

MuhlenkampMemorandum

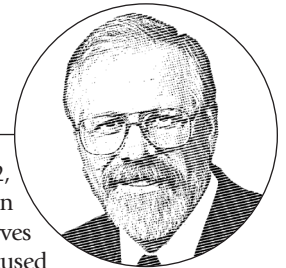
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Quarterly Letter

By Ron Muhlenkamp



2012 was a year of mixed results on the economic front, but generally good investment returns as measured by the S&P 500 Index. Some progress was made in Europe and China, and some clarification in direction was made in the U.S. We presented our thoughts on these topics at our December 6 seminar; an archive is available on our website at www.muhlenkamp.com

A brief review follows:

The U.S. economy continued to expand, but at a modest rate. Consumer spending is growing moderately at a 2%-3% annual rate; consumer saving is at 3%-4% of income. Consumer confidence has improved since 2009, but is still at the subdued levels seen during the prior recession. Gasoline consumption has declined 5% since 2006, after climbing steadily prior to that. Housing has begun to recover and car sales are approaching "normal" levels.

Business investment and hiring remain subdued as businesses await clarification of the rules on taxes, regulation, and government policy. Business and commercial borrowing are picking up a little. Bank health continues to improve.

The Federal Reserve continues to hold interest rates at artificially low levels, squeezing the returns to retirees and pension funds. The Fed's balance sheet is no longer growing. The remaining big question in the U.S. is whether we contain government spending, which has been shown to lower economic growth. A major problem is that many think government spending enhances economic growth.

Commodity prices have leveled off, but remain quite volatile. In the energy markets,

there remains a huge spread between the price of crude oil and natural gas. In early 2012, the fuel cost of natural gas fell below that of coal, causing many power plants to shift consumption to natural gas. We expect these fuels to remain competitive for the foreseeable future.

While the recent rise in tax rates (and FICA taxes) will serve as a drag on the U.S. economy, we expect the U.S. to avoid recession with modest growth.

In Europe, the crisis of policy seems to have peaked, but much of the continent is reentering recession. We think the probability of Europe's problems threatening the viability of the U.S. based international banks has lessened.

China appears to have achieved its goal of containing inflation by slowing the economy and is likely to resume Gross Domestic Product (GDP) growth, but at a slower than historic rate and with a focus on the consumer.

During early 2012, we held more than normal cash reserves and remained focused on large, U.S. based companies with strong balance sheets and cash flows. As some of the above-mentioned issues were clarified, we've invested most of the cash, some of it in smaller companies.

Our resulting performance, while trailing the S&P500 Index for the full year, has tracked a bit above it in recent months. We continue to seek good companies at modest prices. 

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

Glossary

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

Mark Your Calendar

The World Money Show Orlando

January 30 - February 2, 2013
Gaylord Palms Resort, Orlando, FL

Ron Muhlenkamp will deliver the following free workshops:

Thursday, January 31, 4:30 p.m. - 5:00 p.m. *The Market Drivers—U.S., Europe, and China: An Update*
Thursday, January 31, 5:15 p.m. - 6:15 p.m. *The Market Drivers—U.S., Europe, and China: An Update (A Continuation)*

Please check the official "Show Schedule" for room location details. To register,

please call (800)970-4355 or visit www.moneyshow.com; please reference code 030022 when registering.

The Las Vegas Money Show

May 13 - 16, 2013
Caesars Palace, Las Vegas, NV

Ron Muhlenkamp will deliver two free workshops.

Presentation details to be announced later this year.

Please check the official "Show Schedule" for room location details. To register, please call (800)970-4355 or visit <http://www.moneyshow.com>.



Muhlenkamp & Company, Inc.
Intelligent Investment Management

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Required Minimum Distributions

by Susen Friday, Client Service Regional Manager



This is the time of year that we get many questions from IRA shareholders regarding required minimum distributions (RMDs).

If you are an owner of an IRA/qualified plan and turned 70½ during 2012, there is one more thing you will have to do. You will have to determine how you would like to take the required minimum distribution from your accounts. Once you have reached this milestone, you will be required to take this distribution annually.

If you have already taken your first distribution by December 2012, fine. But, if this has somehow slipped your mind,

you still have until 4/1/2013 to take the distribution. However, you will also have to take the 2013 distribution by December 31, 2013. As a result, you may have to pay taxes on two distributions in 2013.

This distribution is definitely something that requires your attention. If you don't take the minimum withdrawal, a 50% tax penalty will be charged on the amount you failed to withdraw in addition to the ordinary income tax owed.

If the IRA account holder dies, RMDs from the account may continue, with the determining factors being if the beneficiary

is a spouse or not, and whether the death was before the 70½ birthday or not. If you are in this situation, any concerns you may have should be presented to your tax professional.

