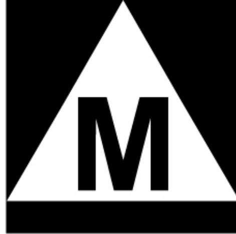


Muhlenkamp & Company, Inc.
Intelligent Investment Management

Where to from Here?

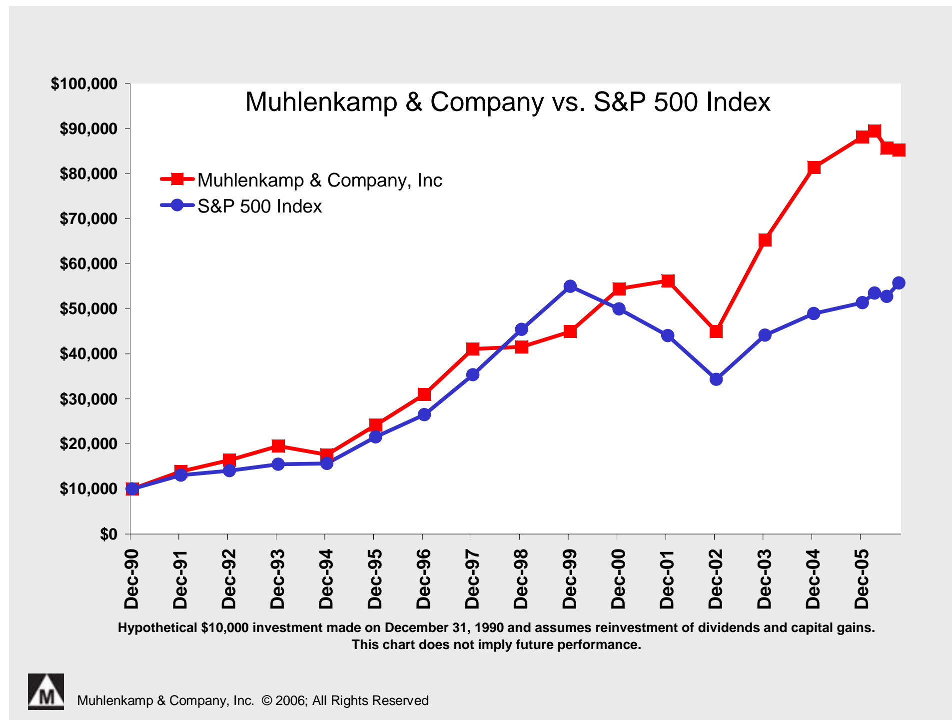
On November 9, 2006, Muhlenkamp & Company hosted a seminar in the Pittsburgh area where Ron Muhlenkamp delivered **Where to from Here**? *In this presentation, Ron provided a candid overview which starts with a review of the markets and our investment performance. Ron then reviewed the data which he and our analysts are using to conclude that the economy is in a soft-landing and many investments are currently attractive.*

For the past year, we've been saying:

- The big picture is back to normal, a "normal" we haven't seen since the 1960s;
- The intermediate picture (the business cycle) looks most like the period between 1994-95, which was a soft landing;
- The short-term period is volatile.

Today, we're going to try to describe why we believe those things.

Following is a plot of the **Muhlenkamp & Company Performance versus S&P 500 Index since 1990**:



What we've been hearing from people is, "Gee, the market has been hitting new highs, why aren't you?"

In the last six months, the Dow and the S&P have hit new highs and are now back to where they were six years ago. While we are not hitting new highs, we are twice where we were six years ago… but, in the last six months, we've looked dumb. The only thing I can tell you is that we also looked dumb back in 1994-95, which was a soft-landing period. We looked dumb in 1998-99, when 'dot-coms' were popular. At the time, I recall being told "Don't even try to beat the S&P; everybody knows you can't do that." We looked dumb in 2002, when there was a panic sell-off. And we looked dumb the last six months.

In the first part of 2006, up through April, commodity, small-cap, and foreign stocks were strong. It was a very aggressive group of stocks leading the marketplace. The fear back in March and April was the economy was growing too fast, and we would have inflation. In May and June, however, everything corrected. Since July, the leaders have all been defensive, (stocks like utilities, REITs, food stocks, pharmaceuticals), which are appropriate if you are going into a recession.

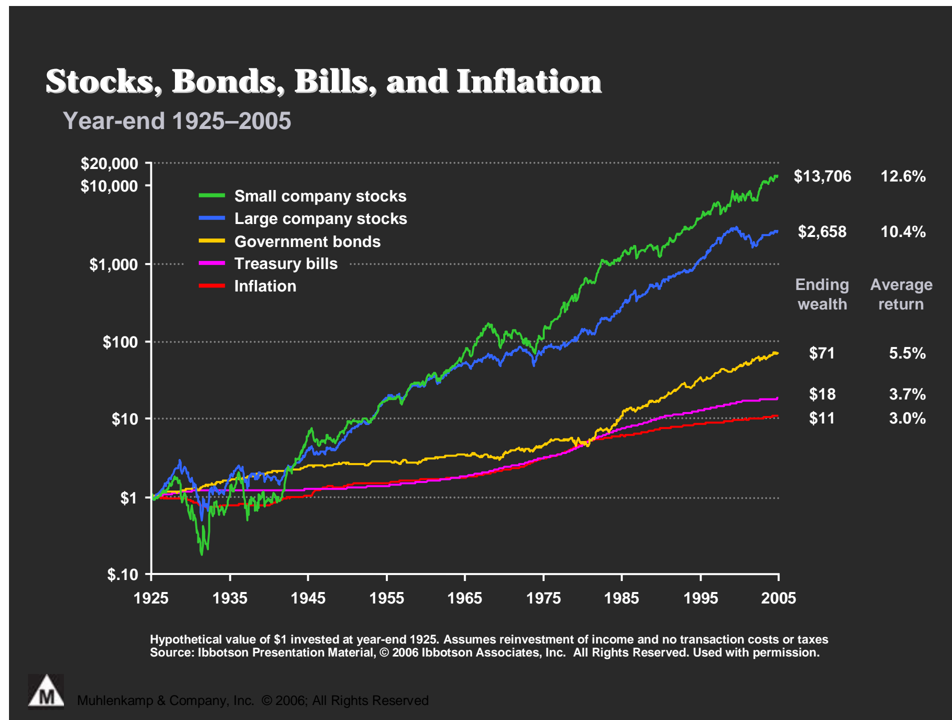
If we thought we were going into a recession then, yes, we should have sold about half of what we own and bought stocks that are more defensive. But we've said for more than a year -- and we still believe -- that a soft landing is more likely. And if we're right about the soft landing, then, we are exactly where we want to be.

It's been pointed out by a lot of folks that since World War II, we've had ten recessions and we've managed a soft landing only once: 1994-95. So the odds appear to be ten-to-one against it. Nevertheless, this time around, bank balance sheets are in much better shape; corporate balance sheets are in much better shape; and consumers are in better shape than generally perceived. Nobody disagrees about the bank and the corporate balance sheets. There is a lot of controversy over what shape the consumer is in. So, today, we'll address the consumer and spend a fair amount on why we think a soft landing is likely.

The Big Picture

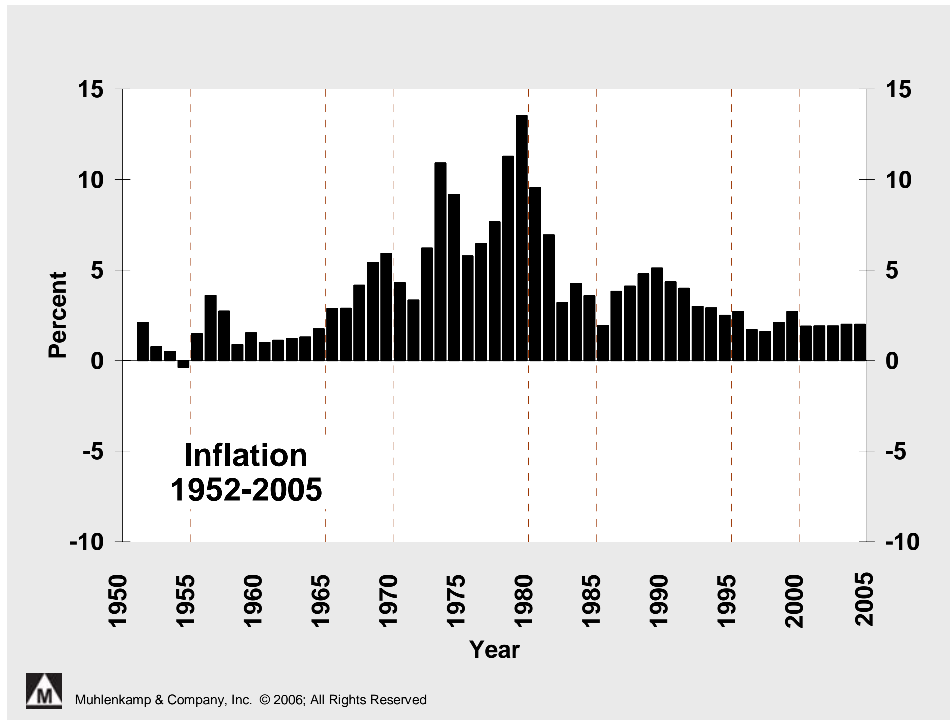
Following is a plot of **Stocks, Bonds, T-Bills and Inflation since 1925**. It says that inflation has averaged about 3%; short-term rates about 4%; long-term rates about 5½% or 2½% over inflation.

What I really find interesting about this chart is that I can find the Depression. I can find deflation that accompanied the Depression. I can find inflation, I can find World War II… but I can't find the Vietnam War. Currently, we're in Iraq. Folks, don't get me wrong, wars are expensive and life-threatening. Our son spent a year in Iraq. But, in the greater scheme of a long-term period in the economy and in the economic signature of markets, these wars are not significant.



