

GRANT'S

INTEREST RATE OBSERVER®

GILCHRIST BERG, PRESIDENT

WATER STREET CAPITAL

MARCH 15, 2017

HALL OF FAME PERFORMANCE

Templeton Growth A (TEPLX) – Inception 11/29/54

| Year | TEPLX | S&P | | TEPLX | S&P |
|------|---------|---------|---------------|--------|---------|
| 1955 | 7.04% | 31.41% | } | 1974 | -12.07% |
| 1956 | 4.64% | 6.48% | | 1975 | 37.60% |
| 1957 | -16.92% | -10.72% | | 1976 | 46.74% |
| 1958 | 48.81% | 43.15% | | 1977 | 20.37% |
| 1959 | 14.00% | 11.95% | | 1978 | 19.21% |
| 1960 | 13.84% | 0.45% | | 1979 | 26.84% |
| 1961 | 18.29% | 26.88% | | 1980 | 25.89% |
| 1962 | -13.52% | -8.66% | | 1981 | -0.24% |
| 1963 | 5.14% | 22.76% | | 1982 | 10.81% |
| 1964 | 28.59% | 16.43% | | 1983 | 32.91% |
| 1965 | 22.14% | 12.46% | | 1984 | 2.17% |
| 1966 | -5.30% | -10.02% | | 1985 | 27.79% |
| 1967 | 13.74% | 23.89% | | 1986 | 21.24% |
| 1968 | 37.76% | 11.04% | | 1987 | 3.11% |
| 1969 | 19.66% | -8.40% | | 1988 | 23.60% |
| 1970 | -6.44% | 3.94% | | 1989 | 22.56% |
| 1971 | 21.93% | 14.30% | 1990 | -9.05% | |
| 1972 | 68.56% | 19.00% | 1991 | 31.33% | |
| 1973 | -9.92% | -14.69% | 1/1-6/30/1992 | 5.77% | |

| | | |
|-------------------|--------------------|------------------|
| Value of \$10,000 | \$1,743,085 | \$475,575 |
| CAGR | 14.75% | 10.85% |

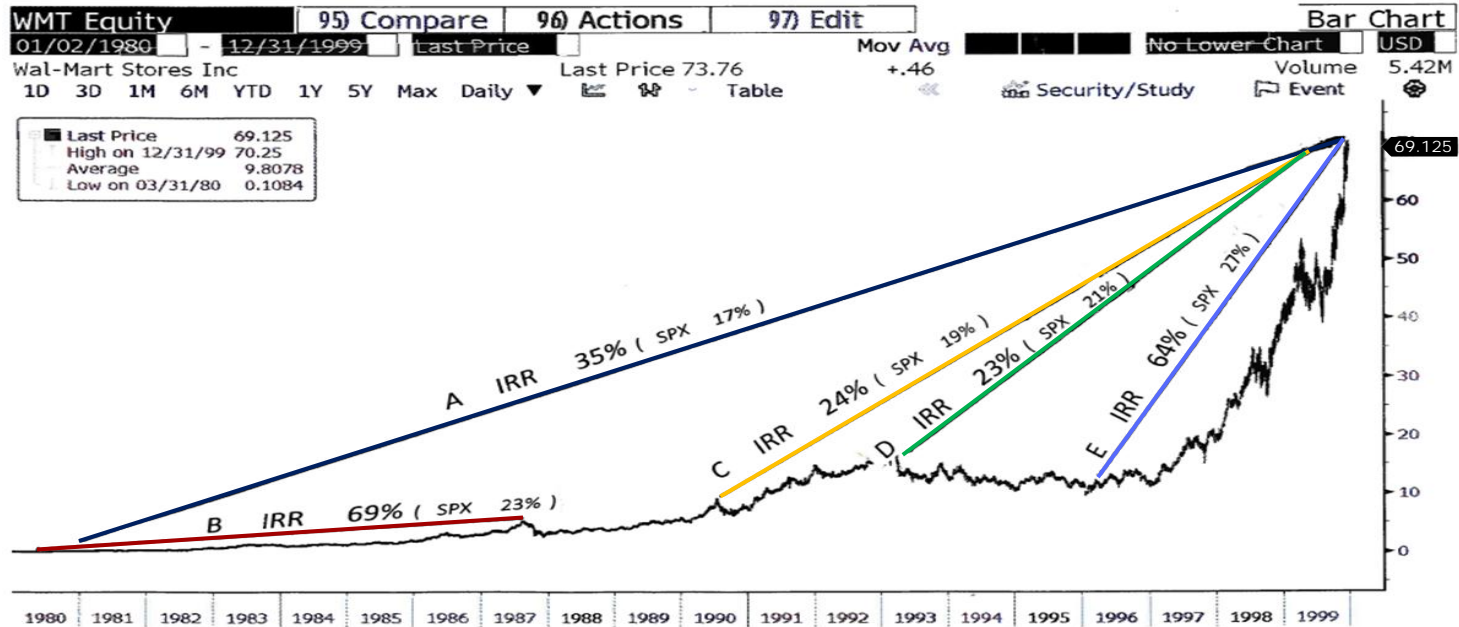
Time period: 1955-1992

| | | |
|-------------------|-----------------|-----------------|
| Value of \$10,000 | \$19,329 | \$28,613 |
| CAGR | 7.60% | 12.39% |

Time period: 1955-1963

Note: TEPLX returns are from Templeton Growth Fund Investor's Guide (57 Great Years) and Morningstar. TEPLX return is without sales charges. S&P returns are with dividends reinvested (compounded monthly prior to 1988 and daily thereafter).

WALMART EQUITY



| | | |
|-------------------------|---------------|---------|
| A. Purchase Date | 12/31/1980 | \$0.24 |
| Sell Date | 12/31/1999 | \$70.25 |
| IRR | 34.81% | |
| SPX IRR | 17.03% | |
| WMT Multiple | 292.7x | |

