March 2018

Elixir News

ELIXIROFINCOME.COM

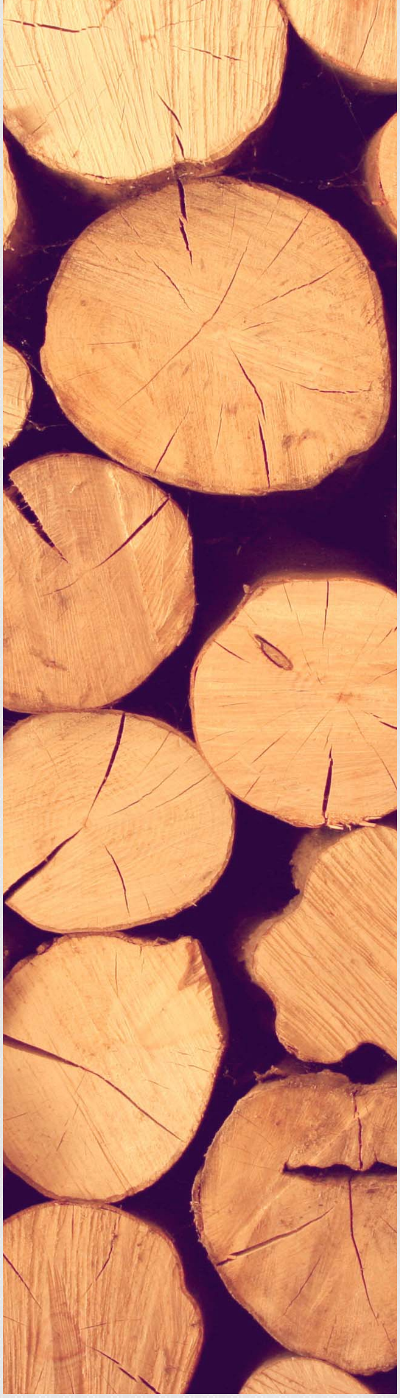
CREATING INCOME FOR EVERYDAY PEOPLE BY USING TECHNOLOGY TO HARVEST VOLATILITY.

Hi Everyone,

March went by quickly. Thank you for continually supporting us and following our Elixir story. We are pleased to announce that our March revenue performance was at 2.57%, which brings our average to 2.67% since last July. I recommend that you pay some attention to the performance report in the newsletter, as it has some forward-looking information on April's performance.

In this March issue, the global market observation is merged with investor's education. The topic of discussion is how we can forecast the global market performance through the US bond market. The feature article in this issue is based on a question that I get often from our readers: Why did you start Elixir? So, I am going to provide some insight on this. Within that article, I am going to share my opinion on Canadian real estate as an investment as well.

We are also making two very important announcements in this newsletter. One is our 2018 redeemable bond rate sale, and the other one is the special Elixir strip bond. I suspect that many of you are aware that, due to a number of reasons, a large number of investors have lost a significant portion of their investment from Secure Care and syndicated mortgage offerings. The purpose of the Elixir strip bond is to help some of these investors recover their losses. If you know someone or yourself who is being affected, I would highly recommend that you read that section and contact us.



On a personal side, as you know, Eve and I are both very curious learners. We want to learn about the plants around us, including whether they are edible or have medical use. So, a few days ago, we hired a plant specialist who walked us through our nearby forest park. Wow! The findings were completely mind-blowing. For example, almost all wild berries in our neighbourhood are edible, and the dandelion is also edible and good for cleansing. Fascinating! We are looking forward to summer and having our kids spent more time in the forest picking all-they-can-eat berries! If you are also interest in this, we will be very happy to put you in touch with the plant specialist!

