

Constantia Capital Merger-Arbitrage Strategy April 2022 Commentary

Our composite returned -0.29% in April, bringing returns to 0.18% for the year-to-date, 4.40% annualized for the past 5 years and 5.26% in 10.5 years annualized since inception.

Both equities and bonds continued their downward trend with major indices in each of those categories falling approximately 8% and 4% respectively for the month. Year-to-date returns for the major equity and bond indices are approximately -12% and -9% respectively. Those returns are striking for the high level of correlation in what are normally lowly correlated asset classes.

Merger-Arb has a reasonably small positive correlation with equity markets. For our strategy the correlation with the S&P 500 is 0.43 (0.30 if we exclude March 2020, the month of the COVID meltdown). In the search for yield, High Yield Bonds are the most frequently chosen alternative to Treasury Bonds and Investment Grade Corporate Bonds. However, High Yield Bonds have much higher correlation with equity markets – for most High Yield Bond funds the correlation with the S&P 500 is close to 0.7. In other words, for a similar return profile, Merger-Arb is a better diversifier than High Yield bonds. Case in point: the Morningstar High Yield Bond category average has posted returns of -7% year-to-date.

Some of the highlights and lowlights of the month:

- The best contributing deal for the month was Frontier Air's acquisition of Spirit Airlines. JetBlue made a counter bid for Spirit at \$33 per share. As a result, the Frontier Air/Spirit deal is trading at a premium, but Spirit (\$23.61) is trading at a significant discount to the JetBlue offer, indicating that investors are skeptical that JetBlue will be allowed to buy Spirit. We took profits in about a third of our position - the deal contributed 30 bps for the month.
- Carl Icahn is attempting to buy utility Southwest Gas and had raised his hostile tender offer price from \$75 to \$82.50 per share during March. In April, reports of a potential counter-bid sent the stock above Icahn's price, resulting in a contribution of 7 bps.
- Take Two Interactive's acquisition of Zynga is a cash and stock deal that has a collar structure with the number of acquirer shares increasing as the price of the acquirer falls. We were able to initiate our position so that it became the equivalent of a free put option, and with Take Two continuing to fall during the month the result was a contribution of 5 bps following an 11 bps contribution in March.
- The largest negative contributor was Elon Musk's purchase of Twitter. After the deal was definitively announced, we bought stock at what appeared to be a decent price that implied a return in excess of 7% annualized. However, the stock subsequently fell on concerns over Musk's

ability to finance the deal. That was somewhat alleviated after the announcement that Musk had sold \$8 billion of Tesla stock to help finance the \$21 billion in equity required for the deal (he is borrowing another \$23 billion). The negative contribution was 10 bps.

- Lemonade, an insurance company, is buying Metromile in a stock-swap deal. The acquirer’s stock has fallen 50% year-to-date and has become expensive to borrow/sell short, resulting in a slight disconnect between the two stocks. The negative contribution was 6 bps for the month although it has been a positive contributor since inception of the deal.
- Activision Blizzard is being acquired by Microsoft. Tough talk from Biden administration antitrust enforcers has hung over this deal since its announcement. Our view is that the Federal Trade Commission has little chance of blocking the deal if it had to go to court, but we are concerned a protracted legal battle could incentivize Microsoft to “walk” from the deal especially given that Activision Blizzard’s earnings have been weaker than expected. As a result of the increased risk, we have reduced our position to 1.25% of the portfolio. The negative contribution was 8 bps for the month and 24 bps since inception.
- Tenneco, an auto parts manufacturer, is being acquired by private equity firm Apollo Global. The spread has widened recently, although there has been no noteworthy news on this deal. Tenneco has a high debt-to-equity ratio and we believe there is concern on Apollo’s ability to finance the deal, resulting in a negative contribution of 10 bps.

New deal announcements continued at a strong pace with 24 new deals announced in April, while 22 closed. Diversification in the portfolio continues to be considerably above average, with the number of deals falling slightly to 114. Leverage is currently 125% (\$125 of long positions for every \$100 of capital).

Constantia Capital Merger-Arbitrage: Performance as of April 30, 2022

Benchmark	Reporting Period	Returns (Net) ^{2 3}	Bench-Mark ²	Excess (Net)	Volatility	Sharpe Ratio
LIBOR 3-month USD	Year-to-date	0.18%	0.26%	-0.08%	N/A	N/A
	Latest 3 Years	3.90%	0.81%	3.09%	6.54%	0.47
	Latest 5 Years	4.40%	1.32%	3.09%	5.26%	0.59
	Latest 10 Years	5.01%	0.88%	4.14%	4.62%	0.90
	Since Inception ¹	5.26%	0.86%	4.40%	4.58%	0.96

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 1/31/2021