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Investing in hedge funds with investment companies

How investment companies can provide access to the dynamic and diversifying asset class of hedge funds.

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BH MACRO LIMITED

First published on 04 Jun 2026

You may ask what the point of having a cake is if you don't eat it. But having a cake means enjoying the prospect of eating it in the future, so if you can do that and eat the cake too, you effectively have two cakes. Or perhaps you have one cake with the power of two cakes? Either way, it is better than scoffing a cake down and contemplating a sad and hungry future, or wistfully eyeing up the last cake on the shelf like a Labrador.

So it is with risk in investment. At a very basic level, there is considered to be a simple risk and return trade-off with the assets the typical investor owns: if you want a higher return, you have to accept greater risk, which will be felt in the value of your investment moving around more, and occasionally your returns looking negative. If you want to reduce the volatility in the investment value, and minimise the drawdowns, you have to accept a lower expected return.

But what if you could potentially get a bit of both? What if you could potentially boost your return potential while minimising your risks, or achieve the expected return of a high-risk portfolio with the volatility and drawdowns of a much less risky one? Then you would have the best of two worlds, perhaps a lemon drizzle cake and a classic Victoria sponge? OK, the analogy may be getting stretched here, but the point is that hedge funds set out to attack both vectors at the same time: aiming to deliver high returns, either similar to equities or potentially even higher, while aiming to delivering a risk profile closer to much less risky assets, like bonds. They seek to offer you the taste of the cake, and attempt to do so with more security that there will be a future cake.

There are many ways they can go about trying to achieve this. Hedge funds are remarkably diverse, with managers utilising many ingenious and sophisticated strategies that have developed over multiple market cycles. The most simple approach harks back to the first hedge fund, launched in 1949 by a journalist named Alfred Winslow Jones. He implemented a long/short equity strategy, taking bets on certain stocks to decline as well as owning long positions in others, to 'hedge' against market movements.

Over half a century later, the Financial Times reports there are now 30,000 hedge funds managing over \$5 trillion in assets for investors seeking positive returns in both rising and falling markets. Traditionally the domain of institutional investors and high-net-worth individuals, hedge funds have become accessible to retail investors via investment companies and UCITS funds, providing a dynamic and diversifying asset class, which we explore in more detail below.

What are the different types of hedge funds?

The main categories of hedge funds are as follows:

- **Long/short equity funds:** whilst most investors are familiar with 'long' positions (where the share is bought on the expectation its price will rise), short strategies are based on an expected fall in share prices (i.e. selling borrowed shares considered to be overpriced in the expectation of buying them back at lower prices, gaining the price difference). Long/short funds aim to capitalise on both types of stock-specific moves whilst reducing overall market risk (as long and short positions benefit from rising and falling markets respectively).
- **Global macro funds:** these aim to profit from market movements caused by political and economic events. Managers take short or long positions in a variety of assets (including equities, bonds, currencies and commodities) around events such as the likely direction of interest rates or the outcome of elections.
- **Relative value funds:** these look to exploit price anomalies between related assets such as equities, bonds, commodities and currencies. These can occur in equity

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markets during corporate events such as takeovers or in bond markets where assumptions on interest rates and inflation vary.

- **Activist funds:** these build a significant stake to influence companies to instigate operational or financial changes to improve shareholder value, such as a restructuring or sale of assets.
- **Event-driven funds:** these look to capitalise on temporary pricing opportunities arising from corporate events such as restructurings, mergers and acquisitions and bankruptcy. This could include buying distressed senior debt and shorting equities if the company has yet to file for bankruptcy (on the assumption that the share price will fall thereafter).
- **Fixed-income arbitrage funds:** these exploit expected temporary pricing inefficiencies in bonds or other fixed-income assets in a similar way to long/short equity funds. This is a market-neutral strategy that potentially includes arbitrage on bond yield curves and/or on corporate bond credit spreads.
- **Quantitative funds:** these use mathematical models and algorithms to make trading decisions, drawing on the modelling and research of large data sets and often involving high-frequency trading.
- **Multi-strategy funds:** these use a blend of the above strategies to offer more flexibility, often with a focus on capital preservation.

Why invest in hedge funds?

Hedge funds may add diversification to an investment portfolio as they offer potential alpha generation (alpha being the excess return versus a benchmark) uncorrelated to core equity and fixed-income assets and seek to provide some protection against downside risk in falling markets. The sort of techniques that allow them to potentially deliver positive returns in falling markets or to minimise the volatility in risky asset classes can deliver performance just when conventional assets are performing poorly. This is a critical advantage in periods when traditional asset classes are more correlated. Recent years have seen equities and bonds showing meaningful correlation, which makes this potentially a very attractive feature in the current macro environment. We look at hedge funds' attractive properties in more detail below:

Portfolio diversification

Famously tipped by Nobel Prize-winning economist Harry Markowitz, the pioneer of modern portfolio theory, as “the only free lunch in finance”, diversification helps investors manage risk and smooth returns by spreading their portfolio across different assets.

