PENDER

BOND UNIVERSE FUND

MAY - JULY 2022

For the three months ending July 31, the Fund generated a small but positive return of 0.1%[1], breaking the string of negative quarters that have resulted from the aggressive rate hiking cycle the Fed and other central banks have embarked upon to control inflation. While this outcome was somewhat less than benchmark returns, the key source of the difference was the short duration profile the Fund has adopted, which has been one of the principal reasons for the Fund's outperformance over longer time horizons.

Current Backdrop

Supply constraints, strong demand and Russia's invasion of Ukraine have combined to elevate inflation globally. In response to a broadening of price pressures – with more than half of the components of the CPI in Canada rising by more than 5% - the Bank of Canada delivered a rate increase of 100 full basis points in July. This was the largest single hike since 1998 and it brought the Bank of Canada's policy rate to 2.5%. As their surveys indicated that more consumers were expecting higher inflation to last longer, a stiff increase was delivered in the hopes of battling the possibility of entrenchment of elevated inflation.

South of the border, in June, we saw the Fed deliver the first 75 basis point rate hike since 1994. That was followed by a second 75 basis point increase in July as they re-iterated their commitment to returning inflation to their 2% objective rate. In their July policy statement, they noted that even though spending and production had softened, job gains have been strong and unemployment has remained low.

Canadian CPI rose 8.1% in June from the previous year, with gas being a key contributor to the advance from May's print. With the price of oil off approximately 19% since June, deceleration of prices at the pump are not outside the realm of possibility. Inflation from May to June in fact, was slower than in recent months, if energy and food were excluded from the calculation. As much as inflation may remain elevated above target ranges with more persistence than normal given current supply side constraints, it is hard to ignore the significant price declines in key input commodities we have already seen, such as steel being down more than 50% from its highs and lumber off in excess of 60%.

Duration Positioning

We consider a couple of important factors when we make the duration call in the Fund. First, we consider the level of the "term premium" which is the amount of extra yield investors are paid to accept duration risk. This factor will fluctuate with the market, but has recently been around zero, a level that provides no compensation for the volatility risk associated with longer tenors.

The second factor we consider, on a more tactical level, is the positioning of market participants. The net futures position on the 10-year treasury provides insight into current market participant positioning and therefore expectations surrounding inflation. A high short interest here may signal increased inflation expectations and can serve as a contrarian indicator moving forward. The short futures position on the 10-year treasury increased somewhat through the beginning of the period but decreased through the month of June and ultimately ended the period lower than where it began, indicating that market participants may have become somewhat less confident that inflation will persist.

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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.*

A non-existent term premium and a reduced short position on 10-year treasury futures do not combine to provide a compelling argument for taking on additional duration at this time.

Significant Investment Grade Drawdowns & The Following One-Year Return

We recently had a look at several previous Investment Grade drawdowns along with the average subsequent rebound one year later, using the ICE BofA US Corporate Total Return Index as a proxy for US Investment Grade. Drawdowns in 2008, 2013 and 2020 averaged approximately 12.8%, with 2008 representing the most significant previous drawdown of the three periods, registering a 16.7% drop. The average rebound in the year that followed each of these periods was approximately 19.2%, with the most significant of the three again taking place following the Great Financial Crisis. The index was up approximately 30.8% a year following the low in 2008.

Considering the current period, the drawdown to the low reached on June 14, 2022, edged out the Great Financial Crisis as the worst decline going back to 2008 at approximately negative 17%. Since then, we have seen the index rebound 5.2%. As much as past results are not indicative of what may happen going forward, the current gap to even two-thirds of the 19.2% average rebound discussed above remains to be 7.6%. With that said, we do not presume to have any special insight as to what the residual rebound may look like, or even if one will occur at all. The illustration here simply provides some context for the historic moves we have seen.

Fund Positioning

The duration of the Fund was 3.8 years at the end of July 2022 and yield to maturity was 4.9%. The Fund held a 24.5% weight in Pender Corporate Bond Fund units at the end of the month which was down slightly from the end of the previous period. Cash represented 2.9% of the Fund at July 31, 2022.

For those interested in a US dollar version of the Pender Bond Universe Fund, we are happy to report that as of July, our Class A and Class F units are now offered in USD also. Please reach out to us if you would like more information on this option or the Fund in general.

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Standard Performance Information for Pender's Fixed Income Funds may be found here: https://www.penderfund.com/fixed-income/

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