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listening**in**

Hard-Won Market Insights

Muhlenkamp & Co.'s Leader On Turning Market Scares Into Profits


Jeff Muhlenkamp

Muhlenkamp is an old name in the mutual fund business. Indeed, I interviewed this week's interviewee's father, Ron Muhlenkamp, the founder of the eponymous advisory firm, back in 2006 in the pages of WOWS' predecessor publication.

At that point Muhlenkamp was a nearly 30-year-old company growing like gangbusters. Its mutual fund, MUHLX, created practically at the starting gun of the secular bull market, in 1988, boasted AUM topping $3 billion.

Well, then the GFC [Global Financial Crisis] happened, and Ron took a shellacking in a big exposure to homebuilders. But Muhlenkamp survived, if not exactly thrived. It's AUM now stands at roughly 10% of its peak, but the company makes a virtue of its more manageable size and the personal touch with clients facilitated by its "small town" base outside of Pittsburgh.

That all seems to suit Jeff Muhlenkamp, pictured on this issue's cover just fine. A West Pointer and 20-year veteran of the U.S. Army, the Lieutenant Colonel retired in 2008 to join in the family business. Little did he know he was trading the Iraqi desert for a financial crisis.

Thrown into the thick of financial battles as novice analyst, Jeff admits, he made rookie gaffs. But he also studied and learned from them, picking up a career's worth of practical market sense — as well as a CFA — in short order.

By 2013, Jeff had moved into the co-manager role, working next to his father. There's no doubt Jeff was fully indoctrinated into the history, practice and principles of value investing, Muhlenkamp-style, by 2019, when Ron decided to take it easy and turned the lead portfolio manager's seat over to him. Jeff's performance in the tough markets since are clear evidence he's a go. Listen in to our March 15 chat by reading on. — KMW

Welcome to WOWS, Jeff. I just survived a bout of Covid; thankful for the vaccines. But what I'm really wishing for is one against financial crises now —

JEFF MUHLENKAMP: I hope you feel better.

I do, well enough to realize that a vax against human nature is beyond the reach of science.

Jeff: I do doubt there's a cure for that, although we keep trying.

Panic, fear and greed are pretty deeply embedded in human nature, along with manias and depressions.

Jeff: Deeply. I agree.

It's been almost exactly 17 years since I interviewed your father. WOWS was still called Welling@Weeden. I pulled it out and reread it. Ron was ahead of his time in figuring out 21st Century value investing.

Jeff: Wow. 2006. There's been a lot of water under the bridge since then.

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Exactly. Please bring me up to date. You joined Ron in the firm a few years after that interview, didn't you?

Jeff: Yes. I retired from the Army in the summer of 2008, and joined the firm in October, as an analyst — so my formative experience in finance was the '08/'09 crash. Then when Ron was looking to push back from the table, a little over four or five years ago, I stepped up as a co-manager role, then became the sole PM a few years ago. That's the short version.

Gee, two financial crises in your first 15 years. Does it make you yearn for your "tranquil" days at the Pentagon?

Jeff: Well, I went from wars in Iraq and Afghanistan to financial crises. I'm not sure which are better. At least I get to go home during financial crises. I'm not out in some desert someplace.

Another case of everything's relative.

Jeff: It was interesting. I bring up the GFC because I think everybody is a little bit shaped by their first experience in any job. Some of the things I took away from that period have stuck with me pretty hard and should continue to be useful. Somebody who started investing in 2014, 2015, 2016 — and saw nothing but tech stocks go to the moon — can scarcely escape having a very different mindset and expectations about how markets work than somebody who saw all the shenanigans and all the crashes in 2008/2009. Not to mention the European crisis of 2012 and all that other happy stuff.

It was definitely a challenge.

Jeff: Definitely.

What stuck with you the most?

Jeff: Well, that money management is a learning process — and you'd better learn fast from your mistakes. One of the things that happened — I guess it was in January of '09 — was that I wrote a memo to Ron from myself and a couple of the other analysts. It was all about our concerns around the nasty bear market — as it continued to go down, and then down some more. We actually included a list of portfolio holdings we thought we ought to be *selling* at that juncture.

Oops!

Jeff: It wasn't until a year or two later that I really reflected on that memo and realized just how far off-base we were. I realized that, okay, *in the best period of time to buy stocks at great prices* — when I literally could have bought almost anything and become a hero — I was recommending *the exact wrong move*.

I can imagine that your chagrin helps the lesson stick.

Jeff: Of course, so I've really focused on how do I prevent that the next time. Why did I do it that time? What led me to believe those stocks were sells? And, how do I inoculate myself against similarly errant recommendations the next time?

That's really important, because *there will be a next time*. And the next time that came up for me was in March of 2020.

I take it you felt much better equipped, as you faced the Covid Crisis hit?

Jeff: Well, one of the things we have done to better prepare the portfolio for the next opportunity is to keep more cash on hand, so you can go into a crisis focusing not on how much everything you own is going down, which is a very depressing, very negative way to think. You can instead focus your attention on looking at the opportunities that present themselves when the market goes into baby-with-the-bathwater mode. When you do that, you're thinking, I've got all this cash aching to go to work — where can I best invest it? Now, there's research and preparation required to do a good job of it when the opportunity arises, but I think we do a good job of that.

Sure, luck favors the prepared mind and all that — but some chutzpah helps, too.

Jeff: Oh, yes.

It helps to believe you know the long-term value of the "temporarily" cheap stocks you're buying — when it seems everyone else can't dump them fast enough.

Jeff: It also helps a lot to have a little bit of optimism that the market won't, in fact, go to zero — or at least stay there long. Because you've seen a panic before.

Yep.

Jeff: Don't get me wrong. I didn't really do a world-beating job in late winter of '20. I did not anticipate that the entire U.S. would shut down. That was truly a possibility I did not foresee. The lesson I took from that was really to consciously open up wide the range of what you consider possible events. Almost anything can happen. So you have to think much more broadly than you probably want to or are comfortable with.

Nevertheless, in late March and early April of 2020, I saw prices on assets that I was very familiar with — that literally *made no sense*. That was how I framed it at the time. "This is a nonsense price."

The research work I had done on the companies and the industries told me that if these companies didn't go out of business — and I could tick off many strong reasons why they wouldn't — these were just crazy prices. That realization enabled me to put some real money in those opportunities.

It does take real conviction or courage to stake money against the crowd —

Jeff: It does. But when I had reflected on how you feel when everything in the market is going down — I had to admit, you feel really miserable. Well, that is a sign. If you can step back from dwelling on feeling miserable — think about your own state of being — and say, hey, wait a minute, the last time I felt this awful was actually a really great time to buy stocks. So maybe feeling that miserable again is a sign that I ought to be focusing my attention on potential profits and opportunities — and quit stewing in fear of the potential downside."

