PENDER

STRATEGIC GROWTH AND INCOME FUND

THE MANAGER'S COMMENTARY – Q3 2021

Dear unitholders,

The Pender Strategic Growth & Income Fund (PSGIF) was down 1.8%[1] and the Pender Enhanced Income Fund (PEIF) was down 1.5%[1] for the quarter. On a year-to-date basis, PSGIF was up 16.3%[1], while PEIF was up 21.0%[2]. The long-term performance of PSGIF remains solid, with 5-year annualized returns of 8.8%[3]. PSGIF and PEIF are largely mirrored portfolios, but the PEIF has a material amount of tax losses available to shelter taxable income. This commentary refers to PSGIF unless otherwise noted.

At the end of the quarter, the equity weighting in PSGIF stood at 61.3%. This is down from a 63.8% equity weight at the end of the previous quarter. The portfolio's allocation to Fixed Income rose slightly to 33.6% (from 32.6%), while cash also rose to 5.1% (from 3.4%).

Portfolio Update

Fixed Income

The Fund's fixed income weighting is comprised of its weight in the Pender Corporate Bond Fund (PCBF). In the third quarter, PCBF was a positive contributor as it shook off the effects of rising sovereign interest rates through a combination of tight duration and the performance of a number of credit positions.

One area of strength in credit was in the biotechnology sector, where we have made several investments in discounted credits that we believe to be well covered by asset values. In August, we were part of a group of securities holders who exchanged discounted convertible notes of Intercept Pharmaceuticals, Inc. for new secured convertibles with a reduced strike price. The result of the exchange was a double-digit improvement in the value of our Intercept position. In a similar vein, in September, we exchanged discounted notes of Accelerate Diagnostics, Inc. for an advantageously priced equity stake in that issuer, resulting in a positive impact on our position value.

Looking forward, on the fixed income side, we are maintaining our shorter duration positioning which we believe to be appropriate given the minimal compensation for duration risk existing in the market. Our credit emphasis remains on finding wide-spread bonds or discounted convertible opportunities in sectors or issuers suffering from unpopularity not warranted by underlying fundamentals. For additional background on PCBF, please see Geoff Castle's latest commentary here.

Equities

Performance in the third quarter gave back some of the positive returns generated in the first half of the year. Equity markets faced some volatility, particularly in September, as the S&P 500 returned 2.8% and the S&P/TSX Composite 0.2% during the quarter.

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[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 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%).*

[3] *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 taxable income. This may make it preferable for taxable accounts.*

In the portfolio, third quarter performance benefited from contributions from ARC Resources Ltd. (ARX), Brookfield Asset Management Inc. (BAM.A) and Exchange Income Corporation (EIF).

Shares of ARC rose in tandem with higher energy prices. Although our overall exposure to commodity linked businesses is low, we saw an opportunity in ARC due to their experienced management team which has a good track record of allocating capital. A lack of capital investment in the industry over the last number of years has allowed ARC to make investments at attractive rates of return or to expand through acquisitions. The company is more geared to natural gas and has benefited from higher prices.

Brookfield Asset Management also performed well during the quarter and has compounded at a high rate historically due in part to their management team's exemplary capital allocation abilities. They are patient capital allocators and have excelled in deploying capital with a long-term view and are often contrarian. The acquisition of Brookfield Property Partners L.P. (BPY) earlier this year is an example of acquiring a portfolio of high-quality commercial real estate assets in a challenging environment as the industry recovers following the pandemic.

Exchange Income is focused on growing through the acquisition of businesses in the aerospace, aviation and manufacturing industries. They target profitable, well-established businesses with cash flows operating in niche markets with a defendable market position. The company announced quarterly results that continue to recover to pre-pandemic levels, while highlighting the recent purchase of Carson Air Ltd., an air ambulance service operating in British Columbia as part of their acquisition strategy.

Detractors during the quarter included Alibaba Group Holding Limited (BABA), MAV Beauty Brands Inc. (MAV) and Baidu, Inc. (BIDU). Our investments in Alibaba and Baidu were impacted by the ongoing concerns over regulatory measures being brought against China-based technology firms. We believe that the regulatory fears are discounted, and the risk/reward is highly attractive for these companies. Both businesses are leaders in their respective industries of retail and search in China, while offering additional optionality for future growth and value drivers. Baidu, for example, has been developing world class artificial intelligence capabilities for autonomous driving, conversational computing, and enterprise cloud functionality. While not accounting for significant cash flows today, this could be a driver of future returns for Baidu as these capabilities are further developed and monetized.

MAV reported weaker-than-expected results during the quarter and currently has execution challenges with its latest product launches. The board announced a new management team with significant industry experience to improve operational performance. Contributing to the share price weakness was the announcement of the conclusion of their strategic review. While no deal was agreed, based on the M&A levels in the industry, it is our opinion that the company likely turned down an offer they deemed inadequate. In situations like this, it is usually not a question of "if" a deal will materialize but "when".

Additions to the Portfolios

During the quarter we added Altius Renewable Royalties Corp. (ARR) and the aforementioned Exchange Income Corporation to the portfolio. Altius is a renewable energy royalty company that provides tailored royalty-based financing solutions to the renewable power market, primarily in wind and solar projects. These projects will continue to attract investment and Altius is well positioned to benefit from this growth through their royalty business model. We sold Brookfield Property Partners as further upside was capped following the take-out announcement by parent Brookfield Asset Management. We were not eager sellers of BPY and believe that Brookfield got a good deal. Fortunately, the Fund also holds a large weighting in BAM and benefited from the deal, which contributed nicely during the quarter. We also sold our position in the preferred shares of Brookfield Properties Corp. (BPO) following a nice recovery and in favour of what we view as better risk/reward opportunities for the portfolio.

Outlook

We believe the current portfolio is well positioned to delivered solid, risk-adjusted returns to our clients. The fixed income exposure is more conservatively positioned today compared to a year ago. With spreads having tightened, we are conscious that a more attractive opportunity set could arise in the future. We have been adding securities at the more conservative end of the risk spectrum as the risk/reward backdrop has evolved. Within equities, we continue to find idiosyncratic opportunities to cycle capital and make investments where we believe we are being compensated for the risks.

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

Felix Narhi and Geoff Castle
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PenderFund Capital Management Ltd.