

October 2018

# Elixir News



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





Hi everyone,

I hope you had a great October. The last 30 days have been very exciting for us at Elixir. We have so much to share with you.

First, our October proprietary trading revenue as a percentage of bonds outstanding ended at 2.98%. When our revenue from “software as a service” is added, our actual performance was 3.01% of bonds outstanding. High market volatility contributed to this higher-than-normal return. In the coming months, we expect our monthly returns to normalize back to 2.0% unless the market experiences extreme volatility again.

The feature article in this issue of Elixir News provides a performance update on ElixirTech 2.0 and a sneak peek at ElixirTech 3.0. As many of you are aware, we took our board and a handful of investors to Mexico at the end of October. Everyone had a wonderful time. In this newsletter, two articles focus on the trip. One is an extensive report about Mexico’s economy, including our ground-level observations. The other is a brief piece highlighting the memorable cultural experience we had during the *Día de Muertos* (Day of the Dead Festival).

Lastly, we have a couple of important board decisions to announce. First, to make our balance sheet more robust, the board has approved a rate sale of an additional 2% yield on term bonds starting November 1, 2018 and ending February 28, 2019. With the bonus rate, the yield for a 1-year bond is 10%, while for a 2-year bond it’s 11%, for a 3-year bond it’s 12%, for a 4-year bond it’s 13% and for a 5-year bond it’s 14%. Secondly, to better reflect the company’s value, the board decided to raise Elixir’s price per share to \$50.00, effective January 7, 2019.

We hope you enjoy this issue of Elixir News. Please feel free to reach out anytime.

Sincerely,

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.



