

OAK HILL NEXPOINT GLOBAL MERGER ARBITRAGE FUND

MARCH 2025 COMMENTARY

Market Comments

Risk Repricing Amid Trade Uncertainty and AI Disruption

U.S. companies reported one of their strongest earnings seasons in over three years during Q4 2024, underpinned by resilient economic activity. However, positive earnings were overshadowed by mounting macro concerns — namely, the reintroduction of protectionist trade policies under President Trump, rising interest rates, and questionable AI-related capital expenditures triggered by competitive threats from China's DeepSeek, a Chinese artificial intelligence company challenging established large language models from companies like OpenAI and Alphabet.

Economic indicators diverged sharply in the first quarter, intensifying the debate over whether escalating trade friction will tip a slowing economy into stagflation or a mild recession. Risk assets responded accordingly. The S&P 500 declined 4.28% in Q1 2025, erasing post-election gains and recording its weakest quarterly performance since Q3 2022. At quarter-end, the index was 8.51% below its all-time high set on February 19th, nearing a correction.

Trade Policy Drives Market Rerating

The equity market downturn was mainly driven by the market's repricing of risk around renewed tariffs. President Trump's planned levies on steel, aluminum, and autos reignited fears of cost-push inflation alongside weaker growth. Investors began to price in lower margins and reduced business investment. Technology stocks were hit hardest, with Nvidia down nearly 30% since its inclusion in the Dow in November 2024. The sector faced a one-two punch from tightening export controls and competitive pressure from China's DeepSeek, whose R1 model may match top-tier AI performance at significantly lower costs.

Broader tech weakness spread to Tesla, Apple, and Microsoft. Since the DeepSeek announcement on January 27, the so-called Magnificent Seven — which accounts for roughly one-third of the S&P 500's market cap — have declined 18.7%. Considering these companies have driven the majority of equity gains over the past decade, a reset of growth expectations, even to more normalized levels, significantly reduces market momentum.

AI Rerating, Not a Bubble

The Big Tech selloff doesn't reflect speculative excess akin to the dot-com era. The Bloomberg Magnificent Seven Index has returned 36% annually from mid-2015 through early 2025, versus approximately 5% for the equal-weighted S&P 500, excluding the Magnificent Seven. Those stock gains were primarily driven by earnings growth not multiple expansion. Earnings for the Magnificent Seven grew 37% annually during that period, and valuations remain largely justifiable, outside of Tesla.

Still, their sheer size means a rerating in Big Tech is systemically important. If these names continue to underperform, headline indices may decline even as broader market breadth improves. Alternatively, should tariffs disproportionately impact smaller, less diversified companies with limited pricing power, we could see hidden damage under a seemingly stable index.

Sector and Geographic Rotation

While technology lagged, defensive and commodity-linked sectors outperformed. Energy, materials, consumer staples, and utilities posted gains. Companies like CVS Health and Philip Morris saw strong relative performance, highlighting investor rotation into cash flow stability and non-cyclical growth.

International equities also outperformed. The MSCI All Country World Index ex-U.S. ETF (ACWX) outpaced the S&P 500 by nearly 11%, its strongest first-quarter relative performance since 1987. This was primarily driven by the unwinding of concentrated AI trades and rising uncertainty around U.S. policy.

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Credit: Relative Stability Amid Equity Volatility

In the first quarter, U.S. investment-grade corporate bonds, high-yield bonds, and government bonds experienced solid performance influenced by various economic and policy factors. The Bloomberg U.S. Corporate Bond Index achieved a total return of approximately 2.31% during the first quarter. This positive performance was primarily driven by declining Treasury yields and consistent coupon income. High-yield bonds posted a 1.23% return in the first quarter. Investor demand for yield remains intact, reflecting confidence in credit fundamentals, albeit with rising sensitivity to policy shocks. The outlook for high-yield bonds in 2025 remains constructive, assuming default rates remain contained.

Trumponomics 2.0: Policy Uncertainty

Soft economic data — sentiment surveys of consumers, small businesses, and homebuilders — signal a deteriorating outlook in the first quarter. Confidence has waned since the post-election surge, hurt by equity volatility, inflation in household staples, and a lack of concrete fiscal stimulus. Meanwhile, hard data such as employment and manufacturing remain solid, creating a confusing macro backdrop for investors.

