Kinetics Mutual Funds

Fourth Quarter 2022 - Conference Call with Peter Doyle

January 17, 2023

Important Risk Disclosures:

Horizon Kinetics Asset Management LLC ("HKAM") is pleased to announce that on January 17, 2023, Peter Doyle, Co-Founder of HKAM 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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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® 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. The iShares MSCI ACWI Index seeks to measure the performance of both the MSCI World Index and MSCI Emerging Markets Index. The iShares EAFE Index measures international equity performance across large and mid-cap equities across developed markets in Europe, Australasia and the Far East, excluding the U.S. and Canada. The Barclays 1-3 U.S. Credit Bond Index is composed of investment grade U.S. credit securities with a maturity between one and three years. The Barclays U.S. Aggregate Bond Index is composed of the Barclays U.S. Government/Corporate Bond Index, Mortgage-Backed Securities Index, and Asset-Backed Securities Index, and includes securities that are of investment grade quality or better, have at least one year to maturity, and have an outstanding par value of at least $100 million. An investor cannot invest directly in an index.

Chris: Good morning, everyone, and thank you for joining us for the 2022 Year-End Kinetics Mutual Fund Update Webinar. Today we're joined by Peter Doyle, cofounder of Horizon Kinetics, president of Kinetics Mutual Funds, and James Davolos, vice-president and portfolio manager.

Today, Peter will discuss our view of how to create wealth over time, and then James will drill down on where we are with respect to the current market versus prior decades as it relates to commodity inflation and valuation. Then he will speak to where we think the markets will head in 2023 and beyond. After that, we will take questions.

Performance last year was outstanding. Not only were more than half of our mutual funds positive on the year, but out of more than 1400 funds that met the criteria, we were the numbers 1, 2, and 4 on the Wall Street Journal's Top Funds Ranking for 2022. Number 1 was the Small Cap Opportunities Fund, which was up +31.96% while the Russell 2000 was down -20.44%. Number 2, the flagship Paradigm Fund, was up +29.18% on the year while the S&P 500 returned -18.11%.

For more information concerning our funds and presentations, please go to our website, www.kineticsfunds.com. For research, white papers, and other strategies, please go to www.horizonkinetics.com. There you can find information about our ETFs, information about our closed-end fund, as well as our separately managed account and private funds and other strategies.

Please note that this call is being recorded and will be available for replay in a few days as well as a transcript a few weeks later. Fact sheets should be up on the website within a few weeks, and if you need more information, please reach out to me or one of our wholesalers at 914-703-6950 or your HRC representative.

And with that, I'd like to turn the webinar over to Peter Doyle.

Peter Doyle: Thank you, Chris. And good morning to everyone. Also, Happy New Year and much health, happiness, and adventure in 2023. And thank you all for joining us today.

So every good story touches on at least of one of eight key emotions, and Chris touched on the yay emotion. We had great performance. If you look at our Flagship Fund, as Chris pointed out, the performance since inception has outperformed the S&P 500 by over five percentage points per annum. In the world of investments, that's just off the charts. Now, I don't think people have a full appreciation for how difficult that is to do, not so much that it's impossible to do, but how difficult it is to do because of the institutional imperatives that are actually put up to block you from doing that. That performance was largely done through a buy and hold strategy. The typical turnover of the professional money managers and mutual funds and equities is well over 100% per annum on balance. Our turnover in the Paradigm Fund for the first nine months of 2022 was zero. I think it's going to be close to zero for the full year.
So now, how did we do that? Obviously, people who know us know that Texas Pacific Land Corp. (TPL) is a big component of that performance and a big, big weighting within the Fund itself. And why is it that nobody has that strategy? One, Wall Street does not encourage it. If people invested the way we invested, Wall Street would not really exist. And two, most of the compliance departments and the fund allocators don't want you to do that because they believe that concentration is great risk. I came to understand the importance of leaving portfolios alone when I worked at Bankers Trust Company. When I was first assigned to be a portfolio manager at Bankers Trust Company, I was given some of the smaller accounts, and one of the accounts was an account that had essentially one position in it. And it was a co-trustee, and the co-trustee never allowed us to trade. And I looked at it, and I said, "This performance is better than any of our accounts." And it was largely because this guy—every time we proposed something, he would tell us no. And as a result of that, the single position, which was a company called Warner-Lambert, grew, and grew substantially and outperformed the S&P 500, outperformed every account.

What investors should have been looking at, what the trust department that I worked in at the time should have realized, is that this was an indictment of how we were managing money. And really, if you own something great, you should leave it alone, and that's what that co-trustee did. So what ended up happening is that Warner-Lambert was a maker of Trident, Dentyne, Certs, a whole host of other things. They owned Parke-Davis Pharmaceuticals, and that trustee looked at it and said "If I owned 100% of this company, I would be very happy. Some years the earnings are going to be up, some years the earnings are going to be down, but I think over time, this is going to grow, and I'm going to make a tremendous amount of money." And owning a fraction of that through the shares, he said "Let's just leave the thing alone."

And that essentially is our strategy, and one of the first think pieces that Murray Stahl wrote when we first opened up Horizon Asset Management was, can a bad manager beat the S&P 500? And the answer is, yes, provided they actually have low turnover and they let the portfolio naturally un-diversify. And you're going to have bad investments. You're going to have average investments. You're going to have some good investments. Ultimately, those good investments will start dictating the return characteristics of the fund, and you'll end up with great results. And really, that's the whole trick of what we do. So it's really discouraged within the investment profession, and we are truly an anomaly. I can count on literally one hand the number of people that actually have allowed for concentration over the time through a buy and hold strategy within the mutual fund industry itself.

So let's talk about the largest position there, TPL. TPL obviously has a large impact on our returns. It's going to have a large impact on our returns going forward. If you look at TPL today, it has a market capitalization of roughly $16.5 billion. It has zero debt. It has roughly half a billion dollars' worth of cash, so in terms of financial risk, there's no financial risk to TPL. That does not mean that TPL cannot go down in price. In fact, I don't even know where it is today. It could be down today for all I know. But if you look at it, TPL is approaching or might even be exceeding $700 million of revenue in 2022.

There's really no reason for TPL to have any type of expenses. The current management and directors have built up expenses, but the reality is that the net margin for TPL really could be in excess of 70%. Really, the only expense really should be taxes. So if that's true, then today's revenue number, it could generate net income of about $500 million. You put a 25 multiple on that, not excessive, in fact, below what the Shiller P/E index is right now, and you get to about $12.5 billion of value. You look at the 900,000 acres of land that they own, and you put a reasonable valuation. Texas A&M has a per-acreage land of rural real estate in Texas of about $4,400. I think TPL's is a little bit more, so let's make it $5,000. You get about another $4.5 billion. So that currently justifies the price of TPL.

If you believe that the spending that's going on to discover oil and gas is going on in the Permian, and it's going to continue to grow, TPL is essentially a gateway in order for that to happen. And we don't really view TPL as an oil company, even though that's how it's technically labeled. It's really a real estate company. And it's a toll road. In order for people to get on the property to put pipelines through the property, they're going to have to pay TPL some type of fee. And that fee is likely to grow very substantially. And if you believe as we do that the price of energy is likely to go higher because the demand continues to grow but the supply is not growing to meet that demand, and no amount of warm weather in Europe for the last several weeks, no amount of releases from the Strategic Petroleum Reserve (SPR) is going to stop that dynamic, longer term, the price of energy is likely to move a lot higher, and hence, TPL is likely to move a lot higher.

That being said, I want everyone to be perfectly clear in their understanding. There is price risk with what we do. In the words of Warren Buffett, we'd much rather take a lumpy 15% return than a smooth 10% rate of return. So, a long way of saying that TPL has been a wonderful investment for us for a long period of time. We've owned it professionally since the mid-1980s, so we're talking about a long-term investment. And it's likely to continue to be a very good investment for a long period of time.

