Rinehart
WEALTH & INVESTMENT
ADVISORY

June 2016

# INSIGHTS

## Investment Overview

### The Melancholy M&A Market

Merger and acquisition ("M&A") activity has been adversely affected by two factors this year: an unfriendly regulatory environment and an increase in volatility across financial markets, causing credit conditions to tighten effecting a rapid deceleration in M&A announcements. So far this year, over $300 billion of potential M&A activity involving US-based companies has been terminated. This surpasses the annual amount of cancelled M&A activity for each of the past 5 years, excluding 2014, when over $510 billion of M&A deal volume was cancelled- including a failed attempt by Pfizer, Inc. to acquire AstraZenica PLC ("AZN") for $116.6 billion. The recent decline in the volume of broken deals has implications for merger arbitrage investment strategies, such as those we include in our Hybrids asset class, which seek to profitably capture the spread between current market prices and prices upon completion of announced deals. The Investment Team has been actively communicating with Mr. Christopher Pultz, Portfolio Manager of the Kellner Merger Funds, and conducting due diligence to ascertain the impact of the regulatory environment and estimate the longevity of the recent downturn in M&A volume.

#### Regulatory Environment

The regulatory assault on the M&A industry, as typified by the unprecedented action out of the U.S. Department of the Treasury on April 5th that forced Pfizer, Inc. ("PFE") to terminate its planned $194 billion acquisition of Allergan PLC

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## Wealth Advisory Overview

### The Encore Career

Retirement is being redefined as the "traditional retirement" is becoming a dying concept. More individuals are taking their lifetime of experience and reinventing themselves with a new sense of purpose – to launch an encore career and embrace a new state of life when the time is right to intentionally seek meaningful work where they can have an impact.

It is a fact that people are living longer, healthier lives. Therefore, a new phase of life is emerging for individuals between their mid-50s and mid-70s. As baby boomers finish up long careers, they are realizing that they are not ready for traditional retirement. This may be due to financial reasons or the desire to embark on an encore career – a second career that can provide income but also fulfillment and social impact that may have been lacking in their previous career. People in this new phase of life have a drive for a greater purpose. They don't want to leave a legacy, they want to live a legacy.

Traditional retirement meant freedom from work. However, longevity is increasing and is projected to continue to increase even more in the future, creating a need to

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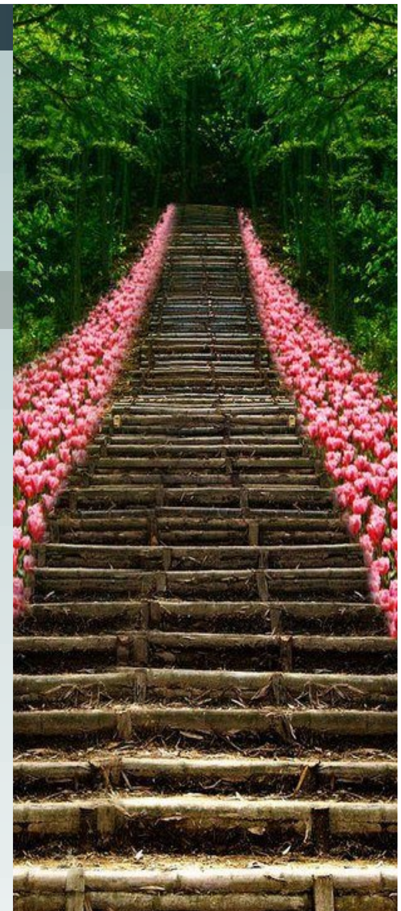


### Investment Team

Daniele Donahoe, CFA
*CEO & Chief Investment Officer*
Elliott Van Ness, CFA
*Director of Research & Portfolio Manager*
Mary Rinehart, CFP®
*Chairman & Portfolio Manager*
Brittany Danahey, CFA
*Portfolio Manager*

### Wealth Advisory Team

Sandy Carlson, CFP®, CPA, CDFA™
*President & Wealth Advisor*
Brandon Davis, CFP®
*Wealth Advisor*
Lorri Tomlin, RP®
*Wealth Associate*
Cynthia Sims, JD
*Client Service Associate & Communications Manager*
Jeremy Williamson
*Client Service Associate*

