# Kinetics Mutual Funds
# First Quarter 2018 Commentaries

## The Alternative Income Fund

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Dear Fellow Shareholders,

The Alternative Income Fund's (the "Fund") strategy seeks to provide an efficient source of income alongside traditional longer-term fixed income and broader yield-oriented strategies while, at the same time, beneficially diversifying risk exposures. Some of the strategy's intended benefits include:

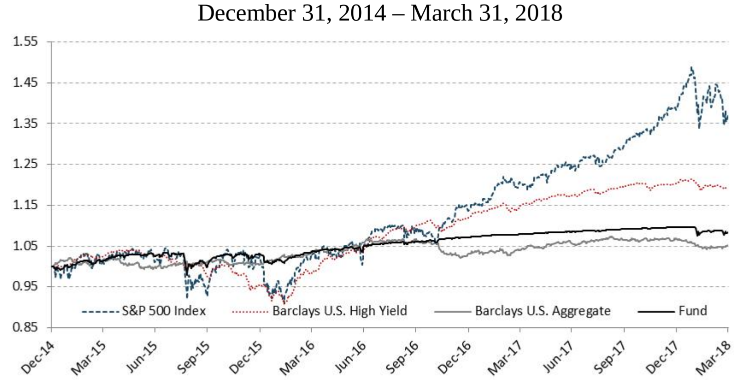
a. *A reasonable rate of return; that is, income in excess of short-to-intermediate-term bonds.*
b. *Long-term volatility levels more consistent with bond markets than with equity markets.*
c. *Avoidance of duration, convexity[1], and reinvestment risks inherent in traditional long-term bonds.*
d. *Minimal or negative correlation with traditional bond portfolios.*
e. *Liquidity, transparency, and cost effectiveness, each of which has proven to be particularly important in a low-return world.*

The Fund intends to generate returns from a conservative, short duration bond portfolio, and from the time decay of out-of-the-money put option premiums. To this end, the Fund implements a two-part investment strategy focused on generating current income and gains in excess of traditional short duration, investment grade, fixed income indexes, yet, with similar volatility.

Part 1: A base strategy invests primarily in a diversified portfolio of short-term, investment grade bonds. Bond exposures seek to emphasize liquidity, diversification, and lower interest rate or duration risk (1-3 years).

Part 2: An equity put writing option strategy seeks to supplement bond portfolio income via the collection of option premiums. Option exposures are allocated broadly across quality companies and/or exchange-traded funds ("ETFs") offering similar exposures.

Cumulative Returns
December 31, 2014 – March 31, 2018




*Source: Bloomberg LP*

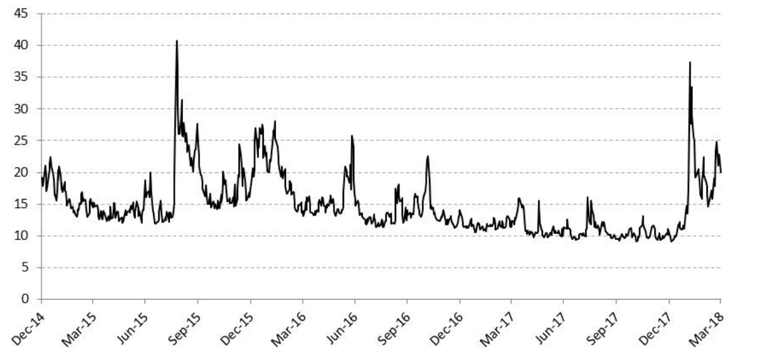
The Alternative Income Fund No Load Class inception date is 6/29/07. Figures include changes in principal value, reinvested dividends and capital gain distributions. Performance data quoted represents past performance and does not guarantee future results. Investment return and principal value will vary, and shares may be worth more or less at redemption than at original purchase. Call 1-800-930-3828 or visit us at www.kineticsfunds.com for the most recent month-end performance data. Current performance may be lower or higher than the performance data quoted. Performance data does not reflect the deduction of sales load or fee which, if reflected, would reduce the performance quoted.

[1] Convexity is a measure of the rate of change of duration as interest rates change.

U.S. equity market volatility increased significantly during the first quarter of 2018. The net result for the S&P 500 Index ("S&P 500") was a first quarter loss of -0.76%, compared to a fourth quarter gain of 6.64%. Investment grade bonds, as measured by the Barclays U.S. Aggregate Bond Index ("U.S. Agg."), realized a first quarter loss of -1.46%, compared to a fourth quarter gain of 0.39%. The Barclays U.S. High Yield Index ("High Yield") recorded a first quarter loss of -0.86%, compared to a fourth quarter gain of 0.47%. And the Barclays 1-3 Year Credit Index ("1-3 Year Credit") realized a first quarter loss of -0.31%, compared to a fourth quarter loss of -0.07%.

S&P 500 Index options implied volatility, defined as the CBOE S&P 500 Implied Volatility Index ("VIX"), averaged approximately 17 during the first quarter, compared to an average of approximately 10 during the fourth quarter. The collection of higher option premiums serves to protect against losses in the event of market declines and provides yield during periods of flat or rising markets. Much like an insurance business, the Fund will underwrite equity risk in exchange for a deductible, i.e., out-of-the-money options, and cash premiums, i.e., option premiums.

*CBOE S&P 500 Volatility Index ("VIX")*
*December 31, 2014 – March 31, 2018*




*Source: Bloomberg LP*

The Fund continued to perform as designed by experiencing significantly less volatility than U.S. equity market indexes and providing a return profile that was differentiated from that of U.S. bond market indexes. After a fourth quarter gain of 0.36%, the Fund realized a first quarter loss of -1.01%.

