Edition 06 February 2026

BlackRock

The Portfolio of the Future

A spotlight on portfolio trends

An essential series of guides to effective portfolio construction

EDITION 06.

Meeting a higher performance bar: hedge funds

- Higher volatility and dispersion, diverging monetary policy and heightened geopolitical tensions have reduced the reliability of traditional diversifiers, resulting in **less predictable outcomes in portfolios.**
- **Hedge funds** have emerged as increasingly important sources of **durable alpha, uncorrelated returns and downside portfolio protection** across market cycles.
- Spanning macro, equity-hedged, event-driven and multi-strategy approaches, hedge funds offer tailored exposures that could **enhance portfolio resilience,** as illustrated by our case studies.
- **Blending hedge fund strategies –** through multi-strategy approaches or alongside other asset classes, such as private markets – can further improve risk-adjusted returns and portfolio efficiency.
- In an environment where traditional approaches may no longer suffice, hedge funds are redefining diversification and **shaping the evolution of portfolio construction.**

Hedge funds are increasingly becoming central to portfolios, as sources of durable alpha, uncorrelated returns and downside portfolio protection.

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Hedge funds: the next chapter of portfolio design

1. A shift in multi-asset portfolios

Since 2019, **risk in multi-asset portfolios, such as the traditional 60/40, has risen by over 22%, while returns have declined by over 5%** (see Fig. 1). **Market volatility has become a defining feature of this new regime**, a change magnified by the reduced reliability of stock-bond correlations. In this environment, **static factor exposures may increasingly constrain portfolio outcomes**. This raises a critical question: how can investors restore a more attractive balance of returns and risk? **Hedge funds are well suited to this market shift, we believe.** Through dynamic asset allocation, the ability to go long and short, the use of derivatives and a focus on idiosyncratic opportunities, they can help **transform volatility from a headwind into a source of return.** As uncertainty persists, hedge funds can complement traditional diversifiers while supporting more consistent, risk-adjusted outcomes.

2. A growing and evolving industry

The hedge fund industry has matured, supported by greater transparency, institutional capital and technological sophistication. **Assets now exceed $4.5 trillion,**[1] following a strong rebound since 2023, with scale favouring large managers and specialisation distinguishing smaller firms. BlackRock Investment Institute (BII) **analysis suggests that hedge fund allocations within a portfolio could increase by up to five percentage points while maintaining a traditional portfolio risk profile** (see Fig. 2). **Lower-volatility strategies could be funded from developed market government bonds, while higher-volatility strategies could be funded from public equities, and not at the expense of private markets.** This positions hedge funds as core components of diversified portfolios, with access increasingly favouring early, strategic partnerships.

3. Higher returns with lower risk — and enhanced transparency

BlackRock's Capital Market Assumptions CMAs) highlight **hedge funds' superior risk-return efficiency, based on our expectations for the next 10 years** (see Fig. 3). Event-driven, equity-hedged, relative-value and macro strategies look set to deliver resilient returns – particularly amid weak stock-bond correlations – positioning them as portfolio ballast. While leverage, derivatives and liquidity are important considerations, **UCITS-compliant hedge funds offer greater oversight and accessibility** through leverage limits, regular liquidity and enhanced regulation. Combining innovation with discipline, hedge funds are emerging as key drivers of potential resilience and returns in an increasingly **anchorless macro environment.**

[1]Source: Hedge Fund Research (HFR) Industry data as of 31 March 2025. Figures represent the aggregate capital invested across hedge funds worldwide, including fund-level reporting and estimation models for non-reporting hedge funds.

Figure 1: Portfolio risk has risen – historical risk and returns for a 60/40 portfolio

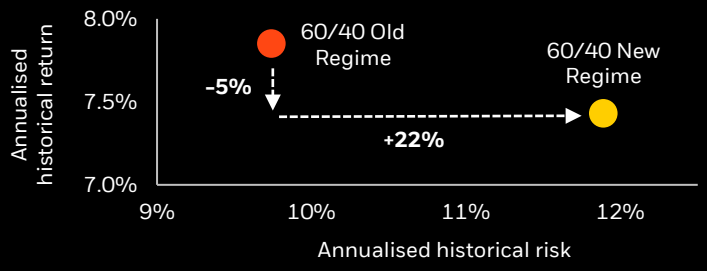


Figure 2: Funding the allocation – BII estimates of hypothetical changes in portfolio allocations

