OTSI KETA QUARTERLY

OTSI KETA CAPITAL

Thirty-Fourth Edition - October 2018

Q3 2018

SENTIMENT CHANGES FASTER THAN FUNDAMENTALS

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

IN THIS ISSUE...

QUESTIONS...

Contact us at:

312.473.3982

F. William Schwarz, III
bill@otsiketacapital.com

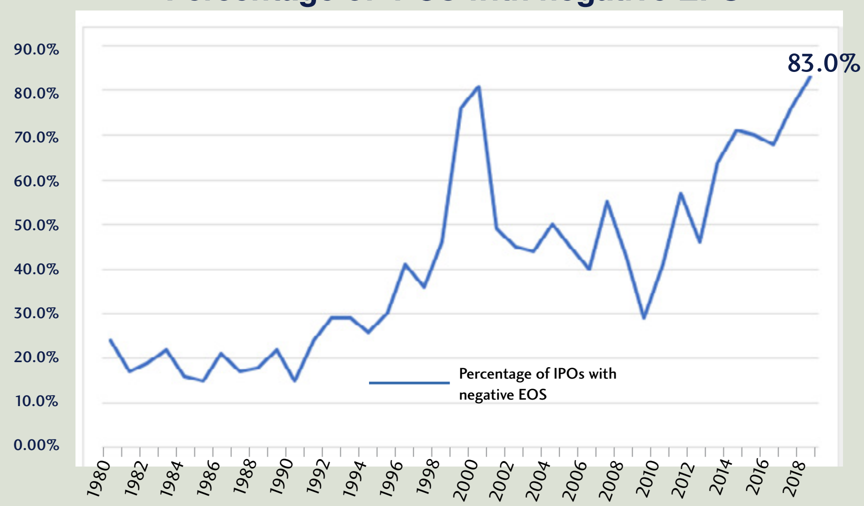
Frederick P. Rollins, Jr.
fred@otsiketacapital.com

Substituting easy questions in the place of hard questions is a popular human behavior. It is subconscious, effortless and happens instinctively. Based on the success of the human race, one could assume it's a relatively effective coping mechanism—keeping us moving in times of uncertainty and complexity. However effective our instincts as a species have been, it doesn't take a great deal of imagination to envision how shortcutting the thinking part of problem solving might lead to some poor decisions.

We like answering easy questions, too. Right now, if the question is "are stocks undervalued?" the consensus answer among the cocktail party crowd is "no." The answer is almost uniform and is an instinctive response requiring minimal effort. If the car in front of us slams on their brakes, we slam on our brakes. No need to call up Newton's first law of motion or calculate momentum by multiplying mass by velocity.

We wish it were that simple. As investors, we have to guard against skipping the thinking part and acting exclusively on sentiment. Sentiment is real, but it isn't fundamental. Positive and negative market sentiment changes much faster than business fundamentals. Anecdotally, we can confirm that many people have negative sentiment toward the general level of the market. The proof used to support the claim usually begins and ends with look how far and fast the market has climbed. We think sentiment got ahead of itself as shown in the chart below.

Percentage of IPOs with negative EPS



Source:
Jay Ritter, University of Florida

Continued on page 2...

Continued from page 1

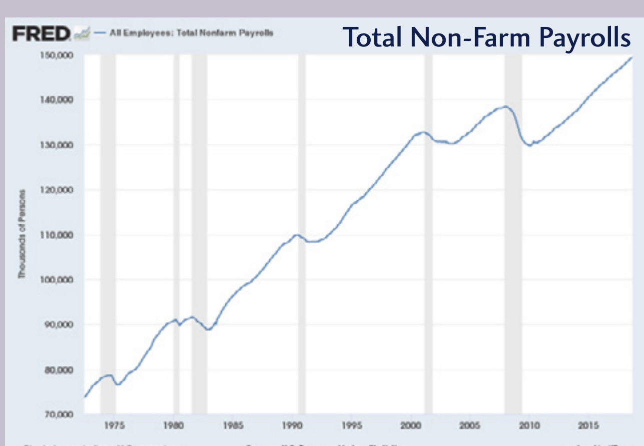
As a fund, we do not invest in IPOs. We believe they are one of the best representations of investor sentiment. The types of companies and their earnings/valuations say volumes about what the investor class believes. The graph on page one looks at the percentage of IPOs in 2018 that had negative earnings in the year prior to going public. In days past, a company wouldn't go public until it had established clear profitability. Alas, no more. More than 80% of the companies going public this year had losses in the prior 12 months.

