Updated **April 13, 2010**

The Merger Fund®

Portfolio Managers' Q & A

Q. **How would you describe your investment strategy? Do you stay within this style at all times, or do you modify it as market conditions change?**

A. We're in the merger-arbitrage business. Under normal market conditions, The Merger Fund invests at least 80% of its assets in the equity securities of companies which are involved in publicly announced mergers, takeovers, tender offers, leveraged buyouts, spin-offs, liquidations and other corporate reorganizations. In each case, we purchase these securities at a discount to their expected value upon completion of the transaction, and a variety of hedging strategies are employed to limit market-related risk. The mix of deals in our portfolio may change with economic and market conditions, but the fundamental investment strategy remains the same.

Q. What is an arbitrage "spread"?

A. It's the difference, expressed either in dollars or as a percentage, between the current price of a takeover stock and the deal price.

Q. **Do you perform your own research or do you use Street research?**

A. We perform our own primary research and supplement it with Street research as required. We also routinely employ the services of outside advisers, including industry consultants and lawyers with antitrust or other regulatory expertise.

Q. How many investment professionals do you have on staff?

A. We have a five-person portfolio-management team, a chief operating officer and four people in the back office.

Q. What is the maximum amount that The Merger Fund can invest in any one company or in any one industry?

A. There is no restriction on the amount that the Fund may invest in any one long position, provided that no single industry group represents more than 25% of net assets. As a practical matter, the Fund's individual arbitrage investments rarely approach 10% of net assets, and our median position size is currently less than 2%.

Q. Do you typically visit the companies you are interested in before making the decision to buy?

A. We rarely visit companies before purchasing shares, but unlike many other arbitrageurs, we often meet with management during the pendency of the transaction. These face-to-face meetings are an important element of our research process.

Q. Which arbitrage situations fall within your investment universe?

A. We typically invest only in publicly announced deals in which the target company has a market capitalization of greater than $300 million.

Q. How do you evaluate potential investments?

A. Our analysis of the deal includes consideration of the strategic rationale for the transaction, the history and reputation of the management teams involved, the conditions attached to completion of the deal, regulatory issues, liquidity, timing, downside and rate of return.

Q. What are your criteria for selling a position?

A. We will sell a position if the arbitrage spread narrows to a level at which the risk-reward ratio is no longer favorable or if we become concerned about the status of the transaction; otherwise, we hold the position through completion of the deal.

Q. How long is your average holding period?

A. Our average holding period is three to four months, roughly the amount of time it takes for most deals to be completed.

Q. Do you consider The Merger Fund to be tax efficient?

A. No, since most of our gains are short-term.

Q. Does the Fund invest in hostile deals?

A. Yes. Unsolicited takeover attempts can represent attractive arbitrage opportunities, although researching these situations typically requires a somewhat different analytical framework.

Q. Aren't hostile deals more risky than friendly ones?

A. Not necessarily. And whether the deal is friendly or hostile, every investment that we make must pass the same rigorous qualitative and quantitative screens designed to identify those situations offering the most favorable risk-reward ratios.

Q. Do you ever invest in a deal before a definitive merger agreement has been signed?

A. Yes. Sometimes we get involved when a company announces that it has hired investment bankers to explore a possible sale or other type of corporate reorganization. Hostile deals fall into this category, as well.

Q. Does The Merger Fund invest in foreign takeover situations?

A. Yes. In recent years, some of our most compelling arbitrage opportunities have been found in Europe, and non-U.S. transactions have represented as much as 30% of the Fund's portfolio.

Q. What risks are associated with your arbitrage strategy? How do you mitigate these risks?

A. The principal risk is that certain of the proposed reorganizations in which the Fund invests may be renegotiated or terminated. To mitigate the risk of a broken deal, we carefully research potential investments, maintain a diversified portfolio of approximately 30-50 deals and avoid outsized positions. To mitigate market-related risk in stock-for-stock mergers with fixed exchange ratios, we sell short the acquiring company's shares or otherwise hedge the position. Sometimes we also employ macro hedges.

