Water Island Capital

The ArbCast – Episode #14: A Conversation About Alternatives, featuring The Bahnsen Group and Sarian Strategic Partners

Gregg Loprete: [00:00:00] Hi, I'm Gregg Loprete, Portfolio Manager at Water Island Capital, and today I have the pleasure of speaking with two top advisors about how they are using alternatives in their client portfolios. First is Steve Tresnan from New York City, who utilizes our Water Island Credit Opportunities Fund, ticker ACFIX, and Jeremiah Riethmiller from Wayne, Pennsylvania, just outside of Philadelphia, who utilizes our Arbitrage Fund, ticker ARBNX. Today the three of us will discuss what's happening in the markets, why it matters to your investment strategy, and we'll also talk about alternative investments; what they are and how they might be used as part of a diversified portfolio.

Steve Tresnan: [00:00:47] Great, so we thought it'd be fun today to start with random trivia or facts about each of us. So, this is Steve and I'll go first. I think back on life, I started playing guitar when I was 12 years old and that's had a pretty profound effect on really my whole life since then in terms of the best friends I have now, my wife, how I met her, why I'm sitting here in front of you today. So, without going into all those details, I guess the point is it's interesting how these other things you do in life that may not be your main profession or central focus can have such a broad impact.

Jeremiah Riethmiller: [00:01:21] I'm going to go a different direction. I'm a drummer, but I'm actually an undefeated axe thrower, fun fact. Starting with my first competition when I was 12. I've been in two subsequent events, one with my team here and another one with friends. So, three events, three wins. I'm going with it.

Steve Tresnan: [00:01:46] That's like national-regional-national champion?

Jeremiah Riethmiller: [00:01:48] Sure! I like to think of myself as a modern day Paul Bunyan. And obviously if you're listening to the podcast you can't see me, but I at least have the beard to go with that description.

Steve Tresnan: [00:02:05] Gregg, what don't we know about you?

Gregg Loprete: [00:02:09] I guess following the theme of starting things at 12 years old, I actually started riding motorcycles, dirt bikes, and motocross when I was 12. And that journey has taken me really through today. I went from riding motocross through college and then getting into mountain bike racing. And then from there, of course, everybody said

you have to get a road bike to get in better shape. And so next thing is I had a road bike and probably about 10 or 15 years of my life, just prior to kids, I was traveling all over the country, racing bikes. Then, of course, I had kids and I got involved with a lot of travel sports and my bike collected a lot of dust and cobwebs. And I gained a couple of pounds, of course. And now the kids are older, they're done with all their travel soccer and the like, and over the last year and a half or so I picked up the bike again and I'm riding quite a bit. And now that I don't have to commute so far - I just have to commute to my basement currently - I've got about an additional 15 hours a week. So, it's been very good for me as far as health and happiness. And my wife will probably say it's really helped our marriage because I'm out of the house for 15 hours a day. So, it's all good.

Steve Tresnan: [00:03:28] Some bright spots to the pandemic. And I just started my biking career in the basement as we got this NordicTrack bike recently. So, that's my new foray, but nothing on the roads. I’m steering clear of that for now.

So Gregg, maybe we'll hand it over to you to get into the discussion and the real topic of today.

Gregg Loprete: [00:03:52] Sure. So, today we're talking about alternatives, and from the top, many people have different definitions of what an alternative investment is.

First of all, we know that there are two main types of investments. Most investors are invested in bonds and stocks. And so, the very broad definition of alternative is anything other than a bond or a stock. But I think what we'll find out in our discussion today, that there are also a lot of alternatives within bonds and stocks.

Many of you are probably familiar with some of the other alternatives. A lot of people are invested in real estate through REITs. They're invested in commodities through gold ETFs and silver ETFs and that sort of thing. And currencies now, I know people can trade currencies on some of these online platforms.

