August 2018

Elixir News

elixir

ELIXIROFINCOME.COM

CREATING INCOME FOR EVERYDAY PEOPLE BY USING TECHNOLOGY
TO HARVEST VOLATILITY.

Hi Everyone,

Welcome to fall! On the West Coast, the rainy season has already started, and all our rain-proof clothing is out of storage. Summer is way too short in Vancouver, if you ask my wife and kids.

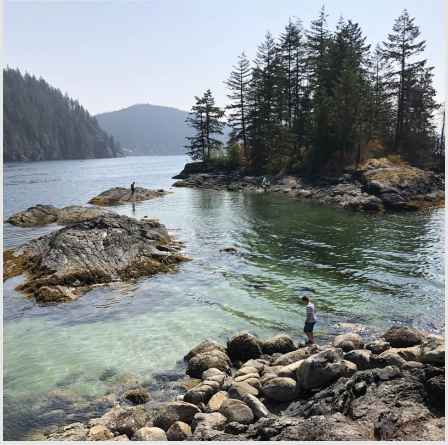
Our proprietary trading performance came in at 2.47% for August. The performance section of the newsletter will talk about the role that ElixirTech 1.0 played in creating this revenue. In the Global Market Observations section, I provide real-life examples of ways in which our algorithm identified various opportunities for Elixir in the marketplace. The feature article in this issue talks about Elixir's valuation and online valuation calculator. Lastly, as the fourth article under the "Why did we start Elixir" series, I discuss my concerns about extreme leverage and the shortage of real asset in the current global financial system.

On the personal side, I had a fantastic August. We brought home our Westie puppy "Shredder" and my birthday gift, a new motorcycle. I also finished the 44km knee-knacker hiking challenge along the North Shore Mountains (over 1800 meters in elevation) in under 10 hours.

Have a great September. I look forward to catching up sometime!

Best regards,
Bill

*This key performance metric is calculated based on realized revenue divided by bonds outstanding at the beginning of the month. The realized revenue is from interest earned on deposits and from rebalancing our hedge.



ELIXIR AUGUST 2018

TRADING REVENUE PERFORMANCE

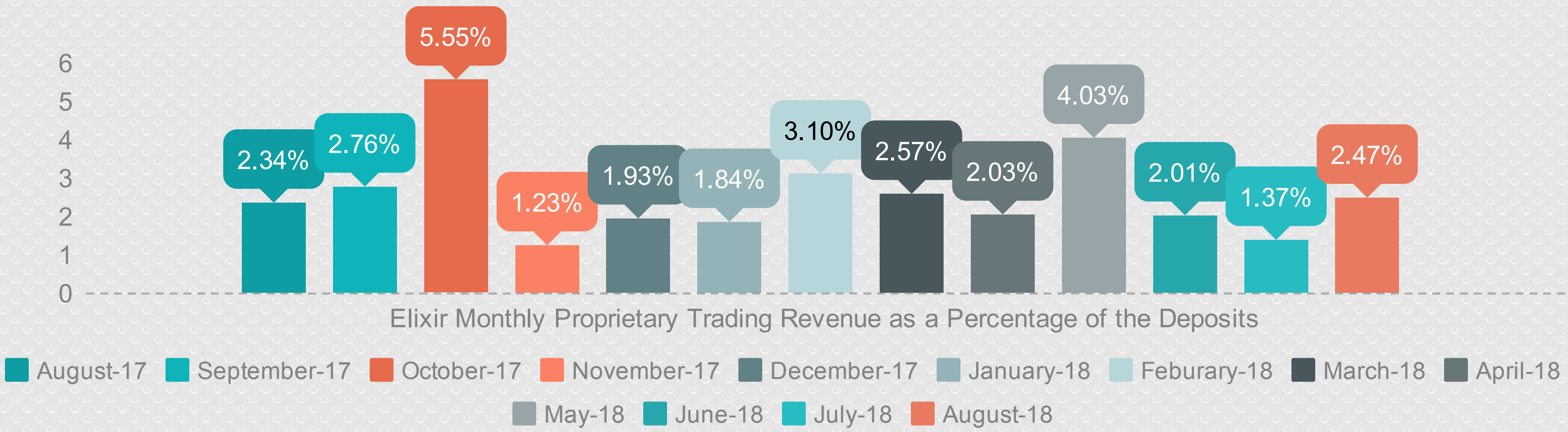
In August, we produced 2.47% revenue on bond outstanding from proprietary trading activities. This performance was above our monthly target of 2%. I would like to talk about the significance of this return.

