PICTON MAHONEY Asset Management

# PICTON MAHONEY **MERGER ARBITRAGE FUNDS**

## **WHY** CONSIDER A MERGER ARBITRAGE STRATEGY?

**Diversifying a portfolio with market neutral sources, that is, assets that are not correlated with the traditional asset classes of equities and bonds, can help improve the overall risk and return profile of a portfolio.**

**A merger arbitrage strategy can help augment a traditional portfolio by:**

Reducing impact of market-based effects

&

Focusing on mergers and acquisitions to generate returns

Picton Mahoney Asset Management (Picton Mahoney) offers both unlevered and levered merger arbitrage strategies. The majority of returns generated within the strategy are capital gains, so they are taxed at a more efficient rate. To a taxable investor, that's a powerful benefit.

For investors looking to diversify their portfolio, merger arbitrage strategies offer exposure to markets generally uncorrelated to what they own. Additionally, they provide a compelling alternative strategy during periods of extreme market volatility.

# **HOW** DOES MERGER ARBITRAGE WORK?

Merger arbitrage, also known as risk arbitrage, is an investment strategy designed to benefit from the successful completion of an announced merger and acquisition (M&A) deal. The aim of the strategy is to capitalize on pricing inefficiencies caused by an event, such as the takeover of one company by another, capturing a profitable spread between a company's current trading price and the target price when the deal closes.

Merger Arbitrage involves investing on announced merger & acquistion (M&A) deals. The arbitrage generally involves capturing a spread between the trading price and the deal price:

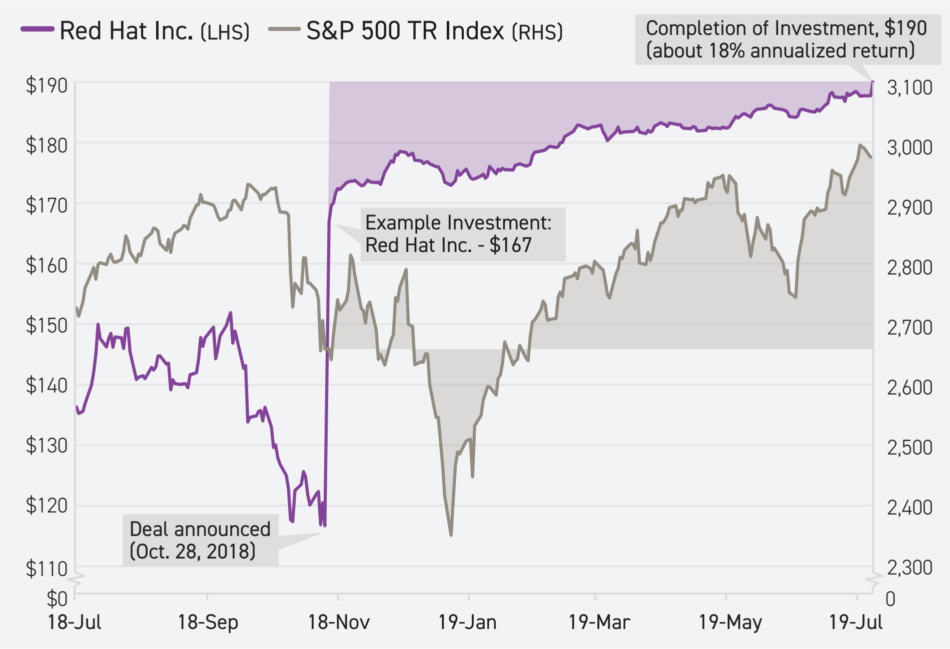
**1.** Purchase stock of the target at a discount


**2.** Hedge by shorting the acquirer (unless cash deal)


**We are focused on investing in legally-binding merger situations after they have been announced. We do not speculate on rumours of takeout bids.**

# THE STRATEGY AT WORK

This is an example of the all-cash acquisition of Red Hat Inc. (purple) by International Business Machines Corp. (IBM) with a comparison to the U.S. stock market (grey) over the same time period. A profit can be generated from the closing of the spread between the market price and deal price, which occurred independently of the market's movement.




## OUR PROCESS

**1** Determine rate of return – bid value, spread and approximate time to close.

**2** Determine risk/return – downside risk, probability of deal success, other factors.

**3** If we estimate high likelihood of success, and the return is attractive, we execute.

## RESULTS

Shares of Red Hat Inc. are purchased at about $167. Should the deal close, we receive $190 for every share we own. The spread is $23 per share. In this example, the deal closed on 07/09/2019, which equals about a 18% annualized return. Also, as this deal was a cash transaction the price of IBM is irrelevant, and no hedging is required.

## WHAT TOOLS DO WE USE?

There are two components and return drivers used in our merger arbitrage strategy.  Besides using common shares in public companies, the funds also invest in SPACs (Special Purpose Acquisition Companies). Put simplistically, SPACs are the “A” in M&A. They are used when public companies acquire private ones.

## MERGER ARBITRAGE CHECK LIST

**Merger Arbitrage strategies may be suitable for investors who:**

- Seek steady and absolute returns
- Desire diversification through a strategy that has low correlation to stocks, bonds and other alternatives
- Are focused on the tax efficiency of their investments
- Seek to reduce interest rate risk – returns tend to rise with an increase in interest rates

### Special Purpose Acquisition Companies (SPACs)

A SPAC is a company with no commercial operations formed specifically to raise capital through an initial public offering of its securities for the purpose of acquiring an existing company. SPACs are used in our Merger Arbitrage funds.

- SPACs are an advantageous way to gain access to newly-formed business combinations and the potential return therein
- There are some risks implicit within their structures (for example liquidity, litigation, corporate action and tax risks)
- There are also a number of benefits to SPACS (such as interest on the trust proceeds, warrant value and redemption rights attached to the SPAC units) that make it an attractive investment option

# OUR PROSPECTUS-BASED ARBITRAGE FUNDS

| | PICTON MAHONEY **FORTIFIED ARBITRAGE ALTERNATIVE FUND** CLASS A PIC 3800 \| CLASS F PIC 3801 | PICTON MAHONEY **FORTIFIED ARBITRAGE PLUS ALTERNATIVE FUND** CLASS A PIC 3900 \| CLASS F PIC 3901 |
|---|---|---|
| **Strategy Highlights** | The strategy seeks to generate consistent, positive returns with low volatility and low correlation to equity markets. This strategy aims to generate returns captured from the discount between the market price and "deal" price for target companies in announced, legally-binding merger situations. | The strategy seeks to generate consistent, positive returns with low volatility and low correlation to equity markets. This strategy provides leveraged exposure to the returns captured from the discount between the market price and "deal" price for target companies in announced, legally-binding merger situations. |
| **Volatility Target** | 2% annualized standard deviation | 4% annualized standard deviation |
| **Typical Position Size** | 3% | 6% |
| **Number of Positions** | 20-40 | 20-40 |
| **Use of Leverage** | Total long exposure can reach 130% of the fund's net asset value | Total long exposure can reach 260% of the fund's net asset value |

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