

Manager's Commentary

David Barr, CFA

The Pender Value Fund returned 8.7% in the fourth quarter of 2023, bringing performance for the year to 7.7%.¹ The Fund finished the year on a positive, gaining 6.5% in December as investor expectation of a pivot in interest rate policy from the US Federal Reserve, and interest rate cuts in 2024, supported small cap companies and equity markets more broadly. In the quarter, the Russell 2000 Index gained 11.2% and the large cap S&P 500 finished 9.0% higher in Canadian dollar terms. These results compare to the S&P/TSX Composite Index posting an 8.1% gain and S&P/TSX SmallCap Index returning 6.1% in the quarter.

Interest rate policy from the US Federal Reserve was squarely in focus during the quarter, with commentary signaling the end of their interest rate hiking campaign and underscoring the market narrative of an upcoming pivot to interest rate cuts in 2024. This underpinned a rally across virtually all liquid asset classes, highlighted by the Federal Open Market Committee (FOMC) meeting on December 13. That was the best FOMC meeting day for all assets in almost 15 years. With the sharp rally, equity indices pushed higher to fresh 52-week highs. The bond market also took its cues from the Fed and digested these shifting expectations with the US 10-year Treasury yields settling lower by 71 bps during the quarter to close at 3.88% at the end of the quarter and credit spreads tightening during the quarter.

One of the key themes for equity markets throughout most of 2023 was the narrow leadership of a handful of mega-cap technology companies. Through the first three quarters of the year, seven companies in the S&P 500 have contributed nearly 85% of the gains. This group included 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). As another sign of narrow leadership, the average company in the S&P 500 gained a meager 2.4% compared to the overall index performance of approximately 13% through the first three quarters of 2023.

This trend changed dramatically in the fourth quarter, with those same seven companies contributing around 35% to overall S&P 500 performance and the average company gaining 11.8%. This broad-based participation in the market rally with the contribution from smaller companies much more in line with their weight in the index is a positive signal that the momentum in these mega-cap technology firms is finally waning.

Portfolio updates

Performance in the Fund during the quarter was driven by positive contributions by D2L Inc. (TSX: DTOL), Dye & Durham Ltd. (TSX: DND) and KKR and Co L.P (NYSE: KKR), while Baidu Inc. (Nasdaq: BIDU), Tiny Ltd. (CVE: TINY) and Texas Pacific Land Trust (NYSE: TPL) detracted.

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.

To highlight a couple of the positive contributors, which are also high-conviction holdings in the portfolio. D2L offers a cloud-based learning software platform and reported impressive quarterly results, posting low double-digit annual recurring revenue growth of approximately 13% and continued EBITDA margins expansion. The company has a strong balance sheet and announced a share buyback program representing 10% of the float. They continued to execute to their plans and the quarter reaffirmed our investment thesis in the company. The company represented a top-10 holding at the end of the year, representing a 5.0% weight in the portfolio.

“We continue to find attractive opportunities in small and mid-sized companies in North America where we see a disconnect between the intrinsic value and the underlying fundamentals of the businesses.”

The second largest contributor in the portfolio during the quarter was Dye & Durham, a cloud-based software and technology solutions provider for law firms, financial services institutions, and government organizations in numerous countries around the world. The company reported their quarterly results, with adjusted-EBITDA slightly ahead of expectations, recurring revenue growth of 13% year-over-year and significant debt repayment of \$45 million. They are targeting an improvement of \$70 million in free cash flow from a combination of factors including lower capex, better pricing and lower operating expenses. Later in the quarter, they also announced a strategic review of non-core assets to significantly expedite their goal of reducing total leverage to less than 4x EBITDA, from 5.1x in their last reported earnings. This is a high conviction holding within the portfolio, closing the year as the largest weight at 6.6%.

There were also a number of portfolio changes during the quarter. We sold our positions in Baidu Inc. (Nasdaq: BIDU) and JD.com Inc. (Nasdaq: JD). We deployed that capital into existing holdings where we have high conviction as well as reducing cash levels to 0.2% at the end of December.

We continue to find attractive opportunities in small and mid-sized companies in North America where we see a disconnect between the intrinsic value and the underlying fundamentals of the businesses. Our weight in Canadian equities stood at 63.8% at the end of the year, up from 50.3% at the end of 2022. As our Canadian exposure has grown, we have been reducing our weights to international companies from 8.5% at the end of December 2022 to 2.7% at the end of the year. This positioning is the result of identifying high conviction opportunities in companies we know well.

During the protracted downturn in small cap technology companies over the last couple years, we have taken the opportunity to increase the quality of the portfolio and the position size of these companies. Comparing the portfolio at year end 2023 to the previous year, our top ten has increased to represent 53% of the portfolio from 44% of the portfolio in 2022. This has increased the concentration in the portfolio into our highest conviction companies, with the total portfolio holdings declining to 36, from 40 last year.

We believe this positions us well for potential returns over the next three to five years as the intrinsic value of the companies becomes apparent. Although few investors are paying attention, this is an exciting time for small cap investors who recognize that the tide might be finally turning.

David Barr, CFA

January 22, 2024