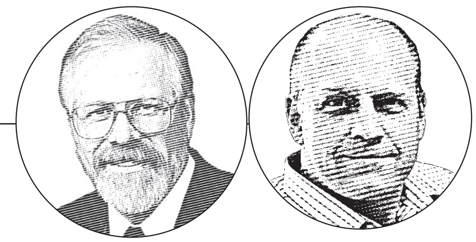
Muhlenkamp Memorandum

Issue 118 | Published Second Quarter | April 2016

Quarterly Letter



Dear Clients,

In the spirit of our times, when trigger warnings abound, we should probably warn you now that what we're about to discuss may make you uncomfortable. Continue reading at your own risk. And no, we won't be discussing politics.

In many ways the first quarter of 2016 was a repeat of the events of late last year. The 10% correction in the S&P 500 Index in January and February closely matched the August–October 2015 correction. Both were immediately preceded by a sharp decline in the value of the renminbi (Chinese currency) versus the dollar, and crude oil prices moved in lockstep with the stock market. During the quarter companies published their 4th Quarter 2015 business results. In the aggregate, both revenues and earnings declined for the top 3,000 U.S. companies on a year-over-year basis. For those of you not keeping your own scorecards, that's three consecutive quarters of declining revenues, and two consecutive quarters of declining earnings. As before, falling energy prices and a strong dollar accounted for the bulk of the declines. As was true late last year, the Central Banks of Europe and Japan continue to use asset purchases to keep interest rates down in an effort to goose their economies. This year, Japan joined Europe in the use of negative interest rates in pursuit of that elusive goal.

There has been a change in the apparent willingness of the U.S. Federal Reserve to continue raising our interest rates. You'll recall last year that the Fed spent a lot of time talking about the circumstances under which they would raise rates, and they actually raised them a quarter-of-a-percent in December. This year, even though the conditions they outlined last year remain in place, they have indicated they are in no hurry to raise rates further. We believe this is important as the policy differences between our Central Bank and the European and Japanese helped drive the dollar up and oil down. The dollar has weakened since the Fed changed its tone, and, coincidentally, markets recovered and oil bounced. We'll continue to pay close attention to the central banks.

We were asked the other day what the impact of negative interest rates would be if they came to the U.S. The short answer is negative rates would do more of what low rates have already done—hurt savers. Think of negative interest rates as a tax on assets: some owners will stand and pay the tax; others will run to try to avoid it. Banks would try to pass along the negative rates, which would probably show up in higher banking fees of some sort. Insurance companies, which invest heavily in bonds, would be forced to raise premiums because they'd get lower returns on their assets. Pension plans, many of which are already massively underfunded, would become even more so, requiring greater contributions from the business or municipality that sponsors them. (Guess where a municipality gets funds: from you, the taxpayer.) Money market funds, which have been waiving fees for years to avoid "breaking the buck," would find creative ways to pass the cost on to their clients or simply close up shop. That was just off the top of our heads. We've seen much of that start to unfold in Europe already, and it's disquieting. We hope our leaders are smarter than that; we'll see. We also realized that lower interest rates alone have made all of the conventional assumptions used in retirement planning obsolete. We'll lay out our thoughts on that during the May 12 investment seminar. We hope you can catch that, either live or on the web.

Briefly reprising our list of expectations from last quarter, we expect U.S. Gross Domestic Product (GDP) growth to be in the vicinity of 2% at best with risks to the downside caused by falling corporate revenues and earnings. We have yet to see the full impact of low crude oil prices on the energy sector; we expect more bankruptcies to come with follow-on impacts to the banks. Having said that, high-yield credit spreads have come down a little bit in the last month, which is positive. We don't expect a rapid rise in energy prices or a rapid decline in the dollar, but both will be driven by central bank policy as indicated above.

We put a little bit of money to work in February and bought some interesting companies at very good prices. We still hold a large cash reserve and continue to look for good places to put it to work. As you know, we like to be buying when others are in a hurry to sell, but we don't want to be early to that party either.

Until next quarter….

Ron Muhlenkamp and Jeff Muhlenkamp

The comments made by Muhlenkamp & Company in this newsletter 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.***

"Spreads" refer to the difference in the number of percentage points or basis points in yield. The level of risk correlates with the potential for returns.

Announcements

Request for Email Address
Muhlenkamp & Company regularly publishes information that gets distributed only by email. To be added to our email list, visit www.muhlenkamp.com or call us at (877) 935-5520 extension 4. Your contact information will not be released to any third party.

