U ACCESS (IRL) CHEYNE ARBITRAGE UCITS

Quarterly Comment

For Qualified Investors in Switzerland or Professional Investors or Eligible Counterparties as defined by the relevant laws.

Market Comment

- The second quarter was very strong for equities and credit as central banks and governments provided enormous amounts of stimulus and economies started to reopen. World equities rallied across the board, up close to 20% on aggregate, with the US and EM leading the way, while Europe and Japan lagged somewhat. In terms of styles, growth continued to strongly outperform value, as we have seen in the last several quarters. Central bank support also helped supporting High Yield which rallied by close to 10% in Q2. EM Debt also rallied as many central banks cut rates, some even implemented QE for the first time, and oil rallied following an extraordinary collapse into negative territory. Despite the strong rebound in risk assets, traditional portfolio hedges such as government bonds and gold held up well. US Treasuries are up about 9% year to date, while gold is up close to 18%.
- The lock down has reduced consumers' spending and led to a surge in savings rates. This provided the liquidity for retail day trading via cheap trading platforms. The retail trading combined with algorithmic systems designed to piggyback on this approach has led to some staggering moves in individual stock prices driven by key words rather than earnings prospects.
- Credit and Event Driven strategies performed strongly during the quarter. Within Event and credit, Activist equities were the top performing strategy with higher beta names bought at the depths of the March crisis performed strongly in the rebound. Merger Arbitrage managers also performed well, largely capturing the collapse in spreads in April (from extreme levels in March). The fixed income side of the market also performed well, but also typically lagging equity markets. Asset backed positions (portfolios of RMBS, CMBS) that were added in the March crisis performed well as fundamentals began to reassert their influence on prices after several months of negative technicals.
- As described more in detail below, the market dislocations experienced since the beginning of the year provide 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 then alternative sources of yield to traditional bonds with limited duration and has historically shown low correlation to traditional asset classes.

Performance Review

- For the second quarter of 2020, U Access (IRL) Cheyne Arbitrage UCITS posted a positive return of +10.93%, bringing the YTD to -4.89% (Class C EUR, net of fees). Similarly to the broader market, arbitrage spreads recovered from their March low. To put things in perspective, the average (non-annualised) merger arbitrage spread, which measures the difference between the market price and the announced transaction price of the target company, went from 2% in mid-february to 16% at the end of the Q1, peaking at near 24% during the third week of March, to settle to 12% at the end of Q2.
- While this is a significant recovery, spreads levels remain historically high. To date, the narrowing of the spreads was tightly correlated to the decline in market volatility. Practically, it seems that the general improvement in credit market conditions led investors to take advantage of the comparatively attractive spreads levels.

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.

- On the positive side, the top three contributors during the quarter were Caesar Entertainments, TGE and FCA/Peugeot. The portfolio's merger arbitrage position in Caesar paid off as the proposed divestments of two casinos to Twin River were accepted by the FTC while venues were simultaneously being re-opened. The only outstanding approval is now the horse racing commission in Iowa. This is not expected to be a significant hurdle and the deal should close in July.
- Another top performer was a position in Tallgrass Energy LP. The full value of the spread was realised during Q2 as the Blackrock led consortium bought out the 45% of the capital that they did not own.
- The third largest contributor was a merger arbitrage position in Fiat Chrysler Automobile which is merging with Peugeot. The spread narrowed considerably after both companies successfully refinanced their debt and re-opened their main continental plants. The improvement in the spread levels were consolidated after both companies' management team reiterated their commitment to the transaction in their respective AGMs.
- On the negative side, the top three detractors over the quarter were ForeScout Technologies, Cineplex Inc, and Taubman Centres Inc. The Cineplex merger arbitrage spread widened as Cineworld announced that they did not intend to complete the transaction. In essence, they argued that the company was in breach of the merger contract because of the effects of Covid-19.
- The claim was immediately disputed by Cineplex that lodged a formal complaint with the Ontario Commercial court. Under Canadian commercial law, Cineplex is entitled to receive damages that will compensate shareholders fully for the loss of the $34 offer. We think that they have a strong chance to prevail as the risk of Pandemic is carved out of the Major Adverse Effect (MAE) clause in the definitive merger agreement. Consequently, the buyer cannot use this excuse to walk away from the deal. The loss that resulted from the announcement was limited as we had structured the position using put options. As it stands, our structured investment in Cineplex offers up to 240% upside for less than 15% downside. We intend to grow the position as we come closer to the court date.
- The buyer's decision to enter a litigation process with little chance of success is actually a tactic that we have seen playing out repeatedly in the recent weeks. Typically, it has happened in situations where the acquirer had no leverage to bargain a discount on the agreed price and where they were therefore contractually bound to pay the full price. In those instances, buyers have an incentive to enter in legal proceedings as it will have a minor impact on their purchase price but will positively impact their treasury as payment will be typically delayed by a couple of quarters. In that sense, it is a low downside strategy as it will have a minimal impact on the cost of the acquisition, but you will have an opportunity to use the uncertainties associated with a court decision to extract a price cut from the seller.
- This is the same "Shotgun" negotiation tactic that was at play in the setback we experienced in Forescout and Taubman. As for Cineplex, the companies have an explicit protection against pandemic in their merger agreement and were rumoured to have rebuffed their buyer's attempt to negotiate a price cut.
- The case opposing Forescout Technologies to Advent Capital will be judged in the first week of August. It is seen by many as a guideline to the future attitude of the judges towards this wave of "Buyer's remorse" cases. Interestingly, the Delaware judge assigned to the case has been unusually responsive in granting accelerated proceeding indirectly showing that he was seeing through the delaying tactics of the buyers.
- We expect all three companies to be successful in enforcing the terms of their contract and close their respective transactions successfully. Nevertheless, we recognize that the outcome of a lawsuit can not be predicted with certainty. To account for the unlikely scenario of an adverse decision we have structured the

