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To My Partners:

The performance of our portfolio for the second quarter of 2023 and since inception is summarized below.

	1578 Partners, LP		S&P 500
	Gross	Net	Total Return
2023:			
Q2	16.62%	16.19%	8.74%
Year-to-Date	29.87%	28.90%	16.89%
Since Inception (08/01/15):			
Annualized	16.09%	14.35%	12.01%
Cumulative	225.58%	188.86%	145.38%

The $64,000 question continues to be whether the Fed will be able to rein in inflation without pushing the economy into a recession. Developments during the second quarter were generally encouraging.

The U.S. economy is proving more resilient than many expected. Despite facing sharply higher interest rates and related turbulence in the banking system in March, the economy appears to have grown at a healthy rate in the first half of 2023. According to the BEA's advance estimate, the U.S. economy grew at a 2.4% annualized rate in the second quarter, bringing the same figure for the first half of 2023 to 2.2%. Data from the labor market tell a similar story. Although the rate of job creation has steadily slowed over the past several quarters, the 244,000 jobs that the U.S. economy added on average each month during the second quarter remained above the 192,000 jobs the economy gained on average each month from the beginning of 2015 to the end of 2019. The headline unemployment rate has hardly budged from where it sat at the end of 2021. A year ago, many economists expected a recession by now.

While the rate of inflation is not yet at the Fed's target, it is showing more signs of cracking than the economy. The "core" consumer price index, which excludes changes in food and energy prices, increased just 0.2% in June. Core CPI is now running up 4.8% year-over-year, down from up 5.6% year-over-year in January. Signals from the "supercore" consumer price index, which removes changes in shelter and used car prices from the core figure, are even more encouraging. In June, supercore inflation was flat over the prior month and up at a 2.7% annualized rate since the beginning of the year. The price index for personal consumption expenditures, the Fed's preferred measure of inflation, shows the same trend of moderating inflation. The "core" PCE price index increased at an annualized rate of just 2.0% in June. While it is too early to unfurl the "Mission Accomplished" banner, developments during the second quarter in the fight against inflation were certainly encouraging.

Better than expected data on economic growth and inflation as well as an easing of stress in the banking system boosted financial markets. High yield credit spreads fell to their lowest levels since early 2022 — reflecting falling odds of a recession — and various measures of implied volatility fell to their lowest levels since the onset of the pandemic — reflecting the fact that the economy is increasingly approaching a new, post-pandemic "normal." The equity market rallied too.

Our portfolio outperformed the S&P 500 on a mark-to-market basis for the quarter, extending its outperformance for the year-to-date. Five of our seven positions dramatically outperformed the market, registering gains during the quarter ranging from 16.3% to 36.2%. Interactive Brokers Group, Inc. Class A common stock (NASDAQ: IBKR), our largest position, was roughly flat for the quarter.

Performance Attribution

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

Performance Attribution			
2Q 2023		YTD 2023	
Uber	4.18%	Uber	7.48%
Netflix	4.15%	Netflix	7.08%
Alphabet	2.85%	Alphabet	6.03%
Northeast Bank	2.79%	Interactive Brokers Group	4.78%
Amazon.com	2.44%	Amazon.com	4.66%
Other	0.22%	Other	-0.15%
Gross Performance	16.62%	Gross Performance	29.87%

Portfolio Composition

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

Portfolio Composition	
Equities – Long	98.0%
Cash	2.0%

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 sole portfolio update for this quarter covers our investment in Netflix, Inc. common stock (NASDAQ: NFLX), a compounder that we have held for a little bit more than a year.

Netflix, Inc.
(NASDAQ: NFLX)

When we made our investment in Netflix last year, I framed it as perfectly fitting Warren Buffett's model for a great investment.[1] So far, Netflix is sticking to the script.

The "one-time huge, but solvable problem" Netflix faced was an abrupt slowdown in new member additions around the world. Netflix shocked financial markets when it reported that its global membership base declined by 203,000 members in the first quarter of 2022 and that it expected to lose an additional 2.0 million members in the following quarter. It ended up losing only 969,000 members in the second quarter of 2022,

[1] "A great investment opportunity occurs when a marvelous business encounters a one-time huge, but solvable problem." – Warren Buffett

bringing the decline in its global membership base during the first half of 2022 to roughly 1.2 million members. In contrast, Netflix *added* 5.5 million members to its ranks in the first half of 2021. Many pundits interpreted stalling membership growth as a sign that Netflix not only had fully saturated its addressable market but also was succumbing to heightened competition. The market priced the stock accordingly.

Barely more than a year later, Netflix is well on its way to solving its "problem" and proving its skeptics wrong. Netflix has grown its global membership base by 17.7 million members over the past 12 months, including by 5.9 million members in the second quarter of 2023. Netflix's member additions during the most recent quarter are especially noteworthy because it tends to be the seasonally weakest quarter for membership growth. The 5.9 million members Netflix added in the second quarter of 2023 is nearly four times the 1.5 million members it added during the second quarter of 2021. Moreover, most of those 5.9 million new members joined toward the end of the quarter. Netflix expects its revenue growth to accelerate over the remainder of 2023, and it continues to target a return to sustained double-digit revenue growth and operating margin expansion over the long term.

The speed at which Netflix has addressed its "growth problem" is a testament to just how "marvelous" of a business it is, mainly with respect to the strength of its management team and corporate culture.

