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.

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QUESTIONS...

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WHAT TO DO NOW

There are many tough questions in life. Questions that resist certainty even after deep contemplation—when to quit something, what to be when you grow up, is my child getting the education I'm paying for, is now a good time to invest. If you feel like throwing in the towel at times, you're not alone. There are 322 million people in America, and everybody has a different point of view and reaches their own conclusions. While we don't have a lot to offer on whether college will pay off for Junior, we aren't struggling in our conviction about what to do now in investments.

Is the market overvalued? Probably. Yes. No. Maybe. The benefit of being value investors is that the market doesn't change what we do and our strategies. We are not buying and selling the market. Make no mistake, it is easier to go up with an up market and down with a down market, but our investment strategy doesn't change. Sounds convenient, but it is 100% the truth. Markets resist certainty and conviction as to their value. We focus on individual companies, and while certainty is still impossible, conviction around valuation is not. Things aren't always what they seem, but they usually are.

So, we aren't asking ourselves whether the market is cheap or expensive. We aren't thinking about when the market might correct. We are asking the same questions we have asked for six-plus years. What is this company worth? Can we buy it at least 25% below that estimate?

Make no mistake, we understand the anxiety investors feel as markets climb. With significant and growing flows of capital into indexes, more conversations will focus on market valuation and timing. It turns out conviction—while necessary for successful investing—is hard to get for 500 companies in the S&P 500, or the almost 2000 companies in the Russell 2000.

Having competed against the Russell 2000 for the last six years, we have a lot of respect for indexes, the Russell specifically. Indexes work particularly well in strong, up markets. As greater amounts of investor money flows into indexes, the major indexes will rise faster in good markets and sink more quickly in bad markets. At Otsi Keta, we have historically lagged the index in up markets and outperformed in down markets.

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This quarterly newsletter has been prepared by Otsi Keta Capital LLC (OKC), a private investment partnership, for our clients and other interested persons. Within this newsletter, we express opinions about direction of the market, investment sectors and other trends. The opinions should not be considered predictions of future results. Discussion in this newsletter relating to a particular company is not intended to represent, and should not be interpreted to imply, a past or current specific recommendation to purchase or sell a security, and the companies discussed do not include all the purchases and sales by OKC for the fund during the quarter. The information contained in this newsletter, which is based on outside sources, is believed to be reliable, but is not guaranteed and not necessarily complete. Past performance does not guarantee future returns.

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Invariably, when markets rise, discussion focuses on which sectors are leading the charge and which are lagging. Yup, you guessed it; we don't look at sectors as part of our investment process. We do keep track of our sector exposure and share it with our investors quarterly. Below is the data on sector exposure we get from Morningstar, based on our holdings. The chart below shows how the portfolio's composition has changed Q4 2012 through Q1 2017.

	OKFF Portfolio (Equity Weights)	End of Q4 2012	End of Q1 2017	CHANGE
CYCLICAL (%)		**57.14**	**40.71**	**-16.43**
	Basic Material	8.24	13.26	
	Consumer Cyclical	48.90	26.52	
	Financial Services	--	0.62	
	Real Estate	--	0.31	
SENSITIVE (%)		**36.52**	**37.95**	**1.43**
	Communication Services	3.38	0.04	
	Energy	3.31	2.67	
	Industrials	18.71	19.10	
	Technology	11.12	16.14	
DEFENSIVE (%)		**10.39**	**21.35**	**10.96**
	Consumer Defensive	3.94	20.81	
	Healthcare	6.45	0.41	
	Utilities	--	0.13	
	Not Classified	--	--	
TOTAL (%)		**10.39**	**21.35**	**10.96**

The chart above show that where we are finding value today is different than four years ago. Per Morningstar, our portfolio is more defensive today, and we hold less cyclical names—from our perspective, we are just holding a different set of undervalued companies.

There are a couple of attributes in indexes that most people underappreciate. Indexes are great for forcing you to invest more in things going up than you might otherwise. Indexes typically are market weighted, which means buyers will have the greatest exposure to stocks that have gained the most in the last year and have the highest valuation multiples. Getting people to buy more of their winners and highest multiple stocks is usually hard to do, but indexes force the issue.

