# Tailoring Your Pathfinder Portfolio

## Putting it All Together

Last week and in the coming weeks, the investment team will be presenting our Pathfinder mandate reports in lieu of our usual Pathfinder Investment Outlook (PIO). Each one of these reports provides insight into the state of the fund or portfolio, a look back at 2024, and thoughts around the year to come.

The purpose of today's write-up is to explain how the recent reports and associated mandates are directly linked to your personal Pathfinder portfolio. In this report, we are shifting focus to your financial plan and how your portfolio is tailored to achieve your financial goals and objectives. The process of setting up a Pathfinder portfolio is thorough. We will breakdown the process of determining an appropriate asset mix, shed light on our portfolio construction approach, and dive into the steps of portfolio optimization.

## Where We Start – Discovery

To begin, we look to determine a client's financial goals and purpose of investing with Pathfinder. Generally, the purpose of investing is to commit money to earn a financial return and increase one's wealth. But typically a client will come to the relationship with goals such as building wealth for retirement, saving for children's education, and/or leaving an estate to loved ones, among many other potential objectives.

To understand our clients, we start the relationship with the discovery process. There are quantitative and qualitative questions asked during our initial discussions that uncover crucial information about our clients and their financial situations. This is also when we assess a client's risk profile. It is important for us to clearly understand a client's goals, what matters most to them, and any potential areas of concern. The goal of discovery is to begin establishing a relationship built on trust and to gain an understanding of who our clients are and what motivates them.

**Investment Horizon**

The timeline of financial goals is paramount in determining the strategy for the investment accounts. There are often some accounts within a portfolio that will have different goals and different time horizons. For example, a RRSP account is intended to help fund retirement, and a RESP account to help with a child's post-secondary education. The time horizon and risk of investment are related. The longer the investment horizon, the greater the risk that can be taken as there is more time to recover. Short-term financial goals are best achieved with more conservative strategies.

Once the goals and purpose of the portfolio are established, we then look at a client's risk profile. A risk profile is a combination of risk tolerance and risk capacity. There is also the risk of not taking enough risk, associated with risk requirements. Each is an important concept, warranting a closer look.

**Risk Tolerance**

All investments come with risks. Generally, the higher the potential return an investment offers, the higher the risk. But there are no guarantees higher risk investments will pay off with higher growth. Risk tolerance is related to the emotions involved with investing, essentially one's willingness to tolerate risk. Portfolio fluctuation and volatility can often invoke an emotional reaction. This is often referred to as the "sleep factor". The "sleep factor" boils down to the idea that if you are losing sleep over your portfolio, then a conservative adjustment may be needed. An investor needs to be comfortable with the risk level of their investments.

**Risk Capacity**

Risk Capacity is one's ability to accept risk or how much risk can be handled. Risk capacity is based on your wealth and your human capital (which is one's ability to earn income from future endeavors). Typically, a wealthier household can afford to take greater investment risk because a potential financial loss won't burden them as much as someone less wealthy. We always look at risk capacity on a holistic basis, ensuring we incorporate all assets and liabilities held by a client.

**Risk Requirement**

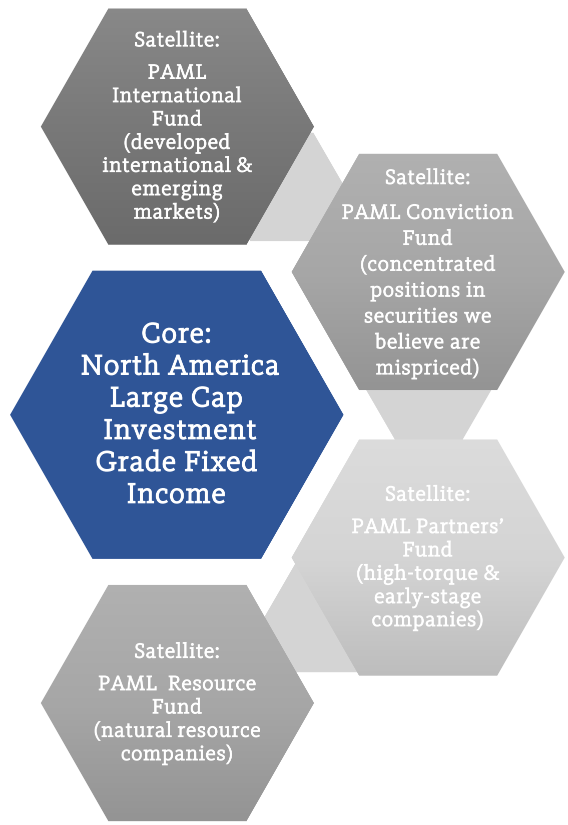
To achieve a specific goal, such as a desired retirement lifestyle, a minimum rate of return can be calculated. For example, consider an investor who needs to accumulate $750,000 by retirement in 10 years. This investor is only relying on growth within their portfolio. With $300,000 in the portfolio today and 10 years to grow it, the investor would need an average annualized rate of return of 9.6% to achieve the $750,000 goal. This 9.6% may require a riskier approach than what was determined by their risk tolerance and capacity. It is important to have clear expectations and disclosures of specific requirements. All three components of one's risk profile are interconnected and related. Risk profiles are dynamic, changing with the client over time.

