

PENDER PENDER

VALUE FUND

SMALL CAP OPPORTUNITIES FUND

THE MANAGER'S COMMENTARY - OCTOBER 2019

Fellow Unitholders,

Fund performance was mixed in October. The Pender Value Fund had a positive return of 1.4% while Pender Small Cap Opportunities Fund had a negative return of 1.4%¹. During the same time period, US markets outperformed Canadian markets with the S&P 500 index up 1.6% and the S&P/TSX Composite index down 0.9%. Small cap indices in the US, such as the Russell 2000 and Russell Microcap also outperformed, up 2.0% each. With an active share of over 99% in both funds, our performance is generally differentiated from the index. However, the Pender Small Cap Opportunities Fund's higher exposure to Canada was a driver of the relative discrepancy in the performance between the two funds this month.

Portfolio updates

Q3 earnings season kicked off again in October. While some of our holdings reported financial results last month, the majority of earnings are scheduled in November. Among the few that have reported, Aritizia Inc. had a strong run and was one of the top contributors in the Pender Small Cap Opportunities Fund. On the non-earnings-related front, Sangoma Technologies Corp announced its acquisition of VoIP Innovations. It was well received by investors as it has not only increased Sangoma's scale, but also grown its percentage of recurring revenue base. As a result, Sangoma was the top contributor for both the Pender Small Opportunities Fund and Pender Value Fund. More on Sangoma later. Exor N.V. also announced that one of its key holdings, Fiat Chrysler, was in a merger proposal with Peugeot as part of its strategic review process. Exor was one of the top contributors for the Pender Value Fund in October.

On the negative side, Athabasca Oil Corp and Medicure Inc. were among the key detractors for both funds. That being said, Medicure's stock was up sharply after they announced a substantial issuer bid at \$6.50, a 102% premium to the stock's previous close price of \$3.22 on November 1.

The Pender Small Cap Opportunities Fund is essentially fully invested with 0.6% cash on hand. We have kept cash at high single digits in the Pender Value Fund over the past few months and we continue to increase the portfolio's exposure to Canadian markets and small/micro cap companies as we see more opportunities in these parts of market. At the end of October, the small/micro cap weighting represented the largest market cap allocation in the Pender Value Fund, and we continue to increase our Canadian exposure in the Fund.

Small Cap & Microcap Swimming Upstream?

We are clearly in a "risk off" world today with investors having a low tolerance for investments perceived as risky. We recently took a look at equity fund flows and it was not a pretty sight. Investors pulled roughly \$60 billion from stock funds in the third quarter, marking the largest equity outflow since 2009, according to Morningstar data. We then went looking to see where the funds were flowing. While investors pulled money from funds, they put more capital into traditionally safer "risk off" assets. Bond funds took in over \$118 billion over the same period, according to Morningstar, while money-market funds saw a net inflow of \$225 billion. Money market funds were very green (no pun intended). Indeed, money market fund assets in the US today are near the levels that they were during the financial crisis. A clear indication that investors are risk off. It's incredibly interesting that money market funds can be at

¹ F Class; source - PenderFund

this level while at the same time we can have indexes near all time highs in the US. It makes us think there may be a crowded trade in a few large cap stocks that could unravel quickly if it starts to reverse.

We have spoken a lot recently about how this environment has affected valuations in the small cap part of the market. In this type of environment, we are continually asking ourselves, “what is the catalyst that will positively impact the share price?” We have spoken a lot about looking for companies that have a higher probability of being acquired. These events are usually positive for fund performance and very exciting as they create a sudden move in fund value, but they always leave us with a hangover - so what next?

Another catalyst we factor into our analysis and should, over time, have a bigger influence on the funds’ underlying performance is the improving fundamentals of smaller companies as they hit the radars of larger and larger pools of capital. Former acquired Pender holdings QHR and Tio Networks were two wonderful examples of this and during October we began to see the same pattern emerging as impressive revenue growth and improving operating fundamentals (as evidenced by record levels of EBITDA) made analysts notice Sangoma. It’s hard to believe we have followed Sangoma for over 10 years. We held it in the early days of the portfolio but moved on when we had some concerns but kept an eye on it and ultimately returned it to the portfolio in 2017. Following the company and management for all these years, even after we exited our original position, has given us confidence both in their plan to grow the business and in management’s ability to execute. While a bump in the value today from an acquisition would be nice short term, with the company’s recent track record and large market opportunity still in front of it, I hope to be writing again about the company positively five years from now.

The current market opportunity has provided us the opportunity to enter several other small but growing companies that should be hitting the radar of larger pools of capital in the near term. We are confident that these small/microcap names will add value to our funds over the long term.

David Barr, CFA
November 12, 2019

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