FRANKLIN TEMPLETON

K2 Alternative Strategies Fund

Advisor Class: FABZX Class A: FAAAX | **Commentary | as of March 31, 2025**

Key Takeaways

- **Markets:** Global stocks declined during the quarter, despite a strong start, amid increasing worries about US trade policy and its impact on growth, as well as spending on artificial intelligence. Returns varied across regions, with the US trailing its developed market peers—boosted by strong gains in Europe—while a rally in China helped propel quarterly gains in broad emerging markets. Bonds broadly posted positive returns as yields declined, while commodities moved modestly higher.
- **Contributors:** The relative value strategy drove the portfolio's modest quarterly advance, led by subadvisors Athena, Lazard and Apollo, all top overall contributors. From an asset class perspective, equity and cash positioning powered gains. The event driven strategy's slight advance was also accretive. Within the long-short equity strategy, subadvisor ActusRay was a leading overall contributor, powered by both the quantitative and discretionary portions of the subadvisor's portfolio.
- **Detractors:** The long-short equity strategy weighed substantially on returns, as subadvisors Jennison and Electron were the largest overall detractors, owing to long equity positioning, especially in the health care sector—a focus for Jennison. At the portfolio level, long positioning in fixed income and short positioning in commodities helped drive losses. The Strategic Overlay hindered returns. The global macro strategy also detracted, due to subadvisor CFM, which started the year strong before commodity positioning—specifically shorts of copper and silver—helped create a quarterly loss.
- **Outlook:** Uncertainty heightened in the first quarter, around economic growth, trade wars and geopolitical risks, weighing on stocks and helping widen credit spreads. We anticipate that continuing volatility is likely across markets—and with it, dispersion. While we hold a neutral outlook toward most hedge fund strategies, we believe the coming months will present hedge fund managers with a favorable environment, because of elevated levels of dispersion. In our view, discretionary global macro and relative value strategies could be well-positioned to capitalize, along with volatility and risk-mitigation strategies.

Performance Review

- After starting 2025 on a strong note, global equities collectively declined during the rest of the first quarter due to investor concerns about US economic growth, President Donald Trump's trade policy and a broadening trade war. Despite reaching new closing highs earlier in the quarter, the Dow Jones Industrial Average and the S&P 500 Index ended the quarter with negative returns. The technology-heavy NASDAQ Composite Index suffered a significantly larger decline as investors remained concerned about the potential effects of a Chinese company's new artificial intelligence (AI) model on US companies' AI spending. European stocks produced strong gains during the period amid signs of economic improvements and interest-rate cuts. Better-than-expected earnings reports by some companies and increased fiscal budgets by many of the region's countries, notably Germany, supported investor sentiment. In Asia, stocks collectively posted a modest gain, driven by the strong performance of Chinese stocks amid investor enthusiasm about the new AI model and signs of a more supportive stance from the Chinese government. As measured by MSCI indexes in US-dollar terms, developed market equities modestly underperformed a global index, while emerging market equities significantly outpaced it with positive results. In terms of investment style, global value stocks generated strong gains and substantially outperformed global growth stocks. Most fixed income spread sectors recorded positive total returns during the quarter. Higher-rated credits generally fared better than their lower-rated counterparts. Over the period, US Treasury (UST) yields fell across much of the curve. With tailwind support from a depreciating US dollar and slight improvements in global manufacturing activity, the commodity complex's quarterly results skewed to the upside, though early strength gave way to bouts of weakness later the period. Commodity-linked energy and materials sector stocks broadly posted gains, both in the US and globally.
- On a gross basis, two of four strategies contributed to the portfolio's performance in the first quarter, while six of the 10 underlying managers produced positive results. Gains were largely driven by the relative value strategy, as well as cash positioning. The event driven strategy was a slight contributor. Conversely, the long/short equity strategy and the Strategic Overlay weighed the most on returns. At the asset-class level, equity positioning, which was long overall, and cash positioning were the key contributors. In contrast, long fixed income positioning and commodity positioning (short overall) weighed the most on returns, with additional detraction from currency hedges.
- The relative value strategy was the largest contributor to positive performance, due primarily to equity positioning, which was slightly long overall. The strategy was home three of the top four subadvisors, led by Athena, the quarter's largest overall contributor. Athena's equity and currency positioning, both long overall, drove the subadvisor's gains. Strength in industrials and communication services longs led the way in the equity portfolio. Long positions in the Japanese yen and the Norwegian krone bolstered currency gains, along with shorts of the US dollar. Lazard's strong performance was due to short equity positioning, partially offset by weakness in long fixed income positioning. All factors aided performance, with notable contribution from special situations. Subadvisor Apollo benefited from a conservatively positioned book and fixed income positioning, including a short position in a US-based pharmaceutical firm that traded down in sympathy with the market.
- The event-driven strategy was a slight contributor as modest gains in long equity positioning were only partially offset by modest losses in currency positioning. Subadvisor Bardin Hill posted a modest gain, despite merger and acquisition volumes continuing to decline year over year. Top individual contributors included a Germany-based producer of polymer materials, one of Bardin Hill's largest positions, as spreads continued to tighten. A US-based commercial-stage biopharmaceutical company was a notable detractor, as the firm's acquisition timeline dragged amid pressure from market volatility late in the period.
- The long/short equity was the quarter's largest detractor, weighed down by long equity positioning, especially in health care and equity index futures. Subadvisors Jennison and Electron were the quarter's largest detractors across all strategies, while