The following is an example of how the required minimum distribution is calculated for an IRA account holder who turned 70½ in 2012. If you will be turning 70½ in 2013, simply add one year to the dates in the example.

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Announcements

2012/2013 IRA Contributions

Contributions can be made to your IRA for tax year 2012 by the due date for filing your 2012 tax return, not including extensions. For most people, this means contributions for 2012 must be made by April 15, 2013. This includes Traditional, Roth, and Coverdell Education Savings Accounts (CESA).

When making a contribution between January 1 and the due date for filing your tax return, we suggest that you specify the year for which you are making the contribution. Too many people realize too late that they made a current year contribution (the year in which the contribution is actually received), and not a prior year contribution (the year for which they are filing their return). If you have any questions, please call us toll-free at (877)935-5520 extension 4.

Traditional and Roth IRA contribution limits for 2012 are the lesser of \$5,000 (\$6,000 if you are age 50 or older) or 100% of your earned income. For 2013, Traditional and Roth IRA contributions are the lesser of \$5,500 (\$6,500 if you are age 50 or older), or 100% of your earned income. Please refer to IRS Publication 590 for more information.

CESA annual contribution limits are \$2,000 for each beneficiary. Please refer to IRS Publication 970 for more information.

You can download copies of the above mentioned IRS publications at www.irs.gov. Remember: It's not too early to begin funding your 2013 IRA!

Request for Email Address

To ensure that you receive all of the correspondence that Muhlenkamp & Company publishes and distributes, please share your email address with us. From time to time, we publish information that gets distributed as email only, (e.g. September 7, 2012 and November 13, 2012 Market Commentaries; to view these materials, please visit our website.)

To be added to our email distribution, please visit the "Contact Us" section of our website, or give us a call at (877) 935-5520 extension 4. You can be assured that any of your contact information will not be released to any third party. As a reminder, any information we publish is available on our website at www.muhlenkamp.com.

Retirements

Jean Leister

After 26+ years of service, Jean Leister is retiring from Muhlenkamp & Company. As Executive Assistant, Jean managed the

administrative functions of Muhlenkamp & Company and also served as Secretary to the Muhlenkamp Fund. We will miss her professional expertise and wish her all of the best in her future endeavors.

Lisa Muhlenkamp-Cox

After 13 years of service at Muhlenkamp & Company, Lisa Muhlenkamp-Cox is retiring from her role as Southwest Regional Manager. She wishes to focus her efforts on her family, including her husband, Paul, and their children (Henry, age 12, and Patricia, age 4).

Lisa extends her thanks and best wishes to all those with whom she's worked over the years. Any assistance you may now require can be readily provided by our Client Service team, available at (877) 935-5520 ext.4.

Financial Fitness: What Are Your Goals?

by Michelle Orphall, Marketing Specialist



As we begin another New Year, having financial goals in place may make you more disciplined in your spending. Rather than exhausting your tax refund on a weekend away, you may decide to add this money to your emergency fund. That way you are prepared to pay for any unexpected home repairs. You might be tempted to go on a shopping spree with a recent bonus, but your goal may be to pay off your outstanding debt first. Though you don't want to deny yourself all the pleasures of today, saving extra funds for a future expenditure may give you peace-of-mind, knowing you are prepared for upcoming financial events or at least on your way.

Are your financial goals written down—or are they something that you think about occasionally, but then push them out of your mind because they seem overwhelming? Some people establish their goals during discussions with their spouse, but then never put them in writing. That works for some individuals, but others may need to document them to become more committed to reaching their goals.

So if you haven't yet identified your financial goals or written them down, let's get started.

Types of Financial Goals:

1. Eliminate Current Outstanding Debt
2. Create an Emergency Fund
3. Save for a Significant Upcoming Expenditure
4. Invest for a Significant Future Expenditure
5. Determine Non-Monetary Financial Goals

Eliminate Current Outstanding Debt – Interest on debt costs you money! Rather than paying money out every month in interest, strive to rid your personal balance sheet of debt, then you may be able to invest those extra assets and start making your money work for you. Since debts with the highest interest rates, such as high-interest credit cards, cost you the most, it's usually best to pay these off first. It is not

necessary to pay off all debts before you begin investing. Mortgage payments are usually at a more manageable interest rate than credit cards or other debt. Depending on the IRS (Internal Revenue Service) rules at the time, interest payments on your mortgage may be tax-deductible, lowering the overall cost of this debt. If rates are lower now than when you obtained your mortgage or last refinanced and, if you are eligible to refinance, you may be able to reduce the amount of your mortgage payments.

Another way to reduce your expenses is to consolidate high-interest credit card balances to a credit card company offering a lower rate. Once you are able to pay off your entire credit card balance, try to only spend what you are able to pay for each month. If you ever overspend, make sure to pay what you can on-time so that you don't waste any money on late fees.

