

Key Focus Remains AI and Rate Policy

Hedge Funds 2026 Midyear Outlook

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“Hedge funds currently remain well-positioned to navigate both interest rate policy divergence and a sustained higher-for-longer rate environment.”

Key Reflections

In many ways, the beginning of 2026 mirrors 2025. Once again, equity markets have weathered a major geopolitical shock, experiencing a sharp drawdown before rebounding quickly amid shifting headlines. After falling more than 7% through late March, the S&P 500 has since returned approximately 8.6% year to date, reaching multiple all-time highs and demonstrating the resilience we highlighted at year-end.¹

But the cracks beneath the surface that we foreshadowed have appeared with increasing frequency. Sharp reversals in AI and technology positioning have triggered crowded unwinds and highlighted concentration risk. Meanwhile, rising bond yields have pushed stock-bond correlations higher, reducing the benefit from diversification that fixed income has traditionally provided. As markets grow more complex and the dispersion of outcomes increases, we believe hedge funds will continue to play a valuable role in investor portfolios through 2026, offering the potential to enhance returns, reduce volatility, and provide diversification regardless of the market's ultimate direction.

What We Are Seeing

Beneath the surface of equity markets' resilience, AI positioning is evolving from thematic to fundamental. Early outperformance was concentrated in semiconductors and hyperscalers, as markets rewarded exposure to AI infrastructure and scale. Since then, leadership has spread into memory and power as investors increasingly distinguish between companies that are

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¹ Source: Yahoo Finance. As of June 29, 2026.

spending on AI and those that are capable of translating that investment into durable revenue and earnings growth. This rotation across the AI value chain, combined with a greater emphasis on fundamentals, is contributing to elevated dispersion, creating a rich opportunity set for hedge fund managers.

What We Are Doing

As the AI investment cycle evolves from an infrastructure buildout toward greater monetization, and that this evolution spreads to more sectors, we expect clear winners and losers to emerge. We prefer specialist equity and credit managers who are good at analyzing and capitalizing on these alpha opportunities, and who take a relative value, low-net or market neutral approach with minimal beta.

We also see a compelling opportunity for event-driven strategies as capital markets activity accelerates. A resurgence of IPO issuance, highlighted by SpaceX’s blockbuster listing, as well as a robust pipeline that includes Anthropic and OpenAI, creates opportunities that extend well beyond initial allocations. Specialist event-driven managers are positioned to underwrite pre-IPO valuations and navigate post-listing volatility as secondary offerings, sell-side coverage, index-inclusion dynamics as well as lock-up expirations play out. We expect this favorable backdrop to persist through 2026.

Finally, we continue to believe that there is a constructive environment for discretionary macro managers who can continue their strong performance, capitalizing on diverging Central Bank policy, geopolitical crosscurrents, and ongoing volatility in FX, rates and commodities markets. In particular, the flexible and nimble nature of these managers should also prove useful in offering convex returns if markets experience episodic volatility.

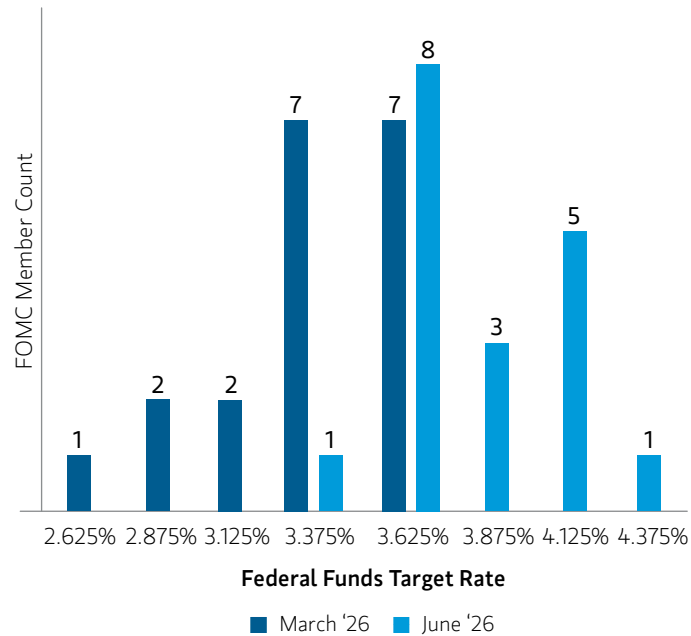
What We Are Watching

Recent geopolitical developments have increased the risk that inflationary pressures will reaccelerate. In response, we are closely watching global Central Bank policy effectiveness, its

alignment with market expectations and its divergence across regions. Markets entered the year pricing-in rate cuts, but they have since shifted toward a higher-for-longer rate outlook. In June, both the European Central Bank and the Bank of Japan raised interest rates in response to rising inflation, with the latter raising rates to their highest level since 1995. At the same time, we are monitoring newly appointed Fed Chair Kevin Warsh for indications of how his approach to policy communication and implementation may differ.

Against this backdrop, hedge funds currently remain well-positioned to navigate both interest rate policy divergence and a sustained higher-for-longer rate environment. We believe hedge funds may be able to capitalize on relative value opportunities across asset classes while delivering differentiated return streams and meaningful diversification, thereby reinforcing their role as a core component of portfolios.

FOMC Members Shift Toward Higher Interest Rates



Source: Bloomberg, as of June 24, 2026.

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