EDGEPOINT®

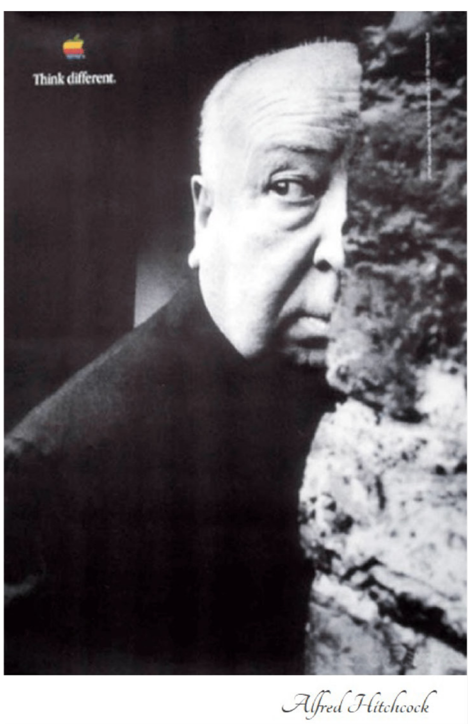
EQUITY COMMENTS For the quarter ending September 30, 2022

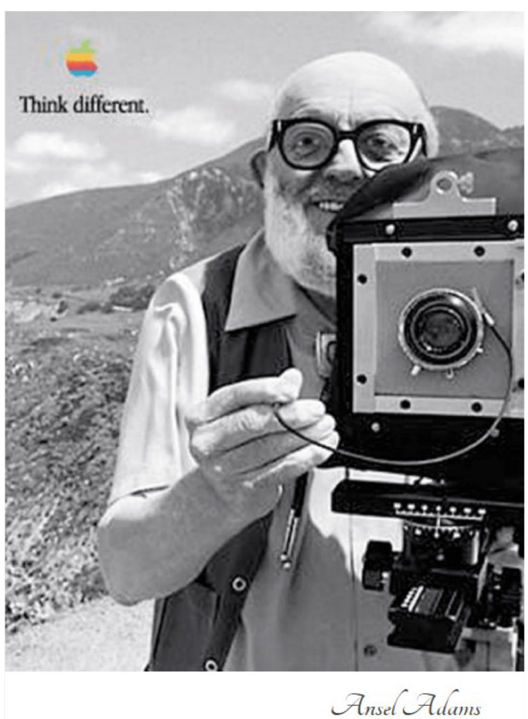
Think different

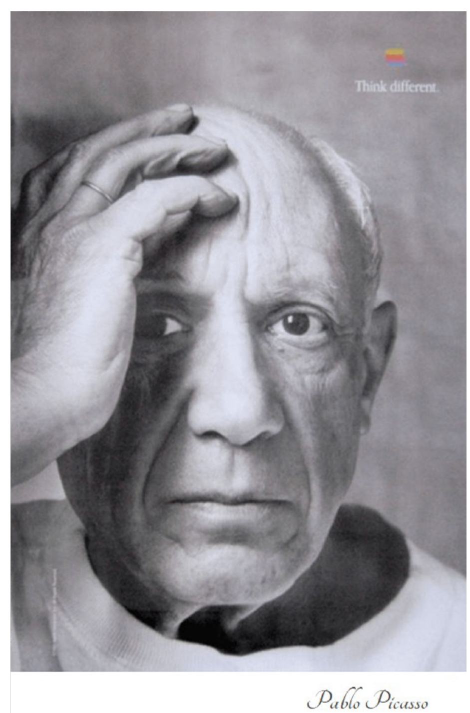
By Jeff Hyrich

Whenever I'm looking at a potential investment for the EdgePoint Portfolios, I'm always thinking of what's special about the business or what advantage(s) it has that will allow for continued success in the future. Culture usually plays an important role but many times before the culture developed, the company or its founders were doing things differently from the prevailing wisdom of the times. For example, most airlines flying between two cities only use the biggest airport because that's what everyone else does. Ryanair,[i] a previous EdgePoint holding, upended this practice by often flying into smaller, secondary airports, which are both cheaper and less crowded. The result was faster turnaround times, more flights per day and less time waiting to takeoff. Ryanair passes these savings back to customers by offering some of the lowest fares in the industry. Their planes fly fuller and they have some of the industry's highest margins and returns on capital. Go figure.

