

Fund Performance

Share Class (Principal series)	NAV	September 2002		2002 Year to Date		Year to September 2002	
		Fund (%)	FT World (%)*	Fund (%)	FT World (%)*	Fund (%)	FT World (%)*
Class A – US\$	US\$101.19	(1.07)	(11.06)	(0.07)	(25.04)	+1.19	(17.78)
Class B - £	£102.37	(0.90)	(12.52)	+1.39	(30.63)	+2.37	(23.16)
Class C - €	€101.57	(0.90)	(11.74)	+0.84	(32.46)	+1.57	(24.25)

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

After August's brief respite, what at times has seemed like a meltdown in corporate bond and stock markets accelerated in September. A host of new records, most of them unwelcome, were set as the FT World Share Index suffered its worst month since August 1998, falling by 11% in local currency terms. However, this almost seems mild compared with the 25% drop in Germany's main DAX Index during the month. At the same time, US Treasury bond yields fell to their lowest levels since 1958. The last quarter was the worst for equities since the third quarter of 1990 and extended the fall in the FT World Share Index since the beginning of the year to 27.5% and since its all-time peak on 24th March 2000 to 44%. Due to effects of compounding, the Index must now rise by 79% just to regain this peak.

In such brutal conditions, it would be relatively easy to claim that limiting the decline in the price of the Class A (US\$-denominated) shares of the Absolute Fund to 1.07% is a creditable achievement. However, and as we have stated many times before, we are not in the business of relative returns and can never be satisfied with any performance number which is preceded by a minus sign. The truth is that we are bitterly disappointed and angry that the Absolute Fund was down at all last month as our investment strategy really proved its worth. Indeed, no less than 30 of the underlying 44 hedge funds were profitable and 15 of them produced returns of 1% or more. September was therefore a month in which we could, should and, but for a single investment, would have made money for investors.

The cause of our anguish is Fund MFIA1, a mortgage-backed bond arbitrage fund in which portfolios which were the precursors of the Absolute Fund have been invested since March 1998. Apart from one pardonable blip at the time of the Russian debt and LTCM crises in October of that year, MFIA1 had produced highly stable returns averaging nearly 13% p.a. In September, however, the combination of an unprecedented surge in prepayments of US residential mortgages (for re-mortgaging purposes), soaring US Treasury bond prices (used to hedge interest rate risk within the fund) and moderate leverage conspired to bring about a shocking 54% decline in MFIA1's net asset value. The extent of this loss suggests to us that the risk management controls which had previously proven so successful within the fund either failed almost totally on this occasion or, probably more likely, were overridden as its manager went into denial and gambled wrongly that prices would move back in his favour. In any case, the loss on MFIA1 alone cost the Absolute Fund about 1.3% in overall performance in September. Without it we would therefore have been celebrating a gain of approximately 0.3% and the total vindication of our investment strategy.

The loss on MFIA1 overshadowed some heroic returns achieved by many of our other managers. Short bias funds predictably occupied the top two places in September's Best Funds list but Fund ELS7 (+4.3%), Fund JLS1 (+4.2%) and Fund JLS3 (+3.1%) also merit special commendation.

Biggest 5 Holdings as at 30th September 2002

Name of Fund	%	Strategy	September (%)	Year to Date (%)
MS3	3.5	Multi-strategy	0.3	3.2
DHY2	3.4	Distressed Securities	0.9	1.7
CBA4	3.3	Convertible Bond Arbitrage	0.5	7.0
USSB3	2.9	Short Bias Equity	4.4	14.8
ED2	2.9	Event Driven	0.5	2.9

Best 3 Funds in September

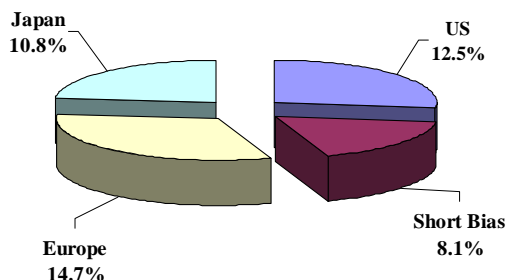
Name of Fund	Strategy	September	YTD
USSB5	Short Bias Equity	5.9	23.9
USSB3	Short Bias Equity	4.4	14.8
ELS7	European L/S	4.3	12.4

