The Arbitrage Funds

ADVISED BY WATER ISLAND CAPITAL

Merger Arbitrage Today

Offering Consistency in Uncertain Markets

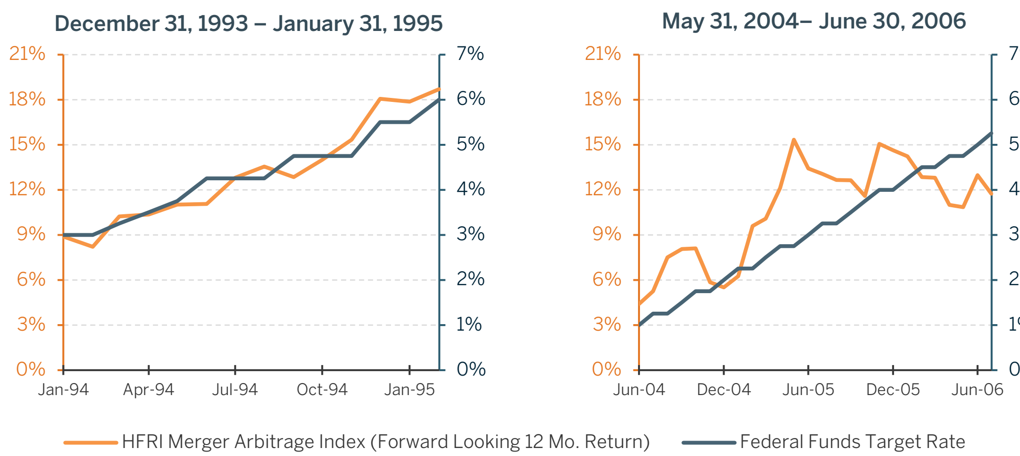
Entering 2018, investors face a growing list of uncertainties. Extended bull markets in equities and bonds have pushed valuations to record levels – an occurrence that has historically prefaced periods of muted returns. The Federal Reserve has committed to additional interest rate hikes and the unwinding of its massive balance sheet, which may cause yields to drift higher and hurt bond investors in the process. To further complicate matters, 2018 has also ushered in the sudden return of volatility. While these factors cast a shadow of uncertainty over the markets, we believe Merger Arbitrage may be capable of delivering attractive risk-adjusted returns regardless of market direction. The strategy has historically provided diversification and positive absolute returns in most environments, and expectations of rising interest rates and greater levels of volatility – factors that have historically served as tailwinds for the strategy – have many investors optimistic about its prospects in 2018.

In this paper: Positive Factors Developing in 2018; Implementing Merger Arbitrage in Your Portfolio.

Positive Factors on the Rise

Rising Interest Rates

As a key building block of Merger Arbitrage returns, rising interest rates can bolster performance. In the last two periods of significant increases in the Fed Funds Target Rate, Merger Arbitrage returns (as measured by the HFRI Merger Arbitrage Index) moved in a similar direction.



Source: Morningstar. Index returns are for illustrative purposes only and do not represent actual performance. **Past performance does not guarantee future results**. Index listed is the HRFI ED Merger Arbitrage Index ("HFRI Merger Arb"). Index returns do not reflect any management fees, transaction costs, or expenses. Indices are unmanaged and one cannot invest directly in an index.

90 Days

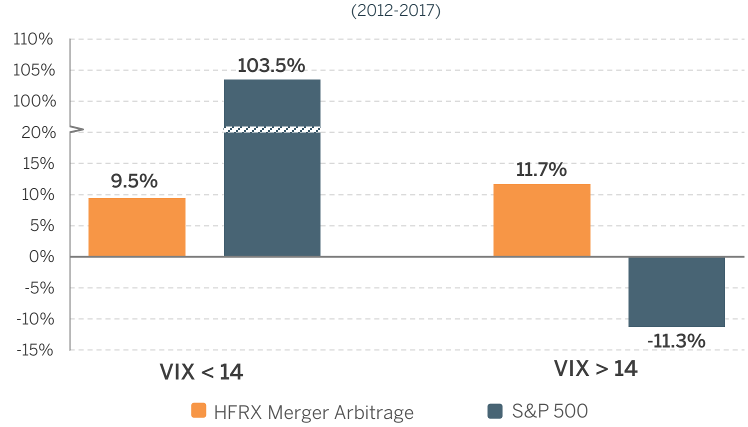
The average merger takes approximately 90 to 100 days to complete. As deals roll off the portfolio and capital is reinvested, the return potential is typically correlated to the new interest rate environment.

