2025 Hedge Fund Outlook

Adapting to the New Regime

Q4 2025

BlackRock.

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Foreword

Michael Pyle, CFA
Deputy Head of the Portfolio Management Group

Long-term asset allocation and diversification frameworks designed for the last decade are not fit for purpose in this new moment. Hedge funds can play a central role in adapting to today's environment.

Markets today are defined by macro risk — but not in the way investors grew accustomed to over the past decade. Long-term macro anchors like stable monetary and fiscal policy frameworks have eroded, while geopolitics and the AI revolution introduce new and unpredictable forces for growth and inflation.

This fall's macro picture reflects that dynamic: a weakening labor market, signs of renewed inflation picking up amid higher tariffs, widening U.S. fiscal deficits and a rapid buildout of AI infrastructure. The range of possible outcomes is unusually wide — scenarios from a productivity boom to an AI reversal all seem plausible.

In this environment, traditional portfolio diversifiers such as government bonds may be less reliable. Investors must look to alternative sources of return and diversification, and hedge fund strategies are well positioned to help. In the first half of this year, USD 37.3 billion flowed into hedge funds — the strongest six-month period since 2015.[1] BlackRock ranked fourth in inflows, reflecting client trust in our ability to navigate this environment.[2]

Our hedge fund platform seeks to help allocators address macro risk in two complementary ways: by targeting uncorrelated return streams, as discussed by our Systematic team (page 4), or by turning macro risk itself into alpha, as highlighted by our Global Tactical Asset Allocation team (page 6).

The 2020s, in many respects, look more like the 1990s and early 2000s than the 2010s. Alongside renewed dispersion, volatility and higher interest rates, this decade is also defined by an explosion of new technological advances that are reshaping industries and productivity — themes our Fundamental Equity and Event-Driven teams explore (page 8 and 10) in the context of how they are positioning portfolios. Together, these forces are creating one of the most opportunity-rich environments for hedge funds in decades.

Recent research from the BlackRock Investment Institute shows room for some investors to boost hedge fund allocations by up to five percentage points without increasing portfolio risk.[3] Investor surveys reinforce this trend, indicating hedge funds are set to receive the largest incremental allocations of capital this year, a shift our Multi-Asset and Hedge Fund Solutions teams analyze (page 11).

What's clear is that investors need to adapt. Long-term asset allocation and diversification frameworks designed for the last decade are not fit for purpose in this new moment. Hedge funds can play a central role in that adaptation.

1 Hedge Fund Research. "Global hedge fund industry surges through 2Q volatility." July 18, 2025. https://www.hfr.com/media/market-commentary/global-hedge-fund-industry-surges-through-2q-volatility/.
2 With Intelligence Data. "Multi-strategy growth overtakes equity to push Billion Dollar Club to new asset high." September 17, 2025.
3 BlackRock Investment Institute. "More room for hedge funds." BlackRock Investment Perspectives. August 2025. https://www.blackrock.com/institutions/en-global/literature/whitepaper/bii-investment-perspectives-august-2025.pdf.
Source: BlackRock as of October 2025. The opinions expressed may change as subsequent conditions vary. The information and opinions contained in this material are derived from proprietary and non-proprietary sources deemed by BlackRock to be reliable. No representation is made that this information is accurate or complete. There is no guarantee that any forecasts made will come to pass.

Systematic multi-strategy: Investing through reversals and extrapolations

Raffaele Savi
Global Head of BlackRock Systematic

> **The goal isn't to predict every turn. It's to run a repeatable, adaptive process that compounds through volatility and evolves as the data evolves.**

2025 has reminded us that markets rarely move in straight lines — they lurch, pivot and accelerate in unexpected ways. The year's rhythm has been defined by sharp reversals and rapid extrapolations. A Q2 tariff shock sparked a swift selloff, only to be followed by violent rebounds as crowded positioning unwound and risk appetite surged. Reversals forced shorts to cover in a rush, sending even unprofitable stocks soaring. Extrapolations quickly followed, pulling investors into the next narrative — from AI to deregulation to retail-driven rallies.