So that's really what an alternative in its basic definition is, but we also at Water Island Capital, we do go through other definitions. One of the things that we look for in alternatives is we look for - not to use the word alternative - a different type of return profile that is independent of the market, and we like to call that idiosyncratic. That simply means that the investments that we have walk to their own beat. They're somewhat independent of market moves, and as long as these events or catalysts (that we'll talk about) go through then we should be able to achieve our return.

So that's really how we look at things. Later on, I can certainly get into a little bit of the nuts and bolts about what we do, but that's it in a nutshell.

Steve Tresnan: [00:05:28] Nicely done. Jeremiah, anything to add about how you guys view alternatives?

Jeremiah Riethmiller: [00:05:33] Yeah, I think we take a similar but maybe different view as advisors to end clients, the retail investor. I mean, academically, I define an alternative as something that can bend that efficient frontier. You’ve got bonds as the anchor in the

portfolio and the stocks as the return generator. And somewhere in between there's ways to add diversification with stuff that's not correlated and bend that efficient frontier. So, we kind of take that academic approach and to me, like Gregg mentioned, there's a lot of different alternatives, but you have to define for a portfolio what you're trying to solve for. Are you trying to solve for a different return profile? Are you trying to solve for a different risk profile? And does what you're investing in as an alternative, what you're defining as an alternative, actually deliver that?

You need to be clear on that if you're doing a strategy in a portfolio, and then it also needs to translate to the client level because different clients have different risk profiles, return expectations, etc.

I know, Steve, you probably use a few more alternatives in your client portfolios than we do in our offices. So how do you guys look at it?

Steve Tresnan: [00:06:54] Yeah, I'd say similarly you both touched on a lot of things that I like. I would say broadly that they're just other investments that should do something different than what we can accomplish in the traditional markets. Gregg talked about things that are idiosyncratic, different sort of risk, different return profiles, maybe different income. And like you're saying too, the goal within a given portfolio can really drive alternatives or investments that are appropriate for that and the attributes that you're seeking, which then you hopefully can achieve.

So I think all of that is a really nice summation of what alternatives are designed to do and how we use them. So, I fully agree with both of you.

Jeremiah Riethmiller: [00:07:39] Yeah, I would just add that you can throw everything in the alternatives bucket, but in my opinion, there're good alternatives and there're alternatives behaving badly. Let's say it's doing something different and maybe it's just going down. That's not a good different. You need to be clear that there's a good alternative and there's a bad alternative.

Steve Tresnan: [00:07:59] Yeah, good different, not bad different. And I'll take that a step further and just say there are things that are often referred to as alternatives because they don't fit neatly in the stock or bond box. But for me, they're not really alternatives because they're not going to help us increase our income or return at the same time of decreasing volatility, which is pretty common among the attributes we want out of alternatives. So, some examples like that: publicly traded REITs, which can look very much like equities and even be more volatile than equities in a general sense. These are not things you're going to put in your portfolio and then dampen risk or do what you think comes with that alternatives bucket in the sense that I use it.

Jeremiah Riethmiller: [00:08:44] Yeah, I throw hedged equity strategies in there too and these have been popular lately. So, I'll look at like the return profile of a hedged equity strategy, daily returns, and you can marry that up with a 60/40 portfolio and it looks exactly the same. It may be for a specific client, if it's functioning as an alternative as that I couldn't get them into equities, but the alternative is they get hedged equity. That's better than not

being in equities at least. But if you already have stocks and bonds and a 60/40 portfolio, a hedged equity strategy isn't really giving you any diversification.

Steve Tresnan: [00:09:17] Yeah, I would agree. That's commonly the case.

Gregg Loprete: [00:09:21] Everybody's made some really good points. I think the thing that is important about alternatives, or frankly any type of strategy or investment, is really it's good to have an expectation of, as Jeremiah said, what that's contributing to your portfolio – whether it's low volatility, high returns, a mix of both – but also, I think it's important to have an expectation about what that fund is going to do in a particular market.

Because even though you have an alternative, like Steve pointed out, it can certainly have an extreme amount of volatility. And what is that really contributing? Is it excess return? Is it just increasing volatility in your portfolio? So, I think the approach that our firm takes is we really have a capital preservation mandate.

