THE QUESTION:

The M&A market is booming. The first quarter of 2015 has been the busiest for mega-deals in nine years, an indication that companies are keen to take advantage of record low interest rates and cheap finance. But how long can it last? And how are you tapping the deal-making trend in your portfolios?

EDITOR'S VERDICT

AMY WILLIAMS
EDITOR
CITYWIRE GLOBAL

As Paris-based Isabel Azoulay says, 'It's an exciting time to be in merger arbitrage.' The fund of funds manager thinks the environment for corporate M&A remains very robust.

Michel Jetzer of Woodman Asset Management in Switzerland is in agreement, which is why he's substantially increased his allocation to event-driven managers over the past 12 months as he believes they are benefiting from increased capital market activity through participating in IPOs, divestitures, refinancing and recapitalisations.

In Denmark, however, Lars Hermann of CPH Advisors is cautious that the M&A wave is disrupting his short book, which is why he's steering his portfolios clear.

Those favouring long-only strategies are finding promise in small- and mid-caps, with takeover targets in sectors such as healthcare, oil and gas and telcos.

Tuomas Kallunki of Finland-based United Bankers is focusing his real asset portfolios around these targets but says the collected acquisition premiums, rather than being the key ingredient, are instead a nice add-on to overall performance.

In Belgium Carlo Luigi Grabau is homing in on special situations funds, a section of the market which has grown rapidly in recent years.

Another selector on the lookout for specialists is Luca Carlo Giovannone. While wary that re-leveraging through M&A is adding further risk to an already uncertain global outlook, he's looking to up his healthcare exposure, thereby taping the trend indirectly. These companies, he says, are among the most affected by the current wave of consolidation.

Over in Asia Deutsche Bank selector Tuan Huynh is less optimistic. He thinks the window of opportunity to capture the M&A boom will close in the second half of this year in line with his expectation of the Fed hiking interest rates.

Merger arbitrage, event driven, small and mid-cap equity, biotech; from the views across these pages, there are many ways to get upside from all the dealmaking activity – just keep an eye on the Fed!

BUYERS' VERDICTS

CARSTEN RIESTER

W&W ASSET MANAGEMENT
GERMANY

Stock markets have been doing quite well but that leads to the question: What could drive stocks even further? Since earnings and fundamental numbers probably won't catch up soon with most of their valuations, and central bank stimulus isn't a sustainable price driver, markets might have to look temporarily for another artificial boost to prices. In the past months more and more M&A announcements have been made and this could mark the start of a new trend that could lift markets – at least in some specific areas – even higher.

We favour a split strategy to anticipate that development. On the one hand we will stick to our core funds, especially if they have an exposure to mid and small caps because these segments offer more potential takeover candidates than the pure large or mega-cap space.

On the other hand, an even more opportunistic way to benefit from these activities is an investment in either certain sector funds that offer a positive M&A momentum trend such as biotech, healthcare or technology, or to participate indirectly with specialised funds such as the **Partners Group - Listed Private Equity**. **Reto Munz** and his team are well experienced, offer a long and successful track record and still see attractive value for investors in the broader market environment.

ISABEL AZOULAY

LUTETIA CAPITAL
FRANCE

The surge in corporate M&A should continue and potentially accelerate through to the end of the year. The deal environment remains very robust, and a significant amount of global private equity money is still waiting to be put to use. Additionally, corporate buyers are keen to utilise the US$2 trillion in cash on their balance sheets and share buy-back programmes are already fully used.

Cheap money from ultra-low interest rates isn't the only reason for the high volume of M&A. The key driver of this activity is corporate confidence and managements' appetite for external growth to fuel earnings accretion. In North America, the most important and dynamic M&A geography, this hunger is back. One of the most interesting indicators of future deal making activity is the use of electronic data rooms. Providers' data indicates that this use is at record levels and increasing every quarter, which points to more deal announcements in the months ahead.

It's definitely an exciting time to be in merger arbitrage.

LUCA CARLO GIOVANNONE

SYMPHONIA
ITALY

The M&A market boom is being driven by three conditions: a lack of growth, cheap money, and the advantage of lighter balance sheets.

Following the global financial crisis, companies deleveraged, avoided all unnecessary investments, and cut expenses and staff.

