Kinetics Mutual Funds

Second Quarter 2018 - Conference Call with Peter Doyle

July 11, 2018

Important Risk Disclosures:

Kinetics Asset Management LLC ("Kinetics") is pleased to announce that on July 11, 2018, Peter Doyle, Co-Founder of Kinetics and Senior Portfolio Manager for Kinetics Mutual Funds, Inc., hosted a conference call to financial advisors. The transcript set forth below is intended to provide a summary of Mr. Doyle's remarks.

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Chris Bell: Thank you, everyone for spending some time with us today. I'd like to start off by just mentioning that if you want more information on our mutual funds or more information on Horizon Kinetics in general, you can go to www.kineticsfunds.com or www.horizonkinetics.com. Also, if you go to SoundCloud—it's an app that you can download to your phone—you can search for Horizon Kinetics, and we have a variety of podcasts that are now available there. Also, you can follow us on Twitter. Our handle is @horizonkinetics. If you search for that, you'll see some of our latest white papers. And then, of course, you can always call our Marketing Department at 914-703-6950.

Performance in the quarter has been very good as certain of our funds are outperforming their primary benchmarks by multiple hundreds of basis points. And, as some of you may have seen, James Davolos, who is on the call today, was on the front page of the Investment section of *The Wall Street Journal* yesterday, cited as being one of the portfolio managers for the number one mutual fund for the year. With that, I'd like to turn it over to Peter Doyle, President and co-founder of Kinetics Mutual Funds.

Peter Doyle: Thank you, Chris, and good morning to everyone. My remarks are really going to be an amalgamation of comments that we have made in the past, a kind of variation on Steve Bregman's first quarter commentary. As Chris pointed out, if you go on our website, I think you would find those comments very enlightening and really an excellent job regarding ETFs and the potential for both a melt-up and a meltdown, due to the way ETFs are being used in the marketplace. Then, of course, there are Murray Stahl's writings. So, let's start off with the issue of debt and the various issues pertaining to debt. As of this moment, the entire outstanding debt of the United States is approximately $70 trillion. Globally, the number hovers around $250 trillion. The overwhelming preponderance of this debt earns a very low rate of return or a negative real rate of return, and that is not a situation that can endure. Investors are just not going to tolerate such results.

In fact, I live it personally; I have a fair amount of money in fixed income or closed-end funds, and between paying the government's taxes and the inflation rate that we have, I'm probably getting at best a modest real rate of return—maybe not even a modest rate of return. Just as an example, the current 10-Year Treasury Note is yielding about 2.85%. Let's say you're in a 35% federal tax bracket; you take away 1%, that leaves you with a net return—and that's probably a pretty generous net return—of 1.85%. I think the inflation rate just came out this morning. It's at about 2.8%. So your real rate of return is negative.

Now, if you were buying the 10-Year Treasury two years ago, yielding 1.36% in July of 2016, it was pretty obvious that your returns were going to be poor; and we said as much at that time. Despite the fact that the yield has gone from 1.36% in 2016 to 2.85% today, really, investors are confronted with the same circumstance. So, fixed income is not a solution for people. Here are a few things that are alarming that are happening in the fixed income market.

The 2-Year Treasury Note is now yielding only 29 basis points less than a 10-Year. If the yield curve becomes inverted, that historically has forecasted a recession. That is something to look out for. Also, investment-grade corporate bonds are yielding about 4.9%. This is about 2% more than the 10-Year Treasury. Generally, that has also been a pretty good predictor of an economic slowdown. We're not predicting that, but it is just something to look out for and certainly something to be concerned about.

It's not a situation where investors can sit still and accept a negative rate of return. They're going to look for alternatives, and those alternatives may be away from fixed income, and this is going to cause problems for governments around the world. As an example, in fiscal 2018, the United States is likely to run a deficit of about $800 billion; and in fiscal 2019, it's projected to be over a trillion dollars. In order to fund that debt, the U.S. Treasury will have to find investors who are willing to pony up $133 billion a month. That's new debt that's being added plus existing debt that's being rolled over. And who says they're going to be willing to accept that at a rate of 2.85% or 2.5%?

So, there's a possibility—I'm not predicting it; I'm just saying that there's a real possibility—that there will be a backlash, and rates could seriously rise. If you ever got to a normalized 10-Year Treasury Bond yield, historically that's hovered around 6%. If that were to change from today's current rate of 2.85%, as an investor you'd lose about 25% of your capital. That's a real risk. Now, we're not predicting such an eventuality; however, we believe you should certainly be prepared for this possibility.

Shifting over to equities, we're also confronted with a very difficult circumstance. By most measures, equity valuations are at an all-time high. The S&P 500 Index ("S&P 500") trades at, roughly, 24x trailing earnings; the price to book value ratio is over 3x; and the market capitalization of the stock market to GDP is over 105% and is expected to rise to about 107% by the end of 2018. That number, 105%, is the highest level it's been since 1947, and 1947 was just after World War II, when we had assumed a fair amount of debt to fund the war. A normal range for equities has typically hovered around the 90% mark. So you can see, to get back to a normal range you could experience a correction of 15-plus percent. If it ever overshot that normal range, which it frequently does during a fair market, it's not unusual for the ratio to fall below 60%. But you can see how you could actually have a real correction then. Now, as a result of the concentrated and concerted effort of central banks around the world to bring down interest rates, to ameliorate what was going on in the financial markets in 2008, most assets rose in value, and there was an inducement for managers and marketers to get people into risk assets, and they were successful in doing that—they got them into bonds and into equities.

As a consequence, it's very hard as an investor to find good investment opportunities, and it's certainly very hard to find investment opportunities with a margin of safety. Therefore, it should not be a great surprise that our portfolios have become more concentrated with the passage of time—we are finding fewer and fewer good investment opportunities, and we're actually holding a fair amount of cash in a lot of our portfolios, as a defensive measure. I think that's a natural result of everything that I just mentioned.