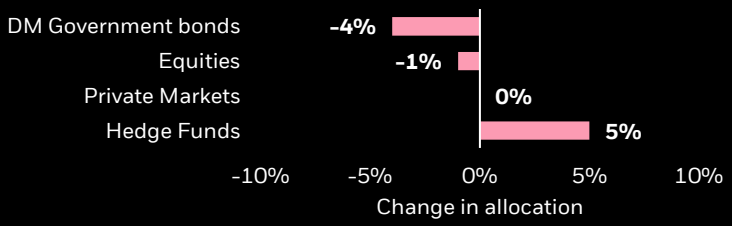
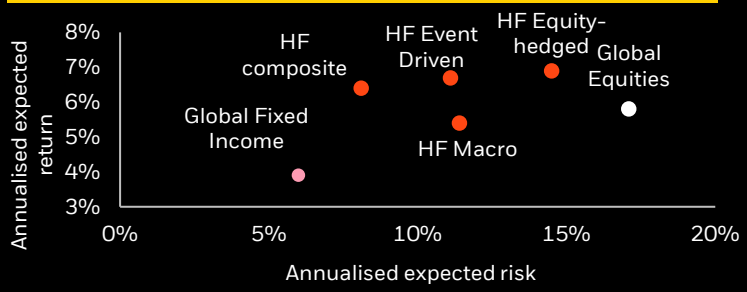


Figure 3: Expected forward-looking risk and return with BlackRock's CMAs (USD, 10y tenor)



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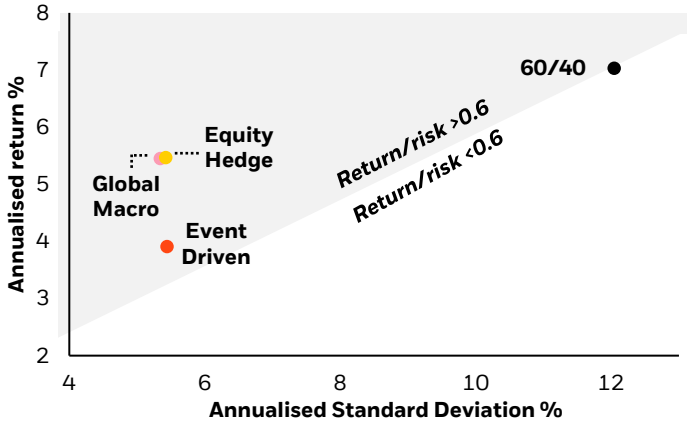
Benefits of hedge funds

1. Long-term returns

Hedge funds can **enhance portfolio resilience** by **capturing value from return dispersion** and **generating durable alpha**. Supported by disciplined risk management, our preferred BlackRock strategies have delivered **stronger risk-adjusted outcomes** and **higher return efficiency than the traditional 60/40 portfolio** (see Fig. 4). With **low beta to global markets**, these strategies could provide diversification benefits and **support more consistent performance** across market cycles and investment horizons.

Figure 4: Strong risk-adjusted performance

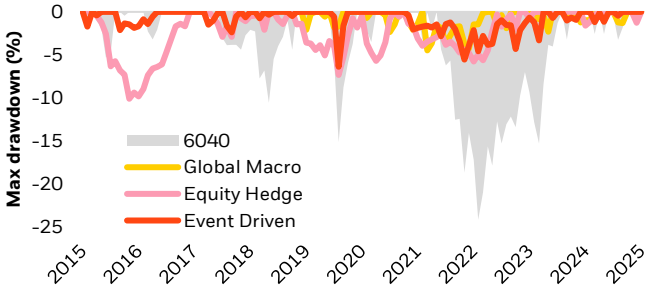


The figures shown relate to past performance. Past performance is not a reliable indicator of current or future results and should not be the sole factor of consideration when selecting a product or strategy. Source Time period: August 2019 to December 2025 given recent inception of some funds. Currency: USD. Hedge Fund strategies are proxied by illustrative proprietary Global Macro, Event Driven, and Equity Hedge Fund strategies.