Once a clear set of financial goals are in place and a risk profile is established, then we determine the appropriate asset mix. This is tailored to each client's holistic financial position. The asset classes we select have different levels of associated risk and expected returns. Assigning specified exposure to different types of assets allows us to uniquely structure the path of returns to best meet financial goals. This is achieved by investing in different portfolio strategies.

## Life is about Balance – Portfolio Construction

Balance underscores the importance of avoiding uncompensated portfolio risks through diversification. Our portfolio construction framework fulfills the principle of diversification allowing us to position each client's portfolio to preserve purchasing power as well as accumulate wealth. We evaluate clients' assets from a unified household perspective to construct a portfolio without overlapping any investment strategies.

To diversify sources of return, we take a risk budgeting approach, allowing us to allocate clients' given level of risk across various asset classes. The amount of risk that can be saved in the conservative portion of the portfolio can then be budgeted for and used in more aggressive asset classes with higher expected returns. Thus, providing our clients with an actively managed Core and Satellite portfolio. We also have numerous clients who employ the Pathfinder Funds as the managed performance segment of their Household portfolio.




We listen to our clients to understand their investment needs and risk budget whilst considering any investment constraints such as liquidity needs or domestic allocation biases. Once the investment objectives are defined, we apply our capital market model to generate forward-looking risk and return assumptions for each asset class. Our model considers various situations from positive surprises to black swan events. In this way, clients' portfolios can be constructed to capture the upside potential and mitigate downside risk. The next stage of the asset allocation process is the application of efficient frontier analysis to identify the level of portfolio diversification that is suitable for the desired risk appetite and target return.

An example of a strategic asset allocation that aims to optimize target return within a moderately defined risk budget.

| Asset Allocation | Moderate | Pathfinder Investment Mandate | Target Return |
|---|---|---|---|
| Core: Stocks<br>Bonds<br>Cash | 75% | Actively managed long-only segregated portfolio of high-quality, cash flow focused large capitalization companies based in Canada and the US.<br><br>The portfolio is also employed as a swing mandate in combination with fixed income and cash for a balanced approach.<br><br>The Core mandate is highly customizable often used to manage cash flow objectives and after-tax returns. | 3% - 9% |
| Risk Capital | 25% | Pathfinder's performance-driven Funds | 10% - 15% |

The strategic allocation can have a significant impact on a client's investment success. Studies have shown that 93% of portfolio performance is dependent on the asset allocation of the portfolio; the remaining 7% was due to security selection, and investment timing (Brinson, Hood, & Beebower, 1986). In the developed markets of Canada, Australia, and the United Kingdom, between 80% and 90% of returns have been attributed to asset allocation (Wallick, Shanahan, Tasopoulos, & Yoon, 2012).

We also employ a tactical asset allocation strategy to add value to our clients by temporarily departing from the portfolio's long-term asset mix. Tactical asset allocation may take the form of tilting by asset category (core vs. satellite) or within an asset class. We mainly employ this active management strategy within the risk capital component of a client's portfolio. A tactical tilt operates independently from the client's risk profile as it assumes a constant risk profile.

Another component of our portfolio construction process is asset location or the division of assets among taxable, tax-deferred, and tax-exempt accounts. This allows us to maximize return and minimize taxes by sorting investments for the best potential tax treatment, or tax efficiency.

Our final step in constructing a client's portfolio is laying out an implementation timeline, minimizing asset turnover, and determining the operational framework including rebalancing and monitoring mechanisms.

# Taxes… Part of Life and Investing

**Just don't pay more than you have to.**

We call this the tax optimization of your accounts. Once we come up with an asset mix that we feel will meet your financial goals, we look at all the various account types we have at our disposal to ensure we grow the account in the most tax-efficient way possible.

Clients come to us with various portfolio structures. For this report, we will use an example of an individual who is 50 years old and has a $500,000 investment portfolio. The portfolio is made up of a non-registered investment account, an RRSP, a LIRA from a previous employer, and a TFSA. We have determined that the client needs a balanced portfolio and has a medium risk tolerance. Detailed below is which Pathfinder mandate we will put in each account and why.

**Non-Registered Account - $125,000**

- **Pathfinder Core North American – 100%**
    - Dividends and capital gains are taxed favorably. This portfolio is made up of individual equities and the growth is going to come from dividends and capital gains. Therefore, we want to own this portfolio in any non-registered account.

