Oak Hill NexPoint Global Merger Arbitrage Fund

MANAGER'S DISCUSSION

Equity Markets: Geopolitical Shock Overrides Strong Fundamentals

U.S. equities delivered their first negative quarter since the tariff-driven selloff of early 2025, as the dual shock of the Iran conflict and a sharp rotation out of technology names overwhelmed otherwise robust corporate earnings. The S&P 500 declined 4.35% for the quarter, with March alone accounting for a 5.0% month-over-month drop. The Nasdaq fell 4.8% in March, and the Dow Jones Industrial Average declined 5.2% over the same period. Small caps fared modestly better with the Russell 2000 ending the quarter up 0.92%, benefiting from its lower exposure to the technology-sector rotation and a domestic revenue mix that was less immediately sensitive to the oil price shock.

On February 28, the United States and Israel launched military operations against Iran, unexpectedly resulting in the effective closure of the Strait of Hormuz. Brent crude surged from approximately $72 per barrel to nearly $120 at its peak—a 55% increase—producing what the International Energy Agency characterized as the largest supply disruption in several decades. Energy stocks outperformed, while the technology sector bore the brunt of the risk-off rotation as investors repriced duration-sensitive assets against a materially higher inflation trajectory.

The Federal Reserve held the federal funds rate steady at 3.50%–3.75% at both the January and March FOMC meetings, following three rate cuts in 2025. Policymakers cited solid economic expansion and low-but-stable job gains alongside "somewhat elevated" inflation—language that took on new urgency as energy prices surged in the wake of the conflict in Iran. The 10-year Treasury yield closed the quarter at 4.32%, up 16 basis points from 4.16% at year-end, as the market began to price a longer path to the Fed's next cut.

Oil Price Spike Hinders Bullish Consensus

When oil prices spike, it reverberates across nearly every category of economic life. Higher energy costs flow through transportation, food, housing, industrial production, and ultimately consumer purchasing power. Central banks are then forced to respond to inflationary pressure with tighter policy, even as businesses defer investment and consumers retrench. The feedback loop is familiar and dangerous: higher input costs pressure margins, demand weakens, employment deteriorates, GDP slows, and the cycle begins to reinforce itself. Unlike a conventional demand shock, an energy shock is not easily resolved by rate cuts or fiscal stimulus. There is no clean policy response to a sudden and sustained increase in the cost of the world's primary input.

It is worth emphasizing how regressive the impact is. Larry Fink of BlackRock has described higher oil prices as a tax on consumption—a framing we find apt. Wealthier households can absorb higher energy bills with limited changes in behavior, while lower-income households are forced to cut spending on essentials. For the bottom half of the global population, higher oil prices immediately show up in grocery bills, rent, electricity, and transportation—the categories that comprise the largest share of household budgets. An oil shock is not merely a market event; it is a broad-based tax that falls most heavily on those least able to bear it.

The market, however, still appears to be pricing in hope: a quick resolution, a negotiated settlement, or a permanent ceasefire. The more important question is whether the market is properly discounting the risk of a prolonged global oil shock. To frame the issue, consider the market's reaction to last April's tariff announcement—another potential shock to the global economy. The S&P 500 declined 17% over nine trading days on fears that tariffs would disrupt global trade and push the economy toward recession. Had the proposed tariffs taken full effect at roughly 25%, they would have raised approximately $400 billion per year, a cost largely borne by U.S. consumers.

The arithmetic of the current oil shock is at least as severe. The United States consumes approximately 7.5 billion barrels of oil per year, which means a $400 billion annual cost is roughly equivalent to a $50-per-barrel price increase for the U.S. economy.

The Iran conflict has pushed oil from approximately $60 to $100 per barrel—a $40 increase. Applied to global consumption of roughly 100 million barrels per day, that translates to an annualized cost of approximately $1.5 trillion. This is the economic equivalent of a massive global tariff, with one critical distinction: under the tariff scenario, the U.S. Treasury at least captured the revenue. Under an oil shock, the transfer accrues to producing countries and private energy enterprises, while consuming economies absorb the cost through lower real income and reduced purchasing power. This is why we believe the market's roughly 5% decline in equity prices during March underestimates the macroeconomic impact of sustained higher oil prices over the coming quarters.

As we enter the second quarter, the dominant question is whether the geopolitical premium embedded in energy prices and equity volatility will subside or become a more durable feature of the investment landscape. The trajectory of the Iran conflict—and the status of the Strait of Hormuz—remains the single most consequential variable for markets, with implications spanning energy, inflation, monetary policy, and risk appetite. Corporate fundamentals remain robust, with S&P 500 earnings growth projected to sustain double-digit levels and profit margins at record highs. M&A activity shows no signs of slowing, and a more constructive regulatory environment should continue to provide tailwinds for dealmaking. We remain constructive on the intermediate-term outlook while maintaining a heightened focus on risk management and portfolio positioning appropriate for an environment where strong fundamentals coexist with elevated geopolitical uncertainty.

