

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

- The third quarter of 2023 saw a pullback in global markets with most asset classes, including global equities and bonds, ending the quarter in negative territory. The only exceptions were commodities and High Yield (HY). Equity and bond volatility increased during the quarter, although only moderately. Developed Market (DM) equities were down -3.4% in Q3, keeping the YTD gains well into double digits (+11.6%), while Emerging Markets (EM) lost -2.8% in Q3 and settled at +2.2% YTD. In DM, the Japanese market was one of the few in positive territory in local terms (+2.5% in Q3, +25.7% YTD for the Topix). The weakening of the JPY vs major trading partners (-12.5% vs USD YTD) continues to be a tailwind. The other positive outlier in Q3 was the UK market, supported by the relatively good performance of energy stocks. In the US, the S&P 500 was down -3.3% in Q3 and is up +13.1% YTD. In terms of styles, value (-1.7%) outperformed growth (-4.9%) over the quarter, which only modestly reduced the YTD gap which sees growth still outperform value by a large degree.
- In Fixed Income, DM government bonds, EM Debt and investment grade were down, negatively impacted by the rise in bond yields. On the bright side, HY managed to be in positive territory, thanks to the high carry and the shorter dated profile the asset class is exhibiting, spreads remained stable over the quarter. On the other end, inflation linked securities were the most negatively impacted by the slow-down in inflation data. The focus of fixed income investors, which had been focused on the level of peak rates, has now started to switch to how “higher for longer” rates will affect the economy and fiscal sustainability. On the economic front, the sharp rise in oil prices in Q3 constituted the main headwind and increasing signs of a slowdown are impacting markets. The other interesting observation is that the correlation between stocks and bonds was once again positive in Q3. For asset allocators, this is a reminder that alternative strategies should be key to diversify against some of the risks the economy and markets are facing.
- 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 third quarter of 2023, U Access (IRL) Cheyne Arbitrage UCITS posted a return of +3.96% (Class C EUR, net of fees). Annualized net deals spreads (LIBOR adjusted) were at a representative level of 7.9% in 3 Q23. Contributing to the tightening of spreads in 3Q23 were (i) the closing of several high profile deals with large spreads (ii) a decrease in regulatory risk and timing uncertainty (iii) More visibility on the gliding path of interest rates.



- The investment team believes that the the M&A markets will continue on their path towards normalization in the fourth quarter of 2023. Going forward, the rate of new deal announcements will depend heavily on the economic backdrop. Importantly, The number of announced deals is up y-o-y for the second consecutive quarter. If this is repeated in the fourth quarter this will be a sign that we M&A could be on a raising path again.
- The largest contributor to the quarter's results was our merger arbitrage position in FHN. We had maintained an exposure to the name following the calling off of the deal with Toronto Dominion as we thought that the stock was trading well below its intrinsic value. As the distressed selling flows abated, the price normalized and we exited fully the position.
- The second largest contributor to the quarter's performance was our merger arbitrage position in Horizon Therapeutics (HZNP). Following a poor start in court, the FTC elected to settle outside of court. The fund benefited greatly as we had made this holding one of our core position on the basis that we saw little merit in the watchdog case. We now expect the transaction to be completed in the first half of October.
- The third largest contributor to the quarter's results was the long position in Seagen. The spread tighten as investors see the HZNP settlement as the sign of the fledging resolve of the FTC to tackle Big Pharma M&A. While we agree that there is an increasing pressure on Lina Khan's team to improve its court records we are also of the opinion that there is an incentive to bring another politically charged case in an election year.
- On the negative side, the top detractors over the quarter were Silicon Motion, PGS and Westrock.
- The first detractor to the period earnings was our Merger Arbitrage position in semiconductor company Silicon Motion. The stock price declined as investors who could not hold the position to the expected positive outcome of the arbitration process exited the position causing a dislocation of the share price below the fundamental value, and certainly below the fair value including the significant upside possible from their ongoing arbitration process
- The second detractor to the quarter earnings was our merger arbitrage position in PGS. The spread widened as the results were below consensus. There were market fears that it could trigger a renegotiation of the exchange ratio. This has been now denied by the companies.
- The third detractor to the quarter earnings was the Westrock position. This position is a new addition to the portfolio and the change only accounts for the set-up costs of the position.

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 is currently under the long term average as we think that opportunities will arise as a result of the strong seasonality.
- In terms of positioning, the investment team continues to favour deals with robust contractual protection. We have actively curated the portfolio from positions that were either exposed to the Ukrainian situation or had DMA that did not protect them enough in the eventuality of a worsening of the conflict. In doing so, we focused our attention on the contractual protection available in case of a nuclear attack. Overall, we have reduced the gross exposure of the portfolio. We were particularly aggressive in reducing our exposure to Private equity deals as it is our opinion that we will see a worsening of the credit environment. The goal is to have enough "dry powder" to take advantage of the next volatility spike.



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- At the end of September, there were 18 active Arbitrage Strategies in the portfolio. The Merger Arbitrage portfolio had 17 investments while the mixed arbitrage strategy was made of 1 position.

Outlook

- As previously mentioned, global M&A was down 48% at the end of the first semester. Given the geopolitical tensions, we do not see a prospect for a medium-term improvement in European flow. The exception being the United-Kingdom as we believe that the weakness of the pound is exposing British companies to predatory M&A. This is particularly true for companies with dollar denominated debt as they are likely to appear very cheap to a USD funded buyer.
- The team expects that the share of Private Equity deals will continue to be under pressure as banks took a resolute step back from financing the most risky transactions following a raft of high profile losses (TWTR, Citrix...) and the turmoil at the regional banks. In parallel strategic M&A (particularly in the US) should remain strong. Overall, we expect that the M&A volumes will consolidate towards the last five years average.
- The base forecast guidance from Investment banks for this year is that following lackluster H1 activity, we should start to see a rebound in the second half. We think that this recovery in announced transactions will see the prevalence of structured transactions (Spin-off, break-up...).
- Strategic deals at the regional levels will continue to be the focus for corporates. Inversely, we believe that the conditions are not yet ripped for a robust comeback of cross border transactions. The Private Equity deals will continue to be Highly structured (and sometimes fully financed). Banks will continue to avoid large deals.
- In terms of sector focus, we are of the view that Technology, Financial and defensive transactions will remain the main themes driving M&A in the boardroom. Recently, we also saw the first signs that consolidation was accelerating in some corners of the "new Economy" (Cybersecurity, 3D-Printing, Cloud services).
- It is also likely that the Biden administration will continue to have a critical stance towards further consolidation in those sectors. In particular, "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.



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- The general widening of the spread levels is also a positive development for the strategy. The increased technicality induced by the current headwinds means that “Arb Tourists” have largely left and the rate of return on offer to invest in Merger Arbitrage is now a lot more attractive at about 11.5%

over LIBOR. This is a game changing improvement in yields to maturity at near 16.7% gross in USD terms for a market neutral strategy!

- Given the quality of the microstructure of the Merger Arbitrage market (Decent number of deals outstanding, large spreads) in the recent period, the investment team believes that next twelve months will continue to provide a supportive environment for the strategy.
- At the time of writing, the portfolio offers a yield-to-maturity of close to 7.3% in EUR with an associated duration of 5.2 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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