

# The Arbitrage Fund

## First Quarter Update as of March 31, 2006

### Portfolio Characteristics

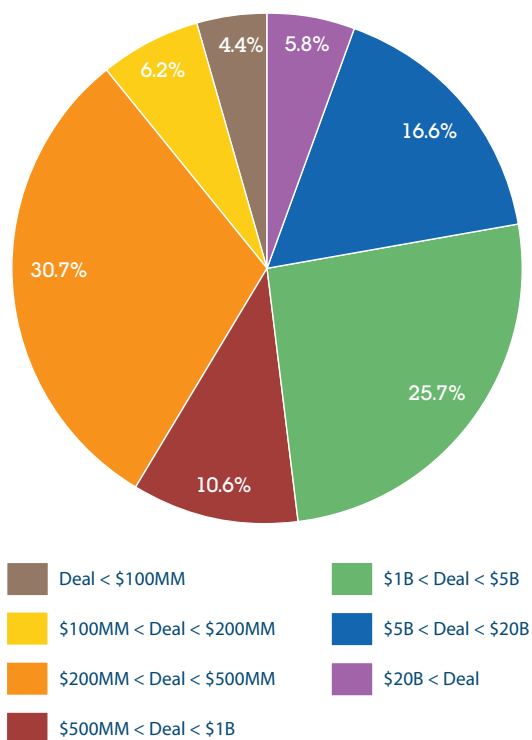
Standard Deviation	5.58%
Sharpe Ratio	0.55
Beta	0.46
Weighted Average Market Cap	\$4.1 B
Total Assets	\$173.6 MM
Turnover (Annualized)	336.0%
<b>Retail Class</b>	
Fees and Expenses	1.95%
Assets	\$87.8 MM
<b>Institutional Class</b>	
Fees and Expenses	1.70%
Assets	\$85.8 MM

Standard Deviation measures the degree of variation of returns around the average return. Sharpe Ratio measures a portfolio's return adjusted for risk. Beta measures the overall risk of a financial security relative to the broader market.

### Composition

Stocks	97.5%
Cash	2.5%

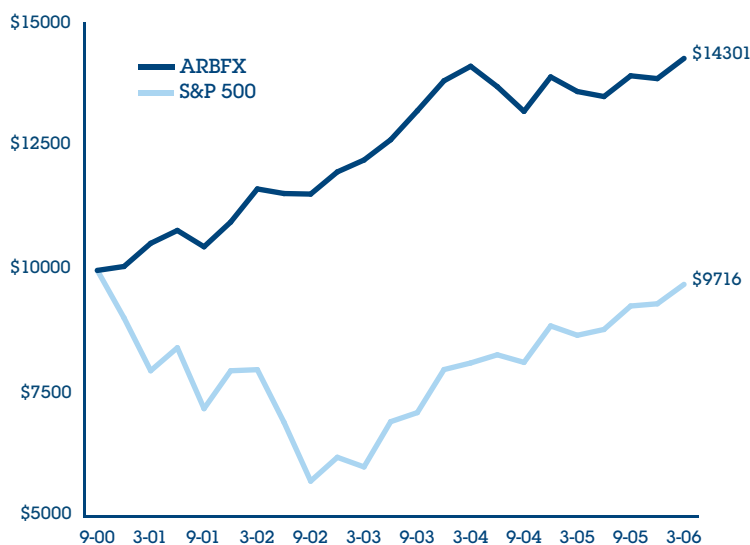
### Deal Market Cap Breakdown



The pie chart above shows a breakdown of the market capitalization of the deals in which we are invested. Investing across the market cap spectrum aids in the diversification of the portfolio.

### Performance Comparison (ARBFX)

Change in value of a \$10,000 investment in The Arbitrage Fund versus the S&P 500.



	Total returns for the period ending 3.31.06	Quarter ending 3.31.06	One year ending 3.31.06	Five year avg. ending 3.31.06	Annualized return since inception 3.31.06
The Arbitrage Fund		2.95%	4.92%	6.23%	6.68%
S&P 500		4.21%	11.74%	3.97%	-0.52%

Current performance may be higher or lower than performance quoted above. Performance data current to the most recent month-end is available at the Fund's website at [thearbfund.com](http://thearbfund.com). Any performance data quoted represents past performance and past performance does not guarantee future results. The investment return and principal value of an investment in the Fund will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost.

### First Quarter Review

The first quarter of 2006 exhibited all of the characteristics one could want for a merger arbitrage strategy: plentiful dealflow in all major geographic markets, higher but stable short term rates, still low long term financing costs, spreads which now reflect these positive factors, and (with the exception of the highly politicized P&O Ports transaction), a relatively benign regulatory environment. To put things in perspective, 5800 mergers with values totaling \$859 billion were announced around the globe during the first quarter. According to Bloomberg, this is the "fastest start since the record M&A year 2000." Unsolicited offers reached an all time high during the quarter. At the same time, David Barnes, global head of corporate law at the leading London firm Linklaters, commented: "The merger and acquisition cycle isn't over yet ... I don't think we're at the peak yet because people aren't gearing up to do silly things." In short, we agree.

### Advisor

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### For Additional Information:

An investor should consider the Fund's investment objectives, risks, and charges and expenses carefully before investing. The Fund's prospectus contains this and other important information. You may obtain a copy of the Fund's prospectus at [thearbfund.com](http://thearbfund.com) or by calling (800) 295-4485. Please read the prospectus carefully before you invest or send money.