So I was able to do that, the next time around in the early Spring of 2020, and say, okay, "this is exactly what it feels like when you want to be buying." Now I really pay attention to that indicator. I regard it as Jeff's own little personal indicator. It has worked out pretty well.

That huge pit in your stomach is your personal contrary indicator —

Jeff: Absolutely. I mean, you just don't want to come into work when the market has been puking, down 2% or 3% every day, and it just seems to do it relentlessly. When the news is awful and getting worse. What you really want to do is shut all of that out. That's your emotional response. You want to pay zero attention to the markets. That's a sign, too.

That was one of the lessons I took out of '08/'09. That emotional state is a sign — that you need to put those feelings aside — knuckle down and find the opportunities that all the indiscriminate selling is creating — because those opportunities are more plentiful then, than in more "normal" times in the market. Opportunities are the most present in times of market volatility and turmoil. But it is hard, when everyone is going the other way.

But if it were easy, you'd have a lot more competition in the race for those bargains.

Jeff: I'll absolutely agree. But I've gone against that headwind at least twice. And it is hard.

The other thing I've learned the hard way is, of course, to be a little patient. I wasn't in the business yet in 2007 when the GFC's long list of problems really started breaking into the headlines. But from start to finish, that entire market crisis and great recession took, what, more than two years to play out?

Yes, with an accent on the "more than," if you'd been following some of the fanciful finance that led to quite a bit of the ruin.

Jeff: What I was getting at is that within that fairly long span now called the GFC, we had problems, we resolved those problems, everybody thought they got the all-clear — and then things started getting worse again. As a result, any number of very accomplished investors kept dollar-cost averaging into financials — and by the real end of the GFC and its accumulation of crises, they had gotten their heads handed to them. That's also how I learned about the flip side of being a little patient.

Which is?

Jeff: The other thing I learned is not to be too quick to snap up what looks like a relative value. It's tempting to say, "oh, look, it's down 30% from its peak. It *must* be cheap.

Ain't necessarily so.

Jeff: Right. Pay attention to other things, like sustainable cashflow, an unassailable balance sheet, a moat — and be more patient than it's probably my nature to be.

But I'm not sure that I've developed yet a great rule of thumb on how to avoid being too early versus too late. In retrospect, you can say, oh well, clearly there were two market bottoms in '08/'09. One was when the government finally stepped in after the Thanksgiving 2008 debacle when Congress had failed to pass a bill — a bailout, basically. Then, after about a week in which the market puked up another 10% of the index's value, Congress came around and did it. And then the last one, of course, came the next March, after the FASB [**Financial Accounting Standards Board**] changed the rules on banks having to mark their holdings to market, which got all the financials out of their doom loop on asset prices. Those were two big markers that significant actions were being taken to resolve the underlying issues. If you were able to see them for what they were, that was helpful.

In the Covid Panic of 2020, the key really was that you needed to pay attention to when the Fed basically said, "We're going to do whatever it takes," and not just the Fed, but the rest of the government chimed in, too. The Fed essentially said, "We'll lend whoever as much as they need," and the government said, "We'll spend as much as we need to, regardless."

If you were paying attention to that response, it probably struck you that it might be a very useful market indicator. And it would have helped you step in and start buying when things pretty soon stopped getting worse in the markets — and started getting a little better.

That turn came very quickly.
Jeff: Basically because people started seeing the government throwing really huge sums of money at the problem.

Most dramatic market slides aren't reversed nearly so expeditiously. Then again, most aren't sparked by a virus. A typical bear market is both long and torturous as complex imbalances aren't worked out overnight.
Jeff: Correct. And frankly, it's easier on your psyche to be late, rather than early. If you miss the precise bottom but you catch it on the upswing, the good news is once you've got back in, you're generally going to see positive results. If you're early in scooping up a "bargain" and you discover a still-deeper bottom ahead of you, you're going to feel really, really, really bad, for a period of time.

Really bad?
Jeff: Really bad. Assuming you hold on, it'll work out quite well in the end, but for a period of time you're going to feel phenomenally stupid and bad. I used the totality of that experience in 2020. I put some money to work in late March, early April. But then I held back a bit and didn't put some more money to work until later in May and early June. WESCO International (WCC), for instance, is a stock that I was a little late on. They had won a bidding war to buy another B2B services company [Anixter International] just before the shut down, and there was some concern that WESCO was going to "kitchen sink" their earnings on their next earnings call, so I decided to be a little patient. Did I nail the bottom on that company? No, I did not. Did I get a nice double out of it in the next year? Yes, I did. Good enough.

Gordon Gekko was wrong. Greed can kill.
Jeff: Good enough is good enough.

I'm curious. I got to know Ron a bit doing that interview. How did he react to getting that 2009 "sell" advice from you and your colleagues? I can't imagine he was pleased. **Jeff:** [Whistles] I don't know what he said, but I know he *didn't act on it*. [Laughing]

I assumed that, but I wasn't so sure he'd hold his tongue.
Jeff: Well, part of it probably was that he was feeling pretty beaten up at the time, since we had been heavy in homebuilders going into that crisis. And we did not time the exit very well.

They got ugly. The housing market was the bubble's helium.
Jeff: Which brings to mind another bit of market "wisdom" I've come to only through reflection, after the fact. The "everything bubble" that we've seen in the last four, five, six, seven years was in everything from crypto to profitless tech, and all sorts of things. I know some people who invested in various aspects of the bubble, early on, and did very well in, for instance, Tesla (TSLA). But I just could not wrap my head around it. I've had debates with those people, back and forth. And what that taught me is that the investors who participate in those bubbles *don't recognize it as a bubble*, because it *makes sense to them*. The bubble stock's price matches their view of what ought to be happening — it doesn't strike them as anomalous. That's why Ron, back in 2006-2007, didn't realize that he was in fact riding a bubble in homebuilders. What was happening made sense to him. It is just very, very hard to see a mania from the inside.

True. Rising home prices and booming housing were considered integral to the American dream. *That* couldn't be a bubble. Home prices *never* fell. Until spiraling financial excesses, and fraud brought the whole structure down.
Jeff: Right. The homebuilders' fundamentals looked solid, rising backlogs and all, blah, blah, blah. Ron wasn't looking for no-doc and all that stuff. My takeaway from that is that investors really have to look for and pay close attention to alternative opinions on stocks — particularly ones you are holding that have already done well for you for some time. For instance, if your housing position has already gone up quite smartly for you for over five years. Or if your speculative position in Tesla has already gone up 10X, 20X, 30X —

Take your profits — and run.
Jeff: Be happy you nailed it, but at that point it's wise to investigate why others disagree that it's wonderful. You really need to think hard about whether *what you think* is likely to happen — or *what they think* — is more likely to happen. It's tough to do that, but it's a very valuable exercise.

