PENDER
BOND UNIVERSE FUND

December 2023

Manager's Commentary

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The Pender Bond Universe Fund realized it's highest three-month return since inception this quarter with the class F units up 6.3%[1] for the period ended December 31, 2023. The year-to-date return for the Fund was 6.9% to the end of December.

The past quarter was characterized by a strong bond market reaction to the disinflationary trend that became established in Q4. This rising tide lifted most of the Fund's boats. Longer dated, high grade bonds however were the strongest contributors to performance over the period. The Fund's more recent additions including a Warner Brother's Discovery Inc. 2062 bond and a line of Treasury Inflation Protected Securities maturing in 2052 were stand out performers.

Sowing the Seeds

We have noted frequently how the Fund's credit and duration exposure is adjusted according to the cycling of spreads and the term premium respectively. Q4 provided a good illustration of the benefits that can at times be reaped from this strategy when the seeds have been previously sown. The term premium cycled higher in Q3, and as mentioned in the previous update, we extended the Fund's duration somewhat one quarter ago. Even though we did not necessarily expect a drop in yields to occur as soon as it did, as evidenced by the BBB YTW being down one full percent in Q4, the seeds that were sown in Q3 bore fruit in Q4.

A combination of spread tightening and benchmark yield declines drove a favourable return in Q4 for our Warner Brothers Discovery Inc.'s 2062 holding. The company reported Q3 earnings this quarter that exceeded expectations with a significant pick up in EBITDA and free cash flow sequentially and on a year-over-year basis. The company repaid $2.4 billion in debt in Q3 as de-levering continues. Increased EBITDA generation also helped this cause. In Q4, this line saw spread tightening of approximately 46 basis points which contributed to a price return of 16.8% for the quarter ended December 31, 2023.

Another strong performer in Q4 was the fund's position in a 2052 US Treasury Inflation Protected Security. A fortuitously timed addition to the portfolio at the end of Q3, these notes rallied approximately 12.2% in the final quarter of 2023 as real yields declined.

In this context and given Jerome Powell's comments at the latest FOMC meeting in December suggesting that the committee is considering when to start easing policy restraint, the most recent Fed dot plot is worth noting. The median of the FOMC dots data projection for the 2024 target rate went from 5.125% at the September meeting to 4.625% at their most recent meeting, implying 3 rate cuts in 2024.

[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.*

Given the rally in benchmark bonds going into year end, we think it's worth providing some context for the rebound seen to date versus treasury rallies in the past, following note worthy sell offs. We looked at the decline in the 10-year treasury yield from peak to trough and its corresponding subsequent total return around the recessions in 2000 and 2008. What we found was that from January 2000 to June 2003 the 10-year yield declined 3.68% and provided a total return over that period of 54.2%. The 2008 period experienced a decline of 3.21% and a total return of 35.4%. In the current period, the 10-year yield has dropped 1.11% from a high on October 19, 2023 for a total return of 10%. This is a strong high-grade rally over a short period of time to be sure, however, in the context of previous downturns, the current period represents only a fraction of the total return vs these previous two periods.

> "It remains possible that the full impact of higher rates on the economy has yet to be seen."

Fund Positioning

High yield spreads fell approximately 64 basis points over the quarter to a relatively benign 339 bps at quarter end, providing little incentive to add credit exposure to the fund. In addition, the high yield default rate in the US has been picking up over the last couple of years. Edward Altman, a leading academic in High Yield and Distress Credit has noted that corporate default rates tend to peak at the end of or soon after a recession ends. And "in many recession-stressed periods, default rates actually begin to rise two to three years before the recession starts".[2] Although to some degree we have seen the Fed signal an intended pivot in terms of the direction of rates, given the increase in high yield default rates, it remains possible that the full impact of higher rates on the economy has yet to be seen. As a result, the Fund's exposure to credit via it's Corporate Bond Fund holdings remains lower relative to historic weightings. The Bond Universe Fund had a 21.6% weight in Pender Corporate Bond Fund units at the end of December, resulting in a non-investment grade weight of 16%.

Yield to maturity of the Fund was 5.26% at December 31, 2023 and duration was 5.12 years. Cash represented 2.8% of the Fund at quarter end.

Emily Wheeler, CFA
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[2] *Corporate Financial Distress, Restructuring and Bankruptcy 4th Addition, Edward I. Altman, Edith Hotchkiss, Wei Wang.*

Standard Performance Information for Pender's Fixed Income Funds may be found here: https://www.penderfund.com/fixed-income/
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