

Fund Performance

Share Class (Principal series)	NAV	December 2002		2002		Since Inception [†]	
		Fund (%)	FT World (%) [*]	Fund (%)	FT World (%) [*]	Fund (%)	FT World (%) [*]
Class A – US\$	US\$101.79	+0.83	(4.79)	+0.53	(19.06)	+1.79	(11.23)
Class B - £	£103.62	+1.07	(7.98)	+2.57	(26.83)	+3.62	(18.96)
Class C - €	€102.62	+0.99	(9.75)	+1.88	(31.33)	+2.62	(22.97)

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

†1st October 2001

The bear market rally which saw the FT World Share Index bounce by 13% in local currency terms in October and November finally ran out of steam in December as investors peered nervously into 2003 to find only more economic, corporate and political uncertainty. The Index shed just over half of the two previous months' gains to finish the year down by 23.1%, its worst annual performance since 1974. Having fallen three years in a row, the Index stands 41% below its March 2000 peak and must rise by 69% to regain it.

The Absolute Fund performed exactly as it is supposed to in December and even delivered its biggest monthly gain since launch. The improvement was also sufficient to make all three share classes profitable for the whole of last year. Returns fell well short of our target of a double-digit return, but 2002 was a year when it was probably an achievement just to have preserved previous years' gains. How we rue, however, the ill-fated investment in Bristol Fund without which performance would have been about 1.3% better. At least we can draw positively from this experience as it clearly demonstrates that our risk management is effective.

In terms of attribution, we estimate that The Absolute Fund's equity managers contributed about 0.1% to the overall return in December, the short-bias managers another 0.1% and the 'arbitrage & other' managers 0.7%. Stock market volatility, although mercifully lower than in the summer and autumn months, remained high by historic standards in December and this continued to make life challenging for long/short equity managers. Indeed, the toll that the unprecedented volatility has taken is demonstrated by the decline of 1.6% in the equity long/short component of the CSFB/Tremont Hedge Fund Index in 2002. Despite the mitigating circumstances, however, we can only be disappointed by the performance achieved by the Absolute Fund's equity hedge fund managers last year.

Elsewhere, the surprisingly modest returns achieved by the Fund's short-bias managers in December suggest that they had largely disengaged and were perhaps protecting performance fees earned earlier in the year. We certainly don't begrudge them this given the benefits they have delivered to the Fund throughout the year. Once again, however, it was the 'arbitrage & other' managers who provided the major contribution to overall performance, with convertible bond arbitrage proving particularly successful. 20 of the 22 funds in this half of the portfolio were profitable in December, exactly the same as in November.

Biggest 5 Holdings as at 31st December 2002

Name of Fund	%	Strategy	December (%)	2002 (%)
DHY2	3.6	Distressed Securities	0.6	4.0
MS3	3.6	Multi-strategy	1.4	4.4
CBA4	3.6	Convertible Bond Arbitrage	2.2	13.2
ED2	3.0	Event Driven	0.8	5.0
ELS1	2.9	European Long/Short	0.1	6.3

Best 3 Funds in December

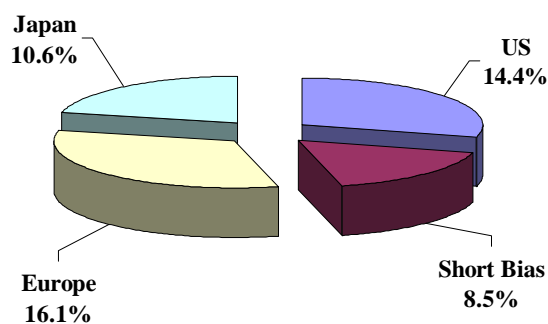
Name of Fund	Strategy	December	2002
DHY3	Distressed	5.3	25.1
OA1	Option Arbitrage	4.6	17.2
USSB2	US Long/Short	4.4	(7.6)