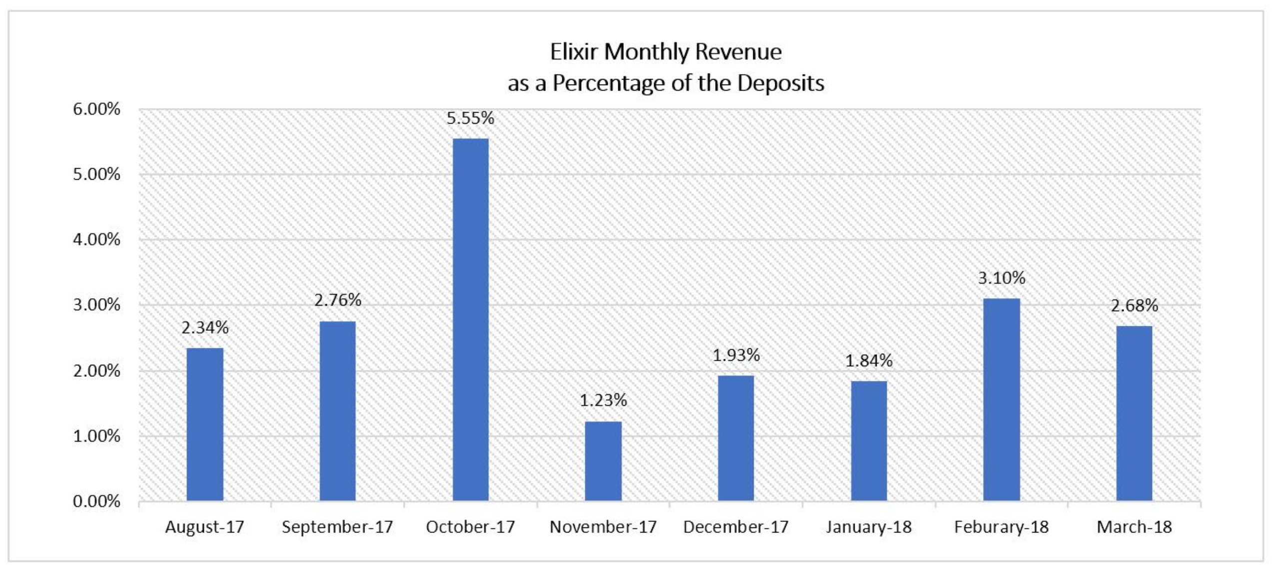
Have a great rest of April, and feel free to reach out at any time!

Sincerely,
Bill McNarland

ELIXIR'S MARCH REVENUE PERFORMANCE

Elixir's financial target is to produce revenue of 2% of investors' deposits each month. Revenue comes from earnings on deposit interest and from capital gains created from rebalancing the DDVARH hedge, which is audited independently by a third party, Myfxbook. The auditor has direct access to Elixir's accounts and can calculate Elixir's income performance directly.

March was a strong month. Revenue performance as a percentage of redeemable bond deposits ended at 2.57%. April, however, will likely be in the 1% range. The reason for this is because we may potentially need to liquidate about 25% of our redeemable bonds. One large early bond investor may redeem his bond to fund his other projects. We have not received a formal redemption notice as of this day but have been deleveraging to prepare for it. We are building more cash and liquidity than normal, which will result in a cash drag on April's revenue. It is unlikely that a quarter of the bond deposit will be taken out in one setting in the future. Nevertheless, it is a great exercise to stress test our system.



GLOBAL MARKET OBSERVATIONS

As many of you know, I believe that a recession is coming to the US and Canada. Today, I would like to put a timeline on it. I think it's going to happen in the next 6 to 18 months. My thesis is based on the observation that the US bond yield curve is flattening. An inverted yield curve is on its way. Every recession in the past 60 years in the US and many other advanced economies (Canada, UK, Germany, and France) was preceded by an inverted government bond yield curve.

What is an inverted government bond yield curve?

An inverted yield curve is when long-term rates of bonds are lower than the short-term rate. For example, if a 2-year bond pays 4% while a 10-year bond pays 3%, the yield curve is inverted. Normally, investors need to be paid higher interest to invest longer.

Why can the inverted yield curve predict recessions?