The same thing happens in the art world, where every so often someone creative will upend the traditional ways of doing things and create magic. "Think different" was an advertising campaign used by Apple from 1997 to 2002 that featured historical subjects who were giants in their field. People were shooting movies, taking pictures and painting well before Alfred Hitchcock, Ansel Adams or Pablo Picasso came onto the scene. Each of them pursued their craft differently from peers and, as a result, their work has stood the test of time. Most box office movies are quickly forgotten after their release, yet people are still talking about the horror movie Psycho released in 1960. Picasso painted 100 years ago and his art not only commands some of the highest prices at auctions, but his unique style changed the way people viewed art itself.

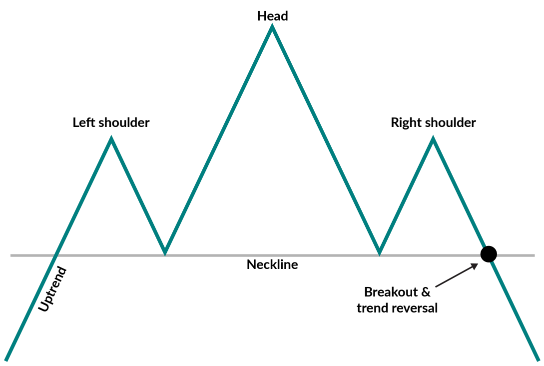






Thinking differently in the investment world

Closer to home, the first mutual fund was launched in 1924,[ii] long after investors began trying to find ways to consistently make money in the markets. Tye Bousada highlighted examples in his Q2 2019 commentary, Still the same old investment approach. First, there's technical analysis that studies historical stock prices and graphs them to predict the future. No time is spent trying to understand what the company does or its future prospects. Here is the famous "head and shoulders" pattern:



Source: "13 Stock Chart Patterns That You Can't Afford to Forget", optionalpha.com,https://optionalpha.com/13-stock-chart-patterns-that-you-cant-afford-to-forget-10585.html.

Next, we have the momentum crowd that just follows trends and buys stocks that are rising, and sells when their prices are going down. There's still no attention paid to what the companies underlying these stocks actually do. This cartoon illustrates this – people are selling simply because the person beside them is selling.

Source: Kevin Kallaugher, "Just a normal day at the nation's most important financial institution...", The Baltimore Sun, October 17, 1989.

Finally, we have the quants. These are people with PhDs who use complicated math equations with lots of Greek letters and that run on very powerful computers. They combine historical prices with lots of other data sets and fancy math to build portfolios. Most quant portfolios have short holding periods, some buy stocks in the morning and sell in the afternoon. Again, little focus is spent analyzing individual company fundamentals. The following is an example of what they do, but don't ask me to explain it.

- $\Phi_{RR_T|N=T}(s) = \mathrm{E}\left[e^{\{i[\sum_{t=1}^{T} R_t \times I_{\{B_{t-1}\geq 0\}}]s\}} | N = T\right]$
- $= \mathrm{E}\left[e^{\{i[\sum_{t=1}^{T} R_t \times I_{\{B_{t-1}\geq 0\}}]s\}} | B_T < 0, B_{T-1} \geq 0, \dots, B_0 \geq 0\right]$
- $= \mathrm{E}\left[e^{\{i[\sum_{t=1}^{T} R_t]s\}} | Z_T = 0, Z_{T-1} = 1, \dots, Z_1 = 1\right]$
- $= \mathrm{E}\left[e^{\{i[\varepsilon_1 + \dots + \varepsilon_{T-1} - \delta_T]s\}}\right]$
- $= \begin{cases} \Phi_{\varepsilon}{}^{T-1}(s)\Phi_{\delta}(-s), & T \geq 1 \\ \Phi_{\delta}(-s), & T = 0 \end{cases}$

Source: Li, Haksun, "Quantitative Trading as a Mathematical Science", https://www.slideshare.net/Quantopian/quantitative-trading-as-a-mathematical-science-by-dr-haksun-li-founder-and-ceo-numerical method-inc.

As crazy and scary as everything I've just talked about sounds, there are many "professional" managers employing various forms of these strategies to invest people's lifetime savings. To paraphrase Warren Buffett, "stocks are not pieces of paper to trade, but rather ownership in underlying businesses." Is it any surprise why most professionals underperform?

