PENDER
CORPORATE BOND FUND

The Manager's Monthly Commentary – March 2019

The Pender Corporate Bond Fund returned 0.4% in March, amidst a backdrop of generally strong performance of corporate credit, particularly in the higher quality bands.

Leading the gains in the Fund was our position in the convertible notes of recently defaulted Aceto Corp, which rallied almost 6% on improved market visibility to likely recoveries. SunPower notes also rose as the distributed generation solar power company's improved outlook was met enthusiastically by investors. Finally, our Maple bond positions, including the C$ notes of McDonalds, Pepsi and Walt Disney, rose strongly in sympathy with a generally powerful rally in investment grade credit.

Offsetting the strength above was weakness in Dean Foods, which received a ratings downgrade from S&P. Our position in convertible notes of Global Eagle Entertainment, the airline media company, was down on financial results that disappointed some analysts. Additionally, rate reset preferred shares, where we have been adding a little weight, were down about 5% in March.

A Tale of Two Cities: "Bidsville" and "Ask-a-Toon"

About a year ago, the talk of the town in Credit Land was rising rates, and the persistent increases to the risk-free rate being driven by new Federal Reserve Chairman, Jerome Powell. Since that time, the environment has changed markedly. From worries of runaway inflation, investors' fears now seem to be centred on the potential for a spiral of deflation. The financial press is full of professional opinions regarding the likelihood of a recession developing as well as the implications of an inverted yield curve. As mere practitioners, we will not add our voice to the chorus of experts on those subjects. What we can comment on, however, is a readily observable change in behavior of market participants. Owning a wide range of security types, as we do, our travels in Credit Land have led us to discover two remarkably different encampments, which one might call "Bidsville" and "Ask-a-Toon."

Bidsville is full of buyers of government bonds, long duration investment grade paper and anything that delivers a close approximation to a fixed, risk-free rate. Even hinting in Bidsville that you may have a T-bond to offer creates a flash mob of panicked buyers, pleading for a piece of the action.

Ask-a-Toon, just a few miles down the road from Bidsville, is a different story. Ask-a-Tooners are all loaded to the gills with rate reset preferred shares, floating rate bank loans, distressed credit and securities of issuers where some uncertainty exists about near-term financial performance. You can still see the debris of the big party Ask-a-Tooners were holding last summer. But now tumbleweed blows down Main Street as a ragged, limping man cries out faintly for a bid.

Comfortable as it is, with much of the Fund parked in Bidsville, we are now increasingly spending our time researching securities being offered plentifully by the inhabitants of Ask-a Toon. While these securities bear some uncertainty of outcome, we believe a fair amount is already discounted in the price. We don't know if inflation will wax or wane, but we do know that securities which offer protection against inflation through variable coupons are considerably cheaper than their fixed-rate securities from the same issuer. Likewise, distressed securities are discounting seemingly bleak outcomes ahead…outcomes that don't jive with the euphoria in the higher bands of corporate credit. It's always tough to buy into a market that is descending, and we understand that Ask-a-Toon is loaded with securities that may not perform particularly well in a deep recession, but value is value. We believe it's worth sifting through this new pile of unpopular securities before a crowd arrives.

New Positions

One of our newly added positions in the Canadian preferred share market has been in several series issued by Husky Energy Inc. We like Husky, a relatively un-levered integrated oil producer and marketer, and we have confidence in the company's leadership under Chairman Victor Li. Husky's heavily discounted preferred series "C", which is set to reset its dividend in December at 3.13% above the 5-year Canada bond, bears an approximate current dividend of 6.3% and an approximate future dividend of 6.2% at recent prices. In tax-equivalent terms, Husky preferred C's are similar to bonds yielding 8%. Yet, Husky's 5-year bond yields only about 3.3%. While the risk of the two securities is not identical, and the reset dividend is subject to future movements of the 5-year Canada yield, we believe the additional spread available in the preferred share is very attractive.

We also added a position in the unsecured bonds of MSCI Inc. MSCI is a publisher of various indices and other financial information products that have proved themselves to be increasingly indispensable to modern capital markets. MSCI has a strong credit profile, with a good base of recurring subscription revenue underpinning its strong cashflow. With a market capitalization in excess of $16 Billion and net debt below $2 Billion, we find MSCI bonds yielding between 4.5% and 5.0% to be attractive risk/reward propositions, especially given the company's low underlying default risk. We view 1-year default probability for MSCI as less than 0.1%. With odds of success that are this good, even we will capitulate to "buying the index."

Another position added in March was in the 2025 5.25% notes of Gartner Inc. Gartner is a supplier of market studies and industry data that companies use for forecasting and evaluation of new business opportunities. The company also organizes trade shows and offers well-trafficked online forums for software buyers, such as Capterra and GetApp. We like the moat that Gartner has developed in some of these critical information markets and believe the company has a strong future ahead. The Gartner balance sheet has reasonable leverage and the company's EBITDA covered its interest charges more than four times in 2018. We view default probability as less than 0.01% on a one-year basis, which compares favourably to yields slightly below 5%.

On the higher yield side, we also initiated a position in the 2026 8.5% bonds of Canadian oilfield services player Calfrac Inc. Calfrac is a significant player in the production of fracking-based oil and gas in continental North America and some international markets. We consider Calfrac's market opportunity to be growing somewhat as a period of sustained, high cost of capital has discouraged new capital investment in the oilpatch and has also drawn down inventories. On a liquidation basis, we view Calfrac's fleet of rigs to be attractively priced compared to private market transactions of bankrupt fracking players. Priced at around 75% of face value, the Calfrac notes offer significant upside, although at a level of risk which causes us to initiate this weight below 1% of Fund assets.

Fund Positioning

The Fund yield to maturity at March 31 was 5.2% with current yield of 4.7% and average duration of maturity-based instruments of 2.4 years. There is a 2.3% weight in distressed securities purchased for workout value whose notional yield is not included in the foregoing calculation. Cash represented 4.2% of the total portfolio at March 31.

Geoff Castle
April 3, 2019

[1] *F Class*
For full standard performance information, please visit: http://www.penderfund.com/funds-and-performance