2. Downside management

As traditional diversification becomes less reliable, hedge funds offer **dynamic risk management** and **capital preservation** during periods of heightened volatility and structural change. Historically, they have experienced **shallower and less frequent drawdowns than broad equity and fixed income markets** (see Fig. 5). Some strategies, such as event driven, exhibit **positive asymmetry** – capturing upside while cushioning downside risk. Others, including global macro and equity hedge strategies, have delivered **positive performance across both rising and falling equity markets**, supporting portfolio stability, particularly when traditional fixed income has been less effective as an equity hedge.

Figure 5: Shallower drawdowns, faster recovery



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3. Uncorrelated alpha

Hedge funds aim to generate alpha independent of **market beta**, offering a valuable source of differentiated returns. With **low correlation both among themselves and against traditional assets (see Fig. 6)**, BlackRock hedge fund strategies can provide **consistent, capital-efficient returns** even when stock-bond correlations are unstable. Hedge funds also add **differentiated risk profiles** through distinct sources of risk and return that generate meaningful diversification benefits. With **significant proportions of risk exposures being idiosyncratic,** they reduce reliance on traditional market beta as well as on broad macroeconomic anchors, compared to global equities and fixed income. This can help enhance **portfolio diversification in a range of market environments.**

Figure 6: Correlations across BlackRock hedge funds

	1	2	3	4	5
MSCI ACWI (1)	1.00				
Global Agg (2)	0.63	1.00			
Global Macro (3)	0.19	-0.13	1.00		
Equity Hedge (4)	0.35	0.21	0.13	1.00	
Event Driven (5)	0.74	0.48	0.20	0.31	1.00

Negative (<0.0)	Low (0.0-0.3)	Moderate (0.4-0.5)	High (0.6-0.7)	Very High (0.8-1.0)

The figures shown relate to past performance. Past performance is not a reliable indicator of current or future results and should not be the sole factor of consideration when selecting a product or strategy. Source: BlackRock, MPI, Morningstar. Time Period: August 2019 to December 2025. Data frequency: month. Currency: USD. All historical fund performance is net. Hedge Fund strategies are proxied by illustrative proprietary Global Macro, Event Driven, and Equity Hedge Fund strategies.

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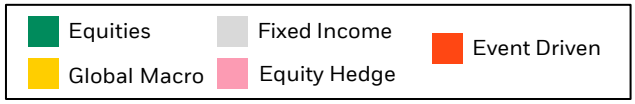
Incorporating hedge funds into portfolios

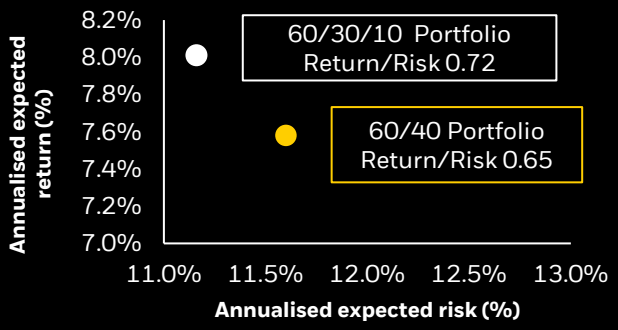
Allocating to Hedge Funds in 60/40 Portfolios

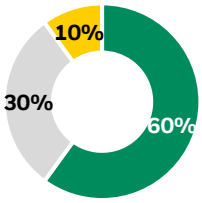
Adopting a whole-portfolio approach, we show how allocating 10% to either a global macro hedge fund, an equity hedge fund or an event driven strategy could help diversify a traditional 60/40 portfolio.



