Manager's Commentary

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Dear Unitholders,

The Pender Alternative Arbitrage Fund was returned -0.6%[1] in January 2024.

M&A Market Update

Global M&A activity is off to a strong start in 2024 with $227 billion of deals announced in January, a 56% increase from last year. With 2023 capping off the lowest level of M&A in a decade due to rising interest rates and market uncertainty, the backdrop for M&A is much more favorable in 2024 . We are seeing broad evidence that deal activity is poised to rise. After dropping from the top position for deal activity by sector last year, Technology deals resurged leading activity in January followed by the Energy & Power and Financials sectors. Mega-cap mergers or deals greater than $10 billion in size are also rising with four mega-mergers announced in January, equaling December's mega-merger tally.[2] The eight mega-cap deals announced during the past two months are the highest consecutive two month total since spring 2022. The return of mega-mergers is an encouraging sign that dealmakers have increased confidence in markets, visibility on interest rates and ample access to financing, conditions which should drive more M&A throughout the year.

Private-equity (PE) backed deals are also making a comeback with $48 billion announced in the first month of 2024, a 62% increase from last year and a total that was only exceeded once in the past two quarters. Private equity saw its share of buyouts increase to record levels in 2021 and 2022 accounting for nearly a quarter of all deals before falling in 2023. The decline in PE deals has largely been driven by higher interest rates and challenging financing conditions. Key lenders retreated from providing buyout debt funding after suffering major losses on LBO's after committing financing during the midst of record rate hikes and tightening their lending standards, following the regional bank crisis last spring. With improved visibility on the path of interest rates and increased confidence in financial markets, the LBO market is primed for activity this year with traditional bank lenders who pulled back on lending and conceded some of their share to new entrants in the last two years, aggressively looking to win back business. Traditional and non-traditional lenders are stepping up the competition by pricing new deals aggressively to win business, offering higher risk subordinate loans and even offering payment-in-kind interest deferred loans. With financing conditions loosening and ample capital available for dealmakers who have been sitting on the sidelines, M&A is positioned to take off.

There was an unprecedented wave of shareholder activism last year and continuing into this year, with nearly half of all activists' campaigns being targeted towards some form of M&A.[3]

[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] https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/large-m-a-rebound-picks-up-in-2024-where-2023-left-off-80383129

[3] https://bnnbreaking.com/tech/shareholder-activism-reaches-record-highs-in-2023-fueling-ma-demands

Traditionally, shareholder activism has been directed towards demands for change in corporate strategy, capital allocation or governance as a means to unlock value. However, in the last year given the widening dislocation between intrinsic and market value exacerbated by the growth of passive investing and index flows benefitting only the largest corporations, activists are increasingly focusing their efforts on an outright sale of a key asset, business segment or entire company. We are seeing activist campaigns succeed on both sides of the border with activist leveraging their track records to increasingly demand material corporate transactions, nominate candidates for board seats, and intensify their efforts to influence corporate strategies. As M&A conditions improve, there's a potential feedback loop set to occur with increased M&A expected to drive more activism as there's greater potential for a campaign targeting a sale to occur when there's an active market of buyers in turn leading to more M&A.

SPAC Market Update

The first month of 2024 saw one SPAC IPO, one SPAC liquidation and four de-SPAC deal closings, continuing the decline of the SPAC sector albeit at a slower pace as the industry size has shrunk to a fraction of its peak size in 2021. The number of SPACs outstanding declined to 264 with the value held in trust by those SPACs declining to $16.6 billion.[4] 2023 capped off another poor year for de-SPAC performance with at least 21 companies that went public by merging with a SPAC going bankrupt through the year representing an estimated loss of $46 billion in equity value for investors who poured money into these former SPACs.[5] We Work Inc., Bird Global Inc and Lordstown Motors Corp. are among some of the more notable de-SPACs that succumbed to Chapter 11 recently. The realistic long-term viability of these businesses varied, but all benefited from the SPAC frenzy during the pandemic when investors poured hundreds of billions of dollars into blank cheque businesses on the hopes of the sponsor striking a hot deal resulting in the SPAC shares popping and fortunes being made. More trouble is expected for the hundreds of de-SPACs in the market with nearly half likely needing additional financing this year, more big losses are expected.

