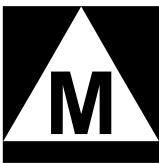


The Frugal Consumer...

Will It Last?



Muhlenkamp & Company, Inc.
Intelligent Investment Management



Ronald H. Muhlenkamp is founder and president of Muhlenkamp & Company, Inc., established in 1977. He is a nationally recognized, award-winning investment manager, frequent guest of the media and featured speaker at investment conferences nationwide. He has developed a proprietary method of evaluating both equity and fixed-income securities, which continues to be employed by Muhlenkamp & Company. In addition to publishing a quarterly newsletter, *Muhlenkamp Memorandum*, Mr. Muhlenkamp is the author of *Ron's Road to Wealth: Insights for the Curious Investor*.

Mr. Muhlenkamp received a Bachelor of Science degree in Engineering from M.I.T. in 1966, and a Masters in Business Administration from the Harvard Business School in 1968. He holds a Chartered Financial Analyst (CFA) designation. He and his wife, Connie, make their home on a farm near Pittsburgh, but travel extensively to meet and talk with companies and clients around the country.

The majority of Mr. Muhlenkamp's long-term investment assets are invested in the Company's self-named mutual fund.

Ronald H. Muhlenkamp

Founder & President, Muhlenkamp & Company, Inc.

The following essay, *The Frugal Consumer... Will It Last?* is adapted from a presentation Ron Muhlenkamp delivered at the Muhlenkamp & Company Seminar in May 2010. Supporting figures are updated through March 2010.

Audience-asked questions and Ron's responses will be featured in *Muhlenkamp Memorandum*, Issue 95, scheduled for publishing in July 2010. The most recent copy of the 'Memorandum, along with an archive of past copies, is available at www.muhlenkamp.com.

We hope you find this booklet useful.
Let us know what you think.

The comments made by Ron Muhlenkamp in this essay are his opinion and are not intended to be investment advice or a forecast of future events.

The Fund's investment objectives, risks, charges and expenses must be considered carefully before investing. The Prospectus contains this and other important information about the investment company, and it may be obtained by calling (800) 860-3863, or visiting www.muhlenkamp.com. Read it carefully before investing.

Mutual fund investing involves risk. Principal loss is possible. The Fund may invest in smaller companies, which involve additional risks such as limited liquidity and greater volatility. The Fund may also invest in foreign securities which involve greater volatility and political, economic and currency risks and differences in accounting methods. Investments in debt securities typically decrease in value when interest rates rise. This risk is usually greater for longer-term debt securities.

As of 3/31/10 the Fund held 0.0% of total net assets in Morgan Stanley, Goldman Sachs, Citigroup, Wells Fargo, JP Morgan Chase, Bank of New York Mellon, PNC, Winnebago, Harley-Davidson, Wal-Mart, Ford and General Motors.

The Fund held 3.4% of total net assets in Bank of America, 3.0% of total net assets in State Street, 3.2% of total net assets in Cisco, and 1.0% of total net assets in IBM.

Fund holdings and sector allocations are subject to change at any time and are not recommendations to buy or sell any security. **Current and future portfolio holdings are subject to risk.**

Past performance does not guarantee future results.

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The Frugal Consumer... Will It Last?

This presentation continues to build on the material presented at past seminars:

Recessions: What Do They Look Like? (May 2008);
Bailouts, Your Dollars & the Whole Credit Mess (November 2008);
The Sign Posts of Change: Economics – Rules – Markets (May 2009); and
What's the New Normal? Economics – Rules – Markets (November 2009).

Copies of these presentations are available on our website at www.muhlenkamp.com.

How Many Think the Recession Is Over?

Looks like about 10% of this audience thinks the recession is over. It's no wonder, then, that every time I tell someone the recession is over, they appear surprised. So I have to point out that there are at least three different definitions of recession:

1. An economist's definition of recession is two consecutive quarters of negative growth in GDP (Gross Domestic Product). This figure turned positive in August 2009 and remains positive to date, indicating the recession is officially over.
2. The media, however, won't think the recession is over until everybody that lost a job last year has a new one, GDP's back above where it was, and unemployment's below where it was.
3. From an investor's point of view, the recession ended in March 2009. As an investor, if you wait until you get confirmation that a recession is over, you've usually missed most of the up-move. Key lesson: If you are trying to be a successful investor, do not let the media set your agenda.

Any time you talk about recession, be aware there are multiple definitions — and if you are using one definition and listening or talking to someone with a different definition, you are not going to come to a common ground. Regardless of definition, it's my observation that during a recession people tend to work a little harder, spend a little less, save a little more, and the pattern tends to heal itself.

So, in the aggregate, some of the numbers and patterns of this recession look familiar:

Figure 1 2008-09 vs. Prior Slowdown / Recession

2008-09 vs. Prior Slowdown / Recession

Aggregate #'s Look Familiar

- 1)GDP
- 2)Employment
- 3)Fed Squeeze → Inverted Yield Curve
- 4)Consumer Confidence

Recessions are generally characterized by:

- Two consecutive quarters of down GDP; (the economist's definition);
- A downturn in employment;
- The Federal Reserve triggering an inverted yield curve, (when short-term rates are below long-term rates); and
- Subdued consumer confidence.

I used to think that recessions were useful. I now believe that recessions are necessary — they take the excesses of the prior expansion out of the system.

Figure 2 Specific to 2008-09

Specific to 2008-09	
Minuses	<ol style="list-style-type: none"> 1) Crunch in Financials / Credit Markets = 1990 S&L's & Banks 2) Price of Energy = 1990 & 1973-1974 3) Food Prices = 1973-1974 4) Weak Dollar
Pluses	<ol style="list-style-type: none"> 1) Service Economy 2) Corporate Balance Sheets 3) International Growth 4) International Liquidity

Minuses

During this recession, the excesses were in the financial and credit markets, but that had also occurred back in 1990. So far, we've had 236 banks go out of business during this recession. Some of you may remember that in '89 and '90, a third of our savings-and-loans (S&Ls) went out of business along with approximately 1,200 banks. So pieces of this we have seen before.

During this recession, we were worried about the cost of energy and, mostly, our focus was on the price of gasoline. But do you remember when energy prices tripled back in 1990? Some may recall the same in 1973-74. So, this, too, looks familiar.

During this recession, grain prices tripled as they had in 1973-74.

And, as a consumer, the weak dollar was a negative.

Pluses

The pluses we saw were in the service-oriented economy; corporate balance sheets; international growth; international liquidity; and, if you're a producer, the weak dollar is actually a plus. (You'll notice that a weak dollar appears both as a plus and a minus. When the dollar is weak, it's expensive for American consumers, but helps American producers. When the dollar is strong, it squeezes American producers, but helps American consumers.)

Most of these pluses remain. International growth, however, has slowed. We'll speak more about this, particularly what's happening in Greece and the rest of Europe, in just a minute.

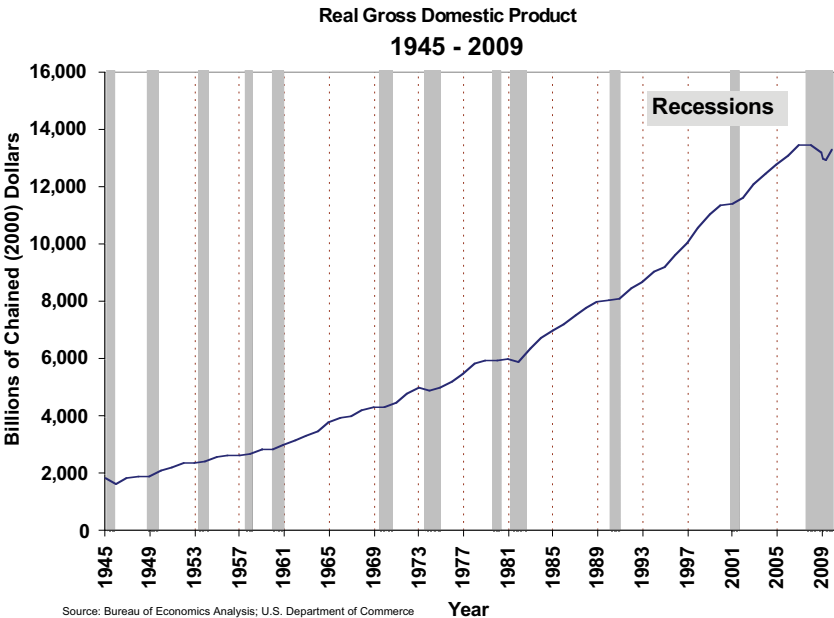
What we are trying to sort out is which parts of this recession look familiar, and those that do not. I once had a professor who said to me, "Ron, if you don't know *why*, you don't *know*." Accordingly, we are attempting to understand the drivers of this recession, as well as the lingering repercussions.

To do so, let's turn to specific recession indicators.

As stated previously, economists define a recession as two consecutive quarters of negative growth in GDP. So let's examine Real Gross Domestic Product. ("Real" means adjusted for inflation; this plot is not adjusted per capita.)

As you can see from looking at Figure 3, this was our twelfth recession since 1945:

Figure 3 Real Gross Domestic Product, 1945-2009



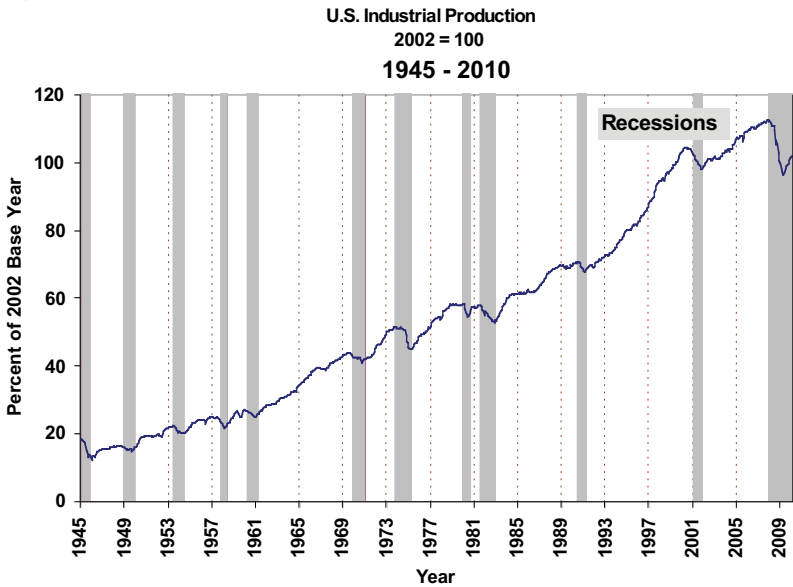
Source: Bureau of Economic Analysis; U.S. Department of Commerce

NOTE: In 1996, the U.S. Department of Commerce introduced the chained-dollar measure. The new measure is based on the average weights of goods and services in successive pairs of years. It is "chained" because the second year in each pair, with its weights, becomes the first year of the next pair. The advantage of using the chained-dollar measure is that it is more closely related to any given period covered and is therefore subject to less distortion over time.

While Real GDP has gone from \$2 trillion to \$13 trillion in a 64-year period, recessions are often difficult to find. You can spot a bit of a decline back in 1973-74, along with another in 1980-82. This recession, however, is one that we will be able to find with no problem. The degree of decline is more than the past few recessions, and may be a bit greater than '73-'74 and '80-'82, but the pattern is familiar.

Figure 4 shows that each time we have a recession there is a decline in Industrial Production. Once again, you'll note this was a serious recession:

Figure 4 U.S. Industrial Production, 1945-2010



Source: U.S. Federal Reserve

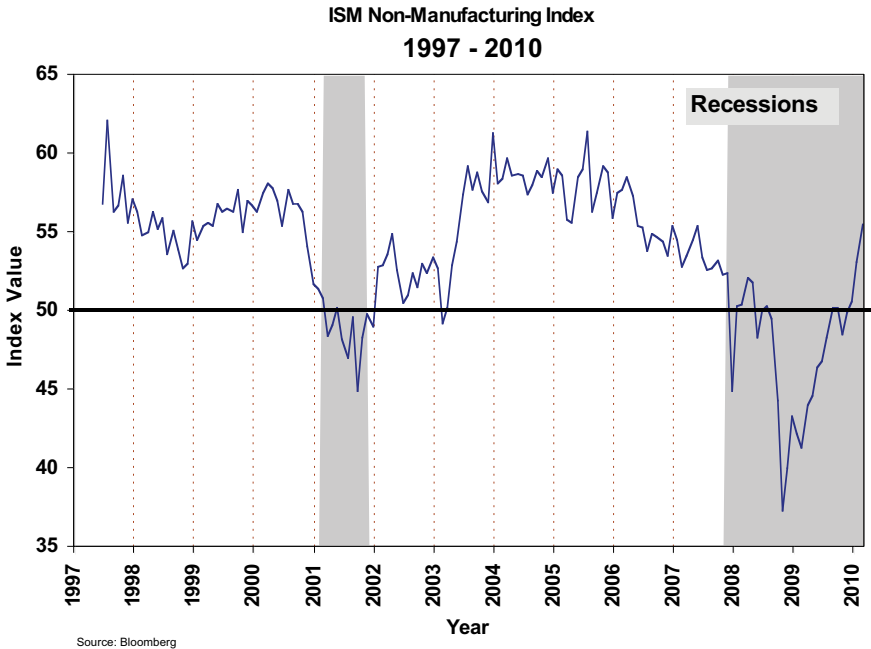
NOTE: The U.S. Industrial Production Index measures real output and is expressed as a percentage of real output in a base year, currently 2002. The production indexes are computed as Fisher indexes since 1972; the weights are based on annual estimates of value added.

