

K2 Alternative Strategies Fund

Advisor Class: FABZX Class A: FAAAX

Commentary | as of September 30, 2025

Key Takeaways

- Markets: Global equity markets advanced through the third quarter of 2025 as tariff anxieties gradually eased, central
 banks tilted more accommodative and technology leadership persisted. Together, these dynamics, calmer rate volatility
 and robust corporate results underpinned risk assets into quarter-end.
- Contributors: Overall, all four primary strategies and all 10 underlying managers contributed to relative returns, along
 with the Strategic Overlay. At the asset-class level, long fixed income positioning made the largest contribution,
 followed by equity positioning, which was long overall. Cash and commodity positioning also contributed, though more
 modestly.
- **Detractors:** Currency positioning weighed on returns.
- Outlook: The investment environment remains defined by elevated economic uncertainty, heightened geopolitical
 risks, stretched valuations and tight credit spreads. While risk perceptions have shifted at the margin—valuations are
 more demanding, and credit spreads tight—the system does not yet appear distressed. Volatility remains contained and
 liquidity ample as central banks are now cutting rates, providing more liquidity to the global system. For hedge funds,
 this backdrop presents both opportunity and risk. Fatter upside and downside tails are likely, with greater divergence in
 manager performance. We believe success will depend on portfolios that are diversified, liquid and flexible.

Performance Review

- Global equity markets advanced through the third quarter of 2025 as tariff anxieties gradually eased, central banks tilted more accommodative and technology leadership persisted. July's tone improved on clearer trade signals and resilient US earnings; August added gains despite episodic volatility around new tariff measures and September capped the quarter with a Federal Reserve rate cut that steadied rate-sensitive assets and lifted risk appetite. The Fed lowered its target rate by 25 basis points to 4.00–4.25%, while the ECB and BoE held policy steady. Together, these dynamics, calmer rate volatility and robust corporate results underpinned risk assets into quarter-end. Against this backdrop, the MSCI All Country World Index advanced in USD terms, with growth outpacing value and large caps edging small caps. Within the index, 10 of 11 sectors advanced, led by information technology and communication services, followed by materials and consumer discretionary. Consumer staples was the sole decliner. US equities led developed markets over the quarter as strong earnings, fading recession fears and Al-linked capital spending kept risk appetite firm, but emerging markets stocks outperformed the US and developed markets. Credit markets witnessed positive absolute returns over the period as spreads tightened. Lower-rated credits such as high-yield bonds generally outperformed their higher-rated counterparts. Over the period, US Treasury (UST) yields moved lower with the yield curve steepening. Commodity indexes generally appreciated mildly and unevenly during the quarter. Precious metals and base metals outperformed, while energy and crop products weakened. Benchmark US and international crude oil futures prices fell 4.2% and 0.9%, respectively, as traders continued to watch for signs of a glut that's widely expected to arrive in the fourth quarter and extend into 2026.
- On a gross basis, all four primary strategies and all 10 of the underlying managers contributed to the portfolio's performance
 in the third quarter. The Strategic Overlay also boosted returns. The Long Short Equity strategy was by far the largest
 contributor during the quarter. The Global Macro and Relative Value strategies were substantial contributors, as was the
 Strategic Overlay. The Event Driven strategy was a more modest contributor. At the asset-class level, long fixed income
 positioning made the largest contribution, followed by long equity positioning, cash positioning and commodity-related
 holdings. Conversely, currency positioning was the lone asset class with a meaningful, though modest, detraction.
- Long Short Equity was the quarter's largest contributor, driven by long equity positioning, especially in the health care and industrials sectors, as well as financials and utilities. No asset class was a significant detractor. The three subadvisors ranked in the top four overall during the quarter, with ActusRay and Electron as the quarter's largest contributors across all strategies. ActusRay's quant base and discretionary overlay both aided performance, and European alpha was strong, as investor flows continued into European equities and trading volumes increased. The subadvisor was less short than the quant base suggested in select cohorts—including data centers, semiconductors and high growth—which contributed positively. By country, developed market trades drove gains, led by the United Kingdom and Japan. From a sector perspective, the leaders were industrials and financials. Subadvisor Electron continued to post gains, led by its long book, as continued market sentiment and consistent earnings beats drove performance, despite a modestly negative return in August. Battery storage continued to perform well amid an Al-fueled investor sentiment boom. Key contributors ranged from battery manufacturers to power-generation businesses and electric utilities, many of which benefited from Inflation Reduction Act incentives moving to the Big Beautiful Bill. Subadvisor Jennison's long equity positioning in the pharmaceuticals, biotechnology and life sciences industry drove gains. A US-based commercial-stage biopharmaceutical company was a key contributor, benefiting from better-than-expected revenue growth for its key eyecare product, as well as strong sales and margin guidance.
- The Global Macro strategy was a substantial contributor. Long equity positioning was the largest contributing asset class, followed by commodity and credit positioning, partially offset by losses from currency positioning. Subadvisors CFM and BlueBay were substantial contributors. CFM made money in long equity positioning through the ISTrends strategy, led by US and emerging Asia longs, and in currency hedges, as the US dollar was volatile during the quarter. Commodity positioning weighed modestly on returns. Subadvisor BlueBay was a meaningful contributor on the strength of its long fixed income positioning, driven in part by gains in emerging market sovereign credit, especially from Columbia, where the country bought back dollar-denominated debt, and South Africa, which saw strong inflows into the market amid a more benign inflation outlook. Subadvisor Graham posted a positive return and a more modest contribution as its quant-macro strategy advanced, led by equity and commodity positioning. Long positions in metals and in US equity indexes drove gains, partially offset by some weakness in currency positioning, especially shorts of the Japanese ven.

