PATHFINDER

Real Fund

Semi-Annual

JUNE 30, 2023

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 11.4% in the first half of 2023. Inflation was 0.7% as measured by our custom cost of living index and 1.4% as measured by the Canadian Consumer Price Index (CPI). Over the same period, the TSX Composite Index had a total return of 5.7% and the Canadian Universe Bond Index had a total return of 2.5%.

Performance — June 30, 2023

						Annualized			
	YTD	2022	2021	2020	2019	3 Yr	5 Yr	7 Yr	Incpt*
Pathfinder Real Fund	11.4%	-6.5%	20.7%	6.5%	15.3%	15.2%	6.6%	8.4%	7.2%
Inflation Measures									
Custom Cost of Living Index*	0.7%	10.5%	16.7%	0.7%	1.9%	10.6%	4.8%	3.2%	2.8%
CPI	1.4%	6.5%	4.8%	0.7%	2.2%	4.5%	3.3%	2.8%	2.4%

Source: Bloomberg Markets LP, Pathfinder Asset Management

We continue to view conditions constructive to stock-picking. The world is dealing with a lot of unfamiliar changes in interest rates, technology, labour, and consumer preferences. This unfamiliarity creates confusion and confusion creates asset mispricing. Given this uncertain environment, we focused the portfolio on companies and industries we know well, taking concentrated positions in companies we believe are mispriced based on a well-researched thesis.

Performance was driven by positive developments in these concentrated positions. Our top 5 positions contributed 7.7% to our first half return and added 15.4% over the last 12 months. We comment on two of these positions in our asset allocation section below and highlight another position in our investment outlook. We also held short positions in commercial real estate and retailers, these positions added 0.9% to our first half return.

Technology stocks performed strongly, rebounding from a correction last year. Our investment team had discussed the opportunity in technology stocks last year, but the Real Fund didn't make a meaningful incremental investment. We view this as a missed opportunity.

ASSET ALLOCATION

COMPANIES: 77% WEIGHT

After maintaining a full weight in equities for the last decade, we recently reduced our allocation. This is simply because we are finding competitive opportunities in fixed income.

- **Stella-Jones Inc. (+42% in H1/23)** produces utility poles, rail-ties, and residential wood structures in North America. The company has impressed investors with recent growth and margins. At its investor day, Stella guided to 8% sales growth and 16% EBITDA margins. Just a year ago, the street described Stella as a no growth business with just 10-12% EBITDA margins. We have owned Stella for a decade but made it our 2nd largest position last year when our research suggested the security was strongly mispriced.

- **Fairfax Financial Holdings Ltd. (+26% in H1/23)** is a property and casualty insurance company engaged in the associated investment management of insurance proceeds. The company has had a difficult decade marked by low insurance margins, low returns in fixed income, and poor results in equity investing. However, business fundamentals have improved driven by higher margins in the insurance business and much higher returns in fixed income. Recent earnings power has strongly exceeded street expectations. We initiated our investment 15 months ago when our research suggested the security was mispriced, it is currently our 3rd largest position.

HARD ASSETS: 5% COMMODITIES + 3% REAL ESTATE

Commercial real estate is under a negative spotlight as higher interest rates pressure valuations while also increasing mortgage interest costs. Office and retail properties face additional pressure from increased vacancies as people work and shop from home. We felt some of these headwinds were underappreciated and held a net short position through most of this year. We recently covered our short position as real estate valuations retreated in recent months. Our lone real estate investment is in a high-quality operator of multi-family apartments.

CURRENCIES/CREDIT: 15%

Higher interest rates have made fixed income more attractive on an absolute and relative basis.

- We are finding the most attractive opportunities in the Canadian preferred share market. The market is too small for most institutional credit investors and perhaps too complicated for individual retail investors. These securities have floating or rate reset features that result in the security benefiting from higher interest rates. Despite this, many of these securities traded down when rates went up, which piqued our interest. While many preferred shares are issued by companies with questionable credit quality, we researched a few that we believe have sound credit. These securities have safe credit, yield over 10%, and have tax-advantages over traditional income from bonds. On this analysis, we initiated a ~10% investment and we continue to selectively add to these positions.

INVESTMENT OUTLOOK

EXAMPLE OF OUR RESEARCH – GUARDIAN CAPITAL GROUP

While our outlook often highlights macroeconomic issues like interest rates and economies, it is important to highlight that views on these issues are not the primary driver of investment decisions. We base investment decisions on company, industry, and security specific issues. Issues like corporate profitability, industry competition, management competence, capital allocation, and valuation relative to our assessment of true worth. In this outlook, we provide an example of this analysis.

Guardian Capital Group is a long-standing Canadian asset manager that was founded in 1962. The company has several business segments including asset management (private client and institutional), an insurance network, and a mutual fund dealer. We first met Guardian in 2013 and were impressed by management's competency and philosophy around capital allocation. This drove us to do more research, where we discovered business qualities we thought was underappreciated by the market. In particular, Guardian's insurance network was ignored because it made up <5% of total assets under management. However, we felt the insurance network was very valuable given deep competitive advantages over peers, a strong reoccurring revenue model, and tremendous economies of scale potential. After completing our research, we presented Guardian to investment committee with the following thesis: **"We would own GCG for its quality hidden assets that are persistently undervalued in the market."**

We then monitored our thesis to manage how we can be wrong or right. The insurance network ended up having a tremendous decade, attracting a significant amount of new insurance agents while also acquiring peers at attractive prices. Combined, the segment saw a >10x in revenue and a >20x in profit. Despite this, the market continued to mostly ignore the inherent value. This changed in November 2022, when Desjardins Group announced it would be acquiring Guardian's insurance network for $600 million (~$485 mm net to GCG), which was triple the market ascribed value to all of Guardian's businesses at the time.

We invested in Guardian 9.5 years ago at $14/share. Since that time, we have received $5.10/share in cumulative dividends, and we could sell our investment today at ~$42.00/share: implying a cumulative total return to date of 236%. That return has also come tax deferred (aside from a small amount on dividends) as buying and holding undervalued securities has an underappreciated tax deferral benefit. We also emphasize that our investment was not influenced by macroeconomic views. Our decision was based on our view of the business, management, and valuation. In the end, these are also the variables that made GCG a successful investment.

This is an example of an investment gone right and it doesn't always play out that way. However, this gives insight into our research process: our goal is to form a thesis that is correct but also different. With Guardian, we ended up investing in a quality growing company at a value price, a deal you can only get if you have a view that is different from the consensus. We continue to hold GCG on a thesis that there are still other quality hidden assets that are undervalued by the market.

FINAL REMARKS

As we mentioned in our last semi-annual, higher interest rates benefit savers and investors IF you survive the time frame when they go up. We are now 18 months into the largest upward revision in interest rates in the last 40 years. The Bank of Canada has raised the overnight interest rate from 0% to 5% and this has led to a meaningful negative price reset across all assets: equities, fixed income, and real estate.

In that light, we are pleased with our fund's cumulative positive return (+4.4%) over this time frame. We have survived a great interest rate reset and while rates may continue resetting, we are finding more attractive investment opportunities today than in the last 10 years.

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 (this is so timely and important that the quote is repeated from the last semi-annual)

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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.

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.

For more information, please follow the links above to review the fund term sheets.

*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.