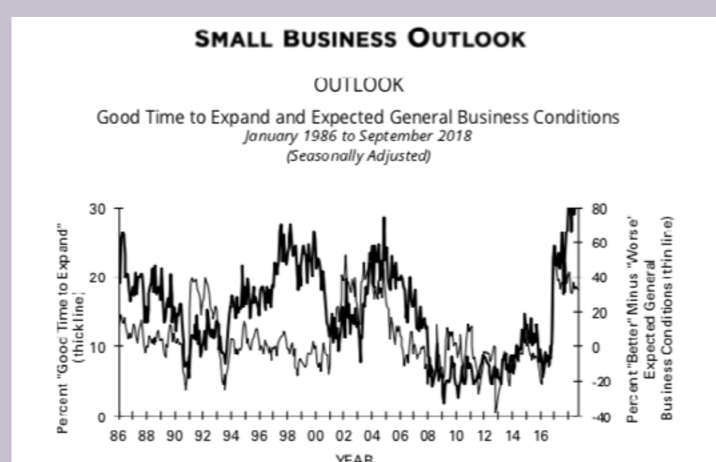
This year has continued a recent trend where investors are more supportive of a company's future prospects than its current profitability. In other words, earnings have been getting the short shrift over the last 10 years.

As the third quarter begins, the market seems to be acting on the negative sentiment we have heard at gatherings —where the well-heeled and market prognosticators espoused the market must correct. In reality, the vast majority of stocks have already corrected downward. Roughly 80% of the individual companies in the S&P are down more than 10% from their 52-week highs.

It is hard to have conviction supported by the sentiment of a crowd. We continue to have conviction in the fundamentals. Three economic drivers tell a different story than the price action in the market. We have always espoused that the consumer or customer is at the center of every great investment. Principles tell us that to be a good consumer you will need employment, rising wages and a business willing to hire. See the three graphs below.

So, let's refer back to the question, "are stocks undervalued?" Using sentiment only—or, answering the easy question—no. We believe looking at the fundamentals of individual companies and the economic reality of today —or, answering the hard question—most assuredly, yes.





The Overachievers and Underachievers

As we venture into another political cycle, the promises from both sides seem laser focused on the condition of bridges and roads—not to mention various other topics that are easy to talk about and difficult to solve (see U.S. student test scores). With all this focus on “infrastructure” over the past decade, one would think that a “sure thing” in the investment world would be companies that revolve around this industry.

This information from S&P Capital IQ shows a different story unfolding in the investment world. One that features a population that likes their devices, tends to boat during leisure time and doesn’t hesitate to see the doctor. All the while, they have little appetite for shelter, prefer to walk or ride a bike and are letting the infrastructure go by way of the buggy whip.

One has to ask, “How does a booming economy not value basic materials, construction and transportation?” Heck, even electric cars are put into the automobiles category!

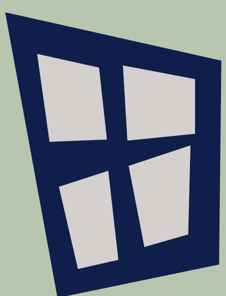
We believe this is a telling sign that the forces of growth will not outstrip the value proposition. When the investing public takes pause, docks their water craft and starts to repair their vehicle, the “boring” value companies will come back into favor. We are still advocating for a check-up from time to time, but the rest of the market could start to reset back in our favor. Time will tell.

Industry Performance Highlights - YTD

TOP-PERFORMING INDUSTRIES *	% CHANGE	WORST-PERFORMING INDUSTRIES *	% CHANGE
Internet and Direct Marketing Retail	51.68%	Construction Materials	-32.01%
Technology Hardware, Storage and Peripherals	27.58%	Household Durables	-31.40%
Software	25.60%	Automobiles	-25.26%
Health Care Equipment and Supplies	21.02%	Metals and Mining	-20.16%
Marine	19.58%	Auto Components	-20.09%

** by index value*

The Window Indicator



Washington D.C. – No, there is no new canal sending “lakers” to the nation’s capital. However, there is a $4.4 billion package of water infrastructure projects that includes $922 million for the construction of a new lock in Sault Ste Marie. The Senate voted 99-1 in favor of the bill, and it now sits on President Trump’s desk for signature. The House had already approved the bill.