This new tempo is more than noise; it's a regime shift. The old anchors of steady growth, contained inflation and fiscal discipline have loosened. Static exposures are fragile when cycles reset overnight. Resilience now comes from adaptability — the ability to reset portfolios dynamically, capture opportunities on both sides of the cycle and thrive in the churn.

Far from being a headwind, this regime may prove richer for alpha than the decade of post-GFC stability. Hedge funds can be not just diversifiers, they can be active engines of differentiated returns, built exactly for this kind of market environment.

Scale as the edge

AI has delivered a blunt but powerful truth: Scale beats cleverness. The same can apply to investing.

In a faster, fragmented regime, scale in data, compute and market access can be what separates those who react from those who lead.

- Data scale means going beyond prices and fundamentals to text, images and alternative sources that reveal shifting corporate and policy dynamics.
- Compute scale enables real time stress-testing, nonlinear risk modeling and faster pivots when shocks hit.
- Implementation scale unlocks trading efficiency and deeper market access, opening new frontiers of alpha.

Scale doesn't erase volatility — it seeks to magnify opportunity. It broadens the ways we can implement ideas across asset classes, in a cost-efficient manner, aiming to deliver differentiated returns with consistency.

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Systematic multi-strategy: Investing through reversals and extrapolations

Fragmentation as an alpha factory

Global markets no longer move in lockstep. Policy paths are diverging, trade flows are being redrawn and AI adoption curves look very different across regions. This fragmentation fuels dispersion — creating more leaders and laggards across equity, rates, credit and volatility.

The opportunity is not just spotting these gaps, but exploiting them systematically at scale. With AI-driven text analysis, we can process torrents of information — from policy speeches and corporate filings to market chatter — and separate sentiment from substance. Our tools recalibrate exposures in near-real time, allowing us to fade overextended narratives and lean into underappreciated ones. Navigated with breadth, speed and discipline, fragmentation can become a repeatable source of alpha.

Macro volatility: A feature, not a bug

Volatility is no longer the exception; it is the baseline. Rallies in "story" stocks, abrupt swings in rate expectations and sudden reversals are now defining features of markets. For hedge funds, these cycles are not risks to endure — they are return streams to harness.

Our edge lies in proprietary tools that let us adapt quickly. They parse data in real time, model nonlinear shocks and identify when narratives are shifting beneath the surface. These tools allow us the ability to reduce risk as reversals build, press advantages when dispersion pays and reposition before markets fully reprice. In a world defined by reversals and extrapolations, resilience comes not from riding out volatility, but from staying ahead of it.

How we're positioned

Today's signals point to persistent inflation pressures beneath the surface, a labor market that's softening outside the top quartile of wage earners, and tariff risks that, while easing, still cloud earnings in exposed sectors. At the same time, the AI cycle is proving resilient — fueled by real investment and adoption, not speculation.

In Europe, we are positioned for curve steepening, expressed as long value over growth and long banks versus bond proxies. In equities, we remain overweight information technology with a contrarian focus on second-order AI adopters — firms leveraging AI within products and operations rather than building foundational models — where valuations are more compelling than the crowded enabler segment. We're long fiscal-stimulus beneficiaries in defense and energy independence, while retaining shorts in tariff-sensitive sectors such as food, beverages and metals, where risks remain underpriced.

Implications for client portfolios

If the last two years were a beta sprint, the next phase is a relay — and alpha carries the baton. In a world of fragmented cycles and constant macro resets, strategies that are scale-enabled, cross-asset and risk-engineered seek to deliver what 60/40 alone cannot: persistence, adaptability and differentiated returns.

The goal isn't to predict every turn. It's to run a repeatable, adaptive process that compounds through volatility and evolves as the data evolves. In 2025's accelerated rhythm of reversals and extrapolations, adaptability is the difference between keeping pace — and setting the pace.