For investors, there are really two critical questions, in my opinion, looking out into the near future. The first is whether or not you get the inflation question correct. And most people believe that the federal reserve, as a result of their interest rate policies, are going to dampen demand and bring down inflation. In the more recent past, that seems to have been the case. Secondarily is: what's really part of the inflation equation? The real inflation is caused by two main factors. One, it's caused by excessive spending, which is really what's going on in this country and around the world. And two, it's going on through the money creation that's going on through the central banks around the world.

So if you look at what's going on, Janet Yellen, actually yesterday, I believe, wrote a letter to Congress saying that as of this Thursday, January 19th, that the US government would be up against its maximum debt ceiling. It would not be able to maintain its normal operations as a country, and it would have to stop funding retirement accounts for postal workers and things of that order. Now, keep in mind, the Congressional Budget Office, back in June of 2022, made a prediction that we would not hit this date, hit this ceiling, until the 3rd quarter of 2023. So six months ago, they made a prediction, and they were off by nine months.

At some point, you know, there's going to be squabbling here. They're going to increase the debt ceiling, and the debt burden of the national debt of this country right now is about $31.5 trillion. And the Congressional Budget Office is expecting that the debt burden by the year 2027 will grow to $44 trillion, and yet, the GDP that they're expecting to grow from roughly $25 trillion today to only $28 trillion in 2027. I think these are probably conservative estimates, $13 trillion more debt to get $3 trillion more of GDP growth.

So the debt crisis that's going on and the inflation that's likely to be caused of that, that's one aspect of it. The second aspect of it has been the gross underinvestment in commodities and natural resources that has gone on in earnest for the last ten years, and I think Murray traces this back more to like, 40 years. It is estimated that we hope to –implement the climate goal policies that are being put in place by the year 2030. At least 180 new mining operations would have to come online for that to be possible. Now, keep in mind that the average mine that comes into existence takes about roughly 17 years. That's between buying the land, the permitting, getting the necessary permits to function, and getting the operations up and running. So in order for that to happen, they would have had to start a number of years ago and would have had to invest at least a half a trillion dollars by this point. So their expectations of hitting the 2030 climate goal is not likely to happen, and as a result of the lack of spending and continued growing demand, the prices of commodities are likely to move substantially higher.

So if you get that inflation question wrong—and that's really the question that we got right in 2022, and therefore, are among the small number of managers that actually performed well in 2022—if you are of the belief that it's going to stay down, interest rates are going to be able to control inflation, and you're making your investments on that determination, you're likely to be in for a very bad experience.

The second thing is that the valuations are not cheap. As I mentioned earlier, the Shiller P/E, CAPE P/E multiple is currently about 29.4x. The mean has been about 17x, and I think the median has been about 15x and change. Bull markets start when that is in the low teens or even single digits, so to think that valuations are going to go up from here, you have to believe that a bull market is going to be starting from very elevated levels, in fact, more elevated than in 2000 before the tech crisis. So there are two real main issues. There's the inflationary issue and the valuation issue. And how inflation seeps its way through the economy and what securities you select are really going to determine your success or failure looking out into the future.

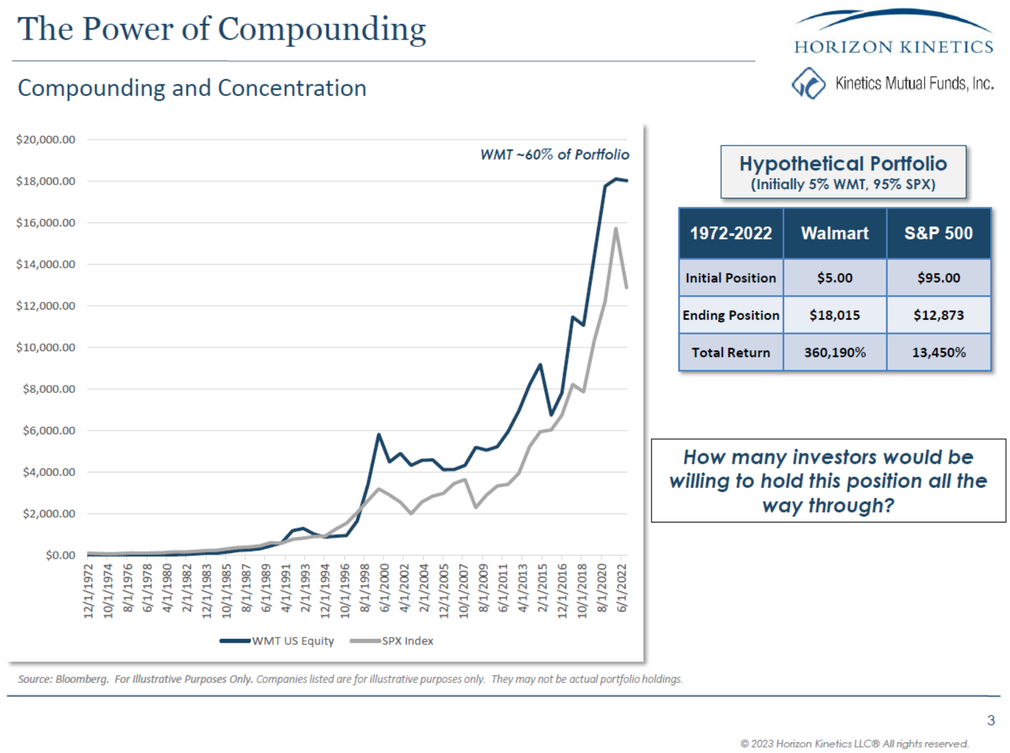
And I think that you know, as we have spoken many times in the past about finding companies that are really capital-light in terms of plant, property, and equipment-light and can basically raise prices without being tagged with the associated costs on the capital side, as these are the ones that are going to do best. So those are the things that we are focused on. Those are the areas that we're trying to navigate on behalf of investors.

We think that we're positioned well; that doesn't mean that on a week to week or month to month basis we're going to outperform, but if you take a longer-term time horizon, the companies that we own have better return characteristics, are more attractively valued on balance, and if you let that play out with the passage of time, you'll end up with much better results. And that's exactly what's happened over the last 20 years for us. So I expect nothing will change. There will be periods of underperformance, but that's just the nature of trying to accomplish what we want to do.

So with that, I will turn it over to James.

James Davolos: So thanks, Peter.

I'm going to have a lot of data to reinforce a lot of the topics that Peter already talked about, but if we move onto the first slide, I think that this is apropos of our current experience with Texas Pacific Land Trust. This is a portfolio that hypothetically started in 1972 with a 5% weighting in Wal-Mart and a 95% weighting in the S&P 500.

