

Oak Hill NexPoint Global Merger Arbitrage Fund

MANAGER'S DISCUSSION

Equity Markets: Modest Quarter Caps Exceptional Year

The fourth quarter delivered a measured +2.65% total return for the S&P 500, bringing full-year 2025 total performance to +17.86%—marking an unprecedented third consecutive year of double-digit gains. The path to those returns was far from linear—US equities declined nearly 19% from their February peak by April 8 before demonstrating remarkable resilience, rebounding sharply to post a 38% gain from the April low through year-end. US large cap stocks outperformed small caps in 2025, marking the fifth consecutive year of large cap outperformance. The concentration dynamics remained extreme—the S&P 500 has outperformed the S&P 500 Equal Weight Index by 34% over the past 3 years, the widest 3-year performance gap in history. The small-cap Russell 2000 Index rose 2.2% in Q4 and 12.8% for the calendar year.

Healthcare emerged as Q4's standout performer with an +11.7% surge, decisively outpacing all other sectors as investors gravitated toward earnings stability and defensive characteristics. This represented a dramatic reversal for a sector that had lagged earlier in the year. Technology's +2.3% quarterly return—matching the broader index—signaled clear deceleration from its earlier momentum, as stretched valuations and concerns about slowing enterprise spending weighed on sentiment despite continued AI infrastructure demand.

The late-year rotation toward defensives was particularly notable: while Tech and Communication Services dominated the full year (driving the Magnificent Seven narrative), Q4 saw investors pivot toward quality and stability. Financials (+2.0%), Materials (+1.7%), Energy (+0.9%), and Industrials (+0.9%) posted modest gains, reflecting a market neither fully risk-on nor risk-off. Real Estate stumbled despite falling rates—a concerning signal given typical rate sensitivity.

More encouraging was evidence of genuine market breadth: the equal-weighted S&P 500 and Russell 2000 both hit new highs toward year-end, suggesting leadership expansion beyond mega-cap tech. This broadening occurred despite forward P/E multiples hovering around 22x—roughly unchanged from year-start and sustained for several years now.

Debt Markets: The Spread Compression Story

The fourth quarter of 2025 delivered a strong performance across fixed-income assets, reflecting a confluence of favorable macroeconomic and corporate fundamentals. Easing inflationary pressures, broadening earnings momentum, and the Federal Reserve's first rate cut since December 2024 provided an environment supportive of risk assets. Corporate credit posted solid gains, while government bonds benefited from modest declines in yields. Investor sentiment was further buoyed by elevated expectations for AI driven growth and continued corporate profitability across multiple sectors.

Credit markets entered year-end with spreads at or near post-GFC (Global Financial Crisis) tightness, reflecting extraordinary investor confidence despite macro crosscurrents. This presents both opportunity and caution for investors. Investment-grade corporates delivered solid absolute returns (+7.3% for the year), driven by spread compression. However, IG spreads tightened to approximately 71 basis points over Treasuries by year-end—sitting in the bottom percentile of the five-year range.

High-yield spreads tightened to approximately 270 basis points by late Q4—dramatically below the 20-year average of 490 basis points and in the bottom percentile of the five-year range. This extreme compression occurred despite default rates that, while declining from 2024's elevated levels, remained above long-term averages. The market is pricing in minimal credit deterioration going forward, with investors seemingly comfortable accepting razor-thin risk premiums.

The Fed delivered 50 basis points of cuts in Q4 (bringing the cumulative total to 175 basis points from September 2024 highs), reaching a 3.50%-3.75% target range by December. However, the Treasury curve told a more nuanced story. While short-end yields declined mechanically with policy rate cuts (2-year ending near 3.54%), long-end yields remained stubborn. The 10-year closed around 4.15% and the 30-year near 4.79%—only modestly lower despite aggressive easing.

This steepening reflected elevated term premia driven by fiscal concerns (the "One Big Beautiful Bill Act" projected to add \$3.4 trillion to federal debt by 2034) and persistent growth/inflation expectations. The disconnect between Fed cuts and long-end behavior underscored that lower policy rates don't guarantee lower borrowing costs when fiscal dynamics and supply concerns dominate. Powell's December commentary that rates are now "in a broad range of estimates of neutral value" signaled a likely pause ahead.