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Global macro: Capitalizing on tactical opportunities

Tom Becker, PhD
Senior Portfolio Manager, Global Tactical Asset Allocation Team

2025 has offered plenty of tactical opportunities to shift portfolio positions as growth and inflation fundamentals diverged across countries while also capitalizing on price overshoots to policy pronouncements.

Markets have been shaken and stirred by a novel set of policy developments this year. Rather than interpreting recent market reactions to data and policy pronouncements as one-offs, we view recent developments as part of a larger story about fiscal dominance, sticky inflation and policy divergence — market drivers that we believe will remain relevant for years to come.

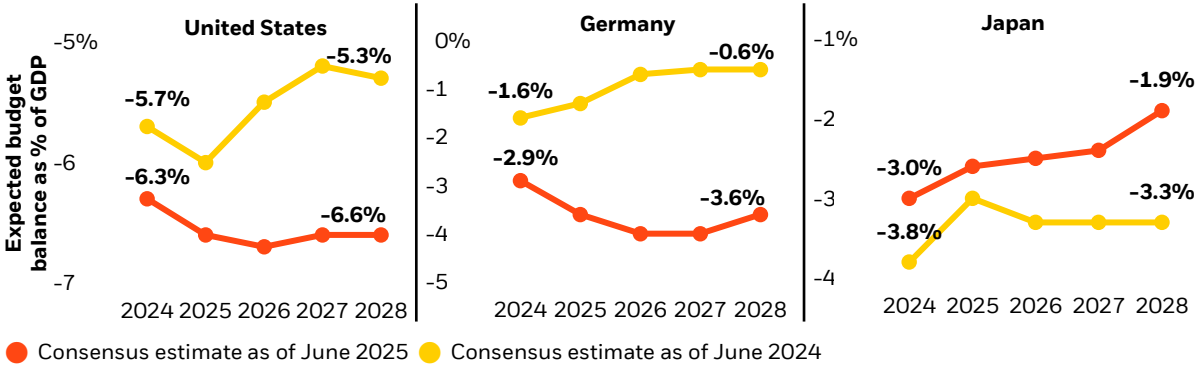
Fiscal dominance

The passage of the One Big Beautiful Bill Act and the sunsetting of the Inflation Reduction Act (IRA) set the stage for a U.S. capex and construction expansion that creates growth upside risk into the end of 2025. That economic boost comes at the cost of a substantial deterioration in the budget outlook.

The dominance of fiscal policy as a driver of nominal growth is increasingly a global phenomenon; Germany's surprise pivot earlier this year to larger deficit spending marked a meaningful macro shift. In contrast to the U.S. and Germany, Japan's exit from decades of debt deflation and sustained, higher nominal growth have improved that country's fiscal outlook. Some examples of positions that we see as potential beneficiaries of policy divergence include long Japanese equities, short German Bunds in the cross-section, and short U.S. dollar.

The fiscal outlook

U.S. and Germany has shifted to structural budget deficits whereas Japan is now forecast to cyclically improve



Source: BlackRock, with data from Consensus Economics as of June 30, 2025. Forecasts of financial market trends that are based on current market conditions constitute our judgment and are subject to change without notice.

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Global macro: Capitalizing on tactical opportunities

Sticky inflation

Inflation emerged as a first-order driver of consumer and corporate behavior earlier in the year amid the U.S. tariff episode: firms frontloaded imports, households pulled forward durable goods purchases and uncertainty slowed real activity in the second quarter. For central banks, this behavioral sensitivity to price shifts is a key challenge for maintaining price stability: inflation isn't just sticky — it's shaping economic decision-making.

Electricity prices highlight structural elements of our above target inflation backdrop. Rising demand from AI data centers and a buoyant U.S. consumer coupled with supply constraints for power generation are driving electricity costs higher. We see a rising risk that U.S. electricity prices converge toward higher global levels and help to further entrench above-target services inflation.