Q1 2026 M&A UPDATE:

Global M&A activity started the year on a strong note, with announced deal value reaching approximately $1.4 trillion—the second-highest quarterly total on record and the strongest opening quarter since 2021. North America was the primary driver, representing a record 64% of global volumes, while EMEA posted a 36% year-over-year increase. Rest of World activity declined 15%, reflecting continued caution among Asia-Pacific acquirers. Importantly, deal volumes held up well despite a challenging macro and geopolitical backdrop, including concerns about private credit markets and elevated U.S.-Iran tensions, which weighed on sentiment throughout the quarter.

North American announced deal value reached approximately $874 billion, the strongest first quarter on record outside of 2021, underscoring the depth and resilience of the U.S. deal market even against the backdrop of the Iran conflict. Large-cap strategic transactions were a defining feature: 33 deals above $5 billion were announced—the second-highest year-to-date count ever—accounting for nearly 60% of total regional volume. Sector breadth was encouraging, with seven of nine sectors posting double-digit volume growth, led by technology, industrials, and healthcare.

Financial sponsor activity totaled $238 billion in the quarter—down from the prior two quarters but still the third-strongest opening quarter on record. Take-private transactions were especially active, reaching their second-highest quarterly volume ever, with the $5 billion-plus segment at its second-highest level in history. With private credit markets under pressure during the quarter, the market applied a wider risk premium to sponsor-backed deals—a dynamic we view as an opportunity to harvest excess spread in situations where financing commitments are robust. The breadth of activity across strategic and sponsor buyers, combined with the elevated contribution from large-cap transactions, continues to provide a constructive opportunity set for the strategy.

Q1 2026 REGULATORY UPDATE:

The FTC and DOJ continued to signal a more constructive posture toward merger reviews during the first quarter, moving back toward a traditional framework centered on market definition, competitive effects, and identifiable theories of harm. Equally important, the agencies demonstrated renewed receptiveness to structural and, in certain cases, behavioral remedies as conditions for approval—a meaningful departure from the prior enforcement cycle, when the agencies were more inclined to challenge transactions outright and less willing to resolve competitive concerns through negotiated settlements. For merger arbitrage investors, this shift narrows the distribution of regulatory outcomes: lower risk of blocks and a higher probability that deals with identifiable but addressable competitive overlaps reach closing. Consistent with this more accommodating posture, only two second requests were issued during the quarter—Boston Scientific's pending acquisition of Penumbra, and Skyworks Solutions' pending acquisition of Qorvo—underscoring the reduced friction in the premerger review process relative to recent years.

Despite an accommodative regulatory backdrop, Alcon's proposed $356 million acquisition of LENSAR was terminated in March, after the FTC signaled its intention to seek an injunction blocking the transaction. The deal, announced in March 2025, had been pending for nearly a year and was originally expected to close in mid-to-late 2025. LNSR shares declined approximately 50% on the news, trading at approximately $6.00—well below the $14.00 deal price and below the stock's pre-announcement levels. The LENSAR termination is a harsh reminder for merger arbitrage investors that a constructive macro-regulatory backdrop does not offset issues in transactions where competitive overlap is present and the theory of harm is straightforward. The fund did not have exposure to the deal.

On the procedural front, the Hart-Scott-Rodino reforms finalized under the Biden administration—which took effect on February 10, 2025, and required substantially more upfront disclosure from merging parties—suffered a significant legal setback. On February 12, a federal district court held that the FTC lacked authority to impose the expanded filing requirements, ruling the changes arbitrary and capricious. The FTC has appealed, and the expanded requirements remain in effect pending resolution. If upheld, the ruling would be incrementally positive for deal timing, as the revised rules had materially increased the burden, complexity, and duration of premerger filings—adding weeks to the regulatory calendar on transactions that, under the prior framework, would have cleared more expeditiously.

The most consequential personnel development was the departure of Gail Slater as Assistant Attorney General for the DOJ Antitrust Division. Her exit appeared to reflect an internal policy clash over the direction of merger enforcement: Slater was associated with a more aggressive, populist approach to antitrust, while other administration officials reportedly favored faster reviews and less reliance on litigation as a first-order enforcement tool. For the strategy, Slater's departure reinforces the broader trend toward more predictable and expeditious merger review. It does not eliminate regulatory risk—particularly in concentrated markets or politically sensitive sectors—but it tilts the balance toward negotiated outcomes and away from open-ended enforcement delays or litigation-driven deal breaks.

Taken together, the first-quarter U.S. regulatory environment was constructive for merger arbitrage. The combination of a more traditional enforcement posture, a favorable court ruling on HSR, and leadership changes at the DOJ all point in the same direction: regulatory risk is lower, rather than systemic and ideologically driven. In our view, the marginal risk in the current environment is shifting toward state-level intervention and foreign regulatory review—areas where we continue to dedicate significant analytical resources.

Investment Focus:

The first quarter's combination of elevated deal flow, evolving regulatory dynamics, and geopolitical dislocation reinforced the core value proposition of the merger arbitrage strategy: the ability to generate returns fundamentally driven by deal-specific outcomes rather than by the direction of broader equity or fixed-income markets. We continue to prioritize transactions with attractive risk-adjusted spreads, identifiable and manageable regulatory paths, and shorter expected closing timelines—an approach designed to compound returns while limiting exposure to the macro and geopolitical uncertainties that defined this quarter.

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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