OTSI KETA QUARTERLY

OTSI KETA CAPITAL

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

IN THIS ISSUE...

QUESTIONS...

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"I hate losing, even more than I like winning." – Billy Beane, General Manager of the Oakland A's

It turns out behavioral researchers agree with Mr. Beane. Investors feel twice the pain from a dollar of loss as they feel pleasure from a dollar of gain. The technical term for this phenomenon is "loss aversion."

As fellow human beings, we all can attest to a profound dislike of losses. The reality is that we are limited by our genetic wiring. Clearly, the instinct to avoid losses (i.e., getting eaten by a dinosaur) has historically served the species well; however, it does at times create some challenges for today's investors.

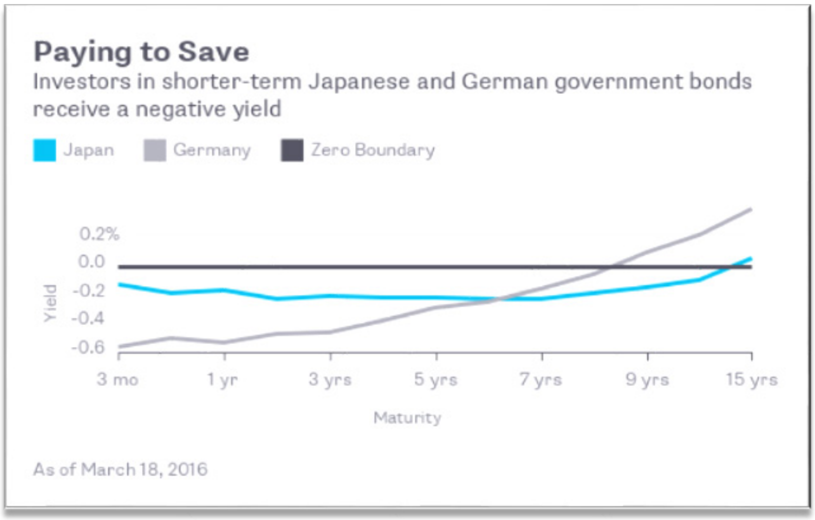
For investors, uncertainty often causes our biases to overpower sound analytical reasoning. People replace the difficult and complex questions with rules of thumb, consensus positions, and short-cut questions that can be answered without really thinking. It turns out that when people skip their homework, risks increase.

Currently, investors thrown by stock market volatility are moving money around reactively. They are underestimating the opportunities for buying undervalued equity assets with great return potential—and, instead are continuing to allocate money into fixed income investments.

Today's investment environment is good. Growth remains a challenge, but value can be found.

A combination of loss aversion and the need for income among a growing demographic of retirees is driving up the price of yield instruments. Investors are overvaluing traditional yield vehicles like bonds, preferreds, MLPs, and consumer staples with the perception that they both are safer and create a coveted income stream.

We don't disagree with the need for yield now and in the future; income is critical to a comfortable retirement. Our concern is that investors are taking more risk than the current available yields support.



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LOOKING AT RETURNS FROM A DIFFERENT ANGLE

For many investors, looking at the actual dollars an investment returns is more tangible than looking at return percentages for an investment. Both metrics have their benefits:

- Returns expressed as a percentage are great for comparing different size investments over time.
- Returns expressed in actual dollars often help an investor actualize what the returns can purchase in their everyday life—if taken each year in distributions.

The chart at the bottom of the following page shows what an investor would have received had they chosen to take their share of the Fund's earnings as a distribution in January of each year, based on the prior year's investment performance. We assumed the investor invested $250,000, the Fund minimum, at inception.

An investor, using the distributed earnings program outlined above, would have received approximately $154,860 in distributions and had an account balance of $243,000 going into 2016. If the same investor had chosen to allow the earnings to compound over the same time period, their account would have grown to approximately $442,275.

As always, past performance is no guarantee of future results. It should be noted that the Fund had negative returns in 2011 and 2015 and will no doubt have down years again in the future.

Whether you plan on letting your earnings compound or spend earnings each year, the table below reminds us that over time, our investments have created real returns for our partners and aren't just numbers on an account statement they can never touch.

