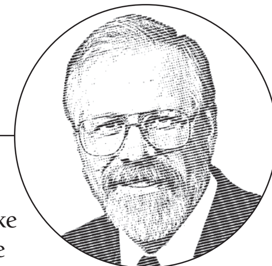
MuhlenkampMemorandum

Issue 106 | **Published Second Quarter** | **April 2013**

Quarterly Letter

By Ron Muhlenkamp



For two years or more, we've been discussing Europe, China, and U.S. politics as drivers for the financial markets. These drivers continue.

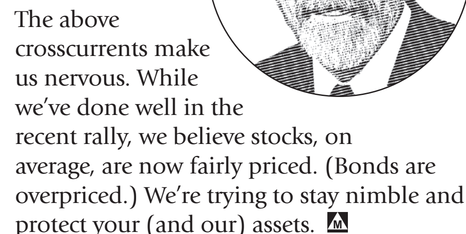
Europe has reentered recession. That was expected. But it was also expected that, by now, Europe would have found an approach to deal with its problems. It has failed to do so, both politically and financially. Elections have been inconclusive (Greece and Italy), and the responses to the recent banking problem in Cyprus (a tiny country) were more problematic than the banking problem itself. Rather than demonstrate that the central bankers had a plan to deal with the situation, they made matters worse.

China remains in transition. Its economy is expanding, but local leadership is resisting Beijing's efforts to redirect the economy to greater domestic consumption. We think it's on track, but will take a while.

In the U.S, the consumer seems to be gradually coming back. Sales growth remains modest, but now includes a pickup in housing and autos. It appears that the increase in FICA taxes (from 4.2% to 6.2% effective 1/1/13) is coming out of savings—not spending—though, in truth, it's a bit early yet.

Employers remain cautious. For years, businessmen have been reluctant to invest or to hire, waiting for clarification of the rules. The rules are becoming clear: it will be increasingly expensive to hire people. (So far, the regulations spawned by the ACA (Affordable Care Act—Obamacare) form a stack of paper seven feet high.) As a result, we expect that hiring will remain subdued (and for less than 30 hours per week), but it may result in a pickup in corporate investment.

The clarification of the rules and continued Federal Reserve buying of bonds and mortgages (currently at $85 billion per month) have helped drive stock prices to new highs. These factors are aided by a lack of good alternatives, either other countries (see above) or bonds (even bond managers are saying the bond bull market is over).



The above crosscurrents make us nervous. While we've done well in the recent rally, we believe stocks, on average, are now fairly priced. (Bonds are overpriced.) We're trying to stay nimble and protect your (and our) assets.

The comments made by Ron Muhlenkamp in this commentary are opinions and are not intended to be investment advice or a forecast of future events.

Announcements

2013 IRA Contributions

Traditional and Roth IRA contribution limits for 2013 are the lesser of $5,500 ($6,500 if you are 50 or older), or 100% of your earned income.

Traditional IRA
Individuals filing as single or head of household who are covered by a retirement plan at work may deduct contributions to a Traditional IRA:

- Fully—if their Modified Adjusted Gross Income (MAGI) is less than $59,000; ($95,000 if filing a joint return); or
- Partially—if their MAGI is between $59,000 and $69,000; ($95,000 and $115,000, if filing a joint return).

Individuals filing as single or head of household who are covered by a retirement plan at work with a MAGI of $69,000 or more ($115,000 or more if filing a joint return) cannot deduct contributions to a Traditional IRA.

Individuals either living with a spouse or filing a joint return who are not covered by a retirement plan at work— but whose spouse is—can deduct contributions to a Traditional IRA:

- Fully—if their MAGI is less than $178,000; or
- Partially—if their MAGI is between $178,000 and $188,000.

Individuals either living with a spouse or filing a joint return who are not covered by a retirement plan at work—but whose spouse is—with a MAGI of $188,000 or more cannot deduct contributions to a Traditional IRA.

Reminder: If you or your spouse have earned income, you can always contribute to a Traditional IRA, even if you cannot deduct the contribution.

Roth IRA
Individuals filing as single or head of household may fund a Roth IRA:

- Fully—if their MAGI is less than $112,000; ($178,000 if filing a joint return); or
- Partially—if their MAGI is between $112,000 and $127,000; ($178,000 and $188,000, if filing a joint return).

Individuals filing as single or head of household with a MAGI of $127,000 or more ($188,000 or more, if filing a joint return) cannot make a Roth IRA contribution.