Integrating a global macro hedge fund

Figure 7: Historical return & risk (September 2019 - December 2025)



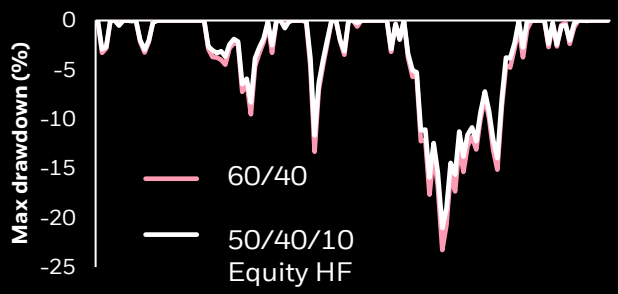


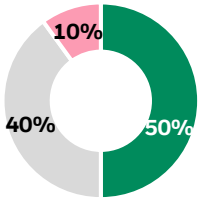
60/30/10 Portfolio with a Global Macro Strategy

Funded from fixed income, global macro strategies can **enhance portfolio diversification** due to their low correlation to both global equities and fixed income, while maintaining **bond-like volatility (5–7% range)**. Historically, allocating to a global macro strategy hedge fund has improved portfolio efficiency by **increasing return potential and strengthening risk control**, hence **shifting portfolios toward a more efficient risk/return frontier.**

Integrating an equity hedge fund

Figure 8: Maximum drawdown (December 2015 - December 2025



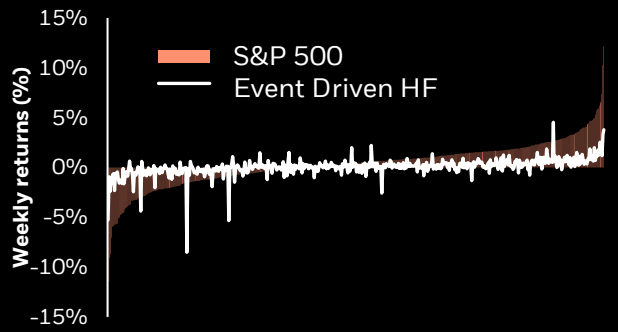


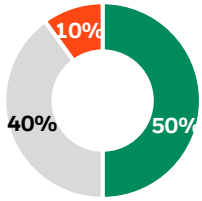
50/40/10 Portfolio with an Equity Hedge Strategy

Funded from equity, an equity hedge fund allocation can **help generate alpha across investment horizons**. These strategies have also historically helped **to limit maximum drawdowns** (see Fig. 8) and **95% CVaR** (ie. average losses in the most adverse 5% scenarios), providing downside protection.

Integrating a global event driven fund

Figure 9: Returns of event driven hedge fund vs. weekly S&P 500, ranked lowest to highest





50/40/10 Portfolio with an Event Driven Strategy

Funded from equities, a global event-driven strategy seeks **uncorrelated returns from idiosyncratic corporate events**. Our preferred event driven hedge fund strategy targets **value dislocations** from restructurings, management changes, and M&A, with returns driven by **company-specific catalysts rather than market direction**. This has resulted in **lower return dispersion than the S&P 500** (see Fig. 9) and historically **reduced portfolio drawdowns** during periods of market volatility over the past seven years.

While proprietary technology platforms may help manage risk, risk cannot be eliminated. Risk management cannot fully eliminate the risk of investment loss. This information is not intended as a recommendation to invest in any particular asset class or strategy or as a promise – or even estimate – of future performance; Forecasts are not a reliable indicator of future performance. Source: Morningstar, as of December 2025 for historical performance, cumulative drawdown, market downturn and risk data. Currency: USD. Global Fixed Income Proxy: Barclays Global Aggregate Index TR USD, Global Equity Proxy: MSCI All Country World Index USD. Indices are unmanaged and one cannot invest directly in an index. Time period: August 2019 to December 2025 for Fig. 7. November 2015 to December 2025 for fig. 8 & 9. Hedge Fund strategies are proxied by illustrative proprietary Global Macro, Event Driven, and Equity Hedge Fund strategies.

