THE ARBITRAGE FUND

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ANNUAL REPORT

May 31, 2009

THE ARBITRAGE FUND

WATER ISLAND CAPITAL, LLC
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28TH FLOOR
NEW YORK, NEW YORK 10010

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Dear Shareholder,

The Arbitrage Fund's (the "Fund") Class R shares generated a gain of 1.64% (and a gain of 1.69% in the Class I shares) for our fiscal year that ended May 31, 2009.

Our positive performance was achieved during a period of extreme volatility for equity and fixed income markets around the globe. Our investment team achieved the primary investment objective of capital preservation and did so during an environment that witnessed a decline in excess of 32% in the S&P 500 Index during the same period. The past year has been a tumultuous one for investors, and although both the economy and financial markets appear to be stabilizing, we remain focused on the core investment principles that underpin our investment strategy: capital preservation, coupled with achieving consistent positive returns during all market cycles.

We're also pleased to announce that the Fund has been declared the **Best Equity Market Neutral Fund** over the five year period ending 2008 in this year's Lipper Fund Awards. It remains our goal to continue to deliver to our shareholders superior risk-adjusted returns over the months and years ahead.

Providing Shelter During the Market Storm

The second half of 2008 was marked by disruptions in global financial markets caused in part by the failure of Lehman Brothers and the meltdown of the financial sector, coupled with an overall lack of transparency, integrity, and risk discipline among many of the participants, both large and small, within the financial sector of our economy. The resultant crisis of confidence among the investing public was further exacerbated by many high-profile episodes of fraud and dishonest behavior of epic proportions that emerged. Perhaps more disappointing for investors were the lack of risk discipline and risk management demonstrated by the caretakers of their investment funds. Our adherence to a risk discipline that protects investor capital from the possibility of severe loss is a bedrock principle of our investment strategy and the primary factor behind the Fund's ability to avoid the massive losses seen throughout the general markets and among many of our peer funds. Our conservative approach toward portfolio construction should be viewed in the context of the role we play as merger arbitrageurs. In essence, we underwrite the risks associated with a successful merger and for that, we receive a fee, or spread, that reflects the difference between today's price, and the consideration we can expect to collect upon the merger's successful close. Our success is predicated upon being able to properly price that risk, and to limit or avoid losses associated with a failed deal. In that context, our risk aversion makes perfect sense. We are opportunistic investors, looking to take advantage of mispriced risk in the marketplace, while positioning our investors' capital to generate positive returns over all investment cycles. Avoiding large hits to capital, however, is a prerequisite to achieving that goal.

Strategic Transactions

As the current year has progressed, the emergence of competitive bidding for companies already subject to an announced deal has accelerated. Such activity is often associated with the early stages of an economic recovery, and can catapult our projected returns for any given merger situation. To some extent, this phenomenon is a result of the sharp market declines of 2007 and 2008. Similar trends were witnessed during the early part of this decade following the bursting of the tech/telecom bubble and associated recessionary environment. There are many parallels between that period and today, not only in the software and technology sectors, but also in the healthcare, biotechnology, energy, natural resources, and banking sectors. Since many of these assets continue to trade below their historic highs, they become prized targets for larger, well capitalized firms that are seeking to generate growth in both their top and bottom lines, while positioning themselves for accelerated growth once the downturn ends.

Deal activity was present across all sectors of the global economy. Strategic transactions continue to dominate both the deal universe and our portfolio, as the lack of access to credit markets continues to sideline LBO activity and private equity buyers. "Opportunistic" would be an apt characterization for today's deal environment. Aggressive approaches and hostile bidding are taking place, given the growing gap between the haves (strong industry leaders with access to cash and credit) and the have-nots (their weakened peers, without strong balance sheets, facing growing competitive pressures).

Consolidation Overseas

Merger activity outside the U.S. has continued to accelerate as well. Pent up demand for acquisitions, particularly in the commodities sectors, has triggered a healthy flow of consolidation activity. We are witnessing aggressive buying on the part of sovereign funds and entities out of both China and the Middle East, as they seek to establish dominant global positions across an array of raw materials sectors, with a goal of ensuring adequate future supplies. The healthcare, financial and technology sectors dominated cross-border deal activity, as global aspirations fueled the desire to enlarge competitive footprints and enhance product offerings. We anticipate this period of robust consolidation to continue overseas and will maintain our global approach toward investing.

Today's investment environment bodes well for our strategy. Opportunistic buyers, low valuations, the absence of financial buyers and the frothy speculation that accompanied their presence during the past few years are contributing to a healthy and favorable risk-adjusted investment horizon for merger arbitrage. It is our expectation that the need for growth through acquisition will lead to strong consolidation activity throughout a number of sectors over the years ahead, as subdued economic conditions threaten organic growth opportunities. We also expect that mergers borne of necessity will continue, particularly within those industries that have undergone considerable stress during the past year.

Having completed a successful year, despite the turmoil throughout the world's financial markets, we will continue to work diligently to provide optimal risk-adjusted returns for our investors. I would like to extend my gratitude, on behalf of the entire team, for the trust and support you have placed in us. Please feel free to contact us or visit our website at www.TheArbFund.com should you have any questions.

Sincerely,

John S. Orrico, CFA
President

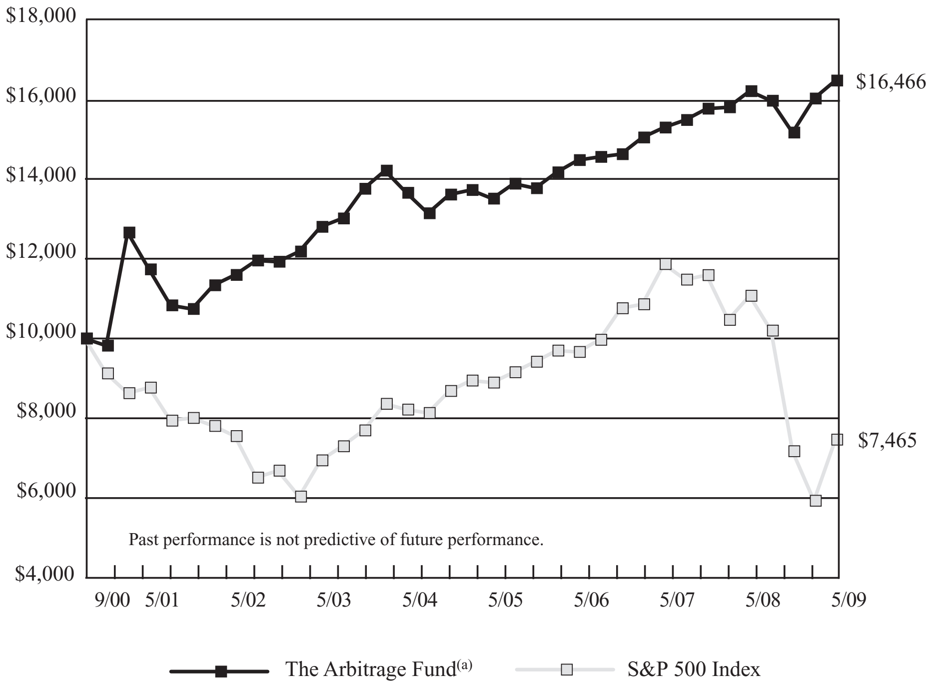
The Arbitrage Fund (ARBNX) was declared the best Equity Market Neutral Fund over the five year period ending December 31, 2008 in the 2009 Lipper Fund Awards. *Lipper, Inc., a Thomson Reuters company, is a nationally recognized organization that ranks the performance of mutual funds. The Arbitrage Fund was ranked 1 out of 23 funds within the Equity Market Neutral Funds category. Past performance is no guarantee of future results.*

The material above reflects the manager's opinion of the market as of a certain date and should not be relied upon as investment advice. 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 risks, option risks, borrowing risks, short sale risks, and foreign investment risks, which may increase volatility and may increase costs and lower performance.

The Arbitrage Fund is distributed by SEI Investments Distribution Co., which is not affiliated with the Adviser or any affiliate.

This report is intended for the Fund's shareholders. It may not be distributed to prospective investors unless it is preceded or accompanied by a current prospectus.

Comparison of the Change in Value of a $10,000 Investment in The Arbitrage Fund[(c)] versus the S&P 500 Index



Average Annual Total Returns[(b)]
(for periods ended May 31, 2009)

	1 Year	5 Years	Since Inception
The Arbitrage Fund - Class R	1.64%	3.82%	5.90%[(c)]
The Arbitrage Fund - Class I	1.69%	3.95	3.83%[(d)]
S&P 500 Index	(32.57)%	(1.90)%	(3.30)%[(e)]

[(a)] The line graph above represents performance of Class R shares only, which will vary from the performance of Class I shares based on the difference in fees paid by shareholders in the different classes.

[(b)] The data quoted herein represents past performance; past performance does not guarantee future results. The returns shown do not reflect the deduction of taxes a shareholder would pay on Fund distributions or the redemption of Fund shares. Fee waivers are in effect. If they had not been in effect, performance would have been lower.

[(c)] Represents the period from the commencement of operations of Class R shares (September 17, 2000) through May 31, 2009.

[(d)] Represents the period from the commencement of operations of Class I shares (October 17, 2003) through May 31, 2009.

[(e)] Represents the period from September 18, 2000 through May 31, 2009.

THE ARBITRAGE FUND

Statement of Assets and Liabilities

May 31, 2009

ASSETS	
Investments:	
At acquisition cost	$ 312,256,807
At value (Note 1)	$ 344,297,074
Deposits with brokers for securities sold short (Note 1)	139,111,416
Deposits with swap counterparties	521,213
Foreign currency (cost $710,183)	794,690
Receivable for investment securities sold	17,651,634
Receivable for capital shares sold	1,965,690
Unrealized appreciation on forward currency exchange contracts (Note 9)	5,018,614
Unrealized appreciation on spot currency exchange contracts	16,235
Unrealized appreciation on equity swap contracts	272,130
Dividends receivable	407,094
Prepaid expenses	71,329
Reclaims receivable	11,697
Total Assets	510,138,816
LIABILITIES	
Securities sold short, at value (Note 1) (proceeds $121,857,268)	139,164,185
Written options, at value (Notes 1 and 9) (premiums received $6,347,326)	5,689,688
Payable for investment securities purchased	24,373,149
Unrealized depreciation on forward currency exchange contracts (Note 9)	10,762,700
Unrealized depreciation on spot currency exchange contracts	17,083
Unrealized depreciation on equity swap contracts	391,067
Payable for capital shares redeemed	752,440
Payable to Adviser (Note 4)	334,220
Dividends payable on securities sold short (Note 1)	296,156
Payable to Distributor (Note 4)	52,643
Payable to Administrator (Note 4)	27,705
Payable to Trustees	15,069
Payable to Chief Compliance Officer (Note 4)	3,833
Other accrued expenses and liabilities	140,950
Total Liabilities	182,020,888
NET ASSETS	$ 328,117,928
NET ASSETS CONSIST OF:	
Paid-in capital	$ 326,161,510
Undistributed net investment income	2,583,464
Accumulated net realized losses on investments, equity swap contracts, securities sold short, written option contracts and foreign currencies	(10,124,356)
Net unrealized appreciation (depreciation) on:	
Investments	32,040,267
Equity swap contracts	(118,937)
Securities sold short	(17,306,917)
Written option contracts	657,638
Translation of assets and liabilities denominated in foreign currencies	(5,774,741)
NET ASSETS	$ 328,117,928
CLASS R SHARES	
Net assets applicable to Class R shares	$ 219,338,303
Shares of beneficial interest outstanding (unlimited number of shares authorized, no par value)	17,642,862
Net asset value and offering price per share (a)	$ 12.43
CLASS I SHARES	
Net assets applicable to Class I shares	$ 108,779,625
Shares of beneficial interest outstanding (unlimited number of shares authorized, no par value)	8,630,935
Net asset value and offering price per share (a)	$ 12.60

(a) Redemption price varies based on length of time held (Note 1).