Swimming against the current

I'd like to think of EdgePoint as being in the "think different" camp. It starts with the idea of understanding a company's underlying business – what they do, their future growth prospects, competitive threats, etc. We're not making decisions based on stock charts, index weights or simply because its share price is going up. We look at the same annual reports and use the same financial data providers as everyone else. As information has proliferated and is easier to access, it's also become more commoditized; in a few seconds I can get detailed financial data on any of the over 60,000 publicly traded companies,[iii] regardless of what language that company uses. EdgePoint has innovated by wrapping our proprietary insights of businesses (that aren't well understood by other investors) around our fundamental analysis. The goal is to "think different" and see something about a business that the market is missing – to buy a business for less than we think it's truly worth. Markets are usually efficient at discounting the impact of near-term events since that's where everyone focuses. They are inefficient at discounting more-distant time horizons where there's greater uncertainty, meaning there's also more opportunity. Most investors are thinking about the next quarter while EdgePoint is thinking three to five years out. As Wayne Gretzky says, "skate to where the puck is going, not where it has been." Think different.

Diversification tends to be based on geography or sectors, but this can be misleading. Both Elevance[iv] (formerly Anthem, and a current EdgePoint holding) and Intel are categorized as U.S. companies. Elevance gets 100% of revenue from the U.S., compared to 18% for Intel[v] – one is national while the other is global, but both count as U.S. companies. When we construct portfolios at EdgePoint, we diversify by our proprietary insights. We believe these insights give them resiliency and make them antifragile.

The world is a very uncertain place. Although every company provides lists of the potential risks that its business is exposed to, how many listed a global pandemic or inflation running at 40-year highs[vi] as a possible threat? In boxing, the most dangerous punch is the one fighters don't see coming.

Future uncertainty is why you want to diversify by idea. We can own several companies in the same industry, which on the surface might imply less diversification. Each company is exposed to different proprietary big ideas, an aspect of diversification that doesn't show up on a data provider's screen. In the Global Portfolio we own both Ross Stores and Dollar Tree[vii] – two U.S. retailers. Ross is a discount clothing retailer, like Winners in Canada but at lower price points. Amazon and e-commerce have been successful in taking share from physical-based retailers such as department stores, yet Ross' business of off-price, discount clothing is very difficult to replicate online. As Amazon continues to grow, they're putting Ross' competitors out of business and those customers still need a place to buy their clothes. Dollar Tree operates a traditional dollar store concept where historically nothing sold for more than $1, a price that's been constant for 34 years. The big opportunity is for Dollar Tree to increase prices, sometimes referred to as "breaking the buck," which can have material impact on store traffic, revenue and margins. Two companies in the same industry, but driven by different ideas.

Drowning in a sea of similarity

Being different isn't only what we own, but also what we've chosen to avoid. One of the investment industry's sins is closet indexing. This is when fund managers who claim to be stock pickers simply clone or copy the big weights in the index. They do so because they don't want to risk underperforming an index and losing assets (or their jobs) – effectively putting their interests ahead of their clients.

Let's take the benchmark for EdgePoint Global Portfolio, the MSCI World Index.[viii] It's composed of 1,513 stocks.[ix] You would think with so many companies to choose from, there would be wide variety in holdings between different global funds. Guess again. The top 25 stocks account for 1.7% of all companies in the index. Despite this, they can be found in 36 of the top 39 Global Equity funds (of which 35 used either the MSCI World Index or MSCI All-Country World Index as their benchmark).[x] The average weight of the top 25 across these funds was 19%, or almost $1 out of every $5.[xi] EdgePoint Global Portfolio is one of only three funds that doesn't hold any of the top 25. No doubt there are some good businesses here, but their continued popularity means higher valuation, lower margin of safety and lower future returns.

Canadian Equity funds are another example. The three biggest funds in the category all use the S&P/TSX Composite Index as their benchmark and share five or six of the Index's top-10 holdings,[xii] accounting for 27%[xiii] of the funds' total assets on average. Not much "think different" happening there. Our Canadian Portfolio's top 10 currently total about

45% of the assets, with only the tenth-largest position overlapping with the index.[xiv] EdgePoint has chosen to fish where its less crowded, valuations are lower and we can magnify our proprietary insights into ideas with higher potential returns.

Investors tend to buy what's done well recently regardless of valuation, and shun what's lagged and is out of favour. I remember buying Microsoft in 2012 when, net of its cash holdings, it was valued less than seven times free cash flow.[xv] We were going out marketing and getting crucified by investors – everyone hated it. Contrary to the crowd's opinion, we had proprietary insights that Microsoft still had a bright future ahead. A decade later it was up 13-fold[xvi] and is a core holding of most funds – both value and growth. When it was deeply undervalued a decade ago you couldn't give it away, and after it became expensive everyone bought it. Go figure.

The following table shows that the biggest and most widely held companies rarely repeat from one decade to the next – it's hard for winners to repeat. Case in point, Japan's market still hasn't gotten back to its all-time high from 1989.[xvii] Not much "think different" out there when everyone owns what's done well.

