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To My Partners:

The performance of our portfolio for the fourth quarter of 2021 and since inception is summarized below.

	1578 Partners, LP		S&P 500
	Gross	Net	Total Return
2021:			
Q4	9.61%	9.20%	11.03%
Year	17.49%	15.74%	28.71%
Since Inception (08/01/15):			
Annualized	18.18%	16.42%	15.80%
Cumulative	192.10%	165.23%	156.35%

In 2021, the U.S. economy overcame two waves of highly infectious SARS-CoV-2 variants, Delta and Omicron, and myriad supply disruptions to deliver strong overall growth. Current estimates suggest U.S. GDP grew at a 6.9% seasonally adjusted annual rate in the fourth quarter relative to the third quarter, bringing growth for the full year to 5.7%, the strongest annual growth in almost four decades.

It is hard to overstate how remarkable the U.S. economy's recovery from the devastating initial shock of the pandemic has been. In the second quarter of 2020 when the economic shock from the pandemic was most acute, the gap between what the U.S. economy was producing and what it had the potential to produce according to estimates from the Congressional Budget Office was nearly 11.0%, the largest it has ever been. Just eighteen months later, that output gap now sits at less than 0.5%. In contrast, it took more than *nine years* after the Global Financial Crisis for the gap between actual and potential output to shrink to its current level from a trough level that was only half as bad as that of the current pandemic.

Although the aggregate level of GDP is nearly "back to normal," the economy overall is still highly distorted by the effects of the pandemic. People continue to spend more on durable goods, like sporting equipment and furniture, and less on services, like dining out at restaurants and staying in hotels, than they normally would. Supply chains disrupted by the abrupt closure and subsequent reopening of significant portions of the global economy have yet to be unsnarled. And a significant portion of the U.S. workforce seems to be on the sidelines for a variety of possible reasons, including opting for early retirement, desiring to avoid exposure to the virus, and needing to care for children whose schools and daycares have been disrupted.

The combination of a strong recovery in overall spending and continued significant disruptions from the pandemic has led to surging inflation. The headline Consumer Price Index grew 7.0% year-over-year in December, the largest such increase since June 1982. Similarly, the Fed's preferred measure of inflation, the price index for personal consumption expenditures excluding food and energy, increased 4.9% year-over-year in December, well above the Fed's long-term target of 2.0%.

For a while, the Fed regarded elevated inflation readings as "transitory." The Fed assumed that inflation would return to its targeted range as the effects of the pandemic subsided without requiring a monetary policy response. It recently changed its tune. The Fed now plans to raise the targeted range for the federal funds rate as early as March of this year. Markets are currently pricing in five 25-basis point hikes over the course of 2022 as the most likely outcome.

Take the reports of roaring inflation and the Fed's lurch toward removing monetary policy accommodation somewhat faster than it had planned with equanimity for the moment. Market-based inflation compensation for the period from five to ten years from now is currently no higher than it was in early 2019. Similarly, U.S. dollar overnight indexed swaps rates imply the Fed will most likely raise its target for the federal funds rate to 1.75% - 2.00% in 2023 and then stay there.

In other words, the market is confident that the Fed has the situation under control. It is neither pricing in runaway inflation nor a Fed-induced recession to bring inflation to heel. Notwithstanding a somewhat less accommodative outlook for monetary policy, both the Fed and the IMF expect the U.S. economy to deliver another year of above trend growth in 2022, clocking in at 4.0% on an inflation-adjusted basis.

Our portfolio underperformed the S&P 500 slightly for the quarter on a mark-to-market basis. Our position in Interactive Brokers Group, Inc. Class A common stock (NASDAQ: IBKR), the largest position in the portfolio, was the most significant positive contributor. IBKR gained 27.4% during the quarter. Our positions in Uber Technologies, Inc. common stock (NYSE: UBER) and Sleep Number Corporation common stock (NASDAQ: SNBR) were notable detractors. UBER and SNBR declined 6.4% and 18.1%, respectively.

For the full year, our portfolio's mark-to-market performance lagged more significantly. Most of the underperformance came from two positions, Covetrus, Inc. common stock (NASDAQ: CVET) and UBER. Both of those positions should ultimately deliver strong returns over time.

Performance Attribution

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

Performance Attribution			
4Q 2021		**2021**	
Interactive Brokers Group	6.96%	Alphabet	10.44%
Alphabet	1.95%	Interactive Brokers Group	7.64%
Covetrus	1.53%	Northeast Bank	5.17%
Uber	-0.73%	Sleep Number	1.77%
Sleep Number	-0.97%	Equities – Short	1.27%
		Uber	-1.17%
		Covetrus	-7.85%
Other	0.87%	Other	0.22%
Gross Performance	9.61%	Gross Performance	17.49%

Portfolio Composition

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

Portfolio Composition	
Equities – Long	94.7%
Cash	5.3%

During the quarter, we closed out our short equity position and the related hedge at modest profit. At the end of the quarter, our portfolio included nine long equity positions and cash.

Select Portfolio Updates

The sole portfolio update for this quarter covers our position in Northeast Bank voting common stock (NASDAQ: NBN). We have been shareholders of Northeast Bank since May 2017.