Couple that with the rise of the ETF industry and the feature of a price indifferent buyer, and you could really have a situation where many of the large liquid names that drive the major indices have become uncoupled from their underlying economic value. How much longer can that go on? Who's to say? Can it go on another six months, another two years? But at some point, as the ETF industry continues to take in money at the expense of active managers, it's going to have a greater consequence. And the same way that they get in and they're price-indifferent, if that trend were ever to reverse itself, you could see how things could unravel very quickly; you would not want to be anywhere close to that potential unraveling.

Now, again, we're not predicting that that's definitely going to happen in the near term future; however, it's certainly a possibility, and you want to be able to avoid it if it were to occur. My colleague, Steven Bregman, as I mentioned earlier, gave what I thought was a very compelling example: he used Amazon, and what might occur if Amazon, the raw material, i.e., the stock itself is not abundantly available for purchase, and if ETFs continue to get more money and active managers were to hold on to Amazon.

In theory, you could actually continue to have a melt-up in Amazon's price. Conversely, if you thought through the implications of that situation, if everyone wanted to sell at the same time because investors stopped believing they were going to get an adequate rate of return in equities, or interest rates were moving higher, and investors decided to price them lower, and people started redeeming ETFs, you could see how Amazon stock could get crushed very quickly. And Amazon is among many of the large liquid names out there. That's really our concern and informs how we have positioned our portfolios, and why we're taking a very cautious view of the world.

In the case of what we're doing in our funds, many of you know one of our largest positions in several of our equity funds is a company called Texas Pacific Land Trust (the "Trust", "TPL"). Texas Pacific Land Trust sits out in the western part of Texas in the Permian Basin, and as a result of the Permian Basin's operators' ability to extract oil from shale, the United States is now the largest oil producer in the world and has been for a number of years, and oil production has now exceeded the highest level it has ever been in the United States. It is also quite likely that the United States will become energy-independent over the next several years and that we will be large exporters of natural gas.

Therefore, from that standpoint, the United States is actually sitting in a pretty good position and there are actually opportunities out there, i.e., our position in Texas Pacific Land. The rise in production is largely attributable to the shale formation in the Permian Basin and to the advances in drilling and extraction—Texas Pacific Land is a direct beneficiary of those developments. The Trust has a tremendous amount of land, and the drilling that's being done on their land, the need to cross their land, and the need to get water for the fracking all plays to their advantage. And the stock—if you looked on the surface, you would say that Texas Pacific Land is not what you would describe as a cheap company: a high P/E multiple, a very high price to book value, all the things that I just railed against earlier. But if you look below the land and you see the potential and the ability to extract that oil, you'll see that it's actually quite compelling.

In previous calls, James has gone through TPL in great detail, but just to give you some perspective on what's happening with Texas Pacific Land Trust as an investment, the net income of the company rose to $76.4 million in 2017, and that's up from $37.2 million in 2016. The volume of oil production underlying the trust royalty income rose by 44% in 2017; the gas production rose by 60% in 2017; royalties from easements rose by a very substantial amount, about 144% in that year; and the company's net profit margin was 58%. Now that we have our new tax code, the profit margins are likely to be higher in 2018. And in earnest, the development of that property is just getting underway. Accordingly, we see the potential for this company to significantly grow its revenues and to grow its earnings; hence our willingness to hold a very large position in the portfolios. With that, I'm going to turn it over to James, in case he wants to add anything on TPL, and I know he wants to speak about some other names within the portfolios.

James Davolos: All right, thanks. I'm actually going to elaborate on a lot of the points Peter made before going into the portfolios. You really can't overemphasize the importance of the yield curve as a predictive mechanism. And the spread between the 10-Year Treasury and the 2-Year Treasury, as Peter mentioned, is down to 29 basis points. To put that in perspective, the last time that spread was this low was in July of 2007, just after the yield curve had inverted, and we went into a global financial crisis.

Prior to the inversion, the spread was approximately this narrow in June of 2005. If you look at June of 2005 and you ignored this warning signal, there was actually about a 30% upside in the S&P 500 before you lost 60% from the peak. The previous time that the yield curve was this tight was in January of 2001, again, after the inversion related to the tech bubble bursting, and before that, in December 1999. Thus, this indicator doesn't necessarily indicate an imminent recession, nor does it indicate any type of imminent trouble, but it's certainly vastly at odds with the multiples that are being assigned to equities and the narratives that you're seeing coming out of large banks and economists that are simply citing strong employment numbers, strong GDP numbers, and stronger margins.

The bond market is sending a very different signal where if you just think about it in objective terms, to only demand that slight a premium for eight extra years of duration risk for a 10-year maturity versus a 2-year is a pretty profound statement. And this is while the Fed is actually unwinding its balance sheet, tapering from the unprecedented expansion related to the global financial crisis. We look at this within the context of being in the ninth year of a market and GDP expansion, starting from the lows of March 2009.

Despite all of these variables, the market, as measured by the S&P 500, is trading at 24x trailing earnings, as Peter mentioned. But if you use Robert Shiller's cyclically adjusted P/E ratio, that's about 32x, which is above the 1929 levels and approaching the 1999 peak. Now, going back to 2007 and also going back to 1999, I recall naysayers discredited the Shiller P/E by citing the fact that negative earnings and very low earnings associated with previous recessions over the 10-yeaer cycle were artificially weighing down earnings. Well, we adjusted the number and actually removed not only the 2008 earnings but also the 2009 earnings and used an average of the subsequent recovery earnings, and we still arrived at a cyclically adjusted P/E of 28x. That's above the 2007 peak and also, the only times it was ever this high was in 1929 and 1999.

Therefore, the market is categorically expensive and the behavior capitalizing what we believe to be unsustainable earnings at this high of a level is probably not in the best interest of long-term capital. But, again, just going back to these indicators, there is nothing to say that there's definitely going to be an imminent change, and there are a lot of people who are highly incentivized not to change their allocations. And what I mean by that—and we touched on this a little bit in the last call—is the Bloomberg Barclays US Aggregate Bond Index of investment-grade U.S. debt still has an SEC yield of around 3%. So, depending on whether you use CPI or PCE measures of inflation, if you remove the impact of inflation and then tax the ordinary income on those bonds, that's effectively a zero-percent real rate of return after tax on the investment-grade debt index.

