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THE ABSOLUTE FUND

Rated AA by Standard & Poor's

Results

Share Class (Principal series)	NAV	August 2011			Year-to-date		
		Fund (%)	Cash (%)*	FT World†	Fund (%)	Cash (%)*	FT World†
Class A - US\$	US\$136.19	(1.39)	+0.02	(7.18)	+0.31	+0.16	(4.07)
Class B - £	£147.97	(1.38)	+0.06	(6.42)	+0.51	+0.46	(7.76)
Class C - Euro	Eur132.92	(1.24)	+0.11	(7.36)	+0.83	+0.70	(10.36)

*Citigroup 3-Month Eurodeposits – Source: Citigroup

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

The Curse of Correlation

As we have noted many times before in these monthly reports, the Absolute Fund strategy is deliberately constructed to provide an investment which is substantially hedged against directional swings in financial markets. Instead, returns are derived mainly from the abilities of the underlying managers to whom we allocate to find securities which are mispriced either entirely anomalously or as a result of corporate change. Dispersion in bond and share prices is therefore the lifeblood of the Absolute Fund 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.

Many of the US-based managers we visited last week told us that the backdrop for investing in August was more challenging even than in 2008 (Lehman and sub-prime) or 2002 (dot-com bust, corporate frauds and recession). In 2002 and 2008, there was at least clarity of the problems and how they would need to be resolved. However, no-one can predict what is going to happen in euro-land or the immediate consequences of it. Anyone who believes that money can be made by timing the peaks and troughs in markets prompted by the latest pronouncements in Berlin or Frankfurt (home of the European Central Bank) is deluded. Many of the Absolute Fund's underlying managers are therefore currently operating with significantly lower levels of exposure than usual, focusing more on controlling risk than on generating big returns. Much as we would like to make 0.5% or more every month for the Absolute Fund's investors, these are times when protecting capital has to be our prime objective. The current disarray and high levels of correlation in financial markets is

certainly creating some outstanding opportunities which our managers are primed to harvest when the euro's fate becomes clearer. By being patient and conservative now, future profits will not be needed just to recoup earlier losses but will instead propel the Absolute Fund's share prices to fresh highs.

Whilst we have no more idea than anyone else what the future is for the euro, it seems increasingly likely that it will be disorderly. The recent resignation of Jurgen Stark, who was openly critical of the bank's purchases of bonds of troubled eurozone members, hints at deep rifts within the European Central Bank. Recent elections in Germany also show that the country's voters are increasingly resentful that prudent Germany is having to bail out its profligate partners in the euro. Mrs Merkel risks political suicide. Whilst the looming default by Greece continues to grab the headlines, the exposure of many European banks to bonds issued by Greece and other fiscally-challenged countries within the euro-zone poses much greater systemic risk. Rumours that certain banks would be insolvent if they used market prices to value their vast holdings of euro-zone sovereign bonds have only been stoked by the ECB's disclosure that several un-named banks have recently drawn on its emergency loan facility (presumably because other banks will no longer lend to them). Rather than using the €440bn European Financial Stability Facility to throw good money after bad at countries which have no hope of repaying, it would perhaps be better spent on recapitalising the banks in much the same way as the US devised its Troubled Asset Relief Programme (TARP) to rescue its banks in the wake of 2008's sub-prime mortgage crisis.

Charles Hovenden & Andrew Wheeler
21st September 2011



ABSOLUTE
FUND MANAGERS LLP

Performance Review

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 Funds of Hedge Funds Index declined by 2.7% in August, has lost 4.6% over the last four months and is down by 2.6% year-to-date.