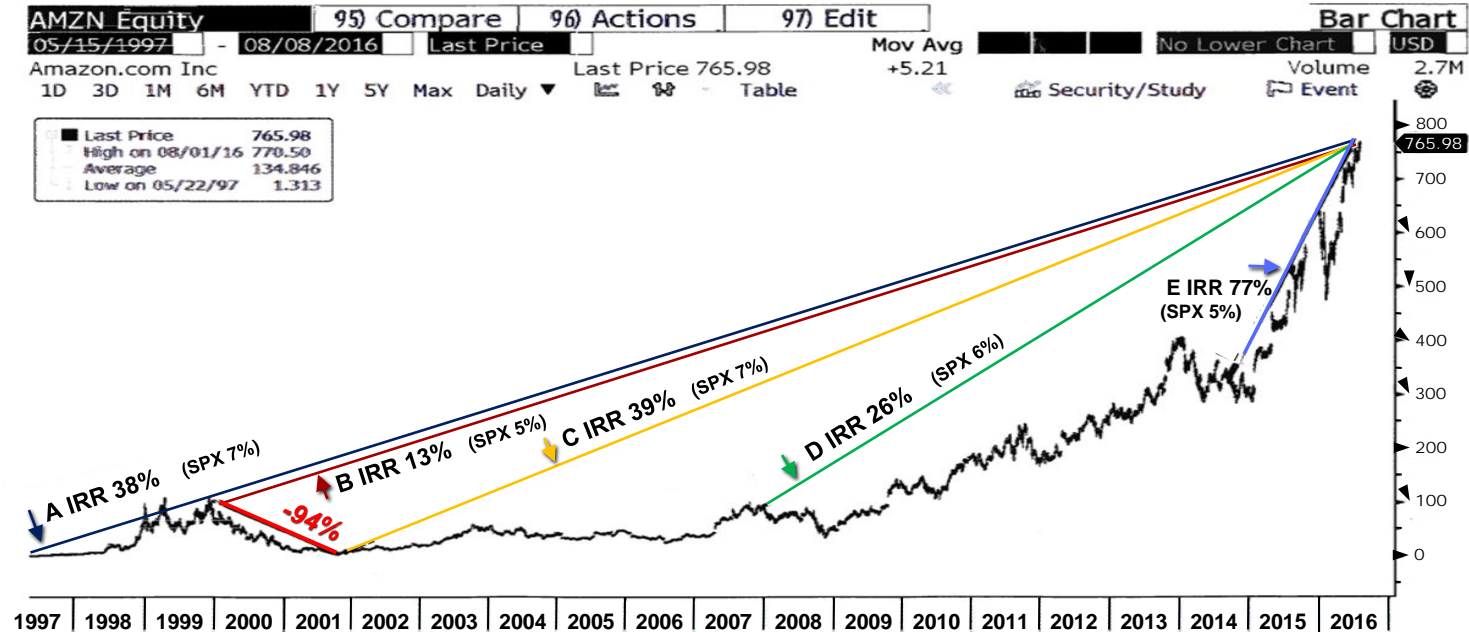
| | | |
|-------------------------|---------------|---------|
| C. Purchase Date | 7/16/1990 | \$9.19 |
| Sell Date | 12/31/1999 | \$70.25 |
| IRR | 23.97% | |
| SPX IRR | 18.56% | |
| WMT Multiple | 7.6x | |

| | | |
|-------------------------|---------------|---------|
| E. Purchase Date | 1/17/1996 | \$10.00 |
| Sell Date | 12/31/1999 | \$70.25 |
| IRR | 63.68% | |
| SPX IRR | 27.17% | |
| WMT Multiple | 7.0x | |

| | | |
|-------------------------|---------------|--------|
| B. Purchase Date | 3/31/1980 | \$0.11 |
| Sell Date | 8/21/1987 | \$5.36 |
| IRR | 69.47% | |
| SPX IRR | 22.76% | |
| WMT Multiple | 49.4x | |

| | | |
|-------------------------|---------------|---------|
| D. Purchase Date | 3/3/1993 | \$17.06 |
| Sell Date | 12/31/1999 | \$70.25 |
| IRR | 23.01% | |
| SPX IRR | 21.48% | |
| WMT Multiple | 4.1x | |

AMAZON EQUITY



| | | |
|-------------------------|-----------|----------|
| A. Purchase Date | 6/20/1997 | \$1.50 |
| Sell Date | 8/04/2016 | \$760.00 |
| IRR | 38.46% | |
| SPX IRR | 6.66% | |
| AMZN Multiple | 506.7x | |

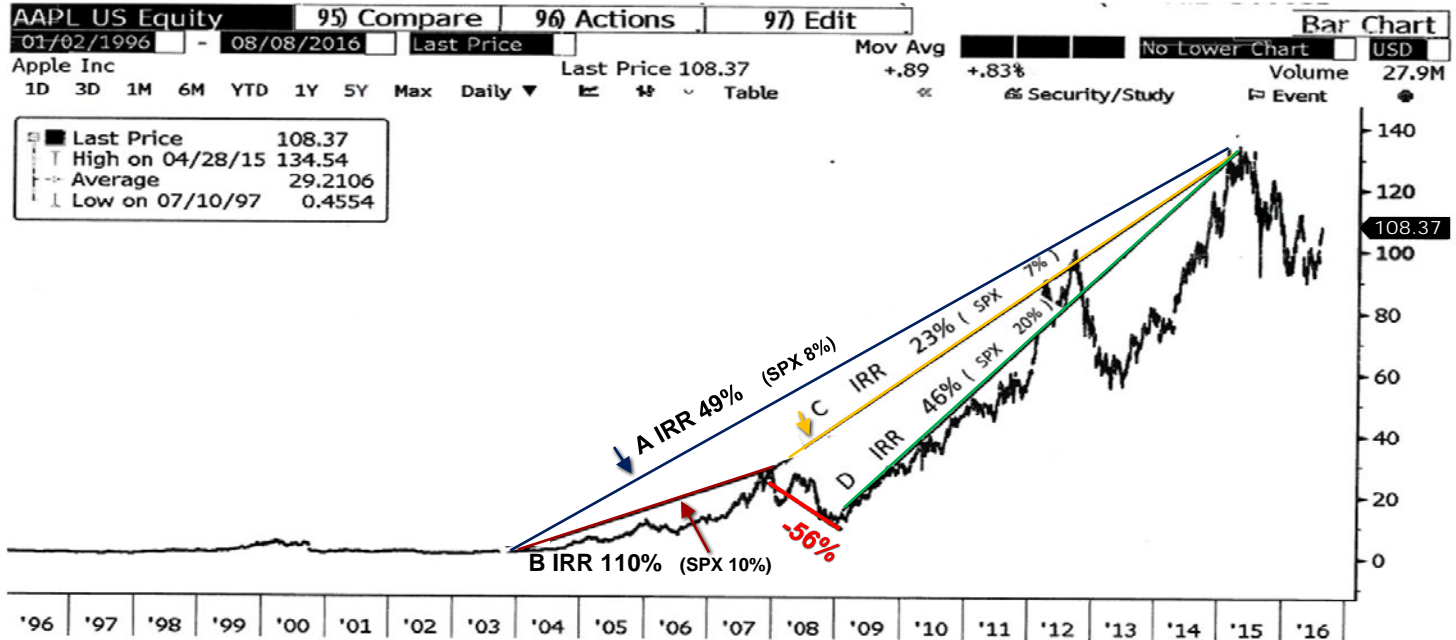
| | | |
|-------------------------|------------|----------|
| D. Purchase Date | 10/23/2007 | \$101.09 |
| Sell Date | 8/04/2016 | \$760.00 |
| IRR | 25.80% | |
| SPX IRR | 6.40% | |
| AMZN Multiple | 7.5x | |

| | | |
|-------------------------|------------|----------|
| B. Purchase Date | 12/10/1999 | \$106.70 |
| Sell Date | 8/04/2016 | \$760.00 |
| IRR | 12.50% | |
| SPX IRR | 4.56% | |
| AMZN Multiple | 7.1x | |

| | | |
|-------------------------|------------|----------|
| E. Purchase Date | 12/19/2014 | \$299.90 |
| Sell Date | 8/04/2016 | \$760.00 |
| IRR | 77.07% | |
| SPX IRR | 4.95% | |
| AMZN Multiple | 2.5x | |

| | | |
|-------------------------|------------|----------|
| C. Purchase Date | 10/01/2001 | \$5.51 |
| Sell Date | 8/04/2016 | \$760.00 |
| IRR | 39.34% | |
| SPX IRR | 7.20% | |
| AMZN Multiple | 137.9x | |

