

PENDER FIXED INCOME

THE MANAGER'S MONTHLY COMMENTARY - OCTOBER 2021

The Pender Corporate Bond Fund returned 0.3%¹ in October. The Fund's progress came amidst a sharp upward move in rates that has seen the 5 year Government of Canada bond yield almost double since early September.

A few notable moves helped propel the Fund to its October gain. During the month our position in the convertible notes in **Flexion Therapeutics Inc.** rallied from the 80s to almost par as the company agreed to be acquired by Pacira BioSciences Inc. Additionally, our rate reset preferred share holdings rallied strongly with the upward movement in rates, a prime example being our position in **BCE Inc.** preferred B shares, up over 11%. Finally, renewed optimism for the end to the conservatorship of **Fannie Mae** drove our small position in Fannie Mae prefs up over 30% during the month.

Offsetting the above strength, to a degree, were several investment grade securities that declined on the upward move in yields. Although we expect that the rate of increase in sovereign interest rates may subside in the coming months, we do retain our short duration positioning, given the lack of adequate term premium compensation for extending duration in the current market.

Uncapping the Upside in Fixed Income

I carry only one coin in my wallet. It's a 1933 Canadian quarter, bearing the likeness of King George V on one side and a thumb-worn circle of maple leaves on the other. It once belonged to my grandfather, and I sometimes imagine him, a low-paid articling accountant at the time, holding on tightly to that coin in the depths of the Great Depression.

Eighty-eight years later, twenty-five cents seems to be hardly worth the bother of minting a coin. However, valued for its silver content, Grandpa's quarter would be worth in today's dollars about \$4.00, which roughly equates to its purchasing power in 1933.

That quarter represents a kind of ideal that we focus on when running our mandates. With "25 cents" stamped on its face, there is a nominal minimum value. And minimum values are useful to investors.

But the value appreciation in that quarter is also important. We live in a world of inflating currency. Exactly how fast the inflation happens, or whether it is interspersed with periods of deflation, these are somewhat uncertain factors. But as Bill Fleckenstein likes to say, "In a social democracy with a fiat currency, all roads lead to inflation". There are just more demands on government than there is ability to fund their fulfillment through taxation...and so inflation of one sort or another is a kind of inevitable social lubricant.

So how does one best fulfill the objective of protecting a minimum nominal value, while at the same time protecting purchasing power against an unknowable level of future inflation?

Here it is useful to consider the role of senior capital. The exact form of the senior capital doesn't particularly matter, it can be a loan or bond or preferred share. But to be effective at protecting nominal value there are a couple of important characteristics. The security should have a par value representing a specific claim at maturity or in the event of default. Secondly, the security's claim should be backed up by some business value that we can calculate or estimate. If we are successful in finding senior capital with strong excess collateral, then protecting a minimum nominal par value can be achieved.

But to protect investors against inflation we need to do more. We need to look for certain *kinds of* senior capital securities which can deliver on purchasing power protection in the same uncapped way that the 1933 silver quarter did. Clearly, we start with the coupon. But beyond the coupon you have some securities that trade at a discount to par.

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.

There are convertible notes. There are distressed securities. There are indexed-returns or floating rate securities that increase payout with rising rates.

So we will talk, excitedly sometimes, about positions. “Esperion convertible bonds at 55c!” “Brookfield preferred shares below half of face value!” And it’s easy to get lost in the flow of names and prices as to what it’s all about. But at the root, we are finding our own versions of the 1933 silver quarter. A security with a par value and a coupon, yes, but priced in such a way as to potentially un-cap our upside ... which can help us with our goal of delivering a return that protects our investors meaningfully from the ravages of inflation.

New Positions

We used the market volatility in October to put on a couple of new positions at significant discounts to par. We acquired a position in **Beyond Meat Inc.** 2027 convertibles, which traded down to the low 80s percent of face value. As a leading plant-based meat substitute supplier, we expect Beyond Meat to continue to grow strongly as consumers look for planet-friendly food sources to displace beef. We like the large equity buffer of \$6B sitting beneath its \$1.1B in debt, and the company’s significant cash balance of \$1B. Although the company’s stock has been weak recently, we think the credit provides strong risk/reward, with a yield to maturity of over 3% with potential upside on equity appreciation, and several years of time for that appreciation to materialize.

Another investment with similar dynamics was made in the 2025 put-able convertible notes of **Liberty TripAdvisor Holdings Inc.**, trading in the mid 80s. Convertible into **TripAdvisor Inc.** stock, we like the yield-to-put in excess of 5%, combined with further possible upside should the stock move towards levels that existed pre-pandemic. Although the rebound in travel activity that had been expected to materialize in 2021 was impacted by the Delta variant, we like the longer-term opportunity that TripAdvisor represents, combined with the short-fused cash put option.

Finally, we established a position in the first lien term loan of **TerrAscend Corp subsidiary, WDB Holding**. TerrAscend is a multi-state operator active predominantly in the US marijuana industry, has a strong market share in a focused set of states and is relatively profitable in comparison to its peers. Investment by US institutions into the debt of American marijuana operators is limited by regulation, despite the approved legal status in the states where they operate. For this reason, we can enjoy an attractive yield in excess of 9% on the WDB paper, notwithstanding TerrAscend’s relatively small debt load (approximately \$184M in comparison to a market capitalization in excess of \$2B) and 1-yr default probability that we view as being less than 0.4%.

Fund Positioning

The Corporate Bond Fund yield to maturity at October 31 was 5.1% with current yield of 4.7% and average duration of maturity-based instruments of 3.6 years. There is a 2.0% weight in distressed securities held for workout value whose notional yield is not included in the foregoing calculation. Cash represented 3.8% of the total portfolio at October 31.

Geoff Castle
November 5, 2021



PENDER
PenderFund Capital Management Ltd.

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