Currently, about 30% of the companies that are in the Russell 2000 have no net income. These companies, with negative income, traditionally gain the most in strong markets. The weakest companies have the most to gain as their left-for-dead status migrates to potential growth. In an up market, junk rises from the dead. In the case of the Russell, the index gets you to hold a whole lot of junk. That is hard to do as an active investor. We just can't get ourselves to do it.

The indexes' exposure to poor companies is its greatest advantage in up markets. We believe that fact is what makes the Russell such a worthy benchmark. The flip side —in down and soft markets, companies with high multiples and companies with negative earnings tend to perform poorly. So, while indexes will continue to get more popular, they aren't a free lunch. We sleep better at night knowing we are not momentum investing and waiting for junk to fly.

OUTLOOK 2017

Results from a monthly survey of business supply managers, in the *Insurance Journal*, suggest that manufacturing is boosting economic conditions in the Midwest. The Mid-America Business Index rose to its highest level in three years as the "rust belt" continues to show signs of life. The strengthening dollar, real estate and consumer sentiment are certainly a driver to these statistics. As reported in past letters, a more business-friendly vibe through "right-to-work" has helped the hiring for these businesses.

Through our conversations with portfolio companies, along with monitoring competitors' quarterly reporting, we see a healthy outlook for 2017. Businesses are reporting strength in formerly weak overseas markets, along with a stronger domestic consumer. Hiring still seems to be a weakness to some businesses, as either the workforce has relocated over the years or there is less desire to work in the labor-intensive fields. The ability to survive without a job has not helped this statistic either.

Here are some of the positive signs that are being seen throughout the Midwest.

Signs of Growth in the Midwest

CertainTeed Corp, a manufacturer of building products, recently wrapped up a three-year, $100 million manufacturing and distribution center expansion in the Missouri community of Jonesburg. In Minnesota, contract medical device manufacturer Biomerics has plans to create 120 high-paying jobs in Brooklyn Park. In Wisconsin, Catalent Pharma Solutions is expanding its operation in Madison with an addition of manufacturing, office and lab space expected to create more than 100 new jobs.

Meanwhile in Indianapolis, the state's tallest building will be renamed the Salesforce Tower after, you guessed it, Salesforce.com. The cloud giant is planning on a $40 million investment in the building while adding 800 jobs over the next five years. In Michigan, ZFS Ithaca recently announced a 74-job plant fueled by a $123 million investment. It will process soybeans, Michigan's top agricultural export.

Plenty of goods traverse the Midwest, thanks to a mix of locations and strong transportation assets. Chicago, Minneapolis and Kansas City are major freight centers. In December 2016, CVS pharmacy announced it would build a 762,000 square-foot distribution center in Kansas City, Missouri, creating over 300 jobs. And, the Iowa community of Cedar Rapids is looking to build a new intermodal transportation facility with the help from the government.

Shipbuilding and Repairs

According to *USA Today*, Sturgeon Bay, Wisconsin, saw its fair share of ship repairs over the winter. Fincantieri Bay Shipbuilding worked on 13 Great Lakes freighters and three tugs. The repairs included repowering from steam to diesel propulsion, steel and piping repairs, bulkhead renewals, machinery repairs, painting and other activities to ready the fleet for the upcoming 2017 shipping season.

The shipyard recently added three acres of working space to expand the yard to 55 acres. The yard works on a 24-7 schedule to ensure that the vessels are ready for the season. In addition to the repairs, they have six vessels under construction that will be ready sometime in the 2017-2018 season.

Agriculture

The USDA has come out with its annual forecast for the Midwest. They are projecting the inflation-adjusted U.S. farm income for 2017 to be at the lowest level since 2002; however, USDA pointed out that overall farm debt-to-asset ratios continue to remain at very low levels. Most agreed that the financial health of the U.S. farmer remains in good shape.

Most grain market analysis predicts 2017 crop acreage totals to remain steady, with increased soybean acreage and reduced corn and wheat. This could put some pressure on the soybean market, particularly if the weather turns out better than expected. This information comes from the *Corn and Soybean Digest*.

