REPRINT

The Adventurous Investor

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Exotic M&A fund lists on specialist funds segment of LSE

by David Stevenson

Readers will know that I try and keep a tab on the latest new funds on the London market but even I sometimes manage to miss a few fund which sneak by my radar. A few days ago for instance fund researchers at Numis reported in one of their daily notes that a new fund called Gabelli Merger Plus+ Trust had started trading under the ticker “GMP” after raising $100m on the Specialist Fund Segment of the London SE and traded on the Official List of the International SE.

Gabelli is not a new name. This US based asset manager already has a US focused investment trust on the main market called the Gabelli Value Plus + which launched a few years back and has assets of around £130m. It uses the core Gabelli methodology which looks to invest in large cap stocks which represent decent value – to an acquirer. The fund describes its Private Market Value ideas thus:

- **Investment Philosophy:** PMV with a Catalyst™
- **Private Market Value (PMV):** The price an informed industrialist would pay for the entire company

- **Catalyst:** An event to surface the value
- Gabelli & Company's approach to **fundamental analysis** focuses on a company's free cash flow, earnings per share, and private market value, taking into account on and off balance sheet assets and liabilities.

Overall the thinking behind Gabelli could be described as value driven although it's not really traditional contrarian investing as understood by the Ben Grahamites of this world. The man behind the firm is Mario Gabelli who is regarded as one of the most original investment thinkers of his day and to date, the existing sibling UK fund (Sterling denominated) has provided decent returns. The Value Plus fund boasts NAV total returns have been 38.8% (14.5% pa) since launch, compared to 46.5% (17.8% pa) from the S&P 500. Over the last 1 year, the share price has returned 23.35 vs 16.4% for the S&P 500. It currently trades at a 4.4% discount to NAV.

So, what's this new US $ denominated Gabelli fund? The first thing to say is that it seems to have raised most of its money from a bunch of largely Italian investors.

According to Numis, the fund will maintain " a diversified portfolio of catalyst event merger arbitrage strategies. It will seek a secondary objective of the protection of capital, uncorrelated to equity and fixed income markets. Opportunities include corporate events such as announced mergers, acquisitions, takeovers, tender offers, leveraged buyouts, restructurings, demergers and other types of reorganisations and corporate actions. The company will invest globally although it is expected to have an emphasis on US equities, without any constraint by market capitalisation. The company will structurally gear, with leverage of around 2x net assets (max. 2.5x at drawdown). " In terms of dividends, the fund intends to pay a quarterly dividend of at least 5% pa of NAV, with the first dividend to be paid by 31 January 2018. The management fee is 0.85% pa of net assets, with a performance fee of 20% of NAV total return, subject to a trigger of twice the return on 13 week US T Bills, capped at 3% of average net assets, and subject to a high watermark.

Merger Arbitrage is not a particularly novel strategy, especially in hedge fund land. Demand for this strategy has boomed as M&A activity in the developed world markets has shot up. According to **Bloomberg's** Global M&A Market Review, merger and acquisition deal flows in the US were strong with $280 billion of deals announced in the first quarter of 2017. M&A arbitrage is an old school form of hedge fund investing and over the years we've seen a whole profusion of new funds – and indices. Only a few weeks ago, for instance, Barclays brought out its own merger arbitrage index which has supposedly produced strong returns with back-tested excess returns of 4.03% in 2016 and 1.60% in 2017 to the end of May, with a low volatility of around 4% over the last year.

Shoot over to the big daddy of hedge fund performance data HFRX – https://www.hedgefundresearch.com/family-indices/hfrx – and you'll see the full range of hedge strategies, and their recent returns. YTD returns (until end of July) for Merger Arbitrage funds is a half decent 1.26% YTD but at the 36-month level, the attraction becomes even more obvious. Over the last three years annualised returns have been running at 5.10% for this strategy (for activist strategies it's closer to 6.15%) compared to a measly positive return of 0.04% for macro/CTA funds overall and an annualised loss of -.035% pa for the entire hedge fund universe.

So, what about the new fund? I'd suggest that Gabelli is probably one of the most established managers in this space, even if it's not really a pure play hedge fund as such. I'd also suggest that IF you believe that US equities are likely to carry on increasing in value, then this structurally leveraged fund (2.5 times) will probably deliver outsize returns, as has its existing peer fund. The fees whilst not a bargain aren't extortionate compared to most mainstream hedge funds and the fund looks like it’s big enough to be viable. In sum an interesting and exotic way to play mainstream US equities – not that I would as I think they’re appallingly overpriced and due a TrumpBump.

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