# Conviction Fund

## Semi-Annual

### JUNE 30, 2024

The Fund takes concentrated positions in securities we believe are mispriced based on a proprietary thesis.

## PERFORMANCE

The Conviction Fund had a net return of 7.7% in the first half of 2024. Inflation was 6.5% as measured by our custom cost of living index and 0.9% as measured by the Canadian Consumer Price Index.

| **Performance** | | | | | | | | | June 30, 2024 |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | | Annualized | | | |
| | YTD | 2023 | 2022 | 2021 | 2020 | 3 Yr | 5 Yr | 7 Yr | Incpt* |
| Pathfinder Conviction Fund | 7.7% | 20.6% | -6.5% | 20.7% | 6.5% | 8.4% | 10.3% | 8.8% | 8.0% |
| Inflation Measures | | | | | | | | | |
| Custom Cost of Living Index* | 6.5% | -1.2% | 10.5% | 16.7% | 0.7% | 7.4% | 6.6% | 4.8% | 4.0% |
| CPI | 0.9% | 3.4% | 6.5% | 4.8% | 0.7% | 4.5% | 3.4% | 3.1% | 2.4% |

Source: Bloomberg Markets LP, Pathfinder Asset Management

The first half of 2024 saw a continuation of recent investment trends. We saw negative returns in fixed income, positive returns in equities, strong price appreciation in mega-cap technology stocks, and heightened dispersion amongst individual securities.

Despite not owning mega-cap technology stocks, we believe the environment remains constructive to our strategy of concentrated security selection. Our top 6 positions make up almost half our portfolio and added 7.4% to our gross portfolio return in the first half of 2024. Our largest positions continue to perform well, fundamentally and in markets. Negatively, Chesswood Group Ltd. and AutoCanada Inc. detracted 2.6% from our gross portfolio return.

Fixed income has gone through a significant structural price correction with passive bond investors receiving a negative total return over the last 5 years. This is before we consider the considerable amount of taxes paid on interest payments (taxed as income!) and the significant amount of inflation over this time. Structural price corrections can unearth attractive investment opportunities, and we believe this is the case within fixed income. We established select fixed income positions last year, with these positions now making up ~11% of our portfolio, adding 0.6% to our gross portfolio return this half year.

# CONVICTION SPOTLIGHT

## MAINSTREET EQUITY CORP.

We are introducing a new conviction spotlight section to our semi-annual report. In this section, we will spotlight a company we are invested in, highlighting our thesis and how the investment has played out. Our inaugural writeup will spotlight longtime fund holding: **Mainstreet Equity Corp. (MEQ:TSX)**

We first met MEQ in 2012 and were impressed with management's entrepreneurial drive and competence. The company had assembled a diversified portfolio of multifamily residential apartment properties in Western Canada (Alberta mainly) and had done so in a value-creating manner. The company had a formula: identify and acquire under-performing multi-family apartments, renovate the interior and exterior of the building to make it more liveable, operate the building more efficiently with their own management, and ultimately provide a higher living standard for tenants while also attracting higher rents and operating profits.

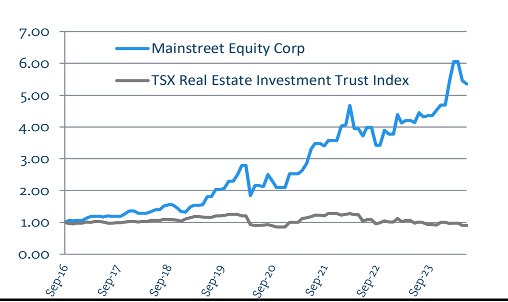
Despite a strong first impression, we didn't invest in MEQ until 2016, when an oil-driven economic crash in Alberta depressed valuations for Alberta-based companies. With a more attractive valuation, we met with management again and completed our due diligence. We invested in MEQ with the following thesis:

1) Alberta and Saskatchewan will still have long-term economic relevance and positive immigration.
2) MEQ is the best identifier, acquirer, renovator, and operator of multi-family apartment buildings in Canada.

After investing, we monitor our thesis to manage how we can be wrong or right. It took some time, but Alberta and Saskatchewan have re-emerged as major economic hubs, now attracting the highest population growth of all the Canadian provinces. Unlike prior commodity-driven booms in these provinces, this boom has been driven by affordability, spare infrastructure (education, health care etc.), and the availability of jobs. We view it as a more structural boom. This is great news for the >17,600 apartment units MEQ now owns, of which 56% are in Alberta and 22% are in Saskatchewan. During the downturn, MEQ executed its strategy brilliantly, adding >4,500 units in Alberta and >2,900 units in Saskatchewan. These were acquired at bargain prices as MEQ's competitors were hastily exiting these provinces, urgently selling these apartments during the downturn. This created significant value for MEQ shareholders, which we quantify below.

