DRIEHAUS
CAPITAL MANAGEMENT

DRIEHAUS EVENT DRIVEN FUND

# Beneath the Calm Surface: Swirling Currents

1ST QUARTER 2021

Entering 2021, investors were hopeful that the new year would usher in a return to normalcy and relative calm. A cursory look at broad market indices after the first quarter of the year seems to reflect a relatively benign start to the year. However, beyond the market's placid surface in the first quarter, there lurked more volatile undercurrents. With that in mind, we've used this letter to explore these pockets of volatility and discuss the potential implications for the fund and our opportunity set going forward.

## *Interest Rates Rising:*

During the first quarter US Treasury yields spiked, reflecting continued economic expansion and the accompanying expectations for higher inflation. The rapid increase in baseline interest rates drove discount rates higher which impacted capital markets activity and led to a rotation in capital allocation from "growth" companies with longer-dated cash flows into "value" companies with cash flows that have shorter time horizons. As a result of this swift rotation, what "worked" for the factor-based investor in 2020 did not work as well in the first quarter of 2021. While this broader market shift dominated the headlines, it has had minimal impact on the opportunity set for idiosyncratic event driven investments. In corporate credit markets, the jump in baseline rates caused assets with the highest embedded duration to experience one of their worst periods of performance in history.

As shareholder focus has shifted from 2020's mantra of "survive and recover" to 2021's mantra of "grow and then grow more", we believe companies will feel pressure to deploy their near-record high levels of cash into acquisitions and strategic growth initiatives. Adding to this dynamic is the fact that base interest rates – while elevated from their all-time lows – remain very low by historical standards, which further incentivizes companies to use cash for projects with higher projected return profiles.

## Exhibits 1 & 2: Global government bonds off to their worst start this century, while corporate credit experienced the second worst quarterly loss on record

*Exhibit 1: YTD total returns, each year from 2000-2021 (red=2021).*
*Global government bonds.*

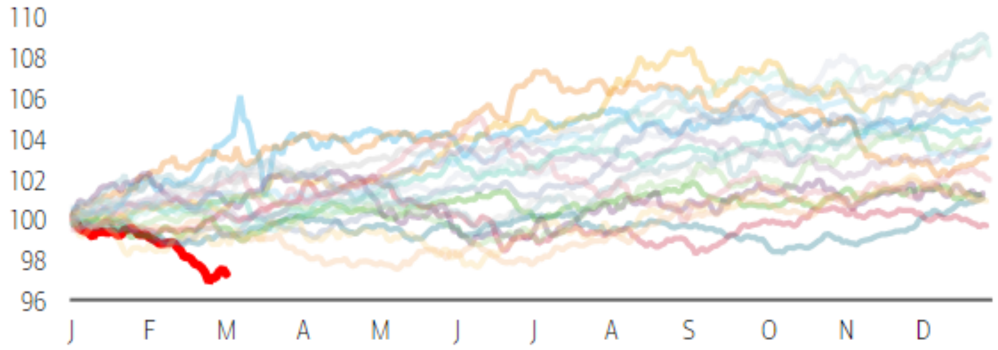
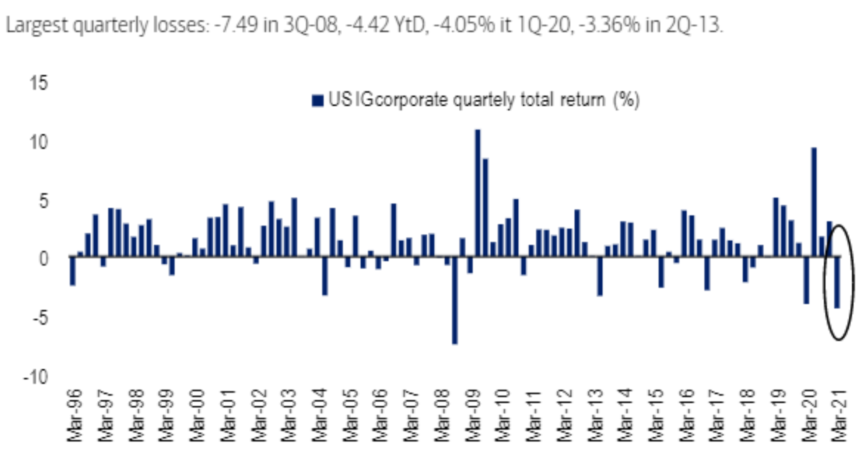



*Exhibit 2: YTD US IG corporate total return loss would be the second largest on record after 3Q-08*




Note: the value for Mar-21 is for the period 12/31/2020 to Mar 26 2021.