And so, when people look at our funds, they're really looking at lower volatility, they're looking at lower correlation. But I think in a lot of cases, they're looking at markets that are challenging. It could be a market like we have now where you have rising interest rates. It could be something like a year ago when COVID first hit. It could be 2008. So, those are the types of situations, I think, where we address all the risks in our portfolio and we like to perform relatively well in those environments. That's really our subset of alternatives and how we deliver that to clients.

So, when we do talk to clients, we're not promising them these insanely high returns. We're really just saying, "look, we're trying to deliver to you steadiness and some predictability, so that you can factor that into your own portfolios". And that's really how we approach it.

Steve Tresnan: [00:10:53] Yeah, it makes sense and it's a good point about touching on markets as well as the things that you solve for within portfolios. We'll see many different markets in many different market cycles over the course of our lives and over the course of our client's lives, and in alternatives you're looking for consistency through these cycles. Things that can be additive in terms of value to your portfolio, in and out of the ups and downs. And at the same time, no one cares about diversification for diversification sake, right? If I get you a zero return and say your portfolio is well diversified then you're not going to be very happy with me. Same as if I put you in a bad, different alternative, like Jeremiah was talking about earlier.

Speaking on that market topic and where we are in cycles, at the same time you can't just set it and forget it. We do have strategic allocations for clients, but now is a - in my mind - realistically different timeframe in which we have to rethink our portfolios. That's a large part of what's driven today's conversation and why we got together. If you pay attention to news at all, you probably noticed that interest rates are at 40-year lows. Generally speaking, it's tough to earn income in a portfolio these days. And so, especially on the fixed income side, we're looking at ways to drive income that may be less traditional but still reliable.

That's really what's brought us here today and I'm happy to have you guys add whatever you'd like to that.

Jeremiah Riethmiller: [00:12:19] So you brought up fixed income and interest rates and I agree with you. To me, that's what is really driving our interest and my interest in alternatives specifically now, because I don't think I can emphasize enough that fixed income is just going to be very different over the next 10 years than it was the last 40 years, like you pointed out Steve. It was the portfolio insurance that you were getting paid to have. You bought the house and then you wanted insurance and they're like, "oh yeah, you can have insurance and we'll give you money to have insurance". Well, that's great. Now that's not the case.

The extreme argument is, well, we'll just forget fixed income. Let's just go into alternatives. I don't think you can take that approach. I was listening to a presentation at our Hightower investment forum recently and one of the speakers made the analogy, so I won't take full credit for this, but he said, "when you're starting a cross country road trip, you don't look up at the blue skies on day one and decide you don't need any insurance". You have to figure out how much are you comfortable having and how much are you willing to pay for it. That's, at the client level, a conversation that you need to have about risk appetite and return expectations which can be very challenging.

We just had a client the other day that filled out a form and they said I expect 7-10% returns. And then in a separate question, at what point would you be uncomfortable with your portfolio being down? And the answer was 10%. Well, I mean, you need to have a conversation about being a little bit more realistic about your return and risk expectations.

Steve Tresnan: [00:13:58] Yeah, absolutely. A quick shout out to our team at the Bahnsen Group which is what I'm part of. We have gone so far as to recontextualize this, in the portfolio sense, over the past year and, and gone with a dedicated effort, which we've deemed Operation Magnify, account by account, client by client, and rethinking this, especially the traditional fixed income. Does it still make sense in the amount that we may have had previously in a portfolio? Should some of it be reworked toward alternatives? Some of it even to strategies like dividend growth equity, which is a big philosophy of ours, near and dear to our hearts. You know, just other places where maybe you even have to accept more volatility than you would have in the past. But gaining comfort with the idea that maybe that is necessary to also drive your future income and returns. It's just a different world now.

Jeremiah Riethmiller: [00:14:55] Yeah. Gregg, I know you focus and concentrate specifically on that sort of fixed income credit space. Can you walk us through an example of the particular investment strategies that you guys would be using?