In July 2018, we officially added ElixirTech 1.0 to our trading activities. Currently, the software is trading about 20% of our balance sheet. It will take another six months before we fully implement ElixirTech 1.0 with all the legacy accounts.

Two weeks into July, our cost of hedging had significantly increased. We expect this to continue through the end of September 2018. If we hadn't started applying ElixirTech 1.0, this would have created a great headwind against our trading performance. We estimate that our August return would have been closer to 1.7%. We were pleased with the performance of ElixirTech 1.0 considering that the software is trading only 20% of our balance sheet.

Here is another highlight I would like to share with you. Elixir currently has 11 segregated sub-accounts that are being traded using different strategies. We have one small sub-account which I started in July and ElixirTech 1.0 has been implemented since its inception.

Among all the accounts, this one has to be the best performer from a "balanced return/risk" standpoint. It produced 19.36% in July and 23.86% in August. While a "more aggressive than usual" trading strategy contributed to the high return, ElixirTech 1.0 was also a key contributor. More importantly, ElixirTech 1.0 made high-frequency micro trading possible, which significantly reduced trading risks for the account.



GLOBAL MARKET OBSERVATIONS

To date, we have published 13 issues of our monthly update, Elixir News. Looking back, we are pleased to see that many of our early predictions, which our algorithm identified, have manifested. In this section, I talk about the predicted performance of AUD, EUR, CAD and NZD over the last 12 months. In addition, I would like to share our algorithm's new pick for owning: the NZD and sliver. As a third topic, I will comment on the emerging market's increased volatility in August and how this affects Elixir's portfolio. Lastly, I will share insight into our significant returns from trading sugar in the last 30 days.

1. Our algorithm was right a year ago: Sell AUD, CAD, EUR and NZD.

In the August 2017 issue of Elixir News, we commented that "The trend of selling USD will not go on forever as all great parties must come to an end eventually. According to the historical data from the Commitment of Traders Report, [our algorithm indicated that] the European, Canadian, Australian and New Zealand currencies are extremely overvalued at the end of August."

Today, a year later, just as our algorithm predicted, AUD, CAD, EUR and NZD have all dropped in value while the price of USD has increased. The following table shows how much each of these currencies fell compared to USD from September 1st, 2017 to August 31st, 2018.

AUD/USD: 13%↓;
NZD/USD: 8%↓;
CAD/USD: 5%↓;
EUR/USD: 4%↓

While our algorithm helped us shift our balance sheet in the right direction over the last 12 months, we also picked up profits along the way from the daily volatilities of these currencies. For example, though AUD fell in value by 13% over the course of 12 months, the currency actually increased in value 47% of the time. Elixir was designed and able to "harvest" these short-term volatilities and produce realized revenue.

2. Our algorithm's new pick: Buy the New Zealand Dollar (NZD) and silver.

Recently, our algorithm identified the New Zealand Dollar (NZD) and silver as great opportunities for value investors. Data from the first week of September in the Commitment of Traders (COT) report confirmed the algorithm's result.

According to the COT report, while commercial buyers (red line) for silver have been "inactive" (below "0") for the last decade, they have quickly ramped up their purchase of the commodity since September.

On the NZD side, although commercial buyers (red line) have been engaged during the last 10 years, they are certainly showing a very aggressive buying trend in September. The buying pressure from commercial buyers will eventually push up the value of silver and NZD. The alignment between our algorithm and the COT report gives us the confidence to start buying these two assets.

