# Kinetics Mutual Funds
# Second Quarter 2017 Commentaries

## The Paradigm Fund

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Dear Fellow Shareholders,

U.S. equity markets ended June with generally modest gains, capping off a very strong first half of the year. Broad market indexes are on track for nearly 20% annual gains this year if the performance is maintained, while technology and growth stocks are on pace for considerably higher returns. We question not only the sustainability of the gains, but also the fundamental justification for the gains achieved thus far. The entire financial asset complex continues to be overly influenced by low interest rates and plentiful capital, resulting in abnormally high asset prices and, consequently, low prospective long-term returns. Evidence of the interest rate dynamic is apparent in June market returns: the U.S. 10 Year Treasury ended the month with a yield to maturity of 2.27%, or approximately 7 basis points higher than at the outset of the month. However, the yield reached a nadir of 2.13% earlier in the month, before reversing sharply, in sympathy with European sovereign bonds.

Modest as the sovereign yield shift may appear in absolute terms, the resultant June returns for the most interest rate sensitive sectors in the U.S. market – utilities, telecommunications and consumer staples – were -2.91%, -2.98% and -2.53%, respectively. These sectors have long been considered safe havens, supported by high dividend payouts and share repurchases. These metrics have largely veiled anemic revenue growth and increasing pressure on margins. The future direction of global interest rates remains highly uncertain, and an argument can be made that they will remain structurally low for an extended period of time. In all likelihood, the current valuations will be revised considerably lower, based on higher interest rates and/ or lower growth.

The current market is experiencing a valuation aberration that is unlikely to be sustained indefinitely, although indexation and passive investing has perpetuated this pattern well beyond most expectations. It is all but certain that indexation will permanently maintain a portion of recent market share gains, but a disruption to the current fund flows from active to passive management is likely to result in a pricing reversion. Prospects for profits from the continuation of this trend, or the reversal of it, are highly speculative. A more prudent approach for risk averse investors is to simply avoid the inflated index securities, rather than trying to predict or exploit the timing of a shift in the trend.

The investment strategy employed by the Fund is structured to find quality companies that are trading at quantifiably low valuations. In the world of indexes, many companies that are trading at quantifiably low valuations fail to meet our business quality criteria. Similarly, many of the quality businesses in the indexes fail to meet our valuation criteria. There is an abundance of professional investors using quantitative screens for such criteria, and even computer algorithms that seek to exploit anomalies in the valuation patterns. However, our definition of quantifiably low valuation is often not consistent with reported figures that can be effortlessly unearthed by computers (whether human directed or not).

For instance, we believe that Texas Pacific Land Trust might be amongst the cheapest securities that we have ever encountered in a non-crisis environment. A computer screen will show that the price to earnings ratio is nearly 55x and the price to book ratio is 56x. The earnings and the book value figures similarly fail to capture the dormant earnings power of the company from a multi-billion dollar land asset that is held at zero value, in accordance with GAAP (generally accepted accounting principles). Now, it might be thought that a growth screen could capture the company given its dramatic growth in royalty and easement revenue. However, optically, it appears that its revenue declined approximately 25% last year because the company had a large one-time land sale in 2015 that amounted to nearly a quarter of its total revenue. Thus, Texas Pacific Land Trust is in the purgatory of stock screens, undetectable by even the "smart-beta" factor ETFs.

There is a similar dynamic at play with Howard Hughes Corporation, a prominent real estate development company that is trading at 1.87x book value and over 80x trailing earnings. A stock screen might consider 1.87x book value to be high for a real estate company, but a balance sheet examination reveals that much of the book value is based on raw land held at the lower of fair value or cost in 2010 (the date of the spin-off) plus capital improvements, less accumulated depreciation. Thus, book value is a conservative estimate of raw land values in 2010, adjusted for improvements and depreciation. This metric fails to capture the dramatic dormant land bank value, the improvements in the real estate portfolio or the value added by recent developments. To the same end, many of the properties are still becoming "stabilized" with tenants and rents, such that depreciation and fixed costs negate much of the current earnings stream. Howard Hughes is alongside Texas Pacific Land Trust in the index/stock screen discard pile.

These are tangible examples of unduly inexpensive securities in the Fund that defy conventional analysis and that are scarcely owned by indexes and conventional asset managers alike. We believe that this exemplifies the value of a truly active strategy, and believe that the Fund will benefit as a result.

| Paradigm Fund<br>**Top 10 Holdings (%) as of June 30, 2017** | |
|---|---|
| Texas Pacific Land Trust | 23.9% |
| The Howard Hughes Corporation | 11.8% |
| Icahn Enterprises LP | 5.1% |
| Brookfield Asset Management Inc. - Class A | 4.8% |
| Liberty Media Corp.-Liberty SiriusXM - Class C | 3.5% |
| Live Nation Entertainment, Inc. | 3.3% |
| Onex Corporation | 2.8% |
| The Wendy's Company | 2.6% |
| EchoStar Corporation - Class A | 2.5% |
| Liberty Broadband Corporation - Series C | 2.5% |

**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 www.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 Paradigm Fund is classified as a non-diversified fund. Therefore, the value of its shares may fluctuate more than shares invested in a broader range of industries. In a non-diversified fund, more of the Fund's assets may be concentrated in the common stock of any single issuer, which may make the value of the Fund's shares more susceptible to certain risks than shares of a diversified mutual fund.

In addition, investing in foreign securities involves more risk than just U.S. investments, including the risk of currency fluctuations, political and economic instability and differences in financial reporting standards. There may also be heightened risks investing in non-investment grade debt securities and the use of options. There are also risks associated with investing in small and medium sized companies. Non-investment grade debt securities, i.e., junk bonds, are subject to greater credit risk, price volatility and risk of loss than investment grade securities. Options contain special risks including the imperfect correlation between the value of the option and the value of the underlying asset. Please refer to the Fund's prospectus for a complete list of risks and fees.

The S&P 500® Index represents an unmanaged, broad-based basket of stocks. It is typically used as a proxy for overall market performance. Index returns assume that dividends are reinvested and do not include the effect of management fees or expenses. You cannot invest directly in an index.

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

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.

Distributor: Kinetics Funds Distributor LLC is an affiliate of Kinetics Asset Management LLC, and is not an affiliate of Kinetics Mutual Funds, Inc.