Create an Emergency Fund – Have emergency money available so you don't have to borrow for unplanned expenses. Not having enough money can cost you interest, late fees, and/or penalties. Since we don't know what the future will bring, it's best to be prepared financially. Whether it's a natural disaster, layoff, or broken dryer, having enough money saved will make a bad situation a little easier to deal with.

The next big storm may take power lines down. Without electricity, credit/debit cards are useless as well as bank ATM machines. So you may want to keep some of your "safety net" in cash in case of an emergency situation. With cash on hand, you may be more likely to purchase any needed supplies.

Hopefully, you will never need to use your emergency fund due to unemployment, but, if so, having one could help get you through rough periods without incurring debt, foreclosure, or bankruptcy. It's suggested to save enough money to cover six to nine months worth of basic living expenses, if not more.

An emergency fund also comes in handy when paying for the unplanned expense incurred when things break down and need repaired or replaced. In addition, knowing that you have money set aside for unplanned expenses may make you decline an offer to buy additional protection plans when in the past you usually accepted. These product protection plans on appliances and electronics can get expensive in relation to the cost of the product.

These "insurances" are things that you have to look at on an individual basis to determine what is right for you and what is unnecessary. An emergency fund does not eliminate your need for certain insurances. Insurances such as Life, Homeowner's, Renter's, Automobile, Health Insurance, etc. are usually recommended for most individuals.

Save for a Significant Upcoming Expenditure (occurring in three years or less) – You may have some significant upcoming expenditure or event that exceeds your monthly budget. Are you able to cut out some current luxuries each month to set aside money to be able to pay for these? Some goals may be only a few years away and others may be further down the road. It's usually advised not to put the money that you set aside for goals occurring in less than three years into investments that have high volatility.

If you are able to accumulate enough assets to pay cash, it can sometimes save you money in two ways. Some retailers offer cash discounts because they don't have to pay the credit card company's fees on your credit purchases. The second way you can save is by not paying interest in addition to the cost of the item when you purchase an item on credit.

Invest for a Significant Future Expenditure (occurring in more than three years) – Start saving for planned significant future expenditures as early as you can. The more

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you are able to save, the less you or your loved ones will have to borrow to pay for an event such as a wedding or college education. If you are saving for a purchase that you expect to occur in more than three years, you may want to invest these assets. This way you can use the effect of compounding to help pay for the expense.

Determine Non-Monetary Financial Goals – Sometimes financial goals aren't about saving money, but about taking action. Maybe you still need to create a will, update beneficiaries on your IRA accounts or life insurance policies, organize your financial records, create a budget, or buy life insurance. You may just want to learn more about finance; economics and its impacts; how to invest; where to invest; or who to turn to for help in managing your investments.

Achieving your financial goals

The documentation portion of goal creation might be the easiest part. Actually achieving your goal can be more difficult. It takes discipline and thought to determine how to best allocate limited funds, but with a goal in place, you know what you are aiming for. The following steps can help you get started in documenting your goal.


Break the goal down:

1. List your goals.
2. Estimate the start date of the expenditures or your target goal date.
3. Estimate the cost per year or occasion.
4. Multiply the cost by the estimated number of years or occasions.
5. Subtract the amount of money that you have saved already for this goal.
6. How many years is it until the estimated start date?
7. Calculate the average savings needed each year to reach your goal.

If you have questions regarding setting or reaching your financial goals, let us know if we can provide assistance. Ron Muhlenkamp has been in the investment industry for over 40 years and has written about all of these areas. Some examples of Ron's financial maxims include:

- "Work to move your assets toward the areas where returns are high and pay off debts where the costs are high."
- "The price of borrowing money is interest—and worry. Keep all borrowing below the worry point and don't borrow to buy things that depreciate; you will lose on both ends."


- "People think of inflation as prices going up. It's not. It's the value of money going down."

Visit the "Investment Principles" section of our website to find a collection of Ron's essays. Also on our website is our Financial Goals Worksheet, available to assist you in defining your goals, determining their costs, and estimating what it takes to reach them. Best wishes in achieving success in all of your fitness goals! 

The S&P 500 is a widely recognized, unmanaged index of common stock prices. The figures for the S&P 500 reflect all dividends reinvested but do not reflect any deductions for fees, expenses, or taxes. One cannot invest directly in an index.

Required Minimum Distributions

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- The amount will be based on all of your IRA balances as of 12/31/2011.
- RMDs are calculated based on your birthday, the beneficiary's birthday, and whether or not the beneficiary is your spouse.
- You can go to any number of RMD calculators available on the Internet and calculate the total for all of your IRA accounts. 

