MuhlenkampMemorandum

Issue 70 | Published Second Quarter | April 2004

On March 31, 2004 the Net Asset Value of the Muhlenkamp Fund was $67.05, up $3.54 year to date.
Click here to see the current Net Asset Value of the Muhlenkamp Fund.

Quarterly Letter

Same as last time.

The important items which we're seeing in the economy and the markets are the same as three months ago. The only change is that unemployment is now 5.6% versus 5.9% at yearend and 6.4% at its peak. So employment has (so far) recovered one-third of what it lost in the recession. The following is verbatim from our letter to you in January.

"The economy continues to expand.

In the past 12 months GDP (Gross Domestic Product) grew by 4% after growing by 3% in 2002. Capital spending and payroll employment, both of which lag the economy, have bottomed and are now trending up. The unemployment rate has declined from 6.4% to 5.9% in the past six months. So, in my opinion, the economy is firmly on a recovery track.

We are, of course, still hearing negatives. Some people seem to think that all economic data must exceed the old highs before they'll admit that things are improving. That's like saying that daily temperatures must match those of last July before concluding that winter is over. Such a stance makes no sense economically and will cause many investors to miss the largest part of a market upswing.

There are negatives, of course. There always are. The biggest negative is that our politicians continue to spend money like… politicians (thereby outspending teenagers and drunken sailors).

At our recent seminar, we received a number of questions about the federal budget deficit, inflation, and the trade deficit with China. These topics are also getting a major play in the media. It's as if we learned nothing about these topics from the inflation of the 1970s, the budget deficits of the 1980s, or the trade deficit with Japan in the 1970s. (We have included a number of these questions and our response in an insert in *MuhlenkampMemorandum, Issue 69*.)

It appears prices of most stocks and bonds have returned to near fair values after suffering from the triple whammy of recession, psychological hangover from the fad (or bubble) prices, and the psychological damage from the 18-month litany of ills from 9/11/01 through the Iraq War. We believe this triple whammy has now worked its way through the markets, although some lingering effects are bound to crop up from time to time.

Thus, the markets remain volatile. While not unscathed, we have come through this period in good shape. The challenge now is to differentiate among those companies that are best serving their customers in a fashion that provides net income and cash flow. We are spending our time and effort accordingly."

— *Ron Muhlenkamp*

Wexford Trust Muhlenkamp Fund Proxy Voting Policy

In the past we've voted our proxies based upon what we perceived to be the merits of the individual proposals. In most cases, we've voted with management (if we don't like what management's doing, we wouldn't own the stock), but in areas such as poison pills and management bonuses, we've often voted against management.

The new rule will require us to keep records of our votes, and presumably, would require us to defend those votes at a future date. To better use our time and to simplify this hassle, we have adopted the policy of simply always voting in line with management recommendations.

Conflicts rarely arise between the Adviser and the Fund with respect to proxy voting. Were one to arise, it would be resolved in the best interests of Fund shareholders, and the Adviser typically would disclose such conflict to the Board of Trustees and obtain their consent before voting.

April 1, 2004

Fellow Shareholders of the Muhlenkamp Fund:

You've recently received your copy of the Annual Report of the Muhlenkamp Fund for the year ended 12/31/03. If you study the Statement of Operations in detail, you will see that the ratio of operating expenses, as a percentage of average net assets, has increased in the past year, after being on a downward trend since the Fund began operation in 1988.

If you dig further into the detail, you will see that three items went up as a percentage of assets.

Relative to assets:

- Expenses for reports to shareholders went up $34,000;
- Trustee Fees and Expenses went up $26,000;
- Professional Fees went up $32,000, (of the $32,000 increase, $26,000 was due to increased legal fees).

These increased expenses are a direct result of the Sarbanes-Oxley Act of 2002 and the accompanying pressure put on mutual fund directors, trustees and management companies. As a result of these pressures, our independent trustees have found it necessary to attend conferences for trustees, where the agenda seems to be how best to scare them into hiring more lawyers. They have been encouraged to hire an additional lawyer who is independent of the one the Fund has already hired to be sure that we are in concert with relevant securities laws. Since we have already hired the best securities attorney we could find in the Pittsburgh area, their search has resulted in the proposed hiring of two additional attorneys (whose function is to ride herd on the first one). Whether they're more qualified than the first one, I don't know. But I do know that their proposed fees are higher. And, of course, the Fund is expected to pay these fees!

