PATHFINDER

Real Fund

Semi-Annual

DECEMBER 31, 2022

The Real Fund invests in assets exhibiting specific qualities that allow for long-term growth beyond inflation.

PERFORMANCE

The Real Fund had a net return of -6.5% in 2022. Inflation was 10.4% as measured by our custom cost of living index and 6.5% as measured by the Canadian Consumer Price Index (CPI).

Performance								December 31, 2022
						Annualized		
	2022	2021	2020	2019	2018	5 Yr	7 Yr	Incpt*
Pathfinder Real Fund	-6.5%	20.7%	6.5%	15.3%	-4.8%	5.7%	7.3%	6.4%
Inflation Measures								
Custom Cost of Living Index*	10.4%	16.7%	0.7%	1.9%	-1.2%	5.5%	4.4%	4.1%
CPI	6.5%	4.8%	0.7%	2.2%	2.0%	3.2%	2.8%	2.3%
Source: Bloomberg Markets LP, Pathfinder Asset Management								

In 2022, we saw structurally higher inflation drive structurally higher interest rates and structurally lower asset valuations. It was the worst year ever for aggregate asset performance with equities, fixed income, real estate, and digital assets incurring double-digit percent losses.

The Real Fund was not immune to the global decline in asset prices, and we view our 2022 return under two perspectives. On one hand, we had a negative return that was well behind inflation. On the other hand, our return could be viewed favourably relative to global asset performance. The fundamentals of our portfolio companies remained strong, our biggest weights reported strong earnings and were rewarded with share price appreciation. This cushioned the significant valuation headwind that arose from the shift to much higher interest rates.

Higher interest rates actually benefit savers and investors IF you can survive the time frame when they go up. We survived a great valuation reset last year and believe we can capitalize on higher prospective returns across asset classes moving forward. Think when was the last time we could earn >4% from just a treasury bond?

ASSET ALLOCATION

COMPANIES: 94% WEIGHT

Our portfolio remains concentrated in quality businesses. Below, we highlight our two largest investments and the investment that declined the most last year.

- **Guardian Capital Group Ltd. (+14% in 2022)** is a diversified financial services firm. Last year, Guardian announced the sale of its insurance network business and its mutual fund dealer business for $600 million and $150 million respectively. These businesses account for just 30% of Guardian's overall assets under management yet the company is selling them for more than double the market ascribed value to all of Guardian's businesses (in terms of enterprise value). We view this as a major win for shareholders. We have owned Guardian since 2014 and made it our largest investment in 2018 when we saw compelling value in the shares.

- **Stella-Jones Inc. (+23% in 2022)** produces rail-ties, utility poles, and residential wood structures in North America. In 2021, there was significant volatility in lumber prices which drove accounting-based volatility in Stella's margins. Shares fell during that time, but our analysis was that there was no change to the structural earnings power of the business. As a result, we added to our investment, making Stella our second largest holding. In 2022, Stella reported strong results, putting to rest questions on its earnings power. Shares re-rated higher but we continue to see good value in them.

- **AutoCanada Inc. (-45% in 2022)** is a multi-brand automotive dealership group in Canada and our worst performing investment in 2022. Shares traded lower on concerns that higher interest rates will drive lower auto sales. This is a valid concern, but the current share price may not be reflecting significant positive strides ACQ has made in repair/service, finance/insurance, market competitiveness, recurring revenue, and profitability. While we expect deterioration in 2023 earnings, we think it will be less than what is factored into the share price. This is a view shared by the company given the fact they recently bought-back 15% of their shares outstanding. We recently added to our ACQ investment.

HARD ASSETS: 1% COMMODITIES + 5% REAL ESTATE

Commodities were the only sector to appreciate in 2022 and we didn't have a meaningful position in resources. We did have a position in natural gas which we exited in October, realizing meaningful gains since our March 2020 initiation. Commodities are difficult to predict, and we typically choose to allocate capital to ideas we have higher conviction in.

CURRENCIES/CREDIT: 0%

After digital assets, long duration fixed income was the worst performing asset class last year. We have avoided fixed income since the inception of the fund but after the recent price collapse, we are beginning to see value.