Similarly, if you go into high yield, you're only getting about 5%, and over a full cycle, typically, when you experience the losses during the downturn of the cycle, that negates a lot of that premium relative to the risk-free or the investment-grade rate. Because of this dearth of yield and certainly dearth of risk-adjusted yield, there are many allocators that require 7-8% returns on their investment portfolios in order to consider their pensions, their endowments or any number of their other funded liabilities.

For example, the State of California, the State of Illinois, the State of New Jersey, and the State of Colorado all require and are discounting investment returns of 7-8% in order to balance these plans. And if they were to shift more heavily into short-duration, higher grade, investment-grade debt, they would be hundreds of basis points below their required rate of return, and the actuarial adjustment would require them to either increase contributions to these plans or cut benefits, both of which are politically, if not ethically, unpalatable for these people, resulting in basically the entire world of long-term liabilities being fully invested in, quote, "high risk."

Quickly, I'll just go into the different segments of equity because there's a belief that there's always somewhere to go. As active managers, we firmly believe that possibilities exist; there's been a decent amount of conversation about the outperformance of growth versus value. The difference in returns is actually striking. As of the end of the second quarter, over a 10-year period, the Russell 3000 Growth outperformed the Russell 3000 Value by 75%. Five years was closer to 47%; three years was 23%; and one year was 15%.

But when you dive into what is in these indices, essentially, you've got high P/E information technology stocks in the growth bucket, and you have somewhat cyclical industrial companies, but more so, financial service companies, in the value bucket. Going back to the very tight yield curve, financial service companies are dramatically constrained in their growth when they're dealing with such a tight yield curve, and a lot of these businesses are trading above book value even though their returns on equity, which are levered up about 10x from returns on assets, are probably below what you would consider to be the requisite funding costs for a financial business.

That's what you're getting in the value bucket, while in the growth bucket I talked about the cyclicality of the broader index, and not many people would consider information technology cyclical. But if you look at one of the driving factors of this dramatic growth, it's the buildout of cloud and enterprise infrastructure. And any number of companies are beneficiaries of this, from the component companies to the software companies, to the warehousing companies, to the chip manufacturers, and there's an unprecedented scale of growth that's going into removing hardware computing, and now even software, away from on-premises and away from the physical and into the cloud.

This is categorically not a permanent phenomenon. And if you look at some of the leading providers of web services, I think that you're going to start to see margin erosion, which might signal the beginning of a breakdown of this dynamic. Another area that's been popular is small-cap; in small-cap, I think you can isolate a significantly higher amount of alpha relative to that within large capitalization stocks. And even though small-caps outperformed by about 7% over a 10-year period, over a rolling 3 and 5-year period they've underperformed between 8% and 3%. But, again, we really don't believe in a systematic tactical approach to allocating to small capitalization stocks, and we'd like to bring people's attention to what I'll call the hot trade of last year, which was to reallocate to emerging market stocks.

The MSCI Emerging Markets Index, believe it or not, is actually only up slightly over the last 10-year period, about 135% under the S&P 500 cumulative return over the period. But based on a variety of top-down allocators and economists, the emerging index trade was popular during 2017 and actually outperformed developed markets, meaning the S&P 500, by 1,500 basis points. Since then, you've given back over 1,200 basis points of that performance, and if you look at what is actually owned in the EM Index, you'll see a lot of Chinese financial service companies that are probably not solvent without the support of the Chinese government. And then if you look at the other bucket of the EM Index, you get a large percentage of Chinese information technology companies that have similar valuation issues as their domestic counterparts in the U.S.

In other words, this is just another cautionary tale indicating that a fundamental, risk-averse, active approach is incredibly important in this environment, but we have no ability to tell when the merits of this strategy will truly show its value in a difficult market. But we're certainly very happy to see our companies appreciating in value in spite of no change in the market dynamic.

With that, I'll transition into the portfolio. Again, I really want to emphasize that we want to buy durable businesses at good prices that can really stand the test of time. And there's no better example than Texas Pacific Land Trust, where if you look at their acreage and their royalty rights, it's very clear that this is an enduring business in which we have great confidence. I know we've gone into great detail in past calls, but there's been a good amount of volatility in the stock over the past quarter, and I think it had a lot to do with differentials pertaining to getting oil and gas out of the Permian Basin.

There's a variety of hubs in Texas and in the Gulf Coast where we can export oil and gas and refine oil and gas. The benchmark hub for Brent oil, which is based off of the North Sea, today stands at about $79 versus the West Texas-Cushing hub at about $74. A $5 spread between Brent and WTI is nothing all that dramatic, although it's been wider at different points. Houston and a variety of the Gulf refineries are closer to Brent pricing because you can either refine the products or you can ship them and realize closer to Brent-based pricing.

Mandolin, which is a much smaller refinery and which has much less capacity, is currently pricing at about $60. So, you're seeing about a $14 spread to Cushing and about almost a $20 spread to Brent. But what's really important to understand is that the capacity is for two producers that don't have locked in transportation, and a lot of this has been private equity funded companies that just bought land and are now forced to develop, or new operators that have bought acreage or bought contiguous acreage in the Delaware Basin and didn't have takeaway contracts.

This created a tremendous amount of volatility across all Delaware Basin-based operators. But it is most important to TPL, whose two primary operators are Anadarko Petroleum and Chevron. Anadarko has committed capacity for over 50% of its oil and gas to get to the Gulf or Cushing in 2018, and in 2019 they have 100% committed capacity. What this means is that TPL realizes the prices at the wellhead for this production. They're realizing much closer to $75-80 for this committed takeaway for Anadarko.

Chevron is in an even better position where they have proprietary pipelines that only move their product of LPG (liquefied petroleum gas) and oil both to Cushing and down to Gulf refineries. We don't expect this to have a dramatic impact on TPL's royalties; however, on an ancillary basis, to the extent that some companies will have issues with large differentials, and that this would affect TPL's land easements and water revenues, we're basically looking at different pipeline operators.

We know that this supply removal problem will be rectified by the middle of 2019, if not fully solved in an excess takeaway capacity by the end of 2019. For those interested in monitoring this dynamic, the Chicago Mercantile Exchange has a contract that trades a WTI Midland differential. And you can see it's going to get a little bit higher throughout the end of this year, then coming down very dramatically throughout the balance of next year, as everybody anticipates the capacity coming online.

