A 315 Montgomery Street
Suite 813
San Francisco, CA 94104
T (415) 992-8125
W hinde-group.com

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To My Partners:

The performance of our portfolio for the third quarter of 2015 is summarized below.

| | Hinde Model Account | | S&P 500 |
|---|---|---|---|
| | Gross | Net | Total Return |
| 3Q15 | -3.14% | -3.51% | -6.44% |

On August 11th, the People's Bank of China, China's central bank, announced a change to its exchange rate system that resulted in a 1.9% devaluation of the renminbi against the dollar on that day and a further slide over the following two days. Although the size of the devaluation may seem small, the technical change underlying the devaluation represented a meaningful step toward a more market-oriented exchange rate system for China and opened the door to further devaluation of China's currency.

The PBoC's move ignited a bout of volatility and risk aversion in global financial markets. The decision to devalue the renminbi raised concerns that China's economy and financial system are in worse shape than many had believed, and added to simmering trade tensions. The announcement also caught most people by surprise, a cardinal sin in financial markets. Coming in the wake of other perceived policy blunders, such as China's various efforts to prop up its stock market earlier this year, the communication misstep led many to question whether China's leaders are up to the herculean task of avoiding calamity as the country unwinds the severe imbalances that have developed in its economy. The combination of these factors sent a shockwave around the globe.

Although the U.S. has relatively low direct economic and financial exposure to the Chinese economy, U.S. financial markets did not escape the quarter unscathed. The U.S. equity market posted its largest quarterly decline in four years during the third quarter of 2015. Our portfolio also experienced a mark-to-market decline, but it did outperform the broader U.S. equity market.

## China's Rebalancing

China has a challenging task ahead of it. Its investment and export-oriented model for economic growth has reached its limits. There simply are not enough productive investments for China to pursue to maintain its recent rate and composition of economic growth over time. Accounts of uneconomic investments, such as ghost cities and bridges to nowhere, made in China over the last decade abound. Take the following example from *The Wall Street Journal*:

> *My own reporting suggests that we are witnessing the end of the Chinese economic miracle. We are seeing just how much of China's success depended on a debt-powered housing bubble and corruption-laced spending. The construction crane isn't necessarily a symbol of economic vitality; it can also be a symbol of an economy run amok.*
>
> *Most of the Chinese cities I visited are ringed by vast, empty apartment complexes whose outlines are visible at night only by the blinking lights on their top floors. I was particularly aware of this on trips to the so-called third- and fourth-tier cities—the 200 or so cities with populations ranging from 500,000 to several million, which Westerners rarely visit but which account for 70% of China's residential property sales.*

*From my hotel window in the northeastern Chinese city of Yingkou, for example, I could see empty apartment buildings stretching for miles, with just a handful of cars driving by. It made me think of the aftermath of a neutron-bomb detonation—the structures left standing but no people in sight.*[1]

or a similar account from the *Financial Times*:

*On a remote patch of swampy farmland about halfway between Beijing and the port city of Tianjin, which was hit by deadly explosions last week, the enormous "Jingjin New City" villa development provides a visual aid for anyone trying to understand the challenges facing China.*

*A little beyond the Kai Xuan Men — literally "Arc de Triomphe" — entrance gate and adjacent golden statue sits an astonishing 800-room Hyatt Regency built to resemble a European palace.*

*Fewer than 10 per cent of the rooms are occupied on any given night, according to staff. The indoor tennis arena and other facilities were locked up and rusting this week. Just seven years after the hotel opened, the building is falling apart and the balconies of many rooms have tall weeds growing on them.*

*From those balconies guests can look out over what property agents boast is "Asia's biggest villa complex", spread over 15 square kilometres. More than 2,000 villas have already been built, hundreds are still under construction and there are plans for another 4,000. The vast majority of the existing villas, built with generous loans from state-owned banks, are empty and some appear abandoned.*

*The Jingjin development is just part of a much larger 105 sq km planned residential zone — nearly twice the size of Manhattan — and around its edges smaller villa complexes, with names like "Dream Life in Europe", are frozen in various stages of construction.*

*"We've stopped building and selling villas because nobody is buying," says the caretaker at the "Dreamland of Town" development on the edge of Jing-jin New City. "I'm not sure if these will ever be finished and put on the market."*[2]

The uneconomic investments China has made over the past decade have led to an exploding debt-to-GDP ratio. China's total debt-to-GDP ratio has climbed from 160% in 2007 to more than 240% today. The McKinsey Global Institute recently estimated that if the current pace of growth were to continue China's debt-to-GDP ratio would reach 400% by 2018, a level that would leave it as one of the most heavily indebted countries in the world.[3] While China is somewhat insulated from a sudden stop in financing because of the government's high degree of control over the country's financial system, it nonetheless faces an inherent limit to its debt capacity at some point. The challenge for China's leaders is to orchestrate an orderly rebalancing of the economy toward consumption and away from investment before a hard landing becomes inevitable.

