



QUARTERLY LETTER, APRIL 2022

Fellow Investors,

"The times they are a-changin'."¹

Inflation appears to be here to stay. The US inflation rate in February (latest data available) as measured by year-over-year change in the Consumer Price Index (CPI) was 7.9% (up from 7% the end of December). Inflation measured this way has been above the Federal Reserve's 2% target since March 2021. Responding to higher inflation the Federal Reserve flipped from encouraging inflation to discouraging inflation. Specifically, they raised the Federal Funds rate .25% in March and are expected to continue increasing the Federal Funds rate for the next 18 months or so. They have also ended their bond purchasing program and have begun discussing reducing their holdings of bonds.

Thus, interest rates are rising. The yield on the 30-year Treasury bond on 28 March was 2.56% (up from 2% at the end of December) and the average rate on new 30-year fixed rate mortgages for a conforming borrower was 4.56% (up from 3.2% in December). You'll notice that both the 30-year Treasury yield and the mortgage rate are significantly below the rate of inflation – so both the Federal Government and homebuyers can borrow today and repay the loan with dollars whose value has declined at a faster rate than payments have accrued. This arrangement, where inflation-adjusted borrowing rates are negative, rewards the borrower at the expense of the lender. We discussed this in greater depth in Memo 140 which we published in October 2021.

As you probably already know, bond yields move in the opposite direction of bond prices. Thus, rising bond yields means falling bond prices. If you held a Treasury Bond that matures in 30 years on 31 December 2021 you've seen its price fall by roughly 10% in three months. The S&P 500 Total Return Index has fallen 4.3% over the same time frame. Reflect on that for a moment. *Over the last three months "safe" treasuries have declined twice as much as "risky" stocks.* Our fear is that the rules of thumb developed by investors over the last 30 years, a period of declining interest rates, will continue to be applied by investors going forward EVEN THOUGH THE CONDITIONS THAT MADE THEM TRUE NO LONGER EXIST. Bonds are no longer "safe." A 60% bond 40% stock portfolio is no longer "conservative." We can't say it any plainer than that.

We expect inflation will impact stocks as well. Inflation will obviously raise the input costs for businesses, many of which will struggle to pass those higher costs along to their customers – reducing their profitability. For those companies that rely on external capital for their growth, or even continued operations, they will find the cost of capital increasing and perhaps becoming less available. In general, we expect profitability to decline and price-to-earnings ratios (P/E ratio) to contract.

This dynamic appears to be unfolding before our eyes. Inflation and rising interest rates have proved to be the pin that popped the bubble in growth stocks. Starting last summer, most of the very popular growth stocks have experienced sharp price declines of up to 80 to 90%. While some of those stocks have reached reasonable valuations many others remain quite expensive. We are spending a fair bit of time looking for investments in this subset of the market but so far, we've kept our wallet in our pocket. We think there is more pain to come for these stocks.

The reappearance of US inflation is not the only potential seismic shift in the investing environment. I think four other shifts may prove to be significant going forward:

First, companies are shifting from optimizing efficiency in their supply chains to improving the reliability of their supply chains. Twenty-five years ago, companies built their new plant in China to take advantage of cheaper labor. Twelve years ago, companies built their new plant in China because that's where the incremental demand for their products was coming from. Tomorrow companies will build a new plant where they can be more confident in its ability to continue to function under adverse circumstances—reducing shipping links and emphasizing reliable political jurisdictions. The change won't be dramatic, but over time it will significantly restructure how and where goods are produced. The shift in this direction started with the Trump tariffs, was turbocharged by COVID-19 related lockdowns, and has been re-emphasized by the Russia-Ukraine War. As an example, I just read an article today which discussed Chinese suppliers to American companies looking to build plants in Mexico at the request of their customers. Another recent example is Intel's decision to build new computer chip plants in Ohio instead of relying on manufacturers in Taiwan for their supply. So, to a small degree we are already seeing this occur. We believe this represents the early days of a new trend.

Second, China is in the beginning stages of dealing with its over-reliance on property development for growth. Several large property developers are in the slow-motion process of failing; property prices are falling, and the government is doing its best to manage the fallout. So far, things are under control. Things may, or may not, get out of hand, but the growth mechanism China has relied on for 30 years is now finished and a new one must be found. If history is any guide, it may take a while for a new source of demand to supplant the old one. Again, this isn't something we are predicting, it is something we are observing: and we think it will turn out to be meaningful. As an aside, our conclusion a year ago that Chinese stocks had become uninvestable appears to have been timely.

