PENDER FIXED INCOME

THE MANAGER'S MONTHLY COMMENTARY – FEBRUARY 2021

The Pender Corporate Bond Fund emerged from February with a gain of 1.5%[1], which was ahead of benchmark measures. Driving the difference was the Fund's avoidance of losses in long duration instruments, which were impacted by rising rates, combined with favourable performance from individual wide-spread credits within the energy and materials sectors. Rate-reset preferred shares were also positive contributors.

February 2021 was extraordinary in fixed income markets. It isn't every month that the yield on the 5-year Canada bond doubles. At the longer end of the curve, there was serious trouble. The price of a 30-year US Treasury bond fell as much as 9% intra-month, closing February down slightly less than 7%. The magnitude and the speed of the bond market sell-off eventually affected stocks and other risk assets, which also declined in the latter half of the month.

The market events of February thus noted, we make no particular forecast of the direction of rates in the near term. Certainly, the rebounding economy of the latter stages of the COVID-19 period may push inflation higher, and rates may follow. On the other hand, there has been ample communication from central banks that they are prepared to use extraordinary measures to suppress interest rates across the curve, if needed, to sustain an economic recovery. If the Powell Fed takes that direction, who are we to fight them? So while we see why rates may rise further, that thought is not really guiding our investing. Instead, we remain focused on line-by-line credit opportunities.

Hey Sailor! New in Town?

"Call me Ishmael," began the weather-beaten trader slumped at the bar beside me. "There is a sweet mystery about the sea, whose awful stirrings seem to speak of deep value beneath."

Now I have come, in the slow rolling months of this pandemic, to recoil from such casual banter with strangers. Yet there was something in the sincere countenance of my companion that compelled me to press him for detail. I paused to finish my drink, then asked, "So you are saying that the ships are cheap?"

But alas, in my hesitation, he had taken his leave. What remained upon the bar where he had been seated was a silver shilling in payment, a few drops of Spanish brandy in his glass, and a smoldering cigar butt in the ashtray…

In the years following the Great Financial Crisis, few sectors have been as stunningly bad for investors as shipping. A great boom in trade in the early years of this century led to over-building of almost every kind of vessel. And, when massive oversupply was joined by tepid end demand, a truly horrific spiral ensued. In attempting to catch the mythic "white whale" of a shipping rebound, more than one investor has been swept overboard, or flailed helplessly in a gushing tide of red ink. Therefore, in initiating a position in convertible debt of a few US-listed shipping entities, we required a fairly high standard of justification.

In a nutshell, what we saw was the combination of a valuation-based opportunity with the presence of cheap convertible securities that allowed us to invest with asymmetric risk/reward dynamics. There is interesting upside if shipping performs, but reasonable credit protection if we are early in this call or, heaven forbid, wrong.

There can be no doubt that industry multiples are on the cheap end. Using the example of Eagle Bulk Shipping, we see EV/Sales recently less than 3x, towards the low end of this company's long term range – the ratio hit 14x back in 2007. Price-to-book tells the same story with the business penned well below 1x, much less than the 2.5x the company was valued at during shipping's last heyday. While Eagle Bulk is an example, many other entities in this industry, from tankers to containers to ship lessors, sport similarly cheap valuation ratios.

Now trailing numbers are one thing and business prospects are another. But, here again, we see cause for optimism. In interviewing the management team of several shipping companies we discovered a wide-reaching

[1] Class F; PenderFund

determination to lower financial leverage and a prevailing cautious attitude towards future investment. There are few new builds on order at any of the major shipbuilders. With supply discipline seemingly in place, the end of the pandemic provides, perhaps, a rekindling of end demand. Such seems to be the signal emanating from indicators such as the recently buoyant Baltic Dry Index or the booming CTS Average Global Container Price Index.

We don't often pay attention to sell side analysts. However, it is interesting that "the street" appears to have been slow to take notice of what we view as the improving dynamics in shipping. The handful of analysts still watching the sector now issue more "holds" than "buys". At shipping's 2007 peak, "buys" outnumbered "holds" by a factor of approximately four to one.

Adding to our interest in the sector was the availability of a wide variety of convertible debt securities trading with yields in the 3-6% range. With debts supported by a reasonable buffer of equity beneath our positions, we are also exposed to participation on the upside with positions within striking distance of equity parity. At slightly less than 5% of the Fund, our weight in the sector has been sized with a tempered enthusiasm. But, like Ishmael, we live in hope that our ship will come in.

New Positions

Our principal new addition to the Fund in February was the weight in shipping industry convertible notes. In addition to Eagle, this included positions in notes of Atlas Corporation (the renamed Seaspan), SFL Corp and Scorpio Tankers.

The largest other addition in February was weight in the 1st lien bonds of US hospital operator, Community Health Systems. We consider this a well-insulated position in the credit of a relatively consistent financial performer that has recently resolved issues relating to a previously unsustainable capital structure. Upgrades from the S&P "B-" rating appear likely.

Another purchase in February was in the capital structure of American Tire Distributors (ATD), with the largest position being in the company's 1st lien Term loan. ATD has successfully deleveraged through its Chapter 11 process, providing the company with more financial flexibility. Moreover, the volatility in its business which was driven originally by the termination of its relationship with Goodyear, appears to have been resolved. We like ATD's prospects for continued recovery as its replacement of Goodyear with alternate suppliers appears to have been received well by the company's customers.

Fund Positioning

The Pender Corporate Bond Fund yield to maturity at February 28 was 5.2% with current yield of 5.1% and average duration of maturity-based instruments of 3.2 years. There is a2.0% weight in distressed securities held for workout value whose notional yield is not included in the foregoing calculation. Cash represented 5.6% of the total portfolio at February 28.

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