Trump's trade policy is now the dominant macro variable. The latest tariff package — the largest since the 1930s — is expected to shave 1.3% off U.S. GDP and increase core inflation by 0.8%, according to Fed models used during Trump's first term. Yale's Budget Lab sees a smaller 0.6% hit in 2025 but warns of long-term productivity drag and sustained inflationary pressures. Beyond tariffs, policy risks include federal workforce cuts, immigration restrictions, and volatile regulatory guidance — all of which cloud the investment outlook and discourage business fixed investment.

Outlook: Volatility to Persist

Equity markets largely avoided major drawdowns in 2024, but Q1 2025 performance reminded investors that valuations remain sensitive to macro shifts. AI disruption, trade fragmentation, and a potential rollback of globalization create a structurally higher-volatility regime. Risk assets may recover, but investors should expect uneven performance across sectors and geographies. A passive approach tied to headline indices is unlikely to outperform in this environment. Instead, a focus on earnings durability, pricing power, and balance sheet strength — particularly in defensive sectors and select international markets — is warranted. The path forward hinges on two variables: how far Trump is willing to push trade policy, and whether the Magnificent Seven can regain their growth premium. Until there's clarity on either front, risk management and diversification will be more important than chasing upside.

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M&A Update

Global M&A activity reached nearly \$1 trillion in announced volume in the first quarter of 2025, up 15% year-over-year. North America held steady versus 2024, supported by a strong March. Europe and the Rest of the World posted significant gains, up 22% and 68%, respectively. Cross-border M&A is at its highest level since 2019, excluding the COVID driven spike in 2021. Deal volumes were up in the first quarter due to an uptick in the \$1 billion to \$5 billion category. This category hit their third-highest Q1 total ever, with 98 deals. March alone saw ~\$250B in North American deal volume, one of the region's strongest months in two years, helping lift Q1 North American total volume to ~\$550B, an 11% increase over Q4 2024.

Trump's chaotic tariff policies are introducing new macroeconomic uncertainty across the globe. Dealmakers are already seeing early signs of impact on valuation expectations, deal timing, and financing conditions. Sectors directly exposed to tariffs may see a temporary slowdown in announcements as companies reassess supply chains and demand forecasts. Policy specifics and potential retaliatory measures will shape the depth and duration of this disruption. However, long-term, M&A remains a strategic lever. Companies are expected to use it to reinforce supply chains, diversify geographically, and pivot toward regions with more favorable trade conditions—likely to set up a strong deal activity in the second-half of 2025.

Regulatory Update

The first quarter of 2025 saw significant regulatory and transactional developments, including a high-profile deal closing, two major antitrust lawsuits, another FTC loss in court, two anticipated second requests from the Federal Trade Commission (FTC), and one mega biotech deal closing without issue.

Big Blue Wins

On February 28, 2025, IBM completed its \$7.2 billion acquisition of HashiCorp Inc. following a six-month FTC review. The agency closed its investigation without imposing conditions or requiring remedies— an outcome that supports recent public comments by FTC Chairman Ferguson, who criticized former FTC Chair, Lina Khan, for allowing deals to die on the vine.

FTC and DOJ Move to Block

In May 2024, Surmodics, Inc., a provider of medical device coatings and in vitro diagnostic technologies, entered into a definitive agreement to be acquired by GTCR, a private equity firm, for approximately \$627 million. Under the terms of the agreement, Surmodics shareholders were to receive \$43.00 per share in cash, representing a 41% premium over the company's volume-weighted average closing price over the preceding 30 days. However, in March 2025, the FTC filed a lawsuit to block the acquisition, citing antitrust concerns. Surmodics' stock traded down from \$42 at the deal announcement to below \$29, a 30% decline. The FTC argued that combining Surmodics with Biocoat, a company in which GTCR holds a majority stake, would lead to a combined entity controlling over 50% of the market for outsourced hydrophilic coatings. This consolidation was viewed as potentially reducing competition, leading to higher prices, diminished quality, and reduced innovation in the market for these critical medical device coatings.

Surmodics has expressed its disagreement with the FTC's decision and remains committed to completing the merger. The company plans to vigorously defend the acquisition in court, asserting that the merger is pro-competitive and would benefit shareholders, customers, and patients.

In January 2025, the U.S. Department of Justice (DOJ) filed a lawsuit to block Hewlett Packard Enterprise's \$14 billion acquisition of Juniper Networks, citing antitrust concerns. The DOJ argues that the merger would significantly reduce competition in the U.S. enterprise wireless local area network (WLAN) market, where HPE and Juniper are the second- and third-largest providers, respectively. Combining these companies would result in a duopoly with Cisco Systems, controlling over 70% of the market. The DOJ contends that this consolidation could lead to higher prices, reduced innovation, and fewer choices for American businesses and institutions.