In short, this was a lot of noise affecting the area, but we think that at worst, it's short term; at best, it's completely meaningless.

With that I'll just briefly turn to some stocks that we've actually followed and known about for decades, but as it relates to the contract I just spoke about at CME, the Midland WTI differential. When we talk about niche businesses that don't really fit in to the broader beta of the market, I think the Chicago Mercantile Exchange and CBOE really fit into this bucket because they're at their core information technology businesses, with tremendous moats and very high operating margins, but also have an element of financial services.

But neither of these companies is subject to the current cyclical bloat of the infrastructure buildout for the cloud nor the spread-based limitations of traditional financial services. Also, neither of these companies is subject, as much of the IT world is, to ad dollars spent. Plus, they both have cyclical tailwinds, where CBOE's products are going to benefit dramatically from what earlier this year was the first return of volatility as a lot of their products are far more attractive for counterparties to trade with higher volatility than the suppressed volatility we've had for five years now.

CME has even broader tailwinds, where you've got interest rates finally moving on a global basis, which need to be both hedged and traded. You have commodities finally moving, again, both globally and domestically, that need to be hedged and traded, and also currency. These are three very large drivers for CME's core business that have been suppressed over the past four to five years. Neither company is dramatically inexpensive, but when we look at their peer companies that trade in the 21-23x earnings bucket, we see far more sustainable and actually countercyclical elements to these businesses, as opposed to what are probably cyclical headwinds facing a lot of the other software, IT, and financial service peers.

Finally, if you look at the return on tangible common equity of these companies, they're off the charts. Now, there's a good amount of intangibles and goodwill that you'll see on the balance sheets with suppressed reported returns on equity, but if you look at the actual capital intensity relative to the profitability of these companies, it's absolutely tremendous. And both of them run at very, very modest levels of leverage. So, again, these are actually large liquid companies in which we continue to find opportunities, and there are certainly fewer and less attractive opportunities in aggregate. But we're continuing to find niche areas of the market in which to participate, but we remain very diligent in how we are allocated and how we look to steward capital over the next three to five years.

Chris Bell: Operator, we'd like to open the call for questions now.

Chris Bell: Peter, while we're waiting for the queue, I did get a couple of different questions. First of all, with the trade tariffs, how does that affect our portfolio versus, say, the S&P 500? I know that's a softball for you but if you would explain that to some people who were asking?

Peter Doyle: We believe most of the companies that we have will not be affected greatly by trade tariffs. We don't own the large global companies that are exporting things across the world. Accordingly, it's not really a factor for us.

Chris Bell: Peter, Murray was mentioning something a few weeks ago about how the economy could do well potentially and the stock market maybe could not do well. Talking about the trade deficit and diminishing the trade deficit and adding to the economy. Do you want to elaborate on that?

Peter Doyle: Sure. That's perfectly understandable. Ultimately, stock prices have to be related to the underlying business returns of the companies themselves. And whatever the historical rate of return for the S&P 500, if you look closely, it mirrors the underlying returns of the businesses. You're not buying an abstraction; you're buying a fractional interest in a real company, and your success or failure is going to be predicated on that.

The economy could do well and you could have a repricing in equity securities where the stocks actually do very poorly and the economy chugs along just fine. That's not an anomaly; that's actually the way it works. It would not surprise me—I would think that most people, even the largest ETF companies, recognize that you cannot expect a high level rate of return from equities looking out into the future, going out 5-10 years. It would be very shocking if that were to occur. You would have to have some really increased expansion in key multiples and earnings from companies that are really not even growing their top line, which doesn't seem possible.

Eventually, that has to hit a wall. Many companies have done everything they possibly can to grow their earnings, so they take on more debt, they retire shares, they delay payments for future research and development or projects that they should be investing in, just to report better near-term earnings. And that's all going to come out in the wash. Who knows how much longer this will go on, but the ETF industry itself states that they have, roughly, 30% of the market capitalization of the stocks out there. And if you look at the inside, whether that's 10% for a particular company, or15%, the available float to buy is rapidly shrinking. And once you take away the money from the active managers who really set the prices at the margin, I, personally, am of the belief that the market mechanism is broken because of the flows of money into ETFs as they constantly buy the same securities irrespective of price. And I think that's ultimately going to come home to roost, and people that are participating in that side of the market are going to end up regretting it. Now, can it go on for another six months, another year? Absolutely. But at some point it's going to come melting down in a way that's going to be very unkind to investors. And you want to be, and we hopefully are, as far away from that as we possibly can.

Questioner 1: Okay. And this is probably answered already, but my biggest concern, as you pointed out, was the ETF industry buying the same securities over and over again. Has there been any, you know—I know you've looked at this ad nauseam and bought things outside of that to try and find value, but my biggest concern is real liquidity and real float, of who the investors are and when they decide to move out of these positions. Do you have any historical evidence of what happens in a flight type of environment? Because we've certainly seen it in 2008 in different environments.

Peter Doyle: Well, you never saw it because the ETF industry would not have decided it today. Actually, it's unprecedented because the ETF industry really has grown so dramatically in the last 10 years. My guess is that the potential for flight would be accelerated in the current investment structure, with the ETFs. And if everyone wanted to head to the exit, it would happen very quickly. And all the ETFs that own whatever company, Google, Amazon, Netflix, you'd be selling it at the same moment as people would be taking money out of the ETF. Also, an ETF can't adjust what it wants to sell.

So, we can say, you know what? We're willing to concentrate TPL because we're getting redemptions, and we think it's one of our best investments. And I mentioned that earlier. The number of names in our portfolio has gone down over the years because as we've gotten redemptions, we're saying, okay, let's keep our best names. And we can concentrate that. An ETF has to sell everything across the board in its percentage of ownership, in the same way that they go out and buy the percentage of ownership.

