

Manager's Commentary

Justin Jacobsen, CFA

Dear Unitholders,

The Pender Alternative Absolute Return Fund returned -0.3%¹ in May, bringing year-to-date returns to 1.1%.

Following on from the strong rebound in the second half of April, risk assets performed quite well in May with the S&P 500 generating its best monthly return in a year and a half. High yield credit spreads rallied sharply, closing the month 62bp lower at 332bp according to the ICE BofA US High Yield Index. The HFRI Credit Index, the Fund's benchmark had a strong month returning 1.5%.

Portfolio & Market Update

The magnitude of the continued rally in risk assets surprised us in May. The market seemed eager to discount positive outcomes relating to tariffs, interest rates and the global economy, rallying well through levels prior to "Liberation Day."

We continued to sell into strength as risk premiums became increasingly difficult to justify as they shrank, with high yield spreads hitting a low of 309bp Govt OAS early in the month. While it was challenging to recycle capital, we were able to buy some short duration positions and participate in several new issues.

On the short duration side, we more than doubled our position in the **JW Marriott Desert Ridge CMBS** bond early in the month. Shortly thereafter, the property was sold to Ryman Hospitality Properties Inc. (NYSE: RHP). The sale closed on June 10. Our purchase prices were between \$97.50 and \$98.00 with the position closing the month marked at \$99.32. We expect to be paid back at \$100 in the coming weeks.

The Fund's largest risk position is in the **Hilton Hawaiian Village CMBS**, we own four different tranches of this mortgage, with the largest tranche marked at just below \$96 at month end. We expect this bond to be redeemed at par in the next five months as the property owner, Park Hotels & Resorts Inc. (NYSE: PK) has made it clear in their latest earnings call that they plan on redeeming the issue before it becomes a current liability.

We saw opportunities in energy credit in May and added to our position in the **Vermilion Energy Inc. (VET)** 7.25% 2033 bond early in the month at a yield to maturity of about 11% and close to 20 points below par. In June we took sales in this bond at as much as 12 points above our recent purchases. We expect to continue to be active in energy bonds in the coming months but that the best opportunities to buy on weakness have likely passed for a while.

It has been a challenging market to put capital to work as the most optimistic narrative seems to fill every information vacuum. BB spreads, which are often a good proxy for our opportunity set, sit in the low 180s which is lower than they were in the sixteen-year period from the start of 2008 to the start of 2024. While spreads are negatively correlated with treasury yields, risk premiums are still tighter than they should be in our opinion.

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. Standard Performance Information for Pender's Fixed Income Funds may be found here: <https://www.penderfund.com/liquid-alternative-funds/pender-alternative-absolute-return-fund/>

We added an Event Driven position in **Encino Acquisition Partners Holdings LLC** (private) bonds on May 30, which was too late to show up on our month end position report. The company agreed to be acquired by EOG Resources Inc. (NYSE: EOG) in a transaction that we expect will likely close this summer. We expect our holdings to be taken out at a make-whole call price that is greater than our purchase price as we accrue a current yield of about 8% while we wait. This is our first Event Driven bond position of the year.

Market Outlook

While geopolitical risks are elevated from shifting trade policies and escalating conflicts both in west Asia and eastern Europe, the market has brushed it all aside as just noise with technicals and sentiment providing the driving market forces. Ultimately, time will tell as the path of both conflicts appears to be unpredictable to us, with potential impacts on global energy markets and shipping routes. Trade policy is likely to be more impactful on consumers and the economy. The second half of 2025 should bear out whether tariffs will have a significant impact on jobs and consumers or not.

The potential for “bond vigilantes” to force fiscal austerity on the US treasury remains something of a page one story for markets. US deficits are unsustainably high and likely to go higher in the near term if Trumps “Big Beautiful Bill” becomes law. If the US were any other country, the bond market likely would have forced a Liz Truss type reckoning by now.

What is more of a page sixteen story, at least for US markets, is the potential for foreign holders of US assets to be taxed at significantly higher rates. This would be achieved through section 899 of Trump’s Big Beautiful Bill which has been dubbed a “revenge tax” for countries with digital services taxes like Canada, the UK and Australia. The effect of this tax, if it goes ahead, could be to scare capital away from US capital markets, resulting in higher risk premiums and lower asset values. With concerns already growing about the US dollar’s safety, the timing could be quite poor, and we wouldn’t be surprised if markets forced the administration to re-think the net impact of taxing foreign investors in US markets.

Another area of concern for us that we believe is not priced into risk premiums is the potential for a real estate driven recession in Canada. Part of this is likely driven by the fact that Canadian real estate has looked overpriced and Canadian consumers appeared overleveraged for over a decade. While it might take a while for a weak real estate market to filter through the broader economy, it looks to us that 2025 will see significant price declines in both Toronto and Vancouver, which has implications for consumer spending, credit and job creation. We suspect that Canadian bank credit spreads are likely to move wider this year as the economic data deteriorates.

While the strength of the rally over the past two months was surprising to us, we believe that a disciplined approach while we wait for better valuations will ultimately pay off later this year.

Portfolio Metrics

The Fund finished May with long positions of 92.1% (excluding cash and T-bills). 20.2% of these positions are in our Current Income strategy, 71.9% in Relative Value and 0.0% in Event Driven positions. The Fund had a -56.9% short exposure that included -3.2% in government bonds, -37.2% in credit and -16.5% in equities. The Option Adjusted Duration was 1.22 years. Excluding positions that trade at spreads of more than 500bp and positions that trade to call or maturity dates that are 2027 and earlier, Option Adjusted Duration declined to 0.59 years. The Fund’s current yield was 4.47% while yield to maturity was 6.34%

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