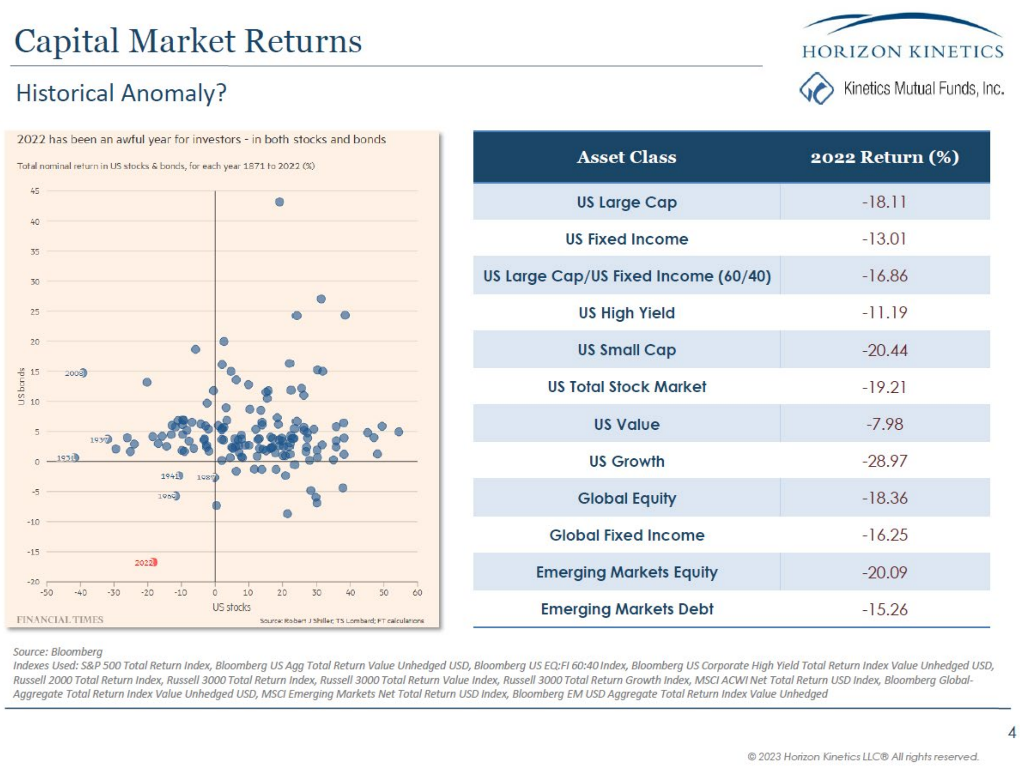


As you can see, obviously it undiversified very rapidly to the point where by the end, you were about 60% Wal-Mart and 40% S&P, but at any point in time, and the scaling makes it hard to see, as the blue line crept higher and higher, so once they've crossed, they're at 50/50, and then obviously, when blue is above gray, you have a higher weighting in a single position than you do in the rest of your entire index. Institutions would have sold at any time, and they would have missed out on a 360,000% cumulative return relative to a 13,000% cumulative return in the S&P 500. And so this begs the question, at what point would it have been prudent to sell?

As you can see, actually, at the very end of this chart, it would have actually never been prudent to sell. I mean, of course, you could have tried to have top-ticked the tech bubble back in 1999, but with the S&P coming back down, you know, 20-some-odd percent off of its peak, Wal-Mart's held its value where you can see the blue line going flat versus the down in the gray. And so yeah, inevitably, there are going to be periods like you experienced in 1999/2001 where performance moderates but then there's another upcycle.

That's really what you're looking to accomplish here. I think obviously there was an excess in the broader market. Wal-Mart was a tech stock back in '99 and 2000, but it has still fundamentally outperformed and provided a lot of diversification and portfolio value to people that were willing to do the fundamental work on the stock. So with that, I'll get into some of the more fundamental data on the portfolios and on our top down and bottom-up outlook.

I think everybody understands what a bad year last year was. You know, obviously in a lot of down years, you can hide, for lack of a better word, in debt. But you can see -- I think what's really striking is you see a huge cluster here on that graph on the left-hand side, where bonds are on your Y axis, and stocks are on your X axis. In a normal year, you're somewhere in the upper-right quadrant, so you know, nominally positive in both stocks and bonds, so your 60/40 portfolio does just hunky dory.



Asset Class	2022 Return (%)
US Large Cap	-18.11
US Fixed Income	-13.01
US Large Cap/US Fixed Income (60/40)	-16.86
US High Yield	-11.19
US Small Cap	-20.44
US Total Stock Market	-19.21
US Value	-7.98
US Growth	-28.97
Global Equity	-18.36
Global Fixed Income	-16.25
Emerging Markets Equity	-20.09
Emerging Markets Debt	-15.26

Source: Bloomberg
Indexes Used: S&P 500 Total Return Index, Bloomberg US Agg Total Return Value Unhedged USD, Bloomberg US EQ:FI 60:40 Index, Bloomberg US Corporate High Yield Total Return Index Value Unhedged USD, Russell 2000 Total Return Index, Russell 3000 Total Return Index, Russell 3000 Total Return Value Index, Russell 3000 Total Return Growth Index, MSCI ACWI Net Total Return USD Index, Bloomberg Global-Aggregate Total Return Index Value Unhedged USD, MSCI Emerging Markets Net Total Return USD Index, Bloomberg EM USD Aggregate Total Return Index Value Unhedged

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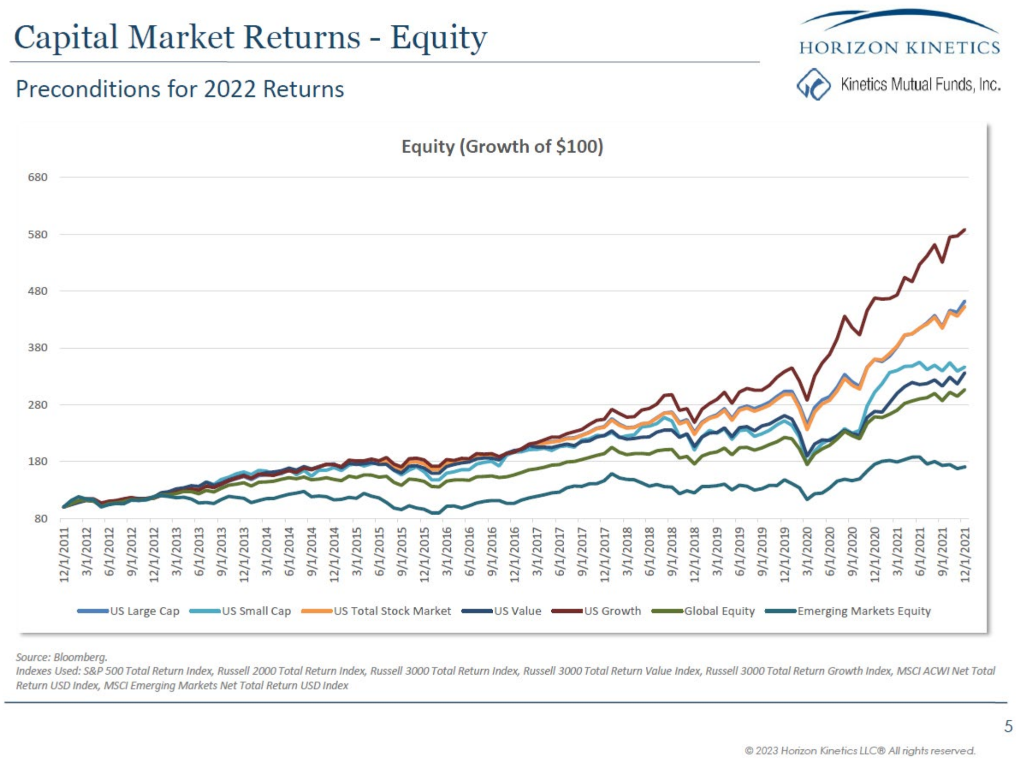
In years where you do have negative stocks, so this is where you're on the left, you tend to be above the horizontal line, meaning that you are still positive with your bonds. So you can see the most extreme outlier, the furthest to the left there is stocks in 2008 where stocks were down almost 40%, but your bonds gave you 15%. 2022 was wholly anomalous in the fact that you had a highly negative year across asset classes. You know, on the right-hand side you can see down 20ish percent in US large cap, down 13% in fixed income, so your 60/40 was down 17%. So this really created a lot of pain for overall market allocations, people who thought they were "diversified." I think a heuristic, or you know, chart-oriented analysis could say, okay, this is an anomaly, I think that we should get constructive on one or both asset classes going into the next couple of years.

But if we shift to Slide 5, what were the preconditions for 2022? So you can see the decade leading up to 2022. Here, we're going back to 2011, so not that long after the snap-back recovery out of '08/'09, but you're not in an extremely distressed crisis environment like you were in '09 and even in early 2010. But you can see the dark red line. You're 6x your money in US growth. Total stock



market value, you're 4.5x, almost 5x your money. You can see kind of the only modest return, which is still an 80% return, is emerging market equity. That underperformance has to do with some things we're going to talk about later, but with the exception of a few deviations—you can see there's a little hiccup in the 4th quarter of '18, obviously, the COVID decline there in 2020—more or less, straight-up trend for every type of equity for ten years, so why should you be surprised that you see them decline the way that they did last year?

Moving onto Slide 6, we show the same series for debt. So obviously, US high yield is the best performer, where you about doubled your money in that decade with very low volatility relative to high yield as an asset class. Most of that return and its ability to preserve value last year is A) you have a higher coupon, and B), you have less duration. Overall, fixed income, you're still up well over 60%. You can kind of see a little bit lower, you have lower returns here in US fixed income as well as global. A big part of that is sovereign debt, yielding 0, 1, 2%, but again, fairly linear, fairly smooth, all upward trajectory.