Folks, all of this is being done despite the fact that we don't do the shady and/or illegal things which others have admitted to doing — nor have we been accused of such.

In addition to this, rules have been proposed which would require that 75% or more of the trustees must be "independent" of the management company and that the Chairman of the Trustees must be independent of the management company. Muhlenkamp Fund has three trustees, of which you have elected me one, and the trustees have elected me Chairman. To the best of my knowledge, I am also the largest individual shareholder of the Fund.

If the first of the above rules is adopted, the Fund would have to hire an additional trustee, or I'd have to resign from the Board. If the second rule is adopted, I must resign either as Chairman of the Trustees, or as your investment manager. When I founded Muhlenkamp & Company it was because I was unable to find a firm or a management that would allow me to invest money as I know how. Nothing I see now convinces me that finding a knowledgeable management or Chairman would be any easier today than it was then. And I have no desire to work for a Chairman who is not knowledgeable.

As you know, we continually try to educate our shareholders in the disciplines and attitudes which help us make money for you. I've found that our shareholders welcome this education. I've also found that many professionals resist it. I repeat: I have no desire to work for a Chairman who is not knowledgeable (or whose "knowledge" I disagree with).

The bottom line in some of the newly proposed regulations is that they would limit the rights and abilities of entrepreneurs to start, and then continue to run, their own companies in the investment management business. Under the proposed rules I could not have started the Muhlenkamp Fund, certainly not when I did. These proposals will limit the flow of talent into this business. A choice similar to mine would be faced by many of the most knowledgeable people in the mutual fund industry.

My questions are:

- How did we get to the point where knowledge in an industry is assumed to be accompanied by a lack of integrity?
- How did we get to the point where it's assumed that the only people whose motives you can trust are those who are ignorant in the given field of endeavor?

I can understand how the ignorant can push this agenda, but have the rest of us really acquiesced to it? I believe not.

Therefore, unless and until I hear differently from you, I will vote against the retaining of additional attorneys and other items which would increase the expenses of the Muhlenkamp Fund, without demonstrable benefit to the shareholders.

If you disagree with me, please call me at (724) 935-5520 ext 115, or click here to e-mail me. If you agree with me, please call your Senators and Representative and tell them you're not in favor of the above legislation.

- The Senate switchboard is (202) 224-3121.
- The House switchboard is (202) 225-3121.

Sincerely,

Ronald H. Muhlenkamp

Investor Education

Net Asset Value Share Price

We've received some comments and questions concerning the Net Asset Value (NAV) share price of the Muhlenkamp Fund. These comments have included:

1. Does the Muhlenkamp Fund plan to split the NAV share price?
2. Since the NAV share price is high, I'll get less shares for the money.
3. When a stock splits, the price usually goes up.
4. I've never heard of a fund that has had a share price this high.
5. Since Mr. Muhlenkamp doesn't turn the portfolio over often, how can the share price rise anymore? How much more can the stocks that are already held in the Fund go up?
6. If the NAV share price is higher than the amount I plan to invest, I won't be able to get into the Fund because I won't be able to afford one share.

It is important to understand how the Muhlenkamp Fund's NAV share price is calculated.

For this, I suggest you refer to the "Statement of Assets and Liabilities" report contained in each Semi-Annual and Annual Report. The Statement of Assets includes *all* of the assets in the Fund consisting primarily of the Schedule of Investments which lists the number of shares and the current market value of each security held by the Fund. The Statement of Liabilities lists all of the liabilities of the Fund. The Net Assets are simply the assets minus the liabilities. The Net Assets are then divided by the number of shares outstanding to get the NAV share price which is reported in the newspaper and other publications.

If we were to split the shares 2 for 1 (2:1), it would double the number of outstanding shares but have no effect on the value of the assets or the liabilities. Therefore, when a company "splits" the shares of its stock, or a mutual fund "splits" it shares, it has no effect on the value of the holding itself. It's like getting two $5 bills for a $10 bill.