Now they find themselves with an ageing and weaker environment of no growth. With interest rates still hovering just above zero, the fastest way to guarantee a future for your firm is by financing growth through external expansion. All this implies a re-leveraging that is already in progress which adds further risks to an uncertain outlook.

We don't target this cyclical trend with specific products, but aim to benefit from it indirectly by being overweight the healthcare sector, one of the most affected by the current waves of consolidation.

In this space we select very active managers like the **Polar Healthcare Opportunities** fund.

TUOMAS KALLUNKI

UNITED BANKERS
FINLAND

We have noticed the M&A trend and we think that in addition to low interest rates and the availability of cheap finance it is also driven by idle cash held in balance sheets and a lack of organic growth opportunities. Should any of these factors be exhausted we will see a reversal in M&A activity.

We haven't played the theme directly, but we have had our fair share of the trend in recent years as a by-product of our longer-term investment strategy.

This is especially the case in our real asset portfolios, where the focus is on the mid-cap segment companies with low market valuation relative to the intrinsic value (price to book, price to NAV, dividend yield etc.).

These are ideal M&A targets for larger companies which usually have a valuation premium relative to their peers with lower market capitalisation.

The collected acquisition premiums are not the defining ingredient in the overall performance but they are certainly a nice add-on. So, one way to play this theme is to have an eye on small and mid-cap funds.

LARS HERMANN

CPH ADVISORS
DENMARK

I tend to look at M&A activity from a different angle as I favour long/short equity and have done so for a while.

Since January I have been very careful not to have too many commitments there, as the M&A wave disrupts the short side of things and makes weak stocks overvalued.

In normal times I'm a great admirer of **Ian Heslop** from **Old Mutual** in this asset class.

CARLO LUIGI GRABAU

LELEUX INVEST
BELGIUM

The current M&A market is supportive of equity valuations. There are several drivers of this activity including a favourable liquidity environment, low interest rates and credit availability. Elsewhere, the recent collapse in commodity prices made smaller energy companies a possible target and dollar strength is helping US cash-rich companies looking for investment opportunities to purchase European assets. Moreover, the activity seems well diversified: we are witnessing both straight-out acquisitions and restructuring.

Will it last? Without genuine growth this trend is fragile and a market correction or the end of the economic cycle would slow the activity.

Within the fund space the first popular special situations fund was the one launched by Fidelity in 1979 managed at the time by Anthony Bolton and now by **Alex Wright**. Since then the offering has become wider and more funds have been launched, especially in the UK, you just need to understand if you are dealing with a marketing badge or a true, dedicated fund. Usually we tend not to play a specific theme and prefer to choose a manager with a broad approach, but capable of exploiting M&A and restructuring opportunities when needed. Among those funds we follow are **Varenne Valeur** and **Edmond de Rothschild Europe Synergy**. For investors who fancy something more focused we'd suggest **Fidelity Special Situations**, which is UK-biased, or to the **BGF European Special Situations** fund.

TUAN HUYNH

DEUTSCHE BANK
SINGAPORE

Low borrowing costs coupled with an increasingly challenging operating environment in certain industries have led to a rise in acquisition deals over the recent months. For instance, in developed markets we've recently seen a pick-up in M&A deal news in industries such as oil & gas and telecommunications. In developing markets such as China, we're also starting to see consolidation in certain sectors, although these are not driven as much by M&A deals but more so by the ongoing state-owned enterprise reforms in China.

In the near term, a further pick-up in M&A deal announcements globally is likely as many corporates are still sitting on huge cash reserves and will want to take advantage of the current low interest rates to expand their footprint and boost inorganic growth opportunities. That said, we reckon that this window of opportunity may be narrowing soon with expectations that the Fed could start to hike interest rates in the second half of this year. The probability of a June rate hike appears low in our view, given still sluggish near-term US economic data, but we expect macro data to start climbing and the US economy to resume its recovery in the second half. This would increase the likelihood of a rate hike in September.

From an investment perspective, while we have always watched these deal-making trends and their implication on capital markets, we do not necessarily chase after them and a keen focus on industry and company fundamentals remains a priority. However, we do think that generally such M&A trends are positive for equity markets, and underpin our continued medium-term optimism for equities.

