



How We Plan to Make Money in the Current Investment Environment



The following essay by Jeff Muhlenkamp, Investment Analyst, is based on Ron Muhlenkamp's May 3, 2011 presentation of the same title, and research by the Muhlenkamp & Company Investment Team.

We hope you find this booklet useful.

Let us know what you think.

How We Plan to Make Money in the Current Investment Environment

Let's start by briefly summarizing what we think are the defining characteristics of the current investment environment, then we'll discuss investment areas best avoided, and finally we'll talk about where we are finding opportunities to invest.

The current investment environment

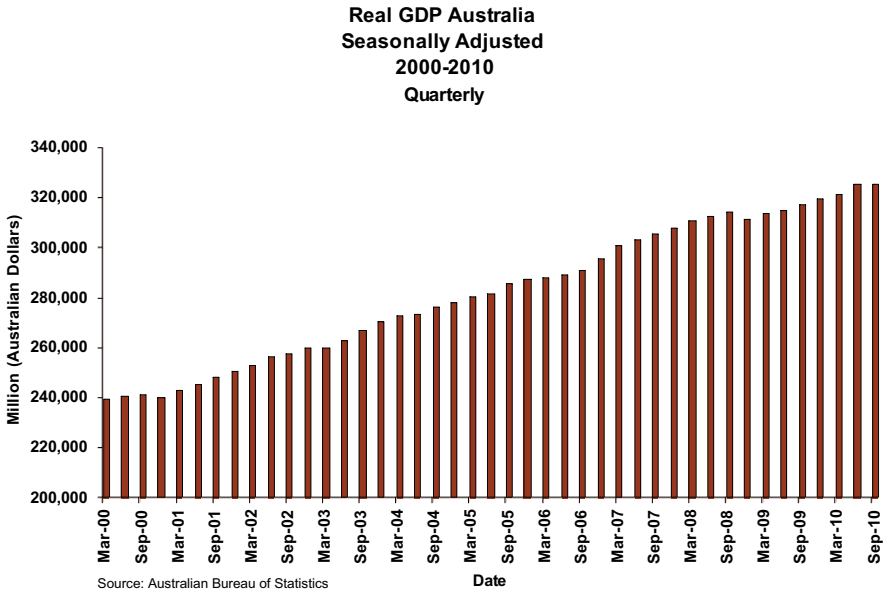
At the global level, developing countries like China, India, and Brazil need capital goods to create and sustain productivity growth. Their demand for these goods has fueled economic activity in Germany and the manufacturing sectors of the United States, contributing to economic recovery in those two nations.

Figure 1: Value of German Exports to China, 2000-2011 (Monthly)



Demand for raw materials, particularly by China, has fueled a boom in Australia:

Figure 2: Australia Real Gross Domestic Product (GDP), 2000-2010 (Quarterly)



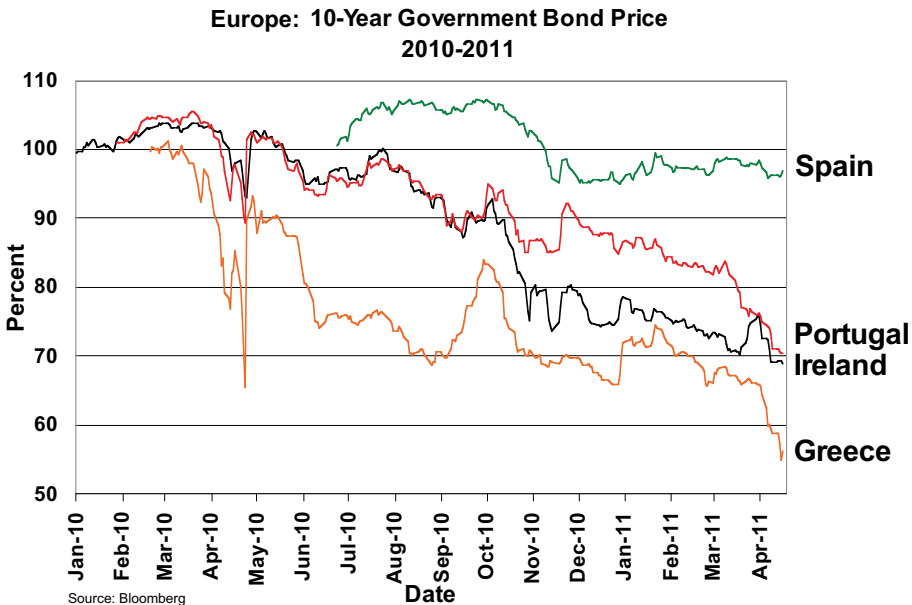
Brazil, China, and India are now experiencing higher than desired levels of inflation and are actively working to combat it. Brazil is implementing capital controls, India and China are raising interest rates, and China is raising reserve requirements. China has also let its currency (yuan) appreciate a small amount versus the U.S. dollar, but not much. It is likely that their efforts to slow GDP growth in their countries will negatively affect demand for capital goods and commodities.

China is particularly concerning: the stimulus it employed in response to the 2008 recession was about twice the size of the U.S. stimulus as a percentage of annual GDP, and was mostly spent in construction. There are legitimate concerns that their stimulus has created a construction bubble in China that will burst as the Chinese Central Bank tightens credit. Chinese banks are at risk because most of the construction boom was fueled by bank loans—if those loans can't be serviced, the banks are going to be in trouble. As a result, the Chinese Central Bank has the "rock" of inflation-fueled discontent on one side, and the "hard place" of a potential bursting construction bubble on the other; it is trying to rein in inflation without massively disrupting the construction sector. Tough business—and they may not get it right. A sharp decline in Chinese growth will likely be felt globally, particularly in commodity markets that have been dominated by Chinese demand.

On the other side of the globe, we have Europe wrestling with sovereign debt and banking problems. Greece and Ireland could no longer pay market rates on loans and had to receive a guaranteed loan package from the rest of the Eurozone. As a part of that deal, these countries are required to rein in government spending and make significant changes to their economies. Portugal recently got priced out of the bond market and is now negotiating with the Eurozone for a guaranteed loan package. Spain is working hard to make necessary changes to its government spending, economy, and banks to avoid getting priced out of the market.

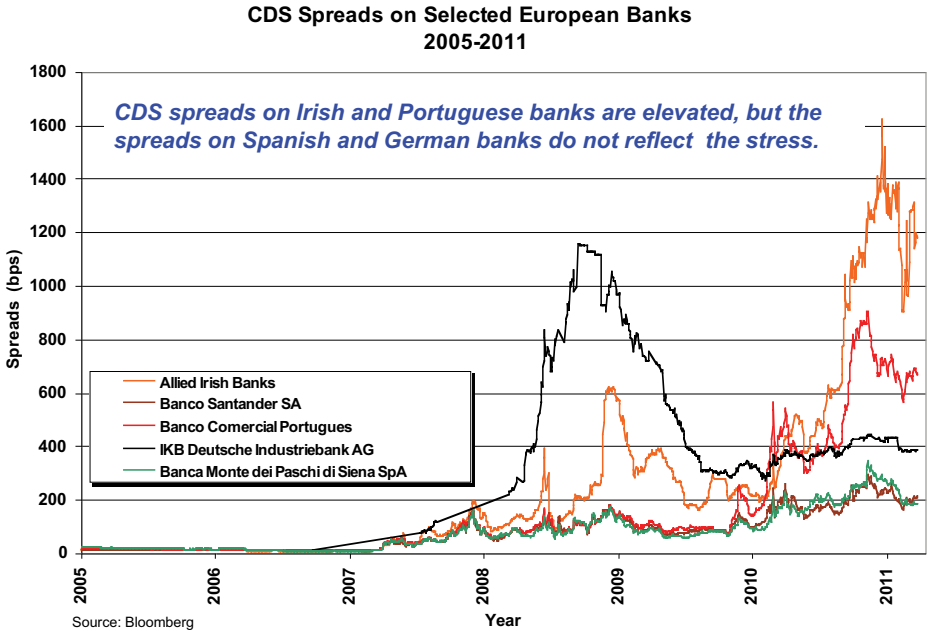
Popular unrest in Greece and Ireland has surfaced as the populations protest against the "austerity" measures imposed by the bailouts. Political turmoil has surfaced in Finland and Germany as the voters in these countries rail against their politicians' decisions to make loans to profligate neighbors. In the meantime, the debts of the peripheral countries are held by banks across Europe and have not been marked down to current market prices—if they were, the banks of Europe collectively would be insolvent.

Figure 3: Europe 10-Year Government Bond Price, 2010-2011



Greek bonds are now selling at about half price, clearly prices reflecting a restructuring or default in the near term, but credit default swaps (CDS) on European banks and the stock prices themselves are not reacting negatively—so the market either doesn't understand the threat to the banks, or believes the problem to be solved; (refer to Figure 4 on the following page).