To our new readers, the COT report is a publication produced by the US government. It provides “inside information” about commercial and speculative investors’ trading activities. At Elixir, we want our actions to align with those of commercial buyers. For more information about how we at Elixir use the COT report, please refer to the Global Market Observations section in the May 2018 issue of Elixir News.

3. Our portfolio is prepared for emerging market volatility.

The media has used words such as “crisis”, “meltdown” and “carnage” to describe the emerging market volatility in the last 30 days. As you may be aware, our portfolio has limited exposure to emerging market currencies, such as the Mexican Peso, Turkish Lira and South African Rand. I would like to summarize our current position on these currencies.

Mexican Peso:

We don’t currently own any Mexican Peso. Our algorithm indicated that the currency will further decrease in value and that we should wait for another 2% drop before we start buying.

South African Rand:

We don’t own any South African Rand either. Our algorithm indicated that the currency will also further decrease in value and that we should wait for another 3% drop before we start buying.

Turkish Lira:

We decided to stop buying Turkish Lira in May of this year. In our June and July 2018 issues of Elixir News, we discussed our concerns about this currency. In summary, we have simply lost confidence in Turkey’s national leadership. While we still have a small ownership from earlier in the year, the holding is paying us around 14% annual interest. For now, we will continue holding our position and collecting interest. We are also working on partially hedging out the exposure.

As you can see, our algorithm has long forecasted the “dark cloud” over the emerging market – a “dark cloud” about which the media is now speaking. Therefore, we have been very cautious about buying these assets. We do believe that high volatility in emerging markets could be the proverbial “canary in the coal mine” – it is often a sign of a significant volatility event occurring across all markets soon.

4. We've been in and out of Sugar twice in the summer

The chart above shows the price of sugar over the last 12 months.

We slowly bought sugar near the end of July 2018, then completely sold out our position at the beginning of August, when sugar first bounced up. This was our first buying/selling cycle with sugar.

We then started slowly buying again every time sugar dropped 1/100th of a cent until it bounced. By the time sugar reached its 10-year historical low price of 9.78 cents per pound, we owned 1,000,000 pounds ($100,000 worth) of sugar. Subsequently, we started selling our position little by little as the price of sugar increased. At the beginning of September, we had completely sold out for a profit of about 2.5%.

At some point in the future, the price of sugar will decrease again. When it does, we will repeat our buying and selling cycle.

In addition to commodities, we do the same with currency. For those who are interested, we wrote an article about our Mexican Peso execution in the April 2017 issue of Elixir News.

FEATURE ARTICLE

Elixir's Valuation

As many of you know, I am a professionally trained financial analyst and I spent the past 10 years focusing on private equity analysis and valuation. To determine a company's value, I usually take the following steps.

1. Determine the most material variables that could affect the company's value. List as many minor variables as possible, too.
2. Build a base financial model with reasonable estimates of the variables.
3. Stress test the model by changing the material variable estimates to suggest best- and worst-case scenarios.

Our comprehensive base model is web-based and interactive. Users can change various material variables and see the effect on Elixir's profitability and share valuation.

Access the model at this link: www.elixirofincome.com/calculator

Balance Sheet	
Bonds Outstanding	$ 30 m
Preferred Shares Outstanding	$ 3 m
Est. Future Total Shares Outstanding	280000
Off Balance Sheet	
AUM of Software Licensing	$ 60 m
Key Assumptions	
Annual Realized Trading Performance	30 %
Annual AUM Management Fee	2 %
Annual Performance Management Fee	20 %
Annual Cost of Capital of Bonds	12 %
Annual Wholesale and Trailer Fees	3 %
Annual Preferred Share Dividend Yield	15 %
Multiple of EBIDTA	20
Annual Software Licensing Wholesale Fees	20 %
Annual Income Tax Rate	20 %