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HPE and Juniper strongly oppose the DOJ's decision, asserting that the merger would enhance competition by creating a stronger U.S.-based alternative to Cisco. They argue that the DOJ's analysis overlooks competition from other players in the market and fails to recognize the benefits of the merger in driving innovation and improving customer choice.

The lawsuit, filed in the Northern District of California, marks the first antitrust action taken by the DOJ under the Trump administration..

Another FTC Loss in Court

In May 2023, Tempur Sealy announced plans to acquire Mattress Firm for approximately \$4 billion. The deal was structured with about \$2.7 billion in cash and \$1.3 billion in stock, resulting in Mattress Firm shareholders owning approximately 16.6% of the combined entity. In July 2024, the FTC unanimously voted to block the merger, expressing concerns that the combined entity could suppress competition and raise prices for consumers. The FTC alleged that Tempur Sealy might limit competitors' access to Mattress Firm's retail space, potentially harming competition in the mattress market. Tempur Sealy and Mattress Firm contested the FTC's claims in court. In January 2025, U.S. District Judge Charles Eskridge denied the FTC's motion for a preliminary injunction, allowing the merger to proceed. The court found that the FTC failed to define a relevant market and did not demonstrate that the merger would substantially lessen competition.

From a legal standpoint, Tempur Sealy's court win over the FTC is significant—not just for the parties involved, but for how merger challenges are likely to play out in 2025 and beyond. The court's decision reinforces that the FTC cannot block mergers on speculative theories alone. Judges continue to expect the agency to demonstrate real, measurable anticompetitive harm—not just a theoretical risk. In this case, the FTC likely failed to show that Tempur Sealy's acquisition of Mattress Firm would substantially lessen competition under the Clayton Act (Section 7).

Tempur Sealy's acquisition of a major retailer (Mattress Firm) was a vertical transaction—a manufacturer buying a distributor. Courts remain more skeptical of FTC challenges to vertical deals unless there's clear evidence of foreclosure or harm to rivals or consumers. This ruling suggests courts will continue to apply a higher bar for proving vertical harm compared to horizontal deals. This outcome adds to a growing trend where courts are pushing back against what they perceive as agency overreach or overly aggressive enforcement. The tone of recent decisions suggests a judiciary that expects the FTC and DOJ to stay within traditional antitrust frameworks rather than pushing the envelope on broader policy objectives. For companies exploring future acquisitions, this decision is a signal that courts remain a viable path if the FTC challenges a deal. While litigation is costly and time-consuming, this win may encourage firms to resist settlement or abandonment when they believe they have a strong legal case.

Second-Request Troubles

In December 2024, Omnicom Group (OMC), a leading global advertising and marketing communications company, announced plans to acquire Interpublic Group (IPG), another major player in the advertising industry. The acquisition is structured as a stock-for-stock transaction. Upon completion, Omnicom shareholders will own approximately 60.6% of the combined entity, while IPG shareholders will hold about 39.4%. This strategic move aims to create the world's largest advertising and marketing services group, surpassing current industry leaders in revenue and market capitalization. Not surprisingly, on March 12, 2025, the FTC issued a second request to review the proposed merger considering the merger signifies a notable consolidation in the advertising sector, potentially influencing competition, client relationships, and the overall dynamics of the global marketing industry.

In December 2024, Aya Healthcare, the largest healthcare staffing firm in the U.S., announced its intention to acquire Cross Country Healthcare (CCRN) in an all-cash transaction valued at \$615 million. Aya is the largest healthcare staffing firm and Cross Country is approximately the sixth largest. Upon completion, the combined entity will hold a market share of ~20% at the national level - concentration in local markets may be higher. Not surprisingly, in February 2025, the FTC issued a second request for additional information regarding the merger, effectively delaying the closing of the deal until at least the second half of 2025.

Regulatory Update (continued)

Encouraging Biopharma M&A

On January 13, 2025, Johnson & Johnson (JNJ) announced its \$14.3 billion acquisition of Intra-Cellular Therapies (ITCI) via a tender offer, which closed on April 2, 2025. Intra-Cellular's key asset is Caplyta (lumateperone), an FDA-approved therapy for schizophrenia with strong commercial momentum and expansion potential in major depressive disorder (MDD) and other CNS indications. The acquisition also brings JNJ a pipeline of late- and early-stage neuropsychiatric assets, strengthening its neuroscience platform and broadening its pharmaceutical portfolio beyond immunology and oncology. The 80-day close, with no regulatory resistance, suggests that biotech deals with minimal market overlap remain viable under the new leadership of the FTC—an encouraging sign for biopharma M&A activity.

