

PENDER FIXED INCOME

THE MANAGER'S MONTHLY COMMENTARY - FEBRUARY 2022

The Pender Corporate Bond Fund delivered a result of -0.5%¹ in February, a period of relatively strong performance in a market beset by numerous headwinds, one of which was a spread-widening in credit.

Bright spots for the Fund included some positions in the precious metals sector, as both SSR Mining Inc. and First Majestic Silver Corp. convertible bonds rallied on a safe-haven trade. Energy sector infrastructure names were also positive credit contributors, including Scorpio Tankers Inc. converts, McDermott International, Ltd. re-org paper and Targa Resources Corp. preferred shares.

These gains, however, were more than offset by several negative marks as risk premiums increased during the month. Preferred share positions in Bell Canada, Morgan Stanley and other issuers suffered in the volatile markets. Our position in Beyond Meat, Inc. 2027 convertible notes was particularly weak as the company's quarterly report disappointed some investors. We continue to like the growth potential for Beyond and consider the credit to be well covered.

Light a Single Candle or Curse the Darkness?

This is a moment of fear. Tanks are rolling. The world is still in the grips of a pandemic and inflation boils. While there are many things to worry about, there are also many great things to hope for in the years ahead. Today, we choose to look forward and consider the good things we expect to transpire. We have invested in many areas currently beset by problems where a better future beckons. Let us count the ways.

Today, we see fear afflicting the biotechnology sector. Take Precigen, Inc., a leader in some important gene therapy-enabling technologies. Despite the company's burgeoning scientific successes, investors are demanding yields of over 20% in Precigen's 2023 debt. The enterprise value of this company has been shaved by over 85% from its high. We look forward to a day, not too long from now, when Precigen's technology may help to cure cancer, correct other previously incurable diseases, and generally better the human condition. Nothing is preordained. We must take a calculated risk. But our sum-of-the parts calculation suggests an enterprise worth far more than total debt. We look forward to Precigen's better days.

Today we observe fear in the renewable energy sector. Convertible debt in Sunrun Inc., which is this continent's largest developer of residential solar power infrastructure, has fallen over 30% in the past year to trade around 77c on the dollar. Sunrun is building a future where clean, distributed electricity generation becomes the norm. Its installations generate positive cash flows once installed. The efficiencies of solar power have never been as good as they are right now, and we believe the future will be even better. We are in!

Today we see fear in the Chinese real estate sector. A decade of aggressive investment has seen the sector turn from boom to bust as well as multiple years of losses in credit instruments. We are not cheerleaders for the mal-investment that plagued the sector at the height of the boom. But along with our friends at CreditSights, Inc., we have come to view the sell-off in bonds of higher quality operators such as Country Garden Holdings Company Limited as overdone. There is no developer in North America with debt of less than one quarter its capital base, which has to pay yields in excess of 15% on two-year USD obligations. Given the strength of the issuer, the renewed determination of China's Ministry of Finance and related entities in buying assets to calm the distress of the property sector and very attractive prices, we anticipate a potential recovery in bond prices ahead.

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 is no magic to taking a contrarian stance. Sometimes a degree of fear or declining prices are met with even more fear and even lower prices. But looking back on the tape over a period of years, one so often sees the moments of panic and fears as lows. And so, in difficult moments such as this, our inclination is to light a single, hopeful candle rather than curse the darkness.

New Positions

During February, we took advantage of weakness in the North American inflation-linked bond market to initiate positions both in Government of Canada Real Return bonds as well as United States Treasury Inflation-Protected Securities (TIPS). One of the great paradoxes of 2022 is that, at a moment when consumer price indices are hitting eye-popping levels, including a 7.4% United States CPI, the recent performance of inflation-linked securities has been quite poor. In fact, the total return of the United States 1.75% 2028 TIPS bond was -7% between August 2021 and mid-February 2022. Markets had been reluctant to discount higher inflationary outcomes and, in early February, the breakeven calculation reflecting five-year expected inflation was only 2.8%. Our purchases essentially took “the over” of a hypothetical over/under scenario, given high levels of existing inflation and numerous reasons to believe that inflation readings well above the breakeven rate may persist going forward.

Another February purchase was in the unsecured bonds of FirstEnergy Corp., an electric utility based in the Northeastern US. FirstEnergy’s existence as a high-yield issuer relates to a legacy issue linked to a 2020 bribery scandal over which management has been replaced and fines have been, in our view, adequately provisioned for. We viewed the combination of very low one-year default probability, (estimated at below 0.1%), and a still interesting yield (above 4% in the company’s 2027 senior unsecured bonds) to be a rare combination that offered good value.

Fund Positioning

The Pender Corporate Bond Fund yield to maturity at February 28 was 6.0% with current yield of 4.8% and average modified duration of maturity-based instruments of 3.5 years. There is a 2.6% weight in distressed securities held for workout value whose notional yield is not included in the foregoing calculation. Cash represented 1.6% of the total portfolio at February 28, 2022.

Geoff Castle
March 7, 2022



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PenderFund Capital Management Ltd.

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