

Constantia Capital Merger-Arbitrage Strategy June 2022 Commentary

Our composite returned -0.17% in June, bringing returns to -1.39% for the year-to-date, 3.62% annualized for the past 5 years and 5.02% in 10.5 years annualized since inception.

In the land of the blind the one-eyed man is king. That is how we feel despite negative performance for the month and the first half of the year. Our composite has outperformed the average of other merger-arb mutual funds and ETFs by over 1% for the year-to-date and by over 2% annualized in the 10.5 years since the inception of our composite (The Merger-Arb Fund Average has returned -2.74% year-to-date and 2.53% annualized in the past 10.5 years.)

As noted in previous commentaries, Merger-Arb in general has a small positive correlation to equities which we estimate to be approximately 0.35 with the S&P 500 (and close to zero correlation with bonds). Hence in a period when equities have fallen approximately 20%, our returns have exceeded our expectations. Probably more relevant is performance relative to High Yield bonds, which is the most frequently used “reach-for-yield” category within fixed income. The Morningstar High Yield bond category average has returned -12.93% year-to-date, which brings the 10-year return for that category to 3.61%. The correlation of High Yield Bond funds with equities is typically in the range of 0.65, making our Merger-Arb strategy a much more attractive investment - a better diversifier with higher returns.

Some of the highlights and lowlights of the month:

- The Spirit Air saga continued, with JetBlue increasing their counterbid including a payout on shareholder approval (that is, before anti-trust approval) and other commitments to increase the probability of anti-trust approval. Frontier countered by increasing their bid although it is still lower than JetBlue’s bid. Spirit twice postponed their shareholder vote on Frontier’s offer to allow for more time to consider the JetBlue proposals. This was the biggest positive contributor for the month, with an impact of 24 bps.
- Hemisphere Media, a Spanish language radio and TV company, is being acquired for \$7 in cash. Its second largest shareholder has stated publicly that they believe the company is worth \$16 causing the stock to trade much higher early in month. Later in the month, news that the company had received bids above \$7 caused another spike. We took advantage of the volatility, resulting in a positive contribution of 14 bps.
- Insurance company Lemonade is acquiring auto insurer MetroMile. The companies announced receipt of anti-trust approval, although various state insurance approvals are still outstanding. That resulted in a positive contribution of 12 bps.

- Rising financing rates are impacting the ability of some Private Equity deals to be financed. Nielsen, being acquired by Elliott Management, and Citrix Systems, being acquired by Vista Equity Partners, appear to be victims of that scenario, resulting in negative contributions of -14 bps and -6 bps respectively.
- Enerflex, a small Canadian oilfield service provider, is acquiring oilfield service equipment producer Exterran in a stock swap deal. Since these are small companies, there is very little news on the deal, but the spread has widened recently coinciding with the acquirer stock becoming expensive and difficult to borrow. That resulted in a negative contribution of -14 bps.
- LHC Group, a home nursing agency, is being acquired by United Healthcare. This would be a new business for United Healthcare, and a similar deal was recently approved for a United competitor. Nevertheless, the anti-trust authorities have requested more information, resulting in a 10 bps negative contribution.
- The saga of Elon Musk’s purchase of Twitter continues. The most significant news item during the month is that Twitter gave Musk access to their data “pipe” to allow him to attempt his own analysis on the number of “bot” users. The stock fell 5% for the month and is now at 41% discount to the definitive deal price of \$54.20. Our position remains at about half a percent of the portfolio. We continue to feel confident that the deal will close (clearly, the market thinks differently), most likely at the agreed-on price, although it is possible that Twitter will have to sue Musk in order for that to happen.

New deal announcements continued at an above average pace with 25 new deals announced in June, while only 19 closed. Diversification in the portfolio continues to be considerably above average, with the number of deals increasing slightly to 121. Leverage is currently 130% (\$130 of long positions for every \$100 of capital).

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

Benchmark	Reporting Period	Returns (Net) ^{2 3}	Bench-Mark ²	Excess (Net)	Volatility	Sharpe Ratio
LIBOR 3-month USD	Year-to-date	-1.39%	0.58%	-1.97%	N/A	N/A
	Latest 3 Years	3.64%	0.79%	2.86%	6.59%	0.43
	Latest 5 Years	3.62%	1.34%	2.28%	5.30%	0.43
	Latest 10 Years	4.67%	0.90%	3.77%	4.65%	0.81
	Since Inception ¹	5.02%	0.88%	4.14%	4.59%	0.90

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