Arquitos Capital Management

April 19, 2017

Dear Partner:

Arquitos Capital Partners returned 17.6% net of fees in the first quarter of 2017. Please see page four for more detailed performance information.

We celebrated the fund's five year anniversary on April 10. During that time period, we returned 30.9% annually net of fees, beating the S&P 500 by 17.2% per year and the HFRI Index, an index that broadly measures the performance of all hedge funds, by 26.9% per year. Before fees, the fund returned 38.8% annually.

Arquitos provided positive returns in four out of five years and beat the market four out of five years. $100,000 invested at the outset is now worth $384,750. At that pace, your money has doubled every two years and seven months.

Do not expect these astronomical gains to continue. We had a variety of things working in our favor. First, the market was up each year during this time period. The S&P 500 itself performed very well, netting 13.7% per year with dividends reinvested. While I have tried to invest in companies outside of the mainstream, we have still ridden a strong wave.

Second, we are small. Assets under management today are $11 million. They were far smaller when we started and along the way. In the investment world, we are a speck. A brightly burning one, for sure, but still not much more than a piece of dust. Right now and since the launch of the fund, we have had the ability to make an investment in nearly any public company no matter the size. As assets grow, some of those companies will be too small for us to make a meaningful investment. My philosophy and approach will stay the same, but at some point the universe of opportunities will begin to shrink. We are not yet to that point, and may not get there for some time, but it will happen and it will have an effect on returns.

In my first letter to you in 2012 I wrote about the partnership that Warren Buffett ran from 1957 to 1968. He beat the markets by about 16% per year and returned 25.3% per year to investors, with no down years, I might add. We simply will not beat that performance over the lifetime of our fund.

The great thing is that because of the power of compound interest, we only have to do a fraction of our past performance in order to do well in the future. Compounding at 10% per year makes an initial $100,000 investment worth about $673,000 in 20 years and $1.75 million in 30 years. That is a tremendous gain. The keys for compounding are getting started and patience.

When I started the fund I knew we would do well. A fundamental value strategy focused on long term results promised that. It turns out that trying to not lose money gives you a big advantage over the competition. I did not strive for this performance by taking risks. It came from investing in companies that I understood, companies that generally had strong balance sheets and low risk of permanent capital loss, and situations where the markets did not fully recognize attractive aspects of the business. We will continue to do well by taking this approach.

While I write these letters and provide performance returns each quarter, and you get investor statements monthly, this is far too short of a time period to make any determination of investment skill. Investors get excited or depressed about specific companies at various times. The emotional state of the market is not a reflection of the actual value of a company. That actual value will generally be reflected over time periods much longer than a month, a quarter, or a year. Ignore short term performance and focus on longer time periods. A three to five year time period is a better gauge. A track record over several market cycles is best.

What has led to our success over the first five years? I have always felt that investing was nothing more than arbitrage. We are arbitraging perception from reality. If you are someone who generally agrees with the consensus, you will find it difficult to do better than the consensus. So, it is important to view the world from a slightly different angle and it pays to be skeptical of market prices at any given time.

The three primary ways to arbitrage perception from reality is through time, emotion, and information. Time arbitrage is the most important.

Time arbitrage is being willing to take on short term volatility on price if it appears that the long term operational results are promising. Time arbitrage is probably the most powerful edge you can have as an investor. It allows for exponential gains in some companies and covers up mistakes in others.

Consider the characteristics of a great company. It would have strong, ethical leadership where management and the board of directors personally own a meaningful share of the company. Those leaders would have strong capital allocation skills and the company would have cash generating power where excess cash could be efficiently deployed. The company would not have a lot of debt. It would have a stable or decreasing share count. The operations would not require a great deal of capital expenditures for maintenance or other equipment upgrades to keep up with the competition. Competition would be light and not based on price.

The share price of a company like that does not get cheap very often. When it does, it is either because of short term difficulties specific to the company, or a more general stock market correction. Having a long term focus helps an investor on both.

Price is simply a mechanism to determine whether to buy or sell. At any given time, the share price is not connected to the value of the company. In the long run, however, the connection to price and value is stronger. If you did not believe in generally efficient markets, the time arbitrage theory would not hold.