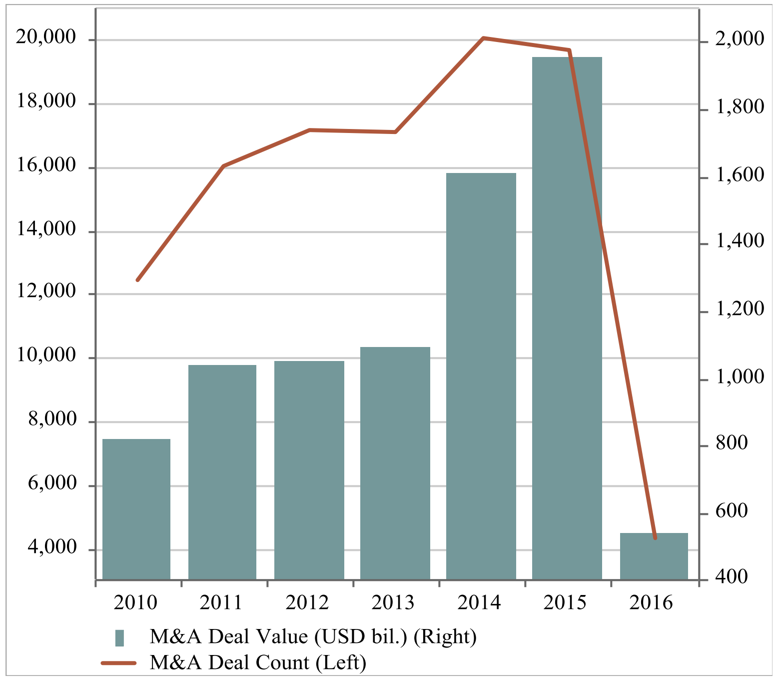
### Special points of interest

- Stock & Strategy Spotlight
- Monthly Index Review
- Around Rinehart

## Investment Overview

### The Melancholy M&A Market

**Chart I: Annual M&A Market Activity**




*Source: PitchBook*

("AGN") in a "tax inversion" transaction, shocked the M&A industry. This move by regulators, while considered to be uniquely deal-specific, is emblematic of the pall cast over the M&A landscape, which had come off of several years of record-setting growth in activity, volume, and size. While the total value of M&A activity peaked in 2015, with dealmakers completing over $1.95 trillion worth of M&A transactions in 2015 across North America and Europe, there was a slight decline in deal volume from the record 20,080 deals completed in 2014 *(Source: PitchBook - M&A Report 2015)*. Chart I illustrates the pronounced growth in M&A market activity over the past six years, using the total annual M&A deal value (green column) and the total number of M&A deal volume (red line), from 2010 through the first quarter of 2016, and the dramatic drop-off in 2016.

Another high-profile instance of the government prohibiting free-market M&A activity is the recent ruling of the U.S. District Court for the District of Columbia granting a preliminary injunction by the Federal Trade Commission ("FTC") to block the planned acquisition of Office Depot, Inc. ("ODP") by Staples, Inc. ("SPLS"). According to the FTC, the proposed combined entity would create a single, national office-supply retailer with no immediate rival, which would threaten the bargaining power of large corporate clients. It's readily apparent that the FTC's argument, reminiscent of the one it made when it blocked Blockbuster's hostile bid to acquire Hollywood Entertainment in 2005, failed to properly account for the competitive dynamics of new technologies and disruptive platforms, such as "Amazon Business" by Amazon.com, Inc. ("AMZN"), or, as was the case back in 2005, Netflix, Inc. ("NFLX"), which was already in its eighth year of operations.

