Manager's Commentary

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Dear Unitholders,

The Pender Alternative Arbitrage Fund was up 1.0%[1] in November 2023.

M&A Market Update

Global M&A activity totaled $2.56 trillion through the first eleven months of 2023, a 21% decline from the same period last year[2]. November saw $217 billion of M&A transactions announced globally, one-third less than the value recorded in October which was the highest monthly M&A value since May 2022. While global M&A activity by value has declined from 2022 and the record 2021 levels, 2023 has seen a historically high level of deal volume with the third highest level on record. The Energy and Power sector continues to lead activity with $460 billion of deals announced this year accounting for 18% of total deal activity followed by the Technology, Healthcare and Industrials sectors. Private equity (PE) backed deals are down by a third relative to last year, accounting for 20% of global M&A compared to 24% at this time last year.

Comments from various bankers and dealmakers have indicated that there is a 'huge backlog' of M&A activity with deal pipelines at many firms at their highest levels ever[3]. Many buyers and sellers of businesses have been waiting on the sidelines for improved visibility and a better environment in which to make deals. While rate cuts will certainly be a driver to stimulate M&A activity, stability in rates could be enough to get deals over the line, given the backlog of activity which has been put on hold in what has been a tightening cycle with the fastest increase in interest rates making it challenging for M&A. As deal making conditions improve, we are seeing catalysts form within our small-cap universe with considerable pent-up M&A potential. Greater visibility on the path of rate hikes, improving market sentiment, trillions in 'dry powder' at PE firms and corporations, wide dispersion in equity valuations, motivated target shareholders and trends like electrification, AI, reshoring as well as hostile geopolitics provide the right incentives and a strong environment to do deals.

SPAC Market Update

Nine SPACs liquidated in November, returning $3.1 billion to unitholders[4]. With four SPAC IPOs raising $600 million of capital. The total amount of capital held in trust by all SPACs fell to $20 billion, continuing its persistent decline as most SPACs fail to secure a target to merger with, and end up liquidating or having their capital held in trust redeemed. Over the past two years, we have consistently discussed the poor performance of De-SPACs (SPACs that have successfully completed a merger with a private company) with most of them

[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://www.bloomberg.com/news/articles/2023-12-06/moelis-sees-huge-backlog-of-deals-after-fed-s-rate hike-regime
[4] https://www.spacresearch.com/

materially underperforming the market and many of them entering bankruptcy in a short period after the merger completion. Indicative of survivorship bias, but also evidence that not all SPAC mergers are poor investments, there has been a recent increase in De-SPACs receiving acquisitions offers and going private again, notably at a premium to their SPAC IPO price. Some recent examples of this include the acquisitions of POINT Biopharma Global Inc. (NASDAQ: PNT), Hammerhead Energy Inc. (TSX: HHRS), Rover Group Inc. (NASDAQ: ROVR) and Cerevel Therapeutics Holdings Inc. (NASDAQ: CERE) which were all De-SPACs with acquisition offers outstanding at a premium to their initial SPAC IPO price. The capital held within the SPAC industry is down more than 80% from the start of the year and a further 80% of its current value is expected to mature in the next year. As the SPAC sector becomes more balanced and with demand for SPAC capital likely to increase, we see the potential for the improved quality of both SPAC sponsors and targets, making SPAC arbitrage a more compelling opportunity.

At the end of November, there were 304 active SPACs in the market with assets of $20 billion, with 157 SPACs actively searching for targets. At the end of November 2023, SPACs searching for targets were trading at a discount to trust value, which provided a yield-to-maturity of 6.68%.[5] With SPAC arbitrage effectively equivalent to acquiring a Treasury Bill at a discount, SPACs currently provide a higher 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

November was a strong month for the Fund driven by the closing of several deals including many of the largest positions in the Fund. Key holdings, including Avantax Inc. (NASDAQ: AVTA), Avid Technology Inc. (NASDAQ: AVID), Polymet Mining Corp. (TSX: POM), Hersha Hospitality Trust (NYSE: HT) and Sculptor Capital Management Inc. (NYSE: SCU), were among the 19 merger deals held by the Fund that closed during the month. As we harvest returns from closed deals, we are actively redeploying that capital into new merger deals with a focus on high-quality small-cap merger deals trading at wide spreads and positioned to deliver attractive returns, and the Fund initiated positions in 11 new deals during November.

While our primary focus is on merger arbitrage, the year-end has also coincided with an uptick in SPAC redemptions and liquidations at attractive implied yields. While our SPAC arbitrage exposure has typically been in the low single-digits over the last few quarters, we have been adding to several new SPAC positions, temporarily increasing our exposure to the high single-digits.

Unlike bond markets, which have been pricing in lower yields on expectations of rate cuts in 2024, merger arbitrage spreads remain wide providing an attractive relative and absolute opportunity. Relevant to our Fund, the spread gap between small-cap merger deals and larger or mega-cap mergers has narrowed as several large- and mega-cap merger deals closed in past few months. This development represents a favourable environment for our

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

small- and mid-cap focused strategy and allows us to benefit from a wider spread environment while avoiding the higher deal and duration risk of larger merger deals. At the end of November 2023, the Fund had 37 investments in small-cap deals under $2 billion, 31 of which were valued at under $1 billion.

Outlook

The Santa Claus rally came early this year with a material shift in market sentiment driving a large move in markets. After three consecutive monthly declines, equity markets saw a strong rebound in November with the S&P 500 up 9.1%, the NASDAQ up 10.7% and the TSX up 7.1%. Its largest monthly gain in three years. As the BoC and Fed signaled that rate hikes had likely peaked for this cycle and inflation data suggesting rates could move down further than expected in 2024, investors have found new confidence which is driving the market rally. This is in stark contrast to 2022 where the year-end saw an already bruised-up market driven even lower through tax loss selling. As investor sentiment shifts from fear to greed, and rate cuts get priced into markets, the path forward for markets and interest rates is difficult to predict with elevated expectations priced in. The November rally saw prices move higher for both equities and fixed income which also corresponds to a greater correlation between those two key asset classes. With the potential for stock and bond correlation to increase, as was the case in 2022 where both asset classes experienced steep declines in value, a non-correlated event-driven alternative strategy like merger arbitrage can be a good diversifier within a portfolio.

The broad-based positive inflection in small-cap equity prices seen in November could be the catalyst to spark a wave of small-cap M&A, given the months of underperformance and the valuation gap relative to large-cap companies reaching historic peaks in October. We have discussed the compelling environment for M&A with ample capital on the side along with motivated and incentivized boards, management and shareholders at target companies who are highly receptive to a deal. Market uncertainty, tighter lending conditions, higher interest rates and a large gap between the bid and the ask have been some key considerations which have held down M&A activity throughout this year. As market conditions improve, interest rate expectations trend lower and equity market valuations increase, buyers are likely to pay up, not wanting to miss out on a compelling acquisition opportunity while still getting a great deal as many small-cap companies trade at deep discounts to intrinsic value. Feedback from companies, bankers and dealmakers who we follow and speak with suggest considerable pent-up M&A potential and we will be positioning the Fund to take advantage of an increase in small and mid-cap merger deals.

We would like to thank our clients and investors for their support and look forward to serving you in 2024. Happy Holidays to you and your families and all the best in the New Year!

Amar Pandya, CFA
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