OTSI KETA QUARTERLY

OTSI KETA CAPITAL

Eighteenth Edition - October 2014

Q3 2014

Otsi Keta Quarterly is designed to share insight on both current performance and future potential.

IN THIS ISSUE...

QUESTIONS...

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A MIDWEST UPDATE

From the Federal Reserve Bank of Chicago comes the Seventh District update on economic conditions impacting the Midwest. Overall conditions were reported as good with growth expectations reported as moderate. The outlook for the remainder of the year is optimistic. Consumer spending was led by the strength in auto sales, and there was an uptick in discretionary spending. The region remains poised to take advantage of the coming holiday season.

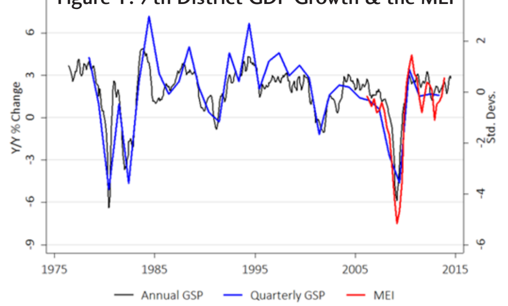
Capital expenditures for business increased as businesses announced plans for expansion in the near future. These plans will dovetail well into the strengthening dollar and dropping transportation costs (read oil). Growth in residential and nonresidential construction remained positive, but started to slow down from the beginning of the year. The commercial vacancy in the region ticked down slightly as business continues to evolve.

On the manufacturing front, auto, aerospace and energy industries remained the leaders in the Midwest. This has driven the demands for more steel, as the construction machinery market has picked up the slack for the slowing agriculture equipment market. As a reminder, the agricultural space is driven by the price of various commodities. As those prices have come in from 2012-2013 highs, demand has curtailed. We believe that this is part of the natural cycle in the agricultural industry.

Banking and finance remain a mixed bag in the Midwest, as well as by and large throughout the country. As we see interest rates compress, we believe there will be a strain on margins for banks in this region and the country. Due to this unknown factor, coupled with the standing mystery of what is included in the books of traditional banks, Otsi Keta Capital LLC continues to shy away from these investments.

Our takeaway from the recent update is that the Midwest should see good follow-through economically for the remainder of 2014 and into 2015. The November elections always throw some excitement into the mix, but our region, and more specifically our portfolio companies, should continue to improve.

Figure 1. 7th District GDP Growth & the MEI



Source: Author's calculations based on data from Haver Analytics

GSP: Gross State Product
MEI: Midwest Economic Indicator

The MEI is a weighted average of 129 state and regional indicators that measure growth in nonfarm business activity. Two separate index values are constructed, the MEI (providing an absolute value), which captures both national and regional factors driving Midwest growth.
–Federal Reserve Bank of Chicago

The takeaway from this graph is that a value above zero indicates growth in the region. The correlation between the annual GSP and the MEI indicates the potential for growth extending out over the next six months.

PEOPLE SAY THE DARNDEST THINGS WHEN ASKED QUESTIONS…

"I manage all the pension investments, and we don't own any bonds in any of the plans and never have."

We find ourselves regularly surprised at the responses the simplest questions can elicit. Our most recent example was an interview done on CNBC with Warren Buffet. (Readers know of our fondness for the octogenarian, known for his investing success and clever turn of a phrase.) Here's what we found surprising:

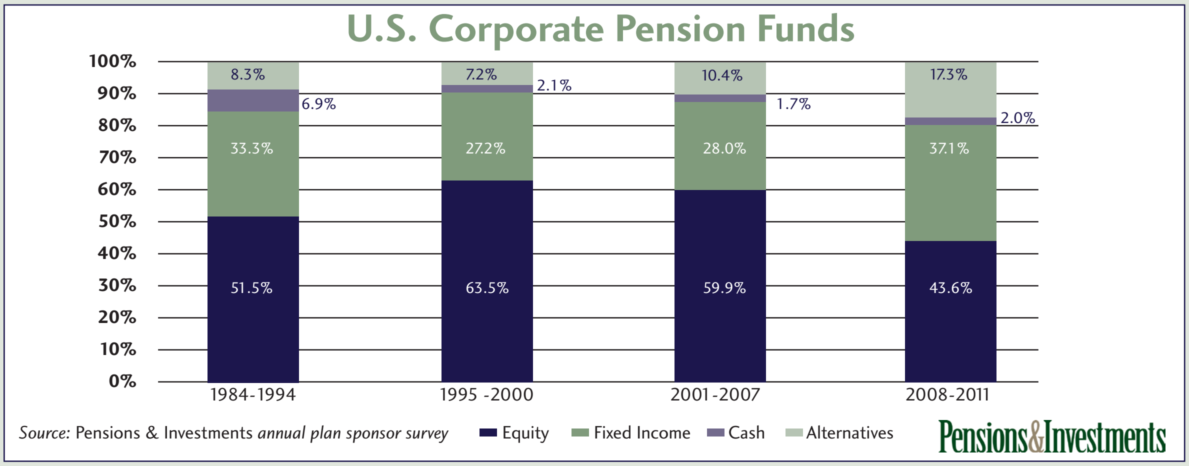
The question was a simple one. The interviewer asked if Berkshire Hathaway had any exposure to PIMCO through its pension plans. PIMCO is the largest bond fund manager in the world, a firm whose founder had resigned that week to go to work for a competitor. Berkshire Hathaway directly owns hundreds of businesses with pension plans, nine of which would be listed in the *Fortune* 500 if traded publicly. It was a solid question to which 99 out of 100 times the answer would be "yes." Buffett's response was "no."

