



## QUARTERLY LETTER, OCTOBER 2025

Fellow Investors,

Let's start with the economy:

- Real (inflation-adjusted) growth in the Gross Domestic Product (GDP) was 2.1% for the second quarter. The Federal Reserve Bank of Atlanta's GDPNOW estimate was 3.3% as of September 17, 2025. Not great numbers, but not bad.
- The unemployment rate (U-3) ticked up a tenth of a percent to 4.3% with the August 31<sup>st</sup> report – the highest level this year. The unemployment rate started the year at 4.0%.
- Inflation as measured by the Consumer Price Index (CPI) was 2.9% on August 31<sup>st</sup>. The high mark for CPI during the year was 3.0% with the January 31<sup>st</sup> number, the low point was 2.3% on April 30<sup>th</sup>.
- The Institute for Supply Management Purchasing Managers Index (ISM PMI) for manufacturing was 48.7 on August 31<sup>st</sup>. A number below 50 indicates contraction, above 50 it indicates expansion. The Manufacturing PMI first dipped below 50 in November 2022 and has stayed below that level since then, with the brief exception of January and February of 2025. The Non-Manufacturing PMI Index was 52.0 on August 31<sup>st</sup> and has remained in expansion territory pretty consistently since the middle of 2020. The U.S. economy is about 30% manufacturing and 70% non-manufacturing.

So, we've had a bit of a two-speed economy for the last three years with services expanding and manufacturing contracting. Currently we have moderate GDP growth, we are seeing some degradation in the labor market, and a little uptick in inflation. Will we see a recession in the near future? We've been writing about the possibility of a recession for something like two and a half years, ever since the yield curve inverted in July 2022. It hasn't happened, and now we don't think it will. We think the manufacturing portion of the economy is more likely to improve than decline, and we will avoid a recession. We hold this opinion lightly and stand ready to change it as events unfold.

In response to the weakness in the labor market the Federal Reserve cut the Federal Funds Rate (FFR) by .25% at their meeting on September 17, 2025. You may recall that they cut the FFR by .25% in November 2024 and again in December 2024, then held it steady until September. We infer they are now more concerned about the unemployment numbers than they are about the inflation numbers. The yield on the 10-year Treasury bond was 4.1% on September 19, 2025, down about .1% from our letter last quarter, so little change there. The 30-year mortgage rate on September 19, 2025 was 6.41%, down 1% from the 7.4% we saw in January. A helpful development if you are looking to buy a house. Also of interest is the weakness of the dollar as

measured by the U.S. Dollar Index (DXY). The DXY has dropped from 110 in January to 97.6 on September 19, 2025, a decline in the value of the dollar relative to a basket of other currencies of about 12% year to date. If you're travelling internationally, you may find things a little more expensive at your destination than you may have expected.

We should probably talk about tariffs and deregulation a little bit. Both remain in a state of flux: both have changed but no one has any confidence that the recent changes themselves won't be revised. This policy uncertainty has, in many cases, caused companies to delay decisions to deploy capital. Over time, the uncertainty should fade, but we don't know how long that will take. The implication for our understanding of the economy is that at least some of the weaknesses in business activity and hiring we've seen recently may be the result of policy uncertainty, not cyclical or structural problems.

Speaking of structural problems, we note the U.S. Deficit for 2025 is \$1.97 trillion ([fiscaldata.treasury.gov](https://fiscaldata.treasury.gov)) or 6.1% of GDP and is projected to average 6.3% of GDP over the next thirty years (Congressional Budget Office: [cbo.gov/publication/61270](https://cbo.gov/publication/61270)). For our national debt to be sustainable the deficit (currently 6.1% of GDP) needs to be less than nominal GDP growth (4.7% y/y in June 2025). If the deficit is higher than nominal GDP growth our debt will continue to expand faster than our economy, making it increasingly difficult to service our debt. Higher interest rates will exacerbate the problem. The Department of Government Efficiency (DOGE) has made little dent in government spending and the "One Big Beautiful Bill Act" doesn't reduce the deficit either. We believe the current administration's efforts to deregulate the economy are an effort to increase the growth rate without increasing government spending. We have no way of estimating the impact of regulatory changes on the economy and haven't found anyone else who is even talking about it. We believe the most likely resolution to our national debt problems will involve some combination of inflation and currency debasement. We also believe it is very unlikely our leaders, of either party, will ever tell you that. We believe this is part of the reason the price of gold in dollars has risen 42% year-to-date (as of September 25<sup>th</sup>, 2025) and why we expect this trend to continue.

The S&P 500 Index has recovered from its March through May dip and now sits at an all-time high. On many metrics, including price/earnings, price/sales, and market capitalization/GDP, the valuation of the S&P 500 is also at high levels. Much of the S&P 500s performance this year comes from investor enthusiasm for artificial intelligence (AI) and all the companies involved in building it. We see that enthusiasm reflected in the price not only of chip and software companies but also in utilities providing the power, construction companies building the data centers, etc. CEOs in these businesses are NOT hesitating to put capital to work and are collectively committing hundreds of billions of dollars to building the data centers and other facilities they believe we need. AI is clearly in a massive boom. It may well be that the boom in all things AI has kept the economy out of recession. At some point, however, we expect the boom will turn to bust as they often do. CEOs that built the datacenters and deployed the software will want to see what return they received on their investments. If those returns are disappointing, they won't build another one. Growth will slow, investors will be disappointed, and the rabid buying of AI stocks

will turn to panicked selling of AI stocks. The high valuation of the overall market and the boom characteristics of AI continue to concern us.

In that context we have put a little bit of money to work over the last quarter in two sectors: Healthcare and Materials. We found a couple of companies we like at prices we like and acted accordingly. Our gold miners and royalty companies continue to make new highs in sympathy with the metal itself. We think the reasons to own gold remain valid and expect the current run in gold may continue for some time, potentially years. We'll see.

If you have any questions, please get in touch with us. We'd love to hear from you.

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

Jeff Muhlenkamp, Portfolio Manager  
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**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).

**S&P 500® Index** - is a widely recognized, unmanaged index of common stock prices. The S&P 500® Index is weighted by market value and its performance is thought to be representative of the stock market as a whole. One cannot invest directly in an index.

**U-3 Unemployment Rate** - a measure of the unemployed, as a percent of the civilian labor force. It only includes those currently looking for work. Listed as the "official unemployment rate" according to the U.S. Bureau of Labor Statistics.

**Past performance does not guarantee future results.**

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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