TARKIO FUND

A No-Load Mutual Fund Managed by:
Front Street Capital Management, Inc.

November 10, 2017

This quarter's letter features the St. Joe Company. St Joe is a different type of holding for us, as our investment in it is purely based on owning a valuable real estate asset. St Joe owns 178,000 acres of real property in the panhandle of Florida, most of which is within a short jaunt to some of the most beautiful beaches in the world.

For me to fully explain our investment in the St. Joe Company, I need to explain our analysis of asset bubbles and baby boomers. Price bubbles in an asset class, in our opinion, are real but rare events. We believe two elements are necessary to create an asset class bubble. The first is actually fairly easy to identify: when an entire asset class has become so popular with investors that investor demand inflates purchase prices, and the cash flow created by investment in the asset is almost meaningless compared to the inflated prices. The second requirement for a bubble is much harder to pinpoint: when prices for the asset class remain elevated for so long that investors begin to believe in a new normal and start to accept that it's natural for "the emperor to have no clothes."

We believe any real investment must be able to produce cash. The investor's job is look out into the future and estimate what that cash flow might be and determine a fair price to pay today for that projected future cash flow. We also believe that assets that do not produce cash are impossible to value, and purchasing these assets is a pure speculation. We are investors, not speculators.

So, given that distinction, we believe there are only three investment asset classes:

1. Equity ownership in businesses (e.g., the stock market)
2. Real estate
3. Fixed income securities (e.g., bonds)

Over time, capital will shift from one of these asset classes to another. A bubble is created when, for a variety of reasons, so many investors find one of these asset classes so attractive that they are willing to accept nothing short of a paltry future cash return for the comfort of being nestled within a large crowd of their peers. This sense of false security can last for years and years, but eventually the emperor will be seen simply swinging in the breeze, igniting a panic that causes a stampede for the exits.

The problem is, of course, that it's not possible to know precisely when reality will set in. (And humans are never satisfied knowing WHETHER something is going to happen; they must know WHEN it will happen.) One thing we do know is that the longer it takes for a bubble to burst, the more people will get hurt when the day of reckoning occurs.

Here are a couple thoughts on bubbles. First, there is only so much money to go around. Therefore, we believe that if such a large amount of investment capital is jammed into one of the three asset classes, then the other two should be in a normal investable condition. Second, once a true bubble bursts, we believe it won't get recreated in that same asset class until the panic fallout fades from investors' collective memory. It can literally take decades for investors to forget their fear enough to overpay for the asset again.

Ok, bear with me as I digress one more time before we get to St. Joe. We believe that the baby boomers (my generation) have over the past three decades helped create a true bubble in each of the three asset classes due to the amount of capital we have collectively moved from asset class to asset class during our investment/retirement lifecycle. First was the stock market bubble that peaked in 2000. This was fueled by the fact that boomers had enough time before retirement that the attraction of investing in technology stocks for the long term fit our life cycle/retirement time horizon. As a result of vast amounts of their capital flowing into tech stocks, the boomers helped drive up stock valuations for the most popular stocks of the day to levels that were many times greater than stock valuations are for today's most popular companies. I saw first-hand that when that bubble burst, many boomers' retirement savings were decimated.

As time continued to pass, we saw lots of boomers starting to panic as retirement neared and they still had not recovered from the stock market bubble. But, lo and behold, real estate prices were starting to escalate. As time went on it became apparent that by borrowing lots of money, one could potentially leverage a modest amount of capital in a short period of time by flipping an inflated piece of property to another desperate boomer looking to borrow lots of money to sell to another flipper.[1] This game was supported by the enablers (in this case, the banks), who made sure all this leverage was available to the boomer/flippers – for a nice fat fee of course. Boomers thought, "if I can just borrow this boatload of money and flip this project I will finally be set for retirement." We saw this time and again in our office from 2002 to 2007.

Over the years, we think we developed a pretty good idea of how bubbles get created and eventually cave in. And the pattern is even more identifiable given the large capital movements resulting from my generation and where we are in our life cycle. In about 2004, we started

[1] New evidence suggests that it was indeed speculative real property investors ("flippers"), rather than poor subprime mortgage borrowers, who contributed most to the 2007-2009 economic crisis. National Bureau of Economic Research Working Paper No. 23740 (August, 2017)

seeing this boomer bubble pattern developing in the real estate market, and began researching real estate companies to try to identify one that we could live with. That way, we could be ready to invest when the real estate hysteria came crashing down. The real estate company we landed on was the St. Joe Company.