Gregg Loprete: [00:15:09] We consider ourselves to be catalyst-driven, or you may have heard event-driven investors. In our portfolios, we are looking at the corporate credit markets. So we're looking at an investment grade, we're looking at high yield, we're looking at convertible bonds, and we're looking at bank loans. The biggest difference is, even though those are multi-trillion-dollar markets, and we may be looking at the same quote-unquote "markets" of traditional fixed income investors, we are choosing our investments for very different reasons. So, if you take a look at our portfolio, you'll see a number of high yield bond positions. And so, the first thing is, why is that in our portfolio? Now, if I was a

traditional high yield investor, I would just be picking credits and saying I think this is a great investment for the next five years or seven years and I can clip a 5% or 6% coupon, and that's great. But the problem is, ex-defaults, is that it's still going to exhibit some market beta. So, if there's a massive high yield sell off like a year ago when high yield was down 25-30%, then we have to face that, and that is volatility that the investors have to endure. So, what we do that's different is we look for specific catalysts and events within those markets and the whole thesis, or the theme, behind what we do is we're looking to choose those investments and generate returns that are based on the timelines and the outcomes of those specific catalysts and events.

So, when I talk about different types of events, one of the things that we do that’s core to our firm and to the strategy, is we look at a lot of mergers, acquisitions, and spinoffs and the like. For example, I'll use a deal that closed about a month ago – Apollo, the private equity firm, made a cash bid for Michaels Stores. We know Michaels Stores from the arts and craft stores that you see in strip malls and the like. And I guess during COVID, when that hit, these stores had done extremely well online and so forth. So, for whatever reason, Apollo made a bid for the company. The company agreed to be taken private and there's two sides to the trade here.

On the equity side, we have a group at our firm, as do a lot of other firms out there, called merger arbitrageurs or merger arb specialists. What they do is they look at the equity predominantly. The idea here is if there's a $35 cash bid for the company on the day that the announcement occurs that stock may trade up to let's say $34. So, their job is to really capture that last $1 spread, and what they will pay for that spread is really based on the timeline of that deal closing, the risk of it not closing, upside, downside – very traditionally.

What we do on the fixed income side in a deal like Michaels Stores, when they have debt outstanding, we do that same type of operation or that same attack, but we're looking at the debt side of the balance sheet.

In Michaels Stores case, once that deal was announced, we asked the question, “what's going to happen to Michaels Stores' debt?” Now they may have had a 2026 or a 2028 bond, which looks like a long duration bond, and something that - I think we would all agree if there was no deal - would be subject to beta and market risk and so forth.

But what we do is we try to assess what's going to happen to that debt. In the case here, we saw that Michaels Stores' debt needed to be redeemed to get this transaction to go through. So, what we do is we purchase sometimes longer dated debt, but it's actually short maturity debt. It's really a yield to event or a yield to call piece of paper. So, in this case, we may have bought a five-year high yield bond, but in essence, it was a six-month bond or even less. It was actually about a four-month bond that we held.

So, what did we get from that? We got a got a yield component to it, so we're clipping coupon during the holding period. We're eliminating, for the most part, credit risk and interest rate risk, and we're able to capture a spread that is really short duration. And as long as that deal closes, it really doesn't matter what's going on in the fixed income markets.

So not only do we do that with mergers and acquisitions, but we do have a broader mandate where we can look at things like asset sales where a company will have to use proceeds to redeem their debt. I know a lot of people have talked about things like SPACs, and that's a whole other conversation for the equity side. But we'll look at those transactions if a SPAC deal is announced just to see if there's debt outstanding at the target company and what's going to happen to it. And so, we take that same approach as we would with a merger or an acquisition, we assess what happens to the debt. And what we like to see is really a short duration portfolio, and if everything works out, we're going to generate those returns that are based on really the timelines of closing that deal.