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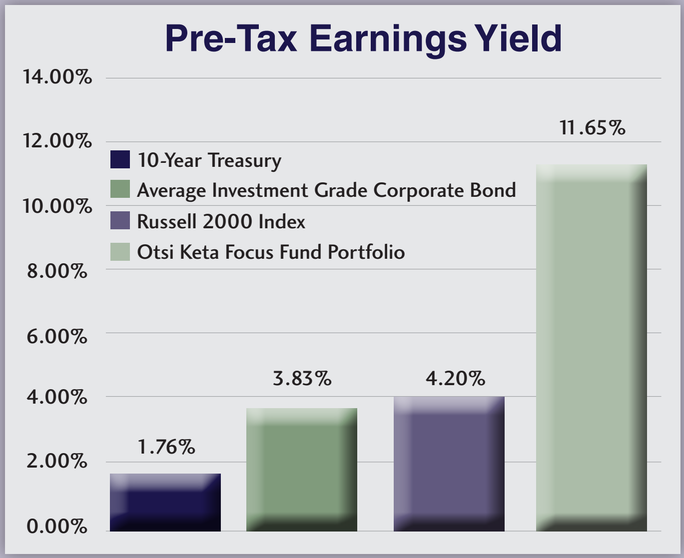
When everybody wants the same thing, it is easy to get swept up in the buying frenzy and over pay. One of the surest ways to create permanent capital loss is to pay more than something is worth.



We believe people are overpaying for yield and missing a great opportunity to invest in the equity of businesses that are trading at 50 to 75 cents on the dollar. Seven countries in the world have sovereign debt trading at a negative interest rate. The idea of a negative rate might make sense to a central banker, but to us it defies investment logic. In essence, you are paying to save.

At Otsi Keta, we continually review our risk return profile by reviewing and comparing our portfolio's pre-tax earnings yield (PTY) to other alternatives in the market.

PTY is calculated by dividing a business' annual operating profit by its enterprise value. What makes the calculation so useful is that it provides a way to compare economic returns across asset classes. Companies we invest in must generate sufficient earnings yields to compensate for the risk we take as equity investors.

The chart above compares the fund's weighted average PTY to the earnings yield on three widely used benchmarks: risk-free, 10-year Treasuries; investment grade corporate bonds; and the Russell 2000 (the benchmark for small cap companies).

OUR PERFORMANCE

For the first quarter ended March 31, 2016, the Otsi Keta Focus Fund was up 3.21%. Year to date the Fund is up the same. Since inception, the Fund has returned 76.91%. 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 versus competitive indexes.

Fund Name	ROR 1st Quarter 2016	ROR YTD Mar. 31, 2016	ROR From Inception (May 7, 2010)
Otsi Keta Focus Fund Limited Partnership*	**3.21%**	**3.21%**	**76.91%**
Russell 2000 Index (^RUT)	(1.92)%	(1.92)%	65.71%
Russell 2000 Value (^RUJ)	1.10%	1.10%	47.24%

Sources: Morningstar, Otsi Keta Capital, Yahoo Finance, and Russell Investment
*Note: All OKFF performance data is shown net of all fees and expenses and is based on an investment between $250,000 and $999,000.

The first quarter of 2016 was an interesting one. January and February saw the Fund wildly outperform the indexes and like competitors. March brought our performance back down to earth, but still maintained a 513 basis-point advantage over the Russell 2000 in the year to-date period. When looking around at competitors that we have profiled in the past on this page, we outperformed the Buffalo Small Cap Fund (BUFSX) by 893 basis points. We have always believed that outperformance would come from owning a smaller basket of well-run, under-followed Midwestern based companies. This quarter was no exception.

The opportunities we are seeing right now in our portfolio make us very excited for 2016. Of course, with our ability to always add or subtract companies from the portfolio, we quite often have a spring in our step about the future of the Fund.

The portfolio ended the quarter with 17 high quality holdings. We exited a long-standing holding at the end of the month due to complications from its structure. In other words, the Street was not realizing the value of the holding, and management was not doing enough to clear the air. This led to a reintroduction of a former holding to the portfolio. We are loath to disclose its name right now, due to our interest in adding more shares. Suffice it to say, we like the recent prospects, as we have been casually monitoring the company since we exited a while back.

