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Midwest Investment Management

Coaching and discipline *(Continued from page 1)*

Earnings and the creation of economic value drive stock prices in the long run. Debt raises the risk of any investment, and research is essential to prudent investment decision-making and risk management.

The stock market can be unpredictable, even volatile. There have been periods of tremendous prosperity, followed by periods of "trials and tribulations."

Past rewards

Whether your risk profile, as an equity investor, is best-suited to a growth style of investing, a value style, or some optimal combination of the two, consistency and long-term commitment to the market have produced their rewards. In fact, over the past 25 years, the single most significant decision an investor could have made was to simply "participate" in the stock market.

However, the landscape is changing, in part because many more people are now responsible for their own retirement income and are forced to make investment decisions for themselves.

> ***"The world of sports has many parallels with the world of investing."***

For many people, investing is difficult (especially in the short-term) because of human emotion. Investing is a long-term, very serious proposition affected by the emotions of fear and greed.

How we assist you

That's where a relationship with Midwest Investment Management can help. As your trusted advisor, it's our job to help assess your risk profile and guide your investment decisions accordingly. We help keep you focused on the long-term plan; help you maintain a fundamental perspective; and develop realistic expectations.

Most importantly, however, it's our job to coach our clients on managing the "emotions" of investing. Almost without fail, what distracts the individual investor from the long-term game plan is the heightened emotional reactions to short-term returns – whether they are positive or negative. As your "coach", we're on your side pulling for your long-term success!

> ***"Most importantly … (we) coach our clients on managing the emotions of investing."***

Have you ever seen an Olympic athlete, some of the world's finest, without a coach? A football team, baseball team, or basketball team without one? Even the Chicago Bulls in their glory years with Michael Jordan relied on head coach Phil Jackson to set the game plan, motivate the players, and keep their emotions in-check.

Tiger Woods, considered by some to be the greatest golfer ever, relies on his coach. According to the Aug. 14, 2000 issue of *Time* magazine, Woods regularly calls his coach, Butch Harmon, from the tee, the fairway, and the green, seeking guidance, perspective, and reassurance.

Shouldn't you have a "coach" to call the next time the pressure is on and you are facing a "tough shot"?

With our combined 170 years of investment industry experience, my partners and I welcome your inquiry and the opportunity to coach your journey to financial success.

If you have any comments or questions about this story, you're invited to contact Chuck Nye at (216) 830-1127 or e-mail: cen@mimllc.com

Third Quarter in Review *(Continued from page 1)*

ment in the number of companies participating in the gain. Then in September, a number of pre-announced earnings disappointments put the market into reverse. We await the release of actual earnings in mid to late October, a period that has been traditionally poor for equity performance.

Not all gloom and doom

With a number of domestic and international indicators showing a clear world-wide slowdown and several destabilizing influences in currency and energy markets, a flexible investment policy should enable us to take advantage of valuation opportunities. Many indicators remain very positive over the long term. U.S. manufacturing capability is strong, our technology infrastructure is improving exponentially, and healthcare breakthroughs promise an improved quality of life. Any near-term weakness resulting from the destabilizing currency and energy forces should be viewed as an opportunity for long-term investment results.

We hope you enjoy reading our quarterly newsletter, which will contain news about our firm, its investment philosophy, the economy and market trends. We suggest you retain these newsletters in a file for future reference about our company, our staff, market trends and the economy.

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.

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Midwest Investment Management

PERSPECTIVE

Other stories in this issue:

3rd Quarter in Review

Indicators show world-wide slowdown; long-term investment outlook remains positive

By Joseph A. Harrison, CFA, Partner

A most unusual quarter has just past. The elements brought firestorms to the Northern Rockies and flood conditions to the Northeast, while Texas sweltered in a drought. Oil and natural gas prices moderated in July, then soared to new highs in September. While interest rates, as measured by 10-year U.S. Treasury Notes, moderated throughout the quarter, equity prices remained in a trading range pattern with considerable rotation among groups. The Olympic games have ended. The political games have begun.

Most indicators move lower

Although economic growth continued, the signs of a slowdown became more apparent as the quarter wore on. Hours worked, industrial production, and consumer spending all declined over the summer. Construction spending declined sharply and the Purchasing Managers' index fell below 50, indicating *declining activity,* not just slower growth.

During late August and September many companies pre-announced weaker than forecast earnings expectations for the third quarter. The affected companies cover many economic sectors and reflect a number of broad economic trends superseding company-specific factors. For some companies with significant European sales, the very weak Euro and slower European growth were responsible for the shortfall. For others, higher raw material costs coupled with an inability to raise prices pressured margins. Yet others faced less-than-expected revenues in the face of slowing demand.

Problems in Europe

In Europe, weaker currency values and higher oil prices had a double-barreled effect on consumer spending and European-based manufacturing and distribution costs. In the past 20 months the price of oil in the U.S. is up 215%. In the U. K., oil was up 276% in £ Sterling and on the continent the increase has been an astounding 331%. Such increases constitute a pervasive world-wide depressant. If oil prices continue to escalate, they could have a serious impact on the global economic outlook.