Steve Tresnan: [00:20:00] That's really interesting stuff. For the alt.Blend blog and podcast in particular, it's interesting to have someone who really is in the space on a day-to-day basis talking about these deals and activities at such a granular level. So, hopefully a different perspective for my listeners.

Jeremiah Riethmiller: [00:20:23] Yeah, it's always fascinating for us to hear about as well because you're playing in the same liquid markets - in the bond markets, or if you're in the equity arb strategy in the equity markets. You're trading the same securities, but you're taking a very different approach and looking at various nuances in those spaces than your traditional market participants.

Gregg Loprete: [00:20:49] That’s right.

Steve Tresnan: [00:20:49] Yeah, agreed, and completely changing the risk profile, to Jeremiah's point. So, you kind of hashed it out. Yes, on the surface I'm holding a longer dated bond and it may be high yield, maybe questionable credit, all these things, but you're also solving for those risks through the structure of the trade itself and completely transforming what that risk profile is, what the income profile is, and what the upside/downside on the situation is.

Gregg Loprete: [00:21:19] What's also interesting is I've been doing these types of investments for virtually my whole career, whether it was through merger arbitrage, or convertible arbitrage, or high yield bonds, whatever it might be. When we were launching this fund about 10 years ago, we've been running this strategy here at the firm for about 10 years, and when we would sit down with investors and we would explain it, they said, "wow, that makes a lot of sense, but show me the numbers." And of course, when you don't have your track record, you really need some time to show that the strategy works.

And so, if you really look at our returns and you go through periods like the Taper Tantrum, or you go through 2014-2015 when the high yield markets were really hit hard, where we had commodities selling off. I think high yield during those times were down 15 to 20%. And then other periods, last year during COVID, I think post-2016 election when longer dated aggregate bond types of products really got hit when interest rates went up. If you look at all those periods, you'll see that the fund did pretty well and a lot of those quarters were positive. And in the quarters where the market was really down dramatically, like with COVID last year, during that quarter we were down 5%. But if we were in a high yield portfolio, we probably would have been down north of 20%.

What we did during that period is, because we had that lower correlation because we were tied to these events – and yes, some of those things did sell off because there were a lot of people liquidating and so forth – we were really in a strong position, I think at that point, through our positions but also through some of the hedging that we do in the portfolio. And I think the important thing is to look and say, “how do we get out to the other side? Okay, we're down 5%. What does it look like in two months from now? Three months from now? Six months from now?” And I think because of the nature of the portfolio, we were looking at very short-dated events that snapped back relatively quickly. And at the same time, we were able to pick, frankly, some investments that you just don't see very often because of the dramatic sell-off. So, we were able to rebound nicely the next month or two, and then through the end of the year. We recouped that and ended up returning just about 6.7%. So, I think that it really demonstrated that the strategy can work. I think it does work if it's done in the right way. So, that's just a little extra color. But it takes time, I think, to introduce investors to it, to show how it performs over various market cycles and when certain events hit. But now, the data's there and it's good to see.

One of the things we do is we look at the data, but then we also continue to look at it and say, “okay, are there better ways to do it? Can we hedge better? Can we select names better?” That's a whole other topic.

Steve Tresnan: [00:24:12] Really good insights there. That all being said, we've kind of touched on it being almost all weather, right?

It is something that we want to work in kind of all environments. Is there an ideal environment, though? If you could pick and choose, and I don't know what the parameters would be for a strategy like this to really shine, what would that be?

Gregg Loprete: [00:24:35] I'd say probably the best market would be when interest rates and credit spreads are just benign. They're not moving one way or another, but you see a lot of deal flow. That means there's a lot of mergers that are announced. You see a lot of diversification from the standpoint of you see mergers, acquisitions, spin-offs, SPAC deals. So, not unlike what we've seen in the last year, from that perspective, except now we're challenged by interest rates. But the best environment would be really what we've had over the last year, coming out of COVID, with respect to the number of deals announced, the types of deals announced, the refinancings that have been going on. Those have all been tailwinds for the strategy. So, that would be the best environment for us.