APPLE EQUITY



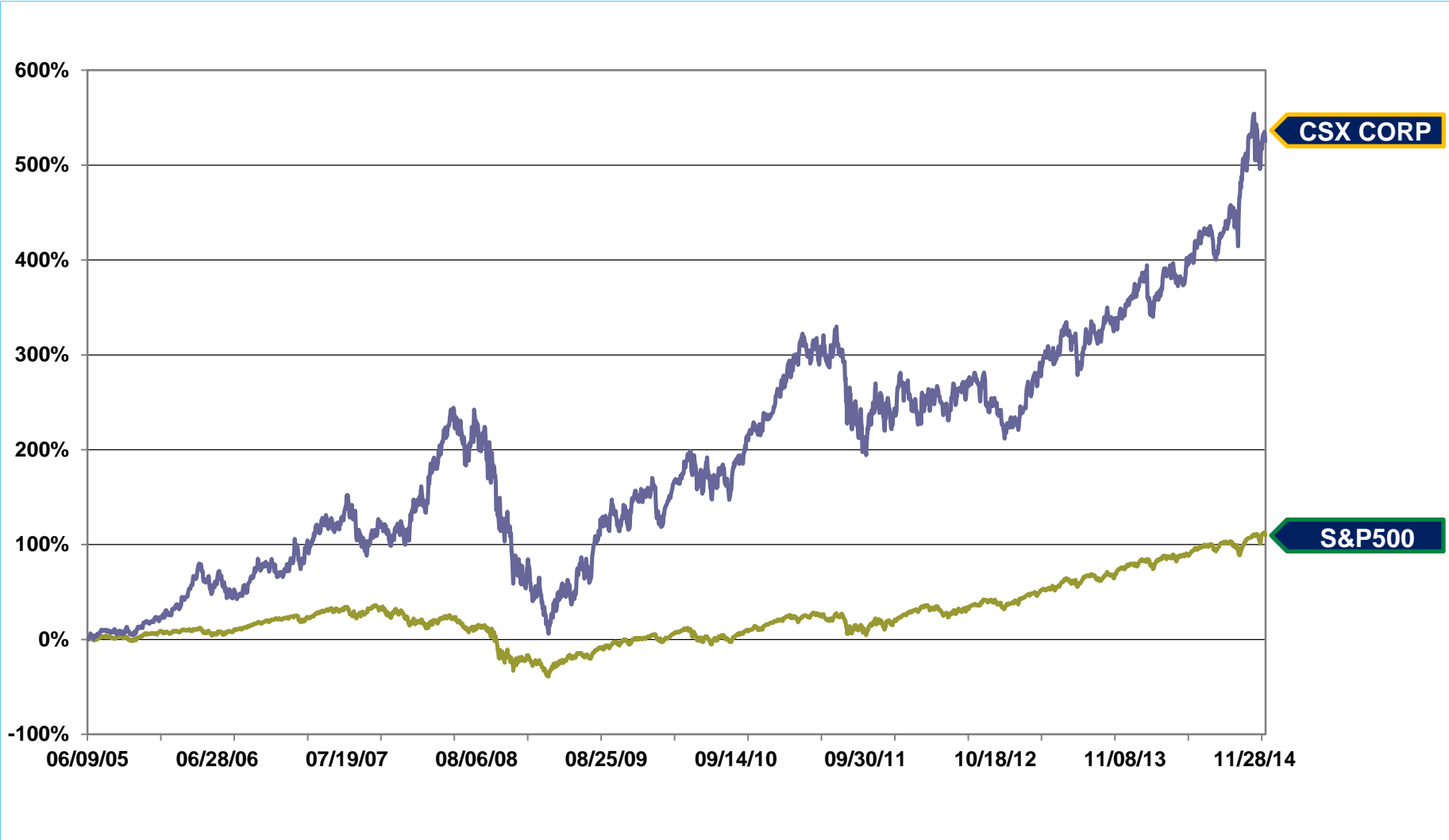
| | | |
|-------------------------|---------------|----------|
| A. Purchase Date | 12/19/2003 | \$1.41 |
| Sell Date | 4/28/2015 | \$134.54 |
| IRR | 49.35% | |
| SPX IRR | 8.21% | |
| APPL Multiple | 95.4x | |

| | | |
|-------------------------|---------------|----------|
| C. Purchase Date | 12/27/2007 | \$28.99 |
| Sell Date | 4/28/2015 | \$134.54 |
| IRR | 23.26% | |
| SPX IRR | 7.32% | |
| APPL Multiple | 4.6x | |

| | | |
|-------------------------|----------------|---------|
| B. Purchase Date | 12/1/2003 | \$1.40 |
| Sell Date | 12/27/2007 | \$28.99 |
| IRR | 110.40% | |
| SPX IRR | 10.24% | |
| APPL Multiple | 20.7x | |

| | | |
|-------------------------|---------------|----------|
| D. Purchase Date | 2/20/2009 | \$12.71 |
| Sell Date | 4/28/2015 | \$134.54 |
| IRR | 46.43% | |
| SPX IRR | 20.24% | |
| APPL Multiple | 10.6x | |

CSX: 5X VERSUS THE S&P OVER NINE YEARS, DIVIDENDS REINVESTED



Source: Bloomberg and Capital IQ. Chart is from June 9, 2005 to December 31, 2014

THE IMPACT OF A HIGH RETURN COMPOUND WINNER

| | % of portfolio | Dollars invested | Year | | | | | | | | | |
|----------------------------------|----------------|------------------|--------|--------|--------|---------|---------|---------|---------|---------|---------|--------------|
| | | | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 |
| % of the portfolio | 25.0% | \$25.0 | \$31.3 | \$39.1 | \$48.8 | \$61.0 | \$76.3 | \$95.4 | \$119.2 | \$149.0 | \$186.3 | \$232.8 |
| Annual growth | | | 25.0% | 25.0% | 25.0% | 25.0% | 25.0% | 25.0% | 25.0% | 25.0% | 25.0% | 25.0% |
| % of the portfolio | 75.0% | \$75.0 | \$82.5 | \$90.8 | \$99.8 | \$109.8 | \$120.8 | \$132.9 | \$146.2 | \$160.8 | \$176.8 | \$194.5 |
| Annual growth | | | 10.0% | 10.0% | 10.0% | 10.0% | 10.0% | 10.0% | 10.0% | 10.0% | 10.0% | 10.0% |
| Total | 100.0% | \$100.0 | | | | | | | | | | |
| Total portfolio - end of year 10 | | | | | | | | | | | | \$427.4 |
| IRR of the portfolio | | | | | | | | | | | | 15.6% |

| | | Year | | | | | | | | | | |
|-----------------------------------|-----|------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|--|
| | | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 | |
| Growth in \$100: | | | | | | | | | | | | |
| Annual return | 10% | \$110 | \$121 | \$133 | \$146 | \$161 | \$177 | \$195 | \$214 | \$236 | \$259 | |
| Annual return | 25% | \$125 | \$156 | \$195 | \$244 | \$305 | \$381 | \$477 | \$596 | \$745 | \$931 | |
| Multiple return - at 10% annually | | 2.6 | | | | | | | | | | |
| Multiple return - at 25% annually | | 9.3 | | | | | | | | | | |
| 25%/10% | | 3.6 | | | | | | | | | | |
| % gain - at 10% annually | | 159% | | | | | | | | | | |
| % gain - at 25% annually | | 831% | | | | | | | | | | |
| 25%/10% | | 5.2 | | | | | | | | | | |

