Kinetics Water Infrastructure Fund
Conference Call with William Brennan
July 14, 2009

Disclosures:

Kinetics Asset Management, Inc. ("Kinetics") is pleased to announce that on July 14, 2009, William Brennan, the Portfolio Manager to the Kinetics Water Infrastructure Fund hosted a conference call to financial advisors. The below transcript is intended to provide a summary of Mr. Brennan's remarks.

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Water Infrastructure Fund Conference Call
July 14, 2009

2nd Quarter Water Fund Conference Call
Kinetics Mutual Funds

Moderator: Good day everyone and welcome to today's 2nd quarter 2009 Kinetics Water Infrastructure Fund update with William Brennan, Portfolio Manager of the Kinetics Water Infrastructure Fund and Chris Bell, Director of Sales and Marketing with Kinetics. As a reminder, today's call is being recorded. All lines are currently in a listen-only mode. However, we will conduct a question and answer session following the presentation. Instructions will be given at that time. Gentlemen, you may proceed.

Chris Bell: Hello and thank you for attending today's call. I am Chris Bell and I want to talk a little about Kinetics and to introduce Bill Brennan. I just want to remind everyone that you can access Bill's commentary on our website, which is www.kineticsfunds.com. The Water Infrastructure Fund is listed as the 4th heading. If you double-click on there, you can go to the Water Infrastructure Fund page. You can also, through the Financial Professionals section, get an updated fact sheet. Bill Brennan has been associated with Kinetics since June of 2007, when he came to Kinetics to launch the Water Infrastructure Fund. Bill has been the Portfolio Manager since the fund's inception. He has over 20 years of experience in the water industry, as an engineer, consultant, analyst, and now, of course, as Portfolio Manager. Bill is going to talk about the fundamental process involved in positioning companies inside the portfolio and the future prospects of the portfolio, as well as water investing in general. So take it away, Bill.

William Brennan: Thanks Chris, and thank you everyone for your participation in today's call. Just as far as an overview for the fund, those of you that have not had an opportunity to sit down with me during the various presentations over the last year, I just want to give you a symbol – KWINX. There is also an A- and C-share class, as well as an institutional share class. As Chris stated, the fund is two years old as of June 29th and it is a value-oriented global water fund. It is multi-cap, and it is basically a go-anywhere water fund that really focuses on water infrastructure first and foremost, as well as hydroelectric, agriculture, security, timber, water rights, medical water treatment, and any place that water is the real essence and backbone of that particular industry. But again, we emphasize that water infrastructure is first and foremost from an investment standpoint. The portfolio team analyzes over 500 companies globally that touch on the water industry. The matrix for whether a company fits within the guidelines of the fund is generally dependent on 50% of the company's revenue being attributable to water related activities. A little bit later in the conference call, I will explain the difference between other water funds and ETFs out there and the Kinetics Water Infrastructure Fund. One of the main differences is the amount of revenue the companies in the Kinetics Water Fund derive from water-related activities compared to other so-called water funds and ETFS.

As Chris said, I have been doing this for 20 years. I started out as an engineer, building wastewater treatment plants, so I have learned this business from the ground up. Going back 15-20 years ago, we identified an opportunity where there was a low-correlation to the market, non-cyclical spending and water was then evolving as a true backbone in every type of manufacturing process that I was seeing globally. We came up with an investment thesis that said water was going to eventually be priced as a commodity, and would probably be our most valuable commodity going forward. I think that we have passed that intersection, where people are looking at water on a daily basis as a true commodity that is non-replaceable and cannot be created. Therefore, the value is going up and will have a significant economic impact, not only here in the States, but globally as far as how it is used, reused, treated and discharged. In a normal market, we typically target returns of anywhere from 12-15%. Unfortunately, over the last 2 years, it has been anything but a normal market, but what we tried to do, tactically, is really take a look at the different sub-sectors of the market within the global water business. We went after the segments where we saw continuous spending and either flat or increased growth rates relative to other sectors of the market. A lot of financial advisors have asked me along the way, "How should I position the fund in the portfolio?" I want to cover that quickly as far as when you are talking to your clients. First and foremost, water is a commodity, and it is really starting to be priced as a commodity through water rights in the Western part of the United States and Australia and in other places in the world where you are going to start to see water sold back and forth as a commodity. The pricing at the end of the tap is changing somewhat as to where it resides in the ground and can be quantified and a price attached to that on a per acre basis. Second, water is a natural resource. It is the ultimate green investment, so it is certainly appropriate for those people that are looking for exposure into a green theme that has consistent spending and low market correlation. Also, we look at it as an alternative, and that can be in the sense of a socially responsible investing. When we analyze companies we are cognizant as far as environmental, social and corporate governance. It's not to say that it is a fund mandate, but we want to make sure they are doing things the right way because ultimately, water is not only a true economic driver, but it is also a public health issue. The water utilities, first and foremost, are public health entities that are providing the conveyance and treatment of that water into some potable form. We are of the opinion that a 10% allocation over a 3-year time horizon is appropriate. We of the opinion that the pricing of water is going to do nothing but increase, so for now, a 10% allocation is a good starting point to go into the portfolio. And like I said, we can allocate more or less as macroeconomic conditions dictate.

