Muhlenkamp Memorandum

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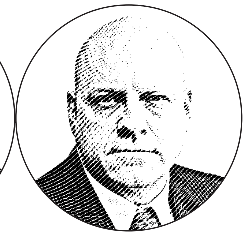
Quarterly Letter



By Ron Muhlenkamp and Jeff Muhlenkamp, Co-Managers

From a market perspective, this has been a quiet summer. As of 9/30/2017, the S&P 500 was up 6.63% over the last six months with hardly a dip. Low economic growth continues on a global basis, none of the major central banks have altered course in any fashion, inflation remains low, second quarter earnings came in nicely, etc. We won't bore you (this time!) by enumerating the things we're watching that haven't changed since we wrote about them in June. There have been a couple of surprises: three destructive hurricanes and escalating tensions with North Korea (which the markets have mostly ignored). We believe that while the hurricanes have had a massive impact on the affected areas, their impact on the national economy will be fairly small and temporary. We believe war with North Korea is unlikely. We'll keep an eye on developments and update our assessment as events unfold.

In March, we highlighted the increase in small business optimism that accompanied the election results. Looking at the latest numbers, business optimism remains at a high level in spite of (because of?) paralysis in Washington. A decline in business optimism would be of concern, but it is holding up nicely. Speaking of Washington, the broad outlines of the proposed tax reform were released in late September and, based on what we saw, it looks like an improvement on the existing situation. We have no idea, however, how much of it will actually be enacted or when.

The markets remain on the expensive side and that's making a lot of investors of all stripes nervous. In an odd way investor nervousness is itself a bit reassuring. It could prevent some of the risky behavior we tend to see when investors are wildly optimistic and convinced they can't lose (recall the internet bubble, the housing bubble, and currently the enthusiasm around Bitcoin and its siblings). If the market is making you nervous, you might consider reviewing your expectations of the market and your financial plans and make sure that you are prepared for the inevitable downturn. Using the four seasons as an analogy, we estimate we're in late summer and while we don't know exactly when winter will arrive, we know it's coming, so it's appropriate to prepare for it. Give us a call if you'd like to discuss these topics in more detail, we'd love to hear from you.

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.

S&P 500 Index is a widely recognized, unmanaged 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.

Announcements

Register for our Upcoming Webcast
Please join us for our webcast with Tony, Ron, and Jeff Muhlenkamp.

Thursday, November 30, 2017
4:00 pm – 5:00 pm ET
Register at www.muhlenkamp.com or call us at (877)935-5520 extension 4.

Webcast Archive Available on Website
During the webcast on August 22, 2017, Jeff Muhlenkamp, Portfolio Manager, summarized the economy using his 10-point checklist. Also, to celebrate our 40th anniversary, we asked Ron Muhlenkamp, Portfolio Manager, to reflect on lessons he has learned and changes he has seen since he founded Muhlenkamp & Company in 1977. Ron's insights and observations are included. Visit www.muhlenkamp.com for the webcast archive and to access other videos and essays available in Our Library collection.

Request for Email Address
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Muhlenkamp & Company, Inc.
Intelligent Investment Management

Reflecting over 40 Years—Lessons Learned and Changes Observed

By Ron Muhlenkamp

To celebrate the anniversary of Muhlenkamp & Company, I was asked to put on paper what I have learned over the last 40+ years in the industry and comment on any changes I've seen over that period. This essay is my attempt at meeting this request. About ten years ago we wrote a book, *Ron's Road to Wealth—Insights for the Curious Investor*, in which we did a similar thing, though in more detail than what we have here.