ANDREA CIACCIO

We believe that the M&A market offers a compelling investment opportunity in terms of risk/reward for investors looking for a low volatility, uncorrelated bond substitute.

In our opinion the trend in the M&A market may persist at least until 2017 due to the following global themes:

- Any attempt by companies in the US and Europe to make acquisitions using cash on their balance sheet is welcomed by the market as it is EPS accretive in a zero-interest rate environment.
- US companies are under a lot of pressure to grow top line and margins and acquisitions are one of the tools they have to create synergies.

In terms of market cap we are still far away from the peaks in M&A activity registered in 2000 (-70%) and 2007 (-50%). That said, we see some peaking signals in the pharma/bio space while in all other sectors we believe the process is still at an early stage. We expect the vast majority of deals to be located in the US but we do not exclude a recovery in the number of transactions in Europe conducted by European companies first and by American and Eastern European companies should the euro continue to weaken.

We currently have no exposure to funds tapping the deal-making trend as we find that strategies available in the Ucits format are generally more event driven in nature, and thus prone to take a higher level of risk than a pure arbitrage strategy.

MICHEL JETZER

We expect M&A and other corporate activity to continue for the foreseeable future fuelled by cheap funding, large corporate cash balances, lack of strong organic earnings growth and pressure from activist investors. Additionally since the AbbVie/Shire deal collapsed last year, investors have benefited from more favourable deal spreads which better compensate for the risk of merger arbitrage strategies and lead to more attractive investment opportunities.

We have substantially increased our allocation to event-driven managers over the last 12 months as the opportunity set became more pronounced. **Pershing Square Holdings**, the largest position in our hedge fund portfolio, had many of its investments involved in M&A deals during 2014, either as target or acquirer. This year we augmented the portfolio's focus on corporate events through an investment in **Fortress Centaurus**. This manager invests predominantly in Europe and Asia and runs a diversified book with a healthy allocation to M&A transactions.

Besides headline-making M&A deals we believe that our event-driven managers are benefiting from increased capital market activity by participating in IPOs, divestitures, refinancing and recapitalisations.

FUNDS SELECTORS ARE WATCHING...

SOURCE: Citywire

Funds	Managers	Citywire rating
BGF European Special Situations	Michael Constantis	Citywire +
Edmond de Rothschild Europe Synergy	Philippe Lecoq	n/a
Fidelity Special Situations	Alex Wright	Citywire AAA
Fortress Centaurus	n/a	n/a
Partners Group - Listed Private Equity	Reto Munz	n/a
Pershing Square Holdings	Bill Ackman	n/a
Polar Healthcare Opportunities	Gareth Powell, Daniel Mahony	Citywire AA (both)
Varenne Valeur	Marco Sormani, Guiseppe Perrone	Citywire + (both)

CITYWIRE RATED MANAGERS

ALT UCITS EVENT DRIVEN

Event driven funds have been making hay off the back of the deal-making bonanza. We trawled our database to highlight the top risk-adjusted performers over three years running Ucits- compliant funds in the sector.

The average alternative Ucits event driven manager's total return over three years to the end of April 2015 was 10.5%. Returns shown in euro terms.

FRÉDÉRIC HAYM
Delta Prime ESSF
Citywire A

Haym manages money at Paris-based Delta Alternative Manager, the hedge fund he co-founded in 2008 with Carlos Andrade and Thibaut Sciard. The group primarily employs a distressed strategy.

TOTAL RETURN **28.3%**

THIBAUT SCIARD
Delta Prime ESSF
Citywire A

Born in Sweden, now living in Paris, Sciard co-founded Delta Alternative Manager with fellow Citywire A rated manager Frédéric Haym and Carlos Andrade.

TOTAL RETURN **28.3%**

OLIVIER LEHERLE
Nemours Event Driven Strategies I
Citywire A

Leherle is the co-founder of Paris-based event driven specialists Nemours Capital Management, previously known as Edmond de Rothschild Active Strategies. He has run funds at the group since 2009.

TOTAL RETURN **14.1%**

HENRI JEANTET
Helium Opportunites A
Citywire +

Another Paris-based manager, Jeantet is the founder of Syquant Capital where he is also CIO and the principal portfolio manager of the Helium Opportunities fund. He has run the strategy since November 2009.

TOTAL RETURN **10.1%**