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VERTEX ARBITRAGE FUND

Third Quarter Report, 2015

Job #1 of the Vertex Arbitrage Fund is to not lose money. Perhaps a modest goal to some, we nevertheless achieved it during one of the most turbulent periods for capital markets in recent years. The fund returned 0.78% for the third quarter (and was positive each month).

Our next goal is to earn a net return in the neighborhood of 4-6% over short-term interest rates, as is consistent with our history in the strategy. Over the long-term, this return approximates equity risk premiums (see appendix) with much less volatility and fewer sleepless nights. Should a long-run investor care about monthly volatility/drawdowns when they have a time horizon measured in years or decades? In theory, one can certainly argue that volatility presents an opportunity that should be embraced by investors if they are being adequately compensated for it via the equity risk premium and a skilled manager's alpha. In practice, it can be challenging for investors to stick to a plan during tumultuous times; we all know somebody who sold near the bottom in 2008/2009. An important element of our low-volatility return profile is that it largely eliminates the peril of an impulsive de-risking at the most inopportune time. It's much easier to stay the course when the sailing is smooth, even if the pace is pedestrian at first glance.

That being said, our most recent history has not met our return expectations. It would be natural to think that in the midst of the highest US merger activity in history, merger arbitrage as a strategy would be performing well. As we've discussed with many investors, merger arbitrage returns do not correlate highly with the level of M&A activity. This is partly due to the fact that merger arbitrage returns are so steady that they don't really correlate with anything. Digging deeper, we often see great arbitrage return opportunities in times of crisis when new deal flow is at its lowest: in late 2008, early 2009, the Vertex Fund rotated into very attractive merger arbitrage spreads (while new deal activity was non-existent).

For arbitrageurs, the current level of M&A activity might be considered 'too much of a good thing'. While we always welcome more deals as a means of building our highly diversified portfolio, we are now seeing mergers that are aggressive in terms of regulatory approvals needed, valuations paid, or financing required. Looking over 6 of the largest deals in the universe currently (only 3 of which are in the portfolio) serves to highlight the nature of the deal flow we are seeing in this environment.

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Deal	Size	Annualized Spread	Issue	VAF Owns
Time Warner Cable/Charter	$50B	16%	Requires FCC approval. FCC recently blocked Comcast from acquiring Time Warner Cable.	Y
Cigna/Anthem	$35B	30%	Anti-trust. Along with the Humana/Aetna merger, seeing the 5 largest players consolidate into 3. Health care costs are politically sensitive in an election cycle.	N
Broadcom/Avago	$31B	15%	Unknown timing of Chinese regulatory approvals. Risk has increased as semiconductor space has weakened. Transaction structure is unique.	Y
Precision Castparts/Berkshire Hathaway	$31B	7%	Vanilla. Best buyer possible.	Y
Williams/ETE	$27B	8%	Extreme volatility in energy mid-stream space. Stocks are down 40% in 3 months.	N
Baker Hughes/Halliburton	$22B	50%	Severe anti-trust risk. #2 and #3 player combining.	N

While we've been weathering some month-to-month volatility in spreads as a result of the types of deals we are seeing, we do think the current environment is conducive to generating attractive returns in the neighborhood of our 4-6% expectation. In a zero-interest rate environment, getting paid 7% in a vanilla transaction, with Warren Buffett as the buyer, (see above Precision Castparts) is one of the most attractive risk/rewards we have seen in a long time. This is our largest weight (still below 10%), and the portfolio is built out from there in over 40 positions.

PERFORMANCE (Class F returns as at September 30, 2015)

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	**Year**
2015	0.40%	0.52%	0.51%	-0.03%	0.91%	-2.11%	0.54%	0.24%	0.00%				0.95%
2014	0.27%	0.39%	0.43%	0.64%	0.04%	0.64%	0.26%	0.07%	0.10%	-0.28%	0.68%	0.60%	3.90%
2013											0.59%	0.78%	1.38%*

Returns are net of all fees and include reinvested distributions.

*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.

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Appendix – Arbitrage and the Equity Risk Premium

The Equity Risk Premium is the long-run return over the risk free rate that investors require in order to compensate them for taking on the risk of owning the stock market. In the academic world, there are two approaches to estimating it: surveying institutional investors (*when you allocate to equities, what return over risk free rates are you expecting in order to justify owning stocks?*), and looking at historical data (*what have been the long-run returns from owning the stock market vs. the risk free bond alternative?*). There is no shortage of research on this topic (compiled well here if you can't sleep: http://people.stern.nyu.edu/adamodar/pdfiles/papers/ERP2012.pdf). The survey approach suggests institutional investors expect about a 4% excess return over Treasury Bonds for owning equities. The historical approach, using data from 1900 to 2011 (pg. 30/31 of the previous link) concludes that US investors have earned a premium of 5% – in the greatest period of economic expansion in history. Canadian investors fared slightly worse at 4%.

The point of this is to put the return stream of merger arbitrage (4-6% over short-term rates) in the context of long-run equity returns (5% over short-term rates); in the end, you aren't giving up much (if any) return, for a much smoother ride.