Policy divergence

The global monetary policy landscape in 2025 has been anything but uniform. From Europe's fiscal-monetary coordination, to the UK's sensitivity around quantitative easing (QE) losses, to the U.S. Federal Reserve's balancing act between easing rates and balance sheet management, policy reaction functions are diverging.

For global macro investors, this policy heterogeneity creates relative value opportunities across equities, rates and currencies. We have flattened out directional equity exposure in portfolios, while longs in U.K. Gilts and short U.S. dollar positions are potential beneficiaries of policy divergence.

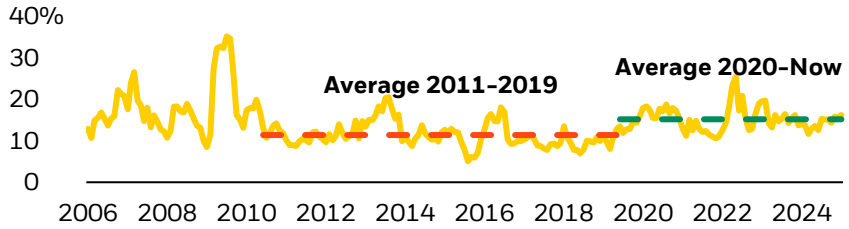
Portfolio positioning

Our investment process focuses on identifying dislocations between macro fundamentals and market prices. 2025 has offered plenty of tactical opportunities to shift portfolio positions as growth and inflation fundamentals diverged across countries while also capitalizing on price overshoots to policy pronouncements.

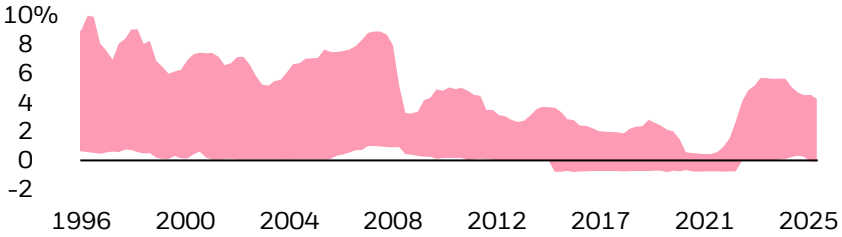
Zooming out, the post-pandemic era has been characterized by more heterogeneous macro fundamentals across countries after a decade of suppressed rates and synchronized outturns. Recent fundamental dispersion is translating into materially higher asset price dispersion — country equity return dispersion and differences in monetary policy rate stances now look more similar to the early 2000s than the 2010s — a dynamic that is clearly visible in the charts below. We see this backdrop benefitting an active, global macro investment approach.

Country-level dispersion has increased across equity returns and policy rates

Dispersion of MSCI ACWI country-level equity returns



Spread of G10 cash rates



Source: BlackRock with data from Bloomberg, Morningstar as of August 31, 2025. Equity dispersion based on root mean squared error (RMSE) of rolling 12-month returns for 27 local country equity markets within MSCI ACWI. Policy rate dispersion represented by spread of cash rates across G10 countries. 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.**

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Fundamental equity: Opportunities amid volatility

Dan Whitestone
Head of the Emerging Companies, Fundamental Equities

We are excited by the signs of increased AI adoption across a broader suite of tools, and we see this benefitting smaller companies as well as large.

Equity markets may look resilient year to date, but the headline performance masks the immense volatility that we have witnessed. From Chinese AI capabilities and U.S. tariffs to anticipation of moves in the rates market, collapse of government bills, rising inflation and geopolitics, it has been a rollercoaster. While the broader macro picture remains unclear, the divergence between different cohorts of consumer, emerging industry trends and intra-market share shifts is creating compelling stock-specific opportunities globally across the market cap spectrum, both long and short. This makes it a very exciting time to be an investor. Our conviction and optimism in the stock-specific opportunity set, which we expect to expand as interest rates come down and market performance broadens out, is reflected in a gross exposure at the high end of our long-term range.

