PENDER FIXED INCOME

THE MANAGER'S MONTHLY COMMENTARY – JULY 2022

The Pender Corporate Bond Fund emerged from July with a positive return of 1.9%[1]. The compressed spring of lower bond prices unwound a bit in the month as a potential slowdown in inflation provided the occasion for a celebratory rally. That inflation slowdown also had positive implications for our sister Fund, the Pender Bond Universe Fund, which rallied 2.1% in July[1].

Leading the way for the Corporate Bond Fund were several bright spots. Our position in the July 2023 notes of Precigen, Inc. (NASDAQ:PGEN) rallied 15% in the month as that company announced plans to sell a subsidiary for a cash consideration that nearly equalled total debt outstanding. The Fund also benefited from a significant rally in longer-dated, higher quality issuers such as MSCI Inc. (NYSE:MSCI), whose 2030 notes gained over 9% in the month.

Offsetting the broadly positive trend, to a degree, were some of the Fund's less liquid lines that tend to follow as opposed to lead rallying credit. Examples of these included some Canadian rate reset preferred shares such as Bell Canada, BCE Inc. (TSE:BCE) series Q and J preferreds, each of which declined more than 6% in July.

Is it Time to Get Sensible Yet?

In discussions with clients this year, so often we have come across questions about timing. Is it time to move from GICs to bonds? Is it time to jump into high yield? Is it time to allocate to or away from investment grade? When is the bottom?

If they do indeed find the correct answer, the clients in question may be able to turn a quick profit from a timely trade in their book. But regularly repeating such fortuitous rebalances is difficult. Putting ourselves in the chair of a client interviewing a prospective manager, we might not spend so much effort on seeking opinions on these difficult-to-know and hard-to-execute subjects. Instead, we might try a different tack. "Is the manager approaching the market sensibly?"

Now, how one determines whether a credit manager is doing their work sensibly is more of an art than a science, but we would point to the following lines of questioning.

Are you managing for value or are you managing for coupon? Sometimes fat coupons make a lot of sense if they are accompanied by an underlying business valuation that well supports the credit stack of an issuer. But on other occasions, smaller coupons can make sense if they offer better capital security or, in the case of a convertible bond, some realistic potential for equity-based appreciation. And sometimes a defaulted security, offering no coupon whatsoever but cleansed of excess debt in the wake of a restructuring, may turn out to offer the most value of all. The key, in our view, is to manage for value.

Do you test the issuers in which you are investing to see if they are robust enough to withstand a typical recession? It is difficult to know whether a recession is or is not going to happen at a given time. However, it is much less difficult to form an opinion of whether a particular issuer, given its business profile and debt burden, is likely to sail through a typical recession without credit troubles. Has the business demonstrated robust profitability in past recessions? Is the company's debt burden small enough that interest can be paid

[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.

easily upon a contraction of profit margins to historic lows? To us, it is more important that a portfolio be comprised of issuers that can withstand recessions than it is to know, in a precise sense, when a recession might arrive.

How do you plan for providing client liquidity at inconvenient moments? Every manager is happy to crow over successful trades in cheap but illiquid securities. But in our view, managing a credit mandate well necessitates both a strong understanding of the liquidity of various parts of a portfolio and the humility to imagine a scenario in which a sizeable proportion of one's clients want their money back. In our case, we stress-test a one day, fifty percent redemption. Thanks to the kind countenance of fate, we have not, thus far, been called on to provide such a flood of liquidity. But we heed Benjamin Franklin's warning, "By failing to prepare, you are preparing to fail." And so, the stress test is our guide.

When it comes to credit mandates, as with shoes, we know 'sensible' is not sexy. But in this year of turbulence and extremes in sentiment, we think managing sensibly is what is needed.

New Positions:

In July, we re-established a position in an old favourite, the Abrdn Asia-Pacific Income Fund VCC (NYSEAM:FAX), a closed-end fund focused on higher quality US dollar bonds from issuers in the Asia Pacific region. Following a long and deep drawdown over the past 18 months, we found FAX trading again at an 18% discount to daily reported NAV. In the event that FAX closes its discount to NAV to the historic average of 8% and it pays its anticipated dividend of approximately 12%, then it appears possible to us that a total return of approximately 20% might be achieved in this vehicle. Of course, nothing is certain, and results will be highly variable based on the direction of net asset value appreciation. But we think there is strong relative value in the Asia Pacific region and that FAX is an interesting, discounted way to take advantage of the cheapness of the region.

Also in July, we expanded our position in Canadian Real Return Bonds and United States Treasury Inflation Protected Securities (TIPS). In both cases, the 5-year breakeven inflation assumptions embedded in inflation-linked securities have declined to less than 3%, yet actual observed inflation is running at over 8% in Canada and over 9% in the United States. We like these securities, which combine sovereign-level credit quality with relatively low-cost inflation protection.

Fund Positioning

The Corporate Bond Fund yield to maturity at July 31 was 8.1% with current yield of 5.6% and average duration of maturity-based instruments of 3.4 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 3.1% of the total portfolio at July 31.

Geoff Castle
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PenderFund Capital Management Ltd.

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