

Muhlenkamp & Company, Inc.

## Quarterly Letter

*Ron Muhlenkamp*

January 2013

2012 was a year of mixed results on the economic front, but generally good investment returns as measured by the S&P 500 Index. Some progress was made in Europe and China, and some clarification in direction was made in the U.S. We presented our thoughts on these topics at our December 6 seminar; an archive will be available on our website.

A brief review follows:

The U.S. economy continued to expand, but at a modest rate. Consumer spending is growing moderately at a 2%-3% annual rate; consumer saving is at 3%-4% of income. Consumer confidence has improved since 2009, but is still at the subdued levels seen during the prior recession. Gasoline consumption has declined 5% since 2006, after climbing steadily prior to that. Housing has begun to recover and car sales are approaching “normal” levels.

Business investment and hiring remain subdued as businesses await clarification of the rules on taxes, regulation, and government policy. Business and commercial borrowing are picking up a little. Bank health continues to improve.

The Federal Reserve continues to hold interest rates at artificially low levels, squeezing the returns to retirees and pension funds. The Fed’s balance sheet is no longer growing. The remaining big question in the U.S. is whether we contain government spending, which has been shown to lower economic growth. A major problem is that many think government spending enhances economic growth.

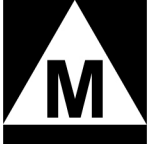
Commodity prices have leveled off, but remain quite volatile. In the energy markets, there remains a huge spread between the price of crude oil and natural gas. In early 2012, the fuel cost of natural gas fell below that of coal, causing many power plants to shift consumption to natural gas. We expect these fuels to remain competitive for the foreseeable future.

While the recent rise in tax rates (and FICA taxes) will serve as a drag on the U.S. economy, we expect the U.S. to avoid recession with modest growth.

In Europe, the crisis of policy seems to have peaked, but much of the continent is reentering recession. We think the probability of Europe’s problems threatening the viability of the U.S. based international banks has lessened.

China appears to have achieved its goal of containing inflation by slowing the economy and is likely to resume Gross Domestic Product (GDP) growth, but at a slower than historic rate and with a focus on the consumer.

During early 2012, we held more than normal cash reserves and remained focused on large, U.S. based companies with strong balance sheets and cash flows. As some of the above-mentioned issues were clarified, we’ve invested most of the cash, some of it in smaller companies.



**Muhlenkamp & Company, Inc.**

Our resulting performance, while trailing the S&P500 Index for the full year, has tracked a bit above it in recent months. We continue to seek good companies at modest prices.

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

# Muhlenkamp & Company, Inc.

FOR THE PERIOD ENDED 12/31/12

## ALL-CAP VALUE COMPOSITE

Muhlenkamp & Company's All-Cap Value Composite includes all fee-paying accounts over \$100,000, full discretion, under management for at least one full quarter, which are invested in the all-cap style. The composite excludes the Muhlenkamp Fund and any wrap fee account.

## OBJECTIVE

Maximize total return, consistent with reasonable risk.

## STRATEGY

Invest 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).

## PORTFOLIO MANAGER

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

## ALL-CAP VALUE COMPOSITE TOP TEN HOLDINGS

Company	Industry	% of Net Assets
Alliance Data Systems Corporation	IT Services	5.2
J.P. Morgan Chase & Co.	Diversified Financial Services	3.4
Covidien LLC	Health Care Equipment & Suppliers	3.2
Discover Financial Services	Consumer Finance	3.2
Microsoft Corporation	Software	3.1
Ford Motor Company	Automobiles	3.0
State Street Corporation	Capital Markets	2.9
General Electric	Industrials	2.9
Intel Corporation	Semiconductors & Semiconductor Equipment	2.9
American International Group	Insurance	2.9

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

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

## ALL-CAP VALUE COMPOSITE PERFORMANCE (NET OF FEES) AS OF DECEMBER 31, 2012

Year-To-Date	Annualized				
	One Year	Past 3 Years	Past 5 Years	Past 10 Years	Past 15 Years
10.34%	10.34%	2.78%	-3.32%	4.59%	2.49%

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.

## INVESTMENT ADVISER

Muhlenkamp & Company, Inc.  
5000 Stonewood Drive, Suite 300  
Wexford, PA 15090-8395  
(877)935-5520

[www.muhlenkamp.com](http://www.muhlenkamp.com)

## ALL-CAP VALUE COMPOSITE FACTS

ROE	17.80% *
Long-Term Earnings Growth	14.48% *
Average P/E	13.08 *
Portfolio Turnover	36.13% **

\* Weighted averages using Bloomberg data as of 12/31/12

**Note:** Average ROE has been adjusted. Reported ROEs >60% have been marked down to 20%, providing a lower, more conservative, (and we believe more meaningful), valuation for the company.

\*\* Trailing 12 Months

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

**Long-Term Earnings Growth is not a forecast of the Composite's future performance.**

**Price-to-Earnings Ratio (P/E)** is the current stock price, divided by the earnings per share.



**Muhlenkamp & Company, Inc.**  
Intelligent Investment Management

# 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	S&P 500 Total Return Index	Composite Dispersion**
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
2000	428	101	99	16.10	15.23	(9.10)			5.98
1999	297	100	110	5.15	4.32	21.04			10.82
1998	338	121	118	0.89	0.12	28.58			3.26
1997	226	86	89	32.02	30.95	33.36			4.24

*Muhlenkamp & Company's All-Cap Value Composite includes all fee-paying accounts over \$100,000, full discretion, under management for at least one full quarter, which are invested in the All-Cap style. The composite excludes the Muhlenkamp Fund and any wrap fee account. The objective of this All-Cap Value Composite is to maximize total 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, 2011 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 December 31, 2011. 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.



**Muhlenkamp & Company, Inc.**  
Intelligent Investment Management

Results 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.

The investment management fee schedule for the Composite is 1% on the first \$1 million, and 0.5% on the remainder. Actual investment advisory fees incurred by clients may vary.

The All-Cap Value Composite was created in November, 1978.

\* **Three-Year 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 tradeable 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.