PENDER FIXED INCOME

## THE MANAGER'S MONTHLY COMMENTARY – NOVEMBER 2020

The Pender Corporate Bond Fund enjoyed a very strong November, gaining 4.6%[1] on the happy confluence of some important tailwinds. A number of important vaccine breakthroughs, combined with a resolution of U.S. election uncertainty, were the key drivers of the rally.

Gains in the Fund were extremely broad-based, as a great majority of our credit positions moved higher during the month. Leading the way were our positions in the convertible notes of Alberta-based Surge Energy and preferred shares of US hospitality operator, Braemar Hotels. Also strong were a number of Canadian preferred share issues including those of Husky Energy and Brookfield Properties. Other sources of strength included a position in Infinera convertible notes and bonds of branded cosmetics player, Coty Inc.

There weren't many weaker positions, but one soft spot was the re-organized equity of Houston-based McDermott International. This position, which we acquired originally as a distressed term loan, traded lower on the announcement of a rights issue in which we plan to participate. We support the rights issue, and view McDermott's pending transaction as similar in nature to the successful September recap by Just Energy Group that delivered a strong gain to the Fund through our rights participation.

**Five Ideas for the Income Investor on Your List**

Many fixed income investors heading into the 2020 holiday season are faced with the prospects of meagre returns. Government bond yields, once a comfortable mainstay of investor portfolios, have been penned well below one percent through a combination of central bank intervention and investor caution. GIC's represent similarly thin gruel. If we imagine contemporary fixed income investors as literary characters, the images that come to mind are decidedly Dickensian. Somewhere there is a modern day Oliver Twist reviewing his portfolio with an advisor, asking, "Please sir, I want some more?" For this investor we offer the following ideas from our Fund.

1. **Discounted Closed-End Funds:** Benjamin Graham, the great teacher of Warren Buffett and other value investors, had a penchant for closed-end mutual funds trading at a discount of more than 15% to daily net asset value. Were Ben Graham to put together a holiday wish list, we would expect him to look fondly on some of the more deeply discounted closed-end credit funds in today's market. Case in point, the Aberdeen Asia Pacific Income Fund (FAP.TO) which ended November at a 25% discount to daily net asset value, and which sports an 8.8% annual dividend. Here's a double-play opportunity to close the discount whilst earning an attractive coupon.
2. **Secured Marijuana Credit:** 1st lien credit of Trulieve and Curaleaf should be on every holiday wish list in 2020. To be owned not merely for their delightfully high yields (over 7% for Trulieve and north of 10% for Curaleaf) but also for their comparatively mellow default probability. Both Trulieve ($4.9B mkt cap vs $169M debt) and Curaleaf ($9.3B mkt cap vs $390M debt) have large market capitalizations relative to tiny senior credit obligations. This equity-heavy capital stack in both cases drives our estimates of 1-year default probability below 0.2%. With improving profitability and possible legalization of marijuana banking in the United States, we see more tailwinds for the sector in 2021.
3. **Rate-Reset Preferred Shares:** No fixed income holiday wish list in Canada can leave out the extraordinarily cheap value proposition of rate reset preferreds. Consider the Bell Canada series "O" preferreds that at current levels offer a 6% dividend, a rate that towers over the mere 1.1% yield available on that issuer's 5-year notes. Even assuming the reset in 2022 is done against the current 5-yr Canada rate of 0.43%, the dividend rate is still over four times the company's bond yield, a ratio that improves to six times when one considers the favourable tax treatment of preferred dividends. We appreciate that the risk off market in March caused some investors to banish resets from their

[1] F class units; PenderFund

reindeer games. But at these prices, we couldn't imagine a better asset class than Canadian rate resets to lead our investing sleigh. On Fairfax! On Husky! On Brookfield and Thomson!

4. **A Seasonal Cream Puff:** In a world of 1% paper, the 5 7/8% 2026 notes of Open Text Corp stand out to us. Priced to yield 4.9% to maturity and only slightly lower to its most realistic call dates, Open Text remains in the cream puff category of relatively high yield in comparison to rather low credit risk. The company's group of mostly corporate clients are very sticky users of its core search and portal software applications. Cash flow is strong and consistent, while $4.7B total debt is underpinned by over $15B of market cap. We estimate 1-year default probability at less than 0.1% for this note yielding 4.9% to 2026.
5. **A Golden Convertible:** We like the convertible bond space generally, and particularly when one combines a reasonably attractive cash yield with realistic convertibility upside. In this area we point to Osisko's 4% notes of December 2022. At last price, the Quebec-based precious metals royalty player's notes yielded 3% to maturity, but provide equity optionality at common stock prices above $22.89. We don't know what is going to happen over the next couple of years in the precious metals space, but given a default probability that we view as being less than 0.2%, we believe we aren't paying anything for the call option value against Osisko common shares.

**New Positions**

In November we added a position in the 2.95% 2027 notes of Cameco, trading around par. We like the dynamics of the uranium business, as mine shutdowns by major global producers have helped rebalance the market. Meanwhile, the prospect for more serious actions to address climate change in the coming years seems positive for uranium demand. With a low default probability and enormous asset coverage, we consider Cameco a relatively attractive credit in the Canadian investment grade area.

Also in November, we initiated a position in the deeply discounted convertible notes of Tricida. Tricida is a drug development company aiming to bring an innovative therapy to market that addresses chronic kidney disease. Recently the company faced a regulatory setback in its efforts to win marketing approval from the FDA and its shares and bonds fell sharply. We consider the company's strengths, which include a cash balance greater than all debt, and a still-promising therapy in an area of important unmet need to be enough to warrant taking a position in the company's 3.5% convertible notes of 2027. These bonds traded recently around 50c on face value to yield over 15% to 2027.

**Fund Positioning**

The Corporate Bond Fund yield to maturity at November 30 was 5.3% with current yield of 5.0% and average duration of maturity-based instruments of 3.0 years. There is a 3.4% weight in distressed securities held for workout value whose notional yield is not included in the foregoing calculation. Cash represented 6.8% of the total portfolio at November 30.

*Geoff Castle*
*December 3, 2020*

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PenderFund Capital Management Ltd.