U ACCESS (IRL) CHEYNE ARBITRAGE UCITS

Quarterly Comment

For Professional Investors in Switzerland or Professional Investors as defined by the relevant laws.
The classification of the fund(s) as per the Sustainable Finance Disclosure Regulation (SFDR) is available on ubp.com or in the latest prospectus.

Market Comment

- Over the fourth quarter of 2021, DM equities, except for Japan, were broadly positive, ending the third year in a row with strong calendar year returns, driven by strong earnings growth. Small cap underperformed large cap, as the fears about weaker growth going forward weighed on their performance. EM equities suffered, mainly dragged down by higher inflation and expectation of more interest hikes, as well as the continually negative news on China, in particular on the real estate sector front.
- The emergence of the Omicron variant in November initially led to a strong increase in equity volatility. However, markets were quick to recover as initial data indicated a lower risk of severe disease. On the fixed income side, uncertainties about future growth due to less accommodative central bank policy led to a flattening of the US yield curve. The front end of the curve moved higher, while the back end remained flat.
- As described more in detail below, the current market environment provides a compelling set of opportunities for our U Access (IRL) Cheyne Arbitrage UCITS fund, which is an arbitrage strategy with a yield component extracted from both merger arbitrage and mixed arbitrage opportunities. This solution offers alternative sources of yield to traditional bonds with limited duration and has historically shown low correlation to traditional asset classes.

Sources: UBP, Bloomberg Finance LP, BofA Merrill Lynch

Performance Review

- For the fourth quarter of 2021, U Access (IRL) Cheyne Arbitrage UCITS posted a return of +1.00%, bringing the YTD return to +2.50% (Class C EUR, net of fees). Annualized deals spreads were down at an average level of 4.4% at the end of Q4 21 from 6.4% in Q3 21. The narrowing reflected the closing of a number of long running tranasations in the year-end and a backdrop of low volatility and raising equity markets that both points toward improving break price dynamics.
- We believe that the good health of the M&A markets will continue in 2022. This trend when combined with the growing opportunity in SPACs has reduced the nominal amount of “Arb” money chasing each opportunity. This is a positive development for the strategy as it means that individual opportunities present a better risk reward while their fair number allow for building a truly differentiated portfolio.
- On the positive side, the top three contributors during the quarter were the SPACs strategy, Millennial Lithium and Playtech. Our SPACs strategy performed well as the average maturity of the portfolio increased and we saw more announcements. While we normally make our investments at 3-5% discount to NAV, The SPACs will normally trade close to NAV once an announcement is made. It also regularly happens that they trade above IPO price when they have made a high-quality acquisition. In this case, we would sell our share in the market. The rest of the time we would apply for redemption at $10 thus realising the initial discount while avoiding friction costs.

All performance figures are given net of fees. Past performance is not a guide to current or future returns. See full disclaimer at the end of the document.

- The second contributor to the quarter's results was the Merger Arbitrage position in Millennial Lithium Corporation. When the company received a bid by Chinese battery producer Amperex, we took the view that the premium paid was insufficient given the scarcity of the asset and built a position at the term of the existing offer. Our aggressivity was rewarded as US company Lithium Americas entered the freight and paid 30% over the previous bid.
- The third largest contributor to the quarter's returns was the merger Arbitrage position in Playtech. Similarly to the previous situation, we took the view that the price offered by the buyer (Aristocrat) did not reflect the strategic value of the assets held by Playtech. In this case, we were able to set-up a position at a discount to the existing terms of the offer shortly before it was announced that the company had been approached by a third party. As it emerged that the potential buyer was not reputable, we opted to exit the position before the end of the PUSU order by the takeover panel to protect our gains.
- On the negative side, the top three detractors over the quarter were Afterpay ltd, the Volkswagen share class spread, and the Xilinx merger arbitrage positions.
- The first detractor to the period earnings was our Merger Arbitrage position in Afterpay ltd. The spread widened as the Reserve Bank of Australia made a referral to the Australian treasury to change the treatment of the customer costs in the services provided by the company. While generally, the adverse effects of a change in the regulatory environment are carved-out in the DMA, the language was vague in this case so we decided to halve our position until the scheme was approved by the shareholder and legally bounding.
- The second detractor to the quarter earning was the Volkswagen share class spread. The spread widened as it was aggressively sold by a fund in liquidation. This was particularly frustrating as it happened when more details emerged over the planned IPO of Porsche. Given the proximity of our catalyst, we believe that the situation is particularly attractive with an IRR of 25% and less than 5% downside. At 8% NAV, the spread continues to be one of our largest positions.
- The third detractor to the quarter's return was a Merger Arbitrage position in Xilinx. The spread to the offer terms widened as Arbitrageurs were frustrated that the transaction did not close by year end. Given the undertaking conceded by AMD to Huawei, we are confident that this transaction will close early in Q1 22.

