PENDER
CORPORATE BOND FUND

THE MANAGER'S MONTHLY COMMENTARY – JANUARY 2020

The Pender Corporate Bond Fund had a modestly positive result in January, as an early year rally in wider spread credits faded towards the end of the period with investors focusing on the risks relating to coronavirus, amongst other issues.

Significant gainers in the portfolio included SunPower convertible notes, as the market digested the company's very positive restructuring towards a distribution-focused business, and McDermott International loans and bonds, driven by significant progress made in debt restructuring.

Offsetting these gains, to a degree, was weakness in the Just Energy debentures, which suffered a hit from a large disposition of notes on the Jan 31 market close by an exchange traded fund. Also weak were some securities issued by companies in resource industries as commodity prices weakened.

At the end of January, the Pender Bond Universe Fund was launched. That mandate combines a 40% portion of the Pender Corporate Bond Fund with an augmented weight of the Canadian dollar investment grade securities currently held within the Corporate Bond Fund.

The Present and Future Value of Money in a World of Money Printing

Every baker needs to understand flour. It is just part of the job. Similarly, those of us who work with money, even if we are usually focused on the more specific work related to investing in individual companies and their credits, need a working understanding of money. Money, after all, is the medium that we use to preserve and grow value.

For almost 50 years, Canadians and most other people in the world have carried on using fiat money, which is currency that is not backed by any particular asset or right. Ultimately the value that money holds **depends on the faith** that people place in its usefulness. If we walk past a billboard in the morning that advertises five dollar beers at happy hour, and the price is still the same at five o'clock, then five dollar bills are useful things to hold during the day to ensure we are raising glasses of beer in the afternoon. Faith is validated.

Over longer time periods, faith in the value of money depends on market participants' views of inflation. There was a time in the 1980's when faith in the future purchasing power was relatively weak, and investors in 10-year government bonds required interest rates of nearly 20% in order to be convinced that the real purchasing power of their invested wealth would be preserved.

Over the past four decades, a number of powerful forces have acted to moderate inflationary pressures. These included a **demographic trend** towards an older population that tends to consume less, a **technological revolution** that has curbed wage increases by allowing significant automation, a **global trade regime** that has opened world markets to low cost production, particularly in Asia, and, more latterly, a burgeoning **mountain of debt** carried by both private citizens and government entities that depresses current consumption[1].

And if those forces, in and of themselves, weren't enough, various central bank interventions have recently acted to fix long bond prices to those levels that would exist if inflationary forces were very low. So here we sit, with 10-year Canada bonds yielding 1.4%.

You Can Print Money But You Can't Print Wealth

We recognize the power of central bank money printing. But we also recognize that, while you can print money, you can't print wealth. Printing up money to buy government bonds will always fix the nominal price of the securities. But money printing doesn't have to increase the **real value** of those bonds. If such a strategy always worked, then Zimbabwe would be the richest country in the world!

So investors still need to think about inflationary drivers, even if central banks continue to buy bonds. And we believe some new drivers that may alter the direction of inflation expectations are perhaps building.

---

[1] For a fuller discussion on these points, please refer to [Predicting the Markets, A Professional Autobiography]() by Edward Yardeni

The first risk is the **apparent trend away from global free trade**. To the extent free trading unwinds, local labour can exert more power and drive up unit costs. The second risk is increasingly evident impacts from **climate change** that create the need for government bailouts and expensive publicly financed restorations in emergencies, while potentially also curtailing production in sectors like agriculture. The third is the unsustainable levels of future **entitlement spending growth** in the US and other major democracies…particularly when you compare growth in entitlements to growth in the income tax base. The fourth risk is **corruption**. It is one thing for central banks to print money to deploy in the markets for ostensibly noble purposes. But noble purposes aren't the only purposes for which money *could be* created. And who's to say that the major Western democracies will always remain under the rule of non-corrupt people. In short, there are a number of emerging drivers that just might, in our view, change the trend of inflation and, by extension, the trend of credit yields.

Putting all those pieces together, we continue to favour short duration obligations, as well as securities with a degree of open-ended upside in a world where inflationary trends may reassert themselves.

New Positions

In January, we purchased a position in the first lien loan and bonds of Parr Pacific Holdings which operates oil refineries in Hawaii and other relatively less competitive US markets. While we are not bullish on the long-term growth in refined petroleum volumes, we consider Parr's regional competitive advantages, and its ability as a refiner to manage for margins rather than volume, to be important credit positives. Yielding in excess of 7% with 1-year default probability that we view as less than 0.05%, we find this risk/reward equation to be attractive.

Also in January, we purchased a position in the convertible notes of one of the world's leading satellite operators, Intelsat S.A. Intelsat is under pressure due to its relatively large debt load, combined with uncertainty surrounding the upcoming disposition of its C-Band spectrum. In January Intelsat bonds fell sharply as posturing in the US Congress caused market participants to lower their expectations for Intelsat spectrum proceeds. We believe the market overacted to congressional manoeuvering and we are of the view that the company still has considerable leverage to gain a strong outcome from the sale of its spectrum rights. Intelsat convertible notes priced slightly below 50% of face value at month-end.

Also we invested in two series of floating rate debentures of Dublin-based Aercap Holdings, the world's largest aircraft leasing firm. Aercap floaters, priced around 80% of face value to yield over 5% to long-dated maturities are under pressure. Their dual unpopularity is due to the exposure to commercial aviation during the coronavirus scare as well as their status as floating rate structures which have developed a distinct discount vs fixed rate securities. We view Aercap as the leading business in the aircraft leasing industry, with key competitive advantages that permit the company to enjoy sustainably higher profitability than competitors. Recently upgraded to BBB by Standard and Poor's, Aercap also now enjoys a cost of funds advantage as one of the few investment grade aircraft lessors.

Fund Positioning

The Corporate Bond Fund yield to maturity at January 31 was 5.4% with current yield of 4.7% and average duration of maturity-based instruments of 2.9 years. There is a 3.5% weight in distressed securities purchased for workout value whose notional yield is not included in the foregoing calculation. Cash represented 0.6% of the total portfolio at January 31.

Geoff Castle
February 6, 2020

PENDER
PenderFund Capital Management Ltd.