# The Arbitrage Fund

## First Quarter Update as of March 31, 2006

### The Arbitrage Corner: Merger Arbitrage as a Fixed Income Alternative

With Bernanke now firmly installed at the Fed and the recent bump in rates, future interest rates are again a popular topic. In a previous Arb Corner, we discussed why higher short term rates are generally positive for The Arbitrage Fund. We noted that higher short term rates tend to lead to higher profit potential in the Fund's strategy. The higher short term rates lead to wider deal spreads (the profit margin in merger arbitrage) because deal spreads are based on short term rates plus a risk premium to account for the additional risks in a merger compared to the risk-free rate. Therefore, all else being equal, spreads are wider in a higher interest rate environment, and the return the Fund can earn in a merger portfolio is higher.

For this reason, merger arbitrage may be thought of as a "Fixed Income Alternative," a strategy that exhibits some of the lower risk, lower volatility characteristics of a bond portfolio while benefiting from, rather than being harmed by, rising rates. For this reason, a number of advisors find it useful to allocate portions of their fixed income portfolios to merger arbitrage in a rising rate environment.

It is also interesting to compare merger arbitrage with other publicly available alternative investment strategies such as REITS, high income/junk bond funds and

commodity funds. Generally speaking, rising rates have a doubly damaging impact on REITS, reducing the value of the underlying real estate assets while also offering other places to go to those who buy REITS for dividend yield/income. Coupled with bubble level valuations, it is difficult to see how REITS can sustain their record highs. Junk bond funds, which are somewhat less interest rate sensitive than other fixed income instruments, are certainly not helped by rising rates and have lately struggled to maintain their multi-year run-ups. Finally, commodities continue to reach record highs, albeit with a dramatically higher volatility than arbitrage generally exhibits. It remains to be seen whether oil will reach \$100 barrel as some predict or drop back to the \$40's or \$50's as others do. The same can be said for gold and certain non-precious metals.

Arbitrage, on the other hand, continues to bounce back from 5 year (indeed, historic) lows in both interest rates and dealflow, two key drivers of merger arbitrage returns. One conclusion that may be drawn from these macroeconomic factors is that the next 2-3 years are likely to be far brighter for merger arbitrage than for REITS, junk bonds or certain commodities.

### Historical Performance

Date	NAV	Calendar YTD Return	3-Month Return	6-Month Return	9-Month Return	12-Month Return	5-Year Annualized Return	Cumulative Return Since Inception
December 31, 2000	\$10.07	2.84%	0.88%					0.98%
March 31, 2001	\$10.54	4.67%	4.67%	5.59%				5.70%
June 30, 2001	\$10.80	7.25%	2.47%	7.25%	8.20%			8.31%
September 30, 2001	\$10.47	3.97%	-3.06%	-0.66%	3.97%	4.89%		5.00%
December 31, 2001	\$10.62	8.95%	4.78%	1.58%	4.09%	8.95%		10.02%
March 31, 2002	\$11.27	6.12%	6.12%	11.20%	7.80%	10.46%		16.75%
June 30, 2002	\$11.18	5.27%	-0.80%	5.27%	10.31%	6.94%		15.82%
September 30, 2002	\$11.17	5.18%	-0.09%	-0.89%	5.18%	10.21%		15.72%
December 31, 2002	\$11.46	9.27%	3.89%	3.80%	2.97%	9.27%		20.22%
March 31, 2003	\$11.69	2.01%	2.01%	5.98%	5.88%	5.04%		22.64%
June 30, 2003	\$12.06	5.24%	3.17%	5.24%	9.33%	9.24%		26.52%
September 30, 2003	\$12.62	10.12%	4.64%	7.96%	10.12%	14.41%		32.39%
December 31, 2003	\$12.70	15.18%	4.60%	9.45%	12.92%	15.18%		38.48%
March 31, 2004	\$12.97	2.13%	2.13%	6.82%	11.78%	15.32%		41.42%
June 30, 2004	\$12.59	-0.87%	-2.93%	-0.87%	3.69%	8.50%		37.28%
September 30, 2004	\$12.13	-4.49%	-3.65%	-6.48%	-4.49%	-0.10%		32.26%
December 31, 2004	\$12.25	0.57%	5.29%	1.45%	-1.53%	0.57%		39.26%
March 31, 2005	\$11.99	-2.12%	-2.12%	3.06%	-0.71%	-3.62%		36.31%
June 30, 2005	\$11.90	-2.86%	-0.75%	-2.86%	2.28%	-1.45%		35.28%
September 30, 2005	\$12.27	0.16%	3.11%	2.34%	0.16%	5.46%	6.86%	39.49%
December 31, 2005	\$12.22	-0.24%	-0.41%	2.69%	1.92%	-0.24%	6.59%	38.92%
March 31, 2006	\$12.58	2.95%	2.95%	2.53%	5.71%	4.92%	6.23%	43.01%

### Risks and Disclosure

The Fund uses investment techniques that are different from the risks ordinarily associated with equity investments. Such techniques and strategies include merger arbitrage risks, high portfolio turnover risks, options risks, borrowing risks, short sale risks, and foreign investment risks, which may increase volatility and may increase costs and lower performance. Past performance is not a guarantee of future results. Fee waivers and reimbursement of fund expenses by the Advisor, which capped the Fund's expense ratio at 1.95%, positively impacted the Fund's total return.

Material represents the manager's opinion and should not be regarded as investment advice or a recommendation of any security or strategy. Contractual fee waivers which expire in 2012 are currently in effect; without such fee waivers, performance would be less than that shown above. The Arbitrage Fund is distributed by SEI Investments Distribution Co.