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July 15, 2020

To My Partners:

<u>2020 Year-to-date (“YTD”) Performance Summary</u>

From January 1 to June 30, 2020, Pinchot Lane Partners LP (“PLP”, the “Fund”) returned 29.3%, net of 0.75% in management fees and accrued incentive allocation. Below is a summary of Fund performance for the first half of 2020 and since inception. As you’ll recall from prior letters, returns are shown dating back to both January 1st, 2018 as well as fund inception (1/22/2018) to demonstrate what Fund performance *would have been* had the Fund started at the beginning of 2018. The difference in annualized performance between these two timeframes is due to the meaningful declines in both the market index and the Fund beginning in late January 2018. This delta will shrink over time as the effect of this decline gets diluted over subsequent years.

	PLP Gross Perf	(A) PLP Net Perf***	(B) S&P 500 Total Return†	= (A)-(B) Relative Performance
2018 Calendar Year*	(1.6%)	(2.3%)	(4.4%)	2.0%
*Fund inception** thru 12/31/18*	*(9.6%)*	*(10.3%)*	*(9.1%)*	*(1.3%)*
2019 Calendar Year	31.1%	28.9%	31.5%	(2.6%)
2020 First Half	**38.5%**	**29.3%**	**(3.1%)**	**32.4%**
Annualized 1/1/18-6/30/20	26.1%	21.5%	8.2%	13.3%
Annualized Inception**-6/30/20	22.5%	17.9%	6.2%	11.7%

** 2018 returns to Limited Partners' if investment had commenced 1/1/2018*
*** Fund inception was 1/22/18*
**** Net performance after 0.75% annualized management fees and accrued incentive allocation*
† S&P500 Total Return includes dividends

<u>Note</u>: Individual returns may vary based on when you joined the partnership.

Suffice it to say, it has been a wild year. After a significant mark-to-market loss in the first quarter, the Fund’s second quarter performance rebounded strongly, driven by the overall market rebound and continued outperformance of our largest portfolio holding. I could not have predicted the growth of our Fund’s value in the second quarter, a period in which many of the names in the portfolio appreciated by over 35% and, in the case of our largest investment, over 200%. Overall Fund value more than doubled from March 31st to June 30th, compared to the S&P 500’s advance of 20%. While the magnitude of this performance was extraordinary, the prior quarter’s market meltdown was among the worst in history – from peak to trough, the S&P 500's 34% price reduction in a mere 22 trading days was the steepest decline ever[1] *including* the Great Depression.

Near the lows, many publicly-listed companies became especially cheap, which led to a robust rebound as consumption patterns stabilized and recovered. Importantly, the first half performance of the Fund and broader market volatility reiterate the age-old observation that anything can happen in markets driven by fear and greed, and that it *rarely ever* pays to sell when everyone else is dumping stocks. As an example, in response to the rapidly evolving market situation in March and April, I made several, small changes in the portfolio to free up liquidity and prepare for even worse outcomes. In retrospect, some of these decisions were good, but most were bad. I console myself with Mark Twain's quote:

"Good decisions come from experience. Experience comes from making bad decisions."

<u>The Coronavirus and Society</u>

> *"The greatest threat we face now is not the virus itself. Rather, it's the lack of leadership and solidarity at the global and national levels… We cannot defeat this pandemic as a divided world. The COVID-19 pandemic is a test of global solidarity and global leadership. The virus thrives on division but is thwarted when we unite. How is it difficult for humans to unite to fight a common enemy that's killing people indiscriminately?"*
>
> – Tedros Ghebreyesus, Director-General, World Health Organization (7/9/20)

> *"My idea of heaven, I know it's politically incorrect, is the coronavirus. It's flooding me with interesting, contradictory, questionable data. Some of it is high grade, some is low grade and some is peer reviewed. Some is rumor and it involves every aspect of humanity and politics and yet in a kind of grim sort of way, there is a scorecard on each country's response."*
>
> – Jeremy Grantham, GMO LLC[2]

There are no easy answers.

The coronavirus pandemic appears to be a 1-in-100-year type of event that is unique among catastrophes in its global scope, rapid transmission, stealthy contagion, lack of available cure, and life-threatening nature. To put it simply, we've never seen anything like this before, making it impossible to accurately estimate a range of outcomes. Compounding this difficulty is the fact that its spread depends on the behavior of individuals, since person-to-person proximity (particularly among those not wearing masks) is the primary transmission mechanism.

