analyst's argument for the $1000 price ($250 post split) was that in the year 2010, he expects the worldwide public to buy 3 billion cellphones for an average price of $180 a piece. He further believes that Qualcomm should then sell for 60 times the resulting earnings. Folks, there are roughly 6 billion people in the world, one-half of whom don't earn $180/year. To predict that 3 billion of them would pay $180 for a cellphone in a given year is crazy. I suspect that a number of Qualcomm stockholders realized this when they saw on paper the assumptions that were required to justify the price of the stock. Since early January, it has fallen from $187 to $140 (post split).

It is always hard to say how far a fad can run or when it will stop, but they do work both ways. In Muhlenkamp Memorandum #52, we named 6 internet stocks (America-On-Line, Amazon, Ameritrade, E-Bay, E-Trade and Mindspring) which were down 30-50% from their April 1999 highs. Despite the tech rally in the fourth quarter (in which 2 of the 6 hit new highs), the six stocks are now down 35-65% from their highs.

Meanwhile, some of the seven "security blanket" stocks (Abbott Labs, American Home Products, Clorox, Coca Cola, Disney, Gillette and Pfizer) we named in Memorandum #52 have partially recovered, but the group remains down 15-40% from their highs. Of the six cyclical stocks we named (Alcoa, Caterpillar, DuPont, GoodYear, International Paper and 3M), three recently hit new highs. In fact, in recent weeks, aluminum, copper and steel stocks have been among the strong performers.

We suspect the market is beginning to pick up on the trend begun in the second quarter of 1999. We said then that, as the fear of recession disappeared, the market's focus would shift from "Security Blankets" and internet stocks to a broader list of companies with good earnings and reasonable prices. We were right -- for three months. Then the Fed and the institutional market shifted to a fear of increased inflation based on strong growth in GDP driving up interest rates - both short-term rates and long-term rates. The retail public ignored these fears. Reflecting a continued strong consumer confidence, it continued to play the "game of the stock market", merely rotating its focus from internet stocks to other technology stocks, primarily in telecommunications.

A number of trend following (momentum playing) professionals extended the game to the point exemplified by the two examples given earlier. These examples and the price action since year-end indicates that the "game" may have peaked although it could once again rotate to a new group.

Meanwhile, similar to Q-2/99, we are seeing strength in name cyclical stocks, indicating that some people are willing to bet on the strength in the economy. Since early December, we're also seeing strength in utilities (normally a proxy for bonds) although we haven't yet seen strength in the bond market itself. This indicates that bond investors are not yet willing to bet that inflation remains low. Since we now have nine months of data showing a strong economy and low inflation, our expectation is that the fears of inflation will soon subside, allowing interest rates and P/E's to stabilize and stock prices to reflect their earning gains of 1999 and 2000. If we are right, the strength should spread to the broad range of companies and stocks that are doing very well in this economy. This broadening of strength should also close the huge valuation gap between the largest companies (and stocks) and the small and midsize companies.

Quarterly letter (continued)

We continue to invest in good companies at cheap prices as indicated by the following table. We also continue to be bought out of a number of our holdings through mergers and management buyouts.

	ROE	EPS Growth 5-year	EPS Growth 1-year	Sales Growth	P/E Growth
S&P Top 15	25	21	20	16	48
Muhlenkamp Top 15	23	26	31	14	22
Average Company	15	--	10	--	15

These buyouts confirm the values we see in our companies. It also validates that companies, at least, value themselves and their competitors much the way we do. We use these valuation methods because they have been proven reliable in all kinds of markets over a long period of time (over 50 years). Whether or not we're in a new economy is debatable, but ultimately, stock prices will reflect company values; and company values are determined by earnings and cash flows. So despite periodic excursions into the "growth" stocks of a given time, values in companies and stocks ultimately provide good returns.

One more point. Some of you have suggested that we should own (have owned?) more technology stocks. Our portfolio is nearly 20% in technology stocks but we're focused on those companies that benefit from a ***greater number*** of integrated circuits used in technology, and in companies with a history of good profitability. We have not invested in companies that are one of many competitors in new markets or in those with no near-term prospects of turning a profit. *-Ron Muhlenkamp*

OLD TAX RETURN VERSUS PROPOSED TAX RETURN

Below we have printed the tax return you would have to file should Steve Forbes be elected president and get his programs enacted.

The Steve Forbes Flat Tax Form

1999

Individual Wage Tax

First name and initial | Last name | Social Security Number

First name of spouse (if applicable) | Last name | Spouse's Social Security Number

Present home address (Number and Street including apartment number or rural route)

City, Town or Post Office, State and Zip Code

Your Occupation | Spouse's Occupation

1. Wages	1.
2. Number of adults in family	2.
3. Number of children in family	3.
4. Deductions for adults (multiply line 2 by $13,000)	4.
5. Deductions for children (multiply line 3 by $5,000)	5.
6. Total deductions (line 4 plus line 5)	6.
7. Taxable income (line 1 minus line 6)	7.
8. Tax (multiply line 7 by 17%)	8.

When you have completed your tax return for 1999, you might want to fill out the form to determine the difference in dollars, time and frustration between his proposal and our current system.