Figure 4: Credit Default Swap (CDS)
Spreads on Selected European Bank, 2005-2011



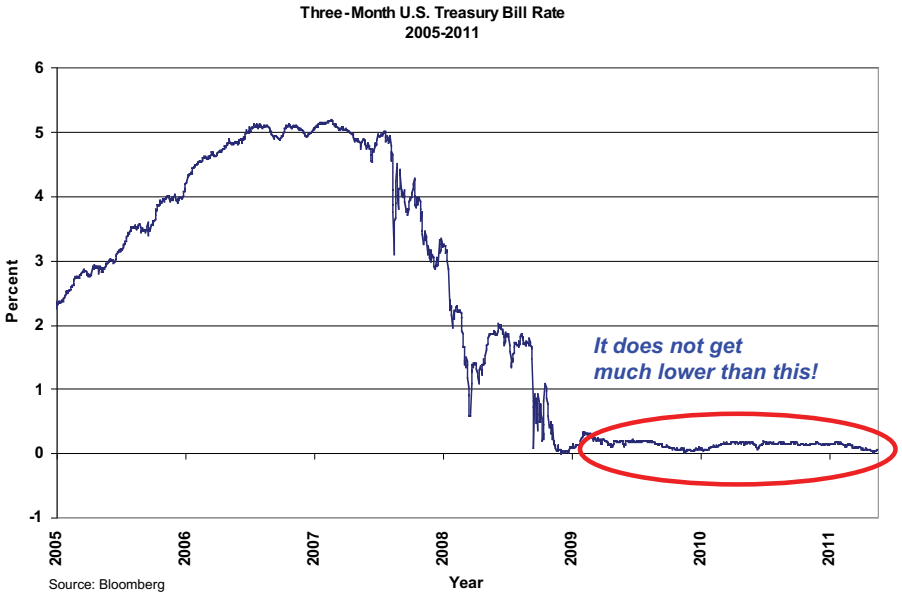
We think European banks remain in a precarious position and would likely collapse if events caused all the bonds on their books to be marked to current market prices. Europe remains a significant risk to global markets.

While we are still roaming the globe, let's stop briefly in Japan. The March 2011 earthquake and tsunami have destroyed enormous amounts of wealth and disrupted economic activity, pushing Japan back into a recession. Internationally, the impacts have been pretty limited—reduced production of Japanese cars, shortages in supply chains of a broad range of auto and electrical components, and a returned fear of nuclear power that has caused Angela Merkel (current Chancellor of Germany) some political pain in one of the German state elections. We don't see the disaster as having much more of a global economic impact than that.

Domestically, we think there are four primary themes impacting the markets in the near term:

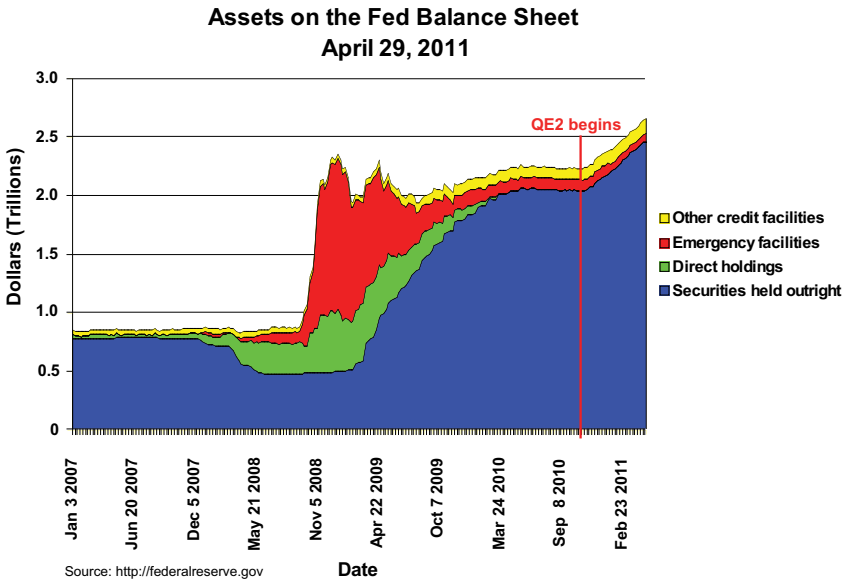
1. The Federal Reserve (Fed) continues its efforts to spur economic growth. It is using two tools: very low short-term interest rates (Figure 5)...

Figure 5: Three-Month U.S. Treasury Bill Rate, 2005-2011



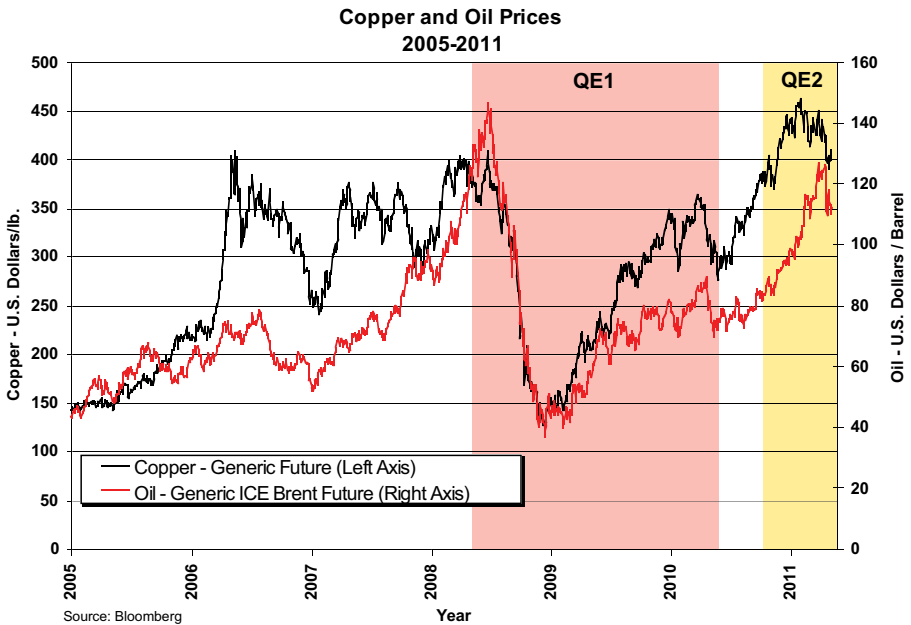
... and pushing money into the investment arena through Treasury purchases (Figure 6) in the hopes that market performance will spur economic activity through a “wealth effect.”

Figure 6: Assets on the Federal Reserve Balance Sheet (April 29, 2011)



The Fed's bond purchasing program, aka quantitative easing two (QE2), comes to an end in June—and folks are nervous about how its absence will affect the markets—but the Fed has stated its intent to keep short rates low for a while longer. We think some of the money flowing into the markets has gone into equities and supported a rally, but a bunch has also made its way into commodity markets where it has helped drive commodity prices to nosebleed levels:

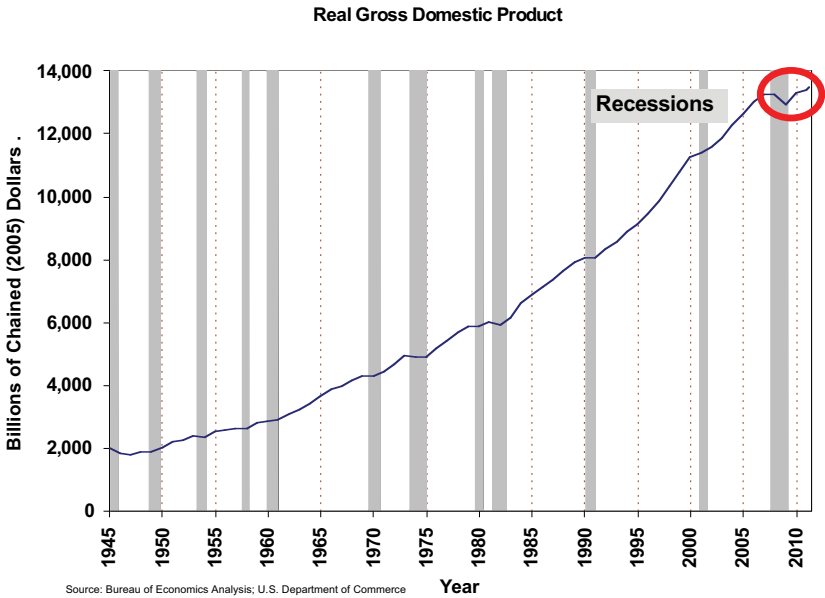
Figure 7: Copper and Oil Prices, 2005-2011



QE2 has also created the potential for more inflation than the Fed desires and, while the Fed states it is ready at a moment's notice to start sopping up all the money it has created, we think it is already behind the curve. High inflation tends to drive up interest rates and depress price-to-earnings (P/E) multiples, so it's bad for the markets and bad for the economy as it penalizes savers and squeezes businesses.