One of the main reasons for the widening of deal spreads and heightened deal uncertainty is the perceived increased in regulatory risk associated with several high-profile M&A deals announced over the past two years. On the next page, Table I provides an overview of recent M&A transactions that were terminated due to a lack of regulatory approval or, as in the case

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## Monthly Index Review (USD Total Return)

| Data as of May 30th 2016 | May 2016 | 2016 YTD | 2015 | 2014 |
|---|---|---|---|---|
| S&P 500 | +1.80% | **+3.57%** | +1.38% | +13.69% |
| Dow Jones Industrial Average | +0.49% | +3.34% | +0.21% | +10.04% |
| NASDAQ Composite | **+3.83%** | -0.61% | **+6.96%** | **+14.75%** |
| Russell 2000 | +2.25% | +2.28% | -4.41% | +4.89% |
| MSCI Emerging Markets | **-3.71%** | +2.40% | **-14.60%** | -1.82% |
| MSCI EAFE | -0.78% | -0.75% | -0.39% | **-4.48%** |
| Barclays US Aggregate | +0.03% | +3.45% | +0.55% | +5.97% |

## Investment Overview

# The Melancholy M&A Market

### Table I: Recent M&A Transactions Terminated due to Regulatory Reasons

| Target/Acquirer | Transaction Value | Announced Date | Terminated Date |
|---|---|---|---|
| Allergan PLC/Pfizer, Inc. | $ 194,382.30 | Oct. 29th 2015 | Apr. 6th 2016 |
| Comcast Corp./ Time Warner Cable, Inc. | $ 69,138.19 | Feb. 13th 2014 | Apr. 24th 2015 |
| Baker Hughes, Inc./Halliburton Co. | $ 38,534.26 | Nov. 17th 2014 | Apr. 30th 2016 |
| Office Depot, Inc./Staples, Inc. | $ 6,750.44 | Feb. 4th 2015 | May 16th 2016 |

*Source: FactSet Research Systems, Inc.*

of the PFE/AGN transaction, prohibitive government regulation: within 2016 alone, approximately $240 billion of M&A deals have been blocked or terminated due to a lack of regulatory approval or increased regulatory scrutiny.

The typical regulatory approval process for M&A transactions includes a consideration of changes in the industry-level competitive landscape and potential negative consequences for market participants. The likelihood of regulatory approval is incorporated in the deal-specific risk premium for merger arbitrage investors, which is included in the deal spread. As the regulatory approval process progresses, the associated regulatory risk *should* decline and the probability of the deal closing should increase, resulting in price appreciation for the target and spread compression.

### Equity Market Volatility

In general, merger arbitrage investment strategies are deal-driven, meaning their risk-return performance is derived predominantly from the relative values and stock prices of those companies participating in an announced transaction, as opposed to the overt performance of equity markets. The M&A market is, however, directly affected by deal volume, regulatory scrutiny, and financing conditions (i.e., interest rates).

Consequently, the dramatic sell-off in equity markets earlier this year and the widening of deal spreads contributed significantly to the decline in the number of M&A deals announced during the first quarter. After a strong +6.24% rally in 4Q15, the S&P 500® Price Index was down as much as -10.51% as of February 11th 2016, while US-based M&A deal announcements fell approximately -20% to ±$256 billion in 1Q16 - their lowest level of any quarter over the past two years.

The market slowdown was preceded by widening spreads in the high-yield bond market, as fixed income investors became concerned about the health of the global economy and the balance sheets of many of the companies, particularly Exploration & Production ("E&P") Energy companies, that had been issuing low-quality debt to finance growth that was now dramatically slowing. When the debt and financing markets seize such as occurred in late-2015 and early-2016, the M&A volume often follows the downturn as financing is increasingly scrutinized.

This drop-off in quarterly M&A activity may be attributable to companies postponing public announcements until markets stabilize in an attempt to mitigate pricing volatility and ensure that markets are able to properly value the proposed transaction.

Normally, incremental equity market volatility can increase the value proposition of merger arbitrage strategies because, as market prices deviate from transaction prices, merger arbitrage is able to take

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### About Rinehart

Rinehart Wealth & Investment Advisory is an experienced, boutique Registered Investment Advisor dedicated to independent, comprehensive wealth management. Founded in 1985 by Mary Rinehart, the firm, from its inception, has had a singular focus: to provide highly customized investment management and financial planning solutions to clients.

*Boutique Firm:*

Being a boutique wealth management firm allows us the flexibility to provide more personalized service and offer unique investment solutions to clients in a Fee-Only environment.

*Team Approach:*

Because each client's situation is different, the team of advisors is hand-selected to ensure areas of expertise are appropriately aligned with the client's specific needs and interests.