However, in splitting a stock, there can be a secondary effect. In the short term, stock prices are influenced by market supply and demand factors. If the announcement of the stock split creates hype or enthusiasm for the stock, it can result in a bump up in the price. Studies have shown that these bumps tend to be temporary. *Our* studies have shown that if conditions are such that the announcement does not create enthusiasm (as often occurs in a bear market) the stock split itself can create downward pressure on the stock. These supply and demand pressures can also affect the price of a closed-end mutual fund because there are a fixed number of shares available at any one time.

But supply and demand pressures do not affect the price of an open-end fund such as the Muhlenkamp Fund. An open-end mutual fund simply issues more shares in response to demand and redeems shares in response to redemptions. So, the number of shares outstanding changes daily and the price is always equal to the NAV.

There is, however, useful information in the "high" NAV share price of the Muhlenkamp Fund.

When we first introduced the Fund in 1988, we began, as most funds do, at $10 per share. An NAV share price in the $60 range means that an investment of $10 in 1988 would be worth at least six times that today. But it also means more than that! The "high" NAV share price indicates that the appreciation occurred in a tax-efficient manner. Mutual fund accounting practices require that any "realized gains" be "declared" as dividends, and the NAV share price be adjusted downward by the amount of that dividend. If, over the years, we had realized our gains on a frequent or short-term basis, our NAV share price would be lower (and our tax bill would have been higher). One reason why other funds have lower NAV share prices — even though they may have had annual returns comparable to the Muhlenkamp Fund — is that they have made taxable distributions over the years. Since inception, we have paid distributions totaling only $5.07 per share. We believe that knowledgeable investors (such as our shareholders) receive useful information from our "high" NAV share price.

Out of curiosity, we took a look at the NAV share prices of the mutual funds which qualified for the *Forbes* Honor Roll in any of the past three years. There are 19 such funds. Of these 19 funds, 11 have at year-end 2003 a NAV over $40 per share. Five funds have NAV's over $60 per share. So we think we're in pretty good company.

If the Fund was measured in full shares only, a $50 investment would not enable you to purchase a single share at a price of $60. But the Fund is measured in fractions of a share. You've probably noticed that the shares on your statement are reported to the third decimal place (in increments of .001 shares). This is similar to our money being measured in dollars but available in $.01 or 1 cent.

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Net Asset Value Share Price *continued from inside*

Thus:

- A $50 investment @ a $60 NAV buys 0.833 shares
- A $51 investment @ a $60 NAV buys 0.850 shares

When you receive your statement, you will see that the number of shares you own is calculated to three decimal places (1/1,000) of a share. Actually, the custodial bank calculates it to four decimal places and then rounds it to three decimal places. So 1 cent = .0001 share @ $100.00 NAV.

To summarize:

1. We do not plan to split the shares of the Muhlenkamp Fund.
2. At a high NAV share price, you do get fewer shares but they have the same value — just as you get fewer pieces of paper if you ask the bank for $10 bills instead of $5 bills.
3. Since the number of shares is calculated to 4 decimal places, a dollar contribution of less than the NAV price means you'll receive fractional shares of the Muhlenkamp Fund.
4. Stock splits are different than open-end mutual fund splits.
5. Some other funds do have "high" share prices. I find they tend to be well-run, tax-efficient funds.

We believe the prices of the stocks in which the Fund has invested are likely to continue up, as long as their managements continue to add value to the companies. The stocks of all of the good companies you can name, went up for periods best measured in decades.

We hope this article helps you understand the cause and effect of stock and/or mutual fund splits. If you have further questions, please give us a call.

— Ron Muhlenkamp

The information in this article represents the opinions of the Fund manager, is subject to change, and any forecasts cannot be guaranteed.

Average Annual Returns as of 3/31/04****

	Year to Date	One Year	Past 3 Years	Past 5 Years	Past 10 Years	Since Inception 11/1/1988
Muhlenkamp Fund						
Return Before Taxes	5.58%	64.38%	12.19%	14.51%	15.98%	14.60%
Return After Taxes on Distributions*	5.58%	64.38%	12.19%	14.19%	15.64%	14.21%
Return After Taxes on Distributions and Sale of Fund Shares*	3.63%	41.85%	10.53%	12.61%	14.32%	13.24%
S&P 500**	1.69%	35.12%	0.63%	-1.20%	11.67%	12.01%
Russell Midcap Value***	5.35%	51.60%	11.69%	10.55%	13.95%	13.58%

Performance data quoted represents past performance and does not guarantee future results. The investment return and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Current performance of the Fund may be lower or higher than the performance quoted. Performance data current to the most recent month end may be found on our website at www.muhlenkamp.com.

