

Manager's Commentary

Amar Pandya, CFA

Dear Unitholders,

The Pender Alternative Arbitrage Fund was up 0.22%¹ in August 2024. The Fund's benchmark, the HFRI ED: Merger Arbitrage Index (USD) returned 0.03% during the same period.

M&A Market Update

Global M&A activity reached over \$2.1 trillion through the end of August, up 16% from the same time last year.² The recovery in deal flow continues to show momentum in North American markets, the investible universe for the Fund, with M&A transaction up 23% in the US and 37% in Canada relative to the same period last year. We continue to see signs of optimism materialize in M&A deal-flow with higher activity across a broad number of sectors and industries. American multinational food company Kellanova (NYSE: K) (commonly known as Kellogg's) announced a deal to be acquired by Mars Inc. during the month. The \$36 billion transaction represents the largest merger announced this year and the first large-cap consumer deal in over a year.³ The return of mega-merger deals is a positive sign for markets and M&A activity as large acquirers are exhibiting confidence in the economy, consumers and credit markets given the risk and complexity of financing and closing a deal of this size. High investor confidence, lower interest rates and strong equity markets are a powerful combination primed to drive M&A activity higher.

SPAC Market Update

August saw the highest level of SPAC new issuance since 2022 with a total of nine SPACs completing an initial public offering during the month raising \$2.1 billion of capital. Part of the pickup in new SPAC activity is mean reversion with the SPAC sector recovering from two years of anemic performance as the vast majority of SPACs issued during the 2020-2021 bubble have been liquidated or redeemed and the SPAC industry shrunk below its pre-pandemic size. With the IPO window remaining largely closed to private companies that are increasingly desperate for capital, SPACs provide an alternative option with an immediate capital injection and access to public markets. The majority of the new SPACs are also being brought to the market by serial SPAC sponsors with a track record of finding a target and successfully completing a de-SPAC.

There were nine SPAC IPOs in August with seven SPAC deals also closing during the month and four SPAC liquidations⁴. As of the end of August, there were 207 active SPACs in the market with assets of \$13.1 billion, 102 of which are actively searching for targets. The Fund

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 Deal Intelligence I as of August 8, 2024

³ <https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/35-57b-snack-deal-revives-global-large-m-a-activity-83195173>

⁴ <https://www.spacresearch.com/>

has increased its exposure to SPACs through a combination of participating in a handful of new issuances while also adding exposure to existing SPACs offering attractive low-risk, tax-efficient arbitrage yields.

With new SPAC issuances competing for capital with existing SPACs, we have seen a widening of SPAC arb yields from liquidations and redemptions. At the end of August 2024, SPACs searching for targets were trading at a discount-to-trust value, which provided a yield-to-maturity of 9.33%.⁵ With SPAC arbitrage effectively equivalent to acquiring a Treasury Bill at a discount, SPACs currently provide a higher yield to US Corporate Investment Grade Bonds with lower credit risk, shorter duration and a tax advantage as SPAC returns are primarily capital gains.

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Portfolio Update

August was a bumpy month in equity markets with a correction occurring early in the month before subsequently recovering. We did see spreads widen for several deals held in the Fund during that period which we were able to take advantage of by adding to those positions as we believed there was no change in the timing and probability of those deals closing. We continue to see an active environment in our core small and mid-cap universe with the Fund benefiting from several large holdings closing allowing us to fully capture those spreads and redeploy that capital into new deals. During the month, the Fund initiated positions in 14 new merger deals with 12 deals held within the Fund closing. The Fund was also active on the SPAC arbitrage portion of the Fund, participating in several SPAC IPOs and investing in several SPAC redemption and liquidation opportunities. Given the opportunity in both merger arbitrage and SPACs, the Fund is fully invested with the highest exposure since 2022 allowing us to allocate capital to deals we believe offer the best risk-adjusted returns.

Small cap M&A activity remains robust in Canada and the US with conditions ripe for activity to pick up. An interesting dynamic we continue to see is many small and mid-cap companies receiving opportunistic acquisition offers at a decent premium to their current market price but well below estimates of intrinsic or fair market value. After years of anemic performance for small cap businesses, shareholder frustration is high. Although reluctant to negotiate a deal when valuations were at a fraction of their value estimate, now that valuations have re-rated, these shareholders may be more receptive to an offer at a modest premium today, even if that offer remains well below fair value. In many cases, the buyers are management or include management rolling in their equity into the new privatized company. With a clear asymmetric informational advantage, minority shareholders may be getting the short end of the stick, but the majority appear willing to take the liquidity and move on. We are seeing

⁵ <https://www.spacinsider.com/>



this dynamic play out in many of Pender's equity holdings, and we anticipate more of these transactions to occur as buyers and sellers converge to a valuation expectation which allows a transaction to occur. Like the adage says: "a good compromise is when both parties are dissatisfied."

At the end of August 2024, the Fund had 37 investments in small cap deals under \$2 billion, 28 of which were valued at under \$1 billion.

Outlook

Major stock market indices ended August near record highs after recovering from the correction at the beginning of the month. The S&P 500 was up 2.4% in August with the NASDAQ up 0.7% and the S&P/TSX up 1% while the Russell 2000 was down 1.5% in the month. With inflation falling as labour markets cool, the Fed is set to cut rates with the market focused on Fed commentary to understand how many rate cuts to expect through the end of the year. With equity markets at highs and rates coming down, there is a favorable tailwind for M&A deal flow in the months and quarters ahead. While the election may add some uncertainty to markets, we expect M&A transactions to remain robust through year end as valuations and interest rates are likely more material factors for acquirers. For private equity buyers in particular who have trillions of dollars of capital waiting to be deployed, higher interest rates have been the key hurdle holding back activity. With rates set to fall and potentially fall fast and far, we could be entering an M&A upcycle.

M&A activity has seen a challenging period with 2023 representing the lowest level of deal flow in decades as rates were raised at a record pace to fend off post pandemic inflation. We are now entering an environment where those headwinds will turn to tailwinds as interest rates are cut and deal activity is set to increase. With equity markets at highs, corporations and private equity firms loaded with capital and financing conditions set to improve, we are optimistic about outlook for M&A and merger arb returns. Arbitrage spreads have remained wide on both a relative and absolute basis and could see further widening as deal volumes increase. This favorable backdrop for M&A contrasts with the headwinds for short-duration fixed-income securities which are set to see their yields decline as interest rates fall. The non-correlated, tax-efficient return potential of arbitrage appears attractive in this environment and investors would be well suited to consider adding an alternative strategy that can complement or substitute short-duration fixed income.

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