Indeed. At this point aren't you managing money for a lot of advisory clients as well as the Muhlenkamp Fund?"
Jeff: Yes, we've got about $230 million in the fund (MUHLX) and another $100 million in AUM outside of that. So we're much smaller than when you talked to us in 2006.

By roughly a factor of 10, I'll say. But the GFC really took it out of lots of mutual funds. Are your clients giving you panicked phone calls in the last few days?
Jeff: No. The only question I got was from my sister-in-law, and it was essentially, "My elderly mother has her money here, do you think it's safe?" So no, we really have not gotten any questions from clients. I will say that we have seen redemptions this year. Last year about this time, we saw a fairly significant *inflow* of money, and this year we're seeing about two-thirds of that inflow, in terms of quantity, go in reverse.

Which is interesting because in 2021, we were up 30% and the market was up 30%. Okay, it was a great year, but we didn't *outperform* in any way, shape or form — but saw that inflow the next year. But in 2022, when the market was down, what, 18%, *we were up* 3%, so I kind of expected that money would be coming in this year — but it is not.

You expected rationality? Fund investors are notorious for chasing performance, *after the fact*. Asking them to step up amid a downturn in the major averages — *and* do math involving negative numbers — that's a lot.
Jeff: I guess that's just part of the business. But so far, our clients haven't been spooked by the banking crisis.

I checked your year-end 2022 portfolio and noticed you didn't get tempted to buy banking stocks as they got hit last year — as some value types did.
Jeff: Well, the way I think about it, that choice was really informed by Nassim Nicholas Taleb's book, "Antifragile: Things That Gain from Disorder." Are you familiar with that?

Oh, quite.
Jeff: His descriptions of fragile and robust and antifragile really made a ton of sense to me. Ever since coming out of the Great Financial Crisis, when I did a lot of research and thinking about the banking industry, I've come to realize that banks are inherently fragile.

What, gathering short-term deposits and lending it long-term doesn't sound like a winning business plan?
Jeff: Especially when you lever up to do it, et cetera, et cetera.

The fractional reserve banking system is inherently fragile, and no matter how well-run – is vulnerable to a run on the bank any day that all its depositors decide to leave. Any day. In light of that, I want to make sure that when the Fed starts to raise interest rates, contract the money supply and tighten the availability of money, I don't want to be in a fragile asset. Meaning, I don't want to own banks. The time to buy banks is in the middle of a crisis when they're all trading at book or less, blah, blah, and things start to get a little better. Then you sell them sometime later before the Fed starts constricting the money supply again.

If you can.
Jeff: We have not owned banks in a year and a half or more. Now, did bank stocks get down to book for a while during that time? Yes, they did. Did they bounce off of those lows? Yes, they did. But what I said was, don't get anxious here. The Fed was still raising rates and the Fed was still shrinking their balance sheet. There might be more pain. That's when you want your holdings to be robust, to be antifragile. And what you want, instead, is to be partnered with an allocator of capital with excess cash when everybody else is desperate for it.

In other words, Warren Buffett?
Jeff: Well, Warren Buffett is probably the best known of the people that do that well. There are certainly others. But when I look at the stocks we hold in our portfolios, they are all very cash-generative. That is not an accident. And yes, we do hold Berkshire Hathaway (BRK.B).

So you're also fond of companies with pretty big moats —
Jeff: Yes. Or if not precisely a moat, at least a company that under some fairly adverse assumptions still continues to generate cash. For example, if I look at the energy sector, I can't tell you that any of those companies anywhere has a real moat. It's a commodity, so unless they were by far the lowest-cost producer of oil, I can see no moat. And the low-cost producer is Saudi Aramco. I don't own it because I don't think we would ultimately benefit from — Sheikh Mohammed bin Salman's profits — we'll put it that way.

But under some reasonable assumptions about what the demand for and the price of gas and oil will be, going forward, we think a domestic natural gas producer like EQT Corp. (EQT) — the nation's largest independent — is going to generate a lot of cash. Their management is very smart about how they deploy their cash and they are also committed to responsible development of their resource assets for all stakeholders. So even if EQT's stock price tanks 10% - 15%, which — look at that, that's what it's doing today —

I was just about to say it's a contrary pick in this crisis —

Jeff: Yes. Energy is selling off hard. Which is *not* what I hoped, but not particularly surprising. Energy tends to be at the whip end of the economy, and when people start to say, "Oh, a recession is now baked into the cake, they don't want to be in —

Anything economically-sensitive —

Jeff: Investors fear less demand for energy. I think today's new statistics on inventories came in high. Or Russia is shipping more oil than people thought. You can take your pick of the excuse of the day. My point is simply that people are dumping energy stocks now.

Beware the Ides of March —

Jeff: But do I think Toby Rice, who is the CEO of EQT, is going to start salivating at his own stock price down here? I do, in fact, think Toby Rice is going to start salivating over his stock's price —and he has the ability to act on buying more back. So longer term, — and in energy I am always looking longer term, looking at a three-to-five-year time horizon — I think we're going to do really well in our energy holdings. In fact, we may get an opportunity to add a little more energy to our portfolio at really good prices here in the near term. While that will possibly hurt a bit in the short term, that's not what I need to be focusing on.

Isn't three to five years still your typical horizon across all your holdings?

Jeff: No. Ron used to play the business cycle, primarily, resulting generally in a 3 - 5-year horizon.

I remember.

Jeff: That's still useful, valid, and we still do have that holding period in many cases. For instance, in energy, we are basically playing the commodity cycle. This time around, the sign that caught our attention was the price of WTI crude dropping to *negative* $40 in that one-day plunge, back in April 2020.

That negative number caught pretty much everybody's attention. Even at the beginning of the Covid pandemic.

Jeff: Right. But you've got to recognize something like that for what it is. That is a signal that there are nonsense prices in the market — that you can take advantage of.

That negative number quote definitely bottom-ticked the commodity cycle.

Jeff: No doubt. But it was hard to immediately recognize that because the entire market was down at the time. So the roof was falling in, the world was shutting down, blah, blah. There were a lot of reasons anyone could still be very negative. Nonetheless, that was a sign. And, since that price collapse, all of the energy companies that were penalized by investors have gotten religion about focusing on the return on the capital they employ, they've gotten religion about shepherding their free cash flows. They definitely are no longer in a "growth at any cost" mode. They now are intently focused in a profitability mode. That's what's changed. And as long as that endures — my guess is on the order of three to five years — I think the survivors of that experience are going to be much better companies to own than they were a decade ago. That's when it was all "borrow and drill baby, drill to grow your asset base." Because that's what investors were rewarding them for doing that back then. Now, they're being very differently incentivized by Wall Street.

I'm shocked, shocked, I tell you.

