



QUARTERLY LETTER, JANUARY 2026

Fellow Investors,

The economy in the 3rd quarter grew by 4.3% adjusted for inflation, the highest growth rate for the year. The inflation rate as measured by the CPI was 2.7% in November (the latest data point), in the middle of the 2.3% - 3.0% range it has been in all year. The U-3 unemployment rate in November was 4.6%, the highest it's been all year. The services sector, as measured by the Services Purchasing Managers Index (PMI), continued to expand in November with an index reading of 52.6 (a reading above 50 indicates expansion), even as the manufacturing sector continued to contract in November with a Manufacturing PMI reading of 48.2. We've heard the economy described as "two-speed" or "k-shaped," usually with the implication that wealthier Americans are doing great and average Americans not so much. We see the breakdown differently: the service economy is doing fine, manufacturing not as well. Since services are a much bigger piece of the economy, the overall picture is one of modest growth.

In response to that economic picture, the Federal Reserve cut the Federal Funds Rate three times this year: in September, October, and December for a total cut of 0.75%. Presumably, they are more concerned about rising unemployment than they are about inflation being above their 2% target. The Federal Reserve also restarted its purchase of Treasury Bills in December, saying it would buy up to \$40 billion per month as part of a "Reserve Management Purchase" program. Federal Reserve members stated repeatedly that this was "not QE" (quantitative easing). As near as we can tell, the only difference between this exercise in money creation and the previous exercises in money creation is the stated intent—the actions are the same. The questions we ask ourselves (and would be happy to ask Fed Members if we get the chance) are "Why are you restarting asset purchases when inflation remains above your 2% target? Won't that tend to create more, not less inflation?" Truth be told, if we were able to ask those questions of the Fed, we would be very surprised if we got a straight answer. Our operating assumption is that they have restarted asset purchases to keep interest rates on government debt affordable (for the government). The risk that this keeps inflation higher than their target is something they are willing to accept.

Interest rates declined during 2025, as did oil prices. The 10-year Treasury Yield fell by about 0.4% from the start of the year to year's end, and the 30-year mortgage rate ended the year at 6.26%, down a full 1% from the start of the year. Oil prices fell from \$70 per barrel in January to \$58 per barrel in December, a 17% drop. In our opinion, the drop in oil prices has kept inflation from running higher than the 2-3% we've seen this year.

The U.S. stock market ended the year near its all-time high, having been led for most of the year by AI related companies. As we've previously stated, we believe the AI boom will eventually bust, but we don't know when. Anecdotally, we observed that when companies involved in AI announced additional capital spending, it generally created a short-term boost to their stock price up until about mid-October. In November and December, however, similar spending announcements were generally met with swift declines in stock prices. This reversal in price action when capital spending increases are announced appears to us to be a sign of waning excitement about AI. We continue to have limited exposure to AI.

Gold has been on a tear this year, up about 70%. We participated very nicely in this move with our gold companies up 70% to 175% each. Early in the year we thought gold companies were being ignored—with stock prices of miners and royalty companies languishing even as the price of the metal marched higher. By October, that was no longer the case as the Wall Street media machine turned its attention to gold, and everyone seemed to be talking about it. After a steep 10% drop in late October the metal resumed its steady move higher. How high will it go? Honestly, we have no idea and have no interest in guessing. We bought gold and related companies because we observed that central banks were increasing their gold holdings and because it seemed very likely that international trade might start to be net settled in gold. Those reasons remain valid. We've also become aware that the cryptocurrency industry has developed gold-backed coins and invested in gold royalty companies. We find this very interesting and potentially a significant tailwind for the metal. Finally, we have read news stories from both the U.S. and Japan that describe an inversion in retail gold buyers' behavior. According to these stories, historically retail physical gold owners would sell into high gold prices like we are seeing now—but that's not what's happening. Instead of selling, they are currently buying. While recognizing that extrapolating two anecdotes into a broader trend is hazardous, we are intrigued by these stories. Overall, we think there are some good reasons for the run in gold to continue. We'll see.

During 2025, we invested in two chemical companies and a microchip maker (not AI-related microchips) as these industries were in the midst of a severe cyclical downturn. Historically, investing in cyclical companies when their business cycle was at its nadir was a profitable endeavor. So far, these investments have not made us any money, but we continue to expect that they will. We'll keep you updated.

In 2025, we also invested in two Chinese companies. One of these investments is doing well, the other did not and was sold. We continue to look at foreign companies in our search for investment opportunities and will invest in them if we find some we like.

As we look forward to 2026, a few questions are top of mind for us:

- When will the AI boom end?
- When will the contraction in manufacturing end?
- Will the tailwinds for gold continue?

- Will the tariff and regulatory upheaval we saw in '25 settle down, allowing CEOs to start making long-term decisions again?
- What will inflation do this year?

We expect 2026 will be another interesting year!

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.

PMI (Purchasing Managers Index) - a key economic indicator from monthly surveys of supply managers.

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.

Cryptocurrencies are a relatively new asset class and are subject to unique and substantial risks.

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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