MuhlenkampMemorandum

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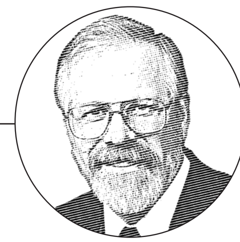
Quarterly Letter

By Ron Muhlenkamp, Portfolio Manager and Jeff Muhlenkamp, Investment Analyst and Co-Manager



The domestic quiet we wrote about in June did not last very long. Between August 17 and August 25 the S&P 500 Index dropped 11%. The S&P 500 Index bounced back about 4% and, as of September 30, it is down 6.4% for the quarter. For the year, the S&P 500 Index is down 5.3%. Our accounts are down approximately 9% for the quarter-to-date and 7% year-to-date.

During the conference call we held on August 27 we were asked what caused the market to drop in August. The short answer is we don't know for sure. The market drop followed a Chinese currency devaluation by a couple of days—was that the cause? Perhaps, but our opinion remains that 10% corrections can occur at any time and for any reason—or no reason. We can't predict them and haven't found anyone who reliably can. Nor do we find much value in trying to determine attribution after the fact. We think the more pertinent question is was the August correction the start of something bigger? That's the question we are spending our time on.

We won't spend as much time going around the world as we have in the past—you've heard much of this before and none of the problems have been solved. Europe is digesting the fallout from the VW scandal, which has driven Greek elections and Central Bank quantitative easing out of the headlines. Japan is quiet. As we expected, the Chinese were unable to prevent the continued selloff of their stocks, though they appear to have slowed the decline. The Chinese economy is growing more slowly than expected, which is not new.

The pain in many commodities has now become acute. Looking at the globe broadly, we are now in the "bust" phase of a boom—bust commodity cycle. The specific reasons differ a little bit by commodity, but everything from energy to metals to grains are oversupplied which has driven prices down dramatically. Brazil is feeling the pain of the bust as their currency falls against the dollar, their debt is downgraded, and they remain stuck in a recession. Several U.S. coal companies have gone bankrupt as have a small number of small U.S. oil and gas producers. Steel prices have plummeted, affecting steel producers and processors. Offshore drilling rigs that come off contract are unable to find new work, and sales of Deere and Caterpillar machinery are down as farmers and construction companies reduce their capital expenditures. Profitability in the commodity businesses will not improve until supply falls or growth in demand catches up with supply. It could be a while.

The impact to the U.S. is not confined to companies in the commodity business or their immediate suppliers. With the drop in commodity prices has come a stronger dollar which hits the revenues and earnings of most companies that sell overseas. We expect to hear more detail about that during the upcoming earnings reporting period. Last quarter, aggregate revenues declined by 3% and earnings increased less than 1%. We believe companies' ability to engineer earnings growth in the absence of revenue growth via cost cutting and other methods is about done. Consensus estimates for 2016 earnings growth are 15%—far too high for the growth we expect to see in the U.S. We think those estimates will come down and are concerned about the ability of the market to remain at its current level in the absence of earnings growth. This is why we are selectively harvesting investments and holding a healthy amount of cash.

The Federal Reserve Bank at their September meeting decided not to raise short-term rates again. Ron likes to put it this way: "They keep doing more of the same because it hasn't worked." Sounds pretty close to the definition of insanity. As a result, real (inflation adjusted) Treasury Note rates out to about 3 years are still negative; holders of those notes are losing purchasing power over time. Or, to put it more plainly, savers are still getting killed. Which is why we still don't like bonds.

We remain confident that buying good companies at a discount and selling them at a premium is a great way to grow wealth over time. We are comfortable holding cash when those opportunities are not immediately present, knowing that if we are patient and continue to look diligently bargains will come our way.

With our best wishes for your continued success,

Ron Muhlenkamp Jeff Muhlenkamp

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

The S&P 500 Index is a widely recognized index of common stock prices. The S&P 500 Index is weighted by market value and its performance is thought to be representative of the stock market as a whole. One cannot invest directly in an index.

Earnings growth is not a measure of future performance.