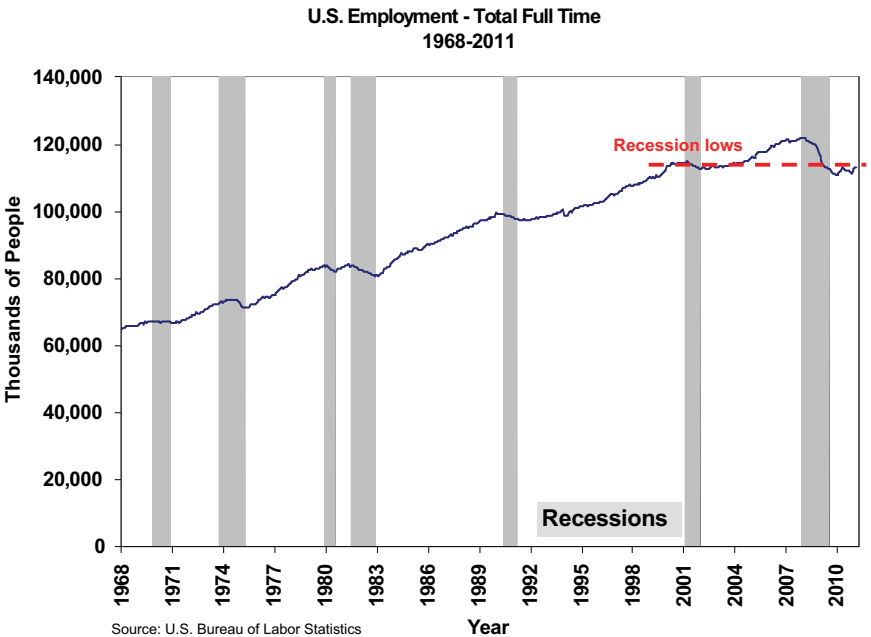
2. The broader U.S. economy has grown slowly coming off the bottom of the '08 recession:

Figure 8: U.S. Real Gross Domestic Product, 1945-2011



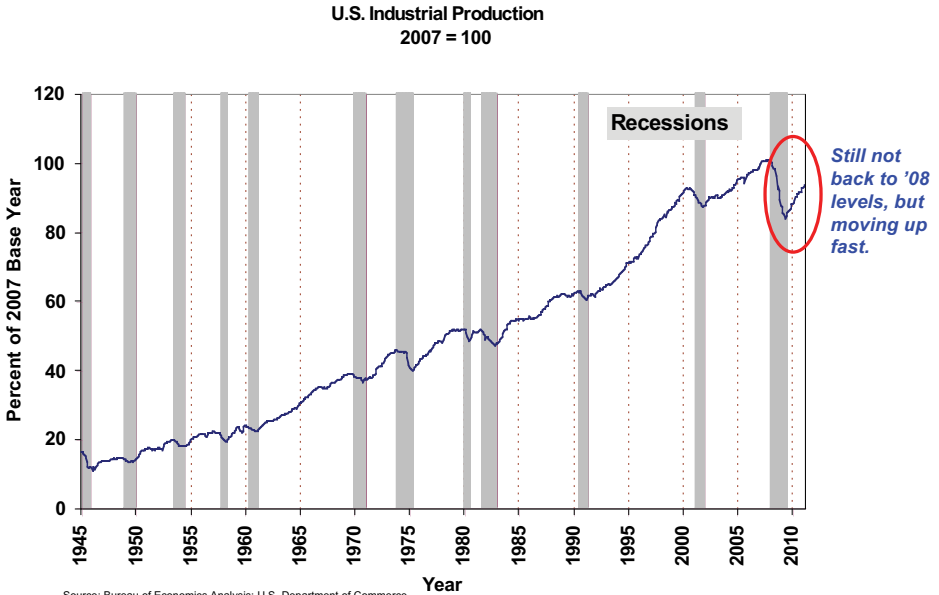
Employment has not noticeably improved from recession lows:

Figure 9: U.S. Employment, Total Full Time, 1968-2011



Some sectors, particularly manufacturing have done well, helped by a weak dollar and booming emerging markets:

Figure 10: U.S. Industrial Production, 1945-2011



Source: Bureau of Economic Analysis; U.S. Department of Commerce

NOTE: In 1996, the U.S. Department of Commerce introduced the chained-dollar measure. The new measure is based on the average weights of goods and services in successive pairs of years. It is "chained" because the second year in each pair, with its weights, becomes the first year of the next pair. The advantage of using the chained-dollar measure is that it is more closely related to any given period covered and is therefore subject to less distortion over time.

Other sectors, most notably housing, have not recovered at all; (refer to Figures 11 and 12).

Figure 11: S&P/Case-Shiller Index Home Price Index for 20 Major U.S. Cities, 2000-2011 (Monthly)

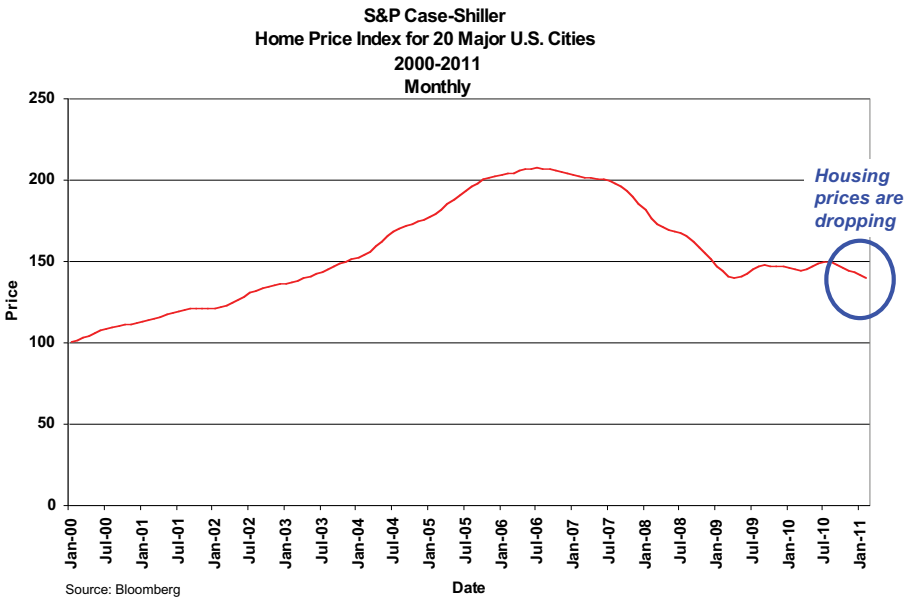
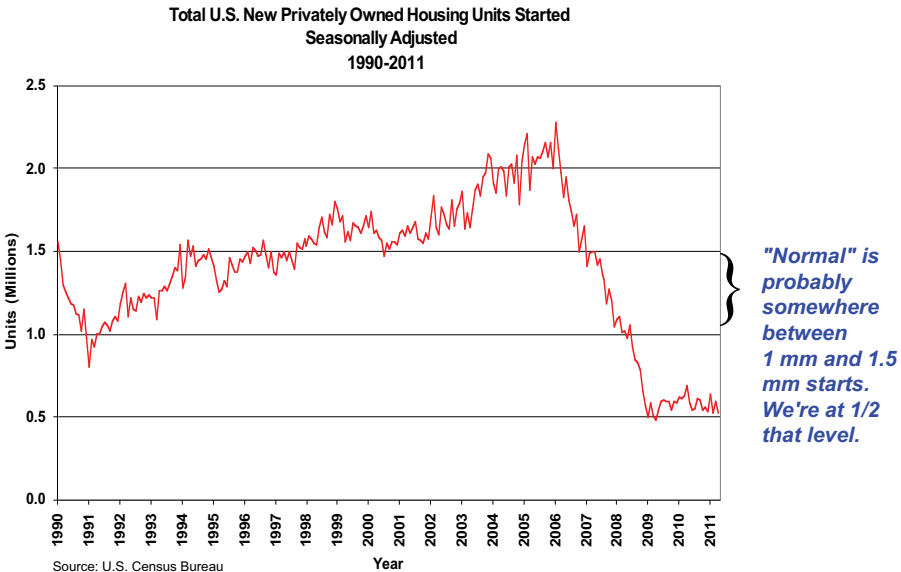
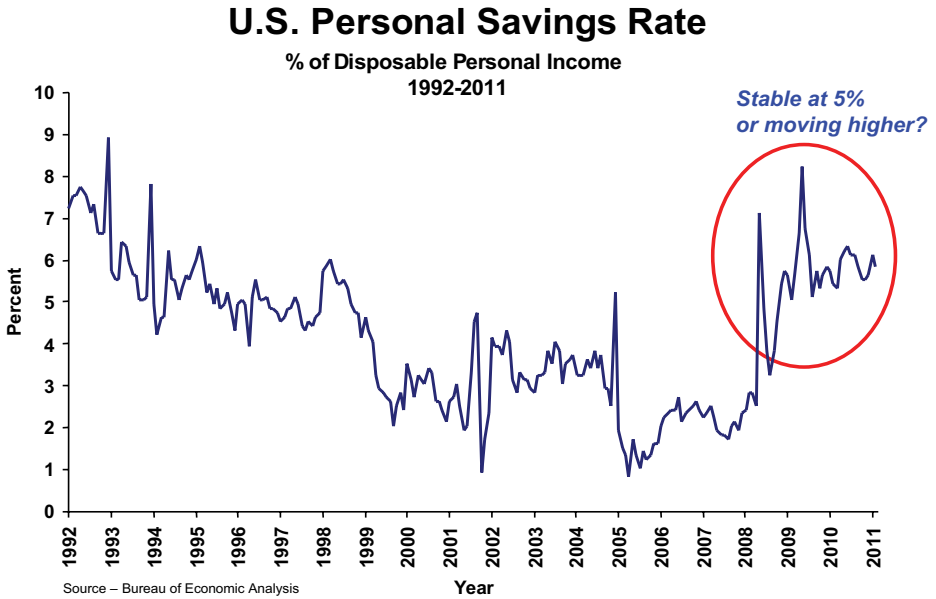