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Muhlenkamp & Company, Inc.
Intelligent Investment Management

Conversations with Clients

Following are some recent questions our Client Service representatives have received from shareholders; responses are provided by Ron Muhlenkamp. If you should have any questions or comments, please don't hesitate to contact us at (877) 935-5520 extension 4.

NOTE: A fine opportunity to learn more about what's taking place with the portfolio is by attending the upcoming investment seminar on Tuesday, May 21; 2:00 pm and 7:00 pm ET webcasts are available. To register, please visit our website at www.muhlenkamp.com, or contact a Client Service representative.

Ron stated he was looking for "clarification" on the direction of the U.S. coming out of the November elections. Has he found it five months later?

We now have clarification: we're going to have more of the same. In our opinion, we've elected slow growth and high unemployment.

We've upped taxes to some extent. We've raised income taxes on higher income earners and the consumer/employee has been hit with Social Security (FICA) taxes going back to 6.2% from 4.2% the last two years. While the Republican House believes the rules on taxes have been clarified, President Obama suggests otherwise. So the rules haven't really been clarified—it's a matter of waiting until the next round of negotiations. President Obama says we don't have a spending problem. We certainly have a spending problem. What the politicians will always do—what governmental institutions will always do—is try to extend the existing trend as long as possible. And the existing trend for the last 30 years has been increased government spending. It hit overdrive since 2000, and has accelerated since 2008.

We'll likely be on this track until something serious hits the fan—and, one of these days, it will. But as long as Europe's in recession and Japan's in recession, there will be a focus on putting your money in the U.S.

"…Slow growth and high unemployment." Can you elaborate on the state of the U.S. economy?

If you look at consumer confidence, we're told that it's higher than it's been in four or five years. That is, in fact, true—but it's still at levels that are typical of a recession. While we think consumer fear is dissipating (e.g. those who haven't lost their job are losing the fear that they're going to), consumer spending continues to grow at a modest rate: approximately 2 percent. We haven't recovered the 5% decline from trend in consumer spending that we saw back in 2008. Remember, (September) 2008 was over four years ago—that's almost what used to be a business cycle. Folks, we've been on a slow expansion without a catch-up.

Auto sales are almost back to what we would consider normal. Housing appears to have turned—house prices have strengthened a bit. It seems we're caught between not having solved the fiscal problems and consumers acting as if they are losing their fear; (i.e. the problems are not going to get worse).

Businesses, in the meantime, are still cautious. The Federal Reserve (Fed) has put a whole lot of money into the marketplace buying Treasuries and mortgages. A lot of the money is simply sitting in the banks. Recently, however, we're seeing the beginning of a pickup in commercial and industrial loans. Businesses are becoming a little bit more willing to borrow, and banks are becoming a little more willing to lend. In all respects, that is good, but we still see a major caution among businessmen; e.g. their tax rates are going up; they're quite certain their regulations are going up; and, of course, their healthcare costs will continue to go up.

By the way, if commercial and industrial loans pick up as they appear to be doing, that gives the potential for the velocity (turnover) of money to pick up, and that means we can get a little more growth than 1 or 2 percent. If it's more than that, the Fed is going to have to start sopping up the extra money it has put into the system sooner than it now expects, but the political pressures will be on keeping interest rates low. The assumption is that low interest rates help the economy. Well, low interest rates are killing the incomes of retirees and they're killing pension funds.

The last time we worried about a really weak economy, there were far fewer retirees and a lot less money in pension funds. The economists should be latching onto this; Bernanke has mentioned it, but dismissed it. If you're a retiree and you're trying to live on your current interest, it gets tough. If you're 55 and trying to build assets for retirement, it's tough. Ask any pension fund: pension funds still carry a 7%-8% return assumption—which hasn't been available and it's not likely to be there anytime soon.

In sum, while we see consumers losing their fear, businessmen are still pretty cautious—all of which makes it pretty tricky from an investment standpoint. If I had to bet—and I do have to bet to some extent—we don't yet see enough drag on the U.S. economy to kick us back into recession, but we do see drag from the increase in taxes.

Without knowing the rules, companies have been reluctant to hire or invest and have continued their focus on cost control. They've "managed for cash," and some companies have raised their dividends and/or repurchased their stocks. The combination means that earnings have grown faster than (modest) revenues.

For more on Ron's thoughts about unemployment, please refer to *When We Change the Rules A Little*… included in this newsletter on page 4.

As the U.S. economy experiences slow growth, how can stock prices do well?

Low interest rates encourage people who manage hedge funds to borrow and to buy securities, commodities, and other financial instruments—which, in fact, the Federal

Reserve is encouraging. The Fed wants to get the stock market up. Remember, you can lift the stock market for a period of time by feeding it money, but, sooner or later, it responds to the underlying values of the companies represented by the stock.

