

### Fund Performance

Share Class (Principal series)	NAV	December 2001		Since Inception <sup>†</sup>	
		Fund	FTWorld*	Fund	FTWorld*
Class A – US\$	US\$101.26	+0.63	+0.97	+1.26	+9.67
Class B - £	£100.97	+0.73	-1.06	+0.97	+10.75
Class C - €	€100.72	+0.74	+1.53	+0.72	+12.17

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

†1<sup>st</sup> October 2001

As the rally in equity markets which began soon after the atrocities of 11th September began to lose momentum in December, the Absolute Fund provided investors with its most profitable month so far. The net asset value of the US\$-denominated Class A shares (Principal Series) rose by 0.63%. Encouragingly, but not entirely unexpectedly given the relatively small monetary value of non-US\$ in-specie subscriptions in December, the performances of the different currency share classes were also much closer than in previous months despite a fairly volatile month in the foreign exchange markets. The net asset values of the £-denominated Class B and €-denominated Class C Principal Series shares increased by 0.73% and 0.74% respectively. There will always be some variation between the performances of the different share classes because the calculation of the amount of currency hedging can never be an exact science due to the delay in receipt of underlying hedge fund prices. In addition, interest rate differentials (which are admittedly quite small at the moment) necessarily mean that currency hedging is not a wholly costless exercise. Consequently, we regard variations of around 0.1% in the performances of the different currency share classes as inevitable and acceptable.

As you can see from the extended track record on the next page of this report, we estimate that the investment strategy adopted by the Absolute Fund provided a net return of just over 4% in 2001. This was achieved despite an almost complete moratorium on transactions between April and November in the run-up to the launch of the Absolute Fund. Although a gain of 4% is somewhat below our target return of 12-15% p.a., there will undoubtedly be years when we will be grateful just to have been able to preserve capital and a return of 4% in 2001 certainly compares very favourably with the decline of 13.5% in the FT World Share Index in local currency terms.

29 of the 35 underlying hedge funds owned by the Absolute Fund were profitable in December with individual fund returns varying between +9.9% (Fund USSB2) to -4.0% (Fund OVA1). Interestingly, the best three funds during the month were all US equity long/short funds, with Fund USLS7 making a welcome appearance in the 'Best 3' list after its appearance in the 'Worst 3' lists in both preceding months. Despite this, USLS7's place in the Absolute Fund remains distinctly vulnerable following a gain of just 0.2% in 2001. There are plenty of rival funds at various stages of our due diligence process which navigated the treacherous conditions far better and posted double-digit returns last year. OVA1's loss of 4% in December was extremely disappointing and RA, the fund's founder, has responded by making changes to his management team. Not least because OVA1 thrives on stock market volatility and was the most profitable fund on our list in September (+6.1%), we are inclined to retain this investment for the time being. However, OVA1 will be sold if the recent changes in management responsibilities do not bring about a significant improvement in the pattern of monthly returns.

### Top 5 Holdings as at 31<sup>st</sup> December 2001

Name of Fund	%	Strategy	December	2001
Fund MM1	5.7	Multi-Strategy	+0.1	+7.1
Fund CBA5	5.2	Convertible Bond & Merger Arbitrage	+1.8	+12.0
Fund CBA4	5.1	Convertible Bond Arbitrage	+1.1	+16.2
Fund MA2	4.7	Event-driven	+1.0	+9.3
Fund MA1	4.6	Merger Arbitrage	+1.2	+8.6

