

Manager's Commentary

Greg Taylor, CFA

Market Insights

For the last year global equity markets have largely done a good job of overlooking adversity. From trade wars to AI disruption, stocks have been able to climb the proverbial 'wall of worry' to record levels. However, as tensions with Iran evolved into a full-on conflict, it became too much to ignore and markets fell. March was a wild month, and while a last day rally made it look better, it has left scars on many investors.

The war with Iran and the resulting blockage of the Strait of Hormuz has caused lasting damage and is highlighting how intertwined the world has become. It is now well known to everyone how much crude oil flows along this channel, but we are just starting to grasp the many other implications of these events. Fertilizer and the supply of other commodities are facing significant disruption, affecting the supply of many goods. Many Asian countries appear to have scaled back their work week to curtail energy demand. For a global economy that was coming into this year battling trade wars and growth concerns, a lasting supply disruption might be too much to handle and will take a long time to recover from.

The bond market was the first to pick up on these risks. We entered the year expecting to see dovish central banks and rate cuts. But those expectations have been thrown to the side. The US 10-year bond is a good gauge of how far the market has flipped. At the end of February yields had dropped below 4% and looked to be trending lower. During the last month yields spiked to 4.5% and there are now concerns we may not see any rate cuts this year, and in some countries there may actually be rate hikes.

These moves higher in yields have a dramatic impact on which asset classes, sectors and securities will outperform. With most investors positioned towards lower rates, having those assumptions reverse so quickly can likely cause violent rotations. Rate cuts are being pushed out by the FOMC and that has led to a US dollar resurgence. The higher dollar directly impacts the price of commodities, and after a great run in gold and silver, prices fell for the month. But that may be the opportunity.

One of the best things in investing can be to think like a contrarian. It's not for the faint of heart but this is starting to likely look like a classic setup. Everyone is bearish and looking for a drop. But at the same time, they all want to buy that dip. That is making for an interesting opportunity. The underlying trends in favour of real assets remain in place. If anything, they are even more entrenched. The US has made a mistake, and everyone knows it. The path forward in the US dollar likely remains lower and will be the overarching theme going forward.

The rally we saw to finish the end of March helped to make many feel better. The problem is that we are still looking at a scenario in which inflation stays higher for longer, changing the outlook for interest rates. It's much easier to get out of a 'trade war' vs a 'shooting war'. That is the new reality and is creating more uncertainty. Headline risk is the biggest worry for most of us now, and we have no way to predict which way it goes. In our view, this is the time to be nimble and flexible.

The next few weeks will be very important to set the path forward. A quick resolution to the conflict could support the markets, yet an escalation may risk the floor dropping out. We believe this is becoming a binary outcome which is unnerving for investors. The rise of passive investing

has increased volatility, yet it is also creating opportunities. When markets selloff and correlations go to one it may be a time to be looking to buy and add exposure to risk assets. That time could be coming up and something to take advantage of. In our view, the perfect time to be a contrarian is when everyone is running for the exits.

Fund Update

The Pender Alternative Select Equity Fund was lower by -1.5%¹ during the month of March compared to the S&P/TSX composite down by -4.3%. For the year the Fund entered the month higher by 15.9%, which compares to the S&P/TSX return of 4.0%. The index began March at its all-time high level, yet as the situation in Iran deteriorated selling accelerated, with the S&P/TSX down over 9% at its worst level. The Fund was able to experience a less volatile month and preserve capital through a combination of defensive strategies such as increasing cash, short-selling and options overlays.

Throughout the month we trimmed our exposure to the materials sector and lowered our exposure to precious metals to its lowest level in a year. Given the geopolitical backdrop most would think of gold stocks as an area that would outperform, but that wasn't the case as profit taking took hold, and several names fell over 20% during the month. We ended the month adding back gold exposure by adding positions in **Artemis Gold Inc. (ARTG)** and **Wheaton Precious Metals Corp. (WPM)**.

The tone of the market has changed to the negative. This should bring with it a more volatile environment. The ability to quickly trim positions and buy on dips has been beneficial and we would expect to see more of this going forward. Sentiment indicators are elevated but not yet at extreme levels. It will take time for investors to get comfortable with the 'new normal'. If energy prices remain elevated bond yields might as well. The upcoming earnings season will offer a glimpse of how companies are dealing with this, and the gap between those companies doing better than others should widen. This could be setting up for a 'stock pickers' market.

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