PENDER
VALUE FUND

June 2023

Manager's Commentary

David Barr, CFA

The Pender Value Fund returned -1.2% in the second quarter of 2023, bringing year-to-date performance to 3.1%[1]. The gains for the Fund were concentrated in June as the Fund returned 5.5% in the month and small caps more broadly caught more investor attention. June was the first month of outperformance for small caps relative to large caps since February, with the S&P 600 gaining 8.2% in June compared to the S&P 500 up 6.6% in local currency terms. These results compare to the S&P/TSX Index posting a 1.1% gain and the Russell 2000 Index returning 3.1% in the quarter.

The key performance drivers for equity markets this quarter – and a continuation of a trend throughout the year – is the leadership in mega-cap technology companies. Year-to-date, seven companies in the S&P 500 have contributed roughly 75% of the gains. This group includes Apple Inc. (Nasdaq: AAPL), Microsoft Corp. (Nasdaq: MSFT), Nvidia Corp. (Nasdaq: NVDA), Alphabet Inc. (Nasdaq: GOOGL), Amazon Inc. (Nasdaq: AMZN), Meta Platforms Inc. (Nasdaq: META) and Tesla Inc. (Nasdaq: TSLA). These companies have propelled the Nasdaq to a remarkable 32.3% gain through the first half of 2023 in local currency terms. Compared to the small cap benchmark, the Russell 2000 Index is up 8.1% (in USD terms) through to the mid-point of 2023. Though the equity gains have been narrow and have yet to filter down to smaller companies.

This narrow equity market leadership has been driven predominately by multiple expansion. At the beginning of 2023, this group of seven companies traded at an average forward earnings multiple of 28.7x. Fast forward to today, and these same companies trade at an average forward earnings multiple of 43.0x – nearly a 50% increase over the six-month period!

The performance differences between small and large companies have continued to push the disconnect in valuation to historically wide levels. The S&P 600 finished the quarter trading at 15.2x forward earnings, compared to the S&P 500 at 20.1x – a nearly 5x discount. It is rare to see such a valuation spread, and we haven't seen a gap this wide since the early 2000s when the S&P peaked at the height of the tech bubble.

There is hope on the horizon. In the aftermath of the dot-com bust, small caps went on a multi-year run of outperformance. In the six years from 2000 to 2005, small caps outperformed in each year at an average rate of nearly 12% per year.

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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.*

Outperformance in Small Caps following Tech-bubble[2]

	2000	2001	2002	2003	2004	2005
S&P 500	-9.1%	-11.9%	-22.1%	28.7%	10.9%	4.9%
S&P 600	11.8%	6.5%	-14.6%	38.8%	22.6%	7.7%
Small Cap Outperformance	**20.9%**	**18.4%**	**7.5%**	**10.1%**	**11.7%**	**2.8%**

After a decade of outperformance in large caps (led by tech), time will tell whether the recent month of outperformance in small caps is the start of a new trend. What we do know is that trends come and go and market leadership evolves. Think about today's darling Microsoft. The company is firing on all cylinders with SaaS, the Cloud and now the prospects of artificial intelligence (AI) powering impressive fundamentals. But with Microsoft trading at 32.3x today compared to 11.4x a decade ago, the multiple re-rating to reflect these fundamentals is likely behind us.

While momentum can carry trends to extremes, at some point it breaks, and new leadership takes hold. What has happened in the past doesn't reflect the future and the next 10 years will surely look different that the last 10.

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Portfolio Updates

A positive note from the quarter was seeing some of our largest weights in the portfolio among the largest contributors. Sylogist Inc (TSX: SYZ) is the largest holding in the Fund and was a top contributor in the quarter. We have been active with the company over the last few months and have successfully negotiated a nomination agreement that allows us to appoint a director to their board. We are pleased with this result and believe the company is well positioned and reaching an inflection point in its growth. Sylogist's last quarterly results are a positive indication, with organic growth accelerating to 17% (adjusted for currency).

Burford Capital Inc (NYSE: BUR) was another positive contributor during the quarter after it announced a long-awaited favourable ruling that will likely result in windfall proceeds to the company. This was a major catalyst for the stock that helps validate its business model as a leading expert in litigation finance. The company was a top five holding in the Pender Value Fund at the end of June.

Copperleaf Technologies (TSX: CPLF), another contributor during the quarter, is exposed to the theme of AI. The company provides AI-powered decision analytics software to its utility customers. Its analytics are based on the vast quantities of domain-specific proprietary data that the company has collected from its global utility customers and partners. Copperleaf

[2] *Source: YCharts.*

focuses on integrating AI on top of existing proprietary data, which we believe offers it a unique advantage and is a top 5 holding.

There were also a number of portfolio changes. During the quarter, we sold our positions in Block Inc. (NYSE: SQ), Magnet Forensics Inc (TSX: MAGT) and Howard Hughes Corp. (NYSE: HHC), while trimming our positions in Exor NV (AMS: EXO) and KKR & Co Inc (NYSE: KKR). We deployed that capital into existing holdings where we have high conviction, as well as using it to increase cash levels to 7.9% at the end of June.

We continue to focus the opportunity set of the portfolio on small and mid-sized companies where we see a disconnect with the underlying fundamentals of the business. Our weight in Canadian equities stood at 48.1% at the end of the quarter, up from 36.3% in June 2022. As our Canadian exposure has grown, we have reduced our weights to international companies from 16.1% at the end of June 2022 to 8.9% at the end of the quarter. We have been transitioning into these companies as our international holdings approach fair value or when we see compelling opportunities to capitalize on companies we know well.

David Barr, CFA
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