PENDER FIXED INCOME

THE MANAGER'S MONTHLY COMMENTARY – APRIL 2022

The Pender Corporate Bond Fund returned -1.6%[1] in April. In a tough market, the Fund continued its streak of outperforming its benchmark and category.

In a market without many bright spots, we benefitted from a few. Continued optimism around the prospective end of the conservatorship of the Government-Sponsored Enterprises (GSEs) led to further gains in our positions in Federal National Mortgage Association (OTCPK: FNMA) and Federal Home Loan Mortgage Corporation (OTCPK: FMCC) preferred shares. Biotech credits, which we consider to have already discounted a rather bleak future, were also strong as convertible bonds in Tricida Inc. (NASDAQ: TCDA), Esperion Therapeutics, Inc. (NASDAQ: ESPR) and Precigen, Inc. (NASDAQ: PGEN) all posted gains in excess of 3%. Finally, we benefitted from the bid for Twitter, Inc. (NYSE: TWTR) by Elon Musk, that allowed us to dispose of our position in that issuer's previously discounted 2027 notes at a price above par.

Notwithstanding the good news noted above, plenty of lines in the Fund were negative as a combination of rising risk-free rates and widening credit spreads hit current quotations. As an example, the 2029 4% notes of MSCI Inc. (NYSE: MSCI) fell by 5 points in April to yield approximately 5.3% to a seven-year maturity. We continue to like the credit profile of MSCI, whose position as an index publisher has utility-like characteristics, and we consider the credit to be attractive.

What You are Asking and What We are Thinking

2022 has seen an historic reset upwards of interest rates, which has resulted in widespread fallout across capital markets. Amidst this volatile and fast-changing market, there are more questions than answers, but we will attempt to provide our thoughts on a few key questions:

What is going on in 2022?

We see the Fed and other central banks reacting to inflation readings that are, frankly, much higher and much less transitory than anticipated. Fed Chairman, Jerome Powell's, guidance regarding a quickly rising Fed funds rate, combined with plans to reverse much of the bond purchasing from the emergency pandemic market support, has caused rates to reset higher all along the curve as investors respond to this new reality. For example, a sudden yield increase of 2% creates a price decline of over 8% in a 5-year bond and a decline of over 16% in a 10-year bond. Yield increases in government bonds can raise the discount rate across equities and other risk assets too, which is why the typical diversified portfolio is showing a lot of red ink in 2022.

When will the correction in bond prices be over?

Clearly, there is no way of knowing this answer, but we can share our thoughts about the possible events and prices that might prove to be turning points. If rising inflation is the problem, then inflation stabilization or decline may be signs of a turning point. The most recent series of consumer price inflation numbers is still hitting new highs. However, we are starting to see some price series (steel, lumber and wheat, for instance) retreat significantly from recent highs. Slowing activity in housing markets, and a sudden reduction in new debt financings and IPO activity are also the sort of indicators that suggest the path of consumer inflation may slow in coming months.

Another signal could be a spike in market volatility… known less politely as a crash. While we don't necessarily expect a crash, we remain cognizant that sometimes these things happen. The critical factor about a crash is that one might expect, in those circumstances, that the Fed could pivot from its inflation-fighting toolkit to its market-stabilizing toolkit. And that, of course, would be the sort of event that might provide an unequivocal bottom.

A common experience in capital markets is that of the investor who loses more money flinching in the anticipation of a crash that doesn't materialize than they make from pivots back and forth to cash. While we ourselves have moved to the brick house from the stick house, we are not huddling in the bunker twelve feet below. Our base case assumption is that a slow, rounding bottom in bond prices is likely to occur sometime this year. Following such a turn, we believe that some pretty interesting pockets of black ink may emerge in a bond market that has been printing red all year.

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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.*

What is the upside for staying the course?

We all know the difference between believing in the theoretical upside on one hand and sitting across from a client experiencing actual cash losses on the other. The humble 1-year GIC, once considered a disregarded wallflower at the investment dance, is now, the belle of the ball. To cash in a GIC in favour of any sort of risk asset in May of 2022 is not the kind of move that today's shell-shocked client is likely to suggest. But for the intrepid few who dare to consider such a move, let us provide some intellectual ammunition.

In our view, rebounds follow drawdowns as surely as summer follows spring. As we look at the history of rebounds in the investment grade category, we see some interesting turns. Following a decline that ended in October 2008, we saw a rebound over the following 12 months that provided investment grade bond investors with a 17.8% return that dwarfed prevailing GIC rates of approximately 1.8%, In September 2013, a drawdown ended and investors of that vintage enjoyed a high grade rebound of 9.2% versus a prevailing GIC rate of 0.8%. And more recently in March 2020, a drawdown ended that saw a rebound in high grade of 14.6% against a prevailing GIC rate of 0.8%[2]. High-yield rebounds, as holders of this Fund are aware, have been even more significant.

We don't know the future, but our experience has been that past markets have paid investors a significant premium over GIC rates for participating in recovering bond markets.

New Positions

In April, we took advantage of some declining prices in relatively low-risk corporate credits to build or expand positions. An example of this was the increase in our position in the 4.75% 2027 notes of internet directory manager, VeriSign, Inc. (NASDAQ: VRSN), which have fallen in price by approximately 4 points in 2022 to yield roughly 4.7% to a 5-year maturity. We consider VeriSign to be a credit with ample ability to service debt, with its cash earnings covering interest charges in excess of 10x, net leverage of less than 1x EBITDA, and a 1-year default probability that we estimate at less than 0.01%. VeriSign, as a monopoly registrar of "dot com" web domains, is significantly insulated against economic risk in our view.

Also in April, we acquired a position in the 8.625% notes of oilfield equipment player, Exterran Corporation (NYSE: EXTN), which has recently agreed to be acquired by Enerflex Ltd. (TSX: EFX). As part of a deal that we anticipate to be consummated in the third or fourth quarter of 2022, we expect our position to pay out at a 101 change of control price, providing a short-term yield in excess of 8%.

Fund Positioning

The Corporate Bond Fund yield to maturity at April 30 was 7.0% with current yield of 5.1% and average duration of maturity-based instruments of 3.4 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 3.4% of the total portfolio at April 30.

Geoff Castle
May 6, 2022

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[2] *Bloomberg*