

ABSOLUTE CONVERTIBLE ARBITRAGE FUND

PORTFOLIO COMMENTARY - ARBIX

Q1 2022



ABSOLUTE FUNDS



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Convertible Arbitrage Fund

The Absolute Convertible Arbitrage Fund (ARBIX) returned -0.54% in the first quarter of 2022.

It is never satisfying to post modest negative returns, but given the extreme circumstances in the bond market during the first quarter, the fund demonstrated significant capital preservation characteristics. The first quarter of 2022 was actually the worst quarter for bonds in over 40 years. The 5 year treasury yield rose the most since 1987. There was no place to hide in bonds as the Barclays AGG posted a -5.93% return, Barclays Investment Grade -7.69% and Barclays High Yield -4.84%. Equities also posted significant negative returns but the decline in bonds during the first quarter was historic. *(see reverse for definitions)*

Convertible arbitrage is a hedged alternative bond strategy with an equity volatility component, but fundamentally a bond/credit strategy nonetheless. One very attractive attribute of the strategy is that it has less interest rate sensitivity versus other bond investments which was clearly apparent in the first quarter given its relative performance. The hybrid nature of the security - part high yield corporate bond, part equity call option - gives it unique characteristics

where credit spreads, equity volatility and interest rates all play a role in valuations. During more normal times, interest rate moves usually have far less relative impact on returns than credit spreads or equity volatility on valuations, but the recent move in interest rates was not normal and the move had a real impact on returns.

We are convertible traders with multiple decades of experience, therefore we have an appreciation for market surprises and a cautious “what can go wrong” first mentality. Part of this mentality comes from trading convertibles since 1989 going through all kinds of market changes and cycles. In fact, the interest rate move in the first quarter of 2022 was a market event we have been ready for since experiencing a similar move in 1994 when 5 year treasury yields rose about 260 bps and convertible arbitrageurs lost more than 5% for the year. 1994 was the first year convertible arbitrageurs learned a hard lesson that a big and sudden interest rate move can have a meaningful negative impact on returns despite the resilient hybrid nature of the strategy. Most of us still around have hedged interest rates ever since.

From an overall gross P&L perspective for the quarter, convertible bond price depreciation versus the underlying stock hedge had a negative impact of about -135 basis points, while the interest rate hedge positively contributed about +65 basis points, yield/carry +30 basis points, and trading +15 basis points. Some of the price moves down in convertible securities were directly related to interest rates, but convertibles also cheapened in valuation during the quarter as some redemptions among long only funds resulted in more sellers than buyers and pushed prices lower.

As we said in our previous commentary, “*we could be at a major inflection point for long only investments as they could face years of stiff headwinds from the Federal Reserve.*” We had a sense it was time to be cautious, but we didn’t necessarily expect it to happen so fast and to the degree it did. What is interesting now is that maybe the reset in 5 year treasury yield (the risk free rate closest to the average convertible duration), could be close to reaching equilibrium. In other words, the great, fast, 2022 reset in treasury yields may be closer to its end than the beginning given the scope of the recent move. Regardless, we will stay hedged. Assuming yields and credit spreads stay in this neighborhood, our convertible arbitrage

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strategy is in a position to see new convertible issues coming to market with higher coupons and better overall terms for investors. In addition, as the Federal Reserve raises the fed funds rate, our short rebate on our stock shorts (money balances that typically make up about half the fund) will also continue to improve from a small negative return over the past few years to slightly below fed funds which are now expected to rise to about 2.5% by year end 2022. Cash and carry (clipping coupons, earning a rebate on stock short) and a market neutral stance with long equity volatility exposure, is what originally gave the convertible arbitrage strategy hedge/alternative appeal during the early 1990’s. We may be headed back to the future.

(Definitions and risk disclosure on reverse)

ANNUALIZED RETURNS as of 3/31/22	1-Year	5-Year	10-Year
Absolute Convertible Arbitrage Fund (ARBIX)	1.13%	4.97%	4.40%
Bloomberg Aggregate Bond Index	-4.15%	2.14%	2.24%
Barclays Investment Grade Bond Index	-4.20%	3.34%	3.64%
Barclays High Yield Bond Index	-0.66%	4.69%	5.75%

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 1.90% and the net expense ratio is 1.59% 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 1.20% through August 1, 2022 (the "Expense Cap"). 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.

DEFINITIONS:

The Bloomberg Aggregate Bond Index (Baclays Agg) is a broad base, market capitalization-weighted bond market index representing intermediate term investment grade bonds traded in the United States. Investors frequently use the index as a stand-in for measuring the performance of the US bond market. **The Barclays Investment Grade Bond Index** (Barclays Investment Grade) tracks the investment results of an index composed of U.S. dollar-denominated, investment grade corporate bonds. **The Barclays High Yield Bond Index** (Barclays High yield) measures the performance of high-yield debt issued by corporations domiciled in the US or Canada. A **Basis Point** (or bps) is 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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