Figure 12: Total U.S. New Privately Owned Housing Units Started, 1990-2011



3. Consumers have shifted from saving 1%-2% of their income a few years ago, to saving about 5% today:

Figure 13: U.S. Personal Savings Rate (% of Disposable Income), 1992-2011



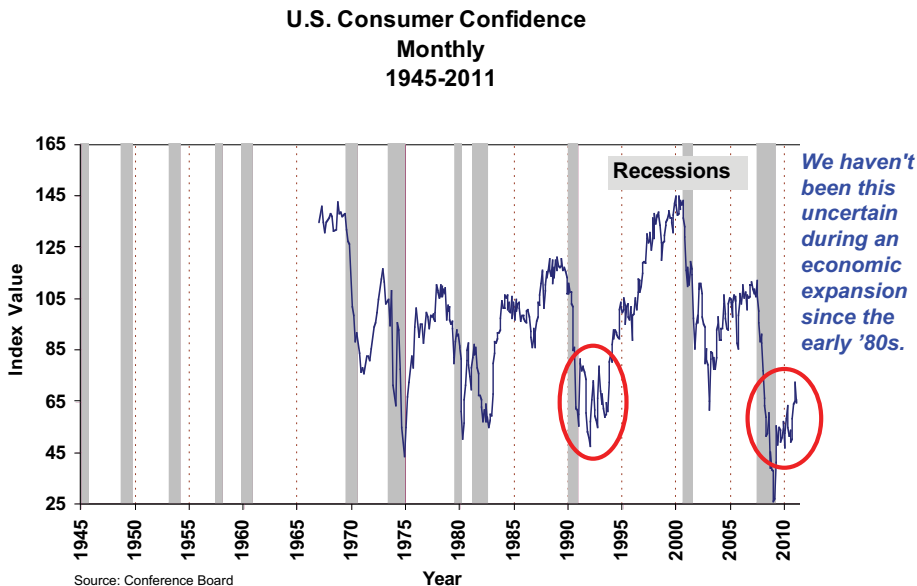
Irrational lending standards of a few years ago—particularly in housing—have returned to more sane standards, reducing the population with access to credit. The rise in food and fuel prices has consumers on edge, and it is possible that a further decrease in consumer spending could push the U.S. back into a recession, particularly if it is coincident with reduced demand for U.S. products overseas.

4. Political uncertainty:

In the meantime, due to budget shortfalls and increased debt a difficult and extremely important political debate is being waged at all levels of government—from the local school board to the federal government—as the U.S. body politic works through the questions of which government promises will be kept, who can and will pay for them, and which promises will be broken. While the debate has honestly and truly begun, we do not see that all the alternatives have been laid on the table yet, and we do not appear to be close to reaching a collective decision. We expect this process to take a while. (For a more detailed discussion on the U.S. economy, refer to *Where is the U.S. Economy Today? Are We on the Road to 'Japan' and A Lost Decade?*)

So, QE2 and strong profits by some very efficient U.S. companies are pushing the U.S. equity markets up. A heated political debate with massive economic implications keeps everyone on edge, (refer to Figure 14), while the very real external threats from China and Europe add to the volatility and potential for disaster. The U.S. consumer struggling in the face of stagnant wages, unemployment, and rising costs may reduce his spending yet again, resulting in a recession sooner than many think likely. If this were a weather forecast, we'd say it is partly sunny with a chance of severe thunderstorms and tornados.

Figure 14: U.S. Consumer Confidence (Monthly), 1945-2011



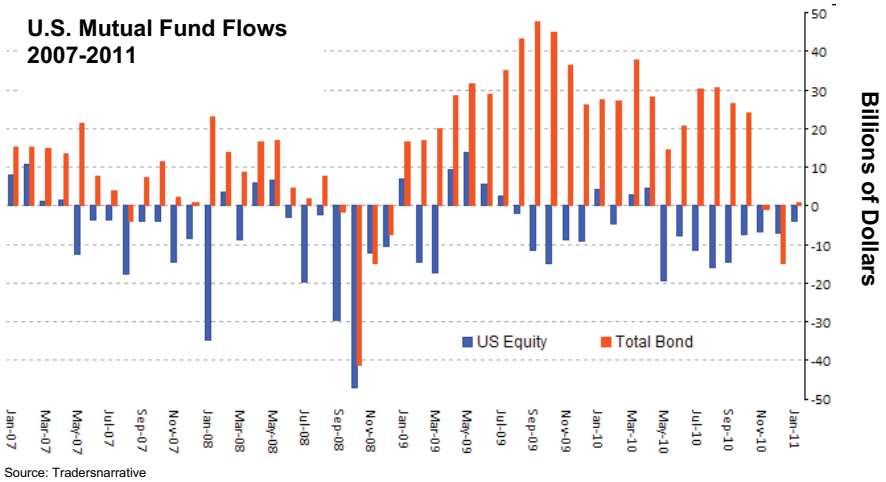
Warnings

It's useful sometimes when trying to figure out where best to invest your money to reverse the question and ask "Where don't I want to invest my money?" We see a couple of areas best avoided:

1. Bonds

Since January '09, investors have favored bonds over equities as evidenced by Figure 15. That's beginning to turn:

Figure 15: U.S. Mutual Fund Flows, 2007-2011 (U.S. Equity vs. Total Bond)

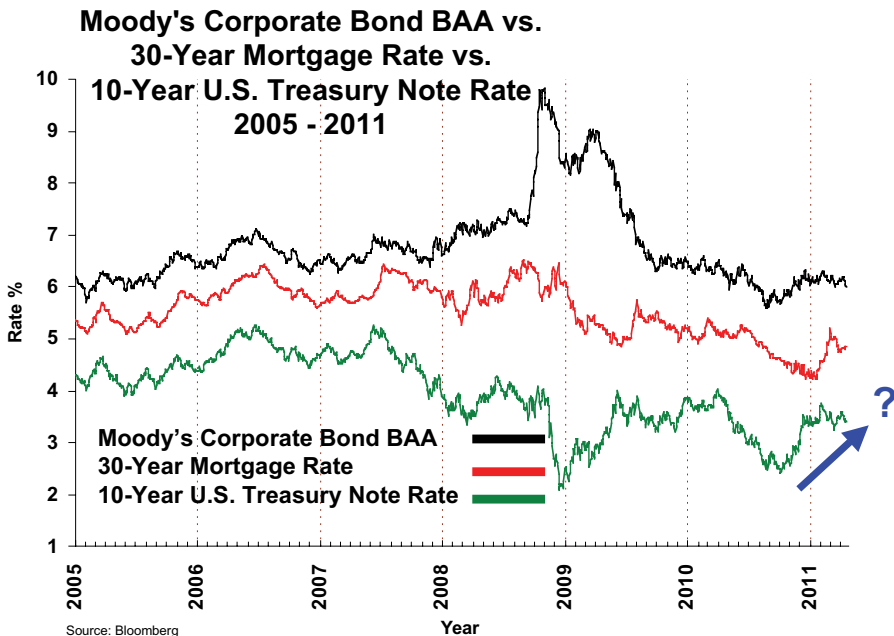


Let's examine why the money that flowed into bonds is now flowing out.

Until the beginning of 2008, the three plots on Figure 16 tracked together. Historically, the BAA corporate bond rate and the 10-year Treasury rate have traded at about 2% spread. The 30-year fixed mortgage rate generally sits in the middle, about 1% above 10-year Treasuries.

As you can see from Figure 16, late in 2008, the spreads between corporate BAA bonds and 10-year Treasuries widened enormously as liquidity dried up and investors ran from "risky" corporate bonds to the safety of Treasuries. (Once the spreads appeared to have peaked in late '08, we bought some BAA bonds and bond mutual funds which have since been sold.) As the Federal Reserve brought down 10-year Treasury rates through its own buying of mortgage-backed securities and Treasuries, mortgage rates came down too. As you can see from this plot, there's now a wider than normal gap between mortgage rates and Treasuries; we think this is because Treasury rates are too low. If the Fed is successful at getting inflation up to 2%, long-term Treasury rates should move up.

Figure 16: Moody's Corporate Bond BAA vs. 30-Year Mortgage Rates vs. 10-Year U.S. Treasury Note Rate



Some folks are curious as to why investment managers like Bill Gross of PIMCO are saying Treasuries are dangerous, when, historically, they have been considered the safest of all investments. In his November 2010 monthly letter titled, *Run Turkey, Run*, Gross discusses his observations of the effects of QE2 on the bond market:

"Check writing in the trillions is not a bondholder's friend; it is in fact inflationary, and, if truth be told, somewhat of a Ponzi scheme. Public debt, actually, has always had a Ponzi-like characteristic."

Gross also adds:

"Having arrived at its destination, the market then offers near 0% returns and a picking of the creditor's pocket via inflation and negative real interest rates."

