CARMIGNAC MERGER ARBITRAGE: LETTER FROM THE PORTFOLIO MANAGERS

10/07/2024 | FABIENNE CRETIN-FUMERON, STÉPHANE DIEUDONNÉ

Dear investors,

The Merger Arbitrage strategy had a rather paradoxical second quarter in 2024.

On the one hand, all the signs were positive at the start of the year: a **strong upturn in M&A activity with, in particular, a return to deals over $10bn, attractive yields, deal failure rates below the historical average and a few increased bids.**

However, the performance of the strategy was disappointing. The HFRX index fell by 2.6% over the quarter. Against this difficult backdrop, we managed to preserve the capital of our funds with positive performances of 0.26% for Carmignac Portfolio Merger Arbitrage (I EUR Acc shareclass) and 0.71% for Carmignac Portfolio Merger Arbitrage Plus (I EUR Acc shareclass). But these performances are still below the cost of financing, which is also, in a way, a disappointment.

Several factors may explain this paradox.

First, **a series of idiosyncratic events disrupted the trajectory of some spreads that were widely held by other arbitrageurs.**We can cite three examples.

The first is obviously Tapestry's acquisition of Capri in the US handbag sector. In April, against all expectations, the FTC ruled that the merger posed a risk of price increases in a market segment with low barriers to entry. Capri's shares fell sharply during the quarter to a level close to the one estimated in the event of the deal's failure. The case is now in court, with a ruling expected in September.

The second is Chevron's acquisition of Hess, another oil company. The spread has proved highly volatile under the combined effect of geopolitical tensions in Guyana, dissatisfaction with the price among some shareholders and the ongoing dispute between Chevron and Exxon. If all goes well, the deal should be finalised before the end of the year.

The third example is the acquisition of the British packaging company DS Smith. The buyer, International Paper, which was to pay with its own shares, was itself the subject of a bid proposal from the Brazilian company Suzano. The DS Smith/International Paper spread, fell sharply, partly as a result of the rise in International Paper's share price. At the end of the quarter, Suzano announced that it was dropping its acquisition plans, which resulted in a significant tightening of the DS Smith/International Paper spread.

All in all, although these three events did not result in the failure of the deals concerned, however, the resulting volatility left its mark on Merger Arbitrage's portfolios.

Another factor explaining the paradox of a disappointing performance in a buoyant environment is that, **under pressure from the competition authorities, particularly in the United States, deals are taking longer to be finalised.**The impact of a deal taking longer than expected can be significant for the arbitrageur. In fact, it sometimes only takes a quarter's delay for the annualised return on a deal to end up below the cost of capital.

While an in-depth study known as a 2nd Request used to be the exception in the FTC's analysis process, it now seems to have become the rule. As a result, even transactions presenting only a low antitrust risk must now undergo a 2nd Request, which may lead to court action.

Recent examples include the Hess/Chevron and Pioneer Natural Resources/Exxon Mobil transactions in the oil sector, both of which were the subject of in-depth investigations despite the fact that there were almost no competition concerns in either case. In the healthcare sector, we might also mention two deals, Catalent/Novo Holding and Cerevel Therapeutics/AbbVie, currently in 2nd request. Although this is a sensitive sector in the eyes of the competition authorities, these two transactions do not seem to us to represent a major risk for the American consumer.

Since her appointment, the new chair of the FTC has consistently stated that she wants to strengthen the role of the competition authorities. While the FTC was unsuccessful in several court cases last year (Activision and Horizon Therapeutics), it has **to be recognised that the pressure on M&A transactions between US players has increased. With the presidential election looming, a political dimension has undeniably been added to the purely industrial and strategic analysis carried out by the FTC.**

In its latest monthly commentary on Merger Arbitration, Morgan Stanley noted that **some fifteen deals were currently under in-depth investigation, compared with an average of half that number over the previous 4 years.**

In the end, as the market did not fully anticipate this change of regime at the start of the year, returns on a number of deals ended up being lower than expected due to the longer duration of the deals.

The final factor explaining the paradox is technical.

In this environment, where deals can be more volatile or take longer than expected, **some multi-asset funds with very tight risk constraints have had to scale back or even close Merger Arbitrage portfolios.**Bloomberg reports that Millenium closed a Merger Arbitrage pod in April following performance problems with Capri and US Steel, and that Balyasny AM and Schonfeld Strategic Advisors did the same in June.

The closure of these Merger Arbitrage funds means that the least liquid spreads have widened, without any specific fundamental news. This self-sustaining liquidity phenomenon explains part of the underperformance of the Merger Arbitrage strategy during the quarter.

For the second half of the year, we remain confident for several reasons:

- The portfolio's embedded yield is at historically high levels.
- M&A activity, although slowing slightly ahead of the US elections, is continuing on a solid trajectory, which should make 2024 a year of recovery for the cycle.
- The market is now more cautious in its estimates of the duration of new deals announced, which should limit the negative impact of any extension on expected returns.
- The companies themselves have also taken account the more difficult antitrust environment when announcing deals, which should probably reduce the risk of a 2nd Request in the future.

