PENDER

ALTERNATIVE ARBITRAGE FUND

MANAGER'S COMMENTARY – JUNE 2022

Dear Unitholders,

The Pender Alternative Arbitrage Fund (PAAF) ended the month of June 2022 with a NAV of $10.27 per unit[1].

The first half of 2022 closed off with $2.2T of global M&A activity continuing the two-year streak of >$1T in quarterly deals[2]. While down 21% from last year's record pace, M&A activity remains strong from a historical perspective, despite equity market volatility and macro and geopolitical uncertainty. Mega-mergers exceeding $10B in deal size continue to drive M&A activity, up 11% over last year and at the highest pace in three years. Feeding the demand for acquisitions are private equity sponsors with ample capital to deploy in a market environment with more favourable valuations. Private equity represented a record 26% of acquirers in M&A deals through the first six months of 2022. The technology sector is also seeing a record level of M&A representing a quarter of all global deals this year. With the PAAF focused on North American merger deals largely dominated by activity in the US, that market continues to see robust levels of deal activity leading the world with over $958B of deals announced in the first half of the year.

Merger arbitrage spreads widened out in the first few weeks of the month as market volatility, rising recession expectations and widening risk premiums impacted equity markets. Another factor impacting spreads, particularly for larger and mega-cap LBO deals, was the perception of increased risk on private equity led leverage buyouts after Thoma Bravo, a well regarded and active PE acquirer, pressured the board of target company Anaplan, Inc. (NYSE: PLAN) to reduce the consideration of their acquisition by 3.4%. While not a material re-pricing (a roughly $400M reduction to the previous $10.7B deal value), the fact that Thoma put pressure on the company to take a reduced offer on what appears to be a minor difference and which would typically be dismissed by the acquirer may have led investors to believe this risk was not deal specific, and there may be read-through to other LBO's. This did not appear play out as the last two weeks of June saw a flurry of mergers including private equity LBO's close successfully.

SPACs remain in a "death spiral", continuing to trade at lower levels on sinking investor sentiment causing SPAC arbitrage yields to surge higher. New SPAC IPO issuance has stalled, while SPAC liquidations are increasing as sponsors fail to find a business target before the SPAC matures and are forced to return capital to investors. Even for sponsors who are able to find a target and bring it to a vote, the vast majority of investors are electing to exercise their option to redeem their capital back, resulting in many of the deals being terminated. The considerably poor performance of de-SPACs (SPACs which have successfully completed a business combination and taken a company public) provides little confidence to investors to risk their capital in a typically early stage and unprofitable business, especially in the current market environment[3]. As previously discussed, newly proposed rules by the SEC limiting the disclosures SPACs can make about a proposed target, underwriters ending their relationship with SPAC sponsors and a general oversupply of SPACs will likely continue to weigh on the industry until enough supply is removed that a new equilibrium can be reached. Another factor limiting the opportunity for SPACs is a steep drop in public market valuations which, in some cases, are below their private market peers, thus removing a key incentive for a business to go public. At the end of June, SPACs searching for targets were trading at a discount to trust which provides a yield-to-maturity in excess of 5%[4]; as such our view is that SPACs currently provide an attractive yield with lower credit risk and a shorter duration than corporate bonds.

Portfolio Update

Equity market volatility and the widening of merger arbitrage spreads during the month provided us with an opportunity to deploy excess cash into several new and existing merger deals. The Fund initiated positions in 10 new or previously announced merger deals with eight deals closing. Our focus remains on high quality small and mid cap merger arb deals which we believe have a higher probability of success than implied by the market, and we have a preference for mergers with a short, expected duration to closing. With the surge in SPAC yields in the past month, we believe there is an increasingly compelling opportunity to invest in SPAC arbitrage. There are several SPACs trading at a discount to trust value which provide a yield-to-maturity in excess of 5%, with a duration under three months until liquation. This compares favorably with merger arbitrage investments with an attractive yield, similar duration and lower risk. The yield environment for both merger arbitrage and SPAC arbitrage is relatively attractive compared to bonds, with the added benefit of shorter duration and tax efficiency.

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[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.*

[2] *https://www.refinitiv.com/perspectives/market-insights/mega-deals-prop-up-a-nervous-ma-market/*

[3] *https://www.institutionalinvestor.com/article/b1y1r55twc3vn6/SPACs-Are-Sputtering-Desperate-New-Terms-Could-Send-Them-Into-a-Death-Spiral*

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

Turning Point Therapeutics, Inc. (NASDAQ: TPTX), Black Knight, Inc. (NYSE: BKI), CDK Global, Inc. (NASDAQ: CDK), TherapeuticsMD, Inc. (NASDAQ: TXMD), US Well Services Inc. (NASDAQ: USWS), Ocean Bio-Chem, Inc. (NASDAQ: OBCI), Steel Connect, Inc. (NASDAQ: STCN), Cornerstone Building Brands, Inc. (NYSE: CNR), F-star Therapeutics Inc. (NASDAQ: FSTX) and Twitter, Inc. (NYSE: TWTR) were among merger deals initiated in the Fund during the month.

