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## THE ABSOLUTE FUND

Rated AA by Standard &amp; Poor's

## Results

Share Class (Principal series)	NAV	April 2011			Year-to-date		
		Fund (%)	Cash (%) <sup>*</sup>	FT World <sup>†</sup>	Fund (%)	Cash (%) <sup>*</sup>	FT World <sup>†</sup>
Class A - US\$	US\$138.70	+0.02	+0.02	+4.34	+2.16	+0.08	+9.17
Class B - £	£150.51	+0.13	+0.06	+0.27	+2.25	+0.22	+2.47
Class C - Euro	Eur134.79	+0.06	+0.08	(0.20)	+2.11	+0.29	(0.99)

\*Citigroup 3-Month Eurodeposits – Source: Citigroup

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

## Sub-strategy Round-up (Part I)

Just over half of the Absolute Fund is invested in equity long/short funds. Alfred Jones is credited with launching the first hedge fund back in 1949 and we are disciples of the model he devised which seeks to suppress directional market risk and earn returns mainly from stock selection. Whilst simplicity, liquidity and transparency of pricing are perennially attractive features of most equity long/short funds, we believe that the current opportunity set is especially rich and that this should translate into much-improved returns after an admittedly lacklustre patch. Negligible interest rates and the creation of money through quantitative easing have fuelled a rally in share prices which has not only been unprecedented (the FT World Share Index has doubled since March 2009 although it is still 12% below its October 2007 high) but also highly correlated. Essentially, the tide of cheap liquidity has lifted all boats and share price dispersion, which is the lifeblood of the hedged managers we allocate to, has been suffocated almost to the point of extinction. Although we expect interest rates to remain exceptionally low for some time, governments are largely maxed out on the other measures they have used to create the illusion of economic recovery. As the life support is involuntarily withdrawn, stock selection will become much more important as investors are forced to differentiate between those companies which can continue to grow in what is likely to be a multi-year period of subdued economic growth and declining living standards and those which cannot. In such circumstances, good hedge fund managers should be able to make money on both and long and short investments.

Geographically, the talent pool is deepest and strongest in the US and this is reflected in the Absolute Fund's collective exposure of 23% split between 10 managers. Moreover, we continue to unearth new managers and funds in the US which are at varying stages of our due

diligence process and which are potentially compelling candidates for inclusion in the Absolute Fund's portfolio. Interestingly, the incumbent US equity long/short funds in which our conviction is weakest (and hence are the most vulnerable to displacement) are also the largest. We are increasingly of the view that the 'sweet spot' in size for equity hedge funds is between US\$50m (below which cash flows may be insufficient to support a robust business infrastructure) and US\$500m.

In complete contrast, we are disappointed with the returns being generated by our European equity long/short managers. This is perplexing because our research and due diligence process in Europe is identical to that in the US. However, we hear anecdotally that we are not alone in being dissatisfied with the performance of many European hedge funds. We simply do not know why this is but it has been suggested to us the European craze for UCITs-compliant hedge funds (which allegedly provide investors with better liquidity, transparency and regulatory protection, but often at the cost of inferior returns) may be a factor. In our opinion, UCITs-compliant hedge funds are primarily a marketing and money-raising gimmick of which the very best, performance-driven managers should have no need. Whatever the reason, fixing this performance conundrum has become a priority in our work, not least because the aggregate allocation of 19% amongst 8 funds is currently the second largest in the portfolio. There is no requirement from a risk management perspective for this to be the case and a review which is underway may see the number of European funds fall sharply as we re-allocate to more profitable regions and strategies.

Charles Hovenden & Andrew Wheeler  
23rd May 2011

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## Sub-strategy Round-up (Part II)

The persistently miserable performance of the Japanese stock market (down by 50% just since the end of 2006) has decimated the ranks of Japanese hedge fund managers and for some time the Absolute Fund's investments in Japan have been limited to two funds managed by the Rockhampton group. However, the Japanese stock market remains the world's second largest in size and the relatively small number of hedge funds operating in it should mean that there is a more-than-adequate opportunity set. As with Europe or indeed any other sub-strategy in which the Absolute Fund invests, we have no pre-set or required allocation to Japan which is instead a function of the manager talent we can find. In a fund research trip to Asia earlier this month, we met with a new Japanese manager who has an outstanding 3-year track record and it is probable that we will shortly be adding a Japanese fund to the Absolute Fund's portfolio for the first time in more than five years.