WHY BOTHER TO SHORT STOCKS? (VERSION 1.0)

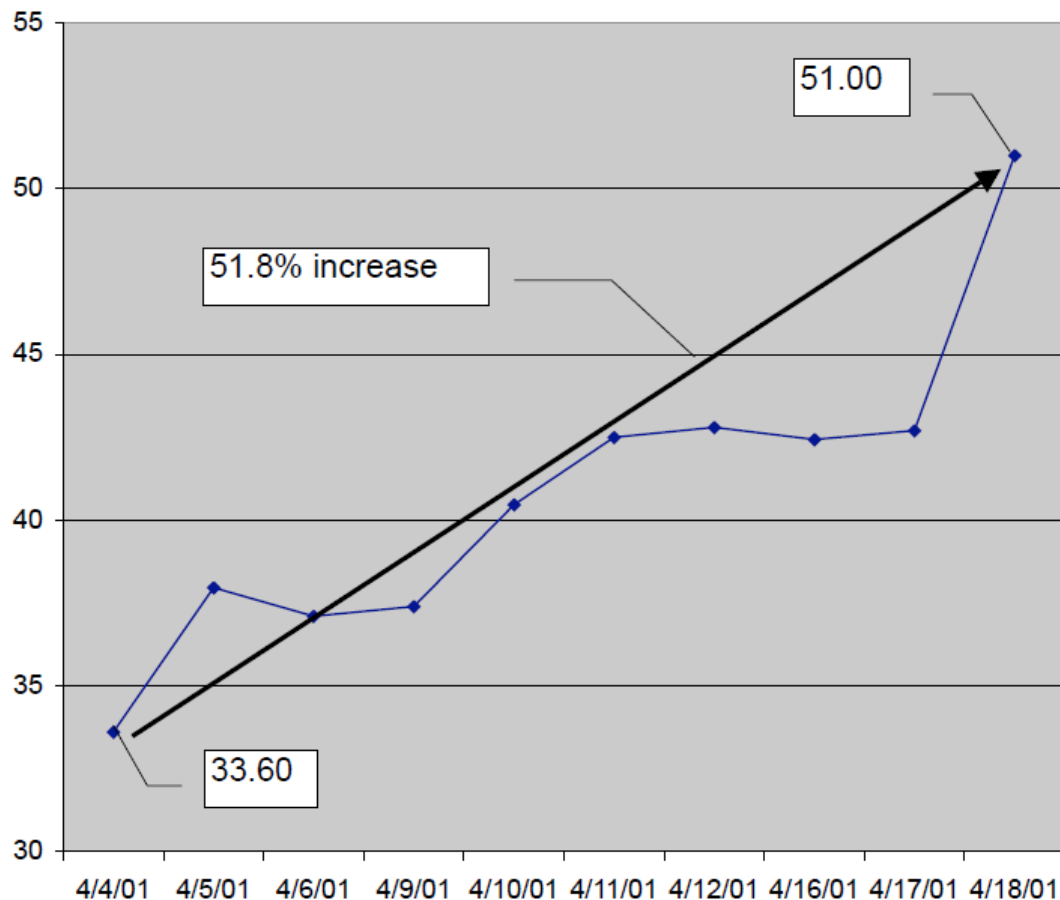
RULE #1, RULE #2, RULE #3...!

| Sequence #1 | |
|---------------|---------------|
| Year 1 Return | 40% |
| Year 2 Return | 40% |
| Year 3 Return | 40% |
| Year 4 Return | <u>(-40%)</u> |
| IRR = | 13% |

| Sequence #2 | |
|---------------|------------|
| Year 1 Return | (-40%) |
| Year 2 Return | 40% |
| Year 3 Return | 40% |
| Year 4 Return | <u>40%</u> |
| IRR = | ??? |