We're all taught that the markets lead the economy by six months. I concluded about 40 years ago that both the economy and the cyclical parts of the market respond when the Fed squeezes interest rates or prints money—and I believe that the markets respond much quicker than the economy does. I have always tracked the Fed and, when the Fed made changes, acted accordingly. The economy would catch up six months or so later. This time around, in '05, '06, '07, and '08, the Fed—while it didn't technically lose control of the money supply—lost control of the velocity (turnover) of money and the "shadow banking" system.

Lesson learned: By all means, consider what's taken place before, but don't rely on history repeating itself. With a pickup in the velocity of money, we may see inflation increase if the Fed doesn't take steps to sop up some of the money it placed in banks through its continued quantitative easing.

Unless we start getting our fiscal act together and the economy gets stronger, the fear becomes that if the market goes much higher, it gets above where it deserves to be.

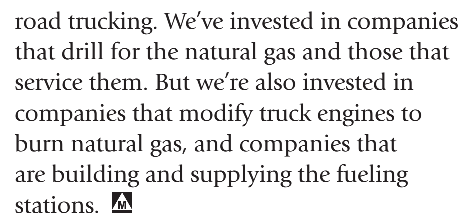
What are the factors contributing to the Muhlenkamp's recent performance?
We continue to have a focus on companies that we believe have rock-solid balance sheets and great cash flows—and aren't doing dumb things with the cash flows.

We think any place you can find a good balance sheet and see earnings growth of 10% or so, you'll probably do very well. We did very well last year in financials. We did very well in pharmaceutical companies. We did very well in U.S. auto retailers. There are opportunities, but you to have to tread lightly and fairly nimbly. We've been quicker to sell than we were in the past because we don't trust the underlying causes.

What are you doing to take advantage of the energy revolution in natural gas?
The area where we are finding the biggest value is between crude oil prices and natural gas prices. There are several ways to play that. The drilling for natural gas has backed off. People are moving toward crude.

Because natural gas got so cheap that it was cheaper than coal, there was a huge shift last year by utilities from burning coal to burning natural gas. The infrastructure (pipelines, plants, etc.) was already in place, so it was easy to change from burning coal to burning natural gas.

We think the next area of opportunity is in transportation, particularly over-the-road trucking. We've invested in companies that drill for the natural gas and those that service them. But we're also invested in companies that modify truck engines to burn natural gas, and companies that are building and supplying the fueling stations.



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Glossary
Cash Flow represents the cash a company is able to generate after paying out the money required to maintain or expand its business.

Book Value (BV) or "Book" equals total assets minus total liabilities. It is the owner's equity in the business, often quoted as Book Value/Share.

Mark Your Calendar

FPA (Financial Planners Association) NY

Tuesday, April 30, 2013
The Chase Conference Center at
1 Chase Manhattan Plaza
New York City, NY

Ron Muhlenkamp will participate in an Economic Panel with industry specialists.

The Las Vegas Money Show

May 13 - 16, 2013
Caesars Palace, Las Vegas, NV
Ron Muhlenkamp will deliver the following free workshops:

Tuesday, May 14, 9:15 a.m.–10:15 a.m.
The Market Drivers—U.S., Europe, and China: An Update

Tuesday, May 14, 5:45 p.m.–6:45 p.m.
Natural Gas: An Energy Game Changer

Please check the official "Show Schedule" for room location details. To register, please call (800)970-4355 or visit www.moneyshow.com.

Muhlenkamp & Company Investment Seminar

Tuesday, May 21, 2013
Regional Learning Alliance
850 Cranberry Woods Drive
Cranberry Township, PA 16066

The Big Squeeze: How taxes are squeezing your income; how interest rates are squeezing your assets

2:00 p.m. and 7:00 p.m. ET live sessions and webcasts

To register, please call our Client Service Department at (877) 935-5520 extension 4; RSVP by Thursday, May 16.

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When We Change the Rules A Little…

by Ron Muhlenkamp

One of our favorite maxims is, *"When we change the rules a little, we change the game a lot."* We find this maxim applies in many areas of life, from games—different versions of pinochle—to sports—no helmet contact—to economics.

We've maintained for the last three years that employers were reluctant to invest and hire because "no one knows what the rules are." This has been particularly true since the Patient Protection and Affordable Care Act (Obamacare) was enacted into law. Even after enactment, it was challenged legally before the Supreme Court, and politically in last year's election.