Jeff: Well, the current situation makes a lot more sense to me. I don't know how long it will last, and so I'm watching for shifts in the mindset, but my guess is it's on the order of three to five years. First, we needed to see a recovery in gas and oil prices, so the producers recovered. Then they started generating a lot of cash and they paid down their debt and other obligations. Then the next thing, of course, that happens is that the producers start to spend a little more on cap-ex. Meanwhile, the energy service providers, Schlumberger (SLB) — where we do have a position — and Haliburton, etcetera, whose cycles lag the producers' are still a little bit further out in terms of when they'll see stock market recognition and an improvement in their businesses. But the service companies' stocks are most likely the next to start moving up.

The upshot is that we're involved in some stocks positioned in three or four places in that cyclical process. They'll probably enjoy good conditions for profitability through the remainder of the energy cycle — 3, 4, or 5 years, as I said. But at this time do I want to contemplate holding energy producers for the next decade or two? I don't think that's a good way to invest at this juncture. I could always change my mind, but we are talking about a commodity, after all. And by the way, our approach to bank stocks is similar. The way to play them is on the basis of the credit cycle.

So what sorts of stocks are you tending to make longer-term holdings these days?

JEFF: How about this one? We've owned Rush Enterprises since *before* 2006, the last time you talked to Ron.

The truck dealer?

JEFF: Yes. Rush Enterprises (RUSHA) is a Texas-based truck dealer, actually an accumulator of truck dealerships. For the last 20 years, CEO Randy Rush has not only been acquiring new dealerships but improving their operations. In fact, they cover 120% - 130% of their costs just off those dealerships' parts and services operations and such — even if they don't sell a single truck.

Not bad at all.

JEFF: So while you might think the cyclicality of new truck sales would make Rush a very cyclical business, the reality is that all its maintenance business tends to smooth that out. So we make no attempt to invest in Rush on a cyclical basis.

Our cost basis in the stock is — no kidding — a dollar, and it is now trading in the region of $52 a share. Its stock chart is a thing of beauty. When I look at that, I say, if I can find more stocks like that, I'll be happy to buy and hold them, too.

Good luck, you're not asking for much —

JEFF: Well, there are two or three — maybe four candidates for that kind of treatment, all tech stocks, that are already in our fund portfolio. Namely, we own Apple (AAPL), we own Microsoft (MSFT), we own a company called Microchip Technology (MCHP), which produces chips, as you might expect. And we own Broadcom (AVGO). We bought them all, in my opinion, quite well. Certainly, in terms of Apple and Microsoft, we bought them in 2015 or 2016 — and they're each up something like seven or eight times since then.

Strictly buying and holding?

JEFF: No. We cut back on our position sizes a couple of times, most recently in the summer of '21 when, in our opinion, the stocks were overvalued. They were still great companies, but too expensive, and the price momentum was coming out of the stock. So we went from like 10% positions to about 3% positions in each stock. But I'm interested in holding them longer term because I think they have the potential to be long-term compounding machines, like Rush, and I want to allow for that possibility.

The reasons I have for holding them are all a little bit different, but I think they're all good candidates to do that. Let's face it, if you could find enough companies like that, the best thing to do would be fill your portfolio with them. That's certainly Warren Buffett's approach, and makes a ton of sense. When I find a company that I think could work like that for us, I'm willing to give it a lot of rope — even knowing that there will be times when that looks stupid. It's going to happen. There are no straight lines up or down in the stock market. It's all a very noisy pattern.

Well, why Microsoft, for instance?

JEFF: One of the things I've concluded is that most companies, albeit not all, but most companies do have product cycles — that you should pay attention to. What we really did with both Apple and Microsoft is buy those stocks at the end of the companies' old product cycles — when their market prices did not include any premiums for growth.

There *was* a lot of doubt that they could come up with new trick ponies.

JEFF: Analysts in the Street were analyzing them as cash cows — great businesses that generate lots of cash — but at the time, they were looking for fresh growth, and they kept pissing away money on acquisitions that didn't work out. Investors decided, they're never going to grow again. They were selling at 10 P/Es. The yield on Microsoft was 3%.

That's when we bought it, and we really didn't predict that Microsoft would have another great product cycle, but in fact they did. They fired the old CEO, hired a new CEO, and he said, "I've got a vision, we're going to go to the cloud, we're going to provide services." Of course, over the next five years they started to grow that business nicely. The market flip-flopped from "they'll never grow again" to, "holy cow, this is a growth machine" I love it. At 30 times earnings, it is still undervalued."

Very few companies are a Microsoft or Apple —

JEFF: But every company has a product cycle. Even something like Facebook — even if it's been renamed Meta Platforms (META). In my opinion, Facebook is at the end of its first product cycle —

You're not betting on Facebook pulling off that a MSFT-syle reinvention, are you?

JEFF: No, we haven't. But it's a somewhat similar situation to at least look at. The first question would have to be, how durable is their existing product — you'd have to form an opinion on that. Or, more precisely, how durable are their existing cashflows?

We are seeing that the answer to both is no, I believe.

Jeff: Well, the next question is what's the likelihood that they have a new product to drive their next growth cycle? So far they've registered a strikeout on that, I'm not seeing any traction where they were spending all their money.

Nevertheless, should someone decide that Facebook should be fairly durable, and that their existing cashflows are fairly sustainable, with the stock now down to 10 P/E, they *might* take a chance on an aging cash generative machine — knowing they're not going to make much on it, until or unless Facebook launches a successful new product. And that's more than a little bit unpredictable.

But it's not necessarily a bad strategy, though a little different for every industry. If you look at drug companies, they all trade on a product cycle. Every pharma analyst can map out those companies' earnings all the way from a new drug's introduction to the expiration date on that patent. And the market discounts those earnings very quickly. Then the question becomes, what's in the company's research pipeline? And investors start making bets about the value of what's in the pipeline — but of course nobody really knows. That's why they are called research *experiments*. The outcome is unknown. But the games are played.

Crazy, no? But it keeps food on the table for lots of brokers' kids.

Jeff: The upshot is that I think it's worthwhile to pay attention to company's product cycles. They can give a patient value investor lots of opportunities to buy stocks at very attractive prices — when a great cash-generating company comes to the end of its product cycle with no obvious replacement in the wings. When a stock like that swoons, you can get great prices IF the company does manage an Act II.

Got it. But you're scooping up Meta here?

Jeff: No, I'm really not — because their source of revenues is the marketing spend of everybody else.

And there's über ferocious competition for those ad dollars these days.

Jeff: Right, starting with Google. I'm not sure Meta has a moat. I'm also mindful that — until Facebook — the half-life of a social app was on the order of six months. I'm not sure I trust Facebook's staying power because what they're selling, really, is your attention. If the users abandon the platform, they've got no product. My personal observation, when I log into it, is that the first dozen posts I see are ads. I talk to others about why they value it, but I'm skeptical. I'm kind of repelled by all the ads. But if Facebook backed off ads to retain eyeballs, its revenues would drop. I have no patience for this. So if, in fact Facebook backed off on that to retain eyeballs, because it's starting to annoy people, that also means their revenues are going to drop. Meta is not high on my list of interesting companies.

