PENDER FIXED INCOME

THE MANAGER'S MONTHLY COMMENTARY – NOVEMBER 2022

The Pender Corporate Bond Fund posted a positive return of 0.9%[1] in November which was a stronger market period that saw positive returns across fixed income markets.

Leading returns in the Fund were some longer-dated, discounted issues that benefitted from the combination of lower yields and a return of value buyers to the credit markets. Examples include our position in the Methanex Corporation 5.65% notes of 2044, which rallied over 8%, and our position in Seagate HDD Cayman 2031 notes, which also gained in excess of 8% as a result of an opportunistic tender offer made by the company.

Offsetting the broad-based strength in the Fund were a few "edgier" credits, where a combination of investor de-risking and hedging and reduced liquidity led to volatile price moves. We often see year-to-date "laggards" being dumped in an indiscriminate fashion in the last six weeks of the year, and 2022 appears to offer a wide array of such opportunities.

2023 Opportunities – Some themes we like:
Notwithstanding a bit of a rebound over the past month, 2022 has seen massive price declines in the bond market. Here are some themes we are focusing on in a lower-priced market going into 2023:

<u>THEME 1: Fixed Coupon + Decent Quality + Belly of the Curve:</u>
In the past six months, we have seen a resolution of many of the supply chain issues and acute labour shortages that characterized the inflationary burst of early 2022. Looking ahead, we expect a further easing of inflation pressures as consumers and companies digest the impact of significantly higher rates. In such a scenario, the Fed may at first slow down, then stop, and finally, start reversing the extraordinary rate hikes that have been the mainstay of the past twelve months, in our opinion.

With this outcome as a plausible base case, we find the prices of relatively strong corporate credits in the three to seven-year tenors to be very attractive. Yes, there may be a recession in 2023. We therefore want to ensure that we are buying credits with fundamentals strong enough to withstand an economic slowdown. But even given this quality constraint, there are still plenty of excellent issuers with credit yields of more than 6%. And, as the table below shows, a 100 basis-point decline in yield of a five-year, 5% coupon bond, currently priced to yield 6% will result in a 12-month total return of approximately 9.7%.

Effect of a 100 basis point yield decline on total return (at various tenors/yields)

Tenor	YTM - Today	Price Today	YTM + 1 year	Price +1 year	Total Return
3 Years	5.50%	$98.63	4.50%	$100.95	7.4%
4 Years	5.75%	$97.35	4.75%	$100.69	8.6%
5 Years	6.00%	$95.73	5.00%	$100.00	9.7%
6 Years	6.25%	$93.82	5.25%	$98.91	10.8%
7 Years	6.50%	$91.67	5.50%	$97.47	11.8%

Note: All bonds assumed to carry 5% coupons, non-callable. Table for illustrative purposes only.

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

Now, the examples in the table above are simply illustrations to demonstrate how bond mathematics work. But we note that there are plenty of real-life issuers that currently exhibit, in approximate terms, the yields and prices outlined in the table. Representative issuers within the Fund include Verisign, Inc., Hologic, Inc., Gartner, Inc., SS&C Technologies, Inc., MSCI Inc. and several others. This is a class where we are comfortable adding weight as we look forward to 2023.

THEME 2: Rebounding Victims of the Great USD Steamroller

As US dollar risk-free yields have risen this year, the United States dollar has also rallied. From a low of approximately 90 in the first half of 2021, the ICE US Dollar Index recently went as high as 114, a move of more than 26%. Over the past decade, the dollar index gained approximately 50%. But no trend lasts forever. What could happen if USD strength were to reverse in the wake of declining rates?

Recently, we studied the last long period of secular dollar weakness – a period that began in the second quarter of 2002 and ran through the first quarter of 2008. What were some good ideas within that era? Well, precious metals tend to outperform in periods of dollar weakness, and that period was no exception. Gold went from $337/oz in March 2002 to $917/oz six years later. Silver started the period at $4.66/oz and reached $17.23/oz by the end of March 2008.

In credit, that 2002-2008 period saw international issues perform particularly well. The Aberdeen Asia-Pacific Income Fund posted a total return of 127% for the six years ending March 2008, a compound rate of return of 14.6%. That return vastly exceeded the 8.3% annualized return available from 10-year US Treasuries in the period.

So, to position the Fund for a potential change in trend, we have been adding to our precious metals credit positions, including several heavily discounted straight bonds from issuers like Coeur Mining, Inc. and Hecla Mining Co. We have also added weight in a couple of convertible precious metals issues from SSR Mining Inc. and First Majestic Silver Corp. In addition, we have built positions in some deeply NAV-discounted closed-end funds, like the Aberdeen Asia-Pacific Income Fund and the Morgan Stanley Emerging Markets Domestic Debt Fund.

THEME 3: Idiosyncratic Credit Value Opportunities

While we do look for opportunities in a top-down fashion, we are also aware of the following inconvenient truth: *We have often been successful* ***despite*** *our strategy, as opposed to* ***because of*** *our strategy*. In other words, rigorously turning over rocks, picking up the ten dollar bills we find on the street, and generally hustling to earn a buck… all this activity is much too profitable to suspend completely in favour of grand strategy. So we remain opportunistic in the face of a pretty substantial wall of worry that confronts credit investors going into the new year.

Fund Positioning

The Pender Corporate Bond Fund yield to maturity at November 30 was 7.9% with current yield of 5.7% and average duration of maturity-based instruments of 3.5 years. There is a 3.3% weight in distressed securities held for workout value whose notional yield is not included in the foregoing calculation. Cash represented 1.6% of the total portfolio at November 30.

Geoff Castle
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