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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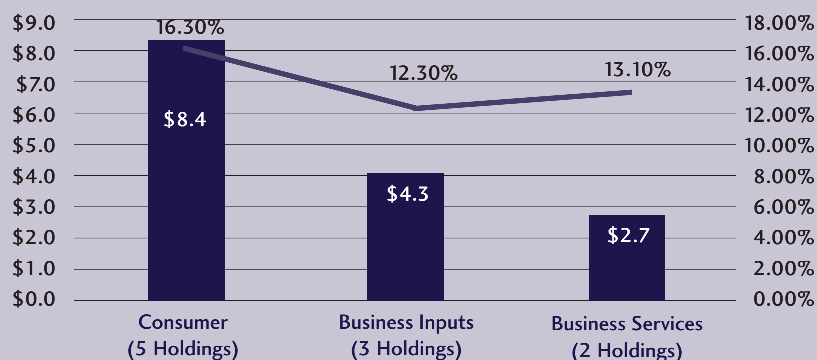
WHERE WE GO FROM HERE

There is never a shortage of macro factors weighing on investors' minds. Doom and gloom always make a more compelling narrative than stability and prosperity. It is just human nature, hardwired into our biology. At Otsi Keta Capital, we are not ignoring the issues of the day. Clearly, trade tension, global warming worries, contagions and the potential for political upheaval are not going to resolve themselves quickly or neatly. However, equally important for investing is to balance those worries about the future with actual facts on the ground. While the future is unknowable, our worst fears are seldom realized. Clouds on the horizon—always; but nothing at the moment lessens our conviction that value and continued economic progress will win out.

In the fourth quarter, we saw our portfolio perform more in line with our expectations. Our consumer-driven investments generated solid outperformance. Conviction around the strength of the consumer remained prominent in our portfolio for 2019 and we expect it to be impactful to our 2020 returns as well. At the end of 2019, five of our 10 largest positions were consumer driven.

We continue to believe the strength of the consumer is underestimated. Levels of employment and wage improvement are key factors buoying the strength of domestic consumption. As the chart on page 2 shows, unemployment has been on a 10-year decline. It is also clear that the reduction in unemployment claims is leveling off and can't be expected to improve at the recent trend line. What we believe is being lost is the lag effect and compounding of consumer strength, which accompanies people being gainfully employed. When people first go back



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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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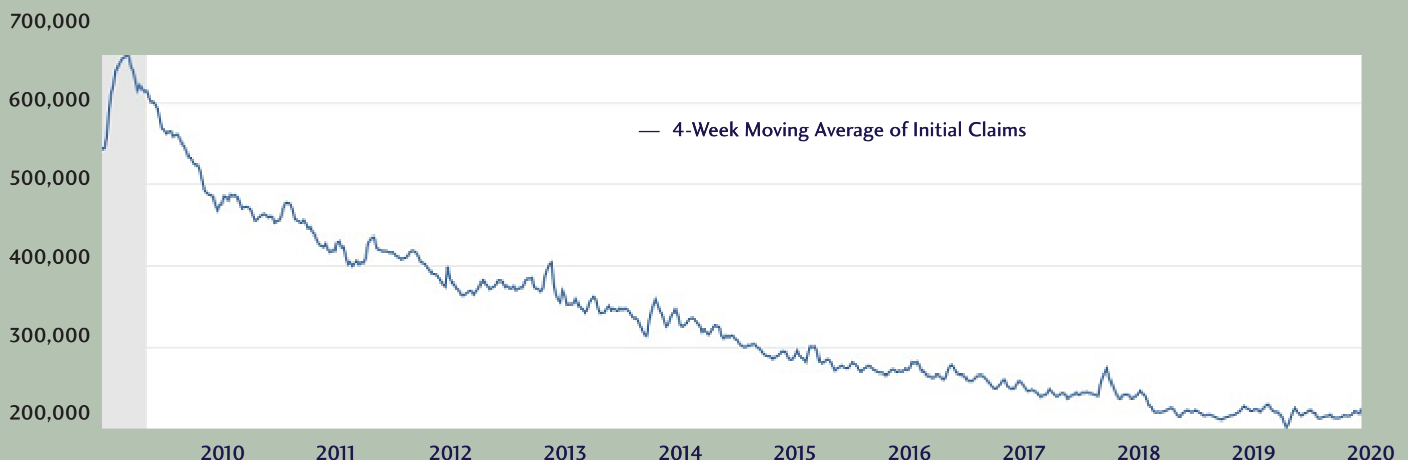
to work, there often is a period of digging out that occurs before confidence rebuilds and optimism about the future stimulates new spending. Greater optimism, combined with the reduction in taxes passed in December 2017, have improved workers' disposable income. We expect these trends to continue to drive spending into and through 2020. Less than half of the companies we own hold any meaningful debt. We remain cautious of debt— but used prudently, it has the ability to improve returns. Borrowing costs for our portfolio companies remain, by any historic standard, highly attractive. With few of the companies we own carrying term loans, we watch the levels they negotiate on their lines of credit agreements. At the end of Q4, our average portfolio company was paying between 3% and 3.5% to borrow against currently maintained lines of credit. The current national prime rate is 4.75%.

