

Manager's Commentary

Justin Jacobsen, CFA

Dear Unitholders,

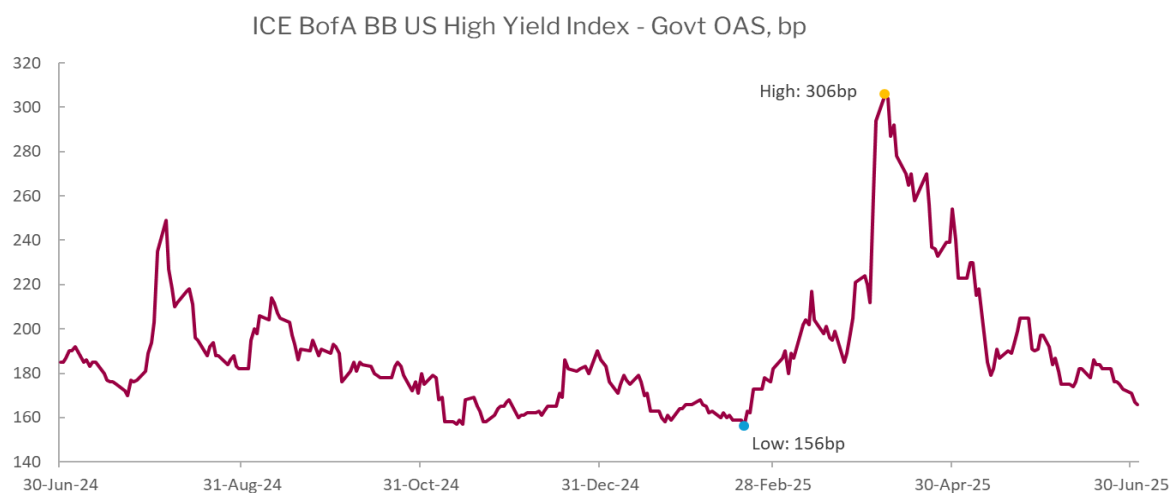
The Pender Alternative Absolute Return Fund returned -0.3%¹ in June, bringing year to date returns to 0.8%.

Markets continued to rally in June as seemingly any positive macro news event continued to drive asset prices higher despite some negative economic data points, concerns about fiscal stability in several developed economies and ongoing trade policy uncertainty. The HFRI Credit Index, the Fund's benchmark, returned 1.4% bringing year to date return to 4%.

Portfolio & Market Update

The past three months have been a challenging period for the Fund. We did not expect the market to brush off increased taxes via tariffs without any impact on risk premiums. Furthermore, the additional policy uncertainty has made decisions around hiring and capital investment more challenging for companies. The dual impacts of increased taxation and policy uncertainty could ultimately prove to be negative for the economy and capital markets, but over the short-term sentiment and technical factors are dominating price movements. Our approach to managing capital through a cycle is driven by valuations, fundamentals and individual opportunities. While there have been some individual opportunities in the past few weeks, valuations look very stretched to us. We failed to appreciate how far momentum could take valuations.

BB spreads, which represent a good proxy for the opportunity set of the Fund reached 4bp above the February lows in early July. The spread bottom earlier this year was the lowest level since 1997. On an all-in yield basis, the high yield market in early July looks even worse than it did in February.



Source: Bloomberg

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 Liquid Alternative Funds may be found here: <https://www.penderfund.com/liquid-alternative-funds/>

The peak BB spread of the past year in April was barely above the 10-year average of 277bp Govt OAS, and still below the 20-year average of 348bp.

While all-in yields still look respectable compared to the recent zero interest rate policy (ZIRP) era, the compensation credit investors receive for moving out the risk curve is poor.



Source: Bloomberg

While in hindsight we were clearly early in selling into strength this spring, we believe that the case for a defensive positioning is compelling at current valuations. Our current focus is on adding value from trading new issues, finding attractive current income carry opportunities and adding event driven trades when prospective returns are sufficient.

Credit has strong mean reverting characteristics over time and in our view, it makes much more sense to prepare for the next significant move rather than try and ride the last bit of momentum in a market rally. We will wait patiently for better valuations before increasing market exposure.

Some market commentators have highlighted that the sharpness of the rebound of the past few months most closely resembled the late 1998 rally following the Long-Term Capital Management (LTCM) blowup. There certainly are similarities in that both sell-offs were primarily driven by human error among a small group, with a solution or capitulation coming together relatively quickly.

This analogy echoes some of the bullish arguments to own risk assets today, in that the current market environment is similar to the late 1990s with the hype around AI mirroring the excitement around the dawn of the internet age. This is effectively a momentum, sentiment and flows argument rather than a valuation argument.

History of course does not repeat itself exactly but it does rhyme. While there were some spectacular short-term gains available late in the run up to the peak of the dot com bubble, the aftermath was brutal for many market participants.

According to Barron's, the forward P/E multiple on the S&P 500 was 23.7x as of July 11. Much like credit markets, valuations for large cap equities offer little margin of safety.

Market Outlook

While summer markets can be slow and unfocused, the market's expectations for the rest of the year have been set quite high following the sharp rally of the past three months. We have low conviction about what the short term will bring, considering that Trump's announcement of 30% tariffs on Europe was met with an equity market rally on July 14. Optimism and flows are driving prices, with the market quick to look past most negative headlines or economic releases.

According to a Bank of America survey, fund managers have increased risk exposures by the most in a three-month period since 2001. We view this as a positive sign that at some point in the next few months the "pain trade" for markets will be lower, as positioning could turn into a headwind rather than the tailwind that it has been since April.

While we haven't followed the crowd in the past quarter and chased the market, we are not against pivoting the Fund's positioning once the facts change, but that pivot has to be supported by value and opportunities, which we see as limited today. It looks to us like short-term considerations are a dominant factor in positioning for many fund managers today.

The robust appetite for risk should help encourage more issuers to come to market and issue bonds. We will look to selectively add exposures where the credit quality is strong enough and relative value attractive to broad markets.

Portfolio Metrics

The Fund finished June with long positions of 113.0% (excluding cash and T-bills). 31.4% of these positions are in our Current Income strategy, 75.2% in Relative Value and 6.4% in Event Driven positions. The Fund had a -58.5% short exposure that included -3.2% in government bonds, -37.5% in credit and -17.8% in equities. The Option Adjusted Duration was 1.48 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 0.93 years.

The Fund's current yield was 5.30% while yield to maturity was 6.56%.

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