Not all investments work as planned but MEQ has been a successful thesis where we have been rewarded: shares have appreciated 435% since our initial investment in 2016. What's amazing is that this has occurred during a difficult time for real estate generally. The TSX Real Estate Index is actually down over the same time! It really highlight's how counter-cyclical MEQ's strategy and execution has been. Finally, we don't believe MEQ is expensive today; in fact, we recently added to our investment. MEQ remains a high conviction position.

**MEQ Share Price Performance** June 30,2024




Source: Bloomberg, Pathfinder Asset Management

# INVESTMENT OUTLOOK

## THE RETURN OF CANADIAN MIDCAPS?

**Small and medium-sized Canadian listed equites have gone through a meaningful price correction over the last three years**, underperforming larger Canadian listed equities and dramatically underperforming global mega-cap stocks. Structural price corrections can unearth attractive investment opportunities, and we believe this is the case again here.

Importantly, in many cases, midcap underperformance hasn't been driven by deteriorating business fundamentals but by deteriorating investor sentiment. Large institutional investors don't have to own these companies because they aren't in the benchmark equity indices they are measured against. So, when economic conditions turn uncertain due to events like COVID and higher interest rates, large institutional investors are quick to orphan these names. Some of these orphaned companies have grown earnings >30% over the last 3 years but have seen their share price decline. This creates opportunity, as these companies now trade at significantly more attractive valuations. We are finding the most attractive opportunities in companies of this size, and this has been reflected in our portfolio. As can be seen below, **our portfolio is heavily weighted to small and medium sized companies**.

**Conviction Fund - Weight by Market Cap** June 30,2024

| Market Capitalization (CAD $Billion) | Weight in Fund |
|---|---|
| 0-1 | 25% |
| 1-10 | 52% |
| 10-100 | 22% |
| >100 | 1% |

Source: Pathfinder Asset Management

Importantly, this is a contrarian position that has not yet worked: the top performing securities remain the mega-cap technology stocks we don't own. However, we are noticing a turn of sentiment in small and medium sized Canadian listed equities. In the last 1.5 months there have been four meaningful acquisitions in the space, with buyers paying big premiums. We saw almost none of this over the last three years, so it suggests that valuations have become too compelling to ignore. While large institutional investors may have orphaned this space, private equity and the industry in which these businesses operate have taken notice. In the table below, you'll see that these are the buyers. Something we have noticed in our career is that **industries will often correct what markets misprice,** and we are seeing this happen again here**. Is this the return of the Canadian midcap?**

**Recent Canadian Mid-Cap Acquisitions**

| Acquiree | Buyer | Announcement | Price Relative to Dec 31, 2023 | Market-cap Dec 31, 2023 ($mm) |
|---|---|---|---|---|
| Park Lawn Corporation | Industry Peer + Private Equity | June 3, 2024 | 34% | 690 |
| Canadian Western Bank | Industry Peer | June 11, 2024 | 69% | 2,975 |
| Heroux-Devtek Inc. | Private Equity | July 11, 2024 | 114% | 517 |
| Stelco Holdings Inc. | Industry Peer | July 15, 2024 | 39% | 2,766 |

Source: Bloomberg Markets LP, Pathfinder Asset Management

## FINAL REMARKS

Recent client conversations have revolved around whether "the market" is due for a correction. Upon further conversation, I've learnt that:

1) Client reference to "the market" is usually a reference to headline equity indices like the S&P 500 or the TSX Composite Index.
2) Clients assume our mandates track and reflect those indices.

As a result of these learnings, I think it is very important to highlight a few things:

1) There are many markets within the overall equity market.
2) The market for small and medium sized Canadian-listed equities has already gone through a long and meaningful correction, it happened.
3) The Conviction fund is not at all a reflection of what clients believe is "the market": we have just a 1% weight in the mega cap names that dominate these indices!

We were fortunate not to have felt the wrath of the midcap correction over the last 3 years, positions like MEQ helped us move forward during the storm. If MEQ had been any other small or medium sized Canadian listed real estate company, we would be in a very different position. However, we sail forward, and we are finally noticing a turning of the tide, a potential market correction so to speak…but maybe one that's upward.

Thank-you for investing.

**Christian Anthony**, CFA | Portfolio Manager

"Basically, price fluctuations have only one significant meaning for the true investor. They provide him/her with an opportunity to buy wisely when prices fall sharply and to sell wisely when they advance a great deal." – Benjamin Graham

**Pathfinder Asset Management Ltd.** | Equally Invested™

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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 Conviction 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.

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