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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LIABILITY MISMATCH

As we navigate the current banking crisis, we thought it would be useful to provide some historical context to better understand the situation. As investors, it's important to remember that turmoil is an inevitable part of the market cycle, and it's how we respond to these events that can make all the difference.

The U.S. has gone through some historically large banking crises, including the Great Depression of the 1930s and the Global Financial Crisis of 2008. Both events had severe implications for the broader economy and financial markets, but they also taught investors and regulators valuable lessons about the risks inherent in the banking system. For the record, we don't think the current banking challenges rise to historic levels, but it is not nothing either.

The banking industry is built on the borrow short, lend long model. So, from time to time, we are going to have asset liability mismatches. This model refers to the practice of banks borrowing funds from short-term sources (such as customer deposits or the money markets) and then using those funds to make longer-term loans (such as mortgages or business loans).

In this model, banks typically pay a lower interest rate on their short-term borrowings than they earn on their longer-term loans, which generates a spread or margin of profit. For example, a bank may borrow money from depositors at 1% interest and then lend that money out to homebuyers in the form of a 30-year mortgage at 6% interest. This 5% spread is the bank's profit margin.

While this model can be profitable for banks in normal economic conditions, it also poses risks. If short-term borrowing rates rise suddenly or if the economy experiences a downturn, the bank may find itself unable to roll over its short-term debt and may be forced to sell off its long-term assets at a loss. This can lead to liquidity problems and potentially even insolvency if the bank is unable to meet its obligations. Investors have been repricing bank risk in the last month. (See graph at the top of the following page.)

Governments and central banks have implemented various measures to stabilize the banking system during past crises, including policies such as deposit insurance and bank bailouts. It looks like this is the direction we are taking today. While these measures can be effective in the short term, they also have long-term implications, such as increased government debt and regulation of the financial sector.

As we navigate the current crisis, we remain vigilant and are limiting our direct exposure to the banking sector. Currently, we hold less than two and a half percent of our assets in banks—a size we are comfortable with. We wish the size of our exposure was all our doing, but the marketplace took its pound of flesh in the last month.

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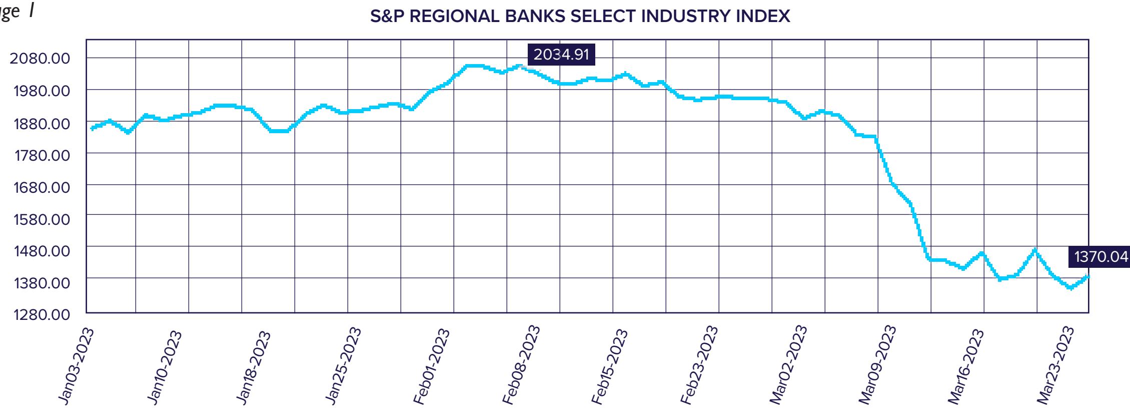


We continue to believe in the importance of taking the long-term view when it comes to investing. Crises can be unsettling, but they can also create opportunities for those who are willing to look beyond the short-term volatility.

The biggest factor contributing to market unease is the recent sharp and sudden rise in interest rates, which is having a profound effect on the value of long-term government bonds carried on bank balance sheets.

As interest rates rise, the value of existing bonds falls as investors demand higher yields to compensate for the increased risk of inflation. This decline in bond prices is particularly pronounced for longer-term bonds, which are more sensitive to changes in interest rates.

Banks, which typically hold large portfolios of government bonds as a way to manage risk and generate income, are experiencing significant losses as a result of the recent increase in rates. This is because the value of their bond portfolios is decreasing, which is reducing their overall profitability and increasing their exposure to risk.

