

MuhlenkampMemorandum

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On June 30, 2006, the Net Asset Value of the Muhlenkamp Fund was \$81.28, down \$3.16 year-to-date.
Click here to see the current Net Asset Value of the Muhlenkamp Fund.

Quarterly Letter

by Ron Muhlenkamp



Economic trends of the past year continue. The economy is growing nicely in the 3% - 3½% range and inflation remains contained in the 2%+ range. If you monitor these numbers, you might think I'm crazy because the GDP in the fourth quarter was about 1.7% (largely due to the hurricanes) and in the first quarter was about 5.7% (largely due to the rebound after the hurricanes). Similarly, inflation numbers have been higher, particularly when food and energy (always volatile) are included. So, reported numbers in GDP and inflation have been quite volatile.

Similarly, the stock and bond markets (both domestic and foreign) have become quite volatile. Some parts of it we foresaw; some we didn't. (See the following essays "Looking for a Rich Harvest," "Questions and Responses" and the "Muhlenkamp Minute.") Suffice it to say that part of our job is to shield your assets when markets turn volatile on the downside, and we haven't done that to our standard in the recent months.

I have frequently been asked to compare the current economy and markets to prior periods. In this vein, I believe the following:

- The economic and investment climate is most similar to the early 1960s; good GDP growth and contained inflation.
- The current stage of the business cycle looks most like 1994-1995 — a soft landing or slowdown after a nice recovery from recession.
- The current psychology and market action are volatile. There is so much money, managed both professionally and privately, which is seeking to latch onto the latest fad or trend and then to be the first one off (which is the hard part) that the markets will remain quite volatile. We think this will continue.

Many think that volatility is a bad thing. We think it is a good thing, allowing us to buy cheap or sell dear.

Because we like the climate and the seasons and, most importantly, we think we're finding good companies at cheap prices (some of which we own — and have gotten cheaper), we think it's an opportune time to be investing money in our companies' stocks.

The comments made by Ron Muhlenkamp in this article are his opinion and are not intended to be investment advice or a forecast of future events. Copies of past newsletters are available on our website at www.muhlenkamp.com.

MARK YOUR CALENDAR

Muhlenkamp & Company Investment Seminar

Marriott Courtyard Denver
August 16

Tony Muhlenkamp will deliver *The Basics of Investing*.

The doors will open at 6:00 p.m. and the seminar will begin at 7:00 p.m. Light refreshments will be served. The Marriott Courtyard Denver Downtown is located at 934 16th Street near the 16th Street Mall.

To attend this event free of charge, please call our Client Service Department at (877)935-5520 x4 to register.

FPA Midwest Continuing Education Symposium

Conference Center at North Pointe, Lewis Center, OH
October 10

Please stop by our exhibit booth.

San Francisco Money Show

San Francisco Marriott
October 16-18

Tony Muhlenkamp will deliver a workshop: *Back to Basics - How to Make Money in the Current Investment Climate*. Ken Dupre, one of our equity analysts, will be conducting a workshop on *Optimizing Investment Performance - Helping Investors Become Better Investors*.

To register for free admission, call (800) 970-4355 or visit www.muhlenkamp.com and reference code #005073. If you'd like to talk with us while at the Show, please stop by our exhibit booth (#408) or call (877) 935-5520 to arrange a visit.

ANNOUNCEMENTS

Muhlenkamp Minute

In addition to publishing our quarterly newsletter, *Muhlenkamp Memorandum*, we find it useful to provide periodic updates on topical issues. To this end, we use the *Muhlenkamp Minute* to record an off-cycle message whenever it seems appropriate. The *Muhlenkamp Minute* is available on our website at www.muhlenkamp.com, and by calling our toll-free telephone number at 1-877.935.5520 ext 5.

The most recent message, recorded by Ron Muhlenkamp on June 1, 2006, is included in this issue of the *Muhlenkamp Memorandum*.

Webcast Archive: Now Available

A webcast archive of Ron Muhlenkamp's presentation *How Much Money Are You Willing to Lose for a Theory?* is now available. Please visit www.muhlenkamp.com and click on the designated link for viewing.



Muhlenkamp & Company, Inc.
Intelligent Investment Management

MuhlenkampMemorandum

Looking for a Rich Harvest? Plant in the Growing Season

Ron Muhlenkamp was the guest columnist for the May 2006 edition of "Louis Rukeyser's Wall Street." The following is a reprint of the article, used with permission.