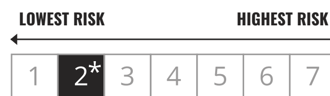
The Merger Arbitrage Team

CARMIGNAC PORTFOLIO MERGER ARBITRAGE I EUR ACC

(ISIN: LU2585801090)

SFDR - Fund Classification** :

Article 8



Recommended minimum investment horizon

MAIN RISKS OF THE FUND

EQUITY: The Fund may be affected by stock price variations, the scale of which is dependent on external factors, stock trading volumes or market capitalization. **ARBITRAGE**: Arbitrage seeks to benefit from such price differences (e.g. in markets, sectors, securities, currencies). If arbitrage performs unfavorably, an investment may lose its value and generate a loss for the Sub-Fund. **RISK ASSOCIATED WITH THE LONG/SHORT STRATEGY**: This risk is linked to long and/or short positions designed to adjust net market exposure. The Fund may suffer high losses if its long and short positions undergo simultaneous unfavourable development in opposite directions. **LIQUIDITY**: Temporary market distortions may have an impact on the pricing conditions under which the Fund might be caused to liquidate, initiate or modify its positions.

The Fund presents a risk of loss of capital.

*Risk Scale from the KID (Key Information Document). Risk 1 does not mean a risk-free investment. This indicator may change over time. **The Sustainable Finance Disclosure Regulation (SFDR) 2019/2088 is a European regulation that requires asset managers to classify their funds as either 'Article 8' funds, which promote environmental and social characteristics, 'Article 9' funds, which make sustainable investments with measurable objectives, or 'Article 6' funds, which do not necessarily have a sustainability objective. For more information please refer to https://eur-lex.europa.eu/eli/reg/2019/2088/oj.

FEES

Entry costs : We do not charge an entry fee.

Exit costs : We do not charge an exit fee for this product.

Management fees and other administrative or operating costs : 0,62% of the value of your investment per year. This estimate is based on actual costs over the past year.

Performance fees : 20,00% when the share class overperforms the Reference indicator during the performance period. It will be payable also in case the share class has overperformed the reference indicator but had a negative performance. Underperformance is clawed back for 5 years. The actual amount will vary depending on how well your investment performs. The aggregated cost estimation above includes the average over the last 5 years, or since the product creation if it is less than 5 years.

Transaction Cost : 0,30% of the value of your investment per year. This is an estimate of the costs incurred when we buy and sell the investments underlying the product. The actual amount varies depending on the quantity we buy and sell.

PERFORMANCE (ISIN: LU2585801090)

Calendar Year Performance (as %)	2023
Carmignac Portfolio Merger Arbitrage	+2.7 %

Annualised Performance	1 Year	3 Years	Since launch
Carmignac Portfolio Merger Arbitrage	+4.2 %	- %	+3.6 %

Source: Carmignac at 28 Jun 2024.
Past performance is not necessarily indicative of future performance. Performances are net of fees (excluding possible entrance fees charged by the distributor).

CARMIGNAC PORTFOLIO MERGER ARBITRAGE PLUS I EUR ACC

(ISIN: LU2585801330)

SFDR - Fund Classification** :

Article 8

Recommended minimum investment horizon 3 YEARS

MAIN RISKS OF THE FUND

EQUITY: The Fund may be affected by stock price variations, the scale of which is dependent on external factors, stock trading volumes or market capitalization. **ARBITRAGE**: Arbitrage seeks to benefit from such price differences (e.g. in markets, sectors, securities, currencies). If arbitrage performs unfavorably, an investment may lose its value and generate a loss for the Sub-Fund. **RISK ASSOCIATED WITH THE LONG/SHORT STRATEGY**: This risk is linked to long and/or short positions designed to adjust net market exposure. The Fund may suffer high losses if its long and short positions undergo simultaneous unfavourable development in opposite directions. **LIQUIDITY**: Temporary market distortions may have an impact on the pricing conditions under which the Fund might be caused to liquidate, initiate or modify its positions.

The Fund presents a risk of loss of capital.

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FEES

Entry costs : We do not charge an entry fee.

Exit costs : We do not charge an exit fee for this product.

Management fees and other administrative or operating costs : 1,11% of the value of your investment per year. This estimate is based on actual costs over the past year.

Performance fees : 20,00% max. of the outperformance if the performance is positive and the net asset value exceeds the high-water mark. The actual amount will vary depending on how well your investment performs. The aggregated cost estimation above includes the average over the last 5 years, or since the product creation if it is less than 5 years.

Transaction Cost : 0,84% of the value of your investment per year. This is an estimate of the costs incurred when we buy and sell the investments underlying the product. The actual amount varies depending on the quantity we buy and sell.

PERFORMANCE (ISIN: LU2585801330)

Calendar Year Performance (as %)	2023
Carmignac Portfolio Merger Arbitrage Plus	+3.2 %

Annualised Performance	1 Year	3 Years	Since launch
Carmignac Portfolio Merger Arbitrage Plus	+4.9 %	- %	+3.6 %

Source: Carmignac at 28 Jun 2024.
Past performance is not necessarily indicative of future performance. Performances are net of fees (excluding possible entrance fees charged by the distributor).

Marketing communication. Please refer to the KID/KIID, prospectus of the fund before making any final investment decisions. This document is intended for professional clients.

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