2026 Outlook - Bullish Consensus

Wall Street has achieved remarkable unanimity heading into 2026—not a single major strategist surveyed by Bloomberg predicts a decline in the S&P 500, marking the first time in years that sell-side consensus is uniformly bullish. The average year-end target of 7,550 implies approximately 9% upside from the December 31, 2025 close of 6,845, with a target range spanning from Bank of America's conservative 7,100 (+4%) to Oppenheimer's aggressive 8,100 (+18%). Wall Street projects S&P 500 EPS growth of +12%-15% in 2026, with estimates ranging from Goldman Sachs at +11% and Morgan Stanley at +16%.

This optimism rests on a foundation of robust earnings growth, continued AI infrastructure spending, accommodative monetary policy, and fiscal stimulus from the “One Big Beautiful Bill Act.” However, the consensus also acknowledges meaningful risks around AI valuation and adoption. The setup is one of late-cycle dynamics meeting transformational technology, creating both opportunity and risks.

Critically, 2025 demonstrated that earnings—not multiple expansion—drove returns. Earnings growth contributed 14% of the S&P 500’s 16% price return (excluding dividends), while the forward P/E remained rangebound around 22x throughout the year. This healthy dynamic is expected to continue, with most strategists forecasting flat-to-slightly-declining multiples in 2026 as the “E” does the heavy lifting.

A key 2026 theme is broadening earnings growth. While Technology remains the earnings growth leader (projected +20%+ led by hyperscalers), eight of eleven S&P 500 sectors are expected to post higher earnings growth in 2026 versus 2025 with overweight recommendations on Technology, Healthcare, and Financials.

Hyperscaler capex is projected to reach approximately \$540 billion in 2026, up from ~\$400 billion in 2025. This represents 35% YoY growth and a significant percentage of 2026 US GDP growth. The scale is reminiscent of the railroad buildout (mid-1800s) and telecom boom (late 1990s), but with better balance sheet strength. The question isn’t whether AI spending continues—it will—but whether returns on invested capital meet lofty expectations. Current valuations embed assumptions that the \$3+ trillion in AI/AI-adjacent capex from 2025-2027 will generate productivity gains approaching those of past transformational technologies. Any disappointment in monetization timelines could trigger multiple compression across the AI value chain.

As we enter 2026 with consensus Wall Street targets implying continued equity market gains, it is critical to maintain rigorous assessment of downside scenarios that could derail the bull market now in its fourth year. The most pressing concern facing equity markets in 2026 centers on valuation and the potential for a significant correction in AI-related securities. This risk has emerged as the dominant worry among institutional investors. The fundamental concern underlying AI valuation risk involves the massive capital expenditure commitments being made without commensurate evidence of revenue generation or productivity enhancement. Current estimates suggest that over \$3 trillion in AI and AI-adjacent capital spending will occur between 2025 and 2027. However, troubling data from MIT’s Media Lab indicates that despite \$30-40 billion in enterprise investment in generative AI, approximately 95% of organizations report receiving zero return on these investments to date. This disconnect between massive capital deployment and measurable business outcomes creates significant downside risks to AI levered stocks.

Adding to valuation concerns are questions about circular financing arrangements that may be artificially inflating market valuations. Notable examples include Nvidia’s intent to invest up to \$100 billion in OpenAI, predicated on expectations that OpenAI will power additional data centers using Nvidia chips, and Nvidia’s \$6.3 billion agreement to purchase unused data center capacity from CoreWeave, a company in which Nvidia holds a 7% equity stake and to which it also supplies semiconductors. These circular flows of capital raise questions about whether current valuations reflect genuine economic value creation or merely financial engineering. Furthermore, the emergence of lower-cost competitors such as DeepSeek, whose unexpectedly successful launch in late January 2025 triggered a 17% single-day decline in Nvidia shares, demonstrates that technological moats in this space may be less durable than current valuations assume.

The potential impact of an AI valuation correction would be severe and far-reaching. A 30-50% decline in AI-related equities, which is not outside historical precedent for speculative technology manias, could eliminate \$10-20 trillion in market capitalization. Such a correction would likely trigger contagion across the broader technology sector and provoke a wholesale reassessment of growth equity valuations. More concerning from a macroeconomic perspective, the reversal of AI capital expenditure—which currently accounts for approximately half of US GDP growth according to recent Wall Street Journal analysis—would likely push the economy into recession.

