Manager's Commentary
Amar Pandya, CFA

Dear Unitholders,

The Pender Alternative Arbitrage Fund was up 0.9%[1] in February 2024. The Fund's benchmark, the HFRI ED: Merger Arbitrage Index (USD) returned -0.2% during the same period.

M&A Market Update

Through mid-March Global M&A Activity totaled $630 billion, a 42% increase from last year as M&A activity continues to recover.[2] North America is seeing a supportive deal environment with M&A activity up 62% from last year driven by a spectrum of strategic, private equity backed and cross-border deals. At sector level, M&A is seeing more broad-based activity with the industrial, healthcare and materials sectors, which saw significant activity in 2023, experiencing a tempering of activity as other sectors are benefitting from a pick-up in deal flow. Whereas the US energy sector has seen mega merger after mega merger as the largest producers seek to secure reserves in high quality basins like the Permian and unlock synergies through scale, it has been quieter north of the border. With key energy infrastructure projects, including the Trans Mountain Pipeline expansion and LNG Canada expected to be completed this year, Canada could experience a similar merger bonanza as the US with the additional capacity to access new end-markets.

While we are still early in the year, expectations for a rebound in mergers are likely high with Morgan Stanley expecting a 50% jump in M&A activity this year "as corporate confidence recovers, and economic growth holds up."[3] This follows 2023's decade-low level of M&A activity as rising interest rates, elevated market volatility and recessionary fears weighed on dealmakers. North America is predicted to lead global M&A with the health care, real estate, consumer staples and technology sectors expected to be the primary beneficiaries of the recovery. Corporate balance sheets and PE firms are flush with cash with tight investment grade and high yield bond spreads providing abundant access to capital. While inflation data is likely to ebb and flow through the year, inflation is predicted to cool this year feeding into expectations of reduced borrowing costs. With rapid technological advances in artificial intelligence, life sciences and clean energy, many industry leaders will be looking to ramp up their capabilities by acquiring the competencies, human capital and intellectual property of other industry players. As the market becomes more bifurcated with a widening gap between mega-cap technology companies and the rest of the market, there are many compelling bargains available and renewed confidence in markets could be the catalyst for acquisitions.

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[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] Investment Banking Scorecard, Deal Intelligence | as of March 14, 2024
[3] https://www.bloomberg.com/news/articles/2024-03-05/morgan-stanley-strategists-see-m-a-surging-as-confidence-builds

SPAC Market Update

The SPAC industry continued to shrink in February with four SPAC liquidations partly offset by three SPAC IPOs which only raised a third of the liquidated value. There were also eleven deals closed during the month with another eleven SPAC mergers announced. The number of SPACs outstanding declined to 251 with the value held in trust by those SPACs declining to $15.8 billion. IPO activity has been slightly higher this year as market conditions improve with some hotly anticipated IPOs including Reddit, Shein and Panera Bread expected to be bellwethers for markets. A successful debut by one of these notable companies would reaffirm the strength of capital markets and indicate that a private to public market valuation gap exists. SPACs can use their pool of capital to quickly take a private company public exploiting this valuation gap. New SEC rules have leveled the advantage between a SPAC merger and IPO for a private company seeking to go public, but the speed and access to capital for earlier stage businesses that SPACs can provide does remain an advantage. . At the end of February 2024, SPACs searching for targets were trading at a discount to trust value, which provided a yield-to-maturity of 6.30%.[4] 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.

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Portfolio Update

After a slow start to the year, February saw a flurry of activity with several mergers held by the Fund achieving the prerequisite requirements to closing. These prerequisites include successful shareholder votes, securing deal financing and receiving various regulatory approvals. Merger arbitrage spreads typically tighten as these requirements are achieved driving returns within the Fund. For some mergers deals the spread can remain wide until the final or key approval is achieved with the closing of the merger being the catalyst that allows the Fund to realize the gain from capturing the spread with the capital received now available to deploy into a new deal. We continue to see a healthy churn of activity in the Fund with a wide side of high-quality merger deals available allowing the Fund to hold a compelling portfolio of merger deals and deploy capital into new ones. Merger arbitrage spreads remain wide on a relative and absolute basis and are particularly attractive to investment grade and high yield bonds in the current environment. With the potential for a pick-up of M&A activity, we are optimistic about the prospects for merger arbitrage and Fund performance this year. During the month, the Fund initiated positions in twelve new merger deals with eleven deals held within the Fund closing.

We continue to see evidence that investors are seeking to exploit the discounted valuations presently available in smaller cap companies with both financial and strategic acquirers

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

active in the market. With improving investor confidence and valuations rerating higher, buyers need to be quick and aggressive in order to secure a deal before the valuation gap narrows further or another acquirer beats them to deal. This environment is primed to see more bidding wars as strategic buyers with higher synergy potential or financial buyers with lower costs of capital can pay a premium to an existing offer.

The Fund held one of these deals which benefitted performance during the month. Osino Resources Corp. (TSXV: OSI) is a junior gold developer with a development mine in Nambia. The company announced that they had agreed to be acquired by Dundee Precious Metals Inc. (TSX: DMP) on December 18, 2023 in a merger with mixed cash and stock consideration with an implied value of roughly $1.55. On February 19, 2024 the company announced that they had received a superior proposal with all-cash consideration of $1.90, a 32% premium to the implied consideration at the previous close. A few days later the board signed a definitive agreement to be acquired by Yintai Gold Co. As the risk profile of the deal is higher with the new acquirer, we've trimmed our position to the deal, realizing an attractive return. With bargains available in the small cap space and acquirers competing to seize the opportunity, we see further potential for bidding wars and deal bumps in the merger deals held by the Fund. At the end of February 2024, the Fund had 35 investments in small cap deals under $2 billion, 27 of which were valued at under $1 billion.

Outlook

Markets rallied across the board in February with the S&P 500 Index up 5.3% in the month while the S&P/TSX Composite Index rose 1.8% and the NASDAQ jumped 6.2%. Speculative fever is gripping markets again with the crypto sector seeing a surge in coin prices spurred by ETF inflows and the AI frenzy is seeing companies like Super Micro Computers shares go parabolic. How much longer can the party last? Core inflation in Canada and the US has been decelerating but treasury yields ended the month having risen across the board. Anticipated rate cuts are now expected at fewer occurrences and pushed back further. The path of interest rates may be down while the prospect for equities is up, but that path is likely to be filled with twists and turns.

With a pick-up of M&A activity in our core small-cap universe we are seeing a compelling merger arbitrage opportunity. Spreads are wide on a historic and absolute basis with a more predictable regulatory environment allowing us to analyze and avoid merger deals with elevated risk. We continue to hear from bankers, dealmakers and the management and boards of the companies we follow that M&A activity is primed to likely rise with pent up demand. With abundant deal-flow, wide-merger arb spreads and small cap M&A primed to rise, we are optimistic about the prospects for merger arbitrage returns this year.

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