PENDER
ALTERNATIVE ARBITRAGE FUND

MANAGER'S COMMENTARY –DECEMBER 2021

Dear Unitholders,

The Pender Alternative Arbitrage Fund (PAAF) ended the month of December 2021 with a NAV of $10.19 per unit[1].

M&A activity capped off 2021 with a record $5.8 trillion in global deal activity, blowing through the previous record of $4.55 trillion from 2007 and surpassing 2020's total global deal value by 64%[2]. Pent-up demand from the pandemic, disruptive technological changes, cheap and abundant access to financing, and a strong stock market provided the ideal backdrop for a strong M&A environment last year. These factors remain largely in place as we enter 2022, and despite the expectation of both higher interest rates and a tougher regulatory environment, the M&A boom is expected to continue this year.

Merger arbitrage spreads ended the year at historically wide levels, with the expected spread for the 20 largest all-cash mergers in the US exceeding 1060 bps[3]. The SPAC market continues to see a high level of new SPAC IPO issuance which is far outpacing announced business combinations and this oversupply is driving SPACs to trade below trust value and is expanding spreads with the yield-to-maturity of SPACs searching for targets exceeding 2.4%[4].

In our view, the current wide spread environment provides a favourable backdrop for merger arbitrage relative to other asset classes, with equity market volatility and interest rates both rising in tandem. We continue to position the Fund to benefit from this environment while optimizing position sizing to manage risk and minimize downside exposure.

Portfolio Update

December was an active month for the Fund with deal activity momentum continuing at its record pace into year-end. The Fund initiated positions in several new and previously announced deals with many deals achieving successful closings in the last few weeks of 2021.

Early in the month, the Fund had its first deal break since inception with the merger between Sportsman's Warehouse Holdings, Inc. (NASDAQ: SPWH) and Great Outdoors Group, LLC being called off. This followed feedback on the deal from the Federal Trade Commission that led the companies to believe they would not receive approval to close the deal.

This break highlights how risk analysis is the most crucial part of our investment process, with the primary goal of avoiding merger deals we believe have the potential to break, but also minimizing the drawdown impact through position sizing for deals with a higher probability of breaking.

Several new holdings for the Fund in December include Phillips 66 Partners LP (PSXP), Casper Sleep Inc. (CSPR), Sol Cuisine Ltd. (VEG), CyrusOne Inc. (CONE), SPX FLOW, Inc. (FLOW), GCP Applied Technologies Inc. (GCP), Goodrich Petroleum Corporation (GDP), Del Taco Restaurants, Inc. (TACO), Bottomline Technologies, Inc. (EPAY), Verso Corporation (VRS) and Hexion Holdings Corporation (HXOH), were among several new holdings for the Fund in December.

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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] https://www.reuters.com/markets/us/global-ma-volumes-hit-record-high-2021-breach-5-trillion-first-time-2021-12-31/

[3] https://mergerarbitragelimited.com/spreads/

[4] https://spacinsider.com/stats/

Among deals that closed during the month were AgJunction Inc. (AJX), Meridian Bancorp, Inc. (EBSB), Hill-Rom Holdings, Inc. (HRC), Dover Motorsports, Inc. (DVD), PPD, Inc. (PPD), Dicerna Pharmaceuticals, Inc., (DRNA), Goodrich Petroleum Corporation (GDP), Zix Corporation (ZIX), Landmark Infrastructure Partners LP (LMRK), PFB Corporation (PFB) and Storm Resources Ltd. (SRX).

At the end of December, the Fund had 22 investments in small-cap deals under $2B with 16 of those deals under $1B. As discussed in last month's commentary, we believe there are many advantages to our focus on mid and small-cap mergers.

This was evidenced during December, when the spreads of two small-cap deals Sol Cuisine Ltd. (VEG) and WOW! Unlimited Media Inc. (WOW) were trading at double-digit expected yields, despite our analysis suggesting a high probability of successful deal closing. We added to both positions during the month, taking advantage of the apparent dislocations, and in the event both spreads narrowed by month-end. The Fund will continue to leverage Pender's existing insights, analysis, and trade execution competencies in small and mid-cap equities, tactically adding value when opportunities are presented.

Outlook

2022 could be another active year for the SPAC market with the industry now exceeding $200B of aggregate market capitalization. SPAC sponsors are in a precarious position. There is an oversupply of SPACs competing for a limited handful of quality targets, up against the clock with looming maturity as well as facing the pressure of high redemption rates and poor average de-SPAC performance. This may lead to a high number of SPAC liquidations, a potentially welcome occurrence for the Fund.

But there are signs that SPACs may continue in their evolution, leveraging their unique structure to pursue opportunistic credit, such as funding debt instruments and more creative deals, including restructurings and corporate carve-outs.

The record pace of M&A activity through 2021 is expected to continue this year, with favourable conditions for deal activity and surveys showing bankers and advisors are expecting deal volumes to grow. The backdrop of a strong pace of deal activity, with historically wide spreads and high success rates of merger deals closing, supports the potential for above average activity for merger arbitrage.

We believe recently volatile market conditions and a spike in Treasury yields at the start of the year highlight the benefits of diversification into more market-neutral and absolute return-focused strategies. With multi-decade high inflation of 4.7% in Canada and 6.8% in the US for the month of November, yield-focused investors seeking to earn positive real returns could consider adding exposure to alternative strategies, such as merger arbitrage, which have historically provided a hedge to rising rates.

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PenderFund Capital Management Ltd.