Now, I'd like to discuss some of the general trends and talking points for you. We believe water rates are going to increase by 2-5x from what your bill presently has. What we are going to see here in the states are areas that are under water stress. Your water bill from the local municipality or from a publicly traded company – we expect that to at least double in the next 5 years, and certain areas (Arizona, Texas, Florida, and California), places that are under water stress and will continue to be under water stress, that bill could go as high as 5x. The growth in developed countries, right now, we are seeing is at about 6-8%, 15% the emerging market and 20% in sub-sectors, such as desalination. China, to us, as it is with some of the other funds in the Kinetics family, is a big push and we have started to reallocate assets into China and really make a push, because the dollars that are being spent in China right now are real dollars, as opposed to money being spent here on the stimulus. I am still trying to figure out where that money is actually going to come from and, eventually, it is going to come from our pockets, and that will be done either through rate increases or things like the water trust tariff. In fact there is going to be a hearing this week in Washington to raise additional taxes of $33 billion specifically for water infrastructure and I will cover that in a couple of minutes.

Last year - let me give you some historical perspective to how much money is being spent in this industry – approximately $550 billion was spent globally in 2008 for water related endeavors. We believe that number could easily move to $1 trillion over the next 5 years. Again, China will be leading the way. The U.S. right now accounts for about 23% of the global allocation on water spending and now with these new tariffs or proposals of new tariffs, which I think have some merit to them, you will see that money increase substantially. Just from the stimulus, during the course of the next 15 months, we expect water infrastructure spending in the Unites States to increase by about roughly 15%. We also believe that a cap and trade will also increase the usage of industrial water by 2-4x in certain geographic regions. The question that I have is the cap-and-trade in its present format will most likely look nothing like what the eventual parts of the bill that gets passed, but people have to realize that energy and water are intertwined. Water requires energy in order to move it and energy requires water in order for it to be generated, especially on the hydroelectric side, so these two issues are coming to a pivotal point, where we believe they are going to be tied at the hip moving forward.

Reuse and in situ treatment of contaminants are two key areas where we are focusing on right now as far as water reuse for gray water and also the treatment of contaminated water in ground. The technology aspect of the water business, which we believe has been somewhat dormant the last 25-30 years - “if it’s not broke, we don’t have to fix it” type of mentality - that is changing, and that is changing because of the industrial applications, especially in the oil, gas and mining industry where significant amounts of water reused to push oil and extract minerals from the ground. That water is heavily contaminated and what is being done to that water to treat it, to turn it into some type of usable form in either gray water or some other application is becoming key areas. Also, water investing over the last 4 years has really started to catch momentum. It has been around for a long time, but no one has been really able to classify it and put it into a package where people could look at it and it would make sense from an infrastructure standpoint. We are starting to take a look at just the sub-sectors that we look at, really focusing on water infrastructure and that is where we believe the spending is going to be.

One other note as far as trends - you are going to see a lot of noise and information in the press about bottled water and the snapback has begun. We have never invested in bottled water and we never will. The health issues as far as BPAs are coming to light and I feel there is going to be a huge health snapback here that will behoove us not to be exposed the area. Some other things that are of interest right now, as far as global capital expenditures on water and wastewater: *Global Water Intelligence*, which is one of the recognized trade magazines that prices out where the spending is going to be, the capital expenditure on water and waste water over the next 5 years really is of interest to us. When you take into account the credit crunch and the stimulus packages, the most significant of which is China's $51 billion wastewater bonanza, 2009 is going to be the toughest year, with municipal water and wastewater showing really no increase in investment. When we look out at 2010, it looks better as stimulus spending starts to kick in not only here in the states but globally. On the industrial side, there is going to be a cut in capital expenditure on water equipment during 2009, but then the 2nd half of 2010-2011 we expect a significant bounce back in that area.

