PENDER

CORPORATE BOND FUND

THE MANAGER'S MONTHLY COMMENTARY – APRIL 2018

The Pender Corporate Bond Fund returned 0.6% in April, a reasonably good result given the continuing upward bias of the trend in interest rates.

Strong performers for the Fund in April included our position in convertible notes of SunPower Corp, which rose multiple points on the company's steps to acquire US-based manufacturing capacity, seen as a solution to current tariff concerns. We like prospects for solar power in the longer term and believe the SunPower position has further potential upside for the Fund. Also driving gains was our position in 2nd lien bonds of W&T Offshore as rating agencies upgraded the company's credit in recognition of the progress the company has made in growing cashflows and de-leveraging. Other boosts were provided by a new position in Aceto converts, discussed below, and strength in Aimia preferred shares.

The gains above were offset, to a degree, by weakness in high-rated securities and some closed-end funds, which experienced price declines related to higher risk free rates. Continued uncertainty related to a pending mine approval hurt our position in bonds of Eldorado Gold.

Give Us Your Tired, Your Poor…The Wretched Refuse of Your Teeming Shore[1]

Every stock in the market, and every bond on a broker's tearsheet, exists for a reason. An investment banker becomes convinced that a particular stock or bond uniquely satisfies an important unmet need of clamouring investors, and, voilà, a security is brought to life. In time, however, investor passion fades.

We were reminded again of this dynamic recently when we saw an interview on a prominent business television network featuring the head of fixed income banking at a leading Canadian dealer. "I hate the bond market," he declared, going on to elaborate his views on the apparently inevitable shredding of value as bond yields march inexorably higher.

There are always people who like things and people who hate things. But we were struck by both the timing and the intensity of that message. Now, more than two years into a bear market of investment grade credit, during which the five year benchmark Canada bond yield has increased more than four times from its low, it seems like an extraordinary time to be "hating" risk-free government bonds and other high grade obligations.

We believe there is a benefit in looking past the emotions that become embedded in the minds of security owners as a result of past performance. And we so often find value in the discard pile of the frustrated and impatient. In recent years that has meant buying bonds of commodity producers at times of low commodity prices, or the credit of industrial firms that have faced setbacks of one sort or other. Generally, we have eschewed the highly rated credit world as overpriced and under-yielding. But with each pricing tick lower we find the relatively strong principal security of high grade credit more and more attractive.

In the geography of the capital markets, we picture this Fund as a sort of Ellis Island, drawing in unpopular cast-offs. We hold no prejudice in this regard against investment grade bonds. Should the cast-offs in question be bonds rated higher than "BBB", we will still welcome them, in the expectation of their eventual rehabilitation as popular securities.

New Positions

In April, we expanded our position in the 2024 Maple bond obligation of Pepsico. Pepsi is a well-diversified, consistently profitable company, with low net financial leverage of 1.5x EBITDA and strong cashflow coverage of interest obligations. At a CAD yield of over 3.0% at the six year tenor, we find Pepsi to be an attractive, higher quality investment.

On the more distressed side, we initiated a position in the 2020 convertible notes of Aceto Corp, which operates in the speciality chemical and generic pharmaceutical industry. Aceto has suffered from overcapacity in this business area, compounded by an ill-considered debt-financed acquisition made in late 2016. Notwithstanding these challenges, we anticipate solid bids for the company's assets as management heads into a strategic review aimed at debt reduction. The company is still profitable and, at least until recently, dividend paying. While we estimate a one year default probability of less than 2% for Aceto, the yield on its 2% convertible notes of 2020 exceeded 25% in April.

We also extended our positions in out of favour high rated credit and related securities. As we highlighted in prior months, we like US Municipal bond closed-end funds, which may stand to benefit on a rebound in high quality credit by virtue of the twin effect of underlying securities return and collapsing NAV discounts. In this vein we added a position in the Blackrock Muniyield California closed end fund (MCA) that traded in April at a discount in excess of 13% of NAV.

We also added our first Government of Canada issue, a four year obligation yielding approximately 2.1% to 2022. As part of an overall mix of credit quality and duration, we now believe there is a benefit to the Fund of a dash of sovereign credit. The power of this issuer to generate the funds to repay the bond either by taxing a very large, diverse economy or through the sale of crown assets, or failing those alternatives, to print in cash the currency of its obligation, is an overwhelming credit strength. Depending on how we view the relative pricing of credit going forward, we may add to this currently small weighting.

Fund Positioning

The Fund yield to maturity at April 30 was 6.4% with current yield of 5.1% and average duration of maturity-based instruments of 2.5 years. There is a 2.1% weight in distressed securities purchased for workout value whose notional yield is not included in the foregoing calculation. Cash represented 3.5% of the total portfolio at April 30.

Geoff Castle
May 3, 2018

1. "The New Colossus", Emma Lazarus, 1883 - engraved on a bronze plaque and mounted in the pedestal of the Statue of Liberty.

For full standard performance information, please visit: http://www.penderfund.com/funds-and-performance