PENDER
ALTERNATIVE ABSOLUTE RETURN FUND

MANAGER'S COMMENTARY – OCTOBER 2021

Dear Unitholders,

The Pender Alternative Absolute Return Fund closed October with a unit price of $9.96 and distributions of $0.04.[1]

It was a challenging month in credit markets as the iBoxx Liquid High Yield Index returned -0.31% while the Bloomberg Barclays High Yield Index returned -0.17%. With a modest increase in US treasury yields, the OAS was largely unchanged. The headline move in index prices understates the price movement within the high yield market as many high-quality bonds sold off by 2% or more from their recent highs, experiencing significant spread widening during the month.

Portfolio updates

The Fund participated in Brookfield Property Partners L.P. 5-year green bond new issue, which priced early in the month. We believed that the issue was attractively priced as it came with a material concession to a well-established credit curve and compressed rapidly to trade in-line with the rest of the bond structure. Aside from this new issue, the Fund continued to focus on its current income strategy as well as market hedges, particularly short positions in high yield ETFs and government bonds.

The Fund also continued to hold positions in bonds we view as attractive 'relative value' opportunities compared to the broad market. Our position in Cablevision Holding S.A. 5% 2031 is one of these. We had purchased this bond in late September in response to what appeared to be an outsized market reaction to weaker than expected subscriber metrics disclosed at an industry conference. In our opinion, the weakening fundamental picture was partially offset by the company's shifting capital allocation priorities away from share buybacks and towards improving their balance sheet. As bond holders, we align with the revised capital allocation priorities and believe the fundamental weakness is priced into the issue.

We took advantage of market weakness to add to exposures in several credits as the month progressed. In our relative value strategy, we added an unsecured bond issued by Charter Communications Inc., 1st lien bonds issued by Park Hotels & Resorts Inc. and Party City Holdco Inc., all of which had sold off multiple points from recent highs and represented good value in our view.

There were relatively limited opportunities to participate in attractively priced new issues in October as many transactions were priced with minimal concessions. Several marginal issuers came to market, which to us is indicative of weak credit underwriting standards and perhaps late cycle dynamics. We participated in new issues from Carnival Corporation and Lamb Weston Holdings Inc. which we believe were priced at a discount to fair value.

The Fund added several positions to its current income strategy in October, replacing called bonds with 1st lien Scientific Games Corp. 5% due 2025 and unsecured Uber Technologies Inc. 8% due 2026, both of which trade to an immediate call, while the Fund earns a very attractive current yield for every day that the issues remain outstanding. We expect the Scientific Games holding to be redeemed with proceeds of the recently announced lottery business sale to Brookfield Business Partners L.P. in the coming months.

The Fund finished the month with an option adjusted duration of 0.4 years as we maintained a disciplined approach to managing duration, given what we view as increased potential for interest rate volatility over the

[1] *All Pender NAV data points are for Class F of the Fund. Other classes are available. Fees, NAV price and performance may differ in those other classes.*

near term. The Fund's duration hedges consist of short positions in 5-to-10-year government bonds, as well as high yield ETFs which track underlying indices with durations of approximately four years. Our long exposures were 135% of net asset value and our hedge book was 32% of net asset value at month end. By strategy, the Fund's positions were 65% current income, 29% relative value and 5% event driven.

Outlook

With some pockets of improved value in October we are slightly more positive on near term return prospects for the Fund but do not believe valuations are compelling enough to warrant increasing broad market exposure yet. We believe that there are attractive opportunities to capture capital gains from relative value trades within and across capital structures without taking material market risk.

Since inception in early September the Fund has been managed closely to a duration of 0.5 years which we believe effectively neutralizes the portfolio's exposure to interest rate moves. Following a decline in US Treasury yields in early November, the Fund further reduced its duration positioning to negative 0.1 years. Earlier this year it appeared plausible that elevated inflation readings could prove to be transitory. Central bankers who are always eager to instill confidence in financial markets clung onto this narrative until it became impossible to justify. The Bank of Canada recognized this and eliminated the word "transitory" from its October policy statement.

In the third quarter, the US Employment Cost Index rose at its highest rate ever. Since then, the US economy has added over 500,000 jobs with the unemployment rate falling from 4.8% to 4.6%. According to the *Wall Street Journal,* Deere & Company recently offered their striking employees an immediate $8,500 bonus, plus a 10% pay increase along with 5% pay increases in both 2023 and 2025 – the offer was rejected. Several large companies have been forced to increase pay significantly, improve benefits and institute signing bonuses for jobs that were previously minimum wage. This is not indicative of a labor market that has much slack.

While supply chain bottlenecks certainly are an issue that is impacting the global economy, sharply higher demand is an underreported driver of these issues. Inbound container shipments to the Port of Los Angeles are 16% higher over the past six months compared to the equivalent period in 2019. We can understand why policy makers would choose to focus on supply chain issues where there should be a happy resolution but, in our view, a more serious issue is the potential for persistently higher wage growth expectations. This is a difficult genie to get back into the bottle, which could make for some awkward policy adjustments in the coming quarters. High wage inflation could pose a risk to broader markets over time. While we had previously sought to neutralize the portfolio's duration, we now believe that at below a 1.5% yield on the 10-year Treasury a modest short position offers an attractive risk-reward profile. With inflation pressures building, central banks unwinding stimulus and being in the early stages of a rate hike cycle, we believe we are well positioned to navigate this environment. We will monitor these developments closely and continuously revisit and adjust our view in response to new information.

Justin Jacobsen, CFA
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PenderFund Capital Management Ltd.