At that time in 2004, St. Joe was the largest private land holder in the state of Florida. It now owns 178,000 prime developable acres, most of which are fairly accessible to the white sand and turquoise water beaches of the Florida panhandle. Most of this property was acquired by the company during the depression of the 1930s at minimal cost. In addition, the land is carried on the company's books at cost, which dramatically understates the reported book value of the company. The company has been developing the property at a steady but measured pace.

In 2004 I started following the stock at about $30 per share and by its peak in 2007, the stock had skyrocketed to over $84 per share. Then the bubble burst. We started buying the stock for our Front Street accounts in 2008 (before the Tarkio Fund was formed) at about $28.00 per share and I think our lowest purchase price cost during its decline was under $13 per share. Tarkio, which started in 2011, purchased St. Joe as low as $14.40 per share.

As you know, the real estate market has made a meaningful recovery since the bubble burst, and that recovery has not been reflected in the price of St. Joe. It is now obvious to me that in 2008 I could have selected a real estate company that would have far outperformed St. Joe by this point in the cycle. That said, it also indicates to us that the stock is potentially undervalued compared to the potential cash that the company's properties can generate into the future. That belief is shared by at least one investor: Bruce Berkowitz from the Fairholme Fund. While Berkowitz had significant success with Fairholme in the first decade of the 2000s (winning Morningstar's "Domestic Equity Manager of the Decade"), since 2010, Fairholme's results have been checkered at best, but part of that underperformance has been Bruce's increased investment in both time and money into The St. Joe Company. Bruce has taken on the role of St. Joe's chairman of the board, which is unusual for a mutual fund manager.

We like the fact that the company has subsequently sold a large tract of land that it considered undevelopable for a significant amount of cash. In addition, as of last quarter the company had reduced the number of outstanding shares during the last three years from about 92 million to about 66 million at prices ranging from $15 per share to $21 per share. Real estate development is the ultimate long-term investment and St. Joe is methodically planning and building for the future while keeping a low profile and retiring a large percentage of its outstanding shares.

St Joe is definitely a one-off investment for us as we attempted to take advantage of a 70-year decline event in the real estate market in 2008. The idea was that even I (venturing outside of our core management expertise) could make a successful real estate investment at that point in time. Again, in hindsight, we could have identified a company in this space that would have been more profitable by this juncture, but that was the commitment we made at the time. If it takes more time than we hoped for St Joe to show the growth that we believe is possible, as ultra-long-term investors, that is ok with us. And we continue to add to the position.

Oh, one more thing: What's next for our baby boomer bubble generation? Well, we think they are now at an age when many will do anything to avoid what the financial community defines as "risk" (i.e., volatility). As a result, we believe they have created the most dangerous bubble of all in an asset class that the enablers have defined as "no-risk": fixed income securities. Two percent return for twenty years in our opinion is as naked as the emperor could get.

We thank you for your continued confidence in the Tarkio Fund.

Warm regards,

Russ

Russ Piazza, Michele Blood, Ginger Belker, Jeremy Brown, and Dominic Piazza

On November 30, 2017, St Joe Company was 3.82% of the Tarkio Fund Portfolio at a share price of $18.80 per share. The mention of any investments in this commentary should not be considered a recommendation to sell or purchase the security(ies) mentioned or similar investments. Please consult an investment professional on how the purchase or sale of such investments can be implemented to meet your particular investment objective or goals. Investments in securities and/or similar investments are subject to risks. It is important to obtain information about and understand these risks prior to investing.

Mutual Fund investing involves risk. Such risks associated with the Tarkio Fund (including but not limited to Small/Medium Capitalization Risks, Foreign Securities Risk, Fixed Income Securities Risk, Non-Diversification Risk, and New Fund/Adviser Risk) as well as applicable investment objectives, charges and expenses must be considered carefully before investing. This and other important information about the Tarkio Fund is found in the Prospectus, a copy of which or current performance information may be obtained by visiting www.tarkiofund.com or by contacting 866-738-3629. We encourage you to read the prospectus before investing.

Tarkio Fund is distributed by Arbor Court Capital, LLC - Member FINRA.