

Manager's Commentary

Geoff Castle

The Pender Corporate Bond Fund returned 0.7% in December¹, capping an excellent year in which the Fund delivered a total return of 16.9%. The Fund's series U, which does not hedge USD exposure, ended 2024 with a total return 23.7%.

Top contributors to the month's return was our position in the American Tire Distributors Inc. term loan, which rebounded over 50% in the wake of our successful legal efforts (discussed in last month's [commentary](#)) to recapture the priority of our position within the company's capital structure. Another key contributor was our holding in convertible bonds of Revance Therapeutics Inc, which rebounded as a pending acquisition of the company was re-affirmed.

Rate-sensitive holdings were generally weak in December, including some longer duration positions in TIPs and in the Petroles Mexicanos (Pemex) structure. Credit positions in Cardlytics Inc and MP Materials Corp were also weak in sympathy with their weaker related equities.

Fannie/Freddie Preferred Shares... An Overnight Success Five Years in the Making

A top contributor in the Fund in 2024 was our rather esoteric investment in the defaulted preferred shares (prefs) issued by Fannie Mae and Freddie Mac, the government sponsored entities (GSE's). The largest line, the Fannie Mae Series "S" preferred, began 2024 at \$3.22 per share and closed Dec 30 at \$11.67/share, which was the day we sold our last block. Any time you own something that triples within a year in a bond fund, it is worth celebrating.

These prefs, trading without dividend since the GSE's defaulted in the height of the 2008 Financial Crisis have for years existed in a state of yieldless limbo. The entities' entire cash flow was subject to a sweep that sent profits from their mortgage insurance operations directly to the US Federal Government.

Colleague Parul Garg and I first got interested in the names back in 2019, when incoming Federal Housing Finance Authority Director, Mark Calabria, set in motion efforts to end the GSE conservatorship, to the immense potential benefit of preferred shareholders. However, Calabria's proposed recapitalization and exit program stalled in the run-up to the 2020 election. Then, in June 2021, an unfavorable Supreme Court ruling upheld the legality of the Federal government's profit sweep. The shares were crushed. Fannie Mae preferred "S" fell below \$2, down more than 50% from our initiation price in 2019.

We gained the confidence to add significant weight to the position in the summer of 2023, after a subsequent legal challenge to a specific period of the cash flow sweep resulted in a jury award of approximately \$2 per \$25 par value. Although that jury award was still subject

¹ All Pender performance data points are for Class F of the Fund unless otherwise stated. Other classes are available. Fees and performance may differ in those other classes.

to a Federal appeal, we felt the shares were now supported by the award value, and any progress in ending the conservatorship would be upside.

The 2024 presidential election proved to be a key catalyst for the GSE prefs as investors picked these as a "Trump trade." And in the wake of the November vote, the Fannie Mae prefs more than doubled. At this point we believe the Fannie and Freddie preferred shares have round-tripped to the set-up that existed in the spring of 2019. We have an incoming administration that wants to end the conservatorship, but there also remains many of the technical constraints that scuppered the last attempt. The entities are still undercapitalized, and there are legal and administrative hurdles which will make their exit complicated and difficult.

This time around, the GSE exit may succeed, and we may have left some money on the table. But the move in Fannie Mae "S" position from \$2 to more than \$11/share seems to be the safest profit to take.

It took five years, from beginning to end, but the key to this success was our work in understanding the risk/reward inflection that arrived in 2023. As is so often the case, it is not brilliant insight on first analysis that delivers the biggest returns, but rather acting on conviction that can build many months into a holding period.

New Positions

In December we continued to build weight in the credit of regulated utilities. One attractive line, in our view, is the Duke Energy Corp 4.125% 2026 convertible bonds due in 2026. Priced around 102% of face value, the BBB-rated Duke converts provide cheap optionality to equity upside above \$118 per share, a mere 10% above the current market.

Also in December, we added to our position in the CrowdStrike Holdings Inc 3% 2029 notes, priced to yield approximately 5.5% to maturity. Internet security leader, CrowdStrike is an extremely strong credit, with total debt of only \$750million versus an equity market capitalization of \$85billion. Operating cash flow of over \$1billion dwarfs annual cash interest expense of \$22million and we view 1 year default probability at less than 0.1%.

Fund Positioning

The Corporate Bond Fund yield to maturity at December 31 was 7.1% with current yield of 5.2% and average duration of maturity-based instruments of 3.5 years. The Fund holds a 3.1% 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 0.3% at December 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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