

## Dear Investor

We deeply appreciate your ongoing support of Pender Credit Opportunities Fund I (PCOF I). Since its inception, the Fund has delivered positive performance of 13.4% net of all fees and expenses, outperforming both the High Yield Market (ICE BofA US High Yield TR USD returned 7.7%) and the CCC index (ICE BofA CCC & Lower US High Yield TR USD returned 10.5%). Currently, PCOF I is fully invested, with 15 securities in the stressed bucket, 11 securities in the distressed bucket and four special opportunities. Our investment period concludes in July 2024, after which the proceeds of any realized investments will be returned to investors, starting from August 2024.

## Broad Market Sentiments

Current market consensus has coalesced around the view that interest rates have reached their peak and central banks will soon begin cutting interest rates. This view assumes that inflation continues to cool towards the Fed's target of 2% and the economy softens enough to allow looser monetary policy, but not too much that we see a recession. This is a true goldilocks economic scenario – not too hot, not too cold. This consensus view is witnessed across financial markets, from large cap equities trading near all-time highs to credit spreads in the high yield market continuing to narrow. With this optimistic scenario baked into markets, concerns are emerging across various fronts, with the rising risk of a potential spill over if a less favourable scenario were to unfold. There are numerous examples, including political discontent in North America and globally, soaring government debts, ongoing conflicts including those involving major powers and the Middle East, and contrasting views on the impact of artificial intelligence, from salvation to existential threat.

Predicting market shifts is challenging, but when they occur, they often happen swiftly, catching many off guard with their magnitude. While it seems we are at a crossroads where a pullback may be imminent, we maintain our conviction in our portfolio positioning and continue to identify company specific investment opportunities that are less impacted by changes in broad market sentiment.

## Current Market Insights

Credit spreads serve as a premium offered to investors to offset the risks associated with bankruptcy. As of March 31, 2024, the BofA ICE US High Yield Index traded at a credit spread of 315 basis points, significantly below its 20-year median of 454 basis points. This quarter, high-yield credit spreads hit a decade-low of 3.05%. Narrower spreads are a reflection of the market's confidence but leave little margin of safety for investors across the broad high yield market.

## Our Focus Areas

In contrast to the broad high yield market, we are uncovering compelling spread levels in unrated credits, often overlooked by indexes. These opportunities typically stem from small to mid-sized companies with straightforward capital structures, offering significant yield potential and catalysts for value recognition. In the distressed sector, we are actively identifying opportunities with spreads surpassing 1000 basis points. As examples held in the



## Manager's Commentary – Q1 2024

portfolio, Lucid's 2026 bond offers a yield exceeding 27.8%, and Novavax' 2027 bond yields 19.3%. Similarly, in stressed assets, we are identifying spreads exceeding 600 basis points, such as Trulieve's 2026 bond yielding 10.1% and Hughes Satellite 2026 bond yielding 13.8%. Since the inception of the Fund, we have exited seven securities and trimmed two profitably, reallocating the capital into higher yielding and wider spread opportunities. Our strategy involves reducing weights in holdings that have become fairly valued and redirecting that capital into securities offering greater intrinsic value relative to their face value.

Some of the top contributors to the portfolio's performance since inception have been investments in Esperion Therapeutics Inc, Bandwidth Inc and Trulieve Cannabis Corp.

**Esperion Therapeutics Inc 4% 2025 notes** have been a significant contributor to the portfolio. The catalyst for the value realization was the FDA's long-awaited approval of their new cholesterol drug. Despite initial commercial challenges amid the pandemic, the recent approval has substantially broadened the company's total addressable market in the US. This news, combined with other positive developments, has instilled renewed confidence among investors. As a result, the price of the 4% notes has risen from \$58 to \$82. We maintain our position and see potential for further gains, with the bonds still offering a yield to maturity of over 16%.

**Bandwidth Inc.'s** convertible notes saw a significant uptick following an impressive earnings report from the communications software company. Particularly noteworthy is the compelling opportunity presented by Bandwidth Inc.'s 0.5% convertible notes, due in April 2028. These notes offer a yield of around 8.7%. With increasing cash margins and the prospect of rapid growth, especially in an election year where modern campaign fundraising relies heavily on text message outreach to donor databases, this presents a catalyst-rich position in the Fund.

**Trulieve Cannabis Corp.** stands out as an issuer whose credit has delivered impressive returns, exceeding 39% since the Fund's inception. Over the past five years, the cannabis industry has undergone significant challenges, with the euphoria of the initial boom giving way to a focus on financial discipline. Trulieve has emerged as a survivor, demonstrating resilience by generating over \$125 million in cash from operations over the past year. With the potential for recreational cannabis use gaining traction in its key market of Florida, and the possibility of the sector opening to banking financing in the near future, Trulieve appears poised for further growth. Despite these positive indicators, Trulieve's 8% 1st lien notes of 2026 still offer a yield of 10%. We are happy to hold.

The recent rally in **Fannie Mae preferred shares** stems from optimism about potential capital reorganization after the 2024 US election. Our position saw an 81.5% surge, reflecting investors' reevaluation of these entities despite their prolonged conservatorship since 2008. We have taken some profits and trimmed our position by 1/3rd but we continue to hold and see the potential for further catalysts to unlock value.

Despite the overall positive performance in the Fund, there have also been some detractors since inception including our positions in McDermott International Ltd and Stem Inc.



## Manager's Commentary – Q1 2024

We continue to hold the reorg equity of **McDermott International Ltd.** (OTCMKTS: MCDIF) and believe its capital structure is undervalued. The company emerged from bankruptcy in 2020 and has largely flown under the radar of capital market participants, despite favourable fundamental developments and an expanding order backlog. Despite the prolonged and challenging turnaround journey, we believe the momentum is finally shifting in favor of this undervalued capital structure.

We also continue to see unrealized value in the busted convertible bonds of **Stem Inc.** The company specializes in software solutions for renewable energy operators, aiding in energy optimization through battery storage. Despite once being a prominent figure in the tech industry during the ESG hype, that pendulum has swung to overly pessimistic and gave us the opportunity to purchase Stem's 0.5% 2028 notes at a discounted rate of below \$0.50 on the dollar. Despite positive cashflows, long term contracts in place and an innovative product offering, Stem bonds are trading at yields exceeding 16%. We continue to hold and see this as a compelling opportunity.

### **The Fixed Income Market is Changing**

In this changing landscape of fixed income, we expect the market to pay more attention to the fundamentals of individual securities and companies. Our approach is straightforward: we aim to find value by understanding these fundamentals deeply and weigh the risk against the reward of all potential investments. While some may think our strategy depends on credit cycles, we disagree strongly. Over the past eight years, we have navigated through different credit cycles and have consistently found good opportunities in stressed and distressed credits. By avoiding big index names and focusing on small and mid-sized business, we are targeting an opportunity set where larger stressed and distressed investors cannot or do not go. This puts us in the enviable position of providing capital in a pocket of capital scarcity, a great starting point for success.

Looking ahead, we believe the next five years hold immense potential for investing in stressed and distressed credits.

Warm Regards,

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