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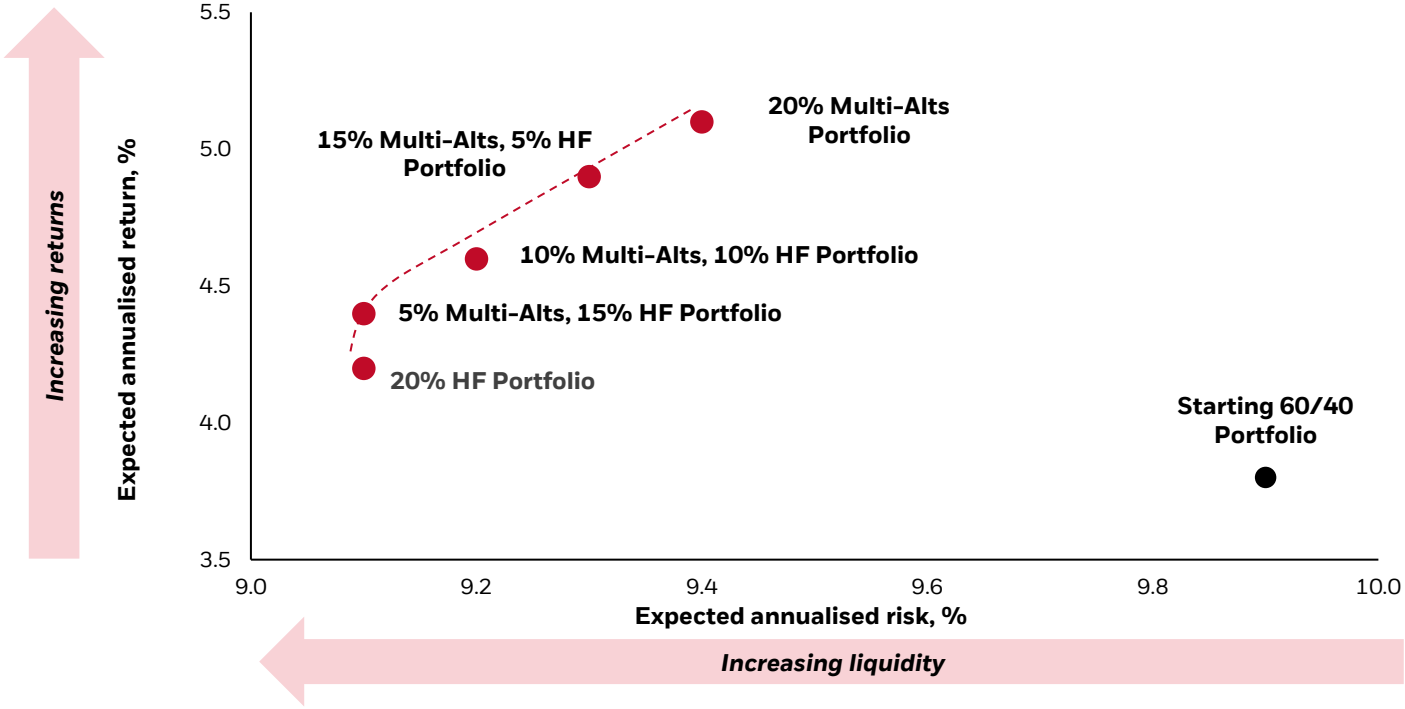
Incorporating hedge fund strategies and a multi-alternatives exposure in a 60/40 portfolio

Investors seeking **returns beyond those available from hedge funds alone – while preserving liquidity and limiting downside risk** – may benefit from combining private markets and hedge funds within a single portfolio.

We illustrate this idea in Fig. 10. Starting from a traditional 60/40 allocation for European investors, we introduce several options for a 20% allocation to alternatives, split between: **(1) diversified private markets exposure** through a multi-alternative growth strategy; and **(2) a hedge fund blend**, equally-weighted between an equity hedge fund and a macro strategy, using illustrative proprietary Equity Hedge and Global Macro strategies as proxies.

In this case study, private markets are funded from the equity sleeve, while hedge funds are funded proportionally from both equities and fixed income to maintain the portfolio's overall risk profile.

Figure 10: Efficiency frontier: from a 60/40 portfolio to a portfolio with equities, fixed income, and a 20% allocation to alternatives



This information is not intended as a recommendation to invest in any particular asset class or strategy or as a promise – or even estimate – of future performance. Forecasts are not a reliable indicator of future performance. Source: BlackRock, as of October 2025. CMA Data as of June 2025 month-end, with 10-year tenor. Currency: EUR. Multi Alternatives exposure was funded from the equity portion of the portfolio. Hedge fund exposures were funded from equity for the equity hedge fund and from fixed income for global macro strategy. We used MSCI ACWI as a proxy for Global Equities and BBG Global Aggregate (EUR hedged) for the fixed income proxy. Hedge fund exposures were EUR hedged. The allocation to alternatives is representative of a Multi Alternatives Growth exposure across private equity, private credit, infrastructure and a liquidity sleeve in terms of the asset class breakdown between private credit, infrastructure, private equity and the liquidity sleeve.

