PENDER FIXED INCOME

MANAGER'S COMMENTARY – APRIL 2023

The Pender Corporate Bond Fund returned 0.5%[1] in April, which was also a positive total return month for North American investment grade and high yield credit.

The Fund's strongest gainers included three bonds from issuers in the biotechnology sector: Paratek Pharmaceuticals, Inc., Emergent BioSolutions Inc. and Esperion Therapeutics, Inc. In each of these cases the bonds moved between 8% and 10% in our favour on no particular catalyst other than, perhaps, the recognition of their extremely low prices by other market participants. Our position in the Bausch Health term loan was also a significant gainer in April.

Most securities made a positive contribution in April, but some sharp decliners included positions in the junior securities of McDermott International, Inc., PHI Group, Inc. and American Tire Distributors, Inc. We like these positions, but in the present environment some investors have sought to liquidate positions in small, recently restructured capital structures.

Ready for What Comes Next

As we wade further into 2023, we find ourselves in a curious environment. Last week, speaking at the Norges Bank conference, storied hedge fund manager Stanley Druckenmiller gave a rather succinct accounting of this year's investing crosscurrents:

"[At] the top of my mind is just how uncertain for me trying to analyze the environment is going forward. I've been doing this for 45 years. I've studied a lot of economic history, but I've never had a situation where you had free money for 11 years, a very broad asset bubble, followed by jacking up rates 500 basis points in 12 months."

Druckenmiller's uncertainty resonates with us. There is no "textbook" for this cycle, because this cycle has few historic benchmarks. Some elements of the existing environment look like the 1970's, others like the 1930's, and some like the early 2000's. But none of those environments had central banks that were in the practice of "fire-hosing" financial crises with massive quantities of freshly created cash.

We understand the playbook for preparing for inflation, and we understand the playbook for preparing for a recession. But what of the playbook for doing both? And, to throw out a devilish idea, what if the hedging that others have done in preparing for difficult times has already created the prices necessary for us to just proceed as if the worrisome events have already taken place?

Given the uncertainty, we are drawn to a few operating principles that seem to fit the occasion. The first is <u>the imperative to stay liquid</u>. Keeping an ample supply of short-term, high-quality securities is not so much a get-rich scheme. It is rather an acknowledgement of our limited ability to forecast the future. Ideally, such abundant liquidity will help us capitalize on opportunities should they become clearer in the coming months. The liquidity also provides us with a strong ability to manage redemptions in the event that our path forward is bumpier than some of our partners can tolerate.

The second imperative is <u>to seek out those market situations where capital is scarce</u>. We believe we are far likelier to earn outsized returns on our credit investments when we are entering situations as one of a small number of investors prepared to underwrite a deeply discounted risk in the secondary market, as opposed to

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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.*

lining up ten rows deep to subscribe for popular new issues. Investing in these situations does expose us to volatility, and we do not succeed in 100% of such cases. But over the passage of time, it is a practice that has borne fruit for holders of this Fund.

And the final imperative in this market is to remain active. In particular, our activity is oriented around the regular assessment and re-assessment of risk vs reward of credit securities. Is the debt from an issuer protected by the fact that the issuing company, in liquidation, would be worth far more than its financial liabilities? Does the yield of a given bond provide a relatively attractive return given the issuer's probability of default? These are the simple questions we are asking ourselves every day, and answering these questions drives our activity.

April Activity

In April, we added some credit positions in DISH Network Corporation, in particular, within its DISH DBS Corporation guarantor structure. DISH Network Corporation is in the midst of building out an ambitious 5G wireless network. While there is relative unanimity over the direction that the wireless business is moving, DISH Network Corporation's investments in both wireless spectrum and new network infrastructure have left the company with a far higher debt load than can be reasonably managed from internally generated cash flow. The assets, in our opinion, are worth far more than the company's debt. The situation needs to be resolved in fairly short order. Either DISH must dispose of some assets to bring its debt load more in line with sustainable debt service levels, or a larger entity might acquire all or part of DISH Network Corporation's network business. We believe that DISH DBS Corporation secured bonds in the 70's or unsecured bonds in the 40's would benefit from a wide variety of potential balance sheet solutions.

Also in April, we added to our position in the busted convertible bonds of Bandwidth Inc. Bandwidth Inc. is a leading player in producing software that enables the interface between web-based applications and the telephony network. As business meetings and customer interactions continue to involve dialing into applications such as Zoom and Microsoft Teams, we expect Bandwidth Inc.'s business to continue on its growth trajectory. The company recently repurchased $160 million of its debt in open market transactions, highlighting the cheapness of those securities. We added to our position in the 0.5% convertible notes due in 2028, which currently yield approximately 10% to that date. Optionality exists in the potential acquisition of Bandwidth Inc., which could accelerate returns in this line.

Fund Positioning

The Pender Corporate Bond Fund yield to maturity at April 30 was 7.9% with current yield of 5.6% and average duration of maturity-based instruments of 3.3 years. There is a 3.0% weight in distressed securities held for workout value whose notional yield is not included in the foregoing calculation. Cash represented 1.7% of the total portfolio at April 30.

Geoff Castle
May 4, 2023

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PenderFund Capital Management Ltd.

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