

Manager's Commentary

Geoff Castle

The Pender Corporate Bond Fund returned 1.1% in October¹, a welcome result given negative returns in both high yield and investment grade indices for the period.

A key performer in October was our position in the secured bonds of **Spirit Airlines Inc** which rallied over twenty points following news of aircraft monetization and speculation regarding business combinations with competing discount airlines. Strength also came from our holdings of **Fannie Mae** and **Freddie Mac** preferreds as investors speculated that the US election may serve as a catalyst for value realization. We trimmed this position somewhat on the rally. And, finally, we benefited from a double-digit percentage rise in **Lucid Group Inc** bonds as incremental equity investment by the Saudi Public Investment Fund underscored the kingdom's implicit support of the car maker's debt structure.

Offsetting this month's gains, to a degree, was a broad decline in rate-sensitive securities that continued their weakness following September's Federal Reserve rate cut. Also declining was our position in the **American Tire Distributors Inc** capital structure. Our holding in ATD's secured term loan was significantly impaired as a surprise Chapter 11 filing arrived alongside an aggressive debtor-in-possession facility which disadvantageously primed our position. "Swim with the sharks," they say, "and you are going to get bit." Well, we got bit. But we haven't given up and are still working to improve our recovery from this holding, where potential upside may significantly exceed its small current portfolio weight of 0.2%.

2025 is Coming... What's your Strategy?

As we think about 2025, our strategy can be summarized in a simple formula: **safety plus opportunity**, held in roughly equivalent quantities.

Safety positions are not held because we are frightened, nor because we know terrible things about the future. We hold safety positions because we understand that panics and crises tend to come along from time to time, and there's an advantage to having dry powder ready for those occasions.

For the safety book, we choose liquid bonds from issuers with relatively impregnable business models and tiny quantities of net financial liability. Index provider **MSCI Inc**, business information publisher **Thomson Reuters Corpor**, and dot com domain registry monopolist **VeriSign Inc** are examples. Depending on the tenor and taking into account the current environment, credit positions like these are 4-6% yielders and are very readily tradeable.

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.

The **opportunity** book is invested in places where we have a view that is different from the market and where we believe we can significantly out-earn our safety holdings.

One opportunity is based on the idea that the high real interest rates of late 2024 are unlikely to last. We don't know whether inflation will re-accelerate or yields will drop, but we do expect some combination of the two to take place. Beneficiaries of a lower real interest rate environment include **TIPS** and **Canadian Real Return Bonds**. In 2024, these inflation-indexed securities have been trading near generational high real yields. Something has to give, and we think longer-tenor TIPS and RRBs are poised to benefit.

Potentially larger beneficiaries of declining real interest rates, if history is any guide, may be equity-sensitive holdings in the precious metal complex. Gold may not be very cheap here, but gold miners seem extremely so. And so chunky positions in **Equinox Gold Corp**, **SSR Mining Inc**, and **First Majestic Silver Corp** convertible bonds put us in good position to participate in a rally in the precious metals sector while maintaining good downside protection.

A second part of the opportunity book is much less “big picture” strategic. It is comprised of a couple of dozen individual corporate capital structures that have traded into stressed or distressed territory. There isn't a common industry theme to such names, **Cineworld Group PLC**, the movie theatre operator bears little in common with **Lucid Group Inc**, the electric car maker. But a common feature, at least at the point of purchase, is extreme unpopularity with investors. And what we have come to understand over the years is that **capital earns higher returns where it is scarce**.

A final category of opportunity relates to holdings that we refer to, in shorthand, as “yield-to-x,” where the “x” represents a put date or the timing of an expected early refinancing. As we have successfully demonstrated this year with the early takeout of bonds from **Athabasca Oil Corp** and **Aris Mining**, a discounted bond with a headline yield of seven or eight percent might earn an effective yield in the mid-teens if it is taken out significantly ahead of maturity. The level of our activity in the “yield-to-x” category depends, to a degree, on market conditions, but going into 2025 this group represents roughly a ten per cent weighting in the Corporate Bond Fund.

New Positions

In October we initiated a position in the 2026 and 2028 bonds of **Fair Isaac Corp**. The company has a unique moat in credit analytics and related software services. Its proprietary FICO score is used by most major North American lenders, including banks, credit unions and mortgage companies, to evaluate consumer credit applications. Fair Isaac enjoys strong profitability, with operating income covering interest charges approximately 7x in the past 12 months. We view one year default probability for this BB+ rated issuer at less than 0.1%.

Also in October, we built a position in the deeply discounted convertible bonds of **Cardlytics Inc**. The company operates an advertising business within proprietary banking applications, sharing revenues with its partners that include top tier US financial institutions. Some

investors have become impatient with the company's slow progression towards profitability and recently issued convertible bonds fell to as low as 50c on the dollar this summer. We see the potential for Cardlytics to become profitable and cash generative once its new partnership with American Express takes hold in 2025.

Fund Positioning

The Corporate Bond Fund yield to maturity at October 31 was 7.8% with current yield of 5.4% and average duration of maturity-based instruments of 3.5 years. The Fund holds a 4.2% 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 and short term working capital accounts represented a deficit of 1.3% at October 31 largely due to a negative mark-to-market in our currency hedges, which are offset within the Fund's NAV by higher value of securities held.

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