

ABSOLUTE CONVERTIBLE ARBITRAGE FUND

PORTFOLIO COMMENTARY - ARBIX

Q1 2021



ABSOLUTE FUNDS



Eric Hage, Chief Investment Officer at Mohican Financial Management and Portfolio Manager of the Absolute Convertible Arbitrage Fund

The Absolute Convertible Arbitrage Fund (ARBIX) delivered a +1.25% return in the first quarter of 2021.

We have consistently communicated to investors that we view the ARBIX strategy as an “alternative fixed income product.” One advantage of being an alternative fixed income strategy is that ARBIX tends to be less susceptible to rising interest rates than most other fixed income products¹. The lack of correlation to interest rate moves has been a function of relatively short duration securities and the hybrid nature of convertibles which include exposure to credit and equity volatility.

Potential future inflation worries weighed heavily on fixed income investments overall in the 1Q2021. The 10 year treasury yield rose from 0.92% to 1.74% in just 90 days leading to negative returns for most fixed income strategies not related to credit. Once again, the resilience of ARBIX to rising rates was tested and the fund delivered a positive return despite a fairly dramatic move in rates.

The big story for convertibles continues to be the dramatic rise in convertible new issuance. We had what we thought was a big year in 2019 when issuance exceeded \$50 billion but in 2020, when the pandemic hit, companies wanted cash to shore up their balance sheets and issuance exploded to over \$100 billion. Despite the economy showing strong signs of recovery and vaccines becoming available, convertible issuance further accelerated in the first quarter of 2021. During the first quarter, \$41 billion of new issues came to market - the highest level of 1Q issuance in 20 years. Technology companies continue to be lead issuers of convertibles, but consumer discretionary companies were a close second over health care related companies which traditionally hold that spot.

Investors often ask us what type of market environment is good for the strategy. Our answer is always the same - an environment where the convertible market supply and demand forces are healthy. On the demand side, a healthy and stable environment is one where there is the proper mix of buyers between long only investors and hedge fund arbitrageurs. We don't want a demand environment with too many hedge funds looking for arbitrage opportunities. Currently, we still see healthy demand dynamics as the majority of buyers remain long only funds and hedge funds remain in the minority. On the supply side, we benefit from increased availability of merchandise which are replenished via the new issue market. Obviously, given the record issuance of convertibles lately, the supply side of the equation is very strong.

In the long term, more issuance should create a much larger and longer lasting opportunity for arbitrageurs like ourselves. Simply, the more securities we have to pick from, the more likely we will find opportunities. In the short term, recent heavy issuance has weighed on prices and short term performance as it will take time for the market to absorb all of the new securities. As a result, convertible valuations have cheapened significantly the past month creating a better expected return for the next 12 months and more. More specifically, despite the narrowing of high yield spreads in junk bonds, implied credit spreads of small/mid cap companies in the convertible market have widened and trade 100 bps or more wider than high yield. These spreads are wider despite significantly lower historical default rates than high yield, less interest rate risk and a large element of credit hedging/volatility exposure resulting in much less net risk exposure for investors. In our 30+ years in convertible bond markets, we have never seen the convertible asset class grow so rapidly which, we believe, sets up well for arbitrage opportunities for years to come.

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Quarter-End Performance for ARBIX: As of 3/31/21, the 1 year, 5 year and 10 year annualized performance for the Absolute Convertible Arbitrage Fund was 13.12%, 7.43% and 4.59% respectively and the 1, 5 and 10 year annualized performance for the Bloomberg Barclays Aggregate index was 0.71%, 3.10% and 3.44% respectively. Performance data quoted represents past performance and is no guarantee of future results. Current performance may be lower or higher than the performance data quoted. Investment return and principal value will fluctuate so that an investor's shares, when redeemed, may be worth more or less than the original cost. To obtain performance information current to the most recent month-end, call the Fund at 888-99-ABSOLUTE. Returns include the reinvestment of dividends and capital gains. Some of the Fund's fees were waived or expenses reimbursed; otherwise, returns would have been lower.

