Manager's Commentary
Justin Jacobsen, CFA

The Pender Alternative Absolute Return Fund finished March with a return of 0.7% bringing year to date return to 2.5%[1].

Credit spreads continued to grind tighter in March with both high yield and investment grade spreads approaching the lowest risk premiums since 2007. Risk assets have shaken off a dramatic repricing of rate cuts from the US Federal Reserve in 2024. In the past quarter, market pricing has shifted from six rate cuts in 2024 to only two or three.

Portfolio and Market Update

Considering our limited market exposure, we are pleased with the Fund's year-to-date performance. Much of the Fund's performance in 2024 has been driven by underfollowed securities which had been structurally cheap heading into the year outperforming broad credit markets. In contrast, many of our credit shorts are in relatively expensive liquid high yield issues which have felt the impact of a significant repricing of government bond curves. As prices have moved higher, we have taken sales in some of our best performing positions and believe there is relatively limited room to run higher from here. Our focus is finding and holding securities that have relatively limited downside if the market were to correct lower.

March was an active month for new issues in Canada and the US high yield markets. Taking advantage of the activity, the Fund participated in several transactions in both markets. Most notably we purchased Canadian dollar denominated issues from Secure Energy Services Inc. (TSX: SES) and Mattr Corp. (TSX: MATR) which have been consistent fund holdings since 2021, Secure's five-year issue priced at a yield of 6.75% while Mattr's seven-year issue priced at a yield of 7.25%. Selectively participating in attractively priced new issues contributed to positive fund performance in the month.

The Fund closed out our modest short position in Hudson Pacific Properties Inc. (NYSE: HPP) equity which hedged our long exposure in HPP bonds. With the equity down over 30% year to date, we believed that enough repricing had occurred to close out the position. Furthermore, the REIT has executed a series of asset sales which have materially improved their credit profile since we initiated a position in the bonds last year, causing us to reassess the necessity of a hedge. While we generally remain cautious about commercial real estate, market pricing for HPP has been dislocated at times, helping generate some nice returns for the fund on both sides of the capital structure.

A theme for the first quarter was finding current income trades to reduce the Fund's excess cash balance. In March we added to a couple preferred share positions where we expect a call in the next few months. We have found the market to be particularly inefficient around dividend record dates, allowing us to purchase shares of a Capital Power Corp. (TSX: CPX) issue at between a 9-10% yield to a June 30, 2024 call. Unfortunately, it is very challenging to scale preferred trades to the extent that we would like. A couple of our bond holdings were called, including CSI Compressco LP 7.5% 2025 bond which paid out on April 1, 2024. We believe it is likely that several other positions will see calls or tenders in the coming weeks.

[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. Standard Performance Information for Pender's Alternative Absolute Return Fund may be found here: https://www.penderfund.com/pender-alternative-absolute-return-fund/*

While strong upward momentum in asset prices continued in March there is relatively limited room for spreads to move tighter from here if history is any guide. Aside from high level risk premiums, there are plenty of examples of individual situations where speculation is driving asset prices. The performance of Trump Media & Technology Group Corp. (Nasdaq: DJT) bears a lot of resemblance to the meme stock bubble of early 2021. While DJT might be the most dislocated stock in the market in terms of price relative to fundamental value, there are others like Super Micro Computer Inc. (Nasdaq: SMCI) where the market's appetite for AI themed trades has caused price movement that greatly exceeds fundamental developments in our view. We view Bitcoin, which hit an all-time high in March, as another data point on generic market speculation and financial conditions.

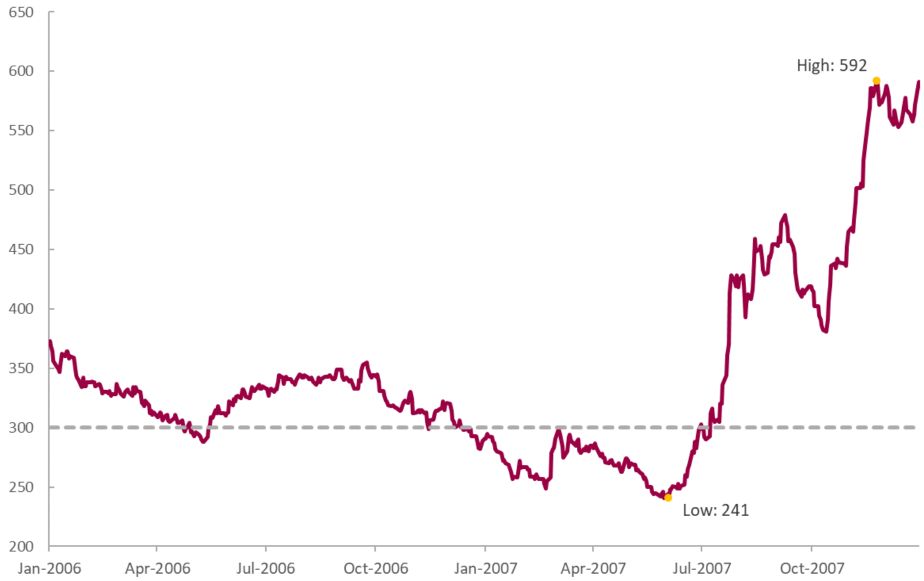
On March 21, the ICE BofA US High Yield Index hit 305bp Govt OAS, the tightest spread in over two years, and just 4bp away from the tightest spread since 2007. Year to date, there has been a clear negative correlation between yields and spreads as both high yield and investment grade markets have been supported by "all-in" yield buyers when government bond yields moved higher. With the past year seeing the highest sustained government bond yields since before the Global Financial Crisis of 2008, it is entirely possible that spreads break through 300bp OAS in high yield for the first time since 2007.

"While strong upward momentum in asset prices continued in March there is relatively limited room for spreads to move tighter from here if history is any guide... we believe it is not a market environment to be chasing market beta."

We have previously detailed that major market bottoms in spreads have consistently seen significant spread widening events within the following six months for the past decade. We thought it was worthwhile to revisit the 2006/07 market experience to see if the same rule held for even tighter spreads. Following spreads bottoming at 241bp on June 1, 2007 spreads hit 400bp within two months and peaked at nearly 600bp within six months. Even in a very robust risk-taking environment, the market only spent about six months in total below 300bp OAS. While there will always be differences between cycles, we believe that its very clear that it is not a market environment to be chasing market beta.

With spreads approaching cyclical lows, the skew to asset prices clearly favors a defensive posture in our view. While positive momentum can continue from here, eventually there will be a shift and we believe it is appropriate to be positioned for that turn rather than try and squeeze the last bit of momentum from the market.

ICE BofA US High Yield Index – Gov't OAS bp



Source: Bloomberg/ICE BofA

Portfolio metrics:

The Fund finished March with long positions of 161.3%. 68.3% of these positions are in our Current Income strategy, 86.7% in Relative Value and 6.3% in Event Driven positions. The Fund had a 59.4% short exposure (excluding cash) that included -5.7% in government bonds, -38.3% in credit and -15.4% in equities. The Option Adjusted Duration was 1.05 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 0.77 years.

The fund's current yield was 4.5% while yield to maturity was 6.5%.

Justin Jacobsen, CFA
April 11, 2024