In response to these challenges, banks may need to consider a range of options. The primary move will be to use additional federal facility that allows banks to sell underwater bonds at par to the Federal Reserve. However, this would only be a temporary facility. Over time, we expect banks will be selling off their bond portfolios, restructuring their balance sheets or finding new sources of income.

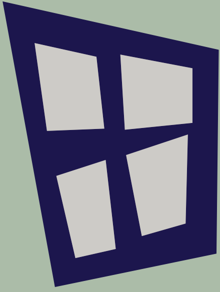
While these actions may be difficult in the short term, they will be essential to ensure the long-term stability and profitability of the banking sector.

We care about banks because they are at the center of the economy and indirectly impact business values based on the strategies they pursue. Here is what we think banks will do next:

1. **Increase interest rates on loans:** When interest rates rise, banks can increase the interest rates they charge on loans to maintain or increase their interest income. This can help offset the increased costs of funding loans with higher interest rates.
2. **Offer longer-term loans:** In a rising interest rate environment, customers may be more interested in longer-term loans with fixed interest rates to protect against future rate increases. Banks that offer longer-term loans with fixed interest rates may attract more customers and generate more income.
3. **Adjust funding mix:** Banks can adjust their funding mix by increasing the proportion of deposits or other low-cost funding sources. This can help reduce the impact of rising interest rates on the bank's cost of funds.
4. **Hedge interest rate risk:** Banks can use financial instruments such as interest rate swaps or options to hedge their interest rate risk. This can help reduce the bank's exposure to interest rate fluctuations.
5. **Diversify revenue sources:** Banks can also diversify their revenue sources to reduce their reliance on interest income. For example, banks can increase their fee income by offering new products and services or by expanding into new markets.
6. **Monitor credit quality:** Rising interest rates can lead to higher default rates, so banks need to closely monitor their credit quality and make sure they are properly pricing the risks of their loans.

Given the history and the path we see forward, we intend to focus on companies with strong balance sheets and the ability to maintain margins in an inflationary environment.

The Window Indicator



MONROE, Mich. — Michigan's first container terminal is rising here, potentially positioning the state to grow its supply chain, support auto manufacturing and move the state's agricultural goods to faraway markets.

The Port of Monroe recently received $16 million in state and federal grants to build a terminal that will allow the port to handle container shipments, the most common and efficient shipment method for goods. The port is located on River Raisin, connecting to the west end of Lake Erie.

U.S. Sen. Gary Peters announced in October that the Port of Monroe would receive roughly $11 million through the Port Infrastructure Development Program. The grant was awarded by the U.S. Maritime Administration (MARAD), an agency of the U.S. Department of Transportation. It also received $5 million in state funds in November. As a part of Michigan Maritime Gateway, it will be the first maritime container terminal in the state and the most modern such facility on the Great Lakes.

"This port has been working for more than seven years to be able to handle containerized cargo, and now with the new container terminal, Michigan automakers can export cars and trucks they make to Europe via the St. Lawrence Seaway," Gov. Gretchen Whitmer said during a tour of the port Monday, adding that the state is in the process of building five electric vehicle battery plants, semiconductor chip facilities, solar panels and wind turbines in Michigan. "By supporting facilities like the Port of Monroe on a state, federal and local level, we can work together to bolster Michigan's supply chain."

She added: "This port is really vital to our state's economy. The goods that flow here represent some of our most profitable and important industries like mining, energy and, soon, agriculture. The diversified economy activity spurred by the port supports thousands of jobs through the supply chain and drives tens of millions of dollars of profit. It's a big deal.

"If you look at a map and see all of the commerce that comes through this part of the Great Lakes system, you'd recognize that this is a really important place for us to be," Whitmer said. "This is critical. A lot of facilities here were born in the 1930s and have not been significantly upgraded until now."

The monies will go toward updating the port's riverfront, turning basin, maritime readiness slip construction and shore power infrastructure, according to its site. Also on tap would be a cargo scanning facility, Gov. Whitmer said.

Riverfront work will include replacing the surface of the existing wharf, constructing a second riverfront wharf to be used exclusively for vessel transfer of wind energy cargos, and reinforcing shoreline stabilization. Turning basinward will include rehabilitating the concrete dock cap, bollard and fender installation, and replacing roughly 390 feet of failed sheet pile.