Frankly, I think the mindset in Washington discourages businesses from growing and hiring. For example, while it has since been removed, the Patient Protection and Affordable Care Act originally contained a provision that outlined 2012 tax guidelines for businesses. All businesses would need to issue a 1099 to any vendor to whom it paid $600. Think about that from a personal level. Suppose you had to report to the IRS every business with which you spent $600—every grocery store, every gas station, every utility, (cable TV, telephone, gas to heat the house…). Wouldn't that change what you do? Every plumber, every carpenter, and every electrician—people who hate bookkeeping—thought so, and demanded the proposed burden be removed!

The point being, government officials wouldn't dare do this to households because such legislation would also be thrown out! Somehow, however, businesses are treated differently than individuals—even though half of the commerce in this country is small businesses: hairdressers, barbers, plumbers, and electricians…

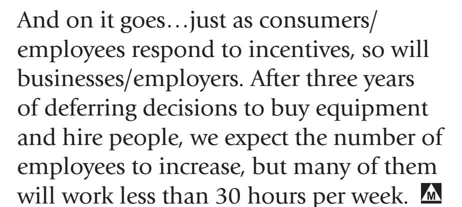
Meanwhile, the American consuming public, faced with higher unemployment and declines in market prices of both homes and equity investments in the 2007-09 recession, chose to save more and spend less. The resulting slow economic recovery (GDP growth of 2%-3% since 2009) allowed businesses to fill their needs primarily through gains in productivity. They've been able to postpone buying capital goods and hiring people. As a consequence, four years after the economy bottomed in 2009, neither capital spending nor employment has returned to the levels of 2007. Recently—particularly with the elections—the rules have been clarified. The net effect: it will be even more expensive to employ people.

After three years of deferring decisions to buy equipment and hire people, employers now see increased costs for hiring. As an employer, after each yearend, we issue a W-2 form to our employees showing the deductions that were taken from their gross pay. Years ago, I realized that my employees weren't aware of the amounts paid by the company (me) on their behalf. In particular, they were not aware of the amount paid for their health insurance which was growing faster than the other parts of their compensation. So we now provide the data shown on the following table:

As you can see, for my employee to take home $37k, it costs me $70k—or $82k, if I am able to fund profit sharing to the maximum. The new rules will add complexity and costs to employing people.

Under the new rules, some regulations kick in at the 50-employee level; other regulations apply to employees who work over 30 hours per week, but not to employees who work less than 30 hours per week. And, of course, regulations chew up time for both the consumer/employee and the business/employer. Have you noticed that government, at all levels, is willing to waste our time?

And on it goes…just as consumers/employees respond to incentives, so will businesses/employers. After three years of deferring decisions to buy equipment and hire people, we expect the number of employees to increase, but many of them will work less than 30 hours per week.



Employment Costs 2013 (W-2 Filing: Married, Two Children)

Employee's Deductions		Employer's Costs	
Gross Wage	$ 45,000.00	Gross Wage	$ 45,000.00
FICA • Social Security (6.2%) • Medicare (1.45%)	$ 3,442.50	FICA • Social Security (6.2%) • Medicare (1.45%)	$ 3,442.50
Federal Withholding (4 exemptions)	$ 2900.00	Health Insurance	$ 21,430.80
PA State Withholding	$ 1,381.50	PA State Unemployment	$ 542.00
PA State Unemployment	$ 32.00	Federal Unemployment	$ 42.00
Local Services Tax	$ 52.00		
Local Earned Income Tax	$ 450.00		
Employee's Take-Home Pay	$ 36,742.00	Employee's Cost to Company	$ 70,457.30
		Pension/Profit Sharing Contribution[1]	$ 11,250.00
		Employee's Cost to Company, including Pension/Profit Sharing	$ 81,707.30

[1] *Based on the maximum allowable contribution by the law: 25% of gross wages.*

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Creative Sources of Yield

by Ron Muhlenkamp

A broker friend of mine told me recently that his clients are looking for “creative sources of yield.” The phrase set off alarm bells in my head! Let me tell you why.

Investment securities have different characteristics. At the simplest level, cash and cash equivalents (short-term Treasuries, bank CDs, money market funds) are a parking place for investors’ assets when markets go down, or to have the money available when it is needed. Debt instruments are designed to protect capital over a period of time and to provide interest payments in the interim. Equity securities represent ownership in a company. A focus on yield or income normally focuses on debt securities. Since 1957, the interest yield on corporate bonds has exceeded the dividend yield on corporate stocks.

Key point: “yield” is generally understood (and I define it) as the interest payment earned on a security over and above the promised return of the principal.

