July 2018

Elixir News

elixir

ELIXIROFINCOME.COM

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

Hi everyone,

I hope you are having a great summer! We have lots of exciting news to share in this July 2018 issue of Elixir News. Time flies. We now have a 12-month proprietary trading track record and our annual revenue divided by bond outstanding is 30.67%! July's monthly performance finished at 1.37%, which was due mainly to low volatility in the market. Having said that, volatility returned at the beginning of August, and we are anticipating an above 2% monthly earning report in the next newsletter.

We are pleased to announce that we successfully completed the testing phase for ElixirTech 1.0 and began using it in our trading activities in July. The software significantly increases our trading efficiency, accuracy, and profitability. The newsletter contains more information about ElixirTech 1.0, as well as ElixirTech 2.0, an advanced software being developed with artificial intelligence. In the newsletter, we talk about the indirect impact that Elixir may face over US sanctions on Iran and FAANG stock performance after its Q2 earnings release. Lastly, for the third article in the "Why We Started Elixir" series, I share my views on what will happen when interest rates increase.

In the last newsletter, we announced that we would be focusing on rebranding. The new confidential information memorandum has been completed and can be found in this link: www.elixirofincome.com/cim

We have added much important content to the new document. I would appreciate hearing any comments and questions you might have.

On the personal side, the highlight of my month was planning and completing my first triathlon challenge. On July 22nd, a friend and I cycled 40km from sea level to the entrance of Grouse Grind. At the 20km cycling mark, we stopped at the legendary outdoor saltwater Kitsilano pool and did our 1500-metre swim. We finished the challenge with a hike up the infamous Grouse Grind (3km/850m elevation). Completing the triathlon has been one of my greatest achievements. It inspired me to create the goal of organizing one fitness challenge per month. The invitation to join me is open to all readers of this newsletter. Please reach out and I will keep you informed about the next challenge.

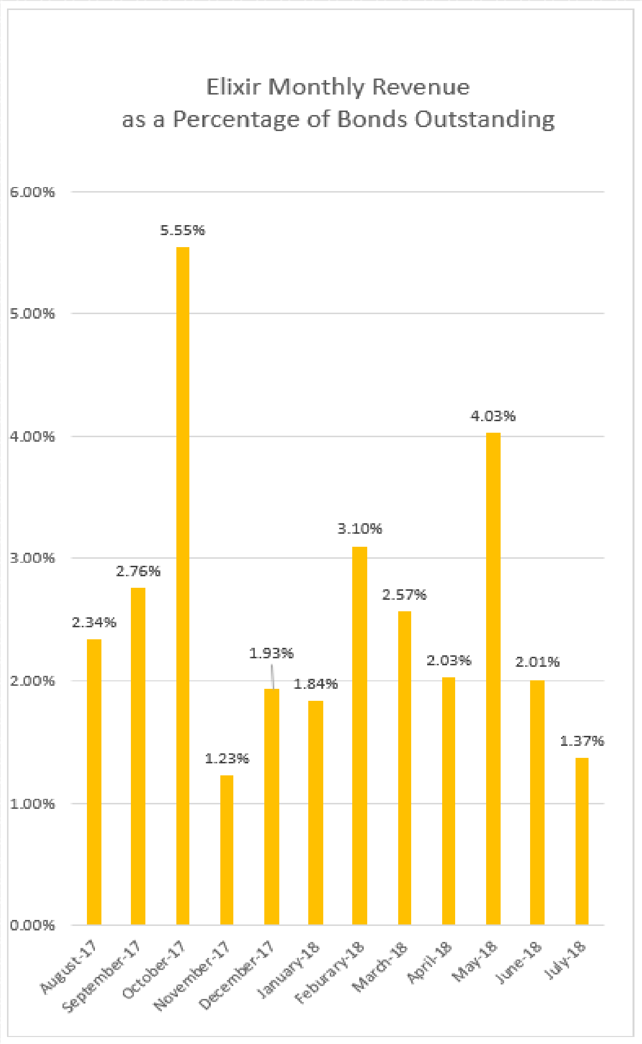
Have a great rest of August!