Our favorite companies have the ability to redeploy their capital at high returns in their business, but when the opportunities warrant restraint, we are glad to see management repurchase their shares from nervous investors. Capital expenditures were softer than we expected in 2019. We like to watch the tradeoff companies make between investing in expansion and share repurchase. For most of the fund's existence, share buyback equaled or exceeded expansion capital spending. For a good part of 2018, we watched as our portfolio companies spent more on expansion than buybacks. In 2019, buybacks again took the lead. We expect 2020 will look a lot like 2019 with the spending on buybacks exceeding expansion capital expenditures.

It is still early days in our Phase I deal with China. If the deal delivers what appears to be agreed to in principle, it should be positive for the United States. The additional purchases spelled out in the Phase I deal should firm up agricultural exports and industrial goods over the next few years. The absolute size of the increase in purchases appears a bit suspect to us. Depending on commodity prices, which have been softer recently, it seems a stretch to sell that much additional volume in agriculture and energy products. The composition of that additional $200 billion is as follows:

- Manufactured goods: $32.9 billion in 2020, $44.8 billion in 2021
- Agricultural goods: $12.5 billion in 2020, $19.5 billion in 2021
- Energy goods: $18.5 billion in 2020, $33.9 billion in 2021
- Services: $12.8 billion in 2020, $25.1 billion in 2021

Many of the tariffs that were placed on Chinese goods will remain in place for now. Companies with supply chains that rely heavily on the China market are likely to continue to look for alternative sources. We expect that over time the tariffs will be removed and the objective of freer and fairer trade will likely be realized. In the short and medium term, we believe trade tension will remain and likely expand to additional trading partners. From our perspective domestically, focused companies should be better positioned to weather the continued macro tensions that are inevitable.



OUR FOCUS IN INVESTING

The markets over the last 18 months have been challenging for the "value" space. They have shown no bias for value companies ranging from small to large. As our partners know, we invest in the small end of the marketplace with a focus on the middle of the United States. This focus has been incredibly fruitful over the life of the Fund, and we continue to believe in this strategy.

Unfortunately, periods of time can be painful for some partners and unrealistically profitable for others. We hold no sway over the exchanges, so we cannot predict the right time to enter or exit the Fund. As general partners of the operation, we tend to be incredibly biased toward our business and our strategy. In other words, our glass seems to skew to permanently half full. We feel comfortable in this bias, because we back that feeling up with hard work and the majority of our own investable dollars.

This strategy cannot put salve in all partners' wounds over periods of time, and we realize that investment choices will ebb and flow as we manage this pool of money. We appreciate the trust that our partners put with us and thank you for the privilege to manage the Fund. The following is from an initial fact sheet that we created in 2016.

> *Successful investors typically have two traits that set them apart:*
>
> 1. *A deep understanding of their investment strategy*
> 2. *A level of commitment that allows them to ride out the inevitable periods of underperformance*
>
> *In short, commitment matters. Building commitment requires asking tough questions and working hard to answer them. Too many investors swap the hard questions for easy questions. Questions like, "What is this company worth?" turn into single dimensional discussions about a new product or customer. Something important gets lost when the hard questions are avoided—the assessment of internal and external factors that could significantly change a company's future value.*
>
> *Lacking a deep understanding of a business' fundamentals and key risks causes both retail and institutional investors to overreact to price changes in the market and underreact to fundamental changes in the companies they invest in.*

Joel Greenblatt, the founder of Gotham Capital, as well as Jonathon Clements, of the *Wall Street Journal*, have written and spoken about how hard it is to find a strategy you believe in and how investors are horrible at riding out the market's bumps. Both Greenblatt and Clements point to research done by Morningstar on the best-performing mutual funds of the last decade (2000-2009):

