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Tye Bousada is a Founding Partner of EdgePoint Investment Group Inc. in Toronto, Ontario, Canada. Tye spoke with the editors of the Ben Graham Centre's Newsletter about his experience being a value investor.

Prior to EdgePoint, you worked at other firms like Invesco and OTPP. Could you shed light on how those experiences shaped your career and got you to move on to an entrepreneurial side?

The investment approach that I believe in and try to practice every day was invented by Bob Krembil, who founded Trimark back in 1981. Bob is also a partner of EdgePoint.

If you look at the mutual fund industry 50 or 60 years ago, it was originally founded by investors like Sir John Templeton at Templeton, Alexander Christ at Mackenzie, Mr. Goldring at AGF, Mr. Goodman at Dynamic, and Bob Krembil at Trimark. They were investors and they were trying to do right by the end investor. For a variety of reasons over time, what ended up happening was that all of these investment-led firms that were created by investment founders were sold or morphed into marketing or sales led companies.

There's nothing wrong with marketing and sales, but I believe that investment firms should be led by investors. Why? Because investment-led firms always try to do right by the end investor, whereas sales and marketing firms are more about gathering assets. And when you're focused on gathering assets, you take whatever assets you can get when you can get them. An unfortunate truth for the end investor is that it's typically easiest to gather assets in our industry when it's the wrong time for the investor to be investing. The industry knows that, but what they care more about is the shareholders of their investment companies, not the unit holders in their investment portfolios. Investment-led firms care first and foremost about the unit holders, the end investor.

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So I started at Trimark under Bob in the late 1990's, and it was very investment-led. Trimark was taken over in the early 2000's and it morphed into being marketing led. Pat, Geoff, and I didn't like the chance. We decided to leave and build an investment-led firm that put investors' interests first again.

Building on the element of founding EdgePoint, what is the most challenging/exciting part of not only having to manage the investments but

also the added element of running a business as well?

There are so many challenging and exciting parts. The first one that comes to mind is the constant challenge of living up to the trust that the end investor places in you. Families take their hard earned savings and turn them over to us to invest for them. There are over 80 partners at EdgePoint that work everyday to be worthy of that trust.

In the exiting column I would put the thrill of being able to pick your own partners. As a co-founder, I've been able to sit in on all the interviews and make sure that the person that we're thinking about hiring is the right person for EdgePoint. Being able to select your own partners is one of the most underrated luxuries on planet Earth. It is fun to surround yourself with people that are intelligent, driven, have solid characters, and passionate about what we are trying to do.

Being part of disruption would also fit into the exciting column. Our firm has been not disruptive for disruptive sake, but disruptive for a good reason — try to do right by the end investor. I remember when we first started, there was an article written about EdgePoint. In the article, someone said*: "They are putting investors first, what a novel concept"*, and it was a serious comment. How is that a novel concept? We are in the investment industry, and it shouldn't be a novel concept, but somehow it was perceived as being novel.

One more for the challenging column would be making mistakes on the investment side. If you are like me, when you invest for a long time, you don't remember the successful investments as well as you remember the mistakes. You wear your mistakes like tattoos, you look at them in your mind all of the time. Part of the challenge is to try and figure out why you made that mistake in the first place, and how to avoid it in the future.

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It sounds like there is another layer of complexity beyond just managing a portfolio. Do the pros outweigh the cons, in your case?

I think so. I believe being a business person can make you a better investor.

Culture, for example, is something that can have a big influence on the future of a business. Being part of helping grow a business has provided me with a better sense for the importance of culture in businesses we are thinking about investing in.

The same thing goes for the importance of incentives. Part of trying to grow a business involves helping set incentive structures, and then watching as behavior is modified by those incentives. I think I've benefited as an investor by helping set incentive structures in a business.

In terms of the investment ideology and philosophy, what drives you and what drives the team to segregate a pick, whether it is a thematic pick or whether it's a sustainable pick? What does that process look like? Do you have red flags or green flags that you look out for?

