

Manager's Commentary – Q4 2024

Dear Investor

Since its inception, the Fund has achieved a net return of 29.6%, outperforming our benchmark¹ return of 14.8%. As of the end of 2024, the Fund's net IRR stands at 20.6%. The investment period concluded in July 2024. On October 1, 2024, we distributed 26% of committed capital to investors, followed by an additional 48% distribution in January 2025.

As the year ends, we reflect on our successes and challenges. Our strategy—centered on stressed and distressed credits in small to mid-sized companies with improving fundamentals—has been a key driver. These complex, undervalued investments often see significant value unlocked through restructuring and turnarounds, with our resilient investment process excelling in such situations.

Additionally, platform support from the larger Pender Corporate Bond Fund has been a significant advantage. Each investment demands rigorous due diligence and operational backing, which can be costly in a world of exclusive service fees. Fortunately, we have been able to avoid these expenses, benefiting from full access to services, brokers, and back-office platforms, thanks to the larger fund.

One area for improvement is extending the investment period, as opportunities typically emerge gradually over a continuous cycle rather than all at once. With a goal to consistently achieve strong performance, we need the flexibility to optimize returns over time. The introduction of our new evergreen fund addresses this challenge, providing a sustainable solution.

Market Backdrop

We are currently navigating market conditions that are as similar if not worse than those at the Fund's inception. The U.S. 10-year yield has risen from 4.02% to 4.56% as of December 31, 2024. High-yield spreads have narrowed from 380 bps to 294 bps, while the high-yield index effective yield declined from 8.23% to 7.30%. These shifts reflect a more negatively skewed risk-to-return profile.

Liquidity, a key driver of bull and bear markets, remains abundant. Credit spreads at 20-year lows signal minimal fear of a corporate credit cycle. The economic effects of the anticipated Trump administration policies—such as tax extensions, tariffs, immigration reforms, and changes to government size—seem largely priced into market valuations, reflecting investors' willingness to accept lower risk premiums typical of elevated valuation periods.

Risks to the investment landscape are increasing, with potential disruptions from a stalled disinflationary trend, disappointing AI-driven capital expenditures, or policy missteps. In overly bullish environments, risks are often underestimated. Currently, the market remains directionless, sustained by a "Goldilocks" balance supported by pro-business expectations like tax cuts and deregulation. While this does not indicate immediate danger, it highlights the importance of preparing for potential volatility and maintaining disciplined strategies in this uncertain environment.

¹ ICE BofA US High Yield TR



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For our portfolio and strategy, credit spreads are driven more by individual fundamentals than broader market forces. While actively managing positions can limit the immediate impact, we anticipate a cycle of credit spread fluctuations over the next three to five years, potentially unveiling new opportunities and clear winners in a shifting market.

Fund Top Contributors

Fannie Mae prefs (FNMAS): A key contributor in 2024 was our investment in Fannie Mae's defaulted preferred shares. These shares, trading without dividends since the 2008 financial crisis, were acquired below \$2.50 per share in August 2023 and sold throughout 2024, with the final block exceeding \$11 per share. The investment gained support from a \$2-per-\$25-par jury award tied to a legal challenge on the cash flow sweep, providing a valuation floor despite being under Federal appeal. The 2024 presidential election acted as a major catalyst. Investors viewed the preferred as a "Trump trade," doubling their value as optimism grew about the new administration's intent to end the conservatorship.

Cineplex Convert: As the dominant player in the Canadian cinema market with a 75% market share, Cineplex operates as a near-monopoly. While the pandemic caused an 80% revenue drop and recovery remains below 2019 levels, the company's fundamentals have improved significantly. Notably, its SCENE+ loyalty program, now reaching one in three Canadians, has grown 44% over three years. Investing during subdued box office expectations and a writers' strike, we leveraged the upside potential and mitigated downside risk through convertible bonds, achieving a realized return of over 35%.

Fund Top Detractors

Stem Inc.: Stem Inc.'s convertible bonds were a drag on performance. Despite the company's potential in utility-scale battery operating systems, its stretched credit metrics have kept bond prices below 30. Both the stock and bonds of Stem were under pressure following disappointing quarterly sales and earnings, impacted by delays in new utility battery installations caused by funding setbacks in municipal utilities. While this has been a challenging position for us, we remain confident in Stem's long-term value as a leader in battery operated system software, which justifies holding our position through this period of underperformance.

McDermott Reorg Equity: Since its 2020 reorganization, McDermott has faced challenges but is now capitalizing on a recovering energy infrastructure market. The company has strengthened its performance through a restructured balance sheet, more profitable cost-plus contracts, and a robust backlog. Despite significant improvements, including a 50% year-over-year increase in EBITDA, the stock remains weighed down by tax-loss selling and dilution from mandatory preferred shareholders. This disconnect between the stock's price and McDermott's improved fundamentals reinforces our confidence in its long-term potential.

It has been another great year. Thank you for the opportunity to grow your wealth alongside our own. Wishing you a prosperous and fulfilling 2025!

Thank you,

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