PENDER FIXED INCOME

THE MANAGER'S MONTHLY COMMENTARY – JANUARY 2021

The Pender Corporate Bond Fund enjoyed a strong January, gaining 2.8%[1], significantly ahead of benchmark measures. Driving the difference was a robust bid within the deeper value segments of the credit market, as well as strong performance by some convertible bonds which benefited from a surge in select underlying equities.

Specific drivers of performance included recently equitized or newly equitizing debt stakes in Just Energy, McDermott International, Chesapeake Energy and PHI, Inc. as investors began to focus on the attractive fundamental value previously obscured by debt reorganization processes. Also helping the Fund was a gain in certain convertible bond lines such as First Majestic and SunPower Corp, as both silver and solar power came into vogue. The Fund was an aggressive seller of several of these lines, locking in gains.

Offsetting the Fund's January strength, to a degree, were a few decliners. These included preferred shares of Fannie Mae, as the timeline for restructuring that entity was cast into doubt by the incoming US Administration. Some convertible bonds were also lower, such as those issued by Osisko Gold and FireEye Inc. We continue to like these positions and, in the case of Fannie Mae especially, consider the lower price to be a unique opportunity.

Spotlight and Shadows

Everybody is talking about it. You know the symbol. *That* trade has pulled its owners from rags to riches overnight. From the shadows of deep obscurity, *that* company now stands alone amid the brightest spotlight the world can muster. So much money has been made, there ought to be a law against it.

We weren't part of *that* trade. But January did see us complete our own journey with a couple of holdings that followed similar, if less extreme, arcs. As we contemplate successful exits in **SunPower** convertible notes and also the **Chesapeake** "FILO" term loan, we must of course give thanks to the "spotlight", to the concentration of investor attention that allowed us to make fairly remarkable returns on these lines. But recognition should really be given to the work done while these entities languished in the shadows.

Our initial buys of SunPower convertible notes came in the depths of an earnings trough for that company. An initial outbound enquiry to the company's investor relations manager in early 2018 got us the VIP treatment. They weren't getting many calls. At the time it seemed as if the solar industry was dead. Chinese overcapacity had devastated industry margins and the political winds of the moment were blowing against the subsidies that solar power needed.

What we saw then, beyond just cheap securities with yield-to-worst nearing 10%, was a company with access to deep pockets, an industry where the future seemed brighter, and a management group with a plan. As an unconsolidated subsidiary of Total S.A., we felt that any short-term funding gaps that SunPower might have could be easily backstopped by its large controlling shareholder. As for solar power as an industry, it seemed then that global warming wasn't going to go away on its own and that the impetus to develop carbon-free power sources was likely to return. And as for management? They had a strong plan to divest underperforming manufacturing assets and refocus on the company's market leading niche in distributing commercial-industrial and residential solar systems. So the IR manager told us. And he was right. He was shouting these points as loud as he could, but at the time no one seemed to hear.

[1] Class F Units; PenderFund

Did we have any idea that the convertible bonds we were buying in the 70s and 80s would be trading a few years later as high as 200? Not at all. But, as an old colleague, Lee, likes to say, good things happen to cheap securities.

Chesapeake, where we acquired a term loan position in the 30s percentage of face value around the time that the oil price hit its low of negative thirty-seven dollars per barrel, was in many ways a parallel story. The model at the time said we might get as much as 100 cents on the dollar if we waited for fair value to be bid in the market. Who would have guessed that our fair value estimate would have been realized, much less surpassed, so soon? But here we are.

Spotlights and shadows define the look of the market, but not its substance. The moon is the same all the time, but it looks different in its phases depending on how the light shines upon it. So, too, the market for business securities. The underlying entities change much less than the perceptions of investors, for whom changes in price can be considered as important as the light of the sun.

Where will the spotlight of investor attention focus next? We don't know. But we'll see you on the dark side of the moon.

New Positions

In January we focused on building weight in less price-volatile securities. As an example, we added weight in Rackspace Technology bonds maturing in 2028, a situation where we found a pleasant combination of greater than 4% yield and decent valuation coverage. We also returned as holders of Tesla 2025 bonds, after a hiatus of more than a year. Tesla's market capitalization of over $700B dwarfs its total debts of less than $12B. As such we found the >4% yield to 2025 maturity attractive, although in this case we risk a lower return in the event of an early call.

On the more adventurous side, we also initiated a position in the 1st lien 2028 bonds of National Cinemedia. National Cinemedia, an entity focused on selling advertisements into motion picture theatre audiences, has seen a striking reduction in business recently. However, we believe the company's strong cash resources which are sufficient to cover all interest charges for more than four years, combined with a relatively lean fixed cost structure, will allow the company to make it to the other side of the pandemic without impairing its senior obligations. Priced in the mid 80s, the bonds yielded over 8% at the point of purchase.

Fund Positioning

The Pender Corporate Bond Fund yield to maturity at January 31 was 4.9% with current yield of 5.0% and average duration of maturity-based instruments of 3.3 years. There is a 2.4% weight in distressed securities held for workout value whose notional yield is not included in the foregoing calculation. Cash represented 6.6% of the total portfolio at January 31.

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