PENDER
BOND UNIVERSE FUND

JANUARY 2022

The return of the class F units of the Pender Bond Universe Fund for the three-month period ended January 31, 2022 was -0.5%[1]. For the full calendar year of 2021, the class F units were up 2.0%[1] with average quarter-end duration of 4.6 years, decreasing somewhat into year-end to 4.03 years at December 31. When looking back over the quarter, the Fund's exposure to a broad spectrum of credit opportunities, through its holdings of Pender Corporate Bond Fund units, combined with relatively short duration positions, allowed the Fund to perform ahead of its benchmark through the period.

A word on strategy

From inception, the Fund's strategy has involved adjusting duration and credit exposure in an opportunistic manner, dictated by movements of the term premium and credit spreads. When compensated sufficiently for taking on duration, during times when a term premium is present, and during periods of elevated credit spreads, duration and credit exposure, respectively, may be added. When the market does not provide these opportunities, both duration and credit exposure may be lowered.

Duration is adjusted by either shifting weight into longer or shorter dated maturities, depending on what the term premium is dictating. Adjustments to credit exposure are achieved by adding to or subtracting from the Fund's allocation to Pender Corporate Bond Fund units, while maintaining a maximum exposure to non-investment grade securities of 25%. These shifts are made within the broader context of individual security selection. Here, we aim to optimize yield received for the level of default probability we are taking on.

A look forward to 2022 and fund positioning

With the consumer starting to feel the effect of significant year-over-year increases across the CPI spectrum, from shelter to energy to food right down to car parts, the talk of inflation has gone mainstream. All eyes have been squarely on the Fed for an indication of what is to come next following a period of unprecedented levels of stimulus in response to COVID-19.

Since 2012, the Fed has used the dot plot to signal their outlook for the path of interest rates with contributions from members of the Board of Governors of the Fed, along with a number of regional bank presidents. Median member expectations for rates in 2023 went from 0.125% at their December 2020 meeting to 1.625% at their meeting at the end of 2021. This change signalled to the market that members were expecting six rate hikes by the end of 2023 - which, coupled with their tapering intentions, has weighed rather heavily on the market since the end of 2021.

At the Fed's January policy meeting, the target range for the federal funds rate was left unchanged. In addition, they indicated they would conclude asset purchases on schedule, leaving them on-track to end in March and that they would likely start to shrink the balance sheet only after they had begun to increase rates. The hawkish tone of the announcements that day caused a flattening of the yield curve in the days that followed, with short-end treasuries extending declines and longer dated treasuries rebounding.

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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.*

On the same day in January, the Bank of Canada held off on hiking rates also. However, they indicated that they expect rates will need to increase with the pace and timing of hikes, dependent on achieving their target of 2% inflation. In December, they mentioned the likelihood of the first rate hike coming in April and during their first meeting of 2022, forward guidance on rates was dropped.

Looking forward to what is in store for the Investment Grade space in 2022, we are taking into consideration several things. As a sector overall, Investment Grade has moved from an average duration of approximately 5.5 years back in 2000 to close to 8.5 years currently, leaving it more duration sensitive, with spread per unit of duration hovering around all-time lows[2].

With inflation front of mind, it is also important to note that prior to a single rate hike, the yield of the US 10-year Treasury is up approximately 43 basis points since the beginning of December, which in our view implies that at least some of what the Fed is forecasting in terms of hikes is already priced in. Although we have seen yields move higher in 2022, several of the indicators that we consider are suggesting a short duration bias remains prudent at this time and, as such, duration of the Fund remains relatively tight at 3.88 years at January 31, 2022.

The term premium, which provides an indication of excess yield for taking on the increased risk of inflation in longer dated maturities continues to hover around 0. A recent push into positive territory at the beginning of 2022 has not, at this point, become compelling enough for a change from our current duration positioning. In addition to this, we consider the net futures position on the US 10-Year Treasury, with a high short interest in the past, signalling institution's expectations for inflation and providing a reasonable contrarian indication for CPI. A short position here is building, and we continue to watch this to help inform any changes to duration positioning within the Fund.

At January 31, Canadian dollar-denominated Investment Grade issues held directly represented 68.2% of the Fund, with its allocation to higher yielding credit through Pender Corporate Bond Fund units representing 28.8%. The duration of the Fund at month-end was 3.88 years with a yield to maturity of 3.30%. Cash represented 4.5% of the portfolio at January 31.

Emily Wheeler & Geoff Castle
February 11, 2022

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[2] *CreditSights, December 2021*