Manager's Commentary

Greg Taylor, CFA

Market Insights

At various points during July, it started to feel like markets were finally going to break. After months of defying negative headlines and ominous signals, this seemed to be the window for the correction many had been waiting for. Yet, it never really played out that way.

As usual the bond market caught on to this first. This was supposed to be the year that saw bond yields fall, but instead they have rallied. Sticky inflation due in part to higher oil prices is making it difficult for yields to decline, which is a problem. The longer yields stay elevated the more impact they may have on consumer spending and corporate profit margins. For earnings to really take off, interest charges need to decline.

This has become the issue for the new FOMC Chair who is officially in a bind. He was appointed with the understanding that rate cuts were the first priority, but that is increasingly harder to implement. Even with recent inflation readings more muted, this remains an issue. Elevated inflation combined with equity indices at all-time highs is more often the backdrop for rate-hikes, not rate cuts.

Which is what equity markets woke up to mid-month. Renewed hostilities between the US and Iran caused Brent Oil to surge over $100 a barrel. The US 10-year yield took notice and hit a high for the year. At the same time corporate earnings were being reported, and following record results from the banks, the first few earnings reports from the large technology companies were below expectations. After a few quarters in which increased spending on AI was cheered, investors began to ask about the return on investment.

The trigger that caused the initial market drop came out of Asia. Semiconductor and memory chip stocks have surged to start the year as these tools are key components for AI data centres. However, as we normally witness during manias, speculative activity takes over and FOMO trading replaces fundamental investing. Add to this the rise of double and triple levered single stock ETFs and you get some wild swings. Look no further than the price action of the KOSPI Index. The Korean market is heavily weighted to semiconductors companies. At one point during June the Korean index was higher by nearly 130% for the year, but gravity caught up as it collapsed 40% during July. In our view, moves such as these are things you see closer to market tops and not bottoms.

The month also saw a classic hedge fund blow up which added to the late month volatility. The aptly named 'Situational Awareness' fund got caught on the wrong side of the semiconductor trade, and as that trade unwound it was forced to liquidate positions to rival funds on the last trading day of the month. These events are not uncommon but can exacerbate a move when they happen after extreme moves, and during low volume summer months.

But even with these headline events, the month finished relatively flat, which should be looked at as a win. Equity markets continue to 'climb the wall of worry' and remain near all-time highs. With valuations of several sectors at record levels we need to see earnings continue to grow for markets to move higher. So far this has been the case, but the debate is how long that can last.

The bull case for equities is for a rotation between leading and lagging sectors to propel the overall market higher. But we remain a headline (or X post) away from a drop. We need to continue to monitor oil prices and yields. Equity markets have been looking over the near-term spike as temporary, while bond investors have turned cautious. Which of these groups is correct will be the story of the balance of 2026.

As we enter the two most volatile months of the year, investors that follow seasonal patterns would be tempted to begin to become more defensive. A lot of good news appears to be priced into valuations at these levels, and heading into uncertain FOMC meetings and a US election, the risk is that things are not as rosy as they appear. In a year that is not playing out according to anyone's expectations, the path forward remains uncertain. But there will be opportunities, it just may not be everyone is looking.

Fund Update

The Pender Alternative Select Equity Fund was -0.6%[1] for the month of July, which brings the year-to-date return to 18.5%. This compares to the S&P/TSX Composite return of 1.2% for July and 12.6% for the year-to-date. The overweight in materials sectors acted as a drag although it was partially offset by strength in the energy sector. In our view, the addition of several Hyperscalers during the month has set the Fund up for a stronger August.

One of the biggest surprises for the year has been the strength of the Canadian banks. This group has outperformed all global banks and most sectors over the past year. In our view, it has been benefiting from a flow of funds back to Canada and an understanding the operations of their business models have materially changed to be less volatile than in the past. The Fund has not participated in this rally as it hasn't fit many of our focus themes that are concentrated with Real Assets and AI, which we still prefer over the longer term. The upcoming earnings reports for these banks will be important to watch to see if they can justify these price moves.

Into August we have seen some relief in the US dollar rally which we believe should benefit the materials (in particular the gold sector) which we remain overweight and have been increasing our exposure to (ARTG and BYN). Given the seasonality and potential for more volatility heading into the next FOMC meeting and US Mid Term Elections, we have been adding to hedges and increasing our cash levels.

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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/*