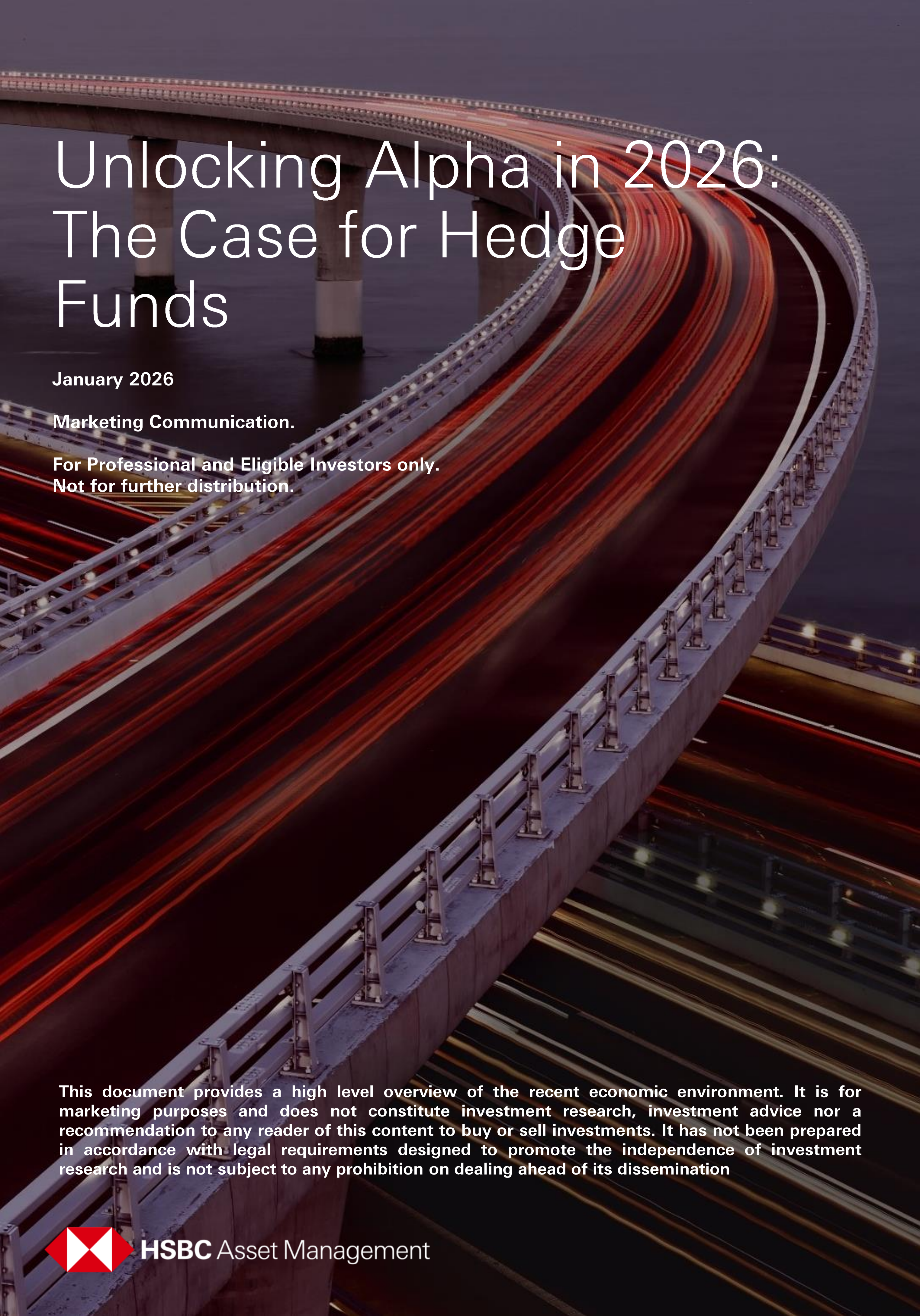

Unlocking Alpha in 2026: The Case for Hedge Funds

January 2026

Marketing Communication.

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HSBC Asset Management

Important Information

Key Investment Risks

Investors in hedge funds should bear in mind that these products can be highly speculative and may not be suitable for all clients.

There are several key issues that one should consider before making an investment into hedge funds. The risks specific to this type of investment may include, but are not limited to:

The value of investments and any income from them can go down as well as up and investors may not get back the amount originally invested. Past performance does not predict future returns. The return may increase or decrease as a result of currency fluctuations.