Income Statement	
Annual Revenue from Proprietary Trading of Bonds Outstanding	$ 9.00m
Revenue from Software Licensing Management Fees	$ 1.20m
Revenue from Software Licensing Performance	$2.40m
Additional Annual Revenue	$ 0
Annual Expenses for Tech Development	$ 100000
Annual Expenses for Administration	$ 100000
Annual Expenses for Marketing	$ 100000
Annual Expenses for Professional Costs	$ 100000
Annual Expenses for Corp. Governance	$ 30000
Office, Technology and Analyst Expense	$ 100000
Trailer and Wholesale Fees on Bonds and Preferred Shares	$0.99m
Trailer and Wholesale Fees on Software Licensing	$0.72m
EBIDTA	$ 10.36m
Interest Expense	$ 3.60m
Gross Income	$ 6.86m
Income Tax	$ 1.37m
Net Income	$ 5.49m
Preferred Share Dividends	$ 0.45m
Available for Shareholder Dividends	$ 5.04m
EBIDTA Per Share	$ 37.00
Value Per Share	$ 740.00

For Individual Current or Potential Shareholders	
No. of Shares You Own or Consider Purchasing	1000
Future Value per Share	$ 740.00
Future Value Total Dollar Value	$ 740000.00
How many years to accomplish our goals?	4
Your Required Rate of Return	25 %
Present Value per Share Today	$ 303.1
Present Value Total Dollar Value	$ 303100.00

CLEAR

Following is a list of key material variables in our model and the rationale behind the median estimates we assigned to each. After this list, I provide a table to show these variables' best- and worst-case scenarios. If you are interested, you can change the numbers in the calculator to see a different outcome for the current and future values of Elixir shares.

Bond Outstanding - The more capital (bond outstanding) we have to trade, the higher our proprietary trading revenue performance will be. Our baseline number is $30M. We estimate that $30M could produce about $5M EBITDA, which is a strong basis for listing as a public company.

AUM of Software License - This is the amount of capital with which third parties are using our software to trade, in which we would earn a percentage of their profits. We decided that $60M is modest and achievable, as it is less than half of what an average bank-based investment advisor in Canada manages.

Annualized Realized Trading Performance - Revenue from proprietary trading is one of the most important measures of our business success. Based on the past 12-month performance at 30.76%, we estimate our baseline for this is 30% per year.

Multiple of EBITDA - Currently, Financial Technology companies trade at about 29X EBITDA, while non-FinTech companies trade at around 15X EBITDA. Depending on the market conditions at the time we go public, our investors' exit value could vary. We estimate 20X EBITDA as a conservative baseline for a fast-growing FinTech company.

Years to Accomplish Our Goals - Elixir shareholders' internal rate of return depends largely on the amount of time that the board and management have to accomplish our business goals and objectives. Our goal is to make Elixir publicly tradeable in four years. So far, we are on track in terms of this timeline.

According to our base model, the current value of an Elixir share should be $301.06. Now let's look at the worst- and best-case scenarios and how they would affect our share price.

Key Variables	Worst Case Scenario	Base Case Scenario	Best Case Scenario
Bonds Outstanding	$20M	$30M	$40M
AUM Software Licensing	$20M	$60M	100M
Annualized Trading Performance	20%	30%	40%
Multiple of EBIDTA	15	20	25
Years to Accomplish our Goal	5	4	3
Share Price	$58.81	$301.06	$937.60

Based on the above estimates, pricing Elixir shares at $40 each is currently a very reasonable and conservative offer. The board plans to reassess our share offer at the beginning of November.

Having said all of the above, I would like to make a final comment. I agree with the "Father of Statistics," George Box: "All models are wrong, but some are useful." Like all financial models, ours is merely a best-effort prediction of Elixir's current and future values. Because many variables could affect our progress and outcome, the reality will most definitely be different from the model. What's most important to us and our potential investors is that our model carefully considers all material variables and the ways in which they affect our financial performance. To that end, our model can serve as a "useful" tool to provide ideas about Elixir's current and future value.

WHY DID WE START ELIXIR?

CONCERNS ABOUT EXTREME LEVERAGE AND A SHORTAGE OF REAL ASSETS IN THE GLOBAL FINANCIAL SYSTEM

In March, I began writing a series of articles explaining the reasons why we founded Elixir. As a brief recap, I believe the easy period of making money in stocks, bonds and real estate has ended. Over the next 50 years, people will have trouble preserving capital and earning an income off these investments. Yet, despite this fact, market volatility still creates income opportunities. We created Elixir to capture those opportunities.

