

Share Class (Principal series)	NAV	August 2004		2004 Year to Date		Since Inception [†]	
		Fund (%)	FT World (%)*	Fund (%)	FT World (%)*	Fund (%)	FT World (%)*
Class A – US\$	US\$112.11	+0.04	+0.71	+2.72	+1.29	+12.11	+20.37
Class B - £	£118.23	+0.34	+1.81	+4.47	+0.79	+18.23	(1.66)
Class C - €	€114.45	+0.14	(0.24)	+3.32	+5.08	+14.45	(9.80)

*The FT World Share Index in the currency of the respective share class – Source: FT/Bloomberg

†1st October 2001

If you were to ask us which is our least favourite month of the year for extracting returns from financial markets our answer would always be August. With so many corporate and investment decision takers away on holiday, August is a month when apathy prevails, markets are listless and, most importantly, price anomalies persist. Thinly-traded markets also add the danger of unjustified and exaggerated price swings in the rare instances when something newsworthy does occur. As such, we are not dispirited by the month's flat performance and we are always relieved to navigate August without erosion to capital. Indeed, the HFR Funds of Hedge Funds Index, probably the best benchmark of returns being achieved by our peer-group, suffered its fourth 'down' month in the last five. The Absolute Fund's year-to-date returns are not exactly mouth-watering but remain better than virtually any other asset class including cash deposits, our primary benchmark which is increasingly relevant in a rising interest rate environment. Moreover, the final months of the year have historically been productive for many hedge fund strategies as corporate activity resumes after the summer lull. Accordingly, the Absolute Fund's twelve-month rolling returns remain competitive at 6.0%, 8.5% and 6.7% for the US\$, £ and €share classes respectively net of all costs.

The dull market conditions were reflected in the Absolute Fund's return attribution with no strategy contributing or losing more than 0.1%. Broadly speaking, the 60% of the portfolio invested in debt-related and arbitrage strategies produced a total return of approximately +0.2% and the 40% invested in equity funds lost 0.1%. Four of the five arbitrage sub-strategies were profitable, with Fixed Income and Credit Arbitrage, Distressed Securities and Convertible Bond Arbitrage each contributing roughly equal, albeit modest, returns. The one losing strategy in the debt-related part of the portfolio was multi-strategy arbitrage but this was really entirely due to MS4, a fund which is invested in Asian securities and which suffered the biggest-ever monthly loss (1.7%). In the equity part of the portfolio only Japan was marginally profitable, thanks mainly to the excellent JLS8 fund. However, we suffered a full house of losses in our US equity long/short funds which, given their quality, is testament to the capriciousness of the US stock market during the month.

As can be deduced from the heroes and villains lists below, the same pattern was repeated at the individual fund level with no stand-out winners or losers. A return of less than 2% was sufficient to put CBA9 on the Best 3 Funds list. As many readers will be aware, we allocate half 'units' of investment to funds which we regard as potentially more volatile and all three funds in the rogues gallery fall into this category. However, the volatility we had in mind when devising this risk control was somewhat greater than losing months of 2-3% down!

Biggest 5 Holdings as at 31st August 2004

Name of Fund	%	Strategy	August (%)	Year to Date (%)
DHY7	3.2	Distressed Securities	+1.0	+5.1
JLS6	3.1	Japanese Equity Long/Short	+0.5	+19.3
DHY10	2.9	Distressed Securities	(0.7)	+7.3
USLS11	2.9	US Equity Long/Short	(0.6)	+2.6
MS4	2.9	Multi-Strategy	(1.7)	+2.5

Best 3 Funds in August

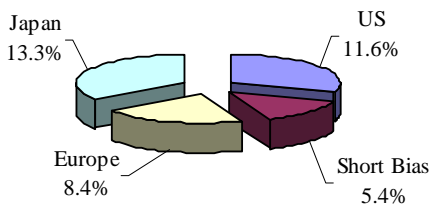
Name of Fund	Strategy	August	YTD
JLS8	Japanese Equity L/S	+2.3	+14.2
FICA5	Credit Arbitrage	+2.1	+5.1
CBA9	Convertible Arbitrage	+2.0	+6.4

Worst 3 Funds in August

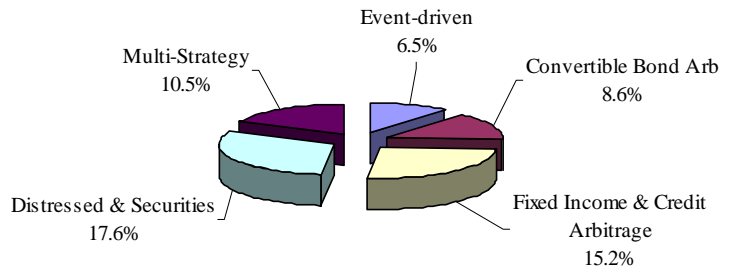
Name of Fund	Strategy	August	YTD
JLS9	Japanese Equity L/S	(3.0)	(6.2)
JLS3	Japanese Equity L/S	(2.4)	(16.8)
USSB5	Short-Bias	(2.2)	(3.8)

Asset Allocation by Strategy (as at 31st August 2004)

Equity Long/ Short (38.6%)



Arbitrage & Other (58.4%)



