

# PENDER FIXED INCOME

## THE MANAGER'S MONTHLY COMMENTARY - MAY 2021

The Pender Corporate Bond Fund gained 0.9%<sup>1</sup> in May, a respectable advance within the context of a fairly tepid period for high yield and a somewhat more positive high-grade market.

Leading the way for the Fund was our position in the reorganized capital structure of American Tire Distributors, which moved up on strong earnings. Also positive were a number of preferred shares of Brookfield entities and the convertible notes of Eagle Bulk Shipping.

Offsetting the gains, to an extent, were a few modest decliners in the pharma industry as Opko and Precigen converts came off slightly. Also weak was the McDermott term loan which suffered continuing fallout from the Mozambique crisis, a factor we consider already excessively discounted by the market.

### Six Mistakes You Could be Making in Fixed Income (And How to Correct Them)

Life for investors these days can be stressful and uncertain, even more so if it is your job to invest on behalf of others. With the wild market swings of the past two years still fresh in many minds, it is no surprise to see some advisors seeking to strike a bargain with the gods. "Get me a few points in fixed income, that's not asking much," they say hopefully, eyes pointed to the heavens, "and allow me some peace on the golf course this summer".

But, alas, the dreamy autopilot of yesteryear's fixed income has all but disappeared. Rather than gliding along effortlessly, many investors are either staring at a near zero return in traditional instruments or flailing helplessly amidst unforeseen risks. In an effort to get advisors from obsessing in front of the quote machine and back onto the tee box where they belong, we outline a number of fixed income pitfalls that one may fall victim to, and how to correct them.

**#1: Focusing on Rating vs Risk:** There was a time many years ago when "investment grade" indicated that a bond was worth owning and issuers below this stature were to be kept for riverboat gambling. Nowadays we often find situations where our margin of safety in lending to a junk-rated or unrated company can be considerably higher than in some issuers anointed as BBB by S&P. It is the risk that matters, not the rating.

**#2: Choosing Coupon over Value:** Fat coupons draw attention, and sometimes they pay out without issue. But often that subordinated private real estate loan might offer less value protection than a more modest coupon backed by a stronger collateral package. It pays to focus on value.

**#3: Not Getting Paid for Extending Duration:** We get it. The 30-year Canada yields slightly more than the 5-year Canada bond. But unless you are ready to accept large price swings and are excellent at timing entry points, you may want to forego a few extra pips for the relatively less exciting but more certain world of short duration.

**#4: Ignoring Equity-linked Upside:** Question. When can a bond pay out more than par on maturity? Answer. When it is a convertible bond linked to an attractively priced stock. Not every convertible bond is a winner, but certain issues do deliver well above par. This is part of the reason convertible bonds are the long-term total return winners within the fixed income category<sup>2</sup>.

**#5: Using Arbitrary Buy-Sell Triggers:** You may not even know you are doing this, but if you are investing in passive fixed income vehicles, the chances are good that your ETF is making some pretty arbitrary calls. Selling after downgrades or buying after index inclusion. These are some of the well-telegraphed trades that some savvy market participants get ahead of to the detriment of the ETF.

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<sup>1</sup> All Pender performance data points are for Class F of the Fund. Other classes are available. Fees and performance may differ in those other classes.

<sup>2</sup> Creditsights, April 30, 2021

**#6: Stigmatizing Lower Rated Bonds:** Everybody likes to say they own top quality, but long-term studies show that lower rated credit delivers markedly higher total returns, even taking into account recessions<sup>3</sup>. Clearly, liquidity is also a consideration in constructing a fixed income portfolio. But a dash of lower rated credit can help a portfolio deliver above average returns in this low yield environment.

While there are numerous mistakes that can be made, as illustrated above, there is really only one way to address them – think like an investor. We believe that investors whose view of credit securities begins with a valuation of the issuer are positioned to do much better than those whose thinking is outsourced to rating agencies. Investors who understand the exponential volatility that is embedded at the long end of the curve are more likely to choose exposures that pay them for duration risk.

### New Positions

In May we added a weight to a couple of senior term loans from issuers where we are also bond investors. We picked up the floating rate senior debt in call centre software specialist, Avaya, attractively yielding LIBOR +4% in the context of a default probability we view as less than 0.5%. We also bought a position in the Term Loan B of ride-hailing leader Uber Technologies, which sports a LIBOR +3.5% coupon. In both cases we consider the term loans to possess little fundamental risk with a reasonable payout.

Somewhat more adventurously, we picked up a position in lipid specialist, Esperion Therapeutics. We like Esperion's growth profile, believing that the relaxation of COVID restrictions will lead to an increase in prescription activity for the company's key cholesterol lowering drug. The company enjoys a strong balance sheet, with cash of over \$200M and market cap in excess of \$600M compared to debt of \$276MM. The company's convertible debt priced near 82 to yield approximately 9% to a 2025 maturity seems attractive to us.

### Fund Positioning

The Pender Corporate Bond Fund's yield to maturity at May 31 was 4.8% with current yield of 4.9% and average duration of maturity-based instruments of 3.7 years. There is a 1.4% weight in distressed securities held for workout value whose notional yield is not included in the foregoing calculation. Cash represented 5.8% of the total portfolio at May 31.

Geoff Castle

June 4, 2021



**PENDER**  
PenderFund Capital Management Ltd.

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<sup>3</sup> [Long-Term Expected Credit Spreads and Excess Returns](#), Erik Hennink Applied Working Paper No. 2016-3 October 2016 Ortec Finance Research Center P.O. Box 4074, 3006 AB Rotterdam, The Netherlands, [www.ortec-finance.com](http://www.ortec-finance.com)