INVESTMENT OUTLOOK

A NEW INVESTMENT ERA

We are changing our outlook for the first time in a decade. We can no longer write that we are in an era of ultra-low interest rates and that there is risk to asset prices if we exit that era. It happened and the investment environment today is very different. Howard Marks from Oaktree Capital recently highlighted that we are likely amid a sea change, just the third sea change he has seen in his 53-year career. He describes the sea change as follows:

Sea Change December 31,2022

	2009 to 2021	Today
Fed Behaviour	Highly Stimulative	Tightening
Inflation	Dormant	40-Year High
Economic Outlook	Positive	Recession Likely
Likelihood of distress	Minimal	Rising
Mood	Optimistic	Guarded
Buyers	Eager	Hesitant
Holders	Complacent	Uncertain
Key Worry	FOMO	Investment Losses
Risk Aversion	Absent	Rising
Credit Window	Wide Open	Constricted
Financing	Plentiful	Scarce
Interest Rates	Lowest Ever	More Normal
Yield Spreads	Modest	Normal
Prospective Returns	Lowest Ever	More than Ample

Source: Oaktree Capital Management

These are drastic changes in economic conditions, monetary policy, and investor psychology. The combination of which could shape a new structural era in investing. What could it look like? Below we present some possibilities:

1) **Inflation and interest rates:** The direction of inflation and interest rates will be the most dominant factor in shaping the new era. We don't know where they will go but we do know that inflation and interest rates are at 40- and 12-year highs respectively. Also, some of the conditions that were conducive to low inflation and interest rates over the last 40-years are reversing (deglobalization, lower ratio of workers to retirees).

2) **Active management and bargain hunting:** conditions today are more constructive bargain hunting and less constructive structural up-trending markets. The prior era of up-trending markets drove the birth of

passive investing: own everything and not knowing what you own. We believe the new era will emphasize active investing: own individual bargains that you know well.

3) **Saving over borrowing:** The prior era greatly benefitted borrowers to the detriment of savers. Low and declining interest rates decrease the cost of borrowing and penalize the reward of saving. Borrowers were in paradise the last 40 years and especially the last 12 years; the future could be brighter for savers. As mentioned earlier, think when was the last time we could earn >4% from just a treasury bond?

4) **Education and Real Estate:** The prior era greatly rewarded the assets we borrowed money to buy. Specifically, we took on significant student loans and mortgages to purchase educations and homes. Is it a surprise that college tuitions and housing saw the most inflation during this time? Could that reverse in a new era? Prior to the 40-year declining interest rate era, student loans and mortgages were not prevalent.

Over short time frames, we see many economic cycles, asset bubbles and bursts but changes in eras happen rarely. A sea change is of utmost significance, as Warren Buffet stresses "only when the tide goes out do we find out who's been swimming naked". Many investment strategies that worked in the prior era could be exposed in the next; in fact, this was already happening in 2022. Also, new strategies could emerge as leaders. We believe the environment could be favourable to our strategy of fundamental conviction and concentration.

FINAL REMARKS

In behavioral economics, recency bias is the tendency for people to overweight recent events without considering the objective probabilities of those events over the long run. In this regard, I was recently asked "when will interest rates return to normal?". The questioner's reference to normal was the last 12 years: a benchmark interest rate of 0% with mortgage rates between 1.5% and 3.5%. It is important to highlight that, under objective probabilities, the last 12 years WAS NOT NORMAL. It is closer to a major outlier than normality.

Last year was likely a return to more normal conditions. As we wrote in our outlook, we don't know where interest rates go from here but many of the conditions that were conducive to low inflation and interest rates are reversing. I'd be shocked if the next 12 and 40 years looked like the prior, please keep that in mind when making decisions.

Thank-you for investing.

Christian Anthony, CFA | Portfolio Manager

"At all times, in all markets, in all parts of the world, the tiniest change in rates changes the value of every financial asset." – Warren Buffett

Pathfinder Asset Management Ltd. | Equally Invested™

1450 - 1066 West Hastings Street, Vancouver, BC V6E 3X1

E info@paml.ca | T 604 682 7312 | www.paml.ca

Sources: Bloomberg, Pathfinder Asset Management Limited

Disclosure

National Instrument 31-103 requires registered firms to disclose information that a reasonable investor would expect to know, including any material conflicts with the firm or its representatives. Doug Johnson and/or Pathfinder Asset Management Limited are an insider of companies periodically mentioned in this report. Please visit www.paml.ca for full disclosures.

*All returns are time weighted and net of fees. Performance returns from the Real Fund are presented based on the Class C Master series. Inception and 2013 returns include the 10 months from inception in March 2013. Returns greater than one year are annualized. The custom cost of living and CPI provide general information and should not be interpreted as a benchmark for your own portfolio return. The custom cost of living represents an equally weighted (at inception) basket of Teranet-National Bank National Composite House Price Index™, UBS E-TRACS CMCI Food Total Return ETN ETF (FUD:NYSE), United States Gasoline ETF (UGA:NYSE) and Canadian import prices from Statistics Canada in Canadian dollars. We created the custom cost of living index to give investors another way to measure their cost of living. It has some differences versus CPI; for example, CPI measures shelter costs as the cost of renting a home versus the custom index which measures it as at the cost of purchasing a home. A bachelor may view renting as an accurate gauge of shelter costs. On the other hand, a mother and father who want to raise their family under the security of the same roof without the risk of forced relocation likely views home ownership as a more accurate gauge of shelter costs.

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