- The Relative Value strategy was also a substantial contributor, owing primarily to subadvisor Apollo. From an asset class perspective, long fixed income positioning drove gains, outweighing substantial detraction from equity hedges. Subadvisor Apollo was the quarter's third-strongest contributor regardless of strategy. Catalysts and event-driven stocks drove Apollo's gains, including a media conglomerate that reported strong earnings growth in July, then rallied further on potential acquisition rumors. A satellite, streaming and wireless mobile firm that announced plans to sell spectrum licenses to a larger competitor was another strong position. Subadvisors Lazard and Athena were more modest contributors. Lazard's positive performance was driven by gains across most factors in the portfolio, especially volatility yield, special situations and carry. The lone notable detractor was macro hedges. Athena's gains were centered in cash positioning, partially offset by detraction from equities and currency positioning.
- The Strategic Overlay was a notable contributor, as its long positioning in S&P 500 and Nasdaq 100 index futures generated a 14% return during the quarter.
- Long equity positioning was the key to the Event Driven strategy's modest contribution. The team exited the strategy's lone active subadvisor, Bardin Hill, in September. The portfolio
 management team anticipates allocating to a selected Event Driven manager in the coming months. Top contributors during the quarter included a long position in a UK-based insurance
 and financial solutions provider that reported strong first-half results, featuring positive news around a recently completed acquisition.
- During the quarter—in September—the team decreased exposure to the Event Driven strategy by exiting subadvisor Bardin Hill. The team also increased exposure to the Strategic Overlay.