Back in the U.S., the equity markets enjoyed a good summer rally with a long-awaited improve-

Continued on page 4

Near-term Fed policy may hinge on U.S. trade deficit

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

The global economies stand at a particularly important balance point. How that balance changes could have significant implications for Federal Reserve policy over the near term. And what is the primary factor influencing that balance? The U.S. trade deficit. Recently, we in the U.S. have been buying in excess of $30 billion more *each month* from sources abroad than we have been selling there. To put this in perspective, as recently as 1992, the trade deficit for the whole year totaled $36 billion. In the last few months it has exceeded $30 billion per month.

> ***"The historically high trade deficit … raises the risk of increased global volatility."***

Problems ahead?

During our historic economic expansion, this has not been a serious problem – *until now.* The availability of goods from abroad reduced

Continued on page 3

Comparisons are strikingly similar

Coaching and discipline required to "win" in athletics – and investing

By Charles E. Nye, Partner

What do famous "world-class" athletes like Michael Jordan, Dan Marino, Mary Lou Retton, and Tiger Woods, have in common? Despite their "star" quality and seemingly endless athletic prowess, they each relied on a trusted coach and advisor to help them attain their lofty position – and then stay there.

Perhaps you never thought about it, but the world of sports has many parallels with the world of investing. Let me explain …

In a world full of unknowns and forecasts, there are few certainties in the stock market.

Continued on page 4

"In my opinion…"

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

SEC move threatens advantage of "real" on-site stock research.

The Securities and Exchange Commission recently released regulations detailing its new policies regarding how companies deal with disclosure of information to individual analysts, or to groups of analysts. Essentially, these regulations require public disclosure of any comments about the earnings outlook. But, more importantly, they also cover other information that had previously been considered immaterial.

Nothing of value?

Some companies, reporters for the financial press, and many analysts and portfolio managers, have decided that this negates any advantage that independent investment research has. They say it has "leveled the playing field" such that there is nothing of value to be gleaned from calling on a company management.

Over the last 35 years in the investment management business, I have heard this many times over – most recently relative to the Internet eliminating the advantage of research. My partners and I believe differently.

Let's define "research"

Perhaps the issue here is the meaning of "research." If "research" means meeting with the investor relations person at a company to review an earnings model and discuss the current quarter and year's estimate, then we say "yes" – these moves by the SEC "level the playing field" for "normal" research and increase the advantages of "creative" research.

But, if firms such as Midwest Investment Management develop good industry trend sources, know a company's competitors, customers, suppliers and other factors that influence the company's future, then we believe we can add even *more investment value* than in the past!

"Real" discussions pay dividends

Also, if we can spend our time talking with the company's senior managers about their long term strategy, their product development, their productivity improvement programs, their competitive advantage, their incentive compensation system and what wakes them up at 4 a.m. in a cold sweat – we can add *significantly more investment value* than discussing what the company might earn in the third quarter of 2000.

Private face-to-face meetings with a company's CEO, its employees, vendors, or others can yield information of tremendous value to an investment analyst.

In our opinion, research is not dying. It is constantly evolving, as it has always evolved. It is the true "art" of the investment management business. As one of our partners once said – "it is the process of connecting the dots." And as research evolves, some of the dots become less clear and others clearer.

If you have questions or comments about this new SEC regulation, you may contact Norm Klopp at (216) 830-1135 or e-mail: nfk@mimllc.com

Check our expanded website

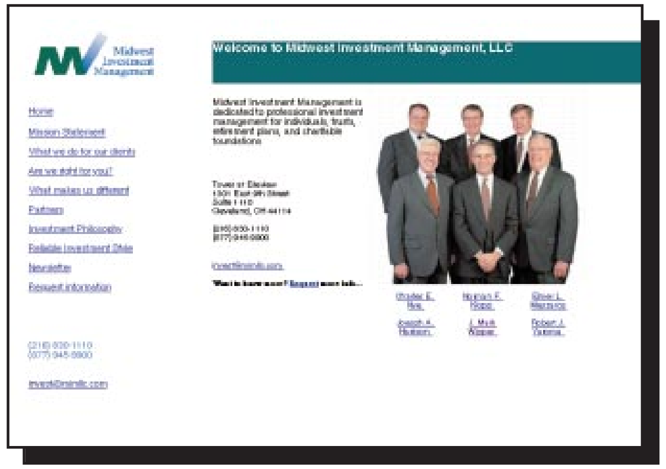
In mid-September, the content of the Midwest Investment Management website was expanded, significantly increasing the amount of information and data available.

For existing clients, perhaps the most significant benefit of our expanded website is the feature which allows them to quickly and easily e-mail any of the firm's partners.

The site offers competitive information about the firm, its partners, investment philosophy, and more. The website will not, however, offer account balance information. This is in keeping with our stated philosophy of maintaining a long-term investment horizon and our commitment to providing clients with individually prepared reports – along with comments about their individual portfolios – at the end of each calendar quarter.

Stories and news will be added to the website as often as necessary.

Please visit our website at **www.mimllc.com** and let us know what you think!



More news and more information is at www.mimllc.com.