Muhlenkamp & Company, Inc.
Intelligent Investment Management

Letter to My Daughters On Financial Freedom

March 30, 2016

At Muhlenkamp & Company, we help people achieve a legacy of financial freedom for themselves and their children. That requires getting an early start. Below, Tony Muhlenkamp, president of Muhlenkamp & Company, outlines for his daughters what he considers are the fundamental principles to being financially free.

Your Grandpa and your Uncle Jeff have written a lot about how to work, save, and invest. So you should read Grandpa's book and Uncle Jeff's article because I'm not going to repeat what they have already written. Instead, I want to talk about some fundamental principles that I think are the core for being free financially. If you really own these ideas everything else will fall into place.

1. **Be a profit center.** Before you can save a nickel (or a dime—or better yet, a quarter) you have to make a buck. And, at your age, that's probably going to mean working for someone else. You may work for yourself at some point, and I'll write about that in #4. But, when you are first getting started, you will probably work for someone else and you need to make more for that person than it costs that person to hire you. That's what I mean by a "profit center."

   How much do you cost your employer? Ask them and find out, but your Grandpa wrote an article that can help you get started. How much do you make for your employer? That's not always easy to measure, but you should try to have some idea and make sure that you make him 5% more than you cost him. Every employer I know needs that nickel for it to be worth staying in business.

2. **It ain't what you make, it's what you spend.** John Templeton is a legendary investor, and some years ago a writer interviewed him and asked him the secret to his wealth. I think the writer expected some kind of stock tip, but what he got was sound advice for all of us. John Templeton said that the way he became wealthy was to save 50 cents out of every dollar he made for the first twenty years after college.

   Think about that. (And I've seen that time and time again with my clients.) People who are financially free never spend a nickel without getting a dime's worth of value from it. They'll spend money, but they save first, spend second, and ALWAYS make sure they spend less than they make. I have clients who never made more than $35,000 a year, but they spent less than that and are financially free. Conversely, I know people who make a million dollars a year, but find a way to spend it all, plus some. They are not free.

   Your Mom and I control our spending by thinking in terms of necessities, conveniences, and luxuries. You'll find the necessities of life are cheap, the luxuries can get expensive. So start out by limiting (or even eliminating) the luxuries while you save as much as you can as early as you can. We have always paid ourselves first through payroll deductions and automatic savings from our checking accounts. And every time we paid off a loan, earned a pay raise, or received a bonus or a gift, we added at least half of that money to our savings and investments.

   Dave Ramsey has very good ideas about budgeting and living on less than you make. Borrow his books from the library, read them, and follow his advice.

3. **Start saving early; compounding interest takes time to work.** I already mentioned saving as much as you can, as early as you can, and here's why: Get a Compound Interest Table and pick any interest rate you like; 3% or 5% or 8%. Now look at how one dollar a year grows for 10 years, then 20, then 40. Even at low interest rates, the compounding is powerful IF YOU START EARLY ENOUGH to have your money working for 40 years. Imagine what that does if you can save $5,000 or $10,000 a year starting in your early twenties. That's why not spending everything you make and having money to save is so important. (Numbers 2 & 3 work hand-in-hand; one does you little good without the other.)

4. **Own, don't lend.** The book *The Millionaire Next Door* documents how most people with serious money earned it by starting and owning their own business (and then not spending everything they earned).The next best way is to partner with those people, or own a piece of the business they are running. To my recollection, nobody gets wealthy by lending those people money.

   The same lessons apply to you: You make the most working for yourself because you work harder when you work for yourself and you are more careful spending your own money.

   If you aren't going to start and run your own business, then find a way to partner with people that do. One easy way to do that is to invest in common stocks, and we'll talk more about that in another letter. Just remember, stocks represent ownership in a business; bonds represent lending money to a business.

   Ibbotson publishes a chart of the hypothetical growth of $1 since before the Great Depression (1926). According to their chart, the compound annual return for large-cap stocks was 10.1%, versus 5.7% for government bonds, from 1926-2014. (This assumes the reinvestment of income and no transaction costs or taxes.)[1] Go to your Compound Interest Table and see what that difference will make to you over the next 20, 30, and 40 years. Own, don't lend.

5. **Price always matters.** As Grandpa says in his *Maxims*,"A good product can be a bad deal if the price is wrong. How do you know a good price? Shop around and be willing to walk away from any 'deal.'"