Regulation

The hedge fund industry is lightly regulated, with the majority of funds domiciled in offshore jurisdictions. Hedge funds are generally classified as "unregulated" and are not typically subject to the same levels of scrutiny and protection as a traditional investment fund. A thorough due diligence process can mitigate these concerns.

Gating

In event that redemptions requests on a particular dealing date are much higher than the normal level and full satisfaction would jeopardise the longer term portfolio balance, a gate or partial execution of redemption requests may be implemented generally on a pro-rata basis.

Side pocket

There may be instances when certain assets in a fund portfolio could become less liquid and the fund manager may segregate these illiquid positions from the main portfolio into a side pocket (or a separate vehicle).

Suspension of redemption

Suspension of redemption is a temporary halt in exiting the fund during a given redemption window. This is a stronger measure than gating because there is no dealing for the fund. This is generally used under special circumstances such as when liquidity conditions have markedly deteriorated in a short period of time or when there are heavy asset outflow such as the loss of a core investor.

Access

Hedge funds operate larger investment minima than traditional investment funds. Investors are often unable to access a hedge fund unless they were willing to invest US$500,000 to US$2million.

Liquidity

Hedge funds typically have much longer dealing cycles than traditional investment funds. Depending on the strategy being utilised, a hedge fund may only allow subscriptions and redemptions on a monthly or quarterly basis. Furthermore, some hedge funds have long lock-up periods, where an investor is not permitted to redeem from the hedge fund unless a period of 6 months, a year or even 2 years has passed. Some may allow a redemption before the lock-up period is over, but the investor would have to pay a hefty penalty to be able to do this.

Transparency

Many hedge fund managers are wary of regularly publishing their positions in the belief that this will remove any advantage that they have over their peers. This can pose a problem to the investor, as he or she cannot be certain to which stocks, geographies, markets or even strategies he or she will be exposed to when investing in the hedge fund. However, trusted investors who have built strong relationships with the hedge funds can access this information for the majority of funds, enabling thorough monitoring of the investment.

Manager failure

Over time, a number of hedge funds will close or fail, due to weak performance or operational difficulties. An investor must take this into consideration before making an investment, seeking professional advice to help minimise the risk of investing in a fund that is likely to fail.

Alternatives Risk

There are additional risks associated with specific alternative investments within the portfolios; these investments may be less readily realizable than others and it may therefore be difficult to sell in a timely manner at a reasonable price or to obtain reliable information about their value; there may also be greater potential for significant price movements.

We have spent much of the last few years highlighting to clients and prospects alike the benefits hedge fund exposure can potentially bring to portfolios. From their downside protection characteristics in times of volatility, to how hedge funds can positively contribute to the traditional 60/40 equity-bonds portfolio construction, we continue to believe in the important role hedge funds play as part of wider asset allocations. And now it seems the wider market is beginning to open up to what we have been preaching. In the first few weeks of 2026, we have seen a marked uptick in widely read financial commentators highlighting the benefits of hedge funds given the prevailing market environment, with the liquidity challenges of private markets and lofty equity valuations just some of the factors playing on investors' minds. This paper will look at the key market characteristics at present which we feel make the case for hedge fund exposure particularly compelling.

Why invest in hedge funds?

We believe hedge funds as an asset class have become a key component of the financial ecosystem and in asset allocation. Regardless of which stage in the market cycle investors find themselves in, we believe there are persistent, longstanding reasons why hedge funds should be included in client portfolios.

Diversification of Strategy

- Hedge funds expand beyond traditional investments, utilizing derivatives, commodities, and bespoke products.
- They offer access to niche markets and innovative strategies not available through conventional vehicles.
- This diversification broadens investment opportunities and enhances portfolio diversification

Alpha Driven Returns

- Hedge funds target alpha, generating returns beyond market averages through skill and insight.
- They leverage proprietary techniques, such as algorithms, to identify undervalued stocks.
- This approach offers potential for superior risk adjusted returns compared to traditional strategies.

Correlation Benefits

- Hedge funds provide correlation benefits by employing uncorrelated return strategies.
- They invest in emerging strategies and complex derivatives to reduce portfolio volatility.
- Diversification through hedge funds mitigates risk and enhances risk-adjusted returns.

Risk Management

- Risk management is embedded in hedge fund processes, using techniques like stress testing.
- They employ hedging strategies to protect against adverse market movements.
- Proactive risk management ensures navigation of complex environments and helps protect investor capital.

Diversification does not ensure a profit or protect against a loss. Any views expressed were held at the time of preparation and are subject to change without notice. Source: HSBC AM Alternatives. As of January 2026.

