KARPUS INVESTMENT MANAGEMENT

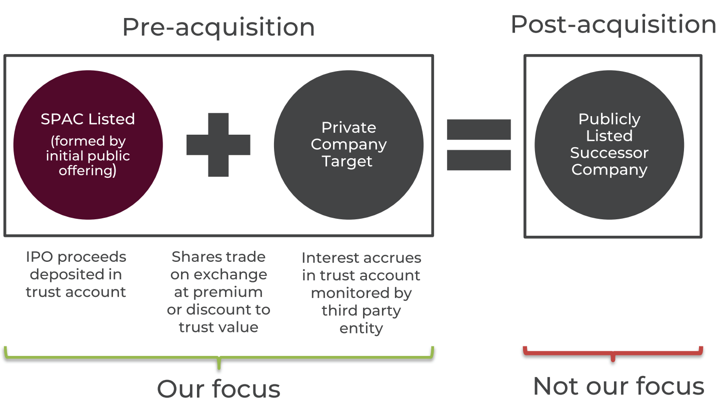
COMMENTARY

November 2023

Our Approach to Investing in Special Purpose Acquisition Companies

As measured by the Bloomberg Municipal Bond Index and the Bloomberg Government/Credit U.S. Bond Index, investors in both municipal and taxable bonds have experienced negative total returns since the Federal Reserve Open-Market Committee (FOMC) began to raise rates in March 2022 through the end of October 2023.

Even though special purpose acquisition companies (SPACs) initial public offerings have slowed down significantly, we think that many opportunities (pre-acquisition) still exist. In particular, in our strategy we look for pre-acquisition SPACs and look to purchase them at a discount to their underlying trust value prior to completing their business combination. Purchased in this manner, we think that pre-acquisition SPACs are one of the best fixed income alternatives that offer attractive returns with minimal interest rate risk.



Keeping yields attractive has typically required an investor to either extend duration or move down in credit quality. Our approach to SPACs doesn't require either.

The first question that likely comes to mind is: what is a SPAC?

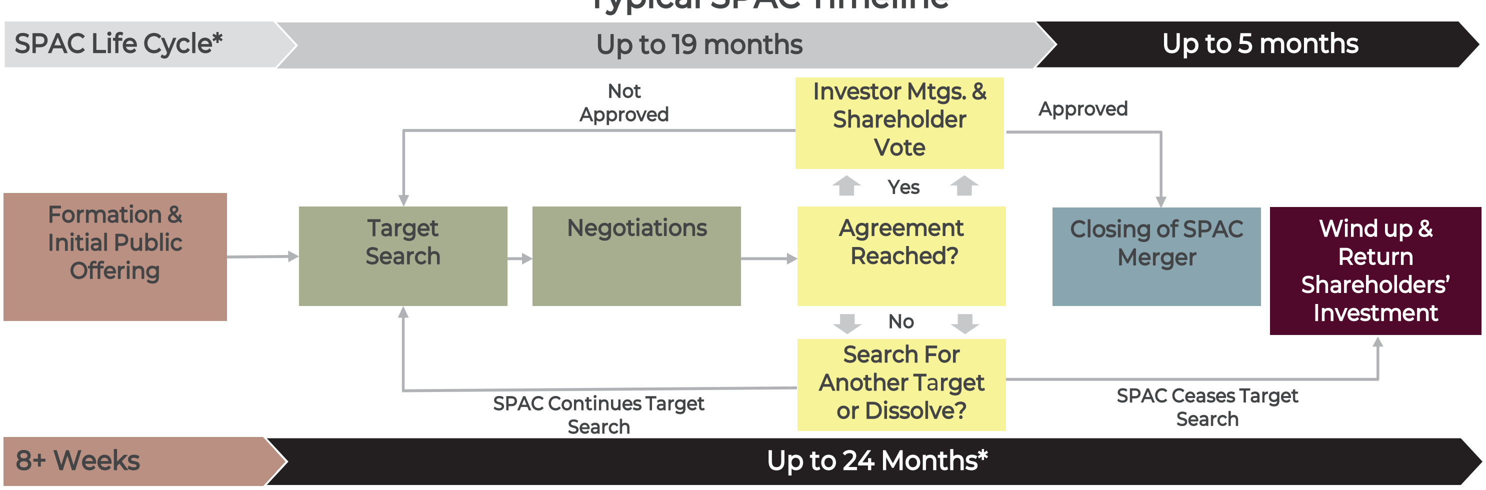
SPACs emerged in the early 1990s. Formed during an initial public offering (IPO), a SPAC essentially consists of a blank check, written by investors to a management team for the sole purpose of effecting an acquisition in a specific period of time based on pre-defined criteria. SPACs generally have 12 to 24 months to find a target company to acquire. An illustration of a typical SPAC timeline is below.

During the IPO, a SPAC is typically sold as a unit and proceeds are deposited into a trust account. Each SPAC unit at IPO typically costs $10 and consists of a varying combination of common shares, warrants, and rights. Further, management teams can contribute additional money to the trust account to incentivize investors to purchase the IPO.

The value of a SPAC unit package often runs inversely to investor's perception of the management team's prospective success in selecting an accretive acquisition candidate. Experienced management teams with a history of accretive acquisitions can sell units that have minimal explicit value. In contrast, we've seen that less experienced management teams tend to pack their units with value in order to make them more attractive. For example, experienced management teams can sell units for $10 consisting of one common share, 1/3 of a warrant and $10.00 cash in trust, whereas a less experienced management team can offer a unit consisting of one common share, one warrant and a starting trust value of $10.10.

