Kinetics Mutual Funds
First Quarter 2017 Commentaries

The Multi-Disciplinary Income Fund

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Dear Fellow Shareholders,

The majority of fixed income investors have come to accept the fact that returns for that asset class are structurally low, and are likely to remain so for an extended period of time. This is the result of two main factors: i.) central banks depressing risk premiums, and ii.) constrained global growth and inflation expectations. The former factor has resulted in a collective willingness to accept lower returns, while the latter has depressed expectations of future investment opportunities (reinforcing the first). Many investors have chosen to simply accept this lower level of market returns: the iShares iBoxx USD High Yield ETF (HYG) and the iShares U.S. Aggregate Bond ETF (AGG) offer 30 day SEC yields of 5.19% and 2.40%, respectively[1].

The lower credit quality of the high yield index is expected to come with a higher yield as compensation for investors taking on credit risk. But the investment grade index has greater duration (interest rate) risk, with a duration of 5.77 years compared to 3.83 years for the high yield index. This elucidates the basic trade-off in fixed income investing between credit risk and duration risk. However, neither of these indexes appears to offer an attractive absolute return figure. Therefore, it seems more logical for investors to evaluate managers based upon actuarial assumptions and returns relative to those assumptions, as opposed to simply anchoring return expectations to benchmarks that take no consideration of the risks.

But therein lies another issue facing fixed income investors: actuarial assumptions for asset class returns are driven by long-term historical averages. Those returns are unlikely to be repeatable at the present time, given current risk premiums and growth potential (this applies to all risk assets). The median portfolio returns for U.S. public pension plans over the 30 years ended December 31, 2016 was 8.3% (Source: Callan Associates). This was generated in the context of thirty-year annualized total returns for the S&P 500 Index and Barclays Aggregate index of 10.03% and 6.33%, respectively. We can work backwards, and, making the simplifying assumption of no alternative or international asset class exposure, this implies an estimated historical weighting of 53% in equities and 47% in fixed income. Even if we assume a slightly more aggressive "traditional" allocation of 60% stocks and 40% bonds, at the prevailing 2.40% yield for the Barclays Aggregate Index, the required rate of return for stocks would be nearly 10.5% in order to reach a 7.25% return objective. This can be compared to the perpetually optimistic projections of the Federal Reserve Board members, projecting "longer run" real GDP growth of 1.8% and inflation of 2%.

There is a silver lining to this sobering math when considering what should be expected for future portfolio returns: investors have the freedom to forego investment when conditions fail to meet return requirements. Typically, there is a temporary distortion of the risk premium, which normalizes over time, facilitating the investment of reserve capital (cash) at far higher future rates of return. It is entirely possible that long-term average risk premiums going forward will be lower than those of the previous thirty years; however, current levels are highly unlikely to be sustained indefinitely. Thus, in the interest of future returns, we find it prudent to think about current allocation levels in terms of future opportunity.

[1] ETF fact sheets as of March 31, 2017.

Market Note: Active Managers and Central Bank Policies

The weight of financials in the S&P 500 Index was 14.1% as of the end of April 2017, which is more or less where it was at the end of 2007. Then, as now, the equity market and the bond market viewed central banks as benefactors. Will a 100 to 200 basis point increase in interest rates be positive or negative for financials?

Active managers have dramatically underperformed in the past 6 to 7 years because they have avoided the segments of the equity market that have benefited most from extreme central bank policies: the high-P/E stocks, the Amazons, the Facebooks, the biotechs, among others. They have also avoided the financials, in particular, the banks, because of their historically very high valuations, and they have sidestepped the high dividend payers, such as utilities.

