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To My Partners:

The performance of our portfolio for the first quarter of 2020 and since inception is summarized below.

	1578 Partners, LP		S&P 500
	Gross	Net	Total Return
2020:			
Q1	-20.09%	-20.38%	-19.60%
Since Inception (08/01/15):			
Annualized	5.17%	3.55%	6.56%
Cumulative	25.49%	16.98%	35.25%

SARS-CoV-2 has spread around the world like wildfire. The first infections seem to have occurred in Wuhan, China in November 2019. On December 31, health authorities there notified the World Health Organization of 27 cases of pneumonia of unknown cause. By March 11, just ten weeks after the world was alerted to its existence, SARS-CoV-2 had proliferated to such an extent that the WHO declared it a global pandemic. As of this writing, there have been more than three million confirmed infections around the world – the true number of infections is almost certainly more than an order of magnitude higher – and the virus has claimed more than 250,000 lives. Unfortunately, the death toll has been highest in the U.S., where more than 65,000 people have tragically lost their lives to COVID-19, the disease caused by SARS-CoV-2.

Governments around the world have fumbled their responses to the virus in various ways. Many of the most developed nations failed to prevent the virus from establishing a foothold in their domains. Finding themselves behind the curve, they have resorted to unprecedented interventions, such as extended lockdowns and shelter-in-place orders, that were inconceivable just months ago.

The uncertainty we face is immense. It remains to be seen how effective and efficient our public health response will ultimately be. At one end of the spectrum, a highly effective treatment could be identified in the near term. At the other end, it may not be possible to develop an effective vaccine, and any immunity someone might get from an infection may prove limited or fleeting. It also remains to be seen how effective and sufficient our fiscal and monetary policy responses will be. A robust, V-shaped recovery is certainly possible with the right fiscal and monetary policies. But it does not take much imagination to envision far worse outcomes. The combination of an inordinately costly public health response and an inadequate fiscal policy response could result in a rerun of the Great Depression.

What is clear is that the outbreak and the interventions being implemented to contain it are having a severe negative impact on global economic activity at the moment. The shock is hitting both the supply and the demand sides of the economy. Lockdowns and shelter-in-place orders are forcing businesses to close and layoff workers, reducing the economy's ability to produce goods and services. At the same time, fear of the virus, shelter-in-place orders, uncertainty about the long-term consequences of the outbreak, and the actual loss of income by the now-unemployed are undermining demand. In the U.S., more than 33 million people have filed claims for unemployment insurance over the past six weeks. That is roughly 20% of the labor force and an amount more than seven times higher than the highest comparable figure during the

global financial crisis. The St. Louis Fed estimates the unemployment rate in the U.S. may ultimately hit 32.1%, well above the 24.9% peak hit during the Great Depression. Three months ago, the IMF expected the U.S. economy to grow by 2.0% in 2020. It now expects the U.S. economy to shrink by 5.9% and the global economy to decline by 3.0%, the worst result since the Great Depression.

The economic shock and immense uncertainty have had a profound effect on financial markets. As the risks of the burgeoning pandemic became increasingly clear, they triggered a tidal wave of capital flows away from risk assets toward safe havens. From its peak on February 19th, the S&P 500 dropped 33.9% in just 23 trading days, its fastest decline of that magnitude ever. Implied volatility exploded to levels comparable to those seen during the most acute phases of the global financial crisis. Demand for U.S. dollars and treasury securities surged. The yield on the 10-year U.S. treasury, which moves inversely to price, plunged to a historic low of 0.54% on March 9th. Liquidity throughout the financial system quickly evaporated, leading to severe dysfunction in a number of essential markets. Not even the U.S. treasury market, the most highly liquid securities market in the world, was spared. In short, the financial system seized up, much in the same way it had after the collapse of Lehman Brothers.

It is hard to overstate how fortunate we are that the experience of the global financial crisis was so fresh in the Fed's mind at the time this crisis struck. The arsenal that the Fed took months to develop and deploy during the financial crisis had not even gathered dust, the barrels still warm to the touch. That allowed the Fed to move with stunning speed and aggressiveness to not only lower interest rates, but also resolve dysfunction in virtually every part of the financial system within a matter of days. Since mid-March, the Fed has purchased a greater combined volume of treasuries and agency mortgage-backed securities than it did over the entire span of its 2012-2014 asset purchase program, so-called "QE3." The Fed also quickly reinstated its alphabet soup of special facilities, including the Commercial Paper Funding Facility ("CPFF"), Primary Dealer Credit Facility ("PDCF") and Term Asset-Backed Securities Loan Facility ("TALF") among others. The shock of the pandemic sent our financial system into cardiac arrest. The Fed did a stellar job of restoring its vital signs in short order. That is a key reason that many financial markets, including the equity market, have partially recovered from the depths they hit in mid-March.

