PINCHOT LANE PARTNERS, L.P.
101 Inara Court
Carrboro, NC 27510

July 30, 2022

To My Partners:

1H 2022 Performance Summary

From January 1 to June 30th, 2022, Pinchot Lane Partners LP ("PLP", the "Fund", the "partnership") returned -31%, net of management fees. No incentive fees were paid, as the Fund's performance did not exceed the annual hurdle rate required to earn them. Below is a summary of Fund performance for 1H 2022 and since inception:

		(A)	(B)	= (A)-(B)
	PLP Gross Perf	PLP Net Perf**	S&P 500 Total Return†	*Relative Performance*
1/22/18* to 12/31/18	(9.6%)	(10.3%)	(9.1%)	*(1.3%)*
1/1/19 to 12/31/19	31.1%	28.9%	31.5%	*(2.6%)*
1/1/20 to 12/31/20	128.3%	97.2%	18.4%	*78.8%*
1/1/21 to 12/31/21	(25.6%)	(26.1%)	28.7%	*(54.8%)*
1/1/22 to 6/30/22	**(30.6%)**	**(30.8%)**	**(20.0%)**	***(10.8%)***
Annualized 1/22/18*-6/30/22	**7.8%**	**3.5%**	**8.9%**	***(5.4%)***

** Fund inception*
*** Net performance after 0.50% annualized mgmt fee (0.75% prior to 2021) and incentive allocation*
Management fee waived following 1Q 2022
† S&P500 total return includes dividends
Note: Individual LP returns may vary based on the timing of your subscription(s).

An Unkind and Ugly Market

The first half of 2022 was a tumultuous period in the markets and unkind to our investment portfolio. In past letters, I've typically included some brief commentary on the current investing environment. I won't endeavor to do that here and will avoid doing so in the future, as near-term events rarely drive my decisions on where to invest. My ability to "read the tea leaves" and divine tomorrow's (or next week's, or next month's) price action is no better than anyone else's, so it would be wildly irresponsible of me to make buying and selling decisions in our portfolio based on what I think will happen in the short term. Pinchot Lane Partners runs a long, concentrated strategy and has never made use of derivatives (puts/calls) to hedge the portfolio against volatile markets. As a result, broad market downturns impact our portfolio's market value. No matter how much the financial news floods us with sensational articles, it is imperative not to get caught up in short-term movements during these volatile times.

I'm focused on the long-term growth and compounding of our portfolio, even if market headwinds continue to drive mark-to-market losses in the coming months. When we invest in shares of a portfolio company, we agree to swap cash for ownership units of that company. From there, successful companies grow their value per share over time in excess of alternatives (cash, shares in other companies, or investments in broad equity indexes). Whenever share prices decline relative to the cash exchanged to own shares (i.e., a paper losses), investors are made to look like fools for having agreed to the exchange in the first place - which was the case during the first half of this year. It's worth remembering that market cycles come and go and unlike the last several years, markets are capable of declining (at times, precipitously). Each market cycle offers "teachable moments," and the current bear market is no different. The first half of 2022 was a good reminder that stratospheric valuations (especially in the tech sector) cannot forever outrun business fundamentals.

The challenge of trying to be a long-term investor in this environment is that "buying and holding" can look stupid if growth drivers of our investments aren't working *in the moment*. In volatile markets, the financial press and social media fixate on sound bites from whoever has made the winning trades in a given week. Never mind, if in the next week their calls are no longer winning – the punditry then moves on to the next set of weekly winners. During volatile times, it is human nature to pull one's focus into the very short term and look to see what others are doing, as scarcity mindset takes over and the same herding mentality that drove prices up works in reverse. Positioning oneself for whatever happens to be working in the moment requires a twitchy, trading-oriented approach to investments that very few have mastered. The label for this behavior: speculation. I won't win this "weekly winning trades" game, and most people who endeavor to do it won't be consistently successful, either. Not only is this approach awfully difficult even for those with vast resources, it's terrible for one's sanity. To be clear, my distaste for market timing does not imply that I endorse an approach that is ignorant of economic cycles and/or valuation. The key difference is a willingness to underwrite probable business outcomes that take years to unfold as opposed to months.

