A 580 California St.
16th Floor
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 fourth quarter of 2022 and since inception is summarized below.

	1578 Partners, LP		S&P 500
	Gross	Net	Total Return
2022:			
Q4	3.81%	3.41%	7.56%
Year	-14.17%	-15.51%	-18.11%
Since Inception (08/01/15):			
Annualized	13.20%	11.50%	10.52%
Cumulative	150.70%	124.09%	109.92%

2022 was a rough year in financial markets. The S&P 500 posted its fourth largest decline for a calendar year in more than 70 years. Only 2008, 2002 and 1974 were worse. Results were bleaker still for the technology-heavy NASDAQ. The price of the NASDAQ Composite fell 33.1% over the course of 2022, its third worst result for a calendar year on record and only slightly less severe than its 40.5% plunge in 2008. Bonds offered little shelter from the storm. The Bloomberg U.S. Treasury Index lost 12.5% in 2022, the largest annual decline since its inception in 1994, after losing 2.3% in 2021.

Most of the blame falls on the Fed's campaign to extinguish inflationary pressures coursing through the economy. The Fed tightened monetary policy at its fastest pace ever. Its target range for the federal funds rate ended 2022 at 4.25% - 4.50%, 425 basis points higher than where it started. That is by far the largest ever increase in the target for the federal funds rate over a 12-month period. Prior to 2022, the Fed had only once raised the federal funds rate by 75 basis points at a single meeting (in November 1994). Over the course of 2022, it hiked the federal funds rate by 75 basis points at an unprecedented four consecutive FOMC meetings.

The Fed's relentless ratcheting of monetary policy over the course of 2022 weighed on the equity market in a variety of ways.

First, realized and expected increases to the Fed's benchmark overnight interest rate – the federal funds rate – affect the levels of all other interest rates. For example, the 10-year treasury yield rose from 1.52% to 3.88% and the 30-year mortgage rate leapt from 3.11% to 6.42% over the course of 2022. The level of interest rates correspondingly affects assets values. Although the 10-year treasury yield probably gets the most attention, the inflation-indexed yield on the 30-year treasury is arguably a better measure for valuing the equity market given the very long duration of the expected cash flows associated with most equity securities. Focusing on the 30-year yield instead of the 10-year yield is especially relevant during periods when short-term interest rates are unusually high or low. We have seen both ends of the spectrum over the past few years. The real 30-year treasury yield jumped from -0.44% at the start of 2022 to 1.67% at the end. *All else being equal*, a change of that magnitude in long-term interest rates puts notable downward pressure on asset values.

Second, tighter monetary policy has dimmed the outlook for the economy and corporate earnings. Sharply higher mortgage rates have dealt a devastating blow to the housing market that will continue to reverberate for at least a few years. The elevated value of the dollar is weighing on the competitiveness of U.S. businesses relative to foreign ones in tradable goods and services. And borrowing costs are up for both consumers and businesses, leading them to reconsider purchases and investments. At best, the economy and corporate earnings will grow far more modestly over the intermediate term than they otherwise would have. At worst, the economy will fall into a recession and corporate earnings will decline. Any way you look at it, the probability weighted outlook for corporate earnings is worse today than it was at the beginning of 2022 on account of the Fed's efforts to rein in inflation. A decline in expected earnings generally results in lower stock prices.

Last but not least, the Fed's determination to bludgeon inflation – and the economy – has stoked fear, uncertainty and doubt among investors. Investors are demanding a higher-than-usual return to bear a given level of risk. That higher prospective return is achieved through a lower current price. In financial market vernacular, risk premiums have blown out. At some point, clear skies and historically normal risk premiums will return. A storm may need to pass before we get there though.

The equity market's modest bounce during the fourth quarter was mainly due to some good news on the inflation front. The trend in annualized one-month trimmed mean PCE inflation steadily slowed from 6.0% in August (reported in September) to 3.4% in November (reported in December), marking not only a long-awaited peak, but also demonstrating substantial progress toward the Fed's 2.0% target. According to some measures of inflation that take into account more current estimates of the cost of housing than official statistics, inflation is already trending below the Fed's 2.0% target.

