

THE MANAGER'S COMMENTARY – AUGUST 2019

Fellow Unitholders,

August was a tough month for our funds. Both the Pender Value and Pender Small Cap Opportunities Funds had a negative month, down -6.8% and -5.7%¹ respectively. While major indices like the S&P 500 index also had a negative return of -0.7%, small cap and micro-cap indices had considerably worse returns: the Russell 2000 index and the Russell Microcap index returned -4.1% and -5.5% respectively in the month. As our funds tend to be more focused on small and micro-cap companies, our performance is more comparable to small and micro-cap indices.

Portfolio Updates

Q2 earnings season continued into August. As we mentioned in [July's commentary](#), equity markets have been in "risk off" mode, meaning any slight downward revision of guidance or negative outlook would trigger a disproportionate selloff, especially in the small cap world. We witnessed this firsthand throughout earnings season. In our opinion, business fundamentals don't change over just one quarter, but we acknowledge that quarterly earnings releases contribute to portfolio volatility and, in a risk off market, increased downward pressure rather than upward. Investors often over-react as their fears drive their actions, which causes stocks to gap down. Carbonite, which we also discussed in [July's commentary](#), was again one of the key detractors for both funds. Nothing has changed in the last month. We reiterate that we are comfortable with the quality of the business and the new management team, led by interim CEO Steve Munford. As the stock price continued to decline in August, we took the opportunity to increase our weighting for both funds. Then, on September 6, the Carbonite stock price jumped 17%² on the news that they have received takeover interest.

Other key detractors for the Pender Value Fund included Zillow Group, Inc. (NASDAQ: ZG) and Burford Capital Limited (AIM: BUR), while MAV Beauty Brands, Inc. (TSX: MAV) and Leaf Group Ltd. (NYSE: LEAF) were the main detractors for the Pender Small Cap Opportunities Fund.

On the positive side, ProntoForms Corporation (TSX-V: PFM) was one of the main contributors to both funds and Transat A.T. Inc. (TSX: TRZ) was the top contributor, as we used the increased Air Canada offer to exit our position. You can find a full account [in our latest blog post](#).

A Big Opportunity for Small Caps?

The last couple of years have been challenging for small cap stocks. Indices of these stocks have been negative and, with the backdrop of strong performance by large cap stocks, we have reached a point where small caps are lagging large caps by the widest margin since 2003.

Declining stock prices do not necessarily mean the stock is cheap, but we believe that in this market it does. If you take out the unprofitable companies in the Russell 2000, the average PE of the index is less than 12x. The last time we saw this was in the middle of the financial crisis. We believe that now is a good time to own small cap stocks and we are acting accordingly. The Pender Small Cap Opportunities Fund is fully invested today. We haven't been able to say that many times in the last 10 years, if at all. For the Pender Value Fund, we have been rotating the portfolio into small caps. In August our large cap weighting came down from 39% to 34%. Small and micro-cap increased from 28% to 30%.

In allocating more assets to small caps, we have also increased the cash weighting of the Pender Value Fund, both to have dry powder for further purchases and, as we deploy into potentially higher IRR small cap names, to maintain a consistent or increasing potential IRR for the overall portfolio, even with the cash balance.

¹ Refers to Class F units in the Fund. Source: Pender

² September 6, 2019, from \$12.93 to \$15.08, via CapitalIQ

Company Specific Catalysts Driving Performance

It is not pleasant to see fund performance down and August was one of the worst monthly drawdowns we have experienced. As large investors in the funds, we feel the pain too. The flip side to the pain of watching our portfolio come down is the optimism we have, with the firm belief that buying the businesses we want to own for a long time, at good prices, is the best way to drive long term returns. We cannot control where markets go. What we can do in today's environment is to stick to our investment process. To revisit our investment thesis, maintain an understanding of the value of our investments, ensure that there is ample margin of safety and take action when necessary. Contrary to the general pessimistic sentiment in small caps, we think this is a wonderful time to be invested in the space.

David Barr, CFA
September 16, 2019

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