Although the Fed's ammunition – along with their willingness to use it – is indeed unlimited, there is a limit to what can be achieved with that ammunition. U.S. economic performance in the wake of the financial crisis is case in point. The U.S. employment-to-population ratio for 25 to 54-year-olds was 80.3% in January 2007. Despite the extent of the Fed's efforts during and after the financial crisis, it took us until October 2019 to get back to that level of prime working age employment. The main reason the recovery was so tepid is that the U.S.'s fiscal response to the financial crisis was inadequate. We did not spend nearly enough to offset the loss of income and output from the bursting of the housing bubble and ensuing financial crisis. To achieve a complete and V-shaped economic recovery from this crisis, we need not only a comprehensive and effective monetary response, but also an equally strong fiscal one.

On that front, there is some cause for concern. U.S. monetary policy is far more effective than its fiscal policy in responding to crises and economic downturns. The reason is simple. The Fed is an independent, apolitical, and highly credible institution. Congress is none of those things.

Congress has taken some strong initial steps in its fiscal response to the crisis. So far, it has passed four spending acts. The most significant of those is the Coronavirus Aid, Relief and Economic Security ("CARES") Act, which includes approximately $1.5 trillion (7.0% of GDP) for domestic spending initiatives and $500 million to support a corporate lending facility managed by the Fed. The CARES Act was signed into law on March 27th. Congress followed up on the CARES Act with the Paycheck Protection and Healthcare Enhancement Act, which provided $484 billion (2.3% of GDP) in additional funding for the SBA's Paycheck Protection Program, hospitals and COVID-19 testing. That bill was signed into law on April 24th. Much more may ultimately need to be done to ensure a complete and timely economic recovery though.

The Congressional Budget Office updated its forecasts for the U.S. economy after the Paycheck Protection and Healthcare Enhancement Act was signed into law. Despite the massive amount of fiscal spending that has already been authorized, the CBO expects the U.S. economy to remain highly depressed at least through the end of 2021. The total amount of fiscal stimulus required to fully heal our economy will depend on the efficiency and effectiveness of the public health response, something that is highly uncertain at the moment. That said, $2 trillion or more in additional fiscal spending may ultimately be required.

Whether Congress will be willing to do whatever it takes to heal the economy is an open question. There are already signs that Congress's appetite for further spending is waning. It will only diminish further as the most acute phase of the crisis passes. The outcome of elections later this year could undermine Congress's willingness to spend even more. We only seem to hear about the imminent dangers of debt and deficits under certain configurations of political power in our government.

Ultimately, nobody knows how this will all play out. Hinde Group's approach is to "hope for the best, but plan for the worst." The investments in our portfolio are not completely immune to the fallout from the pandemic, but they were each made using conservative, "through-the-cycle" assumptions that explicitly contemplated an economic downturn. Even if pessimistic scenarios for the future come to pass, our investments should deliver good returns when all is said and done.

Nonetheless, the market prices of our positions were not spared from the carnage in the equity market during the quarter. The companies worst hit by the equity market sell-off were generally those that are most directly affected by the outbreak, such as those in the travel, restaurants and live events industries, as well as those with any meaningful amount of leverage on their balance sheet. None of the companies in our portfolio fall squarely into the first category, but a few of them, such as Covetrus, Northeast Bank and Colfax Corporation, do have levered balance sheets. The stocks of each of those companies declined by more than the equity market overall. CVET, NBN and CFX declined 38.3%, 47.0% and 45.6%, respectively. CVET and NBN are relatively large positions in our portfolio, while CFX is a much smaller one. The combined mark-to-market loss from our positions in CVET and NBN accounted for more than two-thirds of the portfolio's total decline. Notwithstanding the poor performance of their stock prices during the quarter, each of these companies should make it through this crisis fine. The returns we ultimately earn on those positions should continue to be good, if not spectacular, over time.

Performance Attribution

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

Performance Attribution	
1Q 2020	
Interactive Brokers Group	-1.28%
Colfax Corporation	-1.32%
Alphabet	-2.52%
Northeast Bank	-6.37%
Covetrus	-7.98%
Other	-0.61%
Gross Performance	-20.09%

Portfolio Composition

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

Portfolio Composition	
Equities – Long	73.2%
Equities – Short	-1.5%
Cash[1]	28.3%

During the quarter, we added to our position in CVET in mid-January and trimmed our position in Fastenal Company common stock (NASDAQ: FAST) in mid-March. At the end of the quarter, our portfolio included 7 long equity positions, 1 short equity position and cash.

Select Portfolio Updates

Every single company in the world will be affected by the pandemic and its economic consequences. The companies in our portfolio are no exception. The portfolio updates for this quarter include a discussion of how the pandemic is likely to affect each of the long equity positions in our portfolio.

