A rose by any other name

By Derek Skomorowski

Rule number one in essay writing class was "never choose a title before writing the essay." Too bad, this title has a nice ring to it.

Actually, the first title of this commentary was going to be "What's in a name?" because that would also have a nice ring to it. For anyone not up to speed on English literature, the quotes are attributable to none other than William Shakespeare – something about Juliet saying to Romeo, "What's in a name? That which we call a rose by any other name would smell just as sweet."

I never really understood this Shakespeare stuff, but the point is that names are irrelevant. "A rose by any other name" is still a rose, or something. Unless you're naming an investment fund. Because the name of an investment fund should describe what an investment fund is trying to do.

We're changing the name of EdgePoint Variable Income Portfolio, our high-conviction corporate credit (i.e., debt) portfolio that focuses on high yield bonds.[i] Not because we're changing anything about the way we manage money, but because the previous name wasn't helpful in making an investment decision. Specifically, helping you decide whether the (formerly known as) EdgePoint Variable Income Portfolio is worthy of your investment.

Before you think this commentary is only relevant to investors in our Variable Income Portfolio, this name change relates directly to the way we run money across all of our fixed income mandates.

The name game

What does "Variable Income" even mean? Why did we call it "Variable Income Portfolio" in the first place? Good questions.

As you know, the investment industry is better at marketing than it is at investing, and will always take the opportunity to sell investors exactly what they want, exactly when they shouldn't want it. In March 2018, when we first launched the Portfolio, the industry "fad" was low-volatility investment products. There's nothing inherently wrong with trying to deliver investment returns that don't fluctuate with the vicissitudes of the stock market. But when the investment industry takes a good idea to such an extreme that it becomes an abhorrently bad idea, we'll do what we can to avoid it.

In choosing the name, we weren't doing ourselves any favours. One of the most attractive characteristics of high yield bonds is that they tend to decline less than equities. In other words, a central benefit of the Variable Income Portfolio is that we expect it to have less "variability" than an equity fund, while also offering competitive returns.[ii] If we were a marketing company, we probably would have called it the "Steady Income Portfolio" or "Consistent Income Portfolio" or "Straight Line Return Portfolio." But this would have been a mischaracterization of what we were trying to achieve.

Our vision was a concentrated, high-conviction portfolio that could capitalize on dislocations in low-rated corporate debt. We spend our days studying businesses, and occasionally these businesses borrow money at very high rates of interest (often by issuing high yield bonds). Our new Portfolio was built to be the lender. We had been using our investment approach to manage the fixed income sleeve of the EdgePoint Global and Canadian Growth & Income Portfolios since EdgePoint's inception, so we knew we had an approach that worked.

Change is good

We invest in bonds when we have high conviction that the borrower will pay us back, and we know that the contractual nature of a bond means that its price will gravitate toward par at maturity. This "pull to par" is what minimizes volatility within a high yield portfolio. However, the overwhelming majority of the bonds we buy will trade on a near-daily basis and prices will fluctuate while we own them. There's a business cycle, and prospects for any individual company can change. Different investors will gauge such changes differently, buying and selling bonds at different prices as a result.

In the "low-volatility" craze surrounding March 2018, the whole "prices can change" thing was apparently a real problem. So, like avoiding cancer diagnosis by not going to the doctor, the investment industry's solution was to invest in things whose prices wouldn't change because they could never be bought or sold. Private debt funds, private mortgage funds and private REITs exploded in popularity. As we've seen on more than a couple occasions, the fact that the price isn't deteriorating doesn't mean the value isn't deteriorating in these never-know-until-it's-too-late investment grenades.

If we have *any* skillset *at all* in valuing or understanding businesses – just better than *average* – the fact that we buy bonds whose price will change while we own them can only work to our advantage. If short-term business prospects deteriorate and the bond price declines while our long-term thesis remains intact, that's an opportunity to add to our position. If the business improves and the bond price goes up, we can sell our position and find better opportunities elsewhere. Minimizing these price changes was far from our primary objective. So we called it "Variable Income."

We still expect all of our credit portfolios to deliver substantially lower volatility than equity fund alternatives – that's a benefit of the high yield asset class. We also expect our credit portfolios to offer lower risk of permanent loss by lending money to the types of companies where we would gladly own the stock – another benefit of the asset class.

But this isn't your typical high yield fund, either. Anything with the word "high yield" in its name will typically own hundreds of bonds with a selection process that starts with hugging an index and working backward from there. Applying our approach, we expect to deliver returns that are competitive with any alternative – fixed income *or* equity – by opportunistically buying bonds when we have a view on a business that's not properly reflected in the price.