We continue to remain bullish on the Midwestern United States. As value investors, we pride ourselves on finding the undervalued businesses that reside in this part of the country. We believe 2017 will show us plenty of opportunities to revisit former holdings and/or look at new businesses. See you in the second quarter when the window opens, and we are finished with the first half of the year!

OUR PERFORMANCE

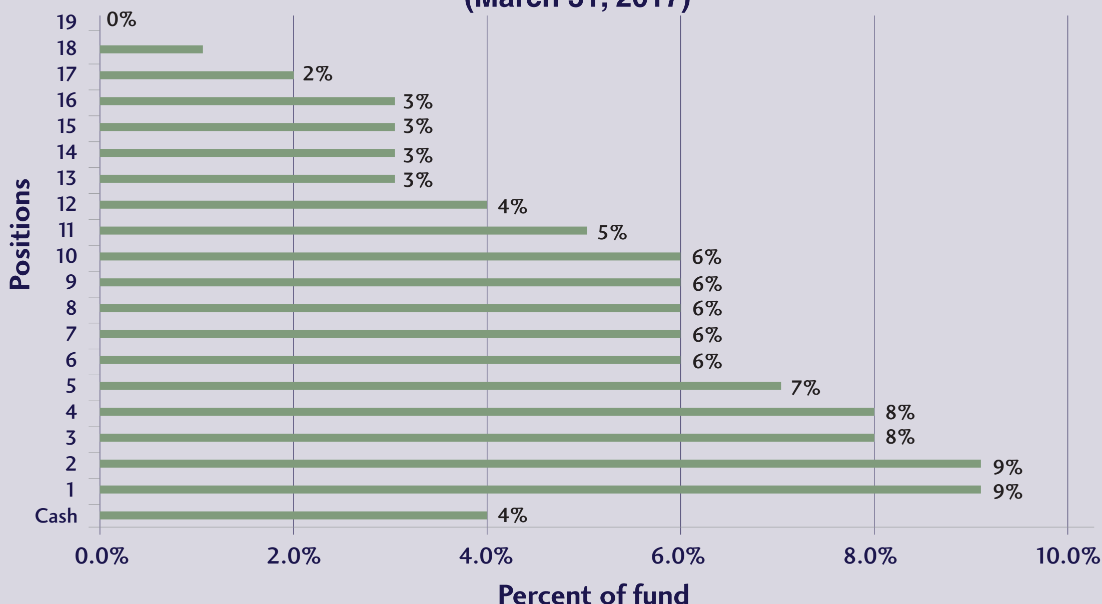
For the first quarter ended March 31, 2017, the Otsi Keta Focus Fund was up 0.51%. Year to date, the Fund was up 0.51%. Since inception, the Fund has returned 119.32%. All Otsi Keta Focus Fund numbers mentioned are net of all fees and expenses. Please see the table below to review the performance of Otsi Keta Focus Fund Limited Partnership versus competitive indexes.

Fund Name	ROR 1st Quarter 2017	ROR YTD March 31, 2017	ROR From Inception (May 7, 2010)
Otsi Keta Focus Fund Limited Partnership*	**0.51%**	**0.51%**	**119.32%**
Russell 2000 Index (^RUT)	2.12%	2.12%	106.17%
Russell 2000 Value (^RUJ)	(0.59)%	(0.59)%	86.65%

Sources: Otsi Keta Capital and Russell Investment
*Note: All OKFF performance data is shown net of all fees and expenses and is based on an investment with the maximum charge of 1.5%/10%.

The first quarter of 2017 saw a choppy three months for smaller companies. We were very encouraged by our 108-basis point outperformance of the value index. This value index better represents the type of businesses in which we invest.

We feel we are well positioned for the typically quieter second quarter of the year—based on our deployment of cash in undervalued companies toward the end of the first quarter. We also took profits in a longer-term holding and exited some small positions that moved away from us very fast in the beginning of the year. Infrastructure-oriented, consumer discretionary and industrial companies are top of our search list right now.



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