Ron Muhlenkamp is president of Muhlenkamp & Co., manager of the Muhlenkamp Fund and author of a new book, *Harvesting Profits on Wall Street: Essays in Investing*.

Investors cite many reasons for favoring a particular class of investment, but the most common is simply, "It has done so well." The unspoken assumption is that it will continue to do well. Investors aren't alone in this line of reasoning. The media, too, tends to focus on recent price trends to extrapolate future performance.

In the past few years, small-cap and foreign stocks (especially emerging markets) have performed very well, drawing the media's attention and the public's money. Money flows into mutual funds show that people are investing heavily in small caps and emerging securities; recent flows into foreign and international funds have outpaced flows into domestic funds.

We think extrapolating price trends into the future is likely to lead to poor investment results. Investing in a market sector simply because "it's done so well" is like choosing to plant corn in October because your neighbor's corn has grown so well since April.

This tendency of the media and the investing public to extrapolate price trends is nothing new. Let's look at a couple of examples from the past, then address what we expect from small-cap and foreign stocks.

Our first example is the tech-stock fad of 1998-1999. During the upswing, people expected tech stocks to go up because they had gone up. The media's focus on price trends encouraged this belief.

Today, we realize the dramatic prices those stocks reached were unsustainable. The prices were running on momentum, exceeding the value of the companies involved. But at the time, to those in it, the fad looked like a long-term trend. The question is: how do you distinguish between the two? We believe it requires two things: (1) a perspective that acknowledges fads and looks for them; (2) a value discipline to help determine whether prices are in a range of fair value or trading outside that range due to current psychology (either positive or negative).

Let's look at a second example, this time in bonds. In 1984, inflation was 4%, corporate-bond yields were at 13% and corporate return on equity (ROE) was 13%. This meant that a corporation had to pay 13% in interest to borrow money, but it could expect to earn only 13% in return. This left them no margin of profit on the loan, so it made no sense for companies to borrow.

However, since inflation was at 4%, bond investors could earn a real return of 9% (13% interest minus 4% inflation). We found this very attractive, so we bought bonds. The response from our clients was, "Are you crazy? We own bonds; they're priced at 55 cents on the dollar!" To which we replied, "Those are the bonds we want. They are on sale."

Our clients were focusing on the recent trend in bond prices. They were responding to the losses they had seen on bonds they had already bought and assumed they would lose more in the future—extrapolating future performance from recent performance. We were looking at the current environment and historical norms to determine what to expect from bonds and saw a chance to

buy at a cheap price. Nine years later, we sold those 55-cent bonds at 95 cents.

Today, core inflation is 2%. Treasury-bond rates are 5% and corporate return on equity (ROE) is 14%. So it makes sense for companies to borrow money (they can pay 5% to borrow money on which they can earn 14% returns), but not much sense for investors to buy bonds (netting only 3%). Even PIMCO's Bill Gross warns that at current interest rates, there are insufficient premiums available to justify buying long-term, foreign or low-quality (high-yield) bonds. Yet many investment professionals will tell you that bonds are safe, citing the returns and the low volatility of the past 20 years.

However you measure risk—whether as loss of money, loss of purchasing power or volatility in price—bonds are much safer when interest rates decline (as they have for the past 20 years) than when interest rates are stable or rising. Bonds are decidedly unsafe when interest rates go up, as they did in the 1970s. (By the end of the 1970s, professionals described bonds as "Certificates of Guaranteed Confiscation.") We do not expect a repeat of the 1970s, but neither do we expect interest rates to continue to decline as they have for the past 20 years. As a result, we believe that predictions about the safety of bonds based on the data of the past 20 years are irrelevant.

Now let's look at small-cap stocks. In 1998, when we screened stocks for good value (ROE above average, P/E below the ROE and revenue growth above average), those that met our criteria were nearly all small and mid caps. At the time, many academics had concluded that the large-cap S&P 500 Index was unbeatable; it had outperformed most other indices (and most money managers) for the

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prior decade, and academics and the media believed this trend would continue.


Today, the situation is reversed. For the past six years, small- and mid-cap stocks have easily outperformed large-cap stocks. The difference has been so dramatic that the April 17, 2006 cover of Business Week features the title "Blue Chip Blues" and a stack of chips illustrating the returns of the S&P 100 stocks (the largest of the large-cap). Over the past five years, the share price of these stocks is up less than 1%, while the earnings of the companies are up over 200%. But the focus of the article is on price, not value. What if the stock prices were too high, relative to values, five years ago—and are cheap, relative to values, today?