2023 Merger Guidelines Maintained and New HSR Forms

In February, the FTC and DOJ announced that the 2023 Merger Guidelines would be maintained. We anticipated this decision and support the Guidelines in part because it helps frame regulatory risk through the lens of the FTC and DOJ. Andrew N. Ferguson, FTC Chairman, reaffirmed the agency's commitment to the 2023 Merger Guidelines, stating that they would remain in effect for the foreseeable future. He emphasized the importance of stability in antitrust enforcement, cautioning against frequent changes that could undermine the guidelines' effectiveness and the FTC's credibility. Ferguson noted that while the guidelines are imperfect and revisions might be considered based on experience, any changes should be approached cautiously and transparently.

The revised filing rules under the Hart-Scott-Rodino (HSR) Act, which requires companies to provide more detailed and comprehensive information, became effective on February 10, 2025. These updates mandate that merging parties submit extensive details, including descriptions of competitive overlaps, supply relationships, and ownership structures. The FTC estimates that preparing an HSR filing under these new requirements will take approximately 105 hours on average—an increase of 68 hours compared to the previous guidelines. This change adds complexity and costs to the merger review process, particularly for private equity firms.

On a positive note, FTC Commissioner Melissa Holyoak emphasized that the current leadership is working to restore the agency's "legitimacy and reputation" by reinstating the early termination program for HSR filings. This program, suspended in February 2021, allows parties to close transactions before the standard 30-day waiting period, provided the FTC and DOJ determine there are no competitive concerns. This reinstatement is expected to expedite certain mergers going forward. Additionally, Commissioner Holyoak noted that under the Biden administration, the FTC deliberately slowed M&A activity, introducing friction in merger reviews. She criticized the previous administration's approach, highlighting what she termed "unjustified hostility to divestitures" and "procedural and substantive inefficiencies."

Slaughter vs. Trump

In March 2025, President Donald Trump dismissed two Democratic commissioners of the FTC, Rebecca Kelly Slaughter and Alvaro M. Bedoya, prompting significant legal and constitutional debates. Both Slaughter and Bedoya were appointed to the FTC during the Biden administration. Slaughter's term was set to expire in September 2029, and Bedoya's in September 2026. Slaughter was first appointed as a Commissioner in May 2018 by President Trump. She was subsequently reappointed by President Joe Biden on February 13, 2023. On March 18, 2025, the White House informed Slaughter and Bedoya of their immediate removal from the FTC, citing that their continued service was "inconsistent with [the] Administration's priorities." This was an odd decision by the President, considering he appointed her in 2018.

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On March 27, 2025, Slaughter and Bedoya filed a lawsuit against President Trump in the U.S. District Court for the District of Columbia. They argue that their dismissals violate federal law and Supreme Court precedent, specifically referencing the 1935 case *Humphrey's Executor v. United States*, which established that FTC commissioners can only be removed for cause. The plaintiffs contend that the President's action is unlawful, as no cause, such as inefficiency, neglect of duty, or malfeasance, was provided for their removal. They seek a court order declaring their terminations unlawful and reinstating them to the FTC. Andrew Ferguson supports the President's authority, stating that Trump has the constitutional power to remove commissioners from agencies wielding substantial executive power.

The case raises significant questions about the balance of power between the executive branch and independent regulatory agencies. A ruling against the President could reinforce the autonomy of such agencies, impacting the administration's influence over regulatory bodies. The outcome may have wider implications for the independence of other federal agencies, including the Federal Reserve and the Securities and Exchange Commission, which also operate with a degree of separation from direct Presidential control. As the legal proceedings unfold, they will likely provide clarity on the limits of presidential authority concerning the removal of independent agency officials and could set significant precedents for the governance of federal regulatory bodies.

Investment Focus

The Fund maintains a high level of confidence in its investment strategy, designed to deliver investors low-volatility returns that are uncorrelated with broader fixed-income and equity markets. By prioritizing deals with appealing spreads, regulatory obstacles that can be managed effectively, and shorter expected closing timelines, the Fund strives to provide investors with a favorable risk-reward profile. We want to express our sincere appreciation to our shareholders for their ongoing support.

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