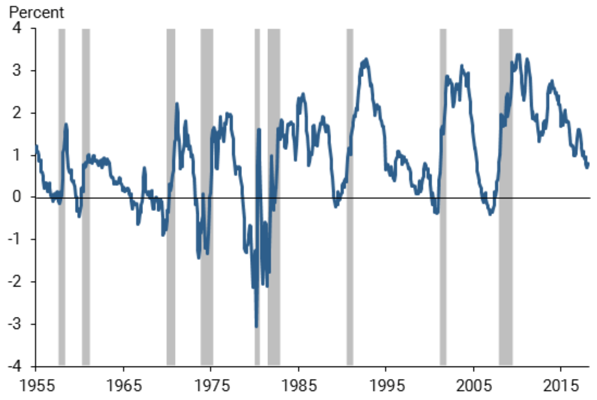
Generally speaking, one of the biggest expenses that companies have is interest expense on the loans they borrow. The interest rate on these loans are often variable, just like a variable mortgage rate. If the biggest expense of companies goes up, it will have a significant negative impact on their cash flow. When that happens, their earnings will go down. Lower earnings lead to poorer stock market performance, and people's investments start to deplete. As companies won't have the money available for new hiring, it will be harder to find a job. Bonus payouts will also be less, and people who are employed may be laid off.

With that ripple effect, people will feel less confident to spend money. With the higher interest rate, there will be less disposable income to spend as well, as bigger chunks of earnings will be used to pay down mortgages and other loans. When people don't have or don't want to spend money, we are in a recession.

Has the inverted yield curve accurately predicted every recession in the past?

Michael Bauer and Thomas Mertens at the San Francisco Federal Reserve Bank completed a great analysis, "Economic Forecasts with the Yield Curve," on how the yield curve was able to predict recessions over past 60 years. The chart below was pulled out of their paper. The grey bars in the chart represent recessions. An inverted yield curve is when the blue line is below 0. Notice that whenever the blue line falls below 0, a grey recession period always shortly follows.

Figure 1
The term spread and recessions

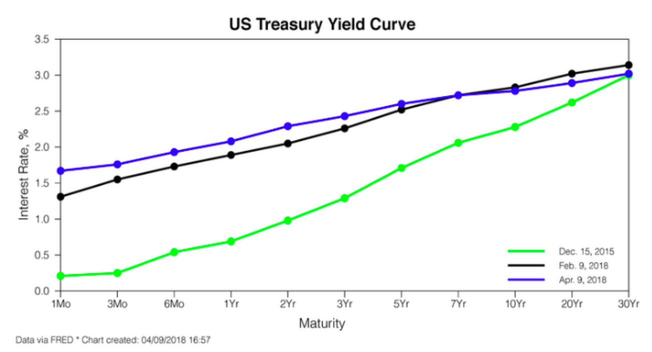


Note: Gray bars indicate NBER recession dates.

The study was published on March 5, 2018, and can be read at this link: *https://www.frbsf.org/economic-research/publications/economic-letter/2018/march/economic-forecasts-with-yield-curve/.*

Our current situation

Now, we take a look at more recent data. The green line in the chart below represents the US bond yield curve from the end of 2015. The 10-year bond interest rate was sitting at around 2%, while the interest for short-term 1-month bonds paid .25%. The long-term rate is much higher than the short-term rate, so that was not an inverted yield curve. Then, the chart also showed us two yield curves from this year, one at February 9, 2018, and the other one at two months later on April 9, 2018. It is very easy and clear to see the yield curve is flattening fast.



Today, the overnight rate of interest in the US is set at 1.75%. The number is expected to increase as high as 3.25% over the next 18 months. The 10-year rate is 2.8%, and the 30-year rate is 3.0%. When the overnight interest rate rises above the long-term rates, the inverted yield curve will be drawn out, and a recession will most definitely occur soon after.

What does this mean for Elixir?