Confusing Times

To everyone who finds the current investment climate hard, difficult, and somewhat confusing, I would say, "welcome to adult life."
– Charlie Munger (2022 address to Daily Journal investors)

After arriving in the U.S. over two years ago, COVID continues to unleash uncertainty in our economy. We may be less fearful about the direct health effects of the disease today, but we remain mired in the consequences of the massive economic policy response and consumer spending shifts. Hindsight is 20/20, as it has become clear that showering the public with stimulus money combined with broken global supply chains have led to some unpleasant repercussions – specifically, rampant inflation.

When it comes to understanding the inflation predicament, numerous debates revolve around ascertaining whether we have problems with demand or supply. The rationale for these debates is as follows: if we're able to determine which side is responsible for hyperinflation, policy can be better targeted. For instance, if excessive demand is outstripping productive capacity, the Fed can raise interest rates expeditiously to choke off demand (by making the opportunity cost of spending so high that consumers and businesses are better off saving their money instead of buying things). If constrained supply is the issue, the Fed may be less aggressive with rate increases, hoping that investments in supply will enable it to catch up to demand.

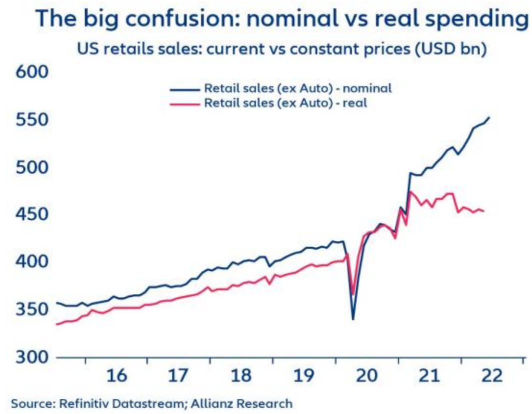
The most rational explanation is that we have issues of *both* undersupply and overdemand. During the pandemic, average consumption of goods trended far above normal due to people being sequestered in homes and having excess cash to spend. Emerging from COVID's lockdown phase, households pivoted their spending to services, including restaurants, experiences, and travel. On the supply side, large, complex economic systems like ours resemble heavy machines comprising thousands of subsystems and millions of parts. They don't work well when halted and likewise, don't spring back quickly following a prolonged shutdown. Take the airline industry, for example. During the depths of COVID, more than half of global airline pilots were grounded (according to one study). As travel demand roars back (with leisure passenger air traffic in the U.S. now exceeding pre-pandemic levels), there simply aren't enough personnel to meet demand levels, forcing airlines to cut back route schedules and causing massive cancellations. Could these extreme demand and supply imbalances have been anticipated in advance? Probably, but accurate predictions would still not have averted shortages. An economy as large as ours possesses substantial inertia, so getting back to full capacity is a gradual process.

Ultimately, the great inflationary debates taking place today are important, but overlook the economy's ability to restore balance through market forces. As time passes, inflation forces consumers to rein in demand. High prices also stimulate investments in the people, machines, software, and equipment needed to expand supply. It takes time for these balancing mechanisms to work, with the greatest discomfort experienced before the wheels are actually in motion (i.e., the moment we're in now). Of course, policy mistakes (e.g., not raising rates enough, or raising them too aggressively) can hamper a return to balanced supply and demand. The Federal Reserve's job is not an easy one, but an abundance of data and historical precedent help inform their decisions.

Give It Time

What do we do? Give it time - give the Fed and the economic machine time to work to bring supply and demand closer together, which will bring inflation down. Invest in the companies that benefit most from increasing supply and are candidates for sustained levels of demand. Trust that "high prices cure high prices," and that no demand curve is so inelastic that buyers are willing to pay *any* price if their wages aren't keeping pace. We're already seeing demand curtailed in industries that have driven the most inflation (food, gas, materials, travel, and housing) which should lead to attenuated price growth going forward.

Why am I confident that inflation will not spiral out of control for the better part of a decade, like the 1970s? One reason is that the 1970s' economic conditions and policy are quite well-documented, so the Fed knows what it needs to do to avoid a similar fate. Second, the average consumer has more choices of what and how to consume, turning to alternatives when budgets are squeezed. Third, new business models emerge that are capable of delivering goods and services at cheaper prices. For example, Costco, a temple to disinflation, was founded in the middle of the 1970s.