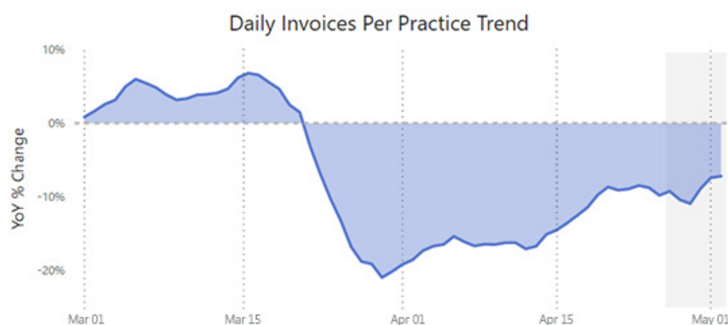
Covetrus, Inc.
(NASDAQ: CVET)

Covetrus is a global animal health technology and services company. It was created in early 2019 through the merger of Henry Schein Animal Health, one of the leading distributors of medications, supplies and equipment to veterinary practices, and Vets First Choice, an innovative, animal health-focused prescription management platform that is still in the early stages of adoption by veterinary clinics.

The SAR-CoV-2 outbreak seems to be having a mixed impact on Covetrus's business thus far. The company is seeing both negative and positive effects.

On the negative side, traffic to veterinary clinics has taken a hit since mid-March when shelter-in-place orders became widespread. Based on data provided by VetSuccess and IDEXX Laboratories, the year-over-year decline in traffic to veterinary clinics hit a nadir of around 20% at the end of March.[2;3] More discretionary wellness visits, which account for 40% to 50% of total visits, have experienced a sharper decline than less discretionary critical care visits, which account for the remainder of visits. Since the beginning of April, the trend in traffic to veterinary clinics has steadily improved. Daily invoices per practice were down only 7% year-over-year for the week ended May 2 according to VetSuccess.

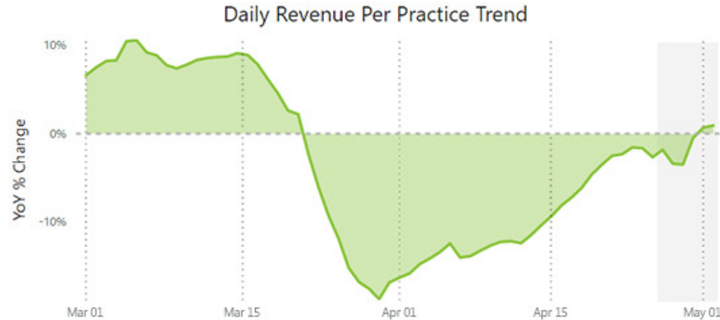
Exhibit 1: VetSuccess Veterinary Industry Impact Tracker Traffic Data



[1] Includes cash collateral related to short positions.
[2] https://vetsuccess.com/resources/covid-19-resources/
[3] https://www.idexx.com/files/earnings-snapshot-2020-q1.pdf

Veterinary practice revenue trends seem to have held up better than traffic trends. After bottoming at a 16.8% year-over-year decline for the week ended March 28, the trend in veterinary practice revenue has improved to a 1.1% year-over-year increase for the week ended May 2.

Exhibit 2: VetSuccess Veterinary Industry Impact Tracker Revenue Data



There are two main reasons why veterinary practice revenue has held up better than traffic. First, critical care visits, which have proven relatively resilient, drive a disproportionate amount of veterinary practice revenue relative to wellness visits. Second, veterinary practice pharmacy revenues have benefitted as clients are less willing or able to shop around for pet medications and are more willing to stock-up. According to VetSuccess, average daily pharmacy revenue per practice was up 10.6% year-over-year for the week ended May 2, above the 4.8% increase for the first two months of the year.

The resilience of veterinary practices' revenue, and their pharmacy revenue in particular, will mitigate the adverse impact of declining traffic to veterinary clinics on Covetrus's supply chain business. Around 60% of the revenue from Covetrus's supply chain business comes from pharmaceuticals. Revenue trends in Covetrus's supply chain business have likely held up even better than overall veterinary practice revenue trends since the beginning of the year.

On the positive side, Vets First Choice, Covetrus's prescription management platform, is booming. Revenue for the Vets First Choice platform grew 48% in the fourth quarter of 2019. Proprietary data suggests its growth rate may have accelerated to around 80% year-over-year since mid-March. Vets First Choice enables vets to get clients the prescriptions they need for their pets even if they cannot come to the clinic. Both clients and veterinary practices have meaningfully increased their engagement with the Vets First Choice platform as a result of the extensive social distancing measures implemented in the U.S.

