Kinetics Mutual Funds
First Quarter 2017 Commentaries

The Global Fund

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Dear Fellow Shareholders,

What is the goal of "global" investing? Many investors would answer that the goal is to increase portfolio diversification. But is that really being achieved? In the 3-, 5-, and 10-year periods ending March 31, 2017, the correlation coefficient between the total returns for the S&P 500 Index ("S&P 500") and the MSCI All County World Index ("ACWI") was greater than 0.93. Now, it is worthy of note that, for the trailing 12-month period, the correlation was lower (0.74); it remains to be seen whether this is an anomaly or an indication of a new trend.

Looking back, though, it seems clear that those seeking to diversify their portfolios by adding exposure to a global index such as the MSCI ACWI have not really achieved that goal. But should this come as a surprise? Consider the largest holdings in the ETFs tracking the ACWI and the S&P 500 (shown at right). Now, it is important to note that these top positions comprise a much larger weight in the S&P 500 (18.6%) than in the ACWI (9.2%), but it still seems apparent that many of the same stocks are driving returns.

Top 10 Holdings

iShares MSCI ACWI ETF	iShares Core S&P 500 ETF
Apple Inc.	Apple Inc.
Microsoft Corp.	Microsoft Corp.
Amazon.com Inc.	Amazon.com Inc.
Johnson & Johnson	Exxon Mobil Corp.
Exxon Mobil Corp.	Johnson & Johnson
JP Morgan Chase & Co.	Facebook Inc.
Facebook Inc.	Berkshire Hathaway Inc.
Wells Fargo	JP Morgan Chase & Co.
General Electric	General Electric
Alphabet Inc.	AT & T Inc

Source: iShares as of 3/31/2017

And what if we look a bit further afield? The top 10 holdings in the iShares MSCI Emerging Markets ETF ("EEM") are as follows: Samsung Electronics Ltd., Tencent Holdings Ltd ("Tencent")., Taiwan Semiconductor Manufacturing, Alibaba Group, Naspers Limited (in fact, a proxy South African owner of Tencent), China Construction Bank Corp., China Mobile Ltd., Industrial and Commercial Bank of China, Baidu, and Hon Hai Precision Industry Ltd. These companies provide much more exposure to their local economies, but even here, some of the businesses earn most of their revenues outside of their countries of domicile, and outside of the emerging markets (Samsung and Taiwan Semiconductor, for example). Per the most recent fact sheet, EEM has a *negative* beta relative to the S&P 500 Index, so, historically, it may have provided diversification to a portfolio.

The negative beta may be quite appealing to statistically-driven asset allocators, but let's examine several characteristics of the fund composition. The top four country allocations are China (26.19%), Korea (14.99%), Taiwan (12.2%) and India (8.74%), collectively representing over 62% of the aggregate exposure. Many of these economies are export-oriented, and are increasingly providing work force outsourcing at cost advantages to western firms. Given the campaign promises of the U.S. administration and increasingly nationalistic rhetoric across Europe, it would appear that this dynamic is under threat. Should there be a shift in this trend, growth will be highly dependent on domestic labor growth, productivity, and ultimately, consumption.

Consumption growth may end up being a more challenging dynamic to support as government fixed asset investments decline, and these economies are left seeking private capital for investment. This is particularly relevant to Tencent (and Naspers), Alibaba and Baidu, as these companies are focused on local consumers. Additional top holdings in EEM are exposures to risks in mobile handset competition/pricing and market saturation (Samsung) and weakening domestic loan performance/depressed interest rates (China Construction Bank and Industrial and Commercial Bank of China). Taking a step back, there are many parallels between the top EEM constituents and Apple Inc., Facebook Inc., J.P. Morgan Chase & Co. and Alphabet Inc., which are the largest holdings in the S&P 500 and the MSCI ACWI, though the EEM positions have different end markets. To believe that either end market can decouple from the overpowering forces of the United States and China would be a naive assumption regarding diversification.