As it relates to the investment approach, let me start with the idea that broadly describes it: businesspeople buying businesses. What we are trying to do is to go out and find a business that will look materially different in the future than it does today, where we are not being asked to pay for that growth today. We are trying to get future growth for free.

The second part of your question is how you go about narrowing the universe. We don't do what I believe traditionally is done out there. For example, we don't run screens of low price-tobook ratios, low PEs, low EV to free EBITDA, that type of thing. Instead, we are constantly trying to make ourselves more intelligent about different businesses in the world. We are constantly gathering facts and trying to apply reasoning to those facts. When you are gathering all of these facts, you don't really know if they are going to lead to an idea. A lot of the work we do never ends up producing an idea. On a rare occasion, however, a bunch of historical dots can connect and you might have an investment idea.

Let me give you an example. Five years ago, you might be at an automotive conference and you heard a presentation from Ford about the future of electric vehicles (EV's) and the need for charging infrastructure on highways in the US. Four years ago, you were talking to an automotive analyst and you learned that the number one reason people don't like EV's is range anxiety. Three years ago, a colleague shared some information about how EV chargers were unreliable in cold weather. Last year, you were talking to a former executive from the automotive industry, and she told you about a new piece of legislation that will fund the development of an EV charging network across the US. And this year, you read an annual report about a new company that manufactures EV chargers. They claim that their chargers are 99.9% reliable in cold weather and that they are positioned to benefit from the new legislation and all of a sudden, those five previously uncorrelated events connect, and you have what we like to call: a proprietary insight. The idea is that you see an opportunity to buy growth and not pay for it.

What has got you convinced that value investing is an approach for the long term, given your previous experience at Procter and Gamble on the operation side?

Let me try to answer this by walking you through a mental exercise. Imagine that you have a family that you have to provide for and I show up and take away your job and all of your positions. In exchange I give you half a million dollars. Then I tell you that to provide for your family you have to take that half a million dollars and buy a business. Now, imagine I show up on your doorstep and I say to you: *"I got a business for sale and the price that I put on that business is half a million dollars."* You're going to say: *"Geez, I have half a million dollars, tell me about your business."* But the only thing I'm going to tell you is that next quarter's earnings are bigger than this quarter's earnings. Are you going to give me your money? You are going to ask me to tell you about the business and competition. If I say, that's not important, all that matters is that next quarter's earnings are bigger than this quarter's earnings. Would you give your money to me? Of course you won't. Likewise, if I showed up with a pretty little chart and I say: *"Historically when these two lines of my chart have crossed, it's been a good time for you to give me your money and for me to give you the business underlying these lines."* You are not going to do it either. I could show up and say, *"I've got this business for sale and it's going to do awesome if interest rates go down, but if interest rates go up, it probably will do badly."* You won't give me money in this case either. What you would do is think and act like a rational business person. You would want to buy a business that was going to grow, had barriers to entry that could protect its margins, had good management, and you would want to buy all of that at a discount to what it's truly worth. You wouldn't want to take the money that is there to feed, shelter, and clothe your family and put and buy an overvalued business with it. It sounds like common sense because it is. Interestingly though, common sense is often not that common in the stock market. That fact allows you to buy growth without paying for it.

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Everybody wants to own a good business with a good management team, with lots of growth ahead of it, with a management succession in place and good margins, and not pay for that. And buy all of that good stuff at a discount. So how do you go about doing that? That's where the proprietary insights come into play.

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Where do you start to evaluate the risk and the investment and how does that process evolve?