Top-10 companies in the world by market cap
1980 to Sep. 30, 2022

1980	1990	2000	2010	2020	Sep. 30, 2022 (US$B)
IBM	NTT	Microsoft	Exxon Mobil	Apple	Apple ($2,221)
AT&T	Bank of Tokyo-Mitsubishi	General Electric	PetroChina	Saudi Aramco	Saudi Aramco ($2,099)
Exxon	Industrial Bank of Japan	NTT DoCoMo	Apple Inc.	Microsoft	Microsoft ($1,737)
Standard Oil	Sumitomo Mitsui Banking	Cisco Systems	BHP Billiton	Amazon	Alphabet ($1,251)
Schlumberger	Toyota Motors	Wal-Mart	Microsoft	Alphabet	Amazon ($1,151)
Shell	Fuji Bank	Intel	ICBC	Facebook	Telsa ($831)
Mobil	Dai-Ichi Kangyo Bank	NTT	Petrobras	Tencent	Berkshire ($597)
Atlantic Richfield	IBM	Exxon Mobil	China Construction Bank	Tesla	UnitedHealth ($472)
General Electric	UFJ Bank	Lucent Technologies	Royal Dutch Shell	Alibaba	Johnson & Johnson ($430)
Eastman Kodak	Exxon	Deutsche Telecom	Nestlé	Berkshire	Visa ($368)
Prominent belief Peak oil	**Prominent belief** Japan takeover	**Prominent belief** Tech/telecom boom	**Prominent belief** Oil and China	**Prominent belief** Tech/telecom 2.0	**Prominent belief** Tech/telecom 2.0 cont.

Source, decades: J. Mauldin, "Bonfire of the Absurdities", Mauldin Economics, November 17, 2017, http://www.mauldineconomics.com/frontlinethoughts/bonfire-of-the-absurdities/. Source, 2020 and 2022: FactSet Research Systems Inc. Market cap in US$.

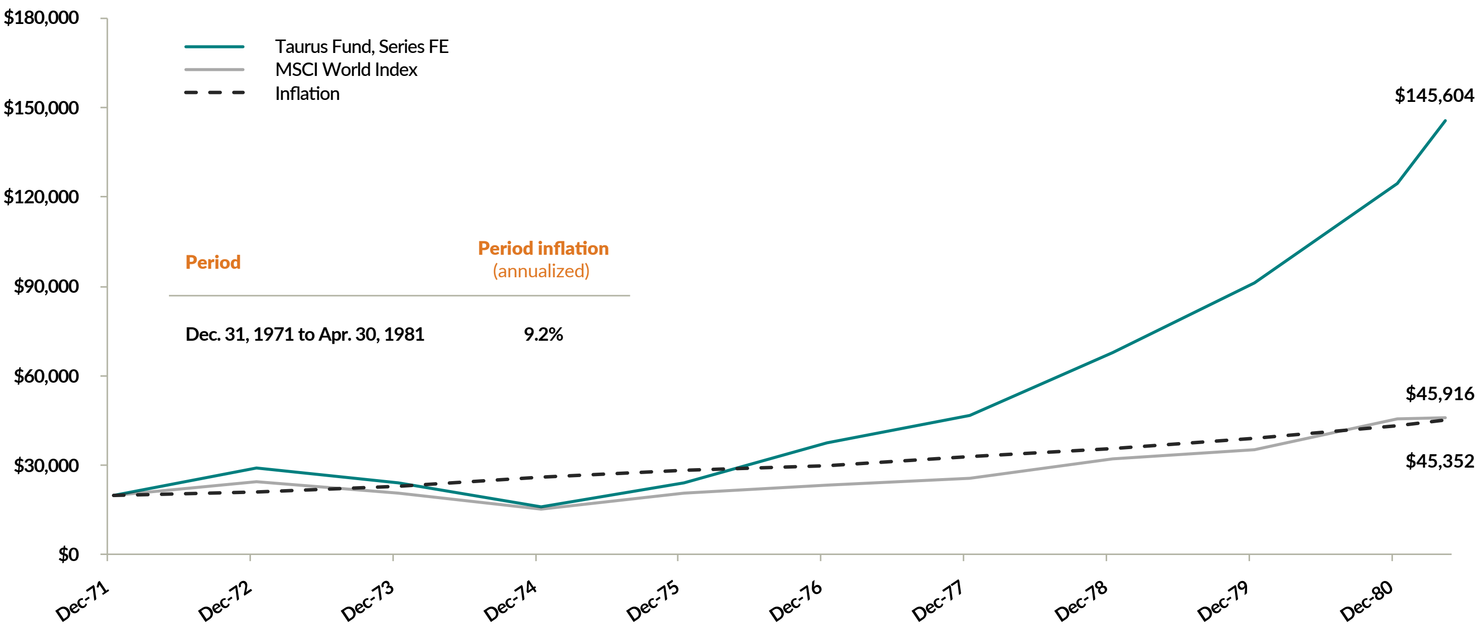
Many global funds have repeatedly made the same bet again and again. They've become funds of "one idea" – with the two biggest areas being tech and quality at any price, as shown by the overlap by Global Equity funds with the MSCI World Index's top-25 holdings. Interest rates were at all-time lows[xviii] and created a perfect fairy-tale environment where profitability and valuation for tech stocks were subordinated to growth at all costs. Investments were made with the hope that today's wart-covered toads would turn into tomorrow's princes. Owning high-quality companies is a great way to compound wealth, but paying 35 times earning multiples to buy them might not be the answer. The dominant themes for over 10 years were based on assumptions that interest rates would stay low forever. What do you do when your investment strategy over the last decade has been to buy the dips and own the same crowded stocks as everyone else regardless of valuation…and that strategy stops working?

