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 second quarter of 2021, equities rose as vaccination campaigns accelerated in most developed economies, particularly in Europe. In EM, vaccination campaigns continued to lag but cases seemed to remain under control. Economic data was generally very strong in Q2, both on the GDP and business sentiment fronts. This strong rebound in economic activity has fueled inflation in some countries and sectors. Whether this is temporary or not remains to be seen, but it has had an implication on the Fed’s stance, that has become slightly more hawkish.
- The pace of vaccination campaigns and reopening of economies was the main driver of equities, as US and Europe, which were at the forefront, outperformed EM and Japan. In terms of styles, growth outperformed value in Q2, after a few quarters of underperformance. In fixed income markets, inflation was the main driver of performance, as investors looked for yield and inflation hedges in a context of very low or even negative sovereign bond yields.
- 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 second quarter of 2021, U Access (IRL) Cheyne Arbitrage UCITS posted a positive return of +1.79%, bringing YTD performance to +2.32% (Class C EUR, net of fees). Annualized deals spreads were at their widest levels for the year averaging 10.2%. Importantly, a large portion of the widening is attributable to timing uncertainties, resulting in a number of annualized spreads above 30%. Similarly to last quarter, this widening occured despite 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 combined with the growing opportunity in SPACs decreased the nominal amount of “Arb” money chasing each opportunity. This is a positive development for the strategy as it means that individual opportunities presents 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 Kinnevik, Alexion and our SPAC book. The largest contributor to the quarter’s returns was the Zalando spin-off position. In the process of executing on their strategy to refocus the company on Scandinavian bound VC type investments, Kinnevik spinned-off their holdings in Zalando. A large portion of the Swedish shareholders could not hold the German shares because of their mandate and had to sell the stock. Consequently, we could buy the covered rights at a discount and capture a near 5% net spread over a month (60% IRR)!

- The second largest contributor was a Merger Arbitrage position in biotechnology firm Alexion. The portfolio's merger arbitrage position paid off as the acquisition was cleared by the CMA and deemed unproblematic by HSR in the US.
- The third largest contributor to the quarter's returns was our SPAC book. Our investment in SPACs is spread over 80 different names that meet our investment criteria. The strategy is to be positioned in the "front-end" of the SPAC life cycle i.e between the time the SPAC has its IPO and the time where an acquisition is announced. The specificity of this positioning is that there is very little downside (Currently less than 0.3% at the book level) while maintaining an exposure to positive announcements. Assuming that 60% of the SPACs in the portfolio will make an acquisition in the next twelve months and that the portfolio can capture 10% of the "IPO pop" the strategy could contribute up to 300bps to the overall portfolio returns. Given the limited downside, this represents a first-class risk-reward opportunity.
- On the negative side, the top three detractors over the quarter were the Hedge book, the Volkswagen share class spread, and the Willis Tower Watson Plc arbitrage position.
- The top detractor to the fund's performance was the hedge book. The investment team maintains a hedge book to account for the residual beta of the portfolio. While the portfolio is managed strictly on a market neutral basis it typically has 2-3% of "negative beta" which result of the impact of index and ETFs flows on individual cash positions. As part of the overall hedging of the portfolio, the team maintains an adequate hedge book to prevent those "convexity" effects.
- The volatility in the Volkswagen share class spread has remained elevated in the quarter due to increased retail participation, as the company became the the focus of the "Reddit crowd" who singled out the company as their "top picks" in social media. This led to a strong increase in the company's valuation in a matter of weeks. As it often happens, the large moves in the share price gave way to some dislocations in the pricing of the share classes that constitute their capital structure. The investment team remains wary of the "retail element" and intend to reduce exposure to share class and holding spread arbitrage as long as retail participation remain at an elevated level.
- The third detractor to the quarter's return was a Merger Arbitrage investment in insurance broker Willis Tower Watson. The spread widened when it was announced that the DOJ would sue to prevent the closing of the transaction. While the team would normally handicap heavily a deal following government action, the wording of the complaint leaves ample room for settlement. Should the parties fail to find a way forward, the team see less than 5% downside to the position which given the 13% net spread currently on offer is a great risk-reward proposition.

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 six tenth of the portfolio's exposure.

- Importantly, the exposure to SPACs was increased when the team was able to buy 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. This is particularly true for defensive transactions who have often seen their rational reinforced in this crisis (e.g. FCA/Peugeot).
- At the end of June, there were 41 active arbitrage strategies in the portfolio. The merger arbitrage portfolio had 37 investments while the mixed arbitrage strategy was made of 4 distinct positions including the SPAC book.

Outlook

- Deal flow has continued unabated in the second quarter with significant contribution from unsolicited and competitive bids. Coupled to the fact that large transactions were well represented in the mix, it indicates that boards rooms are particularly bold at the moment and the financial system healthy.
- The numbers are particularly impressive with more than $2.5 trillions of M&A announced year-to-date. With more than $1.5 trillions of new transactions, Q2 is the busiest quarter on record and the fourth consecutive quarter with more than a trillion of M&A. The month activity was driven mainly by sponsor deals and large caps US M&A.
- It is worth noting that with $500 billion of Private Equity deals, the last 6 months were the busiest in over 40 years for sponsors.
- In Europe, the UK has been the center of new M&A activity. The team expects that this trend will grow as the removal of a long-term political overhang and a large valuation disconnect are likely to act as a catalyst for deal makers. Atypically private equity deals accounted for 80% of all transactions well above the 45% witnessed historically.
- 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 2021 could offer one of the best environments for the strategy we have seen in years.
- In prolonging the current deal bonanza, Private Equity industry should play a front runner role here as they are currently sitting on a $2.5Tr war chest and raising money aggressively There is currently anecdotical evidence that LBO and non-strategic deal activity has shifted towards small transactions in disguised rescue deals. The team also expects to see strategic buyers stepping in 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 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 5.1% in EUR with an associated duration of 4.1 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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