

Share Class (Principal series)	NAV	December 2004		2004 Year to Date		Since Inception <sup>†</sup>	
		Fund (%)	FT World (%)*	Fund (%)	FT World (%)*	Fund (%)	FT World (%)*
Class A - US\$	US\$115.30	+1.02	+3.88	+5.66	+16.08	+15.30	+37.95
Class B - £	£122.57	+1.12	+3.44	+8.29	+8.23	+22.57	+2.39
Class C - €	€17.66	+0.94	+1.57	+6.20	+7.68	+17.66	(7.57)

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

†1st October 2001

December was another very satisfactory month for the Absolute Fund which, along with November, helped elevate 2004's full year's returns from merely acceptable to highly respectable. In what was a challenging year for a variety of hedge fund strategies, we are also extremely proud that May was the Absolute Fund's only losing month. In contrast, the HFR Fund of Funds Index, which we interpret as representative of our peers' returns, suffered four 'down' months last year. Many readers will have heard us talk of compounding as an investor's best friend or worst enemy which basically means that it is much easier to make money if you haven't got to recover earlier losses first!

Our biggest allocation (16%) to funds which invest in Distressed Securities contributed just over half of the Absolute Fund's return in December. As is evident from the Best 3 Fund's list, DHY10 and DHY5 enjoyed bumper months but all seven of our Distressed funds posted gains of more than 1%. Allocations to Fixed Income and Credit Arbitrage, Event-driven and US Equity Long/Short funds each contributed approximately 0.20% to the Absolute Fund's overall gain. The obvious deduction that all of last month's performance was therefore generated by just four of the Absolute Fund's ten sub-strategies is, for us, encouraging rather than disappointing. We would find it much more worrying if a 1%-return-month required the Absolute Fund to be firing on all cylinders. Indeed, we even lost money, albeit not very much, in three sub-strategies in December: Short-bias Equity, Short-bias Credit and Japanese Equity Long/Short. Losses in the first two were hardly surprising given the upward trend in equity and corporate bond markets. As regular readers of our Monthly Reports will be aware, our Japanese managers have been struggling to make money in a capricious equity market since July and in December they were collectively wrong-footed as retail and speculative money poured into low-priced and, in many cases, low quality shares in closing days of 2004.

Despite a modest loss in the second half of the year, Japanese Equity Long/Short was still the pick of our equity-based sub-strategies in 2004. This is entirely consistent with our acknowledgement that returns from what is arguably the most aggressive asset allocation within the Fund are always likely to be a matter of feast or famine. Distressed Securities took the prize for the most profitable sub-strategy overall in the Absolute Fund in 2004 and the best performing underlying fund was Event-driven ED5 with a gain of 25%. Four other funds (DHY10, JLS6, FICA5 and SBE2) also achieved returns of more than 20%.

### Biggest 5 Holdings as at 31<sup>st</sup> December 2004

Name of Fund	%	Strategy	December (%)	Year to Date (%)
ED6	3.2	Event-driven	+1.5	N/A
DHY7	3.0	Distressed Securities	+1.1	+9.9
USLS14	3.0	US Equity Long/Short	+1.8	+9.3
USLS13	3.0	US Equity Long/Short	+1.3	+6.5
DHY10	3.0	Distressed Securities	+7.4	+22.2

### Best 3 Funds in December

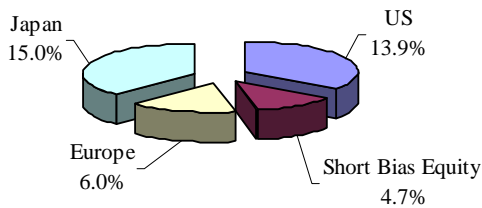
Name of Fund	Strategy	December	YTD
DHY10	Distressed Securities	+7.4	+22.2
DHY5	Distressed Securities	+6.5	+16.4
ED5	Event-driven	+4.9	+25.0

### Worst 3 Funds in December

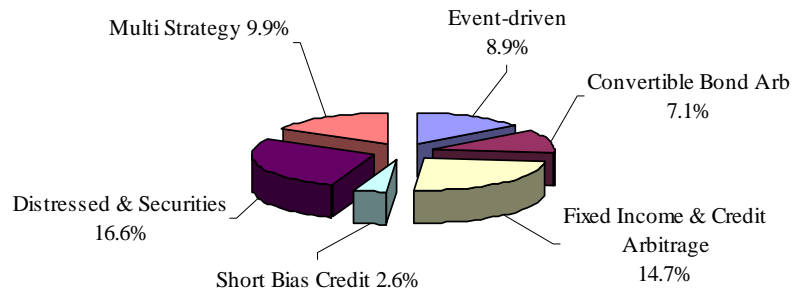
Name of Fund	Strategy	December	YTD
SBE3	Short-bias Equity	(3.9)	(17.3)
SBE5	Short-bias Equity	(2.8)	(13.4)
SBC1	Short-bias Credit	(2.5)	(13.1)