A slower growing, more-consumption oriented China does not necessarily spell doom for the world economy in general or the U.S. economy in particular. There are certainly some sectors and countries that

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[1] Davis, Bob "The End of China's Economic Miracle?" *The Wall Street Journal* Nov. 21, 2014
[2] Anderlini, Jamil "China: Weakened Foundations" *Financial Times* Aug. 19, 2015
[3] McKinsey Global Institute (2015). *Debt And (Not Much) Deleveraging.* McKinsey & Company

will be adversely affected. Anything related to the investment side of China's economy, such as non-food commodities and construction equipment, is probably in for tough times. On the flip side, anything related to the consumption side of China's economy will probably prove relatively resilient. The impact of a slowdown in China's growth on overall global economic growth will depend in part on how China's trade balance evolves through its rebalancing process. In the recent past, China has consistently run trade surpluses – at times massive ones – that have effectively drained demand from the rest of the world. If growth in the consumption side of China's economy leads to a more neutral trade balance, the impact of slowing overall economic growth in China on the rest of the world would be cushioned to a degree. It is also worth pointing out that while China will likely have to deal with significant bad debts throughout its financial system over the coming years, the relatively closed nature of China's financial system limits the likelihood that China's financial problems will infect the global financial system.

No one can predict precisely how China's economic rebalancing will play out and what impact it may have on the global economy and financial system. Hinde Group's approach relies on conservatism, not prescience. The conservative assumption in this case is that China's rebalancing will not proceed smoothly; however, I do not believe this assumption results in a doomsday scenario for the global economy and financial system or even a recession in the United States. My view on this may change. The important point is that Hinde Group is closely monitoring China's economic rebalancing, continually seeking to understand realistic downside scenarios, and will protect the portfolio from those downside scenarios through conservative valuation of existing and prospective investments, on-going consideration of various hedging alternatives, and a willingness to hold cash in lieu of safe, attractive investments.

## Performance Attribution

Positions that had a material impact on the portfolio's mark-to-market performance for the quarter are outlined below.

| Performance Attribution | |
|---|---|
| | 3Q 2015 |
| Amazon.com | 1.24% |
| News Corporation | -0.97% |
| E*TRADE Financial Corporation | -1.03% |
| Sears Hometown & Outlet Stores | -1.63% |
| | |
| Other | -0.75% |
| Gross Performance | -3.14% |

## Portfolio Composition

The composition of the portfolio at the end of the quarter is depicted below.

| Portfolio Composition | |
|---|---|
| Equities | 78.6% |
| Cash | 21.4% |

## Select Portfolio Updates

Hinde Group derives a distinct competitive advantage from the long-term investment perspective of its investor partners. To foster that long-term perspective, Hinde Group's policy is to discuss each position in detail only about once a year. Discussing positions in detail more frequently would put too much emphasis on short-term developments and transitory price fluctuations. Notwithstanding this policy, any positions with material fundamental developments during a quarter will be addressed in that quarter's letter. That should result in an in-depth discussion of around two positions in each letter given the concentrated nature of our portfolio.

*TopBuild Corp.*
*(NYSE: BLD)*

Although by some measures the U.S. economy has returned to a more normal level of activity in the seven years since the financial crisis, one part of the economy that remains depressed is new residential construction activity. Construction started on just shy of 1.1 million total homes over the past 12 months. While that represents a 98% increase from the trough hit in 2009, it is still 29% below the average annual level of activity from 1959 to 2007, barely above recession lows during the 1959 to 2007 period, and well below the level justified by demographics.

It seems likely that new residential construction will continue to recover to a more normal level over time. Household formation has been depressed by the lingering effects of the financial crisis, but it should rebound as the economy continues to improve, individuals continue to bolster their balance sheets, and lenders loosen the reigns on mortgage credit. Moreover, while one could argue that the U.S. had built too many homes on the eve of the financial crisis, the U.S. may now be in exactly the opposite position after more than 7 years of well below normal new residential construction activity. In other words, there may be some pent-up demand for housing that, if released, could drive new residential construction activity to an above-normal, "catch-up" level for a period of time.