Source: BofA Global Research, ICE Data Indices LLC. W0G1 Index. Returns rebalanced at the start of each year.

## Exhibits 3 & 4: Inflation breakevens are at levels not seen in a decade as expectations sit at all-time highs – a stark contrast to one year ago

*Exhibit 3: Inflation breakevens at 10-yr highs*

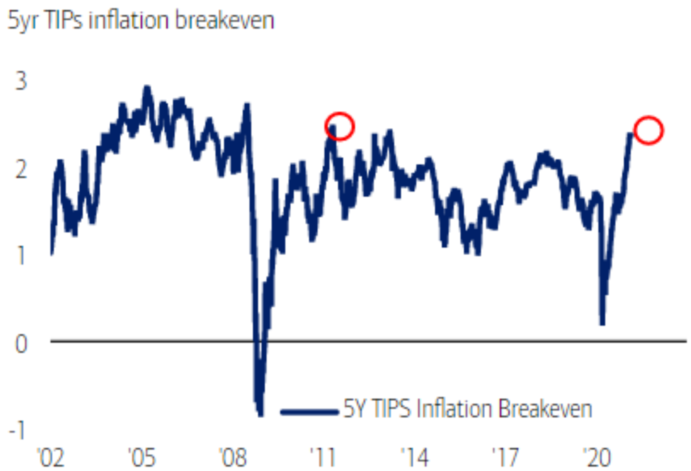



*Exhibit 4: Inflation expectations at an all-time high*


Source: BofA Global Research, Bloomberg, BofA Global Fund Manager Survey.

## Exhibit 5: Rising rates impact on internal market rotation – from long duration to cyclicals


Source: Goldman Sachs Global Investment Research

### M&A Regulatory Oversight:

While the agenda for the new administration in Washington is still evolving, one noticeable difference has been at the Federal Trade Commission (FTC). The commission has hinted at implementing a new evaluation approach for deals in the technology industry, due to the perception of previous missteps in the space. Additionally, they have created a working group to consider how pharmaceutical deals impact the consumer and whether to implement changes to their review processes for deals in that sector. Although formal action has not yet been taken, the change in tone and focus warrants close attention when investing in the merger arbitrage space.

Historically the fund has been highly selective in merger arbitrage, and even more so when regulators are the gating item. We expect our vigilance to increase and we believe that this patient approach to the opportunity set will serve us well as the potential for volatility increases. As always, we continue to keenly monitor the impact to overall M&A activity levels, premiums paid, and appetite for risk capital to establish spread at attractive prices.

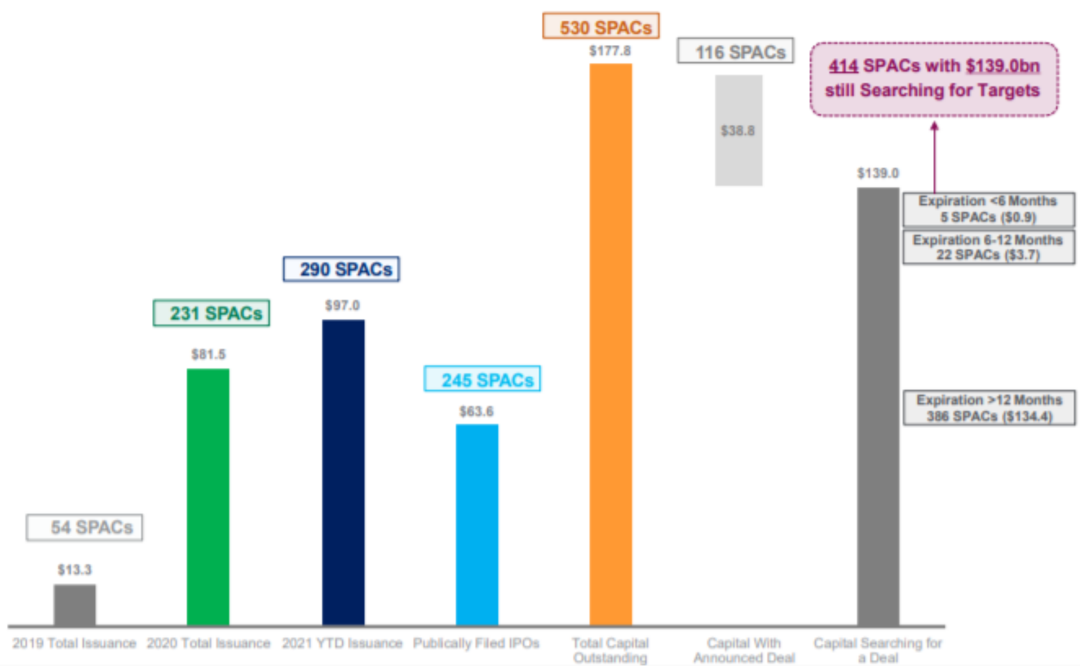
### Capital Markets: The year of the SPAC