NO SHORT AND HOLD FOR SHORTS: TEN DAYS FROM HELL

QQQQ Equity: April 4-18, 2001



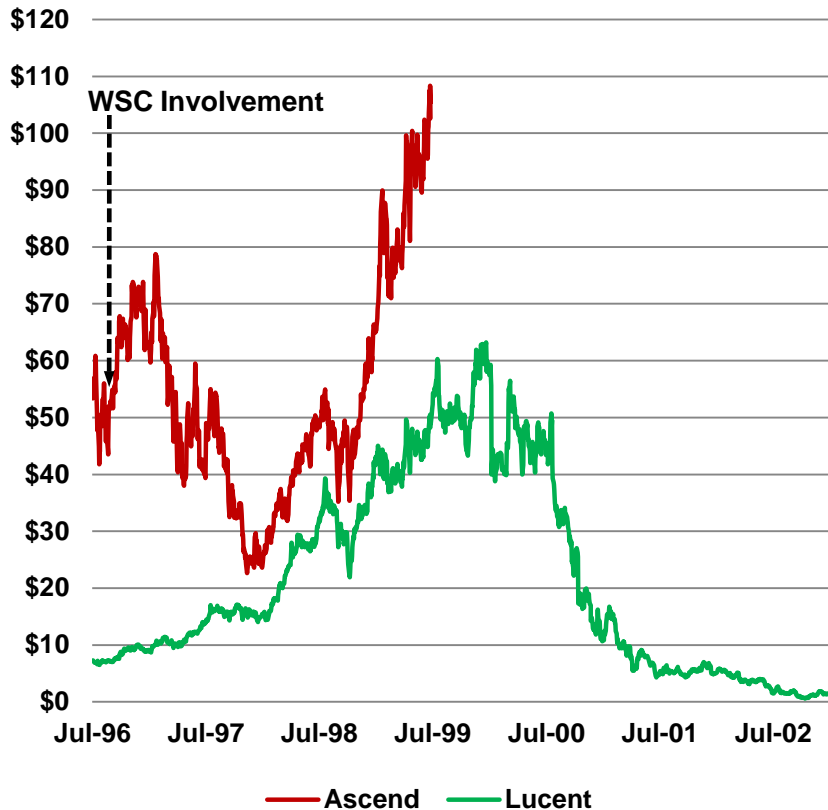
TIMING

WAIT UNTIL YOU SEE THE WHITES OF THEIR EYES

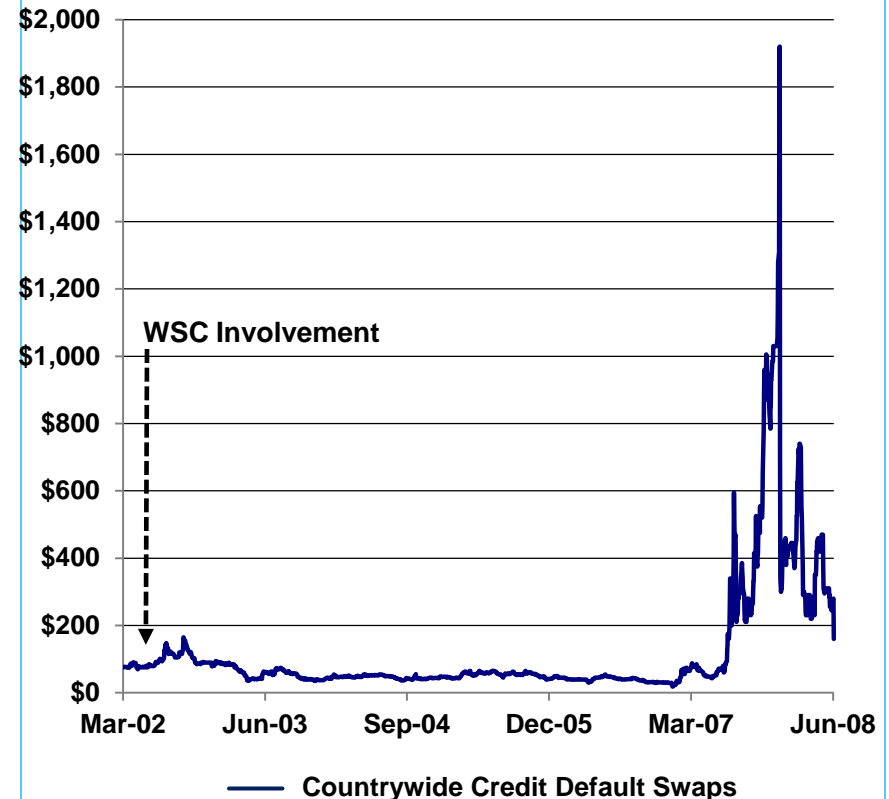
“It isn’t a very good fraud unless it goes against you at least 50%.”

– Robert Wilson

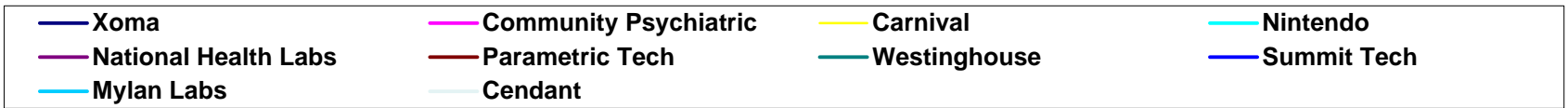
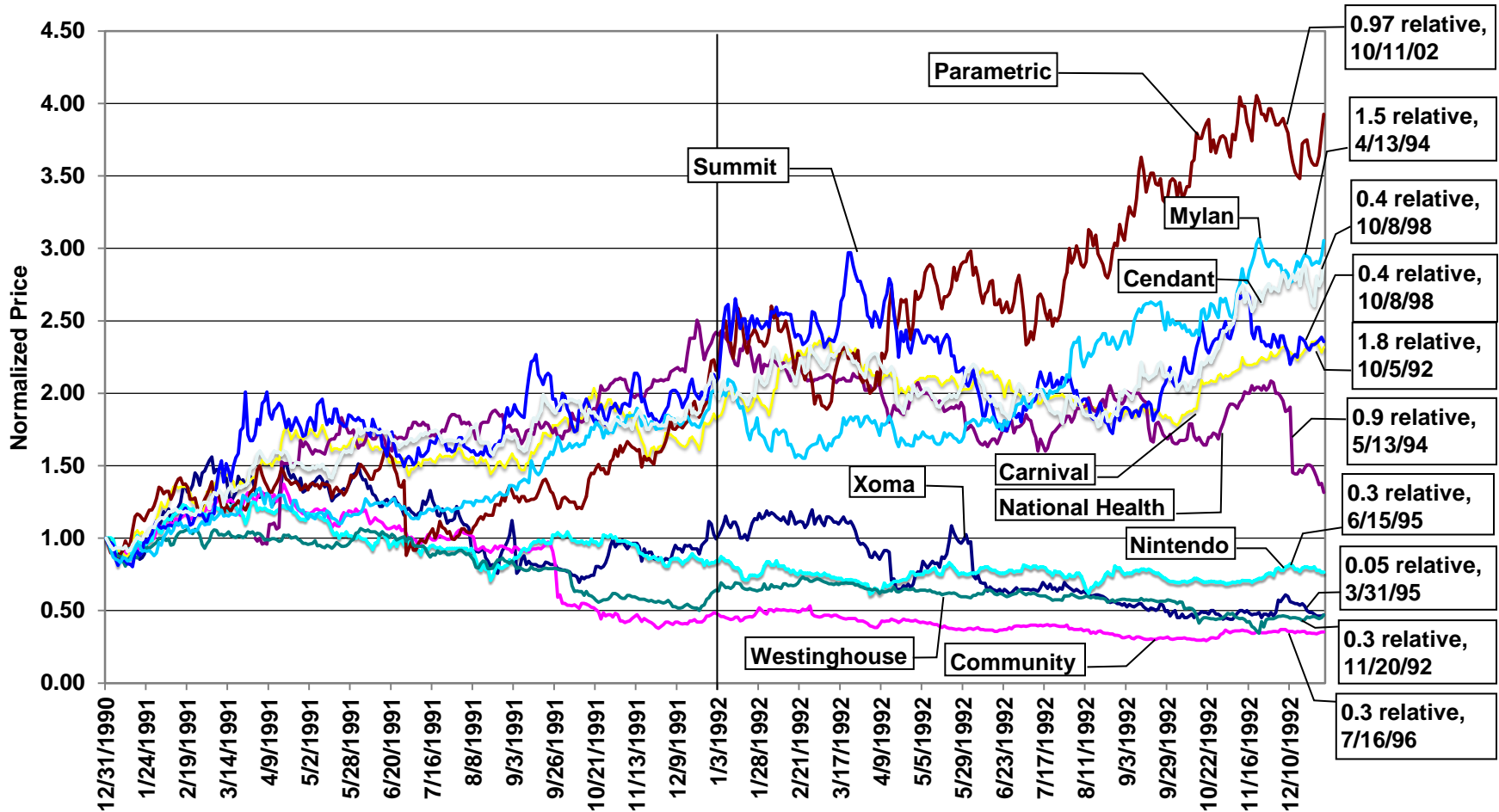
ASCEND / LUCENT