Forescout and Cineplex positions with downside protection. In the case of Taubman where this approach was not available, we have sized down our investment accordingly.

Portfolio Activity

- U Access (IRL) Cheyne Arbitrage UCITS focuses on merger arbitrage and mixed arbitrage. At portfolio level, the overall exposure of the book has normalised as we have selectively reinvested in new positions and increased the size of existing positions.
- As we are cognizant that market conditions could deteriorate again, we have kept our exposure to Mixed Arbitrage low so we can take full advantage of the current unprecedented opportunity in merger arbitrage and maintain a moderate overall risk exposure at the same time. Merger arbitrage now accounts for seven tenth of the portfolio's exposure.
- In terms of positioning, we continue to favour deals with robust contractual protection. We also favour transactions with a strong strategic rational as their synergetic nature make them much less likely to be terminated. This is particularly true for defensive transactions who have often seen their rational reinforced in this crisis (e.g. FCA/Peugeot)~~.~~
- In terms of duration, the team continues to favour the transactions that offered the shortest time to completion. It should allow for a continued accelerated recovery of the mark to market losses as spreads are fully realised, if and when the deals are closing.
- At the end of June, there were 26 active arbitrage strategies in the portfolio. The merger arbitrage portfolio had 16 investments while the mixed arbitrage strategy was made of 10 distinct positions.

Outlook

- Unsurprisingly, M&A activity declined strongly in the second quarter. The current universe of pending deals is characterized by a 9% below-average duration. And 24% below historical average deal size. In general, the current opportunity set carries a moderate element of regulatory and antitrust risk. In terms of sector representation, communication and financials continue to lead the way.
- The investment team expects that the deal flow will recover gradually as visibility improves on the severity of the damage made to the economy. The Private Equity industry should play a front runner role here as they are currently sitting on a $2Tr war chest. In a second phase possibly starting towards the end of the third quarter, the team expects to see strategic buyers stepping in with rescue deals for the weakest players in the cash strapped industries (Oil, Leisure). It also expects a raft of defensive deals in the cyclically challenged industries (Auto).
- Looking at mixed arbitrage, the positions left in the portfolio all present extremely attractive risk-reward ratios. The overall gross size of the exposure to the strategy 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. A key differentiator between the attractiveness of the two strategies lies in the visibility on the duration of merger arbitrage spreads. In other words, merger arbitrage investments allow the team to put a date on when the portfolio will be able to recover from the dislocations experienced as a result of COVID-19. A luxury in the context of this crisis.
- At the time of writing, the portfolio offers a yield-to-maturity of close to 10.3% in EUR with an associated duration of 4.3 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 close to its performance objective for the year. More conservatively, it means that even if a number of these deals are being renegotiated, the portfolio could recoup most, if not all the YTD losses by year end, without accounting for any future reinvestment opportunity.