One of the classic allocation models is a 60% equities/40% bonds portfolio, which seeks to balance upside potential with downside risk. Thanks to an often negative correlation between equities and bonds, this portfolio has, over the medium to long run, historically yielded stable returns with bond market returns generally offsetting downturns in equity markets, although this negative correlation is not guaranteed in the short run and some years have seen falls in both equities and bonds.

For example, correlation between equities and bonds turned positive in 2022 as rising interest rates triggered a risk-off exodus from equities, and bond markets suffered their worst performance in more than a century. By the end of the year, both the S&P 500 (US equities) and FTSE World Government Bond indices had fallen by almost 20% (source: FE Analytics, total returns in US dollars).

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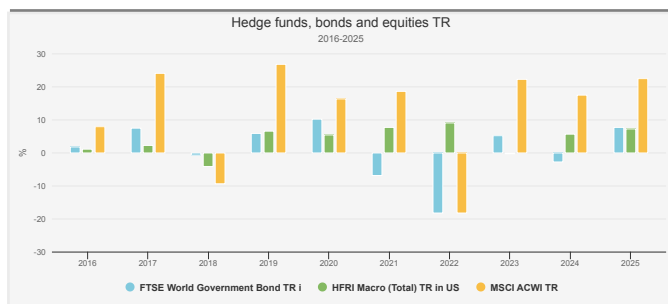
As this illustrates, bonds do not always provide a hedge against equity falls and vice-versa. In fact, the correlation between bonds and equities was positive in the 1970s, which was dominated by high inflation. While inflation does not dominate current markets in the same way, it continues to be a factor and, as such, may contribute to investors looking for a further source of diversification to mainstream bonds and equities.

Hedge funds are potentially one such option, offering a dynamic source of diversification across different asset classes with the aim of generating returns in both rising and falling markets. This approach differs from mainstream equity and bond funds due to the broader investment universe (including commodities and currencies, which are typically less correlated with equity and bond markets) alongside the use of long/short equity, market-neutral and arbitrage strategies.

As shown in the chart below, the HFRI Macro Hedge Fund I-index has delivered positive total returns in all but two of the last ten years (from 2016 – 2025). Whilst outperformed by global equities (represented by the Morgan Stanley Capital International All Country World Index) and sometimes also by global government bonds (represented by the FTSE World Government Bond Index) in ‘good’ years for those investments, its characteristic as a diversifying asset class is best illustrated looking at performance in the poorer performing years for equities or bonds. For example, in 2022, the macro hedge fund index achieved a positive return of almost 10%, in contrast to the near 20% decrease in both global government bond and equity markets.

Clearly, past performance is not a faultless predictor of future performance, but this analysis helps to show how hedge funds may provide a useful source of diversification and protection against losses beyond a traditional equity and bond portfolio.

Fig.1: USD Annual Returns



Source: FE Analytics, total returns in US dollars. Based on FTSE World Government Bond and MSCI ACWI indices.

Past performance is not a reliable indicator of future results

Potential for attractive risk-adjusted returns

Hedge funds typically seek to generate positive returns on a risk-adjusted basis, in contrast to traditional equity and bond funds that typically aim to outperform a benchmark. Whereas traditional funds tend to follow a buy-and-hold approach with returns often highly correlated to the wider market, hedge funds use sophisticated investment strategies involving leverage and short selling to potentially capitalise on market inefficiencies with the aim of achieving positive returns in both rising and falling markets.

In recent years, equity and bond markets have experienced heightened volatility driven by geopolitical risks such as the conflicts in Ukraine and the Middle East, as well as macroeconomic challenges including high inflation and fears of economic recession. Greater volatility generally creates the opportunity for hedge funds to generate superior alpha irrespective of the direction of markets.