COUNTRYWIDE CDS



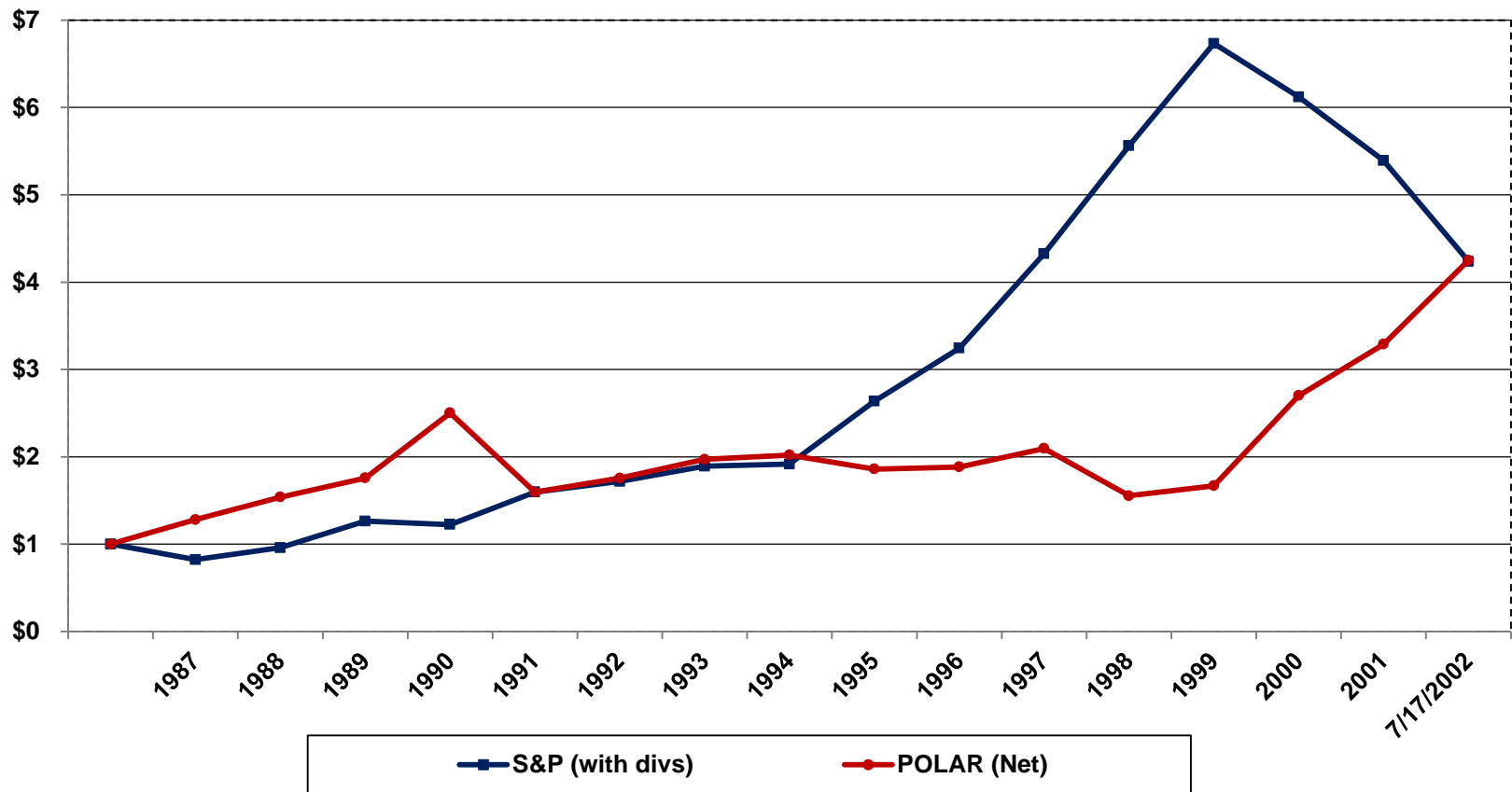
PERFORMANCE OF 1991 TOP TEN SHORT POSITIONS



WATER STREET CAPITAL: POLAR FUND

THE RACE IS NOT TO THE SWIFT

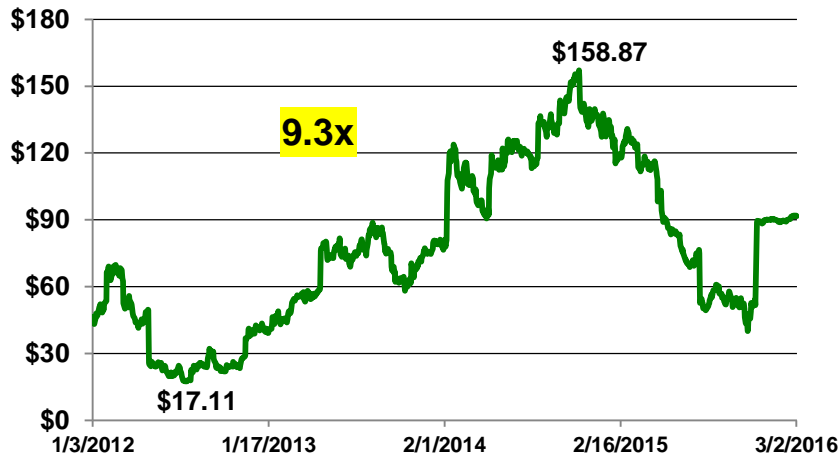
POLAR: GROWTH OF A DOLLAR INVESTED AT INCEPTION



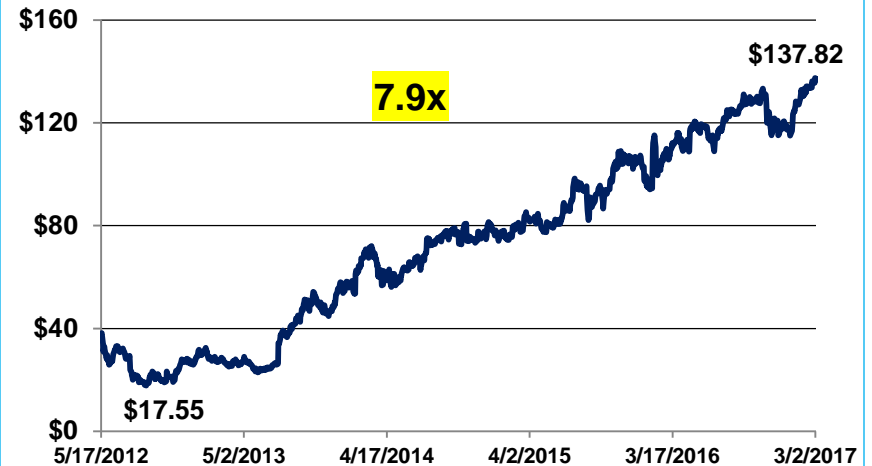
WHY BOTHER TO SHORT STOCKS? (VERSION 2.0)

THE BEST KEPT SECRET

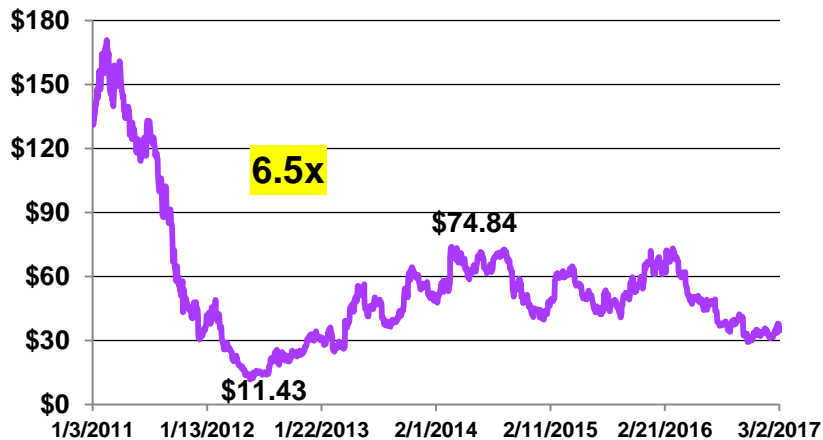
Green Mountain (GMCR)