My colleague Steven Bregman, and I mentioned this earlier; he did a call for the first quarter—you can get it on our website—and he went into great detail on the case of Amazon, using the ETF industry's kind of numbers, which we think are actually underreported. If the ETF industry has 37% of the market share of stocks out there, and Amazon insiders own 17%, that means the available float is really something like 46%. And if the active managers who own Amazon recognize the ETFs want to buy it and they want to hold a larger percentage that what the typical ETF owns, there's no supply. So you could see how you could have this melt up. And I personally think, to some extent, that's what's been going on.

But, conversely, if the flows ever started to reverse themselves, you could have a meltdown. And it would not surprise me at some point if we were to see something like that.

Questioner 1: And we did see that, I guess, in this last crash, right? We've seen it in some of the big disparity of ETFs in the market—I don't know if they're market makers, but they tried to adjust, and you saw some ETFs during that 6-minute last crash of—when it down, and they couldn't adjust for it. And some ETFs were mispriced by 10-20% and they were pretty big.

Peter Doyle: Right. Yes.

Chris Bell: You all just saw it with the collapse of the inverse Volatility Index just a few months ago.

Peter Doyle: Yes, this is really all uncharted territory. And all I can say is, just from a common sense standpoint—you don't have to be an equity analyst to understand this. If you're continuing to buy and you're not paying attention to valuation or price, good things are not going to happen at the end of the day. You're going to end up with a bad result, and that's really what's going on. Steven in that call also talked about the returns, since coming out of the financial crisis, are well in excess of what they've been historically. The volatility is down, and people think it's on autopilot. And I don't know what's going to trip it but it's not going to remain on autopilot. And when they want out, they're going to get out. And they don't do it in a staggered, measured way. They'll all want out at the same time. Because when everyone thinks it's going down, I'll be getting to the door as fast as I possibly can.

I can easily see something like that happening. I'm not predicting it; I can't tell you when it's going to happen. But I can tell you that the ETF industry itself is going to have to hit a wall if it continues to grow the way it is. You can't continue to grow your assets by 20% and take 20 away from active managers. At some point you are 100% of the market, and now you're not going to get the same floats. So, you can't get the same types of rates of return from the ETFs pushing up those stocks. Just looking at it just from a practical, common sense standpoint, you're not going to end up with a good result. Now, can stocks rally 7% when we hang up the phone, for over the next 2 months? Absolutely. But looking out longer term, if you're involved in that, I don't personally think you're going to have a positive rate of return over the next five years. In fact, you can actually have a very significant negative rate of return.

Chris Bell: Peter, I've been emailed a request that you talk about what you think the Multi-Disciplinary Fund will do versus our equity funds and versus the Bloomberg Barclays Aggregate Bond Index ("Agg"), in particular, if we're talking about a market potentially being unstable, if there's a place to hide like the Multi-Disciplinary Income Fund?

Peter Doyle: I'm going to let James answer that.

James Davolos: Hi, this is James. So, the Multi-Disciplinary Income Fund right now has very short-term credit, 1-3 years. If you actually look at the money market rates of return that you can now get in 6 to 12-month CDs and commercial lending, you can actually manufacture around a 2-plus percent return. So, the spread on a very small amount of the collateral is already approaching the Agg, which has far more duration, probably 2-3x more duration. Now, if you look at the put-writing aspect, it's still very unattractive. The CBOE has a PutWrite Index and there's a variety of active strategies out there that have actually lost money this year while the market is up. And that's because if you write puts when vol is suppressed and then the market blows out from under you, you lose a lot of that premium and it's almost impossible to catch up by writing even more aggressively throughout the year. So, the Fund right now has a variety of bonds in which we have very high conviction, that I would say are in the high yield category, meaning, let's say, a lot of them are unrated but anywhere from single-B to triple-B.

A lot of the shorter dated stuff is actually now getting a pretty attractive rate of return for ultrashort-term paper, and we're being incredibly selective with respect to where we write the puts. That run rate return can be in the 4% range, depending on the performance of the higher yield bonds. And then it is very short duration on the other end, so that's probably going to roll off every couple of quarters or so. In the fullness of time, we hope to supplement that with a pretty robust put-writing strategy but, obviously, right now is not the time. So, we certainly expect to have well above Agg returns in the long run. Equity market returns are anybody's guess in the short term. But longer-term, we think that having a disciplined approach to writing as opposed to a systematic one makes a lot of sense.

Peter Doyle: Yes, Murray Stahl is, I think, great at having discipline—he's not going to do something unless he feels like he's being adequately compensated. And with the volatility out of the market for put-writing, it doesn't make sense, so he curtailed that sometime ago and hasn't really done it. If volatility ever comes back and if premiums are there, you'll see us being very aggressive about that.

Chris Bell: And just to add, if you look at the track record of the Multi-Disciplinary Income Fund over time it's actually performed very well during periods of high volatility.

Questioner 2: Hi there. Thank you very much for the call. I was just a few minutes late getting it. So maybe you already talked about Howard Hughes Corp. I see it's getting back to what price it hit four years ago. And did they pay like, $100-and some million for an acre of land? So, just a couple of comments on it? Thanks.

James Davolos: Yes. So, it's working its way back up. It's hard to really identify exactly what is driving the stock today, but let's look at what were once ignored assets, like the Summerlin, Nevada. Basically, if you want to live in a reasonably nice neighborhood in Nevada that is new construction, they own the entire market. And you have the Golden Knights of hockey, you have the Oakland Raiders moving to Las Vegas, and it's a far more diversified, robust economy.

You've also seen Columbia, Maryland, which is a suburb of Baltimore and Washington, D.C., dramatically outperform. And even kind of an asset nobody even talked about where there's a commercial center outside of Allen, Texas, a suburb of Dallas, that's currently getting greenlit.

The transaction that you're talking about was there was a parking lot at the entrance of what we'll call the Seaport District that had been owned by a local New York developer for decades, who never was able to get the right permitting and get the right project signed to build that lot. And Howard Hughes came in and realized that it was very strategic for their longer-term vision of the Seaport, and they're probably going to be able to go in. And if you look at entitlements there, they go up to four floors and I think about 200,000 or 180,000 square feet, depending on your assumptions for what the ground floor retail will do, and then looking at what their margins on building either condos or multipurpose above that, I think that they'd probably be able to earn something in the region of a 6 or an 8% yield on cost.