- Incorporating both private markets and hedge funds enhances **portfolio diversification while improving the portfolio's risk-return profile**. As shown in Fig. 7, each optimised portfolio on the efficiency frontier sits at an improved risk-adjusted return position compared to the starting 60/40.
- The **largest improvement in risk-adjusted performance** comes from **private markets,** which have become critical for long-term returns, resilience and portfolio efficiency. The 20% Multi-Alts portfolio enhances the 60/40 through a sole additional exposure to private markets and shows the greatest uplift in returns.
- Larger **hedge fund exposures** in portfolios can also contribute positively to **portfolio performance**, while offering an additional advantage of **improved liquidity**. The 20% HF portfolio showcases material risk-efficient return enhancement, supported by lower correlations and stronger downside protection.

Bottom line: We believe that a portfolio fit for the future should include **hedge funds as a key building block to enhance diversification, resilience and returns** in an environment where traditional approaches may no longer suffice for reliable portfolio outcomes.

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Appendix

YoY Performance, %

	2021	2022	2023	2024	2025
Global Macro HF	0.2	5.6	2.9	10.9	6.2
Event Driven HF	1.9	-2.3	7.4	1.4	10.3
Equity Hedge Fund	3.3	0.7	10.7	17.1	13.1
60/40 Portfolio	8.8	-17.3	15.4	9.5	16.6
MSCI ACWI Index	18.7	-18.0	22.1	16.8	22.7
Bloomberg Global Aggregate Index	-4.7	-16.3	5.7	-1.7	8.2

The figures shown relate to past performance. Past performance is not a reliable indicator of current or future results and should not be the sole factor of consideration when selecting a product or strategy. Source: BlackRock, MPI. Time Period: 04/01/20 – 31/12/25. Data Frequency: month. Currency: USD. Hedge Fund strategies are proxied by illustrative proprietary Global Macro, Event Driven, and Equity Hedge Fund strategies. The allocation decisions in the hypothetical were not made under actual market conditions and cannot account for the financial risk. Past hypothetical performance results are not indicative of future returns. This information demonstrates, in part, the firm's Risk/Return analysis. This material is provided for informational purposes only and is not intended to be investment advice or a recommendation to take any particular investment action.

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Methodology

Interest Rates: Our model provides a way to chart the yield curve at multiple time horizons in the future. We base this on our estimates of: (1) the short rate and (2) model implied term premia. We base our estimates of short rates on market data in the near term and on macro-informed data in the long term. We assume investors’ views about long run inflation and real growth, coupled with changing preferences as to savings and risk aversion, will ultimately determine their expectations for short rates (the “long run short rate”). We use an affine term structure model -a type of model that assumes bond yields as a linear function of a small set of parameters (Piazzesi, 2010) –to compute model-implied term premia. In our implementation, we represent the yield curve using the first five principal components of yield, as laid out by Adrian et al. (2013). We then blend the model implied term premia from the affine term structure model with market implied term premia, with the relative weights dependent on the relevant time horizon.

Appendix

Equities: Expectations of cash flows and discount rates can help explain the variability in equity returns as shown by Campbell (1990). We have used this insight to develop a discounted cash flow (DCF) model, with a few key innovative features. Most academic research focuses on the question of whether stock returns are predictable at all. We are concerned with making the best estimates that we can. We make two additional contributions. First, the baseline DCF model estimates earnings by leveraging analyst earnings estimates in the near term as discussed by Li et al (2013) to derive the implied cost of capital. The common assumption in implied cost of capital (ICC) studies is that earnings growth implied by analyst earnings estimates in the near term should trend towards GDP growth in the long term. This can introduce an unintended assumption of continued expansion of profit margins. We have introduced a modification to account for late economic cycle dynamics. We allow for corporate profit margins to revert to trend (the median over a rolling 10-year history) as margins typically peak late-cycle. The standard ICC approach typically tests for equity returns using linear regression tests. For our DCF model, we take the desired time horizon as an input (number of years) and we estimate the appropriate discount rate for the specific time horizon using our aggregate implied cost of capital. This way, we account for both key sources of variability in equity returns, namely changes in cash flows and changes in the discount rate.

