Kinetics Mutual Funds
Second Quarter 2018 Commentaries

The Small Cap Opportunities Fund

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Dear Fellow Shareholders,

Investments in small capitalization stocks have become increasingly popular in recent months, but not for the reasons that these companies typically come into investor favor. Broader measures of small capitalization stocks (indexes) have materially outperformed larger peer companies over extended time periods. An academic approach would posit that this dynamic holds because small capitalization stocks carry more risk, and investors accrue a higher return for the higher risk acceptance over time. Deeply flawed and contradictory as this line of logic may be, it is a generally accepted premise by many investors. Thus, it might be perplexing that many top down asset allocators, who follow the theories that form the basis of this logic, are advocating small capitalization investing today as a lower risk equity investment.

This popular narrative is largely based upon the belief that larger multinational companies are more sensitive to global trade, and hence, vulnerable to ongoing developments regarding global tariffs. Recall that not very long ago, small capitalization companies were theorized to be the primary beneficiaries of a lower federal tax rate, as larger companies were already paying far lower than statutory tax rates due to income earned in foreign jurisdictions. This is based on the fact that companies in the S&P 500 Index ("S&P 500") earn approximately 33% of their revenue from outside of the United States, while small cap companies earn closer to 20%. While this argument may have merit, marginal as it may be, it also fails to consider the companies' vulnerability to the costs of imported goods, which are certain to rise with tariffs on certain raw materials. Derivative to this, smaller companies may have less ability to establish domestic supply chains or internalize resource procurement – this is not a simple analysis.

The argument of a "safety" trade loses even more credibility when one considers the most important factor in investment risk: valuation. Small cap companies (as represented by the Russell 2000® Index) are trading at approximately 26x estimated forward earnings, compared to approximately 18x for the companies within the S&P 500. This includes the full benefits of the Tax Cuts and Jobs Act of 2017; hence, annual growth rates will no longer be compared to a lower bar beginning in the 1st quarter of 2019. Furthermore, while these indexes both exclude negative earnings from the reported calculation, this is far more important for smaller companies that are more prone to reporting accounting losses.

In any event, Morningstar reported that small cap dedicated funds and ETFs attracted over $4 billion in fund flows during May and June of this year, while broader U.S. equity funds experienced outflows. This is surely a meaningful contributing factor to the relative outperformance of small cap stocks on a year-to-date and full year basis. However, we view this with caution, as emerging market stocks became a popular allocation in early 2017 based on similar faulty logic. Fund flows resulted in nearly 2,000 basis points of trailing twelve month outperformance over the S&P 500 Index through late January of this year, only to subsequently relinquish all of their relative performance as of this writing. It is of greater importance that both emerging markets and the S&P 500 are up over 25% since the beginning of 2017, with small caps only slightly behind, while global GDP growth was approximately 3% over this period.

Beneath the veil of top down allocations to small capitalization stocks, we continue to identify unique business models that are building value for shareholders. The valuation gap between certain small cap companies, and larger, yet still small cap peers that are in major indexes is widening. We believe that this is a function of continued passive fund flows, but also an early manifestation of MiFID II regulations in Europe. A predictable secondary result of these regulations has been a substantial decline in the investment research industry across the European Union. While U.S. markets aren't subject to these measures, many of the largest U.S. managers have large operations and product distribution in Europe. As a result, preliminary indications of a similar market bifurcation are apparent domestically. This will likely be a boon to dedicated fundamental small capitalization investors, but largely irrelevant to index investors.

To summarize, we are very conscious of the factors that we believe are driving asset prices, and sensitive to not only these prices, but also to the fundamental backdrop that underpins these companies. We continue to believe that the current stage of the investment/economic cycle is not conducive to seeking higher risk exposure, and are acutely aware of what actual risks are embedded in various investments. To this end, we are comfortable with what we own, what we don't own, and the backlog of potential future investments.

Small Cap Opportunities Fund **Top 10 Holdings (%) as of June 30, 2018**	
Texas Pacific Land Trust	27.8%
Icahn Enterprises LP	7.7%
Dream Unlimited Corp. - Class A	5.4%
The Howard Hughes Corporation	4.4%
Civeo Corporation	4.2%
The Wendy's Company	2.9%
Live Nation Entertainment, Inc.	2.7%
Associated Capital Group, Inc. - Class A	2.1%
Onex Corporation	1.8%
Rubis SCA	1.2%

Important Risk Disclosures

You should consider the investment objectives, risks, charges and expenses of the Small Cap Opportunities 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 Small Cap Opportunities 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.

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. Further, 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.
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. The S&P SmallCap 600® Index measures the small-cap segment of the U.S. equity market. The index is designed to track companies that meet specific inclusion criteria to ensure that they are liquid and financially viable. Index returns assume that dividends are reinvested and do not include the effect of management fees or expenses.

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 Russell 2000 index is an index measuring the performance of approximately 2,000 small-cap companies in the Russell 3000 Index, which is made up of 3,000 of the biggest U.S. stocks.

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.

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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