Historically, recessions have been primarily corrections in inventory and capital spending. That remains true. If you're on the industrial side of the economy, for anything from autos to capital goods, a recession is easy to identify. This is especially true today.

As we become more of a service economy, (as opposed to a production or industrial economy), the percentage weight of this particular metric decreases as a part of overall GDP.

So, let's turn our attention to the service side of the economy.

Figure 5 ISM Non-Manufacturing Index, 1997-2010



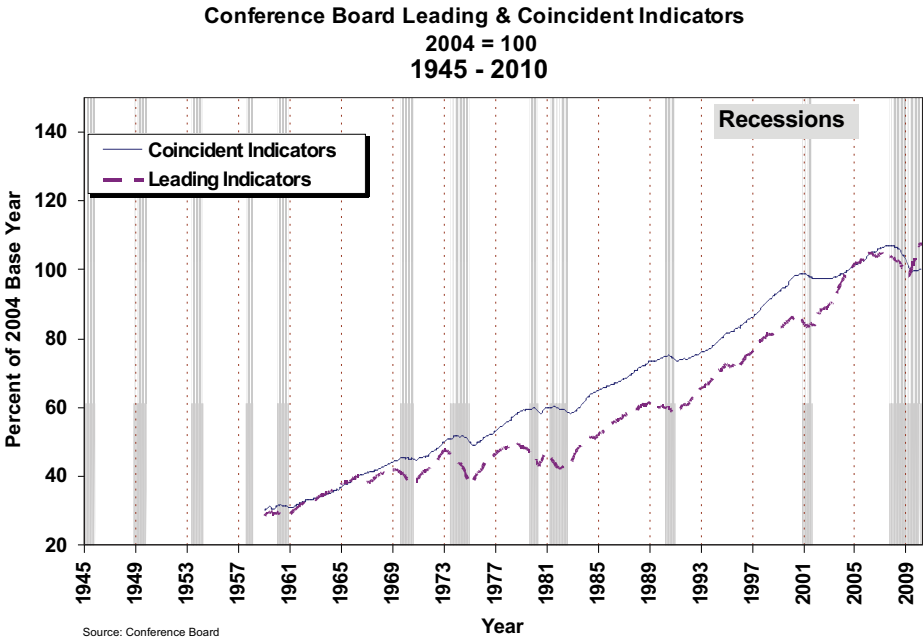
In Figure 5, when the Index value is above 50, more companies are expanding than contracting. If it is below 50, more companies are contracting than expanding.

While this plot dates back only to 1997 you will notice in 2001 that non-manufacturing fell below the 50th percentile. (I think the drop was probably when the “dot-com’s” laid people off.) It dipped briefly in 2008 and came back up, and then fell off a cliff in September, October, and November of that year — meaning the recession became serious during these months. The most recent drop, I suspect, can be attributed to a lot of Wall Street people losing their jobs — all non-manufacturing.

Historically, recessions have been concentrated in the manufacturing part of the business. Think about it: in a recession, how much less food do you buy? How much less electricity do you buy? Maybe it’s a little, but not much. But you postponed the purchase of a car or the purchase of a house — large, manufactured goods. This time, we had a big drop in services — think of finance; think of Wall Street. Yes, General Motors and Ford got hit and so did finance, which is why we had a big drop in non-manufacturing during this recession.

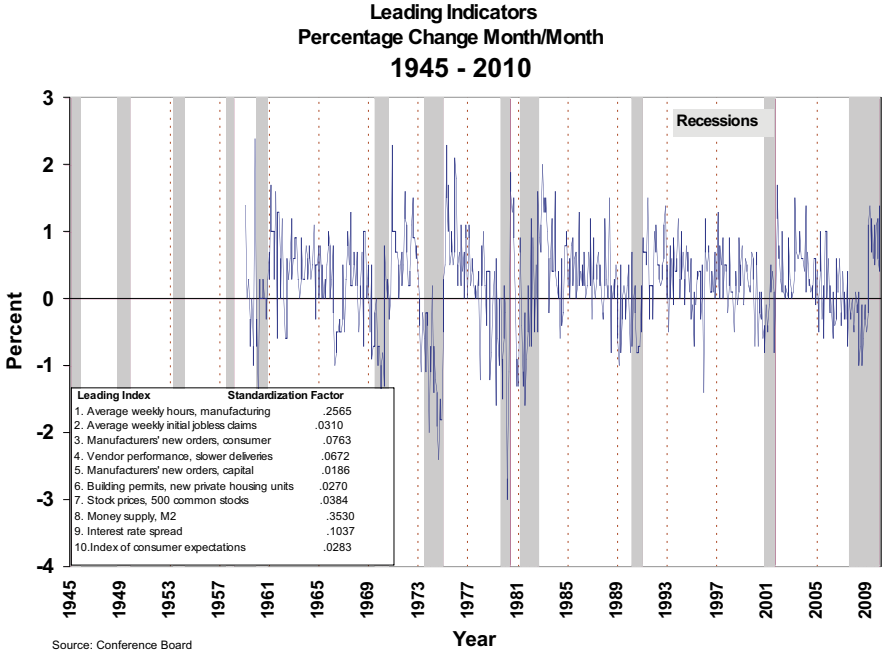
As you can see from Figure 6, when we look at both leading and coincident indicators, the patterns are pretty much familiar. What we're saying is in the economic sphere, (there are also political and financial spheres to consider), the pattern of this recession looks largely familiar.

Figure 6 Conference Board Leading & Coincident Indicators, 1945-2010 (2004=100)



Let's drill a bit further into the leading indicators:

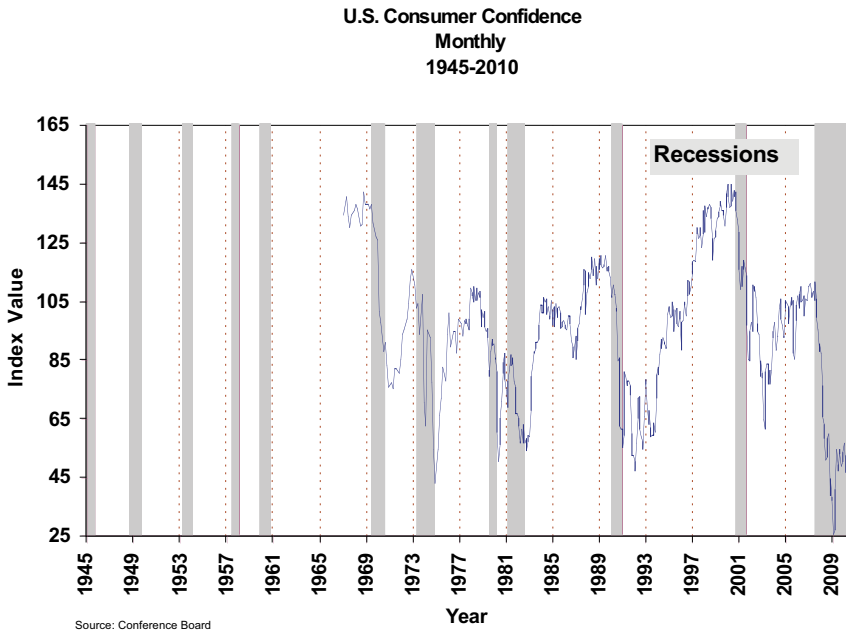
Figure 7 Leading Indicators, Percentage Change Month/Month, 1945-2010



The biggest pieces of the leading indicators are items like the money supply, stock prices, and interest rate spreads. On a month-to-month basis, you get a whole lot of volatility and that remains true. In this plot, it is difficult to point out anything that is much different than what we've experienced in prior recessions.

Reminder: Every time we have had a recession, there has been a downturn in the leading indicators — but not every downturn means there is a recession.

Figure 8 U.S. Consumer Confidence, 1945-2010



As seen in Figure 8, in most cases consumer confidence drops considerably during a recession and responds pretty quickly thereafter. An exception was back in 1990-93, when it took a couple of years for consumer confidence to come back. My suspicion is that with a third of the S&Ls going bankrupt, and hundreds of banks going out of business, consumer confidence was severely rattled.

In 2001, the recession was triggered by the excesses in dot-com's and the aftermath of 9/11. Afterwards, consumer confidence bounced up a bit and then dropped back down around the time we were going to war in Iraq. I recall investors responding to these circumstances as being very careful due to the uncertainties.

Coming out of this recession, with the problems in our credit markets and financial institutions, it wouldn't surprise me if consumer confidence stays subdued for a long time. Remember, however, the economy often rebounds long before a return of consumer confidence.

Here are two other maxims worth noting:

- Public perception lags the economist's definition.
- The markets anticipate the economist's definition.

The latter is evident in the following figure:

Figure 9 S&P 500 Index, 1945-2010

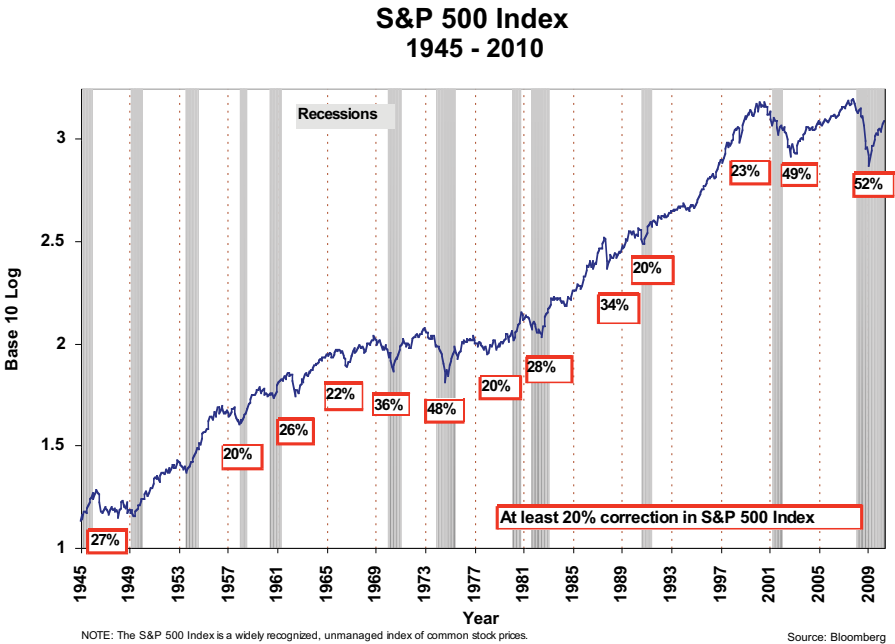
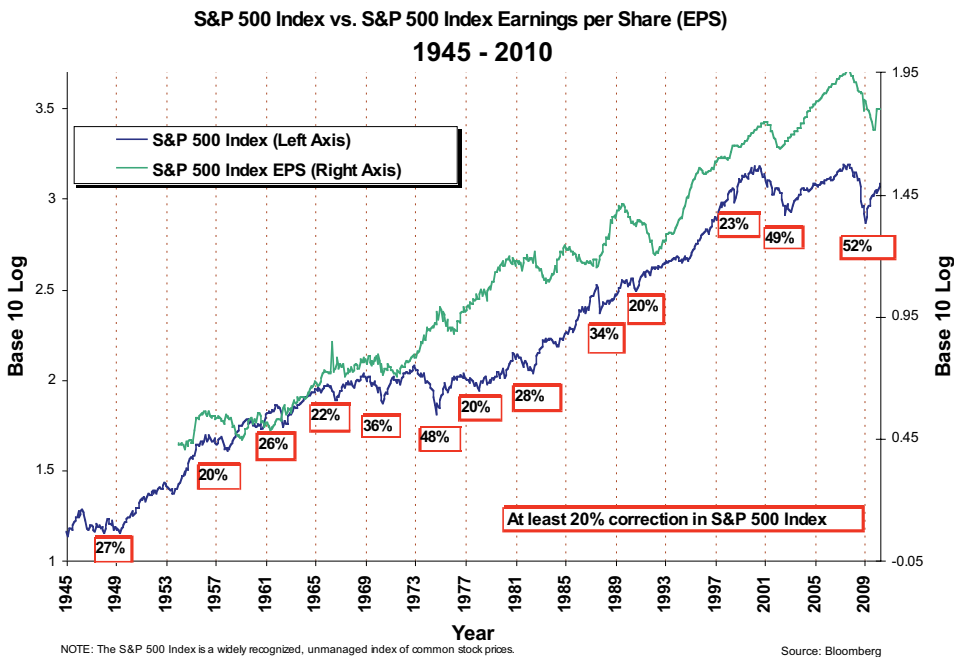


Figure 9 shows corrections of at least 20% or more in the S&P 500 Index since 1945. In most cases, the corrections and recessions are coincident, but not always. Remember “Black Monday” (October 19) back in 1987? In one day, the Dow Jones Industrial Average (DJIA) dropped by 508 points to 1738.74 (22.61%), but there was no recession.

