PENDER

STRATEGIC GROWTH AND INCOME FUND

THE MANAGER'S COMMENTARY – FOURTH QUARTER 2022

Dear Unitholders,

The Pender Strategic Growth and Income Fund returned 4.4% in the fourth quarter of 2022, ending the year with a return of -7.9%[1]. The Fund recovered nicely in the fourth quarter and demonstrated comparative resilience throughout the year against one of the most challenging market backdrops for both equities and fixed income assets in history. Despite this ugly macro backdrop, the Fund outperformed the benchmark on a relative basis. And gratifyingly, the Fund has remained a top-quartile performer on a relative *and absolute* basis over the long term as well[2].

The recent challenges stemmed from macro factors, with rising interest rates from central banks around the world being a defining theme in 2022. Throughout the year, 82 central banks raised rates and collectively delivered 386 rate hikes to tighten monetary policy and tame inflationary pressures. This was a significant acceleration in tightening compared to 2021, when there were 123 rate hikes across 41 central banks. In the US we witnessed one of the most aggressive tightening cycles by the Fed in the last 50 years, with only the tightening in 1980 occurring at a more rapid pace.

This regime change in the interest rate environment had a broad impact across all asset classes[3]. There have been only a handful of times over the previous two centuries when both stocks and fixed income assets sold off in tandem. Last year's market swoon put new records into the history books. 2022 was the worst year on record for US bonds[4] and the largest drawdown in US stocks since 2008. Canadian stocks fared better due to their higher energy weighting, but still posted a negative performance. There was almost no place to hide, except cash and even that safe-haven status is illusionary. The higher the inflation rate, the more quickly cash loses value. Idle cash lost purchasing power at the fastest pace since the early 80s. In short, 2022 was 'annus horribilis.'

We did not anticipate such aggressive actions by the central banks. Yet, like all investors, we do not get to choose the market conditions. We must "play the game on the field" in any given year to the best of our abilities, regardless of our expectations or preferred scenarios. Unexpected market twists and turns have unfortunately been routine over the last seven years.

Since we began managing the Fund in late 2015, we have experienced:

1. An extended period where US mega-cap tech drove the broader large-cap markets higher.
2. A period when negative yielding bonds ballooned to the highest point in history due to a bizarre multi-year central bank experiment. In September 2019, the percentage of all government-issued bonds that had a negative yield peaked at a stunning 40%!

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

[2] At the end of 2022, the Pender Strategic Growth and Income Fund had a first quartile track record over 1, 3, 5 and 7 years since the current PM team has managed the Fund.

[3] In equities throughout 2022, the S&P/TSX Composite Index returned -5.7%, the S&P 500 Index (CAD) returned -12.4%, the Russell 2000 Index (CAD) delivered -14.9%, while the tech-heavy Nasdaq Composite Index (CAD) lagged, returning -27.8%. The returns weren't any better in fixed income either with the high yield bonds returning -11.7% on the year and investment grade debt performing even worse, delivering -16.2% (as measured by the ICE BofA US High Yield Index and S&P 500 Investment Grade Corporate Bond Index respectively).

[4] https://www.cnbc.com/2023/01/07/2022-was-the-worst-ever-year-for-us-bonds-how-to-position-for-2023.html

3. The COVID-19 pandemic, which was the deadliest pandemic in more than a century and shut down much of the global economy for several years.
4. The fastest Fed tightening in modern history impacting virtually all asset classes (2022).
5. The Ukraine-Russia conflict — the largest conflict in Europe since WW2 — which sent energy prices soaring.

We did not predict ANY of these massive market-moving events, nor were we beneficiaries of any major tailwinds as a result. Nevertheless, the "all-weather" positioning of the Fund enabled it to deliver benchmark-topping returns to unitholders over the short-to-medium haul.

We believe the role of a balanced fund is not to make dramatic changes based on short-term macro predictions. Rather, we seek to find balance in an uncertain world and deliver decent results over extended periods. While we are not happy with the negative return in 2022, we are pleased with its first-quartile performance and more importantly, outperformance over the extended business cycle. We aim to stay the course and continue to find balance through hedging strategies of our liquid alternative fund holdings, opportunistic fixed income exposure from the Pender Corporate Bond Fund (PCBF), small-cap exposure through the Pender Small Cap Opportunities Fund (PSCOF) and individual equities that we believe will continue to add value through the entire cycle. We believe this multi-strategy approach of differentiated Pender mandates will enable the Fund to continue to navigate through different economic conditions better than traditional balanced approaches.

Equities and Fixed Income

Within our equity holdings, our exposure to Energy companies led the way in the fourth quarter of 2022. Spartan Delta Corp. (TSX: SDE), ARC Resources Ltd. (TSX: ARX) and Texas Pacific Land Corporation (NYSE: TPL) were all among the top five contributors. While oil prices closed relatively flat on the quarter, these businesses continued to perform well and are generating substantial cash flows. Defense contractor Northrop Grumman Corporation (NYSE: NOC) was also among the top contributors during the quarter. The company has continued to see its backlog grow — a leading indicator to an acceleration in revenue growth — while generating strong cashflows that will be returned to shareholders via dividends and share repurchases.

Among the top detractors in the fourth quarter was CCL Industries Inc. (TSX: CCL.B). We continue to own the company in the portfolio and see it as a long-term compounder of shareholder value. CCL Industries exited 2022 with a strong balance sheet that is under-leveraged relative to its history. With strong cash flow generation expected in 2023, its leverage should continue to decline and provide the company significant opportunity to add value through M&A. CCL has been an excellent acquirer historically and management has highlighted a deep pipeline of potential targets focused on tuck-ins.

Our small-cap exposure through the Pender Small Cap Opportunities Fund contributed positively to overall performance during the quarter. Small caps rebounded along with the general sentiment of the market during quarter, as well as through strong stock selection. The market dislocation has allowed us to add high-quality businesses to the portfolio where we have the highest conviction levels. We have continued to position our small-cap holdings in businesses that have robust business models and balance sheets to weather a challenging environment. For more details on PSCOF, see the Fund's December update here.

Our fixed income investments are mostly reflected by our position in the Pender Corporate Bond Fund. This contributed positively to performance in the quarter, against the backdrop of a rally in corporate bonds. Although corporate debt rallied in the quarter, one of the positive offsets to the selloff in bond markets over the last year was the corresponding backup in yields. This has significantly changed the opportunity set for our fixed income investments. PCBF begins the year with an average yield-to-maturity of approximately 8%, significantly higher than the start of last year, with a current yield of 5.6% and an average duration of maturity-based instruments of 3.4 years. For more details on the PCBF, see the Fund's December update here.

Fund Positioning and Outlook

The portfolio ended the quarter with approximately 48.2% invested in direct equities, 6.5% allocated to PSCOF, 37.3% invested in PCBF and limited cash. The Fund also held approximately 6.2% across the Pender Alternative Absolute Return Fund and the Pender Alternative Arbitrage Fund. These strategies were added to the portfolio earlier in 2022 and have contributed positively, while providing uncorrelated returns in this environment, as anticipated. Over the long term, these strategies should dampen overall portfolio volatility, while delivering returns with a low correlation to the overall portfolio.

As we look forward to 2023, we remained balanced in our positioning and are finding a wide range of attractive opportunities. The economy and macro forces, such as inflation, interest rates and growth, will continue to be front-page news. Leading economic indicators are also trending lower, which could lead to further market volatility. We will target investments that can withstand a wide range of economic scenarios, while not losing sight of the short-term hurdles and long-term opportunities that market dislocations present.

Felix Narhi & Geoff Castle
January 19, 2023