Capital Market Returns – Debt

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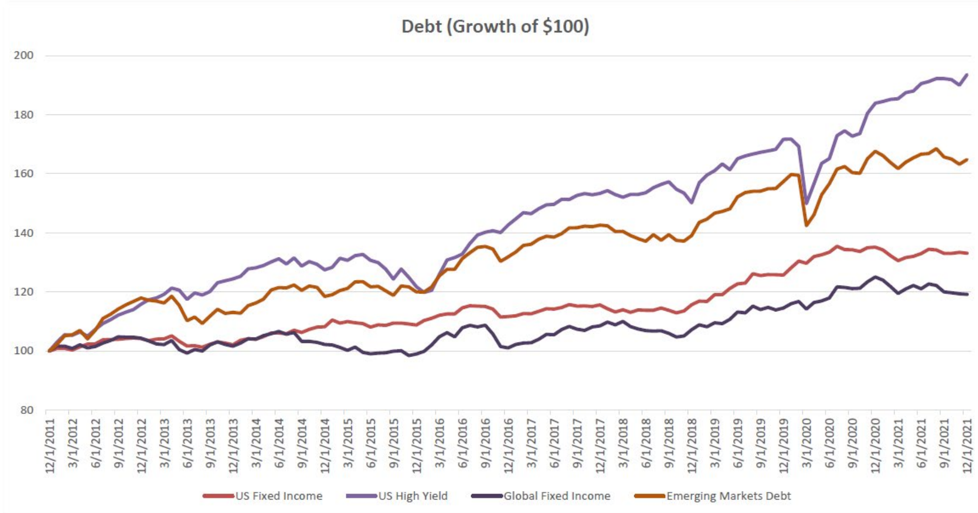
Preconditions for 2022 Returns



Source: Bloomberg
Indexes Used: Bloomberg US Agg Total Return Value Unhedged USD, Bloomberg US Corporate High Yield Total Return Index Value Unhedged USD, Bloomberg Global-Aggregate Total Return Index Value Unhedged USD, Bloomberg EM USD Aggregate Total Return Index Value Unhedged

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So Slide 7 shows you what were the preconditions that really allowed this, and this follows five big drivers and, I think, things that need to be really considered today. So obviously, the first four, you have effective Fed funds, 10-year Treasuries, CPI, and PPI. So we started at

Capital Market Returns

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Drivers of Previous Decade Returns

	Fed Funds Effective Rate	10 Year Treasury Yield	CPI YoY	PPI YoY	S&P 500 Profit Margin
12/31/2012	0.09	1.76	1.70	1.40	8.32
12/31/2013	0.07	3.03	1.50	1.40	9.60
12/31/2014	0.06	2.17	0.80	-0.60	9.23
12/31/2015	0.20	2.27	0.70	-2.70	8.25
12/31/2016	0.55	2.44	2.10	1.90	8.55
12/31/2017	1.33	2.41	2.10	3.20	9.15
12/31/2018	2.40	2.68	1.90	1.30	10.23
12/31/2019	1.55	1.92	2.30	1.70	9.45
12/31/2020	0.09	0.91	1.40	-0.80	7.36
12/31/2021	0.07	1.51	**7.00**	**12.30**	**13.13**
12/31/2022	**4.33**	**3.87**	**7.10**	**10.60**	**11.14**

A new "normal" is emerging.

Source: Bloomberg

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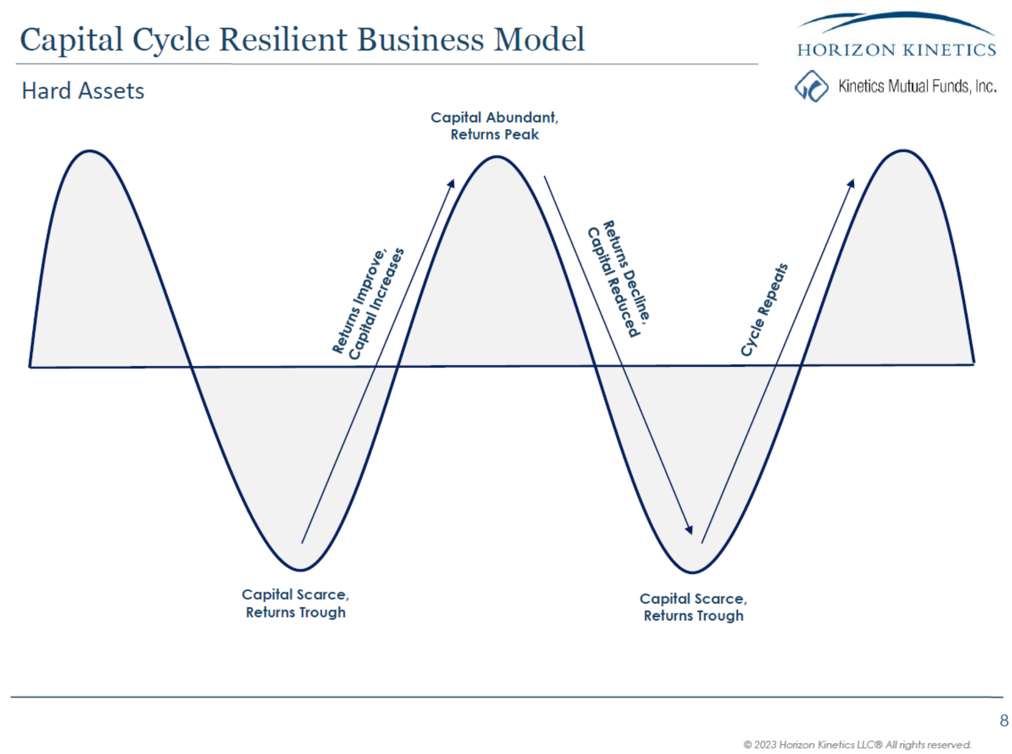
nine basis points (bps). We got it all the way up to 240 bps in 2018. We took it back to zero. Today you're at 4.33%. Again, this is the effective rate at the end of 2020. Same thing with the 10-year, you know, we started it at 175bp. We were still under 3% at the end of 2018, back down to 90 bps, the actual bottom. I think in 2020 it was 50 bps. Now we're at 4%.

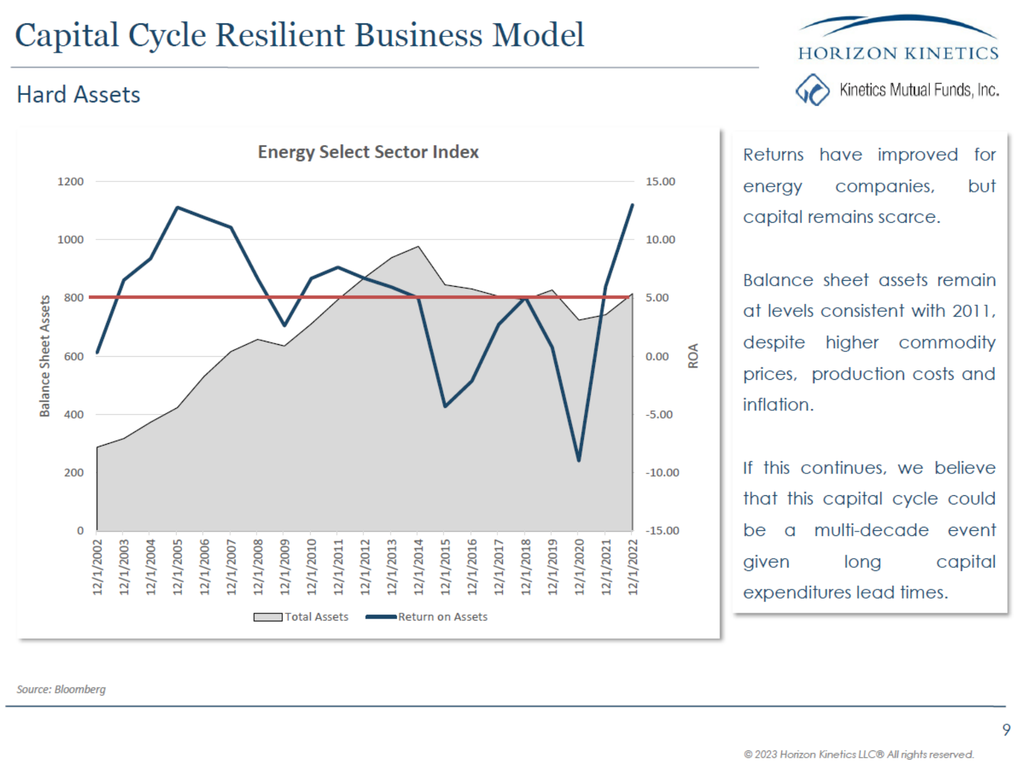
What caused this? Obviously, CPI; so pretty much throughout that whole time series, you were in the Fed's kind of band of 2ish percent inflation. You know, you can bump a little bit above at 2.30%. Long before the pandemic, we were well below 70 and 80 bps in 2014 and '15. Then you see a 7% in consecutive years for 2021 and 2022. PPIs, which are much more volatile, you know, you can see some negative years, but we started at 140bp, you know, even had a -3%, but then 12% followed by 10%, so and when you think about where we are relative to "transitory," I'll talk about this later, a 7% compounded at another 7% for CPI, a 12% compounded at another 10% for PPI, you know, and we're holding these levels.