Portfolio Activity

- U Access (IRL) Cheyne Arbitrage UCITS focuses on merger arbitrage and mixed arbitrage. At the portfolio level, the overall exposure of the book has now normalised as the team has selectively reinvested in new positions and increased the size of existing positions.
- In order to contain the risks caused by irrational retail participation (see above), the team is in the process of reducing exposure to Share Class and Holding Arbitrage. This seems particularly adequate as the PM believes that the Merger Arbitrage and SPACs opportunity set are particularly attractive at the moment. Merger arbitrage now accounts for seven tenth of the portfolio's exposure.
- The increased Portfolio's exposure to SPACs reflects the fact that the team is currently able to buy equity optionality cheaply. As a reminder, a SPAC is an investment vehicle that enables a sponsor to raise capital via an IPO ($10 standard) with the purpose of acquiring a private company and taking it public. The cash raised in the IPO is subsequently held in a trust until the shareholders validate an acquisition in a vote.

- The arbitrage opportunity arises from the fact that shareholders have the option to redeem at the time of the vote and recoup their initial investment. Practically, the team will wait until an acquisition is announced. If the acquisition is creating value, the SPAC will trade above $10 and it will be sold prior to the vote. If the acquisition is perceived poorly, the team will simply redeem the shares and recoup $10.
- In terms of positioning, the investment team continues to favour deals with robust contractual protection. It also favours transactions with a strong strategic rational as their synergetic nature make them much less likely to be terminated. In contrast, we avoid long dated Sponsor Deals as we believe that they would likely exhibit a high beta if the markets should retreat.
- At the end of December, there were 29 active Arbitrage Strategies in the portfolio. The merger arbitrage portfolio had 25 investments while the mixed arbitrage strategy was made of 4 distinct positions including the SPAC book. Note that the SPAC book itself is a diversified strategy made of 130 different units.

Outlook

- Deal flow has continued unabated in the fourth quarter with significant contribution from Private Equity buyers. At about $4.0tr at year end, 2021 is at all-time highs. Goldman Sachs analysts expect the acceleration to continue due to still-solid growth, attractive funding costs, record levels of capital & elevated CEO confidence.
- Given that M&A as a percentage of market cap (5%) is still far below the long-term average of 6% and prior cycle peaks of 8-10%, the bankers forecasts sound right. This assumption is supported by the fact that large transactions are well represented in the mix as it indicates that boards rooms are particularly bold at the moment and the financial system healthy.
- In a continuation of the previous quarter trend, strategic buyers have continued to take the lead in this M&A wave. This also reads positively for the chances of further M&A because when two players of a same industry consolidate it tends to have a snowball effect on the other players.
- In terms of sector focus, we are of the view that Technology, ESG and simplification transactions will remain the main themes driving M&A in the boardroom. It is also likely that the Biden administration will continue to have a critical stance towards further consolidation in the sector. Consequently, “Big Tech” could also see an increase in regulatory pressure as bi-partisan support (Howley, Klobuchar) is emerging to stop “predatory M&A” from the FANGS.
- The Private Equity industry should play a front runner role in prolonging the current deal bonanza. In its H1 report, Bain estimates that the industry is sitting on a $3.3Tr war chest. This reinforces our viewpoint that the activity of sponsors should continue unabated from their current levels (40% of M&A activity year-to date which is a 20-year record).
- In Europe, the UK has been the center of new M&A activity. We expect that this trend will continue as the removal of a long-term political overhang and a large valuation disconnect are likely to act as a catalyst for deal makers.
- Given the quality of the microstructure of the Merger Arbitrage market (High number of deals, large spreads) in the recent period, the investment team believes that next twelve months could offer one of the best environments for the strategy we have seen in years.

- Looking at mixed arbitrage, the share class and holding spread arbitrage positions left in the portfolio all present extremely attractive risk-reward ratios. The overall gross size of the exposure to these sub-strategies as well as each single position has been reduced. This is to take into account the increase in volatility in the market but also to make room for the currently superior opportunity offered in merger arbitrage spreads and SPACs. A key differentiator between the attractiveness of the two strategies lies in the visibility on the duration of merger arbitrage spreads. In other words, the merger arbitrage and SPACs strategies allow the team to associate a duration with each investment
- At the time of writing, the portfolio offers a yield-to-maturity of close to 4.8% in EUR with an associated duration of 2.5 months. To put things in perspective, if the deals in the portfolio all close as expected and accounting for a reasonable contribution from the mixed arbitrage book, the gross fund performance could be comfortably in the zone of its performance objective for the year.

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