

Commentary from the Investment Management Team at Bousard & Gavaudan

Strong Start to 2026

Equity markets in Europe and the US were up in January with the EuroStoxx 50[®] Total Return gaining +2.76% and the S&P500[®] Total Return gaining +1.45%. The market implied volatility measure VStoxx[®] increased, finishing the month at 20.0% and the iTraxx Crossover[®] (S43) increased to 220bps.

January was a constructive month for convertible bond arbitrage, risk arbitrage, special situations and equity trading strategies. We remain optimistic on the outlook for 2026 with early signs of an uptick in M&A activity and volatility.

Convertible Bond Arbitrage

In the US, 5-year treasury yields rose modestly from 3.73% to 3.79%, HY CDX spreads declined more meaningfully from 317bps to 296bps. This decline in spreads was a significant tailwind for convertible arbitrage strategies in January. However, the main sentiment driver was the strength of underlying equity performance, as evidenced by the Bloomberg U.S. Convertibles Liquid Bond Index TR Unhedged USD which was up 4.7% for the month.

In Europe, the primary market saw six new issues, three of which were synthetic convertibles. The expansion of the convertible bond universe remained limited, with several repeat issuers launching new deals while simultaneously tendering previous ones. Activity in the secondary market was muted, with flows remaining subdued.

Asian markets were more active than Europe across both the primary and secondary segments. In the primary market, nine new issues came to market, with sizeable transactions in Hong Kong, which remains the region's most active hub. We were able to initiate new positions in several of these deals. The market continues to present attractive opportunities, although a high degree of selectivity is key given its specific features, limited repo availability and the short maturity profile of many convertibles. As a result, thorough analysis of the prospectus, credit fundamentals, and stock borrow conditions remains critical.

Recent secondary market activity has seen pronounced gamma trading flows, such as that on the Baidu/Trip.com exchangeable convertible bond structure. Volatility was catalysed in mid-January when Chinese regulators launched an antitrust investigation into Trip.com, mirroring the scrutiny applied to Alibaba in 2020.

The announcement precipitated a sharp 19% correction in Trip.com's equity. This dislocation provided a textbook environment for volatility arbitrage, allowing active management of the embedded option's gamma. The instrument offers a unique bifurcation of risk: while the gamma exposure is derived from Trip.com's underlying equity volatility, the credit risk remains anchored to the issuer, Baidu. This distinct separation of idiosyncratic equity risk from the creditworthiness of Baidu creates interesting opportunities for arbitrage.

Volatility Trading

Following the sharp compression of implied volatility towards the end of 2025, the start of the year saw a strong risk-on environment with a spot up and vol up dynamic, which helped to push implied volatility higher over the month in both the US and Europe, supporting portfolio valuation and resulting in positive mark-to-market. This move was further underpinned by ongoing geopolitical noise (notably concerning Greenland and Iran), which kept a bid on volatility levels. Finally, despite already elevated levels, dispersion strategies continued to perform well. This was helped by the start of the earnings season and several unexpected moves in large-cap stocks.

Equity Strategies

On the risk arbitrage front, following the initial approach late last year, Deutsche Börse has formally submitted its offer for Allfunds Group. While Allfunds' share price rallied on the announcement, it continues to trade at a meaningful discount to the offer price due to expectations of an extended regulatory review process.

M&A activity is gaining momentum in Europe, with several new situations emerging, notably:

- Rio Tinto has approached Glencore on a potential merger, before eventually walking away on price
- Zurich Insurance submitted an indicative bid for Beazley and has recently increased its offer
- Spire Healthcare has announced that it is in discussions with both Bridgepoint and Triton
- Oxford Biomedica has received an approach from EQT
- InPost has been approached by an undisclosed buyer

Activity in the region is broadening significantly, extending to the mid-cap space, where the potential for arbitrage strategies is typically richer.

Trading Strategies

Gold, and precious metals continued their rally in January reaching new highs before a sharp sell-off at the end of the month.

During the rally in gold, we partially switched our exposure into upside call structures and selectively adding downside protection, allowing us to crystallize gains while preserving convexity and maintaining our long-term stance. Recent volatility suggests the gold trade is maturing, and we anticipate that 2026 could be the last year with significant upside potential for gold in this cycle. Recent movements have challenged gold's traditional flight-to-safety role, and it is becoming increasingly difficult to categorise gold as a strictly risk-off holding.

We remain vigilant, actively managing exposure and downside risk as market dynamics continue to evolve.

Outlook

Geopolitical instability was embedded in our 2026 framework, yet the velocity and magnitude of developments in the opening weeks of the year materially exceeded expectations, establishing a fundamentally elevated volatility regime. Simultaneously, valuation concerns within the artificial intelligence complex, which had receded in late 2025, have resurfaced. Digital asset markets have

experienced significant liquidations, adding to the broader theme of asset-specific repricing. Meanwhile, gold's traditional role as a risk-off hedge has continued to blur, with the metal increasingly trading as a debasement hedge rather than its traditional flight-to-safety role.

These parallel dislocations underscore a structural shift toward higher dispersion and increased two-way volatility. For relative value and arbitrage mandates, this environment is inherently constructive: widening spreads and price inefficiencies create alpha-generating opportunities, while market-neutral positioning provides insulation from directional beta risk. We view the current paradigm as offering asymmetric payoff profiles for those seeking to capture upside from volatility expansion while maintaining strict downside protection through low net exposure.

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