We recently screened a universe of 6,000 stocks for good value; 60% of the stocks that met our criteria have a market cap over \$3 billion. Today, we're finding more values among large caps than in small caps. Yet we are told that we should own small and mid caps because they have done so well. We're being encouraged to plant corn when, to us, it looks like October.

And what about foreign investing? Two years ago, we found many foreign stocks selling at discounts of 10%-20% relative to similar U.S. companies. However, since we were finding U.S. stocks at discounts equal to or greater than this without the risks we perceived in other countries (such as currency risk), we chose not to invest heavily in foreign stocks. In the past two years, the performance of many foreign stocks (particularly in "emerging countries") has been quite good. This has encouraged investors to invest heavily overseas, driving the prices of foreign stocks up (relative to value). The discounts on foreign stocks, for the most part, are gone.

"Investing in a market sector simply because 'it's done so well' is like choosing to plant corn in October because your neighbor's corn has grown so well since April."

We believe many foreign stocks now trade on momentum, not on value. Granted, this momentum can be self-enforcing, for a while. We don't know how long, or how far, this momentum might go. We do know that, in the past, momentum trends have all died. They tended to be killed by: (1) a change in the business cycle (which is reasonably well understood); (2) a change in the economic climate (which is not well understood); or (3) exuberance that couldn't be sustained and/or expectations that can't be met, as in the "tech" stocks.

In general, investment managers who look for value tend to be early in their buying and selling because the public's focus on price momentum often drives prices well below or above economic values. Momentum investors tend to be late in their buying and selling because new trends are different enough from the old trends to be hard to recognize. As investors, you get to choose which approach you are comfortable with. But with either approach, it is critical to recognize the difference between momentum and economic value. You can't just extrapolate price trends and expect a good harvest. 

Top Ten Holdings as of 6/30/06

Description	% Of Portfolio	Industry
Cemex S.A. de C.V.	4.39%	Materials
Capital One Financial Corporation	4.07%	Diversified Financials
Countrywide Financial Corporation	3.98%	Diversified Financials
The Allstate Corporation	3.98%	Insurance
Merrill Lynch & Co.	3.71%	Diversified Financials
ConocoPhillips	3.64%	Energy
Citigroup	3.58%	Diversified Financials
Anadarko Petroleum Corp.	3.57%	Energy
Nabors Industries Ltd.	3.52%	Energy
American International Group, Inc.	3.37%	Insurance

Fund holdings are subject to change at any time and are not recommendations to buy or sell any security.

Small and medium-capitalization companies tend to have limited liquidity and greater price volatility than large-capitalization companies.

Return on Equity (ROE) is a company's net income (earnings), divided by the owner's equity in the business. This percentage indicates company profitability or how effectively a company is using its equity capital.

Price-to-Earnings Ratio (P/E) equals the current stock price divided by the current earnings per share; it is the price currently paid for \$1.00 worth of earnings.

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Questions and Responses

At our semi-annual seminar on April 27, 2006, Ron Muhlenkamp presented "How Much Money Are You Willing to Lose for a Theory?" to an audience in Pittsburgh and to others nationally via live webcast. Afterwards, Ron Muhlenkamp and his team of investment analysts entertained questions. Following is an abridged edition of the "Q&R" session. For additional commentary, please visit www.muhlenkamp.com.

About the Economy...

What will \$100 per barrel crude do to the economy and the market? And since increasing oil costs should affect the cost of transportation for all imports, will inflation go up everywhere?

Ron Muhlenkamp: First of all, the cost of transport: Folks, truckers and railways have a pass-through of fuel surcharges, so they pass along those costs. At \$100 per barrel, things would slow down big time. Whether we'll get there or not, I have no idea – but my guess would be that if we did, it wouldn't last very long.

What we found interesting in the last year is as gasoline went from \$1.50 to \$2.50 to... well, did anybody start carpooling? Have you noticed that your neighbors are driving less? When you get out on the interstate, have you noticed that traffic has been cut in half? None of that! It looks like at \$3.00 [per gallon] it may be starting to bite. Folks, when prices change, until they change far enough that people start to change their behavior as a result, not much happens.