QE2 is the equivalent of starting up the Fed's printing presses to create money for buying financial assets in the market—in this case, long-term U.S. Treasury bonds. Buying bonds pushes down their yields along with interest rates across the debt markets that are closely tied to U.S. Treasury rates. Why is the Fed taking this measure? It introduces new money into investment markets, supporting asset prices and may contribute to keeping short-term interest rates low; (we have our doubts.) We suspect much of the new money has made its way into the commodity markets. Coming out of a recession, there have been times when lowering interest rates has boosted the economy. This time, however, there are many other economic crosscurrents. As a result, we think the Fed is applying the wrong prescription.

So, essentially, Gross was saying that if the Federal Reserve wants to buy Treasury bonds, he'd be happy to sell them. And since that time, PIMCO has moved completely out of long-term U.S. debt, though it still owns some short-term debt.

We've been hearing for the last 10 years that bonds are safe. In the prior 20 years interest rates came down, which means the price of the bond stayed at par or above. The economy grew, which means there was no credit risk. So for 20 years, bonds have been safe because interest rates were coming down and the economy was growing.

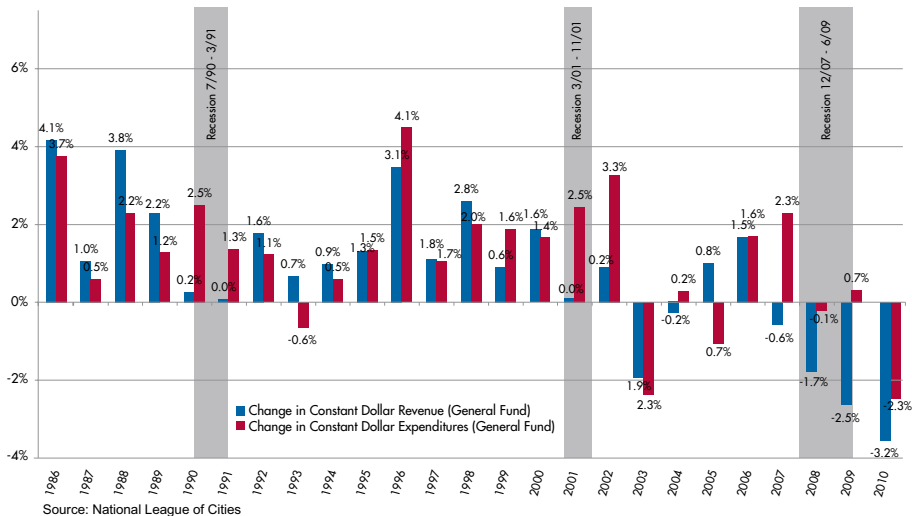
An investment that is safe under one set of circumstances can be dangerous in another. The easy thing for people to trust is what's worked well lately. As human beings, we all want to extrapolate what has worked in the recent past into the present rather than taking into account today's investment values. As a result, a lot of money poured into bonds during the last year. If there's a bubble out there today, it's probably in the Treasury market.

We also remain wary of Muni bonds. Here's why:

For 50 years or more, Muni bonds have had very few defaults. Now, however, we are in a period of time where you have to do your homework. You have to figure out the specific assets and the specific cash flows behind the bond that you own. We think there are going to be blow-ups in the Muni bond market because cities, counties, and states have made promises that cannot be kept, and it's going to come home to roost. (Notice in Figure 17 how general fund revenues have fallen faster than expenditures.)

Figure 17: Year-to-Year Change in General Fund Revenues and Expenditures by City Governments

Year-to-Year Change in General Fund Revenues and Expenditures by City Governments (Constant Dollars)



Let's use Illinois as an example, where tax rates are increasing sizably to close their budget gap. Neighboring governors are encouraging companies to move to Indiana and Wisconsin—away from Illinois—to avoid the taxes. If Illinois based companies do move out of the state to avoid the tax increases this will only serve to reduce the tax base and tax revenues, exacerbating the problem and making it harder for Illinois and its municipalities to meet their financial obligations, including paying their bondholders.

Bottom line: If you own bonds, we think that now is the time to harvest that crop. We think interest rates are below where they should be, and below where they will be even though the Fed is purchasing \$600 billion of Treasuries in an effort to keep interest rates down.

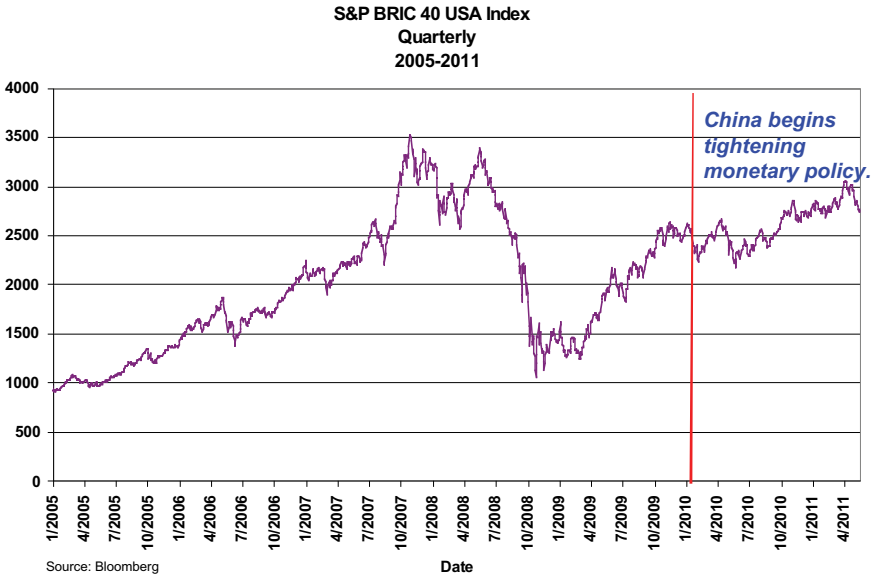
For investors interested in income, where can they go—other than bonds?

For 2011, we believe it is useful to look for companies with dividend yields over 2½ percent. With interest rates at current levels, dividend yields will look better than bond yields for a lot of people, particularly after taxes. Our favorite way of pursuing income is to buy companies where the yields are higher and the cash flows are superb—companies such as Philip Morris or AT&T.

2. Emerging markets

Emerging markets is another area in which we are avoiding a lot of exposure. Figure 18 plots the performance of some of the most popular emerging markets, widely referred to as BRIC; (Brazil, Russia, India, and China).

Figure 18: S&P BRIC 40 USA Index, 2005-2011 (Quarterly)

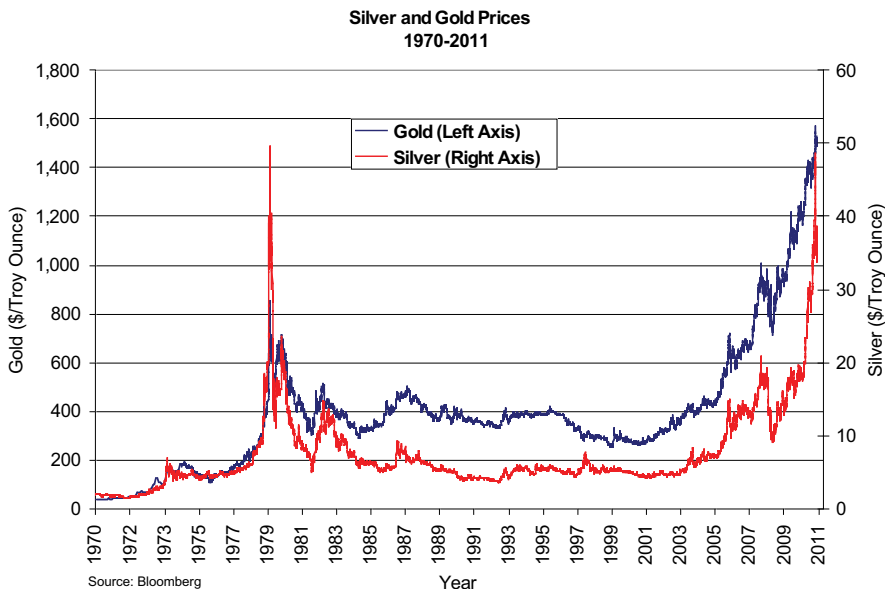


China has become the swing end of the world markets and, of course, China has been recently tightening. We're also seeing tightening in Brazil, where it is raising interest rates. We don't want a lot of direct exposure to these markets while their central banks are tightening credit conditions.

3. Commodities

The third area in which we are cautious is commodities. When the Fed printed money in the 1970s, it went into consumer inflation. This time around, it looks like the money is flowing into commodities like gold and silver—even grains.

