



**Kinetics Mutual Funds
Third Quarter 2023 Commentaries**



The Global Fund

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Dear Fellow Shareholders,

We believe energy assets are uniquely undervalued, despite strong long-term supply and demand fundamentals—and the Fund is structured accordingly.

Global energy capital expenditures for exploration and production peaked in 2014 at nearly \$700 billion. U.S. crude oil prices have averaged over \$90 per barrel for the five-year period leading into 2014, and companies have been scavenging the globe for reserves to replace production. In 2015, the market came to appreciate the full magnitude of shale oil production (a new and transformative technology) and the accompanying oversupply. This promptly sparked a reaction by OPEC nations to fight for market share—by further increasing supply—in an attempt to force marginal shale producers out of business.

The resultant eight-year collapse in global energy capital expenditures, to approximately \$410 billion, was a drop of over 40%. Myriad factors drove this trend, including lower upfront development costs for shale drilling and exploration which, for a time, induced financially marginal players to continue to maintain volumes in order to generate needed cash flow, thereby, exacerbating the oversupply situation.

However, this also coincided with investors beginning to avoid energy investments, both for fundamental and environmental policy reasons. The withdrawal of capital both from energy sector equities (leading to collapsing valuations) and from credit extension, caused companies' cost of capital to soar. This occurred right around the time it became far more difficult (and expensive) to find and extract critical energy worldwide. Capital expenditures in 2022 totaled approximately \$500 billion, or about 30% below the 2014 peak in nominal terms, but 60% below the peak in inflation-adjusted real terms—which is a real-world issue, since it applies to everything from capital equipment to labor and insurance costs. This is despite U.S. crude oil prices averaging a healthy \$94 per barrel in 2022.

The current environment for energy investing is almost the polar opposite of what it was in 2014. Capital is scarce, shale development is mature and decelerating, and inventories are low and declining. One view of the structural situation: in the 34 years since January 1990, U.S. stocks of crude oil and petroleum stocks, *excluding* the Strategic Petroleum Reserve, are 27% higher, but U.S. nominal GDP is 381% higher and the U.S. population is 39% higher; and total stocks, including the SPR, are 2.5% higher.

Perhaps most critical is the "OPEC Factor." As noted earlier, the 2014 market cycle forced OPEC—led by Saudi Arabia—to fight for market share in order to combat the growth of U.S. shale production. OPEC produces approximately 40% of global oil, but actively manages production to "balance the market." The lack of non-OPEC investment and the slowing growth of shale have facilitated OPEC's decision to withdraw production from the market recently. This was related to both unexpected supply—provided by the release of over 300 million barrels from the U.S. Strategic Petroleum Reserve—and to a weaker-than-expected economic recovery in China.



In any event, instead of fighting for market share, OPEC is now in a position to manage supply. Yet, there has been a tepid response to such a strategy from non-OPEC producers, who have not responded to higher price support with higher production. We believe this will result in a higher floor for energy prices going forward, although we also expect OPEC to prevent prices from surging to levels that would impair aggregate demand. This could catalyze a step-function difference compared to the historical cyclicity of oil prices, hence, energy company profits, which has, in turn, resulted in a very heavy discount rate (low valuations) being applied to energy companies.

Amidst all this, our investment focus is on companies with several traits that have proven to be extremely profitable for them as businesses, despite the virtual decade-long depression in the energy sector, and remunerative as equity investments, as well: vast high-quality reserves; capital-light balance sheets with limited or near-zero capital expenditure and external funding requirements; strong operational jurisdiction; robust operator profiles; and sustainable profit margins. These criteria invariably lead us to invest in energy royalty companies with extensive acreage positions, and specifically, North American royalty companies.

This thesis appears to have been recently validated by ExxonMobil's agreement to acquire Pioneer Natural Resources for approximately \$60 billion, followed by Chevron Corporation's decision to purchase Hess Corporation for \$53 billion this past October. The acquired companies have large U.S. shale positions with long reserve lives (Hess also has a material position in Guyana). Furthermore, the acquirers logically determined that incumbent reserves are more valuable than new ones, which require significant capital expenditures.

Perhaps the best opportunities, in our opinion, are among royalty companies. Texas Pacific Land Corp. and PrairieSky Royalty Ltd. are the largest public royalty companies in the U.S. and Canada. Permian Basin Royalty Trust is located adjacent to Texas Pacific's acreage and is uniquely positioned for sustained production growth. The royalty business model is essentially a cash flow stream based on gross production by third-party operators, which is not subject to operating costs or capital expenditures.

As such, the EBITDA¹ margins for these companies averaged over 90% in 2023. In general, we are not particularly fond of utilizing EBITDA, as it is the most generous definition of cash flow and is often applied to highly leveraged and/or capital-intensive companies with substantial capital expenditure requirements that generate little or negative free cash flow. However, we believe that EBITDA is indicative of the profitability of royalty companies, given that, being free of claims for interest expense and capital expenditures, free cash flow is generally simply an after-tax EBITDA (i.e., 70% of revenue).

Due to their capital efficient business models, the analysis of these companies is primarily related to the volume of production, price of the commodities, and reserve life. Texas Pacific and PrairieSky reported daily volume of 24,900 barrels and 23,500 barrels in the second quarter of this year, respectively, which represented year-to-date growth of approximately 17% and -9%. Permian Basin Royalty Trust reports monthly, and June volumes were approximately 7,770 barrels per day, or 18% year-to-date growth.

The U.S. royalty companies outperformed aggregate U.S. production growth of approximately 6%, while the Canadian company experienced sequential declines related to this summer's wildfires. Critically, all three companies have a strong line of sight into sustained growth for years to come, based on operator activities.

¹ Earnings before interest, taxes, depreciation, and amortization.



The trajectories of these companies' volumes stand in contrast to most established conventional energy portfolios and indexes, which we expect will be growth-challenged, in spite of high energy prices. That is why they comprise such a large proportion of our holdings.

Global Fund Top 10 Holdings (%) as of September 30, 2023	
Texas Pacific Land Corp	31.3%
Grayscale Bitcoin Trust	17.6%
Permian Basin Royalty Trust	5.3%
GAMCO Investors, Inc. - Class A	3.3%
Sandstorm Gold Ltd.	3.0%
Associated Capital Group, Inc. - Class A	2.9%
Mesabi Trust	2.5%
PrairieSky Royalty Ltd	2.5%
Civeo Corp.	2.3%
Clarkson plc	2.2%



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 <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.

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.

The Fund holds investments that provide exposure to bitcoin. The value of bitcoin is determined by the supply of and demand for bitcoin in the global market for the trading of bitcoin, 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 bitcoin 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.

Murray Stahl is member of the Board of Directors of Texas Pacific Land Corporation ("TPL"), a large holding in certain client accounts and funds managed by Horizon Kinetics Asset Management LLC ("HKAM"). Officers, directors, and employees may also hold substantial amounts of TPL, both directly and indirectly, in their personal accounts. HKAM seeks to address potential conflicts of interest through the adoption of various policies and procedures, which include both electronic and physical safeguards. All personal and proprietary trading is also subject to HKAM's Code of Ethics, and is monitored by the firm's Legal and Compliance Department.

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. 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.

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

The Global Fund is a diversified fund. Diversification does not ensure a profit or protect against loss in a declining market.

The iShares MSCI ACWI ETF seeks to track the investment results of an index composed of large and mid-capitalization developed and emerging market equities. The iShares MSCI ACWI ex U.S. ETF seeks to track the investment results of an index composed of large- and mid-capitalization non-U.S. equities. iShares is property of BlackRock.

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.

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