We don't know what the price of oil will do. If I had to guess, I'd say it's not going back down to \$30 per barrel, and it's not going to stay at \$70 a barrel because it does look like it's biting — and the volume used appears to be leveling off, so it's not growing at quite the rate it was before. Again, we don't know what the price of a barrel of oil is going to do, but we suspect that it stays below \$70 and that it's not going back to \$30 or \$35.

Ken Dupre: Also, one of the things that you never see advertised or reported in the media is that we are twice as efficient as we used to be with the oil. The effect of oil as it works its way through the economy is half of what it used to be, regardless of the price.

Ron Muhlenkamp: When we saw the price of oil run up in the 1970s, we ended up with

a decade of inflation. The interesting thing about inflation is that the way we calculate it is to add up prices. But that's not what causes it. What causes inflation is the government printing money faster than the economy is growing. The 1970s and '80s proved that.

Today, we're not printing money faster than the economy is growing. The M's, (various measures used by the Federal Reserve to compute the money supply), are growing at about 4%-4½%. The economy is growing at about 5%. You don't see inflation running out of the box. Granted, I can only see out about a year ahead, but, basically the growth of the money supply doesn't work beyond that.

Six months ago, with hurricanes Katrina and Rita shutting down about a third of our refineries and moving from operating at about 95% of capacity to about 65%, we warned we might have a shortage of gasoline. (Today, we're operating at about 80%-85% of capacity.) Well, the oil companies managed to import tankers of gasoline, rather than crude oil, by using refineries in the rest of the world. More recently, we thought the effect might be that people would have to spend a lot more on heating oil this year. Well, we had a warmer winter. So we haven't yet seen what the bite will be. We know that people will be spending more on gasoline than we had expected a year ago. What they spend less on, we don't know. The surveys tell us that they'll spend less on eating out and on movies and clothing. We're rather skeptical of surveys. We want to see what happens. What will happen is that there will be a transfer to the extent that when you and I spend more money on gasoline, we'll spend less on something else. We simply don't know yet what that something else is. It probably includes SUVs, but we really don't know that just yet. The fact that the price of oil goes up does not mean that inflation goes up. It means that the money you spend on oil doesn't get spent some place else.

What are your views on trade deficits and China?

Ken Dupre: China fixes their currency to ours so that it is not floating. And the big loser with China having a fixed currency is the Chinese worker, who gets less for what he earns because the Chinese Yuan is so cheap. How that impacts the US is, yes, we do lose some jobs to other countries. But, as a result,

US corporations have focused more on growth industries. We have a lot of high-tech and a lot of value-added industries where we've focused our capital and because of that, we have high value-added jobs. Workers here in the US get paid much more than they do in China — and since China does not float its currency, it hurts their workers. The flip side is it helps the American consumer. Since we let the markets decide and we let people decide where to spend their money, we get goods better, faster, and cheaper. So the US consumer wins — and as long as China wants to keep buying US bonds — our businesses and consumers get loans cheaper. In sum, for China to fix their currency to the US dollar, it ultimately hurts China and helps us more.

Ron Muhlenkamp: Remember in the 1970s when we worried about the trade deficit with Japan? What happened? For a while, the Japanese bought our Treasury bonds because they trusted the US Treasury market more than they trusted Japanese banks. The same applies today: the Chinese trust the US Treasury market more than they trust Chinese banks. Back in the '70s, the Japanese got very prosperous and bought things like Rockefeller Center and Pebble Beach. I saw the prospectus on Rockefeller Center — and the Japanese paid three times what it was worth! The media complained about that, but the Rockefeller's didn't complain. And I suspect that one of these days, the Chinese will start buying overpriced stuff in the United States.

What really happened in Japan was once the next generation came along, they were not as willing to work quite as hard as their parents had, and things leveled off. My best guess for what is going to happen with China is a repeat of what happened in the 1970s with Japan. Incidentally, in the '70s, the Dean of Engineering of MIT came to Pittsburgh and said, "We've got a problem. The US, in terms of technical papers, publishes more than any other country in the world; Japan is second." He continued to say, "The Japanese translate all of our papers into their language, but we don't bother to translate theirs into our language." And, if you remember the '70s, that's what was going on. Well, China is doing amazing things as an economy, but nobody's taking for granted that we have nothing to learn from the Chinese, as we did about the Japanese thirty years ago. To me, the overall argument is a repeat of the past. And it's worked out rather well.

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About our Investment Strategy...

Can you tell us if you're investing internationally and why?