Most of the acceleration Netflix has seen in its membership growth trends thus far is due to the company's initiatives to crackdown on password sharing between households. While Netflix was aware that passwords were being shared between households around the world for many years, addressing the issue was never a priority. That changed when membership growth hit a wall in early 2022. Within a few months, Netflix began testing a variety of alternative approaches in several countries throughout Latin America. Based on what it learned in Latin America, Netflix expanded the rollout of those initiatives to Canada, New Zealand, Portugal and Spain in early February 2023. A few months later in May 2023, Netflix implemented its initiatives to monetize password sharing in markets representing 80% of revenue, including the United States. Over the course of July, Netflix expanded those initiatives to essentially all the remaining countries in which it operates. The process of monetizing password sharing is a gradual one. The benefit to membership and revenue growth Netflix realized from initiatives to monetize password sharing during the second quarter was just the beginning. Netflix estimates that more than *100 million* households around the world, including 30 million in the U.S. and Canada., were sharing a password. Even modest success from Netflix's efforts to monetize password sharing could have an enormous impact on Netflix's membership and revenue growth over the coming quarters and years.

Another piece of Netflix's solution to its "growth problem" is offering advertising-supported plans. Here again, the speed with which Netflix was able to execute is breathtaking. Netflix was able to launch its "basic with ads" plan in 12 markets, including the U.S., over the first half of November 2022. The initial results have been promising. Average monthly revenue per member for the ad-supported plan in the U.S. ($6.99 + advertising revenue) exceeds the comparable figure for the standard plan ($15.49). The strength of the unit economics for the ad-supported plan led Netflix to upgrade the features of that plan and eliminate the lowest priced, basic tier of ad-free plans. Alternative data suggests around 20-30% of Netflix's new memberships in the U.S. were signing up for the ad-supported plan in the U.S. and Canada before Netflix dropped its basic ad-free plan. The number of members on the ad-supported plan nearly doubled in the second quarter. Although Netflix's nascent advertising revenue makes an immaterial contribution to the business at the moment, it is easy to see how it could grow to 15% or more of revenue over time and enable Netflix to serve a meaningfully larger membership base while at the same time better optimizing its overall pricing strategy.

Greater focus on efficiency is also part of the solution to Netflix's "problem." Since creating its stand-alone streaming service just over a decade ago, Netflix's primary focus has been on expanding around the world as fast as possible. Netflix spent $2.5 billion of cash on streaming content in 2012. By 2022, that figure had grown

to just under $17 billion, up nearly seven-fold in a decade. Moreover, Netflix was pouring all that money into a market that needed to significantly expand capacity to fulfill that demand. Securing a sufficient volume of original and licensed content to satisfy Netflix's global ambitions was an enormous challenge. Optimizing the efficiency of that spending was at best a secondary consideration. Now that Netflix has achieved preeminent global scale and the pace of its growth has moderated, the company can harvest the opportunities to improve efficiency that built up during its period of breakneck growth. That is true for both content spending and all other line items on the P&L. In other words, even without meaningful growth in spending going forward, Netflix has a significant opportunity to improve the quality of its service through efficiency gains.

Netflix's future looks bright. There are over 1.4 billion households in the countries in which Netflix currently operates. Just under 700 million of those households have a fixed broadband subscription. By 2030, that figure should grow to more than 1 billion. All those households are potential Netflix subscribers. Moreover, Netflix continues to have an enormous opportunity to further improve its service. Even in Netflix's most mature markets, Netflix accounts for less than 10% of the average household's television viewing time. Linear broadcast and cable networks still garner the vast majority of viewing time, but their business models are collapsing. As Bob Iger, CEO of Disney, recently said, "[cable, broadcast and satellite TV are] marching towards a great precipice and [will] be pushed off. I can't tell you when, but it goes away."[2] Netflix has at least as good of a chance as anyone to claim the viewing time that currently goes to linear networks. The more a household engages with Netflix, the more value that household will get from it and the more that household will be willing to pay for the service. Netflix also continues to have ample opportunity to optimize the degree to which it captures the value it creates for members through pricing. The launch of an advertising-supported plan is only the latest significant development on that front.

Netflix is aiming for sustained double digit revenue growth, operating margin expansion and growing free cash flow. It also plans to allocate most of the free cash it generates to share repurchases. Shareholders should do very well over time even if Netflix just barely meets those open-ended targets.

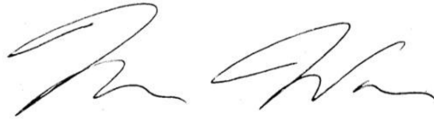
Our investment in NFLX has delivered strong returns thus far. At the end of the second quarter, our position in NFLX had delivered a compound annualized return of 61.1% and a multiple of invested capital of 1.81x. Nonetheless, the prospective returns remain attractive. Even based on conservative assumptions about Netflix's future growth trajectory, NFLX would have to exceed its all-time high of $700.99 to offer a market-level return.

[2] Whelan, Robbie, and Dean Seal. "Disney Seeks Strategic Partner for ESPN." The Wall Street Journal, 14 July 2023, www.wsj.com/articles/disneys-iger-hints-at-strategic-partner-for-espn-possible-sale-for-linear-tv-assets-35230a1a.

I have been saying for a while that our portfolio has a significant amount of “potential energy” waiting to be realized. While some of that came through during the first half of 2023, it was only the tip of the iceberg, in my view. Although the equity market strikes me as richly valued overall and the economic outlook remains uncertain, I continue to be enthusiastic about the positions that comprise our portfolio and optimistic about the returns they will deliver in the coming quarters and years.

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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