MUHLENKAMP Memorandum

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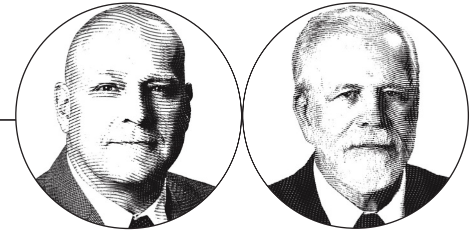
QUARTERLY LETTER



By Jeff Muhlenkamp, Portfolio Manager and Ron Muhlenkamp, Founder

2022 was the year inflation ended ultra-low interest rates. Inflation, as measured by the U.S. Consumer Price Index (CPI), began the year at 7.0% and was still at 7.1% in November, having peaked at 9.1% in June. The ongoing high levels of inflation prompted the U.S. Federal Reserve to reduce the assets on their balance sheet and to raise their target for the Federal Funds Rate (the interest rate at which the Fed makes short duration loans to banks) beginning in March. As a result, assets held by the Fed at year end sum to $8.56 trillion, down 4.5% from the April peak of $8.96 trillion while the Federal Funds Target Rate increased from .25% at the beginning of the year to 4.25% at the end of the year. Other interest rates similarly moved higher, with the yield on 2-year treasuries moving from .73% at the start of the year to 4.33% at year's end, the yield on the 10-year treasury bond moving from 1.49% at the start of the year to 3.84% at the end of the year and conforming 30-year mortgage rates moving from 3.3% at the beginning of the year to 6.57% at the end of the year.
The Fed's goal in raising interest rates and pulling cash out of the banking system by shrinking their balance sheet was to reduce demand for goods and services and thus reduce prices.

To an extent they are succeeding. In the housing market, for instance, new homes sold in November were 640,000 (source U.S. Census Bureau), about the same level as March 2020 and median new home prices in November are down about 3% from their October peak. Essentially the housing industry is in a recession as buyers have become scarce. Rising interest rates also popped the bubbles in cryptocurrencies and profitless tech companies, kicked off a bear market in the broader U.S. stock indices, and resulted in losses of between 13% and 18% in bonds, with high-yield bonds losing less than government bonds. It's been a long time since both stocks and bonds declined simultaneously and anyone who was counting on their bond portfolio to offset declines in their stock portfolio was disappointed this year.

Throughout the year we talked about four other changes that we thought would be meaningful and we should keep an eye on. We'll discuss each of them briefly below, but the summary is that none of them created a crisis that disrupted global financial markets in 2022.

China continues to struggle due to the collapse of their housing industry and the economic impact of their "Zero COVID" policy. The recent end of that policy has coincided with a wave of COVID infections which will probably disrupt their economy for a while as workers stay home to recover from the illness. Will this create a new round of global supply chain disruptions? We're not sure, but it could. We continue to keep an eye on China.

European countries continue to work through the energy problems created by the Russia-Ukraine War, and so far they are managing better than we expected they would. Other than a hiccup in the UK bond market in the 3rd quarter nothing happened in Europe that impacted the global financial markets. So far so good.

Foreign currency turbulence caused by rising U.S. interest rates has been sporadic. The Bank of Japan has been controlling the yield on government bonds as part of an inflationary policy. Rising U.S. interest rates made dollars more attractive to Japanese investors than yen and we saw a rapid decline in the value of the yen versus the dollar. In response, the Bank of Japan has intervened in currency markets at least once and has raised the upper limit on the yield of the 10-year Japanese Government Bond from .25% to .50%. If Japan ended its yield-curve control and interest rates in Japan became economic again, it could trigger a sizeable move in currencies as Japanese investors repatriated overseas money. It hasn't happened yet, but the possibility remains.

Finally, there are ongoing efforts to diversify global trade out of the dollar and into other currencies. Russia is now selling energy in rubles and Saudi Arabia is selling oil in the Japanese yen, so to a small degree it is happening. Will these sorts of trades grow in size and frequency and start to impact the value of the dollar? Perhaps, but it isn't certain.

That pretty well covers what happened in 2022 and provides an update on our major concerns for the year. As we look forward to 2023, we think there are three important questions:

- Will inflation remain high? If so, how high will it be?
- Will the U.S. enter a recession? If so, how bad will it be?
- Will a financial crisis erupt that prompts the Federal Reserve to drop interest rates and perhaps restart quantitative easing in response? If so, will this cause inflation to run up again?