   This is true for an education, a house, a car, clothes, food, etc. It's also true when you are looking to buy a business, either outright or through the stock market. Grandpa wrote a good primer how to buy cars and stocks, in his essay *Fund Your IRA, or How to Retire Wealthy by Driving Used Cars.* Your Mom has become an excellent buyer of used cars—and pianos—by following the advice in his essay. And we've done well by funding our IRAs and investing them with a money manager who shares our conclusion that price always matters.

Those are the five principles that I think are key to financial freedom. There's a lot more that we can talk about for each of these items, so I hope you'll come to me with your thoughts, ideas, comments, and questions, so we can talk about them.

Love you,

Dad

[1] *Source: Ibbotson® SBBI® Stocks, Bonds, Bills, and Inflation 1926–2014. Used for illustrative purposes only and not indicative of any investment.* ***An investment cannot be made directly into an Index.***

Stocks are generally perceived to have more financial risk than bonds, in that bond holders have a claim on firm operations or assets that is senior to that of equity holders. In addition, stock prices are generally more volatile than bond prices. Equities, bonds, and other asset classes have different risk profiles, which should be considered when investing. All investments contain risk and may lose value.

February 25, 2016: Conference Call Highlight

Muhlenkamp & Company communicates with clients and shareholders on a regular basis, so that they may sleep better at night. In addition to publishing four quarterly newsletters (Muhlenkamp Memorandum), we host semi-annual investment seminars (May and December) and semi-annual conference calls (February and August).

During our February 25 conference call, portfolio managers Ron and Jeff Muhlenkamp provided an update on what they're observing in global economies and markets. As part of the conversation, Ron asked Jeff to discuss the feedback loop affecting broad segments of the global economy, originating from China's economic slowdown:

Ron Muhlenkamp: Jeff, discuss the feedback loop we're seeing among banks, China's slowdown, the cyclical parts of the economy, and how that affects the emerging markets.

Jeff Muhlenkamp: We've been saying for a number of years that we think China drove demand for commodities, driving up their prices as demand from China increased. But, China didn't just consume the commodities; they would also shape them, form them, assemble them, and sell them. China would import the commodity and export the finished good.

Ron Muhlenkamp: In addition to oil, we're talking steel, aluminum, copper…all of these basic commodities.

Jeff Muhlenkamp: Correct.

Ron Muhlenkamp: …Much of which was supplied by likes of Australia, South America, Canada—the emerging economies of the world.

Jeff Muhlenkamp: Correct; Brazil being the poster child for that, as was Australia.

In order to meet demand from China—and I'm going to specifically talk about the harder metals, because crude oil gets into Saudi Arabia and there are different dynamics—everybody that was producing those products (coal, iron ore), ramped up their capacity: they dug an additional mine; they put extra money to work in the ground. Prices have been coming off in those commodities for three or four years now; all of that extra capacity, which had been built in anticipation of China's demand, is now excess. That's, of course, what's driving commodity prices down.

Regarding the impact of that domestically… First, it impacts prices, right? You've got excess capacity, which means inventory is built, which means prices go down very quickly. The impact directly to the United States has been that the coal miners are decimated. It is truly a depression in the U.S. coal industry; a large number of coal companies have gone bankrupt or are on the verge of bankruptcy. It's the same with iron ore. One of the largest U.S. producers of iron ore is Cliffs Natural Resources, which has been struggling for about two years with its debt.

Remember, China is a processor of raw materials: so you take coal, you take iron ore…you make steel. China had built a lot of capacity to make steel, which is now excess supply—and that has depressed steel markets across the globe. Everybody, from Nucor Corporation [Nucor pioneered electric arc furnaces and mini-mills] to especially the blast furnaces of U.S. Steel Corporation, is experiencing a lot of pain right now.

That's true not just in the U.S., it also hit Australia, and Brazil, which has been in a recession now for about three years; it has hit a number of the exporting countries. Because these countries had revenues in dollars, they had borrowed money in dollars. As they see their dollar revenues declining, they've got a problem paying off those dollar loans. The supply of dollars internationally, both because of what's happening in hard metals, and also because of what's happening in crude oil… As the price of crude oil comes down—even if you're selling a million barrels a day—if the price of oil drops in half, your dollar revenues dropped in half, but the payments you have to make on your loan didn't go away.

There's now a shortage of dollars internationally to pay off loans that were incurred during the commodity boom (both in oil and in the harder metals), which feeds back into the banks. As a result, banks start contracting credit, creating a negative credit cycle on a global basis… coming out of commodities…coming out of less demand from China than people had expected. Is that the feedback loop you wanted me to address?

