PENDER

STRATEGIC GROWTH AND INCOME FUND

THE MANAGER'S COMMENTARY – Q2 2021

Dear unitholders,

The Pender Strategic Growth & Income Fund (PSGIF) was up 6.2%[1] for the quarter, and the Pender Enhanced Income Fund (PEIF) was up 5.9%[1]. On a year-to-date (YTD) basis, PSGIF was up 18.4%[1], while PEIF was up 22.9%[1]. The PEIF edged out PSGIF YTD performance primarily due to the sale of a private investment holding in the first quarter (Agawa Canyon Inc for a return of 3.3%). Remaining legacy private holdings account for 0.6% of PEIF. The long-term performance of PSGIF remains solid, with 5-year annualized returns of 10.8%[1,2]. PSGIF and PEIF are largely mirrored portfolios, but the PEIF has a significant amount of tax losses available to shelter income. This commentary refers to PSGIF unless otherwise noted.

In today's zero-coupon world, we believe PSGIF is well-positioned as a "modern makeover" of the traditional 60/40 balanced portfolio. Rather than owning government bonds with ultra-low or negative yields in this Fund, the fixed income component is made up of the Pender Corporate Bond Fund (PCBF). The Fund is a blended portfolio which includes both investment-grade and high-yield bonds. It invests primarily in the most senior and mature credit positions and is hedged to limit volatility caused by currency fluctuations. The relatively smaller size of this mandate (~$1.2B) allows it to strategically shift the portfolio allocation to access different parts of the market that are not available to larger fixed income funds.

Asset Allocation	PSGIF	PEIF
Equities	53.2%	52.3%
Pender Corporate Bond Fund	38.4%	38.3%
Pender Small Cap Opportunities Fund	7.1%	7.3%
Cash	1.3%	1.5%
Private holdings	0.0%	0.6%

PORTFOLIO UPDATE

Fixed Income

The PCBF's weighting in bonds and other fixed income instruments contributed positively to the quarter ending June 30. Stronger contributors included rate reset preferred shares, with several issues delivering double-digit returns in the period. Also positive were several bonds and convertible bonds associated with the shipping industry, as investors re-rated this previously lagging sector. A third contributing area was oil and gas related credit, as tight inventories and rebounding demand led to tightening credit spreads in this unpopular sector. Offsetting a portion of the credit returns was weakness in the preferred shares of Fannie Mae, which were impacted by a negative Supreme Court ruling. That being said, our analysis continues to give us high conviction in this position.

The Pender Corporate Bond Fund yield to maturity on June 30 was 4.9% with a current yield of 4.8% and an average duration of maturity-based instruments of 3.8 years. There is a 1.0% weight in distressed securities held for workout value whose notional yield is not included in the foregoing calculation. Cash represented 4.7% of the total portfolio on June 30. For additional background on PCBF, please see Geoff Castle's latest commentary here.

[1] 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.

[2] The current portfolio managers have managed PSGIF since September 1, 2015, and PEIF since December 15, 2019. These balanced mandates are managed to largely mirror each other following a transition period. The primary difference between the two balanced funds is that PEIF has substantial tax losses to shelter income. This may make it preferable for taxable accounts.

Equities
Second quarter performance benefited from positive contributions from Pender Small Cap Opportunities Fund, our exposure to energy holdings ARC Resources and Spartan Delta, and our basket of alternative asset managers.

Growing signs of an economic recovery drove energy prices to heights not seen since 2014. Although our energy holdings benefited from this tailwind, our exposure is mainly related to special situations with investment theses not focused or reliant on the underlying commodity price. Instead, we invest in companies led by strong management teams with track records of good capital allocation. It helps to have a contrarian mindset when allocating capital in this notoriously cyclical industry.

Some dynamics occurring globally but more pronounced in the Canadian energy sector are the increasing importance of size and diversification, along with an increased focus on ESG in investing. The industry has been capital constrained for years but the double impact of the pandemic and this growing focus on ESG has made it even more challenging to raise capital within the sector. As a result, many small and mid-cap energy producers have been trading at depressed levels with double-digit free cash flow yields.

This market dynamic has provided a compelling opportunity for well-capitalized, acquisition-oriented companies like Spartan Delta and ARC Resources to buy energy assets at attractive prices. When the expected energy price recovery occurs, these companies may have additional upside from the assets they bought at distressed prices. We consider ARC an ESG exemplar within the industry. We take a fundamental integrated approach to ESG and rate it "high" on our internal ESG scorecard.