Tammy Neff : We look for good companies at value prices, and wherever the company is headquartered doesn't really matter; location is not a constraint for us. That said, when investing internationally, you have to consider some additional risk factors like currency risk, accounting differences, and geopolitical concerns.

Right now, we think a lot of attention is being paid to international [equities] because they have done so well. It's a momentum play. And you can certainly make money with momentum, if you are good at predicting the future. We think we do a better job at identifying values.

Ron Muhlenkamp : We have no objection to investing in foreign companies — we just want to get paid for it. We don't currently see the values there; we're not finding enough to be heavily invested.

Please discuss your perspective on technology companies.

Jack Kunkle : About five years ago I'd go to parties and "high-five" people because I'm a tech nerd. Now, I'm lonely at parties. I believe there is a sea change taking place in the technology industry, something we have not seen for over 20 years. In fact, Bill Gates seems to see the same thing in the sense that a few months ago he spoke to his engineers and said there is a major change going on in technology and that we must seize the change today. It is not something in the near future. It is today — and Microsoft's survival is dependent on how we make this transition.

I believe firmly that "technology" should no longer be considered personal computers and chips and software. It's about services on the Internet and in the family room and how we, as consumers, deal with these types of services. So I am watching, and I have to make sure that the companies that I choose grow their earnings, as Ron suggested.

Are the investments of 15 years ago good investments today? For example, GM, Xerox, IBM, Steel, Reynolds, soap companies, etc.

Ron Muhlenkamp : Number one, you can't lump them. You have to look at them individually.

Folks, GM is owned by its employees past and present. What happens at GM and Ford is up to the UAW (United Auto Workers), not up to the board of directors of GM and Ford. So if you want to bet your pick on the intelligence of the UAW... Roughly 15 years ago I was at a luncheon, sitting next to the president of the United Steel Workers and he was very proud of the fact that they had just signed a contract with National Steel, basically saying that National Steel couldn't lay off anybody. In response, I asked "Who did National Steel get to guarantee to buy their steel?" He looked at me kind of funny and I said, "If nobody buys their steel, your contract is worthless." That hadn't occurred to him. That is what is going on at Ford and GM and with the UAW today.

We look at the "blue chips" if the return on equity (ROE) is over 14% and if the price-to-earnings ratio (PE) is below the ROE, and if the earnings are growing. IBM? Yes. Xerox? No, I don't find it interesting. It's item by item, company by company.

Folks, the media love to think in broad concepts. Usually, after the fact, they can identify a broad concept that encompasses what has worked. We don't think that's useful going forward. We think it's useful to buy good companies at cheap prices. And if a number of them end up being in a "concept" later, well that's about the time we are ready to sell them. Bottom line: we look at individual companies.

You have reviewed criteria and analytics for stock picking, but what about evaluating the company's management? Does this go into your evaluation?

Ron Muhlenkamp : We ask these questions: Do we trust these people with our money? Do we trust their intelligence? Do we trust their judgment? Do we trust their integrity? If you don't trust their integrity, then intelligence is a negative. I know I'm not capable of beating a smart crook; I'm capable of beating a dumb crook. So if you don't trust their integrity, you walk because there are more companies out there. In the final analysis, we evaluate management teams using the same criteria you use for evaluating us. The reason we never owned Enron is that we could never get the numbers to stack up. We saw what they were reporting and we couldn't understand why the numbers were what they were. So we didn't own Enron. When Tyco was at \$60 [per share], it looked to us as if it was worth \$30. And then we

found out that Kozlowski was spending \$800 million a year on all kinds of nonsense stuff. When it looked like he was going out the door, the stock fell to \$20 and we thought that it was worth \$30 — so we started buying it. It dropped to \$10 based on the momentum, before returning to \$30. We made good money in Tyco.

Tyco bought good companies and the top management didn't mess around and screw up the companies they bought. We liked the underlying companies and we trusted the products and the markets they were in, and we felt that they could make money. So once rid of the problem, [Kozlowski], you could buy Tyco quite cheap. Our average cost was something like \$17. We wish we had waited and bought it at \$10.

Folks, people who look for value tend to be early. We have a discipline that allows us to put a reasonable value on a company. When it is selling 30%-40% below that, we get excited. But, sometimes, the current reputation can drive it much below that. So value folks tend to be early, both on the buying and on the selling. Momentum

continued

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people tend to be late. By the time a trend is identified and it's in all the newspapers, the momentum is well on its way. Folks, I learned in high school that I'm not good at fashions or trends.