Artificial intelligence – large and small

AI is one of the most dynamic themes shaping markets today, with opportunities spanning the market cap spectrum. Until recently, AI demand has shown up primarily in the revenues of a handful of semiconductor names, driven by large U.S. tech companies who spend hundreds of billions of dollars a year on AI infrastructure, such as data centers. This has sparked repeated debates: Would data center capex earn adequate returns? Was AI hardware demand sustainable? Were we seeing echoes of the late 1990s internet capex boom?

We think a lot has changed over the course of the year. Evidence of generative use cases is mounting, creating a rich seam of opportunity as the addressable universe increases.

The first place we have observed increased adoption of AI is in the usage of ChatGPT and other large language models. Sam Altman, the CEO of OpenAI, said in April this year that "the ChatGPT launch 26 months ago was one of the craziest viral moments I'd seen, and we added one million users in five days... [now] we added one million users in the last hour." ChatGPT is now the world's fifth most-visited website with nearly half its users under 25, according to Semrush data as of September. Enterprise adoption is also on the rise, fueled by the increased functionality of reasoning models and deep research tools. The exponential increase in usage is driving higher demand for compute, with AI token usage at Google reportedly up 50x in the past year. Microsoft's AI annualized recurring revenue has grown +175% year-over-year to $13bn, with a likely +$20bn run rate by year end, according to our analysis. For context, this was zero only three years ago. This pace of growth we are witnessing has no historical precedent, in our view.

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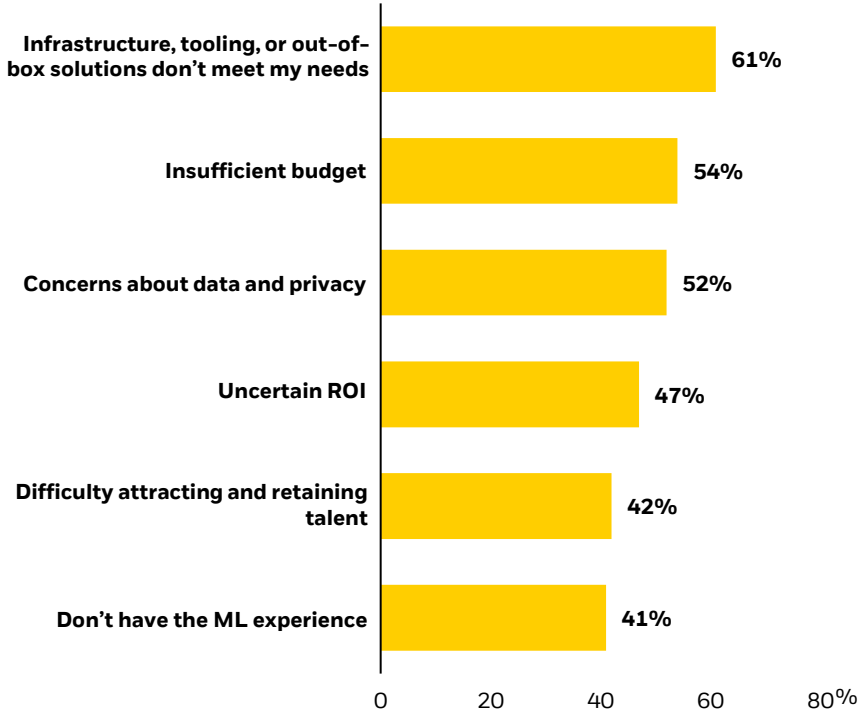
Fundamental equity: Opportunities amid volatility

What are the top challenges in implementing AI technologies at your company?



Source: Scale AI's AI Readiness Report, May 2024. Machine Learning (ML). Data based on survey of 1800 companies who are using or beginning to use generative AI. https://go.scale.com/hubfs/Content/Scale%20Zeitgeist%20AI%20Readiness%20Report%202024%204-29%20final.pdf.