See accompanying notes to financial statements.

THE ARBITRAGE FUND

Statement of Operations

For the Year Ended May 31, 2009

INVESTMENT INCOME	
Dividends (net of withholding taxes of $33,461)	$ 4,512,443
Total Income	4,512,443
EXPENSES	
Investment advisory fees (Note 4)	2,802,056
Distribution expense, Class R (Note 4)	350,896
Administration fees (Note 4)	224,805
Trustees' fees	50,550
Chief Compliance Officer fees (Note 4)	20,000
Dividend expense	1,661,928
Interest rebate expense	1,295,068
Professional fees	231,425
Transfer agent fees (Note 4)	180,738
Custodian and bank service fees	157,117
Registration and filing fees	67,147
Insurance expense	55,820
Printing of shareholder reports	19,314
Other expenses	8,735
Total Expenses	7,125,599
Recovery of investment advisory fees previously waived (Note 4)	8,157
Net Expenses	7,133,756
NET INVESTMENT LOSS	(2,621,313)
REALIZED AND UNREALIZED GAINS (LOSSES) ON INVESTMENTS AND FOREIGN CURRENCIES	
Net realized gains (losses) from:	
Investments	(14,473,238)
Equity swap contracts	(5,245,013)
Securities sold short	5,525,291
Written option contracts	12,124,366
Foreign currency transactions (Note 6)	4,515,636
Net change in unrealized appreciation (depreciation) on:	
Investments	26,707,371
Equity swap contracts	(1,094)
Securities sold short	(16,059,789)
Written option contracts	300,102
Foreign currency transactions (Note 6)	(5,217,366)
NET REALIZED AND UNREALIZED GAINS ON INVESTMENTS AND FOREIGN CURRENCIES	8,176,266
NET INCREASE IN NET ASSETS RESULTING FROM OPERATIONS	$ 5,554,953

See accompanying notes to financial statements.

THE ARBITRAGE FUND
Statement of Changes in Net Assets

	Year Ended May 31, 2009	Year Ended May 31, 2008
FROM OPERATIONS		
Net investment loss	$ (2,621,313)	$ (119,389)
Net realized gains (losses) from:		
Investments and equity swap contracts	(19,718,251)	11,342,105
Securities sold short	5,525,291	(279,471)
Written option contracts	12,124,366	3,126,665
Foreign currency transactions	4,515,636	(4,701,276)
Net change in unrealized appreciation (depreciation) on:		
Investments and equity swap contracts	26,706,277	213,964
Securities sold short	(16,059,789)	553,363
Written option contracts	300,102	363,699
Foreign currency transactions	(5,217,366)	(66,020)
Net increase in net assets resulting from operations	5,554,953	10,433,640
FROM DISTRIBUTIONS TO SHAREHOLDERS		
Distributions from net realized gains, Class R	(5,041,580)	(5,491,369)
Distributions from net realized gains, Class I	(3,356,818)	(5,509,264)
Decrease in net assets from distributions to shareholders	(8,398,398)	(11,000,633)
FROM CAPITAL SHARE TRANSACTIONS (Note 5)		
CLASS R		
Proceeds from shares sold	180,375,541	60,775,206
Shares issued in reinvestment of distributions	4,854,981	5,214,569
Proceeds from redemption fees collected (Note 1)	283,341	6,761
Payments for shares redeemed	(77,181,667)	(29,038,185)
Net increase in net assets from Class R share transactions	108,332,196	36,958,351
CLASS I		
Proceeds from shares sold	69,651,784	34,167,669
Shares issued in reinvestment of distributions	2,854,085	4,541,919
Proceeds from redemption fees collected (Note 1)	4,742	8,323
Payments for shares redeemed	(43,805,570)	(48,327,160)
Net increase (decrease) in net assets from Class I share transactions	28,705,041	(9,609,249)
TOTAL INCREASE IN NET ASSETS	134,193,792	26,782,109
NET ASSETS		
Beginning of year	193,924,136	167,142,027
End of year	$328,117,928	$ 193,924,136
UNDISTRIBUTED NET INVESTMENT INCOME (ACCUMULATED NET INVESTMENT LOSS)	$ 2,583,464	$ (1,522,048)

See accompanying notes to financial statements.

THE ARBITRAGE FUND

Statement of Cash Flows

For the Year Ended May 31, 2009

CASH FLOWS FROM OPERATING ACTIVITIES	
Net increase in net assets resulting from operations	$ 5,554,953
Adjustments to reconcile net increase in net assets resulting from operations to net cash used in operating activities:	
Purchases of long-term portfolio investments	(1,736,492,055)
Proceeds from sales of long-term portfolio investments	1,414,148,437
Proceeds from boxed positions	202,930,233
Purchases of short-term investments	(26,996,600)
Payments to cover securities sold short	(348,247,433)
Proceeds from securities sold short	452,627,655
Realized gain on written option contracts	(12,124,366)
Premiums received from written option contracts	35,077,016
Premiums paid to closed option contracts	(17,668,634)
Realized losses from security transactions	8,947,947
Change in unrealized appreciation from security transactions	(10,947,684)
Increase in foreign currency	(794,690)
Decrease in deposits with swap counterparties	7,111,837
Increase in deposits with brokers for securities sold short	(115,445,161)
Increase in receivable for investment securities sold	(4,415,768)
Increase in unrealized appreciation on forward currency exchange contracts	(4,587,814)
Increase in unrealized appreciation on spot currency exchange contracts	(16,229)
Increase in unrealized appreciation on equity swap contracts	(123,455)
Increase in prepaid expenses	(8,567)
Decrease in reclaims receivable	3,355
Increase in dividends receivable	(402,066)
Decrease in bank overdraft denominated in foreign currency	(142,846)
Increase in payable for investment securities purchased	14,242,069
Increase in unrealized depreciation on forward currency exchange contracts	9,777,775
Increase in unrealized depreciation on spot currency exchange contracts	16,020
Increase in unrealized depreciation on equity swap contracts	124,549
Increase in payable to Adviser	141,364
Increase in payable to Distributor	24,900
Increase in payable to Administrator	11,653
Decrease in payable to Trustees	(431)
Increase in dividends payable on securities sold short	286,703
Increase in other accrued expenses and liabilities	18,896
Net cash used in operating activities	(127,368,437)

THE ARBITRAGE FUND

Statement of Cash Flows (Continued)

For the Year Ended May 31, 2009

CASH FLOWS FROM FINANCING ACTIVITIES	
Proceeds from shares sold	$ 250,027,325
Shares issued in reinvestment of distributions	7,709,066
Payments for shares redeemed	(120,699,154)
Distributions from net realized gains paid to shareholders	(8,398,398)
Increase in receivable for capital shares sold	(145,499)
Increase in payable for capital shares redeemed	561,610
Net cash provided by financing activities	129,054,950
NET INCREASE IN CASH	1,686,513
BANK OVERDRAFT — BEGINNING OF YEAR	(1,686,513)
CASH — END OF YEAR	$ —

See accompanying notes to financial statements.

THE ARBITRAGE FUND – CLASS R
Financial Highlights

Selected Per Share Data and Ratios for a Share Outstanding Throughout Each Year

	Year Ended May 31, 2009	Year Ended May 31, 2008	Year Ended May 31, 2007	Year Ended May 31, 2006	Year Ended May 31, 2005
Net asset value at beginning of year	$ 12.79	$ 12.91	$ 12.73	$ 11.88	$ 12.52
Income (loss) from investment operations:					
Net investment income (loss)	(0.16)(d)	(0.03)(d)	0.03 (d)	(0.10)	(0.19)
Net realized and unrealized gains on investments and foreign currencies	0.30 (d)	0.78 (d)	0.67 (d)	0.95	0.07
Total from investment operations	0.14	0.75	0.70	0.85	(0.12)
Less distributions:					
From net realized gains	(0.52)	(0.87)	(0.52)	—	(0.52)
Proceeds from redemption fees collected	0.02	0.00 (a)	0.00 (a)	0.00 (a)	0.00 (a)
Net asset value at end of year	$ 12.43	$ 12.79	$ 12.91	$ 12.73	$ 11.88
Total return (b)	1.64%	5.97%	5.64%	7.15%	(1.07%)
Net assets at end of year (000's)	$219,338	$112,092	$75,207	$87,643	$134,035
Ratio of gross expenses to average net assets	3.28%	2.44%	2.38%	2.41%	2.36%
Ratio of gross expenses to average net assets excluding interest and dividend expense (c)(e)	1.95%	1.96%	2.12%	2.12%	2.06%
Ratio of net expenses to average net assets excluding interest and dividend expense (c)(e)	1.95%	1.90%	1.95%	1.95%	1.95%
Ratio of net expenses to average net assets excluding tax, interest and dividend expense	1.88%	1.90%	1.95%	1.95%	1.95%
Ratio of net investment income (loss) to average net assets:					
Before advisory fees waived and expenses reimbursed	(1.34%)	(0.31%)	0.06%	(0.44%)	(1.27%)
After advisory fees waived and expenses reimbursed	(1.34%)	(0.25%)	0.23%	(0.28%)	(1.16%)
Portfolio turnover rate	709%	712%	383%	394%	387%

(a) Amount rounds to less than $0.01 per share.

(b) Total return is a measure of the change in the value of an investment in the Fund over the periods covered, which assumes any dividends or capital gains distributions are reinvested in shares of the Fund. Returns shown do not reflect the deduction of taxes a shareholder would pay on Fund distributions or the redemption of Fund shares.

(c) Dividend expense totaled 0.74%, 0.48%, 0.26%, 0.29%, and 0.30% of average net assets for the years ended May 31, 2009, 2008, 2007, 2006 and 2005, respectively.

(d) Per share amounts were calculated using average shares for the year.

(e) Interest expense and interest rebate expense totaled 0.58% of average net assets for the year ended May 31, 2009.

Amounts designated as "—" are either $0 or have been rounded to $0.

See accompanying notes to financial statements.