This response begged the follow-up question, "How can you be sure, given the size and number of pension plans at Berkshire?" Now comes the best part of the story. Buffet said, and we're paraphrasing now, "I manage all the pension investments, and we don't own any bonds in any of the plans and never have."

You might want to read that last sentence again. The greatest investor in history doesn't use bonds as a component in the retirement portfolios of one of the largest companies in the world. Wow!

When asked why, he responded, "It just wouldn't make sense given that stocks historically outperform bonds over longer periods of time." Instead, he keeps enough cash on hand to pay for immediate benefit requirements and to ride out volatile performance stretches. The rest goes into well-run businesses he intends to hold for extended periods of time.

To our knowledge, there is no other company in the world doing it this way. Below is a chart on how the rest of the corporate pension funds in the country are investing.



It makes perfect sense when Warren shares his philosophy—despite how others handle the same situation.

In a funny aside, the U.S. Social Security system believes in investing in just one asset class to meet its future retirement obligations. The investment choice of the Social Security Administration—100% U.S. government bonds.

Current results: Berkshire Hathaway fully funded; Social Security Trustees say $13.4 trillion underfunded. Ugh.

WEATHERING THE STORM

"Does anyone know where the love of God goes when the waves turn the minutes to hours?"

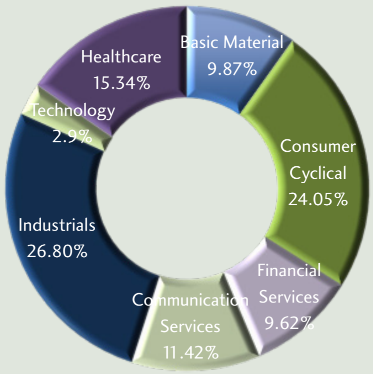
Gordon Lightfoot wrote those lyrics in 1976. The song, about the wreck of an iron ore carrier sunk by a storm, resonated with the nation and went to number two on the Billboard Top 100 Chart. We think Mr. Lightfoot wrote a pretty good ditty and benefitted from the public's insatiable fascination with storms and the carnage they reap.

The lyrics are a reminder that the world never stands still, but in trying times it often feels like it does. Feelings no doubt shared by the medical personnel quarantined for 21 days in Dallas waiting for an Ebola pardon. Investors could even be forgiven for thinking the songwriter had them in mind, given the volatility of market prices and global unrest during the quarter. Investors waiting for an all clear sign will have to wait longer for their pardon.

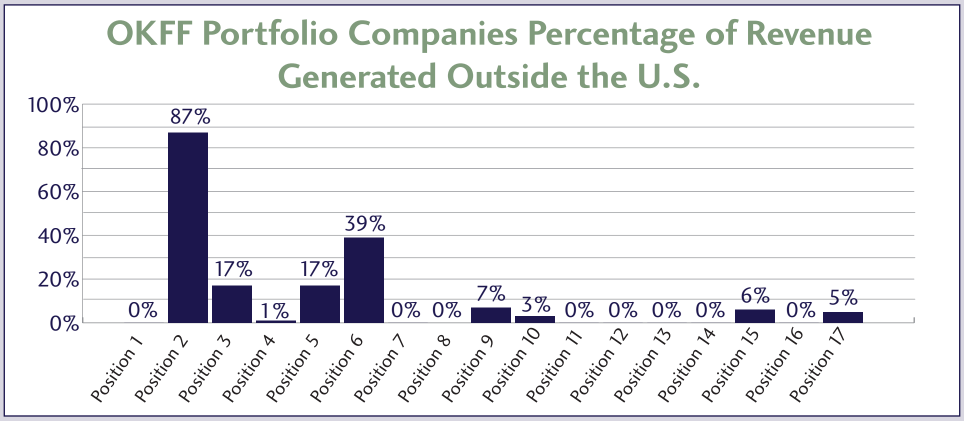
Today, investors confront a world that looks rougher, more distant and less recognizable. At Otsi Keta, we compensate for this new world by staying focused on investing in businesses we understand and geographies we know well. Too many investors use diversification to avoid understanding what they own. Trust and hope have become an excuse to skip the homework and thinking. As in the past, our preferred method of managing risk is deep knowledge of the companies we're invested in—a job made easier due to our focused portfolio of 17 companies and the domestic nature of our holdings.

