

# ABSOLUTE CONVERTIBLE ARBITRAGE FUND

PORTFOLIO COMMENTARY - ARBIX

Q4 2024



ABSOLUTE FUNDS

**Performance Overview:** In Q4 2024, the Absolute Convertible Arbitrage Fund (ARBIX) delivered a positive net return of +1.19%, marking the 10th consecutive quarter of positive performance. This occurred despite a challenging quarter, where rising medium- and long-term interest rates led most bond strategies to post significant losses. For the full year of 2024, ARBIX achieved a total return of +7.53%.

**Medium/Long-Term Interest Rates:** From a medium-term perspective, Q4 2024 saw a reversal of the previous quarter's trends. Bond yields on the 5-year Treasury increased by 82 basis points, almost the exact same amount they had dropped in Q3 2024. This change was driven by solid economic data and persistently high inflation. The underperformance of most bond strategies in Q4 highlights the significant beta exposure these strategies have to interest rates. In contrast, ARBIX showed consistent resilience, regardless of the direction of risk-free rates. Changes in credit spreads and volatility were minimal, having little overall impact on returns or valuations.

**Short-Term Rates:** Ongoing inflation and strong economic indicators, coupled with optimism surrounding a new pro-business administration, have altered expectations for short-term interest rates in 2025. According to the latest Fed dot plot, the Fed is now expected to reduce rates by just 50 basis points over the next 12 months. This is significant for convertible arbitrage, as the strategy benefits from rebates on short positions taken against individual equities, which hedge each convertible bond. The higher the short-term rates, and the longer they remain elevated, the greater the rebate we receive. Positive carry—the combination of coupon income from bonds and the rebate from short positions—is a critical driver of the strategy's ability to deliver consistent, low-volatility returns.

**New Issuance:** One of the most significant developments in 2024 was the surge in new convertible bond issuance. Total issuance reached \$88.6 billion, a 72% increase over the \$51.6 billion issued in 2023. A healthy new-issue calendar is vital for arbitrageurs, as new issues often come to market below their theoretical fair value. They also tend to attract sellers from other names we target in the secondary market, increasing overall trading activity and liquidity. Technology companies remain the most active issuers, while crypto-related firms, such as MicroStrategy, have emerged as significant players with six convertible deals currently trading. While we avoid exposure to crypto companies due to the lack of reliable credit analysis in the sector, their presence in the market is still beneficial, as it generates additional trading activity.

## Fund Performance Breakdown:

The Fund's gross Profit and Loss (P&L) for Q4 highlighted several contributing factors:

- Appreciation of convertible bond prices relative to underlying stock hedges: +33 basis points.
- Interest rate hedge: +7 basis points.
- Trading activities: +9 basis points.
- Yield/carry: +100 basis points.

*“The convertible arbitrage strategy is well-positioned for the future...A healthy new-issue calendar is vital for arbitrageurs, as new issues often come to market below their theoretical fair value. They also tend to attract sellers from other names we target in the secondary market, increasing overall trading activity and liquidity.”*

**Outlook for 2025 and Beyond:** The convertible arbitrage strategy is well-positioned for the future, with ample opportunities, solid performance expectations, and strong relative performance compared to higher-beta strategies. As discussed, the new-issue calendar is expected to remain active, driven by companies refinancing maturing debt over the next 2-3 years, accounting for roughly half of the market. More issuance means greater opportunities to identify underpriced convertibles. Furthermore, as rates remain elevated, companies will increasingly turn to convertible bonds instead of straight debt due to the significant coupon savings, which can range from 1.5% to 3.5%, depending on the use of capped call transactions (according to BofA research).

The performance for 2024 aligned with expectations, given the prevailing rate and credit spread environment. Absolute return expectations have risen considerably in recent years due to the higher rate environment, which compels companies to issue debt on more favorable terms for investors. Additionally, convertible bonds are still trading about 100 basis points wider than single-B high-yield paper.

On a relative basis, the outlook for equity prices (due to high valuations), interest rates (due to persistent inflation and a robust economy), and credit spreads (which are already near historical tights) remains uncertain. In this unpredictable environment, a short-duration, long-equity-volatility strategy like convertible arbitrage appears to be a prudent approach.

(Definitions and risk disclosure on reverse)

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**Quarter-End Performance for ARBIX:** As of 12/31/24, the 1 year, 5 year and 10-year annualized performance for the Absolute Convertible Arbitrage Fund was 7.53%, 4.85% and 4.81% 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 for Institutional Shares is 1.47% (gross) and 1.41% (net) through July 31, 2025. 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 July 31, 2025 (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:**

**Single-B high-yield paper** is a subset of the ICE BofA US High Yield Master II Index, which tracks the performance of below investment grade corporate debt in the US. A **Basis Point** (or bps) is 1/100th of a percent. The **beta** of an investment security is a measurement of its volatility of returns relative to the entire market and is used as a measure of risk.

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 investment 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](http://www.absoluteadvisers.com). Please read the prospectus carefully before you invest.**

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