

# MUHLENKAMP Memorandum

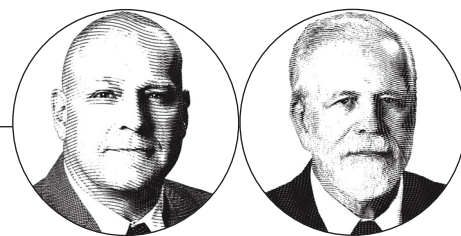
Issue 139

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## QUARTERLY LETTER

By Jeff Muhlenkamp, Portfolio Manager and Ron Muhlenkamp, Founder



Fellow Investors,

In our view, the main attribute of the second quarter was noise. The economic noise introduced by COVID-19 and the responses to it by individuals, businesses, and governments made it extremely difficult to determine what the underlying trends were. We expect this noisy environment to persist for at least another quarter or two assuming that COVID countermeasures diminish over time. If there is a resurgence of the virus and additional countermeasures are taken by governments the period of noise will be extended.

This inability to discern the underlying trend makes things difficult for businesses. In many cases demand for goods plummeted a year ago then soared this year—but what will it be next year? Should management expand their capacity or is the soaring demand temporary, and any expansion a waste of money? The service sector was hit even harder as many service providers were forced to close their doors due to lockdowns and are now working hard to get their operations back to a pre-COVID level of efficiency. Big swings in demand make planning difficult. Exacerbating the difficulty for businesses is the continuing chaos in supply chains, particularly those that are international. Not only are suppliers subject to local restrictions and shutdowns but port closures are occurring seemingly at random throwing shipping routes into chaos and driving shipping rates and transit times up. This increases both cost and uncertainty. Should the business owner invest time, effort, and money into diversifying or localizing his sources, or ride it out as best he may? These are the questions each business is asking currently, and

good answers are hard to come by. Their answers will likely affect both employees and customers over the longer term.

The noise in the economy is reflected in the stock and bond markets. Interest rates have fallen over the quarter with the 10-year treasury yield on 29 June at 1.48% (down .2% since our last letter and down .4% since 2 Jan 2020). Contrast that with inflation, which was up 4.99% year over year as of 31 May as measured by the Consumer Price Index. There is a reason inflation remains a top concern for many investors! The Federal Reserve's stated position is that higher inflation will be temporary and if that doesn't prove to be the case they have the tools to bring it back in line with their 2% goal. So far the bond market believes that message as indicated by the low yields on treasury bonds. The Federal Reserve continues to buy roughly \$120 billion worth of bonds monthly to support the economy. After their June meeting they gave just the slightest hint that they might start thinking about reducing those purchases sometime in the future. Fiscal policy remains exceptionally loose as well with the government continuing most COVID-era emergency programs including rent forbearance, unemployment bonuses, student lending forbearance, etc. Some programs have been curtailed, specifically the unemployment bonuses which have been discontinued in a number of states, while some have been extended. The details vary from state to state.

So it's tough to tell what demand looks like in the longer run, what supply looks like in the longer run, and how long government support will really last. Call it noise, call it fog, call it uncertainty.

In that context we continue to pay close attention to companies, not only the ones we own but also the ones we might like to own. Last quarter we highlighted that the economically sensitive companies we own had done quite well for us in the first quarter. This quarter they pulled back somewhat. Of particular note is the housing market where exceptional demand and limited supply drove prices dramatically higher very quickly. Prospective buyers are now getting sticker shock and rethinking their plans, suggesting there will be a shakeout in the industry in the near future. How exactly that will play out is, of course, unclear.

Also worth noting during the quarter was the FDA approval of a drug that treats Alzheimer's disease, Aduhelm, developed by Biogen Incorporated. We happen to own some shares of that company. While the approval was certainly good news and drove the stock price higher there is considerable controversy over both the effectiveness of the new drug and its pricing. We expect volatility in the stock price of Biogen to continue in the near future as market participants learn more about the drug, its effectiveness, demand for it, etc. We continue to hold a bit of gold, which hasn't done much this quarter, and a bit of cash. We continue to look for good opportunities for investment and will take advantage of them when we find them.

As always, if you've got questions or comments feel free to write or give us a call. We'd love to hear from you.

With our best wishes for your continued success and good health. 🏔️

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

## NOBODY ASKED ME (ABOUT CRYPTOCURRENCIES) BUT...

By Jeff Muhlenkamp, Portfolio Manager

I thought I'd share my thoughts on them anyway.