Worst 3 Funds in September

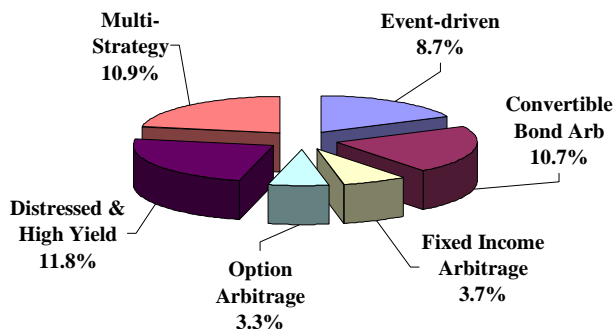
Name of Fund	Strategy	September	YTD
MFIA1	Mortgage Arbitrage	(54.0)	(49.4)
OA1	Option Arbitrage	(9.9)	(9.5)
DHY1	High Yield	(7.1)	(3.1)

Asset Allocation by Strategy (as at 30th September 2002)

Equity Long/Short (46.1%)



Arbitrage & Other (55.7%)



Outlook

Whilst we would have preferred to finish the Absolute Fund's first full year on a brighter note, we have at least preserved capital and provided investors with modest but positive returns in conditions which no-one could have anticipated twelve months ago. In the next week or so, we will be writing and sending to you a review of our first year describing the evolution of the Absolute Fund, the things we think we did well, the mistakes we made and the reasons why we are confident that the Absolute Fund will be a rather more profitable investment for its investors in its second year.

Rather than being demoralised, we can draw positively from the MFIA1 debacle. In particular, it demonstrates that our risk management controls, which are characterised by extensive diversification and no leverage, actually work. From time to time in the past it has been suggested to us that we could be diluting returns because the Absolute Fund is so diversified. This may be so but we are more concerned about minimising risk of loss. Whilst we are bitterly disappointed not to have made money for investors in September, a loss of 1% can hardly be described as an unmitigated disaster. MFIA1 was a big (US\$600m) and widely-owned fund and the pain will have been considerably greater for our peers who owned it within portfolios which are more concentrated or use leverage.

We are also determined to learn from this experience. We have always been wary of funds which engage in complex investment strategies, regardless of how tempting the returns appear to be. Although the magnitude of the loss on our investment in MFIA1 can probably be attributed mostly to human fallibility, we have concluded that mortgage-backed bond arbitrage must now be added to that list of strategies because of the unpredictability of mortgage prepayments and the impact that this can have on mortgage-backed securities. We have also decided to extinguish the Absolute Fund's exposure to option arbitrage not only because it was producing volatile and unpredictable returns but also because of our concerns about the exponential growth in the use of derivatives and associated counterparty risk. We simply do not want the Absolute Fund to be exposed to any strategy in which there is even the **remotest** possibility of another MFIA1-type loss in any circumstances. We like simple strategies and predictable returns. These changes will reduce the Absolute Fund's already low risk profile even further.

At the end of a first year which has not only been far more demanding than we could ever have imagined but also intellectually stimulating and rewarding (except in a financial sense!), we would like to thank all of the Absolute Fund's investors for their confidence and support. As always, we welcome any comments, suggestions and questions.

Charles Hovenden & Christopher Aldous – 23rd October 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)				(0.07)

Annual Rate of Return	8.30	Sharpe Ratio (@ 5% risk free)	1.15	Biggest Monthly Loss	(1.07)
Standard Deviation	2.88	Correlation with FT World Index (Local)	0.47	Biggest Peak-to-Trough Drawdown	(2.39)

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\$ 59.8 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:	44	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 (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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