First of all, let's start with the definition of risk. If we were to stand out on University Avenue and stop a hundred random people to ask them, *"What is risk in the stock market?"* I guess a hundred out of a hundred people would say the risk is volatility. But we think that definition is just plain wrong. We think the real risk is the opportunity for permanent loss of capital. We approach each business at our firm as if it's the business that's going to feed our family and put a roof over their head. People might think that's just a nice tagline, *"Easy to say, tougher to prove."* But at EdgePoint, it's very easy to prove. The reason is that the partners that make up EdgePoint have a lot of our own money, hundreds of millions of dollars of our own money invested in these portfolios. When we buy a business, it's actually charged with feeding, sheltering, and clothing our families. Therefore, we look at real risks, like the risk to revenue growth, the risk to margin contraction, the risk to not knowing what you are doing, the risk to management succession, things like that. We don't want to own anything where we think there's the opportunity for permanent loss of capital. We don't have to own any business.

EdgePoint certainly describes itself as being diversified by the business idea, in contrast to how other firms diversify themselves by simply distributing small percentages in different stocks. How do you take this attitude of being diversified by a business idea and apply it to sizing a position?

This is part of investment management that rarely gets spoken about. A lot of portfolio managers like to talk about how they bought a business for a dollar and sold it for two, but equally important in running the portfolio, you would want to diversify it by business ideas. You would want to diversify it away from obvious correlations and non-obvious correlations. An obvious correlation would be: if you had 50% of your portfolio invested in banks, anybody could look at that portfolio and see right away that 50% is invested in banks. If your idea around why you want to own those banks goes wrong, then you are going to lose money on 50% of the portfolio. The non-obvious correlations are the harder ones to identify. You need to look inside these businesses and think, how much exposure do I have to real-world risk? Imagine if you owned 10 businesses outright. If you were thinking about diversification, you would look at real-world risks as it relates to how those businesses might correlate. For example, you would say to yourself, which one of those 10 businesses would do well if oil went to $200 a barrel? Likewise which ones would do poorly if oil shot up to $200. If 7 out of 10 businesses are materially hurt by $200 oil, then you have a non obvious correlation inside your portfolio that you have to pay attention to. Here is another example: You look inside the portfolio of your 10 businesses and think, which of these businesses would do poorly if interest rates shot up? Which of these businesses would benefit from rising rates? Do you have too much correlation to either one of these scenarios.

Why should you diversify by the business idea? Because when you own 35 ideas, there's a very good chance that one of them is going to be wrong. 35 ideas in a portfolio means the average idea is going to be around a 3% weight. When you make a mistake and the idea falls by 50%, then you lose 1.5%. However, if there is an unobvious correlation inside your portfolio, you may have 50% of your portfolio tied to the same underlying idea. If that idea is wrong and causes those names to fall by 50% then you will lose 25% instead of 1.5%, and impacted by If you've tried to diversify the portfolio by the business idea and you have 35 ideas, the average weight of an idea is 3%, you lose 1.5% instead of 25%. You might say that's an extreme example but look at what happened last year in the market.

You could take an average balanced portfolio out there: 60% equity and 40% fixed income. If the equity portion mimicked an index, then it would have had a big exposure to the tech heavyweights that had very high valuations that got stung by higher interest rates.

Then on the fixed income side, they were making the same bet that rates were going to stay low forever and they had an eight or nine duration. When rates went up, they lost a ton of money on the fixed-income side. So, they in effect thought they owned a balanced portfolio, but what they really owned was a bet that rates were going to stay low for a long time. That is a non-obvious correlation inside a portfolio.

Do you think there's a reason why other investors don't have the same attitude toward risk?

Many investors define risk as volatility. We see volatility differently. We look at volatility as the friend of the investor who knows the value of a business and the enemy of the investor who doesn’t know.

Let me give you an example. Say that I stood outside in front of a fancy car that was worth a hundred thousand dollars and I sell it for a dollar. You are going to have a lineup from here to Windsor of people wanting to buy it. Tomorrow if I’m selling it for $2, the line is going to be from here to Chicago and no one is going to think that yesterday I could get it for a dollar and today it’s costing me two. Why? Because they know the value is a hundred thousand. Likewise, I could hold up a cup of Tim Horton's coffee and say: *“I'm a buyer of cups of Tim Horton's coffee at a million dollars a cup.”* What's going to happen? People are all going to run out and go to the closest Tim Hortons and try and arbitrage them back to me. If I'm a buyer at half a million tomorrow, people are not going to begrudge the fact that yesterday they got a million and today they are only getting half a million, because they know the value is a buck or two.