A time-tested approach

The EdgePoint discipline of building a portfolio of diversified proprietary ideas goes back more than 50 years and has successfully grown wealth for investors over the long term. Mark Twain said, “history doesn’t exactly repeat but it sure rhymes.” Nobody knows the future, but there are three past precedents that could be an indication of what may happen in the future and how our investment approach fared each time.

Inflation is currently running at highs last seen in the 1970s. Bob Krembil, one of EdgePoint’s founders and the originator of the investment approach we apply today, was the lead manager of the Taurus Fund in the 1970s. The team navigated the fund’s returns to more than triple the index during that decade.

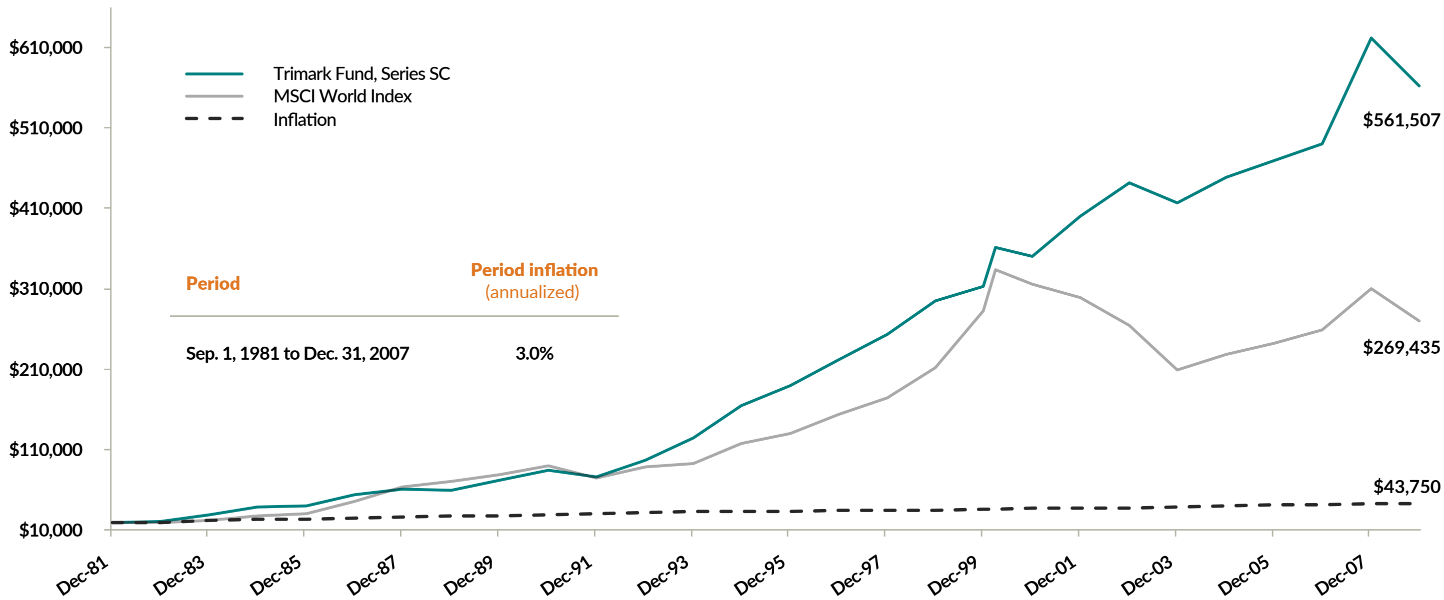
Taurus Fund, Series FE vs. MSCI World Index and inflation
Growth of $20,000
Dec. 31, 1971 to Apr. 30, 1981