Northeast Bank (NASDAQ: NBN)

Northeast Bank, a state-chartered bank organized in 1872 and based in Lewiston, ME, was taken over by an investor group led by the current CEO, Rick Wayne, in 2010. Wayne shifted the bank's strategy from serving its local market area like a typical community bank to purchasing and originating commercial real estate loans nationwide in segments of the market not well served by either small local banks or large national banks. Wayne had achieved tremendous success with this strategy at Capital Crossing Bank, the bank he previously led and eventually sold.

Northeast Bank was last featured in Hinde Group's partner letter for the fourth quarter of 2020. The gist of that update was that despite some adverse effects, Northeast Bank would likely end up benefiting on the whole from the pandemic. Its management team has done a terrific job of taking advantage of several opportunities created by the pandemic, most notably participating in the Paycheck Protection Program ("PPP") and repurchasing stock. The previous update suggested that Northeast Bank's earnings for the fiscal year ended June 30, 2021 could "exceed $4.00 per share, well above the $2.23 per share it earned on an adjusted basis in fiscal 2019."

As it turns out, Northeast Bank earned an eye-popping $8.55 per share for the fiscal year ended June 30, 2021. For the calendar year ended December 31, 2021, that figure grew to $9.22 per share.

Most of the earnings gusher came from Northeast Bank's participation in the PPP. After originating more than 5,000 loans totaling approximately $510.6 million during the first round of the PPP, Northeast Bank invested aggressively in technology, marketing and other initiatives in anticipation of a second round. That investment paid off in a big way. During the second round, Northeast Bank was able to grow its PPP originations to more than $2.8 billion. The sale of those loans generated over $45 million of income. Northeast Bank also benefited from the correspondent relationship it developed with The Loan Source, Inc. ("Loan Source"). Loan Source ended up purchasing $11.2 billion of PPP loans with the funding that Northeast Bank facilitated. Northeast Bank has earned $19.4 million in upfront fees (some of which has yet to be recognized under GAAP) and $24.9 million in net servicing income from those purchases thus far, and it expects to earn additional net servicing income through the third quarter of calendar year 2022.

Although the benefit to Northeast Bank's earnings from its participation in the PPP is non-recurring, the windfall did meaningfully increase the bank's capital. Northeast Bank began calendar year 2020 with tangible book value of $160.8 million. Over the past two calendar years, it has earned a total of $105.9 million, roughly 66% of its book value at the beginning of the period.

The surge in capital will boost Northeast Bank's intrinsic value per share in two ways. First, it will allow Northeast Bank to grow its loan book and earning power much faster than it would have been able to otherwise. You can already see this starting to happen. For the quarter ended December 31, 2022, Northeast Bank generated a record $260.5 million in originations and purchases. That is almost two-thirds of the volume of originations and purchases that Northeast Bank generated for the entire fiscal year in 2019. Second, Northeast Bank can use its excess capital to repurchase stock. Thus far, it has been able to do so at huge discounts to intrinsic value. The company has already repurchased $32.3 million worth of shares since the beginning of calendar year 2020, shrinking its shares outstanding from 9.05 million at December 31, 2019 to 7.82 million at December 31, 2021. As Northeast Bank puts its excess capital to work by prudently growing its loan book and repurchasing shares, its return on equity should trend north of 20%. With tangible book value per share of $30.40 at December 31, 2021, achieving that level of ROE would deliver more than $6.00 of earnings per share over time.

That alone makes for an extremely compelling outlook; *but wait, there's more*. Northeast Bank recently entered into several agreements with a firm called NEWITY that is run by the same people behind Loan Source. NEWITY aims to market small dollar SBA 7(a) loans to most of the 115,000 borrowers that Loan Source developed relationships with by purchasing PPP loans. Northeast Bank would provide most of the funding for those loans and share in the income generated by selling the government-guaranteed portions. Small dollar SBA 7(a) loans have the highest interest rates and government guarantees among SBA loans, so the premiums that can be earned by selling the guaranteed portions in the secondary market are substantial relative to the principal amount of those loans. It is hard to say what the uptake of these loans will be among the 115,000 borrowers Northeast Bank and NEWITY are targeting. As a point of reference, a 10% uptake rate could generate income for Northeast Bank comparable to what it earned from its PPP correspondent relationship with Loan Source.

Through the end of 2021, our investment in NBN has delivered a 14.4% annualized return on a mark-to-market basis. At face value, one could argue it has not been a successful investment. A 14.4% annualized return is below both Hinde Group's investment hurdle rate of at least 15% and the total return on the S&P 500 over the comparable period. But that perspective would be both superficial and flawed. NBN is deeply undervalued at the moment, trading at less than half of Hinde Group's estimate of its intrinsic value. Moreover, the business is performing well and intrinsic value per share has been growing – and should continue to grow – at a healthy clip. The odds are very good that our investment in NBN will ultimately prove to be an unmitigated success.

I feel the same way about our portfolio as I do about our investment in NBN. I believe our portfolio is especially undervalued at the moment and that the returns it will ultimately deliver will be excellent.

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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