On the bond market side, the compensation offered is now very low for what have traditionally been considered higher-risk sectors. For example, the table below displays yields for a selection of iShares bond funds.

iShares Bond Fund Yields

		SEC 30-day Yield	Std. Dev.
CMBS	iShares CMBS ETF	2.79%	2.73%
MBB	iShares MBS ETF	2.02%	2.06%
IEF	iShares 7-10 Year Treasury Bond ETF	2.26%	5.28%
EMHY	iShares Emerging Markets High Yield Bond ETF	5.54%	7.45%
HYG	iShares iBoxx $ High Yield Corporate Bond ETF	5.19%	5.91%

Source: iShares as of 3/31/2017

The iShares MBS ETF (MBB) is comprised of mortgage backed securities, which are Fannie Mae and Freddie Mac bonds. It yields 2.02% for a 7 year maturity, with a standard deviation of 2.06%, versus the iShares 7-10 Year Treasury Bond ETF (IEF) yield of 2.26% and a standard deviation of 5.28%. By way of comparison, as a reminder, the iShares Emerging Markets High Yield Bond ETF (EMHY) has a yield of 5.54%, and the iShares iBoxx High Yield Corporate Bond ETF (HYG) has a yield of 5.19%.

Essentially, if one uses modern portfolio techniques for measuring risk or volatility vis-à-vis return, one effectively views central banks as benefactors and prefers investments in classical dividend payers, and bonds of all sorts, to control variability. One would prefer financial services equities, such as high dividend paying stocks, conventional momentum stocks, private equity, among others—essentially, all the beneficiaries of current Federal Reserve policies—because as far back as various ETF fact sheet volatility statistics go, those beneficiaries historically have low variability and high returns in relation to the low variability. (One understands, of course, that these are not all of the historical volatility statistics, only the recent ones, which reflect the current policy cycle.) One would avoid commodities of all sorts, such as gold, energy, metals, and similar assets. In other words, one would avoid all of the current low valuation investments that exhibit high volatility statistics. For those who do not employ these modern portfolio techniques, including active managers, it is very painful to be this type of equity investor.

In the bond market, it is even more painful to bet against the current environment and its continuation, since the obvious way to do so is via credit- spread- widening trades. In other words, sell short a high-risk asset and go long a lower risk asset and, necessarily, accept a negative carry. Very few investors are willing to engage in a trade such as that.

Fund Positioning

The Fund has two main capital allocation strategies to generate income: option writing and fixed income investment. The flexibility of this approach allows us to direct assets to what we view as the most productive opportunity set at any given time. However, there are times when neither appears particularly attractive. Given the low volatility in the market, the Fund has not been engaged in option writing. But at the same time, as discussed above, fixed income opportunities remain scarce.

As we continue to search for opportunities to deploy additional capital, there are less conventional methods to achieve adequate portfolio income. As noted above, there are two prominent risk considerations in fixed income investing: credit (default) risk, and duration (interest rate) risk. Simplistically speaking, the two threats can be described by economic malaise, stagnation, and perhaps deflation that would cause credit concerns, or the inverse, robust growth, expansion and inflation, which would be harmful to interest rate sensitive investments. Thus, while awaiting superior capital allocation opportunities, it is prudent to attempt to counterbalance these risks within an income oriented allocation.

It has historically been difficult for an individual investor to achieve these counterbalancing exposures while considering efficiency, liquidity and diversification. However, there are highly skilled active managers that offer closed-end fund products that achieve these goals. A Fund holding that is likely to thrive should existing economic conditions be sustained or deteriorate is the DoubleLine Income Solutions Fund. This fund is managed by the esteemed fixed-income manager Jeffrey Gundlach and his team, and offers a current yield of approximately 8.8%. Importantly, and interrelated to the current yield, is the fact that the fund currently trades at approximately a 4% discount to its net asset value – many closed-end funds currently trade well above net asset value, a reflection of yields secured during higher interest rate periods. The fund has a duration of 5.26 years and maintains a significant exposure to emerging market debt, since emerging markets are often beneficiaries of a weaker U.S. economy via a weaker U.S. Dollar, and are showing signs of decoupling economic performance for the developed western economies.