While overall corporate activity is off to a solid start in 2021, capital markets, and particularly Special Purpose Acquisitions Corporation (SPAC) IPOs, have been on a torrid pace. Both the sheer number of SPAC IPOs and the share of overall IPO capital set records in Q1 2021. This comes on the heels of last year's record-breaking tally, which was nearly six-fold that of 2019. Additionally, capital raised via private investments in public equity (PIPEs) has substantially increased in gross dollars and as a percentage of overall funding, equating to approximately 15% of pro forma ownership for SPACs.

Although activity has remained robust, the sheer volume of supply has begun to overwhelm the marketplace in the latter part of the quarter. This has been most pronounced in De-SPACs – situations where a merger target has been announced publicly, but the acquisition has yet to completed. As shown in Exhibit 6, after a strong start to the year, these 'back-end' combinations have given up most of their YTD gains. Similarly, pre-merger SPACs are now pricing in little to no optionality, as many trade at or below their cash-in-trust values (NAV) while awaiting deal announcement.

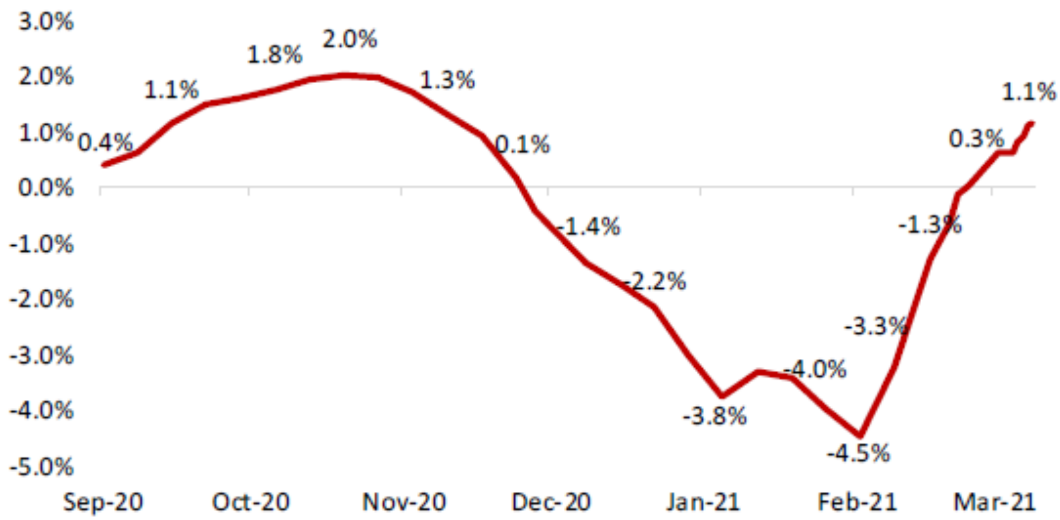
While the euphoria that dominated the second half of 2020 has waned some, we view pre deal SPACs as an attractive way to play for upside optionality stemming from positive reactions to deal announcements, exposure to warrants that come with SPAC IPOs, and minimal downside at trading prices hovering around the share's cash-in-trust value. As such, the lion's share of the fund's exposure to SPACs continues to remain in these pre-deal scenarios, where we have aligned with strong sponsors with proven track records to create value. As supply-and-demand dynamics find a more stable equilibrium, we believe the space will continue to afford unique opportunity, much as it did when we discussed in previous writing (see here).