But, again, the power of controlling that and integrating it with their assets that are contiguous with that lot is incredibly attractive and certainly can out-earn the parking lot and what the previous developer's plans were. So, to elaborate, if you look at the broader Seaport community, they actually are going to launch the concert series on top of Pier 17 in the Seaport this summer, a few of the restaurants are starting to open, and a lot of the what I'll call uplands retail up in the Cobble Stone Historic District have opened, as well as a few popup restaurants and bars. And I continue to have a lot of confidence that this is going to be one of the more vibrant epicenters of New York City over the next 3-5 years, particularly as you're seeing a lot of developers build more condos and restaurants to support a young working population.

Finally, the other variable that no one really talks about is they technically have another 600,000 square feet of entitlements related to the old Seaport and Fulton Fish Market site, which the company stays very quiet about because there's a community board to deal with and they're dealing with the New York City government. But that's really not in anybody's NAV projections. And if that's done right, it could be really exceptional.

So, everything's kind of going in the right direction for Howard Hughes. And if you put a cap rate on their properties and just take the market value of their land, you're looking at a stock that's 40, 50, 60% higher while the rest of the broader real estate investment universe is really struggling. It's not a REIT, so most of the real estate investors aren't even looking at it—but you combine that discount and the differentiated niche assets, and we think it's a great long-term play even though we're not necessarily all that constructive on real estate.

Peter Doyle: Somebody sent me an email yesterday called "By the Numbers" and it just shows you how people doubt and how people don't tolerate things that go on in their lives and actions of the government. The title of this is called "A Lot More Leaving Than Coming". And what it says is: "The cost of renting a 26-foot truck for a one-way trip from San Jose, California to Las Vegas is $1,990. And the cost of renting the same truck going back the other way from Las Vegas to San Jose is $174." And, basically, that's the difference. Because people are leaving California because of the tax rate and the lack of habitability of it and they want out, and they're moving to Las Vegas.

So, you can see when states—federal governments do things, people act. It's not a stationary thing. And that little comment there is really a fascinating thing, and it goes on at a much greater level.

All right, thank you, everyone, for calling in and listening. This call, we will have a replay number if you'd like to listen to it again. We'll be able to email that around to people. Also, go to our website, www.kineticsfunds.com or www.horizonkinetics.com, or download the SoundCloud app and search for us. Also, pay attention to us on Twitter at @horizonkinetics. And, of course, you can always call our Marketing Department at 914-703-6950. Thanks very much for your time today.

PERFORMANCE AND HOLDINGS INFORMATION

Internet Fund

As of June 30, 2018	WWWFX (Net of Fees)	S&P 500 Index	NASDAQ Index
TOTAL RETURN			
Year-to-Date	**-14.83%**	2.65%	8.79%
One Year *(annualized)*	**18.26%**	14.37%	22.31%
Three Year *(annualized)*	**8.94%**	11.93%	14.62%
Five Year *(annualized)*	**10.14%**	13.42%	17.15%
Ten Year *(annualized)*	**11.40%**	10.17%	12.60%
Since Inception*(annualized)*	**14.14%**	8.41%	8.67%

Performance data quoted is as of June 30, 2018. All figures are annualized. Past performance does not guarantee future results. The inception date for WWWFX is October 21, 1996. As a no-load fund, there is no sales charge. The above performance is without dividends reinvested. Investment return and principal value will vary, and shares may be worth more or less at redemption than original purchase. The Fund's operating expense ratio, gross of any fee waiver or expense reimbursements is 1.87%. Visit www.kineticsfunds.com for the most recent month-end performance data and a copy of the most recent Prospectus.

Medical Fund

As of June 30, 2018	MEDRX (Net of Fees)	S&P 500 Index	NASDAQ Index
TOTAL RETURN			
Year-to-Date	**-3.43%**	2.65%	8.79%
One Year *(annualized)*	**-2.04%**	14.37%	22.31%
Three Year *(annualized)*	**-2.05%**	11.93%	14.62%
Five Year *(annualized)*	**7.85%**	13.42%	17.15%
Ten Year *(annualized)*	**8.29%**	10.17%	12.60%
Since Inception*(annualized)*	**8.71%**	6.11%	5.51%

Performance data quoted is as of June 30, 2018. All figures are annualized. Past performance does not guarantee future results. The inception date for MEDRX is September 30, 1999. As a no-load fund, there is no sales charge. The above performance is without dividends reinvested. Investment return and principal value will vary, and shares may be worth more or less at redemption than original purchase. The Fund's operating expense ratio, gross of any fee waiver or expense reimbursements is 2.08%. Kinetics Asset Management LLC, the Investment Adviser to the Medical Fund, has voluntarily agreed to waive fees and reimburse expenses so that Total Annual Fund Operating Expenses do not exceed 1.39% for No Load Class shares. These waivers and reimbursements may be discontinued at any time. Visit www.kineticsfunds.com for the most recent month-end performance data and a copy of the most recent Prospectus.

Global Fund

As of June 30, 2018	WWWEX (Net of Fees)	S&P 500 Index	MSCI ACW Index
TOTAL RETURN			
Year-to-Date	**-6.85%**	2.65%	-0.43%
One Year *(annualized)*	**27.51%**	14.37%	10.73%
Three Year *(annualized)*	**10.04%**	11.93%	8.19%
Five Year *(annualized)*	**7.26%**	13.42%	9.41%
Ten Year *(annualized)*	**7.65%**	10.17%	5.80%
Since Inception*(annualized)*	**-0.38%**	5.40%	4.10%

Performance data quoted is as of June 30, 2018. All figures are annualized. Past performance does not guarantee future results. The inception date for WWWEX is December 31, 1999. As a no-load fund, there is no sales charge. The above performance is without dividends reinvested. Investment return and principal value will vary, and shares may be worth more or less at redemption than original purchase. The Fund's operating expense ratio, gross of any fee waiver or expense reimbursements is 3.06%. Kinetics Asset Management LLC, the Investment Adviser to the Global Fund, has voluntarily agreed to waive fees and reimburse expenses so that Total Annual Fund Operating Expenses do not exceed 1.41% for No Load Class shares. These waivers and reimbursements may be discontinued at any time. Visit www.kineticsfunds.com for the most recent month-end performance data and a copy of the most recent Prospectus.