And then, like I said, we currently have that one tailwind, but then the headwind – not so much for our strategy, but for the market in general – is certainly interest rates. To me, that really presents more opportunities because one of the things that we'll do, and I've been doing this more recently as rates have been spiking up. At year end, we just took the approach that 2021 could be the year that rates are going up. So, we just felt let's stay in things that are tight, let's stay short duration. There's no reason to go out on the limb, even from a standpoint of there might be a merger deal, a utility deal or something, that won't close for 12 months. Well, those are still subject to some duration risk. And so during that period we just said, “let's wait. Let’s wait, and if rates should rise, then let's at least get compensated for it.” And there were a couple of names that were announced recently, and

really over the last two weeks when rates rose, those names came in about a point which doesn't sound significant, but you're talking about going from a 3% investment up to a 5% investment. Nothing dramatic, nothing sexy, but we're now capturing stuff that's closer to that 5% for very, very low risk. So that's really how we will look at this type of environment. Like I said, we're not playing for interest rates or anything like that, but I'd say we're risk aware and that just gives us, I think, the reason to be patient.

Steve Tresnan: [00:26:44] Got it. And one other thought that came to mind, maybe it's useful for the listeners, is it's kind of implied in everything that you've said, but it's worth mentioning, is this idea that in a normal trade you have to get two things right, or at least two things right: your entry point and then your exit point. And with strategies like this, you structure the trade from the get go and then the ending is the event. That you're just typically taken out of the trade, and it's not your decision to have to figure out that end point.

Gregg Loprete: [00:27:16] That's a great question because a lot of people will say, "okay, that's great. You buy this bond, but then you have to sell it. And what if the market is trading down at that time?"

Well, our investments are what we call corporate actions, and a corporate action just means that the company will give you funds and they'll redeem the bonds. So, envision that you have a stock. Right now, Microsoft is in the process of acquiring Nuance Communications (NUAN). They do voice recognition software. If you had had NUAN in your portfolio, if this deal goes through at year-end, and you have shares of NUAN, well, all of a sudden one day that deal's going to close and your 500 shares of NUAN disappears, but you all of a sudden have cash in your account. That's just something that happens on the backend. It's a corporate action and that's exactly what happens with our bond portfolios. There's no need to take market action. We just wait and a notice of redemption is sent out and our bonds are just delivered to the company and they deliver cash to us.

So, on the back end, there there's very little risk of needing to sell into the market. So, that's a really good point, Steve.

Steve Tresnan: [00:28:25] Yeah, thanks for the additional insights. And I'm kind of broadening the scope again, Jeremiah, maybe I'll throw it over to you. What are things that from an advisory standpoint, investors should keep in mind when we're talking about alts more broadly. I mean, we talked about some of the characteristics earlier, but I'm thinking more of portfolio considerations.

Jeremiah Riethmiller: [00:28:45] Yeah. Usually, the conversations we're having with clients - our average client size is two and a half million dollars, so not necessarily a lot of experience with alternatives - is talking about perhaps the tax implications. If you've got a K1 associated with what you're investing in, it's the liquidity differences. Now if you're doing alternatives in a mutual fund structure, you're still daily liquid, but if you're going into private offerings, you might not be liquid for 10 plus years. So, understanding that is important.

I think the biggest thing with our clients is education. And we've kind of touched on this, you need to be clear as to what is the goal of having alternatives for the client. Are you allocating some of your fixed income money into something that you expect to have lower volatility, but still provide you some return profile? Or are you going out of your equities into private equity space where your goal is higher returns, or maybe similar returns but less correlation to the equity markets? And making sure that everybody's on the same page as to what's the goal for your portfolio as to why we're using this specific investment. And then having expectations that are appropriate.

So, I mentioned good alternatives and bad alternatives. Sometimes there's alternatives behaving badly, and I'll say those are alternatives where you expect them to do one thing, and then they do another. I never liked that because you need to have expectations and you'll put an alternative in a portfolio for a specific reason. And when it doesn't match that reasoning, that's not a good conversation that you want to have with a client at the end of the day.

