OTSI KETA QUARTERLY

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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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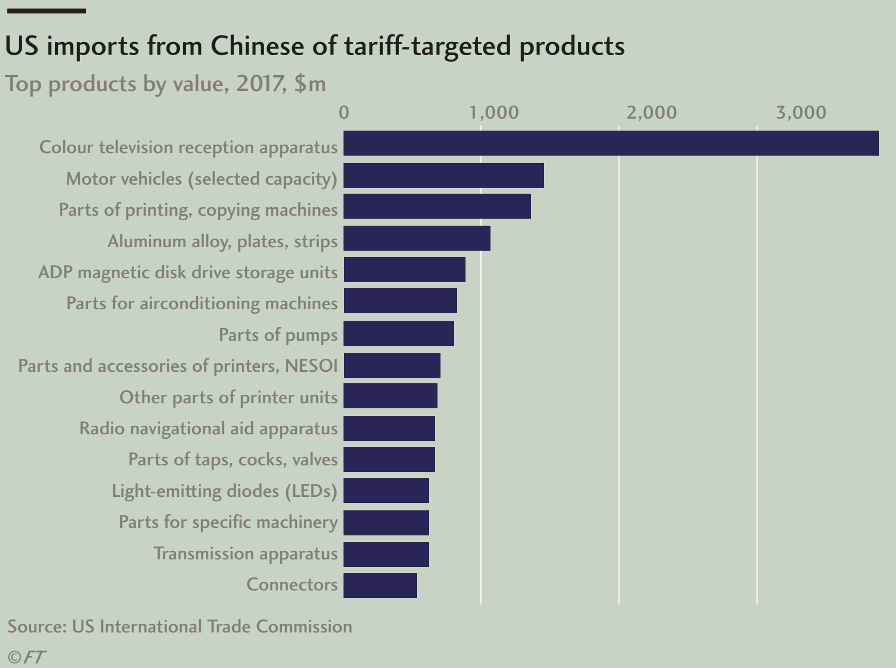
TRADE TARIFFS AND HELP WANTED SIGNS

In the early years of our republic, tariffs were the largest source of revenue for our nascent federal government. Tariffs, or alternatively custom duties, were collected on imported goods of all types. The appeal was strong for two reasons: tariffs could be collected efficiently at ports of entry, and they could be sold to the populous as protecting domestic industries. Tariffs remained a significant funding source until 1913 and the ratification of the Sixteenth Amendment. The Sixteenth Amendment allowed the federal government to levy direct taxes on personal income. Who would have believed what that change would lead to? However, tariffs are back on the front page today, and make no mistake…tariffs are a pure tax on consumption; the more you tax something, the less you get.



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The market seems to have taken a slow burn approach to reacting to the trade and tariff talk. From our perspective, if the long-term outcome of this current tension results in higher and broader tariffs, there is a fair bit of trouble ahead for the markets in general. While we think that is unlikely, the probability of an elongated trade fight is not zero. At Otsi Keta, we hold current positions in poultry producers, energy and iron ore. We believe all of these companies are deeply undervalued and are being impacted by the actual impositions of tariffs and the potential escalation of trade disputes. China remains the biggest trade problem (intellectual capital theft, forced technology transfers, government interference), however, we believe the immediate impact is going to be felt by companies doing business with our neighbors in Mexico and Canada. Over time, we believe the trade fight will narrow in scope and likely result in lower tariffs and trade restrictions between the United States and most other countries.

2017 Goods and Services Balances with our Trading Partners

Country	Exports	Imports	Trade Deficit by Partner
European Union	283,517	434,933	151,416
Canada	266,827	299,975	33,148
Mexico	230,958	314,045	83,087
China	115,774	505,597	389,823
Japan	63,264	136,544	73,280
Totals	**960,340**	**136,544**	**73,280**

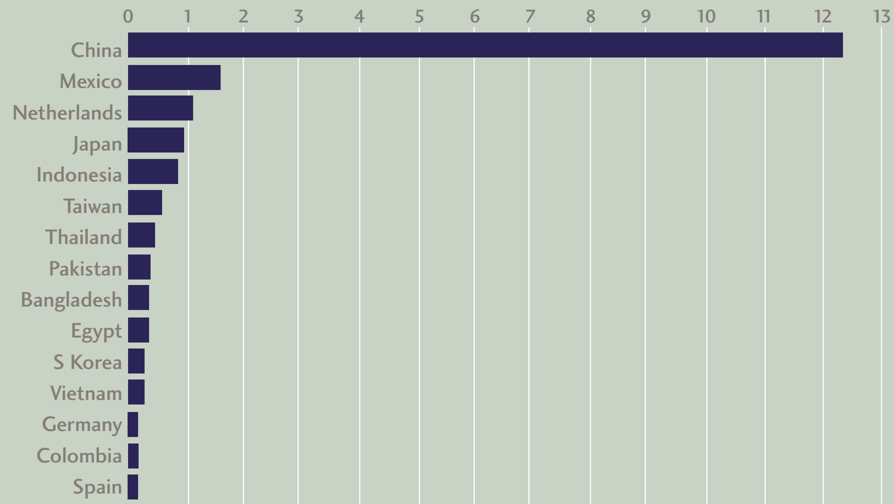
Source: The International Trade Association

From a portfolio construction perspective, a long trade fight will more negatively impact our portfolio as compared to the indexes. The indexes have significantly higher technology and financial weightings that should be less impacted by the current tariff strategy. As trade tensions ease, we are well-positioned to benefit. We remain convinced that the current administration is not looking for higher tariffs as a policy belief—rather, they see higher tariffs today as the only way to bring our trading partners to the table to address lowering tariffs across the board.