Ron Muhlenkamp: Yes.

A complete audio archive and amended transcript for the February 25 conference call are available on our website. Reminder: Our Client Service managers are available to review the entire content of the conference call and to address your questions. Call us at (877) 935-5520 extension 4, or use the "CHAT" button on our website to connect in person.

Muhlenkamp & Company, Inc.
Intelligent Investment Management

MuhlenkampMemorandum

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Save the Date: Thursday, May 12 | Investment Seminar

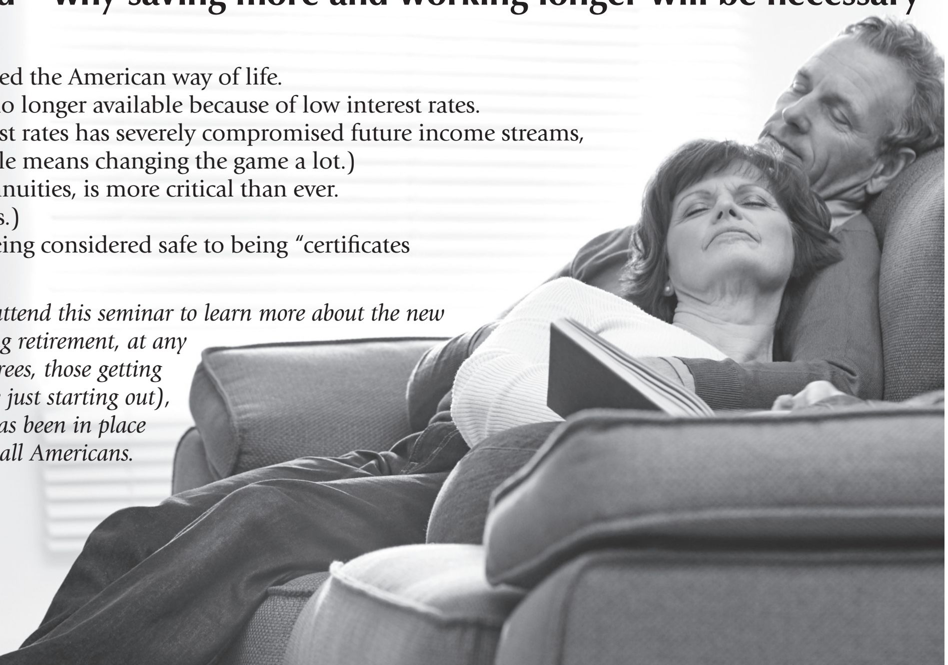
How Retirement Has Changed—why saving more and working longer will be necessary

Attend this seminar and learn:
- How choosing "the path of Japan" has altered the American way of life.
- Why retirement, as we used to expect it, is no longer available because of low interest rates.
- How an extended period of ultra-low interest rates has severely compromised future income streams, critical to retiring. (Changing the rules a little means changing the game a lot.)
- Why reading the fine print, especially for annuities, is more critical than ever. (There are no guarantees—only illustrations.)
- How CDs—and bonds—have gone from being considered safe to being "certificates of guaranteed confiscation."

No matter your age or disposition, you'll want to attend this seminar to learn more about the new and emerging landscape for anybody contemplating retirement, at any point in their life. Designed for all audiences (retirees, those getting ready for retirement…all the way to those who are just starting out), this seminar will tackle the tacit agreement that has been in place for generations and how it has changed, affecting all Americans.

2:00 p.m. or 7:00 p.m. ET
Attend via live video webcast or in person

Regional Learning Alliance
850 Cranberry Woods Drive
Cranberry Township, PA 16066



To register, visit our website or call our Client Service Department at (877) 935-5520 extension 4; RSVP by Tuesday, May 10.

MuhlenkampSMA All-Cap Value

For the period ended 3/31/16

Muhlenkamp & Company's All-Cap Value SMA (Separately Managed Account) is designed for investors' accounts over $100,000. We employ full discretion, applying fundamental analysis.

Investment Objective

We seek to maximize total after-tax return through capital appreciation, and income from dividends and interest, consistent with reasonable risk.

Investment Strategy

We invest in undervalued assets wherever they may be found. Typically, this results in holding a portfolio of companies we believe are materially undervalued by the market. Bonds may be included in the portfolio if they are a good investment.

Investment Process

We start with a bottom-up scan of domestic companies, typically looking at most U.S. companies at least four times per year. We add to that an understanding of the sector dynamics in which companies are operating, an assessment of the business cycle, and a review of macroeconomic conditions.