Figure 19: Silver and Gold Prices, 1970-2011

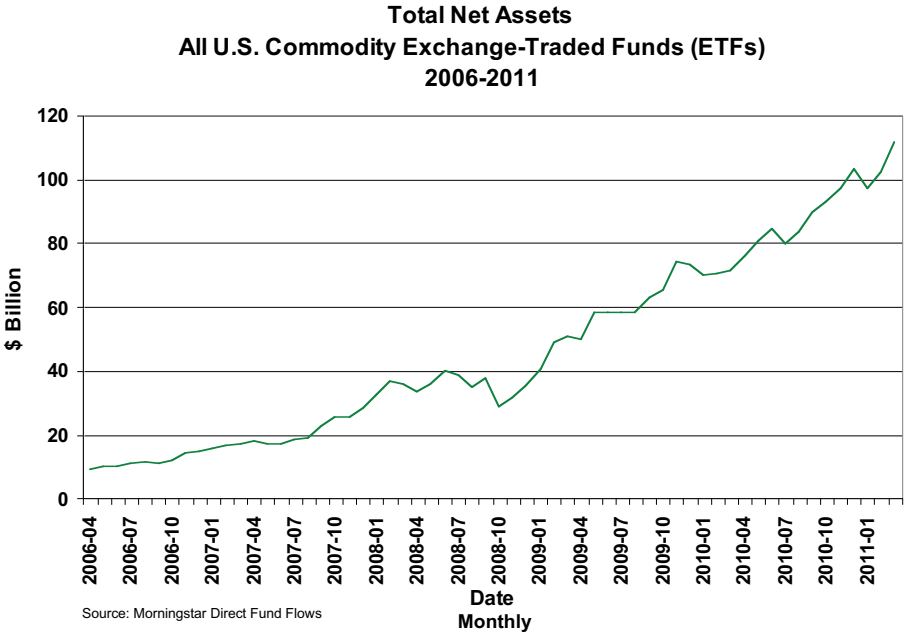


Over the last 18 months, there's been a strong interest in commodities, primarily based on developments in the financial markets. A lot of the focus has been "how do you preserve wealth—how do you grow wealth in an environment where you're not sure about the monetary base?" Exchange Traded Funds (ETFs) have made it very easy to own gold and precious metals.

Ten, fifteen years ago, if you wanted to own gold or other precious metals, you'd have to actually buy them. But ETFs allow you to take a position in gold without actually owning the physical commodity. As a result, the question that has recently surfaced is: if you buy an ETF that represents a precious metal, do you actually own that metal or not? Some do, some don't. Wall Street has created ETF synthetic instruments that represent commodities (and a whole host of other asset classes), but not the actual physical properties.

While we're on the subject of gold/precious metals, some investors use these assets as hedges against inflation, but our belief is that gold is "half religion." The real point is, do we want to chase gold at these prices? We think it's too late. We would much rather own Cisco or Microsoft—companies with 10% free cash flow—based on the price we're paying. Gold has no free cash flow; therefore, as an economic quantity, it's hard to value. (Most investments are valued by calculating the present value of future cash flows; this method is not useful in valuing gold as the only future cash flow is the sale some time in the future.)

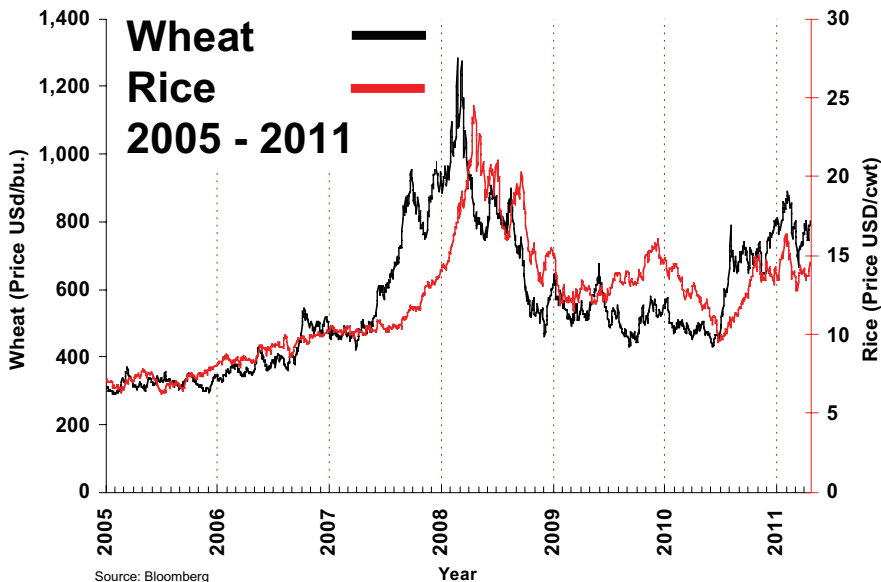
Figure 20: Total Net Assets, All Commodity Exchange Traded Funds, 2006-2011



In any case, one of the reasons we're seeing more money going into commodities is that ETFs make these types of investments easier—with lower transaction costs—and that's part of what's attracting money into this asset class. But, buyers beware: As long as people are putting more money into these types of funds, they remain liquid. When the money flow levels off or reverses, the game is over.

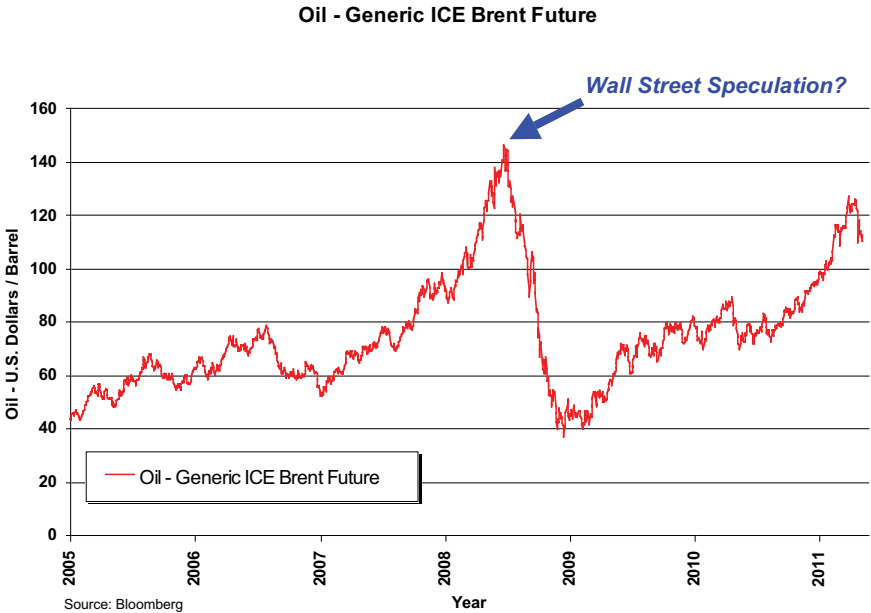
We're also seeing the prices of grains near the levels they were back in '07 and '08 and, as we said then, when the price of wheat goes up 40%, it's an inconvenience for Americans. When the price of rice goes up 40%, it can become downright scary to the Chinese peasant.

Figure 21: Wheat and Rice, 2005-2011



The rise in the price of rice and other commodities has prompted the Chinese workers to demand a fix—and they have gotten the attention of the party and the Central Bank. Chinese workers are receiving sizable wage increases, resulting in higher inflation and the raising of interest rates by the Chinese Central Bank.

Figure 22: Oil – Generic ICE (Intercontinental Exchange) Brent Future



We encourage you to look at the pattern that was shown in '08-'09, when crude prices ran up to \$145 per barrel and then down to \$45. Again, at that time, the fundamentals were favorable—any number of folks on TV and in print explained in detail why demand would continue to grow and supply would continue to decline—driving prices ever higher. We think the swing end, e.g., prices above \$100, were probably set by people buying financial futures as opposed to people buying crude oil. And when prices got below \$60, down to \$45, it was probably the same thing that drove prices down. We think a similar dynamic is at work now. Having just seen a big swing up, we don't want direct exposure to crude prices right now.

How we plan to make money in the current investment environment

So, where do we want to invest these days?

We think there are values to be found among larger companies. Historically, coming out of a recession, values tended to be best among the smaller companies, or the cyclical companies. This time around was not a normal, cyclical recession and we didn't think the markets would treat it like one—but they did. A lot of cyclical stocks rebounded very well last year—more so than we expected, given that the economy has been coming back at half speed.

Presently, we think some cyclical companies are ahead of themselves. As you can see from Figure 23, the latest numbers indicate that expected earnings for companies on the S&P 500 Index will be up 15.4% in 2011, which means the S&P 500 is currently selling at a 13.7 P/E. For the S&P Midcap 400 Index, expected earnings are at 21.7%, which means the S&P 400 is currently selling at a 18.5 P/E. Small companies are expected to do a 34.2% gain in earnings—which we don't quite believe—but the P/E is at 19.6.

Figure 23: Strategic Sector Momentum and Valuation

**Strategic Sector Momentum and Valuation
Summary of April 6, 2011 Reports**

2011 Estimates	S&P 500	S&P 400	S&P 600
Earnings per Share (EPS) Growth	15.4%	21.7%	34.2%
Dividend Yield	1.8%	1.2%	1.2%
Price/Earnings Ratio (P/E)	13.7	18.5	19.6

Source: Dudack Research Group; April 6, 2011

Earnings per share growth is not a measure of the Fund's future performance.

Price-to-Earnings (P/E) is the current price of a stock divided by the (trailing) 12 months earnings per share. It is not possible to invest directly in an index.

So, small companies are selling at a P/E 50% higher than the big companies. Granted, they're expected to do twice that in earnings—but if the earnings don't show up, we think there is room for disappointment.

Frankly, we are reminded of 1999, when folks asked why we were underperforming in the midst of the dot-com bubble. We're saying we simply can't get comfortable with paying those kinds of prices for companies whose potential earnings we can't trust.