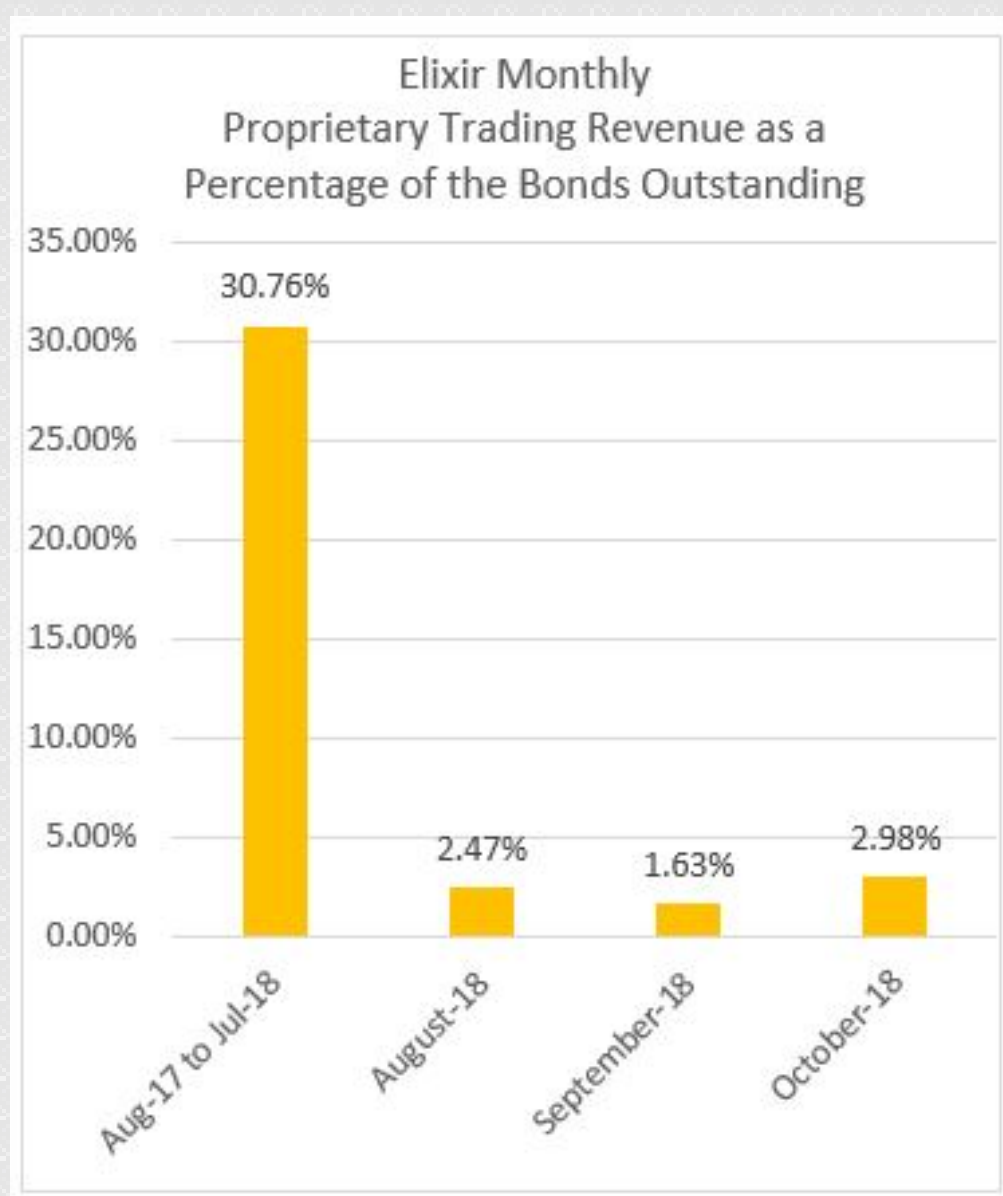
October 2018





# ELIXIR OCTOBER 2018

## Trading Revenue Performance & Global Market Observations



Our October proprietary trading revenue as a percentage of bonds outstanding ended at 2.98%. High market volatility contributed to this higher-than-normal return. In the coming months, we expect our returns to normalize back to 2.0% unless the market experiences extreme volatility again.

### 1. Which asset class performed well in trading in October?

In October, the market experienced two lengthy volatile periods. Volatility was up during the first few days of the month and accelerated to high levels on the afternoon of October 10th. After a

brief recovery period, high volatility returned on October 23rd and continued till the 29th. During these high-volatility periods, while the stock and commodities market suffered great losses, safe assets such as USD bonds and Japanese Yen increased in value.

Elixir was well-positioned for this. We made substantial profits by selling off a good portion of our USD bonds and Japanese Yen. Additionally, we made profits by shorting commodity positions we owned. Volatility has since softened and we were able to repurchase many of the USD bonds and Japanese Yen that we sold. This means we are again well-positioned for another potential volatile event.

### 2. How have the predictions we made in the newsletter panned out?

In our last newsletter, we reported that our algorithm identified four assets at a 100% confidence level on October 9th. Here is how those assets have performed since then:

Asset Class	Position	Return Oct 9-Nov 8
New Zealand Dollar	Long	5.2%
30-Year USD Bonds	Long	0.2%
Gold	Long	3.6%
S&P 500	Short	-2.7%

Source: Investing.com

**3. What is the most undervalued and overvalued asset class that Elixir’s algorithms have recently identified?**

Our algorithm is designed to let us know if an asset is overvalued or undervalued. It also indicates how confident it is about its own findings. The algorithm ranks its confidence between 0 and 100%. For assets over the 80% level, we would start making small purchases. As we continuously refine our calculation and include more data, our algorithm will change and become more accurate.

In future newsletters, we will discuss the mechanics behind our algorithm. For today, we will share a list of assets which our algorithm has identified. Not everything in this list is within our mandate to trade (for example, equity investments), but knowing whether they are overvalued or undervalued is helpful. As a disclaimer, this information is intended to show our investors the assets on which we are currently keeping an eye. It should not be viewed or used as investment or trading advice.

Our last algorithm update was on November 6th at 5pm EST. Base on the result, we do not have 100% confidence in any asset class. The market will be more volatile in the coming year, we are happy with our current conservatively positioned portfolio. For reference, here are the assets that our algorithm identifies as over 80% confidence level.

Asset to Buy	Confidence Level
Orange Juice (Not able to execute currently)	100%
Australian Dollar	87%
New Zealand Dollar	86%
Gold	82%

Asset to Sell	Confidence Level
Natural Gas	84%
US Stock Market	80%





# OCTOBER FEATURE ARTICLE

## ElixirTech 2.0 is Working!

In our July 2018 newsletter, we said that we were diligently working to complete two technology projects (ElixirTech 1.0 and ElixirTech 2.0) and that our target for completion was the end of 2018. In that newsletter, we explained in detail our visions for the two software programs.