From a standpoint of how we match up versus the ETFs - and this is a good segue into that - as I said before, we are a value-based fund and we have a tactical approach. We were fully invested in the fund until June 5th. Right now, we are at about 25% cash, and because we buy one company at a time, we feel since the fund has from trough to pinnacle moved roughly 40%, it was time to take the exposure on the industrial side off of the market, take some cash off and wait for these companies to come back into a more attractive valuation range. We are not afraid to trade in and out of names that we feel are fully valued at this time based on micro or macro conditions in the marketplace and we will go fully invested when we feel the market has deeply discounted the entire sector. Most of the ETFs are very growth-oriented. If you take a look at their websites, you will see that about 65-70% of their portfolio is growth. Our fund, being a value fund, it is extremely important for us to buy these companies at attractive valuations, and we feel that most of these companies do trade in channels, and the market will give us a chance to buy these at the right time and hold them for an extended period for hopefully a larger return from the investment point. The hedge funds are still using ETFs as a short, and from that standpoint, the volatility in that product is up and down. Also, from a trading standpoint, you are only trading those portfolios, at the most, 8 days out of the year, so actively-managed versus an ETF, I feel that there is an argument for actively-managed in the water space. If you want to hold ETFs at certain times when the markets - a rising tide lifts all boats - that is fine to be in those things, but we believe you want to have an actively-managed component to your water investment.

We typically aim for between 25-30% turnover for the fund, and we will use the ETF rebalancing as a tactical tool to see what valuations are pushed beyond what we feel are normal valuations for those companies. Occasionally we'll have identified a company that we like that is being sold out of an ETF, and that might create an attractive buying opportunity for us. The fund right now is about 50% exposed to companies outside of the U.S. We have 45 positions in the fund and it is a global fund so we will typically have at least 35-50% exposure outside the U.S. and we will go higher in this type of market, especially relative to what we expect the dollar to do. It is an attractive means for us on an un-hedged basis to go into some companies in the European market and also in the Asian market. A couple points too about the ETFs. Those products do not give you a direct exposure. In my opinion, they are cap-weighted or equal-weighted and they trade 4 times per year. Right now, I think that their allocations to the industrials are very high. The PHO, for example, is 77% in a period that looks like we could enter into deflation first then rapid inflation afterwards. As we have done our own polls and our own research internally and talked to the industrial side, we see a slowing in 2009. We feel we are going to get that W in the market that allows us to come into these industrials at prices that we saw in March or maybe even lower. That is our mentality and how we are looking at it right now and we want to be in certain areas such as metering, pipe manufacturing, and desalination and filters that we feel will weather the storm if we go into another downturn in the economy. Right now, if you read our commentary, it is important to realize that we are adding more in China, and China to us is a huge growth market. We take a look at some of the characteristics of what is taking place over there with regards to the stimulus package. The nice thing is China is being funded with actual cash and not debt. We are of a mindset right now that we will have a second stimulus package in the U.S., despite what has come out over the past weekend and there will be further pressure on the dollar. As these municipalities wait in anticipation of receiving those dollars, we are taking a look at China and seeing from their stimulus package that water shortages in north China are going to be a driving force, as far as the adoption of wastewater recycling and reuse and also seawater desalination. Their water industry is less impacted by economic fluctuations, as we have seen in the U.S., because of its rigid future belonging to public services and infrastructure construction. Therefore, our growth outlook for the Chinese water market remains strong and the estimated growth rate is about 12-15%. Of interest also is when you take a look at the international ETFs and see their lack of exposure into the Chinese marketplace, where we have specific companies that are listed on the Hong Kong Exchange, and also specific companies that are on the Singapore Exchange and the Thai Exchange that are doing significant revenue generation in China based off of their water infrastructure build-out. I think that is another differential we have versus the ETFs. As far as a market overview, I want to give you a little bit of mindset of how I am looking at the overall market from a macro view. Those of you that have met with me, we have talked about the impact of water relative to what is going on in the economy. What we are seeing right now is reduced capital spending by customers. They are wary about a weak economy, lack of available credit, lower oil prices, and, in our opinion, that indicates to us some of the engineering/construction businesses will likely slow down and decline over the next year. Some of our larger holdings right now are in the engineering business, but what we have done is, we have looked for those companies that have high exposure to water, nuclear and other energy areas that will weather the storm if we go into a downturn. As far as the link to oil and natural gas prices, some of these sectors that we have exposure to through the industrials - refineries, pipelines and other key accessories for engineering projects - these companies that have split water and other strategic business units, so we watch that closely. What we are seeing is the pace of bookings for 2009-2010 earnings and the potential for the stimulus package to improve economic data and some upward movement in commodity prices are definitely there.