Now, what happens, though, if the share price of the company that owns Tim Hortons falls by 25% in one day? They panic. Why do they panic? Because there’s very little as uncomfortable in life as watching the price of something you own go down if you don’t know the value of that something. It’s our job to know the value of a business in the same way as a person on the street would know the value of a $100,000 car or a cup of Tim Hortons coffee. So volatility is our friend. If they are selling a business for half of what it’s worth in the market because of some short term fear, we try to take advantage of it for our stakeholders.

> “There’s very little as uncomfortable in life as watching the price of something you own go down if you don’t know the value of that something.”

As your portfolio size has grown over a period of time, how have you approached portfolio management as a whole and what has been your investment strategy?

First, the approach doesn’t change with the size of the assets. We have this interesting chart that shows that our average market cap over time hasn't changed very much since we were established back in 2008.

The second part of the answer has to do with people. In the beginning, it was just Geoff MacDonald and I on the investment side of EdgePoint, today we have 13 other individuals so there are 15 people in all. They are very talented investors, and they contribute enormous value on a daily basis to the portfolios. They generate ideas, share those ideas with us, and a lot of those ideas are in the portfolios today. The investment team is much stronger today than it was 15 years ago.

Moving on to a broader industry trend, value funds seem to essentially benefit during recessionary times. What do you think is your approach during these times for the funds? Do you plan to implement a similar strategy this time around or how is it different?

It's very important for you to know that we never change our investment approach. Our investment approach has been in place for five decades. It's been used to add value at three different firms over five decades by multiple managers. Bob started using it with a partner named Russell Morrison back in the 1970s at Bolton Tremblay. Bob set up Trimark after that and multiple managers used it there. We then set up EdgePoint and use the same approach.

Now back to your question. Let's just look at the last 14 years of this approach at EdgePoint. The approach has had to deal with the great financial crisis, the European sovereign debt crisis, a US debt downgrade, the emerging market slowdown in 2015, COVID, and the rising rates of 2022 which led to a lot of wealth destruction. There were a lot of periods in there where the economy slowed down, and yet, we've been able to deliver pleasing returns over the long term. Being a business person that buys businesses doesn't go out of style over the long term.

I noticed that some funds in EdgePoint invest in the global market, and some invest specifically in the Canadian market. To a retailer investor, what would your advice be? How should they go about choosing between these funds?

My first piece of advice would be to get a good financial advisor. We partner with financial advisors because we really believe in the value of advice. It's hard to give advice to someone without knowing their financial situation. So, if you're 20 years old and you have hopefully a very long investment horizon, then it makes sense that you would probably want to own the global portfolio. The global portfolio can go anywhere in the world to find 35 ideas where we are not being asked to pay for growth. Over time, that should result in a better outcome than being restricted to just the Canadian market to find good investment opportunities. You just have a bigger pool to fish in. Having said that, there are instances where the Canadian portfolio might make better sense for someone. For example, if you are retired and you have a stream of Canadian liabilities coming your way in terms of living expenses, but you have no Canadian income and you want equity exposure. You might not want the foreign exchange risk that comes with a global portfolio.

You previously alluded to EdgePoint being an investment-led firm as opposed to a marketing-led firm. How do you approach a culture that embodies that sort of attitude?

I think the best way to define our culture is everyone knows what the right thing to do is without being told. Why do we have that culture? We have three goals, and those three goals are: first and foremost, investment performance. We want investment performance for the end investor that's at or near the top of our peer group over a 10-year timeframe.