Today, we are proud to announce to our investors that we are months ahead of schedule! Not only have we completed both software programs, but we started implementing ElixirTech 1.0 in August and ElixirTech 2.0 on October 20th.

Let's briefly recap what these two software programs do. Then I will share some real-life examples and explain what happens next.

### ElixirTech 1.0

ElixirTech 1.0 allows us to pre-program thousands of small trades in minutes, making micro trades with massive diversification. The software is great but has one material limitation: Once a trade makes a profit, it must be reprogrammed manually.

### ElixirTech 2.0

ElixirTech 2.0 eliminates the limitation of ElixirTech 1.0. The software is equipped with automated "listeners" that check our thousands of current positions more than 100 times per second. When a trade makes a profit, ElixirTech 2.0 recognizes this and automatically reprograms the same trade within the same second. The software diligently follows the algorithm to reprogram the trade with extreme accuracy.

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[11/12 02:59:12] Running...
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Start Monitor

A screenshot of the "ElixirTech 2.0 Trades Execution Log" on one account from 11pm, Nov 11th to 3am, Nov 12th. The software is executing trades on its own while we are sleeping.



I often say that using ElixirTech 2.0 is like having hundreds of traders watching the market's micro movements. However, humans can't check trades 100 times per second and certainly wouldn't be nearly as fast or accurate in executing trades as ElixirTech 2.0 is. Because of this powerful feature, ElixirTech 2.0 allows us to capture many more "missed revenue opportunities" with no additional risk.

A real-life example involves our recent trip to Mexico. On October 31st, I spent most of my day travelling. During the next two days, I was very busy with our investors and board (as well as dealing with Eve's accident). I was able to check my phone only periodically during market hours. Yet, during this time, we showed a strong revenue performance. This was because ElixirTech 2.0 was working in the background, automatically putting through trades. During the night, when we are sleeping, the software is also checking and executing trades. I tell you, waking up and seeing that we've made money while I was sleeping is a great feeling!

Some of you may be wondering: With the distance between Vancouver and Toronto (where our custodian is located), how can ElixirTech 2.0 process trades so quickly? Each day has 86,400 seconds. One hundred times per second means 8,640,000 times per day!

Well, given the physical distance, it isn't possible to do this from Vancouver. Our programmer figured out that our custodian's servers are located in a server warehouse in New York City. So, we leased a server in the same warehouse, a few metres from our custodian's. This makes extremely fast communication possible.

### **What's next?**

ElixirTech 3.0 was completed while we were in Mexico. In a future newsletter, we will share more information about it. For this article, I would simply like to explain the concept behind ElixirTech 3.0.

Our algorithm requires ongoing current market data to adjust its calculations. Before ElixirTech 3.0, I had to determine which information was needed and where to find it, then screen through hundreds of pages of reports to locate the valuable data, and finally feed it through a format our algorithm would accept. Researching and analysing data takes up a significant portion of my time.

Instead of hiring an associate researcher, we designed ElixirTech 3.0. The software does exactly what I have described above. It ensures that our algorithm always receives timely and accurate data and it keeps our costs down because we don't have to hire a researcher to complete the same job.

# ELIXIR'S ECONOMIC TRAVELLER'S REPORT

## The “Tip of My Hat” to Mexico

One question I often get from investors is: How do we determine in which currency to invest? While we do consider some unique currency-related factors, such as high volatility, high daily interest yield, and liquidity, we also examine the economic and financial health of the country that prints the currency. We invest only in currencies backed by a stable economy and a strong balance sheet. Of course, as many of you know, I am a strong believer in “fact-checking” through travelling. Therefore, a very important part of my research is to obtain insights by going to the ground level.

With all that said, we’ve designed a new format through which to present our rationales for each currency we trade. We look at 10 categories and rate each with a “tip of my hat,” “shrug of my shoulder,” or “wag of my finger.” This rating system is inspired by comedian Stephen Colbert. We view “tip of my hat” as positive and confident, “shrug of my shoulder” as mediocre or indifference, and “Wag of my finger” as negative or risky.