A likely offset to the duration and U.S. Dollar risk exposure of the DoubleLine Income Solutions Fund is the Tortoise MLP Fund Inc. This Fund has a distribution rate of approximately 8.5%, trading at approximately a 1.2% discount to NAV, and is structured to avoid the onerous tax filing requirements associated with direct MLP investing. Its portfolio is primarily composed of midstream MLP assets, which provide energy transportation and storage between the upstream production companies and downstream refiners and retailers. Thus, its business model is similar to that of infrastructure, and is isolated from, but not immune to, energy price volatility, as evidenced in 2016. In fact, the price volatility in 2016 is the source of the current opportunity in the industry, with upside potential, as the broader energy markets stabilize and resume growth. Robust economic growth and any related or unrelated inflationary pressures are likely to directly benefit this industry, providing greater stability to the current cash flow, while adding potential for growth as energy infrastructure is expanded.

This closed-end fund is one of several held in the Fund, and provides attractive positioning within the fixed-income portfolio, to supplement the lower yields generally available across the broader market, as we await superior fixed income opportunities elsewhere.

Multi-Disciplinary Income Fund
Top 10 Fixed Income Holdings (%) as of March 31, 2017

Lamb Weston Holdings, Inc.	6.6%
Penske Automotive Group Inc.	6.5%

Brookfield Residential Properties	6.0%
Ashland Inc.	5.5%
Icahn Enterprises	5.4%
Dish DBS Corp.	5.4%
TRI Pointe Holdings, Inc.	3.6%
Lennar Corporation	3.6%
The Howard Hughes Corporation	2.2%
Murphy Oil Corp.	2.1%

Important Disclosures

You should consider the investment objectives, risks, charges and expenses of the Fund carefully before investing. For a free copy of the most recent Prospectus, which contains this and other information, visit our website at www.kineticsfunds.com or call 1-800-930-3828. You should read the Prospectus carefully before you invest. Performance data quoted represents past performance, which does not guarantee future results. Investment return and principal value of an investment may fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Current performance may be lower or higher than the performance data quoted. Please visit http://kineticsfunds.com/ for the most recent month-end performance data.

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

The opinions expressed are not intended to be a forecast of future events, or a guarantee of future results, or investment advice. Additionally, the views expressed herein may change at any time subsequent to the date of issue hereof.

The Fund invests in options and other derivative instruments, which are specialized activities and entail greater than ordinary investment risks, including that they may be illiquid, difficult to price and leveraged so that small changes may produce disproportionate losses. Additionally, the Fund may invest in debt securities. Investments in debt securities rated below investment grade (i.e., junk bonds) are subject to increased risks. International investing presents special risks including currency exchange fluctuation, government regulations, and the potential for political and economic instability. Non-investment grade debt securities (i.e., junk bonds) are subject to greater credit risk, price volatility and risk of loss than are investment grade securities. Further, options contain special risks, including the imperfect correlation between the value of the option and the value of the underlying asset.

The Kinetics Multi-Disciplinary Income Fund is classified as 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.

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 Bloomberg Barclays US Corporate High Yield Bond Index measures the USD-denominated, high yield, fixed-rate corporate bond market. 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. The CBOE Volatility Index® (VIX® Index®) is a key measure of market expectations of near-term volatility conveyed by S&P 500 stock index option prices. The S&P 500 Index represents an unmanaged, broad-based basket of stocks. It is typically used as a proxy for overall market performance. You cannot invest directly in an index. The iShares 20+ Year Treasury Bond ETF seeks to track the investment results of an index composed of U.S. Treasury bonds with remaining maturities greater than twenty years. The iShares Core High Dividend ETF (HDV) seeks to track the investment results of an index composed of relatively high dividend paying U.S. equities. iShares is property of Blackrock. Index returns assume that dividends are reinvested and do not include management fees or expenses. You cannot invest directly in an index.

You will be charged a redemption fee of 2.0% of the net amount of the redemption if you redeem or exchange your shares 30 days or less after you purchase them.

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