As stated in the prospectus, the Absolute Convertible Arbitrage Fund's Total Annual Operating Expense ratio (gross) for Institutional Shares is 1.67% and the net expense ratio is 1.29% through August 1, 2022. However, Absolute Investment Advisers LLC, the Fund's Adviser, has contractually agreed to waive its fee and/or reimburse Fund expenses to limit Total Annual Fund Operating Expenses to 1.40% through August 1, 2022 (the "Expense Cap") and to 1.20% when the Fund reaches \$250 million in assets under management. This Expense Cap, which excludes all taxes, interest, portfolio transaction expenses, dividend and interest expenses on short sales, acquired fund fees and expenses, broker charges, proxy expenses and extraordinary expenses, may only be raised or eliminated with the consent of the Board of Trustees.

¹ ARBIX has been positive in all 8 rising rate environments (measured by the 10 year US Treasury) since its inception in 2002. Conversely, the Bloomberg Barclays Aggregate Index (a broad based market capitalization-weighted bond market index representing intermediate term investment grade bonds traded in the United States) has been negative in seven of the eight rising rate environments.

	June 2003 to June 2004	July 2005 to June 2006	Dec 2008 to June 2009	Oct 2010 to Feb 2011	July 2012 to Dec 2013	July to Dec 2016	9/8/ to 10/8/2018	8/4/2020 to 3/31/2021
Yield Increase (BPS):	127 bps	113 bps	128 bps	90 bps	153 bps	96 bps	117 bps	123 bps
Barclays Aggregate Index Performance	0.12%	-0.81%	1.90%	-0.93%	-1.62%	-2.53%	-2.88%	-3.70%
ARBIX Performance	7.21%	15.47%	30.33%	3.57%	7.73%	6.26%	3.82%	5.50%

Data Through 3/31/21. Past performance is not indicative of future results. bps = Basis Points. 1 basis point = 1/100th of a percent

Past performance does not guarantee future results. The Fund's net asset value and investment return will fluctuate based upon changes in the value of its portfolio securities. There is no assurance that the Fund will achieve its investment objective, and an investment in the Fund is not by itself a complete or balanced investment program. For a complete description of the Fund's principal investment risks please refer to the prospectus.

Asset allocation decisions may not always be correct and may adversely affect Fund performance. The value of a convertible security is influenced by changes in interest rates, with investment value declining as interest rates increase and increasing as interest rates decline. The credit standing of the issuer and other factors also may have an effect on a convertible security's investment value. Debt securities have interest rate, inflation and credit risks and are subject to prepayment and default risk. High yield and junk securities involve greater risk and tend to be more sensitive to economic conditions and credit risk. Short sales may be considered speculative and it may be difficult to purchase securities to meet delivery obligations. The Fund may leverage transactions which include selling securities short as well as borrowing for other than temporary or emergency purposes. Leverage creates the risk of magnified capital losses. Diversification does not prevent loss or enhance returns. Foreign investments present additional risk due to currency fluctuations, economic and political factors, govern-

ment regulations, differences in accounting standards and other factors. Investments in emerging markets involve even greater risks. Small, mid and large cap stocks are subject to substantial risks such as market, business, size volatility, management experience, product diversification, financial resource, competitive strength, liquidity, and potential to fall out of favor that may cause their prices to fluctuate over time, sometimes rapidly and unpredictably. The Fund is actively managed and may experience high turnover. This may cause higher fees, expenses and taxes, which could detract from Fund performance.

These views are subject to change at any time based on market and other conditions, and Absolute Investment Advisers disclaims any responsibility to update such views. No forecasts can be guaranteed. These views may not be relied upon as investment advice or as an indication of trading intent on behalf of any Absolute Investment Advised investment product.

Investors should carefully consider the Fund's investments objectives, risks, charges and expenses before investing. This and other information is in the prospectus, a copy of which may be obtained by calling (888) 992-2765 or visiting the Fund's web site: www.absoluteadvisers.com. Please read the prospectus carefully before you invest.

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