

### Fund Performance

Share Class (Principal series)	NAV	May 2002		2002 Year to Date		Since Inception <sup>†</sup>	
		Fund	FTWorld*	Fund	FT World*	Fund	FT World*
Class A – US\$	US\$103.67	+0.41%	+0.33%	+2.40%	-2.44%	+3.67%	+7.00%
Class B - £	£104.22	+0.56%	-0.06%	+3.20%	-2.95%	+4.22%	+7.49%
Class C - €	€103.79	+0.50%	-3.23%	+3.04%	-7.01%	+3.79%	+4.30%

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

<sup>†</sup>1<sup>st</sup> October 2001

It's tough out there! The FT World Share Index may have fallen by only just under 1% in May in local currency terms but this flattered the underlying tone in stock markets. Indeed, most of the Absolute Fund's managers found last month to be even more treacherous and lacking in trends from which to profit than April when the FT World Share Index fell by more than 4%. Although we have again failed to achieve our target return of 1% per month, we actually feel relieved and fortunate to be reporting gains of 0.41%, 0.56% and 0.50% for investors in the US\$, £ and € share classes respectively. In the first five months of the year, investments in the Absolute Fund have provided gains of between 2.4% and 3.2% (depending on currency share class) and the FT World Share Index is down by approximately the same amount (and rather more in €).

Our systematic policy of hedging out all currency exposure in the Absolute Fund certainly protected investors in the € share class in May as the dollar began to crumble, sending investors scrambling for the safety (?) of the euro. As many investors in the Absolute Fund know, long and often painful experience of the fickleness of currency markets has taught us to treat them as a source of risk rather than return. We therefore make no apology for adopting a hedging policy which allows us the luxury of being disinterested about movements in exchange rates. For what it is worth, however, we suspect that the dollar has further to fall.

As evidence of the challenging conditions, 31 of the 45 of the underlying hedge funds within the Absolute Fund were profitable in May, a lower figure than in April. Unprofitable funds were broadly spread amongst the different strategies and only three (Japanese equity long/short, short bias equity and fixed income arbitrage) produced full houses of positive fund returns. Indeed, the Japanese equity long/short component, which comprises five funds, provided approximately half of Absolute Fund's overall gain. As most readers know, we have long believed that the Japanese equity market is the most inefficient of the major stock markets and is rich in anomalies which, the actions of the Japanese government permitting, can be harvested by hedge fund managers.

The strategy in which our fund selection continues to frustrate us most is US equity long/short. Five of the Absolute Fund's seven US equity hedge funds lost money in May, a statistic which we regard as wholly unacceptable. However, we derive some encouragement from the fact that the two funds which were up were our two most recent purchases. We are also inclined to 'forgive' Fund USLS5 for a loss of 0.03% as this fund has provided a gain of almost 10% since we invested in February. However, time has run out for some of our longer-standing US hedge funds and changes have to be made. The Absolute Fund's investments in Fund USLS1 and Fund USLS4 were redeemed on 1st June.

### Top 5 Holdings as at 31st May 2002

Name of Fund	%	Strategy	May	Year to Date
Fund DHY2	3.6	Distressed Securities	+0.6%	+3.5%
Fund MM1	3.6	Multi-strategy	+0.6%	+3.2%
Fund CBA5	3.3	Convertible Bond & Merger Arbitrage	+0.1%	+2.8%
Fund CBA4	3.1	Convertible Bond Arbitrage	+1.0%	+5.7%
Fund MA2	2.9	Event-driven	+0.8%	+2.7%

### Best 3 Funds in May

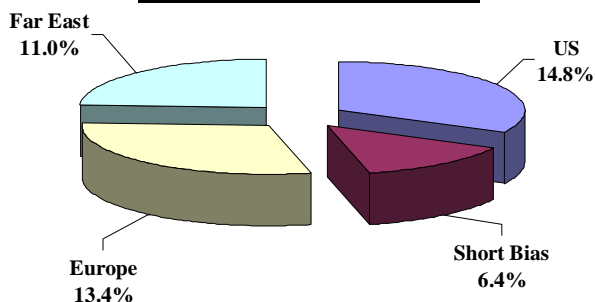
Name of Fund	Strategy	May	YTD
Fund JLS1	Japanese Equity L/S	+4.6%	+5.2%
Fund DHY3	Asian Distressed	+4.2%	+13.9%
Fund JLS2	Japanese Equity L/S	+3.5%	+4.3%