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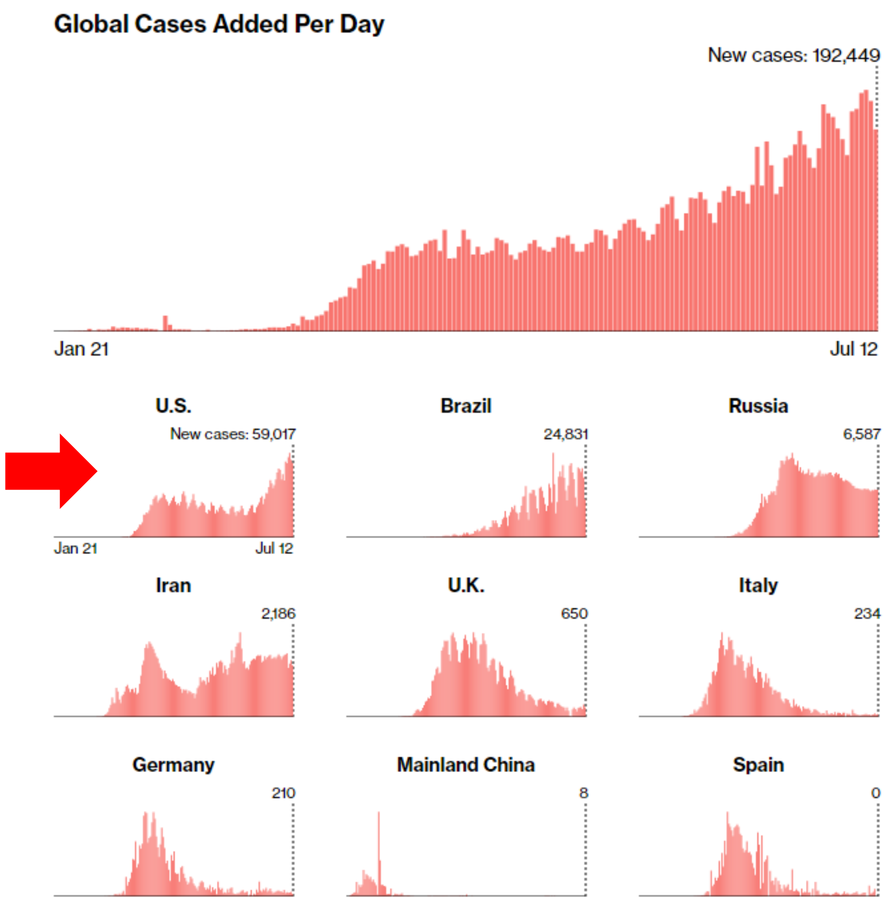
[1] https://www.cnbc.com/2020/03/23/this-was-the-fastest-30percent-stock-market-decline-ever.html
[2] http://investorfieldguide.com/jeremy-grantham-an-uncertain-crisis-invest-like-the-best-ep-177/

In commenting on the coronavirus pandemic, I realize I may be treading off of the beaten path, both in terms of my typical subject matter and my area of expertise (the last class I took in biology was my sophomore year…*in high school*). I hope you'll indulge me in reading further, as I think these topics are important to understanding our current environment as citizens and investors.

Imagine that pre-coronavirus, you could play God (or your preferred omnipotent deity(-ies)) and had the desire to invent some misfortune that would subject humankind's sense of superiority and advancement to the mother of all tests. A test that would thoroughly challenge the idea of what it means to be part of civilized society. Furthermore, this test would be global and affect every human being regardless of race, gender, socioeconomic status, ideology, and religion. Could you have designed a better experiment than the coronavirus?

Viewed from a distance, the reaction of both nations and individuals has been a fascinating study in human nature and governance in the midst of extreme uncertainty and peril. And, as Grantham mentions above, we're getting preliminary report cards on a country-by-country basis.



