Manager's Commentary

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Over the three-month period ended September 30, 2023, The Class F units of the Pender Bond Universe Fund outperformed their benchmark by 2.9%. The Fund's three-month return over the quarter was -1%[1] versus the benchmark's -3.9% over the same period.

Shorter-dated, high-grade corporate bonds such as the Fund's 2024 maturities of Apple Inc. and PepsiCo Inc. provided relative strength over the quarter, as did exposure to credit as benchmark yields rose considerably and several high yield positions performed well.

Periods of Inversion and Recession

From the 1980's onwards, the 10-Year minus the 2-Year Treasury index has been negative on only a handful of occasions. Peak inversions in the '80s, in 2001 and through the global financial crisis were each followed by a recession with no instances of inversion existing in the absence of recession.

An inverted yield curve impacts a bank's ability to do what a bank does, which is borrow short and lend long. The business no longer works if borrowing must be done at a rate higher than that at which it is lending. This situation has preceded recessions in past periods.

Why do we care? Because if you had purchased a 10-year Treasury at the peak of the inverted yield curve during the 2001 and 2008 recessions, which occurred in 2000 and 2006 respectively, your maximum total return coming out of those periods would have been over 40% in the case of the 2001 example and ~35% coming out of the 2008 period. Quite attractive returns for a security backed by the full faith of the US government.

The current inversion is rivalled only by that which was present during the early 1980s.

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Duration Positioning

After decades of predominantly positive readings, the US 10-year term premium turned negative several years ago, and as a result, fund duration has remained relatively tight. More recently, however, a term premium has materialized. With the existence of a modestly positive term premium and a long-term interest rate noticeably higher than the current rate of inflation, some compensation has actually emerged for taking on the higher volatility inherent in longer-dated bonds.

[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.

Given the amount and speed with which the Fed Funds rate has increased, we thought it was worth considering previous periods characterized by similar step-ups in rates along with a look at the 10-year yield change coming out of these periods. Currently, the Fed Funds rate is up more than 5% over the last 18 months. The previous two periods that had a significant step-up in rates (around 2007 and 2019) were followed by a decline in the 10-year yield of more than two thirds from the late cycle peak.

Considering several factors, including the current characteristics of the term premium, the inversion of the yield curve discussed above, the speed with which North American central banks have increased rates along with participant positioning and an extreme pricing environment versus history in the investment grade space, we extended Fund duration somewhat in Q3.

In the third quarter, we reduced the Fund's weight in several shorter-dated, high quality corporate issuers and government bonds and reallocated proceeds to longer-dated holdings. Included here was the addition of the Warner Brothers Discover Inc. 5.391% '62.

Several characteristics make the Warner Brothers long bonds attractive in our opinion. The company is actively de-levering and has considerable cash generation that covers interest several times over. Priced at 74c on the dollar, these BBB-rated bonds offer an attractive 7.4% yield to maturity. Risk/reward is also attractive. Should rates decrease 1%, price appreciation would be ~15% with a potential one-year total return of greater than 20% if you factor in the coupon over this period. Conversely, for a 1% increase in yield, the one-year total return would be a loss of only around-6.4%.

The Fund's position in Inflation-Linked Bonds was slightly higher at quarter-end versus the beginning of Q3. The real yield, or the yield above breakeven CPI, in the Real Return Bonds held by the Fund is currently above 2%. The last time that was the case occurred during the financial crisis in 2008. The price appreciation for these issues from the end of 2008 when their real yield was over 2% was ~40% to the end of 2012 coming out of that period.

Fund Positioning

With high yield spreads essentially unchanged at quarter-end versus the beginning of Q3 and in the face of generally decelerating CPI, somewhat weakened economic conditions and central bank rates at levels that we may have yet to see the full impact of, the Fund's exposure to credit via its Pender Corporate Bond Fund holdings remains lower relative to historic weightings. The Pender Bond Universe Fund had a 19.7% weight in Pender Corporate Bond Fund units at the end of September, resulting in a non-investment grade weight of 13%.

Yield to maturity of the Fund was 5.94% at September 30 and duration was 4.7 years. Cash represented 2% of the Fund at quarter-end.

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October 10, 2023