



# The **Advisor's Guide** to Client Conversations about **Merger Arbitrage**

## Why This Conversation Matters

When markets are choppy, bonds are shaky, and clients want more predictability.

**Merger Arbitrage can be a quiet stabilizer.**

But most clients (and even some advisors) have never heard of it.

That's why this guide exists: **to help you explain what merger arbitrage is, why it may make sense in a portfolio, and how to respond to common client concerns.**

## What Is Merger Arbitrage, in Plain English

Merger arbitrage is a strategy that seeks to earn a steady return by buying companies *after* they've agreed to be acquired. When a takeover is announced, the target's stock usually trades a bit below the offer price due to "deal risk". Merger arbitrageurs try to "clip the spread" between today's price and the closing price if/when the deal closes.

The spread is captured in one of two ways:

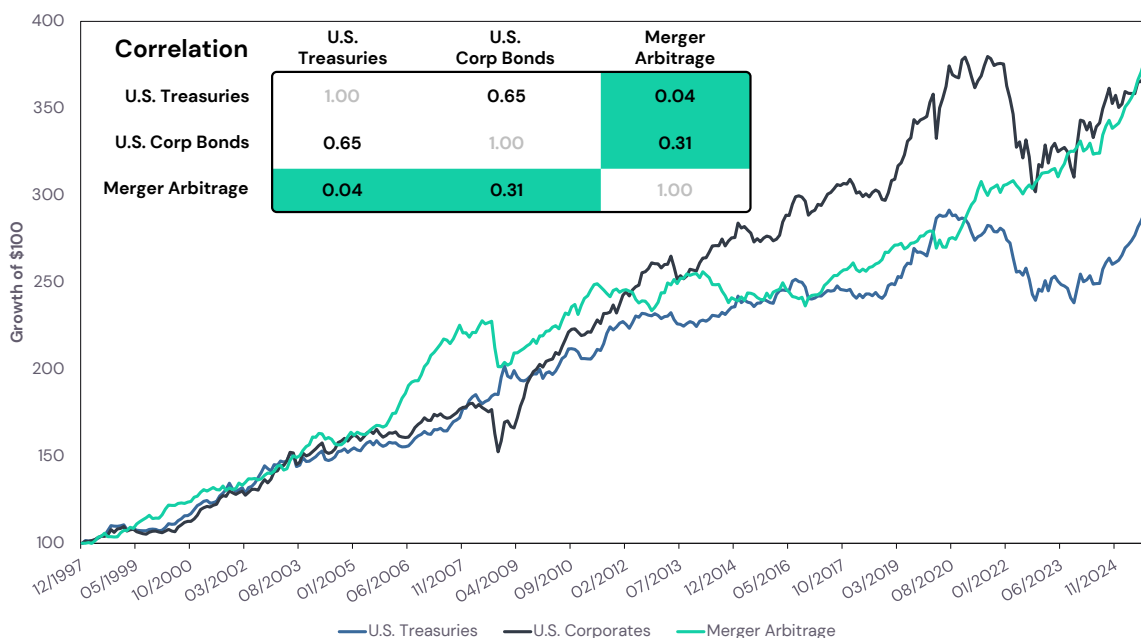
- **Cash deal:** buy the target stock at market and wait to get cashed out at the announced takeover price (most deals).
- **Stock deal:** buy the target stock and short the acquirer in the announced exchange ratio.

Importantly, it's not about guessing which company will be bought. It's about stepping in after the announcement and waiting for the deal to close. The profits tend to be small, steady and exhibit low correlation to equities, bonds and other alternative strategies over time.

## Why Might This Make Sense for Clients?

### A Time-Tested Category with Steady Returns and Low Market Exposure

Merger arbitrage is one of the oldest and most broadly adopted alternative strategies used by advisors and institutions. Further, it doesn't depend on stock or bond markets going up. The strategy's returns are tied to deal completion, not economic growth.



Source: Bloomberg. U.S. Treasuries is the Bloomberg US Treasury Total Return Index ("LUATTRUU"). U.S. Corporates is Bloomberg US Corporate Total Return Index ("LUACTRUU"). The Merger Arbitrage ("Merger Arb") is the LAB Merger Arbitrage Liquid Index ("CSLABMA"). You cannot invest in an index. Returns are gross of all fees. Returns are gross of taxes. Returns assume the reinvestment of all distributions. Past performance is not indicative of future results. Period is 12/31/1997 through 09/30/2025. The starting date is chosen based upon the earliest date data is available for the underlying indexes.

## Opportunity Born from Uncertainty

The return comes from deal risk: delays, financing questions, or regulatory issues. Fundamental investors often want to redeploy capital elsewhere so arbitrageurs step in and get paid to bear the risk that announced deals may take longer to complete than expected, or even fall through.

## U.S. Deal Law is Incredibly Strong

One of the reasons most announced deals actually close is because U.S. merger law is strict and enforceable. A great example? Elon Musk's attempt to walk away from buying Twitter.