We feel the threat of deflation or significant inflation is very real and you can get into this argument back and forth of what is going to take place in the market. You have got two very black-and-white camps as far as that is concerned. I do not have the answer for it, but we have got to watch both very closely. In our opinion right now, the S&P is fully valued and the 2010 estimates are highly uncertain and that again goes back to our underlying thesis with the utilities that these companies, the publicly traded utilities, have a high residential exposure and an inelastic demand, especially in an economic downturn. So from that standpoint, we feel that we are protecting the portfolio right now with the significant upward trend in these utilities as we see rate base increases move towards the 15% mark in the U.S. and we are watching what is going to happen in the U.K. with OFWAT (the economic regulator for the water and sewerage industry in England and Wales). But the price of water continues to move forward and, despite what some people have said in the market with regards that at some point there will be a snapback, I think it's worth noting that water is still the cheapest utility that comes into your house. It is roughly a half to a third of what your cell phone bill is on a monthly basis and half of your cable bill. Indiscriminate spending will become necessity spending and you will see that transition, because no one will operate a household without electric, heat, and water, and if that means that the value of the property is diminished by removal of any one of those, believe me, people will pay their water bill first and they will go necessity versus the indiscriminate spending.

With regard to the credit markets, we believe either the paper is extraordinarily cheap right now or something bad will happen soon, so we continue to watch that. The weak trends in employment, household balance sheets, consumer spending and housing - employment data, right now, are probably the most disturbing in our opinion. What we see is that government spending is really the only life energy, and, infrastructure is certainly seeing new projects. The question I have is how long can the U.S. stimulus be taken out to beyond the next 15 months, and then year after year after that?

Speaking a little bit about the stimulus: we expect the stimulus funds to impact companies in the water sector in the 2^{nd} half of 2009. Once these projects are approved and the contractors selected, what we have seen are states and municipalities have put spending on hold as they await the word of potential stimulus package moneys coming their way. The financial landscape for the foreseeable future is changed. The retail lenders are far more conservative, warning potential homebuyers that they will need serious skin in the game in order to qualify for a mortgage, so we are watching areas where we feel the real estate market will continue to decline, and one of the things we did with our portfolio is remove the California utilities out of the portfolio for the immediate future. As far as the drought situation in California, we were very concerned going into it, not only from a fiscal standpoint of the state, but also the fact that California is in probably the worst drought we have seen in the last 50 years. Most of the companies, the California utilities, have to buy from third parties. So, we expected the price of water to go up. Whether there was enough water for those utilities in order to meet the demand during the peak season was a concern and we felt we would get a better opportunity to own these water utilities again at a much lower valuation than we have owned them in the course of the last 6 months.

Right now, as far as immediate impact to the water sector, tomorrow I will be headed down to Washington D.C. to sit in on the House and Transportation Subcommittee, because they have now proposed an industry finance clean water trust fund that will raise $33 billion over the next 3 years, and this is very interesting. It is going to be the first of several subcommittee hearings aimed at tackling the growing wastewater infrastructure needs. Representative Earl Blumenauer from Oregon will introduce a bill that will raise $10 billion a year for clean water projects through new taxes on corporate income, water-based beverages, pesticides, fertilizers, pharmaceuticals, and disposable items like toothpaste and toilet paper. I expect all of those things to go up in cost in order to rebuild the infrastructure, and the exact quote from the Representative is, “We need new sources of revenue to meet our communities’ water infrastructure and environmental restoration needs.” And this is a way to offset what they see coming, which is 20%- plus rate increases year-over-year over the next 10 years in order to rebuild the infrastructure from where we are right now. That is concerning, because we always felt that there was going to be a surcharge tariff as far as water usage. This is one of the ways that the government is taking a look to offset that. As California continues to go, so goes the rest of the U.S. on their side with the stimulus. Even though the spending is a bit slow, there is a lot lined up with regards to pipes, pumps, desalinization, and the stimulus will kick in and it is going to start many projects. The western states such as in California, where epic water projects from the mid-1990s helped propel growth, are receiving less than $1 billion for water projects and we don’t believe that is enough. That is a band-aid relative to an open gash that needs to be stitched. When I talk about water and energy, California is just a great example of how the two are tied, because right now one-third of the energy on a daily basis in California is used to move water over the California aqueduct, including over 2 mountains and to 24 cities. The federal stimulus effort was meant to spur job growth, but we are of the opinion that it has really flubbed it up as far as water. Now, I just want to preface my preceding comments on that, that the stimulus package is, we feel, at about $14 to $15 billion this year for the U.S. It will have an impact, but really when you take a look, it is just a band-aid where a major surgery that is required. The recent estimates put the infrastructure spending on water, roads, bridges and dams and levees at $2.2 trillion over the next 5 years, before chaos and mass failure comes out of this. You will see more and more tax dollars allotted into infrastructure rebuilt, than we have seen over the course of the last 80 years. We cannot afford to be in a situation where we have a high incidence of failing potable and wastewater systems in various shapes and forms and we feel that the likelihood of that happening, based on current spending, is extraordinarily high and we have put that in our note for the quarter's end. We believe capital will continue to be directed toward the water utility companies who sit at the top of the water investment pyramid and from there it will flow into the industrials. We continue to be tactical in this market, and based on what we see coming out of the U.S., China, what is going to happen in Europe, and how the water landscape has really changed, the opportunities, from an investment standpoint, are probably the best that I have seen at anytime in the last 10-15 years. I want to throw this out to you at the end, as far as just something to think about with your clients, that I talked a little bit about deflation and inflation and right now one of the things that we have seen is where the world in which credit-based assets (real estate, financial instruments) continue to deflate, and they might even be better described as liabilities, while more cash-based assets, such as agriculture, foodstuffs, energy and especially water, inflate or at least hold their value. Perhaps the focus of this debate that is going on in the market right now should not be inflation or deflation, but it should be the performance of specific asset classes, given the prevailing influences and government intervention. We can envision a state of affairs where a strong dichotomy emerges within the global markets and when we take a look at the water market in particular, and we see what is going on in various economic markets and asset classes globally, we are very, very thankful that we are in the water sector right now and we feel it is the best way to transcend the conflicting inflationary pressures and to focus on a good, with no economic substitute, regardless of price. No matter what scenario we envision, we really continue to be strong proponents and believe that the fund is moving in the right direction. We are in good shape, with less volatility and less intrinsic risk than any other investment class that is out there, and on that note, Chris, I will open it up for questions.