It is best when it was not necessary for the operations of the company to improve. We have had this come up in most of our investments, where it was only necessary for the markets to recognize what the company was already doing well. It is far better from a risk perspective to not need to rely on a company to do things differently. We only had to wait until other investors recognized what I already had.

Of course I have and will continue to make mistakes in analysis, timing, allocation size, omission, and a whole host of other things. I try to limit and learn from these mistakes, but there will always be a new one to make. The great thing about investing is that we don't have to throw a perfect game to win.

In order to effectively carry out this time arbitrage strategy, it is necessary that the limited partners in the fund have a long term focus and share an appreciation for the power of compounding. I have been lucky to attract such great partners and am indebted to you for your support.

Thank you for being an investor in the partnership. I look forward to continuing to compound funds on your behalf.
Best regards,

Steven L. Kiel
Arquitos Capital Management

Arquitos Capital Partners Performance Compared to the S&P 500

	Arquitos Capital Partners (Gross)	Arquitos Capital Partners (Net)	S&P 500	Arquitos Capital Partners (Net) v. S&P 500
2017 YTD	22.1%	17.6%	6.1%	+11.6%
2016	64.9%	54.9%	12.0%	+42.9%
2015	-13.8%	-14.8%	1.4%	-16.2%
2014	72.2%	57.8%	13.7%	+44.1%
2013	58.2%	46.6%	32.4%	+14.2%
2012*	9.0%	7.2%	4.9%	+2.3%
Cumulative	415.1%	284.8%	90.1%	+194.7%
Annualized	**38.8%**	**30.9%**	**13.7%**	**+17.2%**

*Founded April 10, 2012

Arquitos Capital Partners Monthly Performance (Net of Fees)

		Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD
2017	**Arquitos Capital Partners**	3.3%	6.9%	6.5%	-	-	-	-	-	-	-	-	-	**17.6%**
	S&P 500	1.9%	0.9%	0.2%	-	-	-	-	-	-	-	-	-	**6.1%**
2016	**Arquitos Capital Partners**	-4.4%	-3.2%	8.1%	0.1%	6.1%	13.6%	8.9%	1.9%	3.3%	6.2%	4.3%	1.3%	**54.9%**
	S&P 500	-5.0%	-0.1%	6.8%	0.4%	1.8%	0.3%	3.7%	0.1%	0.0%	-1.8%	3.7%	2.0%	**12.0%**
2015	**Arquitos Capital Partners**	-6.1%	5.9%	-4.5%	9.5%	-1.5%	0.2%	-3.1%	-7.0%	-5.3%	0.0%	0.4%	-3.0%	**-14.8%**
	S&P 500	-3.0%	5.8%	-1.6%	1.0%	1.3%	-1.9%	2.1%	-6.0%	-2.5%	8.4%	0.3%	-1.6%	**1.4%**
2014	**Arquitos Capital Partners**	4.3%	0.7%	2.2%	-0.7%	16.2%	-1.6%	10.4%	7.9%	-2.7%	-1.6%	10.1%	3.3%	**57.8%**
	S&P 500	-3.5%	4.6%	0.8%	0.7%	2.4%	2.1%	-1.4%	4.0%	-1.4%	2.5%	2.7%	-0.3%	**13.7%**
2013	**Arquitos Capital Partners**	4.1%	0.2%	3.8%	0.5%	3.8%	-3.6%	0.6%	-2.3%	0.3%	26.4%	4.3%	3.6%	**46.6%**
	S&P 500	5.2%	1.4%	3.8%	1.9%	2.3%	-1.3%	5.1%	-2.9%	3.1%	4.6%	3.1%	2.5%	**32.4%**
2012	**Arquitos Capital Partners**	-	-	-	0.0%	-3.3%	5.1%	-0.1%	2.9%	2.6%	-1.4%	-0.9%	2.2%	**7.2%**
	S&P 500	-	-	-	1.2%	-6.0%	4.1%	1.4%	2.3%	2.6%	-1.9%	0.6%	0.9%	**4.9%**

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Performance returns for Arquitos Capital Partners reflect the fund's total return, net of fees and expenses. They are net of the high water mark and the 20% performance fee, applied after a 4% hurdle, as detailed in the confidential private offering memorandum.

Performance returns for 2017 are estimated by our third party administrator, pending the year-end audit. Actual returns may differ from the returns presented. Positions reflected in this letter do not represent all the positions held, purchased or sold.

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