GMO

YEAR-END LETTER FOR 2024

Event-Driven Team: Event-Driven Strategy

Dear Client,

GMO's Event-Driven Strategy posted a +10.5% return, net of fees, in 2024. This result compares favorably to the returns of our benchmark (the FTSE 3-month Treasury Bill returned +5.4%) and our peers (the HFRX Merger Arbitrage Index returned -1.8%) over the same period.

As the HFRX Index returns demonstrate, it was a challenging year for merger arbitrage investors. 2024 was only the fourth negative return in the last two decades for the Index, and its -1.8% return was only 30 bps shy of the worst year in its history. Given the divergence in returns compared to our peers, we have been asked recently how we came to deliver such favorable results against a challenging backdrop. The answer is equal parts complicated and simple. The complicated part is that in looking through the positions contributing most to our Strategy's strong 2024 performance, no name or theme stands out as a singular driver. Our top 2024 performers included:

- Two Japanese mergers (Shinko Electric and JSR Corp) that required, and received, Chinese antitrust approval.
- A paper sector deal (DS Smith-International Paper) where the emergence of a Brazilian interloper (Suzano) for the buyer made the deal prospects (and short-term returns) briefly terrifying before resolving favorably when Suzano abandoned its pursuit of International Paper.
- A broken deal in the equipment rental sector (McGrath RentCorp), where the company's strong fundamental performance caused us to make almost as much money holding the deal through the break as we would have had the merger closed successfully.
- A gaming sector deal (Endeavor Group) where the insufficient value offered by the buyer was gradually recognized by the market and shares eventually traded well-through the deal terms.
- A tech sector deal (Ansys-Synopsys) that six months ago was viewed by merger investors as "too hard" but saw steady accretion in the deal spread as the companies cleared regulatory hurdles.
- Finally, and most impactfully, a tracking stock pairs trade we've held for several years (Liberty Broadband-Charter Communications) where our bull case scenario of a collapse of the tracking stock discount turned into the base case scenario when the companies announced a merger this past fall.

The simple commonality among this esoteric group of positions is our assessment that they were trading at a discount to a probabilistic assessment of their fair value. While most of these positions were new to us in 2024, the process we used to determine their attractiveness was not. Event-driven investing is a probabilistic endeavor, where assessments of an individual event's upside and downside are paired with a view of each outcome's likelihood. In evaluating investments, we combine a sense of the historical odds of success for similar situations with a research-intensive effort to determine what might be different this time around. Such an approach is simple in theory yet challenging in practice, with constant temptations to lose faith amidst negative developments or to become overconfident when things go well. And yet we have found that combining a probabilistic value approach with a steady temperament has led to considerable long-term success.

The proof statement for our approach's virtue doesn't come from a single winner or loser or a single year's performance. Instead, we encourage investors to examine our long-term handicapping results and the returns we have used to generate those results over time. At year-end 2024, both counts were encouraging.

Let's begin with handicapping. After all, our success has not come from a complete avoidance of missteps. The natural conclusion of running a probabilistic process is the admission that a certain percentage of investments will be unsuccessful. As we often say by way of example, if we think something is 90% likely to succeed, we are by definition also saying that it has a 10% chance of failure. Calibrating the accuracy of our probabilistic assessments is thus core to our process. A unique attribute of merger arbitrage investing is its sample size. Every year we have the opportunity to make probabilistic assessments on a significant number of mergers and similar event-driven opportunities. And since the outcomes of these events tend to resolve fairly quickly (typical duration is ~6 months), we get regular feedback on the accuracy of our forecasts. The result is a robust sample size of situations we have evaluated and seen through to a conclusion. Since we began tracking this data granularly in 2015, we have been invested in 393 positions that had a definitive outcome as of year-end 2024. Our average probability on this sample was 90%. Mathematically we expected 354 (90% of 393) to resolve favorably and 39 (10% of 393) to fail. The results bear out the accuracy of our forecasts. Our actual experience was a 91% success rate (35 total breaks), slightly better than forecasted. The importance of this accuracy is core to our investment process. Having confidence in our probability assessments allows us to act boldly when we find situations trading at a discount to our view of the odds.

