Kinetics Mutual Funds
First Quarter 2018 Commentaries

The Paradigm Fund

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Dear Fellow Shareholders,

The first quarter of this year has been a reminder to investors that investments in stocks and bonds carry risks, and public markets can be highly volatile. In all likelihood, the message has yet to be heeded by most investors, as the losses from January peak levels are unsettling, but year to date losses remain modest. Sentiment remains quite high, consistent with record high levels of margin debt and equity exposure, coupled with record low cash balances. However, it appears that the preconditions for the past nine years of market returns, equating to a staggering 19% annualized gain from March 2009 lows, are utterly nonexistent. These include, most notably and importantly, a low equity valuation multiple upon normalized earnings, coupled with markedly higher risk-free interest rates and a cyclically depressed economy recovering from the global financial crisis. However, trailing ten year market returns currently amount to nearly 10%, from early 2007, prior to the market decline. Consider that S&P 500 Index earnings have grown by 32% over this ten year period (2.8% annually), despite a 160% total market return since early 2007. Solving for the unknown variable, valuations are markedly higher.

We have long opined on the potentially destabilizing effect of the rapid growth of passive investment vehicles. The first quarter of this year supports this thesis, as volatility (CBOE Volatility Index levels) surged from a January low of slightly greater than 9, to a closing high of over 37 in February. The corresponding decline in equity markets amounted to over 6% from the end of January. However, market participants cited volatility-targeting investment strategies for the suppressed volatility, and the “unwind” of losing positions as the reason for the anomalous spike. Suffice it to say that there are parallels between funds that are structurally short volatility, and funds that are structurally long equity, even though the latter are many magnitudes larger in size. These same market participants might cite quantitative easing for suppressed interest rates, and the second derivative of higher investor exposure to equity as a result. The question will be: should the accommodative backdrop cease to exist, where is an equilibrium level for equity markets?

To this end, the question of risk compensation must be revisited. Equity investing is inherently risky, as company earnings may decline, growth may stall, or funding costs may rise. This is why, historically, equity investors have received a risk premium compared to debt investors. Long-term equity advocates, Warren Buffett amongst them, believe that with a sufficiently long investment time horizon, equity investors will invariably earn higher rates of return commensurate with the risk. While historical returns validate this thesis in the United States, those returns have been supported by declining interest rates, higher historical equity risk premiums, and a dramatic increase in the work force and productivity over the past forty years. All four of these variables are now inverted: we now observe structurally low interest rates, low equity risk premiums (in absolute terms), declining workforce participation rates, and working age population demographics. Productivity is a bit more complex calculation; however, post-crisis the 2007/2008 liquidity crisis, average growth has been materially lower than during the previous two expansions.

Our conclusion is that an index-based equity exposure at current levels must be justified by the assumptions of i.) sustained modest economic growth, ii.) sustained low inflation, iii.) sustained low interest rates, and, most importantly, iv.) sustained low equity risk premiums. Should any of these variables alter the market narrative and sentiment, the volatility and equity price movements in the first quarter may be indicative of what the future holds.

The Fund has adapted to this investment environment through increased concentration in idiosyncratic companies, with return profiles that we believe are not overly dependent upon any of the four factors listed above. While the results have been encouraging, we believe the true benefits to be realized when broader markets cease their incessant upward trajectory, and greater discretion is given to valuations and risk. At the very least, the portfolio should have limited "co-dependence" to broader benchmarks, which should translate into highly differentiated returns over time.

Paradigm Fund **Top 10 Holdings (%) as of March 31, 2018**	
Texas Pacific Land Trust	34.3%
The Howard Hughes Corporation	11.0%
Icahn Enterprises LP	4.5%
Brookfield Asset Management Inc. - Class A	4.0%
Cboe Global Markets, Inc.	2.8%
Liberty Media Corp.-Liberty SiriusXM - Class C	2.8%
Live Nation Entertainment, Inc.	2.7%
Markel Corporation	2.3%
Onex Corporation	2.1%
Franco-Nevada Corporation	2.0%

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.

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.

The Fund holds investments that provide exposure to bitcoin. The value of bitcoins is determined by the supply of and demand for bitcoins in the global market for the trading of bitcoins, which consists of transactions on electronic bitcoin exchanges ("Bitcoin Exchanges"). Pricing on Bitcoin Exchanges and other venues can be volatile and can adversely affect the value of the bitcoin. Currently, there is relatively small use of bitcoins in the retail and commercial marketplace in comparison to the relatively large use of bitcoins by speculators, thus contributing to price volatility that could adversely affect a portfolio's direct or indirect investments in bitcoin. Bitcoin transactions are irrevocable, and stolen or incorrectly transferred bitcoins may be irretrievable. As a result, any incorrectly executed bitcoin transactions could adversely affect the value of a portfolio's direct or indirect investment in bitcoin. Only investors who can appreciate the risks associated with an investment should invest in cryptocurrencies or products that offer cryptocurrency exposure. As with all investments, investors should consult with their investment, legal and tax professionals before investing, as you may lose money.

Please refer to the Fund's prospectus for a complete list of risks and fees.

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.

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.

The CBOE Volatility Index is a calculation designed to produce a measure of constant, 30-day expected volatility of the U.S. stock market, derived from real-time, mid-quote prices of S&P 500® Index call and put options.

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.

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