I'll give you an example of an alternative behaving badly, and this could probably be a whole other podcast, but I'm personally not a fan of gold, and I struggle with commodities. Gold, people think, “okay, that's the equity hedge, right?” Well, if you go back in history and look at one-year periods or calendar periods, sometimes the correlation is one to equity, sometimes it's negative one. So, it's hard in the context of a portfolio to know how gold is going to behave. So, I simply avoid it. Others may disagree, but that's kind of the approach because to me that's an alternative behaving badly because it's not doing what I expect it to do.

Steve Tresnan: [00:31:15] Yeah, great point, and maybe I'll try and tie this all together and use Gregg's strategy as an example. Thinking in a portfolio context, something like this credit arbitrage, I can get some income, I expect relative stability, and some reasonable returns. Let's call it more than what traditional fixed income provides now, less probably than equities will provide over the long-term. Where does that fit?

To give you a sense, I think it fits in a few different places, but it's all situation specific. You could think of it as, for me, a more attractive piece of what used to be your traditional fixed income allocation if I'm going to hold that for the long-term, because I think the risk/reward will benefit us. It could be a component of some sort of broader, medium term, cash kind of allocation where you want to have, back to Gregg's original point, all these different idiosyncratic risks to create a more stable overall profile. You know, this is an example of idiosyncratic risks, event related risks, very different than what's happening in the markets, that you can put into that situation. And then another place I think personally where I like to use this is for capital calls. So, quick background for listeners, but when you go into certain alternative investments, you may commit upfront and then from time to time, they will ask you for the money that you told them you would give them. You have to put that money somewhere, but know that you're going to need it at some point. So, it's a little bit tricky. Well, this is the way I think, again, relatively stable and earning some income and return along the way, and it still sits in your alternative bucket. So, when they come asking for their

money, they call the capital, you're simply taking one kind of alternative exchanging into this other one. I've had it play a good role there.

Jeremiah Riethmiller: [00:33:06] Yeah, we've used it specifically. We built in the last year or so what we call a short duration income model. It's for that money, like you're talking about for capital calls, maybe they're going to buy a house or whatever. So, it's that one-to-two-year cash bucket. You pair it with some shorter duration, traditional investment grade corporates, but this is giving you a different risk/return profile. And it's also been a way for us to start introducing more liquid alternatives to clients because, to Gregg's point earlier, they need a track record before you can kind of sell it. So, they need to have some experience with it and maybe a small cash bucket to get them comfortable with it. Yeah, okay this is different, but I can get a reasonable return with a pretty low risk profile over time. And then you can start to weave in maybe more different alternatives.

Steve Tresnan: [00:33:57] So to toot Gregg's horn a little bit, this falls into the good different bucket, right?

Jeremiah Riethmiller: [00:34:08] Yeah. Gregg is the good different, he's not the alternative behaving badly. That's the take away from this podcast. Gregg's the good alternative.

Gregg Loprete: [00:34:19] I'll take that.

Steve Tresnan: [00:34:20] Fantastic. I think with that, we should wrap it up unless anyone wants to add anything further.

Jeremiah Riethmiller: [00:34:27] No. Thanks, Steve. Thanks, Gregg.

Steve Tresnan: [00:34:29] Yeah, thank you both for your time and have a great day.

Gregg Loprete: [00:34:33] You too. Take care, Steve.

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As of May 13, 2021.

An investor should consider the investment objectives, risks, charges, and expenses of the funds carefully before investing. The current prospectus contains this and other information about the funds. To obtain a prospectus, please visit https://arbitragefunds.com/ or call (800) 295-4485. Please read the prospectus carefully before investing. Investing involves risk, including potential loss of principal.

The discussion of market trends and companies throughout this podcast are not intended as advice to any person regarding the advisability of investing in any particular security or strategy. Any securities mentioned are selected for discussion purposes only and may not represent current holdings of Water Island Capital, LLC ("Water Island") or The Arbitrage Funds. Our views, opinions, and estimates – including any forward-looking statements – are a reflection of our best judgment at the time of recording and are subject to change based on

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ACFIX and ARBNX have limited availability and may not be accessible to all investors. The funds are also available in other share classes. Please see the fund's prospectus for more details.