THE ARBITRAGE FUND – CLASS I
Financial Highlights

Selected Per Share Data and Ratios for a Share Outstanding Throughout Each Year

	Year Ended May 31, 2009	Year Ended May 31, 2008	Year Ended May 31, 2007	Year Ended May 31, 2006	Year Ended May 31, 2005
Net asset value at beginning of year	$ 12.95	$ 13.03	$ 12.81	$ 11.93	$ 12.54
Income (loss) from investment operations:					
Net investment income (loss)	(0.11)(d)	0.01 (d)(e)	0.06 (d)	(0.10)	(0.15)
Net realized and unrealized gains on investments and foreign currencies	0.28 (d)	0.78 (d)	0.68 (d)	0.98	0.06
Total from investment operations	0.17	0.79	0.74	0.88	(0.09)
Less distributions:					
From net realized gains	(0.52)	(0.87)	(0.52)	—	(0.52)
Proceeds from redemption fees collected	0.00 (a)	0.00 (a)	0.00 (a)	0.00 (a)	0.00 (a)
Net asset value at end of year	$ 12.60	$ 12.95	$ 13.03	$ 12.81	$ 11.93
Total return (b)	1.69%	6.23%	5.92%	7.38%	(0.82%)
Net assets at end of year (000's)	$108,780	$81,832	$91,935	$ 88,011	$ 94,417
Ratio of gross expenses to average net assets	3.03%	2.20%	2.13%	2.16%	2.14%
Ratio of gross expenses to average net assets excluding interest and dividend expense (c)(f)	1.70%	1.72%	1.87%	1.87%	1.84%
Ratio of net expenses to average net assets excluding interest and dividend expense (c)(f)	1.70%	1.65%	1.70%	1.70%	1.70%
Ratio of net expenses to average net assets excluding tax, interest and dividend expense	1.63%	1.65%	1.70%	1.70%	1.70%
Ratio of net investment income (loss) to average net assets:					
Before advisory fees waived and expenses reimbursed	(0.87%)	0.04%	0.28%	(0.29%)	(1.05%)
After advisory fees waived and expenses reimbursed	(0.87%)	0.11%	0.46%	(0.12%)	(0.91%)
Portfolio turnover rate	709%	712%	383%	394%	387%

(a) Amount rounds to less than $0.01 per share.
(b) Total return is a measure of the change in the value of an investment in the Fund over the periods covered, which assumes any dividends or capital gains distributions are reinvested in shares of the Fund. Returns shown do not reflect the deduction of taxes a shareholder would pay on Fund distributions or the redemption of Fund shares.
(c) Dividend expense totaled 0.74%, 0.48%, 0.26%, 0.29%, and 0.30% of average net assets for the periods ended May 31, 2009, 2008, 2007, 2006 and 2005, respectively.
(d) Per share amounts were calculated using average shares for the year.
(e) The amount shown for a share outstanding throughout the period does not accord with the aggregate net losses on investments for the period because of the sales and repurchases of Fund shares in relation to fluctuating market value of the investments of the Fund.
(f) Interest expense and interest rebate expense totaled 0.58% of average net assets for the year ended May 31, 2009.

Amounts designated as "—" are either $0 or have been rounded to $0.
See accompanying notes to financial statements.

THE ARBITRAGE FUND
Portfolio of Investments
May 31, 2009

Shares	COMMON STOCK — 92.07%	Value
	Agriculture — 1.81%	
817,690	ABB Grain Ltd.	$ 5,956,119
	Banks — 1.00%	
104,487	American Bancorp of New Jersey[e]	1,021,695
66,820	Banca Italease SpA[a]	141,208
21,110	Citigroup, Inc.	78,529
295,796	Republic First Bancorp, Inc.[a][b][e]	2,041,229
		3,282,661
	Beverages — 7.56%	
1,502,033	Lion Nathan Ltd.	14,127,021
164,603	Pepsi Bottling Group, Inc.[b]	5,408,855
201,058	PepsiAmericas, Inc.[b]	5,287,825
		24,823,701
	Biotechnology — 4.76%	
1,687,762	Arana Therapeutics Ltd.	1,884,598
102,906	CombiMatrix Corp.[a]	823,248
166,057	Cougar Biotechnology, Inc.[a]	7,138,790
47,387	Cubist Pharmaceuticals, Inc.[a][c]	808,422
1,633,087	CuraGen Corp.[a]	2,188,337
1,059,050	IDM Pharma, Inc.[a]	2,785,302
		15,628,697
	Broadcasting, Newspapers, & Advertising — 1.63%	
220,993	Liberty Media Corp. Entertainment[a][b]	5,339,191
	Building & Construction Supplies — 4.16%	
1,620,734	Centex Corp.[b][c]	13,662,788
	Chemicals — 0.35%	
10,432	CF Industries Holdings, Inc.[c]	809,940
57,131	Nova Chemicals Corp.	331,360
		1,141,300
	Coal — 3.65%	
65,617	Alpha Natural Resources, Inc.[a][b][c]	1,807,748
62,741	Foundation Coal Holdings, Inc.[c]	1,841,448
1,416,959	Gloucester Coal Ltd.	7,928,075
166,137	Whitehaven Coal Ltd.	392,303
		11,969,574

THE ARBITRAGE FUND
Portfolio of Investments (Continued)
May 31, 2009

Shares	COMMON STOCK — 92.07% (Continued)	Value
	Computers & Services — 5.20%	
482,270	Data Domain, Inc.[(a)]	$ 12,283,417
208,765	Hypercom Corp.[(a)]	281,833
499,588	Sun Microsystems, Inc.[(a)(b)(c)]	4,496,292
		17,061,542
	Financial Services — 5.27%	
117,514	Macquarie Communications Infrastructure Group	226,694
1,692,283	Thinkorswim Group, Inc.[(a)(b)]	17,075,135
		17,301,829
	Food Products — 0.56%	
249,007	Sadia SA	1,830,201
	Insurance — 0.23%	
30,015	IPC Holdings Ltd.[(b)]	745,873
	Medical Products & Services — 10.61%	
290,576	Medicult A/S[(a)]	478,077
449,661	ScheringPlough Corp.[(b)(c)]	10,971,728
508,358	Vnus Medical Technologies, Inc.[(a)(b)]	14,722,048
192,496	Wyeth[(b)(c)]	8,635,370
		34,807,223
	Metals & Mining — 1.21%	
22,265	Compass Minerals International, Inc.[(b)(c)]	1,194,072
921,837	Western Goldfields, Inc.[(a)(e)]	2,767,698
		3,961,770
	Miscellaneous Business Services — 7.12%	
300,415	Autobytel, Inc.[(a)]	135,187
651,804	Gmarket, Inc. ADR[(a)]	15,591,151
721,005	Goldleaf Financial Solutions, Inc.[(a)]	533,544
548,854	Vignette Corp.[(a)(b)]	7,102,171
		23,362,053
	Petroleum Exploration & Production — 6.67%	
480,481	Atlas Energy Resources LLC[(b)]	10,056,467
170,463	Legacy Reserves[(b)]	2,100,104
157,630	PetroCanada[(b)]	7,019,264
1,381,825	Profound Energy, Inc.[(a)]	2,017,631
480,708	UTS Energy Corp.[(a)]	697,505
		21,890,971

Shares	COMMON STOCK — 92.07% (Continued)	Value
	Pipelines — 3.85%	
41,600	Enterprise Products Partners LP	$ 1,081,600
350,138	Magellan Midstream Holdings[b]	7,363,402
140,417	TEPPCO Partners[b]	4,188,639
		12,633,641
	Public Thoroughfares — 0.24%	
140,690	Itinere Infraestructuras SA[a]	784,609
	SemiConductors — 5.01%	
146,117	Emulex Corp.[a][c]	1,605,826
824,966	Logicvision, Inc.[a]	923,962
2,736,671	SiRF Technology Holdings, Inc.[a]	10,891,950
528,216	Tundra Semiconductor Corp.[a]	3,003,090
		16,424,828
	Silver Mining — 2.02%	
633,709	Silver Wheaton Corp.[a]	6,644,749
	Software — 8.54%	
2,332,816	Borland Software Corp.[a]	2,288,493
676,093	Catapult Communications Corp.[a][b]	6,341,752
1,188,226	Entrust, Inc.[a]	2,507,157
580,866	Metavante Technologies, Inc.[a][b]	14,899,213
412,910	SumTotal Systems, Inc.[a]	1,981,968
		28,018,583
	Telephones & Telecommunications — 7.22%	
440,891	D&E Communications, Inc.[b]	4,298,688
391,261	Embarq Corp.[b]	16,440,787
263,191	Fibernet Telecom Group, Inc.[a]	2,947,739
		23,687,214
	Tobacco — 0.04%	
24,877	Star Scientific Inc.[a]	124,385
	Trading Companies & Distributors — 0.44%	
21,515	Eriks NV	1,443,185
	Trucking — 2.92%	
1,042,210	Eveready, Inc.	9,577,528
	Total Common Stock (Cost $272,816,341)	$ 302,104,215

THE ARBITRAGE FUND

Portfolio of Investments (Continued)

May 31, 2009

Shares	PREFERRED STOCK — 3.22%	Value
	Banks — 3.22%	
18,963	Bank of America Corp.	$ 360,297
18,963	Bank of America Corp.	295,823
442,381	Citigroup, Inc.[c]	9,701,415
10,262	Citigroup, Inc.[c]	227,817
		10,585,352
	Total Preferred Stock (Cost $8,293,135)	$ 10,585,352

Shares	WARRANTS[a] — 0.00%	Value
308,857	Buru Energy Ltd., Expires 10/10	$ —
49,000	CombiMatrix Corp., Expires 05/14	—
	Total Warrants (Cost $—)	$ —

Contracts	CALL OPTION CONTRACTS[a] — 0.57%	Value
	Alpha Natural Resources, Inc.,	
99	06/09 at $35	$ 2,228
100	06/09 at $40	1,000
	Centex Corp.,	
500	07/09 at $9	35,000
	Foundation Coal Holdings, Inc.,	
100	06/09 at $35	4,250
	Sun Microsystems, Inc.,	
959	06/09 at $10	1,918
795	07/09 at $10	1,590
5,000	07/09 at $8	585,000
	Suncor Energy, Inc.,	
1,535	06/09 at $27.5	1,228,000
	Total Call Option Contracts (Cost $880,954)	$ 1,858,986

THE ARBITRAGE FUND
Portfolio of Investments (Continued)
May 31, 2009

Contracts	PUT OPTION CONTRACTS[(a)] — 0.84%	Value
	CF Industries Holdings, Inc.,	
300	06/09 at $70	$ 34,500
	Citigroup, Inc.,	
9,767	07/09 at $5	1,792,244
5,447	07/09 at $4	509,295
600	09/09 at $7	237,000
350	09/09 at $5	71,400
	Emulex Corp.,	
695	06/09 at $7.5	3,475
	Enterprise Products Partners,	
416	06/09 at $25	5,200
	Foundation Coal Holdings, Inc.,	
147	06/09 at $25	8,085
145	06/09 at $22.5	2,900
	Metavante Technologies, Inc.,	
300	06/09 at $22.5	12,000
	NetApp, Inc.,	
1,191	07/09 at $16	29,775
995	07/09 at $17	39,800
	Nova Chemicals Corp.,	
496	06/09 at $5	4,960
	Sun Microsystems, Inc.,	
234	06/09 at $8	1,287
	Total Put Option Contracts (Cost $3,269,777)	$ 2,751,921

Shares	MONEY MARKET FUND[(d)] — 8.23%	Value
26,996,600	State Street Institutional Liquid Reserves Fund, 0.579% (Cost $26,996,600)	$ 26,996,600
	Total Investments at Value — 104.93% (Cost $312,256,807)	$344,297,074

As of May 31, 2009, the Fund had long equity swap contracts outstanding as follows:

Shares		Unrealized Appreciation
250,000	Western Goldfields, Inc., Equity Swap[e] (Cost $478,463, Market Value $750,593) Terminating 04/13/10	$ 272,130

Percentages are based on Net Assets of $328,117,928.

[a] Non-income producing security.

[b] All or a portion of the shares have been committed as collateral for open short positions.

[c] Underlying security for a written/purchased call/put option.

[d] Rate shown is the 7-day effective yield as of May 31, 2009.

[e] Security fair valued using methods determined in good faith by the Pricing Committee. As of May 31, 2009, the total market value of these securities was $6,102,752, representing 1.9% of net assets.

ADR — American Depositary Receipt
LLC — Limited Liability Company
LP — Limited Partnership
Ltd. — Limited
Amounts designated as "—" are either $0 or have been rounded to $0.