The small boat readiness slip construction will include demolishing and rehabilitating an existing small boat slip to be used by harbor assist vessels. And shore power infrastructure will include removing existing overhead lines and providing shore power to the riverfront wharves.

Coal for DTE Energy Co.'s power plant in Monroe accounts for most of the cargo received at the Monroe port, which received about 2.5 million tons of cargo in 2022. It moves other major freight via ships, trains and trucks. The Monroe port, the only one on Lake Erie, will be the first container facility in the country to scan, by radiation and X-ray, 100% of the containers that come through the facility, said Paul LaMarre, the port's director.

"Now, Michigan will be in that business to ensure that goods can travel to and from our region as expeditiously as possible and as economically as possible," LaMarre said. "We won't be moving record numbers of containers. We will be moving value containers that are adding value to our regional manufacturing."

Over 10 years ago, the port was a field "overgrown with trees and an underutilized piece of property that wasn't creating jobs or commerce," LaMarre said. "We've gotten to a point where we are being regarded as a national example of how you put a port and intermodal facility in a small community like Monroe back on the map."

"We've been making ongoing investments in the port since 2012," he said. "We've had the most exponential tonnage growth of any port in the Great Lakes St. Lawrence Seaway system during that time. ... We're the biggest little port on the Great Lakes," he said.

The port is expected to finish its updates for its full-service container business by the Spring 2024.

Detroit News

The locks opened at the end of March. We will report what we see next quarter. Cheers!

OUR PERFORMANCE

For the first quarter ended March 31, 2023, the Otsi Keta Focus Fund was up 5.79% versus the Russell 2000 Index up 2.33%. Since inception, the Fund has returned 262.26%. 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 2023	Since Inception Annualized	7-Year Annualized	Since Inception
Otsi Keta Focus Fund Limited Partnership*	**5.79%**	**10.48%**	**10.78%**	**262.26%**
Russell 2000 Index (^RUT)	2.33%	7.93%	7.11%	168.11%
Russell 2000 Value (^RUJ)	(1.24)%	6.19%	5.71%	117.24%

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% from inception, May 7, 2010. The figures are blended with a former maximum charge of 1.5%/20%.

Fund Activity

Market volatility continued to influence the portfolio in the fourth quarter. Here's a look at the activity during the quarter:

Portfolio Highlights		
Position	**Activity**	**Comments**
Boise Cascade Co.	Initiated	A North American manufacturer of wood products and building materials. A company that was monitored since our position of Cavco initiated.
Clearfield Inc.	Initiated	A communications equipment company that was on our radar for the better part of 2022. Fiber-to-the-premises will be vogue for many years to come.
Hudson Technologies	Initiated	Consulting in the Engineering, Health Care and Life Sciences sectors.
Sensus Healthcare Inc.	Initiated	A medical device company that manufactures and sells radiation therapy devices. A micro-cap play that should bear fruit.
Cavco Industries	Added	A manufactured home builder that is geographically positioned to benefit from the underbuilt housing stock in the U.S.
DRS Technologies Inc.	Added	Aerospace and defense company with critical technology in the sensing and mission platforms.
Onewater Marine Inc.	Added	A recreational boat dealer and service provider with an ever-expanding presence in the Southeastern U.S.
Timken Steel Corp.	Added	Alloy, Micro Alloy and Carbon Steel manufacturer.
First Foundation Inc.	Trimmed	A regional bank and asset manager.
Triumph Bancorp, Inc.	Trimmed	Financial and technology company focused on payments, factoring and traditional banking.
Great Lakes Dock & Dredge	Exited	A major player in the maintenance of the commercial harbors and waterways. Capital outlays on the horizon made it less attractive.
M Y R Group, Inc.	Called Away from Option Writing (overvalued)	A Midwest-based construction company servicing the energy generation sector.

Conclusion

We feel the portfolio is well positioned for 2023 and the current administration in the U.S. We initiated four new names into the portfolio as 2023 began and added to three not listed positions in the portfolio. We are exiting our financial names due to the pressure in the space created by failures and a Fed that appears to be unrelenting in raising rates.

Underperformance is never a standalone reason to exit or trim a company. However, if the business or the environment that the business operates within changes (see Great Lakes Dredge & Dock), we will act accordingly for the benefit of the partners. We still see a lot of shifting sands in the economy for 2023. As always, we will remain fluid in our research and attempt to set up 2023 as a nice recovery to a bumpy 2022.

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