Source, Taurus: Bolton Tremblay Funds Inc. 1982 Annual Report. Source, MSCI returns: Morningstar Direct. Source, inflation: FactSet Research Systems Inc. As at April 30, 1981. The above values are for illustrative purposes only and do not represent an actual client’s results. Total annual returns, net of fees, in C$. Historical performance is not indicative of future returns. The Taurus Fund is used for illustrative purposes only to demonstrate the history of the investment approach applied at EdgePoint. The MSCI World Index is a market-capitalization-weighted index comprising equity securities available in developed markets globally. The MSCI World Index was used for comparison purposes as it represents a broad global equity universe across several developed market countries, although it may not be a fair comparison for the Taurus Fund, due to a possible small-cap exposure in the Fund. Standard performance for the Taurus Fund is unavailable since it is no longer in existence. Inflation is the Canadian Consumer Price Index – All Items.

The last time we saw a bubble in tech stocks and its subsequent popping was in the late 1990s. The Trimark Fund was up 32%[xix] from the beginning of 2000 to the start of 2005, a period when Tye went from co-manager to lead manager of the fund.[xx] That might not sound impressive on its own, but for context, the MSCI World Index was down 27%.[xxi]

Trimark Fund, Series SC vs. MSCI World Index and inflation
Growth of $20,000
Sep. 1, 1981 to Dec. 31, 2007



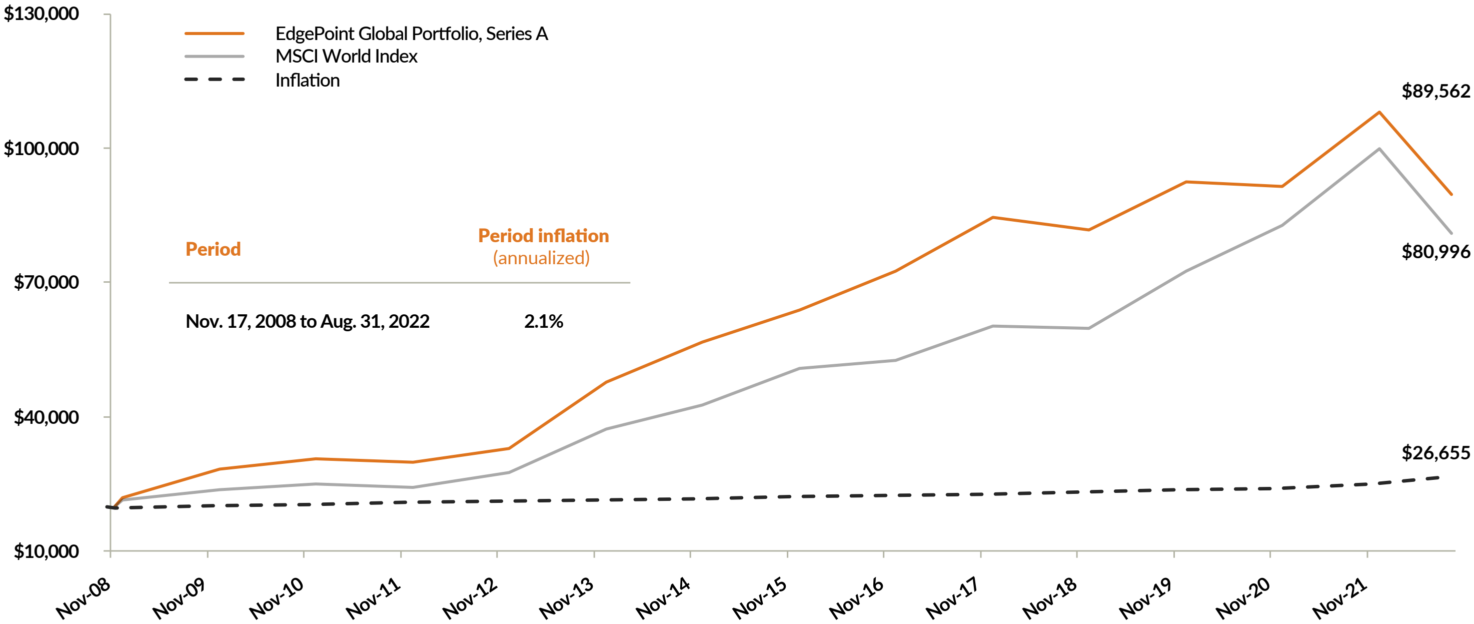
Annualized total return, net of fees, performance in C$ as at September 30, 2022