ActusRay was a top overall contributor. Jennison's performance was primarily driven by long positions; the short book was positive as the market entered into a significant period of volatility and turbulence. Biotechnology stocks in the book were notable detractors, encompassing many of the largest detractors in Jennison's portfolio. Negative earnings reports weighed on some of these stocks, including shares of a diabetes care company. Electron, which had a strong January, was later impacted by the broader equity market sell-off as macroeconomic volatility increased, driven by the Trump administration's erratic tariff policy reversals and weaker consumer spending and sentiment. Detractors included a US-based electric utility whose shares declined along with the overall market despite a significant earnings beat. ActusRay was the strategy outlier, in a largely positive environment for quantitative investing. The discretionary piece of ActusRay's approach was also additive to returns. From a factor perspective, Value led the way.

- The global macro strategy also weighed on returns, due largely to commodity (short overall) and long fixed income positioning. Currency positioning (short) also detracted meaningfully. At the subadvisor level, CFM was the lone detractor, despite a solid contribution in January. Three of six asset classes weighed on returns, with commodity positioning as the largest negative driver, owing to short positions in copper and silver. Long fixed income positioning also detracted. Subadvisor BlueBay was a modest contributor, while Graham posted a modest gain and had a limited impact. BlueBay's gains were mostly due to long fixed income positioning, especially in Columbia. Interest rate positioning also contributed.
- The Strategic Overlay was a meaningful detractor, owing primarily to long positioning in NASDAQ 100 Index and S&P 500 Index futures.
- During the quarter, the team increased exposure to the event driven strategy, while reducing exposure to the relative value strategy, through subadvisors Lazard and Athena.