### Worst 3 Funds in May

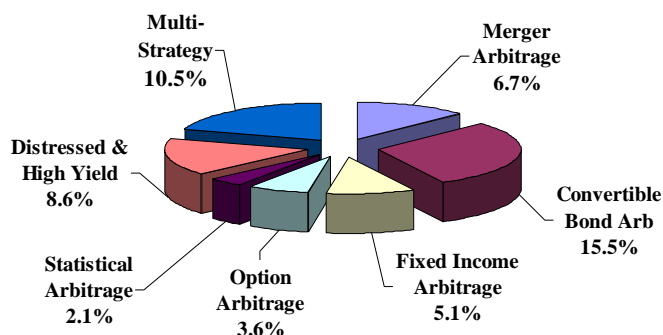
Name of Fund	Strategy	May	YTD
Fund USLS4	US Equity L/S	-2.7%	-2.9%
Fund DHY1	High Yield	-1.3%	+5.8%
Fund USLS2	US Equity L/S	-1.3%	-6.4%

## Asset Allocation by Strategy (as at 31st May 2002)

### Equity Long/Short (45.7%)



### Arbitrage & Other (52.0%)



## Outlook

As we write, the FT World Share Index has fallen by another 8% so far in June as fears about the US economy, the dollar, the credibility of US corporate accounting, the threat of more terrorist attacks and the conflict in the Middle East have conspired to produce a crisis of confidence. Even the most accomplished hedge fund managers are struggling to make money in these circumstances and only those who are markedly net short are prospering. Sentiment towards corporate bond markets has also been rocked again by revelations of fraudulent accounting at cable TV company Adelphia Communications and this has robbed strategies such as convertible bond arbitrage of some of their defensive characteristics. As things stand, a realistic objective in June for us as manager of the Absolute Fund is to preserve capital for the Fund's investors as best as we can.

We have often demonstrated in the past that we do not need stock markets to be going up to make satisfactory returns for the investors in the Absolute Fund. However, it is all but impossible to deliver decent returns in months when selling is indiscriminate and everything is being marked down. At the end of last year we warned that the widespread optimism about prospects for stock markets in 2002 was unwarranted and suggested that returns in double digits would be exceptional. Up until the end of May, and based on the success of our newer investments, we believed that a return of 10% for investors in the Absolute Fund was still achievable this year. In the light of events so far in June, however, it is only realistic to revise that target downwards, say, to perhaps 6-8%. This does not mean that we have abandoned our investment objective of 1-2% per month but we are sensible enough to accept that this will not be possible every year. In some years we will only be able to make (hopefully high) single digit returns but in other years we expect to make 20%. We manage the investments of the Absolute Fund first and foremost to minimise the risk of loss rather than to provide a specific return and we will not compromise the former to achieve the latter. In any case, we remain confident that the performance of the Absolute Fund in 2002 will compare favourably to cash deposits, equities and most other asset classes.

Finishing on a brighter note, we have just spent a week interviewing managers in Los Angeles and San Francisco. This was possibly the most productive research trip we have ever made. As well as visiting eight managers with whom we have already invested, we found three or four other funds which are compelling candidates for inclusion in the Absolute Fund. Properly combined, we are confident that these funds (the underlying strategies of which are US equity long/short, event-driven and short selling) can improve the performance of the Absolute Fund without increasing the risk. As always, we welcome your comments, suggestions and questions.

Charles Hovenden & Christopher Aldous – 23<sup>rd</sup> May 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	0.50	(0.01)	0.82	0.66	0.41								2.40

Annual Rate of Return	9.94	Sharpe Ratio (@ 5% risk free)	1.89	Biggest Monthly Loss	(0.32)
Standard Deviation	2.61	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

<b>Size of Fund:</b> US\$57.6m	<b>Investment Manager:</b> Absolute Fund Management Ltd. 33, St. James's Square London SW1Y 4JS Telephone: +44 (0) 20 7661 9342
<b>No. of Holdings:</b> 45	<b>Contact: Christopher Aldous</b>
<b>Share Classes:</b> US\$, £, €	<b>Administrator:</b> International Fund Managers (Ireland) Ltd. IFSC House International Financial Services Centre Dublin 1 Telephone: +353 1 670 0660
<b>Basic Fee:</b> 1%	<b>Contact: Andrew Martin</b>
<b>Incentive Fee:</b> 15% of gains between 6% and 24% p.a.	
<b>High Water Mark:</b> Yes	
<b>Dealing:</b> Monthly (35 days notice for redemptions)	
<b>Min. Investment:</b> US\$100,000	
<b>Fund Domicile:</b> Cayman Islands	
<b>Listing:</b> Irish Stock Exchange	
<b>Price Information:</b> Financial Times under The Absolute Fund Ltd.	

## Risk Warning

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