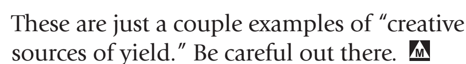
In February I attended a large “Money Show” in Florida. The topic that generated the most interest was: “How can I generate more income from my investments?” One speaker spoke in favor of “royalty trusts,” but he used the words “yield” and “payout” interchangeably, as if they were the same thing. They are not—particularly in a royalty trust. A royalty trust is a trust (a pool of investors) which owns the royalty rights on a group of oil or gas wells. As the oil from the wells is produced and sold, the investors in the royalty trust receive their pro-rata shares of the proceeds. When the oil is gone, so are the assets. I think of the oil as being in a warehouse; once you have sold the contents, the warehouse is empty.

But nearly all oil fields produce at a declining rate, with higher rates at the beginning. Let’s assume we sell the contents of the warehouse over 20 years, but sell 10% in the first year, declining to 1% in the 20th year. Your proceeds from the first year sales would not be representative of the later years. The speaker’s recommendation on the royalty trust (buying the warehouse contents), however, was based largely on the expected “payout” (proceeds) in the first year, which he expected to be over 10 percent. He also stated that most of the payout (which he often spoke of as yield) was “tax sheltered.” Folks, the reason it is expected to be tax sheltered is that most of the payment is a return of capital—and we are not required to pay taxes on a return of our capital. We are only required to pay taxes on the money earned in excess of our investment.

Another speaker at the Money Show recommended a Mortgage Participation Fund currently yielding 5¼ percent. It wasn’t clear whether the 5¼% was “yield” or “payout.” Think of your own experience with paying a mortgage: unless you have an interest-only mortgage, each payment is part interest and part principal. The payments are calculated to amortize the principal balance to zero at the end of the period, typically 30 years. So your payments each year (“pay in”) are part interest and part principal. As an investor in a Mortgage Participation Fund, you are on the receiving end of similar payments. The payout is part income (yield), which is taxed—and part return of principal, which is not taxed.

But let’s say the 5¼% promised yield truly represents interest payments of the mortgages. To pay 5¼% to the investors would require a pool of mortgages with 5½% to 5¾% interest rates because the various parties who pool the mortgages (the underwriters), guarantee the mortgages (Fannie Mae?), and manage the funds must all get paid. In today’s market of 30-year fixed-rate mortgages at 3.35%, the mortgages in the pool are likely to be refinanced to a lower rate (and the process gets repeated). So the investors get the money back sooner than desired; the 5¼% return is only temporary.

These are just a couple examples of “creative sources of yield.” Be careful out there.



An investment in a ***money market fund*** *is neither insured nor guaranteed by the Federal Deposit Insurance Corporation or any other government agency. Although a money market fund seeks to preserve the value of an investment at $1.00 per share, it is possible to lose money.*

Royalty trusts *are a ‘pass through’ vehicle available to get income from the corporation to the individual with only one level of taxation (the individual income tax). As a result, royalty trusts do not own the properties that are producing, they simply collect royalties and distribute them. Royalty trusts trade on the basis of income; therefore, it is important to check not only today’s yield, but, more importantly, what the yield will be or is projected to be in the future. The price of oil and gas drive the payouts, so as oil and gas prices fall and rise, the payouts change from month to month.*

In General:

- *Royalty trusts have no employees;*
- *Royalty trusts generally own no land or any other asset excepting the right to receive a percentage of either revenues or profits from a production asset that someone else owns; and*
- *Royalty trusts generally have a finite life, either measured in time (years), or volumes (i.e. a certain amount of oil or gas), or, in some cases, they terminate upon deaths of certain named individuals.*

Mortgage funds *are offered by a fiduciary that has legal title to the mortgage and sells fractional shares to investors.*

Mortgage securities are subject to prepayment risk, which can limit gains due to declining interest rates, and increase losses due to rising rates. Leverage can increase market exposure and magnify investment risk.

Note: Fixed income investments entail interest rate risk (i.e. as interest rates rise, bond prices usually fall), the risk of issuer default, issuer credit risk, and inflation risk.

The "FRIDAY FOCUS" on Retirement

by Susen Friday, Client Service Regional Manager

Long-time participant in the DCIO(Defined Contribution Investment Only) market, former secretary and active member of the Women in Pensions Network(WIPN), member of the American Society of Pension Professionals and Actuaries(ASPPA) and former plan administrator, Susen also holds an Accredited Investment Fiduciary (AIF) designation.

