

PENDER PENDER

VALUE FUND SMALL CAP OPPORTUNITIES FUND

THE MANAGER'S COMMENTARY - NOVEMBER 2019

Fellow Unitholders,

After the strong equity performance in the month of November it brings to my mind the quote, "Please sir, I want some more". The Pender Value Fund had a positive return of 5.5% while the Pender Small Cap Opportunities Fund gained 6.3%¹, outperforming both US and Canadian large cap indices with the S&P 500 up 4.5% and the S&P/TSX Composite Index up 3.6%. During the same time period, small cap indices like the Russell 2000 and Russell Microcap also outperformed, advancing 5.0% and 5.5% respectively.

Portfolio Updates

Q3 earnings season turned out to be relatively smooth. We did not see many of the knee jerk reactions we had witnessed during July and August when companies reported their second quarters. Carbonite was the top contributor for both funds, having announced that it is to be acquired by OpenText for \$23. Zillow, which has been a battle ground stock, had a strong quarter and was one of the top contributors for the Pender Value Fund. Having initially bought MAV beauty in the Pender Small Cap Opportunities Fund, the stock price suffered a huge decline post its Q3 earnings report. However, we believed this provided a good entry point, where the risk reward profile looked even more attractive than when we initially bought it, so we added it to Pender Value Fund during the month. MAV had a nice rebound after and ended up being one of the top contributors for the Fund in November. For the Pender Small Cap Opportunities Fund, Medicare was one of the top contributors alongside Sangoma ([which we talked about in the last commentary](#)). Medicare's stock price went up sharply after the company announced its intention to commence a substantial issuer bid to acquire shares at \$6.50, significantly higher than the previous close at \$3.22 on November 1.

On the negative side, performance of the Pender Value Fund and the Pender Small Cap Opportunities Fund was adversely impacted by our limited energy exposure (single digit portfolio weighting). TripAdvisor was a big detractor for Pender Value Fund. We made the decision to sell the entire position after we reassessed the business risks of the company and found that these had increased significantly with increasing competition risks from Google's aggressive entrance into the travel and hotel space.

There has been no material change to the Funds' geographic or market cap allocations, or cash positions. The Pender Small Cap Opportunities Fund remains essentially fully invested with 2.2% cash on hand. We have kept cash at high single digits in the Pender Value Fund over the past few months.

How long will the bifurcated market last?

The theme we are seeing right now is that the market has increasingly become bifurcated. Indices have gone up significantly this year in both US and Canada with the S&P 500 up 24% and the S&P/TSX Composite Index up 22%². As a result, there have been a huge amount of capital gains realized and a lot of tax planning is underway. What does this mean? To crystalize tax losses, investors start selling stocks on the way down which puts more pressure on stocks that have not done well. On the other hand, investors are unwilling to sell stocks that have outperformed which triggers additional capital gains, so it has created a bimodal market where winners keep on winning and losers keep losing.

¹ F Class; source - PenderFund

² Year to date until November 30th, 2019; source – PenderFund, Bloomberg

If tax planning is the main reason behind this bifurcation, we expect to see a major reversal and renewed flows in the New Year, whereby companies that have been out of favour for an extended period of time start to attract investor interest again.

We have talked about the “risk off” status and relative underperformance of small and microcap companies in previous commentaries. Increased volatility in the small and microcap space has created selling pressure on a wide range of names in this universe. The additional tax planning measures have further exacerbated the downward pressure on these names. We believe that having more sellers than buyers of these businesses today creates a wonderful opportunity for these names over the longer run. We await for things to unfold.

David Barr, CFA
December 16, 2019

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