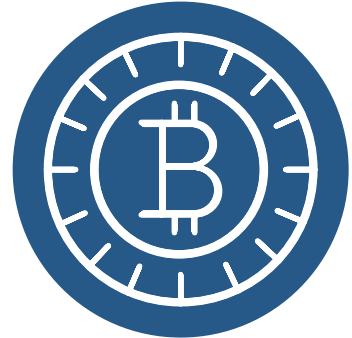
At a high level, cryptocurrencies are built on a distributed database, called a blockchain. The "distributed" part means that the database is replicated on a number of computers, not just one or two, and so no one really "controls" it. Bitcoin, the original cryptocurrency, is a token awarded to people who use their computers to run the ledgers of the database and record new transactions—it is their payment for doing the work the system requires. Bitcoin also has a maximum number of tokens, or coins that can be created, so it takes increasing amounts of computer processing to earn the next bitcoin. The limitation on the number of bitcoins that can be created is for some an attractive feature but while the number of Bitcoins that can be created is limited, the number of cryptocurrencies that can be created is not. Bitcoin has split three times since its creation as the rules governing it have changed, so there is now bitcoin, bitcoin cash, bitcoin sv, and bitcoin gold. Further, not all cryptocurrencies limit the number of tokens or coins that can be created as they have different rules and try to solve different problems. Ethereum, for instance, allows developers to deploy immutable contracts on it—ones that execute without further human intervention and can't be changed at a later date. The Ethereum blockchain also serves as the basis for other tokens using the ERC-20 protocol (ERC-20 stands for Ethereum Request for Comments 20). More on that a little later.

Cryptocurrencies have been suggested as replacements for other currencies ever since the original white paper published by Satoshi Nakamoto in 2008. The name itself is a marketing pitch for that idea. Cryptocurrency bulls, people who think the value of cryptocurrencies will continue to rise, justify their stance by asserting that as a given cryptocurrency is more widely adopted

the value will inevitably increase. That is logical for cryptocurrencies with limits on coin or token creation, but not for cryptocurrencies without that limitation. Thirteen years after the original whitepaper and twelve years after the creation of the first bitcoin how attractive are cryptocurrencies as currencies?

I think currencies in general perform three useful functions. They serve as a medium of exchange, a unit of account, and as a store of value. How do cryptocurrencies stack up in these areas?

- At this time, transacting in cryptocurrencies is less convenient than transacting in traditional currencies, either in cash or via electronic transfers. That may improve over time but right now the relative inconvenience is a barrier to wider use of cryptocurrencies as a medium of exchange. Additionally, very few sellers accept any cryptocurrency as payment for a good or service with the biggest exception being cyber attackers who demand ransom payments be made in a cryptocurrency (usually bitcoin). The reason they require bitcoin is because ownership is relatively anonymous. Finally, nation states have asserted the right to specify what will be considered legal tender within their borders. They guard that right jealously. China and India, for example, are restricting cryptocurrency mining and use. El Salvador, on the other hand, became the first country to adopt bitcoin as legal tender in 2021. The government of El Salvador destroyed confidence in its old currency and is trying to rebuild trust in both the currency and the government. The El Salvadoran colon was legal tender in that country from 1892-2001, joined by the US dollar in 2001, and by Bitcoin in 2021. It's not yet clear if adoption of bitcoin as legal tender has resulted



in widespread bitcoin use in El Salvador or improved the citizens confidence in their government. I think most countries will fight the widespread adoption of a currency they don't control and they have a lot of tools available to do that. I have a hard time envisioning a day when Uncle Sam pays my pension in bitcoin, lets me pay my taxes in bitcoin, and the Federal Reserve closes its doors because it no longer has a job. Honestly, I don't think governments are willing to relinquish control. Thus, I think there may be some legal hurdles to the adoption of cryptocurrencies as a medium of exchange.

- Unit of account is interesting - it's basically saying: "I will use this (a meter, a pound, a second) as the basis for measuring characteristics of things like distance, weight, or time." No one is pricing dollars in bitcoin, they are pricing bitcoin in dollars (or euro, or yen). The same is true of gold and silver—they are priced in dollars per ounce not ounces of gold per dollar. Thus, gold is not a unit of account. For a cryptocurrency to become a unit of account I think it would take a near simultaneous shift in how everyone measures value—to stop measuring it in dollars (or euro or yen) and start measuring it in bitcoin (or bitcoin sv or bitcoin gold). I think that could happen if fiat currencies become worthless—people no longer trust them to hold their value or accept them as payment. This is what happened

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in El Salvador where an untrusted currency has been replaced as legal tender by something else: first the dollar and now bitcoin. It has happened before (anyone still use the pre-US revolution continental?) and will almost certainly happen again, but I don't think we are near that point now with the dollar.

