

PENDER PENDER

VALUE FUND

SMALL CAP OPPORTUNITIES FUND

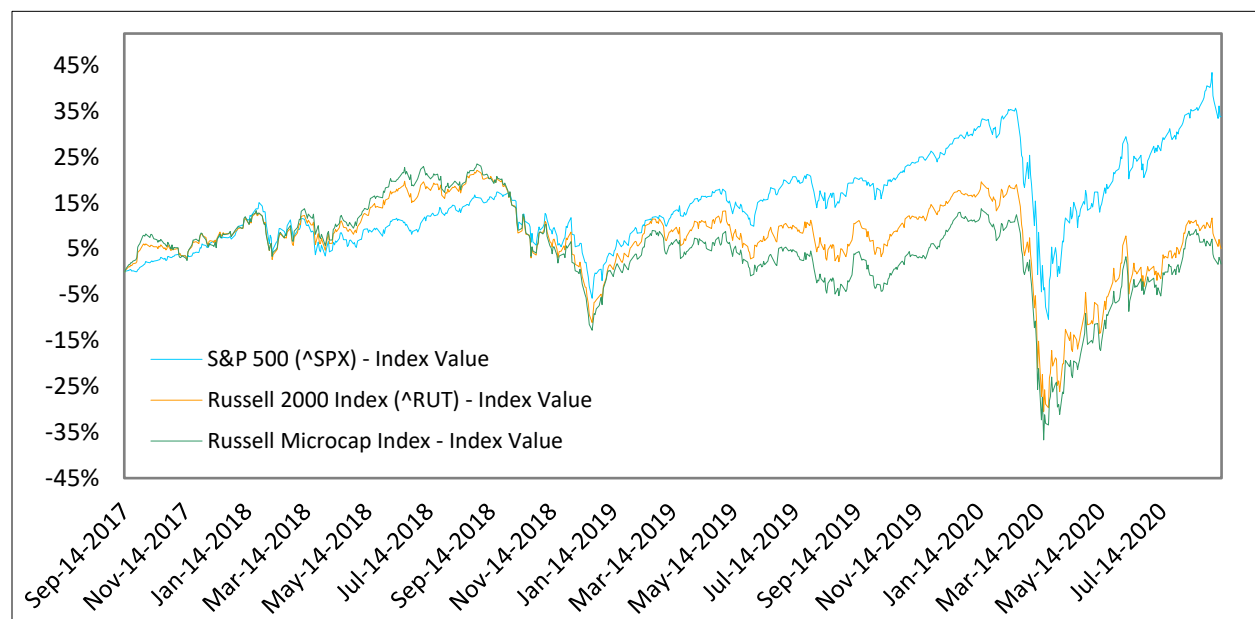
THE MANAGER'S COMMENTARY - AUGUST 2020

Fellow Unitholders,

August marked the fifth straight monthly gain for major markets. The S&P 500 (CAD) was up 4.4% and the S&P/TSX Composite was up 2.3%, while the Pender Value Fund generated a total return of 6.4% and the Pender Small Cap Opportunities Fund generated a total return of 7.3%¹ in the month. We are happy that our funds had such strong returns in the month, but what really excites us is the long term performance of our funds – in particular the Pender Small Cap Opportunities Fund which is ranked 1st quartile in its category over 1, 3, 5 and 10 years². We remain fully aware of the uncertainty ahead of us in these challenging times, but at the same time, it's good to remind ourselves and our unitholders that it is the long term that really matters.

Mean reversion for small caps? It's like looking for Ferris Bueller in class!

While small cap indices outperformed their large cap peers for the month, the indexation of global capital markets continued to put active management under pressure. The multi year transition of capital from actively managed mandates to primarily market cap weighted indices is having the predictable effect. The bigger you are, the more capital you attract. We've watched this firsthand with the outperformance of large to small. We can see this discrepancy in performance and valuation metrics between bigger and smaller companies even in the large cap S&P500.