Prescriptions sold through the Vets First Choice platform are much more profitable for Covetrus than those sold through the supply chain business. Unit-level contribution margins in the Vets First Choice business are more than double those in the supply chain business. Vets First Choice also drives higher compliance rates than veterinary clinics through its technology features resulting in as much as a four-fold increase in unit volume over the course of a year. In other words, every prescription that shifts from the supply chain business to Vets First Choice should result in a substantial boost to Covetrus's profits.

In the short-term, the net effect of the pandemic on Covetrus's business should be a modest negative at worst and eminently manageable with respect to the company's leverage and liquidity. Covetrus could even realize a net benefit in the short-term if growth at Vets First Choice is strong enough. In the long-term though, the impact of the SARS-CoV-2 outbreak on Covetrus is likely to be positive.

Virtually all of Covetrus's tremendous growth potential lies in its Vets First Choice platform. The key to realizing that potential is driving adoption of the platform among veterinary practices and pet owners. Many

vets are not yet enrolled on a prescription management platform. Those that are enrolled on Vets First Choice are, in general, barely scratching the surface of the platform's potential. The SARS-CoV-2 outbreak has forced both veterinary practices and pet owners to start using the platform extensively. Vets First Choice offers meaningful benefits for both veterinary practices and pet owners. As many vets and pet owners engage with the platform for the first time, they will hopefully come to appreciate those benefits and permanently change their behavior. Covetrus could end up as a far larger, more profitable company once veterinary traffic trends normalize than it otherwise would have been in the absence of the outbreak.

Northeast Bank (NASDAQ: NBN)

Northeast Bank is a state-chartered bank organized in 1872 and based in Lewiston, Maine. The heart of Northeast Bank's business is its Boston-based Loan Acquisition & Servicing Group ("LASG"), which purchases and originates commercial real estate-backed mortgages nationwide. Although Northeast Bank has deemphasized lending under the Small Business Administration's 7(a) loan program and through its community banking branches in Maine, it still retains some exposure to those loans on its balance sheet.

Northeast Bank is well positioned to weather the storm created by the pandemic. As of March 31, Northeast Bank's loan portfolio had a weighted average loan-to-value ratio of just 53%. Generally speaking, commercial real estate prices across property types and geographies would need to decline by more than 40% for Northeast Bank's portfolio to be at risk of meaningful principal losses. As a point of reference, the Green Street Commercial Property Price Index declined 37% from peak to trough during the financial crisis. Northeast Bank's portfolio is also well-diversified by collateral type and geography, and has no exposure to construction and development loans, historically one of the most risky types of commercial real estate loans. Additionally, the bank has robust levels of capital and liquidity. Its Tier 1 Capital ratio on March 31 was 13.04%, well above its target level of 9.0%, and the bank had access to $468.2 million of liquidity accessible within seven days, amounting to almost 50% of its loan portfolio, as of December 31. Although the bank will certainly incur some incremental losses as a result of the current crisis, it will remain profitable and continue to grow.

The part of Northeast Bank's portfolio that is most exposed to the risk of principal loss is its SBA portfolio. SBA loans by their nature are made to borrowers who are not able to access credit from other sources. Northeast Bank would historically originate an SBA 7(a) loan, sell the SBA-guaranteed portion into the secondary market at a large premium and retain the unguaranteed portion. It is the retained, unguaranteed portion of SBA 7(a) loans that carries the highest level of risk in Northeast Bank's portfolio. At March 31, the unguaranteed portion of SBA 7(a) loans on Northeast Bank's balance sheet amounted to $43.1 million, or 4.2% of its total loan portfolio. Those loans have a weighted average loan-to-value ratio of 78%. Approximately half have hospitality properties as collateral. When Northeast Bank reported results for the quarter ended March 31, it took a $3 million charge to increase the allowance for loan losses associated with the unguaranteed portion of its SBA loans to $4.6 million, or roughly 10.6% of the total principal outstanding. After taking this charge, Northeast Bank appears well-reserved against the losses it is likely to experience from these loans, even assuming relatively high default and loss severity rates.

With an outstanding balance of $908.0 million, Northeast Bank's LASG portfolio accounts for the lion's share – about 87.8% – of its total loan portfolio. The weighted average loan-to-value of the LASG portfolio is 51%. Almost 90% of the loans in the LASG portfolio have LTVs below 70%. The LASG portfolio is well-diversified across collateral types, geographies and borrowers. The average outstanding balance is $427,000 for purchase loans, $1.9 million for originated loans, and $3.0 million for portfolio finance loans. Hospitality and retail properties are collateral for 9.2% and 19.7% of the portfolio's loans by outstanding balance. Northeast Bank does not have exposure to the most structurally challenged segments of the retail market, such as enclosed shopping malls or single-tenant, big box locations. Based on the highly conservative loan-to-value ratios in Northeast Bank's LASG portfolio, existing reserves against the portfolio appear sufficient to absorb likely losses.

