PENDER
ALTERNATIVE ABSOLUTE RETURN FUND

December 2023

Manager's Commentary

Justin Jacobsen, CFA

The Pender Alternative Absolute Return Fund finished December with a return of -0.3% bringing year to date return to 7.5%[1].

High quality high yield continued to rally sharply in December, despite starting the month at the tightest spread in over eighteen months. The Federal Open Market Committee (FOMC) meeting on December 13 cemented the market narrative of an upcoming pivot from the Federal Reserve, causing a sharp rally across virtually all liquid asset classes. According to Bloomberg, it was the best FOMC meeting day for all assets in almost 15 years, which aligns with the depths of the Global Financial Crisis (GFC) in early 2009, when the risk-taking impulse and valuations were radically different than December 2023. The ICE BofA BB US High Yield Index finished the year with an Option Adjusted Spread (OAS) of 205bp, which is below the lowest level reached in the 2021 market rally, and within 20bp of the lowest spreads of the past 16 years. With BB spreads tighter by 35bp on the month, we believe that further tightening will likely be a slow and difficult process.

Portfolio and Market Update

It was an awkward month to be positioned defensively, but we believe that patience will be rewarded in the months ahead. When valuations become stretched in credit, it is usually a slow and choppy process for risk premiums to grind tighter. We try to be positioned in a way where we are protecting against a swift move lower for risk assets, while maintaining enough positive carry to generate positive monthly returns if markets continue to move higher. This was not the case in December as the magnitude of the move in risk assets was consistent with valuations being significantly cheaper than they were.

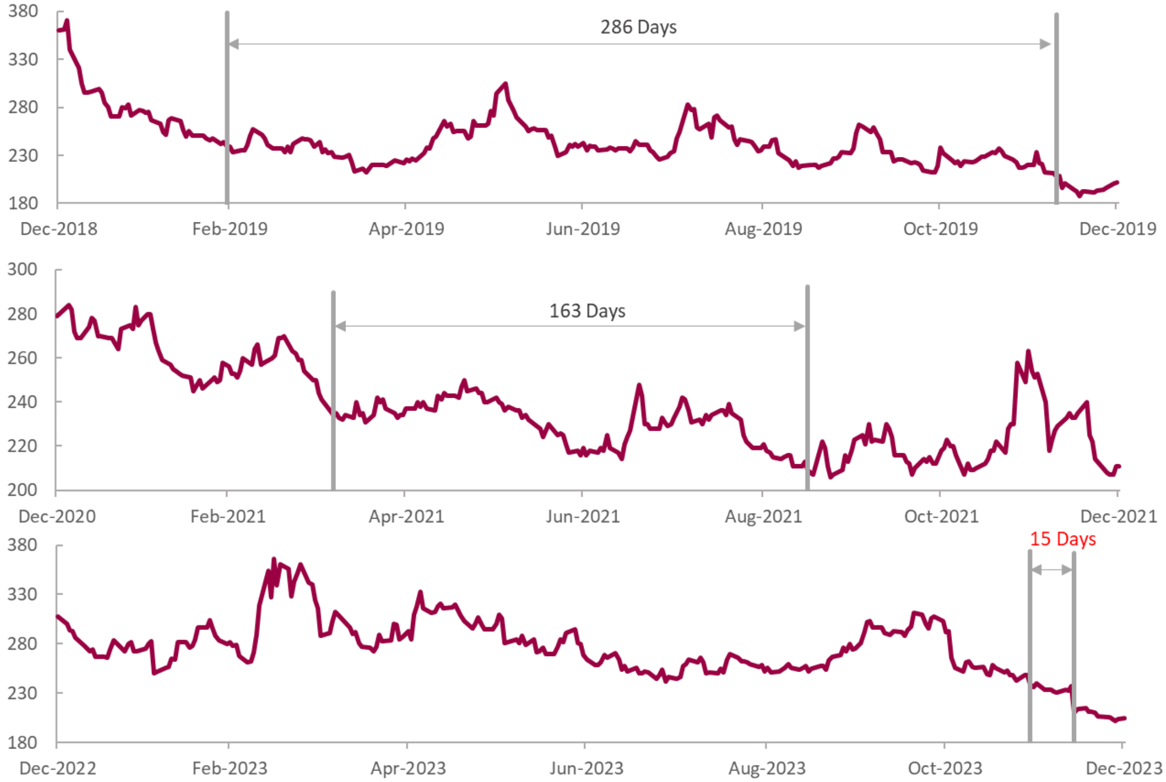
BB spreads are a good proxy for our broad opportunity set in The Fund, as our spectrum is typically issues rated between B and BBB. When BB spreads first hit 240bp like they did at the end of November, it often takes six months or more before they reach 210bp, and in some cases widen back out to 280bp or more first as they did in both 2017 and 2019 as part of a consolidation process. The time it took BBs to hit 240bp for the first time in over 18 months then reach 210bp is unprecedented in the post GFC era.

