

## Manager's Commentary

### Justin Jacobsen, CFA

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The Pender Alternative Absolute Return Fund finished January with a return of 1.4%<sup>1</sup>.

Markets started 2024 giving up a small amount of the buoyant rally at the end of 2023 before continuing their move higher for risk assets for much of the month. The ICE BofA US High Yield Index returned 0.02% and saw Option Adjusted Spread (OAS) widen 20bp, to finish the month at 359bp. By contrast, investment grade spreads in the ICE BofA US Corporate Index was tighter on the month, breaking below 100bp for the first time since early 2022.

#### Portfolio and Market Update

While the high yield market was roughly flat on the month, there was wide dispersion of returns within the market. The strong rally that finished 2023 occurred with relatively low engagement from investors over the last two weeks of the year, which resulted in an outsized influence of ETFs and small trades dictating year-end marks causing dislocated relationships. This meant that relatively illiquid and under followed bonds significantly outperformed the broad market in January which benefited the Fund, as we had sold a quantity of more liquid high yield issues in the prior two months.

A major theme in January was the reopening of the primary market in North American liquid credit, following limited issuance in late 2023. The Fund selectively participated in new issues in both investment grade and high yield markets. With generally attractive new issue concessions, we focused on high yield bonds with all-in yields of 7% or more as well as investment grade bonds with spreads above 200bp. Unfortunately, the robust capital markets environment also extended to loans, where a couple of our positions repriced at tighter spreads, significantly eroding the value, and causing us to net reduce our exposure to repriced issues.

*“Dispersion is likely to be an ongoing theme for markets in 2024... Even though credit spreads are historically tight, there are pockets of opportunity where we believe individual situations are mispriced.”*

Dispersion is likely to be an ongoing theme for markets in 2024. While some corners of the market attempted to revert to 2021 levels in December, the path forward for commercial real estate and certain telecommunications businesses are likely to be challenging. With so much optimism baked into valuations, earnings releases have the potential to drive outsized reactions. We saw this in late January and early February with New York Community Bancorp, Inc (NYSE: NYCB) reporting significant impairments in their loan book exposed to office buildings, and Charter Communications Inc. (NASDAQ: CHTR) reported a net loss of broadband subscribers. The market's reaction was decisive, with a 1-day return on Charter's stock of -16.5%, and -38% on NYCB's. In both cases the Fund was well positioned, with two small short positions in office REIT equities as well as a large short position in Charter's high yield bonds that we have maintained since late last year. We took note of former Charter CEO, Tom Rutledge, selling his entire shareholdings to zero in November generating pre-tax proceeds of about

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<sup>1</sup> 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/>

\$100 million, just two weeks before he would not be required to disclose a sale as he was retiring as the company's Chairman. As of February 2, CHTR's stock was down more than 20% from where he exited.

The Fund added several short-duration holdings in bonds that we expect to be called in relation to mergers. We purchased a first lien 7.5% 2025 bond issued by CSI Compressco LP (NASDAQ: CCLP) which we expect to be converted to cash in the next six months, realizing a horizon return of about 7% as we purchased at a slight premium to par. Additionally, we accumulated a position in CrownRock LP 5.625% 2025 bond that we expect to be called once Occidental Petroleum Corp (NYSE: OXY)'s acquisition of the company closes in the next few months, and expect to earn about a 7% IRR on that position. In both cases we believe there is little downside risk given the asset quality and short maturity profiles of the instruments, while picking up an attractive premium to cash as we wait for better opportunities to arise. We also added to loans backed by Hilton Worldwide Holdings Inc. (NYSE: HLT) at SOFR +210bp (about a 7.4% current yield) and TransDigm Group Inc. (NYSE: TDG) at SOFR + 325bp (about an 8.5% current yield).

The January FOMC meeting outcome was aligned with our expectations. We had thought that the market's enthusiasm for a March rate cut was misplaced, which drove our decision for buying term loans over the last two months. The December change in Fed's median dot plot for year-end 2024 implied three cuts, up from two implied cuts in September, however the mean change in policy expectations was only about 10bp lower between the two releases. The market ran with the narrative of easing policy expectations, pricing in as many as six cuts for much of the last several weeks. With relatively easy financial conditions, strong labour markets and large cap equities at all-time highs, we see little incentive for the Fed to rush towards more accommodative policy. Our base case remains consistent with the Fed's own communication of three cuts in 2024, which would most likely occur in June, September and December.

Even though credit spreads are historically tight, there are pockets of opportunity in the market where we believe individual situations are mispriced. In some cases, convertible bonds and CMBS offer better risk premiums than high yield bonds backed by the same parent issuer. We expect that much of our attention over the coming weeks will remain on short duration opportunities as well as new issues. After three months of relatively limited pullbacks, the strong seasonal technical trade may have limited room to run. Insider stock sales by one measure are the highest they have been since late 2021, and history has shown that insiders are remarkably good at knowing when to sell. We are hopeful that volatility will increase our opportunity set in the months ahead.

#### **Portfolio metrics:**

The Fund finished January with long positions (excluding cash) of 166.4%. 80.8% of these positions are in our Current Income strategy, 85.6% in Relative Value and 0.0% in Event Driven positions. The Fund had a -67.5% short exposure that included -10.9% in government bonds, -41.2% in credit and -15.4% in equities. The Option Adjusted Duration was 0.52 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 0.09 years. The duration figure include an Event Driven position where we believe duration does not accurately reflect the option value embedded in the security.

The fund's current yield was 3.7% while yield to maturity was 6.8%

**Justin Jacobsen, CFA**

*February 12, 2024*