Throughout 2013, Susen's expertise and experience in the retirement field will be showcased in the Muhlenkamp Memorandum, *referred to as* **The "FRIDAY FOCUS" on Retirement.**

If you are participating in any type of employer-sponsored retirement plan, congratulations! According to the Bureau of Labor Statistics in March 2012, 84% of state and local government workers participated in employer-sponsored retirement benefits, compared with 48% of private industry workers.[2] In these times, when we are living longer, healthcare costs are rising, and the future of Social Security is uncertain, it is imperative that people are aware of all of their options. The first step is having a clear understanding of your employer's plan.

There are qualified and non-qualified retirement plans. A qualified retirement plan is for the exclusive benefit of employees or their beneficiaries and must be non-discriminatory. This means that highly compensated employees (those being paid $115,000 or more in 2013) cannot benefit more than others. As such, every qualified retirement plan is required to have a "plan document" which serves as a blueprint for how it is operated, defining such things as eligibility requirements, funding, distributions, etc. Employer-sponsored qualified plans are governed by ERISA (Employee Retirement Income Security Act of 1974); they must satisfy specific IRS requirements and ever-evolving regulations to enjoy certain tax benefits and ensure employee protection. As a result of changing times and regulations, qualified retirement plans are dynamic entities.

In contrast, a non-qualified retirement plan does not have to adhere to all ERISA guidelines, and does not have to be made available to all employees. Such plans are often used to provide additional compensation to executives or specific employees. The employer will enjoy a tax benefit only when the participant receives payment. At that time, the participant must pay taxes at their regular income tax rate. Unlike most qualified retirement plans, payments cannot be rolled over to IRAs.

Following is a brief summary of each qualified retirement plan type:

Defined Benefit

In the United States, a handful of employers offered pensions to employees in the late 1800s. As time went on, more employers were able to offer pensions as a result of insurance companies offering group annuity contracts. However, the real growth in plans did not occur until WWII, Korea, and beyond. During the war years, the government imposed price and wage stabilization programs. By offering a pension, companies had a way of rewarding their employees without giving them a raise. After the war, the government provided tax incentives to companies offering pensions.

The result was a defined benefit plan; i.e., it defines the benefit that the employee will receive in retirement. The employer or plan sponsor provides all of the funding and assumes all of the risk. Once the benefit has been determined, the employer or plan sponsor makes investments that are professionally managed to achieve a specific rate of return. If those investments fall short, additional funding is required to make up the difference. If the investments outperform, the funding can be cut back. Should the employer go out of business or no longer support the plan, participants enjoy a limited guarantee of their benefits through the Pension Benefit Guaranty Corporation (PBGC), a federal agency created by ERISA to protect pension benefits in the private sector.

There is no single method of defining the retiree benefit for all pensions. Each plan has its own plan document which contains the formulas for calculating the benefit. These formulas can be simple or complex, taking into consideration compensation, age, and years of service.

Defined benefit plan payments are usually paid to the retiree monthly in the form of an annuity, beginning at normal retirement age, typically defined as 65. The retiree will be presented with several options on how they can be paid:

- Life Annuity, during which payments cease at the participant's death. In most cases, this is the highest monthly amount;
- Life Annuity with Ten Years Certain, meaning that if the participant passes away before ten years of benefits have been paid, their beneficiaries will receive the benefit for the remaining period. The retiree receives less each month than the first option, but has the comfort of knowing their beneficiaries will receive something for an additional number of years;
- Joint and Survivor Annuity, which not only pays the retiree, but continues to pay a surviving spouse at a prescribed rate until their death. This option usually provides lower monthly payments than the first and second options, but furnishes peace of mind knowing the spouse will be taken care of to an extent; and
- Lump sum, which can be reinvested into an IRA. It should be kept in mind that if the proceeds from a defined benefit plan are not reinvested into an IRA, they are subject to Federal Income Tax.

Defined Contribution

A defined contribution plan also does exactly what it says: defines the contribution to the retirement plan, while leaving the benefit to be determined by a variety of factors. The contribution can be made by the participant, the employer, or both. (Prior to 1978, defined contribution plans took the form of Cash or Deferred Arrangements (CODA), with limited oversight by the IRS.)

[2] *www.bls.gov/news.release/pdf/ebs2.pdf*

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There are several kinds of defined contribution plans, each governed by their own set of regulations. Often, the adoption of a defined contribution plan shifts the funding responsibility and the risk from the employer or plan sponsor to the participant. It is incumbent upon the participant to make a lot of decisions, the first being whether or not to participate! If yes, the participant must select investments from a prescribed menu and determine their relative allocations.