## Asset Allocation by Strategy (as at 31st December 2004)

### Equity Long/ Short (39.6%)



### Arbitrage & Other (59.8%)



## Outlook

The New Year has predictably brought a fresh round of accusations in parts of the Press and amongst conventional long-only managers that hedge funds are past their 'sell-by date' and that the fad is over. Articles cite how hedge fund portfolios like the Absolute Fund have produced inferior returns to equity market indices for the second year in succession. What short-term and selective memories people have! The facts are these: despite the two-year rally in stock markets, the local-currency FT World Share Index still needs to rise by 20% and the FTSE 100 Index by 40% just to regain peaks achieved more than four years ago. Even in dollar terms, the FT World Index is still almost 10% below its peak despite the value of the US currency crumbling by 33% against the euro and by 24% against the pound. In contrast, the Absolute Fund strategy has delivered a net return of more than 20% in dollars and more in sterling and euros over the same period.

Still, the past, as they say, is history and we believe that investors should always look to the future. Again we hear cynics dismiss hedge funds as victims of their own success, claiming that there is now too much money invested in hedge funds amongst which a finite quantum of return must be shared. We agree that opportunities in certain strategies such as convertible bond arbitrage have been suffocated partly by money flows. Accordingly, we have slashed exposure within the Absolute Fund to its lowest ever level and none of the three funds we have retained engages in what we would term traditional convertible bond arbitrage. We categorise them thus only because most of the arbitrages which their managers have set-up within corporate capital structures feature long or short positions in convertible bonds. In any case, one of the virtues of hedge funds is that they are effectively self-regulating with regard to capital. Whilst the rewards for success can be considerable, it is also a brutal business in which the size of a fund can contract rapidly if returns disappoint. At some stage in the future, traditional convertible bond arbitrage will almost certainly again be an attractive strategy and when it is we may rebuild exposure. Finally, hedge funds still account for relatively small amount of the ownership of corporate bonds and equities. It is therefore clearly nonsensical to claim that opportunities within these asset classes no longer exist. Moreover, with economic growth apparently faltering and corporate credit spreads at record lows, we are confident that the flexibility to sell shares and bonds of selected companies short as well as to invest conventionally will prove invaluable in 2005.

Accordingly, we continue to have absolute conviction in our investment strategy and both of us have effectively all of our financial assets, including any pension funds we were able to transfer, invested in the Absolute Fund. Investing is a marathon, not a sprint, and we believe that the Absolute Fund will be hard to beat if we can continue to grind out returns similar to those we have delivered in our six-year track record.

Charles Hovenden & Christopher Aldous

25th January 2005

## 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	0.45	0.22	1.14	1.02	5.66
<b>Annual Rate of Return</b>	7.43			<b>Sharpe Ratio (@ 5% risk free)</b>				0.97	<b>Biggest Monthly Loss</b>			(1.07)	
<b>Standard Deviation</b>	2.50			<b>Correlation with FT World Index (Local)</b>				0.34	<b>Biggest Peak-to-Trough Drawdown</b>			(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

<b>Size of Fund:</b>	US\$105.2m	<b>Investment Manager:</b>	Absolute Fund Management Ltd. 4, Arlington Street London SW1A 1RA Telephone: +44 (0) 20 7307 0000 Website: <a href="http://www.absolutefund.co.uk">www.absolutefund.co.uk</a> <b>Contact: Christopher Aldous</b>
<b>No. of Holdings:</b>	46	<b>Administrator:</b>	International Fund Managers (Ireland) Ltd. IFSC House International Financial Services Centre Dublin 1 Telephone: +353 1 670 0660 <b>Contact: Andrew Martin</b>
<b>Share Classes:</b>	US\$, £, €		
<b>Basic Fee:</b>	1%		
<b>Incentive Fee:</b>	15% of gains between 6% and 24% p.a.		
<b>High Water Mark:</b>	Yes		
<b>Dealing:</b>	Monthly (with 35 days notice for redemptions)		
<b>Min. Investment:</b>	US\$100,000		
<b>Fund Domicile:</b>	Cayman Islands		
<b>Listing:</b>	Irish Stock Exchange		

## Price Information

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

## Risk Warning

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