PENDER FIXED INCOME

THE MANAGER'S MONTHLY COMMENTARY – DECEMBER 2020

The Pender Corporate Bond Fund capped off the year with a strong December, gaining 2.6%[1]. Despite a rather tumultuous period early in the pandemic, the full year turned out fairly well, ending with a total return after all fees and costs of 7.0%[1]. Annualized performance for the five years ending Dec 31, 2020 was 9.9%[1].

Gains in December were led by our position in FireEye Inc. convertible notes, which surged on renewed interest in security software firms following a high-profile hack on several US entities. Other strength came from a successful par plus accrued cash recovery on the completion of Aceto Corp.'s liquidation. Commodity-related positions, including Transocean secured notes, also contributed positively.

Weakness in the portfolio was limited, due to the fairly buoyant environment. However, we did see some pressure in the credit of both Accelerate Diagnostics and Intercept Pharmaceuticals. In both cases we continue to view total company debts as just a fraction of the private market value of these enterprises.

Making Hay…Instead of Nothing at All

"And I know the roads to riches…And I'll never let you fall," belted out Air Supply's curly haired Australian frontman, Russell Hitchcock, that summer of 1983 when anything seemed possible, "And I don't know how you do it…Making love…out of nothing at all". Little did that cheering Montreal Forum audience know, thirty-seven years later, a version of Air Supply's epic query would still swirl in their heads. Except the matter that presses today is not making love but making money. And, technically speaking, our starting point isn't "nothing at all", but rather the thirty-nine basis points of yield still available from the Government of Canada's five-year note.

To grow returns beyond four tenths of a percent in 2021, while at the same time providing investors as much security of principal as possible requires a mix of creativity and discipline. This year's market, we believe offers a few different classes of opportunities:

- **Default Risk / Yield Mismatches:** The market still contains a number of bonds with wide spreads from issuers, but who should be viewed as minimal credit risks. Often these bonds are mildly non-conforming in some respect to the criteria of Standard & Poor's and their colleagues, or the agencies have just been slow to catch up to good news. These 'cream puffs' remain the heart of our 2021 lineup, with equity market caps and cash positions that dwarf relatively small debt loads. Current examples include **Uber Technologies**, **Trulieve Cannabis** and **Open Text**.
- **Upside Focused Asymmetry:** In markets with interest rates much lower than inflation, we have often observed powerful moves in growth companies' stocks. In 2020, as that macro situation unfolded, we chose to hold on to certain convertible bond positions, acquired near or below par, which grew to much higher levels. That allowed us to participate in big moves by **Palo Alto Networks**, **SunPower** and **Opko**, amongst others, riding these positions to levels as high as 160% of face value before taking profits. We continue to explore opportunities to buy into growth converts that we believe exhibit minimal default risk and enjoy a downside protected by a robust bond floor. Call us fair weather friends, or cake-and-eat-it-too investors. We can take it. But "upside-oriented asymmetry hunting" remains a focus in 2021.
- **Diamonds in the Rough:** A third focus for 2021 is in the distressed/reorganized credit arena. While 2020 did not result in the uncontained corporate carnage that many envisioned, there were plenty

[1] Class F units; PenderFund

of bankruptcies and there remain plenty of undervalued corporate assets. Amongst 2020's winners in this area was the **Chesapeake FILO** term loan, acquired at less than half of current trading levels. In 2021 we are looking for returns from a variety of entities, with recent acquisitions of distressed names in the chemicals and telecommunications sectors. While the actual payoff here may be through rights participation, as in the case of **Just Energy**, or in liquidation, as we achieved in 2020 with **Aceto**, we continue to turn over ideas in search of strong risk/reward.

We recognize that the straightforward coupon-clipping game in fixed income has gotten harder. Coupons from many issuers, particularly sovereigns, have all but disappeared. But in corporate credit, where enterprise values may be misunderstood, or may be ignored by passive investors, there is still plenty to do.

New Positions

In December we added a position in the 2025 senior unsecured notes of Arizona-based Carvana Co. Carvana, which operates an online platform for buying and selling used vehicles throughout the US, has strong growth prospects as online auto sales gain share from traditional dealer lots. With a market cap in excess of $40B compared to less than $1.5B in total debt, we believe Carvana's notes, which yielded 4.8% at the end of December, represent attractive risk/reward.

Also in December, we added a position in the convertible notes of Toronto-based Chemtrade Logistics. Chemtrade has been negatively impacted by the economic slowdown that has arrived with the pandemic, along with coincidental cyclical capacity issues in certain product lines. While the company's balance sheet is stretched, we are confident that management is sufficiently focused on deleveraging and we are also positive on prospects for some end market recoveries in 2021. Chemtrade convertible notes recently were priced to yield up to 15%.

The buoyant market conditions in December also led us to sell down some stronger equity-linked positions, including the convertible notes of SunPower, Etsy, Twitter and Palo Alto Networks.

Fund Positioning

The Pender Corporate Bond Fund yield to maturity at December 31 was 4.8% with current yield of 5.0% and average duration of maturity-based instruments of 3.1 years. There is a 4.1% weight in distressed securities held for workout value whose notional yield is not included in the foregoing calculation. Cash represented 5.7% of the total portfolio at December 31.

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PenderFund Capital Management Ltd.