Checkmate Pharmaceuticals, Inc. (NASDAQ: CMPI), TriState Capital Holdings, Inc. (NASDAQ: TSC), Leucrotta Exploration Inc. (TSXV: LXE), Cerner Corporation (NASDAQ: CERN), Renewable Energy Group, Inc. (NASDAQ: REGI), Anaplan, Inc. (NYSE: PLAN), Summer Infant, Inc. (NASDAQ: SUMR), Trecora Resources (NYSE: TREC) and Intertape Polymer Group Inc. (TSX: ITP) were among the merged deals that closed in June.

At the end of June, the Fund had 27 investments in small cap deals under $2B, with 24 of those deals valued at under $1B. The benefits of our small and mid-cap focus, along with leveraging organic deal flow from Pender's equity portfolios, was made evident during the month. Intertape Polymer Group Inc. (TSX: ITP), a holding in the Pender Small/Mid Cap Dividend Fund entered into an arrangement to be acquired by US private equity group Clearlake Capital Group, L.P. in March of this year. Our knowledge of the industry and business, our analysis on the company's private market value and our research on precedent M&A and transaction multiples in the sector was utilized in the analysis undertaken prior to initiating a position in the Fund. Although management indicated at the time of the merger announcement that it expected the deal to close by the end of September, our analysis which leveraged our historical research led us to conclude that the merger had a high probability of closing well before that date. Intertape was the largest holding in the PAAF in June based on our view of the deal being high quality with a high probability of success and a shorter duration than implied by the market. The merger deal closed at the end of the month, taking just under four months to close and well before the seven months initially contemplated in the merger agreement. Duration can be a key contributor to merger arbitrage performance as capital from closed merger can be redeployed into a new deal providing an attractive annualized return. With many large and mega mergers facing regulatory delays and extended periods to closing, we believe small and mid-caps can benefit from shorter relative duration and more opportunities to reinvest cash to drive returns.

Outlook

Investors have experienced one of the worst first half-year periods in history for both equity and bonds in 2022. The S&P 500 declined more than 8% in June, bringing the year-to-date performance to -20.0%. U.S. treasuries and the Bloomberg U.S. Aggregate Bond Index have both declined by more than 10% since the start of the year. The traditional 60/40 portfolio continues to struggle with the Bloomberg US EQ:FI 60:40 Index down 16.9% this year through to the end of June. While expectations suggest a hopeful inflation peak with some moderation in the coming quarters, inflation remains well above central bank targets with an 8.6% US inflation print in June, followed by a 7.7% CPI print for Canada. The Fed has suggested that interest rates may need to keep rising to prevent higher inflation from becoming entrenched. In the face of high inflation, weaker sentiment and slower growth, recession fears have mounted, gripping the market. It is uncertain whether the economy will enter into a recession or if this will be a moderate and short-lived contraction until inflation is slowed and central banks can cut rates to stimulate growth. This uncertainty will make it increasingly challenging for investors to navigate a highly volatile market where there have been few places to preserve capital, let alone generate a moderate return.

We believe the benefits of a non-correlated event-driven investment strategy with a history of generating absolute returns in different market environments is a compelling compliment to investor portfolios. Unlike traditional assets like equities and bonds, the returns for event-driven investment strategies such as merger arbitrage are dependent on a number of identifiable and discreet variables, as opposed to market conditions. In our view the opportunity set for merger arbitrage remains favourable with wide spreads, elevated M&A activity and a high level of merger deals closing. The opportunity is similarly attractive for SPACs as negative sentiment has resulted in a surge in SPAC arb yields providing investors with what we view as a low-risk and tax-favourable alternative to bonds. With both merger arbitrage and SPAC arbitrage spreads widening in the past month, we believe there is a compelling opportunity to supplement equity exposure and replace fixed income exposure with an investment in merger arbitrage. With the underperformance of both equities and bonds in 2022 and many alternative strategies delivering on their stated target of non-correlated and absolute returns, we believe alternative funds have earned a place in investors portfolios.

Amar Pandya, CFA
July 13, 2022

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PenderFund Capital Management Ltd.

The Pender Alternative Arbitrage Fund was launched in September 2021. Standard Performance Information for this Fund will be available one year after inception. More information on the Fund can be found here: https://www.penderfund.com/liquid-alternative-funds/