Unfortunately, the dirty little secret with tariffs is they concentrate pain and disperse benefit. Most people will only feel modest impacts from higher tariffs—a few extra cents per beer can or slightly cheaper chicken and pork. While a 100% tariff on motorcycles in Europe hits a few overseas Harley-Davidson riders, it hurts the manufacturer a great deal. Soybeans will be a little more expensive to 1.4 billion Chinese consumers this year, but will have all but eliminated soybean exports for a concentrated group of farmers in the plains states.

US soyabean exports

2017, $bn



Source: US Census Bureau

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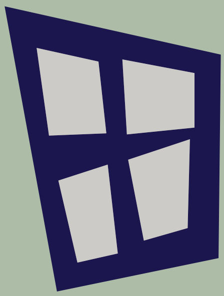
The Window Indicator



The shipping season continues to be robust as good weather and deep water allow the Great Lakes' vessels to run often and fully loaded. This is most pronounced in the heavier commodities that ply the lakes season over season: limestone and taconite. The influence on coal is not as pronounced, as the volume of that commodity does not supercede the weight in the freighters.

Speaking of limestone, the Lake Carriers Association reports a bump in shipments of 17% for the month of June. The year is currently trending about 10% higher. As stated, higher water followed by increased demand has this important, steel-making commodity on the upswing. Limestone is critical in the steel-making process, along with taconite (iron ore). Iron ore shipments from U.S. ports through the Soo Locks totaled 5.6 million tons in June, an increase of 4.1%, stated the Lake Carriers Association. Iron ore shipments for the year remain well ahead of their 5-year average.

The current tariff talks and improving economy continue to bolster the steel-making business. U.S. steel mills are running at a capacity utilization rate of 75.4% this year, up from 74.4% at the same point in 2017, according to the American Iron and Steel Institute. Steel output around 90% would be a very healthy sign for the industry. As reported in previous "window indicators," we are monitoring the evolution of the new steel plants, not only with our eyes, but with our investing. Good things appear to be on the horizon.

The clock is currently running on the coal trade, as new power distributors are looking for alternatives to traditional coal plants. This will undoubtedly put pressure on the shipping industry. Just recently I was looking out the window to watch the Algorail and American Victory (formerly the Middletown) on their last journey south to the scrap yard. Undersized and inefficient boats are finding their way out of the fleets and to the cutting torch. A healthy scrap iron market is making these decisions easier, too.

As the dog days of summer approach, we will continue to keep looking out the window with our air conditioning on. The boats have kept a steady pace by the window this year with loads that will test their capacities. More to come in the fall!

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In the coming weeks and months, we expect the conversation in the country will get more interesting as people focus on what is fair and what is folly in terms of trade. It will take strength to achieve a fairer deal for our products and services abroad—something our country in the last administration wasn't always quick to show. If these problems were easy, they would have been solved many moons ago.

Being value investors is never easy, but macro events like this can often serve as catalyst for wonderful opportunities. We believe we are seeing a number of those opportunities today and are optimistic we will be able to put some meaningful money to work and take advantage.

One last item we think is being overshadowed by all the global tariff talk: the number of help wanted signs we are seeing here in the Midwest. According to the BLS, we now have more job openings than people looking for work. It's hard to see how that isn't, in a strange way, a good indicator our economy is humming and people are being productive. Find a good customer and you will often find a great business. More people working should make for a whole lot of good customers using our nation's products and services.

OUR PERFORMANCE

For the second quarter ended June 30, 2018, the Otsi Keta Focus Fund was up 1.58% versus the Russell 2000 Value Index at 7.81%. Since inception, the Fund has returned 137.98%. 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.

Just a reminder, our performance "benchmark" has always been the Russell 2000 Index as indicated below. The Russell 2000 Value Index more closely represents the style of company that is found within our portfolio. Because we are loathe to change our paperwork to update our "benchmark," Otsi Keta will continue to focus on beating both indexes going forward.

Fund Name	ROR 2nd Quarter 2018	Annualized 5-year return	ROR From Inception (May 7, 2010)
Otsi Keta Focus Fund Limited Partnership*	**1.58%**	**10.53%**	**137.98%**
Russell 2000 Index (^RUT)	7.43%	10.95%	144.42%
Russell 2000 Value (^RUJ)	7.81%	8.96%	107.57%

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%.

PORTFOLIO CHANGES FOR OTSI KETA FOCUS FUND L.P.

Additions:

- Smart Sand Inc (SND)
- Atkore International (ATKR)
- Hurco Companies (HURC)
- Mesabi Trust (MSB)
- Nutri System (NTRI)
- Sanderson Farms (SAFM)
- Star Gas Partners LP (SGU)

Reductions:

- Capella Education (CPLA)
- Cooper Tire & Rubber (CTB)
- Oil-Dri Corp of America (ODC)
- Westlake Chemical Partner LP (WLKP)

The "additions" refer to equities that were added to or new positions that were established. For the second quarter, all of the additions were with current holdings.

The "reductions" refer to positions that were downsized or eliminated. In the case of Cooper Tire & Rubber, Oil-Dri and Westlake Chemical, they were liquidations. The Capella Education position was a reduction in the quarter.

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