Typically, investments that are considered risky will fall in value when an inverted yield curve happens. This would include deposits in the Mexican peso, Turkish lira, South African rand, and all commodities. Historically, "safe haven" deposits, such as the Japanese yen, Swiss franc, and US bonds, will increase in value. As the Mexican peso, South African rand, and commodities are currently expensive, we will wait until they drop in price to buy them. On the other hand, our DDVARH have bought US bonds, Japanese yen deposits, and short ownership in Canadian dollars to protect our balance sheet. Shorting Canadian dollars is an indirect way to participate in the falling of oil price. Overall, I believe we are going to experience some challenges economically, and we are prepared to profit from this at Elixir.

WHY DID WE STARTED ELIXIR?

I've had the privilege of meeting many entrepreneurs during my career, and I always enjoy asking them why they started their companies. I often find that people with the most passion and a meaningful reason to start their business have a greater chance of success. I am happy to share with all investors why we are so passionate about Elixir and why Elixir was created.

To answer that question, I think it will be better to talk about myself first. I admit that I worry about money, even though I have had financial success in the past. As a dad of three young kids and a husband to a young wife, financial security for my family is always on my mind and is very important to me. I also worry about the financial wellbeing of my friends who have young families, just like me, and those who just passed the halfway mark in lives, just like me.

My worry comes from my belief that we are heading toward a very long and bleak financial era. In my view, both analytically and intuitively, we have reached the end of making easy money in stocks, bonds, commodities, and real estate. It will be very difficult for people to preserve their capital over the next 50 years in these investments, let alone make money off them. I'm going to share my analysis of why I'm concerned about each of these investments in future newsletters. I will start by commenting on real estate in the latter part of this article.

The dark future is so real to me. On the other hand, I am an optimist and a believer that every crisis is an opportunity. Elixir is set up to capture that opportunity. Our vision for Elixir is that the bondholders and shareholders can join in this Elixir community and create wealth without concerns about long-term trends in stocks, bonds, commodities, and real estate. I would like this community to work together and share our knowledge to help ourselves and as many people as we possibly can.

This may sound abstract to some, but I know Elixir is one of my two life purposes that I'm supposed to serve. Never have I felt this energized and motivated to make Elixir a success.

Real Estate Concerns

Over the next few months, I am going to share my views on a number of asset classes and a basis for my concern regarding each one. This month, I will discuss why I predict that the passive returns in real estate in the short and long term will be poor. My comments are regarding passive return and not actively driven real estate return through manager skill. To provide clarity on this matter, passive return is from the market going up or down. Actively driven return, which can also be called forced appreciation or alpha, is based on manager skill. Even in poor markets, skilled real estate managers will be able to produce returns through improving properties or benefiting from development or rezoning. My concern is limited to investors that are looking for passive returns.

I believe that the best way to determine the future expected return is to look at history. In this section, we are going to look at the historic return on real estate compared to inflation, interest rates, population growth, and affordability. Some people view a long period of history as relevant, and some do not. Personally, I believe it is very relevant when it comes to investing. After sharing what we have learned, we will present our prediction on the future short- and long-term return.

Let's start with comparing inflation data with real estate prices. The Federal Reserve Bank of Dallas studied global home prices from 1870 to 2012 in 14 countries, including Canada. It released comprehensive research in 2014. In the study, data for Canada was shorter compared to some older countries given Canada's young age. The house prices indexes covered the entire country from 1921 to 2012 with a minor gap during World War II. We can combine this with inflation data from the Bank of Canada and updated real estate price data from 2013 to 2017 from the National Bank of Canada.

Prior to World War II, Canadian house prices remained stable. Inflation growth was lower than home increases in value. Throughout the post-war decades until growth leveled off in the 1990s, the value of homes rose by an average of 2.8% per year and inflation was at 4.4%. After a brief period of flat prices, Canada experienced a significant boom period for the housing market in the 2000s with average annual growth rates over 7%.

Period of Time	Inflation Rate	Real Estate Return	Net Return
1921 to 1945	-(0.71%)	0%	+0.71%
1946 to 2000	4.40%	2.80%	-1.60%
2001 to 2017	1.85%	7.26%	+5.41%
1921 to 2017	2.62%	2.76%	+0.14%

The growth totaling over 7% that we have witnessed in real estate has only been there during the last 18 years. Based on history, we can see that the last 18 years have been an anomaly compare to 79 years below or equal to the inflation rate. Prior to the year 2000, house prices were actually lower than the inflation rate. If this is a subject of interest, here is the link to the study: https://www.dallasfed.org/~/media/documents/institute/wpapers/2014/0208.pdf.

