Manager's Commentary
Justin Jacobsen, CFA

The Pender Alternative Absolute Return Fund finished June with a return of 0.0% bringing year to date return to 4.2%[1].

Volatility hit new cyclical lows in June, which is a challenging set up for the Fund as uncovering opportunities has become increasingly difficult as value in higher quality credit continues to erode. Spreads were broadly unchanged for the US high yield market, closing the month at 321bp Govt OAS, up from 320bp at the start of the month. It has now been over two months since the most recent low in spreads was put in on May 6.

Portfolio and Market Update

As the market becomes increasingly picked over, we continue to look for opportunities to recycle capital out of existing positions and into better opportunities. The Fund participated in new issues from Saturn Oil & Gas Inc (TSX: SOIL) and G. Cooper Equipment Rentals (private) both of which were bid close to two points above issue price as of the second week of July. As we continue to patiently wait for a return of volatility and opportunities to scale into core positions, much of our attention is focused on shorter duration and event driven positions with good carry and minimal downside.

While the lows in spread for the year in both high yield and investment grade markets were reached in early May, the B rated segment of the high yield market hit a new low in June. We believe this was driven by rotation out of expensive BB rated bonds into issues with higher yields and spreads, as investors looked to capture another, perhaps final leg of spread compression.

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

Source: Bloomberg/ICE BofA

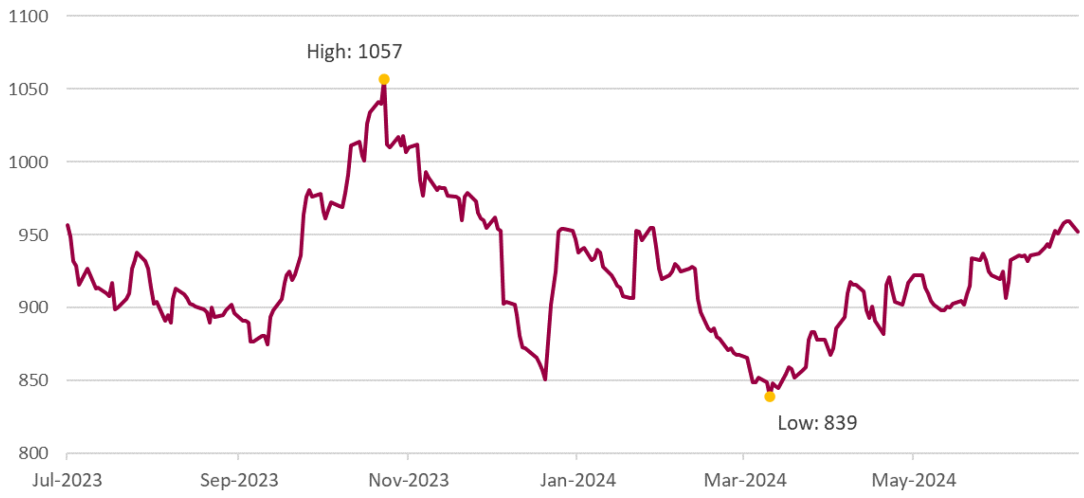
[1] *All Pender performance data points are for Class F of the Fund. Other classes are available. Fees and performance may differ in those other classes. Standard Performance Information for Pender's Alternative Absolute Return Fund may be found here: https://www.penderfund.com/pender-alternative-absolute-return-fund/*

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

Source: Bloomberg/ICE BofA

Despite the robust risk appetite for performing high yield credit in the lowest rating segment, issues rated CCC and lower have been moving wider since spreads bottomed out in March. Currently, spreads are materially wider in this ratings bucket than they were at any point in 2021. Stressed and distressed securities underperforming can be a leading indicator for broad risk markets, but it is likely too early to make a definitive judgment. Some sectors like telecom might not have significant read throughs for the market, while a sector like commercial real estate where there is distress in pockets has the scale to impact credit conditions broadly, given its impact on banks, institutional investors and broad credit impulse.

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



Source: Bloomberg/ICE BofA

The divergence between broad markets and economically sensitive segments is also apparent in equities, with the S&P transportation sector having reached its high for the year in March. There have been previous instances where this sector has been a leading indicator of a market downturn.

Low risk premiums and some signals that a cycle turn could be coming argues for defensive positioning. According to Goldman Sachs, realized volatility for the S&P 500 hit six (equivalent to a realized VIX index) over past month as of July 8, ranking in the 1st percentile over the past five years, which is exceptionally low volatility [2]. If history is any guide, these periods tend to create excesses and imbalances in risk positioning, which will need to be unwound at some point.

Portfolio metrics:
The Fund finished June with long positions (excluding cash) of 150.0%. 75.4% of these positions are in our Current Income strategy, 71.1% in Relative Value and 3.5% in Event Driven positions. The Fund had a -54.4% short exposure that included -5.2% in government bonds, -33.1% in credit and -16.1% in equities. The Option Adjusted Duration was 0.63 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 0.34 years.

The fund's current yield was 4.0% while yield to maturity was 6.2%

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[2] *Source: Goldman Sachs, as of July 8, 2024.*