PENDER

STRATEGIC GROWTH AND INCOME FUND

THE MANAGER'S COMMENTARY – FIRST QUARTER 2023

Dear Unitholders,

The Pender Strategic Growth & Income Fund returned 2.6% in the first quarter of 2023, ending the past year with a return of -3.4%. Over the last three years, concurrent with the COVID-19 market lows, performance has been strong at 17.3%[1].

The Fund performed well in the first quarter of 2023 against a backdrop of overall positive results in global financial markets despite some intra-quarter volatility. The Canadian and US stock markets had positive performance, with the S&P/TSX Composite advancing 4.6% and the S&P 500 gaining 7.3%. Concerns of a regional banking crisis in the US were short-lived, but still caused a reset in interest rates and piled investors back into mega-cap technology. The six largest companies in the S&P 500, which happen to be technology firms, contributed about three quarters of the total gains to the index in the quarter.

The Federal Reserve continued on its path to cooling inflation, raising interest rates twice in the quarter with the Fed Funds target rate ending the period at 5%. Despite rising benchmark interest rates, bond yields moved lower throughout the quarter, with the benchmark 10-year yield finishing at 3.48% after starting the year at 3.88%. This reset in interest rate expectations was driven by the upheaval in regional banks, combined with cooling inflation trends and a Fed signalling the aggressive interest rate hiking campaign is nearing at an end. Overall, against the backdrop of these macro events, we were pleased with the Fund's performance.

Silicon Valley Bank fallout and some notable bargains in "Financials"

One of the major areas of market concern during the quarter was the meltdown of Silicon Valley Bank (SVB), and the subsequent fallout to US regional banks and fears of a possible wider contagion to the financial system. Much has been written about this latest crisis, but we feel amongst the most insightful was Oaktree's Howard Marks' latest memo, "Lessons from Silicon Valley Bank". He asks if this is a one-off or a harbinger of things to come. In short, he feels SVB was something of a special case and does not see its collapse leading to widespread contagion. We do not own any U.S regional banks in the Fund, nor any other banks for that matter. We also do not hold companies that were dependent on continued financing from SVB. Direct fallout has been negligible.

Nevertheless, we own numerous companies that are categorized as "financials" despite getting most of their value from operations in other sectors. For example, the value creation machine (in our opinion) of Exor NV (BIT: EXOR) is driven by its major holdings in the consumer discretionary and industrial sectors. Likewise, Onex Corporation (TSX: ONEX) owns some financial services companies, but its intrinsic value is driven more by its core investments in the healthcare and technology sectors. Companies like Onex and Exor do not easily fit into a single "sector" classification, which is standard practice in the investment industry.

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

It's like logging into your Netflix account and seeing every movie is labelled "comedy". Just because the lead actor makes a joke in an action movie does not automatically turn it into a comedy. But if it was a stock, the folks at data analytics company MSCI, who maintain industry classification standards and determine individual sectors for each company, might label it as such. Banks are certainly "financials", but when it comes to Exor and Onex, in *Star Wars* parlance, "*These are not the financials you are looking for*." We view both companies as well-run collections of diverse, good-to-great businesses, which are currently trading at bargain valuations. We believe the risk/reward ratio for both stocks have seldom been more favourable.

Exor NV is a family-run holding company based in Italy. CEO John Elkann is a fifth-generation family heir to the Agnelli family fortune (Fiat), who is intelligently transforming his family's predecessor firms into a consistent wealth compounder. The company takes a long-term approach to its investments, focusing on building sustainable value rather than pursuing short-term gains. "*Il diavolo fa le pentole ma non*"[2]. Per share NAV has appreciated more than 10x since Elkann created Exor in early 2009, or about 18% on an annualized basis. Elkann is only 47 years old. We believe he has the ability and motivation to continue to compound his family's wealth alongside us as shareholders at a decent pace.

Today, Exor is comprised of a portfolio of assets that include a wide range of companies in sectors such as automotive, construction farming equipment, media and technology. Some notable investments include large stakes in Ferrari (NYSE: RACE), Stellantis NV (NYSE: STLA), maker of car brands Chrysler, Fiat, Peugeot and others and CNH Industrial (NYSE: CNHI), maker of Case construction equipment and New Holland farming equipment. Exor owned a large reinsurer (PartnerRe) for many years—which partly explains its historical industry classification as a "financial" —but sold it for a nice gain last year.

We estimate EXOR's NAV at the end of the first quarter was approximately €133 per share and the stock traded at 57% of the NAV. The recent market value of its holdings Ferrari and Stellantis alone exceeds the market value of the entire company. We believe this dislocation puts it deep into bargain territory, relative to its historical trading metrics.

We have been reminded over the last three years that stocks often trade at truly foolish prices, both high and low. When dislocations are unusually wide, exemplary management teams often recognize these opportunities and act. We believe that observing actions when it comes to share repurchases is one of the best methods to assess management rationality and shareholder alignment[3]. When your stock is overvalued, issue more of it. When it is cheap, buy it back. Last year, when Exor was *particularly* cheap, Exor spent a record amount buying back its stock (€254 million). Bravo!

Closer to home, Onex, one of Canada's alternative asset firms, was the Fund's fourth largest direct holding. Like Exor, despite being categorized as "financial services", most of the intrinsic value of the firm is not related to its holdings in financial services, but partial ownerships of numerous private and

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[2] This Italian saying roughly translates to "the devil makes the pots but not the lids", which is equivalent to "the proof is in the pudding". Something may look good on the surface, but its true value is only revealed when put to the test. Just like a pot without a lid may look good, but its functionality is only proven when it is used to cook something.