Chris Bell: Ok, thank you Bill. I have a couple of questions for you, but before that I wanted to mention to everyone that Bill's commentary for the June ending quarter is now on our website and it is www.kineticsfunds.com. Click on the Water Infrastructure Fund (KWINX) and it will take you to another page that has a commentary banner on the left-hand side. Bill, one of the things you and I talked about a while ago, which I thought was very interesting, was the future of business development as it relates to all of the states that are contiguous to the 5 Great Lakes. Can you talk about that, and a little why that is so important?

William Brennan: Sure. It is a great question because people have approached us and talked about the coming of what we call the "blue economy" and the "hydro-economy," in the sense that the Great Lakes is the largest freshwater mass that exists anywhere in the world, and where you see Michigan, Ohio, Pennsylvania - real industrial states that relied on manufacturing from an economic standpoint - go to the side, we feel that there is going to be a transition, where industries that use water as a backbone, say the chip industry, will take a look at Michigan and say, you have skilled workers, you have got a great setup from a commercial/industrial real estate standpoint, to handle a movement of jobs for that specific industry into the state. Even more importantly, you have got waters that will sustain that industry for the foreseeable future. One of the things that was interesting back in December - the 8 largest institutional investors in the world approached the largest 100 companies in the world and said, we need your water footprint, and by that we mean water usage liabilities. Do you have enough water to sustain your manufacturing over the course of the next 5 years, because if you are in areas of India or China where that water could potentially run out, if you are using surface water and that river dries to a trickle just based on climate change, then we need to know about it. What are you going to do to adjust your manufacturing processes and pick up and move to an area where water is freshly available? So we feel that there is going to be a migration to the Great Lakes over the course of the next, I would say, 10-20 years, as far as manufacturing that is dependent on water usage and also the areas where there is a sustainable water source vis-à-vis desalination or the fact that there is substantial reservoirs or surface water to be pulled on. The large urban areas that have a good sustainable water presence will be the ones that I feel, from an economic standpoint, flourish because of this water-driven market that we are seeing that is evolving at a rapid pace.

Chris Bell: Thank you.

Q1: Hi, Bill. Thanks for the call. I have noticed Veolia has been working its way to the top holdings of the fund for a while, and I saw an article the other day that discussed how New Orleans is outsourcing their public transportation to Veolia. What impact does this have on the fund and water investing in general?

William Brennan: Thanks for the question. Veolia is a very interesting situation, in the sense that they are a true infrastructure company, and when you see certain infrastructure companies globally like ACEA and some of the other ones that are involved in various shapes and formats, Veolia I look at as a logistic infrastructure company, in the sense that they go after the cabs, the buses, the water, and the waste side of it. They want to come in and take that whole infrastructure piece out of the populous urban areas and basically take that over and take what is typically a liability, especially the transportation side, and take that off the shoulders of the municipalities. We feel now that Veolia has been through the wild swing as far as energy costs last year, that did have a significant impact on the stock and took it down quite a bit, because they were not prepared contractually to deal with the high cost of energy and the movement that occurred so quickly, although it took them only about 9 months to recapture about half of that increase in cost. We feel that they are very well positioned now and moving forward, they have been through that, they have learned from their sins of the past and from a structural standpoint, it is one of the best configured infrastructure companies we see in the marketplace because transportation as far as we know it today will definitely go through a revolution over the course of the next decade or so. Not only here in the U.S., but a significant impact over in China, because there is no way that their infrastructure is going to sustain millions and millions of cars on the roads. I think Veolia has really put themselves in a driver's seat to take advantage of larger urban sprawls that will inevitably occur as people move out of the rural areas and back towards heavily, densely populated urban areas because the increase in the cost of energy. You are going to have to be closer to the sources, whether it is for a job or whatever the case may be, or a lower cost provider in those areas, so we feel that Veolia is, along with Suez, just on the water side alone, very well positioned in growth markets in China. Indeed when we take a look at logistical infrastructure, I think Veolia is also one of the best in the world.