Source: Bloomberg News, (July 12, 2020)

It is interesting to observe differences in outcomes thus far in the U.S. compared to other countries and theorize on the drivers of these disparities. There is so much about this pandemic that even experts don't understand, and yet some countries have taken measures that seem to have reduced spread of the disease and curtailed sharply escalating mortality curves. The United States stands alone among large, developed economies in managing to re-accelerate the spread of coronavirus, a phenomenon that merits examination of what has gone wrong for us.

Dr. Anthony Fauci, the director of the U.S. National Institute of Allergy and Infectious Diseases, captures the essence of what makes it so difficult for our country to contain the spread of coronavirus in the following NPR interview[3] on July 2, 2020:

> Marco Werman: *How do you understand why Americans are seemingly such outliers when it comes to smart behavior around the pandemic?*
>
> Dr. Fauci: *I know I can't explain it. We are a complex country, we have a lot of different opinions about things. What I think we need to try and make more clear is that we are all in this together and even though we are a heterogeneous country, we should not forget that we are interconnected. If you look at it, a person getting infected, feeling that it doesn't matter if they wear a mask because to them it's not a big deal to get infected, [is] really part of the process of the dynamics of the outbreak, and they can't think of themselves in a vacuum, and when you get infected even though it doesn't bother you, you may be helping to propagate a process that's going to have serious consequences for others, so it really becomes a societal responsibility more than worrying just about yourself.*

Since its founding in 1776, the United States has always been a country that prioritized "life, liberty and the pursuit of happiness[4]" as fundamental, "unalienable rights" of its citizens. Taken to extremes, however, lazy interpretations of these founding principles could lead to outcomes that stray from the founders' intentions and unravel our vision of a functioning, sustainable democracy. One could argue that spiraling levels of inequality (of opportunity, education, health, and compensation) have contributed to lower levels of the mutual trust and "togetherness" required to underpin a cohesive, well-functioning society. Prior to the coronavirus, even in the midst of an ostensibly strong economy, inequality was palpable all around us. We increasingly live in our own bubbles now, limiting contact with others who have backgrounds different than our own. If you tell me the five retailers at which you spend most of your money, I'll be able to hone in on your socioeconomic situation with passable accuracy. Social media and the

[3] https://www.npr.org/podcasts/381444246/pri-s-the-world
[4] https://en.wikipedia.org/wiki/Life,_Liberty_and_the_pursuit_of_Happiness

polarization of news further allow us to atomize our relationships and provide cover for the flawed notion that we can choose our own facts and construct our own reality. It doesn't take an advanced social science degree to see that our country has become vastly more stratified over time.

Back to the coronavirus "test" that the world is enduring at the moment. The U.S. may (in aggregate) be the richest, most prosperous country the world has ever seen, but the pandemic is exposing our system for what it has become – increasingly, a feast-or-famine economy where opportunities and outcomes in life depend heavily on circumstances at birth. For certain minority groups, this is not a recent phenomenon. Coronavirus not only exposes these faults but also demonstrates how rampant inequality impedes the coordination needed to beat the disease.

Let's not forget that, like any system of self-governance, American democracy is an experiment based on ideals. During its 244-year lifespan, it has produced amazing wealth and quality of life for many of its citizens, including those of us lucky enough to have been born here and those who gained entry through immigration. But even the most dominant empires have finite shelf lives. For instance, the average Chinese dynasty ruled for slightly less than 300 years[5], and the western Roman Empire lived to roughly 500[6].

Thinking about these issues in time frames beyond the short term leads one to the conclusion that if we don't fix our problems, bigger crises lie ahead. Even affluent households who think of themselves as disconnected from what's going on don't have the luxury of ignoring what's right in front of them, since letting national problems metastasize will have negative socioeconomic implications for all Americans, *within our expected lifetimes*. Whether our version of democracy survives another 50 or 250+ years depends on how we treat each other and our collective ability to think beyond immediate gratification. Only then will we transcend the prevailing mentality of zero-sum scarcity.