U.S. trade deficit *(Continued from page 1)*

pressures on our already tight domestic production capacity. The strong dollar has kept import prices down which in turn helped keep inflation under control. While the U.S. economy has been growing rapidly, international economic growth has been sluggish. This has allowed the Fed to be persistent, but measured, in its successful moves to control domestic inflation.

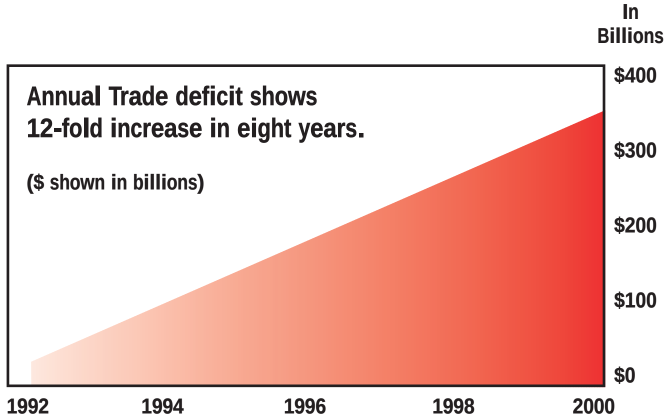
But, what if the balance changes? If, as some expect, the growth rate of the U.S. economy slows while foreign economic growth accelerates, export demand will accelerate, affecting the Fed's desired domestic slowdown. This could force the Federal Reserve Board to extend interest rate increases further than it desires, in order to control the U.S. economy. While the trade deficit might narrow, the economic and market risks in the U.S. are extended.

Potential earnings risk

The second possibility would have foreign economies slowing in sync with the expected U.S. slowdown. Global central bank interest rate increases over the last twelve to eighteen months could cause this to happen. This might result in a lower trade deficit as import and export demand declines, but it would also raise the probability of a much "harder" landing for the domestic economy and cause the Fed to appear to have been much too restrictive. The risk to corporate earnings would be most significant.

"We are not ready to worry, but we are obviously watching closely"!

Finally, if U.S. growth does not slow and foreign economies accelerate, the trade deficit will probably narrow as export demand increases. The pressures on our capacity will also increase, as will the risk of inflation. This inflation risk becomes even greater as the dollar would likely weaken in this scenario, increasing the costs of imports. Pressures on the Fed and other central bankers to continue to raise rates would significantly increase the probabilities of a "hard" landing.



From 1992 to 2000, the annual U.S. foreign trade deficit has grown 12-fold. From an average deficit of $3 billion per month in 1992, the monthly average now exceeds $30 billion. The resulting implications for Federal Reserve Board policies, domestic corporate earnings, and continued U.S. prosperity are significant.

What are the conclusions? The historically high trade deficit increasingly limits the Fed's options in the U.S. economy. It also raises the risk of increased global economic volatility after years of an historic, disciplined domestic economic expansion. The key factor, as we see it, is time.

Close watch necessary

No matter how these options develop, if it happens in an orderly fashion over a reasonable length of time, say five years or more, we will have again resolved an economic imbalance in a disciplined fashion. On the other hand, if short-term volatility in interest rates, currency values, capital movement or other factors begin to appear, the risks identified in each of the scenarios above become real. And the risks in the market increase. We are not ready to worry, but we are obviously watching closely!

If you have questions or comments about this report, you may contact Norm Klopp at (216) 830-1135 or e-mail: nfk@mimllc.com

Strategy involves reducing risk

"Best Funds" program based on Nobel Prize-winning theory

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

Back in June, 1952, a young graduate student at the University of Chicago authored an original work on portfolio selection. Although it wasn't until 1990, Harry M. Markowitz received a Nobel Prize in Economic Science for that effort. His key insight was the strategic role of diversification among investments to reduce risk, which he defined as volatility of returns. Volatility is a bad thing when it causes emotional investors to abandon their long-term plan.

Using the Markowitz strategy

At Midwest Investment Management, our *"Best Funds"* program implements Markowitz's prize winning insight for our clients. We diversify among six different asset classes and styles (i.e., large company, small company, growth, value, international, and bond funds).

Objectivity and low costs

Our *"Best Funds"* program is for small-to-medium-sized accounts, including IRAs, Roth IRAs, 401(k) rollovers and corporate 401(k) programs. We use only low-cost, no-load funds and since we do not accept payments from any fund companies, we are totally objective in choosing the most talented managers from over 8000 choices.

We have selected 18 proven mutual fund managers who we think of as an 18-piece orchestra ready to perform. We actively monitor each fund's performance and rebalance client portfolios as needed.

We also like to meet with the fund managers personally. Recently, for example, we met with two fund managers – Tim Miller who runs a high-performing growth fund of 150 high-quality, fast-growing, mid-sized companies and Bill Nygren who manages a concentrated portfolio of 21 "deep value" stocks. Blending these two very different styles should result in lower volatility, resulting in a "smoother ride" for our investors.

If Harry Markowitz's strategy for reducing investment anxiety appeals to you, why not investigate the program offered by our "18-piece orchestra" of fund managers?

For more information about the *"Best Funds"* program, contact Al Meszaros at (216) 830-1133 or e-mail: elm@mimllc.com.