In this issue, we will take a thorough look at the United Mexican States and the Mexican Peso.

1	GDP Growth		6	National Debt	
2	Unemployment		7	Poverty Rate	
3	Inflation		8	Trade	
4	Interest Rate		9	Ease of Doing Business & Levels of Corruption	
5	Debt Rating		10	Currency Volatility	
Overall Rating for Mexico					

### 1. GDP Growth

Shrug of My Shoulder



According to the World Bank and IMF, Mexico’s GDP is about \$1.1 trillion USD. This is slightly lower than Australia and Spain, which are each at about \$1.3 trillion USD. GDP growth between 2010 and 2017 averaged 2.1%, which is slower than the global average of 2.5% to 4.3%.

After visiting the country’s large cities multiple times and observing how the locals live, I realized that the nation’s GDP growth might be artificially low because large economic activities are not being documented.



In Mexico, it is very common to pay cash for goods and services everywhere. According to the World Bank, only 45% of adults in Mexico have a bank account. The other 55% of the adult population, which includes lower-income workers, use only cash for their daily financial activities. They earn a living in cash and spend in cash; they've literally tacked away their life savings in their mattresses. These transactions are never reported to the government for tax purposes, nor do they show up in the country's GDP numbers.

My personal experience has been consistent with this point. Over 60% of the businesses I frequented took only cash. During my recent trip to Mexico, I was surprised to learn that not only does the low-income population use only cash, but so do high-earning professionals who are "in the system." The latter prefer cash payment if given the opportunity.

Here is a real-life story to demonstrate this point. During our recent trip, Eve suffered an unfortunate accident. On November 2nd, a sharp chef's knife fell on her leg at a restaurant in Cholula. She had a deep, 10-cm-long cut on her left calf. We went to a private hospital in Puebla, where a high-end plastic surgeon performed emergency surgery. After the operation, the surgeon encouraged me to pay him directly in cash instead of paying to the hospital. He offered no receipt, but simply slipped the cash into his pocket and drove away. Given how smooth he was, I am certain this kind of "cash-for-surgery" transaction happens all the time. I knew there was an undocumented economy among the low-income class, but I had no idea it applied to high-income professionals as well.

While Eve was recovering, we stayed in a posh suburb of Mexico City, called Santa Fe. The level of wealth was simply jaw-dropping. Through our hotel window, the side-by-side high-rises stretched as far as my eyes could see, and almost every building had a helicopter landing pad on top of it. During my daily wheelchair walk with Eve, we passed a number of ultra-luxury car dealerships and a humongous high-end mall that was easily 10 times bigger than the Pacific Centre in downtown Vancouver. The cost of living in this city is shockingly high, very similar to that of home. Santa Fe's wealth is not an exception in Mexico, as we saw pockets of ultra-rich communities in Mexico City, Puebla, and other major Mexican cities as well. The locals explained to me that a lot of this wealth comes from drug cartels. Of course, the cartels' income and expenses are all cash-based. This huge underground economy does not appear in the GDP reporting. I've heard that Mexico is planning to legalize recreational marijuana; perhaps that will add some of the drug revenue to Mexico's GDP.

I would have given Mexico's GDP the "wag of my finger" because of its low GDP growth on paper. However, having visited the country, I know that the reported low growth is not a true representation of Mexico's economy. The real GDP is difficult to measure but should most certainly be higher than reported. Therefore, I gave this country's economy the "shrug of my shoulder."



## 2. Unemployment Rate

Tip of My Hat



According to data from Trading Economics, Mexico's unemployment rate averaged 3.76% from 1994 to 2018. It reached an all-time high of 6.42% in September 2009 and a record low of 2.22% in March 1997. For the first nine months of 2018, the unemployment rate ranged between 2.8% and 3.6%. This is a much better number than those of Canada (5.8%) and the US (3.7%) during the same time period.

Given the large undocumented economy that I described earlier, I suspect that the real unemployment rate in Mexico is even lower than what is reported. I didn't see any beggars on the streets, except for the occasional person with a disability. Everyone works. It's common to see even little kids selling small goods at festival fairs. Another observation is that the Mexican government has been offering temporary work permits to all the members of the Honduras immigrant caravan. This led me to believe that Mexico could even be facing a shortage of labour.

