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MARKETING COMMUNICATION

The Merger Arbitrage strategy: Taking advantage of uncertainty in M&A transactions

Behind the scenes of M&A operations

A listed company announces a takeover bid for a competitor. The target's share price rises, but falls short of the offer price. Why? Because the outcome of a transaction is never totally certain: the market factors in potential residual risks, such as regulatory approvals, shareholder approval or unresolved financing issues into the share prices of the companies involved in the transaction. The difference between the offer price and the market price of the share is known as the spread. Merger arbitrage consists in capturing this spread by betting on the success (or failure) of M&A deals announced in the market.

Explore Close up

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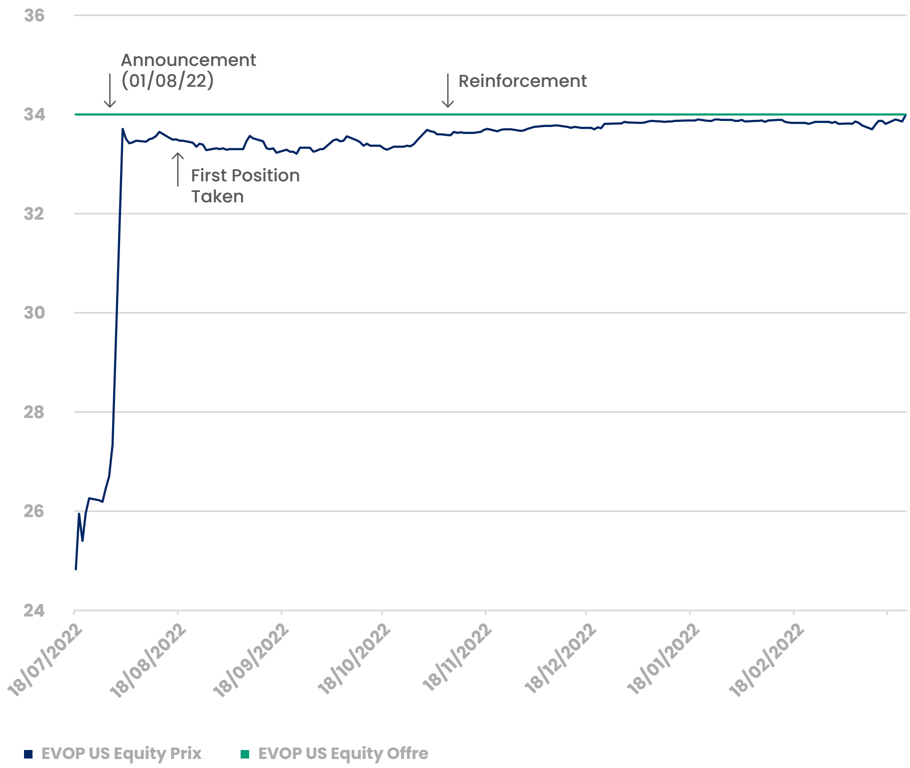
A strategy of arbitrage, not speculation

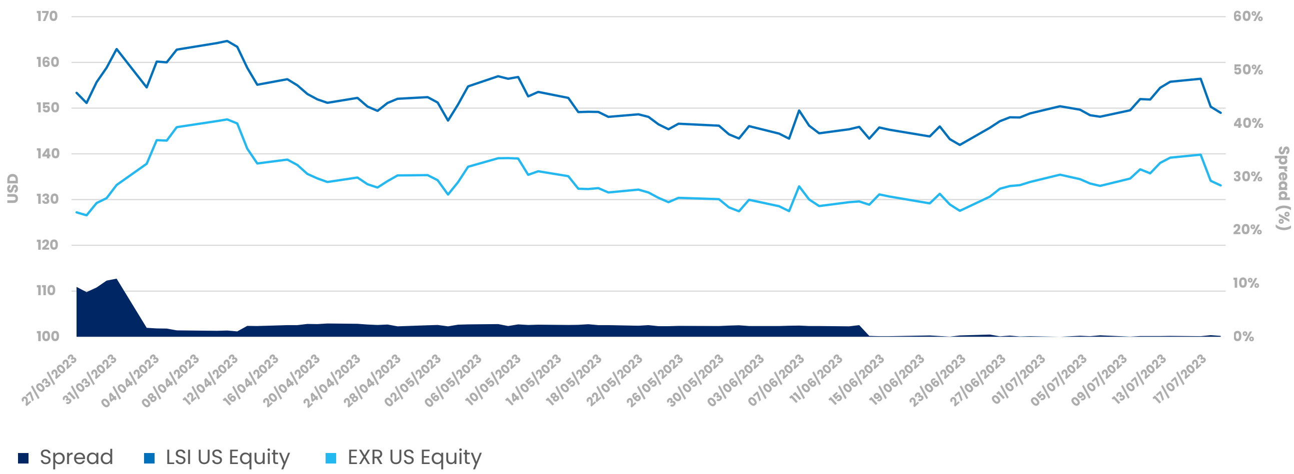
Unlike directional strategies, merger arbitrage relies on defined events: a public transaction, known terms and conditions, and a deadline for completion of the transaction. In the case of a cash offer, the strategy is to buy the target's shares below the proposed price and to cash in the difference if the transaction is successful. When exchanging shares, the manager positions himself "long" on the target and "short" on the buyer.