The point is, if you wait for a recession to be over, you can miss a very good bounce coming out of it. As an investor, we think you want to invest when people fear a catastrophe and it looks like it may not happen. After all, the only time you can buy a good company cheap is when the public is fearful of something.

Figure 10 S&P 500 Index vs. S&P 500 Index Earnings per Share (EPS), 1945-2010



As shown in Figure 10, in some cases, the markets are more volatile than earnings; in other cases, they are not.

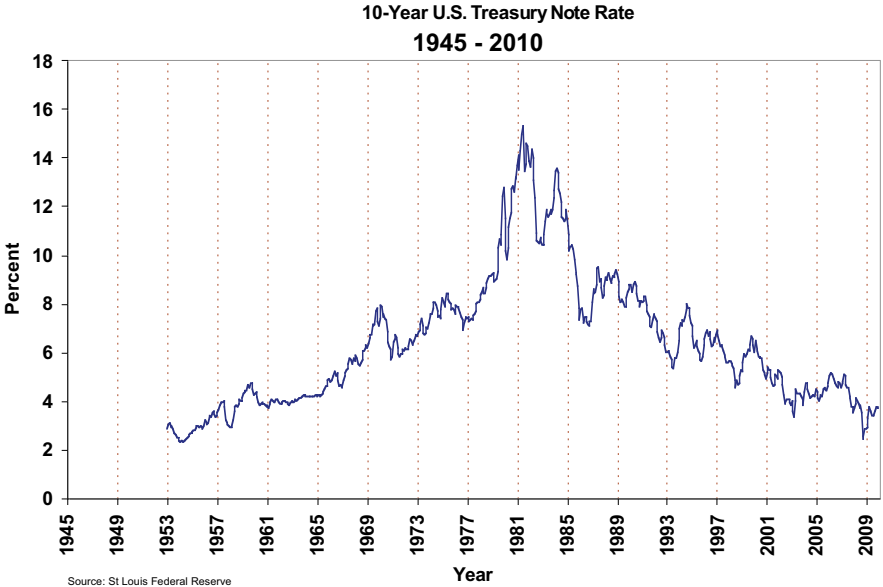
Right now we're seeing a bounce back in earnings at a rapid rate. A lot of companies have done rather well — better than expected. Of those that have recently reported, 68% have met or beat consensus estimates.

From taking a look at all of these recession indicators, you can see that many of the patterns look familiar. But there are some aspects of this recession that were definitely atypical. This was not a normal, cyclical recession.

What Made this Recession Different?

To answer that question, we need to examine interest rates and the role of the Federal Reserve.

Figure 11 10-Year Treasury Note Rate, 1945-2010



U.S. 10-year Treasuries are the benchmark for long-term lending.

In 1981, 10-year Treasury Note interest rates hit 14%-15 percent. After a steady decline, the 10-year Treasury rate is currently at 3½%-4 percent.

Note: We do not think the rate will go much lower. Those who expect deflation, (i.e. when inflation is below 0%), expect the 10-year Treasury rate to drop. We do not.

Figure 12 10-Year Treasury Note Rate less Effective Federal Funds Rate, 1945-2010

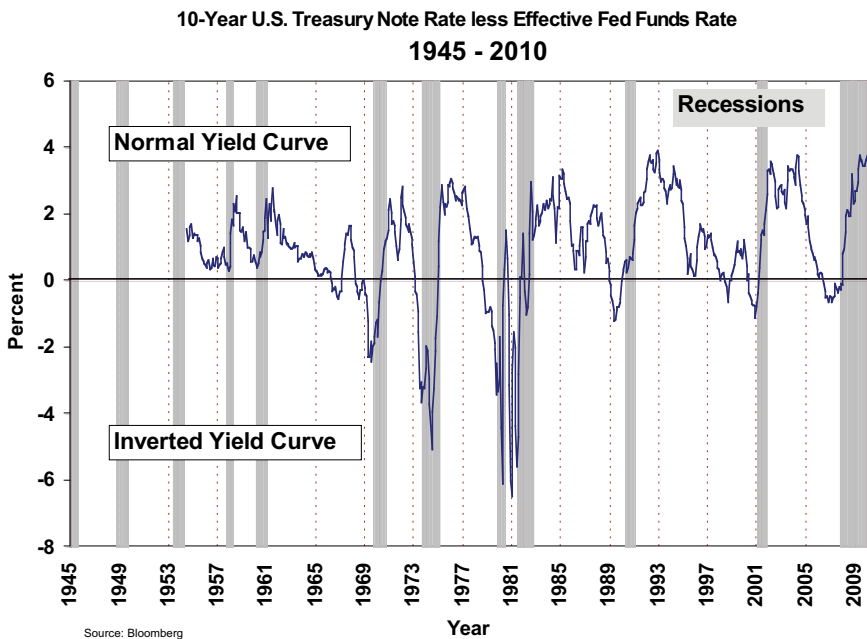


Figure 12 shows the 10-year Treasury Note, less the Effective Funds Rate, which is the spread on which banks work. Right now, the spread is on the order of 4%, so banks are on their way to achieving profitability / decent balance sheets.

But this plot can tell us much more...

When long-term interest rates are above short-term interest rates, we refer to that as positive, and call it a normal yield curve. When the reverse is true, we refer to it as negative, or an inverted yield curve. What you see on this chart is that an inverted yield curve usually precedes a recession. The yield curve has now gone strongly positive, and banks are making good money on the spread between short-term and long-term interest rates. Because of this pattern, over time, recessions become self-correcting.

Folks, when the Federal Reserve (Fed) squeezes money, (i.e., when it raises short-term rates), it tends to trigger a recession. During a recession, the Fed lowers short-term rates to stimulate the economy — and that's just what it has done. Today, short-term Treasuries [Treasury Bills] are at .25%, but keeping interest rates at this level is problematic.

A year ago, inflation was negative and the growth of GDP was negative. So, interest rates at .25% were above inflation and GDP growth. Since then, inflation has moved up to a positive number; GDP growth has moved up to a positive number. As a result, short-term rates should be moving up. Frankly, I think they should be on the order of 1%, maybe a little more than that today. But because everybody thinks in terms of nominal rates [versus “real” rates; i.e. net of inflation], as soon as the Fed starts raising short-term rates, our congressmen and the media will respond by saying, “The Fed is tightening.” What the Fed should do is keep things semi-normal, but political forces will lobby to keep rates low.

Worth noting: When interest rates are low, it benefits the borrowers. When interest rates are up, it benefits the savers. Banks don’t care — they work on the spread. Right now, however, the political pressure is to keep rates low. And that’s what got us into this mess in the first place: having rates too low for too long! My fear is, we’ll repeat that. That’s not a prediction. That’s a fear, so it’s something we’re watching.

The lesson of keeping interest rates too low for too long...

Taking short-term interest rates to 1% after 9/11/01 wasn’t the mistake. Keeping rates there for three years was a major mistake, allowing people to get adjustable rate mortgages below 4% because they were priced off T-bills at 1 percent.

The Fed started raising rates in 2004 and back in 2005-06, we were preparing for a recession. But the Fed stopped raising rates at 5¼ percent. As a result, I thought we might get a soft landing. I was wrong. Wall Street was wrong. Frankly, I think that had the Fed continued raising rates to 6%-7% — having triggered a recession back then — we would have avoided a lot of the junk that has since come back to haunt us.

When rates went up in 2005-06, folks on Wall Street should have said, “The cost of money is going up. We need to back out. We need to borrow less.” Rather, they responded, “The spread is getting narrower; we have to ‘up’ our leverage to make money.” Some investment banks used as much as 30-to-1 leverage to make a deal work! Folks, if you have to borrow \$30 for every \$1 you have in equity in order to make a deal work, it isn’t a good deal. These activities greatly affected the velocity (turnover) of money, which is another factor in determining why this recession was different. (We’ll address the velocity of money in detail later in the essay.)

So the fact that we didn’t raise rates enough to trigger a recession meant the writing of nonsense loans accelerated through ‘06 and ‘07. In trying to avoid a recession, we made things much worse and much harder to correct.

My fear today is, if we keep rates too low for too long, there are a number of institutions in the U.S. (investment banks and hedge funds) that will continue to borrow at very low rates, buying everything from gold, to commodities, to foreign stocks — literally every asset class. In 2008, such firms were told by their bankers that they would no longer extend as much leverage, and hedge funds were forced to sell.

Additionally, investment banks and hedge funds are participating in the carry trade, which can be characterized by borrowing in one currency (e.g. U.S. dollars at .25% or the Japanese yen at .30%) and investing that money in other assets, including the sovereign debt of another currency regime, (e.g. Australian bonds at 4%-6 percent). But this positive interest rate spread can be negated by a change in the relative prices of the currencies, such as the Australian dollar declining against the U.S. dollar, as it has done recently. This makes the investment (trade) a loser, and prompts the trader to unwind (sell) his position.

Two things concern me:

1. The Fed doesn't seem to be too worried about this (the carry trade); and
2. Even when the Fed starts to raise interest rates, I'm quite certain it's going to get political pressure to keep rates down.

How this will sort out, I don't know. The longer short-term rates remain cheap, the more likely we are to repeat a version of the same problem that we created when we had low interest rates for three consecutive years.

Interest Rates and the Bond Market

By the way, some folks are curious as to why investment managers like Bill Gross of PIMCO are saying Treasuries are dangerous, when, historically, they have been considered the safest of all investments.

How can that be?

If you buy a Treasury bond or a Treasury note, you are lending money to the U.S. government, which is considered the best credit in the world. So the odds are very good that you're going to get your money back, and you're going to get the interest as promised. That's why Treasuries are considered safe. But, let's say you buy a 20-year Treasury bond...If interest rates go up during that period, the price of the bond goes down.

As an example, in 1953, Treasury rates were at 3 percent. In 1981, rates were as high as 13 percent. So if you bought a 20-year Treasury bond at 3% in 1953 and interest rates went to 6% in the interim, it would have been priced at just over 50 cents on the dollar if you had to sell. In contrast, if you held the bond until 1973, you did, indeed, get your 100 cents back, along with your 3% interest. But, during that period, inflation ate the return! So, when Bill Gross states that Treasuries are now risky, he's implying that he expects interest rates to go up and the market value of bonds to go down — and that he also expects inflation to go up, impacting the value of purchasing power.

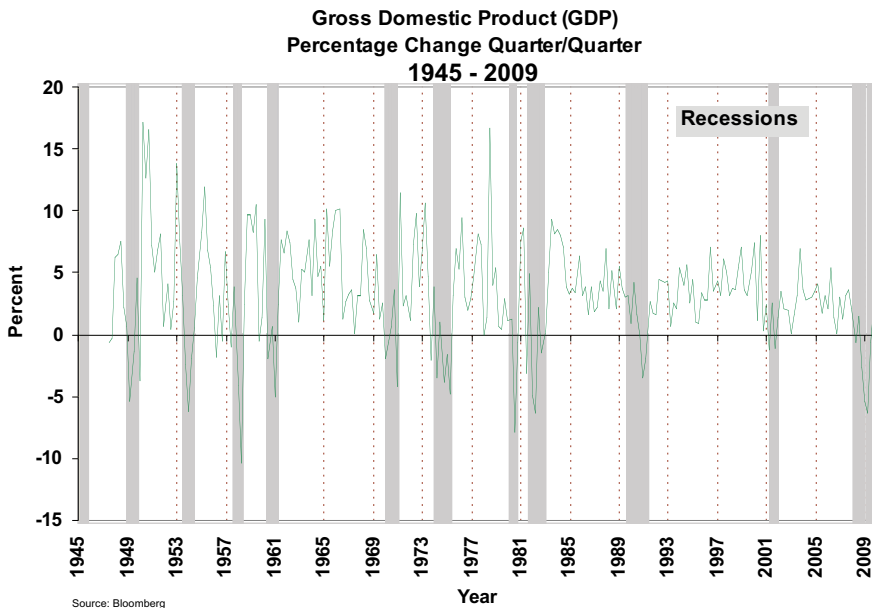
Folks, an investment that is safe under one set of circumstances can be dangerous in another. The easy thing for people to trust is what's worked well lately. And, incidentally, what we've been hearing for the last 10 years is that bonds are safe, because in the prior 20 years interest rates came down — which means the price stayed at par or above. The economy grew — which means there was no credit risk. So for 20 years, bonds have been safe because interest rates were coming down and the economy was growing.

As human beings, we all want to extrapolate the recent past into the present. As a result, a lot of money poured into bonds during the last year. If there's a bubble out there today, it's probably in the Treasury market. We think this is similar to "Planting corn in October, because it grew so well since April!" People want to extrapolate what has worked in the recent past, rather than taking into account today's investment values. Folks, if interest rates go sideways or go up, bonds are not safe. In the 1970s, we talked about bonds as "certificates of guaranteed confiscation!"