Outlook

- Entering 2025, we assessed that the investment climate was best characterized by high economic uncertainty, increased geopolitical risks, elevated valuations, and tight credit spreads. Fast forward to today, both economic uncertainty and geopolitical risks are even higher, valuations have begun to recede, and credit spreads are widening. We expect sustained market volatility and dispersion, fleeting liquidity during surprise news announcements, and crowded unwinds.
- Given that the current market environment can still be characterized by high economic uncertainty, increased geopolitical risks, elevated valuations, and tight credit spreads, even with the hints of changing tides we noted above, we continue to believe the outlook for hedge fund strategies is very favorable. These factors are expected to lead to higher volatility across asset classes and increased dispersion within various sectors, particularly as political and economic influences impact sectors differently. This environment is particularly favorable for both relative value and active strategies that can be appreciated from being dynamic, non-directional, and agile.
- We are optimistic about discretionary global macro strategies due to geopolitical uncertainty, changing interest rates, and shifts in foreign exchange rates. Relative value strategies appear promising, leveraging corporate events and asset class dispersion. Volatility and risk-mitigation strategies also offer diversification from traditional market risks.
- We maintain a neutral rating for long/short equity, relative value, event driven, global macro and commodities strategies. Our outlook for relative value strategies is improving, due to higher political and economic risks creating increased opportunities for volatility and dispersion within and across asset classes. Relative value strategies have an advantage over directional investment styles at a time when the likely direction of markets is harder to predict. This challenge is particularly pronounced during inflection points. When there is a high degree of policy and economic uncertainty, there are strong tailwinds for some assets, and potentially excessive valuations for others. These uncertainties are beginning to be realized in the pricing of volatility across major asset classes. While volatility is generally considered a risk factor for directional strategies, it in fact presents better opportunities for managers that can capitalize on it through active trading in strategies such as volatility arbitrage, convertible bonds, and fixed income relative value
- Within long/short equity, we prefer equity market neutral approaches. The early days of the Trump administration have not lived up to the optimistic consensus that followed the election results in November. Instead, trade and immigration policies are driving volatility higher. At the same time, the American consumer, which has continuously served as the foundation for a strong economy, might finally be feeling stretched. Given this setup, the beta outlook is cloudier than a few months ago. However, the alpha opportunity remains compelling. Volatility has the tendency to challenge returns for the strategy in the near term but can serve as an opportunity for managers to put capital to work at attractive entry points, thereby setting up for greater potential returns over the medium term.
- We continue to favor forward-looking and tactical discretionary macro in an environment dominated by policy announcements that could have binary outcomes. As new policy is implemented and new market narratives emerge over the next several months, the opportunity set could shift toward longer-term thematic investors. Regional dispersion is increasingly in focus, especially with many managers finding opportunities to trade US vs. the rest of the world. Systematic strategies may continue to struggle if markets keep experiencing big shifts around news and policy announcements; however, we think the emergence of new trends and narratives around policy implementation could make the opportunity set more attractive over the medium term.
- Turning to event driven, there remains a lot of pent-up demand for corporate deal-making activity, spanning activism, special situations, and M&A markets. However, that pace of activity has slowed meaningfully in recent months given uncertain policy messaging and increased economic uncertainty. Management team confidence can be a real drag on deal-making activity, which has been observed so far this year. And, lower deal volumes mean a more competitive and less attractively priced merger arbitrage environment, with more efficient pricing and fewer trading opportunities. There are meaningful potential tailwinds to these strategies should the uncertainty abate, so we remain optimistic for the strategy in the long term. In the intermediate stages, however, the elevated volatility and higher uncertainty makes for a more challenging environment, which favors more defensive and highly nimble market participants.
- In the commodities space, relative value strategies may be well-positioned to benefit from recent market dislocations, including those brought about by trade policy expectations and implementation. Directional strategies may continue to be challenged by range-bound markets, especially as markets frequently reprice the potential for opposing outcomes around major geopolitical events (e.g., a Russia/Ukraine peace deal). Long-term themes like the energy transition remain intact but could continue to experience higher volatility around macro headlines.

Average annual total returns and fund expenses (%)

			Without Sales Charge							With Maximum Sales Charge							Expenses		Sales Charges		Inception
Class	CUSIP	Ticker	3-Mo	YTD	1-Yr	3-Yr	5-Yr	10-Yr	Inception	3-Mo	YTD	1-Yr	3-Yr	5-Yr	10-Yr	Inception	Gross	Net	Initial Charge	CDSC	Date
Advisor Class	35241W500	FABZX	0.46	0.46	6.50	3.20	4.70	2.73	3.45	0.46	0.46	6.50	3.20	4.70	2.73	3.45	2.53	2.19	—	—	10/11/2013
Class A	35241W104	FAAAX	0.37	0.37	6.26	2.95	4.46	2.47	3.18	-5.12	-5.12	0.41	1.04	3.29	1.89	2.68	2.76	2.44	5.50	—	10/11/2013
Benchmark 1	—	—	0.53	0.53	3.23	1.87	4.39	1.84	—	0.53	0.53	3.23	1.87	4.39	1.84	—	—	—	—	—	—
Benchmark 2	—	—	1.02	1.02	4.97	4.23	2.56	1.87	—	1.02	1.02	4.97	4.23	2.56	1.87	—	—	—	—	—	—

Benchmark(s)

Benchmark 1=HFRX Global Hedge Fund Index

Benchmark 2=ICE BofA US 3-Month Treasury Bill Index

Performance data quoted represents past performance, which does not guarantee future results. *Current performance may be lower or higher than the figures shown. Principal value and investment returns will fluctuate, and investors' shares, when redeemed, may be worth more or less than the original cost. Performance would have been lower if fees had not been waived in various periods. Total returns assume the reinvestment of all distributions and the deduction of all fund expenses. Returns with sales charge reflect a deduction of the stated maximum sales charge. An investor cannot invest directly in an index, and unmanaged index returns do not reflect any fees, expenses or sales charges. Returns for periods of less than one year are not annualized. All classes of shares may not be available to all investors or through all distribution channels. For current month-end performance, please visit franklintempleton.com.*
Gross expenses are the fund's total annual operating expenses as of the fund's prospectus available at the time of publication. Actual expenses may be higher and may impact portfolio returns. Net expenses reflect contractual fee waivers, expense caps and/or reimbursements, which cannot be terminated prior to 09/30/2025 without Board consent. Additional amounts may be voluntarily waived and/or reimbursed and may be modified or discontinued at any time without notice.
Dividend Expense and Borrowing Fees for Sec. Sold Short: Costs associated with the fund's short positions. The fund's manager and sub-advisors use short positions in an attempt to either protect against losses or provide an additional source of returns versus long-only strategies. **The annual expense is 0.44%.** There is no guarantee that these positions will perform as the fund's manager or sub-advisors intended, and losses may occur.

