PENDER
ALTERNATIVE ABSOLUTE RETURN FUND

MANAGER'S COMMENTARY – SEPTEMBER 2021

Dear Unitholders,

The Pender Alternative Absolute Return Fund ended its first month with a NAV of $9.99[1] per unit and distributions of $0.12[1] per unit.

The high yield market was dragged modestly lower by a combination of rising interest rates and increased sensitivity to risk in credit markets. The Bloomberg Barclays High Yield Index returned -0.01% while the iBoxx Liquid High Yield Index returned -0.17%. The Option Adjusted Spread (OAS) for the Bloomberg Barclays High Yield Index was 1bp higher on the month to close at 289bp. With modestly higher treasury yields, yield to worst (YTW) on the index increased to 4.04% from 3.87%. Market participants are growing increasingly skeptical that inflation is transitory while central banks are slowly pivoting to a more hawkish policy stance. The modest increase in government bond yields in September does not change our view that a strong duration hedge remains appropriate.

Portfolio Update

Great Canadian Gaming Corporation was an event driven holding that was added to the portfolio in September. The 5.25% 2026 debenture was "made whole" in connection with the leveraged buyout of the company late in the month by Apollo Global Management, Inc. We were able to accumulate a position early in the month at an attractive price. Although there was some potential for the transaction to be halted by regulators, we believed it to be relatively low and saw an attractive risk-reward trade off. If the deal were to break, we believed that Great Canadian's bond would have been well supported at our purchase price. In the Offering Memorandum for Apollo's bond financing for the transaction it was clearly stated that this bond was going to be made whole. These Great Canadian Gaming bonds were somewhat of an orphaned security as a C$189 million listed debenture, with a very limited institutional following. The underfollowed nature of this security kept it below most investors' radar allowing us to scale it to one of our largest positions.

The Fund also participated in new issues in September from Allegheny Technologies Incorporated and Secure Energy Services Inc. Both issues were purchased on a duration hedged basis which isolated the potential for spread compression and insulated the positions from rising interest rates. Allegheny's 10-year issue was priced at a spread of 380bp over the 10-year treasury on September 9 and closed the month at approximately 350bp over the 10-year treasury.

Several of the Fund's positions traded modestly lower on general market weakness which was mostly offset by the Fund's hedge book. We believe that limiting exposure to "risk off" events is consistent with our approach to dynamically adjust portfolio positioning in response to valuations.

At month end, the Fund had an option adjusted duration of 0.4 years.

[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.

About 70% of the Fund's long positions are in securities we characterize as defensive Current Income where we own higher quality high yield bonds trading to short-dated calls. The remaining 30% of the portfolio are in Relative Value and Event Driven trades where we see opportunities that have potential for capital gains and are trading cheap to the broader market. We have been able to find value in smaller issuers yielding between 5 and 7.5% in both Canadian and US high yield markets.

At month end, our short positions were entirely composed of government bonds and high yield ETFs. We were short 14.3% of the portfolio in 5-year and 10-year US Treasuries hedging the portfolio against further increases in interest rates, with 13.4% short high yield ETF's to hedge against credit spread widening. We believe this positioning insulates the portfolio from these risks.

Outlook

In our view, the Evergrande scare in September illustrated the high degree of complacency in markets today. Evergrande's 11.5% 2023 bond declined in price from $80 to $43 in July with little fanfare. For any bond trading at roughly 40 cents on the dollar the market is essentially pricing in a default, yet it took until September 20 for the market to focus on the potential second order effects and the broader implications for risk assets.

As September progressed there were several negative company-specific events that caused their credit risk to materially re-price. We can't predict what will cause market-wide risk premiums to increase, but at near record low spreads in credit markets, the risk for disappointing news is heightened, which we believe argues for defensive positioning.

With the extraordinary interventions in credit markets by central banks in 2020, we believe the path to unwinding this stimulus could be bumpy and that there will likely be better opportunities to extract liquidity and risk premiums in the months and years ahead. Our focus remains on generating high quality income in idiosyncratic positions, with relatively limited exposure to broad market moves.

Justin Jacobsen, CFA
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PenderFund Capital Management Ltd.