In August, the Absolute Fund suffered a monthly loss of more than 1% for only the sixth time in the strategy's 13-year track record. However, the Absolute Fund continues to be up for the year and this is no mean feat in the circumstances. We have always stressed the power and importance of compounding and limiting losses is every bit as important to us as making gains. We estimate instinctively that the overall net long exposure within the Absolute Fund is about 10% so the weakness in stock markets and in corporate bond markets (the Merrill Lynch High Yield Bond Index was down by 4% in August) accounts for only a small part of last month's negative performance. Instead, we attribute the major part of August's loss to the extremely high correlation which overwhelmed stock selection, to indiscriminate selling by investors using leverage or margin and by the virtual freezing of corporate bond markets which saw prices marked down savagely even though there was little actual selling. This last factor accounted for the losses in ED1 (-2.5%) and DIS4

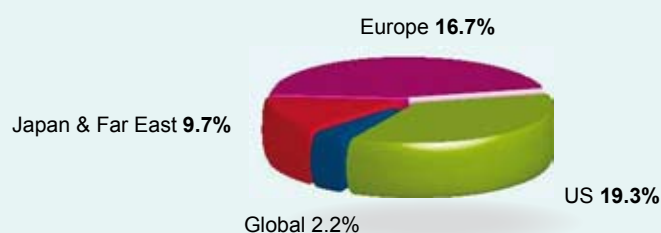
(-1.9%), two funds into which we would unhesitatingly invest the life savings of much-loved grannies and which are cornerstones of the Absolute Fund's portfolio.

Of course, in such a month there were bound to be some individual disappointments amongst the Absolute Fund's investments. DIS6's loss is particularly galling because we had identified changes within its portfolio which were likely to make returns more volatile but the action we took at the end of July of reduce the size of this investment will not be effective until the end of this month. USLS6 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. On a more positive tack, CBA3(+4.5%) did its job and was a well-timed 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. Our two government bonds arbitrage funds, FIA1(+2.1%) and FICA2 (+1.6%), continued to benefit from volatility within the US Treasury bond market following the end of QE2.

Our aversion to losing money is such that a loss of 1.4% would usually have us wallowing in despair. However, we didn't make any heinous mistakes in August, we have high conviction in what we already own and we have an excellent pipeline of new funds competing to get into the Absolute Fund's portfolio. 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.

Asset Allocation by Strategy (as at 31st August 2011)

Equity Long/ Short (47.8%)



Arbitrage & Other (46.4%)



Biggest 5 Holdings as at 31st August 2011

Name of Fund	Size %	Strategy	August (%)	Year-to-date (%)
CBA1	4.3	Convertible Bond Arbitrage	(1.8)	(0.0)
JELS1	4.0	Japanese Equity Long/Short	(2.1)	+0.0
USLS5	3.6	US Equity Long/Short	+3.0	+35.6
ED1	2.9	Event-driven	(2.5)	+6.0
FIA1	2.9	Fixed Income Arbitrage	+2.1	+3.3

Best 3 Funds in August

Name of Fund (size)	Strategy	August %	YTD %
CBA3 (2.5%)	Convertible Bond Arb	+4.5	+2.2
USLS5(3.6%)	US Equity L/S	+3.0	+35.6
AELS1 (1.3%)	Asian Equity L/S	+2.9	+4.8

Worst 3 Funds in August

Name of Fund (size)	Strategy	August %	YTD %
USLS6 (1.3%)	US Equity L/S	(8.7)	+2.9
EELS1 (2.3%)	European Equity L/S	(4.6)	(5.1)
JELS2 (2.0%)	Japanese Equity L/S	(4.5)	(2.5)

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	(0.13)	(0.38)	0.19	(1.38)					0.51
Annual Rate of Return	5.50			Sharpe Ratio (@ 3% risk free)				0.76	Biggest Monthly Loss				(6.45)
Standard Deviation	3.29			Correlation FT World Index (Local)				0.48	Biggest Peak-to-Trough Drawdown				(10.15)

*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\$86.3m/£53.0m
No. of Holdings: 37
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
Class A (US\$)	ABSFNDA KY <Equity>	3111556	KYG0060S1241
Class B (£)	ABSFNDB KY <Equity>	3111523	KYG0060S1324
Class C (Euro)	ABSFNDC KY <Equity>	3111534	KYG0060S1407

Risk Warning

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