Then tell me about what you are finding intriguing.

Jeff: We are mostly being patient now, but we nibbled a little bit at a couple of things here in the first quarter, a little bit in energy, and a very little bit in financials. *Not banks*. There are some interesting insurance companies, an interesting insurance broker that we've nibbled at just a very little bit. I don't want to get frozen in fear, if the market goes against them.

I try to guard against being so certain that I plunge into things, only to get blindsided, or fooled by randomness, if you will. There's aways a range of possible outcomes. I do think a recession is a pretty high probability. The crisis that I expected has arrived, although it didn't arrive in anywhere near the form I thought it would. But that's okay. I still think we'll have more opportunities ahead of us than we've seen so far. I just try to avoid getting too locked into a point of view.

The 40 or 50 "interesting" potential portfolio stocks listed on my office whiteboard — and the 100 or so on Ron's — are companies that have fairly near-term catalysts, that I think make some sense. But I very well may look stupid if I put money in them for the short term.

How many positions are in the portfolio now?

Jeff: About 20. I tend to think of a full position as about 3% - 4% at purchase. That gives you something like 25 to 35 stocks in the portfolio when you're fully invested. But of course, now we're holding a good bit of cash.

You mentioned you didn't get the crisis you were expecting. What was that?

Jeff: My guess was that we would have seen more of a currency or sovereign debt crisis. The Treasury markets. For all I know, we'll still get that. I think we're in early days, and the market is just waking up to that fact. I mean, Credit Suisse (CS) has been out there percolating now for, what, 18 months?

Oh, at least.
JEFF: But today, it has caught everybody's attention very dramatically once again.

All it took were a few words from their Saudi friends —
JEFF: [Laughing] "Put more money in CS? We think not. We already own 10%. That's plenty. Thanks, anyway."

Love the Swiss, and to be quite honest, I couldn't tell you, specifically, what all Credit Suisse's problems are. But it's interesting, how long it has taken for Credit Suisse's many problems to become a real issue — because in many respects it's a slap-your-forehead thing. Duh.

Why do you say that?
JEFF: Just because all these financial companies are sitting on portfolios of bonds. Bonds went down what? 15% - 18% last year as rates rose? If anybody has to realize that loss — it blows a hole in their balance sheet. It's that simple, and it's not just a problem in the U.S. It's all over Europe, too.

Unless they're also sitting on endless liquidity. (A favorite dream of mine.)
JEFF: Or they successfully hedged their bond positions. So I'm not saying the realized price problem is absolutely universal — but that's the nature of what we are facing. Last time around, it was a quality problem. This time, the problem is in high-quality assets that sold off, not because they turned into junk, but because interest rates were raised. Oops. That's what I mean by "Duh." The bankers should have known better. Now, we'll see how many others are out there, about to be caught short.

That's always the way it is. Somebody once told me it's like fishing with a grenade.
JEFF: I've heard that, yes. First, the little fish you kill float to the top and then the bigger ones, and at the end, a whale. We haven't figured out yet who the whale is. That's true. We have yet to see which big fish go belly up, but it's going to be really interesting to see how that unfolds.

Now, I admit, I didn't expect another financial crisis, this time around. Guess I figured the bankers weren't stupid enough to do it twice in just a little more than a decade. I was wrong. But I also don't think it's an accident which banks have blown up so far.

Why's that?
JEFF: I've looked very closely at crypto and also at the profitless techs. This time around, the excesses in financial markets and in asset markets were concentrated in those areas. So it does not surprise me that the people with the most exposure to those manias are going to do the worst.

Then the question — because the financial system is pretty well-integrated — is where does the contagion spread next? There are all sorts of possibilities and I'm trying to think about the full range. Each of them could be on the table.

Well, one lesson of the GFC was that it wasn't the visible leverage that killed you. It was the hidden leverage.
JEFF: Or the exposure to a counterparty you didn't know you had. But all that will only unfold over time. So I'm in no hurry on anything related to banks or banking. Nevertheless, I'm also trying to stay flexible enough to take advantage of stupid market prices — with the full understanding that it might make me quite uncomfortable in the near-term.

That's the mindset to adopt if you're looking to profit, long-term, from buying stocks *temporarily* trading well below their intrinsic values.
JEFF: That's how I think about it. I'm waiting for the fat pitch, and when a fat pitch arrives, I'm probably well served to swing at it, to use Mr. Buffett's analogy. I hope he doesn't mind I borrowed it.

You're scarcely the first.
JEFF: True. He's very widely quoted.

Okay, now will you tell me a little bit about why you own the handful of stocks you do, even now, for the long haul?
JEFF: Okay, but let's caveat that for a moment. I'm always going to talk about things I already own, and anybody that reads this ought to strongly suspect that I'm talking my book because that's all I can do.

To quote you, "Duh."
JEFF: Right, I can't tell you I like something I don't own. I hope your readers know that, but I thought I'd point it out. If I change my mind tomorrow, you will not get a phone call. As long as everybody involved in the conversation understands that —

I'm sure they've all read the standard disclosures, but I always include that, in the small print. I ask, not for soundbites, but

to glean insights into how the investment process you've been describing gets applied in real time.

Jeff: In the energy sector, we own Occidental Petroleum Corp. (OXY), which is like, the biggest gas producer in the country, mostly down in the Permian Basin. But they also have oil and gas fields elsewhere. We also own Schlumberger, the giant energy services company, for the reasons I mentioned earlier. It actually was the first oil and gas name we bought after the price of oil briefly dipped into negative numbers — because it is historically such a high-quality name that it is unusual for it to go on sale. So I felt significantly more comfortable buying into Schlumberger. Still, I did not do that right in April 2020. It was a little bit later, but not much. And that's done very well for us.

And in case anyone's forgotten, you're expecting energy producers and their suppliers to do quite well for the next decade, if not two.

Jeff: Yes, listening to what Schlumberger has to say and watching what their customers are doing with their cap-ex dollars, it looks to me like we're going to have increased capital spending in the oil and gas space for a number of years. Schlumberger should capture at least their fair share and maybe a little more of that. So they've got a good run ahead of them for a couple of years — and more.

Indeed, all three of those energy stocks I have named — EQT, Occidental and Schlumberger — if they get beaten down to very interesting levels amid this market volatility — certainly are candidates for us to put a little more money into. The stocks probably have a good three to five years yet to run up in this cycle. I'll adjust that view as events unfold.

Okay. What else is attractive?