[3] "Repurchases are a sensible allocation of capital for a company when its shares sell at a meaningful discount to conservatively calculated intrinsic value. Indeed, disciplined repurchases are the surest way to use funds intelligently. It's hard to go wrong when you're buying dollar bills for 80c or less. But never forget: In repurchase decisions: price is all important. Value is destroyed when purchases are made above intrinsic value." Warren Buffett

public companies operating in the industrials, business services, and healthcare industries, plus a sizable net cash balance. Similar to most of the industry, the past year was challenging for Onex. However, management has seen numerous market storms over the decades and navigated much worse cycles in the past. Importantly, Onex management also leaned into its stock repurchase program in 2022 when its stock was cheap.

Onex has been a consistent repurchaser of its own stock over the years[4] because the discount to NAV has been fairly persistent. It's an exercise of rationality to buy dollar bills at huge discounts. However, management is typically even more aggressive when the discount is unusually high, like during the pandemic panic in 2020 *and* during last year's brutal market sell-off. Onex is trading at an unbelievably wide +50% discount to a conservative calculation of its NAV. The bargain is even more compelling if you exclude net cash and other liquid investments. At the recent lows, we estimate you could have effectively bought Onex's entire private equity portfolio at less than $0.30 on the dollar! We added to our position during the quarter.

Equities & Fixed Income

Within our equity holdings, key contributors to performance in the quarter included Burford Capital Ltd (NYSE: BUR), Baidu Inc (NasdaqGS: BIDU) and KKR & Co Inc (NYSE: KKR). Burford announced a long-awaited favourable ruling in the YPF case at the end of the quarter. This announcement removed a significant overhang on the stock and created a huge potential profit windfall for the company. There are still some hurdles to overcome, but we estimate the "headline" ruling could ultimately be worth $9 to $24 per share for Burford compared to its pre-YPF verdict closing price of $7.22 on March 30. We continue to own the shares and still view it as mispriced, considering this case win, the core portfolio of cases from its established and growing origination platform as well as a growing asset management business[5].

Our detractors in the quarter included energy companies ARC Resources Ltd (TSX: ARX) and Texas Pacific Land Corporation (NYSE: TPL), as well as defense contractor Northrup Grumman Corp (NYSE: NOC). These companies were among the top contributors to the portfolio in the fourth quarter but gave back some of their gains in the first quarter. The portfolio made some changes, adding Trisura Group Ltd (TSX: TSU) and selling Brookfield Asset Management Ltd (TSX: BAM) late in the quarter after a run to top up our Onex position.

Trisura is a specialty insurer in the US and Canada. It operates in niche markets, relying on specialized underwriting knowledge and structuring expertise. It has a strong history of profitability and growth, notwithstanding a write-down in the fourth quarter, which caused the stock to fall to attractive prices. Trisura is a previously owned, successful holding and we were pleased to reestablish a position after the

[4] Onex's outstanding share count is down 57% since peaking in 1997!

[5] Burford became the Fund's largest direct equity holding at quarter's end after the stock surged to $11.06 the day after the YPF verdict was announced. After accounting for the legal/management team's share of the YPF win, taxes and discount required for a negotiated settlement with Argentina, we believe there continues to be substantial upside to the stock from this verdict which is not fully reflected in the stock price. In addition, we believe there is underappreciated value for the ongoing core business which will likely be viewed more favourably by the market after it digests the YPF win and the current SEC review of the fair valuation methodology for legal financial assets is concluded.

stock sold off. We expect Trisura to leverage its fixed cost base and technology investment to demonstrate sustainable mid-teens ROE and 15%+ EPS growth.

Our small cap exposure through the Pender Small Cap Opportunities Fund (PSCOF) contributed positively to overall performance during the quarter. Small caps began the year on a positive note, bouncing back from weak capital flows and tax loss selling at the end of 2022. The strong start to the year faded, however, as stress in the US regional banking industry became evident and capital flows shifted into large companies. The banking stress and the collapse of Silicon Valley Bank highlighted again the need to focus on the balance sheet and funding sources of the companies we own, particularly smaller companies. We have been focused on owning high-quality companies in the portfolio that have long runways of growth to compound value and that are profitable or where we see a visible path to profitability. For more details on the PSCOF, see the March update here.

Our fixed income investments are mostly reflected by our position in the Pender Corporate Bond Fund (PCBF). This contributed positively to performance in the quarter, against the backdrop of a rally in corporate bonds and despite some volatility. Since 2020, PCBF has delivered an annualized return of over 8% per year, notwithstanding the fact that this period has included a dramatic rise in risk-free bond yields. PCBF ended the quarter with an average yield-to-maturity of approximately 7.9%, significantly higher than the start of last year, with a current yield of 5.6%[1] and an average duration of maturity-based instruments of 3.3 years. For more details on the PCBF, see the March portfolio update here.

Fund Positioning and Outlook

The portfolio ended the quarter with approximately 50.2% invested in direct equities, 6.7% allocated to PSCOF, 36.1% invested in PCBF and limited cash. The Fund also held about 6.8% across the Pender Alternative Absolute Return Fund and the Pender Alternative Arbitrage Fund. These strategies contributed positively to the quarter, while providing uncorrelated returns in this environment as we expected. Over the long term, these strategies should dampen overall portfolio volatility while delivering returns with a low correlation to the overall portfolio.

We have remained balanced in our positioning and are finding a wide range of attractive opportunities across each asset class. The impact of rising interest rates over the last year has put downward pressure on asset prices but to varying degrees. As inflation continues its retreat, economic growth will be closely watched and could lead to further volatility. Our approach will remain consistent and we will continue to target investments where we see value, and that can sustain a wide range of market scenarios.

Felix Narhi & Geoff Castle
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