Horizon Kinetics SPAC Active ETF (SPAQ)

Semi-Annual Report 2024 Commentary

Recent market volatility is a reminder of why we believe SPACs are excellent cash management tools. SPACs are substantially insulated from market volatility because of their redemption feature. Thus, market prices have held up very well in the recent market sell-off. Going back to the end of the semiannual period, as of the end of June, SPAQ held a well-diversified, in terms of both duration and names, portfolio of SPAC equities along with a handful of warrants intended to provide excess return opportunities without compromising the Fund's overriding goal of capital preservation. SPAQ's portfolio is actively managed, seeks to generate realized capital gains in excess of short-term interest rates on a risk-adjusted basis.

We have recently witnessed an uptick in initial public offerings of SPACs. These IPOs are the "raw material" for building our portfolio and enabling us to deliver on our efforts to provide investors competitive low-risk returns with a kicker of upside optionality.

The IPO numbers are illustrative; approximately $1.7 billion of new issuance of SPACs in the past few months compared to about $2.7 billion in the aggregate for the prior 10 months. That is a favorable backdrop not just because it provides more plentiful investment opportunities going forward but also and importantly, it shifts the balance of power with regard to structural terms to those more favorable to SPAQ IPO investors compared to SPAC IPO sponsor groups. That means more cash per share in the trust account, more and/or better warrant terms, etc. This SPAC IPO resurgence may even be characterized as a somewhat remarkable achievement, given that traditional IPOs coming to market are still sporadic at best. There is some logic to what appears at first to be investors' folly: that there are several relatively large private companies looking to go public, many of which are backed by twitchy venture capital and private equity firms. With traditional IPO markets still fairly dormant, SPACs can help fill the void and allow these companies to go public.

One can, however, forgive investors for being skeptical. Since the start of 2022, more than 300 SPACs have liquidated without completing a deal. While we wait to see how the current crop of SPACs will fare. it is worth noting several factors in their favor;

- IPO window is almost shut, so SPACs are the only available route to a public market for many private companies.
- SPACs coming to market have repeat sponsors that have valuable experience in getting deals over the finish line.
- Cheaper valuations currently in private companies.
- Less competition from other SPACs.

While deal completion can be extremely lucrative for SPAC sponsors, mindful of the large number of SPACs that have liquidated without completing a deal, some sponsors have tried to spread the risk around. In addition to funding the SPAC's initial expenses and operations, a SPAC sponsor must also cover costs related to due diligence of a target company and put up "risk capital" to show "skin in the game." In return, SPAC sponsors are paid in deeply discounted shares. If no deal is completed, the SPAC sponsor will lose its initial outlay, while the deeply discounted shares that it received will be worthless. SPACs have resorted to giving up some of their deeply discounted promote shares to outside investors in exchange for these investors providing partial funding for the risk capital.

Every SPAC that one invests in does not have to complete a deal or complete a deal that is a home run in order for us to hit our bogey of mid to high single digit returns. It is worth looking at returns of SPAC deals of a serial sponsor over an entire SPAC life cycle.

Of course, with our pre-merger SPAC strategy, we see a heads we win, tails we don't lose scenario. Worst case, as noted above, we expect to get our investment back with interest. And with money markets paying about 5% now, it's not a bad place to wait as sponsors work to find an attractive acquisition.

Non-Diversification Risk. The Fund is considered to be non-diversified, which means that it may invest more of its assets in the securities of a single issuer or a smaller number of issuers than if it were a diversified fund.

New Fund Risk. The Fund is a recently organized investment company with no operating history. As a result, prospective investors have no track record or history on which to base their investment decision.

Associated Risks of Pre-Combination SPACs. "Pre-Combination" SPACs are SPACs that are either seeking a target for a Combination or have not yet completed a Combination with an identified target. Pre-Combination SPACs often have predetermined time frames to consummate a Combination (typically, two years) or the SPAC will liquidate. The Fund invests in equity securities including common stock, rights and warrants of SPACs, which raise cash to seek potential Combination opportunities. Unless and until a Combination is completed, substantially all of the cash raised by a SPAC is deposited in a trust account that generally invests its assets in U.S. government securities, money market securities, and cash. Because SPACs have no operating history or ongoing business other than seeking Combinations, the value of their securities is particularly dependent in the ability of the entity's management to identify and complete a Combination that investors find attractive. There is no guarantee that the SPACs in which the Fund invests will complete a Combination or that any Combination that is completed will be attractive to investors. Some SPACs may pursue Combinations only within certain industries or regions, which may affect the volatility of their prices.

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HKAM does not provide tax or legal advice, all investors are encouraged to consult their tax and legal advisors regarding an investment in the Fund. You may obtain additional information about HKAM at our website at www.horizonkinetics.com.

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