Chris Bell: And Bill, just so people get a little update on Veolia; it really is the largest water company in the world, is it not?

William Brennan: It is. As far as providing water, water services and water treatment, it is definitely the world leader.

Chris Bell: And maybe this will be a good time to sort of distinguish the fund between the ETFs, because the ETFs really were not able to sell the stock when it was $90 a share. You were, and I remember you purchasing it and beginning to purchase it below $25. You actually were able to be more tactical.

William Brennan: Chris brings up a good point, we buy one business at a time and we do not look to trade the stocks. We will be tactical and say if a stock has a significant increase over a short time period and we just feel it is not sustainable, the valuation is moved, we will get out of it, but Veolia is a great example of where, if that stock is at $90 and you were locked in for a quarter, watching this thing drop all the way down, you'd have been deeply disappointed.

Chris Bell: They signaled their energy costs, didn't they?

William Brennan: They did, absolutely. They were very, very transparent.

Chris Bell: So a normal investor could have gotten out?

William Brennan: That is right. They were transparent to the market with regards to the contract configurations and they did not hide anything at all, much to their credit too. We look at management, the most paramount piece is, as far as our checklist when we go in, is we want to make sure it has the ability to execute and has executed through good and bad times, and especially when they address a serious situation like Veolia did, seeing something for the first time, how they react, how they get through it, because it just gives them better experience for those things that are unforeseen in the future.

Q2: Thank you for taking my call. I had a question about the size of the fund and if you find that there is tremendous interest in overall advisors putting their clients into it, how that will affect pricing valuations going forward, especially since it sounded like you are looking at investment opportunities that are not necessarily the truly, truly large cap in general, so if you could comment just a little bit on that, because I think your strategy sounds terrific and I am looking very much to put in a number of my clients and allocate portfolios accordingly, according to what you said roughly about 10% allocation, but I am just a little concerned in terms of how that is going to drive valuation and price with the companies that you are looking to buy.

William Brennan: Ok, that is a great question. I have lived through this cycle because I did the first two UITs for Claymore and basically launched their water investment business. One of the things from a philosophical standpoint that we went sideways on was that with these names you cannot go in and create 13, 14, 15 UITs that build upon the same name. It's quite possible that you are driving these valuations every time you turn them over and you see the peaks and valleys especially in the small cap companies. I have been doing investments in the water space since 1994, so the last 5 years in particular have created pitfalls but they have also created opportunities to own these companies, and like I said, there is enough out there. We take a look at approximately 550 companies globally and at any one time in a normal market about 120 of those companies will fit our investment parameters, in that we believe their valuations are opportunistic and we believe they will stand up well in a volatile market. One of the things we have seen is a lot of the hedge funds that thought they could play in the water space, thought they were experts in it, leave. They departed the area because they threw their hands up and said how can people make money by investing in water when we cannot? I have seen ETFs that were twice the size of what they are now go in and engage in indiscriminate buying and selling. That gives us an opportunity to trade around them. Like I have said before, and I will preface this with this remark. I am more excited now than I have ever been with regards to the prospects in the water market and the way that we approach our investment thesis specifically in this type of market, than I have been in the last 20 years.

Chris Bell: Bill, most of our facts sheets for our other funds mention the average market cap. I think that would help. Also, can you explain that if you get a fund that has $5+ billion in it, you are not going to have too much trouble as the average market cap of most of the companies in the fund is on the order of $3 to $5 billion?

William Brennan: That is right, and we are really a small to mid cap fund when you take a look at it. Morningstar puts us in that blend and so the average market cap price/SIs really is between $800 million and $1.4 billion on a weighted basis. When you take a look at what we own and how much we own relative to the market caps of these companies, we are capturing at a low valuation, we feel, the highest growth potential in the water market and a lot of these small cap companies still are very much undiscovered by the investment banks. We will continue to dig and find companies that aren't on the radar of the investment banks. Occasionally, we'll identify companies that investment banks don't even consider to be in the water space. We'll analyze the company's revenue stream and discover that 40-50% of their revenue is from water infrastructure or directly water related revenue generations. We are capturing that upside, but we are doing it with a safety net at the bottom from a risk management standpoint, where we look at the valuation. A lot of these stocks trade in channels and having had the experience of working in this industry for the last 15 years has provided me with a real benefit to see how they trade technically, because the fundamental piece of it is one thing, but we pay special attention to the technical aspect, especially around ETF rebalancing and it is important for us to watch our institutional cohorts who own these names in their portfolios. We will specifically stay away from names when we start to see larger hedge funds involved because we feel that they are running the company, they do not own for the long-term. We realize that will increase the volatility and therefore, that is a knock against that specific company. We still want to own it, but we would rather own it when we see some of those people exit it, and they feel that they have gotten what they need out of that position, that is when we come in and say we want to own this for the next 3 years.

