

The Arbitrage Fund

Fourth Quarter Update as of December 31, 2006

Portfolio Characteristics

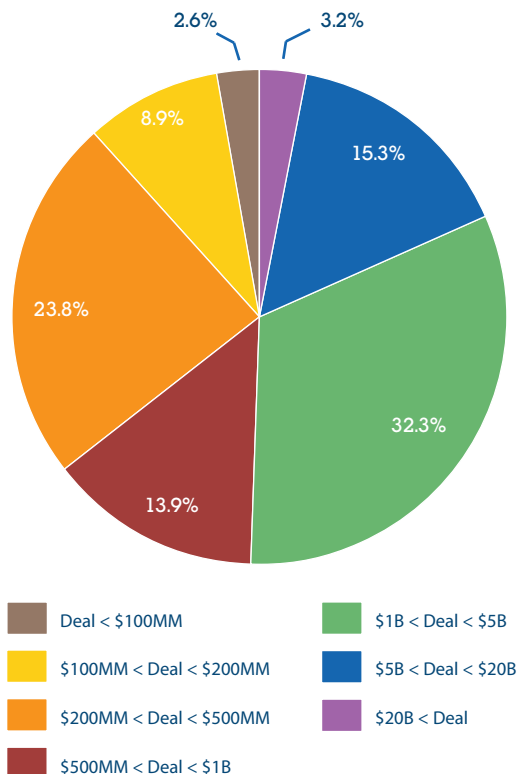
Standard Deviation	4.99%
Sharpe Ratio	-0.22
Beta	0.53
Weighted Average Market Cap	\$3.2 B
Total Assets	\$168.1 MM
Turnover (Annualized)	316.9%
ARBFX - Retail Class	
Fees and Expenses	1.95%
Assets	\$81.0 MM
ARBNX - Institutional Class	
Fees and Expenses	1.70%
Assets	\$87.1 MM

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. Risk measurements are trailing 3-year through quarter-end.

Composition

Stocks	96.7%
Cash	3.3%

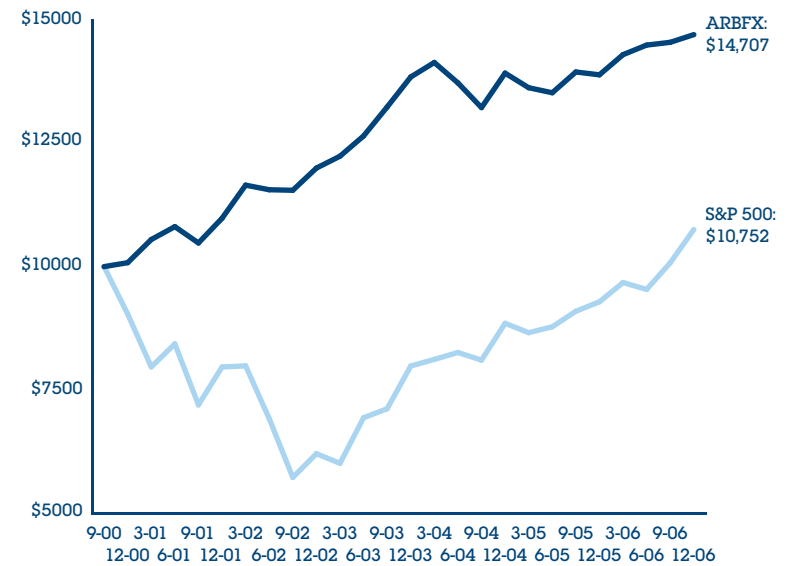
Deal Market Cap Breakdown



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 12.31.06	3-Month	12-Month	5-Year Annualized	Annualized Since Inception (9/17/00)
The Arbitrage Fund	1.07%	5.87%	5.98%	6.32%
S&P 500	6.69%	15.78%	6.19%	11.6%

The performance quoted represents past performance and does not guarantee future results. Investment return and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than the original cost. Current performance may be higher or lower than the performance quoted. Performance data current to the most recent month end may be obtained by calling (800) 295-4485 or visiting our website at <http://www.thearbfund.com/>. Returns do not reflect a 2% redemption fee for shares that are redeemed from the fund within 90 days of purchase, which, if reflected, would reduce the performance quoted. Returns shown above include the reinvestment of all dividends and capital gains.

Fourth Quarter Review

The Arbitrage Fund returned 1.07% for the fourth quarter of 2006. As is frequently the case, the Fund saw a significant number of deals close during the fourth quarter. The Fund also saw a significant number of new deals in which to reinvest those funds. Healthy debt markets and stable short term rates remained conducive to both merger transactions and arbitrage spreads. The fourth quarter brought to a close a record year in M&A which, based on cash levels among both private equity and corporate buyers, shows few signs of abating in 2007.

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 or by calling (800) 295-4485. Please read the prospectus carefully before you invest or send money.

The Arbitrage Fund

Fourth Quarter Update as of December 31, 2006

The Arbitrage Corner: What's Different About Private Equity Today?

2006 may go down as the Year of the LBO. This past year, HCA, the Tennessee healthcare firm founded by Senator Bill Frist's family, broke the 1989 record held by RJR Nabisco for largest LBO ever while private equity accounted for nearly a fifth of all deals. But Henry Kravis' KKR is as old as the 80's, Gordon Gekko and Oliver Stone's movie Wall Street. So what's new?

Three key changes in private equity since the days when Gordon Gekko epitomized the industry may be summarized this way:

(1) LBO shops, now called "private equity", are the Good Guys, not the Bad Guys. Carl Icahn isn't a corporate raider or greenmailer anymore, he's a shareholder activist. And, in the face of Sarbanes-Oxley and frequently greater compensation available in the private sector, management is welcoming the opportunity to go private, rather than fighting it.

(2) The Club Deal: Flush with cash and low interest rates to leverage that cash, private equity shops continue to look for larger and larger investment opportunities. One way to do this, and diversify your portfolio at the same time, is to team up with a group of other private equity firms to make a single large acquisition. These syndicated or "club" deals are fueling the multi-billion dollar LBO's.

(3) Private equity goes public: The recent trend of private equity shops to tap the public markets for capital has come in two forms: IPOs of private equity advisory firms and the development of registered private equity funds. Add to this the movement of hedge funds into private equity, and more money is more money.

What does it all mean?

It probably means more competitive bids, private equity versus strategic buyers (i.e. real companies), and private equity versus private equity. It probably means weaker credit metrics and higher junk bond default rates at recently privatized companies – bondholders beware. And, it probably means weaker returns overall for private equity shops as they find themselves paying higher premiums and leveraging more in an effort to use up the cash they've locked up in their funds for 3-5 years.

As merger arbitrageurs, we welcome the increased and competitive bidding activity, but cast a cautious eye on the speculators of the merger market. As the saying goes, let the buyer beware.

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%
June 30, 2006	\$12.75	4.34%	1.35%	4.34%	3.91%	7.14%	6.00%	44.95%
September 30, 2006	\$12.80	4.75%	0.39%	1.75%	4.75%	4.32%	6.74%	45.51%
December 31, 2006	\$12.42	5.87%	1.07%	1.47%	2.84%	5.87%	5.98%	47.07%

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.