Written by Tye Bousada

How are we managing your money in the face of economic uncertainty and extreme stock market volatility? The answer is by focusing on the market price of a business relative to our view of its value. We are not trying to guess when the market will hit bottom, or if in fact it already has. We are not making investments based on inflation expectations, our guess of next quarter's gross domestic product (GDP), or our estimates for April's unemployment levels in the European Union. Instead, we focus on the price the market is asking us to pay for an ownership interest in a particular business.

Investment Example: TVA Group Inc.

Let's look at an example. One of your holdings is a company called TVA Group Inc.

About the business

TVA is North America's largest producer and distributor of French-language entertainment, information and public-affairs programming. TVA owns six of the 10 television stations in Quebec and has an ownership interest in nine of the most popular specialty channels in the province. They also own a 75% interest in Sun TV, a conventional TV station in Toronto. Furthermore, they are the leading French-language magazine publisher in Quebec (with an 80% market share of the weekly market) and are active in film distribution. In summary, they are the "800 pound gorilla" in French-language media.

Attractive growth prospects

The economics of their business are quite attractive as they earn healthy profit margins and require little capital to be reinvested in the business in order to grow. More recently, the company has done a good job of leveraging its market dominance in a tough environment. Specifically, while the global economy was grinding to a halt during the last three months of 2008, TVA managed to grow its business. More importantly, we believe TVA will continue to grow its revenue and profitability even in the face of a tough economic environment.

A great price

Now that you have a sense for TVA's business, let's move on to what we believe is the most interesting part of the story. In January, 2009, as fear reigned supreme in the world, we had the opportunity to buy a stake in TVA for approximately $5 a share. What should we expect to receive in exchange for this purchase? In 2008 TVA provided shareholders with $1.57 in earnings for each share owned, and in 2009 shareholders should expect to earn even more. The price that we paid per share equated to approximately three times earnings. Stated another way, if you could buy 100% of the business at $5 per share, you should reasonably expect to achieve a return on your investment of 33% in 2009. Furthermore, in subsequent years, you would expect to earn returns in excess of 33% as the business grows. At this point, you are likely asking yourself, why would someone willingly sell a high-quality business such as TVA to you for only three times earnings? The answer is that fear makes investors do silly things and as a result, the market is not always rational. It is our job to analyze the facts and apply reasoning to those facts. This includes determining when fear is clouding the market's judgment resulting in attractive investment opportunities in businesses like TVA. We believe that the purchase of TVA at $5 per share was one such opportunity.

Since purchasing a stake in TVA at $5 per share, the price has recently appreciated above $8 (a price movement of over 60%). What change has occurred in the business since January that would result in such a material price move in such a short amount of time? The answer is absolutely nothing. The only change is that the market became greedier. Specifically, the market is now demanding a price of approximately five times earnings for TVA instead of only three. Even at five times earnings, we could reasonably expect to earn a 20% return on our investment. As such, we continue to be happy owners of TVA on your behalf.

Opportunities in Smaller-Cap Companies

We continue to find tremendous value in small- to mid-cap stocks in Canada. Of the 43 Canadian equity companies in the Portfolio, 21 have market capitalizations of less than $500 million. Another 6 companies have market capitalizations between $500 million and $1.5 billion. We have not seen such value in Canadian small- and mid-cap stocks since 1998. Given our recent start, our Portfolio is small enough to take advantage of this valuation discrepancy.

No Value in Government Bonds

At the end of the March 2009, EdgePoint Global Growth & Income Portfolio had a 26% investment in fixed income with 100% of this exposure invested in corporate bonds. With 10-year U.S. government debt yielding less than 3%, we don't consider earning 3% before fees for the next 10 years to be an attractive investment. While corporate spreads over government bonds have narrowed in the past quarter benefiting our existing holdings, we continue to find attractive value in corporate bonds. In the last quarter, we added a number of new fixed-income holdings, increasing our bond exposure from 21%. We own very high-quality corporate debt that is yielding, on average, between 200 to 450 points above treasury bonds. We feel this is a strong competitive advantage as many of our balanced fund competitors typically own low-yielding government bonds.

Investment Approach

At this point, we would like to review our investment approach. We are long-term investors in businesses. We view a stock as an ownership interest in a business and we endeavour to acquire ownership stakes in quality businesses at prices below our assessment of their true worth. We believe that the best way to buy a business at an attractive price is to have an idea that is not widely shared by others – what we refer to as a "proprietary insight". We look for businesses that we understand, and that are led by trustworthy and competent management teams. These businesses should also have long-term growth prospects and defendable barriers to entry, leading to attractive return characteristics for the businesses.

Our approach is deceptively simple. We buy good, undervalued businesses and hold them until the market recognizes their full potential. Following this approach requires an ability to think independently and a commitment to embrace the thorough research that is required to uncover opportunities the market doesn't fully appreciate. TVA Group is an example of our approach at work.

We thank you for your confidence in us, and look forward to having the opportunity to build wealth for you over the long term.

Tax Grab on MERs is Terrible for Investors

The recent Ontario budget contains a massive tax grab that our Investment Partners should be aware of. The McGuinty government is proposing the harmonization of Ontario's provincial sales tax with the federal GST. The decision to jam an additional 8% tax on the MERs of your investment products is shockingly unwise and dangerous. While it has less of a negative impact on mutual fund companies, we feel it's terrible for the long-term investor. We urge you to read our comments regarding this proposal (available on our website) which illustrate how this could cost you up to 100% to 350% of your initial investment over time. For residents of Ontario, if you feel as strongly as we do about this decision, we urge you to contact your Member of the Legislative Assembly (MLA). Contact information can be found in our comment letter.

Sincerely,

Tye Bousada

Note to readers: We will endeavour to share with you what we would want to hear if our positions were reversed. In an effort to improve our communication with you, Geoff MacDonald and I will alternate writing the commentary for your Portfolio, giving you a chance to hear from each us twice a year. While we adhere to the same investment approach, our styles of communication are different. Our hope is that you gain a solid understanding of how your money is being invested.

Investment Results

In accordance with the Canadian Securities Administrators' National Instrument 81-102 under which the Portfolio is governed, we are not permitted to discuss investment performance until the Portfolio is one-year old. This information, however, is readily available from publically-accessible websites and newspapers.