<u>Q2</u>: Thank you. May I just ask a follow up question to that? You said this is the most excited you have been in the last 20 years. Can you put it in some historical perspective,

because frankly, I have no idea what happened 20 years ago. What made it so exciting 20 years ago and what are you seeing now that, you know, just to give some perspective?

William Brennan: The thing is, when you take a look at valuations, we saw a peak in the utilities roughly about 3 years ago, and we have seen them come off as of late, and we feel that the underlying aspect of the utilities is this: we look at them as a mine. When I say that, I am saying if you own a gold mine or silver mine, you know the quantity of ounces that are there and you can roughly figure out revenue generation on a year by year basis, how much is going to be extracted. On the water side, when we take a look at the availability of water to these utilities, either through the company-owned reservoirs or sources such as surface water where the states have given them a right–of –way to pull x amount of gallons on a daily basis , these companies' values, their intrinsic value starts to go up. Timber companies are another example of a type of company with water rights in the western part of the United States. Most water related activities of these companies are not included in balance sheets, so people scratch their heads and they do not even think water is a component or significant piece. The equipment valuations we have seen come down from the 2007 highs and what we are seeing is an uptick in the cycle. As I said earlier in the conference call, 2009 will probably be a down year as far as water, but we see a pent-up demand and backlog for 2010, especially at the municipal level. As the municipalities have held off projects in anticipation of the stimulus, and as they do not get them, they realize they just cannot put off a water pipe or a rebuild of a water municipal system as they can a playground at the local elementary school, so these things are building backlog in the pipeline and there is going to be a time and a place for us to come back into the industrials. I am just saying on a macro level right now, we feel we are going to be in a W, and we are going to get another downturn and certain parts of the industrial water sector we will be able to own cheaper than the valuations when see at today's market.

Q3: Hi. Alright, a question and a clarification. The clarification: Bill, did you say that you felt the utilities sector was a place that you would be advocating now as sort of a "hiding place" for capital over the course of the next few months as what we think is a W unfolds? And the question has to do with desalination projects, I was noticing how, I guess it was San Diego or Carlsbad, CA did a recent desalination plant and there are a couple more in the works. How can we get granular, or rather, how are you getting granular, looking at which companies are best suited for this desalination play? Thank you.

William Brennan: Thanks. I will address the utility piece right now. As you have seen, some of the smaller cap utilities have really bounced significantly off their lows and, in particular, you see York and Artesian's lows, and they have come back and acted very, very good in this marketplace. What I feel is that the institutional investors are taking a look across the entire spectrum as far as sector by sector and they are trying to identify what sectors and sub-sectors have sustainable earnings and the potential for earnings increases during volatile to down markets. The water utilities clearly stand out relative to the rate increases and the PUCs. When you are seen going from an 11-12% increase to a 15% increase and in some places like Indianapolis where you have seen a 33% increase granted to Veolia and down in southern Delaware where they have had a 42.5% increase for Tidewater and for Middlesex, the people are starting to take notice of this and say, granted, you may not get that type of increase on a year-by-year basis, but if you normalize that and take that out, this number is rapidly going to go from a 14-15% increase to a 20% increase in a very short time period. Now that is real growth that will be mandated by the PUC and it will be tied to the spending of the utilities as they replace what we consider a dilapidated infrastructure. We anticipate they will build it so it is sustainable for the next 70 years. On the pipe side, you have got to realize that is your way of conveyance and about 70% of the pipes in the United States will go beyond their useful life by 2011. We are talking about over 2 million miles of water conveyance pipe for drinking water and waste water just in the U.S. alone. Now you take into account the Middle East, where they are going to build 33 wastewater treatment plants in the Saudi Kingdom, and they do not have purple pipes that move the sewage from these plants to a treatment center. You're talking globally, millions and millions of pipe that is going to be laid over the next 5-10 years. Part of that is going to be captured in the rate base of these water utilities because there is a significant government component to this. You are not going to have a privatization of this where people come in and it is going to be 50% increases year over year. We think it will be a sustainable increase when it is the lowest utility coming in to your house at 20% year over year for the next five years. We feel this is a very attractive sub-sector of the water business and one where a core position has to be established going forward. There are some utilities that we have seen move off their bottoms that we have not added to. We do everything on limit order, so we are very patient and some of our positions, especially with the utilities; we are waiting for that one day over a 6 month period that we are going to continue to add into that specific position. Now on the 2nd half of your question, with regards to desalination, we are taking a look at this in a number of different ways. You can play it from the engineering side, Tucson