THE ARBITRAGE FUND
Schedule of Securities Sold Short
May 31, 2009

Shares	COMMON STOCK — 40.67%	Value
	Banks — 0.72%	
80,400	Citigroup, Inc.	$ 299,088
58,753	Investors Bancorp, Inc.[(a)]	512,326
86,240	Pennsylvania Commerce Bancorp, Inc.[(a)]	1,566,119
		2,377,533
	Beverages — 1.39%	
87,859	PepsiCo, Inc.[(b)]	4,573,061
	Broadcasting, Newspapers, & Advertising — 0.02%	
2,250	DIRECTV Group, Inc.[(a)(b)]	50,625
	Building & Construction Supplies — 2.57%	
957,592	Pulte Homes, Inc.[(b)]	8,426,810
	Chemicals — 0.19%	
12,733	Agrium, Inc.[(b)]	626,718
	Commercial Services & Supplies — 1.73%	
104,172	Clean Harbors, Inc.[(a)(b)]	5,679,457
	Computers & Services — 0.24%	
39,603	NetApp, Inc.[(a)(b)]	772,259
	Financial Services — 2.98%	
574,429	TD Ameritrade Holding Corp.[(a)(b)]	9,788,270
	Food Products — 1.03%	
12	MEIJI Holdings Co., Ltd.[(a)]	401
49,676	Perdigao SA[(a)]	1,925,442
172,572	Viterra, Inc.[(a)]	1,456,736
		3,382,579
	Gas/Natural Gas — 2.85%	
507,172	Atlas America, Inc.[(b)]	9,342,108
	Medical Products & Services — 3.27%	
276,946	Merck & Co., Inc.[(b)]	7,638,171
202,892	Pfizer, Inc.[(b)]	3,081,929
		10,720,100
	Metals & Mining — 0.84%	
922,234	New Gold, Inc.[(a)]	2,768,890
	Miscellaneous Business Services — 0.85%	
79,336	Open Text Corp.[(a)]	2,795,007

THE ARBITRAGE FUND

Schedule of Securities Sold Short (Continued)

May 31, 2009

Shares	COMMON STOCKS — 40.67% (Continued)	Value
	Petroleum Exploration & Production — 3.24%	
267,525	Paramount Energy Trust	$ 1,054,671
270,152	Suncor Energy, Inc.	9,566,082
		10,620,753
	Pipelines — 3.63%	
161,554	Enterprise Products Partners LP[(b)]	4,200,404
220,687	Magellan Midstream Partners	7,713,011
		11,913,415
	SemiConductors — 3.67%	
2,143,328	CSR Plc[(a)]	12,053,498
	Silver Mining — 2.03%	
343,900	Silver Wheaton Corp.[(a)(b)]	3,617,828
291,285	Silver Wheaton Corp.[(a)(b)]	3,054,266
		6,672,094
	Software — 4.02%	
674,011	Fidelity National Information Services, Inc.[(b)]	12,981,452
38,272	Mentor Graphics Corp.[(a)(b)]	215,088
		13,196,540
	Telephones & Telecommunications — 5.40%	
507,770	CenturyTel, Inc.[(b)]	15,664,704
241,855	Windstream Corp.[(b)]	2,034,001
		17,698,705
	Total Common Stock (Proceeds $116,180,357)	$133,458,422

Shares	EXCHANGE TRADED FUND — 1.74%	Value
61,744	SPDR Trust Series 1 (Proceeds $5,676,911)	$ 5,705,763
	Total Securities Sold Short — 42.41% (Proceeds $121,857,268)	$139,164,185

THE ARBITRAGE FUND

Schedule of Securities Sold Short (Concluded)

May 31, 2009

As of May 31, 2009, the Fund had short equity swap contracts outstanding as follows:

Shares		Unrealized Depreciation
139,100	Paramount, Equity Swap (Cost $411,690, Market Value $548,377) Terminating 04/05/10 – 07/05/10	$ (136,687)
250,000	New Gold, Inc., Equity Swap (Cost $496,213, Market Value $750,593) Terminating 04/13/10	(254,380)
	(Total cost $907,903, Total Market Value $1,298,970)	$ (391,067)

Percentages are based on Net Assets of $328,117,928.

[a] Non-income producing security.

[b] Underlying security for a written/purchased call/put option.

Ltd. — Limited

LP — Limited Partnership

Plc — Public Limited Company

SPDR — Standard & Poor's Depositary Receipt

THE ARBITRAGE FUND

Schedule of Open Options Written

May 31, 2009

Contracts	WRITTEN CALL OPTIONS[(a)] — 1.49%	Value
	Agrium, Inc.,	
275	06/09 at $45	$ 132,000
25	07/09 at $45	14,750
	Alpha Natural Resources, Inc.,	
100	06/09 at $25	35,500
299	06/09 at $30	28,405
50	06/09 at $32.5	2,250
448	06/09 at $27.5	89,600
	Atlas America, Inc.,	
368	09/09 at $12.5	217,120
20	09/09 at $17.5	4,500
	Centex Corp.,	
2,164	06/09 at $10	21,640
500	06/09 at $9	17,500
	CenturyTel, Inc.,	
274	06/09 at $30	32,195
	CF Industries Holdings, Inc.,	
100	06/09 at $80	24,750
	Citigroup, Inc.,	
995	06/06 at $47.5	12,437
1,491	06/09 at $10	1,491
28,647	06/09 at $5	100,264
1,991	06/09 at $7.5	1,991
9,529	07/09 at $5	85,761
1,526	07/09 at $3	106,057
5,705	07/09 at $4	128,362
600	09/09 at $7	4,800
350	09/09 at $5	7,350
2,152	09/09 at $2	363,688
11,448	09/09 at $3	915,840
	Clean Harbors, Inc.,	
336	06/09 at $50	162,960
	Compass Minerals International, Inc.,	
75	06/09 at $50	33,375
75	06/09 at $55	12,000
75	06/09 at $60	3,562
	Cubist Pharmaceuticals, Inc.,	
402	06/09 at $17.5	25,125
36	08/09 at $20	2,430
	DIRECTV Group, Inc.,	
50	06/09 at $20	13,375
1,544	06/09 at $25	19,300
449	06/09 at $22.5	38,165

Contracts	WRITTEN CALL OPTIONS[(a)] — 1.49% (Continued)	Value
	DIRECTV Group, Inc. (continued),	
945	06/09 at $27.5	$ 9,450
99	07/09 at $25	3,960
	Emulex Corp.,	
1,299	06/09 at $10	136,395
915	06/09 at $12.5	13,725
	Enterprise Products Partners,	
416	06/09 at $25	40,560
	Fidelity National Information Services, Inc.,	
377	06/09 at $20	6,598
979	06/09 at $17.5	173,773
	Foundation Coal Holdings, Inc.,	
145	06/09 at $25	68,875
571	06/09 at $30	95,642
	Mentor Graphics Corp.,	
1,075	06/09 at $7.5	5,375
	NetApp, Inc.,	
998	06/09 at $20	62,375
209	06/09 at $21	7,315
832	06/09 at $19	91,520
1,396	07/09 at $20	136,110
498	07/09 at $18	103,335
597	07/09 at $21	37,313
1,288	07/09 at $19	189,980
	PepsiCo, Inc.,	
62	06/09 at $52.5	3,410
	Pulte Homes, Inc.,	
3,808	06/09 at $10	57,120
500	06/09 at $9	22,500
4,013	06/09 at $11	20,065
	Schering-Plough Corp.,	
300	06/09 at $24	24,750
249	06/09 at $23	39,218
	Silver Wheaton Corp.,	
198	06/09 at $10	17,325
	Sun Microsystems, Inc.,	
5,000	06/09 at $9	70,000
	Suncor Energy, Inc.,	
299	06/09 at $31	143,520
299	06/09 at $30	170,430
199	06/09 at $32	79,600
100	06/09 at $33	32,000

THE ARBITRAGE FUND

Schedule of Open Options Written (Continued)

May 31, 2009

Contracts	WRITTEN CALL OPTIONS[(a)] — 1.49% (Continued)	Value
	TD Ameritrade Holding Corp.,	
997	06/09 at $15	$ 216,848
99	06/09 at $17.5	4,950
	Windstream Corp.,	
447	06/09 at $7.5	42,465
	Wyeth,	
200	06/09 at $45	14,500
349	06/09 at $42.5	90,740
	Total Written Call Options (Premiums Received $5,445,867)	$ 4,890,285

Contracts	WRITTEN PUT OPTIONS[(a)] — 0.24%	Value
	Agrium, Inc.,	
100	06/09 at $45	$ 8,000
300	06/09 at $50	84,000
	Alpha Natural Resources, Inc.,	
100	06/09 at $27.5	18,000
	Centex Corp.,	
330	06/09 at $10	56,100
657	06/09 at $7.5	16,425
	CF Industries Holdings, Inc.,	
300	06/09 at $65	15,750
	DIRECTV Group, Inc.,	
200	06/09 at $20	3,000
1,463	06/09 at $22.5	128,012
	Emulex Corp.,	
925	06/09 at $10	16,187
	Merck & Co., Inc.,	
149	06/09 at $25	2,607
300	06/09 at $26	10,500
100	06/09 at $27	6,500
	NetApp, Inc.,	
933	06/09 at $15	9,330
899	06/09 at $19	58,435
323	06/09 at $17.5	8,883
978	07/09 at $18	63,570
779	07/09 at $19	81,795
	Pfizer, Inc.,	
649	06/09 at $15	22,391
	Pulte Homes, Inc.,	
300	06/09 at $10	41,250
500	06/09 at $8	13,750
1,467	06/09 at $9	102,690

THE ARBITRAGE FUND

Schedule of Open Options Written (Concluded)

May 31, 2009

Contracts	WRITTEN PUT OPTIONS[a] — 0.24% (Continued)	Value
	Silver Wheaton Corp.,	
99	06/09 at $5	$ 990
	Sun Microsystems, Inc.,	
896	06/09 at $9	11,200
1,145	07/09 at $9	20,038
	Total Written Put Options	
	(Premiums Received $901,459)	$ 799,403
	Total Open Options Written — 1.73%	
	(Premiums Received $6,347,326)	$ 5,689,688

Percentages are based on Net Assets of $328,117,928.

[a] Non-income producing security.

See accompanying notes to financial statements.

1. Organization and Significant Accounting Policies

The Arbitrage Fund (the "Trust") was organized as a Delaware business trust on December 22, 1999 and is registered under the Investment Company Act of 1940, as amended (the "1940 Act"), as an open-end management investment company issuing its shares in series, each series representing a distinct portfolio with its own investment objective and policies. The one series presently authorized is The Arbitrage Fund (the "Fund"), a diversified series, which offers two classes of shares. Class R shares and Class I shares commenced operations on September 17, 2000 and October 17, 2003, respectively.

The investment objective of the Fund is to achieve capital growth by engaging in merger arbitrage.

The Fund's two classes of shares, Class R and Class I, represent interests in the same portfolio of investments and have the same rights, but differ primarily in the expenses to which they are subject and the investment eligibility requirements. Class R shares are subject to an annual distribution fee of up to 0.25% of the Fund's average daily net assets attributable to Class R shares, whereas Class I shares are not subject to any distribution fees.

The following is a summary of the Fund's significant accounting policies:

Use of estimates – The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of increases and decreases in net assets from operations during the reporting period. Actual results could differ from those estimates.