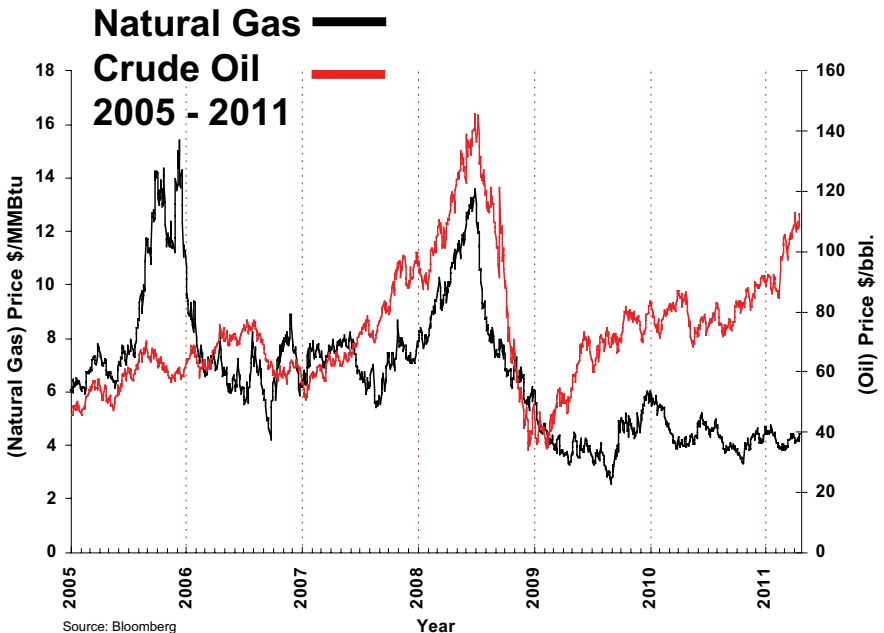
Coming out of this recession, we'd rather own companies that by-and-large manufacture goods and provide services to companies, not the general public. We think owning companies that are servicing a global demand is a great place to be. Plus, a number of such companies have a P/E ratio of 11 or 12 which is hard to resist. (Remember Figure 13, the U.S. Personal Savings Rate?)

When choosing stocks, we use a bottom-up approach with a top-down screen for adjusting our benchmarks. For a couple years we have found great values in a number of big technology companies which happened to be based in the U.S., but really sell throughout the world. For example, IBM does the majority of its business overseas (65%); Cisco does nearly half of its business overseas (46%); last year, 42% of Microsoft's sales took place outside of the U.S. From an investment perspective, one way of playing the strength in emerging economies, while still having confidence in the accounting systems, is to buy these major international firms.

As always, we look for companies with better-than-average profitability, and better-than-average growth, selling cheaply. The last year or so, the numbers have taken us to large cap companies. In 2010, such companies did not keep up with the small companies in the marketplace. In the first quarter of 2011, it's been about even. Recently, big companies seem to be getting a bit more momentum. We obviously hope that continues. UnitedHealth is our biggest holding; it reported good earnings the first quarter of 2011, and it's getting reflected in the stock price.

We also think we can make some money by taking advantage of the spread between natural gas and crude oil prices:

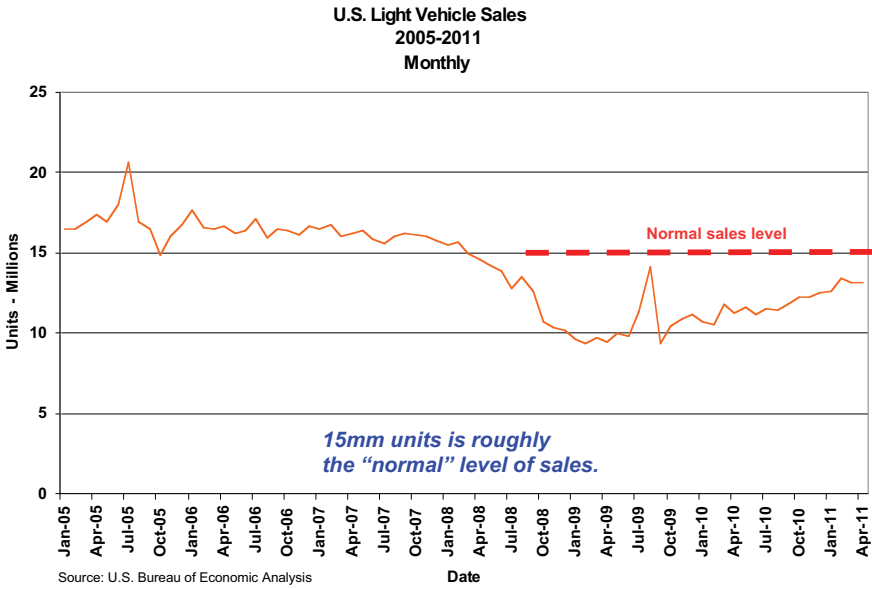
Figure 24: Natural Gas and Crude Oil, 2005-2011



Historically, the spread between prices for natural gas and crude oil was set by the difference in energy content between the two—a ratio of about 8:1. In the last few years, U.S. companies have figured out a way to extract natural gas from plentiful shale deposits, resulting in an explosion in the quantity of natural gas available. The result is that while oil prices have risen, natural gas prices have fallen. We are looking for ways to profit from this change. One way we think we can do that is to invest in companies that use natural gas as a feedstock for chemical production and compete against companies that use crude oil as a feedstock for their production of the same chemical. DuPont is one such company—and it just went from being the high cost producer of ethylene to being the second lowest cost producer in the world. The change has done nice things for their profitability. Chesapeake Energy Corporation has also profited from shale gas—it bought up a lot of gas leases when they were cheap, and recently sold them at a handsome profit. We own a bit of Chesapeake and it has done nicely for us. There is also the potential for natural gas to partially displace gasoline as a transportation fuel, and we've made some investments that we think will benefit if that occurs.

Finally, we think some industries remain depressed, but will eventually return to what we believe is a more normal level of production and consumption. Automobile sales plummeted during the recession and have gradually been returning to what we consider a more normal run rate:

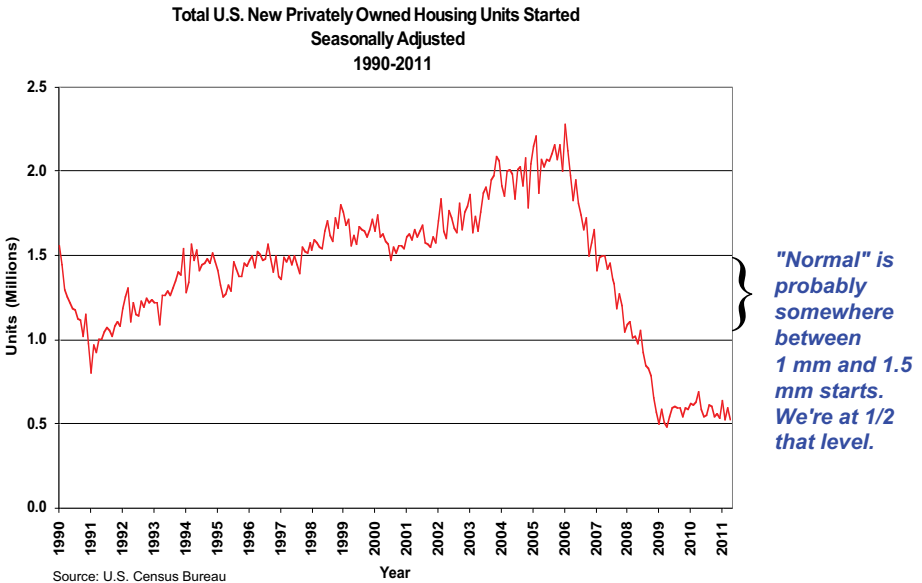
Figure 25 U.S. Light Vehicle Sales, 2005-2011 (Monthly)



Concerns about the solvency of domestic Original Equipment Manufacturers (OEM) and their suppliers kept us out of those companies for a period of time. The component manufacturers ran up before we had confidence in their balance sheets, but we invested in Ford once we were sure the government wasn't going to step in and destroy the owners. We've also invested in auto retailers that we think will benefit from both the gradual return to more normal sales levels and a meaningful reduction in the number of competitors.

In a similar vein, we have put a little money to work in housing stocks. While the timing of a recovery in housing remains hugely uncertain, we are fairly certain it will occur and we are using a covered call strategy while we patiently wait for the recovery.

Figure 26 Total U.S. New Privately Owned Housing Units Started, 1990-2011



In the meantime, the investments we made in healthcare companies are beginning to bear fruit. We were able to purchase some very good companies at very nice prices, complements of all the uncertainty surrounding the healthcare debate. While we have done a little pruning and trimming, we are generally pleased with the way our healthcare investments are working out for us.

Our governing investment principles

We believe that investors of all ages are still best served by buying good companies at reasonable prices. We use return on equity (ROE) as a starting point for looking for investment opportunities. ROE indicates company profitability—how efficiently a company is using its equity capital—which has averaged roughly 13% since WWII. So we look for ROEs above the average that we think are sustainable.

How much should you pay for a good company? Our rule of thumb for a reasonable price is a price-to-earnings ratio (P/E) below the ROE for that company.