Secondly, we want to be a really good partner to those who entrust us with their capital. We want to deliver open, honest, and timely communication. We want to be there when they have questions. What we hope to get in exchange from them is an understanding of our investment approach.

The third thing we want is an internal culture of ownership where everyone thinks and acts like an owner. There's no better way of ensuring that people think and act like an owner than giving people the opportunity to become an owner of the business. I shouldn't use the word give because nothing is given at EdgePoint. There are no warrants or options or leaps, but what we say: "*Would you like to invest in the business?"* And if you would, then you take money out of your pocket and you buy your shares. If you can't afford it, we'll facilitate a loan, but the loan is your ultimate obligation. That creates an ownership-led mentality inside the business. We weight every decision we make inside the firm against those three goals. *"If we do this, is it going to hurt our chances of outperforming over the next 10 years? If we bring on this new investment partner, are they just going to be buying your historical track record? Or do they really understand the investment approach? If we hire this person, are we hiring someone who just wants a job, or are they really going to be able to think and act like an owner?"* If the decision we're trying to make doesn't clear all three hurdles, we move in the opposite direction.

Has it always been a conscious decision to refer to all members of the investment team as partners since the team's inception? Could you please explain the reasoning behind this naming convention?

Yes, everyone at EdgePoint, not just investors, are referred to as partners because they are. They are co-owners of the business. We think titles are silly. They are often not descriptive, can lay the ground work for bureaucracy, and have the potential to be demotivational to many. We are legally required by regulators to use titles sometimes but that's the only time you will see anything other than partner used to describe someone at EdgePoint.

Could you provide insights into the decision-making process behind launching the seventh fund as your organization has grown? Additionally, are there any plans or considerations for launching an eighth fund or any other type of fund in the future?

We only had four funds for the first decade or so of our life. Then we saw an opportunity to generate pleasing returns in the fixed income area and we have the people inside EdgePoint to capitalize on the opportunity so we launched a dedicated fixed income portfolio about five years ago. We put our own money in first and asked our external partners if they wanted to join us. It's early days but so far it has added a material amount of value for those that have invested in it. In late 2019, we saw a change to generate pleasing returns in the energy space. We wanted to put our own money into the idea we had so we launched a portfolio Go West and invested in it. Again, we asked our external partners wanted to join us and some did. Four months after we launched it, oil was somewhere around -$20 a barrel so our timing wasn't the best. Fortunately, though, things got a lot better quickly. If you look at the performance from the inception date through to today, we've achieved very pleasing results. Finally, we recently launched a monthly-income-like portfolio. The problem with that category are the MERs (Management Expense Ratios). When we looked at this space, we saw that the fees / MERs of the funds in the space were eating up over half the investors returns. We thought that was gross. The firms behind these funds knew they were taking, in some cases, well over half of the potential returns from their investors. So, we launched a portfolio with variable fees based on an index associated with the fixed-income space that we'd be investing in. When the yield on the index is low, we believed that the end investor should have lower fees. That way the fees wouldn't eat up the majority of the potential returns. As the yield on the referenced index increased, our fees would go up but we capped the fees at what looked like the average in place fee at the time of launch. This had never been done before in a prospectus based portfolio.

> "We launch a portfolio if we see an outsized probability of making good returns for the end investor and we're willing to be the first money in."

The most that an investor could pay was what we calculated to be the average fee of our competitors, but unlike our competitors, our fees could drop all the way down to seven basis points.

I've mentioned the index a couple of times, that's just what we benchmarked the fees off of. Our portfolio is not an index portfolio. Our portfolio is actively managed. The fee schedule is associated with that benchmark but that's it.

The simple answer is we launch a portfolio if we see an outsized probability of making good returns for the end investor and we're willing to put our own money into the portfolio. If we want to invest our own money, we will launch that portfolio and we will say to everyone*: "If you want to come along, come along. We're happy to have you."* But our money's in there first.