Greater Levels of Volatility

Because returns are closely tied to the outcome of specific, short-term events, rather than overall market direction, volatility can offer attractive entry points. It can also lead to the re-pricing of risk, allowing for greater return potential. Performance has historically been better when market volatility increases.

Cumulative Returns When the VIX is Over or Under 14

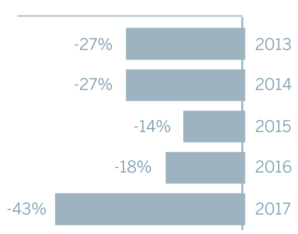
(2012-2017)



Source: Morningstar, Bloomberg. Date Range: 1/1/2012-12/31/2017. **Past performance is not a guarantee of future results**. The Chicago Board Options Exchange (CBOE) Volatility Index (VIX), tracks the market's expectation of 30-day volatility. The VIX is a widely used measure of market risk and is often referred to as the "investor fear gauge." One cannot invest directly in an index. HFRX Merger Arbitrage Index used in lieu of HFRI Merger Arbitrage Index due to availability of daily returns.

-26%

VIX 5 year average relative to its historical average.



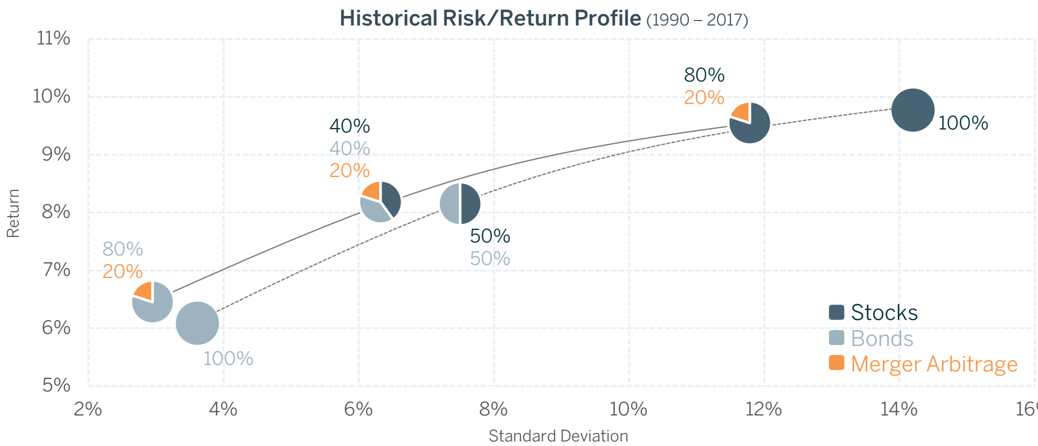
VIX Avg. / Historical Avg.

Source: Morningstar; Water Island Capital. Date range: 1/1/1990-12/31/2017.

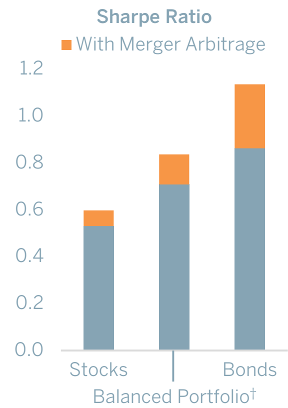
Potential Benefits for Your Portfolio

Diversifier / Risk Reducer

The strategy can act as a diversifier in both credit and equity portfolios, potentially reducing overall portfolio volatility and enhancing returns.



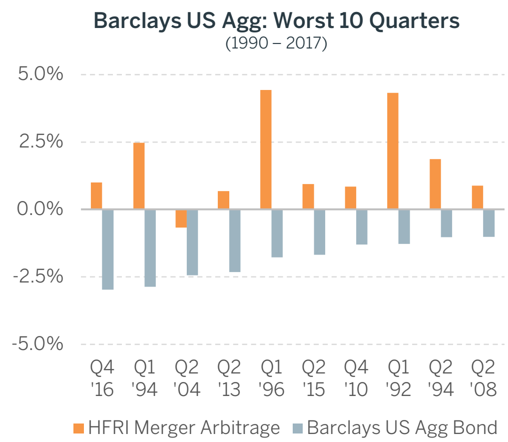
Source: Morningstar. Allocations are for illustration only and are not indicative of any recommendation or investment.