In the March issue of the newsletter, I shared my research into, and concerns about, the long-term value of the North American real estate market. The May issue includes an article about the stock market and the July issue talked about what will happen when interest rates increase.

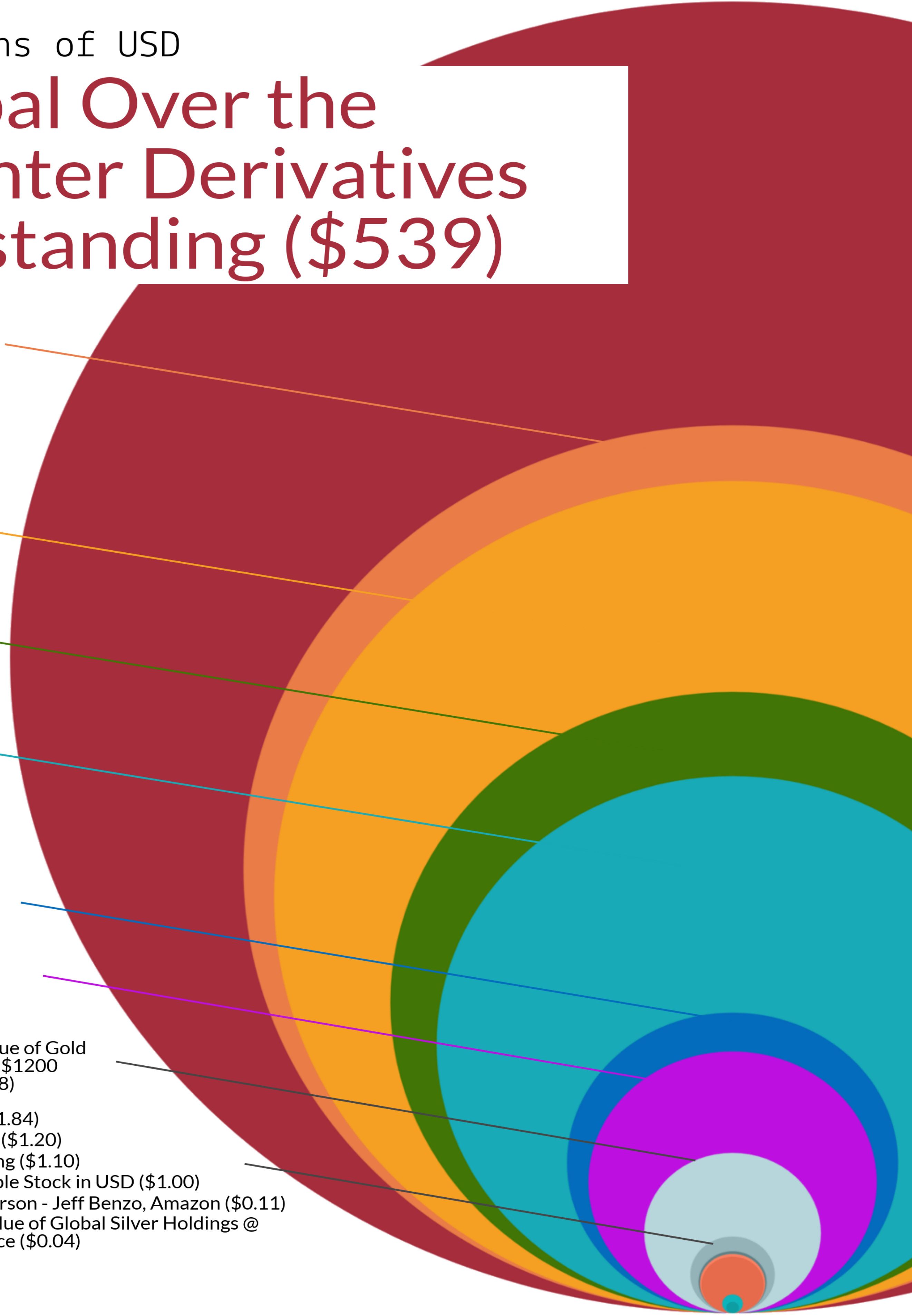
In this August issue, I would like to focus on two very significant concerns: Our global financial system is extremely leveraged, and we have a serious shortage of real assets. While the public generally understands the real estate market and the interest rate, most people aren't familiar with, and don't pay attention to, the financial market on a macro level. Unfortunately, the wellbeing of the global financial market always has a direct or indirect impact on our individual financial health.