Lessons I've Learned

Free economies work; managed economies don't. Let's look at real instances: The obvious examples are to compare East Germany to West Germany during the time before their reunification in 1990. Look at North Korea versus South Korea, both were in shambles in 1950, but South Korea is a thriving economy today. Also, look at Cuba which is stuck in the 1950s. Venezuela has gone from prosperous to destitute in a decade. My observation is that if people are lacking food, clothing, and shelter, they will do almost anything to acquire these basic needs. Once these needs are covered, economics is all about incentives. So the question becomes, how do you get people to produce more? And the answer has been proven time and time again: you allow them to benefit from their own efforts; in other words, you pay them. The beauty of a free market is the incentives are built in. In a free market, you only get paid if you serve your fellow man in a way that he's willing to pay you since you can't force anyone to buy your product. It doesn't matter what I think my services are worth, it only matters what my services or product are worth to someone else.

In a free economy, the consumer is king. In a free economy we, the consumer, can influence price, production, and distribution by exercising our free will (spending our dollars). Sellers have incentive to improve their product or service to meet the needs and requests of the consumers (the "kings"). These continuous improvements to product and services are one reason why free economies thrive relative to managed economies.

Prosperity must be produced before it is consumed. You can't spend your way to prosperity, you can only produce your way to prosperity. Folks, that's true on a personal level, that's true on the local level, and that's true on a national level. Nevertheless, we have economists who encourage us to spend money (many times money we don't have). Debt can kill prosperity. So for an economy to thrive in the long term, it must be productive and live within its means (same goes for personal finances). As we discussed earlier, allowing the worker to benefit from their own effort creates the incentive to produce.

People have three working speeds. Low speed is when you can't be fired and can't earn a bonus—typically, that's working for government. They can't fire you, but you can't earn a bonus either. Medium speed is when you can be fired, but you can also earn a bonus or a premium—typically, that's working for private enterprise. High speed is when people work for themselves—that's when they pull out all the stops (and likely when they experience the most satisfaction in their work). I'm not the only one to notice this: the best-run private companies are those who find a way of compensating their employees in ways that encourage the employee to act as if she's working for herself. The best work comes from people who are working for themselves and can keep the fruits of their labor.

People have four spending modes. One mode is when people spend their own money on themselves. The second mode is when they spend their own money (money they've earned) on someone else—which is typically gifts or charity. Most of us will spend more money on a gift for our friend than we'd spend on ourselves, which I think is kind of fascinating. A third mode is when we spend other people's money on ourselves, and I would encourage you to check the Senate office buildings to see what happens in that regard. And then, the fourth mode is when we spend other people's money on other people—which is what politics is all about. Frankly, I think the major problem with politicians is they're all on O-P-M (they are dealing with Other People's Money). I've found that the best decisions are made when spending your own money on yourself or others.

Notice that these five lessons tie together: free market economies perform better than managed economies because more people are working for themselves than for government and more people are spending their money, not other people's money. It's all about incentives, and the incentives in a market economy create much better decisions than in a managed or planned economy.

Ownership equals responsibility. I've learned that people take better care of property they own than property they rent. And they take better care of property they rent than property held in common (see the former Soviet Union). People take better care of their pets than strays. You can debate the morality of ownership of animals or land all you like, but the practical effect is that establishing ownership generally results in people working harder to care for that which they have acquired the title to, and that's a good (productive) thing.

You must live by Mother Nature's rules. Ignoring reality usually turns out badly. I grew up as a farm kid, you either lived by Mother Nature's rules or you don't prosper as a farmer. When I got into engineering, I found out that you either live by Mother Nature's rules or your engineering doesn't work. The feedback is generally rapid and hard to ignore. There are some endeavors, however, where you can ignore the difference between what actually works and what doesn't for a *long* time. When I got to business school, we were taught that if you can convince the hundred people in the room of something, they can make it happen. That might work (for a while) in marketing, in politics, and in economics, however it does not work in production, in farming, nor in engineering. Mother Nature's rules will overwhelm whatever good logic you think you brought to the game.

People have a nearly unlimited capacity to believe what they want to believe. I've known folks who have been wrong for 40 years, but they're still making a good living because our country is so prosperous and they are "protected" (to use a Peggy Noonan term). "Protected" means that if they are wrong, they don't starve, lose food, clothing, or shelter. They can be wrong for 40 years and still keep their job, particularly if they're an economist or a tenured professor. They could probably be wrong for 40 years as a weather person too. We all laugh at the weatherman, but their record is better than some economists.