## Exhibit 6: SPAC capital proliferation




Source: Citi

## Exhibit 7: SPAC yields - the repricing of optionality




Source: Jefferies, Bloomberg

### Flexibility and Expertise Remain a Key Advantage in 2021

Throughout 2020, the market afforded areas of opportunity that were, for the most part, dramatic but short lived. The ability to maneuver across fast moving regime changes afforded the fund the ability to capitalize as opportunity arose. The first quarter of the year proved to have its fair share of impactful shifts: epic short squeezes, internal market rotations, adjusting inflationary expectations, and dramatic failures of bank risk management systems, to name a few. Through these broad shifts, unique investment opportunities have arisen. As we lap one year into the pandemic world, the team's focus on generating alpha through investments in idiosyncratic corporate events continues to bolster the fund's resiliency across a range of market conditions. In that sense, and maybe only in that way, where we sit today is very similar to last year at this time.

## Performance Review

For the first quarter of 2021, the Driehaus Event Driven Fund returned 3.09% and the S&P 500 Index returned 6.17%.[1] The catalyst driven equities investment strategy was the fund's biggest contributor (2.08%), while no investment strategy was a detractor. The risk arbitrage (0.85%), bond catalyst (0.33%), and portfolio hedges (0.25%) strategies accounted for the remainder of the fund performance.

The largest contributors for the quarter were a pharmaceutical company planning an upcoming spin of a business unit (0.69%), a bank holding company that had an IPO in the second half of 2020 (0.55%), and a SPAC in the prop tech space that announced its acquisition target (0.54%). The largest detractors for the quarter were in the healthcare sector, including a company notified that their drug would not get approval from the FDA (-0.99%), and both a therapeutics company (-0.56%) and diagnostics company (-0.52%) that gave back some of their gains in 2020.

*Stay well,*

*Mike, Tom and Yoav*

**[1]Performance Disclosure**
*The performance data shown represents past performance and does not guarantee future results. Current performance may be lower or higher than the performance data quoted. Principal value and investment returns will fluctuate so that investors' shares, when redeemed, may be worth more or less than their original cost. Performance data represents the rate that an investor would have earned (or lost), during the given month, on an investment in the Fund (assuming reinvestment of all dividends and distributions). Average annual total return reflects annualized change.* **Since Fund performance is subject to change after the month-end, please call (800) 560-6111 or visit www.driehaus.com for more current performance information.**

# Driehaus Event Driven Fund

## % Quarter-End Performance (as of 3/31/21)

| | QTR | YTD | 1 Year | 3 Year (Annualized) | 5 Year (Annualized) | Inception[1] (Annualized) |
|---|---|---|---|---|---|---|
| **Driehaus Event Driven Fund** | **3.09** | **3.09** | **41.74** | **13.70** | **11.03** | **7.00** |
| S&P 500 Index[2] | 6.17 | 6.17 | 56.35 | 16.78 | 16.29 | 14.41 |
| FTSE 3-Month T-Bill Index[3] | 0.02 | 0.02 | 0.21 | 1.45 | 1.15 | 0.77 |
| Alpha to S&P 500 Index | -- | -- | 26.5% | 9.1% | 6.3% | 2.5% |
| Beta to S&P 500 Index | -- | -- | 0.3 | 0.3 | 0.3 | 0.3 |
| Correlation to S&P 500 Index | -- | 0.6 | 0.5 | 0.6 | 0.6 | 0.6 |
| Volatility as a % of S&P 500 Index | -- | -- | 51% | 46% | 49% | -- |

## Morningstar Multi-Alternative Rankings[5] (as of 3/31/21)

| | 1 Year | 3 Year | 5 Year |
|---|---|---|---|
| Number of Funds in Category | 85 | 75 | 63 |
| Position - DEVDX | 3 | 2 | 2 |
| **Percentile Ranking – DEVDX** | **4%** | **3%** | **3%** |

Source: Driehaus Capital Management, FactSet
Data as of 3/31/21

***The performance data shown represents past performance and does not guarantee future results. Current performance may be lower or higher than the performance data quoted. Principal value and investment returns will fluctuate so that investors' shares, when redeemed, may be worth more or less than their original cost. Performance data represents the rate that an investor would have earned (or lost), during the given month, on an investment in the Fund (assuming reinvestment of all dividends and distributions). Average annual total return reflects annualized change. Since Fund performance is subject to change after the month-end, please call (800) 560-6111 or visit www.driehaus.com for more current performance information.***