Throughout the lifetime of the Absolute Fund, we have only ever invested in two emerging market equity hedge funds. This is because the overwhelming majority of emerging markets managers have a very long bias and also because liquidity in emerging markets tends to disappear in a crisis. The HFR index of emerging market hedge fund managers was down by 37% in 2008.

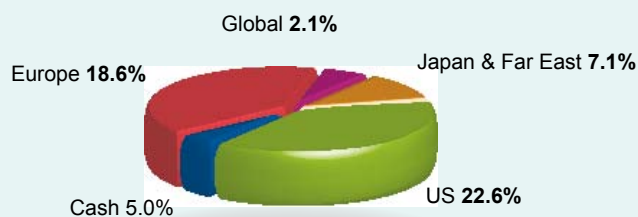
Turning to the arbitrage and credit half of the Absolute Fund's portfolio, our most-favoured sub-strategy is merger arbitrage. The strength of corporate balance sheets, ready availability of debt finance and limited opportunities for organic growth have prompted a spate of takeovers which we expect to continue. Merger arbitrage 'spreads' (which translate into returns as

takeovers are completed) may only be mid-to-high single digits but we view this as attractive in an environment of 0.5% interest rates. Ideally, we would like to increase the Absolute Fund's allocation to merger arbitrage but many funds are corrupted by the inclusion of other strategies such as 'special situations' which can become land-mines. The easy money has been made in corporate credit markets after 2008's meltdown but there should still be sufficient opportunities for managers of hedge funds which invest in corporate credit to earn high, single-digit returns. As in equity long/short, the key to success for credit managers will be the ability to invest both long and short. The returns achieved so far this year by the Absolute Fund's two government bond arbitrage funds have been muted by the lack of volatility in government bond markets. With QE2 about to end and rising inflation stoking fears of higher interest rates, volatility may soon return with a vengeance and this will provide a much more fruitful environment.

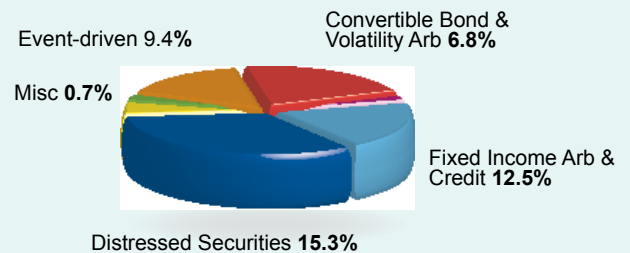
The least interesting sub-strategies currently on a generic basis are convertible bond arbitrage and distressed securities. Convertible bonds are generally fully valued with respect to their credit and equity option components and the easy availability of credit has slowed the pipeline of corporate bankruptcies and restructurings to a trickle. In both sub-strategies, however, we are confident that the managers with whom we remain invested should be able to grind out returns of, say, 6% p.a. whilst they wait for their opportunity sets to richen once again as they surely will. We intend to retain both of the Absolute Fund's investments in convertible bond arbitrage funds and only of the four distressed securities funds in the portfolio is under threat of displacement.

## Asset Allocation by Strategy (as at 30th April 2011)

### Equity Long/ Short (50.4%)



### Arbitrage & Other (44.6%)



## Biggest 5 Holdings as at 30th April 2011

Name of Fund	Size %	Strategy	April (%)	Year-to-date (%)
CBA1	4.3	Convertible Bond Arbitrage	(0.2)	+2.1
JELS1	4.0	Japanese Equity Long/Short	(0.8)	+2.8
USLS6	3.0	US Equity Long/Short	+1.6	+16.8
DIS5	2.8	Distressed Securities	+0.6	+4.2
ED1	2.8	Event-driven	+1.6	+7.1

## Best 3 Funds in April

Name of Fund (size)	Strategy	April %	YTD %
AELS1 (1.2%)	Asian Equity L/S	+2.6	+2.1
DIS2 (2.4%)	Distressed Secs	+2.5	+7.2
USLS6(3.0%)	US Equity L/S	+1.6	+16.8