Paradigm Fund

As of June 30, 2018	WWNPX (Net of Fees)	S&P 500 Index	MSCI ACW Index
TOTAL RETURN			
Year-to-Date	**13.25%**	2.65%	-0.43%
One Year *(annualized)*	**36.02%**	14.37%	10.73%
Three Year *(annualized)*	**15.86%**	11.93%	8.19%
Five Year *(annualized)*	**13.74%**	13.42%	9.41%
Ten Year *(annualized)*	**8.63%**	10.17%	5.80%
Since Inception*(annualized)*	**10.21%**	5.40%	4.10%

Performance data quoted is as of June 30, 2018. All figures are annualized. Past performance does not guarantee future results. The inception date for WWNPX is December 31, 1999. As a no-load fund, there is no sales charge. The above performance is without dividends reinvested. Investment return and principal value will vary, and shares may be worth more or less at redemption than original purchase. The Fund's operating expense ratio, gross of any fee waiver or expense reimbursements is 1.75%. Kinetics Asset Management LLC, the Investment Adviser to the Paradigm Fund, has voluntarily agreed to waive fees and reimburse expenses so that Total Annual Fund Operating Expenses do not exceed 1.64% for No Load Class shares. These waivers and reimbursements may be discontinued at any time. Visit www.kineticsfunds.com for the most recent month-end performance data and a copy of the most recent Prospectus.

Small Cap Opportunities Fund

As of June 30, 2018	KSCOX (Net of Fees)	S&P 600 Index	S&P 500 Index
TOTAL RETURN			
Year-to-Date	**17.91%**	9.39%	2.65%
One Year *(annualized)*	**43.00%**	20.50%	14.37%
Three Year *(annualized)*	**15.70%**	13.84%	11.93%
Five Year *(annualized)*	**13.35%**	14.60%	13.42%
Ten Year *(annualized)*	**10.18%**	12.25%	10.17%
Since Inception*(annualized)*	**11.05%**	10.18%	5.50%

Performance data quoted is as of June 30, 2018. All figures are annualized. Past performance does not guarantee future results. The inception date for KSCOX is March 20, 2000. As a no-load fund, there is no sales charge. The above performance is without dividends reinvested. Investment return and principal value will vary, and shares may be worth more or less at redemption than original purchase. The Fund's operating expense ratio, gross of any fee waiver or expense reimbursements is 1.78%. Kinetics Asset Management LLC, the Investment Adviser to the Small Cap Opportunities Fund, has voluntarily agreed to waive fees and reimburse expenses so that Total Annual Fund Operating Expenses do not exceed 1.66% for No Load Class shares. These waivers and reimbursements may be discontinued at any time. Visit www.kineticsfunds.com for the most recent month-end performance data and a copy of the most recent Prospectus.

Market Opportunities Fund

As of June 30, 2018	KMKNX (Net of Fees)	S&P 500 Index	MSCI EAFE Index
TOTAL RETURN			
Year-to-Date	**1.95%**	2.65%	-2.75%
One Year *(annualized)*	**39.17%**	14.37%	6.84%
Three Year *(annualized)*	**17.11%**	11.93%	4.90%
Five Year *(annualized)*	**13.25%**	13.42%	6.44%
Ten Year *(annualized)*	**9.99%**	10.17%	2.84%
Since Inception*(annualized)*	**9.31%**	8.53%	3.65%

Performance data quoted is as of June 30, 2018. All figures are annualized. Past performance does not guarantee future results. The inception date for KMKNX is January 31, 2006. As a no-load fund, there is no sales charge. The above performance is without dividends reinvested. Investment return and principal value will vary, and shares may be worth more or less at redemption than original purchase. The Fund's operating expense ratio, gross of any fee waiver or expense reimbursements is 1.97%. Kinetics Asset Management LLC, the Investment Adviser to the Market Opportunities Fund, has voluntarily agreed to waive fees and reimburse expenses so that Total Annual Fund Operating Expenses do not exceed 1.64% for No Load Class shares. These waivers and reimbursements may be discontinued at any time. Visit www.kineticsfunds.com for the most recent month-end performance data and a copy of the most recent Prospectus.

Alternative Income Fund

As of June 30, 2018	KWINX (Net of Fees)	Barclays 1-3 Yr. Credit	Barclays U.S. Aggregate
TOTAL RETURN			
Year-to-Date	**-0.07%**	0.11%	-1.62%
One Year *(annualized)*	**0.91%**	0.57%	-0.40%
Three Year *(annualized)*	**2.19%**	1.30%	1.72%
Five Year *(annualized)*	**2.84%**	1.41%	2.27%
Ten Year (annualized)	**0.39%**	2.63%	3.72%
Since Fund Inception*(annualized)*	**0.38%**	2.91%	4.02%

Performance data quoted is as of June 30, 2018. All figures are annualized. Past performance does not guarantee future results. The inception date for KWINX is June 29, 2007. As a no-load fund, there is no sales charge. The above performance is without dividends reinvested. Investment return and principal value will vary, and shares may be worth more or less at redemption than original purchase. The Fund's operating expense ratio, gross of any fee waiver or expense reimbursements is 1.82%. Kinetics Asset Management LLC, the Investment Adviser to the Alternative Income Fund, has voluntarily agreed to waive fees and reimburse expenses so that Total Annual Fund Operating Expenses do not exceed 0.99% for No Load Class shares. These waivers and reimbursements may be discontinued at any time. Performance prior to January 1, 2013 reflects the Fund's prior investment objective and strategy and may not be indicative of the fund's prospective results. Visit www.kineticsfunds.com for the most recent month-end performance data and a copy of the most recent Prospectus.