Our primary screening metric is return on shareholder equity (ROE). We are looking for companies with stable returns that can be purchased cheaply, or for companies with improving returns that have not yet been recognized by the market.

We don't believe that a holding period of "forever" is appropriate in all cases, but are comfortable holding companies as long as they continue to meet expectations.

Investment Risk

We define investment risk as the probability of losing purchasing power over long periods of time, which is quite different from Wall Street's definition of price volatility in very short periods of time. Taxes, inflation, and spending will ALL impact the purchasing power of your assets.

All-Cap Value Composite Performance (Net of Fees)

			Annualized			
	Year to Date	One Year	Past 3 Years	Past 5 Years	Past 10 Years	Past 15 Years
Return	-5.20%	-11.69%	5.83%	5.83%	.57%	3.34%
S&P 500 Total Return*	1.35%	1.78%	11.82%	11.58%	7.01%	5.99%
Consumer Price Index**	0.25%	1.02%	0.70%	1.39%	1.78%	2.01%

* **The S&P 500 is a widely recognized, unmanaged index of common stock prices. The figures for the S&P 500 reflect all dividends reinvested but do not reflect any deductions for fees, expenses, or taxes. One cannot invest directly in an index.**

** Consumer Price Index (CPI) – As of February 2016 – U.S. CPI Urban Consumers NSA (Non-Seasonally Adjusted), Index. The Consumer Price Index tracks the prices paid by urban consumers for goods and services and is generally accepted as a measure of price inflation. Price inflation affects consumers' purchasing power.

Consolidated performance with dividends and other earnings reinvested. Performance figures reflect the deduction of broker commission expenses and the deduction of investment advisory fees. Such fees are described in Part II of the adviser's Form ADV. The advisory fees and any other expenses incurred in the management of the investment advisory account will reduce the client's return. It should not be assumed that recommendations made in the future will be profitable or will equal the performance of the above accounts. A list of all security recommendations made within the past twelve months is available upon request.

Top Twenty Holdings

Company	Industry	% of Net Asset
Alliance Data Systems Corporation	IT Services	5.97%
Gilead Sciences, Inc.	Biotechnology	4.11%
Apple Inc.	Technology Hardware, Storage & Peripherals	3.47%
Annaly Capital Management Inc.	Real Estate Investment Trusts	3.03%
Hanesbrands, Inc.	Textiles, Apparel & Luxury Goods	2.95%
ON Semiconductor Corporation	Semiconductors & Semiconductor Equipment	2.66%
Bristol-Myers Squibb Company	Pharmaceuticals	2.54%
Microsoft Corporation	Software	2.45%
Baker Hughes Incorporated	Energy Equipment & Services	2.31%
PowerShares Buyback Achievers	Exchange Traded Funds	2.30%
NeuStar, Inc.	IT Services	2.23%
Celanese Corporation	Chemicals	2.17%
UnitedHealth Group Incorporated	Healthcare Providers & Services	2.08%
Biogen Inc.	Biotechnology	1.90%
WCI Communities, Inc.	Household Durables	1.89%
Teva Pharmaceutical Industries Ltd.	Pharmaceuticals	1.88%
Lannett Company	Pharmaceuticals	1.84%
Spirit Airlines Inc.	Airlines	1.83%
Pfizer Inc.	Pharmaceuticals	1.48%
Delta Air Lines, Inc.	Airlines	1.34%

Composite holdings are subject to change and are not recommendations to buy or sell any security.

Composite Top Twenty Holdings are presented as supplemental information to the fully compliant presentation on the next page.

Return on Equity (ROE) is a company's net income (earnings), divided by the owner's equity in the business (book value).

Muhlenkamp & Company, Inc.
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Portfolio Managers

Ronald H. Muhlenkamp, Portfolio Manager, CFA, has been active in professional investment management since 1968. He is a graduate of both M.I.T. and the Harvard Business School.

Jeffrey P. Muhlenkamp, Investment Analyst and Co-Manager, has been active in professional investment management since 2008. He is a graduate of both the United States Military Academy and Chapman University.

SMA Facts

Average Number of Equity Holdings	24
Cash & Cash Equivalents	43.33%
Portfolio Turnover	21.30% ‡

‡ *Trailing 12 months*

SMA Facts are presented as supplemental information.

SMA Information

The All-Cap Value Composite was created in December 2003 and includes fee-paying accounts over $100,000, full discretion, under management for at least one full quarter which are invested in the All-Cap Value strategy. The composite excludes the Muhlenkamp Fund and any wrap fee account.