Outlook

- The investment environment remains defined by elevated economic uncertainty, heightened geopolitical risks, stretched valuations and tight credit spreads. While risk perceptions have
 shifted at the margin—valuations are more demanding, and credit spreads tight—the system does not yet appear distressed. Volatility remains contained and liquidity ample as central banks
 are now cutting rates, providing more liquidity to the global system.
- Opinions differ on the drivers: The return of US President Trump and revived "animal spirits," hedge fund manager Ray Dalio's long-term global reordering or unsustainable debt burdens.
 Regardless, we expect volatility, dispersion and sporadic liquidity gaps/bursts to persist, with positioning flows and crowded trades amplifying swings.
- For hedge funds, this backdrop presents both opportunity and risk. Fatter upside and downside tails are likely, with greater divergence in manager performance. We believe success will
 depend on portfolios that are diversified, liquid and flexible. In short, dynamic and opportunistic hedge fund strategies look well positioned to take advantage of dislocations, provided they
 remain disciplined, selective and nimble.
- Amid market uncertainty, geopolitical tensions, and US President Donald Trump's transactional orientation and propensity to change his goals, we believe the outlook for hedge fund strategies remains constructive. Heightened dispersion and constrained liquidity are creating compelling opportunities for dynamic, market-neutral and nimble investment approaches.
- Last quarter, we described the investment environment as one defined by elevated economic uncertainty, rising geopolitical tensions, stretched valuations and tight credit spreads. Today, both uncertainty and geopolitical risk have arguably softened a bit. While valuations have gotten more stretched, we are not yet seeing signs of distress—the VIX is below 17, and credit markets remain mostly orderly.
- Views differ regarding the drivers of this shift. Some point to the return of President Trump and the resurgence of market "animal spirits," others to a broader reordering of the global system
 and still others to the mounting burden of global debt. Regardless of the cause, we anticipate continued market volatility and dispersion, sporadic liquidity during unexpected news events,
 Trump tweets, and the potential for positioning flows to drive markets.
- For hedge fund investors and managers, this environment presents both meaningful opportunities and heightened risk. The tails to both the upside and downside are expected to be fatter than previously experienced over the last five years. We expect to see greater divergence in manager performance—even within the same sector—driven by increased volatility. In our view, success in this environment is likely to require portfolios that are diversified, liquid, opportunistic and patient.
- We maintain a neutral outlook for most of the portfolio's primary strategies.
- The outlook for Global Macro strategies appears positive as central banks implement policy changes, with some divergences between regional centers. We continue to favor discretionary
 managers who focus on these shifts, including emerging market specialists, who may benefit from policy tailwinds.
- Our outlook for Long Short Equity remains neutral as valuations have increased and geopolitical and macro risks are elevated. Select international markets continue to look attractive.
 Increased breadth and valuations in the United States suggest a constructive environment for market-neutral funds. Higher dispersion due to artificial intelligence (AI) trends, goods inflation and reindustrialization portends a favorable trading environment, in our view.
- Turning to Relative Value, the outlook is mixed. Some strategies are benefiting from greater potential dispersion and the possibility of elevated volatility across fixed income markets, while others are suffering from lower risk premia and stretched valuations in asset classes such as convertible bonds.
- We maintain a neutral outlook for Event Driven strategies with a favorable view toward activism and special situations investing, and a muted outlook for traditional merger arbitrage, where
 generally low implied deal spreads have offset strong deal volumes. Expectations for a continued busy corporate activity calendar are contributing to a favorable outlook for more directional
 and opportunistic event-driven strategies, including activism and special situations investing.
- Our outlook for commodities is positive, especially for relative value approaches, as commodity relationships and price moves recover from recent bouts of volatility. Fundamental supply and demand factors can become increasingly important as macro policy paths become well-understood. A normalization of commodity relationships—as markets continue to recover from recent geopolitical and trade policy-led volatility—can be a tailwind for active managers. Managers specializing in a single asset class or sector often view bouts of market volatility as more of a source of risk than opportunity, especially when exogenous or macro events create that volatility. As markets digest outside news, those same managers often find the most attractive trading opportunities. In 2025, commodity markets had two major exogenous shocks—the first around US tariff announcements in April, and the second around a flare-up of Middle East tensions in June. As the initial shock has worn off, investors appear to have shifted their focus to the fundamental implications of these events and realized volatility has decreased. For commodity specialists trying to identify supply and demand imbalances, this shift toward market fundamentals could help improve the alpha opportunity set.

Average annual total returns and fund expenses (%) - as of September 30, 2025

			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-Мо	YTD	1-Yr	3-Yr	5-Yr	10-Yr	Inception	Gross	Net	Initial Charge	CDSC	Date
Advisor Class	35241W500	FABZX	3.72	6.75	9.11	7.48	4.17	3.65	3.82	3.72	6.75	9.11	7.48	4.17	3.65	3.82	2.47	2.18	_	_	10/11/2013
Class A	35241W104	FAAAX	3.66	6.51	8.89	7.22	3.91	3.40	3.56	-2.03	0.69	2.92	5.22	2.74	2.82	3.08	2.72	2.43	5.50	_	10/11/2013
Benchmark 1	_	_	3.19	5.65	5.84	4.72	3.61	2.87	_	3.19	5.65	5.84	4.72	3.61	2.87	_	_	_	_	_	_
Benchmark 2	_	_	1.08	3.17	4.38	4.77	2.98	2.08	_	1.08	3.17	4.38	4.77	2.98	2.08	_	_	_	_	_	_

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. Net 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 09/30/2026 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

A basis point (bp, or bps) is one one-hundredth of one percent (1/100% or 0.01%).

The MSCI All Country World Index is a market capitalization-weighted index that is designed to measure equity market performance of developed and emerging markets. Source: MSCI makes no warranties and shall have no liability with respect to any MSCI data reproduced herein. No further redistribution or use is permitted. This report is not prepared or endorsed by MSCI.

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.

Risk premia refers to the amount by which the return of a risky asset is expected to outperform the known return on a risk-free asset.

The **yield curve** shows the relationship between yields and maturity dates for a similar class of bonds.

Important Information

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.

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. 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.

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Before investing, carefully consider a fund's investment objectives, risks, charges and expenses. You can find this and other information in each prospectus, or summary prospectus, if available, at www.franklintempleton.com. Please read it carefully.

