Midwest Investment Management

PERSPECTIVE™

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Other stories in this issue:

Feds Tell Employers: Don't Ignore Pension, 401(k) Laws

By Charles E. Nye, Partner

COLUMBUS, OH — Company CEOs and presidents, take notice.

Your company's pension or 401(k) plan may not be in full compliance with federal regulations if your plan fiduciaries are not living up to the spirit and intent of ERISA, the landmark federal law that governs all private sector pension plans.

That strong message was delivered to owners and managers of medium-sized companies at a U.S. Department of Labor seminar held here in late-July, as part of the DOL's *"Getting It Right—Knowing Your Fiduciary Responsibilities"* employer education campaign which began in May.

ERISA is the Employee Retirement Income Security Act.

"A DOL investigation discovered a lack of understanding..."

Fiduciary responsibility

A DOL investigation discovered a lack of understanding among many employers regarding their responsibilities to pension and 401(k) plan participants, with a subsequent increase in litigation.

"It is more important than ever for CEOs to be aware of, and pay attention to, pension plan governance, especially the liability of fiduciaries," says Labor Secretary Elaine L. Chao.

"We want to educate people about the law and help prevent problems from occurring in the first place," Chao says.

For employers, *"Getting It Right..."* means:

- Understanding all responsibilities under the law;
- Carefully selecting and monitoring service providers;
- Avoiding prohibited transactions or activities that do not directly benefit plan participants;
- Making appropriate disclosures to plan participants.

DOL officials acknowledge that *"Getting It Right..."* can be challenging for employers whose time, resources, and access to professional benefit plan help is limited.

Continued on page 2

A long-term investment outlook in an uncertain world

By Norman F. Klopp, Jr., CFA, Partner

While I don't know what the stock market will do within the next six months (the short term), I have some perspective on what the market might do over the next five years or so (the long term).

A long-term market perspective is important in setting expectations (both ours and our clients) because it can influence a long-term investment ***plan*** and serve as a basis for realism in a personal financial strategy.

"...corporate profits drive 'real' equity returns over the long term."

Our benchmark

When we speak of "the market", we are referring to the Standard and Poors 500 Index. When we speak of "returns" we are referring to *total* returns—price appreciation plus dividend yield.

We have a fundamental belief that "real" corporate profits drive "real" equity returns over the long term. "Real" returns are those adjusted for inflation. The chart on page 4 supports our belief.

Numerous influences

In analyzing long-term market performance, almost every economic factor is translated into real corporate profits which, in our opinion, drive equity returns.

Over the shorter term, the direction or magnitude of interest rate changes, inflation, employment levels and a few other factors can contribute to short-term market volatility, and over the long term are reflected in corporate profits.

Near-term outlook

Consensus estimates call for S&P 500 aggregate earnings to be up 18% in 2004,

Continued on page 4

Don't Ignore Pension, 401(k) Laws *(Continued from page 1)*

"Our Best Funds 401(k)... is very competitive."

However, federal regulations actually **encourage** pension and 401(k) plan sponsors to hire an independent Registered Investment Advisor—such as Midwest Investment Management—to share the fiduciary responsibility for selecting and managing investments of the plan. That action, when executed properly, can help avoid conflicts of interest of the type implicated in the collapse of several major pension plans and the recent mutual fund scandals.

Meets the definition

Because Midwest Investment Management is registered with the Securities and Exchange Commission as an independent Registered Investment Advisor and does not operate its own mutual funds or receive any fees or compensation from mutual funds, it meets the DOL's definition of an "independent investment advisor."

Our *Best Funds*™ 401(k) investment advisory service is especially well-suited for closely held companies. It offers a wide choice of nationally recognized mutual funds, plus our premier, proprietary portfolio of "value-oriented" stocks.

Our service is comprehensive and our management fee is very competitive.

If you are a company owner or CEO with a pension or 401(k) plan, I invite you to contact me for a discussion of the advantages our experience as an *independent, experienced,* and *proven* investment advisor can provide to your plan. I can be reached at **(216) 830-1127 or cen@mimllc.com**

How we help employers meet their fiduciary obligations.

- Midwest Investment Management LLC meets the "independent registered investment advisor" description, as encouraged by the Department of Labor.
- We have no conflicts of interest with mutual fund families and receive no compensation from them.
- Our proprietary managed account enhances investment choices.
- Our services are not bundled with services you may not want or need.
- We work with your independent third-party administrator to give your plan more flexibility.
- Personal enrollment assistance for plan participants.
- Regular performance review meetings with your plan trustees.
- We offer annual update meetings with plan participants.

