THE MANAGER'S MONTHLY COMMENTARY – AUGUST 2022

The Pender Corporate Bond Fund continued its rebound from the summer's lows, returning 0.4[1] in August.

The Fund's return was bolstered by strong line-item performance in some high conviction credits including Intercept Pharmaceuticals, Inc. (NASDAQ: ICPT) 2% convertible notes of 2026, which rallied more than 10% due to a substantial reduction in the company's senior debt. Our position in Liberty TripAdvisor Holdings Inc. (NASDAQ: LTRPA) convertible bonds rallied significantly following TripAdvisor's strong quarterly results. Our position in Chinese developer credits Country Garden Holdings Company Limited (HKG: 2007) and CIFI Holdings (Group) Co. Ltd. (HKG: 0884) also performed well following state-supported capital raises that stand to benefit these "designated survivor" issuers.

Offsetting the above-mentioned strength to a degree was weakness in some investment grade bonds as benchmark yields rose. As we discuss below, we do see fundamental factors shifting in a way that is more hospitable to high-quality credit, but August did see a pullback from the bond rally of the prior two months.

The Bond Market of 2022 – Is it safe to go back in the water?
Until a couple of years ago, the broader bond market was one of the most reliable places possible to allocate capital. In a 39-year bull market, the 5-year US Treasury bond yield fell from its 1981 high of 16.2% to an ultimate low of less than 0.3%. Even in the later stages of the bull market, capital appreciation from falling yields allowed investors to earn total returns well above coupon levels. In the 5 years ending December 31, 2020, the US Treasury Total Return Index delivered 4.7% annualized.

But bull markets eventually end and this one has ended with a bang. In Canada, broad universe-tracking total return measures are down over 13% from August 2020[2]. Longer duration index trackers are down even more. The I-Shares 20+ Year Treasury Bond ETF is down more than 30% in total return terms from its 2020 high[3]. High-yield credit has fared a little better, but in 2022 index tracking funds, like the I-Shares IBOXX High Yield Corporate Bond ETF, have still delivered a loss of over 7% in total return terms[4].

To the serious capital allocator, the facts above are already well understood. We imagine a good allocator at summer's end surveying the bond market like Roy Scheider, vigilant sheriff of Amity Island in the movie **Jaws**. As he scans the waters for telltale shark fins, there's a question pressing on his worried mind, **"Is it safe to go back in the water?"**

Clearly, the typical retail investor is still scared of the bond market. Year-to-date net outflows from US investment grade bond funds amount to over $120 billion or approximately 6% of total assets, while high-yield net outflows have amounted to over $20 billion or approximately 5% of total assets[5].

When in stampede mode, selling investors don't take much notice of changes in underlying fundamentals. We believe, in the current market environment, pausing to reassess the fundamentals of the bond market makes a lot of sense.

<u>Simply put, the drivers that would make one interested in high-quality bonds are starting to flash a lot of green lights, in our opinion</u>. The yield curve is inverted. Core inflation measures, which were ramping upwards in the first part of 2022, have begun to stall. Many commodity prices are substantially lower than they were in Q1

[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.
[2] XBB (iShares Core Canadian Universe Bond Index ETF) total return from Aug 31, 2020 to Aug 31, 2022; Source: Bloomberg)
[3] TLT (iShares 20+ Year Treasury Bond ETF) total return from high on Aug 4, 2020 to Aug 31, 2022; Source: Bloomberg)
[4] Bloomberg
[5] CreditSights Aug 25, 2022

2022, including lumber (down 65%) and copper (down 25%). Confidence surveys of consumers and business leaders are suggesting a significant economic slowdown is brewing. After seeing nothing but rate hikes out of global central banks, a surprise rate cut out of China may signal a potential turning of the rate hiking cycle. We recognize that Fed Chair Jerome Powell is still talking a hawkish line, but we find it interesting that despite his rather gunslinging speech at Jackson Hole vis-à-vis the promise of "moar" rate hikes, the US 5-year yield is still over 20 basis points **lower** than it was in mid-June.

Given this picture, where do we see the best opportunity?

There are a few different spots. The simplest to wrap one's head around are the shorter-term obligations of solid investment grade issuers like PepsiCo, Inc. (NASDAQ: PEP) and McDonald's Corporation (NYSE: MCD) where yields have risen to around 4.5% at the 3-year tenor.

We also see value in high-yield credit in senior securities with substantial valuation coverage. As an example, Uber Technologies, Inc.'s (NYSE: UBER) 2025 Term Loan B is currently priced to yield over 6%, despite occupying the top $2.5 billion of a capitalization structure that is valued today at $65 billion.

We also have deep conviction in a select number of higher yielding issues, such as the 2025 put-able convertible bonds issued by Liberty TripAdvisor yielding in excess of 13%. But in these somewhat more esoteric positions, we have been purposefully cautious in position sizing and portfolio weighting, given the economic headwinds.

Overall, we see this as a market that may be led by high-quality issues and issuers, and that is where we are focusing our weighting going into the last third of 2022.

New Positions

We were relatively busy in August as we found several situations where strong underlying credit fundamentals collided with low prices and attractive yields. One case in point is the 5.25% 2029 notes of **Great Lakes Dredge & Dock Corporation** (NASDAQ: GLDD) trading near 86 cents on the dollar to yield around 8%. We like GLDD's strong market position as the largest American dredging company, its demonstrated strength in weaker economic periods and its relatively low levels of debt compared to the replacement value of the company's fleet.

Also in August, we expanded our position in the capital structure of **McDermott International, Ltd.** (OTCMKTS: MCDIF). McDermott, which emerged from bankruptcy in 2020, is a company almost entirely forgotten by capital markets. The company's struggles originated with an ill-advised acquisition of Chicago Bridge and Iron back in 2018 that left the energy-focused engineering and construction firm mired with large, unprofitable fixed-price contracts. With the company making substantial progress in resolving unprofitable contracts and with a resurgence of demand in its industry, we consider both McDermott's exit first lien term loan and its re-organized equity attractive at current prices.

Fund Positioning

The Pender Corporate Bond Fund yield to maturity at August 31 was 7.8% with current yield of 5.8% and average duration of maturity-based instruments of 3.7 years. There is a 2.3% weight in distressed securities held for workout value whose notional yield is not included in the foregoing calculation. Cash represented 0.8% of the total portfolio at August 31.

Geoff Castle
September 9, 2022