Invesco Global Companies Fund – Series SC (formerly the Trimark Fund)
YTD: -24.28%; 1-year: -20.53%; 3-year: -1.66%; 5-year: 2.35%; 10-year: 8.18%; since inception (Sep. 1, 1981 to Sep. 30, 2022): 10.38%

Source, returns: Morningstar Direct. Source, inflation: FactSet Research Systems Inc. As at July 27, 2018, Trimark Fund changed its name to Invesco Global Companies Fund. The above values are for illustrative purposes only and do not represent an actual client's results. Total annual returns, net of fees, in C$. Historical performance is not indicative of future returns. The Trimark Fund was used for illustrative purposes only to demonstrate the history of the investment approach applied at EdgePoint. The MSCI World Index is a market-capitalization-weighted index comprising equity securities available in developed markets globally. The MSCI World Index was used for comparison purposes as it represents a broad global equity universe across several developed market countries. The Trimark Fund was managed independently of the index used for comparison purposes. Differences including security holdings and geographic/sector allocations may impact comparability. Inflation is the Canadian Consumer Price Index – All Items.

Finally, there have been warning signs for years about over-heated real estate markets and high leverage in the system. Could rising rates employed by central banks to combat inflation finally cause a reversal? While most Canadians (with the exception being Alberta) haven't seen large and prolonged decline in housing since the 1990s,[xxii] several members of the EdgePoint team managed funds through the global financial crisis of 2007-2008 and the bursting of the U.S. housing bubble. Inflation has always been a hidden drain on investments, but the recent high levels are just another in a long line of macro concerns that add to uncertainty and provide opportunities for investors who understand the value of the businesses they're buying. Since EdgePoint launched in 2008, Geoff MacDonald, Tye Bousada and the now-13 other members of the Investment Team have helped the Global Portfolio outperform the MSCI World Index. Nobody knows the future, but our approach of investing in undervalued ideas, where we can buy growth and not have to pay for it, has stood the test of time.

EdgePoint Global Portfolio, Series A vs. MSCI World Index and inflation
Growth of $20,000
Nov. 17, 2008 to Sep. 30, 2022



Annualized total return, net of fees, performance in C$ as at September 30, 2022

EdgePoint Global Portfolio, Series A
YTD: -17.17%; 1-year: -11.46%; 3-year: -0.67%; 5-year: 2.16%; 10-year: 10.89%; since inception (Nov. 17, 2008 to Sep. 30, 2022): 11.42%.

Source, index: Morningstar Direct. Source, inflation: FactSet Research Systems Inc. The above values are for illustrative purposes only and do not represent an actual client's results. Total annual returns, net of fees, in C$. The MSCI World Index was used for comparison purposes as it represents a broad global equity universe across several developed market countries. The index was chosen for being a widely used benchmark of the global equity market. We manage our Portfolios independently of the indexes we use as long-term performance comparisons. Differences including security holdings and geographic/sector allocations may impact comparability and could result in periods when our performance differs materially from the index. Inflation is the Canadian Consumer Price Index – All Items. 2.1% is the annualized inflation rate from October 31, 2008 to August 31, 2022. Inflation data is only available on a monthly basis.

Currently the EdgePoint Investment Team is 15 members strong, with a combined experience of over 200 years (nine of whom have worked for at least 11 years in the industry). We have firsthand experience investing across numerous stock market cycles and crises over the last 25 years. Every crisis creates opportunity for investors who are both disciplined and well prepared. The entire team of 81 employees at EdgePoint is invested alongside unitholders to the tune of $319 million.[xxiii] We're committed to investing our personal money in thinking differently.

Thank you for your continued support in entrusting your savings to us.

[i] EdgePoint Global Portfolio, EdgePoint Global Growth & Income Portfolio and Cymbria held RyanAir securities from November 2008 to December 2015. EdgePoint Canadian Portfolio and EdgePoint Canadian Growth & Income Portfolio held RyanAir securities from July 2009 to December 2014.

[ii] Source: Chuck Jaffe, "First fund's 85th birthday shows why mutual funds will survive", The Seattle Times, March 15, 2009. https://www.seattletimes.com/business/first-funds-85th-birthday-shows-why-mutual-funds-will-survive/. The first open-end mutual fund, the Massachusetts Investors Trust, was launched on March 21, 1924.