Source: CapitalIQ

¹ F class units; PenderFund

² Morningstar, September 4, 2020

S&P 500 Median Results Through September 13, 2020						
Company Size	Market cap	P/E	P/S	P/FCF	P/B	YTD Returns
Top 10	640.1 billion	30.0	5.6	33.5	7.2	15%
Top 50	208.1 billion	25.6	4.8	28.1	6.2	12%
51-100	82.2 billion	23.4	4.1	25.8	5.9	4%
101-150	51 billion	21.2	3.5	22.0	3.7	0%
151-200	32 billion	22.3	3.0	21.9	3.7	4%
201-250	26 billion	21.3	2.8	22.3	3.8	2%
251-300	20.1 billion	21.9	3.8	22.4	3.3	-3%
301-350	15.3 billion	21.5	2.6	18.7	3.2	-1%
351-400	12.4 billion	18.8	2.1	20.8	2.4	-11%
401-450	9.1 billion	14.1	1.5	13.0	1.9	-19%
451-500	5.1 billion	13.1	0.9	8.0	1.1	-38%
S&P 500	23.5 billion	20.6	2.6	20.0	3.2	-3%

Source: Bloomberg, Capital IQ

The good news is, the longer an asset class remains out of favour, the more attractive the opportunity potentially becomes. Fortunately, the CEOs of our businesses don't spend time worrying about index flows, they spend their time focussed on increasing the underlying economic value of their business. Good news for all of us who are invested.

Recently, the question I get asked the most is "When will small caps come back into favour?" After all, it has been a miserable decade for Canadian small caps. Just ask an institutional consultant how many Canadian small cap searches they have ongoing (blank stares). Over time, our view is mean reversion will occur and small cap stocks will rerate on fundamentals, but this record is slightly broken right now. When I think of looking for mean reversion right now, I can't help seeing that scene from one of the greatest movies from the 80s - "Bueller, Bueller...".

One area that has generated returns for our portfolios over the years is holding companies being acquired. Small and mid cap stocks are quite often subject to M&A, but not this year. According to the Global & Regional M&A Report 1H20 from Mergermarket³, global M&A is off 52.7% compared to 1H19. This is rather obvious given the environment during the first half of the year. However, just because deals didn't close and weren't announced didn't mean negotiations weren't going on in the background. Most M&A is the culmination of a six to twelve-month process. Although deals weren't announced, activity was still high and with the improved landscape, we think we can expect the M&A market to accelerate and maybe even play some catchup to bring this calendar year on par with others. Companies will push to get M&A done with the spector of a second wave of slowdowns on the horizon.

[Last commentary](#) we touched on the improving prospects of the IPO market. Well, it turns out the IPO pipeline for this fall appears to be full. We are very active in this space right now. Our private and public skillset gives us an opportunity to pursue attractive opportunities for our funds, but a strong IPO market is also a sign of risk-on, and risk-on markets can lead to strong small cap performance. Maybe Ferris Bueller is in class after all!

³ <https://www2.deloitte.com/content/dam/Deloitte/rs/Documents/mergers-acquisitions/MergermarketFinancialLeagueTableReport.q22020.pdf>

Portfolio updates

In the month of August, key contributors for the Pender Small Cap Opportunities Fund and the Pender Value Fund included Dye & Durham Limited (DND – a hot IPO stock) and MAV Beauty Brands (MAV – a busted IPO stock). DND, which we detailed in the [last commentary](#), continued its positive momentum in August, almost doubling stock prices again in the month. DND went public at \$7.50 in mid July and ended at \$26.23 on August 31. MAV has exhibited strong execution over several quarters and, after reporting an impressive Q2 in August, has finally regained some confidence back from investors. The company has demonstrated notable growth through the pandemic with e-commerce sales more than doubling and better cost control driving up margins and profitability. PAR was another key contributor for Pender Small Cap Opportunities Fund while eGain and Zillow were among key contributors for Pender Value Fund.

On the flip side, Leaf Group (LEAF), which has been among the top contributors in previous months, pulled back during August, despite its e-commerce business benefitting from the tailwinds of online shopping and growing at triple digits. The activist shareholder campaign is ongoing, and we believe it remains a catalyst to unlocking shareholder value. PhotonControl and Winpak were among key detractors for the Pender Small Cap Opportunities Fund and Pender Value Fund, respectively. We believe the price fluctuations in the month were only temporary and that the long-term business fundamentals of these two companies remain solid.

September started out with some significant drawdowns in the tech market, which saw all the prognosticators predicting the tech-based bull market is finally reversing. Maybe. Maybe not. We take comfort in being invested in a cohort of technology stocks that trade at very reasonable valuations. This potentially protects portfolios relative to the actions of other tech stocks if there is a big drawdown, but also provides significant upside capture if these stocks rerate to where the rest of the market is at.

David Barr, CFA
September 17, 2020



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PenderFund Capital Management Ltd.

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