**Fund Positioning**

During the first quarter, we continued our policy of actively covering higher delta options, i.e., equity sensitive option positions. The Fund's overall option exposure was 40%, compared to 41% at the end of 2017. While the reduction in the Fund's aggregate notional exposure has continued to help mitigate the additional risks associated with short-term index options, the reduced exposure has limited the Fund's participation during the recent market advance. Over time, we believe the higher return potential of index options will result in a higher total return, with only a modest increase in the Fund's total return volatility.

We have allowed the Fund's U.S. corporate bond exposure to mature and have replaced it with cash and short-term U.S. Treasuries. In general, we believe we are not being adequately compensated for assuming credit risk at current levels and are satisfied with slowly increasing the Fund's collateral portfolio yield as the Federal Reserve moves to normalize rates. Over time, we expect portfolio duration to remain between approximately 0.75 and 1.25 years.

**Market Note**

The Fund's objective was established at the beginning of 2013 with the goal of providing investors with a sufficient yield on short-term maturity deposits.[2] Investors have historically relied upon money market funds to provide short-term income. However, many of these funds experienced liquidity shocks during 2008 and 2009, impairing investor confidence. While subsequent regulations have addressed deficiencies in the money market fund market, by 2013, the yields offered on 180-day commercial paper, 1-month repurchase agreements, and 1-year U.S. Treasuries ranged from 0.15% to 0.30% (note that each of these benchmarks was in the range of 5% at various points during 2007). This was, of course, driven by the decline in the Federal Funds rate to less than 0.20%, forcing investors to reckon with a negative real yield on short-term deposits. While the economy and banking system had recovered substantially by 2013, interest rates remained well below what we would

[2] Prior to 2013, the Fund had a different name and objective.

consider a competitive market rate. It was not until very recently that these instruments approached a positive real rate of return.

The Fund addresses this dilemma with a two-pronged approach: short-term put writing designed to supplement income from short-term credit investments. The result has been a five-year total return exceeding that of both the Barclays 1-3 Year Credit Index and the Barclays U.S. Aggregate Bond Index. These indexes both hold high-quality, investment-grade assets; however, the former produced negative real returns for much of the past five years, while the latter has much higher interest rate sensitivity. Options premia have enabled the Fund to enhance the short-term yield on 1-3 year credit instruments, achieving a positive spread relative to inflation.

In order to limit volatility and reduce capital impairment risk, option writing is evaluated continuously and viewed in relation to the prevailing implied volatility environment. Option writing accepts equity market risk, even though the return streams are income oriented. Therefore, an assessment must be made regarding the valuation of the market, coupled with the premium generated from option writing (based on implied volatility). To use a simple example, take a one-year, at-the-money option (i.e., underwriting any market decline) that offers a premium yield of 6%. In the event the market rises or remains flat, the premium yield of 6% is earned, while any decline up to 6% reduces the realized yield. However, any loss in excess of 6% is at the expense of the option seller. While markets remain near all-time highs, during the first quarter, the S&P 500 Index declined over 10% from the January high. This decline, if realized, places the option seller at a considerable loss relative to the prospect of recapturing this income over the next year.

A method to mitigate this risk—when equity valuation and option premiums are not attractive—is to write short term options (one month) that are below current market levels (out of the money). While this produces lower yields compared to longer contracts, it also provides less variability. A second method is to limit the amount of capital dedicated to option writing when implied volatility levels are abnormally low and do not offer sufficient compensation in exchange for the equity risk being underwritten. More recently, the Fund has consistently had far less option exposure relative to its capital base in an attempt to mitigate the risk associated with the prevailing high equity valuation, low option premium environment.

While various strategies seek to systematically write options or earn volatility premia, the imbedded risk of these strategies was exposed in February as the CBOE Volatility Index rose over four-fold in the course of a month. As a result, many aggressive volatility strategies suffered severe losses, while others realized losses in excess of an entire year's worth of income. We continue to run a conservative strategy, and underlying conditions remain unaccommodating to greater option exposure. Excess liquidity and short-term positions will enable the Fund to allocate greater capital when these conditions change.

**Important Risk 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 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. The Fund may rely on SEC orders that permit it to invest greater than 5% of its total assets in the securities of other investment companies, some of which may be ETFs. As a shareholder in an ETF, the Fund will bear its pro rata portion of an ETF's expenses, including advisory fees, in addition to its own expenses. The Fund may invest in debt securities. Investments in debt securities rated below investment grade (i.e., junk bonds) are subject to increased risks.

The Alternative Income 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. You should consult the Fund's prospectus for a complete list of risks associated with your investment.

The Alternative Income Fund No Load Class inception date is 6/29/07. Performance prior to 1/1/13 reflects the Fund's prior investment objective and restrictions and may not be indicative of the Fund's prospective results.

Unlike other investment companies that directly acquire and manage their own portfolios of securities, the Fund pursues its investment objectives by investing all of their 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.

The *S&P 500® Index* represents an unmanaged, broad-based basket of stocks. It is typically used as a proxy for overall market performance. An investor cannot invest directly in an index.

The *CBOE S&P 500 Volatility Index* is a measure of market expectations of near-term volatility conveyed by S&P 500 stock index option prices.

The *Barclays 1-3 US Credit Bond Index* is composed of investment grade United States credit securities with a maturity between one and three years. 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.

<u>*Distributor*</u>: Kinetics Funds Distributor LLC is an affiliate of Kinetics Asset Management LLC and is not an affiliate of Kinetics Mutual Funds, Inc.