PENDER
BOND UNIVERSE FUND

THE MANAGER'S COMMENTARY – JANUARY TO MARCH 2023

For the three months ended March 31, 2023, The Pender Bond Universe Fund generated a 1.9% return.[1] High grade credit started 2023 on a much stronger footing as inflation has shown signs of cooling and stresses in the banking sector have caused a flight to quality in the bond market.

A number of high-quality, defensive, relatively longer-dated lines bolstered performance for the three months ended March 31st. Our positions in longer-dated maturities of Loblaw Companies Ltd., Verisign Inc. and Bell Canada Enterprises Inc. all returned 3% or greater over the quarter as risk-free yields declined.

A Potentially Supportive Backdrop for Investment Grade Bonds

In the face of tightening financial conditions resulting from banking issues, the Fed implemented a 25-basis point rate hike in March - half of what they had previously implied, but a hike nonetheless. North of the border, the Bank of Canada ended a period of eight straight rate increases, leaving its policy rate unchanged in March. With a number of indicators supporting the likelihood of lower inflation and a slowing economy, it's not impossible to assume that the rate hikes to date will prove to be sufficient to ultimately temper inflation.

A number of other signs suggest that the hiking cycle is nearing its peak. Comparing global Purchasing Managers Index (PMI) to the net number of central banks whose last move was a rate cut, the latter is at the lowest it's been since 1997 and the former has fallen approximately 20% from a high in 2022. In addition to weakening manufacturing data, inflation expectations have dropped significantly from the highest levels since 1985[2] and commodities themselves including iron, aluminum, wheat, and natural gas are all down double digits from previous highs. With HOPE (Housing, Orders, Profits, Employment) providing an acronym for the order in which deteriorating data can predict the ending of a Fed tightening cycle, the early April Job Openings and Labor Turnover Survey results saw US employers post the fewest job openings in nearly two years in February, suggesting that the "E" in HOPE may be deteriorating to some degree. Should the rate hikes seen year-to-date ultimately prove to slow the economy more than originally intended, high grade bonds would be a likely beneficiary.

The Cycle of Credit Spreads vs Fund Exposure

Similar to the method employed in the Pender Corporate Bond Fund, we aim to adjust credit exposure in the Pender Bond Universe Fund in relation to the cycle of credit spreads – adding credit exposure when spreads widen and reducing it when they narrow. With a 4.75% increase in the Fed Funds rate in the US since March of last year, effective yields have skyrocketed, however spreads have not widened to compelling levels, given the risk that rate hikes of this magnitude may ultimately impose on the economy once fully digested.

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

[2] Topdown Charts, March 2023

For context, the current increase in the Fed Fund's rate is the fastest rate hike on record since the Fed began targeting this rate in the 1980s[3]. If we look back at previous noteworthy spread widening events following periods of Fed Fund rate increases, such as around the global financial crisis of 2008 and the spike in response to COVID – BBB spreads widened to between 4.8% and 8% depending on time period. In the US high yield space, during the previous two occasions when the Fed Funds rate rose to 4% or higher, US HY spreads blew out to approximately 10% or above[4].

The current period may prove to be somewhat different, perhaps resulting in a more muted spread response. However, with the Fed Funds rate well above 4%, US HY spreads at approximately 5% and the BBB spread below 1.8%, we are reducing some credit exposure at this time so that the Fund is less affected by credit spread widening should that materialize.

We routinely run sensitivity analyses for returns of various grades and duration of credit securities, a process we refer to as "sandbox" stress testing. Our recent findings from this process suggest that if North American central banks need to begin reducing rates in the face of recession, the argument for owning risk-free government bonds is increasingly compelling. As such, during the quarter we reduced the Fund's exposure to credit risk by bolstering our weight in investment grade securities and adding significantly to longer duration sovereign debt. Investment grade bonds now represent 83% of the portfolio. A major new position added during the quarter was a 4.8% weight in a 7-year Government of Canada bond. We believe this weighting change would allow the Fund to improve its relative and absolute return in a situation where yields come down and spreads widen to some degree.

Fund Positioning

The duration of the Fund was 3.61 years at March 31, 2023 and yield to maturity was 5.02%. At the end of the month, the Fund had a 19.5% weight in Pender Corporate Bond Fund units, resulting in a non-investment grade weight of 13%.

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[3] World Economic Forum, October 2022
[4] Topdown Charts, March 2023