What are the Risks?

All investments involve risks, including possible loss of principal. The fund is actively managed and could experience losses if the investment **manager's and subadvisors'** judgment about particular investments made for the fund's portfolio prove to be incorrect. The **allocation** of assets among different strategies, asset classes and investments may not prove beneficial or produce the desired results**.** Some subadvisors may have little or no experience managing the assets of a registered investment company. **International investments** are subject to special risks, including currency fluctuations and social, economic and political uncertainties, which could increase volatility. These risks are magnified in **emerging markets. Derivative instruments** can be illiquid, may disproportionately increase losses, and have a potentially large impact on performance. **Low-rated, high-yield bonds** are subject to greater price volatility, illiquidity and possibility of default. **Currency management** strategies could result in losses to the fund if currencies do not perform as expected. **Short selling** is a speculative strategy. Unlike the possible loss on a security that is purchased, there is no limit on the amount of loss on an appreciating security that is sold short. Investments in companies engaged in **mergers, reorganizations or liquidations** also involve special risks as pending deals may not be completed on time or on favorable terms. **Liquidity risk** exists when securities or other investments become more difficult to sell, or are unable to be sold, at the price at which they have been valued. These and other risks are discussed in the fund's prospectus.

Glossary

Dow Jones Industrial Average (DJIA) is an unmanaged index composed of 30 blue-chip stocks, each with annual sales exceeding $7 billion. The DJIA is price-weighted, reflects large-cap companies representative of U.S. industry, and historically has moved in tandem with other major market indexes such as the S&P 500. Source: © S&P Dow Jones Indices LLC.

The **Nasdaq 100 Index** is a basket of the 100 largest, most actively traded U.S companies listed on the Nasdaq stock exchange. Source: Nasdaq OMX.

Nasdaq Composite Index is a market-capitalization-weighted index that is designed to represent the performance of NASDAQ securities and includes over 3,000 stocks. Source: Nasdaq OMX.

The **S&P 500 Index** features 500 leading U.S. publicly traded companies, with a primary emphasis on market capitalization. Source: © S&P Dow Jones Indices LLC. All rights reserved.

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The information provided is not a complete analysis of every material fact regarding any country, market, industry, security or fund. Because market and economic conditions are subject to change, comments, opinions and analyses are rendered as of the date of this material and may change without notice. A portfolio manager's assessment of a particular security, investment or strategy is not intended as individual investment advice or a recommendation or solicitation to buy, sell or hold any security or to adopt any investment strategy; it is intended only to provide insight into the fund's portfolio selection process. Holdings are subject to change.

Reference Index: S&P 500 Index. The S&P 500 Index is solely utilized as a reference benchmark to illustrate difference in behavior between U.S. equity markets and the fund. However, the S&P 500 Index is not fully reflective of the risk profile of the fund, which is not limited to investing solely for long U.S. equity market exposures.

The **ICE BofA 3-Month U.S. Treasury Bill Index** is an unmanaged index that comprises a single U.S. Treasury issue with approximately three months to final maturity, purchased at the beginning of each month and held for one full month. Source: The index data referenced herein is the property of Intercontinental Exchange ("ICE") and/or its licensors and has been licensed for use by Franklin Templeton. ICE and its licensors accept no liability in connection with this use. Monthly reporting HFRX Index constituents are comprised of private hedge funds. The **HFRX Global Hedge Fund Index** is designed to be representative of the overall composition of the hedge fund universe. It is comprised of all eligible hedge fund strategies, including but not limited to convertible arbitrage, distressed securities, equity hedge, equity market neutral, event driven, macro, merger arbitrage, and relative value arbitrage. The strategies are asset weighted based on the distribution of assets in the hedge fund industry. Source: Hedge Fund Research, Inc. The HFR indices are being used under license from Hedge Fund Research, Inc., which does not endorse or approve of any of the contents of this report. Unlike most asset class indexes, the HFR Index reflect fees and expenses.

Important data provider notices and terms available at www.franklintempletondatasources.com. All data is subject to change.

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