Muhlenkamp & Company, Inc.
Intelligent Investment Management

Monitoring Economies around the Globe

*During our **August 27, 2015** conference call, Tony Muhlenkamp, President, and Jeff Muhlenkamp, Investment Analyst and Co-Manager, discussed what's been going on this past quarter in the U.S. and abroad.*

Jeff talks about Japan's quantitative easing, Greece's debt problem, China's growth challenges, and price changes in crude oil and other commodities. He also shares his thoughts on ETF's, earnings of U.S. companies, and the value of the U.S. dollar. ***Visit our website at www.muhlenkamp.com for an archive of our August 27, 2015 conference call, where an audio recording is available, as well as a printable PDF of the amended transcription.***

Following are some excerpts:

Implications of Crude Oil Pricing

Jeff Muhlenkamp: About a year and a half ago, crude oil, which had been at $100 [per barrel], started declining; it dropped all the way to $40 [per barrel] by about January of this year. It moved back up to $60 a barrel by, call it May, and it's back at $40 a barrel. Oil and the decline in energy prices have continued to be a significant event on a global basis. Part of the reason is because that is one of the ways that the United States gets dollars overseas to be used for international trade…it's the international currency. China buys oil in dollars, China buys copper in dollars, and everybody buys iron ore internationally in dollars. So dollars are important to the world economy. The fact that the price of a barrel of crude has dropped is a benefit, of course, to everybody who consumes oil, but it reduces the revenue stream of everybody who produces oil. If that oil producer has debts in dollars, now he's got a problem. If he had borrowed in dollars to match his revenues in dollars, his revenues just got cut in half—and that may give him, depending on how long it lasts, a real problem paying off his dollar debt. That's something that is creeping back into the market's awareness I believe.

The first drop [in the price of oil] to $40 got everybody's attention. The bounce to $60, everybody kind of breathed a sigh of relief. I think conventional wisdom is that long-term oil prices are $70 or $80, but now that it's back at $40, I think everybody is rethinking that assumption, asking, "What if oil is $40 long term… what if oil is $50 long term…what does that mean? What does that mean to my company? What does that mean to the sustainability of some debts? How does that rearrange the picture?" To a degree, that's been driven by domestic oil production. Certainly the U.S. is a much bigger producer of oil than we were five years ago. To a degree, that's been driven by a willingness of Saudi Arabia to produce, regardless of the consequences to the price. About Thanksgiving last year, Saudi Arabia announced that they were not going to cut back production to maintain pricing power, and they have not come off that. It's not just a U.S. story, it's also at least half driven by what Saudi Arabia's doing and we don't see any—I hesitate to try and predict a change in that, but it's meaningful and it's making a difference around the world in a number of ways.

China's Growth Challenges

Jeff Muhlenkamp: China had been one of the last places where there was strong growth in the world. I distinctly remember three or four years ago during some of the quarterly conference calls, listening to some industrial companies…paint companies, auto parts manufacturers—these kind of companies…and they were all talking at the time that there was no growth in the U.S. They had adequate capacity, they had plenty of stores, and they had plenty of plants in the U.S. They were not putting any more capital into the U.S., but China—China was where the growth was. And they're going to open up a store, and they're going to open up a plant, and they're going to expand—and that's where the capital expenditures were going. That's where the expansion—you know they were all interested in growing their company—and they asked, "Where can we grow? Where is there a demand for our product?"

Tony Muhlenkamp: And the one place to go is China.

Jeff Muhlenkamp: Three or four years later, about the time you would expect all those things to come online and start working,China isn't growing as much as people had expected. It will be interesting to see if those same companies start writing off the value of assets…start talking about disappointment in China. Certainly, they've been talking about reduced revenue because of the strong dollar. So what's going on in China is having a number of impacts on the globe. I'm not sure the coincidence between what's going on in China and the 10% drop we've had in the last 10 market days or so in the U.S. is very close. (Reminder: Conference Call took place on August 27, 2015.) I'm not sure it's as causal as people think, but it's certainly coincident.

To learn more, please visit our website to view an archive of the August 27 conference call.

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Announcements

Semi-Annual Conference Call Archive Available on Website

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Separately Managed Accounts: Tax Planning

We manage your investments to minimize and defer income and capital gains taxes. It will be useful for us to know if you have a tax loss carry forward from 2014. If you reported a tax loss carry forward on your 2014 income tax return, please let us know the amount so that we can incorporate this fact into our tax planning for your account during 2015.

You can respond by telephone, email, or regular mail. Please call if you have any questions.

Tune In!

Ron Muhlenkamp has had several recent appearances on CNBC's Closing Bell. To give you a chance to see your portfolio manager live, we send email notices in advance, so that you can 'tune in" and learn what he has to say. This is another reason to be added to our email list, as we regularly publish information that gets distributed by email only. To be added to our email list, visit our website at www.muhlenkamp.com, or call us at (877) 935-5520 extension 4. Your contact information will not be released to any third party.

If you are interested in searching the archives on CNBC's website, following are the clip titles:

- 9/4/2015 – CNBC's video is titled "Cashin: Fed crazy to hike now."
- 9/18/2015 – CNBC's video is titled "Held hostage by emerging markets."
- 9/28/2015 – CNBC's video is titled "Rhetoric Risk in biotech will continue: Pro."