Patterns: Differences in Degree or Wholesale Changes?

I always try to differentiate whether a pattern is familiar — and whether the differences are in degree, or whether the pattern itself has changed. Apropos of that is our discussion on GDP. Earlier we examined it on an annual basis. Following are quarterly changes:

Figure 13 Gross Domestic Product (GDP) Percentage Change Quarter/Quarter, 1945-2009



Again, we define 'recession' per the economist's definition: two consecutive quarters of negative growth in GDP. That pattern is familiar to us. While there is a lot of noise on this chart, you can see that the last two quarters of 2009 were positive. So, by this definition, the recession ended last July or August.

What's important to remember is we have been down at these levels before. In serious recessions, the numbers remain low for a period of time like '73-'74, '80-'82, and this most recent recession. The downward drivers are almost always significant inventory corrections and reduced spending on capital goods.

The Frugal Consumer... Will It Last?

We think the best way to assess the impact on the consumer is by asking two questions:

1. "Over the past two years, how many of you have cut back on your spending?" (Nearly everyone says they have.)
2. "How much has it hurt?" (Not so much.)

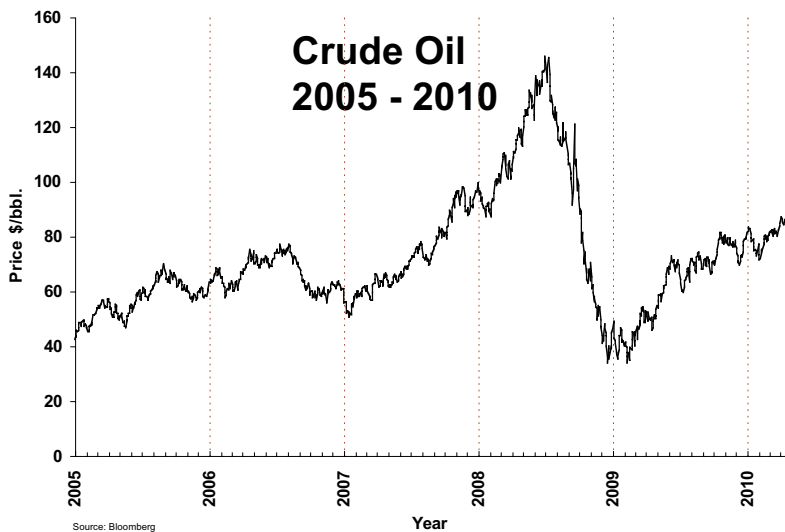
In the fourth quarter of 2008, the American public basically went from spending 100% of its income to spending 95%, which means that savings went from 0% to 5% in the one-quarter period. The question since then has been, "What's the public going to continue to do?"

Pretty much for all of '09 to date, the public has kept its savings at about a 3%-5% rate. My guess is this will continue. After all, if the cutback in spending hasn't been all that painful, and we've gotten used to the new level, then I don't see why it would jump back quickly.

Coming into this recession, it's my observation that what turned the public negative two years ago was the price of gasoline at \$4 per gallon.

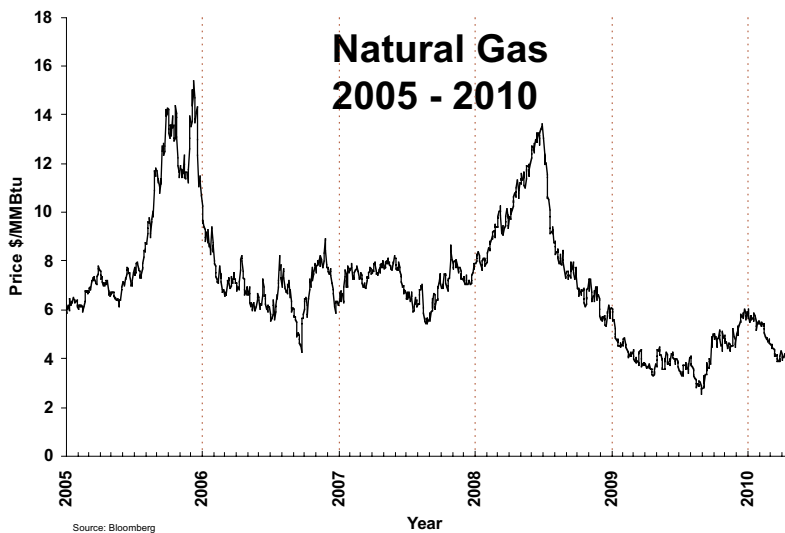
Four years ago, the price of crude oil was \$45 per barrel. It went up to \$145 per barrel in June 2008. There are 42 gallons of crude in a barrel. So what's the cost of a gallon of gasoline when the price of crude was at \$145 a barrel? \$145 divided by 42 gallons is \$3.45 per gallon. Add \$0.70 for expenses and taxes, and the cost of gasoline is \$4.15 per gallon. When it got to \$4 per gallon, people started driving less.

Figure 14 Crude Oil, 2005-2010



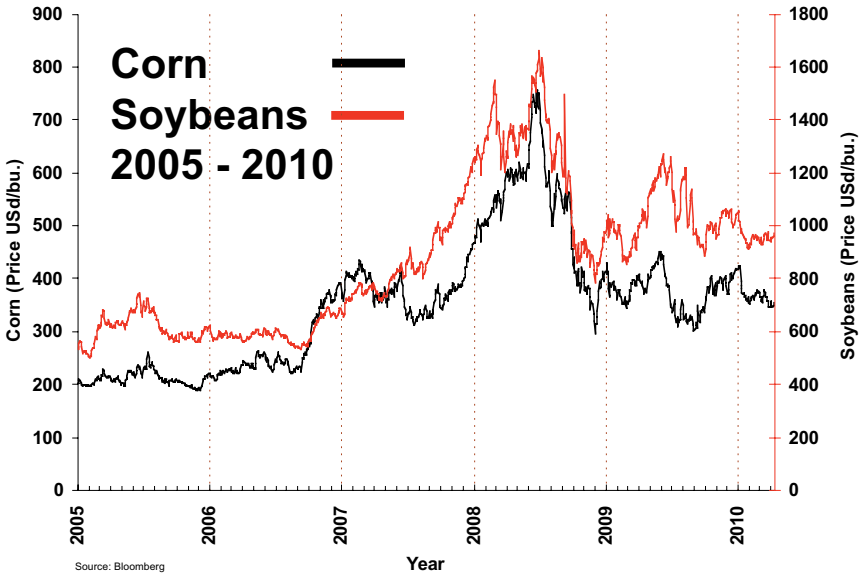
As you can see from Figure 14, today, the cost for crude is roughly \$85 per barrel. Do the same math at today's crude price, and you can see that the cost of gasoline is in the \$2.75 range of where it was three or four years ago.

Figure 15 Natural Gas, 2005-2010



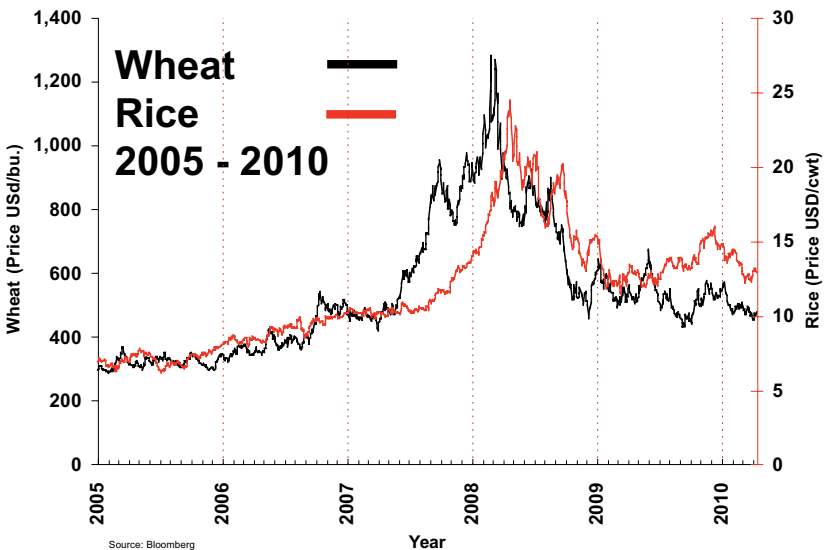
For most of us, natural gas is used for wintertime heating. My fear two years ago was not only the cost of gasoline running up, but the cost of natural gas running up as well. In July 2008, the price had doubled, hitting \$13 per MMBtu. The price of natural gas is now below where it was during the last couple of years. Presently, the price is closer to \$4.20 per MMBtu.

Figure 16 Corn and Soybeans, 2005-2010



Prices of corn and soybeans track together, partly because these crops are grown on the same land. Their prices nearly tripled during 2008. (The last time the price tripled for corn and soybeans was in 1973-74. Within eighteen months, half of the price gain was given back.) This time around, it took five months, but close to half of the price gain was given back. It's a little above where it was a couple of years ago, but not outrageously so.

Figure 17 Wheat and Rice, 2005-2010



Food is about 14% of the budget for the average family in this country. So when the price of wheat triples, it's an inconvenience, but not debilitating. I am told that in China and India, food is about 40% of the family budget. So when the price of rice triples, it's a potential catastrophe.

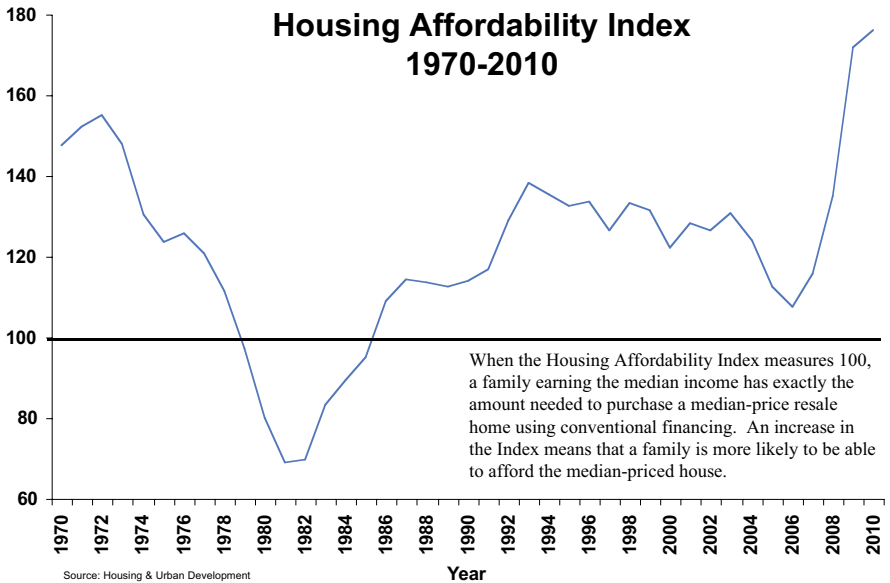
As you can see from Figure 17, two years ago, we were looking at triples in prices for wheat and rice. Since the peak, prices are down 30 percent. By the way, I think prices went up for a number of reasons, including people playing momentum games in the commodities marketplace. The factors that triggered this negativity are now neutralized, and prices are back to where they were two or three years ago. As a result, I am not as worried about the potential impact on the Chinese and Indian consumer.

Figure 18 30-Year Mortgage Rate, 2005-2010



Mortgage rates have come down big time. Currently, 30-year mortgage rates on a conforming mortgage are about $4\frac{3}{4}\%$; 15-year mortgage rates are $4\frac{1}{4}$ percent.

Figure 19 Housing Affordability Index, 1970-2010



In Figure 19, the higher the line goes, the more affordable housing is; i.e. the cost of carrying the house is cheaper.

Remember back in 1981 when mortgage rates were 13%, 14%, and 15 percent? Housing was unaffordable. When mortgage rates were on the order of 6% or 7%, however, house prices were moving up as people bid them up, beyond what they should have been. As a result, affordability came down in '05, '06, and '07. Now, with prices coming down a bit, and mortgage rates coming down a lot, the Affordability Index has improved. In fact, it's the best it has been in over 40 years.

For the last decade or so, we've been seeing people buying houses based on desire, not need. It wasn't based on need in any real sense. It was based on what people thought they could pay for — and they thought a house was a good investment.

If you argue that we are currently producing large, manufactured goods below replacement levels, (which we are), then at some point there should be a rebound. But the rebound may not look the same as it did before. If people start buying 1,800 square foot houses instead of 2,400 square foot houses, or if they start buying small cars instead of luxury cars, that gives a different flavor and a different profitability to what's out there going forward.