Morningstar, (a Chicago-based company that provides stock and fund analysis), cites our average ROE at 23%—which is technically accurate, but not actually real. We own a number of companies that have been fairly aggressive in repurchasing shares. This effort lowers a company's book equity, (the divisor for the ROE calculation), so the ROE becomes a bit overstated. As a result, we normally adjust ROEs greater than 20% down to 20%, as we believe an ROE greater than 20% is unsustainable in the long run. This gives us a lower, more conservative—and we believe more meaningful—valuation for the company.

We think our average ROE is certainly above 16%, and our average P/E is 11. So we own more profitable-than-average companies, selling at below average prices.

Below is Morningstar's analysis of how our holdings look in regard to some common metrics, including value, growth and profitability (first column); and how our holdings compare to Morningstar's large-cap value category average (second column).

Figure 27: Morningstar Metrics of the Holdings of Muhlenkamp Fund as of 12/31/10

Morningstar Metrics

<i>Value Measures</i>	<i>Relative Category</i>	
Price/Earnings	11.28	0.90
Price/Book	1.97	1.11
Price/Sales	0.94	0.82
Price/Cash Flow	4.00	0.69
<i>Growth Measures (%)</i>	<i>Relative Category</i>	
Long-Term Earnings	11.32	1.24
Book Value	3.42	2.50
Sales	-11.44	NMF
Cash Flow	13.06	12.56
Historical Earnings	0.53	0.18
<i>Profitability (%)</i>	<i>Relative Category</i>	
Return on Equity	23.21	1.29
Return on Assets	9.08	1.38
Net Margin	14.02	1.21

Source: Morningstar, Inc. All Rights reserved. Used with permission.

To summarize: Our investment strategy currently favors large, international companies with rock-solid balance sheets and superb free cash flows. (Typically coming out of a recession, we would focus on company earnings growth. Coming out of this recession, we continue to focus on the balance sheet. If a major economic crisis hits, the companies should be able to survive.) These types of companies underperformed in 2010 and still look pretty cheap. We expect that to change and we hope to profit when it does.

Figure 28: Top Holdings as of 6/30/2011

Top Holdings 6/30/2011

Company	ROE (%) Return on Equity	Forward P/E Price/Earnings Ratio	Free Cash Flow Yield (%)	PEG Price/Earnings to Growth Ratio
United Health Group, Inc.	18.3	12.7	9.26	1.1
Philip Morris International	>20	14.5	3.33	1.4
Ford Motor Company	---	7.7	13.16	1.2
Laboratory Corporation of America Holdings	>20	15.3	7.52	1.3
Oracle Corporation	>20	14.1	4.31	1.0
Intel	>20	10.2	6.45	0.9
Abbott Labs	>20	11.3	6.25	1.5
Berkshire Hathaway, Inc. – Class B	6.8	N/A	6.10	2.5
Microsoft	>20	10.0	8.33	0.9
PNC Financial	11.3	10.3	13.51	1.7
Chesapeake Energy Corporation	16.1	10.5	---	1.0
Sonic Automotive	13.8	11.3	24.39	0.7
DuPont	>20	13.9	3.15	1.4
Average	17	12	9	1.3

Source: Bloomberg

Now, having told you where we have put your money to work, it's probably useful to talk a bit about when we sell. If we are right about a company (and bought it on sale), we'll be looking to sell some shares when it reaches what we consider to be a fair price. Historically, companies would often swing from undervalued... past fair value... to overvalued... and it was profitable to hold onto a company for a while after it was fairly valued to capture some of this momentum. We are much less likely to do that now. Obviously, if we have erred in our judgment of a company or industry, we will get out immediately after realizing the error. Finally, if we see the investment environment deteriorating, we will be much quicker to sell than has historically been the case.

Glossary

Basis Point or Basis Point System (BPS) is a unit of measurement equal to 1/100th of 1 percent. It is often used to measure very small changes in interest rates, equity indexes, and the yields of fixed-income securities.

Book Value (BV) or “Book” equals total assets minus total liabilities. It is the owner’s equity in the business, often quoted as Book Value/Share.

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

Credit Default Swap (CDS) is a contract that involves the transfer of credit risk between two parties. It is similar to insurance because it provides the buyer of the contract, who often owns the underlying credit, with protection against default, a credit rating downgrade, or another negative “credit event.” The seller of the contract assumes the credit risk that the buyer does not wish to shoulder in exchange for a periodic protection fee similar to an insurance premium.

Covered Call is an options strategy where the investor owns the underlying stock and writes (sells) a “call contract.” By selling a call, an investor collects a premium for selling someone the right to buy the underlying stock, commodity, currency, index, or debt, at a specified price (the strike price) during a specified period of time. The premium collected by selling a call helps an investor reduce the risk of owning a position by either increasing income or offsetting some of the loss if the stock declines.

Exchange-Traded Fund (ETF) is an investment fund that tracks a commodity, a basket of securities, or an index (e.g. S&P 500, MSCI EAFE), but trades like a stock on an exchange. ETFs experience price changes throughout the day as they are bought and sold.

Forward P/E or Estimated P/E Is an estimate of the price-to-earnings (P/E) ratio where the earnings (E) are the forecasted or estimated future earnings for a company.

(Free) Cash Flow represents the cash a company is able to generate after paying out the money required to maintain or expand its business.

Free Cash Flow Yield is a ratio calculated by dividing the Free Cash Flow per Share by the Current Market Price per Share.

Moody's Corporate Bond Baa Index is considered as medium-grade obligations (i.e., they are neither highly protected nor poorly secured). Interest payments and principal security appear adequate for the present, but certain protective elements may be lacking or may be characteristically unreliable over any great length of time. Such bonds lack outstanding investment characteristics and in fact have speculative characteristics as well. Moody's bond ratings reflect the credit quality of companies. The highest rating is AAA and the lowest rating is D.

Price-to-Book (P/B) is the market capitalization divided by the owner's equity in the business. Note that P/B equals the price-to-earnings ratio (P/E) x (times) return on equity (ROE).

Price-to-Cash-Flow is the current price of a stock divided by cash flow per share. The price-to-cash-flow ratio is used to evaluate the value of a company in much the same way as price-to-earnings and price-to-sales ratios are used.

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

P/E to Growth Ratio, also referred to as PEG, is calculated by dividing the price-to-earnings (P/E) ratio by the Annual Earnings per Share Growth Rate.

Price-to-Sales Ratio equals the stock's current price, divided by the stock's revenue per share. It can be used for measuring a stock relative to its own past performance, other companies, or the market itself.

Return on Assets (ROA) is equal to a fiscal year's earnings divided by its total assets, expressed as a percentage. It can be used as a measure of a company's profitability.

Return on Equity (ROE) is a company's net income (earnings) divided by the owner's equity in the business (Book Value); $ROE = \text{Earnings} / \text{Book Value}$. This percentage indicates company profitability or how efficiently a company is using its equity capital.

S&P 400 Index provides investors with a benchmark for mid-sized companies, covering over 7% of the domestic equities market. You cannot invest directly in an index.

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. You cannot invest directly in an index.

S&P 600 Index covers approximately 3% of the domestic equities market. You cannot invest directly in an index.

S&P BRIC 40 USA Index is designed to offer exposure to four emerging markets: Brazil, Russia, India, and China. Known as the BRIC countries, they are actively watched by investors in recognition of their potential to move from emerging market status to developed market.

S&P/Case-Shiller Home Price Index is calculated from data on repeat sales of single-family homes, an approach developed by economists Karl Case, Robert Shiller and Allan Weiss.

The comments made in this essay are opinion and are not intended to be investment advice or a forecast of future events.

The Fund's investment objectives, risks, charges, and expenses must be considered carefully before investing. Must be preceded or accompanied by a current prospectus.

Mutual fund investing involves risk. Principal loss is possible. The Fund may invest in smaller companies, which involve additional risks such as limited liquidity and greater volatility. The Fund may also invest in foreign securities which involve greater volatility and political, economic and currency risks, and differences in accounting methods. Investments in debt securities typically decrease in value when interest rates rise. This risk is usually greater for longer-term debt securities.

Following are the Top 10 holdings of the Muhlenkamp Fund as of 6/30/11:

Company	Industry	% of Net Assets
UnitedHealth Group, Inc.	Health Care Providers & Services	5.91
Philip Morris International, Inc.	Tobacco	5.56
Ford Motor Company	Automobiles	4.68
Laboratory Corporation of America Holdings	Health Care Providers & Services	4.44
Oracle Corp.	Software	4.19
Intel Corp.	Semiconductors & Semiconductor Equipment	3.63
Abbott Laboratories	Pharmaceuticals	3.57
Berkshire Hathaway, Inc. - Class B	Insurance	3.57
Microsoft Corp.	Software	3.49
PNC Financial Services Group, Inc.	Commercial Banks	3.44

Fund holdings and sector allocations are subject to change at any time and are not recommendations to buy or sell any security. **Current and future portfolio holdings are subject to risk.**

Each Morningstar Category Average is representative of funds with similar investment objectives.

Past performance does not guarantee future results.

The Muhlenkamp Fund is distributed by Quasar Distributors, LLC. (6/11)

Notes



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

www.muhlenkamp.com