Another opportunity we are excited by are the signs of increased AI adoption across a broader suite of tools, specifically benefitting smaller companies as well as large. In software development, for example, AI code-generating tools may have added more annual recurring revenue for mid-cap companies in Q2 2025 than the rest of the mid-cap software industry combined. Many of these mid-cap names with "DevSecOps" (Development, Security, and Operations) platforms and AI coding products offer underexplored growth opportunities beyond the large, well-known AI winners, in our view.

A key bottleneck, however, lies in enterprise data infrastructure. To deploy AI effectively, enterprises need to access data in an efficient and secure way. Given most enterprises have a patchwork of IT infrastructure, both on-premise and in the cloud, across a mix of geographies and multiple systems, this can be a highly complex task. We think there are several small- and mid-cap software companies and cloud infrastructure providers who may benefit from this need to integrate enterprise data in new ways.

In our view, the scale of investment pouring into AI is unprecedented. That isn't to say it will be that way forever, but for now it's hard to overestimate AI's impact in the domains where it has reached critical mass. Our exposure ranges from hyperscalers to chip manufacturers to a range of data infrastructure plays within software, such as "DevSecOps" and database management, observability and analytics.

The pendulum of market sentiment continues to swing back and forth between perceived AI leaders and laggards. This volatility creates both opportunity and risk. As adoption accelerates, many incumbents face mounting pressure on pricing and data strategies, leading to genuine earnings risk. We expect the opportunity for shorts is likely to rise as previously "defensive" companies see their business models challenged.

Finally, of course, it's worth remembering that this is but one of the many themes we are excited about as Q4 unfolds. We continue to see a myriad of opportunities, both long and short, globally and across the full market cap spectrum which makes us excited for the months and year ahead.

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Event driven: Regulatory tailwinds and event-driven catalysts

Mark McKenna
Global Head of
Event Driven

The current antitrust landscape has created tailwinds for event-driven investing, as CEOs have a backlog of potential transactions and a greater focus on strategic transformation.

The second half of 2025 is unfolding against a backdrop that is increasingly favorable for event-driven investing, even as macroeconomic uncertainty lingers. The optimism expressed at the start of the year has been reinforced by structural drivers that are fueling corporate activity, supported by the regulatory tailwinds witnessed over the past six months.

Since the 2025 Presidential inauguration, the regulatory landscape has evolved in ways that have materially reshaped the environment for mergers and acquisitions. Under the leadership of Andrew Ferguson at the Federal Trade Commission and Gail Slater at the Department of Justice, the U.S. has moved away from the more restrictive stance of the previous administration. This has led to the normalization of antitrust regulation, along with faster deal clearance processes and an increased acceptance of remedial measures for transactions perceived to have a competitive overlap.

We believe the current antitrust landscape has created tailwinds for event-driven investing, as CEOs have a backlog of potential transactions and a greater focus on strategic transformation. Industries like the financial sector are beginning to consolidate once again, particularly among regional banks which had been more limited in the previous antitrust regime. In biotechnology, large pharmaceutical companies are actively acquiring assets to strengthen supply chains and fill pipeline gaps. Technology consolidation is also underway, not among the largest "Mag 7" firms, but within the next tier of companies that had previously faced regulatory headwinds. Finally, the energy sector is experiencing its own wave of consolidation, driven not only by the normalized antitrust environment, but also by advancements in AI and an "America-first" policy stance.

Beyond the regulatory backdrop, strategic imperatives are also driving companies to act. In industrials, after a period where many large companies split themselves up, those same firms are now reemerging either as consolidators or as acquisition targets.[4] Infrastructure-related AI has become a focal point with companies investing heavily to strengthen their capabilities and remain competitive. Aerospace companies are also moving to internalize more of their supply chains, motivated by the desire for greater control, resiliency and efficiency.