Dealing with failures, however, is part of what makes a probabilistic approach so challenging. In 2024, two of our worst-performing investments (Albertsons and U.S. Steel) were those that represented the unpleasant end of the probability distribution. Albertsons' acquisition by Kroger was blocked by a federal judge after a long antitrust trial. U.S. Steel's acquisition by Japanese buyer Nippon Steel encountered significant political pushback in the United States before being blocked by President Biden in early-January 2025. In each case, we were able to soften losses somewhat through hedges, but we did lose money on both. It would be tempting in either case to consider how good our Strategy's 2024 returns might have been had we avoided them. Failures always seem obvious in hindsight and merger arbitrage investing is no different from other fields in that the cynic always seems smart for pointing out what didn't work. But there is an important difference between sounding smart and making money. We prefer the latter. We follow a probabilistic approach because we find it works well on average, not because it is perfect (if you find an investor offering a "perfect" investment approach, run, don't walk, in the other direction!). The prospect of deals breaking is a feature, not a bug, of merger arbitrage investing. If deals never broke, there wouldn't be attractive spreads for diligent investors to harvest.

Managing an event-driven merger arbitrage strategy requires a blend of experience and adaptation. We balance a deep understanding of history with considerable "in the weeds" research on the specifics of each investment to search for deviations. The resulting blend serves us well in good times and bad, and is the driver of our long-term success. Since our current Strategy's inception in 2016, it has produced an annualized return, net of fees, of 5.6%. This result has strongly exceeded the annualized returns of Treasury Bills (+2.1%) and the HFRX Merger Arbitrage Index (+1.3%) over the same period. While we are encouraged by these results, we are even more enthused about the process that produced them. Over the course of many years, hundreds of investments, and countless twists and turns, our investment process has proven equal parts timeless and adaptable. Its probabilistic value focus is our bedrock, and its adaptability enables us to leverage our considerable bottom-up research to reflect the realities of the current environment. As we are fond of saying "the names and issues change, but the process doesn't." To that end, we conclude this letter with a quote from our 2018 letter, the first we wrote as a standalone strategy.

"We're often asked what type of market environment we "need" to succeed in a given year. While ample corporate deal-making activity is certainly preferable, we're cognizant that more deals do not always equal a better opportunity set. Similarly, a decline in deal volume doesn't mean tumbleweeds for event-driven investors. As long as companies face key strategic decisions with uncertain outcomes and as long as markets aren't always efficient in pricing that uncertainty, there will be opportunities in the event-driven world. One of the benefits of our approach is its repeatability: even though specific opportunities change from year to year, our investment process and philosophy don't."

We don't know what specifically to expect in 2025, but we are confident we have the team, approach, and process to navigate whatever comes our way.

Yours sincerely,

Doug Francis
Head of Event-Driven Team, Portfolio Manager

Sam Klar
Portfolio Manager

Annualized Returns as of 12/31/2024 (Net, USD)	*Inception*	*1-Year*	*3-Year*	*5-Year*	*ITD*
GMO Event-Driven Strategy	7/31/2016	10.49%	7.88%	4.00%	5.61%
FTSE 3-Month T-Bill		5.45%	4.05%	2.54%	2.11%

Performance data quoted represents past performance and is not predictive of future performance.
Net returns are presented after the deduction of a model advisory fee and incentive fee if applicable. These returns include transaction costs, commissions and withholding taxes on foreign income and capital gains and include the reinvestment of dividends and other income, as applicable. Fees paid by accounts within the composite may be higher or lower than the model fees used. **GMO LLC claims compliance with the Global Investment Performance Standards (GIPS®). A Global Investment Performance Standards (GIPS®) Composite Report is available on GMO.com by clicking the GIPS® Composite Report link in the documents section of the strategy page. GIPS® is a registered trademark owned by CFA Institute. CFA Institute does not endorse or promote this organization, nor does it warrant the accuracy or quality of the content contained herein. Actual fees are disclosed in Part 2 of GMO's Form ADV and are also available in each strategy's Composite Report**. The portfolio is not managed relative to a benchmark. References to an index are for informational purposes only.

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