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## ABSOLUTE FOCUS FUND

## Pavlov's Dog

History will record that global stock markets, as measured by the local currency FT World Share Index, started and finished March 2011 at almost exactly the same level. Whilst memories are still fresh, however, readers need no reminder of what a turbulent month it was in financial markets, the FT Index plunging by 6% in the first half of the month and then recovering almost completely in the second. The reaction of share prices to the earthquake, tsunami and nuclear crisis in Japan, as well as the worsening insurrections in the Middle East and North Africa, was entirely rational. After all, events in Japan dealt a serious blow to the world's third largest economy and a major trading partner of all-important China. At the same time, the price of oil continued to march ever higher on fears of disruption in supply. We defy anyone, however, to justify the subsequent rally in share prices in economic terms. Make no mistake, this can be attributed almost entirely to the artificial investing conditions caused by the prolonged period of near-zero interest rates. Like Pavlov's dog, investors have simply become programmed to treating any setback in share prices as a buying opportunity.

Back in the real world, inflationary pressures continue to build. Admittedly, inflation is concentrated in commodity prices and there has been minimal transfer to wages – at least so far. Whilst this is encouraging for politicians and central bankers, it is potentially harmful for corporate profits and share prices. Profit margins are being squeezed by spiralling raw material prices of everything from oil (up 44% over the last twelve months) to corn (up 75%) and cotton (up 161%), which manufacturers are struggling to pass on because consumer finances are additionally under siege from higher taxes and other austerity measures. Despite the many storm-clouds, however, investors are generally bullish about prospects for stock markets, just as they were at the end of 1999 and the beginning of 2007. As always, Absolute Focus's portfolio carries little directional risk and we are confident that our roster of managers will be able to protect investors' capital if the extraordinary run in stock markets over the last two years comes to an abrupt end.

Clearly March was a month in which the macro dominated and investors had little time or appetite for the micro analysis of individual companies. As the latter is the lifeblood of the managers we choose, we are not surprised that Absolute Focus's share

prices were virtually unchanged over the month. As you would expect in such circumstances, March's performance attribution was very choppy. Remarkably, the most profitable geographic region for us was Japan. It is hard to heap enough praise on the managers of our two Japanese funds, JELS1 and JELS2, which delivered gains of 1.7% and 1.8% respectively in a month in which the Japanese stock market was so volatile and weak. The two funds are, in fact, managed by the same team, with the smaller Yaraka fund (which has been 'hard-closed' to new investors for years) focussing on catalyst-driven opportunities amongst smaller companies. What sets the JELS funds apart from the mediocrity of so many other equity long/short 'hedge' funds we see, however, is risk management monitoring and controls which simply set a standard to which all hedge fund managers should aspire. Absolute Focus's sister fund, the Absolute Fund, invested in the JELS1 fund three months after it launched in 2003 (its lead portfolio manager was previously well-known to us as a principal of another Japanese hedge fund in which we used to have an investment) and it has made money for investors every year. JELS2 has also made money for investors every year since it was launched in 2004 and we count ourselves very fortunate to have been able to gain a shareholding eighteen months ago.

Two of our other 'highest conviction' investments, US equity long/short funds USLS6 and USLS2, took the plaudits/brickbats for respectively being our most profitable and unprofitable investments in March. Part of USLS2's loss was due to a short investment in a company which was bid for (an occupational hazard of short-selling) but adverse price moves in a number of other investments can be attributed to technical factors and impairments should be temporary. In mitigation, USLS2's manager was one of two sources who introduced us to USLS6 which has had a stunning first quarter (up 14.9%). Overall, we are convinced that we have assembled within Absolute Focus a group of managers of the highest quality and we are confident that this will translate into competitive, risk-adjusted returns.

**Charles Hovenden & Andrew Wheeler**  
21st April 2011

## Results

Share Class	NAV	March 2011		Year-to-date	
		Fund (%)	FT World (%)*	Fund (%)	FT World (%)*
Class A - US\$	US\$123.70	(0.06)	(0.37)	+1.59	+4.63
Class B - £	£125.04	(0.05)	+1.10	+1.63	+2.20

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

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## Biggest 5 Holdings as at 31st March 2011

Name of Fund	Size %	Strategy	March (%)	Year-to-date (%)
USLS6	8.0	US Equity Long/Short	+2.8	+14.9
USLS7	7.0	US Equity Long/Short	(0.5)	+2.4
USLS2	6.8	Japanese Equity Long/Short	+1.8	+3.6
EELS1	6.6	European Equity Long/Short	+1.1	+0.1
USLS2	6.4	US Equity Long/Short	(3.7)	(0.1)

## Best 3 Funds in March

Name of Fund (size)	Strategy	March %	YTD%
USLS6 (8.0%)	US Equity L/S	+2.8	+14.9
JELS2 (6.8%)	Japan Equity L/S	+1.8	+3.6
JELS1(3.4%)	Japan Equity L/S	+1.7	+3.7

## Worst 3 Funds in March

Name of Fund (size)	Strategy	March %	YTD%
USLS2 (6.4%)	US Equity L/S	(3.6)	(0.1)
USLS4 (5.9%)	US Equity L/S	(2.3)	(2.0)
USLS3 (5.8%)	US Equity L/S	(0.9)	+0.9

## 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	1.03	(0.05)										<b>1.63</b>
<b>Annual Rate of Return</b>	<b>4.08</b>			<b>Sharpe Ratio (@ 3% risk free)</b>				<b>0.37</b>	<b>Biggest Monthly Loss</b>				<b>(1.61)</b>
<b>Standard Deviation</b>	<b>2.89</b>			<b>Correlation FT World Index (Local)</b>				<b>0.28</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\$89.2m/£55.7m  
**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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## Risk Warning

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Source: Absolute Fund Managers LLP