Jeff: We own some gold. More precisely, we own a couple of gold royalty and streaming companies, Franco-Nevada (FNV) and Royal Gold (RGLD). Both are really bets on the price of gold, obviously. They have some limitations inside the fund about actually holding the metal, so that is the way we're playing it. With some of the things happening inter-nationally — we haven't really gone there — but I think there are some reasons to believe that gold may again become a part of international monetary transactions. Pick up a role it hasn't had in almost 100 years. And if that happens, you've got a lot of upside on the price of gold.

I wouldn't place high odds on it —

Jeff: Even if that doesn't happen, I think you'd have very little downside to the price of gold. Might it sell off 20% - 30%? Sure, it could happen, but I think your upside is multiples of that. That's kind of an invest to lose a little or gain a lot strategy. You don't want the opposite, an invest to lose a lot or to gain a little strategy. That's the wrong way to do it.

Definitely. Stick with high probability, big payoff bets.

Jeff: I love Taleb for making that very clear in my mind. I was like, yes, he's dead right, when I read his book. He puts it very well. I think gold is that kind of a situation here. So am I a goldbug? No, I'm really not.

Are you calling for the collapse of the dollar?

Jeff: Again, no, not really. But there are some reasons to think that the dollar may be weaker going forward. Whether you have read Ray Dalio and his work on credit cycles, or you simply have looked at what the U.S. has done in terms of weaponizing the dollar as a result of the Ukraine War, there are pretty solid reasons to think that the use of the dollar internationally will decline. The question, of course, is what takes over the dollar's status as the premier trading currency? I've seen a number of people make some very interesting analyses and floating ideas that gold will likely play a part there.

It's interesting. Gold is actually rising amid this crisis — something it hasn't done in quite a while.

Jeff: What it's really been doing lately is trading inversely to the dollar. So when DXY is strong, gold is weak. When the DXY is weak, gold is strong. That's been going on for three or four months.

If you want to talk about interesting correlations, I've been fascinated for all of last year watching bitcoin. It was the most speculative of investments and what did it track? The other most-speculative investments. So, when profitless tech sold off, when ARKK sold off, all those sorts of things, bitcoin was selling off *more*.

Yet, in the last week or two, that has *not* been true. It has been acting much more like a store of value and a safe haven, if you will, than it had been. I don't know that this lasts, but it's been quite noticeable. I mean, when the market puked last Monday (3/13), bitcoin was *up* 15% or 20%. I was astonished. I had expected that risk off would continue to mean: Sell your bitcoin.

What's that telling you?

Jeff: Well, I was wrong. Not that I have any investments in bitcoin — I do not — but there *are* correlations — and when those correlations are shifting, it is useful to pay attention to how they're shifting — and to start thinking about what are market participants doing and why are they doing it? How does that help inform me about what's going on out there?

Okay, you mentioned insurance and Berkshire earlier —

Jeff: Yes, we own Berkshire, have owned it for a while. It's just a beautiful antifragile asset. Mr. Buffett has lots of cash. He's going to find opportunities. He will be *presented* with a whole rack of them, and he will take advantage of them. In fact, he may be able to do some things that we would not be in a position to do — his buying the Occidental preferreds, starting back in October of 2019 to help finance its acquisition of Anadarko, and continuing to this day — are a good example of the kind of deals that come to him. He's likely to keep seeing opportunities sets that we can't access — and I trust him to put his cash to work quite well. Berkshire shares are really not trading cheap at this juncture, they are probably about fair value. But I'm perfectly happy to let him basically invest my money for me — having a position in BERKB makes a ton of sense to me. Those shares get cheap only very, very rarely.

The other one we hold is National Mortgage Insurance — NMI Holdings Inc. (NMH). It's a mortgage insurance company that sold off into the housing bust around Covid — and its price has never really come back. But they've got a very good business. It doesn't worry me. Selling mortgage insurance should be a pretty good franchise going forward, yet it's trading at only about 6 times earnings. We've owned it for a while but are still waiting for it to do good things for us.

Go on —

Jeff: Well, we've owned a number of healthcare companies for a while but haven't really done too much with them lately. Essentially, we find them attractive because their revenues aren't really tied to the business cycle. Anyway, we're holding stocks like McKesson (MCK), CVS (CVS), UnitedHealth Group (UNH). We also own Bristol-Myers Squibb (BMY). We bought each of them at a different time, but we've held them all for a couple of years, and some of those stocks have done quite well for us. McKesson and UnitedHealth especially. CVS, and Bristol Myers, a little less so. But all of those companies are very cash-generative.

I'll point out that UnitedHealth is really doing a fantastic job of continuing to grow its business. They have a real growth engine in their Optum segment, which operates through three units. Optum Health provides health care directly to 102 million consumers, providing providers and clients with the technology and data they need to achieve better health.

Optum Insight provides data, analytics, research, consulting, technology and managed services solutions to hospitals, physicians, health plans, governments and life sciences companies — aiming to help reduce administrative costs, meet compliance mandates and improve clinical performance.

Finally, Optum Rx, is UNH's mail-order full-service pharmacy, targeting lower costs for consumers and incentivizing evidence-based clinical guidelines in prescription practices.

They're becoming a Goliath —

Jeff: Lots of folks think UNH is still mostly a health insurer. But as their growth engine in Optum demonstrates, UNH is moving aggressively into things like healthcare data, from many angles. They have been for a while. But, for instance, my health care savings account is now with them — so they've got aspects of a broker about them. If you sign up for an HSA, they say, "Put your money with us." Now they are building AUM.

Meanwhile, UNH has long had lots of health data, and when you start thinking about how you might use that data to help create better outcomes with all the advances we're seeing in data management and analysis — those are the things they're trying to figure out and make into a business. They've been growing revenues at about 10% a year. UNH is not a cheap stock here. They were when we first bought them. And I'm comfortable holding them through a recession — for the longer term — because it is a pretty high-quality company. I expect them to compound my wealth pretty well for me.

If UNH gets a haircut amid market upheaval, will you likely add to your position?

Jeff: Well, I'd probably buy it if I didn't already own a lot of it. Another position I mentioned in passing was a pipeline ETF, the Alerian MLP ETF, (AMLP), which is designed to track the gross price and yield performance of its underlying index, the Alerian MLP Infrastructure Index (AMZI). It is distributed through Alps.

What's your thinking there?

Jeff: It's pretty straightforward. It's an easy and liquid way to gain exposure to a composite of energy infrastructure Master Limited Partnerships that own and operate midstream oil and gas industry infrastructure assets. Things like pipelines, storage facilities and processing plants — assets necessary to connect domestic energy production with local and global demand. The ETF is unlevered, and passes along the fees the MLPs earn to its holders. This country is going to continue to need the sort of midstream services that the MLPs supply for quite a while, while the energy market transforms to a cleaner future.

Why buy an ETF for your mutual fund?

Jeff: Well, it's an ETF that holds MLPs, and we did that primarily for the tax treatment inside the fund. Outside the fund, I wouldn't hesitate to directly own the MLPs — if I were willing personally to live with a K-1 instead of a 1099 when it comes time to file my tax returns. But you obviously wouldn't want to do that in a retirement account — or in any tax-deferred account.