At the same time, part of what is easing inflationary pressures is slowing economic growth. Growth in non-farm payroll employment decelerated in each of the last three months of 2022. For the fourth quarter, monthly gains in non-farm payrolls averaged 247,000, well below the 418,000 average monthly gain in jobs for the first nine months of the year. Temporary help services employment, which tends to be a leading indicator for the economy, seems to have peaked in July. It has been declining at an accelerating rate almost every month since. The Institute for Supply Management's Manufacturing PMI fell into contractionary territory in November and then deteriorated further in December. That is to be expected given the on-going rebalancing of spending between goods and services. Far more concerning is that the ISM's Services PMI also fell abruptly into contractionary territory in December. Ideally, the economy will slow enough to relieve inflationary pressures, but not so much as to set off a self-reinforcing slide into a recession. It is a thin line to walk.

Our portfolio modestly underperformed the market on a mark-to-market basis for the fourth quarter, but still outperformed for the full year. For the quarter, some of our positions outperformed and others underperformed. Our outperformers were Netflix, Inc. common stock (NASDAQ: NFLX), Northeast Bank voting common stock (NASDAQ: NBN) and Interactive Brokers Group, Inc. class A common stock (NASDAQ: IBKR). NFLX, NBN and IBKR gained 25.2%, 14.8% and 13.2%, respectively, over the course of the quarter. Our positions in Amazon.com, Inc. common stock (NASDAQ: AMZN) and Alphabet Inc. class C capital stock (NASDAQ: GOOG) were underperformers. AMZN lost 25.7% and GOOG fell 7.7%.

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 2022		**2022**	
Interactive Brokers Group	3.88%	Northeast Bank	2.13%
Netflix	3.00%	Netflix	2.12%
Northeast Bank	2.18%	Interactive Brokers Group	-2.37%
Alphabet	-1.44%	Amazon.com	-3.69%
Amazon.com	-3.02%	Uber	-3.79%
		Alphabet	-8.80%
Other	-0.79%	Other	-0.24%
Gross Performance	3.81%	Gross Performance	-14.17%

Portfolio Composition

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

Portfolio Composition	
Equities – Long	97.5%
Cash	2.5%

There were no changes to the portfolio during the quarter. At the end of the quarter, our portfolio included seven long equity positions and cash.

Select Portfolio Updates

The 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)

With roots tracing back to 1872, Northeast Bank, a Maine state-chartered bank with $1.7 billion of assets and $252 million of equity as of September 30th, was originally organized to serve communities in western Maine as a run-of-the-mill mutual savings bank. It is anything but that today. Over the past decade, Northeast Bank has transformed itself under the leadership of its current CEO, Rick Wayne. Wayne led an investor group in a friendly takeover of Northeast Bank in 2010 with a plan to implement a fundamentally new strategy. He deemphasized Northeast Bank's traditional community banking lending in favor of purchasing and originating "scratch and dent" and other unconventional commercial real estate loans nationwide. It is roughly the same strategy Wayne executed for nearly two decades as CEO of Capital Crossing Bank, a bank he founded with a partner in 1988, took public in 1996 and then sold to Lehman Brothers in 2007 for nearly ten times its IPO price. Wayne's strategy for Northeast Bank has led to a step function increase in the return on equity and long-term growth the Bank should be able to achieve. It has been steadily making progress over the past decade toward realizing that potential.

In his book, *Playing Poker Like the Pros*, Phil Hellmuth, winner of a record sixteen World Series of Poker bracelets, famously categorized poker players into one of five animal types: the jackal, the elephant, the mouse, the lion and the eagle. The best poker players are eagles. They have the rare combination of conservatism at most times and a willingness to be stunningly aggressive at the right moments. When an eagle goes all-in, you can rest assured without even seeing any cards that he is going to take down the pot.

Northeast Bank is an eagle in the world of commercial real estate lending. And it shoved all its chips into the pot during the fourth quarter.

On its earnings call at the beginning of November, Northeast Bank announced that it had purchased loans with a total unpaid principal balance of $303.6 million in the month of October. That amount exceeded what Northeast Bank had bought in any year since it began its loan purchasing strategy in 2011. For Northeast Bank's fiscal year 2022, which ended in June, the bank purchased total loans with just under $200 million of UPB. In other words, Northeast Bank's loan purchase volume in just the month of October was about 50% more than what it purchased for the entire preceding fiscal year. It was a truly impressive volume of loan purchases for a single month by any measure.