Valuation of investments – The Fund's portfolio securities are valued as of the close of trading of the New York Stock Exchange ("NYSE") (normally 4:00 p.m., Eastern time). Common stocks and other securities, including open short positions, that are traded on a securities exchange are valued at the last quoted sales price at the close of regular trading on the day the valuation is made. Securities which are quoted by NASDAQ are valued at the NASDAQ Official Closing Price. Price information on listed stocks is taken from the exchange where the security is primarily traded. Securities which are listed on an exchange but which are not traded on the valuation date are valued at the mean of the most recent bid and asked prices. Put and call options and securities traded in the over-the-counter market are valued at the mean of the most recent bid and asked prices. Unlisted securities for which market quotations are readily available are valued at the latest quoted bid price. Other assets and securities for which no quotations are readily available are valued at fair value as determined in good faith under the supervision of the Board of Trustees of the Trust. Some of the more common reasons that may necessitate that a security be valued at fair value include: the security's trading has been halted or suspended; the security has been delisted from a national exchange; the security's primary trading market is temporarily closed at a time when under normal conditions it would be open; or the security's primary pricing source is not able or willing to provide a price. Such methods of fair valuation may include, but are not limited to: multiple of earnings, multiple of book value, discount from market of a similar freely traded security, purchase price of a security, subsequent private transactions in the security or related securities, or a combination of these and other factors. Foreign securities are translated from the local currency into U.S. dollars using currency exchange rates supplied by a quotation service (see Note 6). As of May 31, 2009, the market value of securities valued in accordance with the fair value procedures was $6,102,752 and represented 1.9% of net assets.

In September, 2006, the Financial Accounting Standards Board ("FASB") released Statement of Financial Accounting Standards ("SFAS") No. 157, which provides enhanced guidance for using fair value to measure assets and liabilities. The Fund adopted SFAS No. 157 on June 1, 2008. SFAS No. 157 establishes a fair value hierarchy and specifies that a valuation technique used to measure fair value shall maximize the use of observable inputs and minimize the use of unobservable inputs. The objective of a fair value measurement is to determine the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (an exit price). Accordingly, the fair value hierarchy gives the highest priority to quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). The three levels of the fair value hierarchy under SFAS No. 157 are described below:

• Level 1 — Unadjusted quoted prices in active markets for identical, unrestricted assets or liabilities that the Fund has the ability to access at the measurement date;

• Level 2 — Quoted prices which are not active, or inputs that are observable (either directly or indirectly) for substantially the full term of the asset or liability; and

• Level 3 — Prices, inputs or exotic modeling techniques which are both significant to the fair value measurement and unobservable (supported by little or no market activity).

As required by SFAS No.157, investments are classified within the level of the lowest significant input considered in determining fair value. Investments classified within Level 3, whose fair value measurement considers several inputs, may include Level 1 or Level 2 inputs as components of the overall fair value measurement. The table below sets forth information about the level within the fair value hierarchy at which the Fund's investments are measured at May 31, 2009:

	Level 1	Level 2	Level 3	Total
Investments in securities	$ 338,466,452	$5,830,622	$ —	$ 344,297,074
Investments in securities sold short	(139,164,185)	—	—	(139,164,185)
Open options written	(5,689,688)	—	—	(5,689,688)
Other financial instruments*	(6,135,153)	272,130	—	(5,863,023)
Total	$ 187,477,426	$6,102,752	$ —	$ 193,580,178

* Other financial instruments are derivative instruments which include equity swap contracts and forward currency exchange contracts, which are valued at the unrealized appreciation (depreciation) on the instrument.

Share valuation – The net asset value per share of each class of shares of the Fund is calculated daily by dividing the total value of the Fund's assets attributable to that class, less liabilities attributable to that class, by the number of shares of that class outstanding. The offering price and redemption price per share of each class of the Fund is equal to the net asset value per share, except that, shares of each class are subject to a redemption fee of 2% if redeemed within 90 days of the date of purchase. For the year ended May 31, 2009, proceeds from redemption fees were $283,341 in Class R and $4,742 in Class I.

Investment income – Interest income is accrued as earned. Dividend income and expense are recorded on the ex-dividend date.

Dividends and distributions to shareholders – Dividends arising from net investment income and net capital gain distributions, if any, are declared and paid at least annually to shareholders of the Fund. The amount of distributions from net investment income and net realized gains are determined in accordance with Federal income tax regulations which may differ from accounting principles generally accepted in the United States of America. These "book/tax" differences are either temporary or permanent in nature and are primarily due to deferred wash sale losses, deferred post October foreign currency loss and constructive gain from sale of securities.

The tax character of dividends and distributions declared during the years ended May 31, 2009 and May 31, 2008 was as follows:

Year Ended	Ordinary Income	Long-Term Capital Gains	Total Distributions
5/31/09	$ 8,398,398	$ —	$ 8,398,398
5/31/08	10,600,214	400,419	11,000,633

Allocation between classes – Investment income earned, realized capital gains and losses, and unrealized appreciation and depreciation are allocated daily to each class of shares based upon its proportionate shares of total net assets of the Fund. Class specific expenses are charged directly to the class incurring the expense. Common expenses which are not attributable to a specific class are allocated daily to each class of shares based upon its proportionate share of total net assets of the Fund.

Security transactions – Security transactions are accounted for on trade date. Gains and losses on securities sold are determined on a specific identification basis.

Short positions – The Fund may sell securities short for economic hedging purposes. For financial statement purposes, an amount equal to the settlement amount is included in the Statement of Assets and Liabilities as an asset and an equivalent liability. The amount of the liability is subsequently marked-to-market to reflect the current value of the short position. Subsequent fluctuations in the market prices of securities sold, but not yet purchased, may require purchasing the securities at prices which may differ from the market value reflected on the Statement of Assets and Liabilities. The Fund is liable for any dividends payable on securities while those securities are in a short position. As collateral for its short positions, the Fund is required under the 1940 Act to maintain assets consisting of cash, cash equivalents or liquid securities. The amount of the collateral is required to be adjusted daily to reflect changes in the value of the securities sold short.

Written option transactions – The Fund may write (sell) covered call options to hedge portfolio investments and to reduce the risks associated with some of its investments. Put options may also be written by the Fund as part of a merger arbitrage strategy involving a pending corporate reorganization. When the Fund writes (sells) an option, an amount equal to the premium received by the Fund is included in the Statement of Assets and Liabilities as an asset and an equivalent liability. The amount of the liability is subsequently marked-to-market to reflect the current value of the option written. By writing an option, the Fund may become obligated during the term of the option to deliver or purchase the securities underlying the option at the exercise price if the option is exercised. Option contracts are valued at the average of the current bid and asked price reported on the day of valuation. When an option expires on its stipulated expiration date or the Fund enters into a closing purchase transaction, the Fund realizes a gain or loss if the cost of the closing purchase transaction differs from the premium received when the option was sold without regard to any unrealized gain or loss on the underlying security, and the liability related to such option is eliminated. When an option is exercised, the premium originally received decreases the cost basis of the security (or increases the proceeds on a sale of the security).

Equity swap contracts – The Fund may invest in swaps for the purpose of managing its exposure to interest rate, credit or market risk. Additionally, the Fund enters into equity swap agreements for the purpose of attempting to obtain a desired return on, or exposure to, certain equity securities or equity indices in an expedited manner or at a lower cost to the Fund than if the Fund had invested directly in such securities. An equity swap contract entitles the Fund to receive from the counterparty any appreciation and dividends paid on an individual security, while obligating the Fund to pay the counterparty any depreciation on the security. Fluctuations in the value of an open contract are recorded daily as a net unrealized gain or loss. The Fund will realize a gain or loss upon termination or reset of the contract. Either party, under certain conditions, may terminate the contract prior to the contract's expiration date. Collateral, in the form of cash or securities, may be required to be held in segregated accounts with the Fund's custodian and/or counterparty's broker. Risks may exceed amounts recognized on the Statement of Assets and Liabilities. These risks include changes in the returns of the underlying instruments, failure of the counterparties to perform under the contracts' terms and the possible lack of liquidity with respect to the swap agreements. As of May 31, 2009, the Fund had long equity swap contracts outstanding with a market value of $750,593 and short equity swap contracts outstanding with a market value of $1,298,970.

The Fund enters into forward foreign currency exchange contracts as a way of managing foreign exchange rate risk. The Fund may enter into these contracts for the purchase or sale of a specific foreign currency at a fixed price on a future date as a hedge or cross-hedge against either specific transactions or portfolio positions. The objective of the Fund's foreign currency hedging transactions is to reduce risk that the U.S. dollar value of the Fund's securities denominated in foreign currency will decline in value due to changes in foreign currency exchange rates. All foreign currency exchange contracts are "marked-to-market" daily at the applicable translation rates resulting in unrealized gains or losses. Risks may arise upon entering into these contracts from the potential inability of counterparties to meet the terms of their contracts and from unanticipated movements in the value of a foreign currency relative to the U.S. dollar.

Federal income tax – It is the Fund's policy to comply with the special provisions of Subchapter M of the Internal Revenue Code applicable to regulated investment companies. As provided therein, in any fiscal year in which a fund so qualifies and distributes at least 90% of its taxable net income, a fund (but not the shareholders) will be relieved of Federal income tax on the income distributed. Accordingly, no provision for income taxes has been made.

In order to avoid imposition of the excise tax applicable to regulated investment companies, it is also the Fund's intention to declare as dividends in each calendar year at least 98% of its net investment income (earned during the calendar year) and 98% of its net realized capital gains (earned during the twelve months ended October 31) plus undistributed amounts from prior years.

The following information is computed on a tax basis for each item as of May 31, 2009:

Cost of portfolio investments (including equity swap contracts, securities sold short and written options)	$197,324,312
Gross unrealized appreciation	$ 40,163,498
Gross unrealized depreciation	(38,592,986)
Net unrealized appreciation	$ 1,570,512

As of May 31, 2009, the components of Distributable Earnings on a tax basis were as follows:

Undistributed ordinary income	$ 8,443,277
Post-October capital losses	(1,787,513)
Post-October currency losses	(6,240,058)
Net unrealized appreciation	1,570,512
Net unrealized depreciation on translation of assets and liabilities in foreign currencies	(5,774,741)
Other temporary differences	5,744,941
Total Distributable Earnings	$ 1,956,418

The difference between the Federal income tax cost of portfolio investments and the cost reported on the Statement of Assets and Liabilities is due to the tax deferral of losses on wash sales, mark-to-market on open forwards, disallowed losses on tax straddles, gains and losses from Passive Foreign Investment Companies, income from Master Limited Partnerships and gains on the constructive sale of securities.

Post-October capital losses and Post-October currency losses represent losses realized on investment transactions from November 1, 2008 through May 31, 2009 that, in accordance with Federal income tax regulations, the Fund may elect to defer and treat as having arisen in the following year.

For the year ended May 31, 2009, the Fund reclassified net investment gains of $6,574,320 and $152,505 to accumulated net realized gain (loss) and paid-in capital, respectively, on the Statement of Assets and Liabilities. Such reclassification, the result of permanent differences between financial statement and income tax reporting requirements are primarily attributable to gains and losses on certain foreign currency related transactions, investment in Passive Foreign Investment Companies, investments in Master Limited Partnerships, reclassification of short sale related dividend expense to capital loss and non-deductible excise tax, has no effect on the Fund's net asset or net asset value per share.

On July 13, 2006, the FASB released FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes" ("FIN 48"). FIN 48 provides guidance for how uncertain tax positions should be recognized, measured, presented and disclosed in the financial statements. FIN 48 requires the evaluation of tax positions taken or expected to be taken in the course of preparing the Fund's tax returns to determine whether the tax positions are "more-likely-than-not" of being sustained by the applicable tax authority. Tax positions not deemed to meet the more-likely-than-not threshold would be recorded as a tax benefit or expense in the current year. Effective November 30, 2007, the Fund adopted FIN 48. Based on its analysis, management has reviewed all open tax years (2005-2008) and has determined that the adoption of FIN 48 did not have a material impact to the Fund's financial statements upon adoption. However, management's conclusions regarding FIN 48 may be subject to review and adjustment at a later date based on factors including, but not limited to, further implementation guidance expected from the FASB, and ongoing analyses of and changes to tax laws, regulations and interpretations thereof.