So, based on a lengthy history, it would make sense that house prices should increase in value similar to inflation. If this is true and if one was to purchase after a strong increase in value, the expected return would be lower than inflation in the future.

What about population growth and immigration? Has this not caused prices to increase?

Let's compare the above chart and add the population growth of Canada to the same returns to determine if that is a factor. The chart below shows that during the period with the largest population growth per year (1946 to 2000), there were actually the lowest real estate and net real estate returns. During the period of greatest rise in real estate and net real estate returns, there was actually the lowest population growth. This would have us believe that population growth has had little to do with real estate prices.

Period of Time	Inflation Rate	Real Estate Return	Net Real Estate Return	Population Growth
1921 to 1945	-(0.71%)	0%	+0.71%	1.33%
1946 to 2000	4.40%	2.80%	-1.60%	1.74%
2001 to 2017	1.85%	7.26%	+5.41%	0.85%
1921 to 2017	2.62%	2.76%	+0.14%	1.52%

Source Population Growth: Statistics Canada

Many people ask about foreign buyers. Are they not having a large effect on Canadian real estate prices? In some places, there has been foreign buyers, like in Toronto and Vancouver, but this is still a small number. The Canada Mortgage and Housing Corporation estimated in November of 2017 that only 3.4% of residential properties in Toronto and 4.8% in Vancouver were owned by non-residents.

What about interest rates?

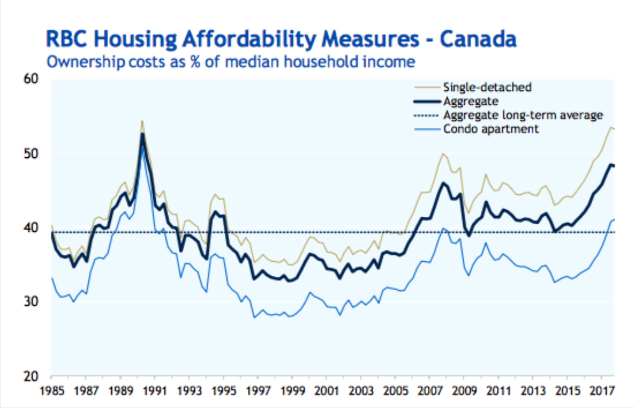
Using data from the Bank of Canada, we can look at the same time periods and see what the level of interest rates were for those periods of performance. We will use the three-month Government of Canada rate.

Period of Time	Inflation Rate	Real Estate Return	Net Real Estate Return	Average Interest Rates
1921 to 1945	-(0.71%)	0%	+0.71%	2.4%
1946 to 2000	4.40%	2.80%	-1.60%	6.19%
2001 to 2017	1.85%	7.26%	+5.41%	2.25%
1921 to 2017	2.62%	2.76%	+0.14%	4.88%

There are a number of interesting points from the above chart. One is that the best performing time periods for real estate are during periods of low inflation and interest rates. During periods of time that interest rates and inflation are high, real estate does very poorly. The chart also shows us that, typically, the three-month treasury has outperformed real estate substantially since 1921.

What about affordability?

Below is a chart from Royal Bank of Canada (RBC) that show the average ownership cost of a home as a percentage of median household income. The theory is that eventually, when affordability reaches above 50%, there will be less new buyers to purchase homes. When affordability drops below 40%, there will be more buyers in the marketplace. This makes sense, as new buyers often consider how much they can afford each month compared to the price of the actual house. The theory is that investors will receive their best returns if they buy when affordability is below 40% and sell when affordability is above 50%. Unfortunately, this data has not been published for very long, but we can go back to 1985.