Yet just 38 days later, Northeast Bank made it look quaint. On December 8th, Northeast Bank issued a press release announcing "significant loan purchase volume." Over the course of November and the first week of December, Northeast Bank had purchased additional loans with a total UPB of nearly $860 million – more than twice the volume it purchased in October – bringing its total loan purchase volume for the final calendar quarter of 2022 to an eye-watering $1.16 billion at the time. That is nearly *six times* the volume that Northeast Bank had purchased in any previous year. In total, the recent purchases should almost double the size of the Bank's balance sheet.

Saying Northeast Bank went all-in with these loan purchases is not just a metaphor. Northeast Bank appears to have pushed its capital ratios right up to their limits. The Bank ended September with just under $260 million of both tier 1 and total capital. At that time, its tier 1 leverage and total capital ratios stood at 15.6% and 17.8%, respectively. By the end of December, those figures had dropped to 12.5% and 11.1%, respectively, primarily as a result of the loans purchased during the quarter. At the end of December, the Bank had just $150 million of available capacity to grow its loan book, down from around $1 billion of available capacity a year earlier. Northeast Bank almost literally used every last cent of its existing capital to fund the recently announced loan purchases.

Now it is rifling through the cushions for spare change to buy even more. Four days after announcing its gargantuan loan purchase volumes for October and November, the Bank announced plans to raise equity capital. Specifically, the Bank hired Piper Sandler to run an on-going, at-the-market offering to raise up to $50 million. An additional $50 million of equity capital should give the bank capacity to purchase additional loans with $500 million or more in unpaid principal balance.

The fallout from the historically steep increase in benchmark interest rates since early 2022 is the driving factor behind the opportunities Northeast Bank is currently seeing. The spike in interest rates has shocked the commercial real estate asset market. Property values are falling and there is uncertainty among investors and lenders about where those values will ultimately settle out. Borrowers with floating rate debt are facing steeply higher payments and a corresponding deterioration in their debt service coverage ratios. Lenders with fixed-rate commercial real estate loans may experience net interest margin compression. Banks have been tightening credit standards for commercial real estate lending in a variety of ways in response to falling property values, deteriorating debt service coverage ratios, increased regulatory scrutiny, and broad-based deposit outflows. For all these reasons, the supply of performing CRE loans for sale is up, returns required by buyers have surged, and the number of buyers with access to financing has shrunk, leading to sharply lower prices for performing CRE loans on the secondary market.

Although the prices for performing commercial real estate loans have been falling sharply on the secondary market, it does not automatically follow that buying those loans will deliver exceptional – or even good – returns. Funding costs are up, collateral values are falling, borrowers may struggle to refinance loans at maturity in light of tighter credit standards, certain property types face secular challenges, and the Fed seems intent on pummeling the economy into submission. However, the track record of Northeast Bank's management is so strong that it is hard to imagine them pursuing these purchases as aggressively as they have unless the prospective returns were truly exceptional and the risks limited.

The details that Northeast Bank has shared support that view. Northeast Bank paid $998.5 million for loans with a total unpaid principal balance of nearly $1.16 billion, or just 86.6% of the UPB. On average, the Bank's basis in the loans represents just 33.5% of the appraised values of the underlying collateral at origination. Most of the loans were originated prior to 2019. Since 2019, the Real Capital Analytics Commercial Property Price Index is up over 30%, and it has nearly doubled since 2013. There is a good chance that the weighted average loan-to-value for the purchased loans based on appraisals done when the loans were originated materially overstates what that figure would be based on current market values. Put simply, the loans appear extremely well protected by the underlying collateral values. The loans are also well diversified in number (2,707 loans with an average balance of $420,000), by collateral type and by location. Northeast Bank is assuming it will not collect around $19 million of the principal and interest it is contractually owed related to these loans. Based on the information Northeast Bank has shared about the loans, there is a good chance that estimate will ultimately prove overly conservative.

