

Manager's Commentary

Geoff Castle

The Pender Corporate Bond Fund ended September with a monthly return of 0.7%¹. The positive result occurred within the context of a robust bond market, which rallied strongly into the Federal Reserve's rate cut decision and then sold off somewhat afterwards.

Strength in the month was driven by top ten holding, the Hughes Satellite Systems 5.25% first lien 2026 bond, which has now rallied over 20 points from its spring lows, most recently on expectations of credit enhancements resulting from a rumored merger with DirecTV. Precious metals securities were strong as well, with Equinox Gold Corp 2028 convertible notes rallying over 10 points in September on improved earnings prospects.

Performance was offset to a degree by stress in some specific credit lines. Revance Therapeutics Inc convertible bonds fell over 12 points on a delay emerging in the consummation of the company's announced acquisition by Crown Laboratories, Inc. We judge the delay, which relates to a commercial dispute with a supplier, not to pose a real threat to the deal. Our position in Spirit Airlines Inc secured 2025 bonds was also impacted by a delay in credit restructuring negotiations, which are still ongoing. In both cases we added to the positions on weakness.

A Fed Cut and Now What?

We will look back at September 2024 as the month that initiated the fourth Federal Reserve rate cutting cycle of this young century. The first of those cutting cycles terminated in 2003 with a Fed Funds rate of 1%. The other two, commencing in late 2007 and mid-2019, respectively, both ended with the Fed Funds rate pegged close to zero.

Are we going back to zero again? It is always possible. But we believe the drivers of inflation have changed from the last decade. We see a spiraling increase in demands on the public purse. Western democracies face, amongst other challenges, the new military threat of Russia and its autocratic allies; the cost of dealing with a growing spate of climate emergencies; and unfunded demands for spending on pensions and medical care for retirees who represent an increasing share of the population.

And while the demands for public spending seem only to increase, the more finite supply of prime-age workers to service such demands suggests that governments in Canada, the U.S. and elsewhere must confront an expanding public sector funding gap. And, given this equation needs to ultimately balance in cash terms, the difference looks likely to be met by money creation.

So, we expect that an economic slowdown, such as we have seen in the wake of the Fed's unprecedented rate hiking cycle of 2022-23, may not produce the same degree of

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.

disinflation observed in past cycles. And therefore, our core view is that we will have a relatively short hiking cycle that leaves Fed Funds a couple of points lower, but which will be terminated amid resurging and persistent inflation.

In the long run, our guess is that North America is ultimately headed back to some form of yield curve control, along the lines of what we currently see in Japan and, from time to time, in Europe. And that environment, from an investing perspective, should favour investments in scarce real assets, like energy commodities or precious metals, and in highly predictable income streams, such as the ones that come from monopolies and regulated utilities.

There are other potential winners. TIPS and Real Return bonds ought to do well in such circumstances. And small, high growth companies may also deliver strong returns in this context. We believe good, distressed debt opportunities should be in fairly abundant supply. So, overall, we think the coming years will offer not a bad environment for a credit investor to invest in, but this will not be your father's bond bull market.

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New Positions

In September we funded a new loan to **Terrascend Corp**, a multi-state cannabis producer and retailer active in several Northeast American states. The new first lien term loan yields 12.75% and enjoys top priority in Terrascend's capital structure. Over the past three years, as a lender, we have been impressed by the progress management has made in both reducing debt while expanding the sales and profitability of the firm. Total debt represents less than one quarter of current enterprise value, and we view one-year default probability at less than 1.0%. Terrascend is subject to several near-term catalysts, including a likely move to legalize cannabis nationally in the United States.

Also in September, we acquired a position in the 7.875% 2025 notes of **Herbalife Ltd**. Sometimes controversial, Herbalife is a direct marketer of nutritional supplements in North America and internationally. We own the company's smallest and most immediate debt maturity, with only \$300 million outstanding as of September 30. Management has committed to the early retirement of this bond, whose principal amount is less than the company's current balance sheet cash. Recently priced to yield over 8%, we view this bond as a pragmatic short-term yield opportunity.

Finally, this month we initiated a position in the secured term loan of **Telesat LLC**, a subsidiary of Ottawa-based Canadian satellite operator Telesat Corp. A distressed position, the loan currently trades near 50% of face value to yield over 40% to a prospective 2026 maturity. Telesat faces challenges related to a declining revenue base for its existing

geostationary (GEO) satellite fleet. We believe that Telesat's new Government of Canada-supported push into the Low Earth Orbit (LEO) satellites is a credit positive. Moreover, the strategic importance of the company to Canada's military and to remote communities in Canada make bankruptcy of the firm unlikely, in our view.

Fund Positioning

The Corporate Bond Fund yield to maturity at September 30 was 8.2% with current yield of 5.6% and average duration of maturity-based instruments of 3.5 years. The Fund holds a 2.2% weight in distressed credit instruments where positions are held for a target value lower than par, and therefore the headline yields of these securities are not included in the foregoing calculation. Cash represented 0.8% of the total portfolio at September 30.

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