Regards,
Bill McNarland

*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'S ONE YEAR & JULY 2018

TRADING REVENUE PERFORMANCE



The end of July marked one year of Elixir performance. July at 1.37% was our second slowest month of the twelve but still brought our total for the year to 30.76% which is a monthly average of 2.56%. That is almost 7% higher than expected annually and .56% a month higher than our target of 2%.

Revenue comes from earnings on deposit interest as well as from capital gains from the rebalancing of our proprietary algorithms. Our algorithms and technology allow us to capture some of the daily volatility that underlying deposits and assets produce. As a reminder, Elixir is a company and uses GAAP accounting; the quoted revenue is realized (not unrealized) revenue.

GLOBAL MARKET OBSERVATIONS

This month, I would like to share two developing stories that we are watching closely. The outcome of these events could affect Elixir's future trading revenue and performance. The first event is Iran's response to US sanctions in the coming months. The second event is the performance of FAANG stocks (Facebook, Apple, Amazon, Netflix and Alphabet's Google) after the US post-second-quarter earnings releases.

At first, it may seem odd that these two events would have anything to do with Elixir's proprietary trading performance, as investing in countries like Iran or in stocks is not within our investment mandate. However, we cannot ignore their indirect influence on the value of the Canadian dollar and on general market volatility.

1. Iran's response to US sanctions in the coming months

Iran's response to US sanctions will directly impact the price of oil. In turn, this will influence the Canadian dollar. First, let's establish a basic understanding. The Canadian dollar is often referred to as a "petrol currency". The price of oil is strongly correlated with the Canadian dollar. This is because of the large amount of oil that foreigners purchase from Canadians every day. For those would like an in-depth understanding of this topic, I recommend an article written by the University of British Columbia: "Is the Canadian Dollar a Petrocurrency?"

Now let's talk about the price of oil and Iran's role in affecting it. At the beginning of 2018, the price of oil (West Texas Intermediate) was $60 per barrel. It rallied as high as $75 in May and is now sitting at $69. This is much higher than the $27 per barrel in January 2016.

What are the causes of the movement of value and high price this year? There are two.

One relates to OPEC and Russia. They held back on their production earlier in the year, which artificially raised the price of oil. However, since Saudi Arabia and Russia went back to pumping at full production alongside the US in June, we have seen a small decrease in the price of oil, to its current cost of $69 per barrel.

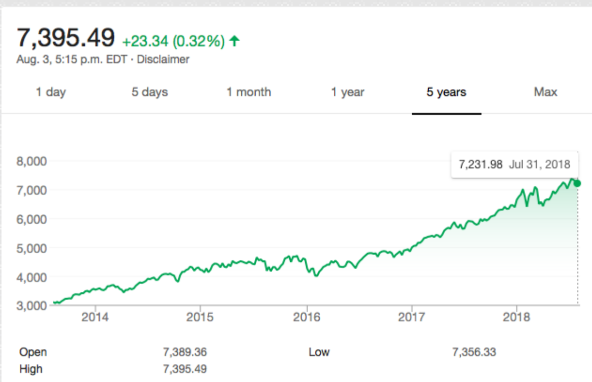
The second reason stems from the US's decision, in May, to re-impose sanctions on Iran. The US has told other countries that they must halt all imports of Iranian oil starting Nov. 4th of this year or face financial consequences. Iran's daily oil production capacity is about one-third of Saudi Arabia's daily output, which accounts for a significant portion of the world's oil supply. The shortage of supply will cause oil prices to inflate and remain high due to the Iranian government's resistance to the sanctions and refusal to meet with the US on August 1st.

Whether the price of oil will stay high or decrease depends on what the Iranian government does. One noticeable development is the social instability that Iran is currently facing. The effects of US sanctions go far beyond simply decreasing the amount of Iran's oil exports. It has created a devastating "ripple effect", starting with the country's financial system. Iran cannot transfer funds in US dollars. This caused the Iranian Rial to lose 70% of its value. Depreciated currency then triggered extremely high inflation. Imported goods and services, such as prescription drugs, have tripled in price. An unbearably high cost of living has caused the people of Iran to revolt against their government. Daily scattered protests started at the end of July.