Credit: Our model for credit asset (excess) returns is anchored on two key elements: 1) our estimate of credit spread at a given horizon and 2) our estimated loss due to defaults and downgrades over the horizon. The first component is projected in a consistent manner with our view of real GDP growth and the link between credit spreads and equity volatility. Our approach helps explain the behaviour of credit spreads using a limited number of predictive variables. Yet, as validated by tests against more complex methods, it retains the ability to help explain a high proportion of the variance in credit spreads. The second component is estimated based on our outlook for spreads, the duration of the asset and an assumed transition matrix which captures migrations and defaults across multiple credit cycles. We currently base our transition matrix on Moody's long-run transition data. We aim to further develop our model by directly modelling transitions based on macroeconomic conditions in order to better capture cycle dynamics and the respective variation in losses due to credit events. In addition to making our estimates of credit spreads consistent with our macroeconomic views, our new credit (excess) return model allows greater flexibility of calibrating our expected returns to different credit rating compositions which may prevail over the entire time horizon.

Uncertainty and optimisation: Expected returns and asset price volatility are difficult to predict. We believe any technique that builds portfolios should incorporate this inherent uncertainty (Ceria et al. 2006). We consider both long-and short-term drivers of return. In the long run, we expect a relatively small number of macroeconomic drivers —economic growth, rates, inflation, credit and currencies —to determine an asset's returns. In the short-run, other factors can overpower the structural drivers causing wider fluctuations from an asset's fair value. Valuations can be helpful in estimating short-term returns. We combine contributions from the long-and short-term return drivers to produce a final set of return expectations with a range of uncertainty around each.

The next step is to use this set of return expectations in an optimisation engine that seeks out the best return without breaching an investors' risk limit. Mean variance optimisation would produce a portfolio that maximises expected return under one base scenario with a given level of risk. In contrast, we look to build a "least-worst" portfolio –one that maximises returns for an investors' target risk levels across the worst outcomes, say for the bottom 50% of the distribution, from a set of stochastically generated scenarios (cf. Tütüncü et al. 2004 and Garlappi et al. 2006). This helps ensure the portfolio is not overly reliant on just the median return. This process seeks to produce a portfolio that is robust to small changes in the central return estimates (Scherer, 2006).

Stochastic engine: We use Monte Carlo simulation to create random distributions informed by historical return distributions and centred on our expected returns. The engine simulates thousands of return pathways for each asset, representing the range of possible outcomes over a five-to 20-year time horizon.

We leverage BlackRock's risk models to help ensure that assets generate similar returns, to the extent that they have common drivers. The range of scenarios incorporate our work on incorporating uncertainty in return expectations. We use an extension of the Black-Litterman model (1990) –a well-known model for portfolio allocation that combines equilibrium returns and medium-term views in a single-period setting. Our model uses a Kalman filter (1960) –an algorithm that extracts insights about return paths by bringing together a number of uncertain inputs -to extend Black-Litterman into a multi-period setting. This allows us to capture the variation of expected returns over time under various scenarios —from economy-related to market sentiment driven. A large part of these variations is not predictable. Constructing portfolios that are robust to, or can exploit, these variations is a major challenge for investors. The ability to calibrate the engine with asset class views with uncertainty at arbitrary time horizons, and to evolve this uncertainty stochastically, drives the dispersion of return outcomes. Highlighting the uncertainty that investors face when building portfolios helps ensure ostensibly precise return expectations do not lead investors to concentrated portfolios.

Simulated return paths support a broader range of applications, such as asset-liability modelling. We believe stochastically generated return scenarios enable investors to move with ease beyond mean-variance and optimise portfolios against their individual needs. Investors can place more emphasis on the tails of the distribution or focus on the path of returns rather than just the total return. They can incorporate flows in or out of the portfolio over the course of the investor's time horizon or place more emphasis on scenarios that are challenging for the investor's business beyond their portfolio. Investors with complex asset-liability matching requirements, such as insurers, typically rely on stochastic simulations of returns to assess and construct portfolios.

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