The Sharpe ratio is a statistical measure of risk-adjusted returns, comparing the return of an investment against its risk, calculated as its excess return (above the risk-free rate) divided by volatility (i.e. the standard deviation of the excess returns, a standard

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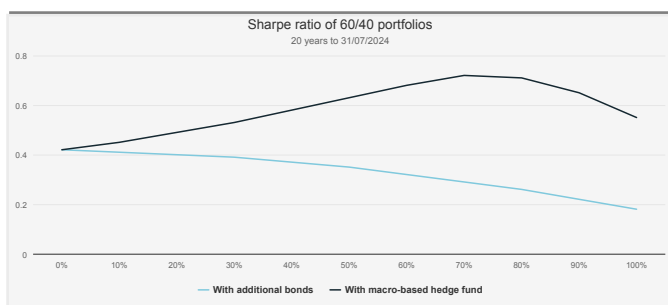


measure of risk). A higher Sharpe ratio for portfolio a over portfolio b indicates better performance by portfolio a relative to the amount of risk taken.

The chart below demonstrates how the addition of hedge funds to a traditional 60/40 equity and bond portfolio would have improved risk-adjusted returns over the 20 years to July 2024. Whilst the addition of further bonds reduces the Sharpe ratio (and risk-adjusted returns), diversifying into a macro hedge fund significantly increases risk-adjusted returns across all levels compared to a standard 60/40 portfolio. The Sharpe ratio peaked for a portfolio with 70% in hedge funds and 20% in equities and bonds (scaled from 60/40).

Putting this into context, the traditional 60/40 portfolio generated annualised returns of 6.3% in the 20 years to 31/07/2024, with an annualised volatility of 12%, but adding a 20% exposure to a macro hedge fund index over the same period would have delivered a slightly lower annualised return of 5.9% but with a 20% reduction in annualised volatility to 10%. The 60/40 portfolio in the chart below is based on NAV (USD) returns

Fig.1: Sharpe Ratios



Source: FE Analytics.

Past performance is not a reliable indicator of future results

for the MSCI World Index (equities) and Bloomberg Global Aggregate (bonds) for the 20-year period ending 31/07/2024. Diversifiers are added in 10% increments (reducing the 60/40 portfolio by 10% each time) based on the Bloomberg Global Aggregate (for additional bonds) and HFRI Macro (for macro-based hedge fund) indices.

By seeking out uncorrelated opportunities, hedge funds aim to reduce the impact of market volatility and economic cycles that underpin returns from conventional assets, as well as to capitalise on elevated geopolitical and macroeconomic uncertainty.

Access to specialist traders

Depending on the strategy, hedge funds can allow investors to leverage the expertise of specialist traders to exploit market inefficiencies and opportunities. Traders tend to have an in-depth understanding of specific markets, asset classes and trading techniques, but seek to gain a competitive edge through trade construction, predicting price movements or executing highly-targeted trades, which can have asymmetric payoffs (a smaller maximum potential loss relative to the larger potential returns achievable).

Risk management is usually very much integrated into the investment process and provides a rigorous framework to maximise potential returns while seeking to protect capital. Traders will typically work to bespoke risk mandates (including the use of stop-losses to protect against downside exposure), alongside designated risk managers.

In recent years, macroeconomic fundamentals such as economic growth, inflation and monetary policy have started to diverge under the pressure of high inflation, geopolitical tensions and what seem to be structurally higher and more volatile interest rates. These factors could increase the level of opportunity for macro traders to generate superior and idiosyncratic returns with a low correlation to mainstream asset classes.

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How difficult is it to invest in hedge funds?

Marketing of hedge funds is heavily regulated and, as a result, it can be difficult for retail investors to meet the strict eligibility criteria required to invest.

In the UK, hedge funds are only directly accessible by professional investors or high net worth and sophisticated investors who are assessed as such by regulated firms. In the latter case, this typically means a very large investment portfolio, a track record of regular trades and evidence of relevant experience.

Eligible investors will often be required to meet minimum investment thresholds (which can be upwards of £1 million) and to complete onboarding procedures. In addition, lock-up periods imposed by the hedge funds themselves can impose liquidity constraints, such as restricting withdrawals to monthly or quarterly intervals. Due to the above criteria, it is challenging for retail investors to invest directly in hedge funds.

Investing in hedge funds using investment companies

However, investment companies (also commonly referred to as investment trusts) can be a solution, allowing the ordinary investor without £1m to participate in some of the exciting hedge fund strategies. It also means the average investor can buy and sell shares in them on the London Stock Exchange.

The number of companies in the AIC Hedge Fund sector has dwindled over the years, with the market conditions post-GFC likely a factor. As a result, there are currently only three members left, one of which is in the process of being wound up. Gabelli Merger Plus+ focuses primarily on arbitrage from mergers and corporate reorganisations. The other remaining active company, **BH Macro** is the only pure, diversified hedge fund in this category.