I have been a fan of Mr. Forbes' flat tax proposal since he first proposed it, for the reasons I gave in last quarter's essay on "Prosperity." But even I was surprised when I heard Steve's response to presidential candidate Gary Bauer in a recent debate. Mr. Bauer took Steve to task for dropping the mortgage interest deduction and the charitable gift deduction in his flat tax proposal. Steve replied, "We'll give you the choice, file either the flat tax form or the old 1040 forms complete with the mortgage deduction and the charitable deduction. The taxpayer can file whichever one he/she chooses." Now I've known for a long time that Steve's program would allow you to do this, and that individual choice and responsibility is at the core of all his programs; yet, I was surprised when I heard a presidential candidate say that an individual taxpayer could calculate his taxes in multiple ways and choose the lesser tax rather than the greater tax, as is now often required.

That Steve Forbes should be the only one of six Republican candidates (all of whom favor some tax cuts) who would allow the taxpayer this choice speaks volumes about how far we are from understanding what makes a free economy work. And it means that I must find better ways of explaining the ideas in my essay on "Prosperity." - *Ron Muhlenkamp*

INDEXING

There are plenty of discussions today about active versus passive management of investments, i.e., using money mangers (mutual funds) versus using index funds. Indexing is gaining in popularity as evidenced by The Vanguard Group (they market primarily index funds) surpassing Fidelity Investments (they market primarily actively managed funds) as the largest mutual fund company in the country.

The SEC requires that all domestic equity mutual funds use a comparison to an index, usually the S&P 500 Index, in financial reports to shareholders. Over the last decade the S&P 500 Index has become the standard for mutual fund comparisons. The media often report that on average only 50% of money managers beat this index.

Because of its market capitalization, the S&P 500 Index represents the entire market. The individual returns for the largest 50 companies in the index will dominate the return for the entire index, because it is a capitalization-weighted index. If those 50 companies do well, the index does well. If those 50 companies suffer, the index most likely suffers, even though the bottom 450 companies may do well. Since the S&P 500 Index represents the market, it follows that one-half of the money mangers in the country will do better than the index and one-half will do worse than the index. When you subtract the average equity fund's 1.5% annual expense ratio, the average managed fund will underperform the index by 1.5% and the percentage of managers who beat the S&P 500 Index becomes less.

When somebody says to me, "Hey, the Muhlenkamp Fund didn't beat the S&P 500 Index over the last 10 years, so why should I buy it?" I generally respond by asking the person if they invested 100% of their assets in the S&P 500 Index over the last 10 years. The answer is always, "No." When I ask them what they did own over the last 10 years, they generally name their winners, but often forget their losers. They forget about that Asian Tiger Fund that went down the drain or the gold coins they bought at $500 per ounce that are now worth $280 per ounce. They forget about the real estate limited partnerships that have little or no value, or the time-share condo they can't unload. They also forget about that stock that they bought on a hot tip from a friend that went to zero. Some of these things they bought for “diversification” and some they bought because they were hot at the time. In 1980 people bought REITs (Real Estate Mutual Funds) because in the 1970’s, real estate investments beat stock investments. In 1994 people bought bond funds because from 1981 to 1993, bond returns matched stock returns. In 1995 people bought foreign funds because from 1990 to 1994 the EAFE (Europe, Australia, and Far East) Index beat the S&P 500 Index. In each case the public was encouraged to chase the index that had been strongest lately, just in time for the leadership to change. The list goes on and on. Most people don't know their total return for the last 10 years because they don't track it.

So what's the point? The point is that if a person invested all of their money in the S&P 500 Index over the last 10 years then they look smarter than most others, Muhlenkamp included. But nobody did. Instead they invested little pieces in different places - they bought some stock funds, some bond funds, some individual stocks and bonds, some REITs, some junk bonds, some foreign funds, etc., and they watered down their returns. In most cases, the Muhlenkamp Fund easily beat these watered down returns. If all (100%) of your money wasn't invested in the S&P 500 Index over the last 10 years, then there is a good chance Muhlenkamp beat your personal total return. The bigger question is who knew back in 1990 that the best index to use for the next decade would have been the S&P 500 Index? The answer is nobody.

What about the next 10 years? Nobody knows for sure, just as nobody predicted in 1990 that the S&P 500 would have done so well. The years 1972-1981 were not a good time to invest in the S&P 500 Index. John Bogle of Vanguard says the Wilshire 5000 is the index you should measure your stock returns against going forward, while new money continues to pour into the Vanguard Index 500 Fund.

At Muhlenkamp, we will continue to buy great companies at cheap prices and put them in our portfolios. As I stated before, it doesn't matter what the index returns, any index, unless you have 100% of your money in that index. I'd rather stake my family's financial future on a carefully selected, diversified portfolio, with a proficient manager at the helm, than try to pick the index fund for the next millennium. - *Grant Duffield*

MUHLENKAMP FUND AVERAGE ANNUAL RETURNS
AS OF 12-31-99

Click here to see the current Net Asset Value for the Muhlenkamp Fund

One Year	Three Year	Five Year	Ten Year
11.4%	*15.3%*	*21.5%*	*15.3%*

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.