The portfolio also continued to benefit from our holdings in leading alternative asset managers, including KKR & Co Inc (KKR), Brookfield Asset Management Inc (BAM.A), Burford Capital Limited (BUR), Onex Corporation (ONEX) and Kennedy-Wilson Holdings Inc (KW). This quintet has four attributes which we believe increase the odds of favourable long-term performance: 1) Outstanding long-term track records in their respective areas of expertise, including infrastructure, renewables, credit strategies, private equity, real estate and legal assets; 2) Additional upside from fees earned from managing third-party capital; 3) Founder-led and/or led by talented managers with significant personal "skin in the game"; 4) Reasonable valuations. We believe these firms will continue to be beneficiaries as institutional investors increasingly seek alternatives in a zero-coupon world. Collectively, this group accounted for 14.5% of the portfolio on June 30.

Detractors during the quarter included Richards Packaging, Inc (RPI.UN), MAV Beauty Brands Inc (MAV) and Baidu Inc (BIDU). Richards Packaging is seeing strong contributions from recent acquisitions, but the company is likely to suffer a decline in organic growth in the coming quarters as they face tough pandemic demand comparisons. Sentiment has come off as a result. We added to our position as the valuation became more attractive. The company is well-positioned with their focus in healthcare, with a solid pipeline of tuck-in acquisition opportunities.

Additions to the Portfolios
During the quarter, we added Alibaba Group Holding Ltd (BABA) to the portfolios. Based in China, Alibaba is a growing economic powerhouse. It operates the world's largest ecommerce platform with more than twice the reach of Amazon when measured by gross merchandise value (GMV). It owns the most consumer data in China, a highly scaled logistics platform, a massive third-party ad network and is China's #1 cloud provider. It has a highly entrenched user base with spending increasing every year. Its vast ecosystem is supported by one of China's largest payment methods, Alipay (BABA holds a 33% equity stake). In many respects, *we believe BABA is akin to an economic toll booth for a growing share of Chinese economic activity*.

Recent headlines of increased regulatory scrutiny have hit investor sentiment of China tech in a big way. We have seen industries go out of favour from time to time. We can think of few industries that are as out of favour as Chinese internet now. When stock prices are driven by the actions and emotions of investors, based on the latest headlines rather than on any disciplined analytical rigor, interesting opportunities often emerge. The gloomy headlines have pushed BABA's valuation to near all-time lows, which we believe provides significant margin of safety to our fair value estimate.

We also added a small 1% position in MicroStrategy Incorporated (MSTR). The company is a leading independent provider of business intelligence software. More recently the stock has become a proxy bet on Bitcoin after it started to accumulate it as its primary treasury reserve asset last summer. This was in response to concerns over the surging money supply caused by unprecedented measures taken by global central banks to deal with the pandemic-driven downturn. When faith in centralized systems declines due to mismanagement, decentralized systems such as cryptocurrencies gain credibility. Also, some investors are recognizing that they need to think about their opportunity costs differently in a zero-coupon world. And in a world going increasingly digital, crypto may continue to gain share on its analog precursor, gold. MicroStrategy has been a beneficiary as one of the earliest companies to embrace crypto in the corporate sector.

Outlook

Our fixed income exposure through the Pender Corporate Bond Fund is more conservatively positioned than a year ago. We are conscious of the potential for a more attractive opportunity set to arise at some point in the future. There is the opportunity set we know now, and we have invested in our best expected return ideas. But there is also the opportunity set of six months or a year from now that we do not know. In anticipation of new, interesting ideas coming along soon, we are building our reserves of dry powder through securities at the more conservative end of the risk spectrum.

As part of our equity investment process, we aim to increase the potential for success by seeking out companies with "predictive attributes". These are systemic anomalies in the market, as evidenced by empirical data or our experience, which have a track record of enhancing returns over time. For example, numerous studies have found that founder-led firms tend to outperform over the long-term. In aggregate, PSGIF equities exposure is skewed to mid-cap companies, most of which are led by either their founders or insiders who have significant insider ownership. This is in sharp contrast to the composition of most large cap indices, which is heavily biased towards professional management. We also seek to balance our exposure to both growth and income holdings opportunistically when we believe we are compensated to take on risk. We believe our current holdings are poised to provide us solid, risk-adjusted returns.

Please do not hesitate to contact us, should you have questions or comments you wish to share with us.

Felix Narhi and Geoff Castle
July 20, 2021

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PenderFund Capital Management Ltd.