Multi-Disciplinary Income Fund

As of June 30, 2018	KMDNX (Net of Fees)	Barclays U.S. Aggregate	Barclays U.S. High Yield
TOTAL RETURN			
Year-to-Date	**0.15%**	-1.62%	0.16%
One Year *(annualized)*	**1.36%**	-0.40%	2.62%
Three Year *(annualized)*	**3.69%**	1.72%	5.53%
Five Year *(annualized)*	**3.77%**	2.27%	5.51%
Ten Year (annualized)	**5.12%**	3.72%	8.19%
Since Inception*(annualized)*	**4.63%**	3.52%	8.01%

Performance data quoted is as of June 30, 2018. All figures are annualized. Past performance does not guarantee future results. The inception date for KMDNX is February 11, 2008. As a no-load fund, there is no sales charge. The above performance is without dividends reinvested. Investment return and principal value will vary, and shares may be worth more or less at redemption than original purchase. The Fund's operating expense ratio, gross of any fee waiver or expense reimbursements is 2.01%. Kinetics Asset Management LLC, the Investment Adviser to the Multi-Disciplinary Income Fund, has voluntarily agreed to waive fees and reimburse expenses so that Total Annual Fund Operating Expenses do not exceed 1.65% for No Load Class shares. These waivers and reimbursements may be discontinued at any time. Visit www.kineticsfunds.com for the most recent month-end performance data and a copy of the most recent Prospectus.

Spin-Off and Restructuring Fund

As of June 30, 2018	LSHUX (Net of Fees)	S&P 500 Index
TOTAL RETURN		
Year-to-Date	**13.50%**	2.65%
One Year *(annualized)*	**27.68%**	14.37%
Three Year *(annualized)*	**8.41%**	11.93%
Five Year *(annualized)*	**7.98%**	13.42%
Ten Year *(annualized)*	**4.78%**	10.17%
Since Inception*(annualized)*	**2.90%**	7.72%

Performance data quoted is as of June 30, 2018. All figures are annualized. Past performance does not guarantee future results. The inception date for LSHUX is July 11, 2007. As a no-load fund, there is no sales charge. The above performance is without dividends reinvested. Investment return and principal value will vary, and shares may be worth more or less at redemption than original purchase. The Fund's operating expense ratio, gross of any fee waiver or expense reimbursements is 1.83%. Visit www.kineticsfunds.com for the most recent month-end performance data and a copy of the most recent Prospectus.

(Holdings begin on next page)

Internet Fund **Top 10 Holdings (%) as of June 30, 2018**	
The Bitcoin Investment Trust	12.3%
Texas Pacific Land Trust	7.5%
Liberty Media Corp.-Liberty SiriusXM - Class C	3.8%
PayPal Holdings, Inc.	3.8%
The Madison Square Garden Company - Class A	3.7%
CACI International, Inc. - Class A	3.6%
Copart, Inc.	3.0%
Alphabet, Inc. - Class A	2.6%
Alphabet, Inc. - Class C	2.6%
OTC Markets Group Inc. - Class A	2.4%

Paradigm Fund **Top 10 Holdings (%) as of June 30, 2018**	
Texas Pacific Land Trust	36.1%
The Howard Hughes Corporation	8.8%
Icahn Enterprises LP	4.8%
Brookfield Asset Management Inc. - Class A	3.5%
Live Nation Entertainment, Inc.	2.5%
Liberty Media Corp.-Liberty SiriusXM - Class C	2.2%
Cboe Global Markets, Inc.	2.1%
Markel Corporation	1.9%
Franco-Nevada Corporation	1.8%
Onex Corporation	1.7%

Medical Fund **Top 10 Holdings (%) as of June 30, 2018**	
Eli Lilly & Company	8.4%
Pfizer, Inc.	8.2%
AbbVie Inc.	7.1%
Bristol-Myers Squibb Company	7.1%
Johnson & Johnson	6.5%
Biogen Inc.	6.5%
Novartis AG - ADR	6.3%
Sanofi - ADR	5.9%
GlaxoSmithKline plc - ADR	5.4%
AstraZeneca plc - ADR	5.4%

Market Opportunities Fund **Top 10 Holdings (%) as of June 30, 2018**	
Texas Pacific Land Trust	29.7%
The Bitcoin Investment Trust	5.8%
Icahn Enterprises LP	3.4%
Dream Unlimited Corp. - Class A	2.4%
Associated Capital Group, Inc. - Class A	1.5%
Onex Corporation	1.5%
The Howard Hughes Corporation	1.5%
Partners Value Investments LP	1.4%
Visa, Inc. - Class A	1.2%
CME Group, Inc.	1.1%

Global Fund **Top 10 Holdings (%) as of June 30, 2018**	
Texas Pacific Land Trust	14.2%
The Bitcoin Investment Trust	9.3%
Civeo Corporation	6.2%
GMO Internet, Inc.	3.1%
Bollore SA	3.0%
Fairfax Financial Holdings Limited	2.4%
Siem Industries Inc.	2.4%
Dream Unlimited Corp. - Class A	1.8%
Clarke Inc.	1.6%
Liberty Media Corp.-Liberty SiriusXM - Class C	1.2%

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%

Multi-Disciplinary Income Fund **Top 10 Fixed Income Holdings (%) as of June 30, 2018**	
Penske Automotive Group, Inc.	8.6%
Lamb Weston Holdings, Inc.	8.4%
Brookfield Residential Properties	7.9%
Ashland Inc.	7.2%
Icahn Enterprises	7.2%
PIMCO Dynamic Income Fund	6.7%
TRI Pointe Holdings, Inc.	4.8%
Lennar Corporation	4.6%
Stolt-Nielsen Limited	4.6%
The Howard Hughes Corporation	3.9%

Spin-Off and Restructuring Fund **Top 10 Holdings (%) as of June 30, 2018**	
Texas Pacific Land Trust	30.2%
The Howard Hughes Corporation	7.2%
DREAM Unlimited Corp.	6.1%
Associated Capital Group, Inc. - Class A	5.2%
Cable One, Inc.	4.8%
PayPal Holdings, Inc.	4.3%
Civeo Corp.	3.8%
Graham Holdings Co.	3.6%
CSW Industrials, Inc.	3.3%
Icahn Enterprises LP	3.3%

The information contained in these charts is updated at the discretion of Kinetics Asset Management LLC and is only representative of each Fund's portfolio on the date specified. Additionally, position size may not be indicative of actual market position due to the use of call and put options.

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