[1]The Driehaus Event Driven Fund has an inception date of August 26, 2013. [2]The Standard & Poor's ("S&P") 500 Index consists of 500 stocks chosen for market size, liquidity, and industry group. It is a market-weighted index (stock price times number of shares outstanding), with each stock's weight in the index proportionate to its market value. [3]The FTSE 3-Month T-Bill Index is designed to mirror the performance of the 3-Month U.S. Treasury Bill. The FTSE 3-Month T-Bill Index is unmanaged and its returns include reinvested dividends. An investor cannot invest directly in an index. [4]Represents the Annual Fund Operating Expenses as disclosed in the current prospectus dated April 30, 2020. It is important to understand that a decline in the Fund's average net assets due to unprecedented market volatility or other factors could cause the Fund's expense ratio for the current fiscal year to be higher than the expense information presented. A shareholder may be required to pay a commission to their financial intermediary. [5]Morningstar peer group: Morningstar Multi Alternative Category (primary share classes). Data based on monthly returns of 85, 75 and 63 mutual funds (primary share classes) for the one, three and five year periods respectively. Net of fees. Past performance is no guarantee of future results.

Terms. **Beta:** A measure of a portfolio's volatility compared to that of the market as a whole. **Effective Duration:** Duration calculation for bonds with embedded options. Effective duration takes into account that expected cash flows will fluctuate as interest rates change. **Spread Duration:** The sensitivity of the price of a bond to a 100 basis point change to its option-adjusted spread.

Ticker
## DEVDX

### Fund Overview

- The Driehaus Event Driven Fund seeks to generate consistently high alpha, low beta and low correlation to major market indexes.
- The fund invests long and short in equities and bonds that we believe are mispriced due to an announced or anticipated idiosyncratic corporate action and/or special situation.
- The fund's long/short hedged portfolio construction is designed to generate idiosyncratic returns, reduce market exposure and provide downside protection.
- The opportunistic mandate across asset classes ensures a robust investment landscape throughout the market cycle.

***The Driehaus Event Driven Fund seeks to provide:***

- Superior risk-adjusted returns
- Consistently strong alpha with minimized beta
- Low volatility and correlation to major asset classes
- Absolute Returns with low market exposure

### Facts

| | |
|---|---|
| Inception Date | 8/26/13 |
| Fund Assets Under Management | $162M |
| Strategy Assets | $700M |
| Firm Assets Under Management | $13.0B |

| *Annual Operating Expenses*[4] | |
|---|---|
| Gross Expenses | 1.93% |
| Net Expenses | 1.93% |

## Portfolio Management

**Yoav Sharon**, Portfolio Manager
*15 years industry experience*

**Tom McCauley**, Portfolio Manager
*14 years industry experience*

**Michael Caldwell**, Portfolio Manager
*13 years of industry experience*

# DEVDX Portfolio Characteristics*

## Fund Information

### Catalyst Spectrum

| Hard | Mergers & Acquisitions | Opportunistic Credit<br>Reorganizations<br>Refinancings<br>Recapitalizations | Capital Allocation<br>Repurchases<br>Divestitures &<br>Asset Sales | Special Situations<br>Spin-offs<br>SPACs<br>IPOs | Activism<br>Collaborative<br>Incentive Alignment | Regulatory<br>Data Releases<br>Bank Regulation | Post M&A Combinations<br>Synergies<br>Shareholder Transition | Soft |
|---|---|---|---|---|---|---|---|---|

## Investment Strategy

| | Long Exposure | Short Exposure | Gross Exposure | Net Exposure |
|---|---|---|---|---|
| Arbitrage | 21.0% | -2.0% | 23.1% | 19.0% |
| Credit | 18.6% | 0.0% | 18.6% | 18.6% |
| Equity | 47.6% | 0.0% | 47.6% | 47.6% |
| Hedges | 0.0% | -15.6% | 15.6% | -15.6% |

### Overall Morningstar Rating™

Based on risk-adjusted returns as of 3/31/21

★★★★★

All Share Classes among 274 Funds in the Multi Alternative Category

## Sector

| GICS[1] | Long Exposure | Short Exposure | Gross Exposure | Net Exposure |
|---|---|---|---|---|
| Communication Services | 5.0% | 0.0% | 5.0% | 5.0% |
| Consumer Discretionary | 7.4% | 0.0% | 7.4% | 7.4% |
| Consumer Staples | 0.0% | 0.0% | 0.0% | 0.0% |
| Energy | 1.1% | 0.0% | 1.1% | 1.1% |
| Financials | 31.1% | 0.0% | 31.1% | 31.1% |
| Health Care | 29.7% | -16.8% | 46.5% | 12.8% |
| Industrials | 7.9% | 0.0% | 7.9% | 7.9% |
| Information Technology | 1.8% | -0.7% | 2.6% | 1.1% |
| Materials | 0.0% | 0.0% | 0.0% | 0.0% |
| Real Estate | 3.3% | 0.0% | 3.3% | 3.3% |
| Utilities | 0.0% | 0.0% | 0.0% | 0.0% |
| Other[2] | 0.0% | 0.0% | 0.0% | 0.0% |