The existence of job opportunities is a sign of a strong country. The Mexican people's work ethic has always impressed me, and I am not surprised to see the nation's consistently low unemployment rate year after year.

## 3. Inflation Rate

Shrug of My Shoulder



Mexico's annual inflation rate has fluctuated in the range of 3% to 6.8% from 2010 to 2018 (Trading Economics). It currently sits at 5%, which is higher than the average emerging market rate of 4.26% (Statista). I believe this higher-than-average inflation rate is related to the tight job market. The low unemployment rate means that employers would have to pay higher salaries to attract workers. The additional earnings are then being spent in the economy and creating inflation. Although Mexico's inflation rate is higher than average, it is still within range – hence, my middle-of-the-road “shoulder shrug” rating.

## 4. Interest Rates

Tip of My Hat



Since the beginning of November, Mexico's 10-year bond has offered a yield of 8.62%, which is much higher than those of Canada (2.33%) and the US (3.20%) (Bloomberg). On average, a 10-year bond changes rate once a month, with minimal fluctuations. Our custodian offers us a yield of 5.75% daily interest on Mexican Peso deposits. Again, this is much higher than the 1.45% we earn on Canadian Dollar daily deposits.

As previous newsletters have explained, one of the criteria we use to select a currency to trade is high daily interest on deposit. “High daily interest” is a “safety cushion.” When the market is not suitable for selling, we can simply hold and earn interest income while we wait. The Mexican Peso fits this requirement. Therefore, I give it the “tip of my hat.”



## 5. Debt Rating

Tip of My Hat



Standard & Poor's credit rating for Mexico stands at BBB+ with a stable outlook. Moody's, Fitch, and DBRS have given the country similar ratings. A BBB+ rating means that Mexico's debt is investment-grade for institutions to invest. "Stable" means that the agencies do not foresee that they will be changing their debt ratings in the future. Because institutions are confident about Mexico's ability to pay back its debt, we don't expect the Mexican Peso to experience a shocking drop in value. This creates confidence in us. Therefore, I give Mexico's debt rating the "tip of my hat."

## 6. National Debt

Tip of My Hat



At the end of September, Mexico's Debt to GDP Ratio was 46.4% (Trading Economics), which was much better than those of Canada (89.6%) and the US (105.4%). In dollar terms, Mexico's national debt is 445 billion USD. After adjusting with its foreign exchange reserves of 177 billion USD, Mexico's net debt is only about 268 billion USD. To put this into perspective, although Mexico is a developing country, its GDP is similar to those of Spain and Australia. The net debt of those two developed countries is 1,379 billion USD and 778 billion USD, respectively.

Mexico is clearly in excellent shape when it comes to managing its debt. In fact, owning Mexican debt/currency is materially less risky than doing the same for some developed countries.

For those who are interested, please refer to the September issue of Elixir News for a more in-depth analysis of this topic. I have a high comfort level with respect to Mexico's national debt. Therefore, I give this area the "tip of my hat."

## 7. Poverty Rate

Tip of My Hat



According to the World Bank, 46.1% of Mexico's population was categorized as "poor" in 2010. This rate dropped to 43.6% in 2016. The more encouraging development is that the "extreme poverty rate" dropped from 11.3% in 2010 to 7.6% in 2016. The country's middle class is growing every year.

I took my first trip to Mexico in 1981, when I was a child. Poverty was much worse at that time than it is today. The country certainly deserves the "tip of my hat" for steadily lifting its population out of poverty.

## 8. Trade

Wag of My Finger



According to the 2017 data from the founder of World's Top Exports, Mexico's top trading partners are the US and Canada. The two countries accounted for 79.9% and 2.8% of total Mexican exports, respectively. This is unsurprising, as the three countries are trading partners through USCMA (known as "NAFTA" before Trump's surgical renegotiation). Being nearly 80% dependent on one country for trade is very dangerous. I believe the people of Mexico have



learnt their lesson through the death of NAFTA. Mexico's top priority should be to expand trade with other countries.