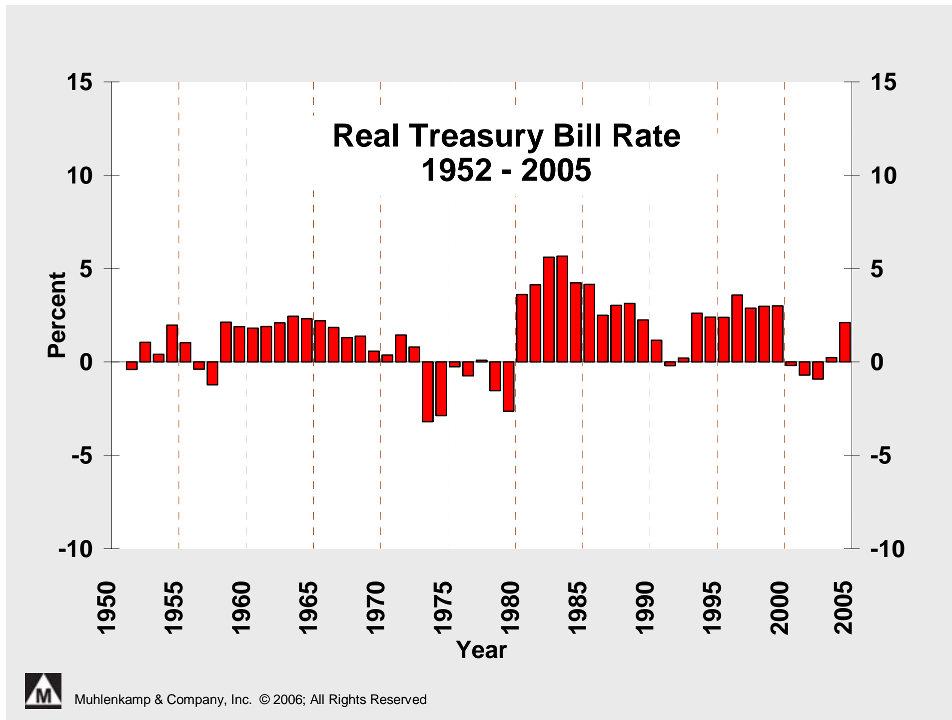
Here's another example: In 1987, the market dropped 20% in two days. But, if you didn't know that, you couldn't find it on this chart. Part of my job is to know what parts of the daily news to pay attention to, and what not. There is *always* something that is a problem. Somebody asked me a year ago what it would take to turn me bearish and I responded, "Can you think of something to worry about that people aren't *already* worried about?" Folks, the times I get worried are when nobody else is. What I'm trying to say is the things people worry about on a day-to-day, or month-to-month, basis pretty much get washed out in the longer-term scheme of things.

The reason we've been saying we are back to "normal," a period similar to the mid-1960s…

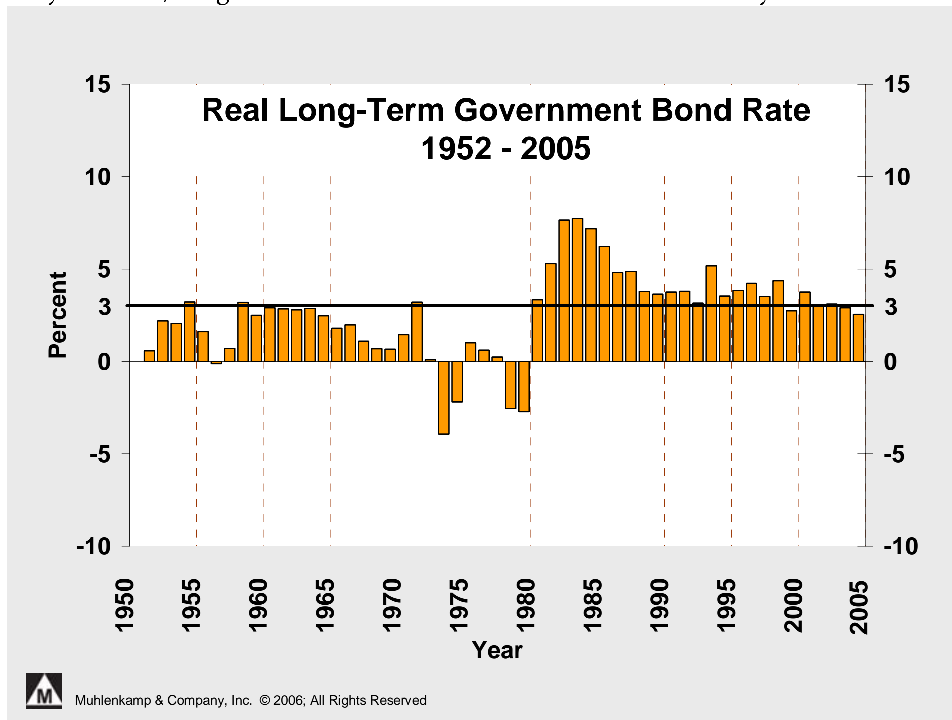


The chart above is the **Consumer Price Index (CPI) since 1950**. Folks, inflation has been between 2%-3% for nine years now. Back in the 1950s and 1960s, inflation averaged around 1½%, but it was actually less stable than it is today. Inflation ticked up a little bit in 1999 -- and we created a recession to be sure that it didn't go any farther. It ticked up just a little bit in the last year, and we've been raising interest rates to be sure it doesn't go farther. But, the last time we had low and stable inflation was in the 1960s.

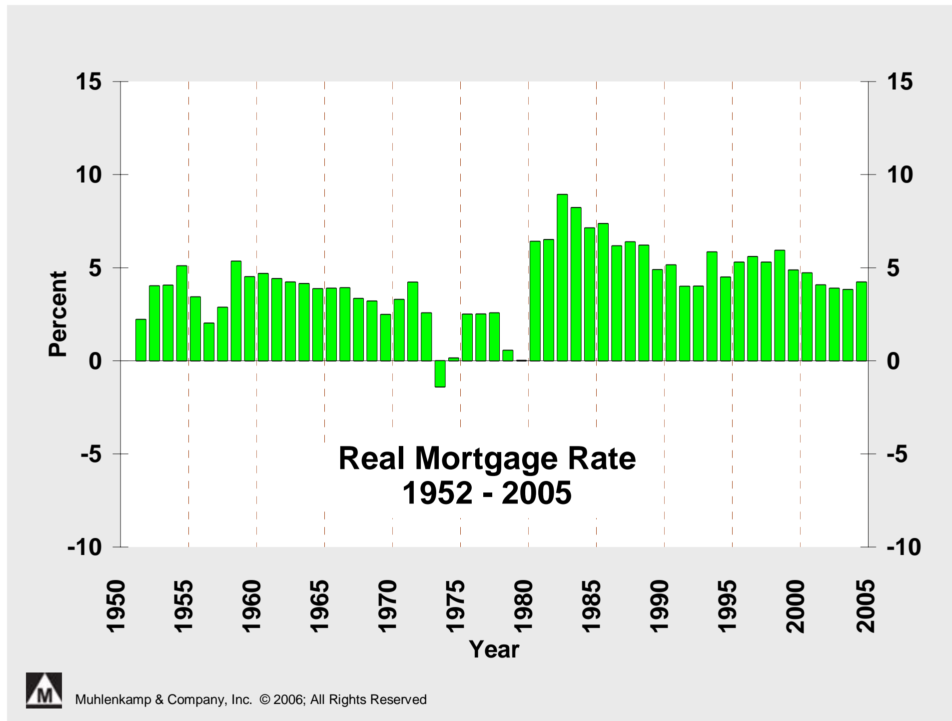
The following chart is **Real Treasury Bill Rates, 1952-2005** (Treasury rates, minus inflation). Real short-term rates were actually negative a couple of years ago. Do you remember when short-term rates were at 1%? Well the Fed raised them to 2%...3%...and then to 4%, which is about normal. Today, we're actually a little above that: we're at 5¼%. Folks, there was no *economic* reason for rates to be at 1%; there was a *political* reason for rates to be at 1%. Today, they are a little bit above normal.



The following chart is **Real Long-Term Government Bond Rates, 1952-2005**, (Long-Term Bond Rates, minus inflation), which have been fair for four years, and five out of the last six. You may remember a couple of years ago that people feared long rates would move up, as short rates did. We didn't think so, because long rates were already fair. Back in 2001-03, long-term rates were at inflation plus three -- even though short rates, on a real basis, were negative. The point is: inflation has been stable for nine years now; long rates have been fair and stable for about four years now.

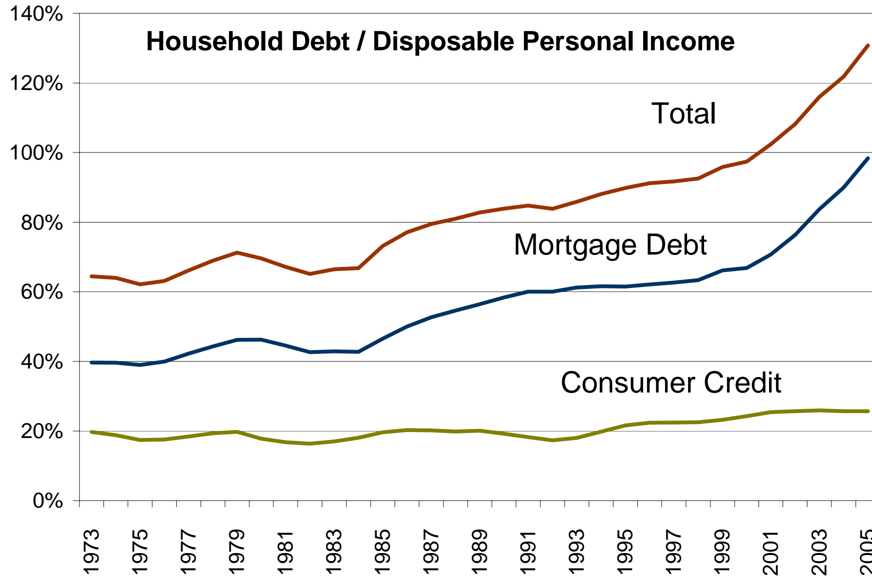


Earlier this year, when people feared that the economy was growing too fast, long rates got up to 5.4%; they're now at 4¾%. Folks, the bond market has concluded that inflation is not going to be a problem. The stock market is trying to figure out if we are going to have a soft landing or a recession. That's what's going on today.