1. Example of a cash transaction



Example 1: On August 1 2022, Global Payments announced the acquisition of EVO for $34/share in cash, valuing EVO at around $4 billion, representing a premium of around 24% to the closing price on July 29 2022. The transaction was aimed at strengthening Global Payments' B2B offering, increasing its geographical presence and integrating EVO's accounts receivable automation capabilities. The operation was successfully completed.

2. Example of a transaction paid for in shares



Example 2: in April 2023, Extra Space Storage acquired Life Storage in a 100% equity transaction, valuing Life Storage at around $12.7 billion. The merger has created the largest self-storage operator in the United States, with over 3,500 sites, and significant synergies are expected. The two companies officially finalized their merger on July 20, 2023, following shareholder approval a few days earlier.

Example of previous transactions carried out as part of our Risk arbitrage investment strategy.

The performance driver: The price differential

Spread variations are mainly due to investors' perception of the risk of the deal failing, and the time remaining until completion. Market volatility and regulatory announcements can also affect the difference between the target's share price on the market and the price proposed in the buyback offer.

With the right diversification and active risk management, merger arbitrage can deliver a steady potential performance regardless of market direction. Historically, this strategy has shown low volatility, decorrelation from traditional asset classes and a good risk/return ratio. The strategy is based on in-depth analysis of complex M&A transactions where transparency is partial and information is imperfectly integrated by the market.

The relatively low correlation of the Merger Arbitrage strategy with equities and bonds

	Equities	Bonds	Merger Arbitration
Equities	1	0	
Bonds	0,16	1	
Merger Arbitration	0,58	0,11	1

Past performance is no guarantee of future results
Data: 1994-2025.
Equities: MSCI World Index
Bonds : Bloomberg U.S. Treasury Bond Index
Merger Arbitrage : HFRI ED: Merger Arbitrage Index.
Sources: Bloomberg©, HFRI.

In a simple cash transaction where the manager takes a long position on the target company, all returns will come from the upside of this long position (net of borrowing costs if leverage is used to finance the position). In the case of an equity transaction, the manager seeks to generate returns through both a long position in the target company and a short position in the acquiring company.

Behind the scenes: Specific risks

The strategy's main risk? The operation doesn't go ahead. In this case, the target company's share price usually falls significantly, usually returning to its pre-announcement level. Other parameters to consider include the duration of a transaction, which often depends on the time required for the competent authorities to approve or reject the transaction (as in the case of antitrust controls, for example). Historically, around 5% of announced operations in the United States and Europe fail[1]. Rigorous analysis of the terms and conditions of transactions, diversification of portfolio positions and appropriate risk management help to anticipate and avoid these pitfalls.

> "M&A arbitrage returns don't just happen - they are the result of an established process of detailed analysis, measured risk-taking, and in-depth study of deal-specific factors that a team of experts can truly understand and manage.
>
> *Bertrand Dardenne*

1 - Source: Candriam observations on Bloomberg data between 1992 and 2024

Given the significant impact of legal issues on transaction risk, merger arbitrage managers generally have a solid background in capital markets law and investment banking. Analysis of potential regulatory obstacles and competition law issues is essential, especially when major players in an industry are involved in the transaction.

Why invest now?

Firstly, because we believe the market context is favorable. There has been a clear upturn in M&A activity: for example, the month of June 2025 saw a sharp acceleration in transaction volumes, confirming the trend began the previous month. A total of 22 new operations were recorded: twelve in North America, nine in Europe and one in Asia[2]. Four of these operations exceeded 5 billion dollars[3]. In addition, the various decision-making bodies of the US administration have shown themselves to be more permissive, as we saw with the takeovers of US Steel by Nippon Steel and Juniper by HP.

We expect this upturn in activity to continue throughout 2025: investors could now benefit from a strong flow of transactions, more flexible US regulations and a global tightening of spreads, meaning that the market believes the risk of M&A deals failing is diminishing. As a result, investors have renewed their appetite for the strategy, which is once again attracting capital.