In 2022, Musk tried to back out of his \$44 billion agreement to acquire Twitter, citing concerns about spam accounts. But Delaware courts – where Twitter is incorporated and most large deals are governed – made it clear: once a binding deal is signed, it's extremely hard to walk away. Musk ultimately completed the acquisition at the original terms.

This real-world case helps illustrate why merger arbitrage can work: contracts are strong, enforcement is reliable, and legal precedents favor deal closure.

## How to Talk to Clients About It

### "Why does a spread even exist when a deal is announced?"

The spread exists because fundamental investors who were holders before the deal was announced now want to move on, deploy capital elsewhere and are willing to pay others to take the risk the deal takes longer to complete than expected or even falls through.

### "What happens if a deal falls through?"

This is why merger arbitrage investors expect to get paid. The math is built into the spread between the market price and the announced deal price. Some deals will fail; that's expected. Historically, the wins more than offset the losses, especially when position sizes are managed carefully.

### "Isn't this just betting on M&A?"

The strategy is not based on guessing who gets acquired. Rather, the strategy buys after deals are announced.

### "Isn't this kind of an obscure strategy?"

It might feel that way because it doesn't get much airtime in the headlines, but institutions and advisors have used merger arbitrage for decades. It's a long-standing strategy with a strong theoretical foundation and real-world track record.

### "Seems too conservative to matter."

Most announced mergers close successfully, and investors are typically paid a small but steady premium for stepping in during the period of uncertainty. Over time, the strategy seeks to string together a series of modest wins, rather than relying on home-run trades. It's the consistency of these base hits that can add up to meaningful contribution with low volatility. *Especially when stacked on top of stocks or bonds.*

***"It's the consistency ... that can add up to meaningful contribution with low volatility. Especially when stacked on top of stocks or bonds."***

## Warren Buffett's Bet on Merger Arbitrage

While Warren Buffett is best known for his buy and hold investments in high quality businesses, he also had a deep appreciation for what he called “risk arbitrage” — today’s merger arbitrage. In his early partnership letters, Buffett outlined how he actively allocated to arbitrage situations when he believed the risk vs. return profile was compelling.

He emphasized that these investments were not speculative, but rather driven by careful analysis of deal terms, regulatory risk, and the probability of completion. At times, risk arbitrage represented a meaningful portion of his portfolio.

Importantly, Buffett also deployed arbitrage strategies inside Berkshire Hathaway’s insurance subsidiaries as a way to generate better returns on idle cash. Instead of letting capital sit in short term instruments, Buffett sometimes used arbitrage as a secure, short duration, yield-enhancing allocation: a clear endorsement of its relative safety and reliability.

Buffett’s approach underscores a timeless principle: when implemented with discipline and selectivity, merger arbitrage can be a rational, repeatable way to enhance portfolio resilience and smooth returns.

**I’ve probably participated in about 300 arbitrage situations at least in my life, maybe more.**

— Buffett Talk to MBA Students at Florida University, 1998

## Key Analogy: Hitting Consistent Singles

This isn’t a home-run strategy. It’s about a steady stream of base hits. Deals typically close in 1–3 months, and the strategy rotates through new ones over time.

## Quick-Reference Bullet Points for Conversations

- 1. Diversification Without Drama:**  
“Low beta, low correlation, and historically steady returns, even in equity drawdowns.”
- 2. Event Driven, Not Macro Driven:**  
“Returns come from deal spreads, not economic cycles.”
- 3. Predictable Process, Not Prediction:**  
“You’re paid to take deal closure risk, a known and diversifiable uncertainty.”
- 4. Stackable Stability:**  
“Return stacking lets us add merger arb on top of core allocations.”
- 5. Consistent Singles:**  
“It’s not about shooting the lights out, it’s about smooth and steady returns.”

## Bridging the Implementation Gap

Clients hesitate because they don't want to sell stocks or bonds to fund a modest returning (but consistent) diversifier. Return stacking changes the equation: we can add merger arbitrage *on top* of a traditional stock/bond portfolio without displacing core exposures.

This minimizes tracking error regret while possibly enhancing long-term returns.

## Advisor Summary

**In One Sentence:** Merger arbitrage seeks to earn steady, low volatility returns by stepping in between a buyer and seller after a merger is announced.

**Why It Matters:** Historically exhibits low correlations to both equities and bonds, adds a safe yet completely different return stream to client portfolios , helping enhance resilience and long-term returns – especially when return stacked.

## Disclosures

This material is for informational and educational purposes only and is intended for use by investment professionals. It is not intended as investment advice or as a recommendation to buy or sell any security or to adopt any investment strategy. The views expressed are those of the authors as of the date of publication and are subject to change without notice.

Investing involves risk, including possible loss of principal. Past performance is not indicative of future results. Diversification and asset allocation do not guarantee profit or protect against loss in declining markets.

Return stacking may involve the use of derivatives, leverage, and short selling. These techniques can magnify gains, but also increase potential losses and risk.

Nothing in this document should be construed as legal, tax, or accounting advice. You should consult your own legal and tax advisors before implementing any transaction or strategy. This material may not be reproduced, distributed, or transmitted in whole or in part without prior written permission.