Now, here's the most important one, which again, we'll address later. You started in 2012 at an 8% profit margin for the S&P. You got as high as 10% in 2018 when it was fairly restrictive policy, dropped down to a low of 7% and change during the pandemic. Obviously, a lot of that was altered by the 1st quarter. In 2021, revenues go up, costs stay flat, 13% margin. In 2022, revenues continue to go up somewhere between 7% and 10%, but simply through CPI and PPI growth, margins coming back down to 11%. So this is a new normal to consider. What's going to happen to those profit margins and what's going to happen to the growth rate of CPI and PPI? You cannot bet on anything remotely close to those preceding ten years that we just showed you, and that's why I think that maybe looking at 2022 in that type of context, it doesn't look all that anomalous.

So Slide 8, I think, goes through a concept that I think is going to be extremely important for our returns, and it's fairly simple, but it's the capital cycle concept of. You can see there at the bottom, capital is scarce and returns trough, and so this could be for an entire economy, but is usually more specific to a single industry. As your returns improve, you start seeing more and more capital going into that industry. So finally, as returns peak, capital is extremely abundant. That actually chases away returns, and then you start seeing those returns decline. These are returns on capital, return on equity, return on invested capital, whatever you want to look at. So eventually, as that capital is reduced, capital becomes scarce, and then your returns trough and you start that cycle all over again.



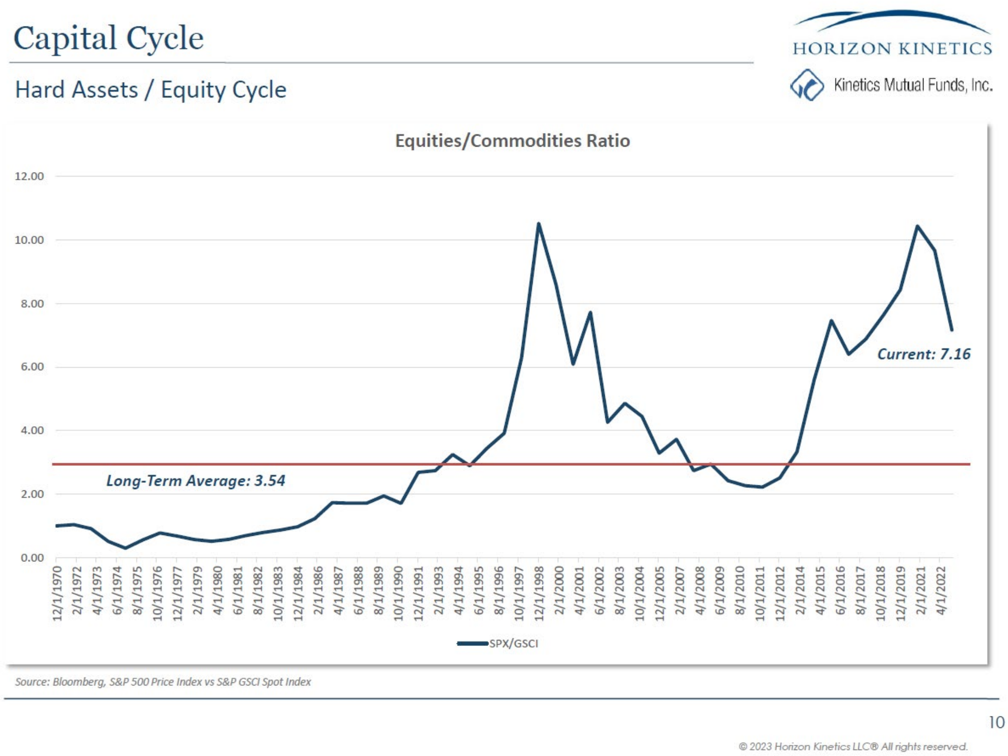
I would think of probably 2021 as a trough in terms of returns and capital availability and energy. And then if you want to look at the peak, that's tech. That's healthcare. That's all of these high-growth sectors. So obviously, you're starting to see some capital being withdrawn from high tech. But you haven't really seen any capital come back into energy, basic materials, things like that.



So on Slide 9, we actually go through the capital cycle for energy. The blue line shows you the return on assets for the Energy Select shares, which is very similar to the S&P Energy Composite. The gray line is the total assets. So, let's go back to 2013 into 2014. That was the last shale boom and bust, where people still believed in the shale growth, that we were going to see free cash flow, we were going to see returns on investment. That was peak capital, so everybody had abundant capital. That's where balance sheet assets peaked.

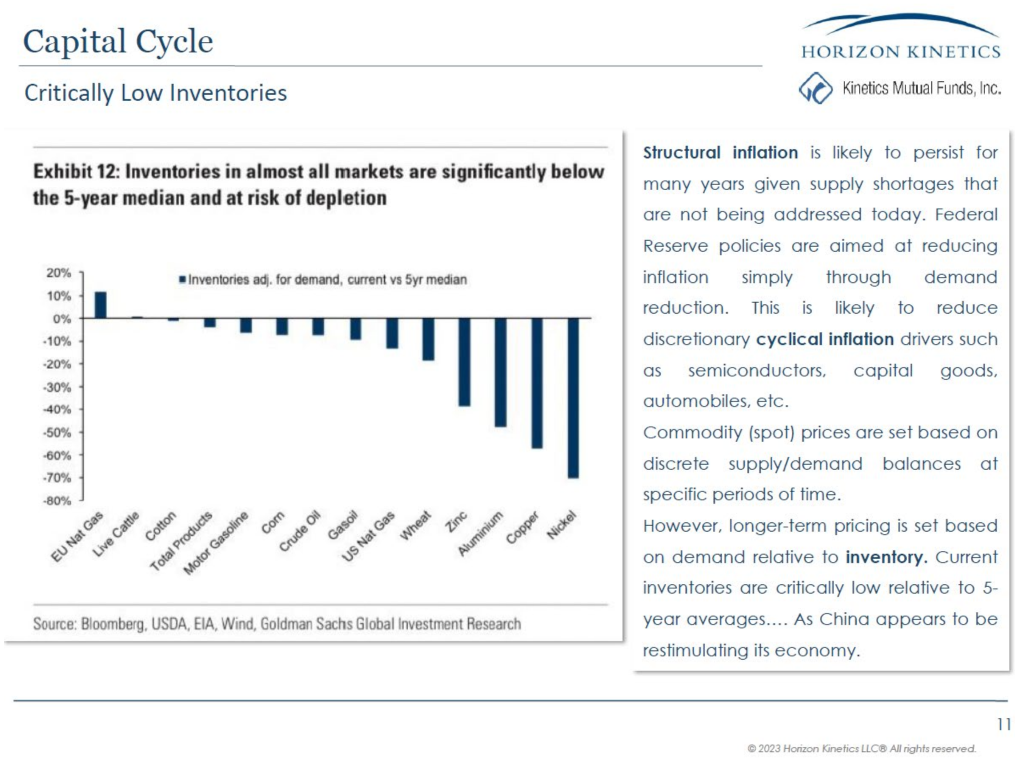
You've seen we've been in a steady decline with pretty poor return on assets, very volatile. We've spent a lot of this time negative, but if you look at the red line, without adjusting for inflation, we're about, in terms of energy sector balance sheet assets, at the same level as in 2011. We're a decade behind, and break-even costs are up. Labor costs are up. By the way, if you even just apply a basic CPI/PPI analysis, your unit economic costs are at least 30% higher. So this is a capital cycle. 2014 was the peak; abundant capital, then capital is withdrawn. Returns stayed poor. There was too much capital chasing bad returns. Now we're at the bottom, but you're not really seeing assets coming back into the industry. That slight uptick you see there in the gray, a lot of that is actually retained cash flow, not actual new capital coming back into the industry.

