Real Fund

Semi-Annual

JUNE 30, 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 -14.9% in the first half of 2022. Inflation was 15.2% as measured by our custom cost of living index and 5.0% as measured by the Canadian Consumer Price Index (CPI).

Performance							June 30, 2022
						Annualized	
	2022 ytd	2021	2020	2019	2018	5 Yr	Incpt*
Pathfinder Real Fund	-14.9%	20.7%	6.5%	15.3%	-4.8%	4.8%	5.7%
Inflation Measures							
Custom Cost of Living Index*	15.2%	16.7%	0.7%	1.9%	-1.2%	7.3%	4.8%
CPI	5.0%	4.8%	0.7%	2.2%	2.0%	3.2%	2.3%

Source: Bloomberg Markets LP, Pathfinder Asset Management

The first half of 2022 saw a significant correction in asset prices. Directionally, global equities were down ~20%, global bonds were down ~15%, and popular new assets like cryptocurrencies and NFT's were down over 60%.

Investor sentiment turned negative on several factors: 1) High inflation caused by disrupted supply-chains from the pandemic; 2) Even higher inflation caused by the sudden war in Ukraine; 3) A spike in interest rates caused by central bankers aggressively raising interest rates to combat inflation; and 4) Recession fears caused by the perceived impact that higher interest rates may have on economies.

The Real Fund was not immune to the global decline in asset prices and our first half-year return was well behind inflation. Many of our assets declined based on the macroeconomic events noted above. When markets obsess over macroeconomic headlines, they tend to ignore bottom-up business fundamentals which can lead to individual asset mispricing. We believe this is the case today and we are finding attractive pricing for many of our companies. We comment on some of those companies below.

ASSET ALLOCATION

COMPANIES: 87% WEIGHT

Below, we highlight the two portfolio companies that have declined the most in price this year. We also describe why we believe they are compelling opportunities today.

- **Goeasy Ltd. (-43% in H1/2022)** provides leasing and lending services to non-prime Canadian borrowers. Shares have traded lower on concerns that the company will see much higher credit losses given the current economic headwinds. However, we believe GSY's credit portfolio has some immunity to the current environment: higher interest rates do not impact non-prime borrowers (they already pay very high rates), high job vacancies greatly benefit non-prime borrowers (easy to get employment income), commodity inflation is generally good for commodity producing countries like Canada, and overall non-prime lending standards have greatly improved since 2007. With this view, we see shares as attractively priced, a view shared by the company given aggressive recent share buybacks.

- **AutoCanada Inc. (-42% in H1/2022)** is a multi-brand automotive dealership group operating in North America (Canada mainly). Shares have traded lower on concerns that current economic headwinds could drive much lower vehicle sales. However, new vehicle sales have already been low for a year given restrictions in producing new cars. Instead ACQ has been excelling in their repair/service, finance/insurance, and used vehicle divisions. We recently met management and believe that they have done a good job turning around operations, focusing on market competitiveness, recurring revenue, and profitability. While we share concerns on slower vehicle sales, we believe that risk is more than priced into shares, a view shared by the company given their recent proposal to buyback 15-17% of the company.

HARD ASSETS: 6% COMMODITIES + 4% REAL ESTATE

We have seen commodity inflation since the pandemic but none greater than natural gas. Natural gas prices are more than triple pre-pandemic levels in North America and 10x pre-pandemic levels in Europe and Asia.

- We own natural gas producers **Peyto Exploration & Development Corp. (+30% in H1/2022**) and **Advantage Energy Ltd. (+24% since Feb 2022 initiation).** These are the two lowest cost producers of natural gas in North America given the quality of their wells and the ownership of their infrastructure. While shares have significantly appreciated over the last two years, we still find them attractively valued.

CURRENCIES/CREDIT: 0% CASH + 0% BONDS +3% MERGER ARB

- **Activision Blizzard Inc (+19% in H1/2022)** is in the process of being acquired by another portfolio company **Microsoft Corp (-20% in H1/2022).** There is concern the deal may not close due to anti-trust issues. For this reason, ATVI shares trade at a discount to the proposed acquisition price, a discount we believe is too large. As a result, we have maintained our ATVI position (we owned before the proposed acquisition), a thesis shared by Warren Buffett who recently bought 10% of the company.

INVESTMENT OUTLOOK

THE INFLATION, INTEREST RATE, AND ASSET VALUATION SHIFT

What we saw in the first half of 2022 was the emergence of an economic scenario we feared: structurally higher inflation, leading to structurally higher interest rates and structurally lower asset valuations. A scenario where all assets rationally decline in price and where there is little or nowhere to hide. It's important to reiterate how we have been describing the investment environment:

1) **All assets are expensive relative to history**. Interest rates are inversely correlated to asset valuations (lower mortgage rate = higher house price), interest rates have dropped from a secular high of 40 years ago and have been at historic lows for a prolonged period. This means that all assets trade expensive relative to history: Equities trade at higher P/E's, bond's yield less interest, and real estate have lower cap rates.

2) **We're (likely) about to find out where interest rates will go**. With inflation high for the first time in decades we're (likely) about to find out where long-term interest rates will go. Structurally higher inflation could lead to structurally higher interest rates and structurally lower asset valuations. On the other hand, if inflation turns out transitory and we survive all this chaos, it likely means low interest rates are here for a long-time.

While we feared a shift to this environment, we had no idea if, when, or how it would happen. It took a global pandemic, a ~2-year shutdown of productive capacity, and a war between commodity rich countries to spark inflation, not the most predictable of equations. The relevant question now is: where do we go from here? Looking forward, **we are more optimistic than most:**

1) Many of the macroeconomic risks are now well known and priced into valuations: we have already seen a major correction in prices across multiple asset classes.

2) We are finding attractive pricing for many of our companies, many of which have not seen a deterioration in business fundamentals.

3) Those same companies are buying back shares at the most aggressive pace we have ever seen, meaning they agree with our assessment of the value embedded in their shares.

4) The above is typically a good setup, and our outlook is more positive than it was six months ago.

When investing for the long-term, recessions and bear markets are normal, healthy, and usually unpredictable as to when they will occur. They typically represent valuation resets that setup healthier returns for the future. We work with clients to immunize short-term spending requirements so that invested capital can retain a long-term and unemotional outlook, and stay the course.

FINAL REMARKS

While our financial outlook is optimistic, it is important to highlight that there are global scenarios for the world that are quite undesirable. We highlight some of these scenarios below:

1) **Global high or even hyperinflation:** Supply-chains and global trade are in stress; labour is scarce, and people are trending to be less productive. An environment where many products and services become unavailable is not out of the question.

2) **Civil War/Wars:** Current politics are extremely tribal. An environment where citizens are at war with each other is not out of the question.

3) **World War 3:** Global tension has been heightened by the pandemic and Russia's invasion of Ukraine.

4) **Return of 10%+ interest rates:** Central banks may have to keep aggressively raising interest rates to combat inflation. If we return to early 1980's interest rates, it would be an ugly scenario for many industries and people who have become reliant on low interest rates.

We consider the above scenarios unlikely and certainly unpredictable. However, while these were previously thought of as impossible outcomes, the current odds of occurrence are not 0%. We should all do our part to aide in the avoidance.

Thank-you for investing!

Christian Anthony, CFA | Portfolio Manager

"You get recessions, you have stock market declines. If you don't understand that's going to happen, then you're not ready, you won't do well in the markets." – Peter Lynch

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Sources: Bloomberg, Pathfinder Asset Management Limited

Disclosure

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*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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