Not only do the purchased loans appear to be very low risk, they should also be enormously accretive to earnings per share over the intermediate term and book value per share ultimately. Since fiscal 2013, Northeast Bank's purchased loans have delivered an average annual net interest spread of 10.43%, with a high of 17.05% in 2013 in the wake of the Global Financial Crisis and a low of just over 8% more recently. Even assuming the net interest spread on the recently announced loan purchases is in-line with the low end of that range, Northeast Bank's recent loan purchases should deliver incremental annual net interest income of around $80 million. Northeast Bank's efficiency ratio came in at just under 50% for its most recently reported quarter. Taking into account incentive compensation, loan servicing expenses and FDIC insurance premiums, the Bank's incremental efficiency ratio with respect to the announced loan purchases should be no more than 20%. As a result, recent loan purchases should add at least $64 million to pre-tax income and $45 million to net income assuming a 30% tax rate. That amounts to more than $6.00 of incremental annual earnings per share from the recently announced loan purchases. If the loans persist for four years on average, the loan purchases will ultimately add an incremental $24.00 to Northeast Bank's book value per share over time.

Any additional loans purchased using funds raised through the Bank's $50 million at-the-money equity offering would only add to those accretion figures, although to a somewhat lesser extent due to dilution from newly issued shares.

On a normalized basis, Northeast Bank earned about $1.00 per share in the quarter ended September 30, 2022. In other words, prior to the recent loan purchases, the Bank was generating run-rate annual earnings of around $4.00 per share. Its balance sheet is slightly asset sensitive with 76.8% of its loans having variable interest rates. Even conservative assumptions for the impact of recently announced loan purchases, which point to $6.00 per share of incremental annual EPS, suggest that the Bank's total annual earnings per share is headed north of $10.00 in the near-term. That is well above the current consensus estimate for the fiscal year ending June 2024 of $7.28. Tangible book value per share should correspondingly increase from $33.57 at September 30, 2022 to more than $70 per share over the next four years.

NBN ended 2022 trading at $42.10. That is an exceedingly low price in light of the outlook for the Bank's earnings and book value. It could prove to be less than four times the EPS the Bank achieves for the 2023 calendar year and just over half the book value per share NBN hits by the end of 2026. Northeast Bank's

differentiated and proven investment strategy should allow it to deliver return on equity in excess of 20% on a normalized basis while steadily growing its originations and balance sheet. A bank with those characteristics would need to trade at more than twice tangible book value to be fairly valued. If Northeast Bank grows its tangible book value to more than $70 per share by the end of 2026 and achieves a valuation of at least two times tangible book value, NBN would soar to more than $140. That would represent more than a triple from the current share price and a forward-looking annualized return in excess of 35%.

On a mark-to-market basis, our position in NBN has delivered a 15.0% compound annual return and more than doubled our invested capital over our holding period thus far, roughly five and a half years. That compound annual return is exactly equal to Hinde Group's ex-ante investment hurdle rate and ex-post threshold for considering an investment successful. Most of the juice is still remains to be squeezed out of NBN though. There is a good chance the returns from our investment in NBN will look much better when all is said and done.

Some say the events of 2022 mean we need to throw out old valuation frameworks. I disagree. Despite their jump over the course of 2022, the interest rates that matter most for equity valuation are not all that different today than they were prior to the pandemic. The 10-year treasury yield sits at 3.51%; in 2018 it hit a peak of 3.24%. The inflation-indexed 30-year treasury yield is 1.33%; its peak in 2018 was 1.37%. Valuation approaches grounded in theory, reality and conservatism continue to be – and always will be – valid. It is the ones based on fantasy, price momentum and greater fools that should – and in many cases have – been discarded. That will not mean much for how our portfolio performs over time.

I remain optimistic about our portfolio. The market value of our portfolio at the end of 2022 was well below a conservative estimate of its intrinsic value and the operating results of the companies in our portfolio should prove highly resilient to whatever the economy may throw at them. Periods of recession and financial stress typically create the greatest opportunities in financial markets. My goal will always be to take advantage of those opportunities when they arise so that our portfolio ultimately ends up performing even better than it would have under more benign conditions.

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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