Worst 3 Funds in December

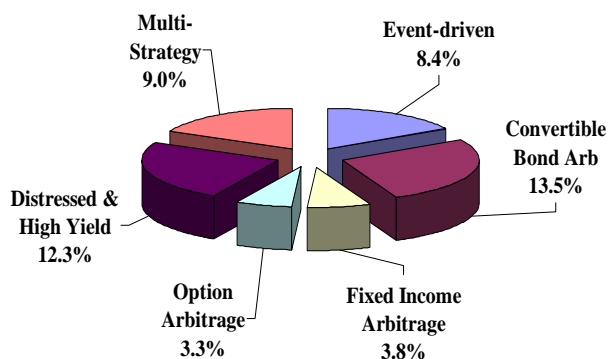
Name of Fund	Strategy	December	2002
USLS10	US Long/Short	(4.1)	(3.2)
JLS6	Japan Long/Short	(2.0)	10.4
USLS5	US Long/Short	(1.9)	(2.7)

Asset Allocation by Strategy (as at 31st December 2002)

Equity Long/ Short (49.6%)



Arbitrage & Other (50.2%)



Outlook

As we enter 2003, economic growth in the US and the UK is being sustained mainly by consumer spending which is being unsustainably financed by increased borrowing. Much of the Eurozone is stagnant as a result of the constraints of the Fiscal Stability Pact and the folly of a one-size-fits-all system whilst Japan's deflationary crisis and policy paralysis continue. Add in Iraq and North Korea, the high price of oil, the falling dollar and the limited scope for further cuts in interest rates and it seems only sensible to be cautious about the prospects for investment returns from most investment classes in the year ahead.

However, aware that it is 'always darkest before the dawn' and that stock markets are a 'leading' rather than a 'lagging' indicator, we believe that it would be risky for investors to adopt an overtly bearish stance. Corporate America has achieved considerable balance sheet repair over the last year and cost-cutting may promote some recovery in company profits which is a vital pre-requisite for a much-needed pick-up in corporate investment.

Fortunately, the way in which the Absolute Fund is structured allows us the luxury of being wholly agnostic as to whether bond and stock market indices finish 2003 up or down. Although many of the underlying funds within the Absolute Fund have directional bias, the Fund as a whole is broadly and deliberately 'market-neutral'. As such, the Fund's main source of return comes from mis-pricings and other anomalies which exist within bond and stock markets rather than from us trying to predict market trends.

The most important decision we need to make in the next few weeks concerns the exposure to equity long/short funds (and US equity long/short funds in particular) which was clearly a drag on performance for much of last year. We do not believe that pure arbitrage strategies in general are capable of delivering the returns we seek without the use of uncomfortably high levels of leverage. In contrast, the magnitude of anomalies which our equity long/short managers are trying to exploit tend to be much greater and leverage is not required to boost returns. The correction of those anomalies and hence capture of return does, however, depend on fundamental factors being dominant in determining share price movements. If stock market volatility declines to nearer its historic average, 2003 should be a great year for skilled stock-pickers. If not, it may be better to reduce exposure to equity long/short strategies or at least to make some changes to our underlying funds.

This conundrum apart, we are excited by the sheer quality of the managers we have assembled within the Absolute Fund and confidently re-affirm our investment objective of a double-digit return in 2003.

Charles Hovenden & Christopher Aldous – 20th 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
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

Annual Rate of Return	7.92	Sharpe Ratio (@ 5% risk free)	1.02	Biggest Monthly Loss	(1.07)
Standard Deviation	2.85	Correlation with FT World Index (Local)	0.37	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\$ 58.2 m	Investment Manager:	Absolute Fund Management Ltd. 33, St. James's Square London SW1Y 4JS Telephone: +44 (0) 20 7661 9342 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	TBC
Class B (£)	"	ABSFNDB KY <Equity>	3093591	TBC
Class C (€)	"	ABSFNDC KY <Equity>	3093610	TBC

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