At any rate, we also still own and still like Rush Enterprises — I think I said we've held it practically forever. Randy Rush continues to do really good things with his company. We have not found a reason to let go of the holding. But that brings to mind something I personally pay close attention to when looking at stocks in typically cyclical industries.

Which is?

Jeff: Well, some investors get confounded trying to analyze the income statements of cyclically sensitive companies, which tend to fluctuate a lot, based on those cycles, *not* on the broad indexes that generally have some correlation of non-cyclical shares. If those usually novice investors are looking primarily at P/Es, they can find that familiar valuation gauge moving in quite counterintuitive directions. When that novice investor sees a cyclical's earnings tank, it typically confuses them to find the company's P/E at fairly lofty levels — generally because the E side of that ratio has slid, not because the P has soared. Indeed, usually you should be buying cyclicals when their P/Es are quite high relative to their long-term averages. That can be just a little hard to wrap your mind around.

I remember a patient editor drilling that into my head decades ago —

Jeff: I usually look at a price-to-book chart to avoid that — with the full understanding that any company that's done a lot of buybacks is going to have an *inaccurate* book value these days. Since one of the things we pay close attention to is return on equity, we inevitably find ourselves making lots of adjustments to reported "book" for those high buyback companies. Still, I frequently find I can pick up patterns very easily in a price-to-book chart, so it helps me with screening. For instance, would I be a buyer of Rush Enterprises at book value? Yes, I would, because typically that's what it sells down to in a recession. I find price-to-book charts help me pick things like that up. They're not definitive, but still useful.

I assume you also do a lot of cashflow analysis?

Jeff: Yes. I love to look at free cashflow. One of the standard longstanding questions we ask of every investment is how much cash is it generating, what are they doing with it, what are they incentivized to do with it? If they're productively reinvesting that cash, compounding wealth, great. Perfect. Love that. If you're giving it back to me, so I can reinvest it, not bad. But if it's disappearing into black holes, it's a no-go. We always investigate whether that cash flow is sustainable, or something extraordinary, too.

For instance, when you look at a company like Moderna (MRNA) or Pfizer (PFE) or CVS (which we do own), you have to realize that their extraordinarily strong cash flows over the last few years were the result of something we all hope was a unique experience we'll never again go through — the Covid pandemic. You have to be quite diligent about backing those out of your investment analysis. Trends not likely to persist.

Please, God. We certainly hope not.

Jeff: I hope they find another way to replace that cash flow — without a global pandemic!

Do you care to bring up any other pointers for investors?

Jeff: Let me think. You asked earlier what I learned early in my money management career about investing amid the volatility of 2008 - 2009, and that reminds me. People tend to talk about volatility being driven by greed and fear. But one of my conclusions, after surviving that financial crisis, was to be very mindful of *leverage*. I think that whole downturn was driven not so much by fear, as it was by the forced unwinding of truly excessive leverage.

There's no doubt about it, once prices slide below the market's collective pain point.

Jeff: Again, once that unwinding of leverage starts, it's an essentially mechanical process. The bank doesn't care if you're hopeful or fearful. You're getting the margin call. It wants its money back, *now*. So you sell whatever you can — likely your best most liquid assets — into the market to repay your margin lender. And that adds even more selling pressure to the rout in progress.

And the knock-on effects are some weird otherwise inexplicable price movements. So I disregard all the behavioral science stuff when it comes to understanding bear markets. Leverage simply turns the market into a machine. Turn the crank and it forces sales.

That's why, while delightful on the upside, leverage is incredibly dangerous and destructive to investment returns, once prices reverse course sharply.
Jeff: It actually surprises me to a degree — but then really doesn't — that the Fed doesn't do more to restrict leverage. Prohibiting margin buying would take a whole lot of volatility swings out of the markets.

Remember, you'd also be slashing opportunities to scoop up bargains during Mr. Market's depressive episodes.
Jeff: I'm pretty sure it'll never happen. Even if I were the Fed chair, all my banker friends would probably argue against prohibiting margin — because it's such a profitable business for them. And they'd probably win the argument. Still, I think it's useful to remember that greed and fear have to be lubricated with lots of leverage for the markets to go to dangerous extremes. And bear markets will typically drive stock prices to levels much cheaper than the prices anyone will *willingly* sell at. But sell they will, when they have no other choice.

I've seen a lot of that. My first exposure to bear markets came when I joined Dow Jones in early 1974.
Jeff: I'm sorry. That is way before my time.

Don't brag. 1973-'74 was an extremely nasty bear — the crash of the '60s growth market.
Jeff: Ah. Gotcha. That's one reason I'm so fortunate that Ron and I have been able to have countless very good conversations, tapping into his experiences. On that score, we haven't yet gotten explicit about our inflation expectation.

Go for it. I can't imagine Ron was surprised to see it re-emerge.
Jeff: No. The first thing we did when we saw inflation rising was bump up the inflation expectation in Ron's investment model — which, of course, lowered our estimates of the fair value of pretty much everything.

Sure, inflated dollars lower expected real investment returns.
Jeff: Subsequently we've had a number of discussions about what we see happening with inflation — and also about what sorts of investments tend to do well in an inflationary environment, and how to position your portfolios for that. The upshot is that one of the things that keeps me in our energy stocks — not the primary one — but definitely something we have looked at — is that the energy stocks were some of the very few sectors that did well throughout that difficult inflationary period.

Learning more about Ron's experiences in the 1970s has also tended to make me a little bit more tolerant of price swings in our holdings.

Because?
Jeff: Well, inflation means everything goes up and, as a practical matter, if I believe inflation is going to be at 2% or higher going forward — and I do — then the most likely outcome is that we'll be seeing higher inflation than anything we've seen since the early 1980s, when Volcker and Regan put a stake through it. That makes me a little bit more tolerant of price swings, assuming that I believe we're going to have higher than 2% inflation going forward, and as a practical matter I do. I think that's the most likely outcome. That's really our base case. While I hesitate to put numbers on it, Ray Dalio says medium-term inflation is likely to run 4% - 5% — and I have no good reasons to disagree. I'm definitely not an economist. I do this as a hobby. But I read plenty of them in the process of getting my CFA!

Can you remember anything?
Jeff: What I took from that is there are really three variables involved in inflation — aggregate demand, the money supply, and aggregate supply. The monetarists want you to believe that the way to manage these things is to manage the money supply in relation to aggregate supply. Meanwhile, the Keynesians want you to believe that the way to manage inflation is to use changes of the money supply to influence aggregate demand — and to run the economy that way.