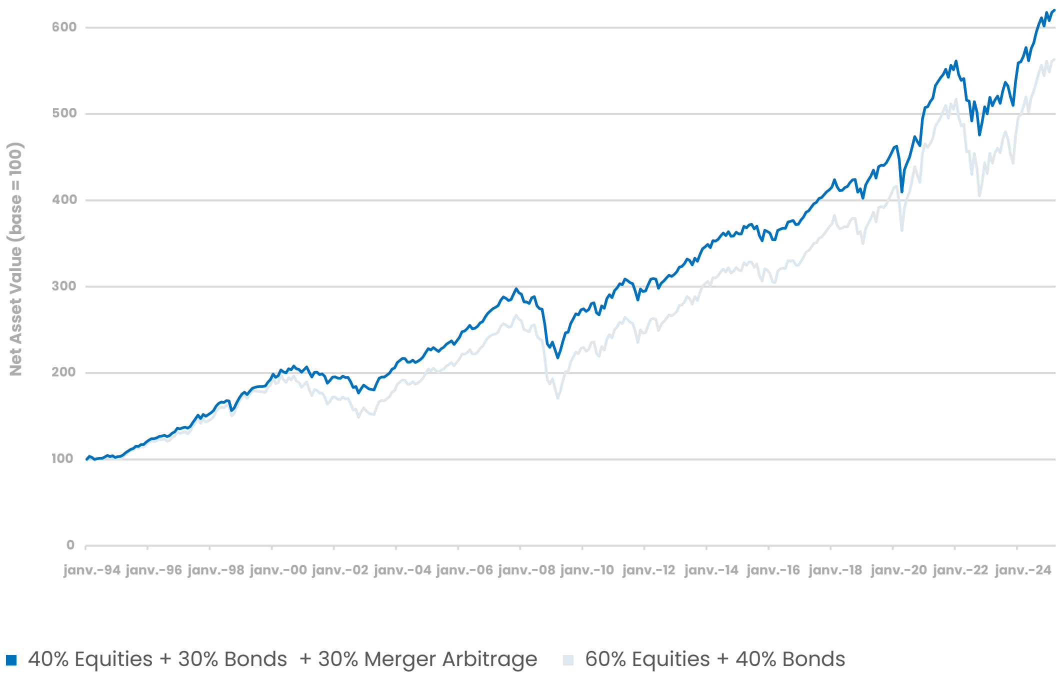
Merger Arbitrage: A strategy of conviction or a diversification tool?

The macroeconomic environment of 2025 presents notable challenges: persistently volatile inflation, structurally high interest rates and elevated geopolitical tensions - illustrated by ongoing military and trade conflicts, as well as a rise in protectionist policies. The increased correlation between equities and bonds fundamentally calls into question the effectiveness of the traditional 60/40 portfolio. As the limits of this portfolio construction become increasingly apparent, we believe that investors should turn to alternative strategies to restore diversification and improve risk-adjusted returns. Merger arbitrage offers a relevant response to this problem, as it can generate stable returns with limited sensitivity to market fluctuations; its performance is based primarily on corporate events, rather than on macroeconomic trends or announcements.

2 - Source: Candriam observations on Bloomberg data, June 2025

3 - Source: Candriam observations on Bloomberg data, June 2025

Integrating merger arbitrage into a diversified portfolio : annual outperformance with 25 % reduction in volatility



Past performance is no guarantee of future results. Markets may evolve differently in the future. The scenarios reflect hypothetical historical performances of index combinations, not all of which can be reproduced. This example is hypothetical and is provided for illustrative and educational purposes only. It does not reflect actual investment results.

Data: 1994-2025.

Equities: MSCI World Index

Bonds : Bloomberg U.S. Treasury Bond Index

Merger Arbitrage: HFRI ED-Merger Arbitrage Index.

Sources: Bloomberg©, HFRI.

Performance and risk over the long term

	Equities	Bonds	Merger Arbitration	60/40 diversified portfolio	Diversified portfolio with Merger Arbitrage
Annualized performance	6,11	4,38	6,69	5,70	6,03
% Volatility (Annualised)	14,96	4,17	4,07	9,40	7,08
Sharpe Ratio	0,41	1,05	1,64	0,61	0,85
Max. drawdown (%)	55,37	17,18	10,89	36,11	26,97

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Data: 1994-2025.

Equities: MSCI World Index

Bonds : Bloomberg U.S. Treasury Bond Index

Merger Arbitrage: HFRI ED-Merger Arbitrage Index.

Sources: Bloomberg©, HFRI.

Thanks to its high potential for absolute and risk-adjusted returns, as well as its low historical correlation with traditional asset classes, merger arbitrage is an attractive strategic tool for investors. However, successful implementation of this strategy requires solid financial and legal expertise, as well as the ability to diversify and manage a portfolio with reasonable levels of leverage. Risk control is essential to success, as a single transaction can have a significant impact on overall portfolio performance. Well executed, it offers a low-correlation and stable return in a world where uncertainty remains the norm.

Risks

All investments involve risk, including the risk of capital loss.

The main risks of risk arbitrage strategies are:

- risk of capital loss
- equity risk
- sustainability risk
- counterparty risk
- risk related to derivative financial instruments
- arbitrage risk

This list is not exhaustive, and further details on the risks associated with investing in the risk arbitrage strategy, as well as the definition of these risks, are available in the regulatory documents relating to the strategy.