Just because everybody knows something doesn't make it true. In fact, in investing, if everybody knows something, that alone makes it false, or at least an unprofitable investment. It is almost poetic—the public adopts a rule of thumb based on one time period and one set of circumstances, but it continues to use this rule of thumb after the circumstances have changed.

How you deal with your mistakes matters. When I watch some uneducated people make a mistake, they say, "Gee, I made a mistake." They change what they do and they go on with life. When I see some educated people make a mistake (especially those "protected" folks), what I tend to hear is, "Well, I would've been right if only." That's how you get economists who are wrong for 40 years but never change their minds or their methods. That's how you get politicians who spend more and more money on programs that have never produced the desired outcomes. They can't admit they were wrong, and they are protected from the results of their failures, so they never have to.

People assume that others act as they themselves do. As a result, honest people have a hard time believing anyone would lie to them, actively deceive them, or misrepresent something to them. They assume everyone else is honest too. I had a client who was so honest that he couldn't conceive of telling someone a lie. And his difficulty was, as a result, he couldn't conceive of anyone telling him a lie. He got a sales pitch one day and asked, "Is that true?" and I said, "No, that's a sales pitch..." and he said, "Oh, it didn't quite make sense, but I didn't think he would lie to me."

People have different approaches to issues. I've observed a difference in what I call the "rural mentality" versus the "urban mentality" and I think this major difference is reflected in our politics. The rural mentality is if you have a problem, you fix it. The urban mentality is if you have a problem, you call somebody else to fix it. Since politicians are quick to promise to solve your problems if you vote for them (and pay their taxes), an urban mentality lends itself to bigger government responsible for more things in our society, whereas a rural mentality does not.

To my mind, Houston's response to Hurricane Harvey reflected the "rural mentality." The media's astonishment at the volunteers reflected an urban mentality (though I witnessed a similar response in New York City on 9/11). I would encourage you to think about your local fire company. If it's a volunteer company, it's reflecting what I call the rural mentality. If it's a paid company, it's reflecting what I would call the urban mentality.

And yes, before you jump all over me, these lessons are not hard and fast, but I find them useful ways of thinking about things. If you don't find them useful, discard them. If you do find them useful, then I've done you some good. Life is not a dress rehearsal, you only get one shot at it. I hope my lessons will help you out or, at least, spur some good conversations.

Changes over the Years

The biggest change that I've seen in the last 40 years is that communication has gotten faster. As a result, we have more short-term cycles within the same long-term cycles. And that the long-term business cycle used to be four to five years, but we've had three experiences in my lifetime: in the '60s and the '80s and the last 10 years when the business cycle got extended. But we continue to get more and more short-term cycles.

The trouble with instant communication is there are no longer any filters. You and I and anyone else can put an opinion out there, frankly, with no consequences. It used to be that a reporter or editor would do some checking of their work, but the incentive now is to be fast, not accurate or balanced. I'm finding I have to wait two or three days to get the story from both sides of an argument and I have to do more of that work myself. So, I say, "Who makes sense and who doesn't?" I've also found that more bias has crept in, and I have to do more work to ferret out the bias in almost all the information I receive.

In order to determine if an article or statement is truly neutral, I change the nouns (or pronouns). For example, every place that says "he," I write "she," and every place that says "she," I write "he." And then I read it again to see if it sounds sexist from either reading. If it's truly neutral, it will not. The fact that I have to do this indicates how rare it is for what is written to be factual and not editorial. Also, many words have become loaded terms (to some people they have much more or a different meaning than what is in the dictionary).

Another change I've noticed is our educated have become more arrogant. I always knew that Harvard was arrogant. MIT has gotten just as bad...a great disappointment to me. That's a bad thing, because arrogant people don't learn from their mistakes (see the discussion on that above).

The things I've just talked about all tie together.