What nobody articulates very well — preferring to laugh at — are the positions of the supply-side guys, who insist that what would be most useful is to free up aggregate supply — usually via lowering regulatory burdens and letting people keep more of their money by lowering taxes. But the supply siders don't really have an academic school of economic thought championing them. They're the bastard stepchildren out in the wilderness as the monetarists and Keynesians duke it out over who gets to tell politicians where to spend the taxpayers' money.

GLOSSARY

Alerian MLP Infrastructure Index (AMZI) - is a composite of energy infrastructure Master Limited Partnerships (MLPs). The majority of the cash flow earned by the constituents involve activities from the midstream energy industry (ex: transportation, storage, and trading of crude oil, natural gas, and refined products).

Financial Accounting Standards Board (FASB) - is a private, independent, not-for-profit organization that establishes reporting standards for companies and organizations.

Free cash flow - represents the cash a company is able to generate after paying out the money required to maintain or expand its business.

Master Limited Partnership (MLP) - A type of limited partnership that is publicly traded. There are two types of partners in this type of partnership: The limited partner is the person or group that provides the capital to the MLP and receives periodic income distributions from the MLP's cash flow, whereas the general partner is the party responsible for managing the MLP's affairs and receives compensation that is linked to the performance of the venture.

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

That's probably a great synthesis of your course work. But does it make any sense?
Jeff: To me it makes sense that those three areas can be kind of "levers" to use to influence the economy and inflation. What we saw in the 1970s was two out of three of them being used to counter inflation. Volcker reduced the growth of the money supply to below the rate of growth of aggregate supply or demand, take your pick. Then, starting with Carter but really championed by Reagan, restraints on productive capacity were eased — on the supply-side theory that more output would create more stuff to spend money on, and beat inflation that way. (The Keynesians, by contrast, would have tried to reduce demand directly, by raising taxes to cool demand while employing deficit spending on public projects to stabilize employment and wages amid a downturn.)

At any rate, it seems clear to me that it took using at least two of those three tools to cool inflation in the 1970s. So what are we doing today?

Tell me.
Jeff: The government continues to increase regulations, and most likely continues to pour money into nonproductive investments. We've been creating loads of credit in the banking system and too much of it ends up being sent by taxpayers to the government to do nonproductive things, which I believe is inflationary. So is keeping a chokehold on productive capacity and labor capacity through regulations and other incentives that slash aggregate supply.

Meanwhile, of course, is the Fed is tightening the money supply in an Keynesian effort to reduce aggregate demand. Their primary thesis really is, well, if we just get unemployment back up to 5% or 6% or 7%, that will get us out of this endless loop of higher wages, higher prices, higher wages, higher prices and we'll see inflation die off. But the Fed is the only one using a tool to try to put a lid on inflation. That's unlikely to work.

My take is a pox on all the economic schools. The economy is a far more complex and fast-evolving animal than any of them conceptualize. And their political wranglings are altogether opportunistic — and policies generally untethered from reality.
Jeff: You are much more blunt than I am. But I would agree. I don't think any of them have it all figured out.

I've usually found West Point grads pretty perceptive about international affairs and the defense business, so I have to ask about them — before letting you go —
Jeff: Ironically, I haven't called those right since I started this job. As an analyst, following defense stocks was part of my job. Early on, in 2008 or 2009, I decided, "We can't afford what we're spending in Washington." I also knew that, historically, at the end of wars, we've cut the snot out of defense spending. And Obama *was* talking about getting out of Iraq at that point. I concluded then that we were being set up for a decade of pain in defense stocks — but then it didn't happen.

Another oops. You didn't consider that the GFC had already cut the snot out of virtually all stocks?
Jeff: Luckily, I'm a quick study. Obviously, the defense stocks were very cheap back then — and haven't really gotten cheap since that bear ended. What's more, as much as people are beating the preparedness drum lately, what the big industrial defense stocks trade on isn't things like munition sales, it's the huge-ticket items like orders for the F-35, the F-22, ships and such.

If you tell them to produce more missiles, that's not going to move the needle. Besides, they're not really priced cheaply enough here for me to expect they'd generate above-average returns going forward. And trying to anticipate what the Pentagon will spend is always a bit dicey. Face it, there have been long periods of time, historically, when the U.S. has massively underspent on defense.

You're not exactly leaping to the defense of prospects for military spending, Colonel.
Jeff: Come on. I have no idea what the political situation might be, post the 2024 election. Or if Ukraine resolves itself in the next six months. Is that likely? Even if you doubt it, it's possible. Then what? Finally, the time you want to buy defense stocks is when everybody's forgotten them and they're trading cheap. I don't see an opportunity from where I sit.

Okay. Anything I haven't asked you about that you wish I did?
Jeff: [Laughing] You are the only person to ever ask me that question. It's the same one I ask managements every time I talk to them. That's really interesting. I guess the one thing I would highlight to your readers, even as I highlight it to my own clients, is that probably your best risk-adjusted reward right now comes in money market funds*.

** An investment in a money market fund is not insured or guaranteed by the Federal Deposit Insurance Corporation (FDIC) or any other governmental agency. Although money market funds seek to preserve the value of your investment, it is possible to lose money by investing in a money market fund.*

They *are* paying real money these days on investments, for the first time in ages.

Jeff: You're taking very, very little risk, particularly if you're in very short-dated governments or sometimes commercial bonds. Yet you're getting a 4% - 4.5% yield. That's been true now for about six months, and there have been a lot of flows out of bank deposits, for instance, and into money market funds. I think those will continue, for very valid reasons. And, *eventually*, that will force banks to pay competitive rates to attract your deposits.

From your lips to Jamie Dimon's ears! Thanks Jeff, for letting me grill you to elicit portfolio insights.

Welling on Wall St. Interviewee disclosure: Jeff Muhlenkamp is a son of Muhlenkamp & Company's founder and chief portfoliio manager, Ron Muhlenkamp, who officially stepped back as lead portfolio manager in February, 2019. Ron had been running the show at the fund management and investment advisory business, based outside of Pittsburgh, since its founding in 1977. And Ron, who had added the Muhlenkamp Fund (MUHLX) to the firm's offerings in 1988, reportedly still "haunts" the firm's research library almost daily, helping to supplements its research and analysis.

Jeff — a West Point grad who served in the United States Army for 20 years, retiring in 2008 at the rank of Lieutenant Colonel — brings to the firm the perspective and discipline of a career Army officer coupled with the rigorous analytical skills of an engineer to bear on portfolio management. He joined Muhlenkamp and Company as an Investment Analyst in 2008 and had served as Co-Manager with Ron since November 2013. As of February 2019, Jeff is the lead Portfolio Manager at Muhlenkamp & Company, Inc. Jeff earned Master of Arts in Organizational Leadership from Chapman University in 1999, and also holds a Chartered Financial Analyst (CFA) designation. Jeff, one of the original investors in the Company's self-named mutual fund and continues to invest most of his assets in the fund.

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