Muhlenkamp & Company, Inc.

Quarterly Letter by Tony Muhlenkamp
January 2015

Tony had some ideas and observations he wanted me to share, but I thought it made sense for him to tell you directly in this edition of our Quarterly Letter. – Ron

2014 was a year of mixed results and mixed emotions.

The headlines make no secret that "the market" is setting new highs. However, the market they are referring to is the S&P 500, which is dominated by the 20 largest market capitalized companies in the United States. Outside those top 20 is a mixed bag of winners and losers. Small caps in the Russell 2000 are flat for the year; energy stocks are down for the year; international stocks were down for the year; bio-tech was up for the year.

Additionally, the gains did not occur uniformly; instead prices were choppy and advanced/declined with your particular choice of stocks. If you were out of the market on particularly good days, or particularly bad ones, then your performance differed radically from that of the market. If you were taking out some money, or adding some money, the timing of that transaction could make a big difference in your performance.

A friend of mine confided that his wife's 401(k) is allocated 30% international, 30% domestic, and 30% bonds and that her performance this year was just 1%. So how you did this year hinged on what you owned (or didn't own) and when you bought or sold it. This was not the homogeneous market we hear about on the news.

For our clients, we continued the strong performance we had in 2013 through the first half of the year, to the extent that we started harvesting the companies that had done well for us and realized some capital gains. In the third quarter the market prices of our companies were bid down and from there it was a mixed bag.

A big factor in the last half of the year was the price of crude oil dropping from $110 per barrel to $60 per barrel; a drop of 45%. Our energy holdings are primarily natural gas related and should not have been impacted by oil prices being halved, or so we thought. We know the price of natural gas and the price of oil have been on separate tracks since 2009; (see our booklet "Natural Gas: An Energy Game Changer"). The separate tracks for the prices of oil and natural gas continued in 2014 but the prices of the stocks of the companies involved went down with the price of crude. This should be an opportunity, but owning natural gas companies hurt our performance in the last half of the year.

The big beneficiary of the decline in the price of oil is the U.S. consumer, and to a lesser extent, the world consumer. There are 42 gallons in a barrel of oil, so a $50 drop in the price per barrel is a drop of $1.20 in the price per gallon, and you've seen that at the gasoline pump (and to a lesser extent, so far, at the diesel pump). We talk more about the effect on consumers around the world in the accompanying article "Effects of Currency Manipulation."

The people hardest hit by the decline in the price of oil are the producers of oil, both domestic U.S. producers and international producers, including the drillers, the service companies, the landowners; etc. Producers who are particularly vulnerable include the nations of Venezuela and Russia. Their problems are compounded by the rapidity of the decline. The producers, their owners, and their lenders have not yet had time to react. We expect some of them to go bankrupt.

Our biotech companies helped us, as did our airlines and our financials. But you never own enough of the ones that go up, and you always own too much of the ones that don't.

We are disappointed when we under-perform "the market," but that disappointment is tempered by the realization that we own very good companies that are selling for less than they are worth. We have written in the past about our internal performance benchmark being average annual returns of at least 5% over inflation for periods of time measured in years, not in days, weeks, or quarters; and we continue to apply that standard.

Returns of 5% over inflation are not available in cash or bonds, so we are looking for companies that are profitable enough, and priced low enough, that we can reasonably expect those returns over time. We are focusing on our companies and how profitable they are; how well they are growing; how well they are managed; and whether they are currently selling for more or less than they are worth. What is the business worth? Can I buy it for less than that or sell it for more than that? How much less, how much more? Simple questions that don't always have simple answers.

We are also paying attention to central banks, government policies and economies around the world because they set the terms by which our businesses have to operate. We have spoken and written extensively comparing investing to farming and how it helps to know the climate and the season you are operating in, and these macro factors determine the investing climate and season. These macro factors help us know what to plant and what is ripe and can be harvested. They determine whether our companies enjoy tail winds or face head winds as they run their business and provide the products and services consumers desire. Those same macro factors can also influence whether consumers have the desire and the ability to purchase those goods and services. In a free economy, the consumer is king and companies do well that benefit the consumer; so consumer incentives are important.

Today we observe that the market is a mixed bag; some companies are profitable and growing, some companies are not. Some companies are selling for much less than they are worth, some are selling for much more. We call that a stock picker's market, and it's where we like to live.

We observe that economies around the world are growing, although some are not growing as fast as they could. Some consumers around the world are OK; some are being squeezed. In general they are OK—not starving, but not necessarily thriving either—and we are on the lookout for policies that will make the consumers life easier, or harder.

We are finding enough companies that meet our criteria, and we think macro conditions are good enough, that we are fully invested in common stocks.

We continue to believe that emotional decisions are bad decisions. This is almost universally true, and clearly true for investing. We write these letters, hold our seminars, and publish booklets on various topics to help build an intellectual framework for investing and to counter the corrosive effects of the emotions that are so prevalent among investors. Please let us know how we are doing and if there is more we can do for you.

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

One cannot invest directly in an index.

MuhlenkampSMA All-Cap Value

For the period ended 12/31/14

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 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	9.37%	9.37%	17.49%	9.80%	2.75%	4.85%
S&P 500 Total Return*	13.69%	13.69%	20.41%	15.45%	7.67%	4.24%
Consumer Price Index**	1.33%	1.32%	1.44%	1.77%	2.14%	2.28%

* **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 – As of November 2014 U.S. CPI Urban Consumers NSA (Non-Seasonally Adjusted), Index**

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	6.89%
Hanesbrands, Inc.	Textiles, Apparel & Luxury Goods	6.16%
Covidien PLC	Health Care Equipment & Supplies	4.01%
Gilead Sciences, Inc.	Biotechnology	3.71%
Discover Financial Services	Consumer Finance	3.65%
J.P. Morgan Chase & Company	Diversified Financial Services	3.40%
American International Group, Inc.	Insurance	3.25%
Microsoft Corporation	Software	3.23%
State Street Corporation	Capital Markets	3.10%
Apple Inc.	Computers & Peripherals	3.08%
Celanese Corporation	Chemicals	2.98%
American Axle & Manufacturing Holdings, Inc.	Auto Components	2.95%
Celgene Corporation	Biotechnology	2.75%
DIRECTV	Media	2.70%
Annaly Capital Management Inc.	Real Estate Investment Trusts	2.66%
General Motors Company	Automobiles	2.60%
American Airlines Group Inc.	Airlines	2.51%
Spirit Airlines Inc.	Airlines	2.43%
Berkshire Hathaway Inc. - Class B	Diversified Financial Services	2.41%
ARRIS Group Inc.	Communication Equipment	2.37%

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.
Intelligent Investment Management

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.

Investment Adviser

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SMA Facts

Average Number of Equity Holdings	31
Cash & Cash Equivalents	7.94%
Portfolio Turnover	23.90% ‡

‡ *Trailing 12 months*

SMA Facts are presented as supplemental information.

SMA Information

Created in December 1993, Muhlenkamp & Company's All-Cap Value Composite includes separately managed fee-paying accounts over $100,000, full discretion, under management for at least one full quarter. 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 Composite Gross	Composite Net	S&P 500 Total Return Index	THREE-YEAR ANNUALIZED STANDARD DEVIATION* Composite	S&P 500 Total Return Index	Composite Dispersion**
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
2000	428	101	99	16.10	15.23	(9.10)			5.98

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, 2013 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, 2013. 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.*

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