The confluence of these regulatory shifts, corporate strategic drivers and renewed capital market activity has created precisely the kind of environment for disciplined event-driven investing that we anticipated in our February 2025 outlook. While bouts of volatility are likely as broader policy implementation continues, the structural trends underpinning corporate activity have only strengthened. As policy uncertainty continues to recede, we expect to see a further normalization in C-suite activity, unlocking a potentially robust and diversified opportunity set across the event-driven spectrum.

4 Citigroup. "Event Driven M&A Executive Summary." August 2025.

Source: BlackRock, with data from Bloomberg and Citi as of August 2025. The opinions expressed may change as subsequent conditions vary. The information and opinions contained in this material are derived from proprietary and non-proprietary sources deemed by BlackRock to be reliable. No representation is made that this information is accurate or complete. There is no guarantee that any forecasts made will come to pass.

An allocator's perspective: Uncertainty to action

Adam Ryan
CIO, Multi-Alternatives

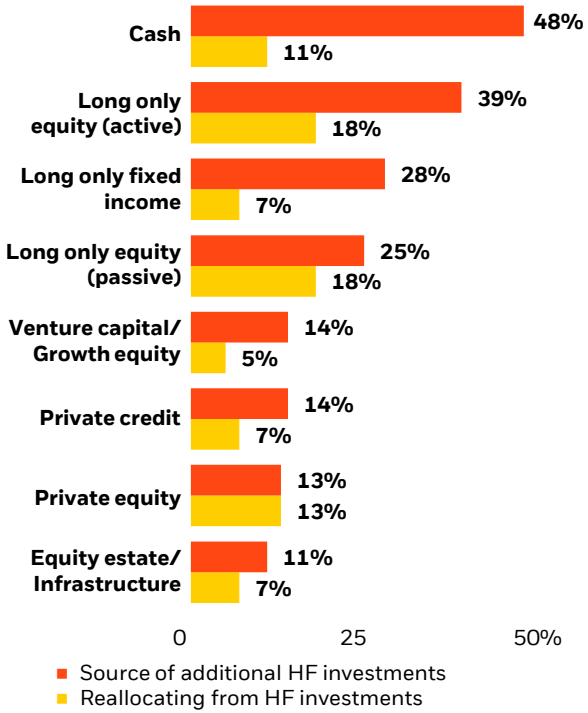
Albert Matriotti
Co-CIO for Hedge Fund Solutions

"In cases where sidelined cash has been redeployed into a diversified, high-quality mix of hedge funds, we have observed strong alpha capture well beyond the risk-free rate.

In the previous Hedge Fund Outlook, we argued that persistent uncertainty is a defining feature of the current market regime. That view still holds and has broadened the opportunity set for skilled hedge fund managers. The environment has become increasingly conducive to the core drivers of hedge fund returns: dispersion, liquidity provision and corporate activity. Unsurprisingly, investor demand has strengthened as well, with allocators leaning into hedge funds as sources of alpha and diversified return streams.

In recent years, hedge funds have re-established themselves as key portfolio building blocks. Across alternative and traditional investment strategies alike, investor surveys indicate that hedge funds are poised to receive the largest incremental allocations of capital this year.[5] As illustrated to the right, the primary funding sources are cash and traditional long-only equity and fixed income sleeves, with a smaller portion reallocated from private market assets. This shift reflects a growing preference for more tactical, complementary alpha engines that sit alongside private market exposures. In parallel, allocators are making greater use of portable-alpha overlays and separately managed accounts (SMAs) to implement hedge fund exposures. These structures free capacity and preserve strategic beta, while enhancing transparency, control and fee efficiency.

Investors are planning to rotate out of cash, equities, and fixed income, and reallocate to hedge funds



Source: BlackRock, with data from Goldman Sachs Capital Introduction Annual Allocator Survey as of January 16, 2025.

5 AIMA. "Hedgeweek-AIMA Mid-year allocator sentiment report 2025." July 2025. https://www.aima.org/article/the-great-manager-hunt-key-highlights-from-the-hedgeweek-aima-mid-year-allocator-sentiment-report-2025.html.