Several decisions will need to be made on how you want to receive your RMD:

- You have the option of deciding if you want to take a portion of the RMD total from each of your IRA/qualified plan accounts, only one of those accounts, or any combination of these accounts;
- You can go to the custodian of each IRA account you have and ask them to calculate the amount for the respective accounts; or

Any tax or legal information provided is merely a summary of our understanding and interpretation of some of the current income tax regulations and is not exhaustive. Investors must consult their tax adviser or legal counsel for advice and information concerning their particular situation.

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The “FRIDAY FOCUS” on Retirement

by Susen Friday, Client Service Regional Manager

Long-time participant in the DCIO(Defined Contribution Investment Only) market, former secretary and active member of the Women in Pensions Network(WIPN), member of the American Society of Pension Professionals and Actuaries(ASPPA) and former plan administrator, Susen also holds an Accredited Investment Fiduciary (AIF) designation.

Throughout 2013, Susen’s expertise and experience in the retirement field will be showcased in the Muhlenkamp Memorandum, referred to as the The “FRIDAY FOCUS” on Retirement.

Ahh...retirement. On a personal level, we save for it, plan for it, and dream about it. But did you ever wonder how the whole notion of retirement and funding it came about? How it has changed over time?

- 5 Believe it or not, it all started with the Ancient Romans back in 13BC. Augustus decided that he would like to reward his legionnaires for their years of service and to offer a carrot to other young men to join the army. For 20 years of service, legionnaires received between two-thirds and three-fourths of their yearly income. Initially, Augustus funded the pension out of general taxation; later, it was covered by a 5% tax on inheritance. When Rome fell, the military pension system collapsed as well.

During the Dark Ages, many members of the nobility maintained standing armies. Some of them devised crude pensions for their military, often granting land to older soldiers.

As European history progressed into the late 1600s and the 1700s there are indications that some sort of pension payouts had been made to non-military persons. Such payouts were not wide spread, nor sanctioned by the government.

Up until this point, no one had given a thought about social insurance—a system of wide-spread coverage sponsored by the government. In 1889, however, Otto von

Bismarck established the first such system in Germany. It consisted not only of a pension, but also accident and health insurance. The system has adapted well over time. In fact, my grandmother collected from this system until her death in 1966.

Much of industrialized Europe followed in Germany’s footsteps and created programs of their own. There were two main types: insurance systems that were related to the earnings of the recipients, and minimum systems which were essentially welfare systems for the elderly.

Retirement in the United States was conceived as a three-legged stool: one leg was the Social Security System, the second was private pensions, and the third was personal savings.

In the United States, the Social Security System was created in 1935 by the Social Security Act. The System initially provided income to retired workers based on their earned income. Since then, it has been amended and expanded. Most notably, the changes are to cover those with disabilities and to provide medical coverage for those on public assistance.

The first private pensions established in the United States were by American Express (1875) and the B&O Railroad (1880). Many other companies followed suit, primarily in the banking, railroad, and public utility industries.

The “retirement industry” was born in the early 1900s when insurance companies began offering group annuity contracts to companies. Insurance companies have continued to play a major role in retirement plans ever since.

Over time, private companies were encouraged to provide pensions to their employees. During both World War II and the Korean Conflict, the U.S. government imposed price and wage stabilization programs. Since companies could not

reward their employees with higher wages, they turned to providing benefits as an alternative.


The growth of pensions in the coal, automobile, and steel industries was a direct result of collective bargaining by their respective unions. The availability of retirement plans spilled over into non-union companies and has been used as a means of being more competitive for skilled labor.

What’s important to remember is that retirement plans are dynamic creations that change over time!

Plan design, or customization of individual plans, provides the framework within which a plan must operate. If the plan sponsor wishes to include a new feature in the plan, he legally amends the plan. Sometimes the government wants to change the rules under which qualified plans operate across the board. This is usually done by passing new legislation that is then implemented by either the Department of Labor (DOL) or the Internal Revenue Service(IRS). An example of this is the recent Regulation 408(b)(2), which requires greater transparency of plan expenses.

Where are we today?

- Social Security, funded as a “pay as you go” system, is in effect.
- A wide variety of privately sponsored retirement plans, including qualified plans created by the Employee Retirement Income Security Act (ERISA) in 1974, are in effect. These plans are governed by the Department of Labor and the IRS. (There are also non-qualified plans that address special situations.)
- In addition to the above, there is the option of contributing to either a traditional Individual Retirement Account (IRA) or a Roth IRA.

Each of the above elements is treated differently at tax time. 



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At our investment seminar on December 6, 2012, Ron Muhlenkamp and his Investment Analysts presented *The Market Drivers—U.S., Europe, and China: An Update* to an audience of clients, shareholders, and prospective investors. A video of the presentation is available on our website at www.muhlenkamp.com. If you prefer, call us at (877) 935-5520 extension 4 and we will mail you a DVD.