As the leading installer and distributor of insulation in the U.S. construction industry, TopBuild Corp. is well positioned to benefit from a continued recovery in new residential construction activity. The company's preeminent scale allows it to purchase insulation on better terms than most competitors. Given that the cost of insulation accounts for around 40% of the company's total cost structure, TopBuild's purchasing power represents a notable competitive advantage. The company also has a solid, tenured management team. TopBuild should be able to maintain or grow market share and meaningfully expand its operating margin as the housing market recovers.

Even using conservative assumptions for a recovery in new residential construction, BLD is distinctly undervalued. BLD's current market price implies an enterprise value-to-revenue multiple of about 0.7x, a sharp discount to the 1.3x multiple at which the market values TopBuild's closest competitor, Installed Building Products. While there are reasons for Installed Building Products to merit a higher valuation multiple, the magnitude of the valuation gap is unwarranted. Another perspective on TopBuild's current valuation is that BLD's current price offers a yield of over 10% relative to a conservative estimate of normalized earnings. TopBuild only recently became a publicly-traded company after being spun-off from Masco Corporation at the beginning of July, and I attribute BLD's mispricing to the various effects of the spin-off transaction.

*E*TRADE Financial Corporation*
*(NASDAQ: ETFC)*

E*TRADE Financial Corporation, one of the most well-known online brokers in the U.S., made a regrettable foray into mortgage lending during the housing boom that led to devastating losses when the boom turned to bust. Ever since then, the company has been licking its wounds. But it has made substantial progress in its recovery and unlocked a significant amount of shareholder value along the way. E*TRADE has run down its loan portfolio, bolstered its capital position, and shored up its risk management capabilities.

The company continued down the final stretches of its road to recovery during the third quarter by achieving two important objectives. First, E*TRADE completed the move of its clearing broker subsidiary, E*TRADE Clearing LLC, out from under its banking subsidiary, E*TRADE Bank, at the very beginning of the quarter. The move will simplify the distribution of capital from E*TRADE Clearing to the parent company, E*TRADE Financial Corporation. Second, E*TRADE terminated $4.4 billion of high-cost, legacy wholesale funding and replaced that funding with low cost deposits that E*TRADE had been keeping off-balance sheet. The wholesale funding carried a weighted average cost of approximately 330 bps, while the deposits that will replace the wholesale funding cost just 1 bps. This highly attractive transaction should be accretive to EPS by about $0.30 on an annual basis. The primary remaining objective necessary to finalize E*TRADE's recovery is to complete the run-off of the company's loan portfolio, which had declined to just under $5 billion by the end of the third quarter from over $30 billion at the end of 2007.

As E*TRADE completes its recovery and as the Fed begins raising interest rates, two things should happen. First, E*TRADE's earnings should head north of $2.00 per share. Second, the likelihood of E*TRADE being acquired by a competitor, such as TD Ameritrade, Fidelity, Charles Schwab or Bank of America/Merrill Edge should rise. ETFC is worth more than $30 per share based on the company's standalone, normalized earnings power, and there is a reasonable probability that E*TRADE will be acquired at some point in the foreseeable future at a premium.

Despite ETFC's merits, the position was one of the notable detractors from the portfolio's mark-to-market performance during the third quarter. E*TRADE's return to a more normalized level of earnings is in part dependent on a return to a more normalized interest rate environment. In response to adverse and uncertain economic and financial developments in emerging markets, including China, as well as some signs of slowing growth in the U.S., market expectations for the timing and pace of a normalization of the Fed's monetary policy declined during the third quarter. A diminished outlook for future interest rates does negatively impact the value of ETFC at the margin, but the stock remains an attractive investment.

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Please feel free to contact me if you have any questions or if there is anything you would like to discuss. Thank you for your continued confidence and support.

Regards,

Marc Werres
Managing Partner

## Important Disclosures

The performance figures depicted herein relate to the Hinde Model Account. This account serves as the model account for the taxable accounts Hinde Group manages. The performance of investor partner accounts may differ from the figures depicted herein for several reasons, including cost basis differentials, the timing of account inflows, tax considerations, or other reasons. The Hinde Model Account's gross results reflect the deduction of trading commissions and other fees charged by Hinde Group's broker. Net results reflect the hypothetical deduction of management fees (1.5% of AUM per annum billed quarterly in advance).

The Hinde Model Account's inception date is July 1, 2015.

The statistical data regarding the performance of the S&P 500 was obtained from the website of S&P Dow Jones Indices. The S&P 500 returns shown do not represent the results of actual trading of investible assets/securities.

Past performance is not necessarily indicative of future results. All investments involve risk including the loss of principal. The views expressed herein are that of Hinde Group as of the date indicated and may change without notice. Hinde Group may buy or sell any security at any time and is under no obligation to provide updates to the information contained herein. This is not a recommendation to buy or sell any security.