Q. Do you use derivatives?

A. Yes, typically for hedging purposes or as a more tax-efficient way to invest in foreign transactions.

Q. Can the Fund employ leverage?

A. Yes, modest amounts. Assuming a typical mix of cash and stock-for-stock transactions, the Fund's long positions cannot exceed 120% of its net assets.

Q. How would your strategy be affected by a pronounced slowdown in merger and acquisition activity? Would you look at other investment strategies? Would you make bigger bets on existing positions? What is your outlook for deal-making over the next year or so?

A. During periods of reduced merger activity, the Fund would hold more cash. We would not look at other investment strategies, increase our average position size or compromise our deal-selection criteria. Nor would we fundamentally change an investment approach that has served us well for nearly 30 years.

Spillover effects from the financial meltdown and ensuing Great Recession contributed to roughly a 40% year-over-year drop in the value of U.S. mergers and takeovers in 2009. Now, however, confidence is returning to corporate boardrooms, the credit markets have unthawed and balance sheets are bulging with cash. More stability in equity valuations should also make it easier for buyers and sellers to come to terms on price.

Regardless of economic conditions, there are always management teams who believe that organic growth can only take their companies so far. But at a time when many firms are struggling to increase revenues and unable to do much more to cut costs, an increasing number of executives may conclude that a strategic business combination or other type of corporate reorganization offers one of the best opportunities to enhance shareholder value. All in all, we expect deal-making to recover over the next year or so, and the Fund should continue to be presented with a sufficient number of investment opportunities from which to choose.

Q. What is your long-term rate-of-return objective for The Merger Fund? What level of volatility do you target? How have you done?

A. Our long-term rate-of-return objective is 8%-12%, which we hope to achieve with very low volatility and little market sensitivity. From inception in 1989 through February 28, 2010, the Fund has returned 7.55% annually and has had only two down years. The Fund's beta has averaged less than .20 and its standard deviation has been roughly one-third that of the S&P 500.

Q. Are your employees encouraged to invest their own money in the Fund?

A. Westchester Capital Management, the Fund's adviser, invests 100% of its pension and profit-sharing plan in The Merger Fund. The portfolio managers have virtually all of their investable assets in the Fund or our hedge funds, and the majority of our employees have their personal money (in addition to their pension assets) invested in one or more of our investment vehicles.

Q. At what point would you consider closing The Merger Fund?

A. We would consider closing the Fund if faced with large inflows and not enough opportunities to put the money to work. The Fund has closed to new investors three times in its 20-year history.

Q. Why should investors consider using your fund over other funds in this category? In other words, what is your edge?

A. Having invested in more than 2,500 corporate reorganizations over three decades that have seen an extraordinary range of market conditions, the adviser's portfolio-management team is one of the most experienced and battle-tested in the merger-arbitrage business. Westchester Capital Management is also one of the largest players in its investment specialty, and this scale, together with the company's reputation for professionalism and integrity, has fostered valuable relationships with Wall Street research, trading and stock-loan departments and their European counterparts. In addition to these long-standing competitive advantages, the adviser has developed an advanced suite of quantitative risk-management tools, which have proven themselves over the past year or so in an extremely challenging market environment.

Q. What role can The Merger Fund play when added to a basket of other mutual funds?

A. Because its performance is largely uncorrelated with the results shown either by bond funds or other equity funds, The Merger Fund is an excellent diversification tool. And as an absolute-return vehicle, the Fund should deliver positive results in most market environments.

Q. How long have you been managing The Merger Fund?

A. Since its inception in 1989.

Q. How often do you provide updates to the Fund's shareholders?

A. We provide quarterly letters, which are among the most detailed in the mutual-fund industry, and annual and semi-annual reports.

Q. What are your total assets under management?

A. Westchester Capital Management and its affiliate, Green & Smith Investment Management, manage approximately $3.1 billion.

Q. Do the adviser's principals have a succession plan in place?

A. Yes. Westchester Capital Management will remain an independent company owned and managed by its employees.

Q. Does the adviser have a disaster recovery plan?

A. Yes.

Q. Has The Merger Fund, its adviser or any employee of the adviser ever had a regulatory problem?

A. No.

Q. Have you experienced much staff turnover?

A. Virtually none. With the return of its former director of research after a one-year "sabbatical" with another firm, the Adviser can represent that it has never lost an investment professional.