A while back I came across an article, "Here's all the money in the world, in one chart", in The Wall Street Journal. The article reminded me of how problematic extreme leverage and a lack of real assets have become. While I prepared my writing on this topic, I realized that much of the data that the article quoted wasn't accurate. Therefore, I did my own research. The following chart shows what I found. For ease of visual comparison, you can skip the chart and go to the next graph.

Money and Market	USD (Trillions)	Source
Above Ground Value of Global Silver Holdings ($15 USD Per Ounce)	$0.04	World Silver Survey 2018 - The Silver Institute
Worlds Richest Person - Jeff Benzo (Amazon)	$0.11	The Billionaires 2018 - Forbes Magazine
Market Cap of Apple Stock USD	$1.00	Source - CNBC August 2nd 2018
Bitcoin Outstanding	$1.10	Source - Coindesk September 5th 2018
Total Printed USD	$1.20	Federal Reserve Bank of New York 2016
GDP of Canada in USD	$1.84	International Monetary Fund 2017
Above Ground Value of Gold Holdings Globally ($1200 USD Per Ounce)	$8	World Gold Survey 2018 - The Gold Institute
US National Debt	$21	www.usdebtclock.org
US Stock Market Valuation	$28	YCHARTS - September 5th 2018
Global Money Supply (Coins, Printed Currency, Chequing and Saving Accounts and Term Deposits)	$90	WSJ (Marketwatch) - March 2018
Global Stock Market Valuation	$121	Vintage Value Investing - December 2017
Global Value of Developed Real Estate	$217	Savills - January 2016
Global Debt	$247	Institute of International Finance - Q2 2018
Global Over the Counter Derivatives Outstanding	$539	Bank of International Settlements

Trillions of USD

Global Over the Counter Derivatives Outstanding ($539)



For most of us who are seeing this graph for the first time, the immediate comment would be, “I thought Global Debt, Real Estate and the Stock Market would be in the front-runner positions. What is this ‘Global Over-the-Counter Derivatives Outstanding at 539 Trillion USD’? And it’s twice the size of Global Debt!”

Indeed, what is ‘Over-the-Counter Derivatives Outstanding’?

According to an online dictionary, derivatives are arrangements or instruments (such as commodity and financial futures, options, over-the-counter forward contracts, or warrants) whose value derives from, and depends on, the value of underlying assets.

Most people are familiar with exchange-regulated derivatives. For example, farmers or hedge funds can buy future contracts to hedge out wheat in the open market. However, most derivative contracts are private bets (over the counter) on the direction of interest rates or equity investments. Unlike exchange-regulated derivatives, leverage is used freely with no restrictions for over-the-counter derivative contracts.

In Berkshire Hathaway's 2002 annual letter, Warren Buffett wrote, “In our view, however, derivatives are financial weapons of mass destruction, carrying dangers that, while now latent, are potentially lethal…” Buffett’s view that derivatives are “weapons of mass destruction” is not an exaggeration. Here’s why.

Let’s say a bank has the thesis that the US stock market is going down and a hedge fund wants to bet that it will go up. The two groups agree to exchange profits or loss based on $100M in two years. When the contract expires, the stock market goes up by 10%; the bank would pay the hedge fund 10% or $10M of the gain on $100M. Banks generally use very high leverage. Over the course of the contract, the bank’s financial position has changed, and it cannot afford the $10M payment it owes to the hedge fund. The bank must sell off assets, which would further worsen its balance sheet. Meanwhile, the hedge fund is counting on the $10M revenue but now has a loss on its books. This creates a bunch of other problems for the hedge fund.

