PENDER FIXED INCOME

THE MANAGER'S MONTHLY COMMENTARY – JULY 2021

The Pender Corporate Bond Fund netted -0.2%[1] in July, as idiosyncratic factors outweighed an otherwise positive fixed income market.

The Fund encountered softness led by energy services player FTSI, an issue sometimes prone to volatility. Other weak spots included Esperion Therapeutics, a maker of cardiovascular drugs, whose bonds declined to the low 70's from the mid 80's on no particular news. We have been generally positive on companies in the pharma/biotech sector as liquidation value support often seems much higher than traded enterprise value. Nevertheless, other market participants held different opinions in July. We took advantage of lower prices in Esperion to add 2025 senior unsecured exposure yielding over 12%. Esperion has substantial credit strengths including over $200M cash (that roughly equates to the market value of the company's debt) and a recently approved cardiovascular therapy whose 2022 sales are estimated to be in excess of $300M.

Several positive contributors offset declining issues, to a substantial degree. Investment grade holdings such as Fairfax, Loblaw and Bell Canada performed well, driven by a combination of lower risk-free rates and tighter spreads. Our position in the Aberdeen Asia Pacific Income Closed-End Fund also performed well, as did the reorganized cap structure of American Tire Distributors.

Surveying the Yield Desert

These are funny days for people who have capital and wish to use it to derive income. At times it feels as if there is a much larger stock of capital that wants to clip coupons than the supply of credible entities that need to borrow. With most government bond yields penned below one percent, the competition for "good" lending opportunities has become fierce. From the lush meadows of last summer, credit investors must now confront a yield desert.

We believe we have identified a few oases in this desert which offer solid return potential and reasonable trading liquidity. These include certain secured bonds and loans issued by US marijuana companies, where relatively tiny debt structures are underpinned by significant equity buffers. Oil and gas is another area where investors are reluctant to extend credit, despite fairly buoyant commodity prices and some attractive looking short term paper. The biotech sector is another capital hungry sector with spots of attractive risk/reward, and we have become involved here as well. There are a few other spots – specific defaulted entities or some preferred shares – but these niches must necessarily entail limited allocations.

Outside of a few of these anomalies, however, the credit markets are being priced at levels that have rarely existed. Ten-year junk bonds are coming to market with yields in the 3's and 4's. In the past ten years there have been three occasions when the average yield of a high yield bond has exceeded 9 percent. A 3.375% coupon ten-year bond which now trades over par would have to price in the mid 60's at a 9% yield. We understand that the cool kids are doing it. And those new issues are working right now. But we have avoided most longer duration high yield with an eye to the unknowable future.

The cost of eschewing the new long-dated maturities is watching the continued tightening of shorter duration spreads, particularly as call schedule dates approach. We love our 5% yield to maturity in the OpenText 2026's, but with those bonds showing a 0.8% yield to a possible August 30 call, we wonder how long we can clip that particular coupon.

[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.

So here are, generically, the choices that are confronting income investors. Sign up for long dated yields with inherently larger price volatility potential, or suffer the slow erosion of yield on shorter dated paper. Do you prefer a rock or a hard place? Our niche investments do cushion the blow, but we are not able to completely disassociate ourselves from the mismatch between capital stock and investment opportunities.

Increasingly we are opting for the accumulation of dry powder instead of trying to find new ways to like things we have already passed over. We continue to turn over rocks and will continue to report back on the better ideas we uncover. But our plan now also entails building reserves of dry powder to be deployed into the panic of some future tumult, be that micro or macro in nature. In this market, discretion may be the better part of valour.

New Positions

In July we added a position in the unsecured debt of Plantronics, Inc. Long the leader in the market for call centre headsets, Plantronics has, in recent years, acquired to build out its technological offerings, including complementary video solutions. While execution of its altered product lineup throws some uncertainty in the mix, we consider the company's relatively strong free cash flow generation and management's commitment to de-leveraging as important credit strengths. The company's 2029 bonds yield over 5% and appear well covered from a valuation perspective.

Also in July we added some weight in the floating rate term loan of Canada Goose Holdings Inc. If Warren Buffett advises investors to buy snow shovels in July, he could hardly object to winter jackets! The loan yields in excess of 4% despite a capital structure that sets a mere $376M of loan debt atop a $5.8B equity structure. Solidly profitable and enjoying a strong net working capital position, we like the credit picture on Canada Goose.

And as a final note for July we added to reserves of dry powder through the acquisition of Government of Canada and Province of British Columbia bonds in the 4 to 5 year tenors. We anticipate redeploying this capital in wider spread opportunities in the future.

Fund Positioning

The Pender Corporate Bond Fund yield to maturity at July 31 was 4.9% with current yield of 4.8% and average duration of maturity-based instruments of 3.9 years. There is a 1.1% weight in distressed securities held for workout value whose notional yield is not included in the foregoing calculation. Cash represented 2.9% of the total portfolio at July 31.

Geoff Castle
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PenderFund Capital Management Ltd.