So, we're changing the name of EdgePoint Variable Income Portfolio to EdgePoint Opportunistic Credit Portfolio. But it's still the same portfolio. A rose by any other name…👍.

When opportunity knocks

Which brings us to the next question. Why weren't we smart enough to call it EdgePoint Opportunistic Credit Portfolio in the first place? Glad you asked.

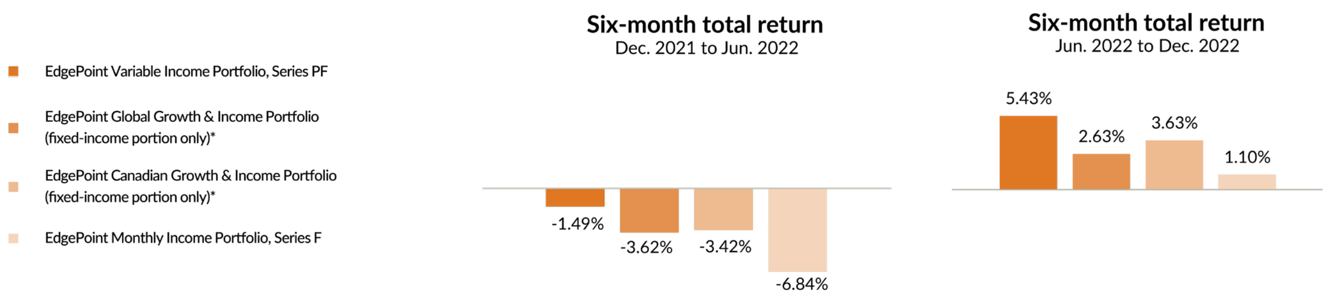
An opportunistic credit portfolio needs opportunity, and it took the current opportunity knocking us over the head before we realized we were going to need a new name. For the better part of the past decade, the outlook for fixed income investors has been miserable. The world of zero-percent interest rates that had persisted since the global financial crisis might have been really good for imaginary currencies and profitless technology stocks, but it was really bad for anyone trying to earn a return lending money to real businesses.

That free-money world is gone. The "borrower's market" we've endured the past 10 years has given way to a "lender's market." Even the best companies are paying up to borrow money. Uncertainty reigns and benign conditions have given way to skittish markets. We love the uncertainty – a lender's market is a moneymaker's market.

We've looked silly harping on the increasing risk in the bond market for the better part of the past 14 years. But even a broken clock gets to be right twice a day, and our warning for misery in traditional fixed income was validated in 2022. We didn't avoid these risks entirely; with the dramatic rise in short-term interest rates, EdgePoint Monthly Income Portfolio – launched in November 2021 specifically to provide an avenue to avoid many risks – had a return that was far more negative than even we would have imagined.

But the painful experience of 2022 was necessary to restore normalcy to investing. We have positive interest rates again, and with positive interest rates comes the prospect of earning a real return. Already across our fixed income mandates, the second half of the year saw returns that were well above our return expectations from the start of the year, all while interest rates continued to move higher. The go-forward return prospects, approximated by the yield-to-maturity at December 31, 2022, suggest a whole new world of return going forward.

EdgePoint fixed income portfolios: total returns, yield-to-maturity and duration
Dec. 31, 2021 to Dec. 31, 2022



	December 31, 2021		June 30, 2022		December 31, 2022	
	Yield-to-maturity	Duration (years)	Yield-to-maturity	Duration (years)	Yield-to-maturity	Duration (years)
EdgePoint Variable Income Portfolio	6.52%	2.94	8.45%	3.23	9.34%	3.35
EdgePoint Global Growth & Income Portfolio	2.79%	2.09	5.37%	2.32	6.07%	1.98
EdgePoint Canadian Growth & Income Portfolio	2.72%	2.06	4.99%	2.24	6.21%	2.11
EdgePoint Monthly Income Portfolio	2.05%	3.85	4.54%	4.17	5.09%	3.78

Annualized total return, net of fees (excluding advisory fees), performance in C$ as at December 31, 2022

EdgePoint Variable Income Portfolio, Series PF
YTD: 3.86%; 1-year: 3.86%; 3-year: 7.88%; since inception (Mar. 16, 2018 to Dec. 31, 2022): 6.73%.

EdgePoint Global Growth & Income Portfolio, Series F
YTD: -2.80%; 1-year: -2.80%; 3-year: 4.23%; 5-year: 4.67%; 10-year: 10.58%; since inception (Nov. 17, 2008 to Dec. 31, 2022): 11.34%.

EdgePoint Canadian Growth & Income Portfolio, Series F
YTD: 2.82%; 1-year: 2.82%; 3-year: 9.81%; 5-year: 7.26%; 10-year: 9.52%; since inception (Nov. 17, 2008 to Dec. 31, 2022): 10.98%.