Heavy; Accione is the one that is providing the Carlsbad, CA plant with expertise as far as desalination technology. In fact, I know the gentleman who worked at the site, which is the largest U.S. developer of desalination, Andy Shea, and went over to Accione two years ago, so we are watching it from the engineering/construction side, we are also taking a look at it from the engineering/recovery side. When we have talked to some of our outside advisers that are in the water business and have asked what they are taking a look at, the one theme that comes up time after time is the energy aspect of desalination and how that energy cost is going to be reduced. Companies like Energy Recovery are ones that will be a staple in the portfolio going forward as far as exposure into a global market where there really is no escape around from building desalinization plants. The key here is to make sure these plants are collocated with an energy source. China, as they take a look going forward and build out their desalinization plants, they realize that they are going to have to build nuclear plants in order to run these desalinization plants, and this goes back to the earlier statement that energy and water are going to be intertwined and the two are going to be tied at the hip going forward, so there are a number of different ways on the desalinization side to play it. The filter and the membranes, as the installed base, which is roughly about 15 thousand desalinization plants of various shapes and sizes globally now, increases and we think that number will probably be a 3-4x increase over the course of the next 5-7 years. Take a look at that from pumps, pipes, filters, membranes, motors, that are moving the water through these massive filters, whether it is ultra-filtration or whether it is straight membrane filtration, the companies that are in those areas are going to be beneficiaries because we believe you are going to see rapid growth in their market. This is because the installed base get larger and then the razor blade mentality that this base keeps grower but there is a replacement cycle to all of these components. It is all finite, and they all wear out.

Chris Bell: Ok, and Moderator, we are coming up on one hour here, but I just wanted to ask to ask Bill one final question as it relates to our largest holding. URS is one of our favorite companies, and if you could just speak briefly about how they participate in the water spend.

William Brennan: URS is a great example as far as the various levels that a company can participate on the water side. On the infrastructure side, they are definitely a main player, not only on the industrial, but also with regards to the Department of Defense government buildings. Their specialty services division is dealing with things such as earthquake services and areas with regard to DamSmart. People do not give that much consideration to these things, but when we are taking a look at the California market, in particular and seismic events there, URS is probably best-equipped, from an earthquake services standpoint, to go in and deal with water issues that may arise out of a seismic event. Their EG&G division, as far as providing logistics to the Department of Defense, Homeland Security, NASA and other federal agencies, even though a lot of people take a look at that from a standpoint that it is military related, there is a significant water component to the military and people forget that one of the biggest expenses logistically, are the C-58 Galaxies the fly out of Dover Air Force Base, providing potable water in Afghanistan and Iraq because there is not enough there to supply troops. So, these guys are in that nuclear, chemical, and biological weapon area, specifically focused on the impact of water, and then the last piece of this we got very interested in is the Washington

D.C. division, which provides the engineering, construction and technical services for environmental management and industrial processes, infrastructure, mining and power projects. That division is really a leader in the design, build and operate services for all of the infrastructure for airports, mass transit and toll roads. They are also involved in the nuclear side of this as well, nuclear waste. People do not realize that nuclear is one of the largest users of water. It needs to be cooled and then has to be safely discharged back into the surface areas. Their Washington D.C. division is literally one of the best in the world with regards to that. We look at the landscape for the next 2-3 years and we feel that partly due to stimulus spending, URS is very well situated in the U.S, as far as a publicly traded engineering and construction company.

Chris Bell: Thank you. I would just like to remind everyone to go to our website to see Bill's most recent commentary and the 2^{nd} quarter-ending facts sheet should be up on our website at www.kineticsfunds.com. You may also contact us directly at (914) 703-6950.

Water Infrastructure Fund Top 15 as of June 30, 2009	
URS Corp New	6.23%
Geberit	4.72%
Lindsay Corp	4.16%
Acea SPA	3.83%
Veolia Environnement	3.62%
Guangdong Invest	3.10%
Connecticut Water Svc Inc	2.89%
Itron Inc	2.77%
Met Pro Corp	2.71%
Northumbrian Water Group	2.31%
York Water Co	2.18%
Empire Dist Elec Co	2.08%
Artesian Resources Corp	2.06%
Manila Water Co	1.99%
Armtec Infrastructure Income Fund	1.92%

The information contained in these charts is updated at the discretion of Kinetics Asset Management, Inc. and is only representative of each Fund's portfolio on the date specified. Additionally, position size may not be indicative of actual market position due to the use of call and put options.

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