## Top Contributors/Detractors (by Investment Strategy)

| Top 5 | | Bottom 5 | |
|---|---|---|---|
| Equity | 0.69% | Equity | -0.99% |
| Equity | 0.55% | Equity | -0.56% |
| Arbitrage | 0.54% | Equity | -0.52% |
| Equity | 0.50% | Credit | -0.50% |
| Equity | 0.39% | Equity | -0.24% |
| **Total** | **2.67%** | **Total** | **-2.82%** |

Source: Driehaus Capital Management, FactSet

## Quarterly Contribution to Return (by Investment Strategy)

| | Jan | Feb | Mar | 1st QTR |
|---|---|---|---|---|
| Arbitrage | 0.85% | 0.51% | -0.51% | 0.85% |
| Credit | 2.47% | 0.08% | -0.46% | 2.08% |
| Equity | 0.50% | -0.36% | 0.17% | 0.33% |
| Hedges | -1.03% | 0.18% | 1.06% | 0.25% |
| Cash/Expenses[3] | -0.13% | -0.13% | -0.14% | -0.40% |
| **Total** | **2.66%** | **0.28%** | **0.14%** | **3.11%** |

Preliminary data. May differ from data shown by third-party providers because of rounding or for other reasons.

*Exposure: please note exposure may be different than market value. For equities, bonds, foreign exchange forwards and interest rate swap products, exposure is the same as market value. For options, exposure represents delta-adjusted underlying exposure. For credit default swap and credit default swap indices,-exposure represents bond equivalent exposure. [1]The Global Industry Classification Standard (GICS), a collaboration between Standard & Poor's and Morgan Stanley Capital International, is a system of classification that identifies a company according to its business activity. [2]The Other Industry Sector data is not categorized within the GICS classification system. [3]Estimated expenses for the month (not annualized) as a percentage of the fund's net assets for the month. Interest on cash balances are netted against fund expenses.

The Morningstar Rating™ for funds, or "star rating", is calculated for managed products (including mutual funds, variable annuity and variable life subaccounts, exchange-traded funds, closed-end funds, and separate accounts) with at least a three-year history. Exchange-traded funds and open-ended mutual funds are considered a single population for comparative purposes. It is calculated based on a Morningstar Risk-Adjusted Return measure that accounts for variation in a managed product's monthly excess performance, placing more emphasis on downward variations and rewarding consistent performance. The top 10% of products in each product category receive 5 stars, the next 22.5% receive 4 stars, the next 35% receive 3 stars, the next 22.5% receive 2 stars, and the bottom 10% receive 1 star. The Overall Morningstar Rating for a managed product is derived from a weighted average of the performance figures associated with its three-, five-, and 10-year (if applicable) Morningstar Rating metrics. The weights are: 100% threeyear rating for 36-59 months of total returns, 60% five-year rating/40% three-year rating for 60-119 months of total returns, and 50% 10-year rating/30% five-year rating/20% three-year rating for 120 or more months of total returns. While the 10-year overall star rating formula seems to give the most weight to the 10-year period, the most recent three-year period actually has the greatest impact because it is included in all three rating periods. The Driehaus Event Driven Fund has a five star rating for the three and five year periods.