Minimum Initial Investment	$100,000.00
Management Fee*	1% (first $1 million); 0.5% on the remainder

** May vary by account.*

Investment Adviser

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Muhlenkamp & Company serves individual and institutional investors through our no-load mutual fund and separately managed accounts.

Muhlenkamp & Company, Inc. All-Cap Value Composite Annual Disclosure Presentation

Year End	Total Firm Assets (USD) (millions)	Composite Assets (USD) (millions)	Number of Accounts	ANNUAL PERFORMANCE Composite Gross	Composite Net	S&P 500 Total Return Index	THREE-YEAR ANNUALIZED STANDARD DEVIATION* Composite	S&P 500 Total Return Index	Composite Dispersion**
2015	422	48	67	(4.66)	(5.45)	1.38	10.45	10.47	0.68
2014	541	51	67	10.27	9.37	13.69	9.55	8.97	2.06
2013	585	50	60	35.50	34.39	32.39	11.29	11.94	3.13
2012	491	41	66	11.29	10.34	16.00	12.02	15.09	1.14
2011	555	45	74	(2.84)	(3.67)	2.11	16.60	18.70	0.85
2010	724	59	82	2.96	2.15	15.06			1.45
2009	839	90	107	32.68	31.72	26.46			2.80
2008	759	112	155	(40.53)	(40.94)	(37.00)			1.97
2007	1886	327	289	(7.61)	(8.19)	5.49			3.77
2006	3393	371	337	6.09	5.34	15.79			3.70
2005	3471	287	289	10.04	9.22	4.91			3.38
2004	2261	197	206	24.54	23.56	10.88			3.33
2003	1350	132	167	43.36	42.10	28.68			5.57
2002	742	81	139	(19.80)	(20.49)	(22.06)			3.65
2001	699	97	124	(2.72)	(3.51)	(11.93)			5.16

The objective of this All-Cap Value Composite is to maximize total after-tax return, consistent with reasonable risk—using a strategy of investing in highly profitable companies, as measured by Return on Equity (ROE), that sell at value prices, as measured by Price-to-Earnings Ratios (P/E).

Muhlenkamp & Company, Inc. ("Muhlenkamp") claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS standards. Muhlenkamp has been independently verified for the periods December 31, 1993 through June 30, 2015 by Ashland Partners & Company LLP.

Verification assesses whether (1) the firm has complied with all the composite construction requirements of the GIPS standards on a firm-wide basis and (2) the firm's policies and procedures are designed to calculate and present performance in compliance with the GIPS standards. The All-Cap Value Composite has been examined for the periods December 31, 1993 through June 30, 2015. The verification and performance examination reports are available upon request.

Muhlenkamp is an independent registered investment advisory firm registered with the Securities and Exchange Commission. The firm's list of composite descriptions is available upon request.

Returns are based on fully discretionary accounts under management, including those accounts no longer with the firm. Composite may invest in American Depositary Receipts (ADRs).*** Accounts may be shown gross or net of withholding tax on foreign dividends based on the custodian. Past performance is not indicative of future results.

The U.S. dollar is the currency used to express performance. Returns are expressed as percentages and are presented gross and net of management fees and include the reinvestment of all income. Net of fee performance was calculated using actual management fees. The annual Composite dispersion presented is an asset-weighted standard deviation calculated for the accounts in the Composite the entire year. Policies for valuing portfolios, calculating performance, and preparing compliant presentations are available upon request.

* **Three-Year Annualized Standard Deviation** *is a measure of volatility, calculated by taking the standard deviation of 36 monthly returns, then multiplying the result by the square root of 12 to annualize it. Since standard deviation measures the dispersion of a set of numbers from its mean, higher results indicate more variation in monthly returns over the trailing three years.*

** **Composite Dispersion** *is a measure of the similarity of returns among accounts in the Composite. It is the standard deviation of the annual returns for all accounts which were in the Composite for the entire year.*

*** **American Depositary Receipts (ADRs)** *are shares that trade in U.S. markets, but represent shares of a foreign company. A bank (the depository) purchases a number of the foreign shares and holds them in a trust or similar account; in turn, the bank issues shares tradable in the U.S. that represent an interest in the foreign company. The ratio of ADRs to foreign shares is set by the bank. ADRs do not mitigate currency risk, but can reduce transaction costs and simplify trading compared to buying the local shares in the foreign markets.*