The protests may soften the current leadership's perspective on the US. The possibility also exists that the government will be overturned, and a new government would be willing to negotiate with the US. Either of these two scenarios would cause the price of oil to fall, which would lead to a lower priced Canadian dollar.

2. Post-share-price reaction to FAANG stocks Q2 earnings

The NASDAQ Index has been on a one-way street uphill for the last five years (see chart below).



As we have discussed many times in the past, all parties eventually come to an end – and so do market trends. When people who have shares to sell outnumber new buyers who want to purchase, the market trend would be to make a reverse movement. One of the noticeable indications of this is when the valuation of stocks is extremely high but good news triggers only a small increase in stock value, while bad news causes a large decrease.

Let's look at a current example. FAANG stocks (Facebook, Apple, Amazon, Netflix and Google-Alphabet), which account for roughly 40% of the NASDAQ Index performance, are traded at their historical high (i.e. Amazon is at over 200 times earnings). Apple and Amazon reported greater Q2 earnings numbers than expected. The day after the good news was released, shares of these two companies increased by only 4% and 3%, respectively. On the other hand, Facebook and Netflix's Q2 earnings were less than expected. The next day, their stock fell significantly, by 20% and 13%.

I believe this is a warning sign that we may be at the end of a long upward trend in technology stocks. The overvalued technology stocks of the year 2000 caused such a great collapse in the NASDAQ that the market didn't fully recover its lost value until 17 years later.

Sadly, history always repeats itself. When these technology stocks fall, like they did in the year 2000, the result will be huge volatility across all market classes, including stocks, bonds, commodities and foreign exchange. Larry McDonald, author of the institutionally followed investment report, The Bear Trap, and considered a premier risk expert, agreed with my view. He said, during a CNBC interview on July 30th, "These are stocks you want to run away from. I see potentially 30 percent to 40 risks in these stocks."

At Elixir, while we perform well during volatility, we must always "stay ahead of the game" and see potential volatility events before they happen. The more we can predict volatility, the more we can prepare and position our hedges appropriately to benefit from these events.

WHY DID WE START ELIXIR?

CONCERNS OVER POTENTIAL INCREASING INTEREST RATES

In March, I began writing a series of articles explaining the reasons for the founding of Elixir. That month, I shared my concerns regarding the value of real estate. In May, I shared my concerns about the stock market. 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.

This month, I would like to share my concerns about the negative impact of a future increase in interest rates. As shown in the chart below, Canada has a decade-low interest rate level. This is also the case throughout Europe, the US and Japan. In this short article, I will describe four consequences of an increase in interest rates throughout the coming decade.

1. US bonds will drop significantly in value.

Because no Canadian data is readily available, we will quote US data. The results of an increasing interest rate are the same in both nations; Canada is simply smaller in scale. The US bond market constitutes a significant amount of investors' savings. For example, in May 2018, Zack Investment Research estimated that the bond market is $40 trillion USD. It is 33% larger than the $30 trillion US stock market. This means that an average investor's portfolio is apportioned as follows: 57% in bonds and 43% in stocks. Typically, bonds are considered the "safe" portion of investors' portfolios.

The most quoted index in bonds is the 10-Year-US-Treasury. Currently, its yield is 3%. If interest rates increase to a more normal level of 6%, a $100,000 bond would be worth only $76,000. That is quite a loss for what's considered the "safe" portion of a person's portfolio. With interest rates falling from the high teens to close to zero today, people seem to have forgotten what happens to the value of bonds when interest rates return to their historical normal level.