The really scary scenario is that the bank files for bankruptcy. Not only would this create financial losses for the hedge fund, but it would void all its other contracts, creating a devastating chain effect in the financial market. The best real-life example of this is Lehman Brothers’ bankruptcy in 2008. Lehman Brothers had lost so much capital from its exposure to sub-prime mortgage investments that it could not fulfill its over-the-counter derivative agreements. The day Lehman shut down marked the start of the 2008 global financial meltdown.

Now that we are clear on the definition of over-the-counter derivatives, let’s talk about my observations regarding the current global capital allocation as demonstrated in the graph.

First, it is alarming to see that the combined total value of gold and silver is only $8.1 trillion compared to the $247 trillion global debt and the $90.4 trillion in global money supply. This shows how much leverage has entered the system since the gold standard was abandoned in 1971. It is unnerving to consider the fact that, essentially, nothing is backing most of our world’s financial assets (outside of real assets). Moreover, asset values have increased to extremely high levels.

Currently, the world has about 75% more assets than debt. However, as we discussed in previous newsletters, the stock and real estate markets are heading towards a long period of devaluation. When that happens, we could have more debt than assets globally.

Second, the inherent leverage from the derivatives is alarming. If the derivative contracts move sharply or in an unexpected direction, they could cause great financial turmoil. Privately-arranged forward contracts are not exchange-traded future contracts. Their transactions details are not disclosed to the public. Therefore, it is impossible to assess how risky the derivatives assets are and who is involved. We know that high-leveraged, over-the-counter derivative contracts caused huge volatility in 2008. Today, they are certainly a leading risk factor in our financial system.

The extremely high level of leverage is concerning. It will undoubtedly trigger extreme volatility in the future. Elixir was created to profit off volatility, so this is good news to us. When thinking about our children's financial future, I felt it was important to start Elixir, so that when all assets fall in value, our children can still make money and support themselves financially.

The ELIXIR Economic TRAVELER

Mexico City & Puebla

Oct 31 - Nov 3, 2018

The Mexican peso is a very important asset in Elixir's investment portfolio. Its volatility has created some impressive return for us over the last seven months. Most people have been to parts of Mexico that is tourism focused. Rarely would people visit the country's economic power cities, such as Mexico City and Puebla. When you spend some time in these cities, you will realize how real and vibrant the Mexican economy really is! After scouting the two cities with my wife personally last year, we have decided to organize our very first Elixir Economic Traveller tour to Mexico City and Puebla, Mexico.

These two cities also happen to offer unique cultural and sightseen experiences. There is so much to see and experience in Puebla, and we are only including some general highlights here. The city is the fourth largest in Mexico and located about a two-hour drive southeast of Mexico City. The city's golden age was during the Spanish colonial era in the 14th century. A walk around downtown is like travelling back in time to 14th-century Spain! With 366 magnificent churches and many other historical sites, the downtown area has been named as a World Heritage Site. The city is also surrounded by brilliant natural scenery. The Popocatépetl Volcano and Tuliman Cascades are only a couple of hours' drive away.

THE BEST TIME TO VISIT THESE TWO CITIES IS DURING HALLOWEEN AND THE DAY OF THE DEAD CELEBRATIONS. IF YOU ARE READING THIS, YOU ARE INVITED TO JOIN US!

We are still fine tuning the details but would like to share a general itinerary and costs. The plan is to arrive on October 31 and leave on November 3 from Mexico City. There are many airlines that fly direct from Vancouver, Calgary, and Toronto to Mexico City. Typically, fares start at $500 in economy seating. We will be staying in luxury hotels. The cost for hotel accommodations will be about $200 CAD per night, including breakfast and an evening cocktail party. With some ground transportation and an English-speaking guide, the total cost would be approximately $1,500 per person.

If you are interested in joining us, please email me for details.