Make no mistake. We think diversification is critical; we just don't buy into the concept of going outside our area of expertise to achieve it.

OKFF Portfolio Investments by Business Sector



We spend the majority of our time determining what things are worth and less on predicting squalls. The key to knowing what something is worth is being able to assess its prospects several years in the future. By sticking to Midwestern-based businesses, we gain the value of knowing the economic, geographic and political risks at a deeper level. It can be tough enough to gauge rates of change domestically, but assessing the Eurozone given the current turmoil is beyond our humble abilities. The average companies in our portfolio earn 90% of their sales and profits in the United States. This limits our direct exposure to currency fluctuations and recessionary pressures in places like Europe and Asia.



Note: Position 2 has 87% of sales outside the U.S. 80 Asia represents 80% of those sales. The company makes wafer polishing slurries and has an 80%+ global market share. The bulk of wafer foundries, the firm's core customers, have all migrated production to Asia in the last 10 years.

It is natural to focus on the power of the storm and underinvest in the things you can control like the quality of the shelter. Nobody likes storms, but they can bring opportunity to those who understand their risks and have the conviction to weather them.

OUR PERFORMANCE

For the third quarter ended September 30, 2014, the Otsi Keta Focus Fund was down 6.23%. Year to date the Fund is down 5.51%. Since inception, the Fund has returned 54.84%. All of the Otsi Keta Focus Fund numbers mentioned are net of all fees and expenses. Please see the table below to review the performance of Otsi Keta Focus Fund Limited Partnership.

Fund Name	Morningstar Rating	ROR 3rd Quarter 2014	ROR YTD Sept. 30, 2014	ROR From Inception (May 7, 2010)
Otsi Keta Focus Fund Limited Partnership*	**3 star**	**(6.23)%**	**(5.51)%**	**54.84%**
Russell 2000 Index (^RUT)	N/A	(7.65)%	(5.32)%	63.87%
Russell 2000 Value (^RUJ)	N/A	(9.02)%	(6.14)%	47.67%

Source: Morningstar, Otsi Keta Capital, Yahoo Finance, Russell Investment
*Note: All OKFF performance data is shown net of all fees and expenses.

The Window Indicator

As we reported in the second quarter newsletter, the shipping industry was hampered by the extended winter the Midwest experienced. This experience drove the activity we saw throughout the summer.

We focus on the iron ore trade for Fund reasons, but we monitor all of the commodities hauled on the Great Lakes. For general commodities, the St. Lawrence Seaway has seen a substantial bump in traffic from last year. The ships from overseas are loaded, which speaks well of our dollar. The boats are returning full as well, which speaks well of our abundance of agricultural commodities and the needs around the globe.

Back to iron ore. Because of the 2013-2014 winter, the steel industry approached this season with a different inventory mindset. The iron ore supply was dangerously low in the spring this year to operate the finishing mills. This, coupled with the falling price of iron ore (under $90 per ton), has the steel makers interested in accumulating a larger supply for the winter. (It's painful to report that this winter in the Midwest is slated to look a lot like last year.)

Another factor influencing the shipping industry is trains. Believe it or not, the major railroads control the lines for most operations between the mines and the docks. The railroads have been successful in the center of the country hauling fracked oil, so they are not interested in maintaining a solid flow from the mines to the shores. This can be a problem if you have an interest in a business that deals in the iron ore trade. We do!

But we did say "most" operations rely on the major railroads. We happen to be invested in a business that owns the short line between the mine and the dock. Good news for us, and good news our partners. The boats have been arriving like clockwork this summer and show no signs of slowing down.

So, business looks good outside our window. The boats should be running right up to the closing around January 15. We'll keep you up to date.

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