Linden Rose Investment

Third Quarter 2018

Letter to LRI Clients

Performance Summary

	Q3 2018	YTD 2018	Since Inception
LRI	-1.18%	1.04%	86.01%
S&P 500	7.71%	10.56%	45.22%

Dear Partners:

Due to ongoing uncertainty regarding global trade, largely as a result of actions taken by the Trump administration, the third quarter of 2018 was difficult for most investors in U.S.-listed Chinese companies. The brewing trade war between the world's two biggest economies, the United States and China, continued to foment, which is the primary reason for underperformance of our portfolio in the third quarter of 2018.

The Linden Rose Investment (LRI) Portfolio return was -1.18% on a consolidated basis versus 7.71% for the S&P 500 index. For the first nine months of 2018, LRI's return was1.04% versus 10.56% for the S&P 500 index. However, since its inception, LRI's performance is up 86.01% versus 45.22% for the S&P 500 index.

In Linden Rose's second quarter letter, I expressed our firm's confidence and we continue to believe that, after some short-term saber rattling, the U.S. and China will eventually reach a satisfactory trade deal that benefits both countries. We believe the most important thing to focus on is the growing businesses of the companies we have invested in. Even if there is a trade war, great companies eventually do well and rise above the "noise". Again, our investment goals remain the same: long-term compounded returns and beating the S&P 500 index by 3-5% annually in the long run.

Our Experience

Most investors tend to talk about their successful investments and avoid discussing their poor stock picks. That's not Linden Rose's approach. We have learned from our mistakes, and would like to share what we have learned from our experiences.

Since 2016, we have aimed to purchase stocks in great businesses with great management teams at reasonable prices. Each recent mis-step made relates to these three key criteria for choosing companies.

In late 2016 and early 2017, as cash flowed in, diversification of our portfolio was a priority. However, we concluded recently that the pressure of managing other people's money impacted portfolio construction. If we had managed our own money, we'd rather put a large amount of the capital in one or two companies we understand very well. Instead, we devoted our time and attention to the identification of eight to ten great companies. While most of the identified companies are indeed great businesses, among them were one or two for which mistaken assumptions were made.

In one case, we overestimated a company's industry tailwinds. This is one of the companies that we knew less well than others. Our assumption of the growth of this industry was higher than it actually turned out to be in the last couple of years. Although it has an appealing corporate culture and the company founder is an impressive leader, it actually fell outside of our 'Circle of Competence,' which is the top one on our "Stop Doing List". We don't like it when our industry or company analyses are inaccurate, .but when we realized that we had made a mistake, we acted fast and quickly rectified the issue by selling our position in the stock.

In a second case, a miscalculation was made about the resilience of a Chinese e-commerce company and the integrity of its CEO. China is not only the largest e-commerce market in the world, but also undoubtedly the most exciting and innovative.

The company's success was driven mostly by the "traffic bonus" brought about by the overall rapid growth in the number of Chinese internet users. Although the company teamed up with the dominant social network company in China, it failed to fully utilize the traffic and the network effect the partner had provided. By contrast, another young e-commerce company took advantage of a similarly structured partnership and, in three years, became China's third largest (and likely soon to be second largest) e-commerce company. The divergent paths of the two companies proved that the management of the former lacked an ability to evolve and seize opportunity, a must in such a rapidly changing industry.

What do we do differently now

Lessons have been learned from these investment experiences. So what do we do differently now?

We have decided to only invest our capital in fewer companies that we fully understand. We will no longer try to diversify simply for the sake of diversification. We would rather hold cash for new customers and waive management fees before we meaningfully allocate their money. This does not mean that we will hold cash to time the market, because future market movements are usually unknown or unpredictable. We will hold cash only when there are no identifiable investment opportunities. It is always our goal to have our assets under management fully invested with the available capital, but we will take the time necessary to invest it wisely and in a timely manner.

A company has to be understood 120% and we have to be comfortable with the integrity of its management team before we add it to our portfolio. Thorough due diligence is necessary to identify whether the attributes of the company are what we are seeking. These attributes include a great, rapidly growing business, a passionate and honest entrepreneur, an obvious competitive advantage, and a significant market opportunity. If we cannot be 120% sure, or if there is one of these attributes missing, we will take no action.

The last question in our due diligence process should be whether to continue buyinga stock if the price goes down in the future. Once we have found a high-quality company that we think can compound its value for the next 10+ years, we will not hesitate to take action and accumulate more shares, just as we will not hesitate to sell a company's stock if an issue is discovered.

Conclusion

There is no doubt that we had a lower than usual performance in our third quarter due to the headwinds for our portfolio. We never expected our performance would be a straight continuously slope going up. But our development and maturation will be the same: investing, learning, improving and then repeating these steps. We view short-term results, no matter positive or negative, as mostly "noise" amid our larger investment objectives. To overemphasize short-term results would distract from our long-term focus, which is the core operating business and intrinsic value of the company. Last but not least, we thank you for entrusting your capital to us. We will continue to do our best to protect and grow your investment over time.

Again, if you have any questions about your accounts, please feel free to contact us by phone at (973) 841-7158 or by email at bing@lindenroseinvestment.com. If you know any friends who need investment advisory services, please refer them to us.

Stay hungry, stay foolish!

Thank you very much!

Yours truly,

Binglin Li
Managing Partner

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Managing Partner

October 24, 2018

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