Disclaimer

This is a marketing document and is intended for informational and/or marketing purposes only. It is confidential and is intended to be used only by the person(s) to whom it was delivered. It may not be reproduced (in whole or in part) or delivered, given, sent or in any other way made accessible, to any other person without the prior written approval of Union Bancaire Privée, UBP SA or any entity of the UBP Group (“UBP”). This document reflects the opinion of UBP as of the date of issue. This document is for distribution only to persons who are Qualified Investors in Switzerland or Professional Clients, Eligible Counterparties or an equivalent category of investors as defined by the relevant laws (all such persons together being referred to as “relevant persons”). This document is directed only at relevant persons and must not be acted on or relied on by persons who are not relevant persons. It is not intended for distribution, publication, or use, in whole or in part, in any jurisdiction where such distribution, publication, or use would be unlawful, nor is it directed to any person to whom or entity to which it would be unlawful to direct such a document. In particular, this document may not be distributed in the United States of America and/or to US persons (including US citizens residing outside the United States of America). This document has not been produced by UBP’s financial analysts and is not to be considered financial research. It is not subject to any guidelines on financial research and independence of financial analysis. Reasonable efforts have been made to ensure that the content of this document is based on information and data obtained from reliable sources. However, UBP has not verified the information from third sources in this document and does not guarantee its accuracy or completeness. UBP makes no representations, provides no warranty and gives no undertaking, express or implied, regarding any of the information, projections or opinions contained herein nor does it accept any liability whatsoever for any errors, omissions or misstatements. The information contained herein is subject to change without prior notice. UBP gives no undertaking to update this document or to correct any inaccuracies in it which may become apparent. This document may refer to the past performance of investment interests. Past performance is not a guide to current or future results. The value of investment interests can fall as well as rise. Any capital invested may be at risk and investors may not get back some or all of their original capital. Any performance data included in this document does not take into account fees, commissions, and expenses charged on issuance and redemption of securities, nor any taxes that may be levied. Changes in exchange rates may cause increases or decreases in investors’ returns. All statements other than statements of historical fact in this document are “forward-looking statements”. Forward-looking statements do not guarantee future performances. The financial projections included in this document do not represent forecasts or budgets but are purely illustrative examples based on a series of current expectations and assumptions which may not eventuate. The actual performance, results, financial condition and prospects of an investment interest may differ materially from those expressed or implied by the forward-looking statements in this document as the projected or targeted returns are inherently subject to significant economic, market and other uncertainties that may adversely affect performance. UBP also disclaims any obligation to update forward-looking statements, as a result of new information, future events or otherwise. The contents of this document should not be construed as any form of advice or recommendation to purchase or sell any security or funds. This document does not replace a prospectus or any other legal documents, which can be obtained free of charge from the registered office of a fund or from UBP. The opinions herein do not take into account individual investors’ circumstances, objectives, or needs. Each investor must make his/her own independent decision regarding any securities or financial instruments mentioned herein and should independently determine the merits or suitability of any investment. In addition, the tax treatment of any investment in the fund(s) mentioned herein depends on each individual investor’s circumstances. Investors are invited to carefully read the risk warnings and the regulations set out in the prospectus or other legal documents and are advised to seek professional counsel from financial, legal and tax specialists. The tax treatment of any investment depends on the investor’s individual circumstances and may be subject to change in the future. This document should not be deemed an offer nor a solicitation to buy, subscribe to, or sell any currency, funds, products, or financial instruments, to make any investment, or to participate in any particular trading strategy in any jurisdiction where such an offer or solicitation would not be authorised, or to any person to whom it would be unlawful to make such an offer or solicitation.
The Swiss representative is 1741 Fund Solutions AG, Burggraben 16, 9000 St. Gallen. The Swiss paying agent is Tellco AG, Bahnhofstrassse 4, 6430 Schwyz. The prospectus, articles of association, KIIDs, and annual and semi-annual reports may be obtained free of charge from UBP as well as from the Swiss representative.
Telephone calls to the telephone number stated in this presentation may be recorded. UBP will assume that, by calling this number, you consent to this recording. In Switzerland, UBP is authorised and regulated by the Swiss Financial Market Supervisory Authority (FINMA); in the United Kingdom, it is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority (FCA).