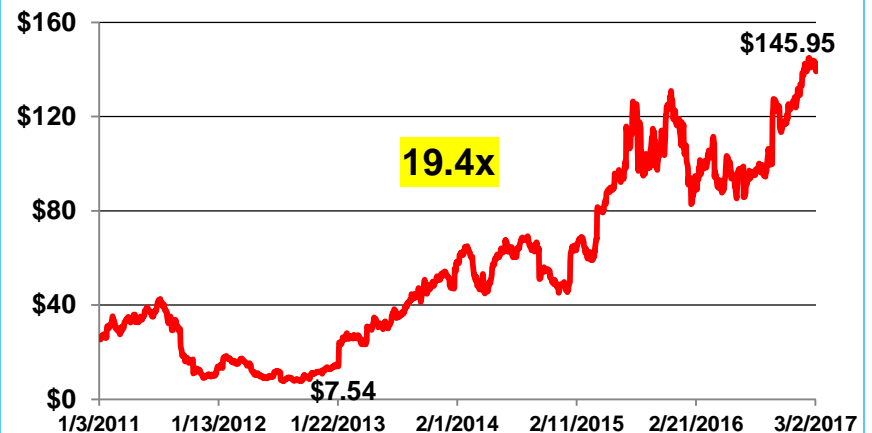
Facebook (FB)



FirstSolar (FSLR)



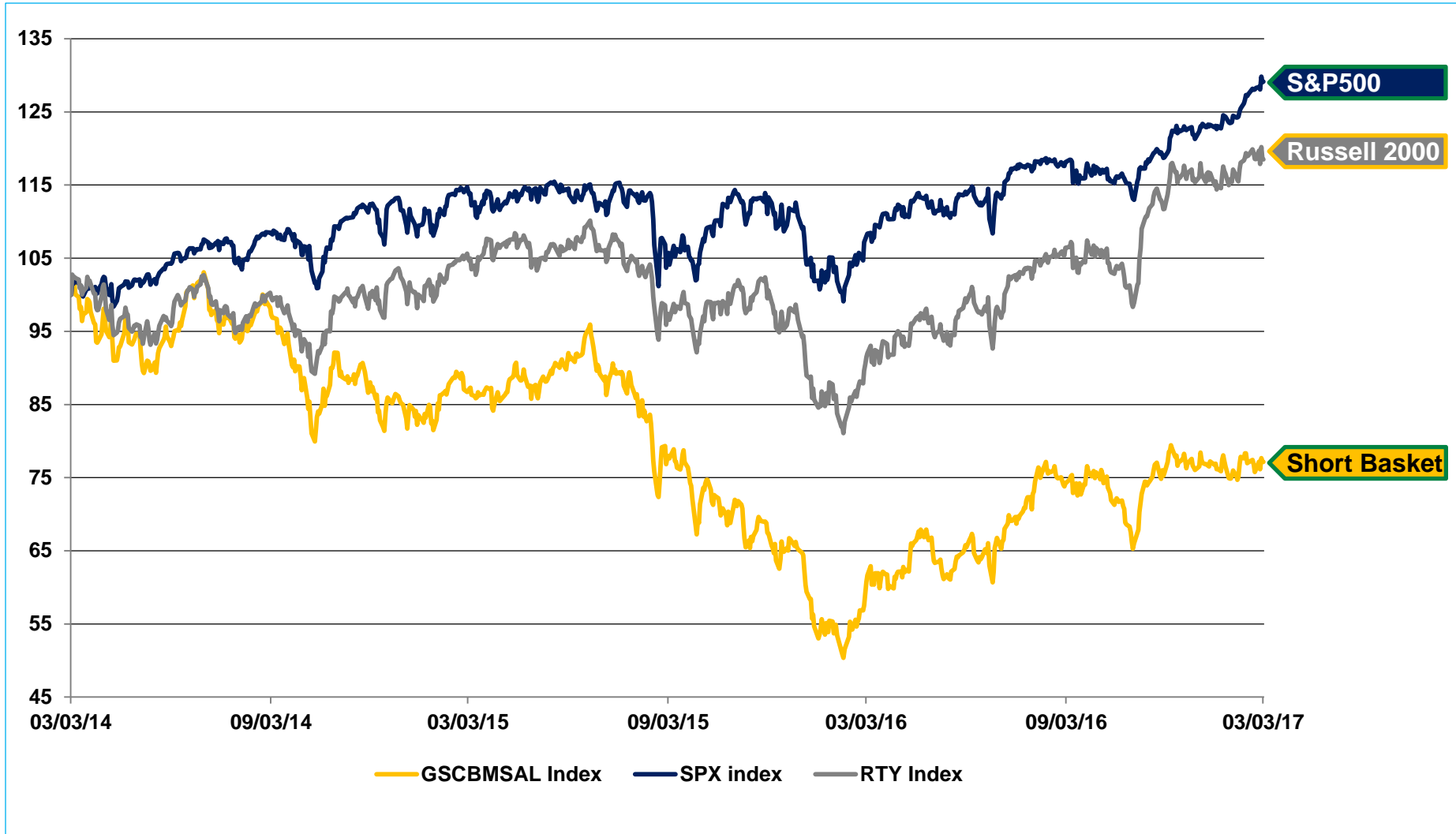
Netflix (NFLX)