Lake Superior – The gales of November came early to the Great Lakes this fall. October 10 -11 saw gale force winds on Lake Superior as an unusual storm came across the largest of the Great Lakes. Winds gusts of up to 50 knots with wave heights exceeding 16 feet had the fleet in port as the storm came through the region (an 18-foot wave is the size of a two-story house). The ports of Duluth, Superior, Two Harbors and Silver Bay saw traffic sheltering in place with the remainder of the lake showing lakers in natural harbors all around the coastline. Traffic in the Soo Locks was ground to a halt as northbound traffic was waiting out the storm in Whitefish Bay. Fortunately, only local flooding in communities was reported as a by-product of this October storm.

Zagreb, Croatia – Canadian shipper Algoma Central Corporation recently canceled a four-boat order with the Eastern European builder Uljanik Group. Algoma executives were worried about the business strength of the company to complete their order. Request for proposals will be reissued in the coming months to seek a new shipyard to modernize their fleet. Maybe a North American yard will be the beneficiary of this recent development.

Lake Carriers Association – Great Lakes freighters moved 10 million tons of cargo in August, which was parity with August of 2017. U.S.-flagged carriers have shipped 48.4 million tons so far this year, a decrease of 4.1 percent from last year. Iron ore cargoes decreased 3.7% to 26.55 million tons and coal by 13.7% to 6.5 million tons, while limestone rose 2.3% to 12.8 million tons. In August, iron ore cargoes rose 6.8% to 5 million tons, the second straight month ore shipments topped 5 million tons. Ore cargoes on the Great Lakes are 7.2% ahead of the five-year average for the first eight months of the year. Shipments of coal stayed about steady at 1.6 million tons in August, while shipments of aggregate, fluxstone, chemical stone and scrubber stone fell 10% to 2.9 million tons.

As we see the final push of another successful shipping season, the window remains alive with activity. The area has become so popular that a cruise ship from Germany came by the window in late September. As efficiency continues to be the order of the day, it will be interesting to see how the fleet evolves over the next decade. See you in January to wrap up the 2018 shipping season.

OUR PERFORMANCE

For the third quarter ended September 30, 2018, the Otsi Keta Focus Fund was up 3.41% versus the Russell 2000 Value Index at 3.26%. Since inception, the Fund has returned 146.10%. 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 3rd Quarter 2018	Annualized 5-year return	ROR From Inception (May 7, 2010)
Otsi Keta Focus Fund Limited Partnership*	**3.41%**	**8.34%**	**146.10%**
Russell 2000 Index (^RUT)	3.26%	9.58%	152.38%
Russell 2000 Value (^RUJ)	1.13%	7.73%	109.92%

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:

- Advanced Energy Industries (AEIS), position was initiated in July
- Big Lots Inc. (BIG)
- Commercial Vehicle Group (CVGI), position was initiated in August
- Electro Scientific Industries (ESIO), position was initiated in July
- FTS International (FTSI)
- Methode Electronics (MEI)
- Star Gas Partners LP (SGU)

Reductions:

- Atkore International (ATKR), exceeded our 9% position size
- Capella Education (CPLA), position was closed in July after exceeding fair value
- Dorman Products (DORM), position was closed in July after exceeding fair value
- Nutri System Inc. (NTRI), position was reduced around fair value
- Sleep Number Corp (SNBR), position was reduced around fair value
- Winmark Corp (WINA), position was reduced around fair value

The above information around additions and deletions could exclude current activity. Otsi Keta Capital LLC reserves the right to protect our proprietary trading activity.

Otsi Keta Capital, LLC
110 South Third Street
Suite 206
Saint Clair, MI 48079

312.473.3982

F. William Schwarz, III
Partner
direct: 810.247.3133
bill@otsiketacapital.com

Frederick P. Rollins, Jr.
Partner
direct: 810.357.8566
fred@otsiketacapital.com

OTSI KETA CAPITAL