- Store of value – the price of cryptocurrencies as measured in dollars moves A LOT, making it difficult to know what it will be worth tomorrow, much less a year from now. Currently they are not a good store of value.

In summary, I really don't think cryptocurrencies are on the verge of replacing any of the major currencies, so buying a cryptocurrency today in the belief that it is the currency of the future will probably require a lot of patience and you run the risk of having your cryptocurrency outlawed. If governments continue to abuse the trust people have placed in their currencies by debasing them (inflation is another word for currency debasement) then there will be an opportunity for cryptocurrencies to be adopted on a wider scale.

But viewing cryptocurrencies as a currency is not the only way to think of them. You can also think of them as a financial asset in the same way that some people think of art, classic cars, or other collectibles as an asset. You buy them with the expectation of selling them later at a higher price. Certainly, the meteoric rise in price of Bitcoin and other cryptocurrencies has encouraged this viewpoint and attracted both Wall Street and scammers. Let's talk about Wall Street first.

Wall Street loves to sell things. It has an enormous marketing arm and it's always looking for "assets" it can package and sell with the associated options, futures, etc. A year or two ago Wall Street declared cryptocurrencies an "asset class" and got busy finding ways to make it easier for both investment professionals and amateurs to invest in them. They have been successful in both creating new products and selling them to investors of all stripes. This additional

demand has coincided with a rise in the price of cryptocurrencies. At some point Wall Street will saturate the market with cryptocurrency products and the inflows of cash into cryptocurrencies due to investor demand will slow, reducing the upward pressure on price.

Cryptocurrencies have also attracted their fair share of scammers. You may recall the headlines from March 2021 describing the New York Adjutant General's investigation into Bitfinex (a cryptocurrency exchange) and Tether (a cryptocurrency company) and the resulting settlement. Essentially Tether (the company) claimed that the tether (their cryptocurrency) was 100% backed by dollars held by the company and therefor the value of 1 tether was essentially pegged at \$1. The New York Adjutant General demonstrated Tether's claims were false, that the reserves were only about 70% of the outstanding value of tether and that those reserves had only recently been lent to Tether by Bitfinex. In other words, the peg was fraudulent. Interestingly, it appears that tether is often used to buy bitcoin. So, one might ask "What happens to the value of bitcoin, the biggest of the cryptocurrencies, if tether (the cryptocurrency) declines in value or Tether (the company) goes out of business." I suspect nothing good.

Coincidentally in early July I read two accounts of cryptocurrencies that were created on top of the Ethereum blockchain (using that ERC-20 protocol mentioned above) and then marketed and sold. One was created as a lark by a British guy, the other appears designed to funnel money into the pocket of the creator. The British guy, an internet personality, explained everything he was doing in a podcast as he did it – creating the token (very easy), creating the twitter account, creating the website, selling some tokens, etc. He was as upfront as he could be that he was creating his coin as a bit of whimsy, and yet some were purchased and established a price for the remainder, which he owns. Should he be able to sell his coins without destroying the price he would be able to convert his paper millions into actual wealth. The other guy was not at all transparent in

what he was doing or why and seems to have simply created a coin with the intent of using interest in all things cryptocurrency to line his own pocket.

It seems to me there is a lot of speculation in cryptocurrencies—people see the price going up and they buy some hoping it will continue to go up and they can become rich. I'm also seeing an increasing awareness of scams and frauds in the space as described above. The scams are probably big enough now that when they collapse, as they likely will, legitimate cryptocurrencies will also decline in price and the damage will probably carry over into stock markets, transmitted by persons or organizations that hold both cryptocurrencies and stocks.

I have no doubt that blockchain technology will prove very useful in the long run and it is likely that some cryptocurrencies will as well. In the short term, however, the whole space looks increasingly hazardous to me. 🚩

*Cryptocurrencies and blockchain systems could be vulnerable to fraud. Investing in cryptocurrencies is highly speculative and an investor can lose the entire amount of their investment.*

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

## ANNOUNCEMENTS

### Request for Email Address

Muhlenkamp & Company regularly publishes information that gets distributed by email only. To be added to our email list, visit [www.muhenkamp.com](http://www.muhenkamp.com) or call us at (877) 935-5520. Join our list so you get notified when our latest Blogs and Webcasts are available!

