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EdgePoint taking different road to riches; Nimble, more potent funds a must



Rod Tyler, of Tyler & Associates (left) and Patrick Farmer
Photograph by: Don Healy, Leader-Post

Patrick Farmer, partner in EdgePoint Wealth Management, isn't your typical investment fund chairman.

Following his presentation in Regina last week, Farmer gathered up a few of the complimentary pens provided by the hotel to replenish his supply. His business card has one colour and looks like it was printed at the neighbourhood quickprint shop. His firm doesn't advertise on TV, or anywhere else for that matter. His marketing department? You're looking at it.

The firm's motto – owned and operated by investors – isn't just a slogan. It's a business philosophy.

Farmer, who formed EdgePoint in 2008 with two compatriots from Trimark Financial Corp., Tye Bousada and Geoff MacDonald, believes investment funds should be

managed on behalf of the fund's unitholders, not its shareholders. While this may seem like common sense, it's not that common in today's well-heeled world of investment fund management.

"It's our view that wealth management companies should be led by people with experience in investing," Farmer told a small group of clients of Tyler & Associates, a local financial planning firm headed by Rod Tyler.

Farmer, a native Torontonionian, who worked with Trimark co-founder Bob Krembil, a native of Grenfell, Sask., in building Trimark into a \$24-billion mutual fund powerhouse, cites one example of the difference between an investor-led company and marketing-led one.

"Bob Krembil's last road show (with Trimark), when we go out to talk to financial advisers about an opportunity, was in 1998. He was on the road with one of my current partners, Geoff MacDonald, to talk about the opportunity in Trimark's resource fund. In 1998, the price of oil was \$10 a barrel; some analysts said it was going to zero. And the average 10-year return for resource funds in 1998 was zero."

"So here we are," Farmer said, recalling Krembil's pitch to advisers. "We've got a great idea, you haven't made money in

(resources) in a decade, but we'd like you to invest in this Trimark resource fund."

And if you had invested in resources, your average return a decade later would have been 13 per cent compounded annually, Farmer added. "That's an illustration of what an investment-led organization does. It launches something when no one else wants to because it's an investment idea."

Today, the mutual fund landscape is far different than it was 20 years ago when Trimark, AGF and Mackenzie mutual funds dominated the marketplace, said Farmer, who served as chief investment officer with Trimark.

"When I look at this industry that has 25,000 mutual funds, that tells me that sales and marketing people have been at the helm for far too long. They typically ask the question: will it sell? Not should we be selling it. It's very, very different."

Farmer, who also did stint with Crown Life in the 1990s before joining Trimark in 1993, said many publicly traded mutual funds are driven by the need to satisfy shareholders, which puts management in a "fiduciary conflict between the shareholder and the unitholder.

"The shareholders want big management fees, big blocks of assets to generate big profits and big dividends. The unitholders in these companies want low management fees and they really wouldn't want \$90 billion in assets. It's hard to manage a big block of assets, so they want smaller assets.

"Who wins? The unitholder or the shareholder? When we see 25,000 mutual funds, clearly the shareholder is getting what he wants. And I can tell you that these wealth management companies sit around

the table, they're \$40-billion enterprises and have 18 per cent redemption rates, and the non-investment executive team is saying, 'How do we keep the assets where they are or grow them?'

"Then someone goes, 'high-yield is selling well, we should have a high-yield fund. Dividends have done well, we should have a dividend fund. Emerging market debt has done well over the past decade, we could sell a billion dollars of that (fund).'"

"Rarely do they ask: Should we be selling it?"

What happens with the marketing or sales-driven approach to mutual fund management is that investment returns are sacrificed in exchange for larger-sized funds that generate larger management fees for the fund managers and returns for the shareholders, he said.

"You end up having the average investor lured into the wrong product at the wrong time and capital is destroyed along the way."

Needless to say, that's not the way EdgePoint operates. "The opportunity in front of us is to repair a relationship of trust that's been destroyed – the relation of trust between the client, the adviser and the (fund) manufacturer," Farmer said.

So what makes EdgePoint different than most other mutual funds on the market today? First of all, EdgePoint, owned by Krembil, Farmer, MacDonald and Bousada, is privately held and will remain privately controlled. Management fees are kept to a minimum. The minimum investment per EdgePoint investor is \$15,000.

Companies are chosen on the basis of value and potential for exponential growth after

extensive due diligence by the investment management team.

Some of EdgePoint's principles actually make it harder for the fund to raise investment capital, Farmer added. "We took a different approach."

EdgePoint's founders were inspired by Warren Buffett, "the Oracle of Omaha," whose Berkshire Hathaway mutual fund sells shares on the open market and uses the proceeds to buy publicly traded global companies like Coca-Cola, American Express, General Electric and Goldman Sachs, as well as private businesses like Geico, Dairy Queen and Fruit of the Loom. It doesn't pay dividends, cash flow is retained in the fund and Buffett uses the proceeds to buy more companies.

"So we went out and launched a company called Cymbria. And we raised \$234 million and Tye and Geoff took the proceeds and invested in 20 or 30 publicly traded global

securities, much as you would've seen in the Trimark funds that Tye and Geoff ran.

"The point is, this \$234 million we raised will pay us a revenue stream forever. If you don't like us, you don't like what we're doing, you sell it. In the traditional mutual fund company, if you don't like what they do, you take out all the money, they have no business. We have a permanent pool of capital so that as long as Tye and Geoff can continue to build wealth, we'll earn our revenue stream."

So far so good. Since their inception in late 2008, EdgePoint's two main funds, EdgePoint Global Portfolio and EdgePoint Canadian Portfolio have returned 22.83 per cent and 32.57 per cent respectively, versus stock market index returns of 12.24 and 25.9 per cent respectively. EdgePoint also offers balanced funds based on global and Canadian equity funds.

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