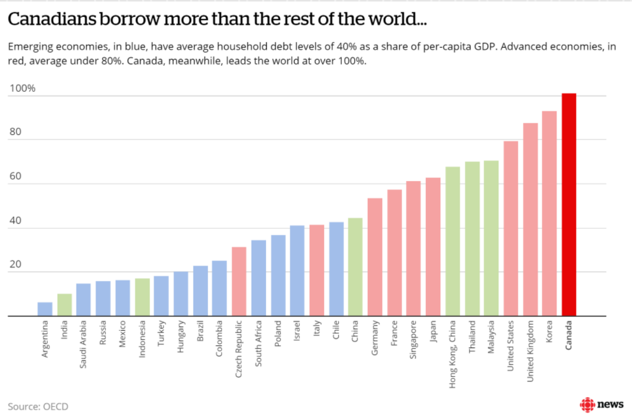
2. Companies' earnings will decline or become negative.

When interest rates increase, companies' earnings decline or become negative. Utility companies are usually considered conservative or safe investments, as their revenue remains consistent, even during economic downturns and recessions. People will always need electricity or natural gas. Take the Canadian utility company, Fortis. It has a footprint in many jurisdictions in Canada, the US and the Caribbean. The company had a profit of $1.12 billion CAD in 2017. Its interest expense on outstanding debt was $0.914 billion CAD. Its interest expense was almost the same amount as its profit! This means that when interest rates are double their current number, Fortis' profit will disappear! What would typically happen to the value of a company's stock when its earnings drop by 90%? Investors can expect a significant decrease in the stock's value.

Fortis isn't alone. Interest is most companies' largest expense. When interest rates increase, companies with “guaranteed income” face the risk of having their profit wiped out. Imagine the negative impact on the vast majority of other companies in the market. Many may even be forced to close their doors.

3. Disposable household income will drop.

Canadians currently have the largest household debt as a percentage of GDP in the world!



According to the last Census by Statistics Canada in 2016, a Canadian family’s median total income is only $70,336. What would happen to household spending if interest rates increased? People would spend more money servicing their debt and less on other purchases. This would lead to declining earnings for companies. As discussed earlier, less revenue and more interest expenses would force companies to lay off workers. An increasing unemployment rate would trigger instability and many other social issues. The situation for Canadians is certainly getting dangerous.

4. The government will run larger deficits. It will cut spending or raise taxes.

The Federal Government of Canada paid interest expenses on its debt of $24.1 billion CAD in 2017, at a time when it ran a deficit of $17.8 billion. If interest rates doubled, the deficit would almost triple in size, to over $50 billion. Program cuts and increased taxes would become necessary means of balancing the budget. What are the outcomes of cutting programs and raising taxes? High taxes would make our country less competitive. In addition, workers would have less disposable income to spend on boosting the economy.

The effects that an increase in interest would have on our economy, bonds, stocks and real estate are devastating. Unfortunately, it will happen one day, sooner or later. Traditional investments will depreciate, and we will be in a bleak financial era for a long time. One thing we know for certain is that volatility will always be there; as the situation worsens, volatility will intensify. We are fortunate that we have learned how to capture volatility for profit and to create wealth for ourselves. We created Elixir so that we can reach out and create income for everyday people and families by using technology to harvest volatility.