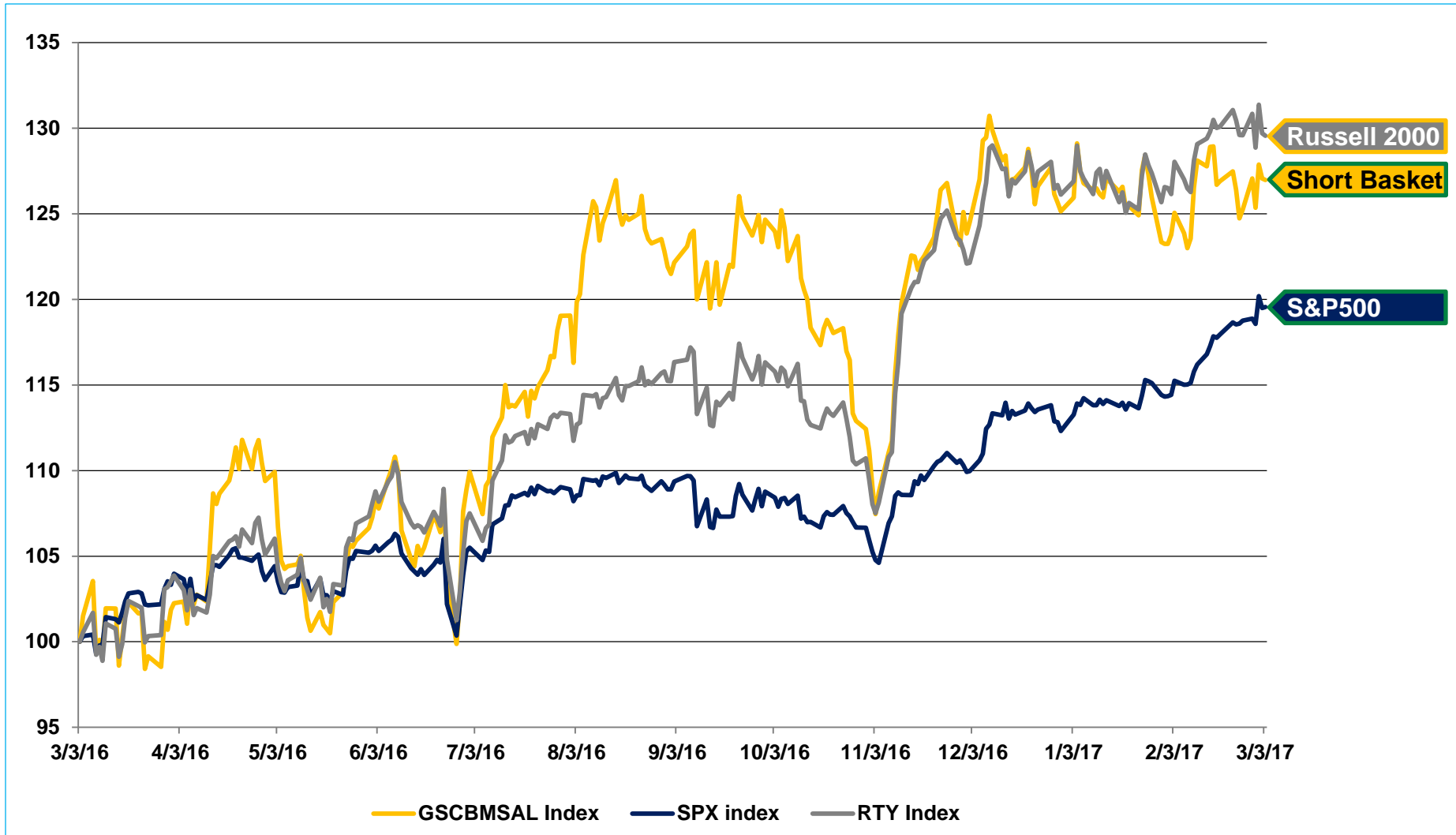
VALEANT PHARMACEUTICALS: A GOOD LONG AND A GREAT SHORT



GOLDMAN SHORT BASKET VERSUS AVERAGES – THREE YEARS



GOLDMAN SHORT BASKET VERSUS AVERAGES – ONE YEAR

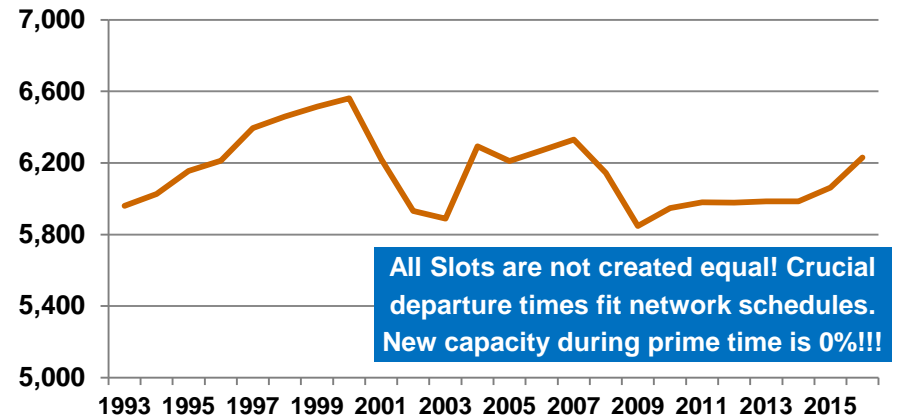


AIRLINES – GREAT LONGS OR SHORTS?

CURRENT OPPORTUNITY

- **Consolidation set the Wheels in Motion**
 - Retrenching around Traditional Network strongholds
 - Leverage Real Estate strengths
 - Focus on Profit
- **The Moat is created by Real Estate – Slots & Gates**
 - All Departures are not created equal. Position matters
 - Valuable departure times are taken and locked down
 - Profitable network connections are established
- **Ticket prices establish a Relative Value Proposition**
 - Plenty of room to grow
 - Further segmentation is available
 - Technology enhancements enable future revenue capture

TOP AIRPORT DEPARTURE SLOTS



Source:FAA

CONSOLIDATION

NETWORK

REAL ESTATE – SLOTS – GATES

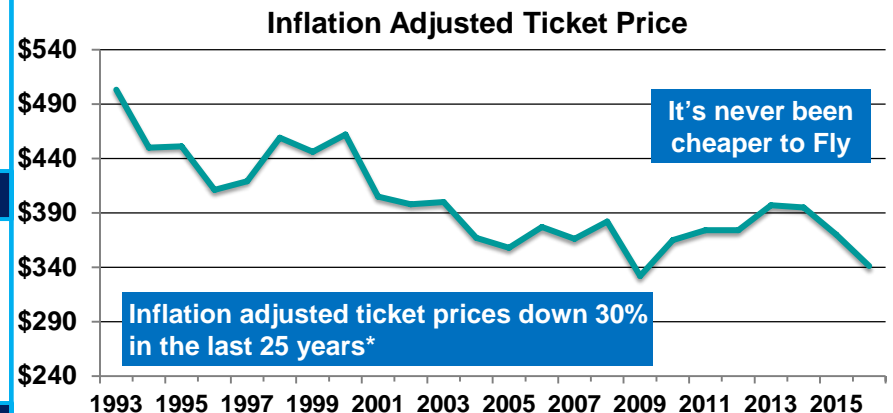
Ancillary Fees

Management and Labor

IT Systems Revenue Optimization

VALUE & PROFIT

AIRLINE TICKET PRICE HISTORY



* Prices in 2016 Dollars Bureau of Transportation Statistics.

INVESTMENT AND MANAGEMENT LESSONS

Investment

1. You must be an original. Trying to emulate other people rather than playing to your own strengths is foolish.
2. Decisions are not made by committee. However, collaboration isn't just desirable, it's essential.
3. People and industries change – there is no substitute for remaining alert and engaged.
4. Emotional control is critical.
5. “Shoe leather” can be as important as reading. By shoe leather I mean get out amongst people and companies and see and hear things for yourself. There is often no substitute for grassroots research.
6. Pay attention to your instincts. You spent your whole life developing them. Disregarding will prove to be the toughest battle that you have ever fought.

Management

1. Communicate clearly, simply.
2. Nurture those who are really important to you and develop relationships without an agenda. Life will be more pleasant.
3. Give credit, give credit, give credit. You can't say thank you too many times.
4. Keep things in context and don't look back except to learn from your mistakes. Make the process enjoyable.
5. The biggest mistake that CEO's and portfolio managers instantly, universally acknowledge is their dallying too long to part ways with people (or stocks). It's not a sign of negativity that they pounce on this answer. Rather, they have frequently experienced great success in helping someone bring out their best or reinvent themselves. Therefore, waiting too long to do what will seem to be the inevitable is often a function of confidence and goodwill.

IMPORTANT DISCLOSURES

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