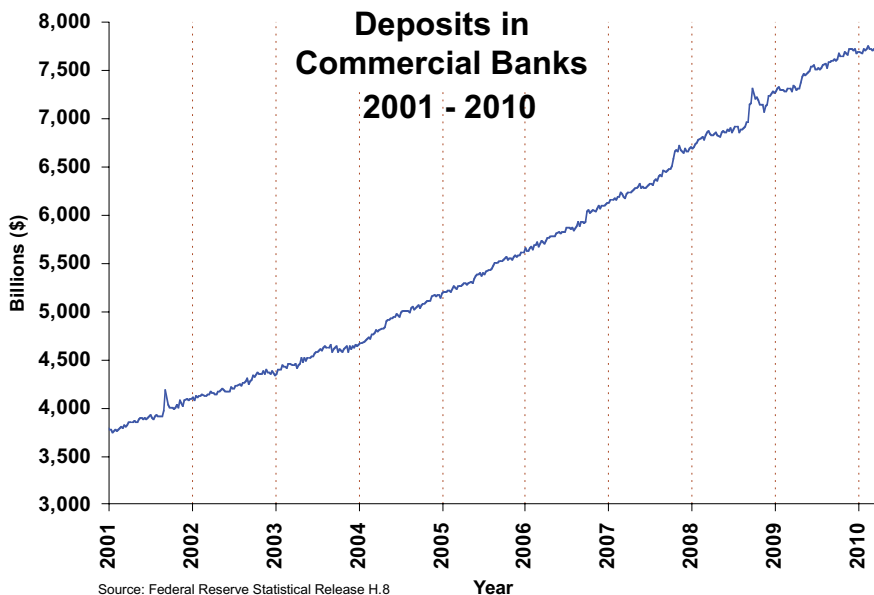
Will people continue to "up-size" two or three years from now, or will they say we've got enough already? That I simply don't know — but there usually comes a point when one is basically satisfied.

As a summary to all of this, here's my headline: For those who still have their job, (which is 90% of the American public), on a cash flow basis they're probably in better shape than they were four or five years ago.

An Update on the Financial Markets

Let's turn our attention to what's happening with commercial banks:

Figure 20 Deposits in Commercial Banks, 2001-2010

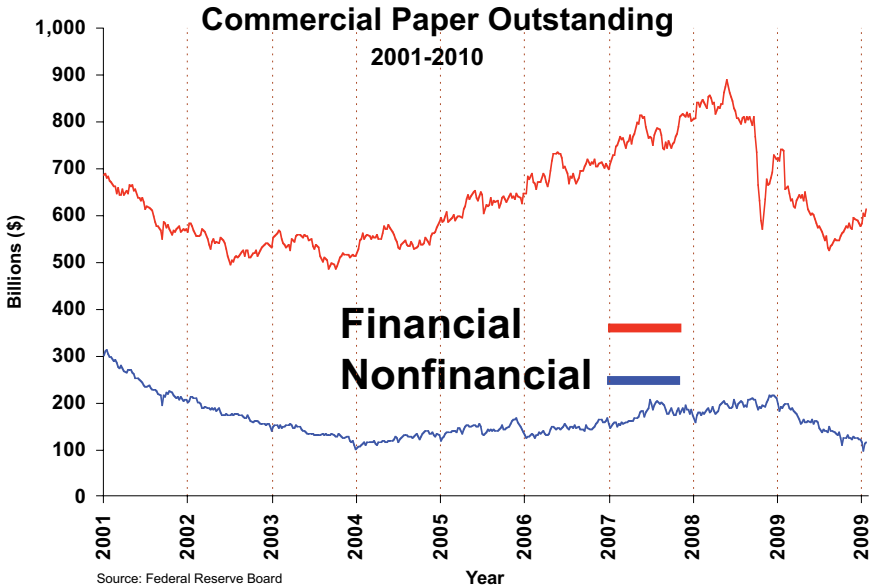


Bank deposits continue to grow. In fact, when I talked with my local bankers and inquired about business, I learned their equity is 18% of the assets. They almost have too much equity! But this makes sense. After all, people are saving more and borrowing less.

I think Figure 20 shows what is happening with most of the smaller and regional banks in the country —particularly those banks that did not participate in mortgage securities and other sub-prime credit. Their deposits keep on growing.

In 1989-90, many of the banks that got in trouble were the small banks. This time around, it was the big banks. The small regional banks, by and large, are in good shape.

Figure 21 Commercial Paper Outstanding, 2001-2010



In Figure 21, the plot splits commercial paper borrowed by financial firms from that borrowed by nonfinancial firms. Nonfinancial commercial paper has slowed a bit (as it usually does in recession), but there was a big drop in financial firm commercial paper.

Remember when you heard that banks were not lending to each other because they lacked confidence? After Lehman Brothers went broke in September '08, a whole lot of the financial industry just locked up. Financial institutions quit lending to each other, which had strong repercussions in the general economy — not only in the U.S., but in other parts of the world.

There was a period of time in late '08 when you couldn't get a Letter of Credit to ship a container of goods across the ocean — and Letters of Credit have been around since the days of Christopher Columbus!

Here's an example of the seize-up:

Let's say Wal-Mart wants to buy a container of goods from China, but doesn't want to pay for it until the goods are received. At the same time, the supplier in China doesn't want to ship until the costs are covered. Sound reasonable on both ends? Sure. So, banks are used as intermediaries.

In this case, a bank will write a Letter of Credit, stating Wal-Mart's money is good, and guaranteeing the payment. In response, the Chinese supplier is confident it can ship the goods and receive payment upon receipt. (This is similar to setting up an escrow account when buying a house.) But there was a period of time in late '08 when Letters of Credit seized up and international trade was in jeopardy.

Today, financial paper has basically neutralized.

Figure 22 LIBOR and T-Bill Rates, 2000-2010

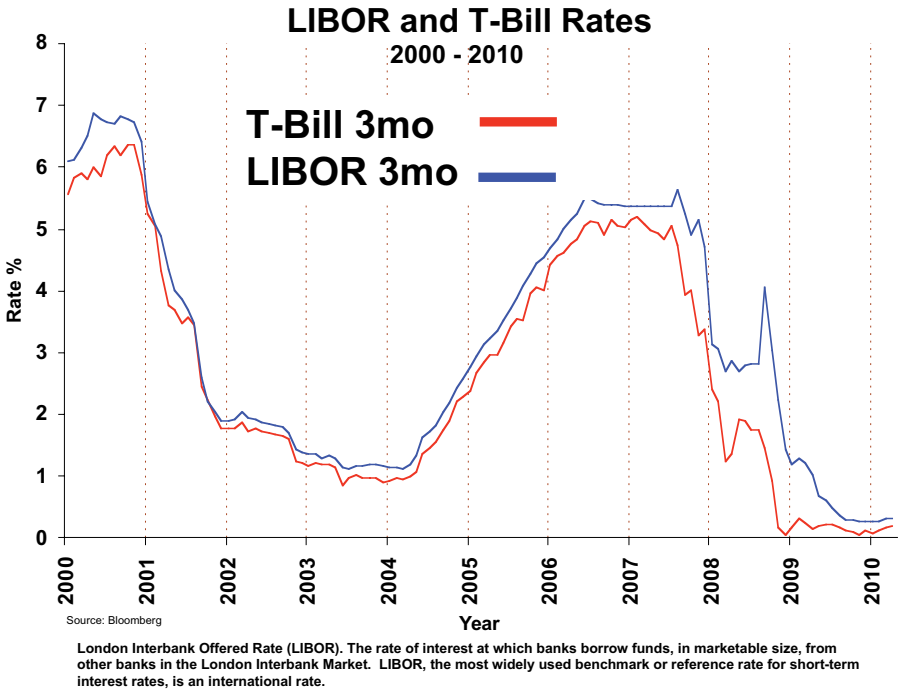


Figure 22 shows both LIBOR (London Interbank Offered Rate), along with three-month T-bill rates since 2000 — the rates at which banks lend to each other. What you'll notice is the rates track together up until early '08, at which time the Fed kept lowering T-bill rates to try to boost the economy. LIBOR started moving sideways. (When people get fearful, it seems they are willing to take an almost zero return for the comfort of U.S. Treasuries. This was not the case with LIBOR.)

Late in 2008, when financial lending locked up everywhere, LIBOR spiked. Since then, LIBOR has come back down to the lowest level in a long time, well beyond the timeframe for this plot. This plot shows us that the panic that occurred in the financial markets has alleviated itself — at least until now.

What's happening now — in Greece and the rest of Europe?

As most of you know, in Europe they've had the euro as a common currency for a little over 15 years. For countries to join the eurozone, they had to get inflation below 3% and they had to agree to keep government deficits and budgets below prescribed levels.

Many countries have failed to keep these agreements, particularly Portugal, Ireland, Italy, Greece, and Spain (hence PIIGS) with little or no consequence to date. Greece was among the worst offenders; its actions included borrowing money without showing the debt on its reports to the European Central Bank.

On April 27, Greek bonds were downgraded by Standard and Poors [rating agency] to junk status, which means they did not qualify as collateral for European banks, negatively affecting lending abilities. The last few days of April and first few days of May saw Greek bonds drop from 90 cents on the dollar to 60 cents on the dollar, prompting the European Central Bank to (panic and) change its rules on May 3, so that once again Greek bonds were acceptable collateral. (This was similar to our government saying, "If Fannie Mae or General Motors can't pay its debt, we'll lighten the rules.") That bought us some time. Asset sales in early May as a result of these rule changes were compounded on May 6 by a "glitch" in the markets, (Engineering Rule #1: All Systems Fail), creating the "Flash Crash."

So, my headline remains: The panic we had in the world markets and in the U.S. markets in the fall of 2008 has been relieved — but it doesn't mean we can't have another round. And gauging the size of the next round of potential forced selling is extremely difficult.

Because of such circumstances, we've added two new questions to our checklist:

1. Will some investors be forced to sell?
2. If so, how much?

We think a whole lot of forced selling took place in this country in 2008 because hedge funds got margin calls and mutual funds faced redemptions. More on this topic, in just a minute...

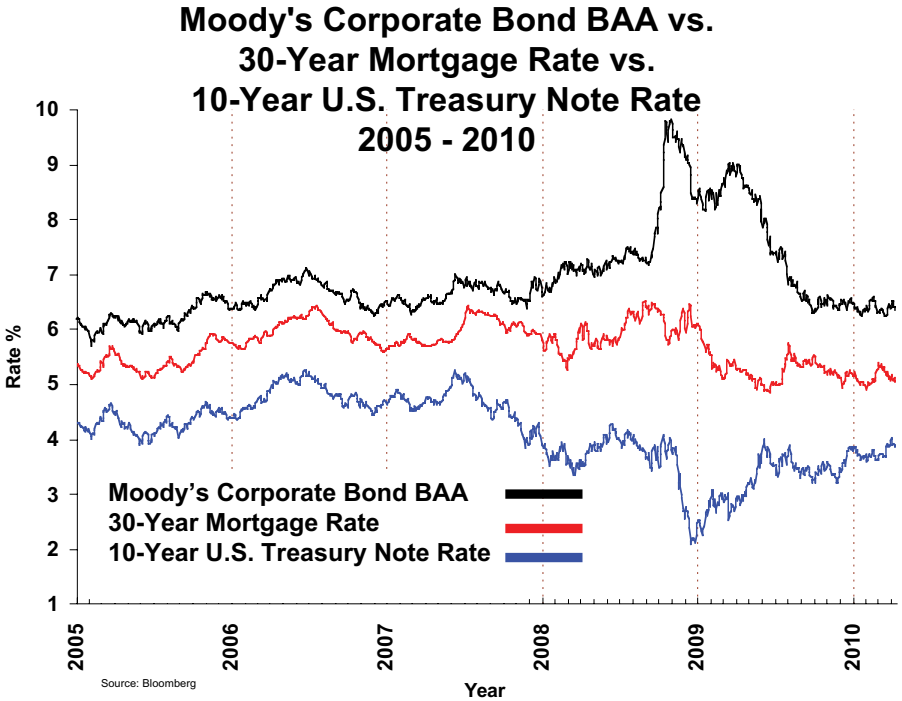
For now, let's look at other important interest rates:

Figure 23 10-Year U.S. Treasury Note Rate, 2005-2010



With the precipitous drop in the stock market a year ago, people fled their equity investments (and everything else) and started buying Treasury Notes. Since then, 10-year Treasury rates have been on the rise and are presently at 3½%-4 percent.

