MUHLENKAMP

QUARTERLY LETTER, OCTOBER 2024

Fellow Investors,

Economic data in the third quarter has been a mixed bag. Improving data points include CPI (Consumer Price Index) inflation, which was 2.5% on August 31st, down from 3.3% on May 31st. Also improved was real (inflation adjusted) GDP (gross domestic product) growth, which was 3.0% on June 30th, up from 1.4% in the first quarter (there is a one quarter lag with the GDP figures). Negative data points include the Federal Reserve Bank of Atlanta's GDPNow™ estimate for real GDP growth of 2.5% as of October 1st, down from the June 20th estimate of 3.0%. The unemployment rate has also worsened with the U-3 Unemployment Rate on August 31st coming in at 4.2%, up from 4.0% in May.

The combination of falling inflation rates and rising unemployment rates prompted the Federal Reserve to cut the federal funds rate by .50% at their September meeting: the target federal funds rate is now 4.75% to 5.00%, down from 5.25% to 5.50% prior to the meeting. The drop in the federal funds rate occurred even as Treasury rates in general have fallen with short-term rates falling more than long-term rates. This has restored the yield curve to its normal, positively sloped configuration with the 2-year treasury yield at 3.55% on September 25th and the 10-year treasury yield at 3.77% the same day. The 30-year fixed-rate mortgage rate has similarly fallen from 7.2% on June 28th to 6.7% on September 25th.

Typically changes to interest rates affect the economy with a variable lag. That's why historically recessions often begin about the same time the Federal Reserve starts cutting rates: by the time the data comes in that prompts the rate cut, the economy is already entering a recession, and the Fed is too late to prevent it. Everybody knows this, and yet it has still worked that way for the last 70 years. Will this time be different? There are some reasons to think it might. The economic repercussions of the COVID shutdowns are still echoing in the economy and affecting the data. It's possible that much of what we see in the data is a return to more normal conditions from highly abnormal conditions and that's what the data is indicating—not an imminent recession. It's also possible we will get a recession and the inverted yield curve that just ended was a useful leading indicator once again. We'll find out in the next couple of quarters.

We would probably be remiss if we didn't talk about the coming election a little bit. Our approach is to focus on the policy choices of the candidates that are likely to affect the economy and our investors' wealth. Both candidates seem comfortable with the current high levels of government spending and borrowing. Both seem comfortable with existing tariffs or increased tariffs and are interested in encouraging domestic production and discouraging imports. Both have stated they will pursue tax cuts for the middle class, neither has specifically addressed the estate tax exemption increase which is currently scheduled to sunset on Dec. 31, 2025. The biggest difference between the two (economically speaking) seems to be that the Republican candidate is interested in reducing regulations to encourage business growth while the Democratic candidate hints at further business regulation to control prices and/or raise tax revenue. You may remember that we think the economic impact of regulations are underappreciated by economists, thus the candidates' different approaches to regulation and by extension business is very significant to us. Also of great interest to us will be the composition of the new Congress, as a split government will make changes to legislation extremely difficult. We're putting together our ideas now for investing in whatever government, and hence political environment, we get.

With the equity markets again at all-time highs and stock valuations also at high levels we have been net sellers, continuing to reduce or completely sell out of companies whose prices have gotten unjustifiably high. This will almost certainly result in realized capital gains for our investors this year. Please call us if you would like to discuss your specific situation. With regards to our cash holdings, our intent is to be patient with the resulting cash and put it to work when we find good opportunities.

As always, please get in touch with us if you have any questions, we'd love to hear from you.

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

Jeff Muhlenkamp, Portfolio Manager
Muhlenkamp & Company, Inc.

Ron Muhlenkamp, Founder
Muhlenkamp & Company, Inc.

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

GDP *(Gross Domestic Product) is the total market value of all goods and services produced within a country in a given period of time (usually a calendar year).*

The comments made in this letter are opinions and are not intended to be a forecast of future events, a guarantee of future results, nor investment advice.

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