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## ABSOLUTE FOCUS FUND

## The Complacency of Lemmings

With the FT All Share Index (including gross dividends) down in January and the peer-group HFR Funds of Hedge Funds Index flat, this was a good start to the year for Absolute Focus Fund. We respectfully remind investors (and potential investors especially!) that Absolute Focus's share prices have set new all-time highs in each of the last three months whilst the HFR Index is still 8.4% below its October 2007 peak.

All and more of January's performance was provided by Focus's investments in US equity long/short funds, with USLS6 (+6.0%) the stand-out star. In contrast, we lost money in Europe. However, this was entirely due to our investment in EELS4 which was down by 3.4%. Although net market exposure has averaged only 22% since the fund was launched, Artemis's manager is an opinionated investor who is not afraid to express strong thematic opinions within the fund. We therefore expect this to be one of the more volatile investments within the Absolute Focus portfolio in terms of monthly returns but with commensurately higher annual returns.

As managers of an investment in which the most important objective is to preserve investors' capital at all times, our glass-half-empty and often sceptical tendencies have served us well over the years. We know that we are once again in the contrarian camp but we find the high degree of complacency currently prevalent in equity markets downright scary. Past experience has taught us that markets often seem to be invincible just before they are suddenly and most painfully not, and we note with some trepidation that overwhelmingly bullish sentiment amongst investors is causing any item of bad news either to be ignored completely or treated as a buying opportunity.

Investors' enthusiasm for emerging markets is, of course, based on rates of economic growth that are multiples of those on offer in developed countries. In recent weeks, however, investors have been reminded of the political risk they accept when investing in emerging markets. Already in 2011, populist revolutions have overthrown the governments of Tunisia and Egypt and the contagion has spread to Libya, Bahrain, Yemen and Jordan. Most of these countries share dictatorial regimes led by long-incumbent rulers, burgeoning numbers of young, well-educated, internet-savvy and increasingly

disaffected citizens, high unemployment and rates of inflation which are particularly sensitive to food prices. Thus far, the world's major stock markets have virtually ignored the turmoil, arguing that the countries affected so far are too small in economic output terms to matter. This is despite the fact that the civil unrest sweeping the region has pushed the oil price back above US\$100 per barrel (which is double the price of a year ago). The one country in the region which truly does matter is Saudi Arabia, which shares many of the characteristics listed above. Its rulers have recognised the destabilising threat of soaring food prices which they have been subsidising. However, with the young of Saudi Arabia surely watching closely the protests for reform and greater freedoms in neighbouring countries, the risk of further, damaging increases in the oil price must be growing.

The rocketing prices of many commodities and foodstuffs are also showing up in the inflation rates of developed countries. Thus far, it is being argued that these are temporary spikes and that structural and wage inflation remains under control as a consequence of high unemployment and plentiful spare capacity after the recession. Even if this rosy prognosis proves correct, it is almost certain that interest rates will begin to rise from 'emergency' to more 'normalised' levels in the year ahead. As we attribute much of the rise in equity markets over the last two years to the flood of cheap liquidity, it will be interesting to see what happens as the drug is withdrawn. Meanwhile, Wall Street and City analysts continue to extrapolate the post-crisis recoveries in corporate profits to infinity, even though margins are at all time highs, the costs of raw materials are rising and the finances of end-user consumers are under siege.

As we noted in last month's report, peaks in investor bullishness invariably occur at market 'tops'. Perhaps the rally will continue but we see the risks as increasingly skewed to the downside. One thing that will remain constant, however, is our investment discipline. Absolute Focus Fund will continue to offer investors an investment option which is truly hedged.

**Charles Hovenden & Andrew Wheeler**  
23rd February 2011

## Results

Share Class	NAV	January 2011		Since inception	
		Fund (%)	FT World (%)*	Fund (%)	FT World (%)*
Class A - US\$	US\$122.53	+0.62	+1.95	+22.53	+31.26
Class B - £	£123.83	+0.64	(0.35)	+23.83	+47.42

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

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## Biggest 5 Holdings as at 31st January 2011

Name of Fund	Size %	Strategy	January (%)	Year-to-date (%)
USLS6	7.4	US Equity Long/Short	+6.0	+6.0
USLS7	7.0	US Equity Long/Short	+1.6	+1.6
EELS1	6.6	European Equity Long/Short	(1.0)	(1.0)
JELS2	6.6	Japanese Equity Long/Short	+0.1	+0.1
USLS2	6.5	US Equity Long/Short	+0.7	+0.7

## Best 3 Funds in January

Name of Fund (size)	Strategy	January %	YTD%
USLS6 (7.4%)	US Equity L/S	+6.0	+6.0
USLS1 (3.7%)	US Equity L/S	+5.2	+5.2
USLS8 (3.2%)	US Equity L/S	+2.0	+2.0

## Worst 3 Funds in January

Name of Fund (size)	Strategy	January %	YTD%
EELS4 (6.0%)	US Equity L/S	(3.4)	(3.4)
EELS1 (6.6%)	Euro Equity L/S	(1.0)	(1.0)
USLS9 (6.2%)	US Equity L/S	(1.0)	(1.0)

## Full Track Record &amp; 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	<b>3.57</b>
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	<b>4.55</b>
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	<b>9.39</b>
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	<b>1.72</b>
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	<b>0.43</b>
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	<b>1.67</b>
2011	0.64												<b>0.64</b>
<b>Annual Rate of Return</b>	<b>4.02</b>			<b>Sharpe Ratio (@ 3% risk free)</b>				<b>0.35</b>		<b>Biggest Monthly Loss</b>			<b>(1.61)</b>
<b>Standard Deviation</b>	<b>2.91</b>			<b>Correlation FT World Index (Local)</b>				<b>0.27</b>		<b>Biggest Peak-to-Trough Drawdown</b>			<b>(2.58)</b>

Source: Absolute Fund Managers LLP

## General Information

**Description:** Equity-focused fund of hedge funds  
**Firm AuM:** US\$86.4m/£53.9m  
**No. of Holdings:** 18  
**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