Outlook

So much money has flowed into hedge funds that they can't produce returns any more and it's a bubble that is set to burst! Such is the latest warning of the anti-hedge fund lobby which we would like to address in this month's Outlook. First, there is no bubble, at least not in the sense of the dotcom-inspired stock market bubble which burst more than four years ago. The difference is that a share price is a function not only of a company's profits (or other financial metric) but also of an arbitrary multiplier called valuation which is determined principally by the balance of supply and demand amongst investors. In the late 1990s belief that new technology would create a new paradigm and economic nirvana caused a frenzy of demand which drove valuations to unsustainably high levels. When this myth was exposed, the valuation bubble burst. Hedge funds are not vulnerable in this way because demand is not a factor in the prices at which shares can be bought or sold. Only in the very rarest circumstances does excess demand cause the price of a hedge fund to stand at a premium to the net value of its underlying investments.

The popularity of hedge funds is much more likely to be spiked by returns failing to meet unrealistic expectations. Unfortunately, many hedge funds and funds of hedge funds are still being marketed to investors with the 'promise' of 12-15% returns. The truth, however, is that returns have fallen short of this figure every year since 1999. The vast sum of money which has flowed into hedge funds over the last twelve months is undoubtedly one of the factors which have depressed returns this year, particularly in arbitrage strategies. However, there are other factors which are just as significant including the simultaneous combination of rising interest rates, low corporate credit spreads and the lack of trends and volatility in stock and bond markets generally. These are all cyclical factors which will turn more favourable again in due course.

Our big advantage is our relatively small size. The bulk of recent money flows has come from pension funds and other institutional investors and has necessarily found its way to the biggest managers of funds of hedge funds. The problem for these goliaths is that the universe of investible hedge funds is much reduced if you need to invest US\$50m or more per fund. Similarly, managers of the US\$1bn plus hedge funds which the biggest funds of funds have to invest in need to be able to invest US\$25m or more in an individual security in order to have a meaningful position. We'd hate to be managing a US\$2bn fund of hedge funds! As our space has become more crowded, our strategy has been to seek out smaller funds which our bigger competitors can't access. Our last three new investments on 1st September were in funds of US\$180m, US\$150m and US\$60m in size. We are confident that this strategy will enable us to continue to deliver competitive returns and we wouldn't invest any of our own money anywhere else.

As always, we welcome your questions, comments and suggestions.

Charles Hovenden & Christopher Aldous

22nd September 2004

Manager's Track Record & Summary Statistics (for Class A US\$ shares)

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Year
1999	0.83	1.07	0.96	2.60	1.43	0.74	1.61	0.37	0.81	0.70	2.46	0.57	15.05
2000	1.36	3.21	1.87	(0.03)	1.01	1.63	0.98	0.80	0.83	0.17	(0.28)	0.58	12.77
2001	0.87	0.41	0.36	0.38	0.62	(0.32)	(0.10)	0.68	(0.19)	0.39	0.24	0.63	4.02
2002	0.49	(0.01)	0.82	0.65	0.41	(0.52)	(0.78)	(0.04)	(1.07)	(0.42)	0.18	0.83	0.53
2003	0.67	0.30	(0.01)	0.46	0.61	0.60	0.36	0.86	0.84	1.41	0.10	0.82	7.24
2004	1.00	0.26	0.87	0.51	(0.74)	0.75	0.01	0.04					2.72
Annual Rate of Return	7.25	Sharpe Ratio (@ 5% risk free)						0.92	Biggest Monthly Loss				(1.07)
Standard Deviation	2.56	Correlation with FT World Index (Local)						0.34	Biggest Peak-to-Trough Drawdown				(2.80)

NB: The monthly returns in the shaded portion of the 'Manager's Track Record' table are those of a portfolio previously managed by the Investment Manager of the Absolute Fund. Together with other almost identical portfolios, it was the forerunner of the Absolute Fund in terms of both investment strategy and procedures and its investments have been absorbed into the Absolute Fund. Returns prior to October 2001 have been adjusted to reflect the Absolute Fund's scale of fees. Figures from October 2001 onwards are for the Class A (Principal series) shares of the Absolute Fund.

General Information

Size of Fund:	US\$93.5m	Investment Manager:	Absolute Fund Management Ltd. 4, Arlington Street London SW1A 1RA Telephone: +44 (0) 20 7307 0000 Website: www.absolutefund.co.uk Contact: Christopher Aldous
No. of Holdings:	45	Administrator:	International Fund Managers (Ireland) Ltd. IFSC House International Financial Services Centre Dublin 1 Telephone: +353 1 670 0660 Contact: Andrew Martin
Share Classes:	US\$, £, €		
Basic Fee:	1%		
Incentive Fee:	15% of gains between 6% and 24% p.a.		
High Water Mark:	Yes		
Dealing:	Monthly (with 35 days notice for redemptions)		
Min. Investment:	US\$100,000		
Fund Domicile:	Cayman Islands		
Listing:	Irish Stock Exchange		

Price Information

	Financial Times	Bloomberg	SEDOL	ISIN
Class A (US\$)	under The Absolute Fund Ltd	ABSFNDA KY <Equity>	3093568	KYG0060S1241
Class B (£)	“	ABSFNDB KY <Equity>	3093591	KYG0060S1324
Class C (€)	“	ABSFNDC KY <Equity>	3093610	KYG0060S1407

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