**RRSP - $250,000**

- **Pathfinder Fixed Income – 50% ($125,000)**
    - Interest is taxed at your highest marginal rate and added to your overall income. Therefore, you want to shelter any fixed income investments inside your registered accounts to avoid paying tax at your highest rate.
- **Pathfinder Core North American – 50% ($125,000)**
    - We will own the Core North American portfolio in the RRSP in addition to the fixed income, aiming to achieve long-term growth.

**LIRA - $30,000**

- **Pathfinder Funds – 100%**
    - Given the LIRA is a small account, we will invest in the Pathfinder Funds, rather than directly into individual securities.
    - The client can't touch this account until they are 55 years old, so it makes more sense to invest it for long term growth.

**TFSA - $95,000**

- **Pathfinder Funds – 100%**
    - Because the TFSA is a smaller part of your overall net worth and the growth is tax free, the TFSA should be invested as aggressively as possible to earn the highest potential rate of return, Tax Free.

When we look at the overall asset mix of the portfolio, it looks like this:

- 50% Blue Chip Equity (Pathfinder Core North American) - long term return target – 6-9%
- 25% Fixed Income (Pathfinder Fixed Income) - long term return target – 3-5%
- 25% Aggressive Equity (Pathfinder Funds) - long term return target – 10-15%

If you had this portfolio with us at the start of 2024, this is what it would look like today:

**Non-Registered Account - $148,125**

- **Pathfinder Core North American – 100%**
  - The Pathfinder Core North American Equity portfolio returned 18.5% in 2024.
  - $7,000 would be transferred to the TFSA with the new 2025 contribution room.

**RRSP - $277,750**

- **Pathfinder Fixed Income – 50% ($129,625)**
  - The Pathfinder Fixed Income portfolio returned 3.7% in 2024.
- **Pathfinder Core North American – 50% ($148,125)**
  - The Pathfinder Core North American Equity portfolio returned 18.5% in 2024.

**LIRA - $36,015**

- **Pathfinder Funds – 100%**
  - The Pathfinder Partners' Fund returned 20.0% in 2024, the Pathfinder Resource Fund returned 26.9% in 2024, the Pathfinder Conviction Fund returned 13.4% in 2024 and the Pathfinder International Fund returned 19.9% in 2024.
  - With the 4 funds balanced across the account at a 25% weighting, the LIRA would have a 2024 return of 20.05%.

**TFSA - $114,047.5**

- **Pathfinder Funds – 100%**
  - The TFSA would have the same 20.05% return as the LIRA.
  - $7,000 would be transferred from the non-registered account to satisfy the new 2025 contribution room & maximize tax free growth.

**Portfolio Value End of 2024: $575,937.5**

- In 2024 the portfolio would have returned 15.19%.

As the client nears retirement, we will likely adjust the asset mix to accommodate cashflow needs and the desire for lower volatility, by investing less into the Pathfinder Funds and more into Blue Chip Dividend paying equities in the Pathfinder Core North American portfolio and Pathfinder Fixed Income.

Pathfinder's investment process is thorough and disciplined. We believe the same amount of diligence and care that is employed through the investment selection process should be given to your financial plan and your portfolio structure. Financial plans are dynamic. The best plans are consistently reviewed and amended to reflect life changes.

For this reason, we reach out to our clients regularly to review and update any life changes or potential adjustments to investment objectives. We treat this part of our investment process as a living document that is always updated. Many financial planners provide a static plan that does not change until the client reengages with the planner again. A fundamental part of our delivery is the continual update to the financial plan as life evolves. There are many variables that go into this process, and they are always changing: expenses, job situation, debts, health, investment return expectations can all change and materially impact a static document. There are many investment risks that the investment team at Pathfinder is managing everyday. The risk of mismatching portfolio construction against investor expectations is very material. This happens regularly in the investment industry (i.e., an advisor does not understand a client's needs and goals properly, either from poor communication or lack of process). With regular contact, open discourse, and a regularly maintained investment management system, this risk can be minimized.

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Sources: Bloomberg, Pathfinder Asset Management Limited

## Disclosure

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*All returns are time weighted and net of investment management fees. Returns from the Pathfinder Partners' Fund and Pathfinder Conviction Fund are presented based on the masters series of each fund. The Pathfinder North American Equity Portfolio and The Pathfinder North American Income Portfolio are live accounts. These are actual accounts owned by the Pathfinder Chairman (Equity) and client (High Income) which contain no legacy positions, cash flows or other Pathfinder investment mandates or products. Monthly inception dates for each fund and portfolio are as follows: Pathfinder North American Equity Portfolio (January 2011), Pathfinder North American High-Income Portfolio (October 2012) Pathfinder Partners' Fund (April 2011), Pathfinder Conviction Fund (April, 2013), and Pathfinder International Fund (November 2014).

Changes in Leverage. We are increasing the asset ceiling to 2.0 times the market value of equity for Pathfinder International Fund and Pathfinder Conviction Fund to be consistent with Pathfinder Partners' Fund and Pathfinder Resource Fund.

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