2. Investment Transactions

During the year ended May 31, 2009, cost of purchases and proceeds from sales and maturities of investment securities, other than short-term investments, U.S. government securities, equity swap contracts, options and short positions, amounted to $1,736,492,055 and $1,414,148,437, respectively.

3. Line of Credit

The Fund entered into an agreement which enables them to participate in a $10,000,000 unsecured committed revolving line of credit with State Street Bank and Trust Company (the "Custodian"). Borrowings will be made solely to temporarily finance the purchase or sale of securities or to finance the redemption of the shares of an investor of the Fund. Interest is charged to the Fund based on its borrowings at a rate per annum equal to the Custodian's overnight federal funds rate plus 0.75%. In addition, a commitment fee of 0.10% per annum payable at the end of each calendar quarter, is accrued by the Fund based on its average daily unused portion of the line of credit. Such fees are included in custodian and bank service fees on the Statement of Operations.

As of May 31, 2009, the Fund did not have outstanding borrowings. For the year ended May 31, 2009, the Fund had average borrowings of $6,570,364 over a period of 55 days at a weighted average interest rate of 1.41%. Interest accrued on the borrowings during the year ended May 31, 2009 was $10,784.

4. Transactions with Affiliates

INVESTMENT ADVISORY AGREEMENT

The Fund's investments are managed by Water Island Capital, LLC (the "Adviser") under the terms of an Investment Advisory Agreement. Under the Investment Advisory Agreement, as amended and restated on October 1, 2007, the Fund pays the Adviser an annual fee, which is computed and accrued daily and paid monthly, of 1.25% on the first $250 million, 1.20% on the next $50 million, 1.15% on the next $50 million, 1.10% on the next $75 million, 1.05% on the next $75 million and 1.00% for amounts over $500 million, based on the Fund's average daily net assets. Prior to October 1, 2007, the Fund paid the Adviser a fee, which was computed and accrued daily and paid monthly, at an annual rate of 1.50% of the Fund's average daily net assets.

Effective October 1, 2007, the Adviser has contractually agreed, at least until August 31, 2012, to waive its advisory fee and/or reimburse the Fund's other expenses to the extent that total operating expenses (exclusive of interest, taxes, dividends on short positions, brokerage commissions and other costs incurred in connection with the purchase or sale of portfolio securities) exceed the annual rate of 1.88% of the Fund's average daily net assets attributable to Class R shares and 1.63% of the Fund's average daily net assets attributable to Class I shares. Prior to October 1, 2007, the Adviser had contractually agreed, at least until August 31, 2012, to waive its advisory fee and/or reimburse the Fund's other expenses to the extent that total operating expenses (exclusive of interest, taxes, dividends on short positions, brokerage commissions and other costs incurred in connection with the purchase or sale of portfolio securities) exceeded the annual rate of 1.95% of the Fund's average daily net assets attributable to Class R shares and 1.70% of the Fund's average daily net assets attributable to Class I shares.

The Adviser is permitted to recapture fees waived or expenses reimbursed to the extent actual fees and expenses for a period are less than the expense limitation of each class, provided, however, that the Adviser shall only be entitled to recapture such amounts for a period of three years from the end of the fiscal year during which such amount was waived or reimbursed. The Adviser cannot recapture any expenses or fees it waived or reimbursed prior to October 1, 2007 under the prior Expense Waiver and Reimbursement Agreement. The Adviser can recapture any expenses or fees it has waived or reimbursed after October 1, 2007 within a three-year period subject to the applicable annual rate of 1.88% for Class R shares and 1.63% for Class I shares. As of May 31, 2009, there are no future recapture amounts from the Fund fees waived and expenses reimbursed. During the year ended May 31, 2009, the Adviser was reimbursed previously waived fees in the amount of $8,157. As of May 31, 2009, there is $0 left to recapture.

Certain officers of the Trust are also officers of the Adviser. Effective October 1, 2004, the Vice President of the Trust also serves as Chief Compliance Officer ("CCO") of the Trust and of the Adviser. The Fund pays the Adviser 15% of the CCO's salary for providing CCO services.

ADMINISTRATION AGREEMENT

Under the terms of an Administration Agreement, SEI Investments Global Funds Services ("SEIGFS") supplies administrative and regulatory services to the Fund, supervises the preparation of tax returns, and coordinates the preparation of reports to shareholders and filings with the Securities and Exchange Commission and state securities authorities. For the performance of these administrative services including fund accounting services, SEIGFS receives a monthly fee at an annual rate of 0.10% of the Fund's average daily net assets up to $250 million; 0.095% of such assets on the next $250 million; and 0.08% of such assets in excess of $500 million, subject to a minimum annual fee of $200,000 for the period beginning September 1, 2008 and ending August 31, 2009. The minimum annual fee increases to $225,000 for the period beginning September 1, 2009 and ending August 31, 2011, pursuant to the current Administration Agreement between SEIGFS and the Fund dated May 17, 2005, as amended July 25, 2008. Prior to September 1, 2008, SEIGFS received a monthly fee at an annual rate of 0.10% of the Fund's average daily net assets up to $500 million; and 0.08% of such assets in excess of $500 million, subject to a minimum fee of $150,000 per year. For the year ended May 31, 2009, SEIGFS was paid $224,805 under the administration agreement. Certain officers of the Trust are also officers of SEIGFS. Such officers are paid no fees by the Trust for serving as officers of the Trust.

TRANSFER AGENT AND SHAREHOLDER SERVICES AGREEMENT

Under the terms of a Transfer Agent and Shareholder Services Agreement between the Trust and DST Systems, Inc. ("DST"), DST maintains the records of each shareholder's account, answers shareholders' inquiries concerning their accounts, processes purchases and redemptions of Fund shares, acts as dividend and distribution disbursing agent and performs other shareholder service functions. For these services, DST receives from the Fund a monthly complex minimum fee, including two cusips, at an annual rate of $50,000 per year. For each cusip thereafter, an additional fee is applied at a minimum fee of $17,500 per cusip per year. For the year ended May 31, 2009, DST was paid $180,738 under the transfer agent and shareholder services agreement.

DISTRIBUTION AGREEMENT

The Fund has adopted a plan of distribution pursuant to Rule 12b-1 under the 1940 Act (the "Plan") for Class R shares, which permits Class R to pay for expenses incurred in the distribution and promotion of Class R shares. Under the Plan, Class R may pay compensation to any broker-dealer with whom the distributor or the Fund, on behalf of Class R shares, has entered into a contract to distribute Class R shares, or to any other qualified financial services firm, for distribution and/or shareholder-related services with respect to shares held or purchased by their respective customers in connection with the purchase of shares attributable to their efforts. The amount of payments under the Plan in any year shall not exceed 0.25% annually of the average daily net assets allocable to Class R shares. During the year ended May 31, 2009, the Fund paid Class R distribution expenses of $350,896 pursuant to the Plan.

Under the terms of a Distribution Agreement between the Trust and SEI Investments Distribution, Co. (the "Distributor"), the Distributor serves as principal underwriter and national distributor for the shares of the Fund. The Fund's shares are sold on a no-load basis and, therefore, the Distributor receives no sales commissions or sales loads for providing services to the Fund. The Distributor is an affiliate of SEI Investments Global Funds Services.

5. Capital Share Transactions

Proceeds and payments on capital shares as shown in the Statement of Changes in Net Assets are the result of the following capital share transactions for the years shown:

	Year Ended May 31, 2009	Year Ended May 31, 2008
CLASS R		
Shares sold	14,891,867	4,797,247
Shares issued in reinvestment of distributions	425,130	419,178
Shares redeemed	(6,436,124)	(2,279,530)
Net increase in shares outstanding	8,880,873	2,936,895
Shares outstanding at beginning of year	8,761,989	5,825,094
Shares outstanding at end of year	17,642,862	8,761,989

	Year Ended May 31, 2009	Year Ended May 31, 2008
CLASS I		
Shares sold	5,669,231	2,665,511
Shares issued in reinvestment of distributions	246,467	361,043
Shares redeemed	(3,602,609)	(3,764,040)
Net increase (decrease) in shares outstanding	2,313,089	(737,486)
Shares outstanding at beginning of year	6,317,846	7,055,332
Shares outstanding at end of year	8,630,935	6,317,846

6. Foreign Currency Translation

Amounts denominated in or expected to settle in foreign currencies are translated to U.S. dollars based on exchange rates on the following basis:

A. The market values of investment securities and other assets and liabilities are translated at the closing rate of exchange each day.

B. Purchases and sales of investment securities and income and expenses are translated at the rate of exchange prevailing on the respective dates of such transactions.

C. The Fund does not isolate that portion of the results of operations caused by changes in foreign exchange rates on investments from those caused by changes in market prices of securities held. Such fluctuations are included with the net realized and unrealized gains or losses on investments.

Reported net realized foreign exchange gains or losses arise from 1) purchases and sales of foreign currencies, 2) currency gains or losses realized between the trade and settlement dates on securities transactions and 3) the difference between the amounts of dividends, interest and foreign withholding taxes recorded on the Fund's books, and the U.S. dollar equivalent of the amounts actually received or paid. Reported net unrealized foreign exchange gains and losses arise from changes in the value of assets and liabilities, other than investment securities, resulting from changes in exchange rates.

7. Contingencies and Commitments

The Fund indemnifies the Trust's officers and trustees for certain liabilities that might arise from their performance of their duties to the Fund. Additionally, in the normal course of business the Fund enters into contracts that contain a variety of representations and warranties and which provide general indemnifications. The Fund's maximum exposure under these arrangements is unknown, as this would involve future claims that may be made against the Fund that have not yet occurred. However, based on experience, the Fund expects the risk of loss to be remote.

8. Securities Lending

In order to generate additional income, the Fund may, from time to time, lend its portfolio securities to broker-dealers, banks or institutional borrowers of securities. The Fund must receive 100% collateral in the form of cash or U.S. government securities. This collateral must be valued daily and, should the market value of the loaned securities increase, the borrower must furnish additional collateral to the Fund. During the time portfolio securities are on loan, the borrower pays the Fund any dividends or interest paid on such securities. Loans are subject to termination by the Fund or the borrower at any time. While the Fund does not have the right to vote securities on loan, it has the right to terminate the loan and regain the right to vote if that is considered important with respect to the investment. In the event the borrower defaults in its obligation to the Fund, the Fund bears the risk of delay in the recovery of its portfolio securities and the risk of loss of rights in the collateral. The Fund will only enter into loan arrangements with broker-dealers, banks or other institutions which the Adviser has determined are creditworthy under guidelines established by the Trustees. There were no securities on loan as of May 31, 2009.

