

## Manager's Commentary

Greg Taylor, CFA

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### Market Insights

February might be remembered as the month the dreams of AI started to turn into a nightmare. After a few years in which just mentioning AI in a press release would get you a multiple boost, that suddenly flipped. Fears of AI disrupting business models and destroying jobs across the entire economy took over. This was the predominate theme that emerged during earnings season, and it may take a while to go away.

Earnings season has come and gone, overall, with positive results. With multiples near record levels, the only way for equity markets to move higher is for earnings to expand. This has been the main concern for US markets for a few years, and while earnings were strong, share prices often did not have a positive reaction. After years of being the strongest global market led by technology stocks, the future of those business models has come into question, causing a change in leadership. The divergence between winners and losers has been massive and can be seen in the long-awaited sector rotation many have been watching for. Value is finally working, while growth is stuck in the penalty box trying to convince investors AI will not kill their business models.

One recent knock-on effect of these AI fears can be seen in the credit markets. For years, private credit has been expanding at a rapid pace as banks tightened lending requirements, leaving a void for many new businesses. With many of these companies in the technology sector, private credit has become overexposed to software. As multiples of public software companies were adjusted down rapidly, a realization has emerged that many of these private credit funds will have to take markdowns. This has led to a mini run on these funds resulting in several being 'gated', meaning no redemptions. Suddenly the volatility of a daily mark to market in public companies does not look so bad. Watch for this story to gain more traction until we get clarity on the underlying business models of SAS and software companies.

But volatility creates opportunity, and one market benefiting from these fears has been Canada. For years, the criticism of the Canadian economy and stock market has been that it is too exposed to commodities and 'old economy' companies. But now those are the factors everyone is looking for, and the S&P/TSX is off to one of its best starts in years. Suddenly having a market that is less exposed to technology is not such a bad thing.

Recent developments in the Middle East look to further extend the commodity rally. Investors have become conditioned to 'buy the dip'. But that might be too easy this time around? There exists a lot of complacency amongst investors who remember other geopolitical events as buying opportunities. The question will be if it is 'different this time'? That remains one of the most dangerous sayings in investing, but what if energy prices do remain elevated for a few months due to supply concerns? The market has been set up for rate cuts in the second half of the year once inflation subsides. Military action is usually inflationary, add to that the prospects of higher oil prices and rate cutting plans might be pushed back.

Higher geopolitical risk, AI fears and the prospects of sticky inflation are not a great setup for what worked over the last cycle. Yet it might lead the transition towards the next cycle. Gold and silver experienced a fantastic run last year, and while there was some profit taking in February, they could experience a lift given global tensions. The energy sector should also benefit. This

group lagged the rally last year but has started to get more attention recently. Higher sustained commodity prices and attractive valuations are leading to an improved flow of funds. Combined with increased power demand, energy is a sector that might return to a leadership position.

The financials have also gained attention led by surprisingly strong bank earnings. The Canadian banks experienced very strong share price performance last year, but given concerns around housing and consumer spending, many have expected a pause. Strength in capital markets and asset management are helping to provide some much needed growth. When the financials, materials, and energy sectors are working, it makes sense that the S&P/TSX will be doing well.

So far, 2026 is building nicely upon the gains of 2025 in most markets. But the divergence between winners and losers is extreme. If you stuck with what worked for the last few years, it has been a very different experience. Under the surface, the sector rotation has been extreme, as AI fears have taken on a life of their own. Adding to that the US/Israel-Iran conflict affecting global trade and commodity supply lines, and the conditions are setting up for an uncertain environment. The Ides of March usually signal increased volatility, and this year that seasonality looks likely to occur.

### Fund Update

The Pender Alternative Select Equity Fund was higher by 6.3%<sup>1</sup> in February to move to 17.7% for the year. This is compared to the S&P/TSX composite which was higher by 7.7% and 8.6% respectfully. We entered the month with a more conservative stance and have maintained that positioning entering March. The volatility that many have been calling looks likely to extend for the foreseeable future, and we are holding a higher percentage in cash (including money market ETFs) to be ready to take advantage of any dislocations that would cause buying opportunities.

The Fund continues to be focused on the commodity sectors, with Energy and Materials combining more than half the portfolio. After staying away from the oil focused energy stocks for most of last year, we began adding them in Q4. This was done initially due to valuation but has paid off as the commodity prices have moved materially higher. Uranium remains a significant portion of our energy exposure and looks well positioned into March. One of our top holdings, **Nexgen Energy Ltd. (NXE)**, received its long-awaited construction permits during the month.

As concerns spread around the impact of AI on software business models, we have been looking at this pullback as overdone, and slowly adding to the technology sector. **Shopify Inc. (SHOP)** was the first name added to the portfolio during the month as its share price fell post reporting their earnings. We have also added to several large cap technology stocks, **NVIDIA Corp. (NVDA)** and **Microsoft Corp (MSFT)**, as the market appears overly cautious on their prospects. In a volatile environment it wouldn't be surprising if these companies return to being looked at as the 'new defensives' in the second half of the year.

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<sup>1</sup> 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://penderfund.com/fund/pender-alternative-select-equity-fund/>