Our second risk factor involves economic growth disappointment, which, despite relatively sanguine consensus forecasts, remains a meaningful possibility given accumulating stress signals in the labor market and consumer sector. Recent data shows elevated jobless claims and increasing announcements of corporate job cuts, suggesting that the labor market is softening from the unusually tight conditions that prevailed through most of 2023-2025. This deterioration is particularly pronounced among lower-income workers, reflecting the persistent K-shaped nature of the economic recovery where the bottom 40% of consumers face mounting pressure from inflation, reduced government benefits, and exhausted savings buffers.

The impact of economic growth disappointment on equity markets would be particularly acute given elevated earnings expectations. Wall Street consensus forecasts call for 12%-15% S&P 500 earnings growth in 2026, well above historical averages and predicated on continued economic expansion. Should growth falter and earnings revisions turn negative, the market would likely face a dual headwind of multiple compression and declining earnings estimates. This combination historically produces swift and painful drawdowns. The speed of repricing would be amplified by the algorithmic and momentum-driven nature of much current positioning, where systematic strategies would likely begin deleveraging at the first signs of deteriorating fundamentals.

The third critical risk concerns Federal Reserve credibility and the potential for interest rate market disruption. This risk has gained prominence as many investors cite Federal Reserve chair replacement uncertainty as their second-greatest market concern. The ongoing conflict between President Trump and Chairman Powell, combined with a pending Supreme Court case regarding Fed independence and the president’s stated desire to be consulted on monetary policy decisions by Powell’s successor when his term expires in May 2026, creates unprecedented uncertainty about the central bank’s autonomy.

Compounding these institutional concerns, long-term interest rates have demonstrated surprising stickiness despite the Federal Reserve's 175 basis points of policy rate cuts since September 2024. Ten-year Treasury yields remain anchored around 4.15% and thirty-year yields near 4.80%, with term premiums expanding as markets price in ongoing fiscal deficits and questions about the Fed's ability to maintain independence from political pressure. The Congressional Budget Office projects that the "One Big Beautiful Bill Act" could add \$3.4 trillion to federal debt by 2034, and markets are beginning to demand higher yields to absorb this increased supply.

Should Federal Reserve credibility become seriously impaired—either through presidential interference, a poorly-received chair replacement, or forced policy decisions that prioritize political considerations over price stability—the consequences for financial markets would be profound. Loss of confidence in the Fed would likely trigger dollar weakness, reignite inflation concerns, provoke Treasury selling by foreign holders, and force a repricing of all risk assets that currently benefit from the presumption of competent central bank crisis management. This scenario represents perhaps the most dangerous risk to market stability, as it would undermine the foundational assumption of monetary policy credibility that has supported asset prices through multiple crisis episodes over the past fifteen years.

The risk landscape facing equity investors in 2026 is characterized by elevated valuations, concentrated exposures, late-cycle dynamics, and multiple potential catalysts for disruption. While our base case remains constructive on equities given strong earnings growth and supportive policy, the asymmetry of returns has shifted unfavorably—downside scenarios appear more severe than incremental upside potential from already-elevated levels. This argues for a measured approach that maintains equity exposure to capture earnings growth while implementing thoughtful risk management to protect against tail outcomes. The year ahead will likely reward investors who can balance opportunism with caution, maintaining flexibility to navigate volatility while avoiding losses should any of our identified risk factors materialize.

M&A UPDATE:

The fourth quarter delivered a historic conclusion to 2025, with global M&A deal value reaching \$947 billion—the strongest quarterly performance on record. Full-year U.S. M&A activity totaled approximately \$3 trillion, representing a 48% increase over 2024, driven by a resurgence in megadeal activity, stabilizing macroeconomic conditions, and a materially altered regulatory posture following the change in administration. The quarter produced 63 global transactions exceeding \$10 billion, the highest annual count in over a decade.

Sector performance exhibited broad-based strength, with most verticals posting double-digit year-over-year volume growth. Media & Telecom, Technology, and Industrials led activity levels, each reaching their second-highest annual volumes on record. Transaction activity above \$1 billion proved a key driver of this momentum: Technology and Industrials recorded their second-best performance in this segment, while the Power sector achieved its highest deal count ever. This strength extended into the \$10 billion-plus category, where Technology, Industrials, and Power each delivered record years for both announced volume and transaction count.