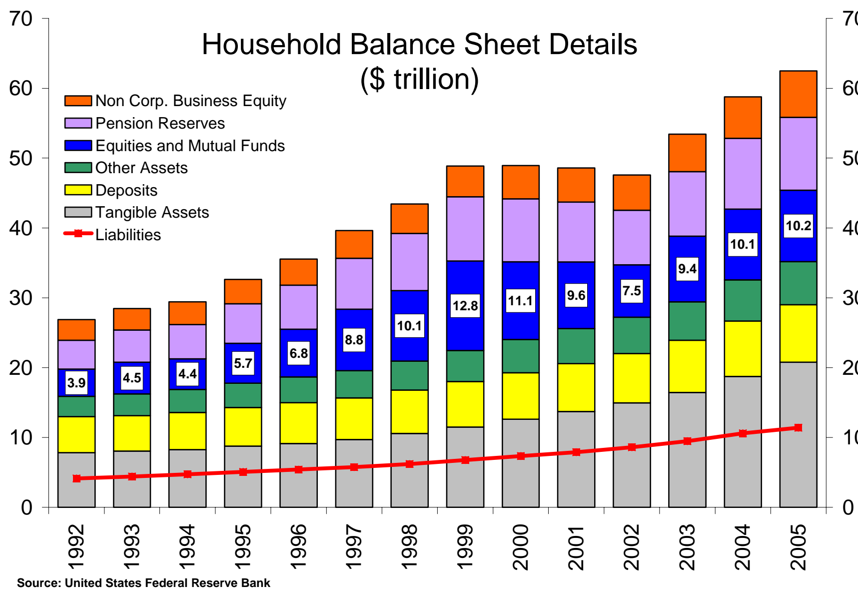
Let's turn to **Real Mortgage Rates, 1952-2005** (Mortgage Rates, minus inflation). As you can see in the above chart, real mortgage rates are a little above normal. Remember, long-term bonds are at 4¾%. Mortgages ought to be just a touch under 6% (nominal); today, they are about 6.2%. We think that mortgage rates will drop a little bit, but much of that game is over.

What about the Consumer Balance Sheet?



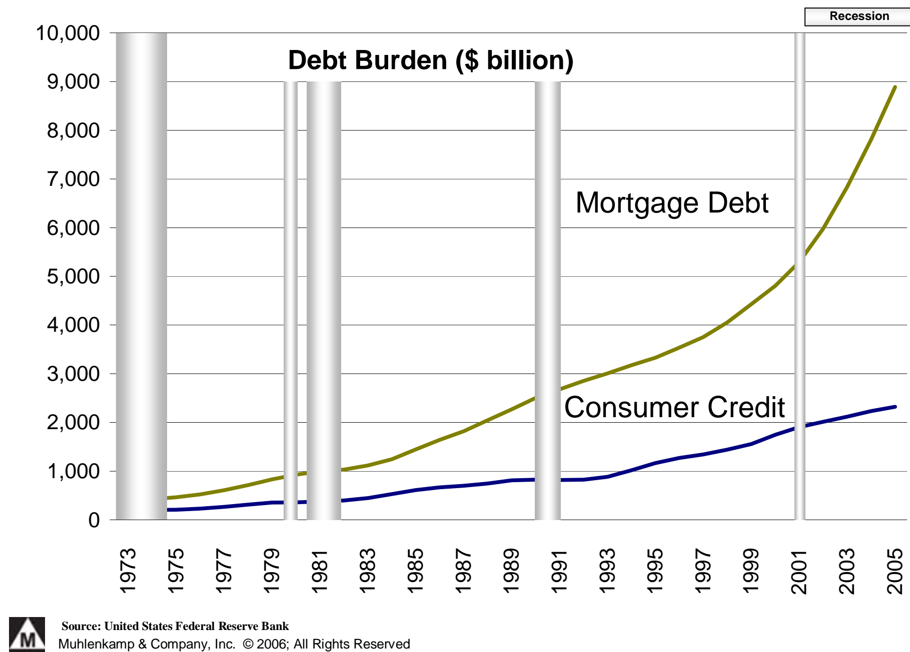
Just about everybody thinks the public is overextended. This graph shows **Household Debt to Disposable Personal Income**. Consumer credit has been stable and mortgage debt has gone up significantly, relative to income. But, we think that if you are going to talk about debt, you should talk about debt-to-assets. What's interesting, of course, is that the average family's assets are 5½ times their debt. In 1950, it was 4½ times their debt.

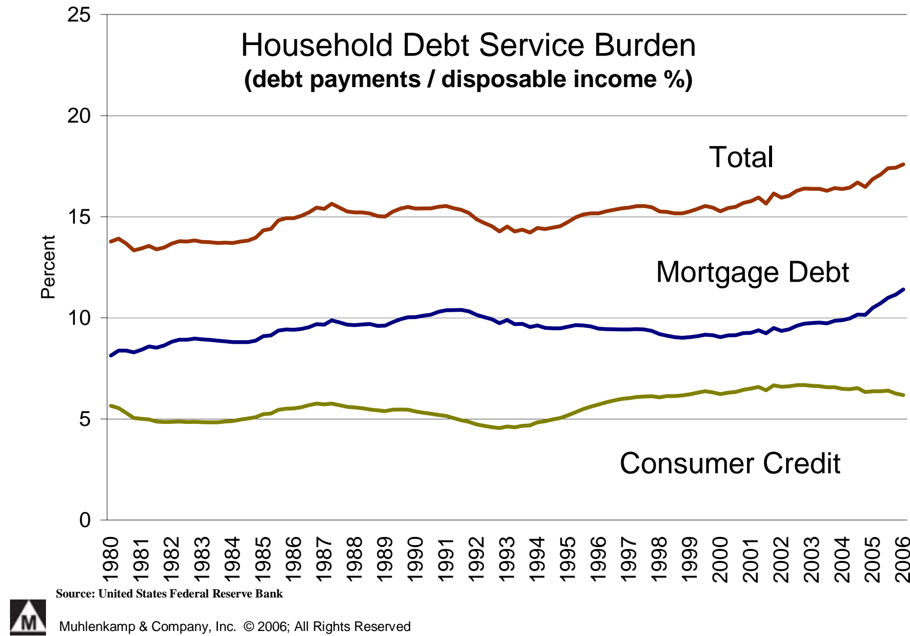
Following is a chart that features **Household Balance Sheet Details.** The point is: Our assets cover our debt (the bottom red line). The grey bars represent tangible assets, largely homes; yellow is deposits; blue is stocks; purple is pension funds. Let me repeat: our assets are 5½ times our debt – we have the assets to carry the debt!



Incidentally, who is likely to have more debt, a 60-year old or a 30-year old? Who is likely to have more income, a 60-year old or a 30-year old? Whose ratio is likely to be higher? Who is likely to have more assets, relative to income, the 60-year old or the 30-year old? The 60-year old… right? Their income may double, but their assets grow even faster, from zip to a pretty sizable amount. So, if debt and assets track together, as we get older, we are more likely to have more debt to income because we have higher assets to income. And let's not forget, the American baby-boomers are gradually getting older.

What isn't on the following **Debt Burden** chart is the fact that rates are half of what they were 20 years ago. You can carry twice as much mortgage at a 6% rate as you could at a 13% rate.

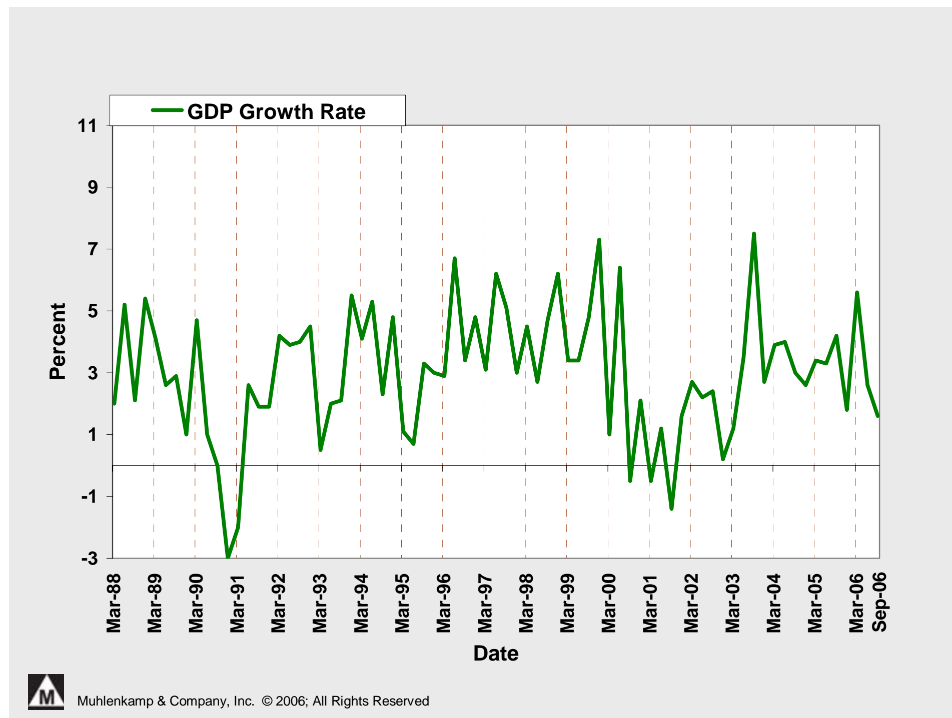




The above chart displays **Household Debt Service Burden since 1980.** When we look at debt payments to disposable income, our service burden total has ticked up a little bit in the past five years, but it has pretty much been between 14%-18% since 1980. The point is our debt-service-to-income ratio is not much worse than it has been for the last 25 years!