Conclusion

Based on the above theory, it would be best to buy a home in 1986 and 1997 and sell your home in 1990, 2008, or 2017. The opposite would also be true; it would be a poor time to buy a house in 1990 and sell in 1997. Let's test the theory in the chart below in the city of Vancouver. We have chosen Vancouver because the local real estate board has detailed records covering this period of time.

Transaction	Return Per Year	Inflation Per Year	Net Return	Average 90 Day Canada T-Bill
Best Time				
Buy in 1986 & Sell 1990	21.07	4.51%	16.56%	4.59%
Buy in 1986 & Sell in 2008	9.38%	2.53%	6.85%	6.0%
Buy in 1986 & Sell in 2017	8.95%	2.27%	6.68%	4.66%
Buy in 1997 & Sell in 2008	7.94%	2.01%	5.93%	3.91%
Worst Time				
Buy in 1990 & Sell in 1997	2.54%	2.23%	0.31%	7.24%

There are three main points I glean from the table above.

1. When one buys at the right time, as predicted by the affordability metric, their return should be much better than average.

2. When purchasing a home at the wrong time, a seller may have returns lower than T-Bill or Guaranteed Investment Certificates (GICs).

3. Notice that even during the 22-year period that was timed well, the return on real estate was only 3.38% higher than 90-day T-Bills or GICs.

Based on the chart above, it seems that in the short term, the largest predictor of real estate returns is affordability. This makes sense; It is just like car purchases. How many more buyers would there be of Porches or Ferraris if the monthly payments were similar to a Honda Civic? It is best to buy a home when it has the highest affordability measured by a low percentage of ownership costs.

The summary of the main points regarding how real estate returns are effected in the long run are similar to inflation. It is better to purchase a home after it has underperformed inflation as it will be less expensive in real dollars. Often, real estate underperforms GIC or T-bills for long periods of time, and population growth does not seem to be a factor. Interest rates decreasing are the largest component in affordability, and this is a very good short-term predictor of future home prices.

So, the best time to buy real estate would be during the following times, 1) Falling interest rates; 2) High current affordability; 3) When real estate has underperformed inflation for long periods.

Currently, we are in just the opposite state:

1. Expectation of increasing interest rates;
2. Lower current affordability;
3. Real estate has significantly outperformed inflation for the last two decades.

At this time, these three factors are strongly stacked against real estate, especially in cities like Toronto and Vancouver. Due to the factors above, I predict that passive real estate returns over the short and long term will be poor. I expect that real estate will underperform inflation and produce negative real returns for the conceivable future.

ELIXIR ANNOUNCEMENTS

Elixir Gives Back: Secure Care or Syndicated Mortgage Assistance

Elixir's Board has heard from many concerned investors and dealing representatives that participated in the Secure Care and other syndicated mortgage offerings that recently were restructured. In the case of Secure Care, investors will receive about 33 cents per dollar they had previously invested.

We are offering a special strip bond to former investors of Secure Care and other syndicated mortgage offerings as a way of giving back. Here are some frequently asked questions:

What is a strip bond?
A strip bond is purchased for a discounted rate and matures at a value of $100. Strip bonds do not pay interest. For example, the Province of Ontario currently has a strip bond that matures at $100 in three years from now and is priced at $93.63. This growth produces an effective rate of return of 2.36% per year.

What are the terms of Elixir's strip bond?
The bond will be priced at $33 and mature at $100 in 8 years. This provides an effective rate of return of 14.86% per year.

Why is Elixir doing this?
We wanted to help. Elixir was designed with the purpose of protecting the investors' net worth, and we want to share this with those that have lost money.

How can Elixir offer such a high rate?
Normally, we offer bond holders 8% annual interest, and Elixir shareholders earn a profit from the amounts that are greater than this. In this case, we are giving away our expected profits to the strip bond investors.

Are there restrictions to who can invest?
There are five restrictions:
1) Non-registered investors only
2) Investors must be accredited.
3) Total offering is capped at $3 million.
4) Maximum investment of $100,000 per investor
5) Investors must provide proof of loss.

How can I learn more about this offering?
Please reach out to us directly for a term sheet.

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.