VERTEX ONE
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VERTEX ARBITRAGE FUND
VERTEX ARBITRAGE FUND PLUS

Third Quarter Report, 2017

The Vertex Arbitrage Fund (Class F) and the Vertex Arbitrage Fund Plus (Class F) were up 0.76% and 1.56% respectively in the third quarter. The funds were up each month and there were no deal breaks.

A key concept in investing is the notion of systematic and non-systematic risk. Non-systematic risk, also called diversifiable risk, is the risk in a stock that is attributable specifically to the company and the industry in which it operates. Apple losing smartphone market share to Samsung or losing a patent dispute are examples of non-systematic risk. As you add more stocks to a portfolio, the impact of these individual non-systematic risks becomes less and less as relative position sizes become smaller and some risks cancel each other out (perhaps you add Samsung to the portfolio). This is the only free lunch in finance: the ability to diversify away non-systematic risk. Once you get to somewhere over 30 stocks in a portfolio, most of the non-systematic risk is gone. Of course, we all know that when we own a portfolio of 30 stocks, it still has volatility and tends to rise and fall with the general stock market. This leftover risk is systematic risk and it is non-diversifiable (adding more stocks won't reduce it).

Why is our letter starting off with a wonky intro on systematic diversifiable risk, you ask? Well, it's relevant for several questions we're frequently asked: *how do you size positions? What is your percentage long/short/net exposure? What's a worst-case scenario for the strategy*? The key to understanding merger arbitrage risk is to realize that, except for very limited circumstances (discussed below), all of the risk in merger arbitrage is non-systematic. We can diversify it away by adding more deals (we usually hold 30+). We aren't left with systematic risk because all of our risk comes from whether a deal closes or not. This depends on deal-specific considerations (usually anti-trust regulators – although there are many others) which are unique to each deal. Deal B doesn't fail because deal A was blocked by a regulator. When a deal closes we earn our spread, regardless of any big swings in the market or economy.

This simple idea has some powerful consequences. When we decide how much of a deal we want to own, we only need to think about the downside of that deal. If we can lose 10% in the position should the deal break, we can have a 10% weight in that deal to have 1% of the fund's NAV-at-risk. If it's a deal with a big premium, where we could lose 50% on a deal break, then we can only have a 2% weight to have the same 1% NAV-at-risk. We don't need to think about how this deal interacts with any of our other deals (because it doesn't). This compares to a stock portfolio, where adding a 5% weight in Apple we would think about how this impacts the net market exposure and whether this risk is additive to other risks already in the portfolio (i.e. do we already own a bunch of tech companies).

We are often asked about our market exposures. At the end of September, the VAF was 84% long, 21% short, for a net exposure of 63%. These "exposures" are largely meaningless to us and do not reflect

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residual market risk of the portfolio (i.e. systematic risk). They are simply an artifact of the mix of deal types in the portfolio: cash deals and SPACs have no offset hedging, so they make us look "long" the market. Stock deals have an offsetting hedge, thus appearing market neutral. The reality is none of these have any systematic market risk; as long as the deals close, we have no market exposure.

When we're asked about the worst-case scenario for merger arbitrage, we answer that it's exceptions to this idea of having no systematic risk in the portfolio. The strategy can handle deals breaking; it happens from time to time and we're sized appropriately so that they don't result in permanent impairment of capital. What we worry about is multiple deals failing at the same time due to some common linkage between them. Below are some that we're focused on:

RISK	**Description**	**Mitigation**
Financing risk	Many deals require issuing debt to fund a portion of the acquisition. If the debt markets are stressed, this funding may not be readily available.	We consider all LBOs (leveraged buyouts) as a single deal in the portfolio. Effectively, this means we have very few LBOs.
Liquidity risk	The risk that similar investors will attempt to sell similar portfolios at the same time.	Most of our positions are in US and Canadian stocks with market caps greater than $1 billion. Thus, they are highly liquid and can be sold with little market impact. We group our SPACs together as one position because they are less liquid. We are conservative in our use of leverage so that we are not "forced sellers" in times of stress.
Regulatory risk	Depending on the merger, there are many required regulatory approvals: DOJ, FTC, CFIUS, Competition Bureau, Investment Canada etc.	The vast majority of the time, the risk of a deal failing due to a regulatory decision is totally independent for each deal. However, we have seen examples in the past with a common risk factor (i.e. changing tax regulations around inversion transactions) that require us to group deals together.

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The common thread here is that any time we identify a risk that is common to multiple deals in our portfolio, we limit our position sizing so that relevant deals, taken together, have a combined break risk that's within our NAV at risk tolerances (1-2% in the VAF, 2-4% in the VAFP). We give up some upside by having smaller weights in deals that we'd otherwise have larger weights in (if not for the common risk factor with other deals), but it's necessary for achieving our risk tolerance levels.

In terms of outlook, arbitrage spreads have continued to tighten over recent months and are now about as tight as they've been in two years. Dealmakers are growing weary waiting for US tax reform – we've seen the pace of US merger activity slow as a result. By dollar volume, North American M&A activity was down 15% relative to this quarter in 2016. None of this is uncharted waters for the arbitrage strategy, which has performed consistently in all kinds of M&A environments. Nevertheless, we think arbitrage returns will be towards the lower end of our expected range (4-6% over short-term interest rates in the Vertex Arbitrage Fund) for the next quarter or so.

As always, please reach out with any questions or concerns.

VERTEX ARBITRAGE FUND:

Net Asset Value	1 Month	3 Month	Year to Date	1 Year	2 Year+	3 Year+	Since Inception+
$ 10.9592	0.28%	0.76%	3.47%	5.04%	5.22%	4.12%	4.25%

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Year
2017	0.32%	0.61%	0.17%	0.68%	0.41%	0.46%	0.28%	0.21%	0.28%				**3.47%**
2016	0.60%	0.69%	1.20%	-1.29%	1.13%	-0.03%	0.20%	0.45%	0.73%	-0.17%	1.21%	0.48%	**5.27%**
2015	0.40%	0.52%	0.51%	-0.03%	0.91%	-2.11%	0.54%	0.24%	0.00%	0.93%	-0.25%	0.95%	**2.60%**
2014	0.27%	0.39%	0.43%	0.64%	0.04%	0.64%	0.26%	0.07%	0.10%	-0.28%	0.68%	0.61%	**3.92%**
2013											0.59%	0.78%	**1.38%**

Portfolio Exposure:

% Long	% Short	% Net
83.9	-20.6	63.4

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VERTEX ARBITRAGE FUND PLUS:

Net Asset Value	1 Month	3 Month	Year to Date
$10.5277	0.58%	1.56%	5.28%

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Year
2017			0.43%	1.28%	0.91%	0.99%	0.47%	0.51%	0.58%				**5.28%**

Portfolio Exposure:

% Long	% Short	% Net
170.0	-57.7	112.3

Class F returns as at September 29, 2017.
Returns are net of all fees and include reinvested distributions.

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 do 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.