Recently, debt has gone up because mortgage rates have gone down. Folks, when mortgage rates went from 8% down to 6%, you could bid more for the house. Nobody really cares what they pay for a house -- they care what their monthly payment is. So, when rates went from 8% to 6%, house prices kicked up and people carried more debt as mortgage rates came down. We said a year ago, "That's over." There were some neighborhoods where some people thought it was a trend and, due to speculation, it got ahead of itself. Do you remember all through the 1980s, when people worried about the debt? We came through in decent shape. Today, a whole lot of people are worried about the debt, but we think it's in decent shape.

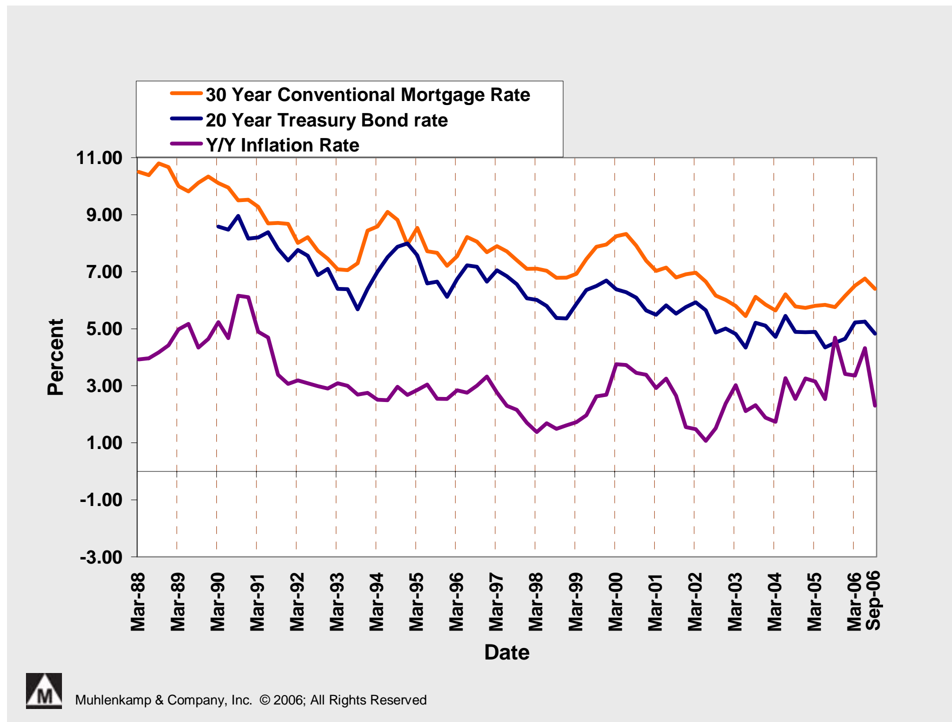
What's Happening Lately?



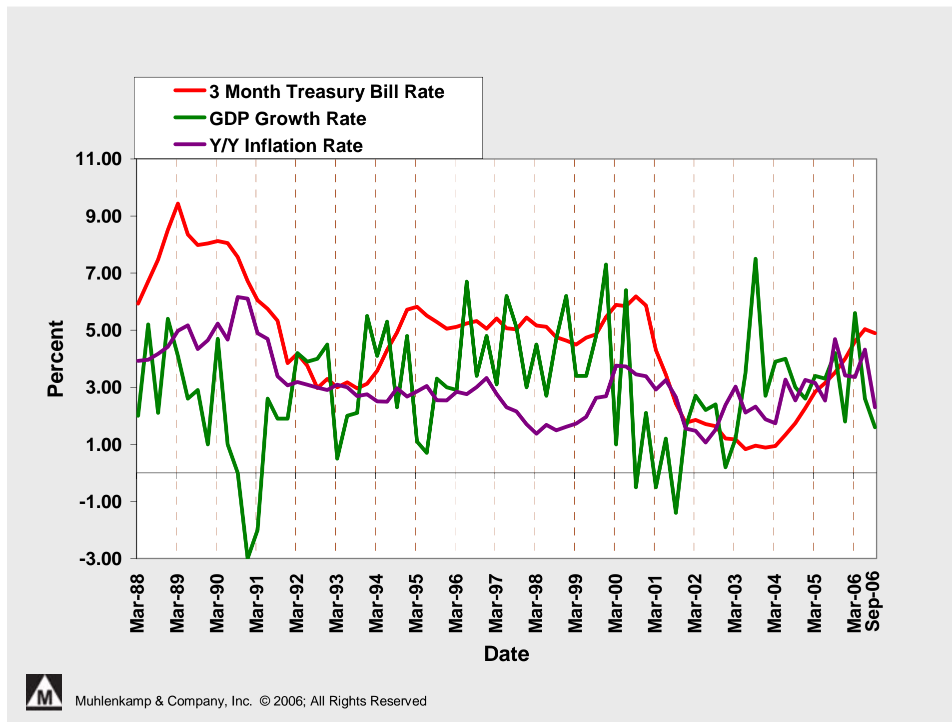
The above plot shows **GDP Growth Rate since 1988**. The first thing you notice is, quarter-to-quarter, the growth rate of GDP (Gross Domestic Product) jumps around a lot. It's interesting to note that Alan Greenspan (former director of the Federal Reserve) slowed down the economy, on purpose, three times:

- The first time was 1990. We don't think we'll ever know if Greenspan could have gotten a soft landing. We think Saddam Hussein rolling into Kuwait gave us a recession. Otherwise, we're not sure if we would have had a soft landing or not.
- In 1994-95, we had a slowdown (a soft landing).
- In 2000, Greenspan slowed things down on purpose and then, in 2001, 9/11 hit and that gave us a recession, which otherwise might have been a slowdown.

In late 2005, in the aftermath of Hurricane Katrina, GDP grew slowly. The rebound (and rebuilding) from Katrina, as witnessed in March '06, is about 5.2% GDP growth. We've been saying for a couple of years that you can't sustain the kinds of growth rates you get when rebounding from a recession; such numbers are in the 3%-4% range. We think, going forward, GDP growth will be in the 2½% - 3% range – and that's the transition we've been trying to warn about for the past year. The economy is transitioning from fairly rapid growth, to somewhat less rapid growth, but, we don't think there's going to be a recession. A lot of people do -- but we're betting on a soft landing.



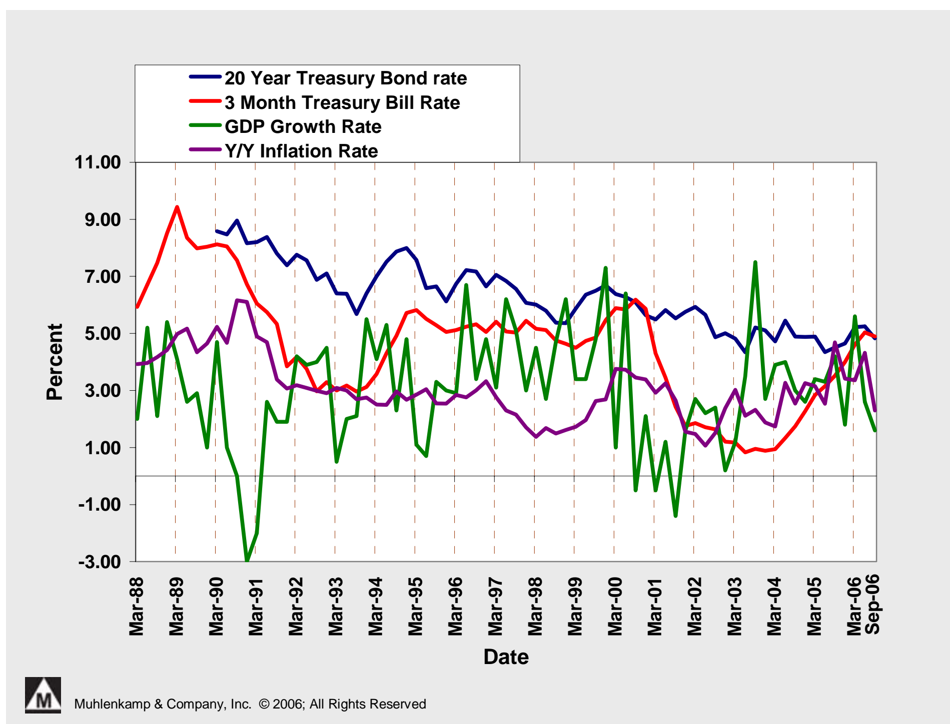
Circling back… Once again, take a look at the bottom line [purple] in the above plot; inflation, going back to 1988. The two top lines are Treasury bond rates and 30-year conventional mortgages. It's interesting to note that Treasuries and mortgages track together, so you can almost use one instead of the other. And here's the point: for the past nine years, inflation has been 2%-3%, while interest rates trended down to fair levels over the last four years and have pretty much flattened.



What does the Federal Reserve do for us? When inflation (the purple line) was ticking up in the late-1980s, they ran interest rates up to 9% (the red line), and that gave us a recession *and* drove inflation down. When

inflation ticked up just a little bit in 1994-95, they drove rates up to 6% and we ended up with a soft landing. Once again, the Fed drove rates up to 6%, but with the help of 9/11/01, we had a recession. In the aftermath of 9/11/01, rates were driven unusually low by the Fed; 1%. (As previously mentioned, it was as much a political reason as it was economic.) In the last two years, the Fed drove rates from 1% to 5¼%. And, in the last couple of quarters, as GDP came down and as inflation has come down, the Fed has paused.

