# PENDER
CORPORATE BOND FUND

## THE MANAGER'S MONTHLY COMMENTARY – JUNE 2019

The Pender Corporate Bond Fund returned 0.9% in June, a result which reflected the broadly benign market conditions. For the half year ending June 30, the Fund returned 4.0%

Strength in June came from our holdings in the convertible notes of Avadel Pharmaceuticals that rallied on an FDA drug approval, and our position in bonds of Coeur Mining that gained on higher precious metals prices. SunPower convertible bonds also rallied on favourable developments in California that will require solar power installations on new homes in that state.

Offsetting the strength above, continuing volatility in recently defaulted PHI subtracted value in June. We consider the bankruptcy of PHI to be a key catalyst in consolidating the Gulf coast helicopter industry and that, despite recent weakness, a recovery close to par remains a possibility. Dean Foods bonds were also weaker in June.

**High Yield vs. Treasuries … the Theory of Relativity**

How high is high? When it comes to thinking about yields available on credit instruments, this question can warrant some serious pondering. As we gaze upwards into the sky over Stanley Park on this late June afternoon, we recognize that "high yield" isn't what it used to be. Back in the days of Drexel Burnham and "Barbarians at the Gate," high yield bonds used to be issued at 15-20%. These days, North American "BB" issuers routinely come to market "4-handle" and Aiful, the issuer behind this month's first ever Japanese high yield issue just priced an 18 month note with a coupon of 0.99%.

Credit spreads can be a useful guide to assessing whether credit is priced attractively or not, and today's current market spread in North America of approximately 4%, while higher than last year, is still below average. But credit spreads tell only part of the story.

Another important gauge is credit yields relative to the risk-free rate. For all the juice in the HY market of the 80's and 90's, the coupons investors received were usually less than twice the prevailing risk-free sovereign yields. In 1996 for instance, the year in which the main high yield index was created, 5-year US Treasuries yielded over 6% and North American high yield paid approximately 9%. These days, 5-year US treasuries offer investors approximately 1.7% while the high yield index pays more than three times that level. On an absolute basis, lower rated issuers paid a lot more in the 1990's, but on a relative basis they pay a lot more today.

Relatively attractive yields must also consider capital at risk, and so more distressed issuers should also be evaluated against likely liquidation value. There's no point in talking spreads in a situation where capital may be impaired. But for solidly covered credit, the relative yield between the issuer and the sovereign are important.

Taking a look at the recent history of relative yields, the last year has seen HY credit rise from as low as 2.0x the risk-free 5-year rate to over 3.3x today. This ratio has risen recently to be close to the average level over the past four years. Therefore, we expect that the marginal impulse towards taking credit risk ought to increase somewhat, as we are being paid somewhat more to accept that risk. Whether it does, or whether it requires an even further improvement in relative yields before the collective risk appetite is awoken, remains to be seen.

**New Positions**

During June we initiated a position in first lien bonds of Frontier Communications, which operates in the internet access, telephony and data services markets in smaller communities in 22 US states. Frontier, we believe, is improperly capitalized, with too much high coupon debt relative to its ability to pay. However, on a standalone basis we think the company's business is necessary in its markets and likely to persist profitably for an extended period of time, once it completes a debt restructuring. Frontier's 1st lien debt represents the top $2 billion of a $17 billion debt structure and is approximately 0.5x of projected EBITDA. This 7% yielding paper may be called as

part of a larger restructuring process, which could result in a couple of additional points of capital gain, given the issue's call schedule. We also purchased a small position in Frontier's April 2020 bonds on the expectation that this small $172 million issue is well within the company's liquidity runway and, we believe, likely to pay on maturity.

Also in June we purchased a few lines of secured debt of Restaurant Brands Inc. Canadian investors may recognize Restaurant Brands as the owner of popular Tim Horton's coffee shops and also the fast food operator, Burger King. We like the predictable nature of the Restaurant Brands business and the strong First and Second Lien seniority of the issuer. With 1-year default probability that we view as less than 0.01% and yields of these lines between 4-5%, we consider Restaurant Brands paper to offer attractive risk/reward characteristics.

Also this month we initiated a position in the convertible notes of US-based optical network equipment manufacturer Infinera Corp. Infinera has managed to navigate a difficult industry environment in the past few decades that shook out heavyweights such as Nortel networks, Lucent and Alcatel. However, the industry remains competitive and Infinera's recent difficulties stem from falling behind competitor Ciena in a recent product cycle. We believe Infinera possesses important capabilities that would make the company valuable in acquisition, and that its current historic low valuation level of 0.6x sales makes such an outcome highly possible. However, we also believe that potential market share gains from customers backing away from controversial industry leader Huawei, combined with Infinera's own second-to-market launch of 800 gigabit, could help return the company to profitable growth in the absence of a takeout. Convertible notes are priced close to 69c on the dollar and offer a yield over 10%, which seems attractive compared to a 1-year default probability we view as less than 1%.

**Fund Positioning**

The Fund yield to maturity at June 30 was 5.1% with current yield of 4.6% and average duration of maturity-based instruments of 2.6 years. There is a 4.2% weight in distressed securities purchased for workout value whose notional yield is not included in the foregoing calculation. Cash represented 3.7% of the total portfolio at June 30.

*Geoff Castle*
*July 4, 2019*

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



*Commissions, trailing commissions, management fees and expenses all may be associated with mutual fund investments. Please read the simplified prospectus before investing. The indicated rates of return are the historical annual compounded total returns including changes in net asset value and assume reinvestment of all distributions and are net of all management and administrative fees, but do not take into account sales, redemption or optional charges or income taxes payable by any security holder that would have reduced returns. Mutual funds are not guaranteed, their values change frequently and past performance may not be repeated. This communication is intended for information purposes only and does not constitute an offer to buy or sell our products or services nor is it intended as investment and/or financial advice on any subject matter and is provided for your information only. Every effort has been made to ensure the accuracy of its contents. Certain of the statements made may contain forward-looking statements, which involve known and unknown risk, uncertainties and other factors which may cause the actual results, performance or achievements of the Company, or industry results, to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements.*

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