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VERTEX ARBITRAGE FUND

Third Quarter Report, 2014

"It was the best of times; it was the worst of times."
- Charles Dickens

M&A activity has certainly stayed on the front pages of the newspapers *("M&A deals in 2014 eclipse levels in past 5 years"* – Financial Times, Sep. 30, 2014). In particular, we have seen a wave of mega-market cap deals this year. The chart below highlights that while the number of deals hasn't necessarily been increasing, the market value of the deals has been exploding.

It is therefore frustrating that the third quarter performance for the Vertex Arbitrage Fund F was +0.43%. There were a number of contributing factors:

- The arbitrage community doesn't have the capital to easily absorb the flow back from institutional selling;
- With bigger deals come bigger problems, such as regulatory scrutiny;
- Bigger deals take longer to complete and the spreads can be more volatile over that period;
- Two of the largest deals were both dealt setbacks by the US administration's attempt to deter companies from re-domiciling overseas.

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Tax inversions, the process by which US companies seek to re-domicile outside of the US by acquiring a smaller foreign company, were very topical. The IRS taxes American companies on their worldwide income, not just income earned in the US (the same applies for US citizens). Because US corporate tax rates are among the highest in the developed world, there is a strong incentive for many US companies to re-domicile in foreign jurisdictions possessing territorial tax systems (paying taxes only in the countries in which income is earned). The pace of tax inversions has been accelerating in recent years, which has not gone unnoticed in Washington. In early August, the Obama administration tasked the Treasury/IRS with toughening the rules around inversions. This was a surprising move given their previous stance of being unable to act without congressional approval of changes to the tax code, something that is highly unlikely in the current political environment.

The two spreads that are most relevant to inversion risk are Covidien being acquired Medtronic and Shire being acquired by AbbVie. Tim Hortons by Burger King is a different type of transaction that is not subject to the same risks (although we find it amusing to see Canada being portrayed as a tax haven). While there are clearly tax benefits that arise from these deals, there are also sound strategic rationales and synergies. Furthermore, terminating these deals will result in significant costs (primarily in the form of break fees) for the acquirers. The Covidien and Shire spreads widened considerably on the surprise August announcement, hurting the fund's performance. On September 22nd, after much uncertainty, the Treasury released their proposed rule changes. The changes were within our expectations and the arbitrage spreads have narrowed slightly on the belief that the changes will not be enough to derail the transactions.

The bright side of all of this M&A activity is that we now have a greater number of attractive, liquid deals in our universe to consider than we have had in a long time and the prospective returns on those deals is wider than in the recent past. There have also been a large number of lower risk Canadian sub-receipt financings that have allowed us to be fully invested. We are hopeful we'll have a bountiful autumn harvest and that the fourth quarter will be a bright finish to the fund's first full year.

PERFORMANCE (Class F returns as at September 30, 2014)

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	**Year**
2014	0.27%	0.39%	0.43%	0.64%	0.04%	0.64%	0.26%	0.07%	0.10%				2.88%
2013											0.59%	0.78%	1.38%*

*Return does not represent a full calendar year. Advertised performance is based on Class F shares. Returns are net of all fees. Important information about the Fund is contained in the Offering Memorandum which should be read carefully before investing. You can obtain an offering memorandum from Vertex One Asset Management Inc. The Offering Memorandum for Vertex One Asset Management Inc.'s investment funds does not constitute an offer or solicitation to anyone in any jurisdiction in which such an offer or solicitation is not authorized or to any person to whom it is unlawful to make such an offer or solicitation. The indicated rates of return are the historical compounded returns for the period indicated, including changes in security value and the reinvestment of all distributions and do not take into account income taxes payable that would have reduced returns. The funds are not guaranteed; their values change frequently and past performance may not be repeated.