Following are brief descriptions of the various types of defined contribution retirement plans:

- **401(k) Plan** – The Revenue Act of 1978 contained a provision that later went on to become Internal Revenue Code Sec. 401(k), and the 401(k) plan was born. This legislation provided for tax deferral treatment of the salary deductions used to fund the 401(k) plans. This is the type of retirement plan with which most people are familiar. Basically, eligible participants can have contributions deducted from their paycheck and deposited into their individual 401(k) account. The contributions are tax deferred and provide an income tax deduction. When distributed, the participant's normal tax rate is applied.

  A 401(k) lends itself to a high degree of customization. Participants should consult the plan document which outlines the features of the particular plan, including eligibility requirements, employer matching, the existence of a profit sharing feature, the availability of loans and hardship distributions, etc.
- **403(b) Plan** – 403(b) plans are also salary deferral plans, developed primarily for schools and healthcare facilities. They are very similar to a 401(k), but operate under some slightly different rules. Efforts are being made to shaping them closer to the 401(k) model.
- **SEP and Simple IRAs** – SEP and SIMPLE IRAs are plan designs that have historically been used by small businesses. They use documents that have been pre-approved by the IRS and have very little room for customization. As a result, administration costs are minimal. Only sponsors can contribute to SEP IRAs. The SIMPLE IRA allows for contributions by both the employer and the participant.
- **Profit Sharing Plan** – A profit sharing plan is one in which the employer allocates a contribution to eligible employees which may, or may not, come from the profits of the business. The employer is not required to make a contribution each year, however, if he does, he can set the amount up to 25% of the total compensation of all eligible participants. A variation of this is an ESOP (Employee Stock Ownership Plan) in which the profit sharing contribution is used to purchase company stock. (In order to qualify as an ESOP, 50% or more of the assets in the plan must be in company stock.)
- **MONEY PURCHASE PLAN** – Money Purchase Plans are very similar to profit sharing plans with two notable exceptions: the percentage of the contribution is fixed, and the contribution must be made each year. Before 2002, tax law stated that the profit sharing contribution could not be more than 15%, and the total employer contribution could not be more than 25 percent of total compensation. Many employers, to reach the 25% upper limit would have an additional money purchase plan at 10 percent. When the profit sharing contribution limit was raised to 25% in 2002, many money purchase plans were terminated.

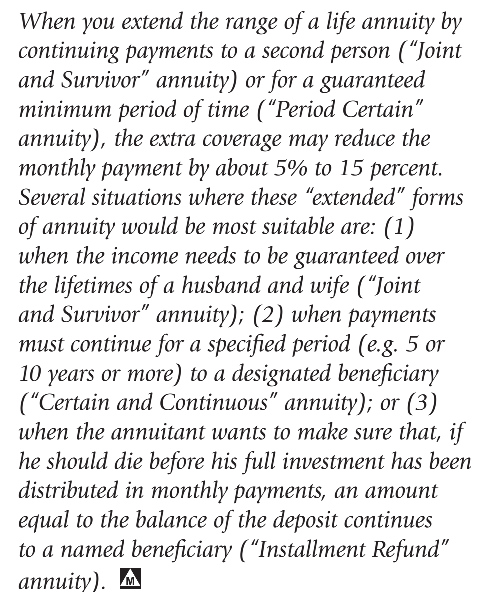
Cash Balance Plan

A cash balance plan is essentially a hybrid between a defined benefit and a defined contribution plan. It resembles a defined contribution plan, creating individual participant accounts into which the employer makes annual contributions defined by the plan document. Upon retirement, the participant has the option of taking either a lump sum or an annuity. The risk and funding responsibility belongs solely to the plan sponsor. Participants in cash balance plans also have limited protection with the PBGC.

In summary, all of the above plans (with the exception of the SEP and SIMPLE IRAS) offer a lot of options to the employer or plan sponsor to truly design a plan to fit their particular circumstances and culture. Since all retirement plans are essentially unique, how does a participant learn about the nuts and bolts of their particular plan? The best place to start is with the Summary Plan Description (SPD) which the employer/plan sponsor must provide to you, particularly any time a change is made to the plan. Participants do have the right to request a copy of the entire plan document from the plan sponsor. If you need additional clarification, consult your human resources department.

But what happens if my employer does not sponsor a retirement plan? The Employment Retirement Income Security Act of 1974 (ERISA) also addressed this situation by creating the Individual Retirement Account (IRA). The passage of the Tax Payer Relief Act in 1997 introduced the Roth IRA. The details of these types of accounts will be addressed in the next edition of the Muhlenkamp Memorandum.