Northeast Bank's community banking portfolio accounts for the remainder of its overall loan exposure, about 7.4% of the total. Like its LASG portfolio, the weighted average LTV of the community banking portfolio ranges from 51% for commercial real estate-backed loans to 65% for residential mortgages. Principal losses in the community banking portfolio in excess of existing reserves should be limited based on the low weighted average LTV of the portfolio.

Notwithstanding the protection Northeast Bank's loan portfolio should enjoy from the portfolio's low weighted average LTV, Northeast Bank will unquestionably need to modify loans for some of its borrowers who are facing a cash flow crunch. Through April 23, borrowers accounting for 10% to 20% of the outstanding balance of LASG and community banking loans have requested modification of their loans. Northeast Bank's current standard modification offers are to defer all payments for three months or to have interest-only payments for six months. Deferred balances will be added to amounts due at loan maturity. Bank regulators are offering blanket forbearance on treating loans modified due to the pandemic as troubled debt restructurings for capital adequacy calculations. Northeast Bank can further support its borrowers facing cash flow challenges by arranging loans for them under the SBA's Paycheck Protection Program. The SBA will also be making payments on $34 million of Northeast Bank's SBA loans on behalf of borrowers for the next six months. Additionally, more than half of Northeast Bank's LASG originated loans have reserves sufficient to cover six months of interest payments. All of these factors provide Northeast Bank with substantial scope to help its borrowers manage through short-term liquidity challenges, in order to keep loans performing and to avoid foreclosures.

Although the pandemic will clearly have a modest negative impact on Northeast Bank through the incremental loan losses it will realize, mainly in its SBA portfolio, the SARS-CoV-2 outbreak will also have two beneficial effects on the company. First, Northeast Bank had a large share repurchase authorization accounting for 10% of its outstanding shares coming into the crisis. Amid the market turmoil, the company was able to repurchase almost 5% of its outstanding shares at a weighted average price of $12.83, or 72.2% of tangible book value at December 31. Those purchases were accretive to tangible book value per share by about 3.3% and to intrinsic value per share by two to three times that amount. Assuming Northeast Bank executes the remainder of its repurchase authorization at similar prices, intrinsic value per share could benefit by around 20% as a result of the repurchase program, a far greater amount than the adverse effect of the incremental loan losses the company is likely to experience.

Second, Northeast Bank will also benefit from far more favorable conditions in the loan purchase market. In 2012 and 2013, Northeast Bank's yield on purchased loans was over 16.0%. As financial markets and the economy continued to recover from the financial crisis, its yield on purchased loans declined to 10.6% in 2019. The yields on loans Northeast Bank purchases, during and in the wake of this crisis should be highly attractive and position the bank for strong earnings in the coming years. Importantly, Northeast Bank's strong capital position coming into this crisis, outlook for continued profitability through it, and relatively rapid loan portfolio turnover position it well to take advantage of both its share repurchase opportunity and its loan growth opportunities.

Despite the severity of the current SARS-CoV-2 pandemic and its economic implications, Northeast Bank's outlook over the next few years is far better than what NBN's 47.0% decline during the first quarter would lead you to believe. A testament to that is the fact that six members of management and the board have collectively purchased almost $1.4 million worth of stock since the end of February at a weighted average price of $15.87 per share.

Interactive Brokers Group, Inc. (NASDAQ: IBKR)

Interactive Brokers ("IB"), a highly automated global securities firm, specializes in routing orders and processing trades in securities, futures, foreign exchange instruments, bonds and mutual funds on more than 120 electronic exchanges and market centers around the world. Interactive Brokers custodies and

services accounts for hedge and mutual funds, registered investment advisors, proprietary trading groups, introducing brokers and individual investors.

IB's business is extremely resilient to both economic downturns and financial crises. During periods of financial market stress, trading volumes spike while net interest income experiences only modest headwinds from lower margin loan balances and lower net interest margin. Except for two years in the early 90s when the company incurred minor losses, Interactive Brokers has been profitable every year since its predecessor, Timber Hill, was formed in 1982. In 2008 and 2009, Interactive Brokers grew its brokerage segment pre-tax income by 13.2% and 3.2%, respectively. Compound annual growth in pre-tax income for the brokerage segment between 2006 and 2011 was 30.3%. There is little doubt that Interactive Brokers will similarly sail through the current pandemic.