> *The top-performing fund earned an average return of 18% per year, during a period when the broader market lost close to 1% per year over the 10-year period. Yet, the average investor in this top-performing fund managed to lose 1% per year on a dollar-weighted basis over those same 10 years.*
>
> *How? After every period in which the fund did well, investors piled in. After every period in which the fund did poorly, investors ran for the exit. So, the average investor managed to lose money in the best-performing fund simply by selling the fund at the wrong times. Most professional allocators follow the same pattern as individuals. They pull money out after the market or manager does poorly. They put money in after the market is already up or the manager has outperformed.*[1]

At Otsi Keta, we know commitment is critical for successful investing. We work to combat pervasive group consensus by conducting our own independent research. We focus on finding undervalued businesses that we can truly understand. We stay away from investments that hinge on a single event or technology. Instead, we focus on companies where executional capabilities can be assessed. This results in us avoiding biotech, software or turnaround companies. We like cash-generating businesses, with little to no net debt, and management teams that hold a significant stake in the companies they manage.

Every investment is initiated with a clear opinion on what we believe it is worth and a specific investment thesis. We acquire positions when they are at least 25% below our estimate of fair value—applying Benjamin Graham's well-known "margin of safety" in our investment process.

Diversification, while a great investment technique, is a poor substitute for knowledge. We stay focused on our best ideas. And, we never allow any single position to exceed 9% of investable assets.

Today's investment funds are often built for asset gathering and not returns. We believe, and history is on our side, that small companies represent the best long-term opportunities for compounding capital. Having too many positions or too large of a pool of capital dilutes the returns a manager can earn for their investors.

If you want to have a deep understanding of your investment strategy and be able to ride out the inevitable bumps in the market, then the Otsi Keta Focus Fund, LP may provide the right combination of attributes to help compound your capital over time.

[1]Gotham Funds, Morningstar "Best stock Fund of the Decade"

OUR PERFORMANCE

For the fourth quarter ended December 31, 2019, the Otsi Keta Focus Fund was up 14.58% versus the Russell 2000 Value Index up 7.88%. Since inception, the Fund has returned 155.11%. 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 4th Quarter 2019	5-year total return
Otsi Keta Focus Fund Limited Partnership*	**14.58%**	**55.87%**
Russell 2000 Index (^RUT)	9.52%	51.45%
Russell 2000 Value (^RUJ)	7.88%	37.62%

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%.

Fund Activity

We introduced this information approximately a year ago to share more about the activity in the Fund. For this quarter:

Additions

Career Education Corporation, Medifast Inc. and Invesco S & P 600 Small Cap Financials were added to the portfolio during the quarter. Career Education (now renamed Perdoceo Education) was our third foray into the education space. The fundamentals of the company, coupled with its mission, attracted us. We believe that the current administration has been much friendlier to the for-profit education companies, too. Medifast Inc. came on our radar in the third quarter. It was the fourth quarter that provided the opportunity for us to take full advantage to take a meaningful position in the company. What we perceived as one-time problems in the third quarter had the stock down substantially, which became an incredible opportunity. Since the fourth quarter, there has been speculation that the company could go private. The final addition was the financial ETF Invesco. After reviewing our exposure to the small cap marketplace over the last two to three years, we deduced that a lack of financial company exposure was weighing on our ability to outperform the market. We concluded that this ETF holding will give us better balance and exposure to the overall small cap market going forward and should be a benefit to all partners.

Reductions

We eliminated our holdings in Advanced Energy Industries and Commercial Vehicle Group during the quarter. Advanced Energy had been an investment in the semiconductor equipment space. There was much conversation from the company's management that the return of a "super cycle" in their industry was on the horizon but wouldn't be obtained until late 2020 to early 2021. The marketplace decided to advance that forecast to near term, and the stock appreciated beyond our fair value estimates. Commercial Vehicle Group is an Ohio-based supplier to the class 8 trucking market amongst other like industries. What we had projected as an opportunity when we purchased the shares never came to fruition. As projections for a slower pace in their major market were forecast for 2020, we decided to move on. The brilliance of owning these companies is they tend to be cyclical, and we will continue to monitor their businesses to look for an opportunity to re-engage in the future.

Several other holdings were modestly trimmed at the end of the year to mitigate some capital gain exposure in the portfolio. These names were not specifically mentioned as they remain in the portfolio as long-term investments.

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