FEATURE ARTICLE

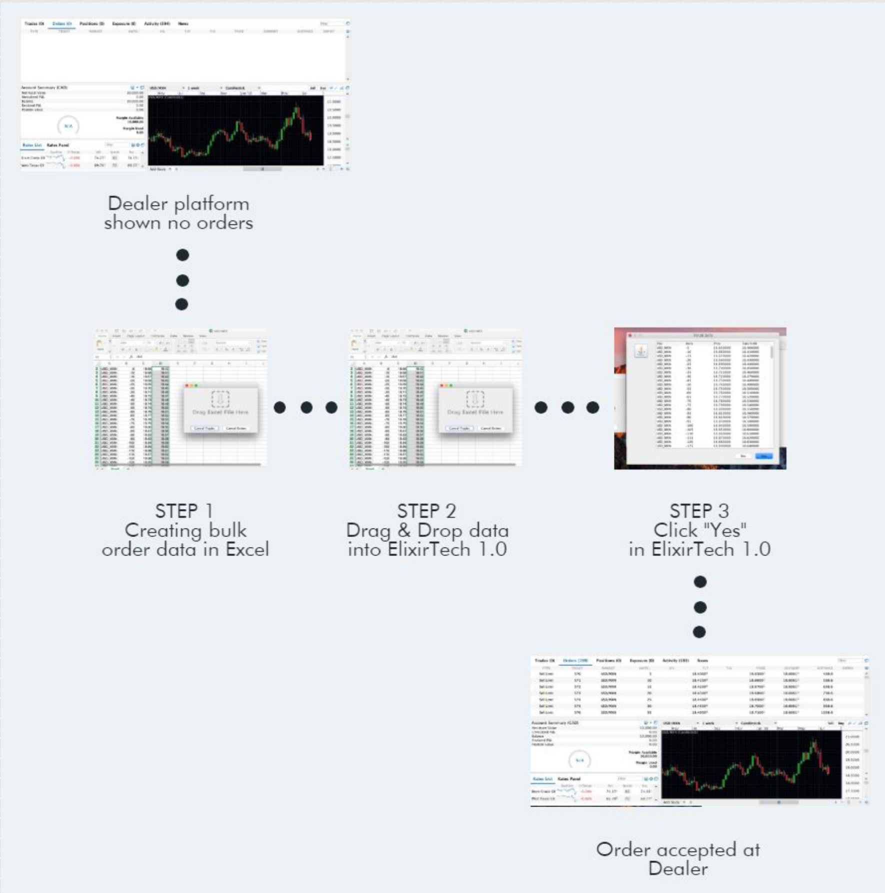
ELIXIR'S PROPRIETARY TECHNOLOGIES

ElixirTech 1.0

While software-based dealers have significantly shortened the time we require to execute a trade order, we would still have to manually create a trade order on their platforms. Typically, entering a trade takes about 10 to 15 seconds.

Micro trading allows us to slowly and safely move into a position and to capture hourly and daily volatility. However, reaping a profit of 1/10th of a penny or higher per trade requires us to make thousands of trades per day. Manually entering thousands of trades is extremely time-consuming and costly. For example, an unskilled staff would need approximately eight hours to manually enter 2,000 trades. Aside from time and labour, human error is also a high-risk issue.

To solve this problem, we created ElixirTech 1.0. Our software can create thousands of orders on a dealer's platform within seconds, using only three steps. The following illustration demonstrates how ElixirTech 1.0 works. ElixirTech 1.0 is a proven software. We use it in our proprietary trading.



ElixirTech 2.0

Market volatility manifests itself in minutes, or even seconds. Take the Mexican Peso; below is an image showing how the price changes within a typical 30-minute period.

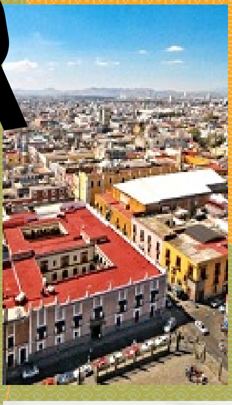
ElixirTech 1.0 allows us to capture hourly and daily volatility. However, it is not sophisticated enough to capture volatility the moment it happens. This is due to the time lost between manual re-orders. With ElixirTech 1.0, although we can enter thousands of trades within seconds, we must still manually identify which orders have reaped profits, and then create new Excel batch orders to re-enter those trades.

To efficiently capture volatility down to the second, we are currently developing ElixirTech 2.0, which will be equipped with artificial intelligence. Not only will its "listener" function recognize trades that have taken profit automatically, the software will also re-enter the positions automatically.

For example, we program ElixirTech 2.0 to buy a 1 USD position at 18.5600 PESO and to sell at 18.5610. After taking the 1/10th of a penny profit, ElixirTech 2.0 would automatically re-enter the trade at 18.5600 to again take a profit at 18.5610, thereby collecting another 1/10th of a penny. The trade will repeat a hundred times a day as long as it meets our pre-set order condition.

ElixirTech 2.0 would tremendously increase our efficiency in terms of taking micro profits. We would be able to capture volatility on a moment-by-moment – instead of hourly or daily – basis. The development of ElixirTech 2.0 is progressing as planned; we will enter the testing phrase in the fall of 2018.

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.