Pathfinder Investment Outlook

For the week ending August 5th, 2016

Macro Outlook: Vancouver Housing - Part II

One year ago we addressed a topical domestic issue: Vancouver housing and whether it was a good investment.

At the time we concluded that it seems Vancouver real estate is mispriced versus other assets and is undoubtedly expensive. As a result, it may be reasonable to expect prices to fall. However, there are several realistic scenarios that could cause Vancouver real estate to keep rising despite being expensive:

1) Vancouver continues to be an "off-shore" store of "questionably earned" wealth. A realtor recently told me a story of a new Chinese immigrant who stated he didn't care if Vancouver real estate fell 50% because if it did he would still be up 50%. What he was referring to was losing 50% of his money in a Vancouver home was better than having 100% of it confiscated if he kept it in China. Worldwide, Vancouver continues to be one of the easiest places for global immigrants to access. Will this continue? An asset will keep going up if the buyers continue buying at any price.

2) The Bank of Canada adopts a "save Canadian housing at any cost" policy. It is possible that the Bank of Canada would prevent a housing correction at any cost by devaluing the Canadian dollar (lowering interest rates, Quantitative Easing) at a quicker pace than the fall of housing. This would create a perception that the Canadian housing market was actually stable relative to Canadian dollars falling relative to other things.

What Has Happened to Prices Since

As we stand today and according to Teranet, Vancouver real estate prices have increased 23.4% since the release of our report, outperforming most, if not all, asset classes during that time frame despite our view that Vancouver real estate was undoubtedly expensive versus other asset classes.

Recap and Macro Outlook: Continued

Why Have Prices Continued to Increase?

The question we ask ourselves now is, why have prices continued to increase despite being "expensive"? Generally, we believe there are two factors:

1) To a lesser extent but on a fundamental basis, rents in Vancouver have been increasing over this time period. This justifies a higher intrinsic value for real estate; perhaps Vancouver real estate was not as expensive as we previously concluded.

2) However, we believe the major factor is that Vancouver has continued as an "off-shore" store of "questionably earned" wealth. Bloomberg estimates that US$500 billion of capital has been moved out of China by mostly individuals, with a significant portion of it landing in the Vancouver housing market. You continue to hear of stories like Tianyu Zhou, a "student" at UBC that was able to purchase a $31.1 million mansion in Vancouver's Point Grey neighborhood. Zhou's LinkedIn said she worked at the UBC cafeteria in her first year – a job typically reserved for low income students. She said the money for the house was her father's but when asked what her father does she said she doesn't know. With our lax laws, there continues to be potential international money laundering coming into Canada.

Will the potential Money Laundering Continue?

It is our belief that a society driven by potential foreign money laundering is not a healthy one:

- From a financial standpoint, a partially socialistic society like Canada provides health care and discounted education to its citizens, funded by the taxes it collects from those same citizens. Generally, this can be a healthy society if citizens are contributing equitably. However, on the one hand, the potential foreign money launder does not claim income or income tax in Canada but he/she is free to enjoy complimentary health care and education. On the other hand, the local Vancouverite is left working to fund these social services while now also dealing with escalated shelter costs driven by the people enjoying the social services for free.

Recap and Macro Outlook: Continued

- From a social standpoint, the potential foreign money launder does not want to be involved in the community or sometimes even seen at all (see all the vacant homes in Vancouver). This does not create healthy communities or atmospheres for families.

As we observe the last year, the rise in Vancouver real estate prices has been impressive but the rise in the local rebellion against high real estate prices has been equally impressive. High real estate prices and the factors driving it have become the number one domestic government issue. We believe this is a result of the financial and social factors noted above.

When the population speaks the government is obligated to respond. In this case, the local provincial government responded with a half million dollar StatsCan program that collected data on foreign real estate ownership (perhaps they could have saved taxpayer money and read our last report). As a response to this study, the government has implemented two new measures:

- A well publicized 15% tax on non-resident real estate buyers;

- A less publicized lifestyle audit (an audit on people whose lifestyle don't match their claimed income). http://www.theglobeandmail.com/news/british-columbia/cra-plans-lifestyle-audits-in-vancouver-as-part-of-real-estate-probe/article30945381/

Generally, we believe the 15% tax will not do much to curb potential money laundering. A Vancouver real estate buyer is already overpaying 50% for a Vancouver home; what's another 15%? Remember, a potential money launderer is at risk of losing all his money at home. However, the lifestyle audit may be more significant. It may be enough for the money launderer to cross Vancouver off its list of potential destination. Remember, a foreign money launderer does not want to be in the spotlight or often even seen.

Conclusion

In conclusion, Vancouver housing seems undoubtedly expensive, money laundering could continue to cause the price of a Vancouver home to rise, but steps are being implemented to address that factor. We believe Vancouver housing has become a speculation on the continuation of loose immigration laws and continued money laundering. Speculating on uncertain events is not a healthy ingredient for consistent long-term investment results. We believe the most consistent investment results are driven by analyzing whether an asset or asset class is expensive or undervalued.

Christian Anthony, CFA | Portfolio Manager

PATHFINDER

Pathfinder Partners' Fund

AnalytixInsight (TSXv:ALY)

Spotlight: AnalytixInsight (TSXv:ALY)

Today, we highlight a relatively recent fund addition - AnalytixInsight (TSXv:ALY), a 'FinTech' company (Financial Technology) that uses machine learning and big data analytics to create various products and solutions. We have followed this company since they went public and like the space in which they are operating, but have found it difficult to 'look under the hood' to determine if the technologies they are developing are cutting-edge or merely average.

The company piqued our interest when they announced a deal with Intesa Sanpaolo, one of the two largest banks in Italy. In this deal, Analytix sold one-third of a subsidiary, MarketWall, to Intesa for $10 million paid over several years. This implies a $30 million valuation for just one of Analytix's subsidiaries, which compares favorably to their market cap of less than $10 million. After this deal was announced, the stock didn't react which led us to establish an initial position. The company has since signed a development contract for $2 million which will cover the company's overhead and ensure they don't need to raise money and dilute current shareholders.

Supported by these cash payments and a third-party valuation of one of their assets, we are excited to follow this company and see what solutions they can develop to create value for shareholders. The FinTech space is undergoing rapid transformation and we believe smart, innovative development groups will capitalize on this change - hopefully AnalytixInsight is one such group. We await more partnerships that can generate revenue, supply third party capital and provide 'look through' valuations of the products under development. We also note that the sector is ripe with accretive acquisition opportunities.

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*All returns are time weighted and net of investment management fees. Returns from the Pathfinder Partners' Fund and Partners' Real Return Plus Fund are presented based on the masters series of each fund. The Pathfinder Core: Equity Portfolio and The Pathfinder Core: High Income Portfolio are live accounts. These are actual accounts owned by the Pathfinder CEO (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 Core: Equity Portfolio (January 2011), Pathfinder Core: High Income Portfolio (October 2012) Partners' Fund (April 2011), Partners' Real Return Plus Fund (April, 2013), and Partners' Core Plus Fund (November 2014).

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