[iii] Source: FactSet Research Systems Inc.

[iv] This is for information and illustrative purposes only and not intended to be investment advice. EdgePoint Investment Group Inc. may be buying or selling positions in Elevance Health, Inc.

[v] Source: FactSet Research Systems Inc. As at September 30, 2022. December 31, 2021 was the last reported Intel revenue date.

[vi] Source: FactSet Research Systems Inc. As at September 30, 2022. Inflation is the Canadian Consumer Price Index – All Items. Current year-over-year inflation is 7.01%. The last time inflation was at this level was 7.29% on March 31, 1983.

[vii] This is for information and illustrative purposes only and not intended to be investment advice. EdgePoint Investment Group Inc. may be buying or selling positions in Ross Stores, Inc. and/or Dollar Tree, Inc.

[viii] The MSCI World Index is a broad-based, market-capitalization-weighted index comprising equity securities available in developed markets globally. The index was chosen for being a widely used benchmark of the global equity market. We manage our Portfolios independently of the indexes we use as long-term performance comparisons. Differences including security holdings and geographic/sector allocations may impact comparability and could result in periods when our performance differs materially from the index.

[ix] Source: FactSet Research Systems Inc. As at June 30, 2022.

[x] Source, holdings and benchmarks: Morningstar Direct. Source, weights: FactSet Research Systems Inc. As at June 30, 2022. The 39 funds only include Global Equity category funds with over C$1 billion in assets under management. Fund of funds are excluded. Morningstar classifies EdgePoint Global Portfolio within the Global Equity peer group, which are open-end mutual funds that invest in securities domiciled anywhere around the world with an average market capitalization greater than the small/mid-cap level. These funds must invest between 10% and 90% of equity holdings in Canadian or U.S. companies. Funds without strict investment restrictions and don't qualify for other geographic categories are assigned to this category. The MSCI World Index is a broad-based, market-capitalization-weighted index comprising equity securities available in developed and emerging markets globally.

[xi] Source: Morningstar Direct. As at June 30, 2022.

[xii] Source, holdings and benchmarks: Morningstar Direct. Source, weights: FactSet Research Systems Inc. Latest available holdings and assets under manager as at June 30, 2022 were used. Funds chosen were the three largest funds by assets under management in the Canadian Equity category. Canadian Equity category funds predominantly invest in securities domiciled in Canada with an average market capitalization greater than the Canadian small/mid-cap level. The S&P/TSX Composite Index is a market-capitalization-weighted index comprising the largest and most widely held stocks traded on the Toronto Stock Exchange. The index was chosen for being a widely used benchmark of the Canadian equity market. The iShares S&P/TSX Composite Index ETF was used as a proxy for the S&P/TSX Composite Index.

[xiii] Ibid.

[xiv] Source, index weights: Morningstar Direct. As at September 30, 2022.

[xv] Source: Internal research. As at January 31, 2012. In US$.

[xvi] Source: FactSet Research Systems Inc. As at January 31, 2022. Cumulative total returns in US$. Microsoft was purchased in January 2012. Return period was January 31, 2012 to January 31, 2022 with a total return of 1,201%.

[xvii] Source: FactSet Research Systems Inc. As at September 30, 2022, the Nikkei 225 Index has not recovered to its 1989-high of 38,916. The Nikkei 225 index is a price weighted average of 225 top-rated Japanese companies listed in the First Section of the Tokyo Stock Exchange.

[xviii] Source: Bloomberg LP. Since December 31, 1990, the Bank of Canada's target overnight rate was 0.25% from April 2009 to May 2010 and March 2020 to March 2022.

[xix] Source: Morningstar Direct. As at December 31, 2004. Total cumulative returns in C$.

[xx] Tye Bousada became co-manager of the Trimark Fund in 2000 and lead manager in 2004. The fund's performance cannot be attributed to one individual as decisions were made by the fund investment team.

[xxi] Source: Morningstar Direct. As at December 31, 2004. Total cumulative returns in C$.

[xii] Source: Derek Decloet, "Rosenberg Sees 1990s-Style Canada Housing Bust Hurting Spending", Bloomberg.com, October 11, 2022. https://www.bloomberg.com/news/articles/2022-10-11/rosenberg-sees-1990s-style-canada-housing-bust-hurting-spending.

[xxiii] Employee count as at September 30, 2022. Co-investment as at December 31, 2021. Investment by EdgePoint employees includes all investments by active company founders and employees in EdgePoint-managed investment funds or Cymbria.

Published October 19, 2022.