PENDER FIXED INCOME

THE MANAGER'S MONTHLY COMMENTARY – SEPTEMBER 2022

The Pender Corporate Bond Fund retreated 1.7%[1] in September within the context of a particularly difficult investing environment. Although we would have preferred gains, we were encouraged that the Fund has thus far held above the summer lows, all the while seeing much improved forward-looking returns available in credit markets.

A very strong US dollar pushed the currency-unhedged version of the Fund (PGF518) into a positive return of +1.6%[2] for September. Launched in mid-2019, that series has proven resilient in weak or liquidating markets, as the CAD/USD exchange rate tends to move counter to risk market trends.

Line items that drove relative outperformance for the Fund included our position in Exterran Corporation 8 1/8% notes, which rallied on signs that the company's acquisition by Enerflex Ltd. may proceed as planned. A resilient performance from high-quality short-term notes such as McDonald's Corporation 2025 maple bond was also a source of relative strength.

Weaker lines generally included longer duration positions that fell in sympathy with the move in the yield curve. Specific weak spots included a position in National CineMedia, LLC 1st lien notes, which suffered from uncertainty created by the bankruptcy filing of theatre operator Cineworld Group, plc. The Cineworld filing, which we believe to be related primarily to the necessity to effectuate lease restructurings, may create credit opportunities across the theatre sector, including in the notes we hold, which now are priced to yield 18% to a 2028 maturity.

Green Shoots – Some Good Signs in a Bad Bond Market

As of September 2022, we are now more than two years into a bear market for bonds. The S&P US Treasury Bond Current 10-Year Total Return Index, which hit its last high on August 4, 2020, has delivered a cumulative loss of over 22% since then[3].

For participants in the "Great Barbecue" – that four-decade run of declining yields and rising bond prices that began in the 1980s – this price reset in the bond market has been shocking. And, as the shock has given way to acceptance, conversations in the market have changed. Two years ago, the unsolicited pitches we received were focused on Austrian 1% "century bonds" or various cryptocurrency convertible deals. Today, the phone rings and a voice says, "Brother, can I sell you a hedge?"

We have no special power to see the future, and we acknowledge that *anything* can trade *anywhere*. But we credit some past success to the use of four factors to identify good entry points: price, positioning, flows and sentiment. And, although there are undeniable risks around, we believe those factors are looking very positive, especially for the higher quality strata of the bond market. Let us elaborate:

Price: If this bear market began with record-low bond yields, a quick check of Bloomberg suggests that we have come a long way in price terms. A 10-year US Treasury bond yielded about 0.5% in August 2020, but is now well over 7x that level. Is 7x a lot? Well, it is the highest level in 14 years. But what about *real interest rates?* Well, granted the CPI is higher than bond yields right now, but the real 10-year interest rate that can be derived from inflation-protected securities is actually +1.67% right now. So both headline yields and real yields on a 10-year Treasury are the highest they have been in over a decade[4].

Positioning: If a few decades of investing has taught us anything, it is that crowded trades can have bad outcomes and unpopular ones can have very good outcomes. In this respect, we decided to take a quick peek at reported short interest in some major fixed income ETFs. It will not surprise the contrarians amongst us that the largest high-yield

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[1] Class F of the Fund. Other classes are available. Fees and performance may differ in those other classes.

[2] Class U of the Fund. Other classes are available. Fees and performance may differ in those other classes.

[3] Bloomberg

[4] Bloomberg

ETFs and investment-grade bond ETFs recently have seen multi-year highs in short interest. In fact, expressed as a percentage of units outstanding, one large high-yield ETF was over 40% sold short at the September 15 disclosure date. Yes, we understand that the news on your Twitter feed is bad. But is it possible that market participants have, through trading, already priced in the bad news[5]?

Flows: What is something else you don't see at the top? How about meaningful retail investor redemptions? The high-yield and investment-grade ETFs we looked at in September had something else in common, and that was massive net unit destruction. The high-yield ETFs had seen approximately 50% net outflows over the past two years, while investment grade was down over 30%[6]. To GIC refugees everywhere, we offer this thought: Remember the 1990s. When GICs are return leaders, the best forward-looking returns could well be elsewhere.

Sentiment: Sentiment with respect to interest rates is also lopsided. Yes, the Fed has been talking tough and it is highly likely that a few more hikes are in the offing. But a key investor survey recently put bearish sentiment on Treasury bonds (bearish = expecting higher yields) as the highest since 2009[7]. All the while, commodity prices are falling, new orders are falling, and business and consumer confidence is tanking. For anyone who considers themselves to be a card-carrying contrarian, this is not a bad sentiment backdrop in which to put money to work in the bond market.

New Positions

In September we continued to add weight in high-quality issuers, including a new position in the 2026 maple bonds of Waste Management, Inc. As a leader in the sector, Waste Management benefits from consistent, stable revenue streams that are relatively insulated from economic swings. Interest coverage at Waste Management is a healthy 13x EBITDA/Interest while we view one-year default probability at less than 0.1%. Nevertheless, these bonds have retreated more than 12 points in the past year to yield approximately 5%.

We also expanded our position in the first lien term loan of Uber Technologies, Inc. First lien debt makes up only $2.5 billion of Uber's $61 billion total capitalization, so we are positioned here in the top 4% of the company's enterprise value, and at a level of debt well below Uber's $4 billion cash balance. The floating rate loan is priced to yield over 7% to a 2025 maturity. We like Uber's business, which has, on an unlevered basis, generated over $1 billion in cash from operations over the past 12 months.

Fund Positioning

The Pender Corporate Bond Fund yield to maturity at September 30 was 9.3% with current yield of 6.0% and average duration of maturity-based instruments of 3.9 years. There is a 0.7% weight in distressed securities held for workout value whose notional yield is not included in the foregoing calculation. Cash represented 0.2% of the total portfolio at September 30.

Geoff Castle
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PENDER
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[5] Bloomberg
[6] Bloomberg, JNK, HYG, LQD data
[7] Topdown Charts, September 2022