Robust nominal spending trends mask underlying flat-to-declining real demand.

The key is to give it time – time for higher rates to work through the economy, time for supply chains to rebuild and catch-up, and time for consumers to make adjustments to their spending patterns. Economy-watchers and patient investors would do well to heed the wise proverb, "*The only way out is through.*"

<u>What We Know</u>

Your success in 2022 is going to be defined by what you choose to ignore.
– Dr. Kevin Elko (podcast)

In times of market paranoia and confusion, it's easy to lose the "forest" (overall trajectory of economic development) for the "trees" (daily noise around short-term data). Long-term investors' attention is better spent focusing on the forest that we know. Below is a partial list of what I know to be true:

- The average American household is more gainfully employed now than at any time in recent history (lowest unemployment rate in 50 years).
- Banks do not suffer from systemic credit problems and solvency issues, as they did in 2007-09.
- Housing demand (and related goods and services) will remain robust over the next decade, driven by generational demographics and an aging stock of existing homes. Nevertheless, homebuilders don't build for charity, and mortgage rate shock will reduce new homebuilding activity in the near-term until affordability is restored.
- The U.S. is largely energy self-sufficient, the strategic importance of which cannot be overstated. Our domestic capabilities of harvesting both fossil and renewably-sourced energy represent massive advantages vs. the 1970s.
- Barring significant increases in immigration and fertility rates, U.S. population growth will continue to be low, putting the burden on productivity growth to drive real economic gains; thus, demand for technology will continue unabated.

- Despite widening levels of inequality, the U.S. maintains a vibrant, healthy economy full of diversity and innovation.
- Recent supply shortages emphasize the need to build up productive/buffer capacity throughout the economy. A16Z's (a venture capital firm) essay from April 2020 (*"Time to Build"*) is as relevant as ever.
- Business fundamentals still matter (durable and resilient demand, pricing power, sound balance sheets, profits and cash flow).
- Investors are extremely scared right now, which typically sets up favorable conditions for gains 18-24 months down the road.
- All in all, the medium to long-term outlook for our investments is positive, and gets more attractive as prices go lower.

Conclusion: Time travel & "Keeping It Going"

If you feel lost in the dark in the current investing environment, I suggest a time travel exercise. Visualize 18 to 24 months into the future, after inflation subsides and the economy returns to its normal growth trend. Under these assumptions, equity valuations do not appear expensive at current levels. Instead of attempting to dart in and out of investments to make nickels and dimes in today's volatile environment, we ought to focus on buying and holding the best quality companies, the ones with durable and resilient advantages that can compound gains for decades to come.

> *Compounding is just returns to the power of time. Time is the exponent that does the heavy lifting, and the common denominator of almost all big fortunes isn't returns; it's endurance and longevity. "Excellent returns for a few years" is not nearly as powerful as "pretty good returns for a long time." And few things can beat, "average returns sustained for a very long time."*
>
> *That's the biggest but most obvious secret in investing: Average returns for an above-average period of time leads to magic.*
>
> – Morgan Housel, *"Keep It Going"*

Portfolio Changes

(Partners should read this section in conjunction with the attached portfolio disclosure)

While I am focused on long-term performance, I own the poor performance our investments have registered over the past year. I'm optimistic about our portfolio beyond the current bear market cycle but also pragmatic about near-term risks.

In the first half of the year, I exited several cyclically-sensitive investments and trimmed some of our larger positions to increase liquidity in advance of a broader downturn. As mentioned in the Note to Partners dated April 22nd, I fully exited our investments in Chinese ADRs for reasons unrelated to company fundamentals. Based on the portfolio allocation framework I shared with partners in May, I am making a concerted effort to evolve the majority of our portfolio toward high quality "stalwart" companies that have the potential to compound capital more consistently over time. This is not to say that I won't still pursue absolute return plays and "special situation" arbitrage opportunities, only that these types of investments will be capped to less than a third of the portfolio going forward. Investing in “stalwarts” may have less annual return potential, but compensate by providing longer periods of gains, less volatility, and superior tax efficiency. Overall, my goals are to trade less, improve underlying asset quality, and lengthen the duration of our returns.

As always, my line is open should you have questions, comments, and/or invectives.

Sincerely,

Drew Peng