We said in *Muhlenkamp Memorandum #80*, (our recent newsletter), that since the Spring of 2006, long-term rates have gone from 5.4% to 4.7%; so long-term rates have broken. Commodity prices, including energy, have broken…oil has gone from $75 to $60 [per barrel]. You saw the price of gasoline drop fifty cents in two weeks, right? Incidentally, gasoline doesn't drop fifty cents in two weeks because supply and demand changed that much. There were a whole lot of folks playing energy futures. You may have heard of Amaranth, a hedge fund, which lost $5 billion in two weeks because they were leveraged in energy futures. We were hearing last Spring that in commodities, particularly in metals, there were more financial buyers of contracts than there were user buyers of contracts! Folks, Caterpillar's orders for steel don't fluctuate a lot. Our individual buying of gasoline doesn't fluctuate a lot. But, there are a lot of hedge funds buying and selling futures -- and their buying and selling *does* fluctuate a lot. So, we think there's going to continue to be a lot of whippy price action in a lot of things because there are so many people and so much money chasing this stuff! As a result, in the short-term, things are going to remain volatile. In the intermediate, we are in a soft landing. Inflation is coming down, and we think the Fed is done with raising rates – that's new since Spring -- which is why we're talking about the end of the transition.



Here's additional proof. This plot shows that GDP growth is slowing down; inflation is slowing down; short-term rates are back to normal; and long-term rates have been normal.

Anybody worried about the inverted yield curve? When the Federal Reserve raises short rates and they get above long rates, it's called an inverted yield curve. Generally, when the Fed raises rates on purpose, it usually presages a slowdown, or recession. What's happened this year, however, is that long rates have fallen through short rates (an inverted yield curve) because the bond market has concluded that inflation is not going to get out of hand. Incidentally, that's not at all unusual. It happened in 2000 and it happened back in 1990. Remember, folks, long rates are *market* rates; changes happen quicker than with short rates which are engineered by the Fed.

To repeat, we believe we are probably at the bottom of a soft landing and, going forward from here, the economy will continue to grow at a reasonable rate on the order of 2½%-3%.

Personal Consumption Expenditures (PCE): 1950-2005

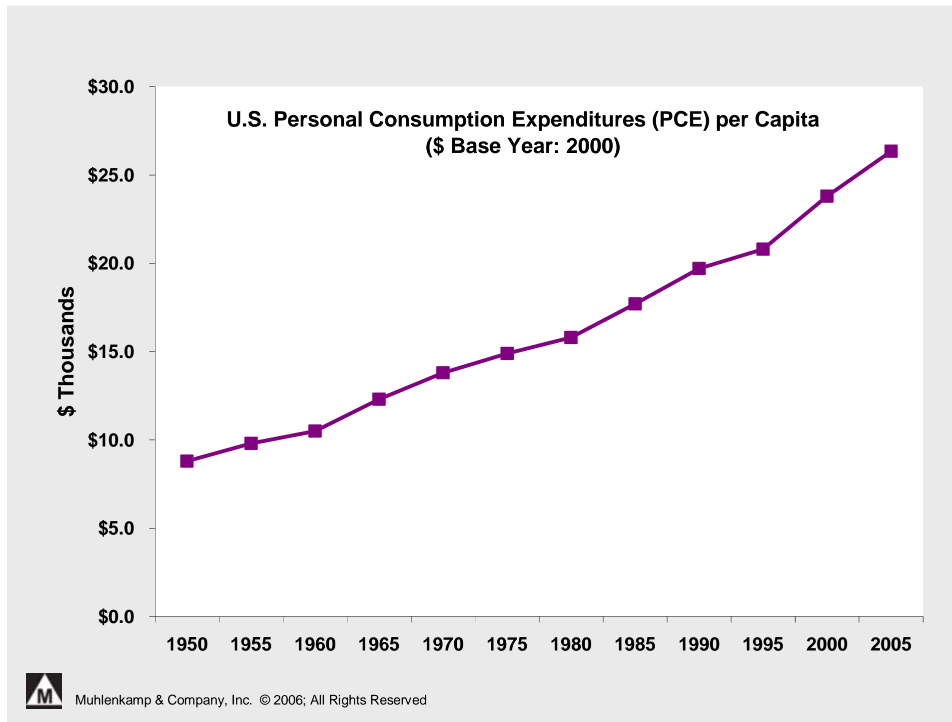
	1950	1955	1960	1965	1970	1975	1980	1985	1990	1995	2000	2005
Total PCE (Billions of Current $)	**$ 192.70**	**$ 259.00**	**$ 332.30**	**$ 444.30**	**$ 648.90**	**$ 1,030.30**	**$ 1,762.90**	**$ 2,712.60**	**$ 3,831.50**	**$ 4,969.00**	**$ 6,683.70**	**8,745.70**
Total PCE (Billions of 2000 $)	$1,336	$1,616	$1,876	$2,354	$2,798	$3,200	$3,576	$4,209	$4,907	$5,523	$6,684	$7,792
U.S. Population (Millions)	151	165	179	191	203	215	227	238	249	265	281	296
PCE per Capita (Thousands of 2000 $)	$8.8	$9.8	$10.5	$12.3	$13.8	$14.9	$15.8	$17.7	$19.7	$20.8	$23.8	$26.3
Consumer Spending (as % of PCE)												
Durable goods	**15.9%**	**15.0%**	**13.0%**	**14.2%**	**13.1%**	**13.0%**	**12.2%**	**13.4%**	**12.2%**	**11.9%**	**12.0%**	**11.7%**
Motor vehicles and parts	7.1%	6.8%	5.9%	6.7%	5.5%	5.3%	4.9%	6.5%	5.4%	5.0%	5.0%	5.1%
Furniture and household equipment	7.1%	6.3%	5.4%	5.6%	5.5%	5.3%	4.9%	4.7%	4.5%	4.5%	4.6%	4.3%
Other	1.7%	1.8%	1.7%	1.8%	2.1%	2.3%	2.3%	2.2%	2.3%	2.3%	2.4%	2.4%
Nondurable goods	**51.0%**	**48.1%**	**46.0%**	**43.1%**	**41.9%**	**40.8%**	**39.5%**	**34.2%**	**32.5%**	**30.1%**	**29.5%**	**29.3%**
Food	28.0%	26.5%	24.8%	22.7%	22.2%	21.7%	20.2%	17.2%	16.6%	15.2%	14.3%	13.9%
Clothing and shoes	10.2%	9.0%	8.1%	7.7%	7.4%	6.9%	6.1%	5.6%	5.3%	5.0%	4.7%	3.9%
Gasoline and oil	2.9%	3.3%	3.6%	3.3%	3.4%	3.9%	4.9%	3.6%	2.8%	2.3%	2.5%	3.3%
Fuel oil and coal	1.8%	1.5%	1.1%	1.0%	0.7%	0.8%	0.9%	0.5%	0.3%	0.3%	0.3%	0.3%
Other	8.2%	7.9%	8.3%	8.5%	8.3%	7.6%	7.4%	7.3%	7.4%	7.4%	7.8%	7.9%
Services	**33.1%**	**36.8%**	**41.0%**	**42.7%**	**45.0%**	**46.2%**	**48.4%**	**52.4%**	**55.3%**	**58.0%**	**58.5%**	**58.9%**
Housing	11.3%	13.3%	14.5%	14.7%	14.5%	14.3%	14.5%	15.0%	15.3%	14.9%	14.4%	14.7%
Household operation	4.9%	5.5%	6.1%	6.0%	5.8%	6.2%	6.5%	6.7%	5.9%	6.0%	5.8%	5.5%
Transportation	3.2%	3.3%	3.4%	3.3%	3.7%	3.5%	3.7%	3.7%	3.7%	4.0%	4.0%	3.7%
Medical care	3.7%	4.4%	5.3%	6.3%	7.8%	9.1%	10.3%	11.9%	14.1%	15.7%	14.8%	17.3%
Recreation	2.0%	2.0%	2.1%	2.2%	2.3%	2.5%	2.4%	2.8%	3.2%	3.5%	3.8%	4.1%
Personal Business	3.4%	3.9%	4.4%	4.7%	5.0%	5.2%	5.9%	6.9%	7.4%	8.2%	9.5%	7.5%
Other	4.5%	4.6%	5.2%	5.6%	5.9%	5.5%	5.2%	5.4%	5.7%	5.7%	6.2%	6.3%
Government Receipts from Social Insurance* (% of PCE)	**2.9%**	**3.5%**	**4.9%**	**5.3%**	**7.2%**	**8.7%**	**9.4%**	**10.4%**	**10.7%**	**10.7%**	**10.5%**	**9.9%**

* This percentage is based on the total dollars contributed to the Government by employers and employees for: Social Security; Medical Insurance; Unemployment; Worker's Compensation; etc. For more information, visit the web site Bureau of Economic Analysis: www.bea.gov. This data was taken from the following table: Table 2.3.5. *Personal Consumption Expenditures by Major Type of Product.*