Though we are not economists, one cannot avoid macroeconomic considerations when deliberating on global investments. After all, to the extent that one allocates US dollars to "global" stocks, the relative strength of the US economy (and the US dollar) are significant determinants of the success of the investment. Effectively, global diversification, as it is has historically been practiced, resembles a weak dollar/strong commodity trade. The current manifestation, as suggested by EEM, suggests a continuation of this dynamic, but with an increasingly overwhelming sensitivity to the relative strength of the Chinese economy.

Our preference is to attempt to identify companies that provide global diversification, rather than choosing between strikingly similar businesses within the two leading global economies. One example is A P Mollar-Maersk ("Maersk"). Founded in 1904, Maersk is a Danish conglomerate with a $37 billion stock market capitalization. Both of its two largest businesses have been in severe cyclical decline: container shipping, Maersk being the world's largest publicly traded line, with a 14% world market share; and oil drilling and exploration. The founding Maersk family, represented by Vice-Chairwoman Ane Maersk Mc-Kinney Uggla, owns 53% of the company.

Remarkably, in two industries that are about as challenged as they can get, the company is profitable and has a strong balance sheet: $1.7 billion of net current assets and $43 billion of property and equipment, as against $13 billion of debt. It trades below book value. It repurchased $1.25 billion of shares since year-end 2014.

Moreover, in late 2016, following the container shipping industry's first major bankruptcy in mid-2016, Maersk announced the acquisition of the world's seventh largest container liner, Hamburg Süd. This will add about 3 percentage points to Maersk's market share. As in past cycles, we believe the company should emerge from this one in a stronger competitive position. When shipping rates rise, whenever that might be, it can be quite fast and sharp. As well, after decades of operating under a holding company structure, in June 2016, the company announced its intention to separate its energy and shipping operations. The two resultant businesses would then, as industry-specific offerings, be much more suitable material for index inclusion, which would be a significant valuation catalyst. We can't know whether Maersk will be successful; time will tell. But, it appears to us that this is an economically and operationally idiosyncratic company with high optionality.

Maersk has many qualities that we find attractive in an investment: market and customer diversification, balance sheet strength, a large asset base and strong current cash flow generation. Perhaps as important, though, is that the industries in which it operates (marine shipping and energy) have already endured considerable recessions. The recovery of these industries may, therefore, be more sensitive to industry dynamics, as opposed to macroeconomic factors—this is the type of idiosyncratic risk that active managers should embrace. Furthermore, there is an event, in the form of the energy and drilling segment spin-off, which may well unlock value for investors.

Global Fund **Top 10 Holdings (%) as of March 31, 2017**	
Texas Pacific Land Trust	9.8%
Bollore SA	4.5%
Icahn Enterprises LP	3.9%
Fairfax Financial Holdings Limited	3.5%
Onex Corporation	3.4%
Siem Industries Inc.	2.8%
Brookfield Asset Management Inc. - Class A	2.7%
Clarke Inc.	2.6%
The Bitcoin Investment Trust	2.5%
Dream Unlimited Corp. - Class A	2.3%

Important Disclosures

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Portfolio holdings information, if any, is subject to change at any time and is as of the date shown.

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International investing presents special risks, including currency exchange fluctuation, government regulations, and the potential for political and economic instability. Because smaller companies often have narrower markets and limited financial resources, they present more risk than larger, more well-established companies.

Unlike other investment companies that directly acquire and manage their own portfolios of securities, the Funds pursue their investment objectives by investing all of their investable assets in a corresponding portfolio series of Kinetics Portfolios Trust.

The Global Fund is a diversified fund. Diversification does not ensure a profit or protect against loss in a declining market. You should consult the fund’s prospectus for a complete list of risks associated with your investment.

The S&P 500 Index represents an unmanaged, broad-based basket of stocks. It is typically used as a proxy for overall market performance. S&P 500 returns assume that dividends are reinvested. The MSCI All Country World Index is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of developed and emerging markets. Index returns do not include the effect of management fees or expenses. You cannot invest directly in an index. The Bloomberg Barclays US Aggregate Bond Index is a broad-based flagship benchmark that measures the investment grade, US dollar-denominated, fixed-rate taxable bond market. Bloomberg is a trademark and service mark of Bloomberg Finance L.P. Barclays indices are trademarks of Barclays Bank PLC.

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