That said, in my travels, I made three observations which led me to believe that improvement is coming. First, I saw a number of large European manufacturing plants in Puebla. My local guide told me that European managers frequently visited the plants and that signs of increased spending were apparent. Second, I saw Chinese goods everywhere! From supermarkets to street vendors, almost everything is made in China. Lastly, while we were in Mexico this last time, a Puebla local whom we knew went to China for the first time, attending a trade show.

These are all very positive signs that the country is promoting trade beyond the North American border. However, I still have to give the "wag of my finger" to this area until we see a better data report.

## 9. Ease of Doing Business & Levels of Corruption

### Wag of My Finger



Based on 2017 World Bank data, Mexico achieved a ranking of 49th out of 189 countries in terms of "ease of doing business." This was not too far behind Canada, which was 18th on the list.

In addition to the World Bank ranking, another commonly used tool to measure the macro business environment is the Distance to Frontier (DTF) score.

*Based on the definition from IndexMundi, "An economy's **distance to frontier (DTF)** is indicated on a scale from 0 to 100, where 0 represents the lowest performance and 100 the frontier. For example, a score of 75 in 2012 means an economy was 25 percentage points away from the frontier constructed from the best performances across all economies and across time."*

On the DTF scale, Mexico received a score of 72.27. While the country is strong in "Getting Credit," "Starting a Business," and "Trading Across Borders," its score is being pulled down by "Protecting Minority Investors," "Registering Property," and "Enforcing Contracts and Corruption." Again, surprisingly, Canada is not that far ahead, with a score of 79.29.

Speaking of corruption, a Puebla judge joined us for dinner during our visit and shared a frightening personal story. A young man was arrested for public drunkenness. He claimed that he belonged to a drug cartel and that she (the judge) should let him go. She didn't believe him and put him in holding. Later, armed cartel members swarmed the court and insisted on his release. The judge was so scared, she let the young man walk. From what we understand, this happened only once to our judge friend. It is clear, however, that when cartels or people in positions of power cross the law, the legal system is often very "flexible," either because of safety threats or bribery. When a country's legal system can't stand firm, I have trouble believing that business contracts would be honored. Hence, my "finger wagging" score.

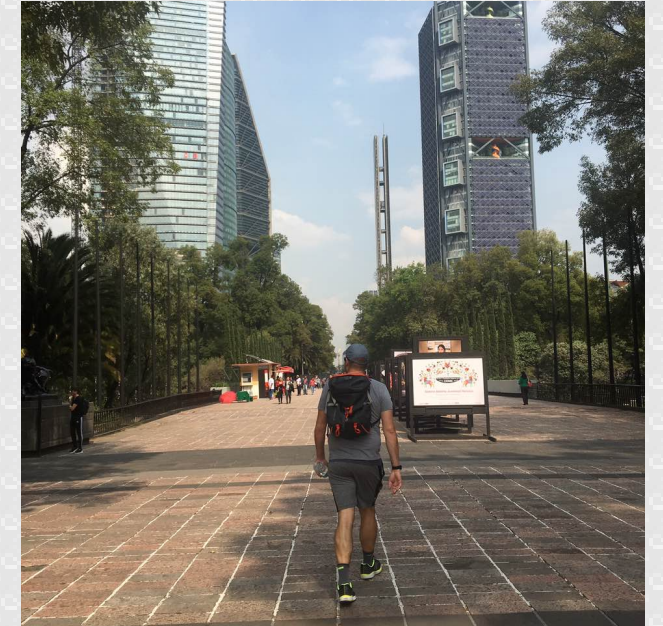


## 10. Currency Volatility

Tip of My Hat



Elixir loves volatility. This is one of the reasons why we love the Mexican Peso. Because it is part of the emerging market, the currency's price often changes over 1% a day. On this trip to Mexico, we saved 4% on our group's hotel costs. If we had checked in a week earlier or a week later, we would have spent 4% more. This volatility creates revenue opportunities for Elixir. Therefore, I give the Mexican Peso the "tip of my hat."



## Mexico's Overall Rating

Tip of My Hat



October 2018

# Mexico City

Based on my research and observations while traveling, I'm comfortable giving Mexico an overall rating of "tip of my hat." The country has a vibrant economy with a strong balance sheet. Its high interest yield and high currency volatility make the Mexican Peso one of our favourite currencies to own and trade.

