2Q 2018

OUR HEDGE
FUND EXPERTS
SPEAK THEIR MINDS:

MERGER MANIA !!!

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Let's Get Ready to Rumble! After 500 days of business-friendly deregulation, robust economic growth, and massive corporate tax cuts, a green wave of cash has finally flooded the market. Corporate chieftains are wheeling and dealing at a record clip. Over the prior 12 months, mergers and acquisitions ("M&A") in the United States climbed 82% to $1 trillion. According to the latest data from Thomson Reuters Deals Intelligence, this accounted for the strongest deal-making period on record. Merger Mania is definitely here.

A flurry of deals may make for interesting headlines, but more importantly, they serve as the raw material for our merger-arbitrage strategy. At the SilverPepper Merger Arbitrage Fund (SPAIX), we monitor the universe of publicly announced M&A deals, scrutinize each deal, and invest in those deals where we have the highest conviction they will close, with an attractive risk-adjusted return.

Approximately 95% of deals successfully close on a historic basis. So picking deals that close might sound pretty easy. If only 5% of deals fail or "break," that's like shooting fish in a barrel, right? Well, avoiding those broken deals is absolutely critical. In the merger arbitrage space, if you miss one of the fish, you can shoot your whole foot off. That's because, a deal break will typically result in the target company's stock falling in price, back to where it was prior to the announcement of the deal — often a very steep reduction. Thus, if a target loses 30% due to a deal break, and it represents 10% of your portfolio, that's a realized fund loss of 3% in a single day! That's why we say: "The deal we avoid, is more important than the deal we invest in."

However, as some of our peers can attest, this record influx of M&A deals has not proceeded as smoothly as anticipated. Along with many other aspects of our country, political drama roiled the M&A market in the first half of this year, creating uncertainty and other pitfalls. Yet, we stuck with our disciplined strategy for deal selection, and managed to keep our investors off the big-drop thrill ride. By selecting only those deals with solid financing, sound business logic, and few regulatory, anti-trust, or political issues, we were able to side-step some problematic deals.

Let's Not Make a Deal

Two deals have been particularly influenced by politics this year. AT&T's merger with Time Warner was controversial from the minute it was announced, because it included CNN, President Trump's least favorite news network. The Justice Department claimed the merger would give too much pricing power to the resulting media and cable giant, and ultimately brought a rare antitrust trial to thwart the merger. This caused enormous volatility in the spread, on concerns the deal would be foiled. Nonetheless, on June 13th, the Justice Department lost its argument, and the merger was wrapped up a couple days later.

The other high-profile deal caught in a political morass continues to have plenty of volatility, though. Qualcomm made a tender offer for NXP Semiconductor in order to expand its business in automobile-based computer chips. That's potentially a huge business, when self-driving cars become a reality. The deal was approved months ago by every relevant government entity across the globe, except China's. The deal remains stuck in Chinese bureaucratic purgatory. Indeed, Qualcomm's tender offer has been extended 28 times. The Chinese have been slow-walking it, using it as a bargaining chip in the other geostrategic games being played between the U.S. and China. Those power-plays include a brewing trade war with escalating tariffs, the tense negotiations over the fate of North Korean nukes, and the United States' punishment of the Chinese company ZTE, which was caught repeatedly shipping technology to North Korea and Iran. NXP stock is now trading at a significant discount to the proposed acquisition price, around 15%. This implies merger arbitrage investors who invested early are probably now underwater on the trade. And those investors not in the deal are reluctant to jump in now, fearing the deal will break under the weight of geopolitical pressure.

How did we avoid that hit? Simple. We never invested in NXP, nor in AT&T, because they didn't pass our smell test. The political and regulatory obstacles were too prohibitive to justify the risk.

Since our Merger Arbitrage Fund manages less capital than many other merger funds, we don't have to invest in as many deals. We remain nimble and selective, and invest in what we want, as opposed to what the market gives us. In a record market now, with $1 trillion in deals, the AT&T/Time Warner and Qualcomm/NXP deals represented $90 billion and $50 billion, respectively, or nearly 15% of the entire market. The larger merger funds often have to jump into investing in these big deals, while we can afford to be more picky, and avoid them.

Bridge Over Troubled Water

While we avoided these high-profile and politically-sensitive deals, we did experience some hair-raising thrills, investing in one of our recent typical, low-profile deals. McDermott International (MDR) agreed to buy Chicago Bridge & Iron (CBI), to expand its infrastructure construction business. A couple of weeks before the deal was expected to be approved by MDR shareholders, a U.K.-based company, Subsea 7, lobbed in a low-ball bid of $7 for McDermott. This jeopardized the deal for CBI, because Subsea 7 didn't want MDR to go through with its acquisition of CBI. As a result, CBI fell 8%, while MDR surged 16%, resulting in simultaneous paper losses on both the long and short sides of the deal.

However, as with any deal that is stressed, we gathered additional intelligence and uncovered that the CEO of Subsea 7 has a reputation as a "vulture buyer." He only wants to buy companies at cheap or distressed prices. Our research indicated he'd be unlikely to raise his bid, from $7, to the $10-dollar level we determined shareholders would demand. Subsea 7's bid seemed too little, too late to upset the likelihood of MDR shareholders approving the original deal. Our conclusion remained that McDermott's deal to buy Chicago Bridge & Iron still had a high probability of closing. Fortunately, the deal did close a couple weeks later, and we were able to recoup our losses, and realize a gain.