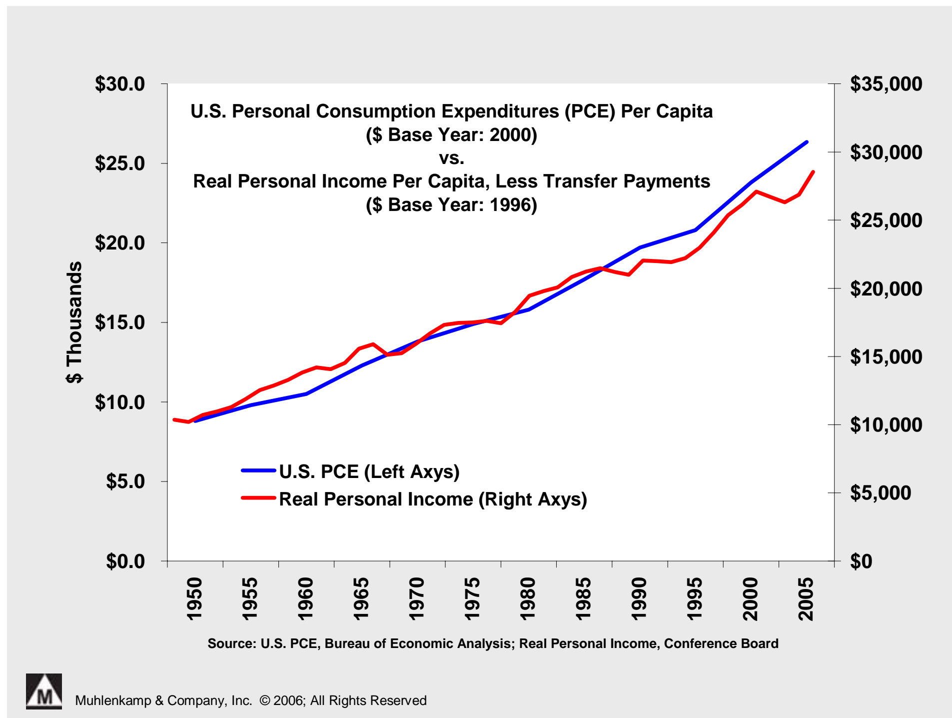
Source: U.S. Bureau of Economic Analysis: www.bea.gov

I've been carrying the above table in my briefcase for several years. Taken directly from the U.S. Bureau of Economic Analysis, the most recent edition lists **Personal Consumption Expenditures (PCE) since 1950.** It then breaks down overall spending as a percentage of the total for broad categories of spending. We've added three lines near the top of the table:

- First, we adjusted the PCE for inflation, bringing all numbers to year 2000 dollar values.
- Next, we listed the U.S. population for each year.
- Finally, we calculated the PCE per capita.

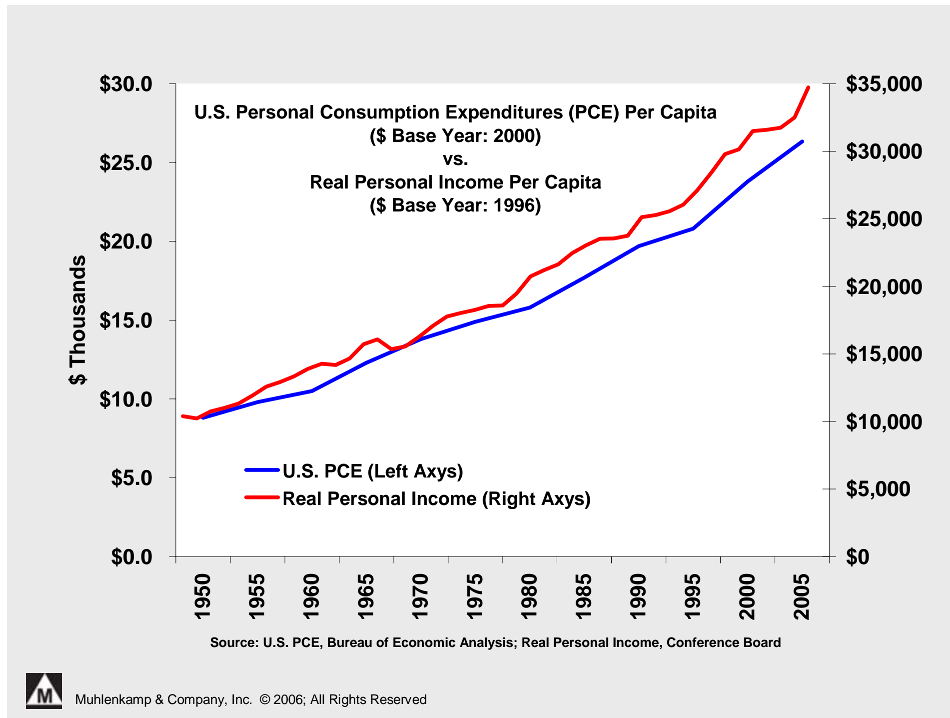


Folks, this plot says we are three times as prosperous as our grandparents were in 1950. When you examine it more thoughtfully, it shows that when things slowed down a little bit, Kennedy cut tax rates. Once more, when things slowed down a little bit, Reagan cut tax rates. And, again, when things slowed down a little bit, Bush cut tax rates. The gist of all this is that we are three times as prosperous. Some folks, say, "That's *spending*, not income." So, let's go one step farther…



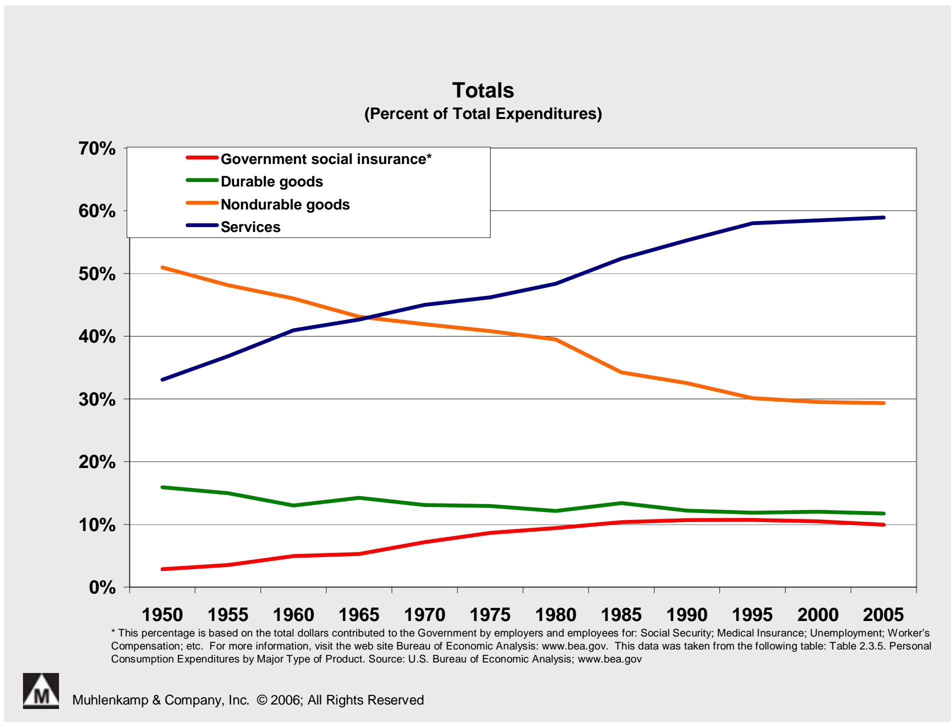
The plot above presents both **Personal Consumption Expenditures vs. Real Personal Income, Less Transfer Payments;** (Transfer Payments are Medicare and Social Security.) Both lines track together until the late 1980s. The blue line shows

what people are spending. The red line shows income, but doesn't include Medicare and Social Security. Each of those categories amounts to about $300 billion a year.



After adding Medicare and Social Security back into the income line, it looks like the plot above, **Personal Consumption Expenditures vs. Real Personal Income.** People often look at these numbers and say that we are spending more than we are earning… And isn't that terrible? Spending more than we're earning… Isn't that called retirement? The reason we are spending more than we are earning is that a lot of us are retired. Further, we have the assets to support it. And when Social Security and Medicare are treated as income, we have the income to support it.

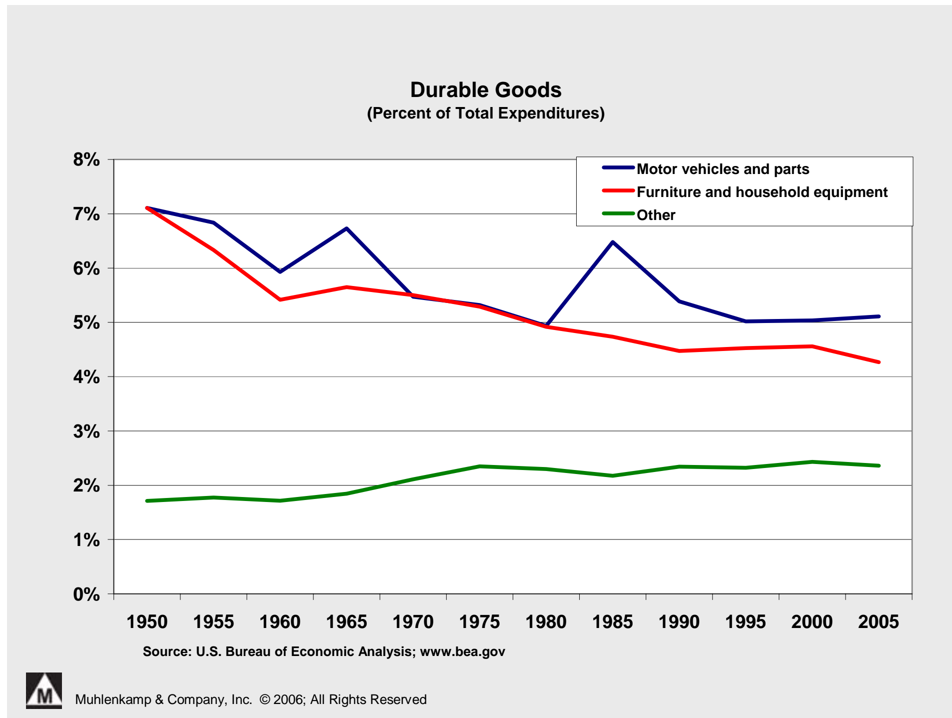
The big break point is the above plot is about 1970. Social Security and Medicare benefits really took off after 1970. The long and the short of it is it doesn't matter whether you talk about income or expenditures. We are three times as prosperous as our grandparents were.



