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## ABSOLUTE FOCUS FUND

## The 'Wrong' Kind of Volatility

September was seemingly yet another highly volatile and ultimately grim month in financial markets, dominated entirely by the twists and turns in euro-land's financial crisis, by growing fears of double-dip recession on both sides of the Atlantic and by mounting evidence that the Chinese economy could be heading for a 'hard' landing. Investors sometimes say to us that they thought that volatility is meant to be good for hedge funds. Accepting that we are risking comparison with British Rail's infamous excuse in 1991 about 'the wrong kind of snow', it depends on the kind of volatility. The volatility experienced over the last two months is unprecedented in our careers but has also been accompanied by record highs in share price correlation. The kind of volatility which we prefer is the 'micro' kind in which prices of individual shares move independently and according to company-specific factors, thus providing attractive entry points and profitable exit points for our managers. In this environment, correlations are, by definition, much lower and this is when our managers can thrive.

We are extremely proud to have made money for investors last month, albeit only a tiny amount. September was the fifth month in a row in which equity markets have fallen and the destruction of wealth suffered by many investors over the last three months, in particular, has been terrible. Over the last quarter, both the UK's FTSE 100 and the US's S&P 500 indices of leading shares were down by 14% and the main French and German indices fell by 25%. At the end of September, the FTSE stood at a level it first attained in 1997 and 26% below its all-time peak at the end of 1999. Investors promised that equities are the best long-term investment must be questioning just how long the long-term is. As all readers will know, Absolute Focus Fund pursues a highly hedged investment strategy but not even we have been able to withstand entirely the highly correlated dislocations in equity markets over the last few months. We hate losing money in any circumstances. The difference between us and most of our peers, however, is that we have limited the declines in the prices of Absolute Focus Fund over the last three months to less than 1% (the HFR Equity Hedge Index is down by 10%). We are also still up year-to-date whereas the HFR

index is down by 9% and the FT World Share Index has dropped by 12%.

In terms of attribution, our US managers (+0.47%) were collectively profitable in September and our European (-0.33%) and Japanese (-0.06%) managers were not. We have commented before on the conundrum that our US funds are delivering substantially better returns than our European ones even though the fund selection process is exactly the same. This perplexing trend continued in September with six of our nine US funds making money, an achievement matched by only one of our four European funds. As our objective is to invest profitably for Absolute Focus's investors, it makes no sense to try and fight this trend, particularly as we are not constrained by a top-down asset allocation which requires a specific allocation to each geographic region. Additionally, and whatever the guardians of the euro announce at the weekend and at next month's G20 summit in Cannes, we believe that there is still significant risk of a disorderly break-up of the euro-zone. Sales are therefore underway which will reduce Absolute Focus's European hedge fund exposure by 10% and it is probable that most of the proceeds will be invested into additional US funds.

The last two months have provided the sternest test of managers' risk management controls since the demise of Lehman in 2008. Most of Absolute Focus's managers have risen to the challenge and protected capital as we would have hoped and expected. However, there have also been a few disappointments, notably EELS3 and US fund USLS6. We are selling half of Focus's investment in EELS3 and are deliberating if we should sell all or half of our investment in USLS6. Fortunately, the pipeline of new funds which are potentially compelling candidates for inclusion in the Absolute Focus's portfolio is very strong and in this respect we have rarely been busier. Therefore, although we are irritated by our small loss over the last two months we are very optimistic and excited about the future.

**Charles Hovenden & Andrew Wheeler**  
20th October 2011

## Results

Share Class	NAV	September 2011		Year-to-date	
		Fund (%)	FT World (%)*	Fund (%)	FT World (%)*
Class A - US\$	US\$122.40	+0.05	(9.23)	+0.53	(12.93)
Class B - £	£123.94	+0.06	(5.13)	+0.74	(12.49)

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

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## Biggest 5 Holdings as at 30th September 2011

Name of Fund	Size %	Strategy	September (%)	Year-to-date (%)
USLS5	9.1	US Equity Long/Short	+3.5	+40.4
USLS2	7.8	US Equity Long/Short	+1.5	+9.8
JELS1	7.2	Japanese Equity Long/Short	(0.2)	(0.3)
EELS2	7.0	European Equity Long/Short	(0.5)	+3.9
USLS9	6.8	US Equity Long/Short	+2.7	+21.8

## Best 3 Funds in September

Name of Fund (size)	Strategy	September %	YTD%
USLS4 (3.2%)	US Equity L/S	+8.6	+6.9
PI1 (3.5%)	Portfolio Insurance	+3.8	+3.2
USS5 (9.1%)	US Equity L/S	+3.5	+40.4

## Worst 3 Funds in September

Name of Fund (size)	Strategy	September %	YTD%
USLS6 (6.3%)	US Equity L/S	(4.3)	(4.8)
EELS3 (6.3%)	European Eq L/S	(3.4)	(8.6)
USLS7 (6.6%)	US Equity L/S	(3.1)	(3.5)

## 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)	(0.15)	(0.19)	0.27	0.76	(1.61)	0.06				<b>0.74</b>
<b>Annual Rate of Return</b>	<b>3.59</b>		<b>Sharpe Ratio (@ 3% risk free)</b>				<b>0.20</b>		<b>Biggest Monthly Loss</b>			<b>(1.61)</b>	
<b>Standard Deviation</b>	<b>2.90</b>		<b>Correlation FT World Index (Local)</b>				<b>0.30</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\$82.3m/£52.8m  
**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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