Figure 24 Moody's Corporate Bond BAA vs. 30-Year Mortgage Rate vs. 10-Year U.S. Treasury Note Rate, 2005-2010



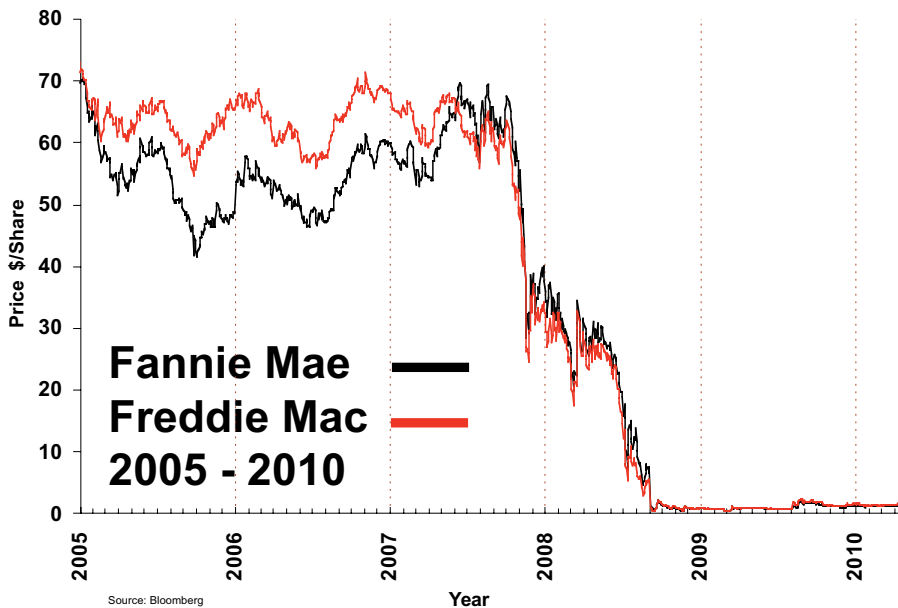
As you can see in Figure 24, these three plots tracked together until the beginning of 2008. Historically, the BAA corporate bond rate and the 10-year Treasury rate have traded at about 2% spread. The 30-year fixed mortgage rate generally sits in the middle.

Late in 2008, the spreads began to widen. Once the spreads appeared to have peaked in late '08, we bought some BAA mutual funds which have since been sold. Because the spread (2%) is back to normal, we think the opportunity for buying bonds is pretty much over.

As the Fed brought 10-year Treasury rates down through its own buying, mortgage rates came down too. (You'll note there's a wider than normal gap between mortgage rates and Treasuries; we think this is because Treasury rates are too low.) As the economy improves, Treasury rates will move up. By the way, when these rates increase by another half percent or so, they'll probably start being a floor under mortgage rates. As a result, if you haven't locked in a fixed mortgage, do so. I don't expect mortgage rates to go much lower.

What we've tried to describe at past seminars — and still believe remains true — is that our Treasury and Federal Reserve tried to keep the problems of Wall Street from infecting Main Street. Our federal government has guaranteed deposits — not just the first \$100,000, but up to \$250,000 per depositor. And it has guaranteed all deposits, including money market funds. Our federal government has also guaranteed mortgages, so through all of this mess you've still been able to get a conforming mortgage. On the other hand, if you owned stock in Fannie Mae or Freddie Mac, you lost your shirt:

Figure 25 Fannie Mae, Freddie Mac, 2005-2010



As you probably know, one way or another, Fannie and Freddie are involved in underwriting over half the mortgages in this country. These companies also had three sets of securities: bonds, stocks, and preferred stock. Because of their significance, the federal government guaranteed the bonds of Fannie Mae and Freddie Mac — which is why you and I can still get a mortgage. The stock price, however, went below \$1 — which means the shareholder did not benefit from the bailout. The third class of securities, “preferred’s” are mostly owned by banks. When the government took a position, it did so with “senior preferred” securities, meaning it stepped in front of the existing preferred’s — requiring bank owners to mark down their value.

As a point of local interest, PNC Bank avoided the whole credit mess. This bank did not target sub-prime mortgages, nor did it participate in securitizing (selling) such loans to Wall Street. But, PNC did own some Fannie Mae preferred stock. When the government acquired “senior preferred” securities at Fannie, PNC had to mark down the value of its balance sheet. (As you know, the amount of business a bank or insurance company can do is limited by the amount of equity it has. When assets get marked down, it limits the amount of business that can be done.) So, here’s a bank that did just about everything right, but got hurt nevertheless by the government taking a senior preferred position.

Figure 26 S&P 500 Index, 2005-2010



NOTE: The S&P 500 Index is a widely recognized, unmanaged index of common stock prices.

Source: Bloomberg

As you can see from Figure 26, this time around, we’re hearing a lot about the V-type rebound in the stock market. The big rebound isn’t so much that the fundamentals are particularly good. It’s simply that we had serious amounts of forced selling in ‘08 and early ‘09. A lot of people want to measure the market from March ‘09, as if those prices were realistic. In March ‘09, there were fire-sale prices! It was very much akin to an estate auction.

What do the stock market and an estate auction have in common?

At an estate auction, everything will sell. (At other auctions, there may be a reserve price. For example, the seller says, "I'll sell – but only down to this price. Beyond that, I'll just keep it.") In an estate auction, there are often no reserve prices; everything will sell. How does this relate to the stock market?

At the end of 2007, there was approximately \$1.8-\$1.9 trillion invested in hedge funds. During 2008, hedge funds received nearly \$300 billion in redemptions. Remember: if you run an open-end mutual fund such as we do, or a hedge fund, and you receive redemptions, you must send people their money. This means if an investment manager is fully invested, he must sell something to cover the redemption. Imagine the impact when hedge funds received approximately \$300 billion in redemptions in 2008, and another \$100+ billion in January and February in 2009!

Add to this situation the leverage with which hedge funds could operate. Let's say a hedge fund had \$1 billion in equity... it might borrow another \$2 billion, \$3 billion, or \$4 billion to buy more stock on that leverage. During the course of 2008, hedge funds received word from their lenders that if they were carrying 4-to-1 leverage, the lenders were no longer willing to lend that much anymore — perhaps, only half that amount. (I don't have final numbers, but it looks like their leverage was cut in half.) So, if you add deleveraging to the redemption amounts, you can get to \$1 trillion of forced selling pretty quickly. Of course, there were no forced buyers to offset it. We think this type of huge reduction drove prices well below what was fair, and it probably ended in March '09.

Today, we think prices are, on average, fair. But ignore the fact that they're up a lot, because they're up from a nonsense base. Don't even think of it as a base. Prices were driven to nonsense levels because of the forced selling caused by the deleveraging amongst hedge funds and the redemptions that took place in both hedge funds and mutual funds.

Do we think the bailouts were necessary?

In fact, yes. When the Fed starting squeezing interest rates in 2005-06, the shadow banking community, (including hedge funds), continued leveraging money. As a result, the velocity of money kept growing until July 2007 and, then, fell off a cliff. The leverage (money) created by the “shadow banking” system collapsed.

In response, in the fall of 2008, the U.S. government invested \$125 billion in eight of the largest banks across the country, including Citigroup, Wells Fargo, Bank of America, Morgan Stanley, Goldman Sachs, JP Morgan Chase, State Street, and Bank of New York Mellon. Several of the banks didn’t need it or want it; nevertheless, they were forced to accept the capital. Since that time, TARP (Troubled Asset Relief Program) hasn’t turned out to be as bad as many feared. Most of the money has been paid back — with interest. As of the beginning of the year, the Treasury made \$19 billion. (Banks were eager to get out of the program due to the interest rates charges, and to escape government restrictions such as caps on executive compensation.)

Before we take a look at how some of the largest institutions are now faring, let’s first discuss why these banks were forced to take government dollars.

For 40 years, I found it proved beneficial to monitor what the Fed is doing. When the Fed engineers an inverted yield curve to squeeze the economy, you should watch out for a recession; watch out for a market correction. When the Fed starts lowering short-term rates, juicing the economy, it’s probably okay to go ahead and buy stocks. But that didn’t work in the recent past. To explain further, I’m going to give a little bit of “Economics 101.”

We started our discussion with Gross Domestic Product. GDP is the quantity of goods produced, times the price of goods produced. But you can also equate GDP to the amount of money in use, times the rate at which it turns over. The rate at which money turns over is called velocity.

In other words:

$$\text{GDP} = \text{Price} \times (\text{times}) \text{Quantity} = \text{Money} \times (\text{times}) \text{Velocity.}$$

What we’re trying to achieve is a greater quantity of goods (per capita) at stable prices. The Federal Reserve attempts to manage this process, which is not an easy task. Here’s why:

We can measure the quantity of goods pretty well. (Examples: How many tons of steel are produced? How many bushels of wheat are harvested? How many cars are manufactured?) And, we can measure prices pretty well. We can also measure the money supply pretty well; in fact, we measure it about five different ways. But we really can’t measure velocity very well.

What's the velocity of money — and how did it come to a crashing halt?

Forty years ago, when you and I got a mortgage, the bank held that mortgage. If they lent us \$100,000, we agreed over a period of 30 years to pay the \$100,000 back to the bank. To accomplish this, the bank would take deposits from its depositors, lend it to people like us, and we paid it off over a period of 30 years.

Ten years ago, if you got a mortgage, the bank would lend you the money (which you would promise to pay back), but it would take your note and run it through Fannie Mae. In turn, Fannie Mae would market the mortgage through Merrill Lynch, which would find an investor who was willing to buy it. So, within a few months, the bank would get its money back and go out and make another loan. Folks, if that happens twice, the velocity of money just doubled.

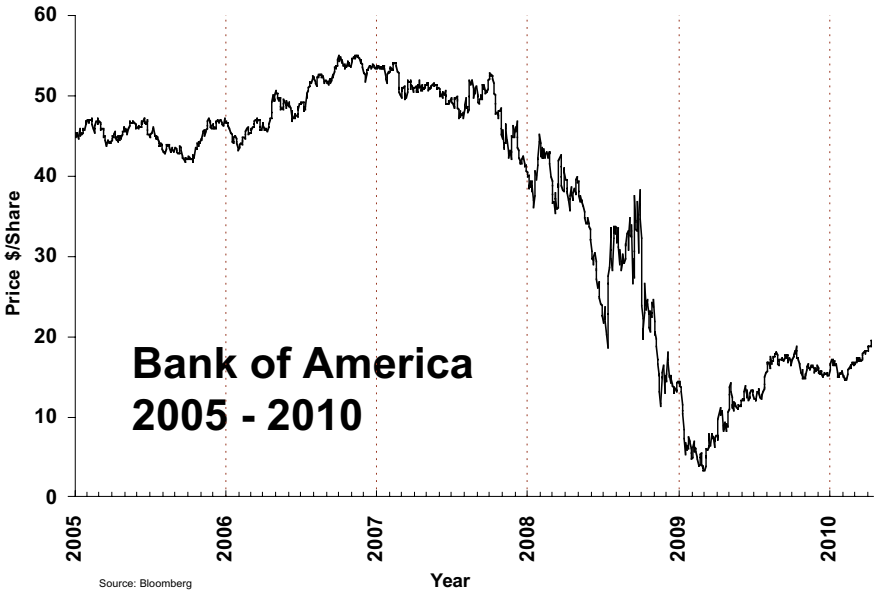
For most of the past 40 years, velocity has been fairly stable or gradually increasing. Let me be clear: The Fed does control the money supply. The velocity of money, however, is a wild card. Velocity is a function of all the turnover and leverage that goes on in the economy by a whole lot of operators — and no party controls it. Technically, the Fed did not lose control of the money supply over the past few years, but it lost control of the combination (MV). When the Fed was trying to squeeze the economy in '04 and '05 by raising rates, the velocity [turnover] of money kept growing and overwhelmed the Fed's actions. In late 2008 and early 2009, as a result of all the deleveraging and the whole credit mess, velocity fell off a cliff.

More specifically, let's say velocity was cut in half. Your goal as head of the Federal Reserve or as Secretary Treasurer is to not let the quantity of goods get cut in half, or the prices of goods to get cut in half, or the combination of the two to get cut in half. To do this, if velocity is cut in half, you have to double the money supply! All the money the federal government shoveled into the economy has been to offset the collapse in velocity.

Because the Fed doubled the money supply, inflation is a real concern. But this action was needed to offset the drop in velocity! As the velocity of money starts to grow again, the Fed will need to sop up some of this money, or we will, indeed, experience high inflation. Remember, velocity is hard to measure — so my fear is the Fed will not know when to begin this process.

Now, let's take a look at what's happened to some of the largest financial institutions. In my opinion, these are the survivors.

Figure 27 Bank of America, 2005-2010



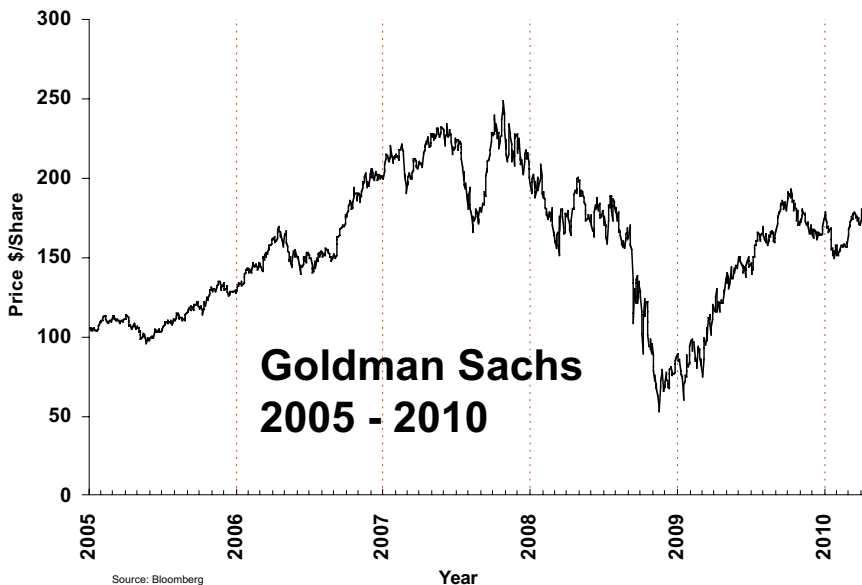
The share price of Bank of America, which was at \$50, fell to \$5, and is now at \$17.50 (as of May 4, 2010).

