PENDER FIXED INCOME

THE MANAGER'S MONTHLY COMMENTARY – NOVEMBER 2021

The Pender Corporate Bond Fund returned 0.5%[1] in November. The positive result was achieved in the face of a rather weak high yield credit market that may have been affected by tapering talk and COVID-19 variant news.

A few notable moves to the upside in the month were in our position in the deeply discounted Tricida, Inc. (NASDAQ: TCDA) 2027 convertible bonds, which rallied on an injection of equity capital from insiders and our position in the reorganized equity of American Tire Distributors, Inc. (OTC: AHLD), which reported strong earnings. Despite somewhat higher trading levels, AHLD still represents a deep discount to our estimate of fair value. Finally, despite some mid-month volatility, investment grade credits held in the Fund performed well as the market drove IG yields lower after American Thanksgiving.

Offsetting the above strength, a few positions shook with risk markets in November. Notable decliners included our position in Beyond Meat, Inc. (NASDAQ: BYND) convertible bonds, which traded down to the low 70s to yield over 6.3% to 2027. Also weak was our position in Liberty TripAdvisor Holdings, Inc. (NASDAQ: LTRPA) notes, which sold off to yield almost 8% to the 2025 put date. We like the prospects for both issuers and continue to add weight here.

On Waves and Tides

I spent a few days in Tofino this month, sitting at the beach, watching the surfers do their thing. Waves come in. Surfers ride the waves or splash into the briny foam. The next waves come in, and the cycle repeats. More persistently, however, the tide gradually pushes toward the beach. The bay swells with water. The beach walkers head home and the exposed rocks disappear below the surface. And then, slowly, gradually, the tide recedes.

As with the beach, so go the markets. We look at situations where the credit of a company becomes stressed or distressed. These situations either resolve themselves through re-pricing back to par, work out, or restructure. These are the waves of the credit market, and we are their surfers.

There are also tides in the market. Inflation, business valuations and risk-free rates to name a few. These trends are themselves governed by forces seemingly as remote as the orbit of the moon is in relation to the tide. As the calendar turns to 2022, it may perhaps be useful to consider any potential shifts in the underlying tides of the credit market.

One tide that we are quite used to watching is the oscillation of credit business valuations, which manifest themselves in our market as credit spreads. A business with a higher valuation is deemed to have a larger equity cushion beneath its bonds. The bigger the cushion, the narrower the spread.

The market for business valuations, as measured by Shiller's cyclically adjusted P/E for the S&P 500, represents a relative high, nearly at the high of the series record set in 2000[2]. The parallel expression in credit markets, which is the BoAML option-adjusted high yield spread, was similarly stretched. Reading recently around 300 basis points over treasuries, high yield credit spreads were within a few basis points of the decade lows[3].

So, what do we make of a credit market which, from an average valuation perspective, represents a potential high tide? The data suggests a more defensive positioning is warranted. Through the year we have generally been edging out of more aggressive trades. Those who follow our risk categorizations will note that we have

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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] Topdown Charts Nov 26, 2021

[3] "Fred" St. Louis Fed series BAMLH0A0HYM2, Nov 30, 2021

added weight to "bucket 1" (high quality most liquid) and reduced "bucket 3" (wider spread credit opportunities).

The caveat we add here is that, just as tides in different locations are not simultaneous, valuations in different markets are not uniformly stretched. So, we continue to turn over ideas in certain sectors (biotech, travel and China-domiciled to name a few) because these are situations where it appears to us that the valuation tides are much lower. It is not that we don't hold some dry powder for potential issues to emerge in the main North American credit market, but we are still finding some "risky" things to do in a few places where investors are paying heightened attention to risk already.

Overall, we operate in a fashion that is neither purely micro nor macro. We pay attention to the valuation tides. But whatever the sea level, we believe there is always the potential to encounter the next perfect wave.

New Positions

New in the portfolio this month is a position in the discounted convertible notes of **Tabula Rasa Healthcare, Inc**. (NASDAQ:TRHC). The company provides a value-added prescription drug medication program for patients that helps reduce the risk of improper dose administration. Recently, Tabula Rasa disappointed investors by announcing a delay in the uptake of a couple of high-profile new accounts. We consider the business to have a strong credit profile with an excellent base of recurring customers, reasonable growth and acceptable coverage of cash interest expenses. Yielding approximately 10% at point of purchase against a 1-year default probability we view as less than 1%, the Tabula Rasa 2026 notes represent attractive risk/reward.

Also this month, we established a position in the December 2023 convertible notes of **Aecon Group Inc**. (TSX:ARE). One of Canada's largest builders of infrastructure projects, the company's resumé includes Toronto's Pearson Airport and Highway 407. We consider the engineering construction industry to be relatively attractive in terms of prospective growth. Not only have governments across Canada committed to an acceleration of infrastructure spending, but recent events involving extreme weather in both British Columbia and Atlantic Canada highlight the ongoing prospect of further time-sensitive, large-scale repair and restoration projects for major roads and transportation infrastructure. From a credit perspective, Aecon's 2023 obligations are well-covered in terms of business valuation. Upside exists in the potential to see Aecon's stock rise toward a $23.70 share price from current trading levels of approximately $16/share.

Fund Positioning

The Pender Corporate Bond Fund yield to maturity at November 30 was 5.5% with current yield of 4.9% and average duration of maturity-based instruments of 4.1 years. There is a 2.8% weight in distressed securities held for workout value whose notional yield is not included in the foregoing calculation. Cash represented 0.3% of the total portfolio at November 30.

Geoff Castle
December 9, 2021

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PenderFund Capital Management Ltd.