The impact of the pandemic on Interactive Brokers thus far has been exactly as one would have expected. Trading volumes have exploded amid the extreme volatility in financial markets. IB's daily average revenue-generating trades ("DARTs") increased 71% during the first quarter of 2020. At the same time, the company is adding new clients at a breakneck pace. Interactive Brokers added 69.7 thousand accounts during the first quarter, up 186.8% over the same figure in the prior year. Partially offsetting those favorable impacts are headwinds against the company's net interest income. The Fed abruptly lowered its target range for the federal funds rate to 0.00% to 0.25% over a matter of days in March. Lower benchmark interest rates put pressure on the interest rate spread Interactive Brokers can earn on client cash balances. Margin loan balances, the bread and butter of IB's net interest income, have also contracted sharply as clients have reigned in risk exposures. The net effect of these impacts is that IB's earnings in 2020 should be roughly flat relative to its earnings in 2019.

While the near-term earnings outlook for Interactive Brokers is somewhat diminished, the company's long-term earnings outlook is essentially unchanged. Margin loan balances, the main driver of IB's net interest income, will rebound as financial market stress eases and the economy stabilizes. IB's margin loan balance at the end of March was the lowest it has ever been relative to client equity, roughly half the median of that ratio since the beginning of 2008. Benchmark interest rates will also move back toward neutral levels over time. Various market-based indicators suggest the Fed may begin raising interest rates within three years. The long-term neutral rate of interest for the U.S. economy has probably not changed all that much as a result of the pandemic. The main drivers of IB's earning power and intrinsic value over time are the number and quality of clients it adds. On that front, the impact of the pandemic has been unambiguously positive. Year-over-year account growth has accelerated to 22.0% at the end of March from 15.3% at the end of December. If recent rates of new client inflows keep up, that figure will continue to accelerate in a big way. To the extent that Interactive Brokers gains more clients over time as a result of the pandemic than it otherwise would have, the long-term impact of the pandemic on Interactive Brokers should be positive.

Alphabet, Inc.
(NASDAQ: GOOG)

Alphabet is the holding company for Google as well as a collection of other, smaller companies, such as Access (broadband internet), Calico (life sciences), Capital G (late-stage growth venture capital), GV (venture capital), Verily (life sciences), Waymo (autonomous vehicles) and X ("moonshot factory"), among others. Google remains by far the most important part of Alphabet, accounting for 99% of Alphabet's revenue and all of its profits. Around 84% of Google's revenue comes from advertising. Search, Google Network, and YouTube advertising revenues account for 73%, 16% and 11%, respectively, of Google's total advertising revenue.

User engagement with Google's products has surged in the wake of the SARS-CoV-2 outbreak. Search traffic and YouTube watch time have increased substantially. Downloads of apps from the Google Play store were up 30% sequentially in March. Chromebook sales soared 400% as lockdowns and shelter-in-place became widespread and people scrambled to adjust to working and learning from home. Usage of Google Meet,

Google's group video conferencing app, is up thirty-fold from its level at the beginning of the year. The increased user engagement Google is seeing across its products bodes well for the long-term health of – and outlook for – Google's business.

At the same time, Google's advertising revenue is taking a hit. Advertisers have abruptly pulled back on spending in the face of collapsing economic activity. Many of the sectors most directly impacted by the pandemic also happen to be some of the most significant in terms of ad spending, such as travel, retail, restaurants, movie studios and the automotive industry. Moreover, although Google's search volume has increased, user searches have shifted to less monetizable topics, such as information about COVID-19. Google is seeing sharply lower prices in its ad auctions. At the end of March, Google's search revenue was running down year-over-year at a mid-teens percent rate. Advertising on Google Network, where Google serves ads on third party sites and applications, ended March down low double digits. Growth in YouTube advertising revenue has slowed down to high single-digit year-over-year growth at the end of March from over 30% growth earlier in the year. Declines in brand advertising account for most of the slowdown in overall ad revenue that YouTube has seen. Direct response advertising on YouTube is proving relatively resilient.

Given how significant Google has become in the global advertising industry, the fate of its advertising business will be inextricably linked to the trajectory for overall ad spending, even as it continues to gain share. Magna Global, part of advertising agency Interpublic Group, now expects ad spending in the U.S. to decline 2.8% this year, significantly worse than the 6.6% growth it had previously expected. Magna expects spending on digital ads to grow 3.9% for the year, down from its earlier forecast of 11% growth. eMarketer, a market research firm, expects U.S. search advertising spending to decline between 8.7% and 14.8% year-over-year during the first half of 2020, with the decline during the second quarter reaching 20% to 29%. Year-over-year trends could improve notably in the second half if the outbreak is brought under control and some social distancing restrictions are relaxed. The year-over-year change in Google's advertising revenue for the full-year will likely be better than its trend at the end of March, but tepid relative to historical trends nonetheless.