Figure 28 Morgan Stanley, 2005-2010



The share price of Morgan Stanley was at \$60, fell to \$10, and is now at \$30.00 (as of May 4, 2010).

Figure 29 Goldman Sachs, 2005-2010



Goldman Sachs was at \$200, fell to \$50, and is now at \$150.00 (as of May 4, 2010).

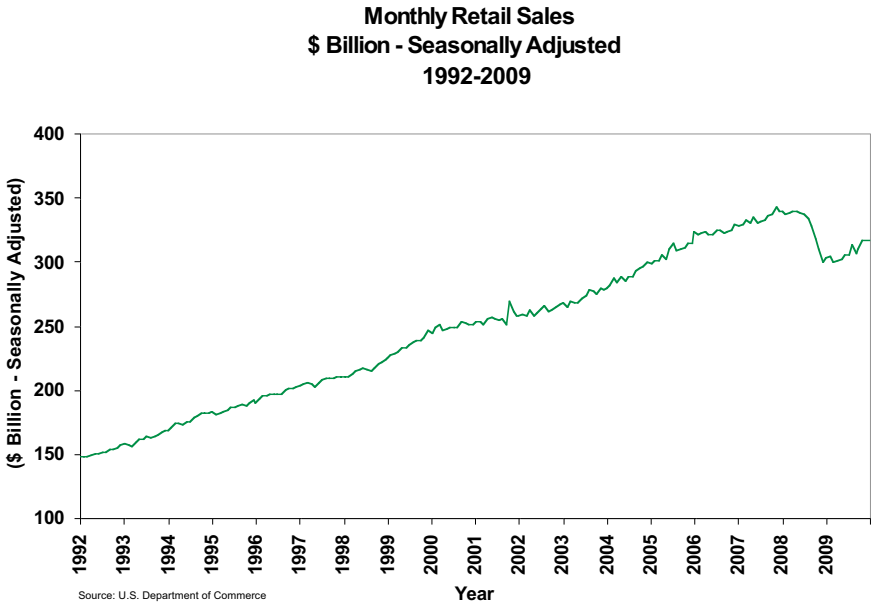
Where to from here?

Those of you who have read what we've written over a period of years know that we think of recessions as a normal part of the business cycle. Once in a while, however, we get a change in investment "climate." We had a climate change back in 1965-68, when inflation started running up. We also had a climate change in 1978-80, when inflation started going down. We have the potential for a climate change now. I don't know how to predict it — so we continue to monitor a variety of factors:

- Consumer Spending;
- Business Investment;
- Velocity of Money;
- Federal Reserve and Treasury;
- Credit Defaults / Bank Health;
- Taxes; and
- Regulation.

To that end, we find the following plots useful to monitor:

Figure 30 Monthly Retail Sales Seasonally Adjusted, 1992-2009



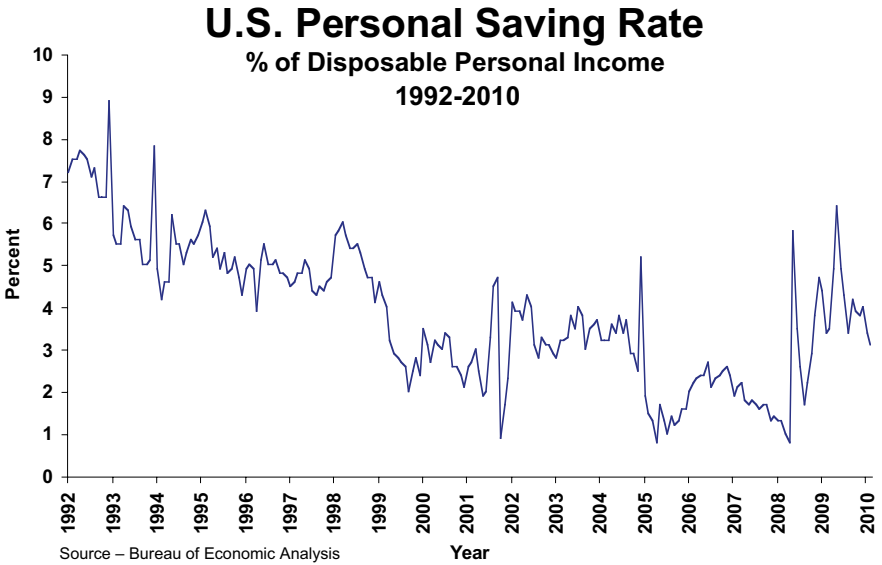
In Figure 30, you cannot detect the 2001 recession. The consumer did not get hit, which is why you wanted to own companies specializing in consumer discretionary goods.

In late 2008, in a single quarter, monthly retail sales dropped considerably, reflecting a step-down in consumer spending. Consumers started buying about 5% less. What's important to assess is if this is akin to stepping off a curb, or the first step in going down a whole staircase. Six months ago, it looked like monthly retail sales were growing at 2 percent. In March and April of this year, there was an up-tick in consumer spending. So, the assessment remains open.

The flip side is, if we're spending 3%-5% less, where is the money going?

Here's what personal saving looks like:

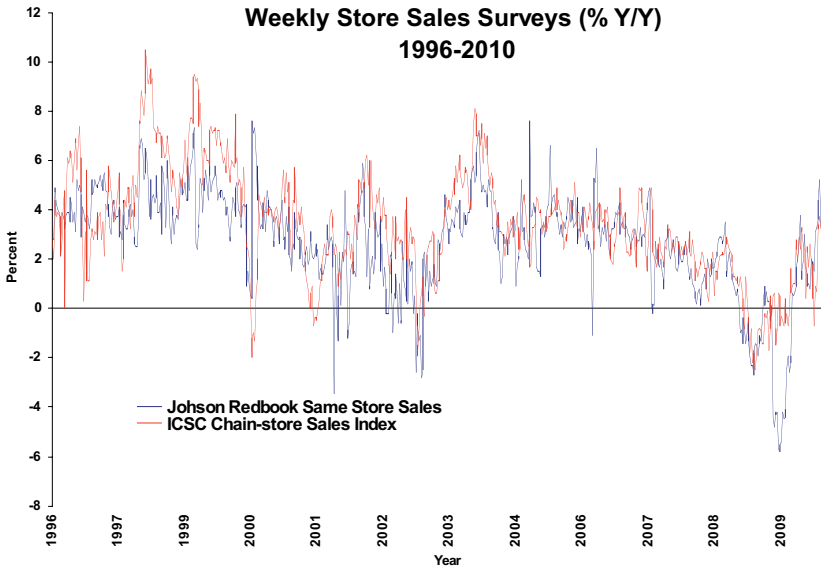
Figure 31 U.S. Personal Saving Rate, 1992-2010



Back in 1992, personal saving was at 8 percent. From 1992-2006, it went from 8% to 1 percent. In the fourth quarter of 2008, personal saving went from 1% back up to 5 percent. Pretty much for all of '09 to date, the public has kept its savings at about a 3%-5% rate. My guess is this will continue.

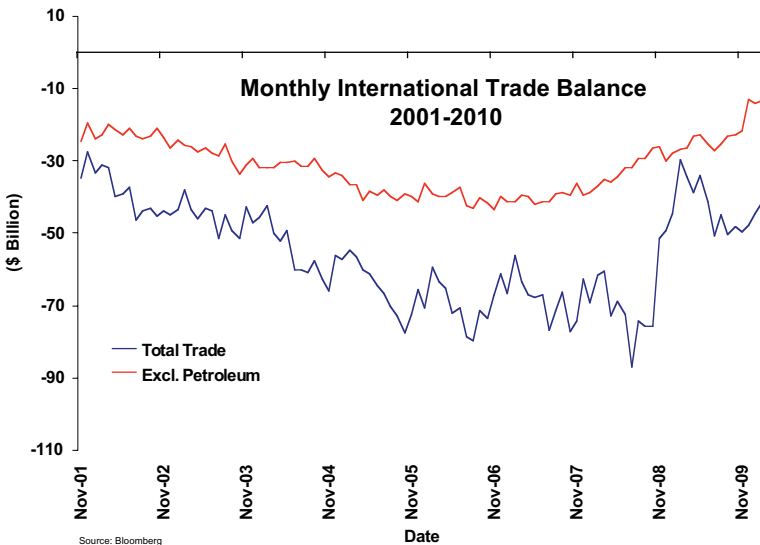
So far, most of the savings is going into CDs and T-bills. Similarly, after the 1990 recession, people began to rebuild their balance sheets. You might remember that economists referred to this as a "half-speed recovery."

Figure 32 Weekly Store Sales Surveys, 1996-2010



As you can see from Figure 32, weekly store sales went from +2% to -5% in the fall of 2008 and early 2009. Having dropped considerably, a number of retail stores are now reporting that weekly sales are within a 2%-4% range year-over-year.

Figure 33 Monthly International Trade Balance, 2001-2010

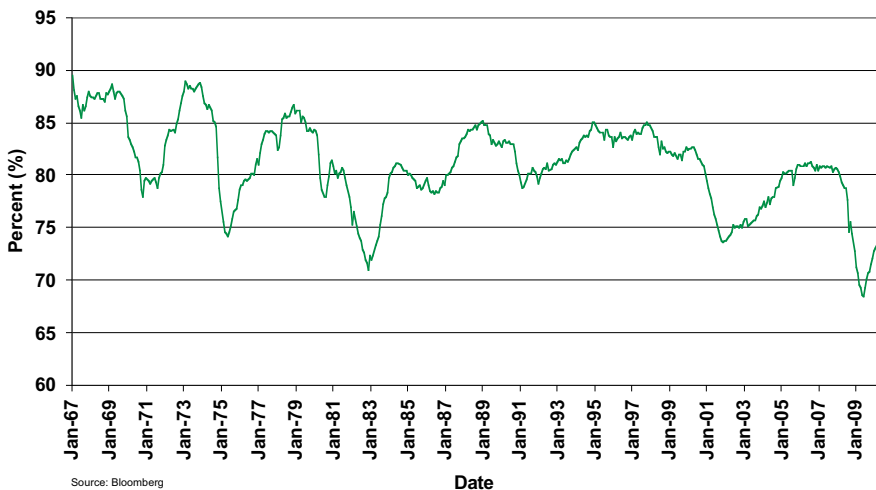


Our trade deficit is half of what it was 3-5 years ago, thanks to the recession. Was it worth it?

Frankly, I don't think the trade deficit is a problem. Personally, I've got a trade deficit at the grocery store, the gas station, and, especially, the tractor supply stores — where I've got a big trade deficit. I spend a lot more money in tractor supplies than they ever spend with me.

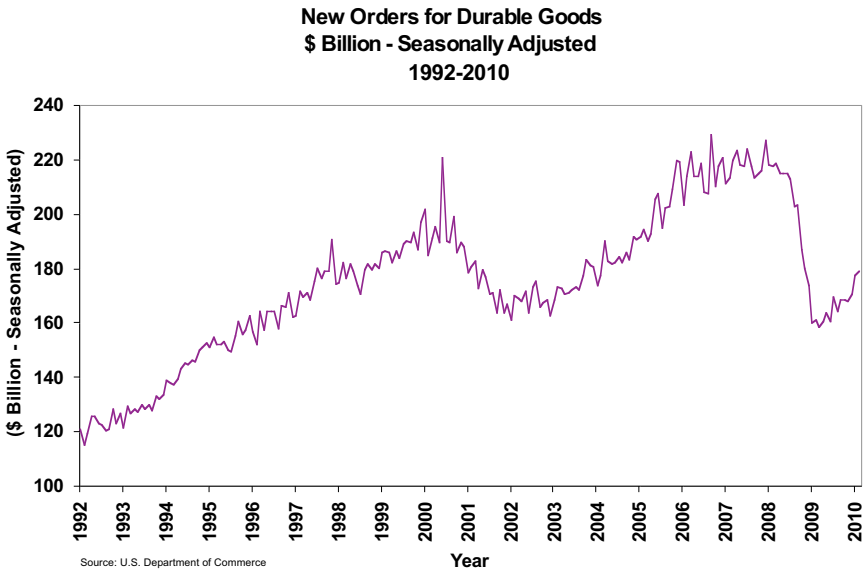
Figure 34 Capacity Utilization, 1967-2010

**Capacity Utilization
1967-2010**



In every recession capacity utilization goes down, usually because businesses cut back on inventory. As you can see from Figure 34, new orders for durable goods fell off a cliff in the fourth quarter of 2008 and are now at similar levels as back in 1981-82.

