

Constantia Capital Merger-Arbitrage Strategy January 2023 Commentary

Our composite returned 0.05% in January, bringing returns to 3.83% annualized for the past 5 years and 4.97% annualized in 11+ years since inception.

The year started off well for both stock and bond markets. The S&P 500 posted a healthy return of 6.3%, but that is far behind the returns of international developed and emerging markets, which returned 8.1% and 8.3% respectively. Bonds also posted positive returns as news on the inflation front continued to be better than expected, with the Bloomberg Aggregate Bond Index returning 3.1%. The classic 60/40 Equity/Bond benchmark (All World Index, Bloomberg US Aggregate Bond Index) returned 5.5% for the month.

Although our composite posted slightly positive returns for January, that was a disappointing start to the year given that we lagged our short-term cash benchmark. A solid start to the month was derailed by a bout of nervousness in Merger-Arb land precipitated by Senator Warren attacking certain specific deals - despite the fact that she has no explicit role in the anti-trust process. Thankfully we have 11 months to achieve our stated goal of returns in the 7% to 8% range for the year (3% to 4% above short-term interest rates).

Another noteworthy development is that biotech deals are including Contingent Value Rights (CVR's) more frequently and the value of the CVR is becoming an increasingly larger percentage of the deal consideration. That is a positive development since in our view the market tends to undervalue the CVR's. However, given the large potential future value of the new batch of CVR's, they are no longer "free". The CVR's are typically linked to future drug approvals and/or sales targets.

Some of the highlights and lowlights of the month:

- Of the 115 deals in the portfolio during the month, no single deal resulted in a positive contribution of more than 10 bps, and only one detracted by more than 10 bps.
- For the 5 new deals with CVR's, the CVR value averages 30% of the deal price, and the 5 deals are trading at an average *premium* of 4.6% to the deal price. Each makes up approximately 1% of the portfolio and in aggregate have contributed 6 bps to portfolio performance since deal announcement.
- Amgen's purchase of Horizon Pharmaceuticals is one of the deals targeted by Senator Warren. Although there appears to us and other analysts we follow that there is little overlap in their drugs (and therefore no anti-competitive impact), the DOJ requested more information from the companies, resulting in a negative 9bps contribution for the month.

- The saga of early-stage biotech F-Star Therapeutics acquisition by Hong Kong based Sino Biopharmaceutical continues. As noted last month, the deal has been delayed three times by CFIUS (Committee for Foreign Investments in the United States) restarting its 45-day review period. Rumors that CFIUS approval would not be granted eventually caused us to close our position, resulting in a negative 12 bps contribution for the month.
- Concern about the anti-trust authorities' distrust of the power of mega-cap technology stocks caused the spread of Amazon's acquisition of 1Life Healthcare to widen, costing 7 bps.

New deal announcements were 19 for the month, while 24 closed. Diversification in the portfolio remains high at 90 deals. The portfolio ended the month slightly unlevered (approximately \$90 of long positions for every \$100 of capital) as a number of large positions closed. We expect to return to normal levels of leverage in the near future.

Constantia Capital Merger-Arbitrage: Performance as of January 31, 2023

Benchmark	Reporting Period	Returns (Net) ^{2 3}	Bench-Mark ²	Excess (Net)	Volatility	Sharpe Ratio
LIBOR/SOFR 3-month USD	Year-to-date	0.05%	0.38%	-0.33%	N/A	N/A
	Latest 3 Years	2.85%	1.15%	1.70%	6.68%	0.25
	Latest 5 Years	3.83%	1.62%	2.21%	5.35%	0.41
	Latest 10 Years	4.68%	1.11%	3.57%	4.69%	0.76
	Since Inception ¹	4.97%	1.03%	3.94%	4.51%	0.87

¹ Returns annualized, since inception date 11/1/2011

² Returns annualized for periods in excess of one year

³ Net returns after performance fee, which three qualified clients have elected as of the date above