No losses overall, but how much gained?

SilverPepper Merger Arbitrage Fund (SPAIX) finished the first half of 2018 with a modest gain of 0.54%*, in contrast to a 2.65% gain for the S&P 500 Index.

We faced a couple of headwinds in the first quarter that limited our gains. First, we went out of our way to avoid deal breaks. We unwound exposure to deals with exposure to China. This included those requiring Chinese government approval, such as Marvell's deal to buy Cavium, and Microchip Technology's purchase of Microsemi Corporation. Also, once it became clear that the U.S. Treasury Department's Committee on Foreign Investment in the United States would be more active in determining whether foreign purchasers of U.S. companies might imperil the national security of the U.S., we sold out of the Italian company Prysmian's purchase of General Cable Corporation.

Second, even though deal volume was large in the first half of the year, deal selection was difficult. Our over-riding concern was risk-versus-return. We just didn't think deal spreads, for high-quality deals, were large enough to compensate for the risk. So, at times, we let cash build in the portfolio, which hindered our returns. We thought, as we often do: Better safe than sorry.

The returns represent past performance. Past performance does not guarantee future results. Investment returns and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Current performance may be lower or higher than the performance data quoted. Call 855-554-5540 for current to most recent month-end performance.

SILVERPEPPER MERGER ARBITRAGE FUND INSTITUTIONAL MONTHLY RETURNS (%)													
	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC	YEAR
2013											0.10	1.00	1.10
2014	-0.10	0.10	0.10	- 1.48	1.40	0.69	0.79	0.68	-0.77	-0.10	1.37	-0.23	2.44
2015	0.60	0.99	0.10	0.29	0.78	0.10	0.48	0.77	0.19	2.47	0.19	1.25	8.49
2016	1.13	0.37	0.00	0.37	0.37	0.18	0.64	-0.27	0.46	-0.18	-0.09	1.25	4.30
2017	-0.18	0.00	0.36	0.36	0.18	0.54	-0.54	0.36	0.90	0.00	0.00	0.57	1.76
2018	-0.18	0.45	-0.36	0.00	0.45	0.18							0.54
						One-Year Return as of 6/30/2018							1.02
						Total Annualized Return Since Inception, (10/31/2013)							3.97

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Total gross/net annual fund annual operating expenses are 4.80%/4.57% for Institutional and 4.98%/4.82% for the Advisor shares. The Advisor has contractually agreed to waive its fees and/or pay for expenses to ensure that total fund operating expenses (excluding, as applicable taxes, leverage interest, brokerage commissions, dividend and interest expenses on short sales, acquired fund fees and expenses (as determined in accordance with Form N-1A), incurred in connection with any merger or reorganization, or any extraordinary expenses such as litigation expenses) do not exceed 1.99% for the Institutional class and 2.24% for the Advisor class. This agreement is in effect until October 31, 2027.

Inception dates for both share classes is October 31, 2013. Performance and risk measures greater than one year are annualized.

Look Out for the Outlook

If the first half of 2018 is any indication, the second half may be just as bountiful. The competitive cost-cutting environment, an accelerating economy, low interest rates, and tax reform, which is encouraging companies to bring offshore cash back home, are all driving more M&A deals. I expect current deal volume — Merger Mania — to continue.

Another promising tailwind may occur, if the Senator Crapo banking bill finally passes into law. The Crapo banking bill recently passed both the House and Senate. It's currently in Conference Committee, and will most likely be signed later this year. The bill will allow banks with deposits of $51 billion to $250 billion to be more active in the M&A market, and

will spur mid-size banks to gobble up smaller regional banks. We have a special affinity for small bank deals: I know the players; they're not controversial deals, laden with regulatory risks; and the strategic and financial incentives for banks to merge continue. Passage of the bill could be a huge win for us at the SilverPepper Merger Arbitrage Fund.

In addition, the tariff mess, which really upset equity markets as the second quarter ended, seemed to actually have a positive effect on the Fund. The market volatility allowed us to build some meaningful positions at attractive spreads in some of our favorite deals. This pickup in activity has allowed us to add a few new positions, and a little leverage to the portfolio. Currently, the Fund has 172% gross exposure: 132% long, and 40% short.

It has been a long time since we held a portfolio with thirty-two, high-quality merger arbitrage positions. With more and more mergers announced each day, it has allowed us to diversify and grow our portfolio. If the current economic conditions simply remain in place, I am optimistic that we will be able to capitalize on the opportunity set. Regardless of the market climate, we believe our investors value the consistent returns with low volatility the SilverPepper Merger Arbitrage Fund strives to provide.

With respect,

Steve Gerbel

Portfolio Manager

SilverPepper Merger Arbitrage Fund

Investors should carefully consider the Fund's investment objectives, risks, charges and expenses. Please see the prospectus for a complete discussion of the risks of investing in this Fund. To obtain a prospectus, please call 855-554-5540 or visit silverpepperfunds.com. The prospectus is boring but should be read carefully before investing.

All investing involves risk including the possible loss of principal. There can be no assurance that the Fund will achieve its investment objective. For the Merger Arbitrage Fund, the primary risk is event risk, which revolves around the successful or unsuccessful completion of an announced merger or acquisition. If a merger doesn't close as expected, the fund could lose money. Other risks include smaller companies risk, foreign investment risk, derivatives risk and non-diversification risk.

IMST Distributors, LLC