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VIEW FROM THE FRONT OFFICE: EVERYBODY KNOWS

By Tony Muhlenkamp, President
January 2023

"Just because everybody knows something doesn't make it true. In fact, in investing, if everybody knows something, that alone makes it false, or at least an unprofitable investment."

— Ron Muhlenkamp from Reflecting Over 40 Years.

For the last several months Ron has commented "This is where I came in" or "We've been here before" when discussing politics/economics/central banks/financial markets. That's not necessarily reassuring, and here's why.

Ron started managing money in 1968, just before a lot of what "everybody knew" to be true ended. Events occurring between 1968-1974 had an impact that created the stagflation of the '70s and lasted until the early '80s.

In 1968 nobody talked about inflation. It had been low and stable at 3% for so long that "everybody knew" it wouldn't change and wasn't a factor in the economy. Just as "everybody knew" normal interest rates were 4 ½ %, growth stocks would go up forever, and that economists/central bankers had figured out how to lick the recession/slow down part of the business cycle by printing money.

By 1974 inflation was over 10% and would peak at 13% in 1980. Interest rates were at 7 ½ %, also on their way to 13% by 1980. Stock prices got cut in half in '73 -'74, and price-to- earnings (P/E) ratios had fallen from 17 to 7. And we were deep in the throes of "stagflation." Stagflation is characterized by high inflation, high unemployment, and slow to negative economic growth; essentially inflation and recession AT THE SAME TIME. This was theoretically impossible and was giving those same economists and central bankers fits. And nobody talked about what "everybody knows" anymore.

In 2021 "everybody knew" that inflation was stable at less than 2%, a Zero Interest Rate Policy (ZIRP) was normal, the FANG stocks would go up forever, and the Fed could solve or prevent any crises by printing money (think Modern Monetary Theory, Quantitative Easing 1-4, "helicoptering money", American Plan Rescue Act of 2021, Inflation Reduction Act of 2022, etc.).

Today, at the beginning of 2023, inflation is up to 7%. Interest rates are 4-5% and rising. The stock market is down 20% in 2022, with the FANG's market values down close to 50%. We are facing a recession. And what "everybody knows" has come under scrutiny and pointed questions.

So, when Ron says this is where he came in, he is saying that 2020-2022 is a time of change just as 1968-1972 was a time of change. And asks if we are facing a decade of slow growth and high inflation just as we endured in the '70s. We are at a decision point in 2023 much like we were at a decision point in 1970.

To prevent a decade of pain, we think it is useful to examine the lessons learned from the prior decade of pain. Solving the stagflation problem of the '70s required Paul Volcker in the Fed slowing the rate of growth in the money supply to 4%, and President Reagan cutting taxes and regulations to spur growth in GDP. Both moves were seen as pure folly by the experts of the day, but after a brief recession in 1982, those changes set the stage for 30 years of high economic growth and low inflation.

As Jeff points out in his Quarterly Letter: if inflation occurs when the rate of growth in the money supply is higher than the rate of growth in goods and services (which Milton Friedman taught, and we tend to agree with), then there are two tools for controlling inflation. Shrink the money supply (monetary policy) or grow GDP (fiscal policy) or both. As Ron discovered in the '70s it takes both, but it also took a decade of pain before consumers forced the policy makers to employ both tools.

We think the current inflation is coming from the huge amounts of money dumped into the system since 2008. The money supply has increased by close to $10 Trillion WITHOUT growth in GDP (which is currently $25 trillion). As Jeff points out in his Quarterly Letter, the Fed is only using the monetary tool for controlling inflation by raising interest rates and shrinking the supply of money. Whether they will continue to do that if the economy goes into recession remains to be seen. And so far, there is no mention of using the fiscal tool at all.

So, Ron thinks 2022 is a lot like 1970. Change is happening, and people are reluctant to recognize these changes and adapt to them. The last time we denied what was happening it took a decade of pain to accept reality. Whether we require another decade of pain to mend our ways remains to be seen.

You should know that as money managers we have been through this (or something similar) before and while we try desperately not to predict the future, we are very busy working to use the lessons from the past to understand the present. We are here to help you get through this.