* After-tax returns are calculated using the historical highest individual federal marginal income tax rates and do not reflect the impact of state and local taxes. Actual after-tax returns depend on your situation and may differ from those shown. Furthermore, the after-tax returns shown are not relevant to those who hold their shares through tax-deferred arrangements such as 401(k) plans or IRAs.

** The S&P 500 is a widely recognized, unmanaged index of common stock prices. The figures for the S&P 500 reflect all dividends reinvested but do not reflect any deductions for fees, expenses or taxes.

***The Russell Midcap Value Index measures the performance of those Russell Midcap companies with lower price-to-book ratios and lower forecasted growth values. The stocks are also members of the Russell 1000 Value Index.

****<u>***Click here***</u> to see current performance information for the Muhlenkamp Fund.

Muhlenkamp Memorandum

Insert Issue 70 | Published Second Quarter | April 2004

America Will Keep Growing if We Don't Overtax Her

March 2004
By Ron Muhlenkamp

With Louis Rukeyser continuing to recover from surgery (and expecting a full recovery), Ron Muhlenkamp filled in as guest commentator for the March edition of Louis Rukeyser's Wall Street.

One of the most useful evenings I've ever spent occurred a few years ago when Louis Rukeyser spoke in Pittsburgh on the economic and political history of the prior 30 years. To return the favor I'd like to provide some insight to his wonderful newsletter subscribers, so here's some of what I've learned about economics in the past 35 years.

In the 1970s we had stagflation, which combines low growth (stagnation) with high inflation. According to the economic theories I was taught in the late 1960s, this wasn't supposed to happen. Inflation was supposed to result from too much growth. Low growth was supposed to result in lower inflation or even deflation (lower prices). So stagflation wasn't supposed to happen—but it did.

Throughout the 1980s and '90s we had accelerating growth and declining inflation along with huge federal-budget deficits. When President Reagan proposed the tax cuts that contributed to the budget deficits, conventional wisdom argued that increased federal borrowing would raise interest rates, "crowd out" commercial borrowers and hurt the economy. Instead, interest rates have fallen and the economy has expanded for more than two decades.

> *"The economy grows when people believe they can improve their lives through their own efforts."*

How come? First, the economy grows when people believe they can improve their lives through their own efforts. A friend told me recently that his son-in-law wanted a new plasma TV. The son-in-law plans to pay for it by putting a snowplow on his pickup and getting up at 2 a.m. to plow. I think that's great. An interesting aspect of the U.S. economy is that many of the goods and services we now consume (including plasma TVs) were unheard of just a generation ago. We use the word "need" to describe goods and services our parents viewed as luxuries and our grandparents never dreamed of. There is no limit to the goods and services desired by the consumer, which means that GDP will not be limited by stagnant demand. The only limit to GDP is what people are willing to produce. In countries like France, where it's illegal to work more than 35 hours a week, economies don't grow.

> *"The only limit to GDP is what people are willing to produce. In countries like France, where it's illegal to work more than 35 hours a week, economies don't grow."*

Second, lower inflation and taxation increase people's willingness to hold jobs. In the 1970s we had 10% inflation and a progressive federal income-tax-rate structure with a top tax bracket of 70%. Each individual needed 10% more money each year just to maintain his or her standard of living. And steeply progressive tax rates meant that if you received a 10% raise (pretax), your taxes went up 20%. (These numbers are straight from the tax tables of 1979.) A 70% tax rate meant that above a certain level of income it didn't pay to work.

The 70% tax bracket also fed a tax-shelter industry, which funneled money into areas that were tax-favored rather than economically productive. So America got a glut of boxcars, barges and "see-thru" (empty) office buildings. Meanwhile, my friends who were farmers got ahead not by growing more food but by borrowing more money and buying more land. My suburban friends spent some of their working hours planning how to borrow more money and buy a bigger house.