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OTSI KETA FOCUS FUND, LP

Year End	2010	2011	2012	2013	2014	2015
Fund Balance After Distribution or Loss	$250,000	$250,000	$246,000	$250,000	$250,000	$243,000
Investor Year-End Earnings Distribution*	$38,500	$0.00	$23,035	$75,000	$18,725	$0.00
Annual Return Percentage	15.42%	(1.6%)	10.99%	30%	7.49%	(2.69%)

*We assume that in down years, distributions are zero, and in good years, distributions are reduced by amount to bring fund balance back to $250,000. All numbers are after all fees and fund expenses have been paid. 2010 was an abbreviated year starting May 7.

The Window Indicator

Typically, the first quarter letter does not include this feature article. We have traditionally closed the "window" until the second quarter. This closure is a direct result of a shipping season that is seasonal in nature.

This year, a Homeland Security report has prompted us to open the window early to share some interesting information on the importance of Midwest industries—shipping and steel.

As background, the Great Lakes are bound by two primary lock systems today—the Soo and the St. Lawrence Seaway. The St. Lawrence Seaway dictates non-North American traffic onto the Great Lakes, and the Soo dictates access to Lake Superior. While both are important mechanisms, we are focusing this article on the state of the two locks at the Soo that handle commercial vessels—the MacArthur and the Poe.

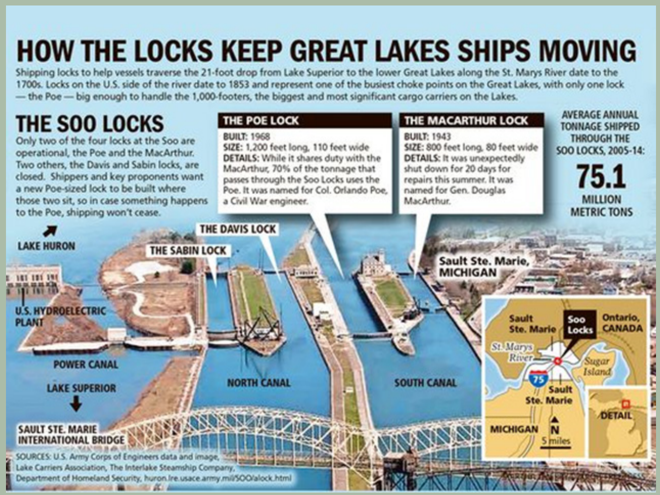
The MacArthur lock was built in 1943 and was set up to handle commercial vessels (freighters) at a time when a large boat was considered 700 feet long. This lock is approximately 800 feet long. With the lengthening of the fleet to 1000-plus feet in the early 1970s, the Poe was rebuilt to 1200 feet to handle the larger traffic.

The Homeland Security report focuses on a failure scenario during the shipping season at the Soo—specifically the Poe. A simple gate failure at the lock could cause a six-month closure. The Army Corps of Engineers has been modeling for this scenario to reduce potential shut down times, but even a couple of months could prove problematic. The shift to "just in time" procedures at our manufacturing facilities has reduced an inventory of iron ore to weeks, amplifying an economic effect.

Trucking and rail options in this scenario do not hold a candle to the hauling power of the lakers. The Homeland Security report shows that each of the thousand footers carries the equivalent of seven trains with 100 railcars each, or about 3000 trucks—a volume that would be impossible to transport over land. Unfortunately, the steel mills are not set up to take those deliveries even if it was an option.

The resulting six-month shutdown could result in tens of billions of lost economic output and the loss of hundreds of thousands of jobs as shown by economic modeling, and the shut down of 75% of the nation's steel output within two to six weeks. Remember, you have to pull on the string of the steel industry to see all of the businesses that rely on their product domestically. Importing steel would be a poor substitute during this scenario, as our country has shown no ability to control product that shows up on our shores.

According to the *Detroit Free Press,* the Obama administration authorized $1.35 million to do a cost-benefit study of finally building a new Poe-sized lock (authorized by Congress over 30 years ago, but never funded)—a process that could take a decade or longer at a cost of $580 million. The study could take years to complete and does not resolve our potential scenario in the mean time.



How the Locks keep Great Lakes ships moving
(Photo: Martha Thierry, *Detroit Free Press*)

We will be back with musings from the window in the second quarter. In the words of the late, great Paul Harvey, now you know the rest of the story.

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