So I think that we're going to have people talk about your conventional seven-year economic cycle, your conventional seven-year market real estate cycle. I think the nature of this cycle is going to make this a multi-decade cycle. Same thing with equity and commodities.



Slide 10, please. This actually tracks, going back to 1970, the ratio of the S&P 500 to the S&P Goldman Sachs Commodity Index. You can see now how they moved roughly in tandem, slight upward trajectory from 1970 through 1990ish, which that should happen. All else equal, companies should earn a return on equity and a return above and beyond prices. So in a normally functioning world and economy, you should see a positive upward-sloping line in that blue.

The deviation started around 1990/1991, which coincidentally is kind of where we saw some Savings & Loan crises, a little bit easier money, and lo and behold, the tech bubble. So you go from a ratio of about 2 to about 11. That blowoff top fully corrected through, we'll call it, the value-investing cycle through a bottom in '08/'09 back to around 2ish. The most recent, I'll call, the zero-interest rate free money tech bubble 2.0, you again went from about 2 at the end of the year in about 2010 through about 2011. We have reverted a little bit. Some of this is commodity appreciation off a low base. Some of it's also the S&P 500 falling. But if we were to take that ratio today of 7.16 and revert to the long-term average of 3.5, commodities and commodity-related assets still need to double relative to equities to bring this back into historical balance, and this doesn't include overshooting, which tends to happen every cycle.



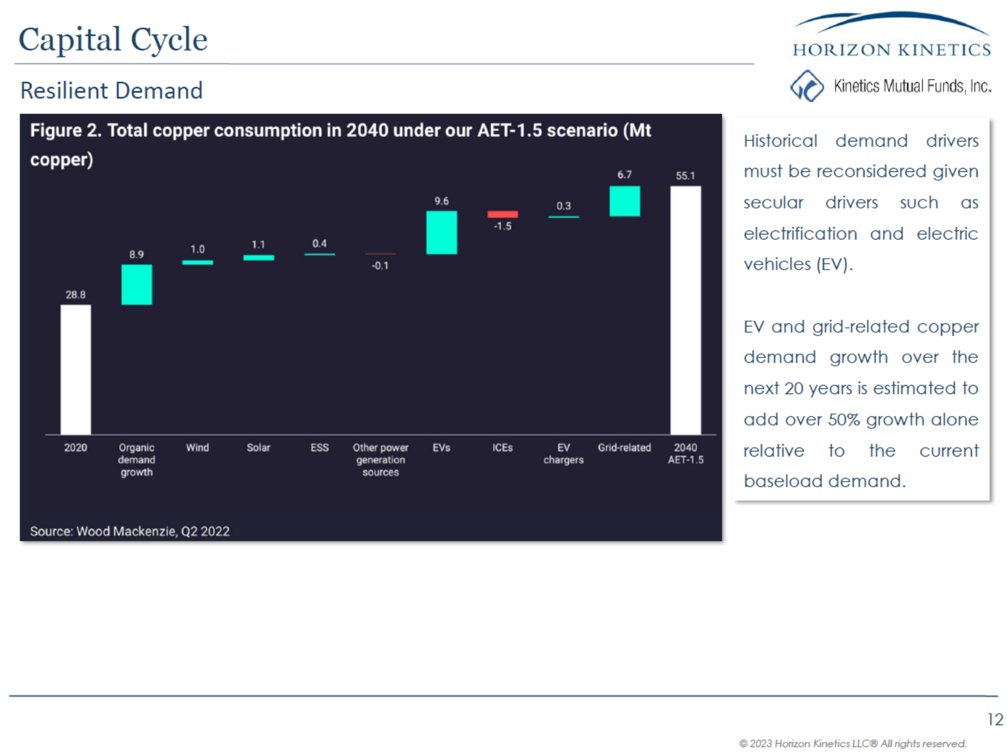
The next slide is on inventory. So this chart is from Goldman Sachs Investment Research, but it's pulled from Bloomberg, USDA, IEA, etc. This shows the relative inventories of strategic commodities relative to five-year median levels. So EU net gas, that's an anomaly because we saw a hoarding of gas going into the winter when we knew there was going to be no Nord Stream and no Russian gas. This data was actually taken before the anomalously warm winter, so I think you need to take that with a grain of salt. You know, basically, if the EU were to fill their coffers full, under negative draconian scenarios, that would have been drawn down and needed to have been restored by US Liquid Natural Gas (LNG) cargo. This warm weather is really helping.

But as you go to the right, you see 80% shortages in nickel, 65% shortages in copper, 50% in aluminum and zinc, also wheat, critical food inputs about 40%. So when you think about how critical these raw materials are, all four of those materials on the right, they're absolutely imperative to the "electrification" of the world and the energy transition. So even without positive economic growth, and I'll get into copper in a moment, these are going to have a huge structural bid, even with very modest economic growth, given the fact that there's just a tremendous amount of solar, wind, charging station, electric vehicle demand for all four of these metals.

Nobody's putting money into the ground, and it's a 15-year lead time for these mines. Wheat and corn are also incredibly important, where food was a huge inflation input. We're seeing much lower yields in the Black Sea region, which is one of the second-largest grains market in the world. Part of that is because of the conflict in Ukraine. Part of that is lower fertilizer implementation, and part of it is also weather, whether it's Brazil and Argentina or also in the Black Sea. So the point here is that these are structural inflation drivers that are going to take a very long time to fix, and this all fits right into the capital cycle theory.

Cyclical inflation drivers, yes, they are rapidly and obviously correcting. There was plenty of semiconductor capacity. We got the plants online. We got workers back into the plants. Now there's plenty of semis. Capital goods, washers, dryers, refrigerators, things like that that people needed when they were renovating homes; there was no lack of ability to produce these things. Automobiles, plenty of used automobiles. You know, there was a lack of semis. There was a lack of auto manufacturing. These things correct, and so for people to kind of think, okay, great, inflation is transitory; these things are correcting, yeah. Obviously, they are and they will.

Then there are the structural drivers, which are energy, base metals, food products, fertilizers, land, things like that, there's really no sign of that correcting other than just kind of typical market volatility. And inventory is going to be an absolutely crucial part of this story. So you can see right now gas prices both in the US and Europe are very weak. That's because there's a discrete component going on here in terms of draws versus injections relative to a very warm situation in Europe and in the US. Freeport LNG is down, which if the US can't export all of this gas we're producing for export, we have to go into what's called containment in the US. There's nowhere to put the gas because we're relying on it getting shipped through Freeport. So there are a lot of things that I think are manipulating short-term prices, but longer term, look at where structural demand is relative to comparative inventory, and it's pretty hard not to get excited about the situation. Oh, yeah, China is reopening, and we haven't even really started to see the real effects of that yet.