In response to the criticism of SPACs and large losses realized by a disproportionate share of retail investors, the SEC implemented a new set of regulations for SPACs in January adding guardrails and further investor protection. The new rules eliminate many of the advantages SPACs had of taking an early-stage private company public via an IPO or direct listing, providing SPAC investors with more disclosures, safeguards and legal protections. The removal of safe harbor, holding sponsors and target company management legally responsible for any statements or projections made about future results is a key change expected to be implemented which would remove a key regulatory arbitrage advantage for SPACs vs. IPOs. These changes are likely to exacerbate the ongoing decline of the SPAC industry making it even more difficult for a sponsor to find and merge with a target at terms deemed attractive to all stakeholders. However, the announcement by Screaming Eagle Acquisition Corp. (NASDAQ: SCRM) in December 2023 to acquire Lionsgate Studios

[4] https://www.spacresearch.com/
[5] https://fortune.com/2023/12/27/spacs-investor-losses-ipo-wework-lordstown/

demonstrates that it's still possible for a high-quality sponsor to secure a deal with an established target company. Even with the new rules, SPACs will likely maintain a speed advantage of providing capital and access to public markets faster than an IPO. Hopefully a higher quality deal like this one provides a blueprint for the types of deal structures where SPACs can provide value.

"The Fund continues to focus on small and mid-cap merger deals which we believe have a higher probability of being mispriced, with less deal risk and a shorter expected duration."

At the end of January there were 264 active SPACs in the market with assets of $16.6 billion, with 120 SPACs actively searching for targets. At the end of December 2023, SPACs searching for targets were trading at a discount to trust value, which provided a yield-to-maturity of 5.97%.[6] With SPAC arbitrage effectively equivalent to acquiring a Treasury Bill at a discount, SPACs currently provide a similar 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

January was a slow month for the Fund after a positive end to 2023 which saw several key deals held by the fund closing. During the month, the Fund initiated positions in 15 new merger deals with only six deals held within the Fund closing. Within the portfolio several deals saw slight delays or extensions of regulatory approvals with spreads widening to price in more duration. For many of these deals we believe they remain on track to close within our expected timeframe and have been adding to these positions on the expectations that approvals and key milestones to close the merger are likely to be achieved in the coming weeks and months. This aligns with the typical seasonality we've experienced since launching the Fund. There's typically a big push to close deals by year-end with various incentives from accounting, legal, regulatory, and even compensation for dealmakers to ensure everything is signed off and closed before the New Year. With the holidays, travel and more pressing issues, there's usually a slower start to the year and a little catchup that needs to occur. We continue to see mispricing opportunities with respect to expected deal duration and will be taking advantage of deals where we believe there is mispriced timing risk.

We are seeing signs of renewed interest in smaller cap companies with strong performance in the final quarter of 2023 and indications of higher flows into small cap ETFs suggesting that investors are looking to take advantage of the bargain valuations available by moving down market cap. Feedback from bankers and M&A advisors indicated that one of the key hurdles to M&A last year was the divergent expectations between buyers and sellers. With buyers unwilling to raise their offers due to uncertain market conditions and tighter financing conditions while sellers remained anchored to high price expectations and were

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

not willing to sign off on a deal well below their estimate of intrinsic value. With rising valuations and renewed confidence, many negotiations are likely closer to a clearing price which should lead to more smaller-cap merger deals. We are starting to see signs of this within our small cap universe with companies like MediaValet Inc (TSX: MVP), Neighbourly Pharmacy Inc. (TSX: NBLY and Tricon Residential Inc (TSX: TCN) announcing definitive merger agreements during the month. The Fund will continue to focus on these small and mid-cap merger deals which we believe have a higher probability of being mispriced, with less deal risk and a shorter expected duration. At the end of January 2024, the Fund had 33 investments in small cap deals under $2 billion, 28 of which were valued at under $1 billion.

Outlook

Markets continued their positive momentum from last quarter with the S&P 500 and S&P/TSX Composite up 1.6% and 1.4% respectively. Despite central bank signals that interest rate cuts may not be as imminent as market expectations, there is increased visibility that interest rates have peaked, and terminal rates will be lower than current levels. This improved visibility has provided renewed confidence to investors and dealmakers allowing them to start executing on a significant backlog of mergers and acquisitions. We remain optimistic on the potential for merger arbitrage this year with an attractive setup of increased M&A activity and wide spreads implying an average gross yield in excess of 10% and more predictable regulatory risk. The many deals challenged and won or lost by regulators has provided us with a better understanding of regulatory policies when it comes to evaluating merger deals. We can implement and leverage this playbook heading into 2024 to analyze and assess merger deals and their underlying deal-risk. The dominance of the 'Magnificent 7' shares accounting for an increasing share of equity performance and the wave of cash hitting credit markets as expectation of a soft landing become priced in is creating an environment where there is potentially more systematic risk in traditional equity and fixed income investments. In this environment a non-correlated, absolute return focused investment strategy like merger arbitrage warrants consideration for investors looking to diversify risk in their portfolios.

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