You, as investors, get to take your pick: value or momentum. In either case, you have to have enough confidence, and the investment manager has to have enough confidence.

You have to believe in something other than public opinion, or that you can be a half-step ahead of public opinion. What's popular in the media is the trend-following stuff. They want to plan corn in October because it's grown so well. If you were good at fads in high school or if you can identify people who are good at that, you can make an awful lot of money. If you are not good at that, you can lose an awful lot of money.

If a company misses an earnings estimate, up or down, it has a big effect. This seems unfortunate. What, if anything, can be done about it?

Ron Muhlenkamp: If the company is doing what we expect it to do and what is reasonable for it to do, then it is a chance for us to buy it cheap. If it's a surprise to us, and we think that there are things going on that we don't quite trust, then it gets sold. If the company is generally doing what we expect it to do, we're pretty patient investors. If the company disappoints, then the stock gets sold pretty quickly.

What's always interesting, of course, is when the company does well and the stock does poorly. Then you review all your information and try to be sure that you still believe the numbers. If the numbers hold up, then the only problem is the 'stomach problem.' Folks, I can teach you the brain part of this stuff. It's just that every now and then the market tests your stomach. We get paid more for our stomach than we get paid for our head.

How do you decide to sell a stock?

Ron Muhlenkamp: If it becomes overpriced, or the company isn't doing what we think it should do, it gets sold. If it gets to be fairly priced and we think it's running on momentum, then we'll sell it down to a normal position.

What's interesting is when the company is doing well and the stock isn't. The trouble with writing the rules is that you feel free, sometimes, to break them. With the stocks that aren't doing well, the rule is that it should be sold. On occasion, I break that

rule. Breaking the rule works about 60% of the time; the other 40% gets pretty painful.

About the Fund...

It seems lately that the Net Asset Value (NAV) has fluctuated more widely than the overall market. What brings this about? Also, what action will the Fund take if NAV reaches or exceeds \$100 per share?

Ron Muhlenkamp: Allow me to answer the second question first. If it gets to the point where you send in an extra penny that gets lost in a rounding error for the number of shares purchased, we might have to do a stock split on the NAV. For example, if you send in \$100 versus \$100.01, the latter gets priced out to the fourth decimal place in shares and then rounded back down to the third. So, if it gets to the point when a penny does not buy an extra fraction of a share, we'll deal with it.

With regard to the volatility of the NAV, there is so much quick money out there among individual investors and hedge fund managers alike that, on a day-to-day basis, prices are very volatile. And we happen to hold things like energy, which is ultra volatile. We hold housing which has been back and forth. Yesterday, good numbers were reported for housing and the stocks jumped. Today, a couple of housing companies reported their sales for the quarter were down. Overall, it looks like February was down and things came back a little bit in March. I call this a digestive process. Some people may think of it as indigestion, but, think about it: digestion is a pretty messy process.

We saw "digestion" play out last year. At the end of September '05, the Fund was up 7%; at the end of October, it was up 0%; and in December, it was up 7.9%. All the things that had run up nicely, and in our case that was energy and home building, gave it back in October. It has a lot to do with the momentum players who, when things turn negative, sell in a flash. We think it's crazy, but it's going on. There is so much money chasing "momentum" that we expect the volatility to continue. And that can either be a good thing or a bad thing.

Anybody here go to auctions? Why do you go to an auction? To get a bargain? Do you think that all prices at an auction are a bargain? If you're the only bidder, you might get a bargain. If there are two or three bidders, can auction prices go crazy? Folks, the New York Stock Exchange (NYSE) is an auction market. The key to getting a bargain

at an auction is knowing exactly what you want and what you are willing to pay for it. When we buy stocks, we want return on equity (ROE) above average with a price-to-earnings ratio (PE) below that, and we want growth above average. And if we don't get a bargain price, we won't chase it.

Another reason some people go to an auction is for the entertainment. Do you think the stock market is entertaining? They certainly think so on CNBC — and they are in the entertainment business! Folks, the real reason to go to an auction is for the volatility. If you know what you want and what you are willing to pay for it, then volatility is a great thing. It gives you the chance to buy it cheap, but it only works when nobody else wants it. You and I cannot buy a Buick at a Chevy price if everybody loves Buicks. Similarly, the only way you are going to get a good company cheap, is if people don't like it. That's the business that we're in. We try to find values and determine what we're willing to pay. We go to the auction. If we can get our product at our price, then we buy it. And if we can't, we won't.