We had high unemployment in the 1970s because it didn't pay prospective employees to work or businesses to hire them. Certainly there were job seekers, nearly all of whom would have been in lower tax brackets. But it didn't pay a businessperson to hire them. Aside from the income taxes, there was a raft of other penalties. When I hired my first full-time employee in 1981, I had to fill out seven different forms and pay seven different taxes. My friends running small businesses told me I was crazy to hire employees instead of temporaries. Yet, few politicians seem to understand that taxing the *employer* is not conducive to creating jobs.

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Muhlenkamp & Company, Inc.
Intelligent Investment Management

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The exception was Ronald Reagan, who in 1983 lowered the top tax rate to 28%. It paid businessmen to earn the incremental dollar, so they started hiring. Except for the recessions of 1990 and 2001, unemployment has fallen ever since (see chart). If we want people to employ others and to produce increasing amounts of discretionary goods and services, we must allow them to earn returns that are meaningful to them.

If we raise taxes on employees, they're likely to quit working. If we raise taxes on employers, they're likely to quit hiring. And the margin of incentives is slim. In our economy, profit to payroll averages $0.06 on the dollar. For my employee to take home $1.00 it costs me $1.51. This means she has to produce $1.57 to provide me with the $0.06. I believe much of the prosperity of the past two decades rides on that six-cent margin of profit.

Third, peoples' incentives to work have changed in the past 30 years. Thirty years ago seniority in a union shop gave a worker preference in working overtime (which pays 1.5 or 2 times the hourly rate). My father worked all the overtime he could. It was a chance to earn more money. Today, seniority still gives preference, but it is the right to *not* work overtime. In 1999 the owner of a tool and die shop in Vandergrift, Pa., could pay less than Allegheny Ludlum (the big local mill) because he had no compulsory overtime. Given similar choices, people have reversed their preferences!

People who lived through the depression were willing to work long hours and live cheaply to make things better for their children. My observation is that people who have been truly poor (without food, clothing and shelter), or who fear being truly poor, will do almost anything to avoid it. Once you are able to take food, clothing and shelter for granted (or believe you can), the willingness to work additional hours becomes a tradeoff between leisure time and additional goods or services. And it involves not just the hours of work but also all the other facets of working, from a sense of challenge and satisfaction to the social and human aspects. If we want people to work and produce increasing amounts of discretionary goods and services we must compensate employees in meaningful ways. I believe we are on that path and that it will become increasingly apparent as our economy continues its expansion out of the recent recession.

> *"We own and are buying those companies that benefit as the economy recovers from recession. This starts with housing and consumer durables."*

Accordingly, we own and are buying those companies that benefit as the economy recovers from recession. This starts with housing and consumer durables; for the holdings of my own mutual fund, see www.muhlenkamp.com. And we're studying year-over-year revenue growth for ideas on where the consumer is going next. If we watch and listen to the consumer, stock picking is a lot easier.

Mark your Calendars:

Muhlenkamp & Company, Inc.
Semi-Annual Seminar
June 9, 2004
Carnegie Science Center,
Pittsburgh, PA
2:00 p.m. and 7:00 p.m.

Recent Media Appearances

Time Magazine: *"Board of Money Managers" roundtable discussion, April 5, 2004*

Smart Money.com: *Muhlenkamp Fund featured in "Skip the Tax Bite," March 26, 2004*

MSN Money: *Muhlenkamp Fund added to "Strategy Lab" portfolio, March 23, 2004*

Fortune Magazine: *Ron quoted in story on homebuilding stocks, "Raising The Roof," March 22, 2004*

Chicago Tribune: *Ron cited on homebuilding stocks in "Home Builders' Stock View Brightens, Analysts Say" March 20, 2004*

Chicago Tribune, Baltimore Sun: *Muhlenkamp Fund recommended by No-Load Fund Investor publisher Sheldon Jacobs, March 7, 2004*

Louis Rukeyser's Wall Street: *guest commentary by Ron Muhlenkamp, "America Will Keep Growing If We Don't Overtax Her," March 2004*

Investor's Business Daily: *"Muhlenkamp Still Likes Home Builders," February 5, 2004*

Smart Money: *Muhlenkamp Fund cited as one of "10 Great Funds For The Long Haul," February 2004 issue*

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