PENDER
ALTERNATIVE ABSOLUTE RETURN FUND

MANAGER'S COMMENTARY – FEBRUARY 2022

Dear Unitholders,

The Pender Alternative Absolute Return Fund finished February with a unit price of $10.01 and distributions of $0.02 per unit[1].

February 2022 was a volatile month for markets with the high-yield market putting up its second consecutive negative month and fifth negative month out of the last six. The ICE BofA US High Yield Index returned -0.90% with the Option Adjusted Spread widening 14bp to finish the month at 377bp and the market's yield to worst increasing 33bp to finish at 5.64%. Markets were whipsawed in February by inflation data coming in hotter than expected in both the United States and Canada, as well as the breakout of war with Russia's invasion of Ukraine. While valuations have undoubtedly improved from December 2021, heightened geopolitical risk, as well as stagflation risk would suggest that there is the potential for continued volatility over the near term.

Portfolio Update

The stance of the Fund did not change dramatically from last month-end. Within the month, the Fund looked to take advantage of market volatility by buying on weakness and selling into strength. With the outbreak of full-scale war in Ukraine and the potential for knock-on unexpected events, we carefully evaluated our exposure to risk and interest rates with a view to heightened potential for "risk-off" market shocks, which caused the Fund to reduce market exposure late in the month. As we have detailed in previous commentaries, we believe the Fund has material hedges in place for both rising interest rates as well as risk-off events.

In February, the Fund established a position in Twitter, Inc. 5% 2030 (Nasdaq: TWTR) which came to market with a $1 billion 8-year new issue on the eve of Russia's invasion of Ukraine. The Fund took advantage of a local peak in market fear to accumulate a position at a discount to issue price. We added to several energy credit exposures in February, notably participating in Tamarack Valley Energy Ltd. (TSX: TVE) 5-year sustainability-linked note that priced at a coupon of 7.25%. There is a provision for an increase in coupon if the company fails to meet targeted emissions intensity reductions (39% by 2025) as well as Indigenous representation in the company's workforce (6% by 2025). While much of the world is proactively looking to avoid Russian supplies of energy, at the time of writing, energy was still not included in the sanctions placed on Russia by most countries. However, we expect that many individual market participants will self-sanction Russian oil, creating a very tight market dynamic which should be quite supportive of prices over the near term.

In the Fund's Current Income Strategy, our holding in Kratos Defense & Security Solutions, Inc. (Nasdaq: KTOS) was called and will pay out in March. The Fund added back a position in MPT Operating Partnership, L.P. (NYSE: MPW) as its valuation improved from our sale in January, as well as establishing a new position in Nuance Communications, Inc. (Nasdaq: NUAN). In our opinion, the Nuance bonds will likely be called over the near term as final approvals are received for their acquisition by Microsoft Corp. (Nasdaq: MSFT) and we believe this position should be well insulated from market volatility.

In the Fund's Event Driven strategy, we established a position in Exterran Energy Solutions, L.P. 8.125% 2025 notes which we expect to be called in Q3 this year once the company's acquisition by Enerflex Ltd. (TSX: EFX) is completed. We view this transaction as highly likely to close as it is a stock-for-stock transaction at a premium that will allow Exterran equity holders to participate in any upside in the business, while being part of a larger, better-capitalized entity. We accumulated this position at an attractive discount to call price.

[1] *All Pender NAV data points are for Class F of the Fund. Other classes are available. Fees, NAV price and performance may differ in those other classes.*

The Fund finished February with relatively limited market exposure, with long positions of 115% - 46% of these positions are in our Current Income strategy, 61% in Relative Value and 8% in Event Driven positions. The Fund had a 43% short exposure that included 22% in government bonds, 13% in credit and 8% in equities. The Option Adjusted Duration was 1.5 years, which we believe effectively limits the portfolio's exposure to interest rates.

Considering geopolitical risks and increased potential for risk-off market environments, which can see sharp rallies in government bonds, we carefully evaluated our duration hedge late in February. We believe that our current income holdings that trade to 2024 and shorter workout dates are more sensitive to risk markets than government bond yields, while the same is true for our positions that trade at Option Adjusted Spreads of more than 500bp. Net of these two groups of holdings, the Fund's Option Adjusted Duration declined significantly to 0.2 years. We are focused on protecting capital over the near term as we continue to evaluate the evolving market environment and remain focused on generating risk-adjusted returns for our clients.

Market Outlook

The conflict in Ukraine and unfolding humanitarian crisis is deeply disturbing both on a personal level as well as to our preconceptions about global stability and order. We were surprised by the strength of the reversal in risk assets over the last three trading days in February following Russia's attack on Ukraine. Over the past decade or so, markets have been conditioned at times to interpret bad fundamental news as positive for risk assets, based on the assumption of supportive central bank actions to follow.

However, sometimes bad news really is bad news. Russia's actions were highly destabilizing. We are of the view that the current and anticipated potential sanctions will have knock-on effects for the global economy. There are no easy outs, the global economy must either take some economic and inflationary pain now, or potentially pay a much higher price later. While the facts are rapidly evolving and therefore difficult to draw definitive conclusions from, the impact of the conflict is likely to be weaker economic growth, particularly in Europe, and increased inflationary pressures globally, driven by energy, grains and aluminum.

Large intraday risk reversals in equity markets, like those that occurred on January 24 and February 24, are usually features of bear markets. The magnitude of these reversals, with the Nasdaq opening down more than 3% and finishing up more than 3% on February 24, only have historical precedent in 2001 and 2008. While there is always a possibility that "this time could be different", it is our base case that we will likely see lower prices for risk assets and better opportunities as the year progresses.

From our experience, when there is as much sustained volatility as we have experienced early in 2022, there usually is a buying opportunity when high-yield market spreads widen to 500bp or more over the ensuing year. With the most recent peak in spreads just under 400bp on February 24, we are maintaining a cautious approach to risk assets for now, with a focus on limiting drawdowns rather than generating capital gains, and selectively adding to credits that are relatively insulated from these dynamics.

Justin Jacobsen, CFA
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PenderFund Capital Management Ltd.