Please feel free to give me a call if you have any general questions about retirement plans.



When you extend the range of a life annuity by continuing payments to a second person ("Joint and Survivor" annuity) or for a guaranteed minimum period of time ("Period Certain" annuity), the extra coverage may reduce the monthly payment by about 5% to 15 percent. Several situations where these "extended" forms of annuity would be most suitable are: (1) when the income needs to be guaranteed over the lifetimes of a husband and wife ("Joint and Survivor" annuity); (2) when payments must continue for a specified period (e.g. 5 or 10 years or more) to a designated beneficiary ("Certain and Continuous" annuity); or (3) when the annuitant wants to make sure that, if he should die before his full investment has been distributed in monthly payments, an amount equal to the balance of the deposit continues to a named beneficiary ("Installment Refund" annuity).

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Announcements

continued from page 1

Please refer to IRS Publication 590 for more information, available at www.irs.gov. If you have any questions, please call our Client Service Department at (877) 935-5520 extension 4.

2013 Coverdell Education Savings Accounts (CESA)

CESA annual contribution limits are $2,000 for each beneficiary.

Individuals (including the designated beneficiary) may fund a CESA:

- Fully—if their MAGI is less than $95,000; ($190,000 if filing a joint return); or
- Partially—if their MAGI is between $95,000 and $110,000; ($190,000 and $220,000 if filing a joint return).

Individuals (including the designated beneficiary) with a MAGI of $110,000 or more ($220,000 or more if filing a joint return) cannot make a contribution to anyone's CESA.

Organizations, such as corporations and trusts, can also contribute to a CESA. (Income restrictions do not apply.)

Please refer to IRS Publication 970 for more information, available at www.irs.gov. If you have any questions, please call our Client Service Department at (877) 935-5520 extension 4.

Any tax or legal information provided is merely a summary of our understanding and interpretation of some of the current income tax regulations and is not exhaustive. Investors must consult their tax adviser or legal counsel for advice and information concerning their particular situation. Neither the Fund nor any of its representatives may give legal or tax advice.

Charitable IRA Rollovers

The passage of the Pension Protection Act in 2006 established the Charitable IRA Rollover. These are direct rollovers from either Traditional or Roth IRAs only, and require a receipt as proof.

Traditional IRA holders above 70½ years old must take an annual Required Minimum Distribution (RMD) from their IRAs and pay tax on that distribution. By using the Charitable IRA Rollover as their RMD, the IRA holder satisfies the requirement and is able to make a charitable donation up to $100,000 to a public charity. Because the distribution is going to an eligible charity, the account holder does not have to pay income tax, and the funds go to the charity tax-free.

The Charitable IRA provision was set to expire on December 31, 2011. As a result of the American Taxpayer Relief Act of 2012, the provision has been extended to December 31, 2013.

IRA Beneficiary Designation

If you haven't named a beneficiary to your IRA account, following are a few reasons to do so:

- It allows the remainder of your IRA account to be distributed according to your wishes upon your death;
- It provides an opportunity for your beneficiary(ies) to preserve the tax-deferred (tax-free in the case of a Roth IRA) compounding of investment gains for years after your death; and
- It avoids the public and potentially inconvenient and costly process of probate for the assets in your IRA account.

If you would like to name or verify beneficiaries listed on your account(s), please contact our Client Service Department at (877) 935-5520 extension 4.

Request for Email Address

To ensure you receive all of the correspondence that Muhlenkamp & Company publishes and distributes, please share your email address with us. From time to time, we publish information that gets distributed as email only. To be added to our email distribution, please visit the "Contact Us" section of our website, or give us a call at (877) 935-5520 extension 4. You can be assured that your contact information will not be released to any third party. As a reminder, any information we publish is available on our website at www.muhlenkamp.com.

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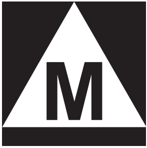

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MuhlenkampMemorandum

Inside this issue:

- Ron's Quarterly Letter
- Conversations with Shareholders
- When We Change the Rules A Little…
- Creative Sources of Yield
- The "FRIDAY FOCUS" on Retirement

Muhlenkamp & Company Investment Seminar

Tuesday, May 21, 2013
Regional Learning Alliance
850 Cranberry Woods Drive
Cranberry Township, PA 16066

The Big Squeeze: How taxes are squeezing your income; how interest rates are squeezing your assets

2:00 p.m. and 7:00 p.m. ET live sessions and webcasts

To register, please call our Client Service Department at (877) 935-5520 extension 4; RSVP by Thursday, May 16.