BB spreads hit 240bp	BB spreads hit 210bp	Days	Average
March 1, 2017	September 28, 2017	211	
February 27, 2019	December 10, 2019	286	220
April 5, 2021	September 15, 2021	163	
November 29, 2023	**December 14, 2023**	**15**	

Source: Bloomberg/ICE BofA

[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. Standard Performance Information for Pender's Alternative Absolute Return Fund may be found here: https://www.penderfund.com/pender-alternative-absolute-return-fund/*

ICE BofA BB US High Yield Index – Gov't OAS bp



Source: Bloomberg/ICE BofA

Credit markets finished the year at historically expensive valuations. According to Bank of America high yield spreads finished the year in the bottom decile across most time periods. Data in other markets echo the same trend. Fear and Greed indices started 2023 with a reading of "Fear" and finished the year reading "Extreme Greed."

> "Fear and Greed indices started 2023 with a reading of 'Fear' and finished the year reading 'Extreme Greed'."

An expensive market can continue to grind along for some time if there are no negative shocks, but once spreads hit their lows, the repricing higher can be rapid. People take comfort in an upward-moving market and increase market exposure. Eventually, something happens which creates a risk aversion impulse. With little valuation support assets can reprice materially lower as markets are autocorrelated with price and sentiment feeding on each other, exacerbating a sell off. A bottom in high yield spreads in the low 300s has on average been followed by high yield spreads of 500bp in just 100 calendar days in the last four instances, less than half of the time it typically takes for BBs to move from 240bp to 210bp.

ICE BofA US High Yield Index

Bottom date	Spread	Next 500bp date	Days to 500bp	Peak spread (6m)	Peak widening (bp)
June 23, 2014	335	October 15, 2014	114	571	236
October 3, 2018	316	December 20, 2018	78	544	228
January 20, 2020	338	February 28, 2020	39	1,087	749
December 28, 2021	301	June 16, 2022	170	587	286
Average	323		100	697	375

Bottom at year end	Spread
December 28, 2023	332

Source: Bloomberg/*ICE BofA*

The last time high yield spreads traded inside of 300bp was 2007, which turned out to be a very good time to be positioned defensively. Of course, past performance is no guarantee of what might happen going forward. The market was generally expensive for about a full year leading into the October 2018 trough in spreads. Even if late December is not the bottom for spreads over the near term, we are expecting better opportunities to put capital to work in 2024. A stretch like the past two months where the market is up every week with little volatility is very unusual, especially considering credit spreads were only about average at the starting point of the frenetic rally.

One of the drivers of market performance in December was strong inflows for risk assets combined with limited new issue supply in credit markets. We expect supply to pick up significantly in January, as the material drop in all-in yields will incentivize CFOs to term out maturities following two years of below average issuance. We expect a lot of the five-year issues from 2020 to be refinanced over the next six months.

Despite our generally defensive positioning there are some areas of markets where we see value and opportunities. We continue to hold our two CMBS (Commercial Mortgage-Backed Securities) issues which are backed by the Fairmont Austin and the Hilton Hawaiian Village. Both offer yields of about 8-9% with maturities in 2024 and 2026.

We continue to like our holdings in high quality term loans which trade at an even wider spread basis to equivalent bonds than they did a month ago. We believe that market pricing for six rate cuts from the Federal Reserve in 2024 is aggressive. The market has been consistently wrong since the current hiking cycle began. A year ago the market had expected Fed policy rate to be about 75bp lower than it was at year end 2023. We continue to like the floating rate aspect of loans. Finally, the dramatic rally in November and December disproportionately rewarded some issuers based on rules from systematic market participants without any fundamental basis. This has created some wide dislocations between issuers within sectors, we believe that there are relative value relationships in sectors like US high yield cable and hotel REITs where pairs trades are as compelling as we have seen at any point in the past year.

Portfolio metrics:
The Fund finished December with long positions (excluding cash) of 160.0%. 78.1% of these positions are in our Current Income strategy, 81.9% in Relative Value and 0.0% in Event Driven positions. The Fund had a -65.3% short exposure that included -11.1% in government bonds, -38.6% in credit and -15.6% in equities. The Option Adjusted Duration was 0.63 years.

Excluding positions that trade at spreads of more than 500bp and positions that trade to call or maturity dates that are 2026 and earlier, Option Adjusted Duration declined to 0.23 years.

The fund's current yield was 3.2% while yield to maturity was 6.6%.

Justin Jacobsen, CFA
January 9, 2024