Investing in the Middle of a Pandemic

Coronavirus has radically changed daily consumption patterns for most of the world, especially the U.S. Every aspect of life ranging from which items are consumed to the manner in which they are purchased has experienced a sudden shift, creating winners and losers. For the most part, it would have been difficult to make a pre-pandemic call on which businesses would be strengthened due to this crisis, and which would be left scrambling for survival. For example, the following themes were deemed "investable" for most of the last decade:

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[5] https://www.quora.com/Why-were-Chinese-dynasties-relatively-short-in-time-scale-among-the-dynasties-of-the-world#:~:text=Each%20dynasty%20built%20upon%20the,the%20empires%20on%20that%20list.
[6] https://www.britannica.com/place/Roman-Empire

- Re-urbanization and development of dense, mixed-use communities
- Secular growth of air travel and hotels due to growing global middle class and rise of ultra low-cost airlines
- Proliferation of chain restaurants and coffee establishments driven by continued rise of busy professionals and increasing share of food purchased/consumed away from home
- "Experiential retail" driven by conversion from merchandise stores to gyms, restaurants, amusement parks, and movie theaters
- Sports and entertainment-related business including franchises, gaming, and media
- Shale-based oil and gas plays
- Cruise ships
- Commercial real estate including office and hospitality

One could be forgiven for not seeing how coronavirus would wreck prior investment theses. After all, prior to the virus there was virtually no market[7] for pandemic insurance. And over time, many of the themes above could still prove to be correct. But as of today, we just don't know.

In the winners column, we have the usual suspects in high-growth technology names, joined by a few surprises (who among us knew that backyard pools and motorhomes would be such hot commodities?). Among the technology names, could coronavirus tip unprofitable, cash-consuming business models into sustained profitability? When this pandemic is over, will we still be traveling in RVs, making dinner at home, buying predominantly through eCommerce, and investing the same amounts in home furnishings?

It's hard enough to pick winners and losers in the absence of a global pandemic. When we're in the middle of one, there is the added complexity of predicting which trends will persist into the future. Warren Buffett has taken a lot of flak for apparently missing the bottom by not deploying material amounts of Berkshire Hathaway's cash in the March/April timeframe. But who really knows how long the pandemic will last and whether we will retest late-March lows? Again, there are no easy answers.

Certainly, the longer the coronavirus pandemic persists, the more likely it is that shifts in habit become permanent. Many of the "stay-at-home" stocks have experienced hyperbolic valuation growth, betting on the staying power of consumption shifts. In this environment, most assets that obviously benefit from the pandemic have been driven to nosebleed levels, creating unattractive risk/return profiles. On the other hand, the Federal Reserve's massive monetary stimulus (also unprecedented) means that at current yields, there is scant return available in bonds of almost any kind.

[7] https://www.wired.com/story/nathan-wolfe-global-economic-fallout-pandemic-insurance/

In this environment of heightened uncertainty (and high valuations for clear winners), there is no compulsion for our Fund to do anything. We can sit and wait until more favorable opportunities appear. The best long-term "hedge" to market volatility is to own well-run companies with in-demand products and services that have attractive underlying profit potential at reasonable-to-cheap valuations. Moreover, volatility gives us chances to invest more in these assets at attractive prices. It is that simple. Our Fund's performance in Q2 sharply rebounded because of the portfolio's concentration in several high-quality, growing businesses whose valuation had been beaten to a pulp. Instead of churning the portfolio and chasing popular technology names in response to the market's decline, staying the course (and in several cases, adding to our stakes) allowed the Fund to bounce back strongly from mark-to-market losses in the first quarter.

The following approach seems like an especially hyperactive way of seeking returns in the current environment:

> *"Hysterical markets are posing particular challenges for systematic strategies. Ones that target volatility have struggled to cut positioning fast enough during drawdowns and then catch up with the rally. Trend followers with a medium-term view may also find fewer winning trades in cross-asset trading that zigzags rapidly. At Mellon Investment, Roberto Croce says it's never been more important to adjust positions based on fast-moving measures of risk -- like three-day realized variance, a measure of stock deviations relative to the mean -- even if it means selling into a down market."*
>
> – "Wall Street Fears Market Fragility in $23 Trillion Stock Frenzy", Bloomberg News, July 8, 2020

When market participants think their objective is to chase returns *all the time* over *any infinitesimal period*, "strategies" develop incorporating esoteric terms of art. Just reading about these approaches makes my head hurt, and it's questionable whether the vast majority of them achieve sustained success or are worth the fees and effort.