9. Derivative Contracts

Written Options — A summary of put and call option contracts written during the year ended May 31, 2009 is as follows:

	Option Contracts	Option Premiums
Options outstanding at beginning of year	12,218	$ 1,063,309
Options written	376,008	35,084,456
Options canceled in a closing purchase transaction	(38,897)	(5,314,604)
Options exercised	(78,458)	(11,737,393)
Options expired	(155,122)	(12,748,442)
Options outstanding at end of year	115,749	$ 6,347,326

Forward Currency Exchange Contracts — As of May 31, 2009, the Fund had forward currency exchange contracts outstanding as follows:

Settlement Date		Currency to Deliver		Currency to Receive	Unrealized Appreciation (Depreciation)
06/12/09	AUD	53,371,619	USD	37,262,336	$ (5,415,088)
06/12/09.	CAD	30,820,373	USD	24,871,843	(3,259,717)
06/12/09	CHF	5,725,600	USD	4,946,066	(424,064)
06/12/09	EUR	6,648,725	USD	8,681,594	(728,001)
06/12/09	GBP	5,221,000	USD	7,701,210	(716,988)
06/12/09	JPY	2,170,000	USD	23,189	451
06/12/09	NOK	13,406,792	USD	1,911,982	(218,842)
06/12/09	USD	10,489,448	AUD	15,150,000	1,624,912
06/12/09	USD	18,579,050	CAD	22,915,000	2,336,813

Settlement Date		Currency to Deliver		Currency to Receive	Unrealized Appreciation (Depreciation)
06/12/09	USD	4,965,441	CHF	5,725,600	404,689
06/12/09	USD	6,536,335	EUR	5,013,696	559,288
06/12/09	USD	291,080	GBP	200,000	31,395
06/12/09	USD	21,817	JPY	2,170,000	921
06/12/09	USD	1,370,281	NOK	9,000,000	60,145
					$ (5,744,086)

AUD — Australian Dollar
CAD — Canadian Dollar
CHF — Swiss Franc
EUR — Euro
GBP — British Pound
JPY — Japanese Yen
NOK — Norwegian Krone
USD — United States Dollar

Fair Value of Derivative Instruments — The fair value of derivative Instruments as of May 31, 2009, was as follows:

	Asset Derivatives Year ended May 31, 2009		Liability Derivatives Year ended May 31, 2009	
Derivatives not accounted for as hedging instruments under Statement 133:	**Balance Sheet Location**	**Fair Value**	**Balance Sheet Location**	**Fair Value**
Forward Currency Exchange Contracts	Unrealized appreciation on forward currency exchange contracts	$5,018,614	Unrealized depreciation on forward currency exchange contracts	$10,762,700
Equity Swap Contracts	Unrealized appreciation on equity swap contracts	272,130	Unrealized depreciation on equity swap contracts	391,067
Equity Option Contracts	Investments, at value	4,610,907	Written Options, at value	5,689,688
Total Derivatives not accounted for as hedging instruments under Statement 133		$9,901,651		$16,843,455

The effect of derivative instruments on the Statement of Operations for the year ended May 31, 2009, was as follows:

Amount of Realized Gain or (Loss) on Derivatives Recognized in Income

Derivatives Not Accounted for as Hedging Instruments under Statement 133	Options	Forward Currency Contracts	Swaps	Total
Forward Currency Exchange Contracts	$ —	$4,515,636	$ —	$ 4,515,636
Equity Swap Contracts	—	—	(5,245,013)	(5,245,013)
Equity Option Contracts	7,660,668	—	—	7,660,668
Total	$7,660,668	$4,515,636	$(5,245,013)	$ 6,931,291

Change in Unrealized Appreciation or (Depreciation) on Derivatives Recognized in Income

Derivatives Not Accounted for as Hedging Instruments under Statement 133	Options	Forward Currency Contracts	Swaps	Total
Forward Currency Exchange Contracts	$ —	$(5,217,366)	$ —	$(5,217,366)
Equity Swap Contracts	—	—	(1,094)	(1,094)
Equity Option Contracts	1,034,112	—	—	1,034,112
Total	$ 1,034,112	$(5,217,366)	$(1,094)	$(4,184,348)

10. New Accounting Pronouncements

In October 2008, the FASB issued Staff Position 157-3, *Determining the Fair Value of a Financial Asset in a Market That Is Not Active* ("FSP 157-3"), which clarifies the application of SFAS 157 in an inactive market and provides an illustrative example to demonstrate how the fair value of a financial asset is determined when the market for that financial asset is not active. The guidance provided by FSP 157-3 did not have an impact on the Fund's approach to valuing financial assets.

In April 2009, the FASB Staff issued Position No. 157-4 — *Determining Fair Value when the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly* ("FSP 157-4") was issued. FSP 157-4 clarifies the process for measuring the fair value of financial instruments when the markets become inactive and quoted prices may reflect distressed transactions. FSP 157-4 provides a non-exclusive list of factors a reporting entity should consider when determining whether there has been a significant decrease in the volume and level of activity for an asset or liability when compared with normal market activity. Under FSP 157-4, if a reporting entity concludes there has been a significant decrease in volume and level of activity for the asset or liability (or similar assets or liabilities), transactions or quoted prices may not be determinative of fair value. Further analysis of the transactions or quoted prices is needed, and a significant adjustment to the transactions or quoted prices may be necessary to estimate fair value in accordance with FASB Statement No. 157 — *Fair Value Measurement.* FSP 157-4 is effective for interim and annual reporting periods ending after June 15, 2009, and shall be applied prospectively. At this time, management is evaluating the impact of FSP 157-4 on the Fund's financial statements.

In May 2009, the FASB issued SFAS No. 165, SUBSEQUENT EVENTS ("SFAS 165"). SFAS 165 provides authoritative accounting literature related to evaluating subsequent events that was previously addressed only in the auditing literature, and is largely similar to the current guidance in the auditing literature with some exceptions that are not intended to result in significant changes in practice. SFAS 165 defines subsequent events and also requires the disclosure of the date through which an entity has evaluated subsequent events and the basis for that date. SFAS 165 is effective on a prospective basis for interim or annual financial periods ending after June 15, 2009. We plan to adopt SFAS 165 in the third quarter of Fiscal 2009 and do not expect it to have a material impact on our financial statements.

Report of Independent Registered Public Accounting Firm

To the Board of Trustees and Shareholders
The Arbitrage Fund

We have audited the accompanying statement of assets and liabilities of The Arbitrage Fund (the "Fund"), including the schedules of investments as of May 31, 2009, and the related statements of operations and cash flows for the year then ended, the statement of changes in net assets for each of the two years in the period then ended, and the financial highlights for each of the five years in the period then ended. These financial statements and financial highlights are the responsibility of the Fund's management. Our responsibility is to express an opinion on these financial statements and financial highlights based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements and financial highlights are free of material misstatement. The Trust is not required to have, nor were we engaged to perform an audit of the Trust's internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Trust's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. Our procedures included confirmation of securities owned as of May 31, 2009 by correspondence with the custodian and brokers or by other appropriate auditing procedures where replies from brokers were not received. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements and financial highlights referred to above present fairly, in all material respects, the financial position of The Arbitrage Fund as of May 31, 2009, the results of its operations and cash flows for the year then ended, the changes in its net assets for each of the two years in the period then ended, and the financial highlights for each of the five years in the period then ended, in conformity with accounting principles generally accepted in the United States of America.

TAIT, WELLER & BAKER LLP

Philadelphia, Pennsylvania
July 28, 2009

Disclosure of Fund Expenses (Unaudited)

All mutual funds have operating expenses. As a shareholder of a mutual fund, your investment is affected by these ongoing costs, which include (among others) costs for portfolio management, administrative services, distribution (12b-1) expenses, and shareholder reports like this one. It is important for you to understand the impact of these costs on your investment returns.

Operating expenses such as these are deducted from a mutual fund's gross income and directly reduce its final investment return. These expenses are expressed as a percentage of a mutual fund's average net assets; this percentage is known as a mutual fund's expense ratio.

The following examples use the expense ratio and are intended to help you understand the ongoing costs (in dollars) of investing in your Fund and to compare these costs with those of other mutual funds. The examples are based on an investment of $1,000 made at the beginning of the period shown and held for the entire period.

The table on the following page illustrates your Fund's costs in two ways.

• **Actual Fund Return.** This section helps you to estimate the actual expenses after fee waivers that your Fund incurred over the period. The "Expenses Paid During Period" column shows the actual dollar expense cost incurred by a $1,000 investment in the Fund, and the "Ending Account Value" number is derived from deducting that expense cost from the Fund's gross investment return.

You can use this information, together with the actual amount you invested in the Fund, to estimate the expenses you paid over that period. Simply divide your actual account value by $1,000 to arrive at a ratio (for example, an $8,600 account value divided by $1,000 = 8.6), then multiply that ratio by the number shown for your Fund under "Expenses Paid During Period."

• **Hypothetical 5% Return.** This section helps you compare your Fund's costs with those of other mutual funds. It assumes that the Fund had an annual 5% return before expenses during the year, but that the expense ratio (Column 3) for the period is unchanged. This example is useful in making comparisons because the Securities and Exchange Commission requires all mutual funds to make this 5% calculation. You can assess your Fund's comparative cost by comparing the hypothetical result for your Fund in the "Expenses Paid During Period" column with those that appear in the same charts in the shareholder reports for other mutual funds.

Note: Because the return is set at 5% for comparison purposes — NOT your Fund's actual return — the account values shown may not apply to your specific investment.

	Beginning Account Value December 1, 2008	Ending Account Value May 31, 2009	Annualized Expense Ratios†	Expenses Paid During Period*
The Arbitrage Fund – Class R				
Based on Actual Fund Return	$1,000.00	$1,119.80	3.85%	$20.35
Based on Hypothetical 5% Return (before expenses)	$1,000.00	$1,005.73	3.85%	$19.25
The Arbitrage Fund – Class I				
Based on Actual Fund Return	$1,000.00	$1,119.70	3.62%	$19.13
Based on Hypothetical 5% Return (before expenses)	$1,000.00	$1,006.88	3.62%	$18.11

† The annualized expense ratios include dividend, interest, and interest rebate expense incurred during the six-month period.

* Expenses are equal to the annualized expense ratios for the period, multiplied by the average account value over the period, multiplied by 182/365 (to reflect the one-half year period).

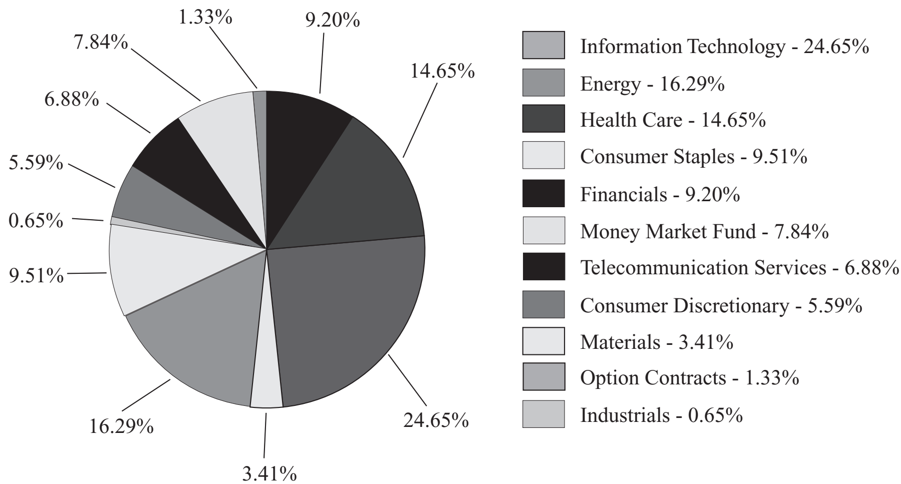
	Beginning Account Value December 1, 2008	Ending Account Value May 31, 2009	Annualized Expense Ratios†	Expenses Paid During Period*
The Arbitrage Fund – Class R				
Based on Actual Fund Return	$1,000.00	$1,119.80	2.00%	$10.57
Based on Hypothetical 5% Return (before expenses)	$1,000.00	$1,014.96	2.00%	$10.05
The Arbitrage Fund – Class I				
Based on Actual Fund Return	$1,000.00	$1,119.70	1.77%	$ 9.35
Based on Hypothetical 5% Return (before expenses)	$1,000.00	$1,016.11	1.77%	$ 8.90

† The annualized expense ratios exclude dividend, interest, and interest rebate expense incurred during the six-month period.