Performance through 3/31/21: ACFIX (I class), 14.23% (one year), 4.06% (five year), 3.22% (since inception 10/1/12); ARBNX (I class), 10.38% (one year), 3.64% (five year), 2.75% (ten year); ICE Bank of America Merrill Lynch U.S. High Yield Index, 23.31% (one year), 7.94% (five year), 6.31% (ten year). Performance greater than one year is annualized. The performance quoted represents past performance and does not guarantee future results. Investment return and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than the original cost. Current performance may be higher or lower than the performance quoted. For performance data current to the most recent month end, please call (800) 295-4485. Returns shown above include the reinvestment of all dividends and capital gains. Total Annual Fund Operating Expenses for ARBNX is 1.46%. Total Annual Fund Operating Expense for ACFIX is 1.72%. The Water Island Credit Opportunities Fund has entered into an Expense Waiver and Reimbursement Agreement whereby the adviser has contractually agreed to limit the total annual operating expenses of the Fund so that they do not exceed 0.98% for Class I shares, not including dividends and interest on short positions, acquired fund fees, costs incurred in connection with the purchase or sale of portfolio securities, and other extraordinary expenses. The agreement remains in effect until September 30, 2021, unless terminated at an earlier time by the Board of Trustees. Without such fee waivers, performance numbers would have been reduced.

FUND RISKS: The Funds use investment techniques and strategies with risks that are different from the risks ordinarily associated with equity and credit investments. Such risks include merger arbitrage risk (in that the proposed reorganizations in which the Funds invest may be renegotiated or terminated, in which case the Funds may realize losses); short sale risk (in that the Funds will suffer a loss if it sells a security short and the value of the security rises rather than falls); event-driven risk; special situations risk; market risk; sector risk; hedging transaction risk; derivatives risk; LIBOR rate risk; credit risk; convertible security risk; concentration risk; special purpose acquisition companies risk; non-diversification risk; active management risk; counterparty risk; high portfolio turnover risk (which may increase the Funds' brokerage costs, which would reduce performance); interest rate risk; liquidity risk; options risk; swap risk; small and medium capitalization securities risk; investment company and ETF risk; when-issued securities risk; large shareholder transaction risk; foreign securities risk (in that the securities of foreign issuers may be less liquid and more volatile than securities of comparable US issuers, and may be subject to political uncertainty and currency fluctuations); leverage risk; currency risk; and temporary investment/cash

management risk. Risks may increase volatility and may increase costs and lower performance.

Water Island Credit Opportunities Fund top ten holdings as of March 31, 2021: Capitol Investment Merger Sub 2 LLC 10% 8/1/2024; Golden Nugget Inc 6.75% 10/15/2024; Hillman Group Inc/The 6.375% 7/15/2022; Ingram Micro Inc 5.45% 12/15/2024; Laureate Education Inc 8.25% 5/1/2025; Michaels Stores Inc 4.75% 10/1/2027; Michaels Stores Inc 8% 7/15/2027; Pluralsight Inc 0.375% 3/1/2024; Stars Group Holdings BV 7% 7/15/2026; T-Mobile USA Inc 6% 3/1/2023. Top ten holdings represent 31.9% of the portfolio. Holdings are subject to change. Current and future holdings are subject to risk.

Arbitrage Fund top ten holdings as of March 31, 2021: Alexion Pharmaceuticals Inc; Cardtronics PLC; Coherent Inc; IHS Markit Ltd; Maxim Integrated Products Inc; Pluralsight Inc; RealPage Inc; Slack Technologies Inc; Water Island Event Driven Fund; Willis Towers Watson PLC. Top ten holdings represent 35.5% of the portfolio. Holdings are subject to change. Current and future holdings are subject to risk.

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