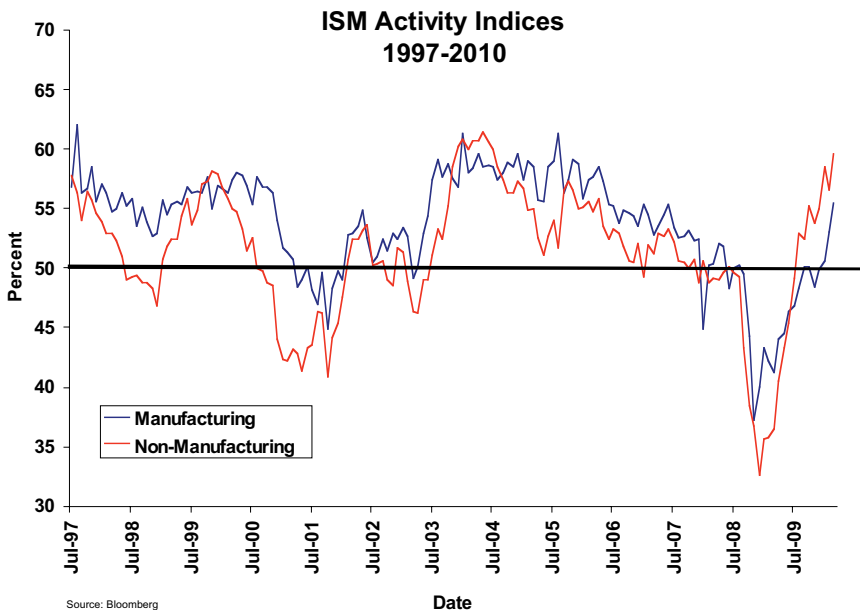
Figure 35 New Orders for Durable Goods, 1992-2010



For the past several years, we have found great values in a number of big technology companies which happened to be based in the U.S., but really sell throughout the world. Cisco does the majority of its business overseas. IBM does the majority of its business overseas. One way of playing the strength in emerging economies — while still having confidence in the accounting systems — was to buy these major international firms.

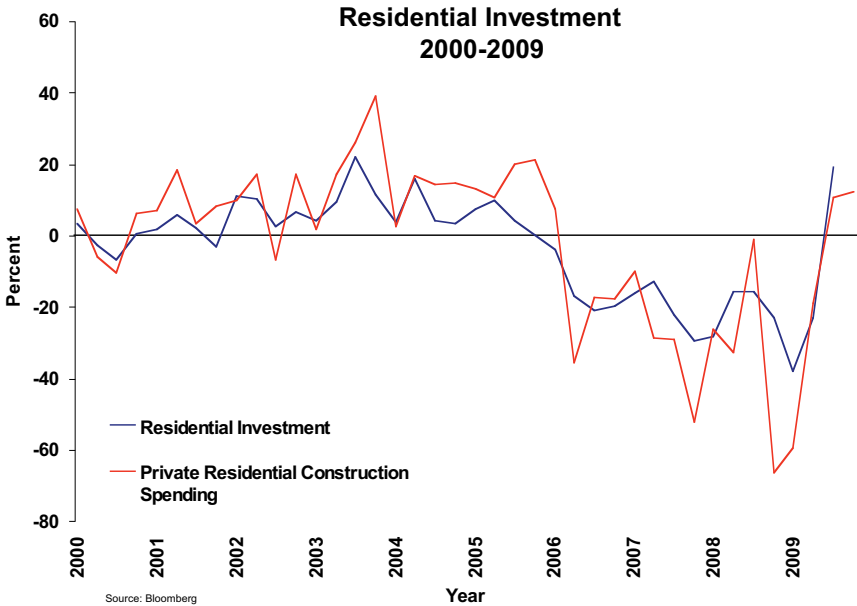
If you have firms that are servicing a global demand — and if their costs are in dollars and their sales are to the emerging markets — we think that's a great place to be. Plus, a number of them have a P/E (price-to-earnings) ratio of 12-15, which is hard to resist.

Figure 36 ISM Activity Indices, 1997-2010



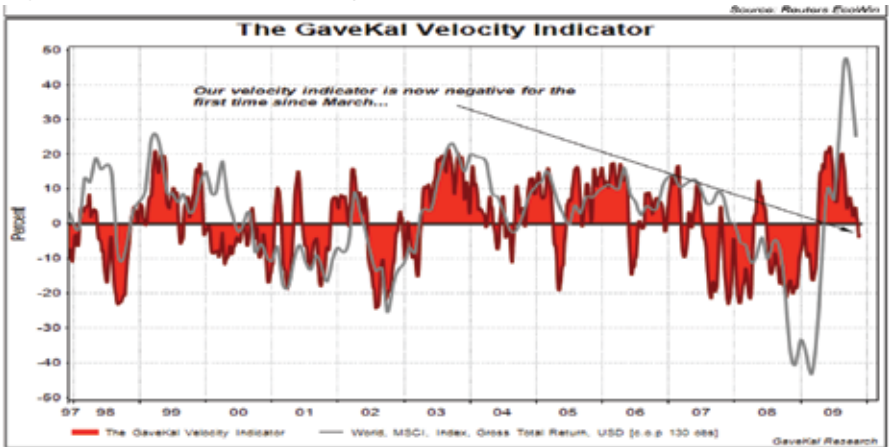
As noted in Figure 36, both manufacturing and non-manufacturing fell off a cliff during the last quarter of 2008 and in early 2009. Recently, these indices seem to be stabilizing. We're seeing this in truck tonnages and railcar loading.

Figure 37 Residential Investment, 2000-2009



Residential investment had been growing rather nicely, dropped off, and is now stabilizing. I believe there remain enough empty houses across the country, and it's going to take a while to work off the inventory.

Figure 38 The GaveKal Velocity Indicator



Many of you have been reading that, with all of the money the Fed put into the economy, we are bound for inflation. Remember, however, that the reason the Fed put so much money into the economy was because velocity had collapsed. Unless the Fed had done so, we would have had serious deflation — which most folks would call Depression.

Velocity turned positive in March 2009, and now seems to be floating somewhere around zero. When velocity turns consistently positive, the Fed is going to have to sop up that extra money, or we will have inflation.

By the way, Milton Friedman said we had turned a normal recession into a Great Depression by doing three things:

1. To protect our gold supply, we raised interest rates;
2. To balance our budget, we raised taxes; and
3. To help our manufacturers, we raised tariffs.

Each of those sounds reasonable, but what does it do to the consumer? If you raise interest rates, taxes, and tariffs, it kills the consumer!

At the core, what's needed for an economy to grow are people who are willing to work. What I've seen in every recession since I've been paying attention, (1968), remains true today: During a recession, people work a little harder and spend a little less. After six months or a year, their balance sheet is in better shape — they've paid down their debt somewhat and feel confident they can start spending money. So, recessions are generally self-correcting.... Unless, you're in Greece, where people are being told to cut back, and air force pilots go on strike, tax collectors go on strike... Bottom line: If your public is unwilling to work harder and spend less to get itself in decent shape, all bets are off.

The second thing that's needed for an economy to grow is for people to perceive working and hiring to be in their interest. When I talk to people and ask if unemployment's too high, everybody says yes. I respond, "Go hire somebody." They ask, "What do you mean?" I repeat, "If you think unemployment is too high, go hire somebody." The response is regularly, "I can't afford to do that." And I say, "If you can't afford to, what makes you think anyone else can?" If only 5% of the people went and hired somebody, unemployment would go from 10% to 5 percent. The point being, if you just ask people to step into the other guy's shoes, you get an entirely different response.

Can anybody tell me what taxes are going to be? Can anybody tell what the costs of healthcare will be?

I'm pretty sure my taxes are going up. I'm pretty certain that my healthcare insurance prices are going up. I'm also confident that regulations will increase. Given the uncertainty about taxes, healthcare, and regulations, there are a whole lot of people who are going to be uncertain about hiring. So I suspect, this time around, employment is going to be pretty slow to come back. And where that takes us, I'm not sure. Folks, I believe we've embarked on "The second great economic experiment of my adult lifetime." And how it comes out, I don't know.

Figure 39 Assets on the Fed Balance Sheet, April 14, 2010

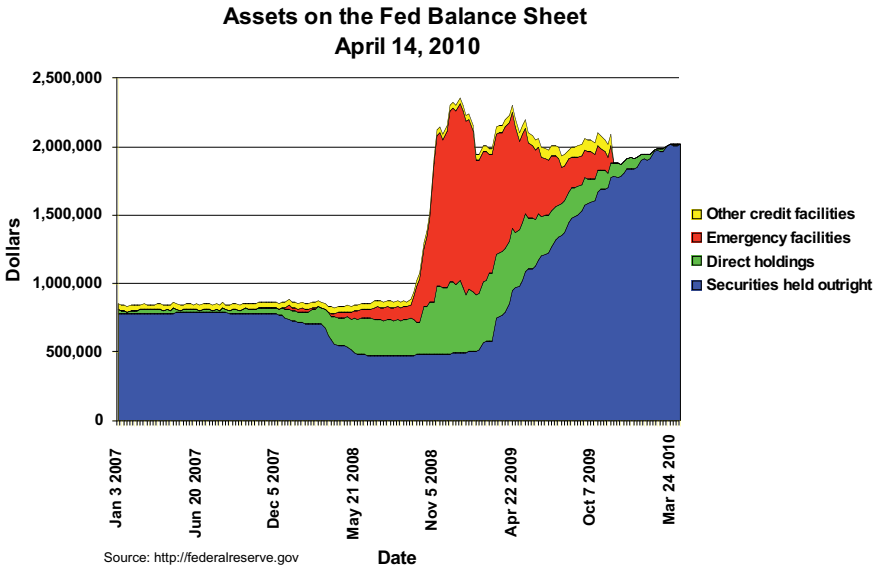


Figure 39 presents the Federal Reserve's balance sheet. Back in 2007-08, it was running at approximately \$800 billion. Today, it's close to \$2 trillion.

The red on this plot represents TARP dollars, which we discussed earlier. Most of the emergency funding has been paid back with interest. The yellow represents other credit facilities — somewhat minor, in comparison to everything else included on this plot. The green represents the direct holding of Treasuries; and the blue represents the purchasing of mortgage-backed securities, which the Fed quit doing at the end of April.

I do think that the velocity of money improved from where it was a year ago. I don't think that velocity will get back to where it was three years ago. What the new level will be, I don't know...which means I don't know the appropriate size that this balance sheet should be — but it will be less. On average, mortgage-backed securities pay off every month. And with the end of purchasing new mortgage-backed securities, the balance sheet should work its way down. It's going to be a real challenge for the Fed to get it right — to bring it down at a rate that does not give us inflation on the upside, or deflation on the downside.

Folks, during this presentation, we've looked at the familiar aspects of this recession, along with the factors that were atypical. Coming out of this recession, there are numerous things that we cannot predict, which is why we continue to monitor:

- Consumer Spending;
- Business Investment;
- Velocity of Money;
- Federal Reserve and Treasury;
- Credit Defaults / Bank Health;
- Taxes; and
- Regulation.

How does this all get reflected in our portfolio?

1. Consumer confidence will remain subdued for the foreseeable future. So we are not purchasing consumer discretionary kinds of companies, as we did coming out of '01 recession; e.g. Winnebago and Harley-Davidson.
2. Return on Shareholder Equity (ROE) has averaged 13% since World War II. We think, going forward, that the average may be on the order of 11% for a couple of years. This is attributed to a number of factors, including capacity utilization, new orders for durable goods, consumer spending, etc.
3. With lower ROEs, we expect companies' earnings and earnings growth to be subdued. As a result, Price-to-Earnings (P/E) ratios may be lower than they have been.
4. Forced selling could once again lead to some (very) good companies being sold at (very) cheap prices. As a result, we have raised some cash, (currently about 20% of our portfolio), in order to position ourselves to take advantage of such opportunities. Remember: The best time to buy stocks is when the public is fearful.

Glossary

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. Most of the companies in the index are mid-cap or large-cap corporations. One cannot invest directly in an index.

Return on Equity (ROE) is a company's net income (earnings) divided by the owner's equity in the business (Book Value). This percentage indicates company profitability or how efficiently a company is using its equity capital. $ROE = \text{Earnings}/\text{Book Value}$.

Price-to-Earnings (P/E) is the current price of a stock divided by the trailing 12 months earnings per share.

Dow Jones Industrial Average (DJIA) is one of several stock market indices, created by 19th century Wall Street Journal editor Charles Dow to gauge the performance of the industrial sector of the American stock market. The DJIA consists of 30 of the largest and most widely held public companies in the United States. Note the "industrial" portion of the name is largely historical; many of the 30 modern companies have little to do with traditional heavy industry.

Earnings Per Share (EPS) is the portion of a company's total profit that may be allocated to each share, computed by dividing net income (or earnings) by the total number of shares outstanding.

Moody's Corp Bond Baa Index is considered as medium-grade obligations (i.e., they are neither highly protected nor poorly secured). Interest payments and principal security appear adequate for the present, but certain protective elements may be lacking or may be characteristically unreliable over any great length of time. Such bonds lack outstanding investment characteristics and in fact have speculative characteristics as well. Moody's bond ratings reflect the credit quality of companies. The highest rating is AAA and the lowest rating is D.

Cash Flow measures the cash generating capability of a company by adding non-cash charges (e.g. depreciation) and interest expense to pretax income.



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