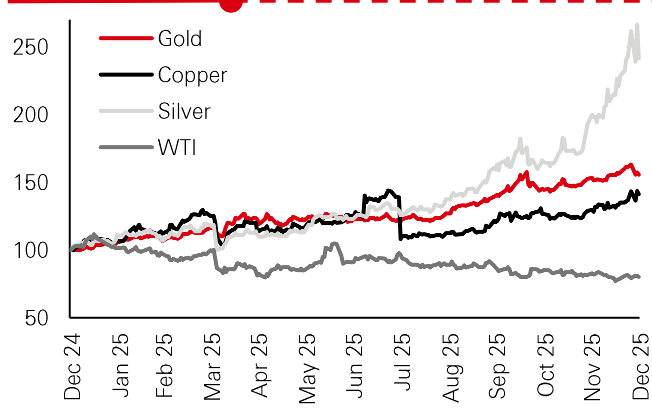
Market dispersion, shifting policies, and rising geopolitical tensions are creating fertile ground for hedge funds to generate alpha across strategies, positioning them as both important diversification tools and potentially effective return boosters within portfolios.

Geopolitical shifts unlock new avenues

Geopolitical uncertainty has been an ongoing theme we have highlighted in recent years – and it is only intensifying. Tensions in the Middle East have seemingly settled in one part of the region only to ignite in another. Meanwhile, in Europe, the Russia-Ukraine conflict continues, which is now being complemented by uncertainty over the future leadership of Greenland. The threat of tariffs has pushed Chinese exports to record highs, whilst the potential impact of additional Venezuelan oil supply is being baked into future commodity prices. It goes without saying that the US, the world's largest economy, has found itself front and centre to these developments.

Whilst the backdrop detailed above is not an exhaustive list of all the geopolitical factors impacting financial markets at present, continued government intervention drives price dislocations which hedge fund managers will look to exploit. Skilled hedge fund managers will look to utilise this fertile opportunity set, particularly within debt, commodity and FX markets, to drive returns. In our view, this backdrop is especially advantageous for Macro and Managed Futures strategies, which are well positioned to navigate such complex and dynamic market conditions, and benefit from resulting pricing dislocations.

Precious metals surge amid volatility

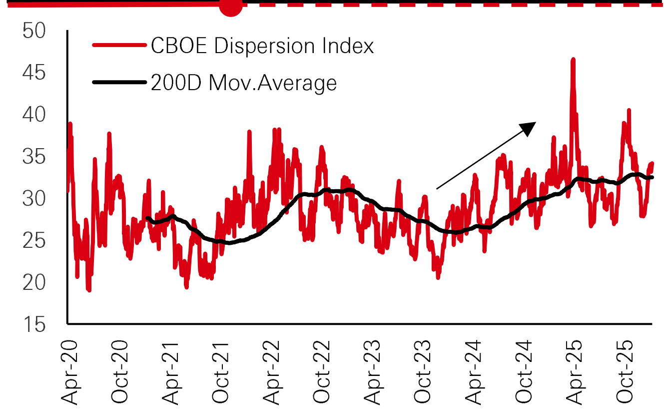


Source: HSBC AM Alternatives, Bloomberg

Dispersion in markets grows

Underperformance in markets outside of the US was a common theme for much of the past decade, however it seems as if the new market paradigm is moving away from this US exceptionalism. 2025 was still a year of solid performance for US indices, albeit performance was inferior to that of international markets as perhaps the long-held view of US perpetual superiority was questioned. As such, across last year and into 2026, we have seen investors broaden their horizons, whether that be due to revisions to their confidence in the US market, or because of apparent greener pastures elsewhere. Also referred to as increasing market dispersion, investors allocating capital away from a concentrated portion of the market and investing in a wider range of securities ultimately widens the opportunity set, especially within equity markets. Astute and skilful investors, such as Equity Long/Short and Market Neutral managers, will be particularly well positioned to capitalize on the opportunity increased dispersion provides, with potential scope for greater alpha.

