PENDER

CORPORATE BOND FUND

THE MANAGER'S MONTHLY COMMENTARY – AUGUST 2019

The Pender Corporate Bond Fund returned -0.6% in August, a relatively volatile period for the Fund, as two discrete events impacted the NAV. This volatility occurred against a backdrop of declines in many risk capital markets and an extraordinary rally in long-dated government bonds.

The chief negative contributors in the period were our position in Just Energy and our basket of rate reset preferred shares, both of which are discussed at length below. Offsetting the declines, to a degree, was strong performance in select convertible debentures, including those issued by Osisko Gold, Infinera Corp, Pretium Resources and Avaya Holdings. Our investment grade corporate and government bond holdings also rallied in sympathy with the very strong market for longer-dated Treasuries. Finally, our positions in precious metals mining bonds, including Eldorado Gold, Coeur Mining and Iamgold were strong positive contributors.

Just Energy

The single largest move in August occurred in our position in Just Energy convertible notes and preferred shares, which experienced a price decline of approximately 32% due to the release of several pieces of news that caught the market off-guard. This news included the suspension of Just Energy's common stock dividend, an additional write-down of some accounts receivable and the replacement of the company's CEO by a member of the Board of Directors. The impact on the Fund was approximately 0.8%.

While we were not hoping for the foregoing events to occur, we do believe the market has over-reacted to the Just Energy news, especially the dividend cut. We think it is still possible, perhaps even likely, that the company's current strategic review process ends with a sale that could cause our securities to be paid out at par. In the event that the Just Energy strategic review does not result in a transaction, the elimination of $75M in annualized common stock dividends would, over time, be a significant boost to the credit profile of the company. Just Energy has generated an annual average of more than $100M of unlevered free cash flow over the past five years. We are confident that the value of debt and preferred equity is fully covered by business value.

Rate Reset Preferred Shares

The other major impact to Fund NAV in August was a sharp decline in prices for rate reset preferred shares. As we have noted earlier in 2019, we believe that rate resets offer compelling value relative to other fixed income securities of nearly identical credit risk from the same issuers. Our position here is spread across 23 different issues from a variety of Canadian companies and amounts to approximately 4% of Fund assets. The decline of these securities during August, at its maximum depth, represented an approximate 0.5% impact to the Fund.

Rate reset share prices have fallen, apparently due to investors believing that dividend resets will occur in the future at strikingly lower levels. Currently, market participants are engaged in a parabolic feeding frenzy in longer duration government bonds, presumably on the basis that owning those securities will protect their holders against a widely forecast global recession. (Lower government bond yields mean lower dividends for resets priced against 5-year Canada yields).

We don't know whether the recession forecasts are accurate and, if accurate, whether holding long duration government bonds at record low yields would actually work to protect capital. Sometimes in the past, popular forecasts have proven to be incorrect. And sometimes, even if forecasts are correct, the effect of an event on actual securities prices may not be in the same direction as anticipated.

Our thesis in preferred shares is based on the idea that the yield available on the rate resets is extremely high in comparison to the yields on the unsecured debt of those same issuers. The difference is only explainable in terms of investors' expectations of future changes in government bond yields. And we wonder whether this stampeding crowd is successfully forecasting the future. The events of the past month have not changed our view. And we remain a patient holder of these positions.

New Positions…A Somewhat More Risk Accepting Stance
We view market conditions in fixed income and other capital markets as unusually risk averse. This is visible not just in the record low long bond yields printing around the world (with Japanese and European curves yielding below zero all the way to 10 years), but also in the flight to gold bullion. We note that, according to the US Commodity Futures Trading Commission, the volume of non-commercial long positions in gold bullion options is at a record high. These are all indications of a stampede towards safety assets.

While we did buy a fair amount of safety-type assets in 2018, the current mania has caused us to reverse the stance to a degree. Safe assets have their place in this portfolio, but not at any price. And so we have been selling some US Treasuries. We also sold our Pretium Resources convertible notes as the gold miner's stock more than doubled and the converts rose more than 15%. We also trimmed back our position in US municipal bond closed end funds, which have returned more than 20% this year. These safety assets have performed well for us this year but may be approaching the point of diminishing returns.

In their place, we have expanded positions in high yield credit, in situations where we believe there is strong business valuation coverage of debt obligations. One of the larger additions in this vein was of bonds and convertible notes of **Tutor Perini Corp**. Tutor is a construction company that provides diversified general contracting services mostly in the United States and mostly to public sector customers. Tutor has come under pressure recently due to a delay in a California commuter rail project, combined with a few issues impacting receivables on other projects. While near term earnings may be impacted, longer term credit fundamentals are solid, as the company's net working capital is almost twice the amount of total debt. Priced to yield over 8%, we find Tutor's 2021 and 2025 notes to offer a good risk/reward profile.

Also new in August was a position in the 2021 convertible notes of **Carbonite Inc**. Carbonite is a Boston-based software company that focuses on data security solutions for business. The company is strongly cash generative and, although performing at a level slightly below high expectations, continues to have a good credit profile. With notes yielding over 7% against a default probability we view in the 0.3% range on a 1-year basis, we consider Carbonite to be an excellent value-for-credit risk.

Fund Positioning
The Fund yield to maturity at August 31 was 5.5% with current yield of 4.8% and average duration of maturity-based instruments of 3.0 years. There is a 5.2% weight in distressed securities purchased for workout value whose notional yield is not included in the foregoing calculation. Cash represented 1.6% of the total portfolio at August 31.

Geoff Castle
September 5, 2019

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