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Case Study

BH Macro

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Name: BH Macro Limited (“BH Macro”)

Launched: 2007

Manager: Brevan Howard Capital Management LP (“BHCMLP”)

Ongoing charges (financial year ending 31/12/2025): 2.47% (GBP shares), 2.40% (USD shares)

Dividend policy: Dividends have not been paid historically

Benchmark: BH Macro does not measure performance against a given benchmark

BH Macro (ticker BHMG (GBP shares) and BHMU (USD shares)) is the only investment company listed on the London Stock Exchange that offers investors exposure to a diversified macro hedge fund and provides a differentiated offering to the long-only, equity-focused mainstream investment companies.

BH Macro provides a liquid access point to a top-tier global macro hedge fund strategy.

While it is designed for professional and institutional investors, the closed-ended, publicly traded vehicle format allows retail investors to potentially gain exposure to an asset class that is traditionally reserved for sophisticated or institutional investors.

BH Macro is a direct feeder into Brevan Howard Master Fund Limited (“Master Fund”), which is managed by BHCMLP, a leading global hedge fund manager with \$34 billion of assets under management and over 1,000 staff across nine main trading hubs located around the world (as of 31/03/2026).

BH Macro seeks to produce compelling, asymmetric returns, independent of the market environment and with low correlation to risk assets.

Data shows that the returns delivered by BH Macro have historically had a low structural correlation to equities and bonds.

1) What is BH Macro’s investment objective?

BH Macro’s investment objective is to deliver consistent, long-term capital appreciation via its investment in the Master Fund. The Master Fund pursues a multi-trader model that employs a combination of macro-directional and macro-relative value strategies.

2) How has BH Macro performed?

Through its investment in the Master Fund, BH Macro seeks to generate positive returns across the market cycle, including equity market downturns. In the two worst years for the FTSE All Share Index during the past decade, the fund delivered excellent returns. In 2018, it was up 12.4% in NAV terms while the All Share Index was down 9.5%. In 2020, UK equities fell 9.8% but BH Macro delivered exceptional returns of 28.1%. In the better years for the equity market, when diversification was less needed, the fund’s returns have been more muted.

BH Macro has achieved an annualised NAV return of 7.6% in the ten years to 31/03/2026 in GBP, with volatility of 9.2% p.a. Returns have therefore been in the same ballpark as those of the FTSE All Share (8.7% p.a.) but with markedly less volatility (12.2% for UK equities). BH Macro share price returns and volatility will differ from NAV returns and volatility, due to movements in the BH Macro share price to NAV premium (discount), over time.

3) What kind of assets does BH Macro invest in?

BH Macro invests exclusively in the Master Fund. The Brevan Howard Master Fund has exposure to a variety of asset classes, with a primary focus on global fixed income and foreign exchange but also peripheral exposure to other asset classes, such as equity, credit commodities and digital assets.

4) Overview of Brevan Howard

Brevan Howard has over 150 portfolio managers and traders, around 25 economists and strategists, more than 25 risk officers, and a 185-plus-strong trading support team (as of 01/04/2026).

5) Are investments driven by a particular style?

Through its investment in the Master Fund, BH Macro seeks to produce compelling, asymmetric returns independent of the market environment, with a low structural correlation to equities and bonds.

The investment style is based around three main pillars:

- Global macro research forms the backbone of the investment process and promotes independent and contrarian thought.

- Brevan Howard seeks to structure convex (i.e. asymmetric) trades where the upside potential significantly outweighs the downside.
- Brevan Howard's 25-plus-strong risk team is integrated into the investment process with each trader having a bespoke risk mandate and working with a designated risk manager to protect capital as well as maximising potential returns.

BH Macro provides diversified capital allocations across Brevan Howard's trading teams, meaning that performance is not dependent on any individual trader, asset class, market view or trading style.

6) What is BH Macro's dividend policy?

BH Macro has not historically paid dividends.

7) Does BH Macro have a management fee and/or a performance fee?

BH Macro pays an annual management fee of 1.5% of the NAV of each class of its shares. BH Macro's investment in the Master Fund is not subject to management fees but is also subject to an operational services fee of 0.5% per annum of the Master Fund NAV attributable to BH Macro.

BH Macro also pays an annual performance fee equal to, broadly, 20% of any increase in the NAV of each class of its shares during the relevant annual calculation period, subject to a high watermark.

8) Does BH Macro use gearing?

BH Macro does not typically employ gearing at the company level, although the Brevan Howard Master Fund's traders will often structure trades through options, which therefore include an element of leverage. These trades are designed to offer geared upside but, in contrast to traditional gearing, should not exacerbate the downside to any great extent.

With the approval of its board of directors, BH Macro is able to borrow up to 20% of its NAV, including to satisfy working capital requirements or share buybacks.

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