

Manager's Commentary

Amar Pandya, CFA

Dear Unitholders,

The Pender Alternative Arbitrage Fund was up 0.24%¹ in September 2024. The Fund's benchmark, the HFRI ED: Merger Arbitrage Index (USD) returned 0.97% during the same period.

M&A Market Update

Global M&A activity totaled \$2.3 trillion during the first nine months of 2024, up 16% from the same period last year.² It is notable that the material increase in deal values this year has come from 20% fewer deals, indicating an increase in the size of the average deal. For mega deals over \$10 billion volumes were up 35% globally while deals under \$500 million saw a 9% decline in activity. The return of larger M&A deals is a positive sign indicating confidence amongst acquirers is on the upswing given the complexity and financing risk of a large acquisition relative to a smaller deal. The US accounted for nearly half of all global M&A which represents a five-year high reflecting the strength of US equity and credit markets. On a sector basis, technology deals lead activity followed by energy & power and financials. The sector led activity is reflective of acquirers seeking competencies in AI, cloud computing, electrification and fintech, with the financial sector also seeing a notable increase in regional bank consolidation. Investment banks, deal advisors and consultants continue to see a healthy pipeline of activity through year-end and with central banks around the world cutting interest rates, we could see a further pickup in activity.

Private Equity-backed buyouts accounted for nearly a quarter of all M&A activity through September, up 20% from the first nine months of 2023. The overall value of PE backed deals was up 40% from last year and ranks as the fourth largest period since records began. PE led buyouts have soared in the past two decades accounting for 10% of deals in 2001 and reaching a peak of 40% of total deal activity in 2022³. With burdensome regulatory, reporting and audit requirements and the obligation to distribute marketing and financial materials to public investors there is considerable complexity and cost in being a public company. As a private company, many of these burdens can be avoided or minimized. As a public company, management incentives can be skewed to the short-term given the quarterly reporting obligation, and the impact quarterly results can have on a company's share price. As a private company, management incentives can be focused on growing long-term intrinsic value better aligning management teams with owners. While public markets have historically provided more abundant access to capital, it may no longer be the case as an ecosystem of private lenders have emerged providing the same level of access to capital

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 LSEG Global Mergers & Acquisitions Review - First Nine Months 2024 | Financial Advisor

³ <https://www.themiddlemarket.com/news-analysis/private-equity-investors-account-for-40-percent-of-u-s-deals>

for private equity acquirers. Given these advantages and the considerable dry powder available for deployment at private equity firms, they are likely to remain a dominant acquirer of public companies for the foreseeable future.

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SPAC Market Update

The SPAC market continued its rebound in September with the market cap of outstanding SPACs increasing from the previous month. Several SPAC IPOs were announced throughout the month and new filings indicated that other sponsors intend to launch new SPACs in the near-term. While these SPACs tend to be backed by well-known sponsors with an established track record of sourcing and closing deals, we have yet to see this new vintage of SPACs announce a merger. It is likely that there are opportunities given the lack of IPO's for nearly two years and higher funding costs impacting many early-stage companies. We continue to monitor new SPAC issuances but intend only to participate in those that offer the most favorable arbitrage return potential.

There were five SPAC IPOs in September with three SPAC deals also closing during the month and two SPAC liquidations⁴. As of the end of September, there were 206 active SPACs in the market with assets of \$13.3 billion, 109 of which are actively searching for targets. The SPAC exposure in the Fund remains at a higher level than throughout the year although exposure declined throughout the month as several SPACs were redeemed or liquidated.

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 September 2024, SPACs searching for targets were trading at a discount-to-trust value, which provided a yield-to-maturity of 8.08%.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.

Portfolio Update

After several months of elevated deal activity, September was relatively slower with 10 new merger deals initiated in the Fund while six deals held within the Fund closed. Merger arbitrage spreads remain wide on both a relative and absolute basis as a recovery in M&A deal volumes, regulatory overhang and a pick-up of small cap M&A has kept spreads wide. We track potential merger deals or pre-deal M&A using a variety of screens, databases and services and it is notable that we are currently seeing the highest level of potential “deals in the works” for small and mid-cap North American companies since launching the Fund. This can include companies that have received an indication of interest, a non-definitive offer, a

⁴ <https://www.spacresearch.com/>

⁵ <https://www.spacinsider.com/>



strategic review initiated after an expression of interest or a credible rumored deal. This does not imply that the majority of these deals in the works will result in a definitive merger agreement, but it is likely that many will become definitive, and it does indicate that markets are primed for more deals. In addition to robust M&A activity within our core small cap universe, there are several large cap deals trading at wide spreads due to elevated regulatory scrutiny that we are following closely including Albertsons Companies, Inc. (NYSE: ACI), Ansys, Inc. (NASDAQ: ANSS), Capri Holdings Limited (NYSE: CPRI) and Kellanova (NYSE: K). These mergers are likely to see catalysts materialize in the coming months blocking or supporting their acquisitions and could present compelling investment opportunities at some point. We are also continuing to find ample deal activity in our core small and mid-cap universe. The Fund continues to be fully invested given the volume of quality merger arbitrage and SPAC arbitrage opportunities. At the end of September 2024, the Fund had 36 investments in small cap deals under \$2 billion, 26 of which were valued at under \$1 billion.

Outlook

Major stock market indices continued their march higher in September recovering from an initial fall early in the month. The S&P 500 rose 2.1% in September with the NASDAQ up 2.8% and the S&P/TSX up 2.8% while the Russell 2000 was up 0.7% in the month. The Fed delivered a jumbo 50bps rate cut during the month, cutting the Fed Fund rate for the first time since March 2020. In Canada the BOC cut rates a further 25bps noting that softening economic data and slowing inflation could drive a more aggressive pace of rate cuts through the year-end. We expect a decline in rates to continue to drive higher M&A activity from both strategic and financial investors. With short-duration fixed income investments facing a headwind of declining interest rates while merger arbitrage benefits from a tailwind of elevated activity and wide spreads, we are in an attractive environment for merger arbitrage investing. We continue to be optimistic about the forward outlook for M&A activity, merger arbitrage returns and small cap M&A in particular.

The upcoming US election could point to a turning point in M&A activity and merger arbitrage returns. The regulatory environment over the past few years has been challenging with the Federal Trade Commission Chair Lina Kahn and the US Department of Justice Antitrust Division assistant attorney general Jonathan Kanter taking a hostile approach to regulate merger deals. This has likely resulted in a decline in M&A activity as the uncertainty of closing a transaction prevented many deals from materializing. This hostile regulatory environment has also delayed the mergers of several large deals. With the potential for change in these key regulatory positions regardless of a Harris or Trump victory, the final quarter of the year appears catalyst rich for merger arbitrage. Many deals which are facing regulatory hurdles are in their final stages of approval yet still trade at wide spreads which in some cases we would consider mispriced. We will be assessing these deals carefully and believe there could be some attractive investment opportunities among them.

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