The end result is that even though we KNOW what works best economically we are pursuing the same old failed solutions touted by our academics and politicians only with increasing vigor. They won't change, and we haven't fired them (yet?). This is pretty frustrating for me to watch. We're doing our very best to strangle the golden goose that is the free market.

A Final Thought

My grandchildren are now ages 9 through 20. I've started asking them what money is for. They all think money is to buy things and I agree with that, up to a point. But once food, clothing, and shelter, and a few other things are covered, I believe that money is to build things—which looks a little bit different. I would encourage you to think about money and how much the purpose is to buy things. At what point does the purpose become to build things?

Thank you to our clients and friends for an interesting 40 years!

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

Muhlenkamp & Company, Inc.
Intelligent Investment Management

MuhlenkampMemorandum

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- Announcements

Upcoming Webcast

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Thursday, November 30, 2017
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Register at www.muhlenkamp.com or call us at (877)935-5520 extension 4.

MuhlenkampSMA All-Cap Value

For the period ended 9/30/17

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.

Muhlenkamp & Company, Inc.
Intelligent Investment Management

All-Cap Value Composite Performance (Net of Fees)

	Year to Date	One Year	Annualized: Past 3 Years	Past 5 Years	Past 10 Years	Past 15 Years
Return	10.54%	11.33%	1.23%	8.57%	1.41%	6.17%
S&P 500 Total Return*	14.24%	18.61%	10.81%	14.22%	7.44%	10.04%
Consumer Price Index**	1.69%	1.94%	1.06%	1.28%	1.68%	2.06%

* **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 August 2017 – 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	4.77%
Gilead Sciences, Inc.	Biotechnology	4.71%
ON Semiconductor Corporation	Semiconductors & Semiconductor Equipment	4.56%
Apple Computer Inc.	Technology Hardware, Storage & Peripherals	4.45%
Hanesbrands, Inc.	Textiles, Apparel & Luxury Goods	3.98%
Microchip Technology	Semiconductors & Semiconductor Equipment	3.50%
Celgene Corporation	Biotechnology	3.27%
Annaly Capital Management Inc.	Real Estate Investment Trusts	3.18%
DowDuPont, Inc.	Chemicals	3.17%
Celanese Corporation - Series A	Chemicals	3.13%
Biogen Idec Inc.	Biotechnology	3.11%
Tencent Holdings Ltd. ADR	Internet Software & Services	3.02%
UnitedHealth Group Inc.	Healthcare Providers & Services	2.96%
Microsoft Corporation	Software	2.95%
McKesson Corporation	Health Care Providers & Services	2.90%
SPDR Gold Shares	Exchange Traded Funds	2.50%
Federated Investors, Inc. - Class B	Capital Markets	2.46%
Cameco Corporation	Oil, Gas, & Consumable Fuels	2.45%
PowerShares Buyback Achievers Portfolio	Exchange Traded Funds	2.42%
Lannett Company, Inc.	Pharmaceuticals	2.40%

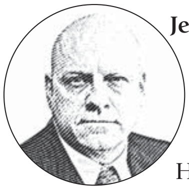
Composite holdings are subject to change and are not recommendations to buy or sell any security.

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).

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, Portfolio Manager, CFA, 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	30
Cash & Cash Equivalents	16.44%
Portfolio Turnover	14.20%‡

‡ *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

				ANNUAL PERFORMANCE			THREE-YEAR ANNUALIZED STANDARD DEVIATION*		
Year End	Total Firm Assets (USD) (millions)	Composite Assets (USD) (millions)	Number of Accounts	Composite Gross	Composite Net	S&P 500 Total Return Index	Composite	S&P 500 Total Return Index	Composite Dispersion**
2016	339	39	52	(1.86)	(2.68)	11.96	9.73	10.59	1.17
2015	422	48	67	(4.66)	(5.45)	1.38	10.41	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

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 December 31, 2016 by ACA Performance Services, LLC.

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 December 31, 2016. 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.*