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P.S. We have more of Ron's thoughts on how inflation drives so much of what happens in the markets and in the economy online at:

Why the Market Went Down – https://muhlenkamp.com/wp-content/uploads/2022/06/why-the-market-went-down.pdf

Basics of Investing – https://muhlenkamp.com/wp-content/uploads/2022/06/BasicsBook2004.pdf

Reflecting Over 40 Years – https://muhlenkamp.com/wp-content/uploads/2022/06/reflecting-over-40-years-lessons-learned.pdf

NEW – A Walk Down Memory Lane – https://muhlenkamp.com/wp-content/uploads/2023/01/a-walk-down-memory-lane.pdf

FANG *is the acronym used to describe the most prominent tech companies in 2013. They included* ***F****acebook,* ***A****mazon,* ***N****etflix, and* ***G****oogle.*

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).*

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

The comments made in this article are opinions and are not intended to be investment advice or a forecast of future returns.

LETTER

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Here is the concise version of our thoughts on these questions:

- Inflation is likely to remain higher than the last decade, probably on the order of 4-5%.
- The U.S. is likely to enter a recession in 2023, we don't really have an estimate regarding how deep it might be.
- It is possible that a crisis of some sort erupts that prompts a Fed response—interest rates are rising globally and typically higher interest rates create problems for shakier borrowers.

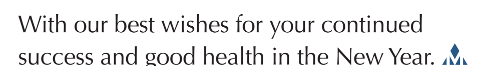
Here's the longer version:

While inflation is measured as an increase in prices, we view it as a decline in the purchasing power of the dollar. We think it is mostly caused by an increase in the supply of money greater than the simultaneous increase in supply of goods and services coupled with stability or an increase in the velocity of money—this is largely Milton Friedman's thinking on the matter. We also think feedback loops play an important role in continuing inflation. In the '70s, economists talked about the wage-price spiral. We observe that such a feedback loop is likely to operate again in '23 as workers continue to demand higher wages based on price increases they saw in '22. As an example, Social Security benefits increased by 9% in January 2023 due to inflation in '22. I suspect most government employees will see similar wage increases. Higher wages will prompt companies to try to increase prices to maintain their margins—to the degree they are successful, you will get a positive feedback loop driving prices and wages higher. Additionally, we also note that in the late '70s and early '80s it took more than just Fed action under Paul Volcker to bring inflation down—regulatory change was also necessary to free up the productive capacity of the economy. We don't see similar de-regulation initiatives today, in fact, we see the reverse. Finally, it is likely that either a recession or a financial crisis, or both, forces a change in Federal Reserve Policy before inflation is back down to the 2% Fed target. This has been our view for about six months, we hold it lightly, and stand ready to change our minds if we start to see events unfold differently than we currently expect.

Our portfolio reflects that view of the immediate future. We continue to hold unusual amounts of cash as markets have not priced in a recession, a crisis, or higher inflation for a long period of time. We have significant investments in energy companies both because of the investment cycle of the energy industry and because commodities often do well in inflationary environments. Our health care investments should be relatively indifferent to a recession in terms of their revenues and earnings. We also note that for the first time in a decade money market funds generate a significant yield—currently a little over 4%-–making them an attractive cash alternative. We continue to look for good companies at bargain prices and will put our cash to work when we find them.

As always, if you have questions or comments, write or give us a call. We'd love to hear from you.

With our best wishes for your continued success and good health in the New Year.



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.*

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MUHLENKAMP
& COMPANY INC.
5000 STONEWOOD DRIVE, SUITE 300 WEXFORD, PA 15090

MUHLENKAMPMemorandum

Inside this issue:

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MUHLENKAMPSMA ALL-CAP VALUE

For the period ended 12/31/2022

Muhlenkamp & Company's All-Cap Value SMA (Separately Managed Account) is designed for investors' accounts over $100,000. We employ full discretion, applying fundamental analysis.

INVESTMENT OBJECTIVE

We seek to maximize total after-tax return through capital appreciation, and income from dividends and interest, consistent with reasonable risk.

INVESTMENT STRATEGY

We invest in undervalued assets wherever they may be found. Typically, this results in holding a portfolio of companies we believe are materially undervalued by the market. Bonds may be included in the portfolio if they are a good investment.

INVESTMENT PROCESS

We start with a bottom-up scan of domestic companies, typically looking at most U.S. companies at least four times per year. We add to that an understanding of the sector dynamics in which companies are operating, an assessment of the business cycle, and a review of macroeconomic conditions.

Our primary screening metric is return on shareholder equity (ROE). We are looking for companies with stable returns that can be purchased cheaply, or for companies with improving returns that have not yet been recognized by the market.

We don't believe that a holding period of "forever" is appropriate in all cases, but are comfortable holding companies as long as they continue to meet expectations.