## Sector Breakout by Top Weighted Investment Strategy

| Sector | Investment Strategy | Security Type | Average Weight | Contribution To Return |
|---|---|---|---|---|
| **Communication Services** | | | **4.98** | **0.34** |
| | Credit | Corporate | 2.20 | 0.13 |
| | Arbitrage | Corporate | 1.14 | 0.01 |
| | Credit | Corporate | 0.86 | 0.01 |
| | Equity | Equity Common | 0.58 | 0.21 |
| | Equity | Equity Common | 0.35 | 0.07 |
| **Consumer Discretionary** | | | **4.90** | **0.48** |
| | Credit | Corporate | 1.20 | 0.18 |
| | Equity | Equity Common | 1.09 | 0.17 |
| | Credit | Corporate | 1.06 | 0.03 |
| | Credit | Corporate | 0.88 | 0.05 |
| | Credit | Preferred | 0.62 | 0.06 |
| **Energy** | | | **1.18** | **0.02** |
| | Credit | Corporate | 1.16 | 0.01 |
| **Financials** | | | **24.60** | **3.30** |
| | Equity | Equity Common | 2.87 | 0.55 |
| | Credit | Corporate | 2.43 | 0.01 |
| | Equity | Equity Common | 1.78 | 0.19 |
| | Credit | Corporate | 1.65 | 0.07 |
| | Equity | Equity Common | 1.57 | 0.19 |
| **Health Care** | | | **16.76** | **-1.20** |
| | Hedges | Exchange Traded Fund | -10.86 | 0.30 |
| | Equity | Private Equity | 4.39 | -0.27 |
| | Equity | Equity Common | 4.03 | -0.06 |
| | Equity | Equity Common | 3.92 | -0.56 |
| | Hedges | Exchange Traded Fund | -2.97 | -0.01 |
| **Industrials** | | | **6.22** | **0.68** |
| | Equity | Equity Common | 1.68 | 0.08 |
| | Credit | Corporate | 1.10 | 0.22 |
| | Equity | Equity Common | 1.04 | 0.21 |
| | Credit | Corporate | 0.93 | 0.02 |
| | Equity | Equity Common | 0.75 | 0.14 |
| **Information Technology** | | | **1.16** | **-0.04** |
| | Arbitrage | Equity Common | 1.96 | -0.07 |
| | Arbitrage | Equity Common | -0.81 | 0.03 |
| **Real Estate** | | | **2.72** | **0.09** |
| | Equity | Equity Common | 1.70 | 0.10 |
| | Equity | Equity Common | 1.02 | -0.01 |
| **Utilities** | | | **1.13** | **-0.16** |
| | Equity | Equity Common | 1.13 | -0.16 |

**Notes**

Investments in overseas markets can pose more risks than U.S. investments, and share prices are expected to be more volatile than that of a U.S.-only fund. The Driehaus Event Driven Fund invests in foreign securities, including small and mid cap stocks, which may be subject to greater volatility than other investments. In addition, returns of this Fund will fluctuate with changes in stock market conditions, currency values, interest rates, foreign government regulations, and economic and political conditions in countries in which this Fund invests. These risks are generally greater when investing in emerging markets. These and other risk considerations are discussed in the prospectus for this Fund. At times, a significant portion of the Fund's return may be attributable to investments in initial public offerings (IPOs) or concentrations in certain strong performing sectors, such as technology. Returns from IPOs or sector concentrations may not be repeated or consistently achieved in the future. In addition, participating in IPOs and other investments during favorable market conditions may enhance the performance of a Fund with a smaller asset base, and this Fund may not experience similar performance results as its assets grow. Stocks of medium-sized companies tend to be more volatile in price than those of larger companies and may have underperformed the stocks of small and large companies during some periods. In addition, investments in medium-sized companies may be more susceptible to particular economic events or competitive factors than are larger, more broadly diversified companies. Growth stocks may involve special risks and their prices may be more volatile than the overall market. The Fund, in addition to investing in unrated and investment grade bonds, may also invest in junk bonds, which involve greater credit risk, including the risk of default. The prices of high yield bonds are more sensitive to changing economic conditions and can fall dramatically in response to negative news about the issuer or its industry, or the economy in general. The use of derivatives involves risks different from, and possibly greater than, the risks associated with investing directly in the underlying assets. Derivatives can be highly volatile, illiquid and difficult to value, and there is a risk that changes in the value of a derivative held by the Fund will not correlate with the Fund's other investments. Further, the Fund may invest in derivatives for speculative purposes. Gains or losses from speculative positions in a derivative may be much greater than the derivative's original cost and potential losses may be substantial. The Fund may make short sales. Short sales expose the Fund to the risk of loss. No investment strategy, including an absolute return strategy, can ensure a profit or protect against loss. Additionally, investing in an absolute return strategy may lead to underperforming results during an upward moving market. When interest rates increase, bond prices decrease and bond funds become more volatile. It is anticipated that the Fund will experience high rates of portfolio turnover, which may result in payment by the Fund of above-average transaction costs. This is a nondiversified fund compared to other funds, the Fund may invest a greater percentage of assets in a particular issuer or a small number of issuers. As a consequence, the Fund may be subject to greater risks and larger losses than diversified funds.

Market Turbulence Resulting from COVID-19. The outbreak of COVID-19 has negatively affected the worldwide economy, individual countries, individual companies and the market in general. The future impact of COVID-19 is currently unknown, and it may exacerbate other risks that apply to the Fund.

