PENDER

Forward thinking. Finding value.

INVESTOR EDUCATION

Pender Strategic Growth & Income Fund: Optimizing the Balanced Portfolio in an Uncertain World

The failure of the 60/40 balanced portfolio

The traditional balanced investment portfolio, typically composed of 60 per cent equities and 40 per cent bonds, is deemed to be the goldilocks of asset allocations—neither too hot, nor too cold but just right for the average investor.

This asset allocation aims to *balance* risk and return, hence the name. Equities represent the risk portion, but they are also the driver of capital growth. Quality bonds represent the income generation and capital preservation portion of the portfolio.

Equity and bond prices are (usually) inversely or negatively correlated to each other. This means when one asset class is trending up, the other is trending down. In theory, holding both assets in a traditional balanced fund should smooth out portfolio volatility and still generate moderate positive returns over the long term.

Unfortunately, sometimes this historical relationship between equities and bonds breaks down as it did dramatically in 2022 when the correlations of all major asset classes converged. Instead of bond prices rising to offset falling equities prices, both asset classes fell in unison. A Bloomberg index tracking a 60/40 mix was down 17 per cent in 2022 from the effects of rising inflation and interest rates that stomped both equities and bonds.

As seen in the chart below, 2022 was the worst-ever year for US bonds going back over two centuries!

A Historic Year for US Bonds, Down 25.6%

Worst-Ever Year Going Back 230 Years....

Returns on US Bonds Hit New Historic Lows in 2022

	2022 RETURN	PREVIOUS WORST Performing 12 Mo. Period	RETURN
Intermediate-Term US Treasurys	-10.6%	October 1994	-5.6%
Total Bond	-13.1%	March 1980	-9.2%
Long-Term US Treasurys	-29.3%	March 1980	-17.1%
Long-Term Investment Grade	-27.0%	January 1842	-22.9%

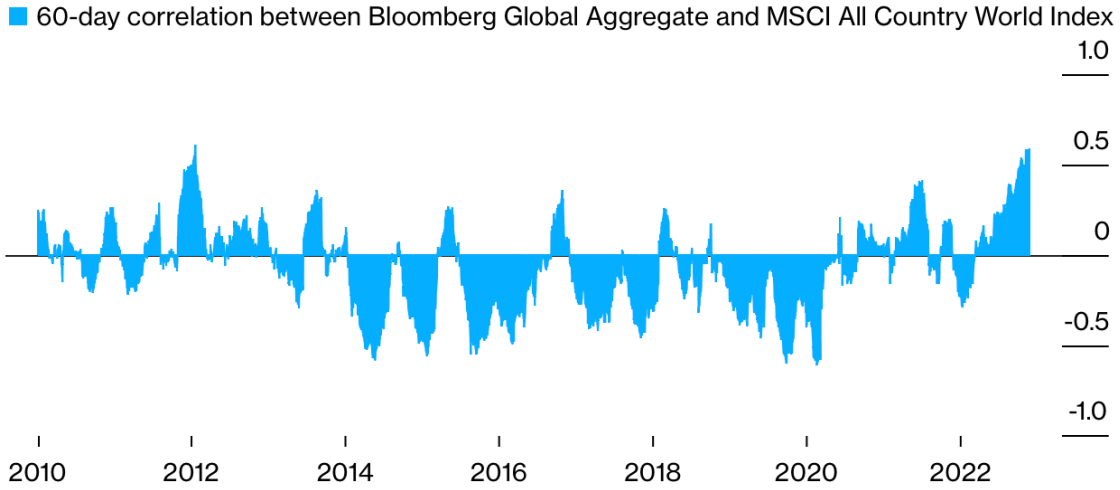
Table: Gabriel Cortes / CNBC

Source: Analysis by Edward F. McQuarrie, professor emeritus, Santa Clara University

Investment strategies and growing market uncertainty

Investors may be wondering if the market volatility of 2022 was an anomaly or perhaps a taste of more uncertainty to come. Will the traditional correlation between stocks and bonds hold or will it continue to be challenged by macro and market uncertainty? As the chart below shows, the trend is for stocks and bonds to move more in lockstep, reacting to economic forces in a similar fashion.

