



Muhlenkamp & Company, Inc.

## Quarterly Letter, July 2017

Fellow Investor,

As June comes to a close, we find that most of the things we talked about in March haven't changed much. Starting at the international level, both the European and Japanese Central banks continue to buy bonds (Japan also buys equities) in order to manage interest rates and support their economies. The European Central Bank hinted during a speech in late June that it may be appropriate to think about ending their program, but the Bank of Japan isn't even discussing ending theirs. We'll have to see how things develop. French elections, which had the potential to be disruptive, turned out to be a non-event. We'll see what Macron does now that he's in power. He may manage to make some changes that will free up the French economy and get it moving again.

International trade has not been disrupted by a U.S./China trade war which some feared based on statements made by President Trump. Chinese economic growth continues to meet their government-set goals of about 6.5% and the renminbi has been fairly stable against the dollar. Interestingly, the organization that governs what countries are included in global stock indices decided in mid-June to start including Chinese shares in the global index (MSCI EAFE Index\*) for the first time. Lastly, the war in Syria hasn't created any economic problems either.

Domestically, the economy continues to grow at about 2% when adjusted for inflation. Inflation remains below 2%, aided by declining oil prices which have dropped from about \$50 per barrel at the start of the year to close to \$40 per barrel currently. Unemployment remains low but wages haven't grown much. The Federal Reserve raised the Federal Funds rate (short-term interest rate they charge banks that sets short-term rates in the U.S.) by another .25% to 1.25% as expected and they detailed how they intend to reduce the size of their balance sheet in the near future, but not when they would start. While short-term interest rates have risen, long term-interest rates have not.

In the March newsletter and again during our May webcast (both of which can be located on our website [www.muhlenkamp.com](http://www.muhlenkamp.com)) we told you that small business optimism had improved immensely postelection—it remains at high levels even though neither the promised health care revamp nor tax cuts have yet come out of Washington. First quarter earnings in the aggregate were good, with both revenues and earnings coming in higher than the prior quarter. On the negative side, we are seeing enormous disruption in the retail sector as consumers change how they shop, creating a few big winners and many big losers. A year ago we saw increased bankruptcies in energy companies, now it's happening to retailers. We are also seeing an increase in credit defaults by consumers—mostly with auto loans but a little bit with credit cards too.

The U.S. stock market, in aggregate, is expensive relative to its own history and margin debt (money borrowed from brokers to buy stocks, using the stocks themselves as collateral) is once again setting new highs.

That's what we are seeing. Here's what we think:

- We expect slow economic growth in the U.S. to continue in the short term while recognizing we can't see very far down the road. The signs we are seeing in the credit markets are not immediately disconcerting, but will become a concern if they get worse. Increased business optimism hasn't resulted in increased capital investment by companies—we're watching for signs of that too.
- We think assets in general (bonds and stocks) have been supported in part by central bank asset purchases. That era may be coming to an end as the Federal Reserve begins to shrink its balance sheet. This makes us cautious and we'll be paying close attention to the plans of the foreign central banks we've talked about as well as the implementation of the Fed's plans.



**Muhlenkamp & Company, Inc.**

Here's what we are doing:

- We continue to sell assets that have done well for us and reached what we consider full value and invest in undervalued companies when we find them. We are comfortable holding cash when we can't immediately find undervalued companies.
- We don't own any bonds as they remain overpriced relative to inflation.
- We are slowly reducing our holdings of companies that are most exposed to the cyclical aspects of the domestic economy.

Until next quarter.....

Ron Muhlenkamp and Jeff Muhlenkamp

*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.*

\***MSCI EAFE Index** is a stock market index that represents the equity market performance of large and mid-cap securities outside the U.S. and Canada. The EAFE acronym indicates that the location of the 21 developed markets are within Europe, Australasia, and the Far East.

# MuhlenkampSMA

# All-Cap Value

For the period ended 6/30/17

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	5.79%	9.33%	-0.78%	8.35%	0.50%	4.49%
S&P 500 Total Return*	9.34%	17.90%	9.61%	14.63%	7.18%	8.34%
Consumer Price Index**	1.37%	1.87%	0.95%	1.27%	1.64%	2.08%

\* 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 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	6.55%
Apple Computer Inc.	Technology Hardware, Storage & Peripherals	4.36%
Gilead Sciences, Inc.	Biotechnology	4.28%
Hanesbrands, Inc.	Textiles, Apparel & Luxury Goods	3.88%
ON Semiconductor Corporation	Semiconductors & Semiconductor Equipment	3.65%
Annaly Capital Management Inc.	Real Estate Investment Trusts	3.40%
McKesson Corporation	Health Care Providers & Services	3.22%
Microchip Technology	Semiconductors & Semiconductor Equipment	3.12%
Celgene Corporation	Biotechnology	3.03%
Dow Chemical Company	Chemicals	2.99%
Celanese Corporation - Series A	Chemicals	2.97%
UnitedHealth Group Inc.	Healthcare Providers & Services	2.90%
Microsoft Corporation	Software	2.85%
Biogen Idec Inc.	Biotechnology	2.80%
Lannett Company, Inc.	Pharmaceuticals	2.76%
SPDR Gold Shares	Exchange Traded Funds	2.57%
Tencent Holdings Ltd. ADR	Internet Software & Services	2.56%
PowerShares Buyback Achievers Portfolio	Exchange Traded Funds	2.46%
Federated Investors, Inc. - Class B	Capital Markets	2.42%
Cameco Corporation	Oil, Gas, & Consumable Fuels	2.39%

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.



## SMA Facts

Average Number of Equity Holdings 32  
Cash & Cash Equivalents 14.99%  
Portfolio Turnover 14.25%†

† 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.



**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

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

www.muhlenkamp.com

**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	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 June 30, 2016 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, 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.