ABSOLUTE CONVERTIBLE ARBITRAGE FUND

PORTFOLIO COMMENTARY - ARBIX

Q4 2021

ABSOLUTE FUNDS

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The Absolute Convertible Arbitrage Fund (ARBIX) returned +0.72% in the fourth quarter of 2021. The Fund provided investors a +2.95% return for all of 2021. After an eventful year in 2020, the past calendar year was less so. This is not unusual for convertibles and convertible arbitrage as the market cycle tends to move back and forth over time. The environment varying from one year to the next is the reason ARBIX is run with such a flexible approach. The Fund has averaged a 5.1% annualized return since the strategy was converted from a limited partnership to a mutual fund structure in August of 2017.

Two of the three primary factors that underlie convertible valuations and drive returns - credit spreads and equity volatility – moved very little throughout 2021. *High yield* credit spreads tightened modestly (about 40 bps) over the course of 2021 as corporate default rates remained very low. Non-investment grade convertible bond spreads generally did not tighten in sympathy. Convertible credit ended the year over 100 basis points wider than high yield (at 444 over - *Barclays Research*). Equity volatility peaked early in 2021 but then moved lower as the VIX Index (CBOE Volatility Index) declined from about 22 to 17 over the year and historical 50-day volatility for the Russell 2000 ended about flat for the year at slightly above 20. Convertible valuations were hurt by the rise in interest rates in 2021 as the 5-year treasury yield rose from 0.36% to 1.26%. ARBIX employs an interest rate hedge for the portfolio which helped to mitigate the move in rates.

From an overall P&L perspective for the year, approximately 43% of the Fund's gross return came from price appreciation of the convertible bonds vs underlying stock short, 27% from yield/carry, 20% from trading, and 10% from an interest rate hedge. 198 different names were held/traded in 2021 with 80% of positions/trades impacting the P&L positively vs. 20% negatively. The Fund was generally more active in the new issue market and in names we already knew from previous years. In one the Fund's larger positions, we were able to sell the bonds back to company at a premium.

Convertible new issuance supported returns for convertible arbitrage, but only modestly compared to previous years as cheapness at issue tightened to 46 basis points in 2021 after averaging 101 basis points the previous 5 years (*Barclays Research*). After an extraordinary year in 2020 when the onset of the pandemic led to huge convertible issuance of $113 billion, 2021 came close to that record with about $93 billion of new convertibles priced. Technology, Consumer Discretionary and Healthcare growth companies continue to be the dominant industries issuing convertibles. Market sources indicate another strong year of convertible issuance in 2022 as companies will become more sensitive to coupon costs in the face of rising interest rates.

Unless we experience a rebound in the severity of Covid on health outcomes, inflation expectations, rising treasury yields and the Federal Reserve rate hikes will very likely dominate the investment backdrop in 2022. The market expects the Fed to increase fed funds 75-100 basis points in 2022, with further rate increases in 2023 and 2024. Higher Fed Funds rates are good for the convertible arbitrage strategy as rebate rates for short stock positions will become positive again after 2 years in negative territory. Additionally, higher rates will force companies to issue converts with significant coupons again, which combined with positive rebate rates, will improve the static positive carry for the strategy.

After a 40 year bull market for bonds and a huge run for equity valuations supported by very low yields/discount rates, we could be at a major inflection point for long only investments as they could face years of stiff headwinds from the Federal Reserve. Alternative, hedged, actively managed, niche, idiosyncratic strategies could quickly become the best way to preserve capital and make modest positive returns without "fighting the Fed." Convertibles are attractive, risk controlled, securities given their relatively short duration and hybrid nature. The convertible arbitrage strategy could prove to be an effective ballast for a portfolio during difficult times given its tightly hedged nature and its non-directional balanced approach. Fortunately, the opportunity set for convertibles is healthy as issuance remains strong and default rates remain low. And as mentioned previously, positive static carry will likely become a larger component of the strategy's return as coupons on new convertible bonds go higher and stock loan rebates become positive again.

(Definitions and risk disclosure on reverse)

Quarter-End Performance for ARBIX: As of 12/31/21, the 1 year, 5 year and 10 year annualized performance for the Absolute Convertible Arbitrage Fund was 2.95%, 5.26% and 4.65% 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 1.90% 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 Russell 2000 is a market cap weighted indexes that include the smallest 2,000 companies covered in the Russell 3000 universe of United States-based listed equities. The Russell is by far the most common benchmark for mutual funds that identify themselves as "small-cap". **The VIX** (Chicago Board Options Exchange's Voaltility Index), is a real-time market index representing the market's expectations for volatility over the coming 30 days. 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, government 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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