

## Special Purpose Acquisition Companies (SPACs)

Amid global market turmoil, short-term US Treasuries are often the first choice as investors clamor for a safe haven. However, Special Purpose Acquisition Companies (SPACs), in their pre-acquisition phase, can offer excess returns while maintaining the safety US Treasuries offer.

SPACs, once popular in the early 1990s only to fade away, have seen a reemergence in recent years. SPACs permit the investing public the opportunity to act like a private equity manager and speculate in securities often reserved for institutional investors and private equity firms. Formed during an Initial Public Offering (IPO), a SPAC essentially consists of a blank check, written by investors to a management team. That management team then typically spends the next 18 to 24 months searching for a merger candidate that they feel would create an accretive transaction that would benefit all investors.

SPAC IPOs are typically a package deal. During the IPO, a SPAC is typically sold as a unit and proceeds are deposited to a trust account. Each unit is priced at \$10 and consists of a varying combination of common shares, warrants and rights. Further, management teams might contribute additional money to the trust account to incentivize investors to purchase the IPO. The cash received from investors is placed in an interest-bearing trust account and held in cash and short-term T-bills. The money will be held in trust, monitored by a third-party trustee, until a business combination is approved by shareholders.

After the IPO, the units trade on an organized stock exchange; providing liquidity for investors. After a short period of time, the units split and individual unit components trade separately on the stock exchange. Similar to closed-end funds, a SPAC's common shares can trade at a discount or premium to their cash trust value.

SPAC investors also hold considerable power with the voting privileges attached to the common shares. If an investor does not like an acquisition proposed by management, the investor has the ability to redeem their shares for their pro-rata portion of the cash held in the investment trust. Additionally, if a significant amount of shareholders vote against the proposed transaction, the SPAC is liquidated and the trust cash is distributed to all shareholders. The majority of an investor's initial investment, plus interest accrued, less operational expenses, will be returned if the deal is deemed not favorable by the holders of the SPAC's voting common shares. This gives a SPAC investor a limited downside with a potentially unlimited upside.

The unique unit structure of SPACs offers investors the ability to custom-tailor their risk/return profile. Investing in warrants and rights can offer high returns but coupled with high risk. However, only the holders of the SPAC's common shares can make a claim to the trust value. To be the most conservative, investors should focus exclusively on the common equity component.

Similar to a laddered bond portfolio, investors can choose to hold a basket of SPAC common shares. The workout of a SPAC investment can happen at any point during the SPAC's life. When buying a SPAC at a discount to the value of the trust, an investor can anticipate one of three scenarios.

The first scenario occurs when the SPAC is unable to affect a transaction and liquidates, causing the cash to be returned to common shareholders. This is the base, worst-case scenario, generating about a 4-6% annualized return, over an approximate 12 to 24 month holding period.

The second and third scenarios occur when a SPAC finds an acquisition target. Because SPAC common shares are freely traded, SPAC common can trade at 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, an investor could exercise our right to demand their shares be redeemed for their pro-rata share the trust account. When this scenario occurs, the investor closes the discount to cash quicker than if a SPAC liquidates, but at lower trust value. However, this scenario tends to slightly outperform the first, base-case scenario on an annualized return basis.

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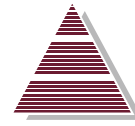
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Lastly, the third scenario is when a SPAC finds an acquisition target and the transaction is well received by the market. The shares of the SPAC trade above the value of cash in the trust and the investor simply sells into the market. The investor not only closes the discount to cash quickly, but earns an extra return above cash in trust. This case produces annualized returns above the first two scenarios.

To see the value implicit in SPAC common shares, let's assume a newly-split SPAC has a twenty-one-month life and the trust is invested in six-month T-bills, earning approximately 4.25%<sup>1</sup>. This SPAC, which was offered at \$10.00 per unit, saw the trust overfunded to \$10.05 to entice investors. Assuming the SPAC runs the full 21 months, the trust can be expected to grow to approximately \$10.78. Common shares on this SPAC currently trade at \$9.91, implying a "yield to liquidation" of 5.13%. For comparison's sake, a twenty-one-month Treasury note currently trades with a yield of just 4.03%<sup>2</sup>.

At no time do investors truly experience owning the 'operating company' that would result from a completed SPAC transaction — which could introduce significant risk. By purchasing SPACs at a discount to trust prior to merger transactions, an investor is essentially buying cash and short-term Treasuries at a discount. By using SPACs in the most exceedingly conservative way possible, it's possible for an investor to produce excess returns over comparable securities.



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1 Bloomberg – 9/11/25 T-Bill rate 4.248% as of 3/14/25

2 Bloomberg – US Treasury 4.25% due 11/30/26 rate 4.048% as of 3/14/25