Manager's Commentary

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Highlights

- October was a tough month for markets as recessionary fears and higher bond yields pressured markets.
- In October, the Fund initiated positions in 23 new or previously announced mergers, while 20 merger deals held within the Fund closed during the month.
- We are cautiously optimistic on M&A potential through the year-end with commentary from investment bank earnings indicating there is pent up demand.

Dear Unitholders,

The Pender Alternative Arbitrage Fund was down 1.2%[1] in October 2023.

M&A Market Update

Global M&A activity totaled $2.4 trillion through the first ten months of 2023, a 20% decline from the same period last year[2]. M&A activity surged in October reaching a 17-month high with $319 billion of M&A transactions announced globally during the month. This was led by two mega energy deals with ExxonMobil Corporation (NYSE: XOM) announcing a $60 billion acquisition for Pioneer Natural Resources Company (NYSE: PXD) followed shortly by Chevron Corporation (NYSE: CVX) announcing a $53 billion acquisition for Hess Corporation (NYSE: HES). With October seeing the third consecutive monthly increase in M&A transactions, in a year where global M&A is down to a multi-year low, we may be at an inflection point where M&A activity is set to increase.

Despite the mega merger deals announced in October, large-cap deal activity as represented by deals in excess of $5 billion, remain depressed with 62 deals announced during the first 10 months of the year, the lowest level since 2013[3]. This is reflective of the hostile regulatory environment with more aggressive regulatory policies and enforcement in the US which has increased the risk associated with larger merger deals. Higher interest rates and tougher credit conditions have also impacted the ability to finance larger deals with private equity backed M&A down 39% from this time last year. The challenges for interest rate sensitive LBO's contrasts with the favorable and opportunistic conditions inherent for commodities and hard assets with the energy and power sector leading M&A activity globally this year through October.

SPAC Market Update

There were six SPACs that liquidated in October, returning $1.7 billion to unitholders.[4] With two SPAC IPOs, the total amount of capital held in trust by all SPACs declined to $22.6

[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] Source: Refinitiv - Deals Intelligence
[3] https://uk.finance.yahoo.com/news/oil-mega-deals-lift-october-141350554.html
[4] https://www.spacresearch.com/

billion. While there are a significant number of mature active SPACs in the market seeking targets, the market, (and recent history) suggests few will be able to find a target to merger with and their unitholders are intent to see the capital held in those SPACs returned through liquidations or redemptions. This continued bear market for mature SPACs contrasts with the IPO market for new SPACs where there is strong support and ample demand to invest with sponsors who are looking launch a new SPAC. When the SPAC bubble popped in late 2021 and through 2022, the structure of new issuance SPACs were sweetened with shorter durations, sponsors using their own capital to overfund trust accounts improving arbitrage returns and other enhancements being offered to incentivize investors. The recent demand for SPAC IPO's has seen some of those sweeteners removed but this has been offset by the higher interest rates now generated for investors on the capital held in trust by a SPAC. Given the lower yields for mature SPAC liquidations and redemptions, the SPAC exposure in the fund has declined to the low single-digits. As the SPAC sector becomes more balanced and demand for SPAC capital has the potential to increase in the coming quarters, new SPAC IPO's have the potential to be a compelling arbitrage investment which we will monitor closely.

At the end of October, there were 321 active SPACs in the market with assets of $22.6 billion, with 158 SPACs actively searching for targets. At the end of October 2023, SPACs searching for targets were trading at a discount to trust value, which provided a yield-to-maturity of 4.95%.[5] With SPAC arbitrage effectively equivalent to acquiring a Treasury Bill at a discount, SPACs currently provide an almost-similar yield to US Corporate Investment Grade Bonds with lower credit risk, shorter duration and a tax advantage, as SPAC returns are primarily capital gains.

Portfolio Update

October was a challenging month for the Fund with a broad sell-off in equity markets widening spreads across many holdings and two deal-breaks impacting performance. With October seeing the highest level of M&A activity in years, the Fund was quite active initiating positions in 23 new or previously announced mergers while 20 merger deals held within the Fund closed during the month. 2023 continues to be one of the most challenging years for merger arbitrage in the past two decades as a hostile regulatory environment, rapidly rising interest rates and tougher credit conditions impact the level and risk associated with active merger deals. Merger arbitrage spreads remain wide and the market continues to adjust to new regulatory developments with that risk typically being priced into new merger deals. We have seen fits and starts of M&A activity for small-cap companies with the potential sustained momentum of activity in that part of the market a tailwind for the fund. At the end of October 2023, the Fund had 46 investments in small-cap deals under $2 billion, 40 of which were valued at under $1 billion.