Much of Google's cost structure is fixed in nature, so the softness it is experiencing in its ad revenue will have an outsized impact on profits. Google is taking measures to manage its expenses more tightly in the current environment, such as implementing hiring freezes in most areas across the company. There is no doubt that Google will continue to be a highly profitable, cash flow positive company throughout this crisis though.

As the global economy's performance rebounds over time, so too will Google's growth — returning to something resembling its prior trend. The flexible, performance-oriented nature of Google's ad products makes it easy for advertisers to quickly cut spending on them when economic activity slows. It also means Google's advertising revenue tends to recover quickly as economic activity begins to improve.

Amazon.com, Inc.
(NASDAQ: AMZN)

From its roots as an online retailer of books, Amazon.com has grown into a sprawling and ever-expanding collection of global businesses, including online and physical storefronts; marketing, product listing and fulfillment services for third-party sellers; consumer-focused subscription services, the leading cloud computing platform in the world, and consumer electronic devices, among others.

The pandemic has had the most significant impact on Amazon's consumer-focused businesses. Amazon saw an abrupt surge in demand on its online storefronts as the global SARS-CoV-2 outbreak became increasingly acute over the course of March. The increased demand was focused on essential products, such as household staples, groceries, health and personal care products and home office supplies. Demand for discretionary products, like apparel, shoes and wireless products softened. For the quarter ended in March,

year-over-year growth in paid units sold through Amazon's global consumer businesses accelerated to 32.0% from 22.0% growth in the prior quarter. Constant currency revenue growth for Amazon's global online and physical stores for the first quarter came in at 25.0% and 8.0%, respectively, both about 10.0% faster than the corresponding growth rates in the fourth quarter.

While the impact of the pandemic has been positive on Amazon's top-line, it has had an adverse effect on the company's costs. The essential products that Amazon's customers are predominantly ordering and whose shipment Amazon is prioritizing amid capacity constraints carry lower than typical average selling prices that strain profitability. At the same time, Amazon is bearing higher operating costs in its fulfillment centers and physical stores. Amazon is purchasing personal protective equipment for employees, shifting to less efficient workflows to accommodate social distancing guidelines, implementing enhanced cleaning procedures, and increasing wages. The net result of lower average selling prices and higher costs is that many of the transactions that Amazon is processing are effectively breakeven at the contribution margin level. While Amazon might have expected to earn $4 billion or more in operating profit in the second quarter under normal circumstances, the pressures it is facing on its profitability as a result of the pandemic may ultimately push the company into the red in the short-term.

Although the financial impact of the pandemic on Amazon is likely to be negative over the short-term, Amazon has the potential to benefit over the long-term in a few ways. Many of Amazon's customers have shifted a higher portion of their spending onto the platform. It is possible that change in behavior will stick even as the pandemic wanes. Additionally, the culling of the herd of brick-and-mortar retailers from whom Amazon has been relentlessly taking share seems poised to accelerate. Finally, Amazon is providing its customers with essential services during this crisis, and that will only further bolster the high-level of affinity most Amazon customers already have for the company.

Fastenal Company
(NASDAQ: FAST)

Founded in 1967, Fastenal is one of the leading wholesale distributors of industrial and construction supplies in North America. Since the mid-90s, the company has expanded beyond its original focus on fasteners, such as screws and bolts, into additional product categories, including safety and janitorial supplies among others. The company sells low-priced – but critical – items for everyday use to a diverse and stable customer base, mostly under long-term contracts. Fastenal's unique distribution infrastructure, which includes selling formats ranging from branch locations to industrial vending machines, provides it with points of presence much closer to customers than those of competitors.

As a distributor of safety supplies, including personal protective equipment, Fastenal has been deemed an essential business during the current pandemic. Most of its locations continue to operate, although branch locations are closed to walk-in customers. To the extent Fastenal's customers have shut down their own facilities, any Fastenal points of presence embedded within those facilities, such as industrial vending machines and "onsite" locations, have also closed. Around 120 of the company's 1,179 on-site locations were closed at the end of March due to customer shutdowns. Onsite locations account for around 30% of Fastenal's revenue.

The pandemic has led to a profound shift in the pattern of demand across Fastenal's product categories. Demand for safety and janitorial supplies has surged, especially among Fastenal's government and healthcare customers, typically a small portion of its business. Sales of safety products were up 31% in March, with sales to healthcare organizations more than doubling. At the same time, demand for Fastenal's core fasteners has slowed sharply due to the adverse impact of the pandemic on overall economic activity. After growing 1.4% year-over-year during January and February, average daily fastener sales declined 10.1% in March. The product mix shifts Fastenal is seeing will adversely affect profitability, because fasteners are the company's highest margin product category by a wide margin. Fastenal's total average daily sales were up 0.6% in March but have since slipped to a decline of slightly more than 10% through the first two weeks

of April. Commentary from Fastenal's regional vice presidents suggests revenue for the second quarter as a whole could end up down around 15% versus the prior year.