Thirty years ago Connie was an Avon Lady. Remember when word got out that a couple of Avon gals had a stash of bottles up in the attic and they sold them for, I don't know, \$25,000 as collectors items? Connie had two gals on her route who bought one of everything. How many Avon ladies are in the country? If each one had just one customer who buys one of everything, what's going to be rare? The only way you get 'rare' is when it's junk. When a lot of people collect one of everything, it's not rare anymore. When it becomes popular, it's over — and that's also true in the business we're in. We refer to it by saying "Everyone wants to plant corn in October because it's grown so well since April." People want to extrapolate the gain as if nothing has changed. We think the time to plant corn is April, after it hasn't grown for six months. 

The comments made by Ron Muhlenkamp and his Investment Team are opinion and are not intended to be investment advice or a forecast of future events.

Dow Jones Industrial Average (DJIA) is a price-weighted average of 30 significant stocks traded on the New York Stock Exchange and NASDAQ. The DJIA was invented by Charles Dow back in 1896.

NASDAQ is a market-capitalization weighted index of more than 3,000 common equities.

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Recent Trends in the International, Commodities, Bond and Stock Markets

Recorded June 1, 2006 – Ron Muhlenkamp, Portfolio Manager

Several trends have been in evidence over the last six to nine months, some of these trends going back several years. Most of these trends have several things in common. They started from a "value" base, their prices rose to value levels but they kept climbing based on momentum. In our view, the public has insisted on playing each of these trends until it lost money.

In particular:

After 20 years of declining interest rates, long-term bonds were viewed as safe – until interest rates rose earlier this year resulting in losses on bonds.

Secondly, after three years of "out-performance," emerging markets attracted a lot of money, then Bolivia nationalized oil and gas reserves and Ecuador seized the assets of Occidental Petroleum. Many

emerging market securities have tanked in the last month with some markets down 30% - 40%.

Thirdly, commodities, especially metals, have been quite high. We've been hearing that financial buyers (think speculators and hedge funds) have bought more metals contracts in the last few months than have the users of these metals (think auto companies and Caterpillar). Metal prices, including gold prices, have cracked in the last few weeks.


Fourthly, small-cap stocks, which were great values several years ago, became fully priced in our view. The fact that many dedicated small and mid-cap funds have been closed to new money indicates their managers had the same view. The prices of some of these stocks have cracked in the last month, to the

extent that the NASDAQ is down year-to-date, although the DJIA is up.

In our case, we didn't trust the prices of bonds, commodities and emerging markets. We've been moving money toward some stocks that are larger in capitalization. Until now, that move has been early. We're about to find out whether it's been right!

In the meantime, we've been hurt by holdings in housing stocks. We continue to hold on to these stocks because we see great value there.

But the stocks have gone from 7-8 times earnings to 5-6 times earnings and this has hurt our performance. We think each of the above trends is now turning.

This is Ron Muhlenkamp with the Muhlenkamp "two" Minutes. 

Average Annual Returns as of 6/30/06

	Year to Date	One Year	Past 3 Years	Past 5 Years	Past 10 Years	Past 15 Years	Since Inception 11/1/1988
Muhlenkamp Fund							
Return Before Taxes	-3.74%	0.37%	16.44%	8.70%	14.41%	15.26%	13.93%
Return After Taxes on Distributions**	-3.74%	0.24%	16.38%	8.67%	14.19%	14.96%	13.58%
Return After Taxes on Distributions and Sale of Fund Shares**	-2.43%	0.43%	14.27%	7.57%	12.94%	13.95%	12.71%
S&P 500**	2.71%	2.71%	11.22%	2.49%	8.32%	10.73%	11.41%

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.

The Fund imposes a 2.00% redemption fee on shares held less than 30 days. Performance data does not reflect the the redemption fee. If reflected, total returns would be reduced.

***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.**

***Returns subject to change pending valuation of qualified dividend income percentage.**

****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.**

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Mutual fund investing involves risk. Principal loss is possible.

The Fund's investment objectives, risks, charges and expenses must be considered carefully before investing. The Prospectus contains this and other important information about the investment company, and it may be obtained by calling (800) 860-3863, or visiting www.muhlenkamp.com. Read it carefully before investing.

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*Numerous clients and shareholders have
commented favorably on Ron's book. If you
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on Amazon.com within the "Review" section.*

Thank you for your consideration.

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MuhlenkampMemorandum
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