Manager's Commentary

Geoff Castle

The Pender Corporate Bond Fund returned 2.0%[1] in November, a month that saw positive returns throughout the fixed income markets. Investment grade securities staged a huge turnaround and our own predominantly investment grade mandate, the Pender Bond Universe Fund, delivered its highest ever monthly return, gaining 2.9%.

There were some eye-popping returns amongst higher grade, long-duration securities. For example, our position in Warnermedia Holdings Inc.'s 2062 notes gained over 13% in November. Preferred shares were very strong as well, with a number of issues gaining over 10%. Below investment-grade credit was a bit more of a mixed bag, but our position in Unisys Corporation 2027 notes did gain 14% on strong third quarter results.

However, a number of credit positions remained under pressure in November as end-of-year tax loss selling and a general risk aversion hit some wide-spread lines. As an example, our position in Esperion Therapeutics Inc 4% notes of 2025 declined by 10% in the month to price at 48% of par value. We believe the value offered in the Esperion notes is extraordinary. In our view, this quickly growing and catalyst-rich pharmaceutical company should be fairly valued far in excess of its total debt.

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Yes, Virginia, the Bond Market is Investible

November saw a major turn in bond market direction. Investors who have spent the past three years watching yields march higher and bonds price drift lower are understandably cautious to chase the newly positive tape. Unlike some of the past head-fakes, however, this change in trend seems well supported by both fundamental and technical factors. So, with apologies to Francis Church[2]...Yes, Virginia, the bond market is investible again.

The difference this time, we believe, is really in the quality of the investing set-up. As we have established in prior notes, a great rally set-up includes four key elements: **an extreme price**, **a positive fundamental change**, **an extreme in sentiment**, and **lopsided positioning** by market participants. Toss in a catalyst and you are off to the races. For the bond market looking into 2024, all of these appear to be in place. Count us amongst the rally's believers.

An Extreme Price: The most important element of an investing set-up is an extremely low price. One can argue whether current bond market prices are extreme from a long-historic sense, but within the context of the past fifteen years, the recent lows represent rock

[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] *In 1897, eight year old Viriginia O'Hanlon, wrote a letter to the New York Sun asking whether Santa Claus was real. The Sun's affirmative editorial, written by Francis Church became an instant classic.*

bottom pricing. There simply hasn't been a market outside of a few days in March 2020 when most high grade bonds yielded more than 6% and any longer-dated government notes priced below $0.50 on the dollar.

A Fundamental Change: Monetary policy works with a long and variable lag. After a year and a half of one of the most aggressive hiking cycles in recent history, some visible cracks have begun to appear in the edifice of economic strength. Consumer confidence, business investment and a variety of other indicators have begun flashing signs that only appear around the onset of recessions. With the slowing outlook, inflation has been moderating. Were a proper recession to arrive, one would expect inflation to cool even further, and that development would provide the key fundamental ingredient required for a sustainable rally in bonds.

Sentiment: The best rallies start from a point of extreme negative sentiment. And, with respect to the bond market, it is worth noting that late October 2023 showed maximum bearish sentiment readings for US Treasuries[3]. As the late, great Richard Russell used to remind us, markets make opinions, as opposed to the other way around. After more than three years of a progressively weakening tape, investors weren't just indifferent to T-bonds, they hated them. What great psychic fuel for a meaningful rally!

Positioning: As with sentiment, extreme positioning often speaks to the magnitude of a potential rally. Again, we see an interesting signal in the Treasuries market. On November 21, the Commodity Futures Trading Commission reported a net short position in the five year US Treasury of approximately 1.5 Million contracts. That total represented the biggest five-year net short position in history, almost doubling the peak net-short of the 2018 cycle high.

We believe long-only asset allocators everywhere are overweight cash-like assets while hedge funds have been pressing bond shorts to extremes. The combined power of unwinding hedge trades with the re-entry into the bond market of GIC-type investors may give the recent reversal the legs needed to establish a full-fledged bond bull market.

November Activity

There are bargains to be had in the busted convertible bonds of one-time technology darlings. In November we initiated a position in the deeply discounted notes of California-based Stem Inc. Stem provides a software platform that enables renewable energy operators using battery storage to optimize energy use and maximize the value of energy production. This business was valued in excess of $2 billion as recently as 12 months ago, and yet we were able to purchase Stem's 0.5% 2028 notes slightly below $0.50 on the dollar. At that price we create Stem at approximately $175 million, netting out cash balances, through the unsecured notes. Stem enjoys a solid base of contractual commitments with terms exceeding ten years that provide steady cash flows. The company also continues to win new business based on its superior product offering which appears to be becoming an industry standard in battery optimization.

[3] *See Topdown Charts, Weekly Macro Themes, October 20, 2023, (p.10).*

Another low-priced line to which we added weight was in the 3.875% 2028 notes of Emergent BioSolutions Inc. These notes, marked at roughly 40% of face value have suffered spectacularly due to a post-pandemic fall-off in enterprise value which was triggered originally by losses at a vaccine manufacturing operation during the pandemic. Combined with uncertain timing of various government procurement programs for strategically important medication for stockpile, Emergent has had its back against the wall, financially speaking. We believe that this business is on the mend, particularly given the surging demand for Narcan, a drug that reverses the effects of opioid use.

Fund Positioning

The Corporate Bond Fund yield to maturity at November 30 was 9.3% with current yield of 5.7% and average duration of maturity-based instruments of 3.80 years. There is a 4.8% weight in distressed securities held for workout value whose notional yield is not included in the foregoing calculation. Cash represented 1.9% of the total portfolio at November 30.

Geoff Castle
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