Manager's Commentary

Emily Wheeler, CFA

After a slow start to the quarter, the Fund posted strong performance in May and June, which drove a respectable relative return in Q2. The Fund was up 1.7% for the quarter ended June 30 versus a 0.9% return over the same period for the Fund's benchmark, the FTSE Canada Universe Bond Index[1].

Strength in Q2 was partially attributable to a rally in the front end of the curve in Canada in response to the Bank of Canada's decision this quarter to reduce the overnight lending rate 0.25%. Marking the first rate cut since March 2020, they suggested the decision was the result of continued evidence of easing inflation. Strength in areas of credit to which the Pender Corporate Bond Fund is exposed also bolstered performance over the quarter through the Fund's holdings.

A Focus on Fundamentals

A fundamental approach drives our research efforts. Finding opportunities that provide credit fundamentals better than their credit rating or yield may suggest, can and has in the past been a driver of returns of our Investment Grade holdings. Finding such a situation can prove fruitful through spread tightening on the back of a ratings upgrade once that value is recognized by a rating agency or the broader market. The Fund has been the grateful recipient of several such outcomes over the years. Thomson Reuters, Fairfax, Choice Properties, Waste Management and Loblaw Co. are several issuers held by the Fund that serve as examples. All had relatively strong fundamentals potentially supportive of an upgrade in our opinion at the time of purchase and all subsequently received upgrades. Turning over many rocks and digging deep into credit specifics is a cornerstone of our process, one that has served the fund well in the past and one that we anticipate will continue to drive relative performance.

Relative Value Opportunity

Areas of the market that appeared interesting over the quarter involved defensive sectors including Utilities and Consumer Staples. Performance of Defensives are, in general, inversely related to the market – performing well in a decreasing market environment and vice versa when the market is strong. In a recent piece, Callum Thomas suggested that Defensives are at their third cheapest level relative to the market going back to the 80s and that defensive sector ETF allocations are the lowest they have been going back to 2006[2]. These two points may suggest that this area is both undervalued and underinvested, which could ultimately be a good setup for these securities at some point in the future.

As such, we had to look for a potential addition to the portfolio that would fall into this category. Something we found interesting in the utilities space was a convertible bond in the

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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] *Source: Topdown Charts, May 31, 2024.*

capital structure of PNM Resources. The company's business involves the operation of regulated utilities that generate and distribute electricity to customers in New Mexico and Texas. Given the locale, much of their electricity generation business focuses on renewable sources such as solar and wind with a goal to be carbon-free by 2040. As the underlying issuer is rated investment grade by S&P and Moody's and given they run regulated utilities, we believe there is a much higher quality of downside protection for this issue than the lack of rating suggests. With the equity trading at under a 20% discount to the convertible's strike price, the bonds offer potentially attractive upside and a 5.9% YTM in the interim.

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A Mean Reversion Scenario – TIPS

Issued and backed by the US Government, Treasury Inflation Protected Securities (TIPS), may offer an attractive Investment Grade opportunity. Real yields, or the yield above breakeven inflation, are currently approximately 2% - a level not reached since 2008. As yields came down in the 5-year period that followed back then, these securities provided an impressive total return of over 50%. For context, the long-term average real yield (using TII 1.75% 2028 as a proxy) is approximately 76 bps and it is currently well over one standard deviation from that mean (2.2% currently). A reversion to the long-term average would provide a reasonable total return here. To illustrate this with a fund specific example - we currently hold TII 0.125% 02/15/2052 in the Bond Universe Fund. Were yields to drop only 1% as opposed to the full mean reversion suggested above, these bonds would realize a positive one-year total return of approximately 31%.

Credit Positioning:

Tightening somewhat through the quarter but finishing the period relatively unchanged versus the end of Q1, both BBB and High Yield spreads in the US remain tight on an historic basis. At 1.18% and 3.21% respectively, spreads of each are approximately one standard deviation below their respective long-term averages going back to the 90s and are therefore not cheap currently. As we endeavor to add credit exposure when spreads are wide as opposed to when little excess yield is offered, the Bond Universe Fund does not currently hold its maximum allowable weight in non-Investment Grade positions. Exposure here represented 23% of the fund at quarter end.

The duration of the Bond Universe Fund at June 30, 2024 was 4.74 years. The yield to maturity of the fund was 5.34% and cash represented 4.3% of the portfolio at quarter-end.

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Standard Performance Information for Pender's Fixed Income Funds may be found here: https://www.penderfund.com/fixed-income/
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