INVESTMENT RISK

We define investment risk as the probability of losing purchasing power over long periods of time, which is quite different from Wall Street's definition of price volatility in very short periods of time. Taxes, inflation, and spending will ALL impact the purchasing power of your assets.

ALL-CAP VALUE COMPOSITE PERFORMANCE (NET OF FEES)

	Year to Date	One Year	Annualized Past 3 Years	Past 5 Years	Past 10 Years	Past 15 Years
Return	2.06%	2.06%	13.65%	7.89%	8.49%	4.40%
S&P 500 Total Return*	-18.11%	-18.11%	7.66%	9.42%	12.56%	8.81%
Consumer Price Index**	6.78%	7.11%	5.00%	3.83%	2.60%	2.35%

* **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.**

** Consumer Price Index (CPI) – As of November 2022 – U.S. CPI Urban Consumers NSA (Non-Seasonally Adjusted), Index. The Consumer Price Index tracks the prices paid by urban consumers for goods and services and is generally accepted as a measure of price inflation. Price inflation affects consumers' purchasing power.

Consolidated performance with dividends and other earnings reinvested. Performance figures reflect the deduction of broker commission expenses and the deduction of investment advisory fees. Such fees are described in Part II of the adviser's Form ADV. The advisory fees and any other expenses incurred in the management of the investment advisory account will reduce the client's return. It should not be assumed that recommendations made in the future will be profitable or will equal the performance of the above accounts. A list of all security recommendations made within the past twelve months is available upon request.

TOP TWENTY HOLDINGS

Company	Industry	% of Net Asset
Schlumberger NV	Energy Equipment & Services	4.97%
EQT Corporation	Oil, Gas, & Consumable Fuels	4.52%
Occidental Petroleum	Oil, Gas, & Consumable Fuels	4.44%
UnitedHealth Group Inc	Health Care Providers & Services	3.72%
McKesson Corporation	Health Care Providers & Services	3.56%
ProShares Short QQQ	Exchange Traded Funds	3.31%
Mastec Inc	Construction & Engineering	3.05%
Berkshire Hathaway Inc Class B	Diversified Financial Services	3.02%
CVS Health Corp	Health Care Providers & Services	3.02%
Dow Inc	Chemicals	2.99%
ALPS Alerian MLP ETF	Exchange Traded Funds	2.98%
Kirby Corp	Marine	2.89%
SPDR Gold Shares	Exhange Traded Funds	2.78%
Bristol-Myers Squibb Company	Pharmaceuticals	2.64%
Broadcom Inc	Semiconductors & Semiconductor Equipment	2.58%
Rush Enterprises Inc	Trading Companies & Distributions	2.29%
Microchip Technology Inc	Semiconductors & Semiconductor Equipment	2.23%
Microsoft Corp	Software	2.16%
Apple Inc	Technology Hardware, Storage & Peripherals	2.09%
NMI Holdings Inc	Thrifts and Mortgage Finance	1.94%

Composite holdings are subject to change and are not recommendations to buy or sell any security.

Composite Top Twenty Holdings are presented as supplemental information to the fully compliant presentation on the next page.

Return on Equity (ROE) is a company's net income (earnings), divided by the owner's equity in the business (book value).

PORTFOLIO MANAGER

Jeffrey P. Muhlenkamp,
Portfolio Manager, CFA, has been active in professional investment management since 2008. He is a graduate of both the United States Military Academy and Chapman University.

INVESTMENT ADVISER

Muhlenkamp & Company, Inc.
5000 Stonewood Drive, Suite 300
Wexford, PA 15090-8395
(877)935-5520
services@muhlenkamp.com

www.muhlenkamp.com

SMA FACTS

Average Number of Equity Holdings	25
Cash & Cash Equivalents	33.13%

SMA Facts are presented as supplemental information.

SMA INFORMATION

The inception date for the All-Cap Value Composite is December 31, 1993. The All-Cap Value Composite was created in December 2003. The Composite includes fee-paying accounts over $100,000, full discretion, under management for at least one full month which are invested in the All-Cap Value strategy. The composite excludes the Muhlenkamp Fund and any wrap fee account.

Minimum Initial Investment	$100,000.00
Management Fee*	1% (first $1 million); 0.5% on the remainder

** May vary by account.*

Muhlenkamp & Company serves individual and institutional investors through our no-load mutual fund and separately managed accounts.