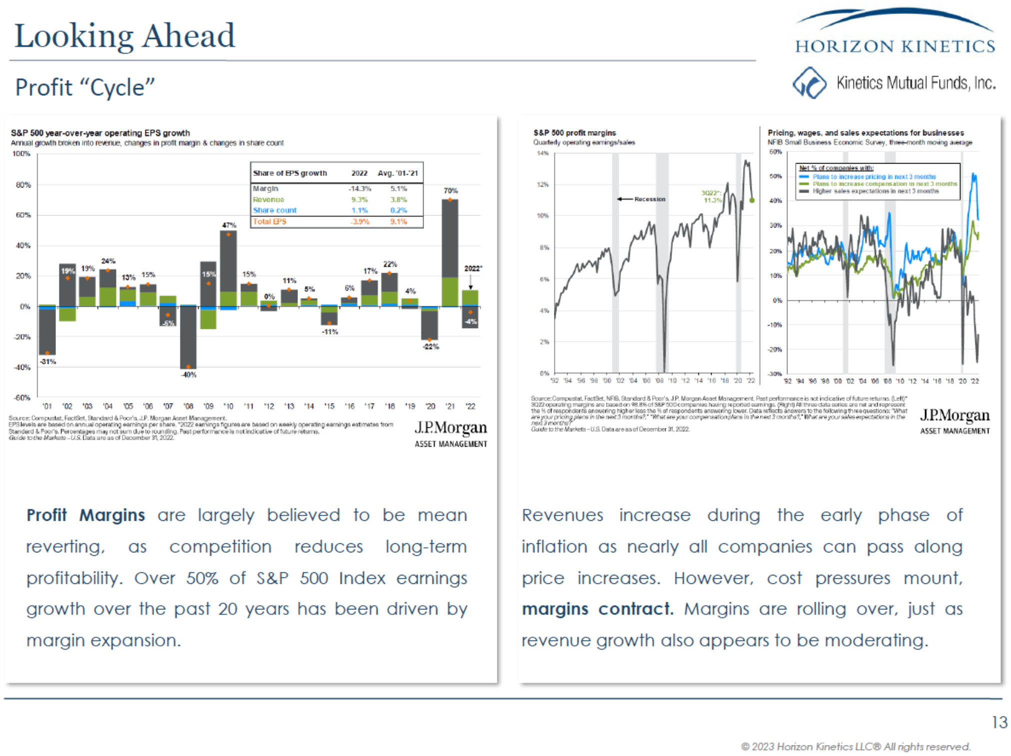


So moving onto the next slide, I talked about copper earlier. So you can see the base line rate of demand of 28.8 million tons in 2020. So a lot of this is things like commercial construction, infrastructure; a lot of that's the power grid. Automobiles and transport manufacturing as well as appliances; appliance manufacturing is actually a huge copper demand. So all four of those are fairly cyclical, fairly big cap cycle driven. So a lot of people say, oh, no, we're going into a recession, these things are going to fall off a cliff.

That's not exactly true, but if you look here, and this is through Wood Mackenzie, who is pretty impartial. I wouldn't say that they're bullish or bearish on all of the material they cover. They're very fact based. This is not even under a net-zero scenario. They've basically said net zero is not possible given the world's mine situation, but under the AET-1.5 scenario, which is a more moderate version of accelerating kind of the EV and grid transition, you're basically going to add almost 20 million tons of incremental demand. Most of it you can see there is EVs and grid-related, large amounts from wind and solar. Also, ESS is electrification service stations.

So that's a big demand driver of about 50% relative to the base level. That doesn't include 9 million tons there, the first blue bar, relative to just simple development of infrastructure, appliances, transportation, and power grid. So structural drivers here, and it takes 15 years to get these mines online, and nobody is putting money into the ground, parallels for this across all of these end markets, and that's why there's going to be a big structural demand push.

The next slide actually goes into what I talked about earlier about profit margins. The left-hand side shows you an analysis from JP Morgan of earnings in the S&P 500 over the last 20 years. You can see earnings per share grew at a CAGR of about 9% a year, which is phenomenal; 500 bps of that was profit margin; 400 bps of that was revenue, and 20 bps was declining share count. So look at that; 500 out of 900bp was growing margins, and these are at risk, big time at risk.



If you move to the right-hand side, you can see that rollover in profit margins I mentioned earlier. But on the right, you see some pretty concerning data points where the companies that are expecting higher sales are actually declining, companies that are going to try to increase price is declining, and companies that need to increase compensation is actually static. So I think all of this is contributing, and the big story going into 2023 and 2024 is profit margins.

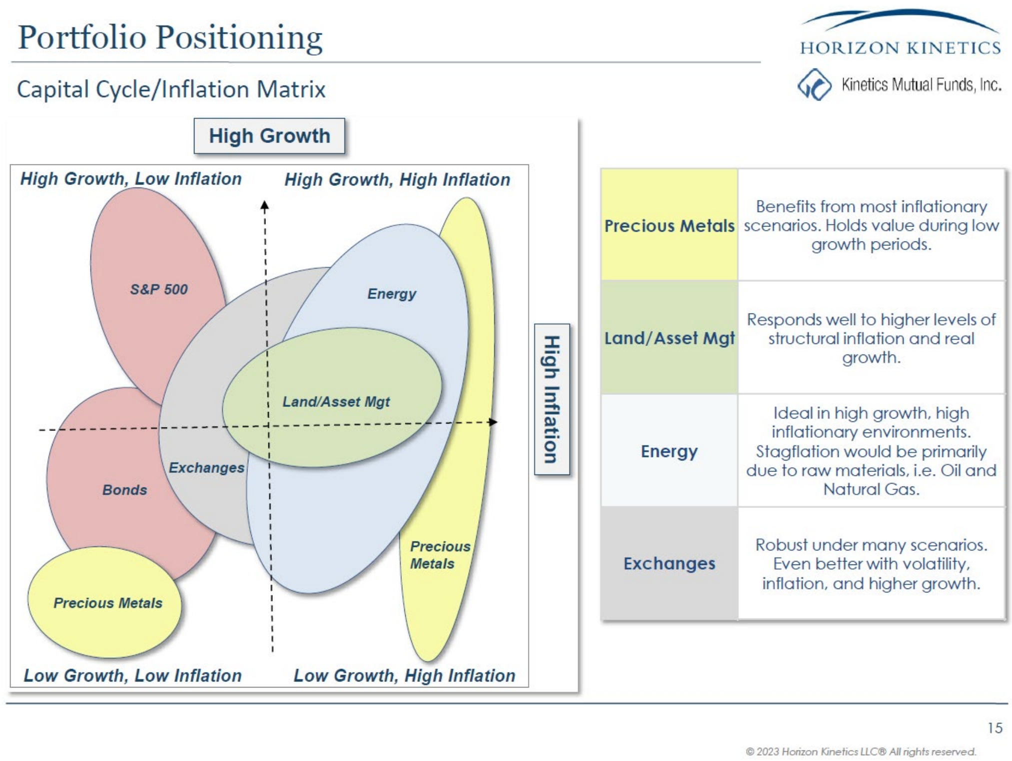
And most companies just aren't set up to have resilient earnings, because as I mentioned before, the knee jerk reaction coming out of inflation is that everyone can push price. No matter, even if you have a horrible business model, it's very easy to push on price. Your revenues go up. You can see, actually, going back to the left-hand side, revenue was a 930bp driver of earnings last year, but you had a 1400bp contraction in margin. Now you're seeing that revenue push is fading, but the cost push is accelerating. So again, you really need to think about what are the unit economics of the businesses you're invested in, and how can they operate in this new type of environment? I'll give you a hint. It doesn't bode well for most of the mega-capitalization companies and certainly not the profitless tech companies that were the big winners of 2020 and 2021.

Moving onto Slide 14, so this is a chart from Howard Marks of Oaktree. This is something we've been talking about a lot lately, whether you've listened to our conference calls or our read our commentaries, but the fact that we're shifting from an era of abundance to an era of scarcity, another way to put it is an era of plenty to an era of shortage, but look at all these differences of the last decade through today. Fed behavior, inflation, economic outlook, and then Howard Marks talks through the lens of credit. So, the likelihood of distress is rising, mood, buyers have gone from eager to hesitant, holders from complacent to uncertain, key worries have changed from fear of missing out to loss, risk aversion, credit window —that's a big one—from wide open to constricted; financing, again, plentiful to scarce market-wide. Interest rates lowest ever, and he's saying they're just more normal today, not even high. Yield spreads modest, again, they're not high; they're normal. Prospective returns, again, this is in credit; lowest ever to more than ample.