3rd Quarter Economic Review

Economy continues moderate growth; main concerns are war, terrorism

By Joseph A. Harrison, CFA, Partner

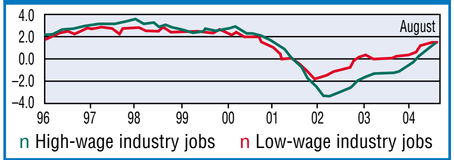
The summer produced many cloudy days across northeast Ohio. Similarly the economy, passing from the robust growth of a recovery to a more normal and sustainable track, posed gloomy thoughts to those caught up in extrapolating long-term implications from isolated statistics. Each nugget of economic gold was greatly enhanced by the alchemy of political rhetoric. Events in Iraq and uncertainties posed by potential terrorist attacks in the U.S. and abroad also helped make the equity markets choppy during the quarter ending Sept. 30th.

"The August report noted very positive gains..."

Employment reports

A weak July employment report evoked thoughts about a possible return of the recession, but employment gains of 144,000 in August dissolved that concern — highlighting the fallacy of looking at a single monthly report as definitive. The August report noted very positive gains in both hours worked and wages, and refuted widely expressed concern that employers are substituting high-paying jobs with low-paying ones (see graph, below). Indeed the largest employment gains were in professional and business services and educational and health services.

High-Wage vs. Low-Wage Job Changes
(Percent change over 12 months)



Source: Bureau of Labor Statistics and UBS

Employment data from the Institute of Supply Management further support the notion that the employment picture is healthy and that the outlook for future incomes will be sufficient to support continued consumer demand.

The U.S. Commerce Department reported that manufacturing output grew 0.6% in July.

Near-record profits

Although corporate earnings reported for the second quarter were very strong, corporate executives were generally cautious about similar

Continued on page 4

The Analyst's Corner

By Elmer L. (Al) Meszaros, CFA, Partner

Like Ted Williams, we wait for the "fat pitch"

For the past several years, approximately 20%-25% of the stocks we held in client portfolios were stocks of consumer product companies. The chief reason is that the broad sectors known as "consumer discretionary" and "consumer staples" companies fit well the philosophy of Midwest Investment Management.

Consumer spending is the largest part of the American economy, accounting for two-thirds of Gross Domestic Product and 22% of the S&P 500 weight.

The better consumer product companies have also grown faster than the aggregate S&P 500 companies in terms of revenue, earnings, and dividends.

Searching for quality

We look diligently for stocks of "quality" companies that have displayed consistent growth, and are available at a value price.

To us, "quality" means a strong industry position and healthy finances. This allows a company to withstand cyclical shocks, should they occur, or unexpected competitive pressures. Superior profitability is a mark of quality because it demonstrates a company's ability to prosper, stay competitive, and grow.

The consumer stocks we like have demonstrated growth in earnings, dividends, and book value, and have done so consistently—preferably each year. We like to have confidence that their business model will generate growth for many years, lifting the stock price.

Dividend growth

Dividend growth is a good reality check on healthy finances and the ability to grow. General Mills has made dividend payments for 105 consecutive years.

Some consumer stocks have records of increasing their dividends over many years (see box bottom left).

Cyclical stocks

But not all consumer stocks are stable or even growing. "Consumer discretionary" stocks are more cyclical, since people can defer buying automobiles, vacations, or home improvement items. Some business models (i.e., department stores) suffer as they are eclipsed by new formats such as discounters or specialty stores.

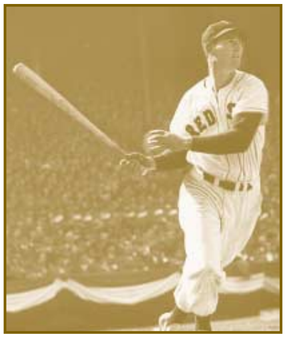
Opportunity often comes in the form of short-term problems for a company with long-term advantages. Such was the case of Proctor & Gamble a few years ago, when our research indicated that P&G's problems would soon be resolved.

But past success is no guarantee of a great future—witness recent problems at Toys-R-Us, Winn Dixie, and more recently, Coca-Cola. Selectivity will always be critical.

Patience pays

Since our clients' investment success is linked to the price we pay for the stock, we use a five-model price discipline to arrive at a fair price, and then try to buy the stock 20% to 30% below that level, our *"value price."* In baseball, it's called waiting for the "fat pitch."

In fact, legendary Ted Williams—the greatest hitter of all time—seldom swung at a ball that was not exactly where he wanted it…even though it might have been in the strike zone. Ted remained patient, waiting for just the right pitch—just as we do when selecting stocks.



His patience in the batter's box made the legendary Ted Williams the best hitter of all time.

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Building long-term wealth requires patience and a disciplined approach to stock selection. If you're not currently a client at Midwest Investment Management, Al Meszaros can help get you started. Contact him at (216) 830-1133 or elm@mimllc.com

"Dividend growth is a good reality check on…the ability to grow."

"But past success is no guarantee of a great future…"

Midwest Investment Management Consumer Stock "Hall of Fame"

Several consumer stocks we have held in client portfolios have outstanding records of increasing dividends over many consecutive years.