Greater dispersion widens the opportunity set



Source: HSBC AM Alternatives, Bloomberg

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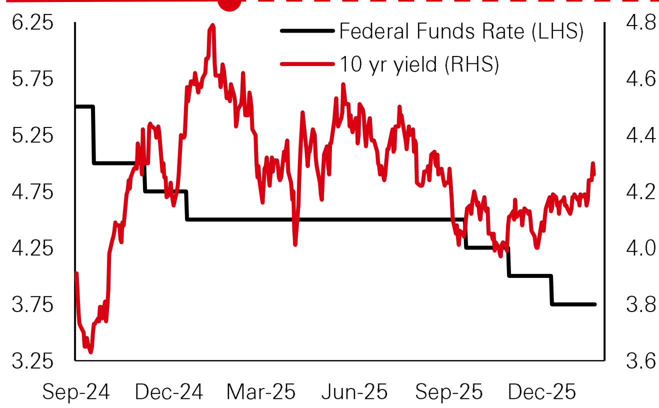
Monetary policy uncertainty creating opportunity

In the near-zero interest rate period of the 2010s, it was notably more difficult for hedge fund managers to generate consistent returns from fixed income. With risk-free rates often a baseline return for many hedge fund strategies, zero rates penalised returns. Combining this with suppressed macro volatility and asset price inflation, the opportunity set for many hedge funds was admittedly smaller. The same cannot be said now. Sticky inflation and elevated rates compared to what much of the market has grown accustomed to over the last decade have swung the door of opportunity wide open for hedge fund strategies. Not only are higher rates and volatility levels a tailwind for many strategies' returns, the trading opportunities which are created bode well for savvy managers. Central banks remain focused on balancing inflation and strained labour markets, with shifting policy creating trading opportunities for hedge funds, especially Macro and Credit managers who often have significant exposure to debt markets. .

LT Rates higher than when rate cuts started

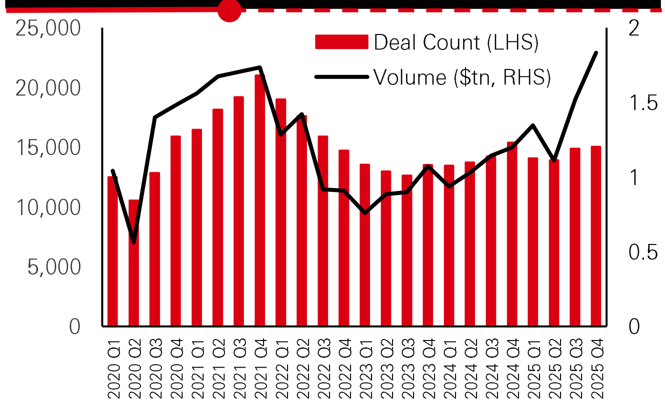


Source: HSBC Global Macro Strategy, Macrobond

Corporate activity back with a vengeance

2025 saw the return of the IPO and M&A market with a strong year for deal-making. Lofty equity valuations and tight credit spreads boosted board confidence making corporate activity a more attainable target. We saw 20%+ QoQ growth in M&A volumes in Q4 2025, with a particular increase in Asia where recent legislative changes have made corporate actions more amenable. Providing no significant reversal in the confidence of boards, we see no reason why these trends should meaningfully reverse. For hedge funds, this means a healthy hunting ground for Event Driven and Credit managers. Corporate activity impacts both equity and credit markets creating price discrepancies as the market attempts to quantify the weighted value of potential synergies. A more buoyant market in corporate activity can also be seen in the large growth in the number of activism campaigns launched in the year. This embodies the confidence hedge fund managers have in being successful activists on company boards where they feel they can deliver higher returns for shareholder than the current c-suite level.

Uptick in M&A Activity a tailwind for returns



Source: HSBC AM Alternatives, Bloomberg

Conclusion

In summary, the current geopolitical landscape and uncertain monetary policy have created compelling opportunities for hedge funds in 2026. In our view, allocating to hedge funds has never been more relevant, as generating alpha becomes increasingly critical for clients seeking portfolio returns regardless of the market environment.

5th Largest Hedge Fund Allocator Globally[1]

30+ Years
Investing in Hedge Funds

42 Investment professionals
dedicated to Hedge Fund investing[2]

$33.2bn
Assets under management[1]

>140
Funds eligible for use in client portfolios

Exclusive Access – Our 30-year legacy, size and network give us access to highly sought after closed managers

On the Ground Expertise – Our analysts are based where the hedge funds are based. Through this, we leverage HSBC AM's global footprint and support local expertise

Rigorous Due Diligence – We strive to identify the best-in-class manager talent at the correct juncture and capture them during their optimal periods

Offering Tailored Solutions – We have extensive knowledge and ability to meet the specific needs of investors with highly customised solutions

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[1]WithIntelligence FoHF Billion Dollar Club Report, November 2025. [2]As of December 2025.

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