*Proprietary Investment Research:*

The differentiating factor of our portfolio management process is the proprietary investment research driving the portfolio construction. All investment research and analysis is done entirely in-house by our Investment Team.

## Investment Overview

## The Melancholy M&A Market

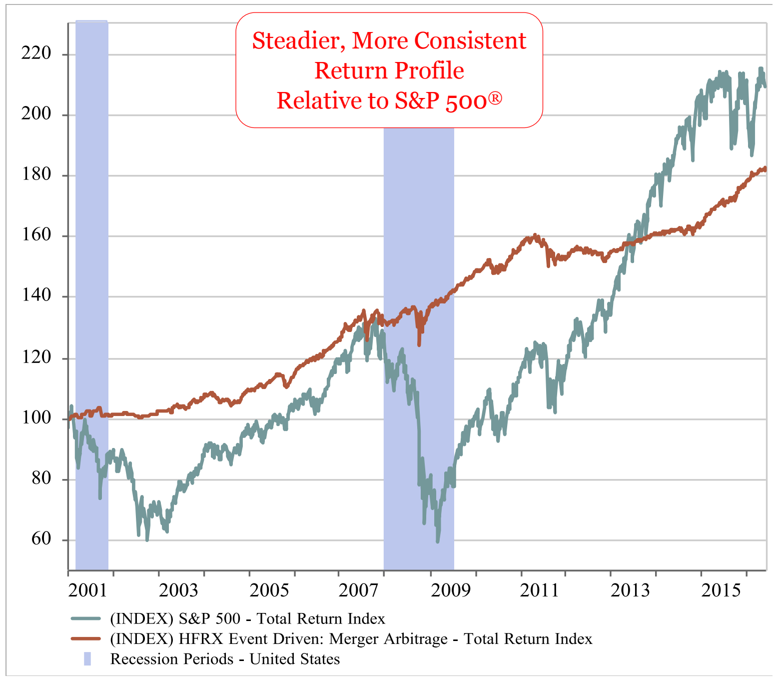
advantage of the spreads *if* the manager accurately predicts the outcome of the transaction. In several instances, however, the sharp spike in volatility earlier this year exacerbated the already pronounced divergence of market prices from transaction prices. Therefore, this incremental market risk and the widening of deal spreads increases the associated price volatility, risk profile, and uncertainty surrounding several pending M&A transactions, resulting in protracted deal spreads and difficult merger arb fund performance.

### Conclusion & Outlook

While an already shaky financial market, combined with an unfriendly regulatory environment eroded investor confidence in the prospects for the M&A market, the shock appears temporary, as we are already seeing improved fundamentals in M&A deal volumes, strategic interest, and private equity capital availability. This backdrop of stability and financing should continue to bolster deal flow, which represents a tailwind for merger arbitrage, as the number of potential deals increases.

The Investment Team remains of the opinion that these short-term headwinds are abating and that merger arbitrage still represents an attractive investment opportunity for investors given the strategy's unique risk-return profile and relative lack of correlation with broad equity market performance, despite an admittedly distinct correlation with regulatory activity.

**Chart II: Merger Arbitrage vs. S&P 500®**




*Source: FactSet Research Systems, Inc.*

We believe this is represented in Chart II, which compares the long-term, total return performance of the S&P 500® to that of the HFRX Event Driven: Merger Arbitrage, illustrating the compelling ability of merger arbitrage to capture significant upside potential, while avoiding excessive equity market drawdowns.

## Stock & Strategy Spotlight

| Name | Ticker | 2016 YTD |
|---|---|---|
| Kellner Merger Fund Institutional | GAKIX | -1.15% |

**Description & Investment Thesis**

The Investment Team had the opportunity to speak at length with Christopher Pultz, Portfolio Manager of the Kellner Merger Funds ("Kellner"), about the current M&A landscape and the strategy's outlook. As many of you may recall, Mr. Pultz participated on our Alternative Investment Manager Forum back in February of this year and was incredibly optimistic about the opportunity set for merger arbitrage. While the portfolio has recently exhibited marginal relative underperformance due to its positioning in two broken deals (i.e., PFE/AGN, SPLS/ODP), as well as negative contribution from exaggerated spread widening in another pending transaction, we believe that these constitute isolated, idiosyncratic risks and temporary near-term headwinds and remain confident in Mr. Pultz and Kellner. Moreover, the Investment Team continues to recommend allocating to merger arbitrage within Hybrids due to the strategy's ability to generate uncorrelated returns and improve portfolio-level risk-adjusted performance.