Global Stocks and Bonds are Moving in Lockstep
Market Moves Show Closest Relationship in a Decade



Source: **https://www.bloomberg.com/news/articles/2022-12-21/is-60-40-a-good-investing-strategy-stock-bond-split-still-makes-sense**

The role of alternative assets in a balanced portfolio

Investors may be entering a period where greater uncertainty is the new normal. The looming probability of recessions in developed economies, pressure on corporate earnings, depressed economic growth, rising geopolitical conflict, and all of it against the backdrop of climate change mean investors may need a different kind of balanced fund, one that is well diversified and less correlated with equities and bonds, to provide better risk-adjusted returns.

There is a growing probability of recessions in developed economies, accompanied by a compression of corporate earnings and diminished economic growth. All of this is against the backdrop of rising geopolitical conflicts and the effects of climate change on businesses and communities. It will become increasingly important for investors of all kinds, not only high-net-worth and institutional investors, to be more strategic in their asset allocations to achieve the solid risk-adjusted returns they may have enjoyed in the past.

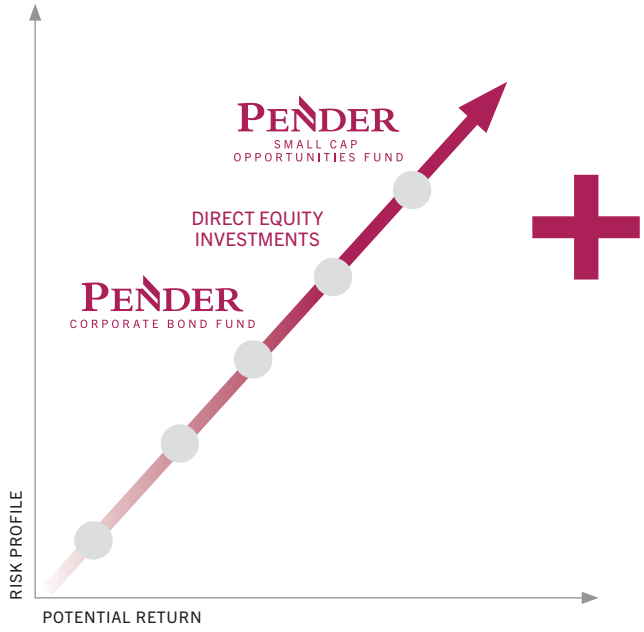
Including an allocation to alternative assets is one way to do this. But what are “alternative assets”? The broad definition is, they are financial assets which do not fit into the conventional investment categories of equities, bonds, and cash. A wide range of assets fall into the “alternative” bucket, including private equity, hedge funds, venture capital, commodities, and derivatives, among others.

Alternative assets usually have a low correlation to conventional investments like stocks and bonds. Including them in a portfolio can make it more resilient to inflation, potentially smooth volatility, and provide better risk-adjusted returns over the long term compared to a conventional balanced portfolio. Alternative strategies can be particularly beneficial in an inflationary environment.

The Pender Strategic Growth & Income Fund

The Pender Strategic Growth and Income Fund is a balanced fund with a difference. A key feature of the Fund is its allocation to alternative assets (up to 10%), in addition to a diversified selection of Canadian and foreign equities, corporate bonds, and government bonds.

Pender SG&I Fund Asset Allocation
+ Liquid Alts: Low Risk, Low Correlation to Traditional



PENDER
ALTERNATIVE ABSOLUTE RETURN FUND

- Ability to hedge against interest rate and spread risks
- Focused on income generation and protecting capital

PENDER
ALTERNATIVE ARBITRAGE FUND

- Attractive merger arbitrage spread environment
- SPAC anomaly also offering attractive risk-return

Why PAARF & PAAF were added:

- Low correlation, lower volatility strategies
- Dampen volatility for overall portfolio
- Provide downside protection

Alternative assets in the Pender Strategic Growth & Income Fund provide the following:

- Low correlation to traditional assets such as equities and bonds
- Offer the potential to dampen portfolio value volatility
- Provide downside protection
- Provide portfolio diversification

To learn more about the Pender Strategic Growth and Income Fund, click **here**.

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