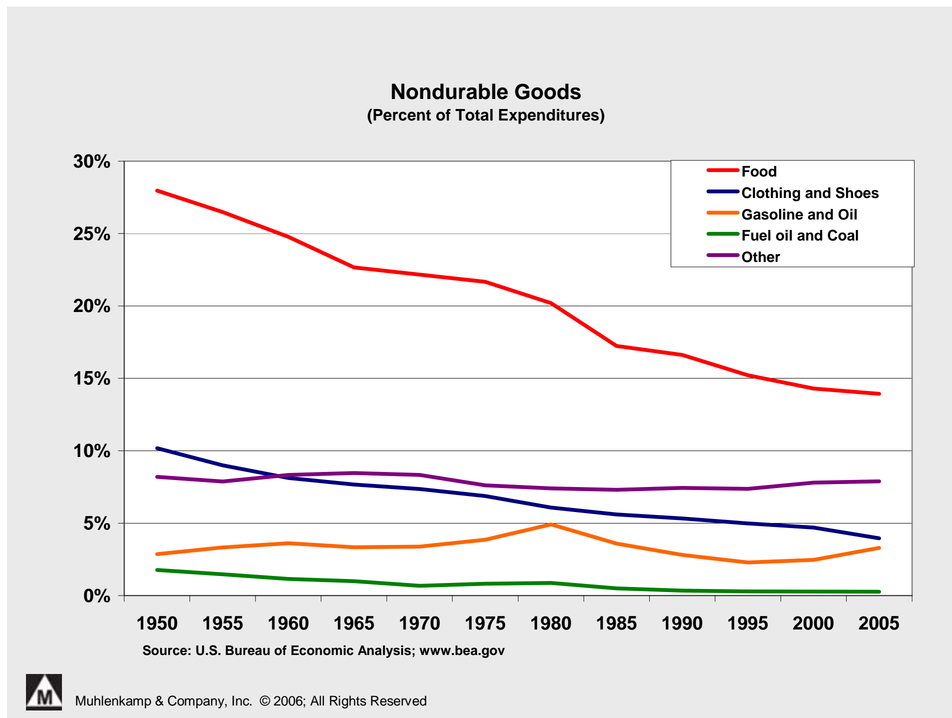
There have been some interesting shifts in the makeup of that spending (current versus grandparents). The previous plot displays the totals over a 55-year period:

- Government Social Insurance;
- Durable Goods;
- Nondurable Goods; and
- Services.

Let's break each of those down in turn…



Let me start with **Durable Goods** -- motor vehicles, parts, furniture and household equipment -- went from 7% to 5%. In 1950 the typical family had one car; today it has two cars. In fact, today, we have more cars and small trucks than we have people with driver's licenses! Furniture and household appliances went from 7% to 4%.

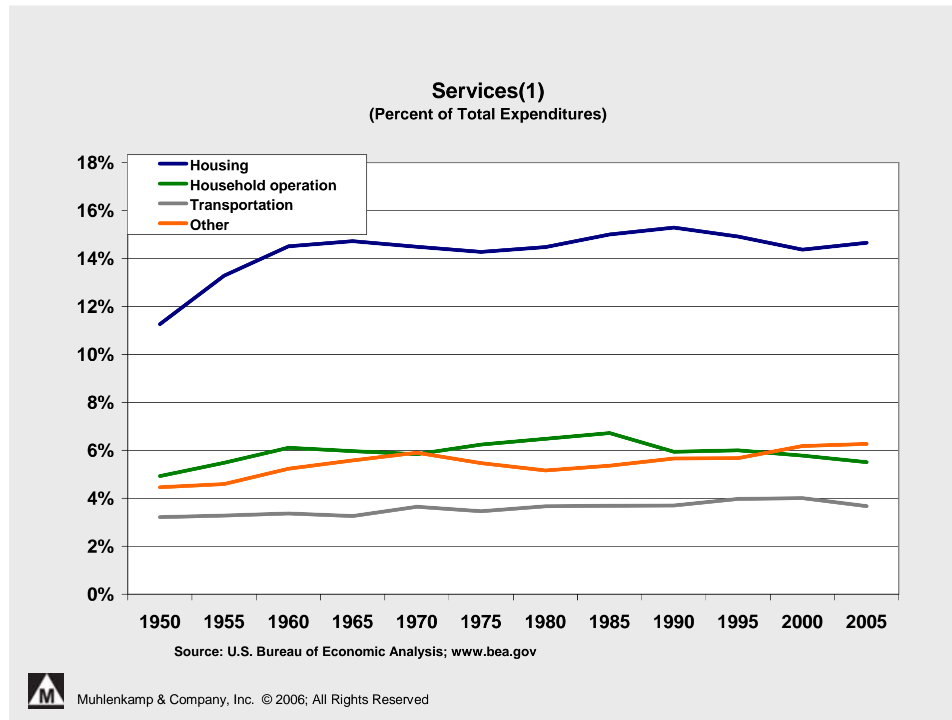


Nondurable Goods -- food, clothing and shoes, fuel. The percentage of consumer disposable income spent on food has been cut in half (28% to 14%) in the past 55 years, despite the fact that half the money we currently spend on food is outside the home and, therefore, includes preparation. To me, the interesting thing about food is, try as we might,

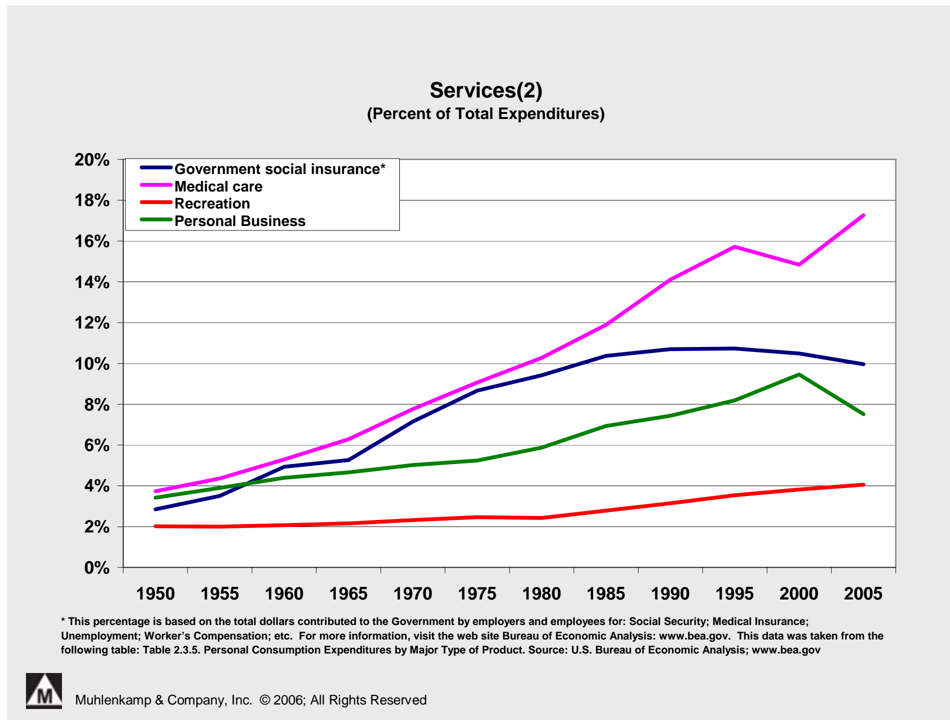
we can't consume much more of it per person than our grandparents did. So if we treat food as stable in its consumption, we are now twice as prosperous (relative to the amount spent on food) as our grandparents were.

The next line, clothing and shoes, also confirms this. Although we each have much more clothing than our grandparents had, (for a rough measure, check the closet space in a new house versus an old house), the amount we spend on clothing as a percentage of our income has also been cut from 10% to 4%.

The sum of those two, what used to be 38%, is now 18% of our budget. That is 20% of our budget available to us that wasn't available to our grandparents!



In **Services**, housing went from 12% to 14½%, and has been flat for 40 years. But folks, in the 1950s the average house was about 850-900 square feet. By 1960, it was about 1,100 square feet. The average new house, today, is over two 2,000 square feet. So our houses are three times the size, even though our families are smaller. We aren't buying the houses we need, in any real sense. We are buying what we *want* and can pay for.



Four items in the family budget have grown dramatically over the past 55 years – all **Service** items.

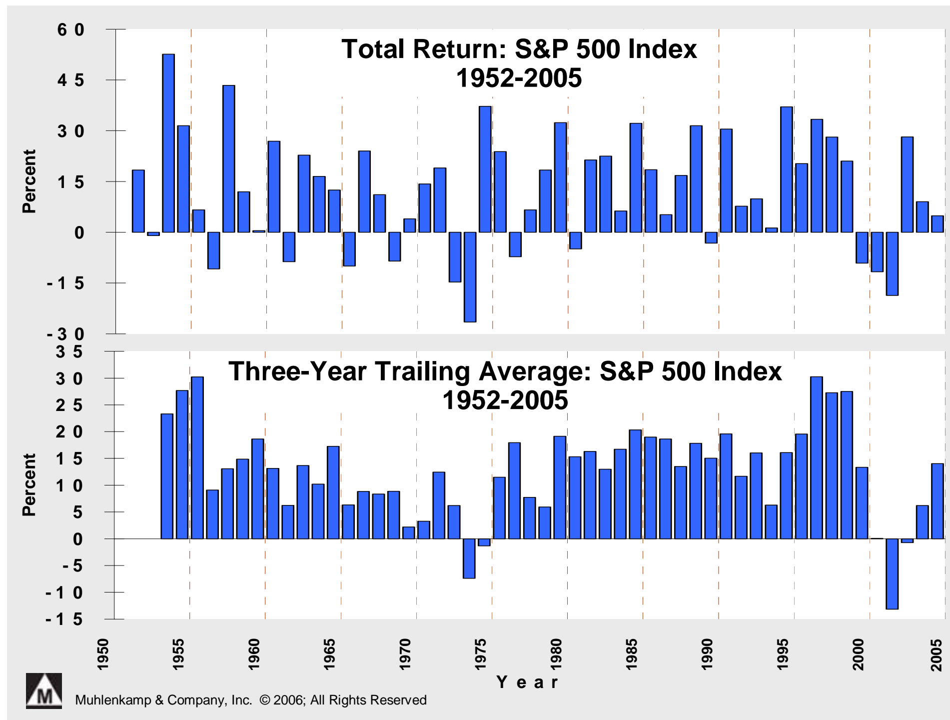
Let's first address Medical Care, which has grown from 4% to 17%. Folks, the dip you see from ten years ago was caused by the HMO effect, which worked for a little while. The fact that medical care has grown doesn't surprise anybody, but the degree of growth often does. You and I can argue about how much of health care is discretionary. My grandfather was lame because a rooster pecked him in the knee. My guess is that there was a little bit of cartilage floating around; today, it would be about three minutes of arthroscopic surgery. Frankly, all knee and hip replacements are discretionary. It depends on whether you can get them paid for, or not. How many folks do you know that, as adults, got their teeth straightened? Why didn't they do it when they were 18? I think most of the people who get their teeth straightened as adults, is because they now have the money.