## Wealth Advisory Overview

### Title

redefine retirement. Most individual retirement plans cannot sustain 30 to 40 years of retirement. Therefore, retirement is becoming a temporary break between mid-life work and their new phase of contribution.

#### How To Find Your Encore Career

- Begin by thinking about the skills, passions and expertise you have and how they can best be put to use in a way that matters to you.
- Review resources available to help you get started. There are a variety of websites that have links to part-time and full-time job listings, as well as training programs, advice and event listings.

meaningful pursuits, while failed retirees devolve into boredom and aimlessness.

- Successful Aging – important because successful retirees focus on growing and well-being, while failed retirees just take what comes.

The Institute of Economic Affairs think tank and the Age Endeavour Fellowship charity, two British groups, released a report assessing whether retirement had a negative impact on people's health. Gabriel Sahlgren, the author of the study, notes that the longer people have been retired, the less likely they are to rate their own health as good, the more likely they are to have a diagnosed medical problem, and the more likely they are to be suffering from clinical depression.

*"What actually registers in the stock market's fluctuations are not the events themselves but the human reactions to those events."*

*Bernard Baruch*

- The Encore Career Handbook: How to Make a Living and a Difference in the Second Half of Life by Marci Alboher – From Encore.org, this book provides a road map to every step of the encore career journey including: how to plan the transition, the pros and cons of going back to school, when to volunteer, etc.

Mitch Anthony writes about the Retirement Life Profile in his book "The New Retirementality". Here, he describes four philosophical pillars to the New Retirementality: Vision, Balance, Work, and Successful Aging.

- Vision – important because successful retirees retire *to* something – failed retirees retire *from* something.
- Balance – important because successful retirees find balance between vocation and vacation, while failed retirees go from bingeing on work to bingeing on leisure.
- Work – important because successful retirees keep themselves plugged into

More than half of those currently in the workplace plan to work past the age of 65 or do not plan to retire at all. Working longer and retiring at an older age is an effective way to alleviate the shortfalls within one's retirement plan; however, fewer than twenty percent have a back-up plan if they are forced into retirement sooner than expected due to life's unforeseen circumstances.

Unfortunately, a majority of individuals lack the financial wherewithal to move into an encore career. Your Rinehart Wealth Advisor is here to help you map out a successful comprehensive retirement plan that incorporates your dream of an encore career. Contact your Wealth Advisor today and let us know how we can be of service to you.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## Around Rinehart

### Congratulations to Rinehart's Lorri Tomlin

Rinehart's newest Wealth Associate and long-time trusted employee Lorri Tomlin recently added to her many accomplishments by securing her Series 65 license. Lorri has been with Rinehart for over four years supporting the firm's wealth advisors with financial planning and client service. She is a Registered Paraplanner and an integral contributor to the financial planning process as well as the daily work related to the management of client accounts, firm reports and technology.


### Happy Birthday to Chairwoman Mary Rinehart

Mary Rinehart, founder of Rinehart Wealth & Investment Advisory celebrated her birthday in good company this past month with Rinehart's 2016 Advisory Board which includes Anne Leggett, Charles Conner and our newest member Ted Garner, IV. Welcome Ted and Happy Birthday Mary!

### Congratulations to Alana Linn & Elliott Van Ness

Rinehart's Director of Research & Portfolio Manager tied the knot with Alana Linn last month. Elliott and Alana met at Rinehart four years ago when Alana began working at Rinehart as the new Managing Associate in charge of operations and business development. Alana left to get her Master's in Accounting at UNC Chapel Hill's Kenan-Flagler School of Business and now works at Bank of America. Members of Rinehart past and present attended the wedding. Please join us in wishing them much happiness together.

**Rinehart Wealth & Investment Advisory**

Wealth management is our only business; therefore, our attention is undivided and our intentions are transparent.

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