### Visit our Vimeo Channel

We have a collection of webcasts and seminars at <https://vimeo.com/muhenkamp>. 🚩



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## MUHLENKAMP Memorandum

Inside this issue:

- Quarterly Letter
- Nobody asked me (about cryptocurrencies) but...
- Announcements



**Pave your path  
to a better  
financial future  
by making  
small changes  
today.**



Do you have a simple money question or need financial advice? If so, it sounds like you should talk with Tony about that! If Tony can't assist you, he can direct you to someone who can.

(724)934-5139 or [tony@muhlenkamp.com](mailto:tony@muhlenkamp.com)

Sometimes it just takes small shifts in daily habits today to put you on a better path for your future.

*Tony Muhlenkamp has been with Muhlenkamp & Company since 1992. He works with clients to identify, avoid, and resolve their money problems; and has written and spoken about the lessons he has learned. Tony serves clients as a counselor, adviser, planner, and manager on a wide variety of financial and investment questions.*

# MUHLENKAMPSMA

# ALL-CAP VALUE

For the period ended 6/30/2021

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)

	Year to Date	One Year	Annualized			
			Past 3 Years	Past 5 Years	Past 10 Years	Past 15 Years
Return	18.80%	45.34%	12.14%	9.60%	7.69%	3.75%
S&P 500 Total Return*	15.25%	40.79%	18.67%	17.65%	14.84%	10.73%
Consumer Price Index**	3.35%	4.99%	2.28%	2.30%	1.77%	1.92%

\* 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 May 2021 – 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
Mastec Inc	Construction & Engineering	4.48%
WESCO International Inc	Trading Companies & Distributions	4.33%
Dow Inc	Chemicals	4.26%
Alliance Data Systems Corp	IT Services	4.09%
Microchip Technology Inc	Semiconductors & Semiconductor Equipment	4.05%
Microsoft Corp	Software	3.78%
Tenneco Inc.	Automobile and Components	3.73%
Apple Inc	Technology Hardware, Storage & Peripherals	3.57%
Broadcom Inc	Semiconductors & Semiconductor Equipment	3.46%
Cameco Corp	Oil, Gas, & Consumable Fuels	3.42%
Schlumberger NV	Energy Equipment & Services	3.26%
Kirby Corp	Marine	3.21%
ALPS Alerian MLP ETF	Exchange Traded Funds	3.10%
McKesson Corporation	Health Care Providers & Services	3.06%
UnitedHealth Group Inc	Health Care Providers & Services	3.06%
Berkshire Hathaway Inc Class B	Diversified Financial Services	2.99%
CVS Health Corp	Health Care Providers & Services	2.91%
Meritage Homes Corp	Household Durables	2.91%
SPDR Gold Shares	Exchange Traded Funds	2.55%
Bristol-Myers Squibb Company	Pharmaceuticals, Biotechnology	2.52%

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 MANAGER



**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.

## INVESTMENT ADVISER

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## SMA FACTS

Average Number of Equity Holdings 30  
Cash & Cash Equivalents 15.12%

*SMA Facts are presented as supplemental information.*

## SMA INFORMATION

The inception date for the All-Cap Value Composite is December 31, 1993. The All-Cap Value Composite was created in December 2003. The Composite 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.

**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			THREE-YEAR ANNUALIZED STANDARD DEVIATION*		
				Composite Gross	Composite Net	S&P 500 Total Return Index	Composite	Total Return Index	Composite Dispersion**
2020	261	38	45	14.06	13.14	18.40	18.63	18.79	1.38
2019	253	34	48	14.70	13.78	31.49	10.33	12.10	1.37
2018	254	32	51	(11.71)	(12.45)	(4.38)	9.24	10.80	1.21
2017	342	40	52	15.24	14.30	21.83	8.70	9.92	2.12
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

*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, 2016 by Ashland Partners & Company LLP and for the periods July 1, 2016 through June 30, 2020 by ACA Performance Services. A firm that claims compliance with the GIPS standards must establish policies and procedures for complying with all the applicable requirements of the GIPS standards. Verification provides assurance on whether the firm's policies and procedures related to composite and pooled fund maintenance, as well as the calculation, presentation, and distribution of performance, have been designed in compliance with the GIPS standards and have been implemented on a firm-wide basis. The All-Cap Value Composite has had a performance examination for the periods December 31, 2006 through June 30, 2020. The verification and performance examination reports are available upon request.

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Muhlenkamp is an independent registered investment advisory firm registered with the Securities and Exchange Commission. A list of composite descriptions and a list of broad distribution pooled funds are 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 investments, calculating performance, and preparing GIPS Reports are available upon request.

\* **Three-Year Annualized Standard Deviation** is a measure of volatility, calculated by taking the standard deviation of 36 monthly returns, net of fees, 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, net of fees, 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.