## Worst 3 Funds in April

Name of Fund (size)	Strategy	April %	YTD %
USLS7 (1.36%)	US Equity L/S	(2.8)	+6.1
EELS6 (2.2%)	European Equity L/S	(2.0)	(0.5)
USLS9 (2.3%)	US Equity L/S	(2.0)	(2.4)

## Manager's Track Record & Summary Statistics (for Class B £ shares)

	Jan	Feb	Mar	Apr	May	June	July	Aug	Sept	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)	(0.11)	0.35	0.73	3.72*
2002	0.73	0.15	0.95	0.77	0.56	(0.36)	(0.59)	0.05	(0.90)	(0.23)	0.36	1.07	2.57
2003	0.84	0.44	0.20	0.64	0.74	0.72	0.56	0.94	0.92	1.57	0.24	1.04	9.21
2004	1.13	0.42	1.09	0.73	(0.50)	0.99	0.20	0.34	0.69	0.45	1.35	1.12	8.29
2005	0.39	0.92	0.50	(0.30)	(0.35)	0.57	1.02	0.73	1.15	(0.18)	0.72	1.63	6.99
2006	1.09	0.02	1.00	0.61	(0.28)	(0.24)	(0.54)	0.44	(0.25)	0.41	0.89	1.12	4.33
2007	0.86	0.93	0.78	0.67	1.42	0.60	0.42	(0.54)	0.94	2.00	(0.47)	0.09	7.95
2008	(0.58)	1.01	(1.07)	0.43	1.10	0.54	(0.57)	(0.38)	(2.69)	(6.45)	0.55	(0.90)	(8.87)
2009	1.37	0.37	(0.31)	(0.02)	1.69	0.69	0.61	0.87	0.62	(0.01)	0.18	1.17	7.45
2010	0.75	(0.08)	0.91	0.92	(1.83)	(1.04)	0.37	0.00	0.42	0.50	0.37	0.47	1.74
2011	0.94	0.98	0.18	0.13									2.25
<b>Annual Rate of Return</b>	<b>5.80</b>			<b>Sharpe Ratio (@ 3% risk free)</b>				<b>0.85</b>	<b>Biggest Monthly Loss</b>				<b>(6.45)</b>
<b>Standard Deviation</b>	<b>3.28</b>			<b>Correlation FT World Index (Local)</b>				<b>0.48</b>	<b>Biggest Peak-to-Trough Drawdown</b>				<b>(10.15)</b>

\*The Manager's Record above consists of actual performance data for the sterling share class of The Absolute Fund from 1st October 2001 onwards. For January 1999 to October 2001 returns have been taken from the Manager's prior and verifiable track record in US dollars (restated to reflect the fee scale of the Absolute Fund). The differential in performance between the US dollar and sterling share classes of the Absolute Fund is a consequence of the differential between US dollar and sterling interest rates. US dollar and sterling interest rates were broadly similar between January 1999 and October 2001 and Absolute Fund Management Limited believes that returns in sterling in the first period would therefore have been broadly the same as in US dollars. Source: Absolute Fund Managers LLP

## General Information

**Description:** Multi-strategy fund of hedge funds  
**Firm AuM:** US\$91.3m/£54.7m  
**No. of Holdings:** 39  
**Share Classes:** US\$, £, Euro  
**Basic Fee:** 1% p.a.  
**Incentive Fee:** 15% of gains between 6% & 24% p.a.  
**High Water Mark:** Yes  
**Dealing:** Monthly (with 35 days notice for redemptions)  
**Min. Investment:** US\$50,000 or currency equivalent  
**Fund Domicile:** Cayman Islands  
**Listing:** Channel Islands Stock Exchange (CISX)

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## Price Information

	Bloomberg	SEDOL	ISIN
<b>Class A (US\$)</b>	ABSFNDA KY <Equity>	3111556	KYG0060S1241
<b>Class B (£)</b>	ABSFNDB KY <Equity>	3111523	KYG0060S1324
<b>Class C (Euro)</b>	ABSFNDC KY <Equity>	3111534	KYG0060S1407

## Risk Warning

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