Consumer Stock	Consecutive Years of Dividend Increases
Proctor & Gamble	48 Years
McGraw-Hill	31 Years
Gannett	37 Years
Pepsico	30 Years
Lowes	18 Years
Dollar General	13 Years

Obviously, there is something very stable about the business models of these companies. Demand for their products is continuous, consistent, and repetitive.

How To Reach Us.

You may contact the partners or staff members at Midwest Investment Management by phone or e-mail. Here is a complete listing for your convenience.

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Midwest Investment Management

Long-term investment outlook...

(Continued from page 1)

following gains of 7% in 2002 and 15% in 2003. Additional gains of 7% are projected for 2005 and 2006—*meaning that 2006 earnings would be up 66% from the recession trough of 2001.* Corporate profitability has benefited significantly from increases in real demand, increased productivity, and low interest rates.

Period	Real GDP Growth	Real Corporate Profits	Real S&P 500 Returns
1st qtr. 1969 – 3rd qtr. 1979	2.8%	–1.4%	–5.4%
4th qtr. 1979 – 4th qtr. 1980	2.4%	14.7%	9.6%
1st qtr. 1981 – 4th qtr. 1986	3.8%	6.1%	5.4%
1st qtr. 1987 – 1st qtr. 2004	3.0%	6.0%	5.5%

Source: LaJolla Economics

Non-economic factors

The "war on terror" is probably with us for the long term. If a major terrorist act occurs, the market will most likely react negatively and then quickly revert to considering economic factors. The implications of the war itself are difficult to factor into a market outlook. But war creates uncertainty and the markets (investors) hate uncertainty. The market has had and will continue to build-in a "war discount."

Long-term view

If corporate profits can continue to grow at their historic 7% nominal annual rate, and are combined with the current yield of 1.5%, they should provide a long-term return of 8.5% for equities. This assumes no significant change in price/earnings ratios, which appear reasonable at the current 16.7 times earnings.

At Midwest Investment Management, we remain dedicated to buying stocks of high quality, profitable companies. Because we are very disciplined about the prices we pay for individual stocks and adhere to a long-term strategy, our clients do not have to be significantly concerned about "the market."

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If you are not currently a Midwest Investment Management client, why not consider Norm Klopp's disciplined approach to long-term growth for your portfolio? To get started, contact Norm at (216) 830-1135 or nfk@mimllc.com

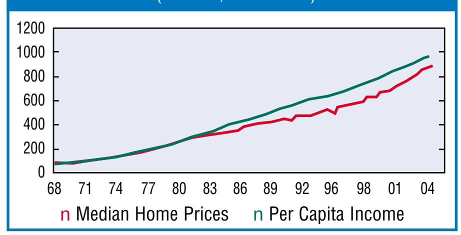
3rd Quarter Economic Review

(Continued from page 2)

prospects for the third quarter. With profit margins approaching record levels, a slower pace of earnings growth is normal and should be expected.

In the past year, companies enjoyed the benefit of significant productivity gains, low interest costs, and lower taxes — none of which are likely to repeat over the next year. Increased energy and material costs are allowing most companies to raise prices as customer demand grows. Nevertheless, profit growth of 8% or 9% would be a very positive result over the next 12 to 18 months.

Median Home Prices vs. Per Capita Disposable Personal Incomes
(Indexed, 1968 = 100)



Source: National Association of Realtors and Bureau of Economic Analysis

Real estate

Very strong gains in residential real estate prices have raised the specter of a "bubble" developing in that market. The trend of the median price of a home and per capita disposable personal income over the past 35 years suggests that the current "bubble" is just returning the trend to its normal relationship. It is interesting that the gap, which developed from the mid-eighties into the mid-nineties, began to close following legislation which effectively removed capital gains taxes from consideration in valuing real estate (see graph, right). At the same time, home equity credit made homes a more valuable personal asset, and subsequent lower interest rates greatly improved the affordability of real estate.

Many concerns of the 3rd quarter have been overcome. The economy continues to grow moderately and should be sustainable, subject to uncertainties in Iraq or the war on terrorism.

Bush or Kerry?

Will the outcome of the Presidential election affect how we manage client portfolios?

Quite simply, no. A diversified portfolio comprised of stocks of good, profitable companies selling at reasonable prices should weather any changing political climate. Although certain events may "shock" our economic system, Americans have always been resilient and looked to the future. We tell our clients to follow an investment path that stresses controlling risks.

We hope you enjoy reading our quarterly newsletter, which contains news about our firm, its investment philosophy, the economy and market trends. We suggest you retain these newsletters for future reference.

Perspective is published quarterly by Midwest Investment Management LLC, Cleveland, Ohio for its clients, friends and members of the business community. All information contained herein reflects the opinions of the authors and does not necessarily constitute investment advice. Past results are no guarantee of future performance.