Hello,

On behalf of Harris Arch and Dan Moore, the portfolio managers of DuPont Capital's merger arbitrage strategies, attached is the September 2021 fact sheet containing performance and risk metrics.

Performance

For the month of September, our Merger Arbitrage strategy increased 47 basis points (bps) net of fees and the Merger Arbitrage Enhanced strategy, which utilizes leverage, increased 107 bps net of fees. Year to date through the end of September, Merger Arb is up 5.27% and Merger Arb Enhanced is up 8.69%, net of fees. The Merger Arb Enhanced strategy is conservatively leveraged at 1.84X gross and 1.69X net leverage.

While the above results include just one month, which is a very short time frame in our six-year performance history, we are pleased that the portfolio demonstrated resilience in a challenging period for equities and fixed income. During the month of September, the S&P 500 declined 4.7%, which was the 2nd worst month in the past 18 months, since the start of the pandemic in March 2020. Additionally, the Bloomberg U.S. Aggregate Bond Index declined 0.87% during September and is down 1.55% year to date. Theoretically, an alternative asset should demonstrate a low correlation to broader risk assets while earning attractive positive returns over the risk-free rate. Again, we caution against extrapolating beyond one monthly data point, but we believe this month's positive absolute return against a challenging market is worth highlighting.

Outlook and Strategy

In merger arbitrage, the healthy pace of new transactions continues. The conditions fueling M&A activity such as low finance costs, strong equity currency, and optimistic corporate executive outlooks remain supportive. Still, as we have long maintained in recent commentaries, the regulatory risks are heightened. It remains to be seen how stringent the Federal Trade Commission and the Department of Justice, both under new leadership, will be regarding pending deal reviews, but the conventional wisdom is that more deals will be challenged with lawsuits, which could deter some future M&A.

As we parse merger docs, one new area to highlight over the past month is a clause in certain merger agreements such as Kadmon/Sanofi that "neither Parent nor the Company shall have received a standard form letter from the Federal Trade Commission ("FTC") Bureau of Competition, in the form announced and disclosed by the FTC Bureau of Competition on August 3, 2021." Historically, after Hart-Scott-Rodino (HSR) approval occurs or the 30-day waiting period expires, the parties can close the transaction if there are no outstanding government approvals. Due to the large number of transactions and increased scrutiny, the FTC announced on August 3 that even if HSR expires after 30 days, the parties that receive the standard form letter are still subject to an open investigation and close at their own risk.

The full text of the August 3rd FTC announcement is:

"Given the recent surge in merger filings, the FTC is reviewing its processes to determine how best to use its limited resources.

The FTC reviews mergers per the Hart-Scott-Rodino (HSR) Act, which requires that companies provide the FTC and Department of Justice with advance notice of certain transactions above a certain threshold. ([The current minimum size-of-transaction threshold is $92 million]().) After the merging parties submit a filing with information about the transaction, the statute generally gives the agencies 30 days to pursue an initial investigation and determine whether additional information is needed to evaluate the transaction. If the FTC or DOJ seeks additional information through what's known as a "second request," the deal is then put on hold until the companies have fully complied with the additional investigatory request. Once the parties have submitted all of the additional information, the reviewing agency has a limited number of days to file a complaint challenging the proposed merger ahead of its consummation. The purpose of this process is to give the FTC and DOJ time to identify illegal mergers prior to their consummation. However, the law permits the antitrust agencies to determine that a merger is illegal even after the companies have merged and even if the merger was subject to premerger review. When the FTC does not challenge a transaction prior to its consummation, this does not constitute an "approval" or "clearance" of the deal, and the agency maintains the right to challenge a deal regardless of whether it was initially investigated. The FTC always has the right to take such further action as the public interest may require.

This year, the FTC has been hit by a tidal wave of merger filings that is straining the agency's capacity to rigorously investigate deals ahead of the statutory deadlines. (We now post [our monthly HSR figures]() on the website and they are astounding.) We believe it is important to be upfront about these capacity constraints. For deals that we cannot fully investigate within the requisite timelines, we have begun to send standard form letters alerting companies that the FTC's investigation remains open and reminding companies that the agency may subsequently determine that the deal was unlawful. Companies that choose to proceed with transactions that have not been fully investigated are doing so at their own risk. Of course, this action should not be construed as a determination that the deal is unlawful, just as the fact that we have not issued such a letter with respect to an HSR filing should not be construed as a determination that a deal is lawful." (https://www.ftc.gov/news-events/blogs/competition-matters/2021/08/adjusting-merger-review-deal-surge-merger-filings)

From a merger arb perspective, this means that buyers could use the existence of a form letter as a reason to abandon a merger if they have a change of heart during the timeline of the deal and no longer wish to complete the transaction. Alternatively, the buyer could waive that condition and still close the transaction, as recently seen in the Core-Mark Holding/Performance Food Group deal. Also, this clause has only been present in certain merger deals and is not widespread as of yet.

In the spac market, yields on existing deals started to firm up, as they had simply become too wide in recent months. It is possible that some "crossover" investors from other areas such as fixed income have entered the space, especially as traditional fixed income prices declined during September's inflation lead rate selloff. In one recent investor commentary we read, that appears to be the case (https://www.calamos.com/blogs/voices/calamos-investment-team-outlooks-october-2021/).

As discussed last month, we continue to find arbitrage opportunity in deals that trade below cash trust value on day 1 as anchor investors reduce their holdings. Additionally, spac investor terms have continued to improve with increased warrant coverage and overfunded cash in trust. Furthermore, the deadline to complete a deal has been shortened, as certain SPACs have a 12-18 month horizon, rather than 24 months. If these spacs need to extend the deadline, often an increased cash contribution is made to trust. It is unlikely that the boom times of Q4 2020 and Q1 2021 will repeat, but we believe that as spacs market dynamics return to the pre-2020 environment, their “rate of return” characteristics will be competitive with traditional merger arb deals.

In September, a few of our positions benefitted from apparent short squeeze “meme” trading behavior. In these spacs, redemption rates were quite high, leading to a low float post the transaction close. While we redeemed our common holdings, in certain cases, we held our warrants and were able to sell into the strength, generating gains during the month. While we question the sustainability of this trend, it does demonstrate the attractive optionality characteristics of spacs where downside protection is assured from the cash in trust and upside potential is possible.

If you have interest in learning more about our merger and spac arbitrage strategy, please let us know and we would be happy to set up a call or meeting with the portfolio management team.

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