EdgePoint Monthly Income Portfolio, Series F
YTD: -5.81%; 1-year: -5.81%; since inception (Nov. 2, 2021 to Dec. 31, 2022): -4.74%.

*These returns aren't investible. They're a best-estimate of our Growth & Income Portfolios' fixed income performance. Total returns, net of fees, in local currency.

Source, yield-to-maturity and duration: Bloomberg LP. EdgePoint Variable Income Portfolio and EdgePoint Monthly Income Portfolio total returns in C$. Series F is available to investors in a fee-based/advisory fee arrangement and doesn't require EdgePoint to incur distribution costs in the form of trailing commissions to dealers. EdgePoint Variable Income Portfolio is only available via prospectus exemption to qualified investors. Please see the *EdgePoint Variable Income Portfolio offering memorandum* for additional details. EdgePoint Growth & Income Portfolio fixed income securities total returns in local currency. EdgePoint Growth & Income Portfolios fixed income performance figures shown for illustrative purposes only and aren't indicative of future performance. They aren't intended to represent returns of an actual fixed-income fund as they weren't investible. EdgePoint Growth & Income Portfolio fixed income performance figures are net of fees and approximations calculated based on end-of-day holdings data (actual trading prices not captured). A hypothetical management expense ratio (MER) of 0.62% was applied to the EdgePoint Growth & Income Portfolio fixed income returns and prorated daily. The fixed income MER was calculated based on the average MER for EdgePoint Global and Canadian Growth & Income Portfolios (0.84% and 0.86%, respectively), relative to the EdgePoint Global and Canadian Portfolios' MER (0.97%), then scaled to reflect the average fixed income weight of the Growth & Income Portfolios (35%). Duration is a measure of a debt instrument's price sensitivity to a change in interest rates. The higher the duration, the more sensitive a bond's price is to changes in interest rates. Yield-to-maturity is the total return anticipated on a bond if it's held until it matures and coupon payments are reinvested at the yield-to-maturity. Yield-to-maturity is expressed as an annual rate of return.

In the meantime let be that I am, and seek not to alter me (Is that even English?)

Our fixed income portfolios don't buy the market – we aren't sure we know what "the market" even means. Prognosticating credit spreads and trajectory of interest rates isn't something we do. What we do know is the return environment is night-and-day from what it was at the start of 2022. Consider this – the *cash* in our Portfolios at year-end is yielding over 4%. If we can't find high-quality companies borrowing money at attractive interest rates when *cash* yields 4%, then we have a real problem.

EdgePoint Opportunistic Credit Portfolio is a rose by any other name, but the outlook isn't always rosy. For the average investor, the future might look particularly not-rosy today. If CNBC is any indication, most fixed income managers seem to think the solution to the current environment is to pray for recession so the U.S. Federal Reserve will cut interest rates and go back to the "funny money" universe of the past 10 years. That's exactly the opposite of how we see the current environment. The current malaise offers ideal conditions. Investors can finally expect the opportunity for a solid return investing in fixed income.

Under current circumstances, 2022 is the year everything changed in fixed income. So, now is the year we change the Portfolio's name.

Was this the first EdgePoint commentary inspired by Shakespeare? Absolutely.

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[i]EdgePoint Variable Income Portfolio is only available via prospectus exemption to qualified investors. See the *EdgePoint Variable Income Portfolio offering memorandum* for more information.

[ii]Between December 1986 and September 2022, the ICE BofA US High Yield Index had an average calendar-year return of 8.26% compared to the 11.67% for the S&P 500 Index. During the same time period, the high yield index had a maximum calendar-year decline of -6.44% and an average recovery trough-to-prior peak time of five months compared to -13.88% and 11 months for the equity index. Source: Bloomberg L.P. As at September 30, 2022. Total returns, includes reinvestment of dividends and in US$. Calendar maximum decline is the largest intra-year market drop from a peak-to-trough during the calendar year. Average trough-to-prior peak recovery time only includes declines greater than 10%. Daily return data is used for calculations except, due to data availability for ICE BofA US High Yield Index, monthly return data is used from periods December 31, 1986, to January 31, 1990, and from December 31, 1993 to May 31, 1994. The S&P 500 Index is a broad-based, market-capitalization-weighted index of 500 of the largest and most widely held U.S. stocks. The ICE BofA US High Yield Index tracks the performance of high-yield (rated BB or below) corporate debt denominated in US$ and publicly issued in the U.S. domestic market. Two indexes are commonly used proxies for their respective asset classes. The examples are not directly comparable and shown for general information purposes the complementary nature of the asset classes and their relative risk/reward ratios.

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