Financial sponsor activity sustained its third-quarter momentum into Q4, reaching its highest quarterly volume in over four years and elevating the second half of 2025 to the third-strongest half-year period on record. Elevated dry powder levels translated into a meaningful increase in sponsor-led acquisitions, which achieved their highest market share in a decade. Deal activity above \$1 billion remained robust, marking its second-highest annual level, while the \$10 billion-plus segment experienced one of its strongest periods on record.

Globally, M&A volume reached \$4.8 trillion in 2025, a 35% increase over 2024 and the most active period since 2021. North America and EMEA each posted their strongest quarterly activity in four years, while cross-border transaction volume reached its second-highest level in five years, supported by strategic consolidation opportunities and improving regulatory clarity across jurisdictions. The sustained strength in deal activity and completion rates points to a constructive environment for merger arbitrage strategies extending well into 2026.

REGULATORY UPDATE:

2025 featured several transformational combinations across the railroad, media, and television broadcasting industries that could reshape them. Specifically, in the quarter's most surprising development, streaming giant Netflix—which had long eschewed industry consolidation—agreed to acquire Warner Bros. Discovery's studio and streaming assets, including HBO Max and the Warner Bros. film library for approximately \$83 billion. The strategic rationale centers on Netflix's acquisition of Warner Bros.' extensive content library and intellectual property, HBO Max's subscriber base to enable more flexible subscription tiers, and expanded production capacity globally. The transaction faces substantial regulatory scrutiny in the US and Europe given horizontal market concentration concerns. Adding to the complexity, Paramount Skydance is seeking to acquire all of WBD in a hostile takeover attempt.

The November 2024 election and subsequent Trump administration inauguration in January 2025 fundamentally transformed the US antitrust landscape. FTC Chairman Andrew Ferguson and DOJ Antitrust Division Assistant Attorney General Gail Slater have articulated a dramatically different enforcement philosophy compared to their Biden-era predecessors Lina Khan and Jonathan Kanter. The new approach emphasizes: (1) transparent merger review with predictable timelines, (2) renewed acceptance of structural remedies (divestitures) to resolve competitive concerns, (3) faster clearance for non-problematic transactions via early terminations, and (4) traditional theories of harm rather than novel or expansive legal theories.

Ferguson has been explicit that the FTC "must get out of the way quickly" when mergers do not violate antitrust laws, contrasting sharply with the prior administration's stated goal of slowing dealmaking generally. This posture reflects a broader Trump administration priority of promoting American business competitiveness, though notably tempered by populist issues focusing on sectors directly impacting consumers, such as healthcare.

Several concrete policy shifts materialized in 2025. First, the Hart-Scott-Rodino (HSR) reforms, including enhanced HSR premerger notification rules finalized under the Biden administration, took effect on February 10, 2025, requiring substantially more upfront disclosure from merging parties. Despite Republican control and initial speculation that these rules might be rescinded, the Trump FTC retained them, recognizing that comprehensive front-end information enables faster triaging of problematic versus benign transactions.

The FTC reinstated the early termination program for HSR waiting periods, which had been suspended under Khan. Commissioner Melissa Holyoak stated that early termination requests help reduce FTC staff workload and allow non-problematic deals to close more quickly. Since reinstatement, the FTC has granted over 100 early terminations through Q4 2025, signaling a genuine commitment to expedited review where warranted. The agencies negotiated five significant merger settlements in 2025, four involving structural remedies (i.e., divestitures) and one behavioral remedy.

The fourth quarter of 2025 demonstrated that well-structured, strategically sound combinations can secure regulatory approval, provided companies invest in rigorous preparation, maintain realistic expectations for remedies, and adapt to evolving enforcement priorities. The megadeal's return signals market participants' growing confidence that the post-pandemic M&A drought has definitively ended, with 2026 positioned for continued robust activity absent macroeconomic deterioration or unforeseen political disruption.

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 unitholders for their ongoing support.

RISKS & DISCLOSURES:

Market commentary contains information about prior investments made by the Portfolio Manager of the Fund. This information was prepared by the Portfolio Manager based on its experience in the industry and on assumptions of fact and opinion as to future events which the Portfolio Manager believed to be reasonable when made. There can be no assurance that the Portfolio Manager and/or the Fund will be as successful as these earlier investments. Prior investment returns are not indicative of future results. It should not be assumed that investment recommendations made in the future will be profitable or will equal the performance of the securities included herein.

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