* Expenses are equal to the annualized expense ratios for the period, multiplied by the average account value over the period, multiplied by 182/365 (to reflect the one-half year period).

Sector Weighting (as a percentage of total investments)

The following chart shows the Fund's sector weightings as of the report date.



A description of the policies and procedures that the Fund uses to vote proxies relating to portfolio securities is available without charge upon request by calling toll-free 1-800-295-4485, or on the Securities and Exchange Commission's ("SEC") website at http://www.sec.gov. Information regarding how the Fund voted proxies relating to portfolio securities during the most recent 12-month period ended June 30 is available without charge upon request by calling toll-free 1-800-295-4485, or on the SEC's website at http://www.sec.gov.

The Trust files a complete listing of portfolio holdings for the Fund with the SEC as of the first and third quarters of each fiscal year on Form N-Q. The filings are available upon request, by calling 1-800-295-4485. Furthermore, you may obtain a copy of the filing on the SEC's website at http://www.sec.gov. The Fund's Forms N-Q may also be reviewed and copied at the SEC's Public Reference Room in Washington, D.C., and information on the operation of the Public Reference Room may be obtained by calling 1-800-SEC-0330.

On April 21, 2009, the Board of Trustees (the "Board") of The Arbitrage Fund (the "Fund"), including a majority of its independent Trustees, approved the continuation of the Fund's investment advisory agreement with Water island Capital, LLC, the Fund's investment adviser (hereafter referred to as the "Adviser"). The Board determined that continuation of the investment advisory agreement was in the best interests of the Fund and its shareholders.

The Board based its decision upon its most recent review of the Adviser's investment personnel, portfolio management process, and performance. The Board discussed the factors below, among others. However, no single factor determined whether the Board approved the continuation of the investment advisory agreement. Rather, it was the totality of the factors that led to the decision.

Nature, Extent, and Quality of Services

The Board considered the experience of the personnel managing the Fund's assets as well as the quality of the Fund's investment management over both short- and long-term periods. The Board concluded the Adviser has provided high quality consistent service to the Fund and its shareholders.

Cost

The Board considered the Fund's overall expense ratio, comparing it to other similarly managed mutual funds. In its consideration of the Fund's overall expense ratio, the Board also considered the Adviser's long term commitment to cap operating expenses reflected first in its decision to waive a portion of its advisory fee, and then in its decision to permanently lower its advisory fee. The Board during its review of costs considered the Fund's advisory fee, comparing the fee to other funds offering similar investment strategies.

The Board recognized that the Fund's overall expense ratio is somewhat higher than the average of comparably managed funds but concluded shareholders are receiving a quality investment option for a reasonable price. The Board also concluded that, although the advisory fees payable to the Adviser are somewhat higher than the average of fees for other comparably managed funds, the fees are reasonable given the quality of services provided by the Adviser and the complexity of investment strategies implemented by the Adviser.

Profitability of Adviser

The Board considered the Adviser's profitability with regards to its management of the Fund, concluding that the Adviser's profitability was not excessive and therefore was a secondary factor in connection with the evaluation of advisory fees paid by the Fund.

The Board considered the Fund's short- and long-term performance, including any periods of outperformance or underperformance of relevant benchmarks and peer groups. The Board concluded that the Fund's performance warranted continuation of the investment advisory agreement.

Economies of Scale and Ancillary Benefits

The Board concluded, given the size of the Fund's assets at the present time, it would not be relevant to consider the extent to which economies of scale would be realized as the Fund grows, and whether fee levels reflect potential future economies of scale.

The Board also considered the "ancillary benefits" to the Adviser, viewing these as secondary factors in connection with the evaluation of the reasonableness of the advisory fees paid by the Fund. The Board did consider the level of soft dollar activity, concluding that research derived from these trades was useful to the Fund and its shareholders.

Board of Trustees and Officers (Unaudited)

Overall responsibility for management of the Fund rests with the Board of Trustees. The Trustees serve during the lifetime of the Trust and until its termination, or until death, resignation, retirement or removal. The Trustees, in turn, elect the officers of the Fund to actively supervise its day-to-day operations. The officers have been elected for an annual term. The following are the Trustees and executive officers of the Fund:

Trustee/ Executive Officer	Address	Age	Position Held with the Trust	Length of Time Served
*John S. Orrico, CFA	41 Madison Avenue, 28th Floor New York, NY 10010	49	President, Secretary, Treasurer and Trustee	Since May 2000
*Joel C. Ackerman	295 Central Park West New York, NY 10024	64	Trustee	Since May 2000
John C. Alvarado	Power Capital Partners LLC 575 Madison Avenue, 10th Floor New York, NY 10022	49	Trustee	Since December 2003
Burtt R. Ehrlich	One Landmark Square, 22nd Floor Stanford, CT 06901	70	Trustee	Since March 2005
Jay N. Goldberg	Hudson Venture Partners 535 Fifth Avenue, 14th Floor New York, NY 10017	68	Trustee	Since May 2000
Matthew Hemberger	41 Madison Avenue, 28th Floor New York, NY 10010	50	Vice President, Chief Compliance Officer and Anti-Money Laundering Compliance Officer	Since May 2000
Eric Kleinschmidt	One Freedom Valley Drive Oaks, PA 19456	41	Chief Financial Officer	Since July 2005
Carolyn Mead	One Freedom Valley Drive Oaks, PA 19456	52	Assistant Vice President and Assistant Secretary	Since November 2008
Bernadette Sparling	One Freedom Valley Drive Oaks, PA 19456	32	Assistant Vice President and Assistant Secretary	Since November 2008
Joseph M. Gallo	One Freedom Valley Drive Oaks, PA 19456	36	Assistant Vice President and Assistant Secretary	Since October 2007

* Messrs. Orrico and Ackerman are "interested persons" of the Trust within the meaning of Section 2(a)(19) of the Investment Company Act of 1940.

Each Trustee oversees one portfolio of the Trust. The principal occupations of the Trustees and executive officers of the Fund during the past five years and public directorships held by the Trustees are set forth below:

John S. Orrico is General Partner of the Adviser. Prior to January 2000, he was Portfolio Manager to private trusts and entities at Lindemann Capital Partners, L.P. and Gruss and Co. (financial management firms).

Joel C. Ackerman is currently a consultant to the Fund's Adviser. During 2003, he was a Partner with Crossroads Investments LP and a Partner with LRL Capital (hedge fund). Prior to September 2002, he was a Partner of Ardsley Partners (hedge fund).

John C. Alvarado is a Managing Member of Power Capital Partners, LLC which is a financial advisory and consulting firm. He is currently Chief Financial Officer of Wax Inc. (men's retail apparel), a Managing Director of Energy Finance Merchants, LLC, and Managing Member of Gordon Alvarado LLC. From 1995 to 2000, he was senior Vice President, Co-Founder and Partner of Stratum Group LP, which is a private equity investment firm.

Burtt R. Ehrlich has served as director of Armor Holdings, Inc. since January 1996, director of Clarus Corp. since June 2002, and as a member of the Board of Directors of Langer, Inc. since February 2001. Mr. Ehrlich served as Chairman and Chief Operating Officer of Ehrlich Bober Financial Corp. (the predecessor of Benson Eyecare Corporation) from December 1986 until October 1992, and as a director of Benson Eyecare Corporation from October 1992 until November 1995.

Jay N. Goldberg is General Partner of Hudson Ventures (a venture capital company).

Matthew Hemberger is Chief Compliance Officer of the Adviser, Chief Compliance Officer to the Trust, and Anti-Money Laundering Compliance Officer to the Trust. Prior to March 2001, he was an Analyst, Assistant Portfolio Manager, and CFO at Lindemann Capital Partners, L.P.

Eric Kleinschmidt is Chief Financial Officer to the Trust. He has been employed by SEI Investments since 1995 and is Director of SEI Investments Fund Accounting since 2004, after serving as Manager from 1999 to 2004.

Joseph M. Gallo is Assistant Vice President and Assistant Secretary to the Trust. He is also Corporate Counsel to the Administrator. Prior to joining SEI, he was Associate Counsel of ICMA Retirement Corporation from 2004 to 2007. From 2002 to 2004, he was a Federal Investigator for the U.S. Department of Labor.

Carolyn Mead is Assistant Vice President and Assistant Secretary to the Trust. She is also Corporate Counsel to the Administrator. Prior to joining SEI, Carolyn served as Associate Counsel at Stradley, Ronon, Stevens & Young. Carolyn also was Associate Counsel at ING Variable Annuities from 1999 to 2002. From 1994 to 1999, she was a Senior Compliance Administrator at PFPC, Inc.

Bernadette Sparling is Assistant Vice President and Assistant Secretary to the Trust. She is also Corporate Counsel to the Administrator and Team Leader of the unit that supports Investment Management Services Department of SEI. Prior to joining SEI, Bernadette was Associate Counsel at Blank Rome LLP from 2001 to 2005.

Additional information about members of the Board of Trustees and Officers is available in the Statement of Additional Information (SAI). To obtain a free copy of the SAI, please call 1-800-295-4485.

THE ARBITRAGE FUND
Notice to Shareholders (Unaudited)

For shareholders that do not have a May 31, 2009 tax year end, this notice is for informational purposes only. For shareholders with a May 31, 2009 tax year end, please consult your tax advisor as to the pertinence of this notice. For the fiscal year ended May 31, 2009, the Fund is designating the following items with regard to distributions paid during the year.

Long Term Capital Gain Distributions	Ordinary Income Distributions	Total Distributions	Qualifying Dividends (1)	Qualifying Dividend Income (2)	Qualifying Interest Income (3)	Qualifying Short-Term Capital Gain(4)
0.00%	100.00%	100.00%	1.89%	3.49%	0.00%	100.00%

(1) Qualifying dividends represent dividends which qualify for the corporate dividends received deduction and are reflected as a percentage of "Ordinary Income Distributions" (the total of short-term capital gain and net investment income distributions).

(2) The percentage in this column represents the amount of "Qualifying Dividend Income" as created by the Jobs and Growth Tax Relief Reconciliation Act of 2003 and is reflected as a percentage of "Ordinary Income Distributions" (the total of short-term capital gain and net investment income distributions). It is the intention of the aforementioned Fund to designate the maximum amount permitted by law.

(3) The percentage in this column represents the amount of "Qualifying Interest Income" as created by the American Jobs Creation Act of 2004 and is reflected as a percentage of net investment income distributions that is exempt from U.S. withholding tax when paid to foreign investors.

(4) The percentage in this column represents the amount of "Qualifying Short-Term Capital Gain" as created by the American Jobs Creation Act of 2004 and is reflected as a percentage of short-term capital gain distributions that is exempt from U.S. withholding tax when paid to foreign investors.

The information reported herein may differ from the information and distributions taxable to the shareholders for the calendar year ending December 31, 2009. Complete information will be computed and reported in conjunction with your Form 1099-DIV.

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THE ARBITRAGE FUND

800-295-4485
www.thearbfund.com

Adviser **Water Island Capital, LLC**
41 Madison Avenue
28th Floor
New York, NY 10010

Distributor **SEI Investments Distribution Co.**
One Freedom Valley Drive
Oaks, PA 19456

Transfer Agent **DST Systems, Inc.**
P.O. Box 219842
Kansas City, MO 64121-9842

Custodian **State Street Bank and Trust Company**
225 Liberty Street
New York, NY 10281

ARB (7/09)