But you know, let's say if you don't think highly of Howard Marks, you can look at Stan Druckenmiller. You can look at any number of very astute investors. Everyone is kind of now echoing what we've been talking about on this shift. So what type of companies do you need to look for? You need resilient revenues. You need stable or rising profit margins. This is really important. You need a fair, if not low, valuation, moderate or low leverage. You know, because some people say, well, leverage works great in a huge inflationary debasement environment. Yes, but you have to get to the other side, which if you're over-levered, you don't know if you can get to the other side. This is also really important; low index representation. So if you look at the chart there back on the left, the mood; optimistic, guarded, buyers eager/hesitant, holders complacent/uncertain, there is still a very large amount of people that are hoarded into the largest constituents across all of the indices, so we still think that a lot of the equity market's going to be at risk.

So I'll just give you a quote, actually, of one of my favorite investors. He's not as well known, but John Arnold of Centaurus Partners. He's a multi-billionaire from trading natural gas. If people remember Amaranth, he was on the other side of the natural gas trade that collapsed that firm, but gas trading is a highly quantitative data-driven exercise. They're looking at comparative inventory. They're looking at injection. They're looking at demand. They're looking at weather patterns. They're looking at exports. It's not speculating. They have a very, very high degree of informational advantage, but things can change. Weather can change. Export can change. Wars can start.

So nothing's a sure thing, but John Arnold, who's now retired, said the multi-decade trend of globalization has created the capacity of massive monetary and fiscal stimulus without inflation. I don't think that there's an appreciation, especially amongst politicians, of how a reversal can have the polar opposite effects. So basically, what he's saying is you can't have your cake and eat it too in this new world. I personally don't see politicians having fiscal discipline, so what this is going to mean is stickier, higher inflation and probably stickier, higher interest rates.



So moving onto Slide 15, how do you invest? The million-dollar question, and again, this is just a matrix of the types of pf companies that we think are going to do well or okay in this environment. But it really comes down to the hard asset capital-light businesses. Do you have a hard asset, tangible, finite, high-valued asset base on your balance sheet that can inflate but you don't have the cost structure to where it costs you a lot of money to monetize that?

Personally, I think precious metals have a very good setup for the year ahead. I think Peter can echo some comments on how that might set up for crypto, but they benefit from most inflationary scenarios but also hold value during low growth. In the event that we do see a pause in Fed policy, which we're not even going to speculate on, or a reversal, I think all of these things may just shoot up. –If the necessary medicine to cure the patient kills the patient, that means that we're just never going to do it, so that means continued debasement, continued above-trend inflation; so fiat currency is not the place you want to be.

Land is actually one of the greatest assets to own through any economic cycle. This is separate and distinct from real estate. There's a carrying cost. There's a yield. There's interest-rate sensitivity. There's cost sensitivity on your NOI. Land is raw land. If you just own raw land and let it appreciate for decades, it's been one of the best-performing assets but almost completely unavailable institutionally. I know of a couple of companies that have a lot of raw land, one of which is in West Texas. Another is in Western Canada. Another is in Southern California. So there are assets out there. Another is in the panhandle of Florida. So there are assets out there. Most people just don't know about them.

Energy, capital cycle; that's all I need to say. So could there be some hiccups with a recession with some demand? Yes, we don't think it's our base case, but structurally, it's where you want to be.

Then lastly, exchanges; I mean, exchanges benefit under a lot of scenarios, but most of it is higher volume. But higher volatility drives higher volume. We actually saw a bit of liquidity drain last year somewhat constrict volumes on the exchanges, but they all performed extraordinarily well.

So I'm going to turn it over to Peter here and just let you know that I think that we're where you want to be. I don't know if it's going to be the place you want to be for a month, three months, six months, but as those months add up and start to turn into years and decades, my confidence is not incrementally, it's logarithmically higher that this is where you're going to want to be. So with that, I'm going to turn it back over to Peter for some closing remarks, and then we'll see how much time we have for some Q and A.

Peter Doyle: So thank you, James. And I was remiss in not mentioning Bitcoin, and James, I think, hammered home the point about structural anomalies and things that are fundamental that are going to drive markets as opposed to cyclical things that are currently driving the markets.

So if you pay attention to Bitcoin, it's the same dynamic. The hashing rate is going higher on a daily basis. The machine prices have collapsed. I don't know that they're at their lows. Maybe they're going to come down further. And the halving gets closer each day, and those are three vectors that Murray has spoken about many, many times that really drive Bitcoin. So my prediction, for what it's worth, is that cryptocurrency, Bitcoin in particular, is going to go on a run that's going to make people very happy. And I said that the performance of our funds in the short term maybe is going to be driven by Texas Pacific Land. I think the crypto side of it is going to add tremendous value with the passage of time.

So two things that are very encouraging; the crypto market is never really going to take off until there's a regulated exchange. People called FTX an exchange. It was not really an exchange. It was a brokerage house. The Chicago Board of Options Exchange has recently opened up a digital exchange, and if they allow a legitimate cash pricing of Bitcoin on a regular basis, the SEC is going to have no good reason for preventing an ETF to be developed in Bitcoin.

Second thing is that we've spoken about Gresham's law in the past, and that's where bad money drives out good. The number of people that are holding Bitcoin that are not transacting, and it continues to grow on a regular basis, and once a cash exchange comes, the small amount of Bitcoin that's going to be available for trading is going to trade like lightning, and it's going to create tremendous things.

So another very positive data point, the Bank of International Settlements recently encouraged all of the banks around the world to get a 2% exposure to cryptocurrency. So this asset class is not going away. It's here to stay, and it's on the verge, in my opinion, of breaking out in a very big way. So whether it's six months, nine months, I can't tell you. Bitcoin has held up and has rallied pretty attractively in the last couple of weeks, but this is something that people should have, and if you value your time, one of the most precious things that we have in life, and you see what central banks are doing to your wealth through the debasement of their currency, Bitcoin is an escape valve out of that system. And I think more and more people are waking up to that realization and are going to get exposure to it. So long way of saying it's a volatile asset, but it's one that's worth holding, and if you subscribe to what I had said earlier, basically buy and hold. You make your bet. This thing is not going away. Everything that we pay attention to on a fundamental basis leads us to be very optimistic about what's likely to unfold.

James Davolos: So, the first question is about where to specifically get copper exposure. There are some interesting companies that we've been buying, but we're in the process of buying them now, so I can't really talk about them.

But one company that I think is really interesting is Glencore. So Glencore was historically a trader of pretty much anything on planet Earth, whether it was grains, metals, energy. They shifted to more of an upstream operating business where they have some mining and infrastructure, but they have a really great incumbent base of low-cost copper with excellent distribution and smelting capacity. There's also a component of Glencore where they have a legacy portfolio that's really in runoff—they're putting no money into it—of thermal coal. And if you look at Newcastle Coal prices, so this is Newcastle, Australia, most of that's getting delivered into southeast Asia.

You know, this stuff has been supposed to be going away for, what, a decade now, and prices are through the moon. So until the non-OECD world stops consuming thermal coal, which is for powering your house (not met coal, which is made for steelmaking), and I don't think that they're going to stop using it anytime soon, I think those prices are going to stay high for a long time. There are only a couple of places that are mining it. A lot of it is in Australia. So Glencore stock trades wildly cheap, but the stub portfolio is everywhere you want to be. It's copper. It's zinc. It's nickel. It's cobalt. It's vanadium. So that's where you have your "electrification" metals, and again, if you do a sum of the parts, it's just incredibly cheap. They're paying down debt. They're paying a dividend. I wouldn't be surprised if they separate the coal business at some point in the next couple of years as a catalyst.

Chris: All right, since there are no more questions, we'd like to thank you for joining us today. And we'll look forward to doing this again in a quarter. Thanks very much for your time today. Good-bye.