The cash received from the IPO (and management) is deposited into a trust account and not released until the earliest of: (1) the completion of a business combination, (2) the redemption of any shares in connection with a shareholder vote, or (3) the redemption of shares at the end of the stated term if the SPAC is unable to complete a business combination. In the interim, the trust is held in cash, Treasury Bills and/or short-term government securities earning interest.

Typical SPAC Timeline



*For illustrative purposes only. The SPAC life cycle presented is based on a 24 month timeline to complete a merger.
Source: https://www.pwc.com/us/en/services/audit-assurance/accounting-advisory/spac-merger.html

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Additionally, the trust is held at a custodian independent of the SPAC management team and is monitored by a third-party trust company. These investor protections are in place regardless of the strength of the SPAC's management team.

Through our analysis, we are able to identify the trust value per share at a SPAC's IPO. Since the trust is invested in short-term U.S. Treasury bills or government money market funds, we can also calculate and estimate how much the trust can earn in interest over the life of the SPAC. Summing the initial value and the estimated potential interest earned, we then estimate the future value of the trust at the end of the stated term. We aim to buy SPACs at a discount to the estimated future value of the trust. This allows us to estimate a "floor" return that can be achieved by holding a SPAC to its stated liquidation date. We view SPACs as buying cash at a discount.

Following the IPO, each unit will subsequently split into the unit's individual, tradable components. Continuing the weaker-management example from earlier, the unit that sold for $10 can now be split into a common share selling for $9.70 and a warrant selling for $0.30. At this point, SPACs can offer a myriad of risk/return combinations to an investor. Investors only interested in the warrants can sell the common shares, which can trade at a discount or premium to an estimated value of the underlying trust.

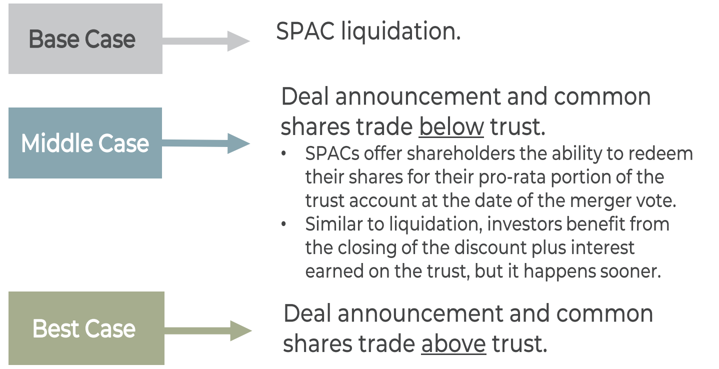
The workout of a SPAC investment can happen at any point during the SPAC's life, but when we buy a SPAC at a discount to the value of the trust, we're anticipating one of three scenarios:

The first scenario occurs when the SPAC is unable to effectuate a transaction and liquidates, causing the cash to be returned to common shareholders. This is our base, "worst-case" scenario, which still results in a positive return to shareholders within the SPAC's life span (12-24 months) dependent on the total return of the underlying securities held in the trust account.

The second and third scenarios occur when a SPAC finds an acquisition target. Because SPAC common shares are freely traded, SPAC common shares can trade a discount or premium to the value of the trust account. If the acquisition target is poorly received, shares will continue to trade below trust value. At that point, under our strategy we'd exercise our right to demand our shares be redeemed for our pro-rata share of the trust account. When this scenario occurs, we close the discount to cash quicker than if a SPAC liquidates.

Lastly, the third scenario is when a SPAC finds an acquisition target and the transaction is well received by the market. The shares of the SPAC trade above the value of cash in the trust and we simply sell into the market. In this scenario, we would not only close the discount to cash quickly, but we would also earn an extra return above cash in the trust.

Importantly, at no time do our clients truly experience owning the "operating company" that would result from a completed SPAC transaction. Also, with SPAC shareholders being able to request their shares be redeemed for their portion of the trust account in each of the above scenarios, they are provided with a known minimum exit price.



Financial market followers have probably heard the term "SPAC" in the media and associate it with risk. Although this characterization can be appropriate for the post-acquisition phase of a SPAC, we feel that our pre-acquisition approach is a conservative one that is one of the most attractive, short-term fixed income alternatives that we are aware of.

By purchasing SPAC common shares pre-acquisition at a discount to their cash value, investors achieve an asymmetric return profile with a known floor return if held to liquidation date and the potential for equity like upside if an attractive acquisition is identified and the SPAC trades at a premium, all with little to no interest rate risk.

To be sure, there are many things investors in SPACs must analyze before and during the length of their investment. Like any other investment, knowing the ins and outs of SPACs is critically important to avoid pitfalls. We feel that our team's experience with investing in SPACs, combined with current market conditions of elevated equity valuations and low fixed income yields, warrants utilization of SPACs as a component of investors' overall portfolios.

To learn more about how we invest in SPACs or if they can be a compliment to your overall strategy, please contact us to see how we can help.

For other Karpus insights, please see our website.

Sources: Bloomberg Finance, L.P., PwC, spacinsider.com, The Wall Street Journal

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