In Closing

As I mentioned in my late-March note to partners, the Fund is largely staying the course and maintaining liquidity to react to whatever opportunities the market throws our way. To reiterate, I do not hedge the portfolio, nor does the Fund ever borrow on margin to make investments. At the midway point in any "ordinary" year, I have no idea what the back half will bring for Fund performance. In the grips of an unprecedented pandemic, making predictions seems especially pointless. I am confident, however, that the companies in our portfolio are well-positioned to make it through this crisis and that over the long term, our partnership will generate attractive returns.

I leave you with the following wisdom from one of my favorite writers, Jason Zweig, in a recent "Intelligent Investor" newsletter:

"To be an intelligent investor is to recognize that you're in a lifelong struggle for self-control – an unending effort to keep yourself from yielding to fear or greed, believing that you know what the future holds or letting short-term news knock your long-term plans off track.

One of the most common mistakes I've seen investors make is to treat investing like a sporting event in which, after every big play, the markets say to them, "Your move." But investing isn't a game, and you almost never have to move. It's a long, repetitive process. As the investment consultant Charley Ellis told me many years ago[8]*:*

> *Go to a continuous-process factory sometime – a chemical plant, a cookie manufacturer, a place that makes toothpaste. Everything is perfectly repetitive, automated, exactly in place. If you find anything interesting, you've found something wrong. Investing is a continuous process too; it isn't supposed to be interesting. It's a responsibility. If you go to the stock market because you want excitement, then sooner or later you will lose."*

I'll have more thoughts about our Fund and long-term ambitions in the year end letter. For now, I'll just say thank you for being a partner, stay safe, and take care of your loved ones.

Back to the toothpaste factory,

Drew Peng

Attached: PLP Top 5 Portfolio Positions as of June 30, 2020

[8] https://jasonzweig.com/wall-streets-wisest-man/

<u>Exhibit A</u>: Pinchot Lane Partners - Top 5 Portfolio Positions as of June 30, 2020

Name	Symbol	Description	Investment Thesis	% of Portfolio Value	Date of initial investment
Purple Innovation	PRPL	A leading consumer comfort brand with substantially differentiated product technology (hyper-elastic polymer grid); Purple is a vertically-integrated designer and manufacturer of mattresses, bedding accessories, seat cushions, and pet beds	Rapidly growing direct-to-consumer mattress industry (which now represents over 10% of the $17b domestic market); Purple wholesale channel sales show explosive growth and brand has built a large consumer following; patented technology differentiates company from proliferation of foam-based competition; valuation substantially below private market comps; new CEO successfully executing operational turnaround	49.2%	Apr-2018
SS&C	SSNC	One of the largest providers of financial software and fund services for the asset management industry	Rollup acquisition strategy led by founder/CEO. Company has grown revenue by 6x over the last 5 years and compounded earnings per share by >25% compounded annual growth rate over same period. Proven acquisition playbook with modest organic growth and continued opportunity to take market share	8.5%	Feb-2016
XPO Logistics	XPO	Provider of transportation and logistics in N. America and Europe; company was formed through a rollup of 17 different acquisitions led by an experienced entrepreneur who used a similar strategy to build and successfully exit two multi-billion companies (United Waste and United Rentals)	Transportation and logistics is a large, fragmented industry and XPO has few comparables who have adopted its integrated approach to delivering customer solutions; XPO's technology-led approach seems poorly understood despite a strong track record of gaining market share and substantially improving margins since completing its last acquisition in 2015	7.5%	Feb-2019
Viasat	VSAT	Provider of satellite equipment and communication services for government/defense sector, consumer broadband, rural community wifi, and commercial aviation	Lowest cost satcom provider on critical cost per bit capacity metric; technology is years ahead of primary competitors; potential to become first truly global internet service provider post-launch of next-generation, advanced Viasat-3 satellite constellation (currently under construction); has taken significant market share of commercial airline connectivity	4.2%	Jun-2012
Middleby	MIDD	A leading provider of commercial, residential, and industrial foodservice equipment with a global footprint across multiple well-recognized brands	Company has largely been built through acquisition strategy, rolling up leading brands with distinctive technologies across major equipment sub-segments, improving operations, rationalizing costs, and recently adopting a unified go-to-market approach; clear track record of creating value and growing share in a relatively fragmented global market	4.0%	Jan-2018
			Total Top 5	**73.4%**	