Notwithstanding the revenue and profit declines Fastenal will experience in the short-term, the company will remain profitable and cash flow positive as long as most of its locations remain open. Moreover, Fastenal has a strong balance sheet with limited debt and ample liquidity from cash on hand as well as availability under committed credit facilities. Despite serving customers in cyclical businesses, Fastenal remained profitable and cash flow positive throughout the global financial crisis and subsequent recession. It continued to gain market share and improve its business, and eventually recovered strongly with the overall economy. From 2007 to 2012, Fastenal grew is revenue and net income at compound annual rates of 8.7% and 12.6%, respectively. Fastenal should deliver similarly impressive through-the-cycle results this time around.

Colfax Corporation (NASDAQ: CFX)

Founded by Steve and Mitch Rales about 10 years after they founded Danaher, Colfax Corporation is a diversified holding company that acquires good companies and turns them into great ones by applying its Colfax Business System. Colfax has substantially repositioned its portfolio of businesses over the past few years. It now operates through two primary subsidiaries: ESAB, a manufacturer of welding and cutting equipment and consumables, and DJO Global, a developer, manufacturer and distributor of orthopedic medical devices.

ESAB and DJO Global will each be affected differently by the pandemic, with ESAB being in for the rougher ride.

ESAB sells its fabrication technology equipment and consumables into cyclical end markets. Its revenue is roughly evenly split between emerging and developed markets, with more exposure to Europe than North America. Its customers are unquestionably experiencing sharply falling demand as economic activity around the globe collapses. The decline in demand that ESAB's customers are experiencing will inevitably flow through to ESAB. The fact that around two-thirds of ESAB's sales are consumable in nature will cushion the adverse impact on its business to some degree, but only partially.

In contrast to ESAB, DJO Global is much less economically sensitive business. Demand for its products is tied to the volume of orthopedic procedures. That may hurt the company in the short-term during the current pandemic though. Many hospitals around the world have postponed elective medical procedures to free up hospital capacity for patients with COVID-19. Most of those orthopedic procedures will be delayed, not canceled. Any postponement of orthopedic procedures will hurt DJO Global's business in the short-term, but the company should make up the lost business over time.

Of all the companies in our portfolio, Colfax Corporation is the one that is likely to be most adversely affected by the pandemic. Not only is it exposed to the inherent cyclicality of ESAB's business, but it also has a relatively leveraged balance sheet as a result of the acquisition of DJO Global in early 2019. The company's robust liquidity position, with more than $925 million available on its revolving credit facility, and lack of near-term debt maturities mitigate its balance sheet risk to a degree. Notwithstanding the adverse impact Colfax experiences to its short-term performance, the long-term outlook for the company is bright. Our position in CFX accounted for approximately 2.0% of the portfolio's value at the end of the quarter.

You probably don't even need to pull up a stock chart to appreciate that investing in Apple Inc. common stock at the end of 2007 – on the cusp of the Global Financial Crisis – and holding it until today would have been an incredible investment. In fact, you would have made more than ten times your money over the past 12 years, or an annualized return of over 21%. But the first 12 months of that investment would have been painful. Apple was not immune to the economy's woes during the financial crisis, and its stock declined nearly 60% from the end of 2007 to the end of 2008.

The Apple examples illustrates two important points. First, there are good long-term equity investments to be made even on the cusp of a severe economic and financial shock. Second, even an investment that is poised to deliver exceptional returns over time may deliver some rough mark-to-market results in the short-term, especially during an economic downturn.

Clearly, I can't guarantee that any of the investments in our portfolio will be the next Apple, but that is certainly the type of investment we are aiming for. The companies in our portfolio have attractive long-term outlooks and are well positioned to weather the storm unleashed by the pandemic. Some may even benefit from the pandemic on balance over time. That does not mean that the stocks in our portfolio will not fluctuate with the overall equity market in the short-term though. On the same note, any fluctuations in the mark-to-market value of our positions should not necessarily be taken as final judgment on the long-term returns they will ultimately generate.

After disappointing mark-to-market results since mid-2018, I was hopeful that the portfolio's mark-to-market performance would rebound with a vengeance in 2020. The extraordinary circumstances of the pandemic mean any rebound will likely take somewhat longer than I had been expecting. Nonetheless, I continue to be excited about the long-term returns our portfolio will deliver, even considering the effects of the pandemic.

Thank you for your continued confidence and support.

Regards,

Marc Werres
Managing Partner

Important Disclosures

The performance figures depicted herein relate to 1578 Partners, LP. 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, but not limited to, cost basis differentials, the timing of account inflows, and tax considerations. 1578 Partners, LP'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).

1578 Partners, LP's inception date is August 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.

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