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An allocator's perspective: Uncertainty to action

In many cases, investors have been rewarded for adding more capital to hedge funds this year. In cases where sidelined cash has been redeployed into a diversified, high-quality mix of hedge funds, we have observed strong alpha capture well beyond the risk-free rate. At the individual strategy level, fundamental long/short equity managers have generated alpha that has materially outpaced the excess returns of their active long-only counterparts.[6] Fundamental equity market-neutral funds have benefited from elevated dispersion, whereas active long-only equity managers have been more challenged to outperform increasingly concentrated benchmarks dominated by a handful of names.

Hedge fund performance across strategies has generally been strong in recent years, as higher yields have raised the floor, elevated dispersion has persisted and pockets of volatility have created market inefficiencies for skilled managers to exploit. While most hedge fund strategies have sustained solid results through 2025,[7] the range of manager outcomes remains wide. Many relative-value, event-driven and fundamental long/short strategies have logged strong gains, yet systematic approaches have faced intermittent challenges. Trend followers, for example, struggled with sharp reversals in March-April as policy uncertainty whipsawed markets; and the quantitative equity hedge fund universe endured one of its most difficult and prolonged performance stretches of the past decade during the June-July rally in low-quality stocks — a reminder that even durable premia are cyclical.

This underscores the need to diversify across hedge fund styles while staying anchored in process and discipline. It's tempting to redeem from recent laggards and add to the latest winners. However, short-sighted moves untethered from underwritten theses can crystallize unnecessary losses instead of leaning into price dislocations. The priority should be a disciplined, process-oriented approach designed for long-term success. When a manager experiences a meaningful performance shock, it calls for a structured post-mortem to assess:

- **Sources of weakness:** Is it market-related or manager-specific?
- **Risk behavior:** Did risk systems and drawdown controls operate as designed?
- **Process evolution:** Have portfolio construction and research adapted appropriately?
- **Opportunity set:** Does the dislocation create a buying opportunity, especially in capacity-constrained strategies where re-entry may be uncertain?

Our current positioning reflects those conclusions. We remain constructive on skilled, systematic hedge fund managers with durable edges that add value within a diversified hedge fund portfolio, alongside fundamental long/short, relative-value and event-driven strategies. The correlations among quants are among the lowest across strategies, from one manager to another, which is one reason we maintain a diverse mix in portfolios. Together, their different techniques help stabilize alpha across varied market environments. More broadly, we favor managers who pair data and technology with fundamental insight, capture market inefficiencies rather than market betas and demonstrate the ability to deliver top-quartile performance consistently over the long run.

As we look ahead, the playbook is unchanged. Hedge funds remain an essential portfolio construction tool, but success still hinges on being selective, diversifying and staying disciplined. With thoughtful manager selection and patience through cycles, hedge fund allocations can enhance resilience and improve portfolio outcomes in a regime where unconstrained, alpha-seeking strategies have room to run.

6 Through June 2025, the HFRI Equity Hedge Index (Total) (which tracks long/short equity managers) has produced a year-to-date return of +6%. Meanwhile, Morningstar (via its Active/Passive Barometer) reports that across 38 U.S. equity categories, the "success rate" (i.e. the fraction of active funds that beat their passive peers over one year) was ~29.0% as of mid-2025.
7 With some limited exceptions, the majority of hedge fund strategies are generating positive performance for 2025, based on HFRI strategy indices as of October 8, 2025. **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.**
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Changes in the rates of exchange between currencies may cause the value of investments to diminish or increase. Fluctuation may be particularly marked in the case of a higher volatility fund and the value of an investment may fall suddenly and substantially. Levels and basis of taxation may change from time to time and depend on personal individual circumstances.

Investments in Hedge Funds involve a high degree of risk and are only suitable for investors who fully understand and are willing to assume the risks involved. The regulatory environment for hedge funds is evolving and changes therein may adversely affect the ability of hedge funds to obtain leverage they might otherwise obtain or to pursue their investment strategies.

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