The termination of the acquisition of Velan Inc. (TSX: VLN) by Flowserve Corporation (NYSE: FLS) was a key detractor for the Fund during the month. We had previously discussed this higher risk merger deal in the August commentary as the company which generated 25% of

[5] https://www.spacinsider.com/

their revenue from France required French regulatory approval to complete the deal. The acquisition of the industrial valve and trap manufacturer got embroiled in a political issue as French politicians didn't want Velan which supplies parts to the French military falling into US hands. We cut our exposure in the deal but maintained a position as it appeared the acquirer was open to concessions to find a solution to appease the French government including, carve-outs, governance oversight and minority ownership. Our view was partly driven by our assessment that if French wanted the most security sensitive business in domestic hands, a carveout was the most logical outcome rather than keeping the company under foreign (Canadian) ownership, but none of the remedies ultimately were successful and the deal was blocked by the French government.

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The acquisition of Great Ajax Corp. (NYSE: AJX) by Ellington Financial Inc. (NYSE: EFC) was also mutually terminated during the month as both companies jointly announced their boards had mutually determined to terminate the merger. Both companies operate as mortgage based real estate investment trusts (mREIT's) sensitive to interest rates and it appears that given the volatility in rates and their respective businesses, the deal may not have been as favorable for either party then when first announced. Deal-break is the key risk for a merger arbitrage strategy and our risk process is focused on avoiding and minimizing the impact of deal-breaks. In some cases the key risk to a merger is known and can be assessed and assigned a specific probability and in other cases the risk may be unknown and unpredictable. We employ a rigorous assessment and review to determine the probability of deal risk which is constantly being refined as new information is presented and we will continue to strive to minimize the impact from deal-breaks as we've done from the over 370 deals invested in the Fund since inception.

We previously discussed the drama filled merger of Sculptor Capital Management, Inc. (NYSE: SCU) with the US hedge fund which had an acquisition offer from Rithm Capital Corp. (NYSE: RITM) facing pushback from its founder Daniel Och and receiving a competing offer from a group of hedge fund mangers including Bill Ackman. There's been plenty of mud slinging back and forth between the various parties over the past few months with the board rejecting the higher risk competing offer and a plethora of lawsuits, personal attacks and sharply worded letters. Ultimately the offer from Rithm was increased by nearly 14% from $11.15 to $12.70 gaining the approval of key insiders including Daniel Och and is now expected to close in November. Bidding wars and higher offers on companies with an existing definitive merger agreement in place, a term we like to call "bumpitrage," can be a large source of returns for arbitrage investors. This is more typical in smaller deals where multiple bidders can emerge, synergies are higher or more realizable as in the case of a tuck-in acquisition and there is a greater likelihood of mispricing.

There's been a recent uptick in M&A activity for small-cap companies based in Quebec with H2O Innovation Inc. (TSX: HEO) and Opsens Inc. (TSX: OPS) and LOGISTEC Corporation

(TSX: LGT.B) all announcing acquisitions offers during the month spanning a variety of industries from water treatment, semiconductors, and marine terminals. All indicative of the steep disconnect between the market value and intrinsic value of these businesses. Conditions are favorable for M&A activity within small-caps as frustrated shareholders are more receptive to offers at a premium to the current market price. Insiders with asymmetric information advantages are seeking to capitalize on this environment and we are seeing increased activism directed at boards to unlock value. With a large pool of buyers for smaller companies, less regulatory risk and easier access to financing for a small deals, the spike of M&A activity in La belle province could spread across the country and continent.

Outlook

October was a tough month for markets with the S&P 500, NASDAQ and TSX down 2.20%, 2.8% and 3.4% respectively during the month as recessionary fears and higher bond yields pressured markets. After a dismal month with a treasury surge and rout in markets there are some signs of optimism as inflation continues to show signs of moderation despite stubbornly resilient labour markets. Elevated interest rates and tight financial conditions are having the intended impact of slowing consumer spending and key economic indicators, like freight volumes, are showing signs of declining demand. While central banks suggest the possibility of a soft landing, whether they are right or a hard landing is ahead, at the very least, there is improving visibility on the path of interest rates and growing consensus that they may have finally peaked. We are cautiously optimistic on M&A potential through the year-end with commentary from investment bank earnings indicating that while capital markets activity has been bleak this year, there is pent up demand and as inflation expectations subside and interest rates stabilize and start moving lower, activity is set to rise.

As evidenced by the recent rise of M&A activity for small cap Canadian businesses based in Quebec, conditions remain ripe for small-cap M&A. It's been a bleak year for small caps with the valuation gap relative to large caps reaching historically wide levels and the October rout in equities seeing the Russel 2000 sell-off by more than 6.2% during the month. A month like October with rising interest rates, increased uncertainty and a sell-off in equity markets makes it more difficult for deals that are in a discussion stage to materialize. Historically small caps tend to outperform large caps following broader market downturns so as inflation subsides and interest rates drop, there's increasing potential for small-cap outperformance which could be the catalyst for deal activity. With attractive valuations for high quality small cap businesses, motivated sellers, incentivized buyers, and easing financing conditions, it appears more a matter of when and not if many small cap companies will be acquired.

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