**Please consider the investment objectives, risks, fees and expenses of the Fund carefully prior to investing. The prospectus and summary prospectus contain this and other important information about the Fund. To obtain a copy of the prospectus and/or summary prospectus, please call us at (800) 560-6111. Please read the prospectus and summary prospectus carefully before investing.**

This snapshot is not intended to provide investment advice. Nothing herein should be construed as a solicitation or a recommendation to buy or sell securities or other investments. You should assess your own investment needs based on your individual financial circumstances and investment objectives. Driehaus does not guarantee the accuracy or completeness of this information. This data was prepared on April 14, 2021 and has not been updated since then. It may not reflect recent market activity. Driehaus assumes no obligation to update or supplement this information to reflect subsequent changes. This material is not intended to be relied upon as a forecast, research or investment advice, and is not a recommendation, offer or solicitation to buy or sell any securities or to adopt any investment strategy. The information and opinions contained in this material are derived from proprietary and non-proprietary sources deemed by Driehaus to be reliable, are not necessarily all inclusive and are not guaranteed as to accuracy. There is no guarantee that any forecasts made will come to pass. Reliance upon information in this material is at the sole discretion of the reader.

Foreside Financial Services, LLC, Distributor

## FUND INFORMATION

Types of events in which the fund frequently invests include:

**Corporate action:** Changes to the company's strategy or capital structure as a result of mergers, acquisitions, spin-offs, lawsuits, etc.

**Earnings:** A trade involving an upside or downside surprise to earnings versus market expectations.

**Market dislocation:** Any mispricing of a security for a non-fundamental reason.

**Product cycle:** A key change to the company's product/service offering, or a change in customer preferences for the company's product/service.

**Restructuring:** A change to the company's capital structure or business prospects as a result of bankruptcy, reorganization or corporate distress.

Types of trades in which the fund frequently invests include:

**Bond catalyst driven:** Event-driven trades that are expressed predominately through bond positions.

**Deep value:** Trade that attempts to capture the mispricing of an extremely undervalued security.

**Equity catalyst driven:** Event-driven trades that are expressed predominately through equity positions.

**Portfolio hedge:** A hedge to an unwanted factor exposure, such as equity, volatility, credit or interest rate risk.

**Risk arbitrage:** Trades that attempt to capture a valuation discrepancy between similar securities.

## DEFINITIONS OF KEY TERMS

**Credit Default Swap (CDS)** - A contract in which the buyer of the CDS makes a series of payments to the seller and, in exchange, receives a payoff if a credit instrument (typically a bond or loan) goes into default. In its simplest form, a credit default swap is a bilateral contract between the buyer and seller of protection.

**Delta** - The ratio that compares the change in the price of a derivative to the corresponding change in the price of an underlying asset.

**Derivatives Premium** – Value of a derivatives contract.

**Effective Duration** - A duration calculation for bonds with embedded options. Effective duration takes into account that expected cash flows will fluctuate as interest rates change.

**Equity Gamma** - The ratio that compares the rate of change for the delta with respect to the underlying asset's price.

**Portfolio Coupon** - The annualized interest earned for the portfolio.

**Portfolio Current Yield** - The annual income (interest or dividends) divided by the current price of the security, aggregated to the portfolio level.

**Portfolio Yield-to-Worst** - The lowest potential yield that can be received on a bond without the issuer actually defaulting, aggregated to the portfolio level. The yield to worst is calculated by making worst-case scenario assumptions on the issue by calculating the returns that would be received if provisions, including prepayment, call or sinking fund, are used by the issuer.

**Spread Duration** - The sensitivity of the price of a bond to a 100 basis point change to its option-adjusted spread. As the rate of the Treasury security in the option-adjusted spread increases, the rate of the option-adjusted spread also increases.

**Sharpe Ratio** is calculated by finding the portfolio's excess return and then dividing by the portfolio's standard deviation.

**Stock Vega** - The change in the price of an option that results from a 1% change in volatility. Vega changes when there are large price movements in the underlying asset and Vega falls as the option gets closer to maturity. Vega can change even if there is no change in the price of the underlying asset (e.g., if there is a change in expected volatility).

**Swap** - A derivative in which two counterparties exchange certain benefits of one party's financial instrument for those of the other party's financial instrument.

**Theta** - A measure of the rate of decline in the value of an option due to the passage of time. Theta can also be referred to as the time decay on the value of an option.