Manager's Commentary

Emily Wheeler, CFA

A strong March lifted the Fund into positive territory for the quarter ended March 31, 2024. The class F units were up 1.5% in Q1 which represented 1% of relative outperformance over the period vs the benchmark return of 0.5% for the FTSE Canada Universe Bond Index.[1]

Whereas the previous quarter saw a strong bond market reaction to waning inflationary pressures, the first quarter of 2024 was characterized more by areas of strength in credit. Exposure to particularly unloved opportunities where spreads had previously widened more than the broader HY index via the Fund's Pender Corporate Bond Fund (PCBF) allocation, provided a tailwind. In addition, select below investment-grade bonds held directly by the Fund, including our Occidental Petroleum 4.1% 02/15/2047s and our OPKO Health 3.75% 01/15/2029s provided a positive contribution to performance this quarter.

Our first purchase of Occidental's 2047s was back in October of 2023 at $63.9. Currently trading about 11 points higher, this issue was up 4.6% in Q1 with spread tightening vs Treasuries of approximately 61 bps over this period. Occidental is one of the largest oil and gas producers in the US and the Permian specifically. We like these bonds as coverage is very strong from several perspectives. Firstly, PP&E vs debt outstanding is considerable. With approximately $59 billion of the former and approximately $19.7 billion in the latter, coverage here is just under 3x. Haircutting PP&E by 50% still provides ample coverage of debt at approximately 1.5x. Secondly, EBITDA and free cash flow coverage of interest expense are also strong - sitting at greater than 10x and 7x respectively in 2023. Equity cushion is also robust with $57 billion in market cap well in excess of debt outstanding. In addition to admirable coverage, Berkshire Hathaway is a significant owner of the equity, holding greater than 25% of shares outstanding and they have been a buyer recently. In addition, should we see rates come down in the future, these longer dated bonds are poised to benefit. A one percent drop in rates would result in approximately 14.5% of price appreciation – a potentially attractive return for a bond of this credit quality.

A star performer this month was our OPKO Health 3.75% 01/15/2029 convertible bond where we hold a 2.2% weight (2.7% weight including look through to PCBF). OPKO is a healthcare company with two main businesses – a lab business called BioReference, which is one of the largest full-service labs in the US, and a pharmaceutical business where they have several irons in the fire. Most noteworthy on this side of the business is their growth hormone drug called Ngenla as it was recently approved in the US for pediatric patients and is being commercialized by Pfizer. They have a profit share with Pfizer on sales of Ngenla and on a similar existing drug of Pfizer's which together could mean significant revenue for OPKO in the years to come. Insider ownership is strong, with the CEO and various directors owning a significant proportion of shares outstanding. They recently refinanced a 2025

[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.*

convert and issued a 2029 in exchange which lowered the strike from $4.22 to $1.15. At the end of March, the company announced that they had sold a portion of their lab business for $237 million - an effort that management suggested would better position this business for profitability going forward. In response to this news, OPKO's share price rose 12% to $1.20 per share, pushing the equity above the strike of the convert. This position was up 6% over the quarter and subsequently, up a further 12.5% as of this writing, providing a strong positive contribution to performance in Q1 and into Q2.

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Credit Positioning

At 150 bps and 312 bps respectively, BBB and High Yield spreads are currently tight versus history. In fact, when we look at both on a long-term basis, the average spread going back to 1997 is 195 basis points for BBBs and 535 bps for the high yield index. Even though we are seeing areas of opportunity in credit, given we are currently approaching one standard deviation below the long-term average in both cases, spreads in general are expensive. Considering our counter-cyclical approach to credit exposure and the current tight spread environment, the Fund has relatively lower exposure to credit vs past periods when spreads offered more attractive compensation. Currently the Fund has a 22% weight in non-investment grade holdings achieved though holding Corporate Bond Fund units along with a handful of individual non-IG bonds.

Duration & Fund Positioning

The term premium has moderated somewhat since a high in October 2023 however remains positive and higher than its year-end reading. As such, duration shows little change from the previous quarter-end. Although globally, more central banks are still cutting rates vs hiking, we have seen some disparity here with nations such as Japan and Taiwan increasing rates as inflation persists. North American economies have shown resilience to the previous hiking cycle however the possibility exists that this may wane in the future. Although some recent growth and inflation numbers have been strong, Personal Consumption Expenditure (PCE) inflation in the US has recently fallen below 3%. Areas of economic weakness include commercial real-estate, credit card delinquencies, which have risen in the face of tightening lending standards, and retail sales which have recently been soft with many companies guiding lower from here. If recent growth proves to be at least in part, the result of supply from higher immigration and increased entrants to the workforce as opposed to demand, which Jerome Powell alluded to recently, it is possible that some degree of the lag effect from interest rate hikes is yet to be realized.

The Duration of the Pender Bond Universe Fund at March 31, 2024 was 4.76 years. The yield to maturity of the fund was 5.39% and cash represented 4% of the portfolio at quarter-end.

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