

Commentary from the Investment Management Team at Boussard & Gavaudan

Increased uncertainty, lower volatility

September was marked by higher interest rates, wider credit spreads and renewed pressure on risk assets, particularly within the convertible bond market. In this environment, Hedge Funds performance was mixed with Risk Arbitrage and Trading strategies doing well while Convertible bond Arbitrage, Volatility Arbitrage, Credit and Macro strategies facing headwinds. We remain disciplined in our capital deployment and are waiting for more attractive entry points before increasing exposure in selected strategies, notably convertible bond arbitrage. At the same time, we are monitoring developments in France closely, where current uncertainties represent both a risk factor and a potential source of attractive investment opportunities.

Convertible Bond Arbitrage

September proved to be another challenging month for U.S. convertible arbitrage. Five-year rates rose sharply from 4.5% to 5.09%, while HY CDX spreads widened from 300bps to 340bps. The market had already entered September on a weak footing, with valuations gradually softening during the first few days of the month. However, the sharp move higher in rates, on 10 September, triggered a much more aggressive wave of selling, which persisted throughout the remainder of the month. Hedge funds own approximately 70% of the market and generally do not hedge credit risk directly, given the practical difficulties involved and the fact that volatility exposure often serves as a natural mitigating factor. Interest rate hedging practices differ across managers, but hedge ratios in the 20%-50% range are generally considered standard. Against this backdrop, our portfolio proved relatively resilient, as we maintain partial credit hedges while running a higher-than-average interest rate hedge ratio.

Recent new issues were particularly affected given their larger size and greater liquidity, making them the easiest positions to reduce. While the weakness eventually spread across the market, datacentre and AI-related names proved somewhat more resilient after having already undergone significant corrections in August. Selling pressure persisted into the first days of October. Looking ahead, we believe the heavy earnings season at the end of October could act as a stabilizing catalyst for the convertible market, as investors reposition portfolios to capture earnings-related opportunities. In the meantime, while we remain patient before increasing exposure, we continue to favour deep in-the-money convertible bonds within the portfolio.

In Europe, primary market activity remained subdued, with only two new issues coming to market: Porr, the Austrian civil engineering and construction group, and Soitec, the French semiconductor manufacturer. While the Porr transaction attracted limited attention, Soitec's offering was highly anticipated and ultimately met with very strong demand. In the secondary market, most European convertibles were repriced to lower implied volatility levels, reflecting a combination of lower realised volatility across underlying equities and continued selling pressure from arbitrage investors. Thanks to our light inventory and disciplined interest rate hedging, our European convertible strategy delivered a broadly flat performance during the month.

Asian convertible strategies posted a modest negative return despite maintaining effective interest rate hedges. Market-wide selling pressure continued to weigh on valuations, although realised volatility across many of our underlying positions remained supportive. We remain

constructive on the opportunity set and are maintaining a cautious stance, waiting for more attractive entry levels to either initiate new positions or increase existing exposures.

Volatility Trading

Our cautious approach following the summer did not pay off, as realised volatility remained subdued despite sharp rotations within the AI sector and rising long-term interest rates. Markets absorbed these developments remarkably well, suggesting an orderly reduction in gross exposures, with little contagion or forced liquidations. While our positions behaved as expected the cost of maintaining convexity weighed on performance. We remain cautious, however, as low realised volatility may conceal underlying market fragilities, particularly given elevated index concentration and the risk of a sudden correlation repricing. With French political uncertainty, US midterm elections, and AI-related developments ahead, we continue to favour selective convexity, while carefully managing its negative carry.

Equity Strategies

In September, Equity strategies were primarily driven by Risk Arbitrage strategies, which continued to deliver solid results. On the announced deals front, several long-standing situations reached important milestones. The acquisition of Warner Bros. Discovery by Paramount was completed following several months of negotiations with the Attorneys General of California and other states. In Italy, the takeover of Telecom Italia was successfully concluded, with the last-minute increase in the offer price by Poste Italiane of approximately 4%, enabling the bidder to secure 85.8% of the share capital. This improvement in the terms was anticipated, as mentioned in last month's newsletter. A similar dynamic has been unfolding in the banking sector. Market participants have increasingly anticipated an improved offer from Intesa Sanpaolo for Banca Monte Dei Paschi di Siena, as the bidder seeks to secure sufficient shareholder support ahead of the Extraordinary General Meeting scheduled for the end of October. A modest enhancement of the offer was indeed announced at the beginning of October.

Corporate activity remains robust despite higher interest rates and a more expensive financing environment. Recent examples include the proposed merger between Agache and Christian Dior, as well as BASF's approach to Evonik. These transactions reinforce our view that strategic buyers remain willing to pursue value-enhancing opportunities, providing a supportive backdrop for our investment universe. A key topic during the month has been the economic situation in France. The sharp increase in French government borrowing costs, driven by concerns surrounding the country's debt burden and fiscal trajectory, has begun to affect other asset classes and raises broader questions for European markets. We continue to monitor developments closely. Our exposure to France remains fully hedged, limiting direct risks from market dislocations. At the same time, periods of uncertainty often create attractive opportunities within the special situations universe, and we remain attentive to potential opportunities that may emerge in the months ahead.

Trading Strategies

After a significant equity pullback over the summer and a global derisking from the hedge fund industry, we managed to increase our exposure in late August. In September, momentum stocks rebounded, fuelled by a renewed interest in the AI theme. We benefited from this recovery and gradually took profits as the month progressed. Meanwhile, the outperformance of the banking, technology, and energy sectors in Europe once again generated gains for our market neutral equity portfolios.

Trend Following strategies were also profitable, as market participants revised their interest rate expectations upwards, and a marked steepening of the yield curve was observed in the United

States. This rate move proved more challenging for fundamental macro investors that were consensually positioned for a lower inflation environment. We were relatively unaffected from this positioning, having mostly exposure to FX option trades.

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