Source: Morningstar.
Date range: 1/1/1990-12/31/2017.
† 50% Stocks, 50% Bonds

Fixed Income Alternative

Merger arbitrage has a similar risk-reward profile to fixed income, but utilizes a different component of the capital structure. It has historically benefitted from rising interest rates, allowing it to provide a natural hedge during periods when fixed income typically declines.



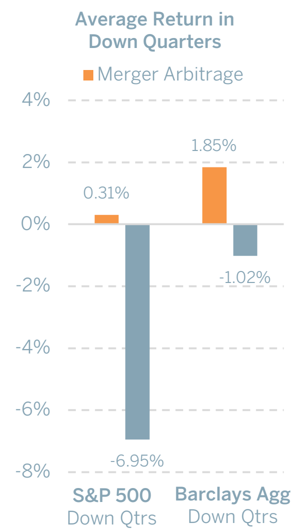
Source: Morningstar. Date range: 1/1/1990-12/31/2017.

Absolute Return

The strategy has historically preserved capital and generated absolute returns in bull, bear, and full market cycles.

		Merger Arbitrage	S&P 500
Bull	1/90 – 3/00	12.8%	18.0%
Bear	4/00 – 9/02	5.2%	(20.6%)
Full Cycle	**1/90 – 9/02**	**11.2%**	**9.2%**
Bull	10/02 – 9/07	8.1%	15.5%
Bear	10/07 – 2/09	(3.5%)	(38.8%)
Full Cycle	**10/02 – 2/09**	**5.4%**	**0.3%**

Source: Morningstar. Date range: 1/1/1990-2/28/2009.



Source: Morningstar.
Date range: 1/1/1990-12/31/2017.

Past performance is no guarantee of future results. Indexes listed are the Barclays US Aggregate Bond Index ("Bonds"), S&P 500 Index ("Stocks") and the HFRI ED Merger Arbitrage Index ("Merger Arbitrage"). Index performance returns do not reflect any management fees, transaction costs or expenses. Indices are unmanaged and one cannot invest directly in an index.

GLOSSARY

Barclays U.S. Aggregate Index: The Bloomberg Barclays U.S. Aggregate Bond Index covers the U.S. investment grade fixed rate bond market.

bear market: A market condition in which the prices of securities are falling, and widespread pessimism causes the negative sentiment to be self-sustaining.

bull market: A financial market characterized by optimism and investor confidence, in which prices are rising or are expected to rise, with expectations that strong results will continue.

correlation: A measure of how two securities move in relation to each other, ranging from -1 to +1. A correlation of 0 means the relationship between the two securities is completely random, while +1 indicates a perfect positive relationship and -1 a perfect negative relationship.

Federal Funds Target Rate: The interest rate at which a depository institution lends funds maintained at the Federal Reserve to another depository institution overnight. Also known as the "fed funds rate".

HFRI Event-Driven Merger Arbitrage Index: A subset of the HFRI Event-Driven Index, this index includes strategies which employ an investment process primarily focused on opportunities in equity and equity related instruments of companies which are currently engaged in a corporate transaction. Constituents report on a monthly basis. Inception 12/29/1989.

HFRX Event-Driven Merger Arbitrage Index: A subset of the HFRI Event-Driven Index, this index includes strategies which employ an investment process primarily focused on opportunities in equity and equity related instruments of companies which are currently engaged in a corporate transaction. Constituents report on a daily basis. Inception 1/30/1998.

Sharpe ratio: A measure of risk-adjusted performance, calculated by subtracting the risk-free rate from the rate of return for a portfolio and dividing the result by the standard deviation of the portfolio returns.

S&P 500 Index: Standard and Poor's 500 Index (S&P 500) is a capitalization-weighted index of 500 stocks designed to measure performance of the broad domestic economy.

standard deviation: A measure of the degree of variation of returns around the average return.