Third, the international role of the dollar as the trading currency of choice and the role of US Treasuries as a reserve for foreign central banks are being challenged. Saudi Arabia is considering allowing China to purchase oil with Renminbi (China's currency) – potentially reducing the demand for dollars as a trading currency. Nearly simultaneously central banks holdings of US treasuries as a reserve has just gotten a lot less attractive in the wake of the US freezing Russia's dollar reserves after the invasion of the Ukraine. What good are savings you can't access when the emergency comes? We expect central banks will think very hard about the assets they hold as reserves and may shift their holdings. Equally interesting were two decisions by Russia last week. First they are now requiring that "unfriendly countries (meaning the European Union) pay for natural gas shipments in Rubles (the Russian currency) not Euro (the European Union's currency). Second their central bank has declared they will buy gold at a fixed Ruble rate—which looks like a gold peg to me. The Euro used to be the "hard currency" and the Ruble was only good inside of Russia. Are we seeing that reverse before our eyes? These developments raise many, many questions in our minds. We have no conclusions yet, but it certainly seems as if some long-standing assumptions are getting challenged when it comes to the international role of currencies.

Fourth. Western Europe is now dealing with the consequences of past energy and defense policies. An emphasis on solar and wind energy created a fragile power grid that fell short in the winter of '21-'22 when the wind was lighter than normal and natural gas prices skyrocketed. The Russian invasion of the Ukraine brought home the reality that European reliance on Russian natural gas and the poor state of Western European militaries severely constrained the ability of European governments to shape their response to Russian aggression. Now Western Europe is quickly declaring natural gas and nuclear power "green" energy and scrambling to diversify away from Russian sources while simultaneously pledging to increase defense spending and revamp their armed forces. Quite the turn of events in a very short time.

We think these changes are large and will likely be long lasting. In many respects the near future will not be like the immediate past and it will be important to shift investing strategies to adapt to the changes. In short, we think the investing environment is changing.



How is this thinking reflected in our process and portfolios? Most obviously we continue to think bonds on anything but a very short-term basis are unlikely to grow your wealth. Bonds went from being *potential* losers to being *actual* losers, and we think that trend continues until the government gets serious about fighting inflation – which they haven't done yet. (It may take an election cycle or two. We probably have to hire politicians who campaigned on the promise to fight inflation in order to get it done). We've also changed the assumed inflation in Ron's valuation model which we use to evaluate companies. In general, this gives us a lower valuation for companies and means fewer stocks look attractive when we compare our estimate of their value to their current price. Last summer we observed that our tech holdings had both gotten above our assessment of fair value and were losing their upward momentum—so we reduced our holdings in those companies. We also observed that energy companies had gotten very disciplined about spending money on new sources of supply for a variety of reasons. This meant the supply of oil and gas is unlikely to grow even as demand returns after the COVID induced restrictions end. This seemed an attractive opportunity and we invested in a couple of energy companies. This shift in our portfolio over the last six to nine months has worked out pretty well so far.

As always, if you have questions, give us a call. We'd love to hear from you.

With our best wishes for your continued success and good health,

Ron Muhlenkamp, Founder
Muhlenkamp & Company, Inc.

Jeff Muhlenkamp, Portfolio Manager
Muhlenkamp & Company, Inc.

¹ Bob Dylan, 1964

CPI – *The Consumer Price Index ("CPI") measures the average change in prices over time that consumers pay for a basket of goods and services, commonly known as inflation. One cannot invest directly in an index.*

S&P 500® Index – *The 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.*

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

MUHLENKAMPSMA

ALL-CAP VALUE

For the period ended 3/31/2022

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	4.58%	19.19%	17.12%	10.45%	8.77%	5.76%
S&P 500 Total Return*	-4.60%	15.65%	18.92%	15.99%	14.64%	11.45%
Consumer Price Index**	1.76%	7.87%	3.92%	3.10%	2.23%	2.24%

* 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 February 2022 – 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
EQT Corporation	Oil, Gas, & Consumable Fuels	4.47%
McKesson Corporation	Health Care Providers & Services	4.17%
Occidental Petroleum	Oil, Gas, & Consumable Fuels	3.89%
Dow Inc	Chemicals	3.67%
Schlumberger NV	Energy Equipment & Services	3.61%
UnitedHealth Group Inc	Health Care Providers & Services	3.35%
Kirby Corp	Marine	3.28%
Berkshire Hathaway Inc Class B	Diversified Financial Services	3.27%
Mastec Inc	Construction & Engineering	3.15%
CVS Health Corp	Health Care Providers & Services	3.04%
Tenneco Inc	Auto Components	3.02%
Broadcom Inc	Semiconductors & Semiconductor Equipment	2.93%
Apple Inc	Technology Hardware, Storage & Peripherals	2.83%
ALPS Alerian MLP ETF	Exchange Traded Funds	2.81%
Microsoft Corp	Software	2.77%
Bristol-Myers Squibb Company	Pharmaceuticals	2.43%
Microchip Technology Inc	Semiconductors & Semiconductor Equipment	2.40%
SPDR Gold Shares	Exchange Traded Funds	2.36%
Lockheed Martin Corp	Aerospace and Defense	2.29%
Rush Enterprises Inc	Trading Companies & Distributions	2.20%

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 31
Cash & Cash Equivalents 21.07%

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**
2021	317	48	48	28.05	27.11	28.71	18.28	17.41	1.67
2020	265	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

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 December 31, 2021 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 December 31, 2021. 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. The firm maintains a complete list of composite descriptions and pooled funds, which 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 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.