PENDER FIXED INCOME

THE MANAGER'S MONTHLY COMMENTARY – SEPTEMBER 2021

The Pender Corporate Bond Fund returned 0.9%[1] in September. The gain came amidst somewhat turbulent markets that saw sovereign rates rise amidst fears of inflation and Fed tapering.

The Fund's September return was bolstered by a variety of special situations where investors refocused on value that had been obscured by the fog of restructuring. Chief amongst these was our position in **American Tire Distributors, Inc.**, where the capital structure gained on strong operating results and a debt refinancing transaction. We were also part of a creditor group that successfully negotiated a pre-packaged bankruptcy and plan of arrangement for **GTT Communications, Inc.**, leading to a double-digit rise in the value of this term loan position.

Other notable gains for the Fund came from our position in **Accelerate Diagnostics, Inc.**, where we participated in a debt-for-equity swap that grew our value by more than 10%, and from our position in **Fannie Mae** preferred shares which began bouncing back from severely depressed levels on signs that the Biden administration may eventually recapitalize government-sponsored mortgage entities.

Offsetting the above strength, to a degree, were a number of investment grade securities that declined somewhat on higher rates. Other notable decliners included the 2022 4% convertible notes of **Osisko Gold Royalties Ltd.**, which sold off on lower metals prices. We consider the Osisko notes, priced to yield over 3% to a December 2022 maturity, to offer a particularly attractive risk/reward given their wide spread, tiny default probability and free optionality to an equity rebound in this depressed sector.

Capital Earns Higher Returns Where it is Scarce – Eight Words to Live By

Some things in investing are complicated. The math can be cumbersome at points, and then there is the legal language in credit agreements. However, some powerful ideas in investing are very simple. And one of the simplest ideas is this: capital earns higher returns where it is scarce, rather than where it is plentiful.

To illustrate the concept, let us imagine a single rental property – say a house in a small town that nets income to the landlord of $1,000 per month. If a single buyer wished to purchase the house and paid $120,000, then the buyer's return on his capital might be 10% p.a. But if two or three buyers were bidding for that house at auction, perhaps the house might fetch a much higher price. At $120,000, the house investment earns 10%; at $240,000, the investment yields only 5%.

The success that we have enjoyed over the past several years has been largely based on taking this simple idea and applying it to the bond and credit markets. What we have tried to do, fairly systematically, is position ourselves at spots without a lot of bidders, with an expectation that sooner or later the crowd will show up. The pandemic period has been particularly filled with fruitful examples of this approach. We were almost entirely alone in bidding for rate reset preferred shares below $10 in the spring of 2020 that now trade in fulsome liquidity above $20. We could almost name our price on senior oil and gas loans and bonds at the moment when oil briefly traded at a negative spot price, but now we see lots of prints on the tape at par or above.

But while the core idea is simple: invest where capital is scarce. Putting it into practice, however, is a little more difficult. Capital scarcity doesn't stay still. It moves around. One day the hot money crowd wants technology exposure and ignores food processing, and another day the situation is reversed. Another complication is that sometimes capital in a particular area is scarce for a good reason. Who wants to invest in Madoff Fund II?

In looking for opportunities to invest where capital is scarce, we do two things. First, we look for several clues that the crowd in a particular part of the market has thinned out. It doesn't take Sherlock Holmes to notice these things, but where you see poor trailing returns, bad headlines, levels of investment that are below replacement levels, numerous

[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.

brokerages "sell" recommendations…and, most of all, extraordinarily low prices vs history…well, you get a feeling that the crowd is thinning out.

The second thing we do is take a hard look at the quality of an enterprise. We are looking to see whether its unpopularity is warranted by a true collapse in value, or alternatively, if there are some transitory or cyclical factors which will one day disappear and reveal more attractive long-term economics. And where we find a decent enterprise looking for credit with few takers, that is an opportunity.

If it sounds simpler than it is, it is perhaps because it takes effort and focus to stay out of the way of the market's trending mob. You won't find us often in a crowded investment banker's cocktail party, chomping smoked salmon canapes as we listen to a pitch about the "new" new thing, although we get plenty of invitations. We are busy in conference calls with the management teams of out-of-favour companies, listening to and critiquing their story and thinking about stepping into a void for their credit which has recently gone "no bid."

Portfolio Activity

September was an active month for the Fund as we trimmed or sold a number of positions that had rebounded from prior lows. These sells included the **JPMorgan Chase & Co.** 4.6% preferred floaters that we had acquired in the wake of the pandemic crash, now bid above par. We also profitably exited credit positions in **Taseko Mines Limited** and **Airbnb, Inc**.

As far as purchases were concerned, we made an investment in the deeply discounted 2026 convertible notes of **Groupon, Inc.**, which traded near 76% of face value. Although many of Groupon's customers, such as nail salons and event entertainment services, were negatively impacted by the pandemic lockdowns, we consider the company's franchise to be durable and we like the prospect for a business rebound into 2022. Groupon is profitable and possesses nearly twice as much cash as total debt. Estimated default probability is near 1%, which is a reasonable risk/reward, given a yield to maturity of over 7.5%.

Finally, we established a position in the cash-puttable convertible notes of Beijing-based **Hello Group Inc.**, a dating-focused social networking platform. As one of the few cash dividend-paying Chinese companies, we are impressed by both the shareholder focus and the clear disclosures of Hello Group management. Although the company has faced some pressure to realign its product offering towards the more recent priorities of China's governing Communist Party, we believe investors have overreacted to this risk. While Hello is profitable, and its cash position of $1.4B exceeds debt of $750M, the company's 1.25% notes yield over 11% to a July 2023 put date, representing an attractive risk/reward profile in our view.

Fund Positioning

The Pender Corporate Bond Fund yield to maturity at September 30 was 5.0% with current yield of 4.7% and average duration of maturity-based instruments of 3.8 years. There is a 1.8% weight in distressed securities held for workout value whose notional yield is not included in the foregoing calculation. Cash represented 4.2% of the total portfolio at September 30.

Geoff Castle
October 6, 2021

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PenderFund Capital Management Ltd.

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