On the personal side, I also enjoy exploring this amazing country. It isn't far away, and it's easily accessible. In addition, it offers beautiful scenery and cultural heritage, and its people are hospitable. Mexico offers great value for our buck.



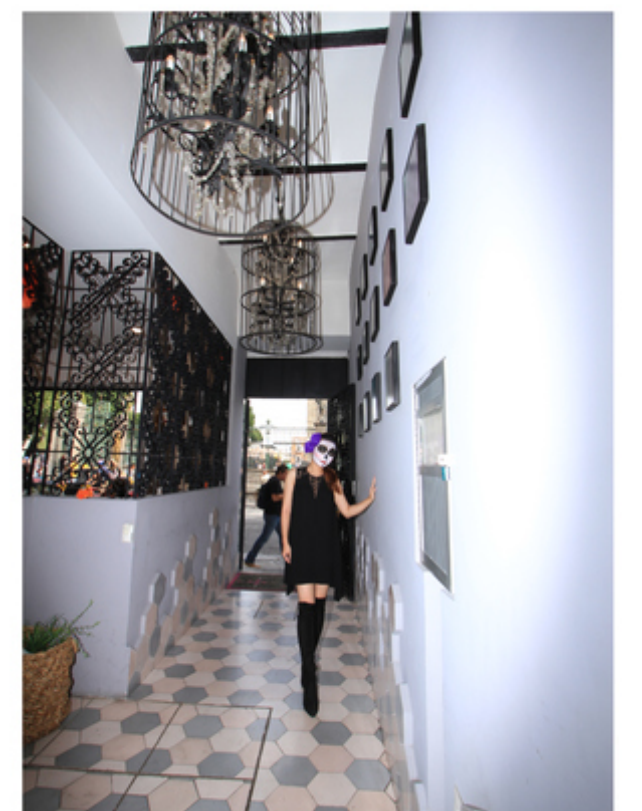
# ELIXIR'S ECONOMIC TRAVELLER'S REPORT

## Highlights from Trip to Puebla

(October 31st to November 3, 2018)

It was an incredibly action-packed two-and-a-half days in Mexico! Soon after we arrived at the Intercontinental Puebla on Halloween, we put on our costumes and hit the streets. Downtown Puebla was packed with scary-looking local “monsters” trick or treating. After only a couple of hours, our 500 pieces of candy were completely gone! It was a memorable first night for everyone in our group. Halloween is fun back home, but the Mexicans certainly raise it to another level!

The next day, early in the morning, while our board held a meeting, make-up artists came to the hotel and got everyone in character for the *Día de Muertos*. To capture everyone's special moments, we arranged for a photographer to follow us around.







After a delightful lunch at the most scenic terrace restaurant in downtown Puebla, we visited two of the city's 366 churches: the Cathedral Puebla from the 15th century, which took 115 years to build, and the "Chapel of Rosario" from the 16th century, also known as the "House of Gold." The old wealth and artistic craftsmanship that these ancient buildings displayed were simply stunning.

The streets were filled with special ceremonial altars for loved ones who had passed away. Locals believe these alters will guild their loved ones home for a visit. The entire city was decorated just like the movie *Coco*. Hundreds of vendors were on the street, selling all kinds of wares, including delicious local foods. Our director, Jay Zdyb, said that the street food alone was worth the trip!



On the second day, after a shareholder update meeting in the morning, everyone took a trip out of town and visited two historical sites: the Plaza Civica Fuertes de Loreto y Guadalupe, where the Battle of Cinco de Mayo was fought against Napoleon III in 1862, and the Piramides Cholula, which is regarded as the largest archaeological site of a pyramid (temple) in the New World, as well as the largest pyramid known to exist in the world today.

Unfortunately, due to Eve's unexpected accident (as mentioned in the previous article), our group was split in two. One group went to the hospital while the other group continued enjoying the last evening in Puebla.

In the end, we all made it home safely and learnt much about the Mexican economy and the opportunities it presented to Elixir. Everyone had an extraordinary experience in Puebla, Mexico and we look forward to our next adventure in 2019! Preliminary planning has already begun, and we will let you know when we have selected the country and dates!