MUHLENKAMP & COMPANY, INC. ALL-CAP VALUE COMPOSITE ANNUAL DISCLOSURE PRESENTATION

				ANNUAL PERFORMANCE			THREE-YEAR ANNUALIZED STANDARD DEVIATION*		
Year End	Total Firm Assets (USD) (millions)	Composite Assets (USD) (millions)	Number of Accounts	Composite Gross	Composite Net	S&P 500 Total Return Index	Composite	S&P 500 Total Return Index	Composite Dispersion**
2022	396	54	57	2.82	2.06	(18.11)	19.51	21.16	0.82
2021	317	48	48	28.05	27.11	28.71	18.28	17.41	1.67
2020	265	38	45	14.06	13.14	18.40	18.63	18.79	1.38
2019	253	34	48	14.70	13.78	31.49	10.33	12.10	1.37
2018	254	32	51	(11.71)	(12.45)	(4.38)	9.24	10.80	1.21
2017	342	40	52	15.24	14.30	21.83	8.70	9.92	2.12
2016	339	39	52	(1.86)	(2.68)	11.96	9.73	10.59	1.17
2015	422	48	67	(4.66)	(5.45)	1.38	10.41	10.47	0.68
2014	541	51	67	10.27	9.37	13.69	9.55	8.97	2.06
2013	585	50	60	35.50	34.39	32.39	11.29	11.94	3.13
2012	491	41	66	11.29	10.34	16.00	12.02	15.09	1.14
2011	555	45	74	(2.84)	(3.67)	2.11	16.60	18.70	0.85
2010	724	59	82	2.96	2.15	15.06			1.45
2009	839	90	107	32.68	31.72	26.46			2.80
2008	759	112	155	(40.53)	(40.94)	(37.00)			1.97

The objective of this All-Cap Value Composite is to maximize total after-tax return, consistent with reasonable risk—using a strategy of investing in highly profitable companies, as measured by Return on Equity (ROE), that sell at value prices, as measured by Price-to-Earnings Ratios (P/E).

Muhlenkamp & Company, Inc. ("Muhlenkamp") claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS standards. Muhlenkamp has been independently verified for the periods December 31, 1993 through June 30, 2016 by Ashland Partners & Company LLP and for the periods July 1, 2016 through June 30, 2022 by ACA Performance Services. A firm that claims compliance with the GIPS standards must establish policies and procedures for complying with all the applicable requirements of the GIPS standards. Verification provides assurance on whether the firm's policies and procedures related to composite and pooled fund maintenance, as well as the calculation, presentation, and distribution of performance, have been designed in compliance with the GIPS standards and have been implemented on a firm-wide basis. The All-Cap Value Composite has had a performance examination for the periods December 31, 2006 through June 30, 2022. The verification and performance examination reports are available upon request.

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Muhlenkamp is an independent registered investment advisory firm registered with the Securities and Exchange Commission. The firm maintains a complete list of composite descriptions and pooled funds, which is available upon request.

Returns are based on fully discretionary accounts under management, including those accounts no longer with the firm. Composite may invest in American Depositary Receipts (ADRs).*** Accounts may be shown gross or net of withholding tax on foreign dividends based on the custodian. Past performance is not indicative of future results.

The U.S. dollar is the currency used to express performance. Returns are expressed as percentages and are presented gross and net of management fees and include the reinvestment of all income. Net of fee performance was calculated using actual management fees. The annual Composite dispersion presented is an asset-weighted standard deviation calculated for the accounts in the Composite the entire year. Policies for valuing investments, calculating performance, and preparing GIPS Reports are available upon request.

* **Three-Year Annualized Standard Deviation** *is a measure of volatility, calculated by taking the standard deviation of 36 monthly returns, net of fees, then multiplying the result by the square root of 12 to annualize it. Since standard deviation measures the dispersion of a set of numbers from its mean, higher results indicate more variation in monthly returns over the trailing three years.*

** **Composite Dispersion** *is a measure of the similarity of returns among accounts in the Composite. It is the standard deviation of the annual returns, net of fees, for all accounts which were in the Composite for the entire year.*

*** **American Depositary Receipts (ADRs)** *are shares that trade in U.S. markets, but represent shares of a foreign company. A bank (the depository) purchases a number of the foreign shares and holds them in a trust or similar account; in turn, the bank issues shares tradable in the U.S. that represent an interest in the foreign company. The ratio of ADRs to foreign shares is set by the bank. ADRs do not mitigate currency risk, but can reduce transaction costs and simplify trading compared to buying the local shares in the foreign markets.*

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