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ABSOLUTE FOCUS FUND

The Curse of Correlation

This is a humbling business. Last month we were able to boast new all-time highs in Absolute Focus's share prices. This month we need to explain our biggest ever monthly loss, albeit of a size which probably all of our peers can only envy. August featured the most violent re-pricing (downwards) of 'risk' assets since the demise of Lehman in October 2008. Down by 13% at one stage in the month, the FT World Share Index clawed back some its decline to finish August with a loss of 6.8%. Although August was particularly brutal, stock market indices have now fallen four months in a row and cumulative losses over that period amount to 12% in the FT World Share Index and 11% in the UK's FTSE 100 Index. Year-to-date, those indices are now down by 7% and 9% respectively. Betraying its directional bias once again, the peer-group HFR Equity Hedge Fund Index declined by 4.2% in August, has lost 6.9% over the last four months and is down by 3.5% year-to-date. In contrast, Absolute Focus is down by less than 1% over the last four months and continues to be up for the year. This is no mean feat in the circumstances.

As we have noted many times before in these monthly reports, Absolute Focus's strategy is deliberately constructed to provide an investment which is substantially hedged against directional swings in stock markets. Instead, returns are derived mainly from the abilities of the underlying managers to whom we allocate to find shares which are mispriced either entirely anomalously or as a result of corporate change. Dispersion in share prices is therefore the lifeblood of Absolute Focus as it provides attractive entry points and profitable exit points. Unfortunately, the dispersion we rely on has been almost non-existent over the last few months as investors have become fixated by the slow-motion car crash that is the euro. Indeed, share price correlations in August reached new records, surpassing previous highs set in the October 1987 crash. We attribute August's performance to the extremely high correlation which made stock-picking largely redundant and to indiscriminate selling by investors who were using leverage or margin.

Of course, in such a month there were bound to be some individual disappointments amongst Absolute Focus's investments. USLS1 was the month's biggest loser but we have always recognised the risks within its concentrated and long-biased portfolio which is why the investment is half-sized. We

are reviewing EELS1's place in the portfolio, at least at its current size, because we find it hard to understand why the fund's net exposure continues to be close to 40% given the uncertainties in Europe. With the benefit of hindsight, the timing of our purchase of JELS2 at the beginning of August was lousy and EELS4 (-3.3%) was simply unlucky as its largest short position in Autonomy was bid for by Hewlett Packard at an unbelievable premium of more than 70%. The 30% decline in Hewlett Packard's stock price since the deal was announced says it all.

On a more positive tack, PI1 (+4.5%) did its job and was a better-timed recent purchase at the beginning of May. US equity long/short fund USLS5 (+3.0%) delivered yet again and is now up by more than 35% year-to-date. The current disarray and high levels of correlation in financial markets is certainly creating some outstanding opportunities which Absolute Focus's managers are primed to harvest when the euro's fate becomes clearer. For the time being, however, many are operating with lower levels of exposure than usual, focusing more on controlling risk than on generating big returns. Much as our managers would like to make 1% every month, there are times when protecting capital has to become the prime objective. By doing this, profits in the future will not be needed just to recoup earlier losses but will instead propel Absolute Focus's share prices beyond last month's highs.

Our aversion to losing money is such that a loss of 1.6% would usually have us wallowing in despair. However, we didn't make any heinous mistakes in August (and there were plenty of double-digit losses amongst hedge funds), we have high conviction in most of what we already own and we have an outstanding pipeline of new funds which we are transitioning into Absolute Focus's portfolio. On 1st September, we made a new investment in San Francisco-based USLS9. We continue to believe that the developed world is destined for years of lacklustre growth as years of excess debt are purged from the financial system and we expect to deliver strong returns in such conditions. In the short term, however, we just need the politicians to end the uncertainty of the euro.

Charles Hovenden & Andrew Wheeler
21st September 2011

Results

Share Class	NAV	August 2011		Year-to-date	
		Fund (%)	FT World (%)*	Fund (%)	FT World (%)*
Class A - US\$	US\$122.34	(1.62)	(7.18)	+0.48	(4.07)
Class B - £	£123.87	(1.61)	(6.42)	+0.68	(7.76)

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

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Biggest 5 Holdings as at 31st August 2011

Name of Fund	Size %	Strategy	August (%)	Year-to-date (%)
USLS5	8.4	US Equity Long/Short	+3.0	+35.6
USLS2	7.3	US Equity Long/Short	(2.4)	+8.2
JELS1	6.9	Japanese Equity Long/Short	(2.6)	(0.1)
EELS2	6.7	European Equity Long/Short	+0.5	+4.4
EELS1	6.6	European Equity Long/Short	(4.6)	(5.1)

Best 3 Funds in August

Name of Fund (size)	Strategy	August %	YTD%
PI1 (3.2%)	Portfolio Insurance	+4.5	(0.6)
USLS5 (8.4%)	US Equity L/S	+3.0	+35.6
USLS4 (2.8%)	US Equity L/S	+1.2	(1.6)

Worst 3 Funds in August

Name of Fund (size)	Strategy	August %	YTD%
USLS1 (3.2%)	US Eq L/S	(8.6)	+2.9
EELS1 (6.6%)	European Eq L/S	(4.6)	(5.1)
JELS2 (5.6%)	Japanese Eq L/S	(4.5)	(2.5)

Full Track Record & Summary Statistics (Class B - £)

	Jan	Feb	Mar	Apr	May	June	July	Aug	Sept	Oct	Nov	Dec	Year	
2005									0.98	(0.05)	0.77	1.83	3.57	
2006	2.13	(0.19)	0.94	0.99	0.25	(0.99)	(1.61)	0.88	0.32	(0.36)	0.30	1.86	4.55	
2007	0.23	1.12	1.08	0.59	1.72	1.17	0.17	(0.11)	0.66	2.59	(0.87)	0.70	9.39	
2008	(0.65)	0.76	(0.51)	0.54	0.57	0.93	0.27	0.19	(0.72)	(1.01)	1.12	0.24	1.72	
2009	0.60	0.15	(0.69)	(0.99)	1.48	0.02	(1.18)	0.05	0.57	(0.12)	(0.15)	0.72	0.43	
2010	0.00	0.03	0.47	0.28	(0.83)	(1.35)	0.68	(0.09)	0.75	0.59	0.66	0.49	1.67	
2011	0.64	1.03	(0.05)	(0.15)	(0.19)	0.27	0.76	(1.61)					0.68	
Annual Rate of Return	3.63			Sharpe Ratio (@ 3% risk free)			0.22			Biggest Monthly Loss			(1.61)	
Standard Deviation	2.91			Correlation FT World Index (Local)			0.30			Biggest Peak-to-Trough Drawdown			(2.58)	

Source: Absolute Fund Managers LLP

General Information

Description: Equity-focused fund of hedge funds
Firm AuM: US\$86.3m/£53.0m
No. of Holdings: 17
Share Classes: US\$, £ and Euro
Basic Fee: 0.50% p.a.
Incentive Fee: 15% of profits
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

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Source: Absolute Fund Managers LLP