Manager's Commentary

Felix Narhi, CFA & Geoff Castle

Dear Unitholders,

The Pender Strategic Growth and Income Fund[1] returned 2.7% in the second quarter of 2023, bringing year-to-date returns to 5.0% to the end of June[2]. The mood towards equities was constructive in the quarter, with the Canadian and US stock markets posting positive results.

The portfolio ended the quarter with approximately 51.3% invested in direct equities, which are mostly mid and large cap, 6.8% allocated to Pender Small Cap Opportunities Fund, 35.5% invested in the Pender Corporate Bond Fund and limited cash. The Fund also held about 6.8% across the Pender Alternative Absolute Return Fund and the Pender Alternative Arbitrage Plus Fund. These Pender strategies have delivered top-quartile performance since their inception. We believe these mandates should provide ample diversification to dampen overall portfolio volatility, while continuing to deliver solid returns with a low correlation to the overall portfolio.

The S&P/TSX Composite advanced 1.1% and the S&P 500 gained 6.6%. Small caps rallied late and gained 3.1% in the quarter, as measured by the Russell 2000 Index (CAD). Bonds markets were mixed as inflation, interest rates and slowing economic growth remained in focus and were closely watched by investors. The yield curve backed up as expectations of interest rate cuts were pushed out in the face of a slowing but so far resilient economic backdrop.

Inflation continued its downward trajectory, with the US inflation rate moving from 5.0% to 3.0% over the quarter after peaking at 9.1% in June 2022. The closely watched core inflation rate declined from 5.6% to 4.8% and has remained sticky. The declining inflation rates caused the Federal Reserve to pause its interest rate hiking campaign at its last meeting in June to assess the impact of higher rates on the broader economy. The labour market was a source of continued strength, with the US unemployment rate hovering around 3.7% - very low levels and within range of the 3.4% low back in the early 1970s.

Almost all FOMC participants voted to keep interest rates unchanged in June, but still some preferred raising 25bps. With inflation still above its stated 2% goal and a resilient labour

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[1] *Effective June 23, 2023, the Pender Strategic Growth and Income Fund merged with the Pender Enhanced Income Fund. On completion of the merger, all of the assets and investments of the Pender Strategic Growth and Income Fund were transferred to the Pender Enhanced Income Fund and unitholders of the Pender Strategic Growth and Income Fund became unitholders of the Pender Enhanced Income Fund. After the Merger, the name of the Pender Enhanced Income Fund was changed to "Pender Strategic Growth and Income Fund".*

[2] *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.*

market, almost all members saw the need to raise rates again this year. At the ECB Forum on Central Banking at the end of June, Fed Chair Jerome Powell spoke of the need for more restrictive interest rate policy and the need to raise rates again this year. While we believe we are near the end of this rate tightening cycle, we likely have not yet seen the peak.

"We are finding opportunities across each asset class and remain diversified in our overall positioning."

Equities & Fixed Income

Within our equity holdings, we had strong positive contributions from Onex Corp. (TSX: ONEX), ARC Resources Ltd. (TSX: ARX) and Burford Capital Ltd. (NYSE: BUR).

Onex shares rallied and began to close their discount to Net Asset Value which had been trading at one of the widest discounts we have seen. On a fundamental level, Onex's per-share NAV has compounded at a faster pace than the S&P 500's EPS or book value per share over the short (three years) and long term (10 years). No doubt investors are worried that the firm has faced a challenging capital raising environment and has had to pause its fundraising efforts on its latest fund, but we feel this near-term headwind is more than reflected by the steep discount to our estimated range of intrinsic value. Our view that there is pent-up value in the shares received - an indication of support as insider buying was strong in the quarter when it was disclosed that Vice Chair Anthony Munk purchased $11.6 million of stock on the open market in May. Onex remains a high conviction holding and was a top-five weight in the portfolio at the end of June.

ARC Resources also performed well in the quarter with its shares rising over 15%. The company hosted an investor day in June, which reinforced our investment thesis that the company can continue to grow revenues and cash flows organically, that it boasts a strong balance sheet and that it is an efficient operator of high-quality assets in the Montney region. Longer term, the company is well positioned to capitalize on growth opportunities arising from potential LNG supply agreements as the export infrastructure in North America continues to be further developed. ARC was a top-10 holding at the end of June.

Burford Capital also contributed to the Fund's performance following a significant catalyst at the end of the first quarter that carried its momentum into the second quarter as investors digested the news. The company announced a long-awaited favourable judgement in a significant case that will likely lead to a huge profit windfall for the company. We estimate that it could ultimately be worth $10-20/share compared to its closing price of $7.22 on March 29, the day prior to the announcement. With shares priced at $12.18 at the end of June, we continue to view the company as discounted considering this case win. Burford was a top-10 holding in the portfolio at the end of June.

Our detractors in the quarter included Texas Pacific Land Corporation (NYSE: TPL), Brookfield Corporation (TSX: BN), as well as Fiera Capital Corp (TSX: FSZ). While Texas Pacific Land and Brookfield detracted from portfolio performance in the quarter, they have both contributed positively to results over the last year. Fiera Capital detracted and has continued to face redemption pressures from its investors. In its most recent quarter, the company announced net outflows of $1.5 billion, which contributed to a revenue decline of 9% over the last year. Despite the headwinds, the company generates ample cash flow and is priced for the current negative trends to continue. We see the shares as discounted and continue to own the company at a relatively small weight in the portfolio.

Our small-cap equity exposure through the Pender Small Cap Opportunities Fund (PSCOF) was a slight detractor from performance during the quarter. Small caps have lagged their large-cap counterparts this year in a market that has been driven by only a handful of mega-cap technology companies. The top seven contributors to the S&P 500 delivered approximately 75% of the total returns with the share price appreciation pushing valuations in these companies to elevated levels. We have remained patient and have focused our smaller company investments on high-quality businesses that have the balance sheet strength to withstand a tougher economic climate, and in the case of companies that are not yet profitable, have a path to profitability without the need to raise additional equity. For more details on the PSCOF, see the June update here.

Our fixed income investments are mostly reflected by our position in the Pender Corporate Bond Fund (PCBF). The Fund contributed positively to performance in the quarter, as spread tightening in corporate bonds offset higher treasury yields in the quarter. The PCBF ended the quarter with an average yield-to-maturity of approximately 8.1%, significantly higher than the start of last year, with a current yield of 5.4% and an average duration of maturity-based instruments of 3.2 years. For more details on the PCBF, see the June portfolio update here.

Fund Outlook

We are finding opportunities across each asset class and remain diversified in our overall positioning. We will continue to closely watch the ongoing debate about the lag effect of interest rate increases and the "boots on the ground" impact on the economy and the companies we cover closely, and we will be opportunistic to compelling investments that could arise from volatility in the coming months.

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July 20, 2023