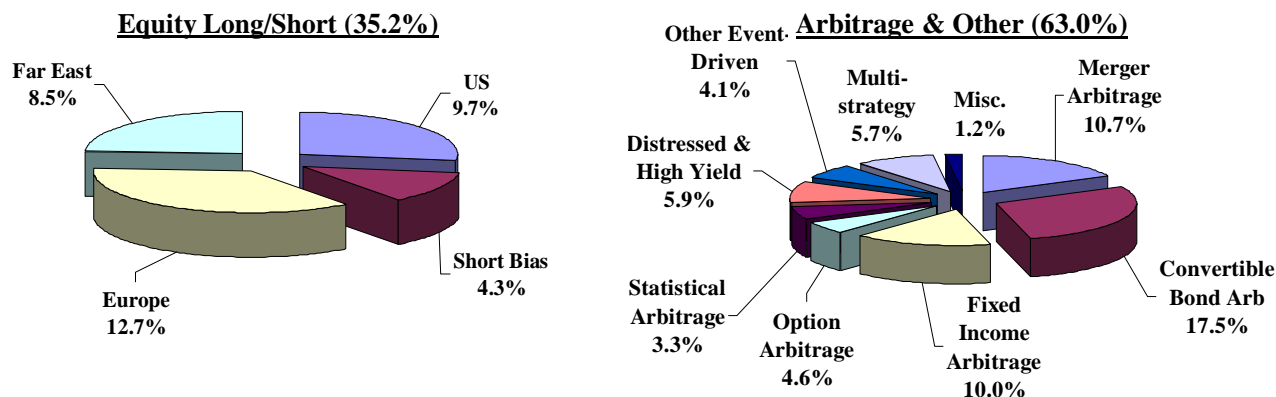
### Best 3 Funds in December

Name of Fund	Strategy	Dec	2001
Fund USSB2	US Equity L/S	+9.9	+16.0
Fund USLS2	US Equity L/S	+4.2	+21.4
Fund USLS7	US Equity L/S	+2.7	+0.2

### Worst 3 Funds in December

Name of Fund	Strategy	Dec	2001
Fund OVA1	Volatility Arbitrage	-4.0	N/A
Fund USSB1	US Equity Short Bias	-1.3	+5.7
Fund DHY1	High Yield Debt	-0.4	-18.9

## Asset Allocation by Strategy (as at 31<sup>st</sup> December 2001)



## Outlook

Despite signs that economic conditions in the US may at least have stopped getting any worse, we believe that equity markets could give investors another bumpy and ultimately frustrating ride in 2002. The problem is that shares are already 'priced for perfection' following the 20% rise in the FT World Share Index in local currency terms between its trough on 21st September and the end of the year. There is clearly little scope for disappointment if the economic recovery, which is widely-expected to be underway by the end of the first half of this year, is delayed or anaemic. We therefore suspect that the Absolute Fund's target return of 12-15% p.a. could again prove to be highly competitive and we would also hope to be able to spare investors much of the torment which can be caused by stock market volatility.

The challenge for us this year is to make sure we deliver our target return. In this respect, the most exciting recent development for the Absolute Fund was the arrival on 1st January of our joint venture partner's substantial subscription which had been delayed by proposed changes to Canadian tax laws. This gave us the firepower we needed to accelerate the refreshment of the Absolute Fund's underlying investments. We added to eight existing investments (including some funds which are officially 'closed' to new subscriptions) and were able to initiate eight brand new investments which we will write about in more detail in January's Investment Report. Meanwhile the process of re-registration of investments which were acquired through in-specie subscriptions into the name of the Absolute Fund's custodian is progressing steadily and its completion will enable us to make other changes.

In December, we initiated new investments in Fund JLS3 and Fund USLS3. The former, which is obviously a long/short Japanese equity fund, is managed in Tokyo by DS and his team, with whom Charles met during his visit to Japan in November. Sterling Multi-hedged is a long/short US equity fund which is managed in San Francisco by SJCM.

As you can see from the pie-charts at the top of the page, at the end of last year more than 60% of the Absolute Fund was invested in 'Arbitrage & Other' strategies and just 35% in 'Equity Long/Short' funds. Over the next few months we intend to increase the proportion in equity long/short funds to 50% or even a little more, with a corresponding decrease in exposure to arbitrage strategies. As investor interest and money flows into hedge funds grow, 'spreads' and hence returns are being squeezed in many arbitrage strategies. We are confident that our proposed increase in exposure to equity long/short funds, coupled with careful selection and combination of underlying investments, can improve the returns of the Absolute Fund with little or no accompanying increase in volatility and risk.

Charles Hovenden & Christopher Aldous – 24<sup>th</sup> January 2002

## Manager's Track Record & Summary Statistics

	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

Annual Rate of Return	10.5	Sharpe Ratio (@ 5% risk free)	2.02	Biggest Monthly Loss	(0.32)
Standard Deviation	2.73	Correlation with FT World Index (Local)	0.31	Biggest Peak-to-Trough Drawdown	(0.42)

*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\$33.4m	Investment Manager:	Absolute Fund Management Ltd. 33, St. James's Square London SW1Y 4JS Telephone: +44 (0) 20 7661 9342 Contact: Christopher Aldous
No. of Holdings:	35	Administrator:	International Fund Mgrs. (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% & 24% p.a.		
High Water Mark:	Yes		
Dealing:	Monthly (35 days notice for redemptions)		
Min. Investment:	US\$100,000		
Fund Details:	Cayman Islands domicile with Irish Stock Exchange listing		
Price Information	Listed in the Financial Times under Offshore & Overseas Funds – Cayman Islands (Regulated).		

## Risk Warning

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