Manager's Commentary

Emily Wheeler, CFA

For the three months to June 30, 2023, The Pender Bond Universe Fund declined 0.3%[1] on an absolute basis, however the Fund relatively outperformed its benchmark over the period by 0.4%.

With yields higher along the curve over the quarter, several shorter-dated, high-quality lines provided ballast. The Fund's exposure to credit through its Pender Corporate Bond Fund holdings also aided performance, as high yield spreads tightened modestly and select credits within the Fund performed well.

A Setup For Lower Yields

After reaching a 40-year high in June of last year, US inflation in May 2023 was down significantly from its peak. In the face of this, and in order to assess the impact of their work to date, the US Federal Reserve announced a pause in rate hikes, leaving open the door for further hikes if necessary. In Canada, CPI fell one full percentage point to 3.4% in May, its lowest level in two years, with it now approaching the upper bound of the Bank of Canada's 1%-3% target range.

Several signals are suggesting that the bulk of central bank tightening may be behind us. The net futures position on the 10-year US Treasury offers a window to how market participants are positioned and helps to inform how we in turn position the Fund. A large short position here suggests that institutional investors are battening down the hatches against inflation or hedging exposure in this area. In May, we saw the largest net short futures position in the 10-year US Treasury going back to the 1990s, three full standard deviations below its mean. The current extreme reading may provide a contrarian indicator of a pending reversal, which could ultimately mean a short covering rally, the size of which we have not seen before.

In addition to participant positioning, the fundamental backdrop itself appears to have weakened from a demand perspective. We recently came across data on a global PMI backlogs indicator where a decline suggests weakening demand and with it, inflation. Over the last decade this data point has moved somewhat in line with bond yields for obvious reasons. Given a decline of ~30% from a high in 2021, current backlog data could provide another indication that the majority of tightening is behind us.[2]

In addition to the above and perhaps most importantly, PCE inflation, which is the Fed's preferred measure, has declined. Following large inflation spikes in the past, a collapse in core inflation has led to a move lower in yields. This move preceded recessions in 1973,

[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.

[2] Topdown Charts, June 2023

1976, 1980, 1990, 2002 and 2008. From a high in 2021, PCE inflation has fallen approximately 50% without a significant move down in yields. Perhaps this period is different – it's possible that we will see inflation pick back up from here as opposed to continuing its trajectory lower. However, when the original cause of the increase in yields abates, it is increasingly likely that we are poised for rates to follow suit.[3]

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Average Dollar Price Within the Portfolio & Investment Options

As we have done in the past, we thought it would be interesting to look at the average dollar price of bonds within the Fund currently versus sunnier days. At end-June, the average price within the portfolio was approximately 97 cents on the dollar versus the end of 2021, when it was approximately 7% higher at ~$104, a non-trivial difference in the investment grade space. When considering investment alternatives in this climate, GIC rates may look quite attractive. However, given where we sit versus history, a portfolio of 80% investment grade bonds has the potential to not only offer competitive yield versus previous periods, but also capital appreciation, which does not factor into a GIC investment.

Three-Year Relative Risk to Reward

At the end of January, the Fund reported a three-year number for the first time. At end-June, the class F units of the Fund were up 0.7%[4] on a three-year basis, versus the benchmark's -3.7% return. Having maintained a relatively short duration bias since inception, the Fund has also outperformed its benchmark from the perspective of risk as measured by standard deviation. Three-year standard deviation of the Fund at June 30th was 3.58 versus the benchmark's 6.31. When taken together, relative risk to reward leaned in favor of the Fund versus its benchmark over the last three years.

Fund Positioning

With high yields spreads remaining at approximately 4% at quarter-end and with the indicators we are seeing in the market skewed to the likelihood of recession, the upside/downside risk here led us to decrease the Fund's exposure to credit several months ago, and our weight in this area remains around the lowest it has been since the Fund's inception. The Pender Bond Universe Fund had an 18.8% weight in Pender Corporate Bond Fund units at the end of June, resulting in a non-investment grade weight of 14%.

The duration of the Fund was 3.3 years at June 30th and yield to maturity was 5.38%.

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[3] Topdown Charts, June 2023
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