Merger Arbitrage in a Rising Rate Environment

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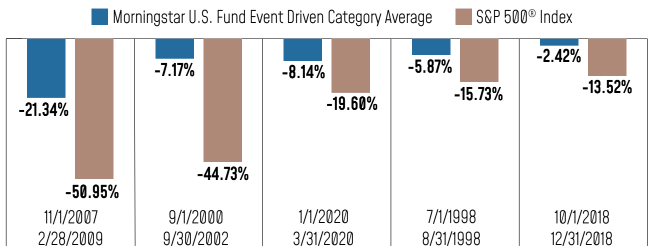
With inflation surging it may be time to consider if your portfolio has too much duration risk—or interest-rate sensitivity.

If so, a non-correlated alternative strategy like merger arbitrage may help by focusing on investing in companies involved in pending mergers, takeovers, and other corporate reorganizations. This strategy has historically provided attractive absolute returns with lower volatility and minimal correlation relative to traditional stock and bond strategies, making for a powerful portfolio diversifier.

Merger arbitrage also should exhibit a positive correlation to interest rates. Therefore, as rates climb, so should total potential returns. And in contrast to traditional long-only strategies, returns are driven primarily by the outcome of the specific transaction rather than the direction of equity or bond markets.

Potential for Diversification in Tough Markets

Performance of Merger Arbitrage Strategies During Largest S&P 500® Index Drawdowns



Past performance is not indicative of future results. Source: Morningstar Direct and Virtus Performance & Analytics. Time periods reflect the five largest S&P 500® Index drawdowns using peak to trough performance. Merger Arbitrage Strategies' performance during periods represented are annualized for periods longer than 12 months and cumulative for periods shorter than 12 months. Merger Arbitrage Strategies represented by the Morningstar U.S. Fund Event Driven Category Average. See page 7 for glossary and index definitions.

The Benefits of Merger Arbitrage Strategies

Market Neutral: In general, merger arbitrage managers seek to hedge away all intrinsic directional exposure, targeting the portfolio to be as market neutral (avoiding general market risk) as possible. This would result in the bulk of the portfolio's exposure being to the occurrence of the specific corporate events themselves. As a result, merger arbitrage strategies have been able to generate positive returns in the vast majority of market environments, with significantly less downside in bear markets.

Targeting Steady Gains and Minimal Drawdowns: By including merger arbitrage in a diversified portfolio, investors have the potential to create a more efficient and less volatile portfolio, targeting steady gains and minimization of drawdowns through up and down markets, respectively.

A Differentiated Source and Pattern of Returns: Returns historically have had low correlation with the stock market and near-zero correlation with bond and commodities markets.

The Potential for Absolute Returns: Merger arbitrage is an absolute return strategy that harnesses return sources associated with idiosyncratic corporate transaction dynamics while limiting downside risk. Unlike traditional investments, the performance of event-driven investments is largely dependent on a number of identifiable variables.

A Potential Hedge for Traditional Portfolios: The historical relative performance in both up and down markets relative to traditional portfolios is a key differentiator for merger arbitrage strategies.

While mergers & acquisitions had a difficult start in 2022, we are confident that M&A activity will remain robust. With abundant liquidity, financial sponsors and corporate buyers are well armed for upcoming opportunities. Private-equity firms have an estimated record total of $2.3 trillion in "dry powder." Citigroup has calculated that corporations have a record $2 trillion in cash sitting on their balance sheets. Acquisition targets trading at significant discounts to recent highs, including underperforming de-SPAC'ed companies, can create attractive opportunities for buyers. Moreover, the presence of activist investors has stepped up pressure on boards to pursue sale processes or break-ups to unlock value for investors. ■

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