Now, let's look at Government Social Insurance. In 1960, the Social Security tax was 3% (paid by the employee), matched by 3% (paid the employer). Today, it is 6% plus 6%.

Recreation went from 2% to 5%, which helps explain why Las Vegas is the fastest-growing city in the country. Is there anything we need in Las Vegas? Las Vegas is a pretty good proxy for how prosperous we are.

The fourth item is Personal Business, which is primarily personal financial business – think stockbrokers and mutual funds growing on a base of banks and insurance companies. We think that some of the money that went into investments and investment-related services back in 2000, has gone into housing during the last few years, for reasons that aren't too hard to figure out.

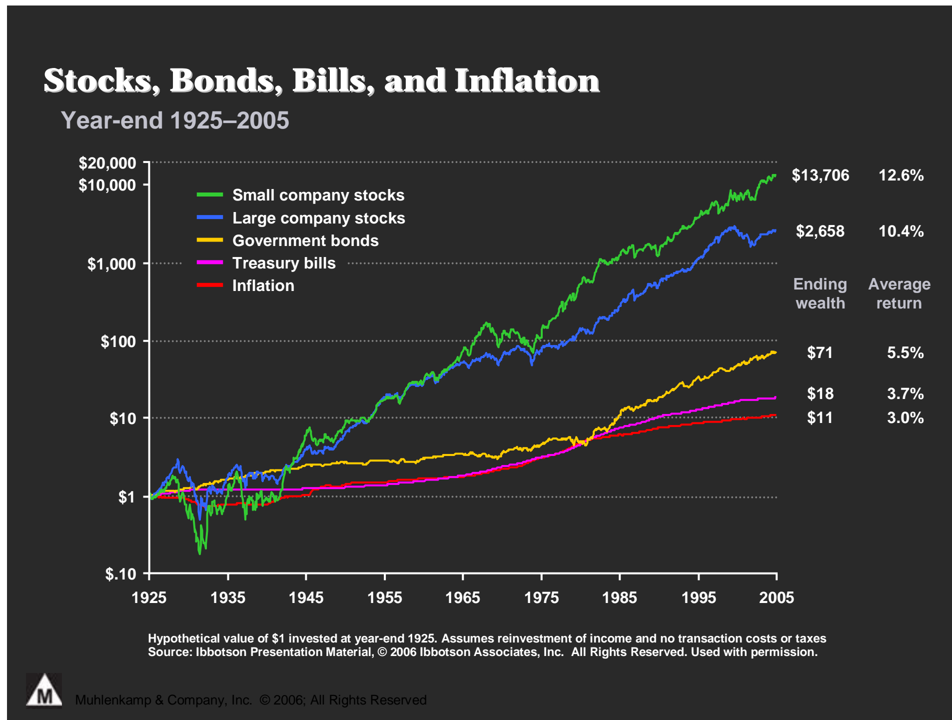
Here's the bottom line: As long as people are working, they are generating a lot of discretionary funds. What's interesting to us is to see where they spend those dollars. As investors, we have a bias toward those areas where the long-term trends are up. It's my observation that if people are going to change what they are spending on, it tends to occur across a recession. Frankly, we did not anticipate, in the last year, how quickly people cut back on buying new houses -- and it's hurt us. For the last five years, it has been a great ride. And for the last six months, it has hurt us. We don't think that people will quit buying houses; we think they will pause for a little while, while it sorts itself out. But, the long and the short of it is, as long as people are working and earning, we think this economy is in pretty good shape. That's our big picture, long-term, point of view.



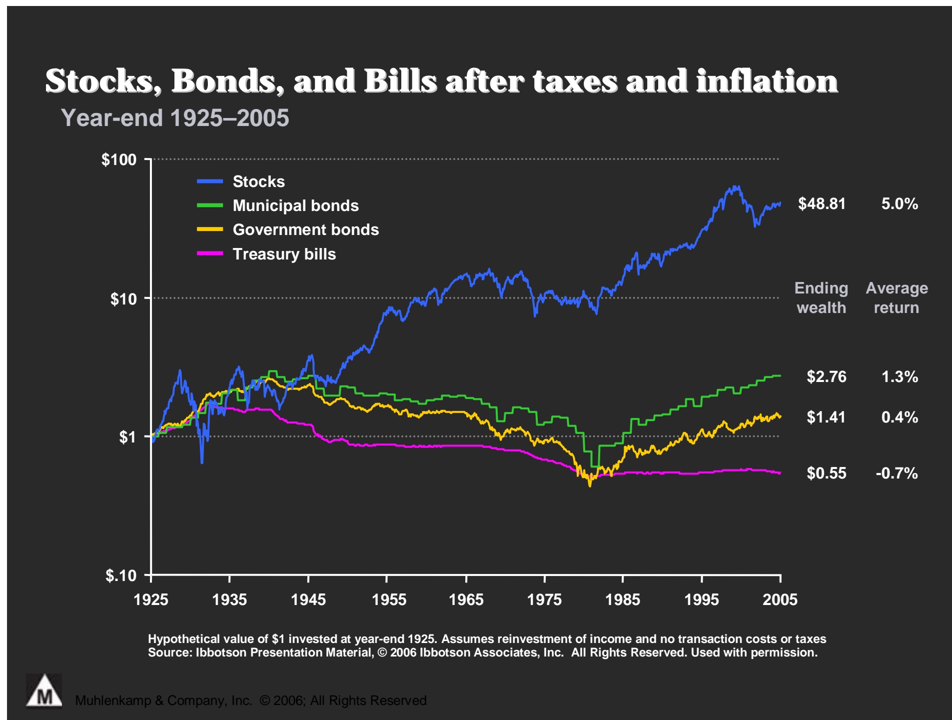
Let's now turn our attention to the intermediate picture, which looks a whole lot like the business cycle. To us, the intermediate picture (the business cycle) looks most like the period between 1994-95which was a soft landing. Back in the 1960s and 1970s, most recessions were about four years apart. In the 1980s and 1990s, we went about ten years between recessions.

I learned this past year that when the economy is in a soft landing, the markets act like it's a recession -- even if the economy doesn't. And, sure enough, what we saw happen this year was a major transition, after Spring, between aggressive stocks and defensive stocks. If I'm right on the soft landing, then, we are about to see some of that defensive premium dissipate.

Again, in the long-term picture it is hard to find most of the things we worry about on a day-to-day basis…



…And, on an after-tax and an after-inflation basis, it's even more so…



Available Returns (%)

	Nominal	After-Tax	Real After-Tax
Short-Term Debt	4.5	2.9	0.9
Long-Term Debt	5	3.2	1.2
Equity	8	6.8	4.8

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Today, we think your choices are:

- Short-Term Debt and / or Long-Term Debt -- On either, you can get 5%, in which case you probably pay 30%-35% in taxes, and keep 3%. If we're right about inflation at 2%, you net 1%.
- Stocks are priced to do 8%-9%. If you hold the investment long enough, it is taxed at 15% (long-term capital gains) instead of 35% (income), so you keep 6.8%. Again, if inflation is 2%, you get to keep 4.8%.

What's interesting to note is that in the last 80 years, bonds, on average, have returned 1% (real, after-tax); stocks have returned 5% (real, after-tax). The difference between 1% and 5% can make you an awful lot of money over a period of time.

To Summarize:

Summary
Big Picture

1) Inflation has been contained.
2) Bank balance sheets are healthy.
3) Corporate balance sheets are healthy.
4) The consumer is in good shape, much better than reported.

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Summary
Business Cycle

1) The transition period is coming to an end.
2) Odds of a soft landing are > 50% and rising.
3) Long-term interest rates rolled over in May and have since declined by over 50 basis points (1/2 percent).
4) The Fed has "paused," leaving short-term rates at 5¼% through their past three meetings.
5) The price of crude oil has declined 15-20%, allowing the price of gasoline to fall roughly $.50/gallon.
6) A number of other commodity prices have also declined.
7) Mortgage rates have followed long-term interest rates downward.

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Summary

Short-Term

1) Market leadership has shifted from inflation beneficiaries (like commodities) to recession leaders (like food and utilities).
2) Volatility remains.

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Folks, that's what we came to talk about. We are happy to entertain any questions.

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

The S&P 500 Index is a widely recognized, unmanaged index of common stock prices.

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

Cash Flow is often used by analysts to gauge financial performance. Companies with ample cash on hand are able to invest the cash back into the business in order to generate more cash and profit.

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.

Any tax or legal information provided is merely a summary of our understanding and interpretation of some of the current income tax regulation and is not exhaustive. Investors must consult their tax advisor or legal counsel for advice and information concerning their particular situation.