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## THE ABSOLUTE FUND

Rated AA by Standard &amp; Poor's

## Results

Share Class (Principal series)	NAV	June 2011			Year-to-date		
		Fund (%)	Cash (%)*	FT World†	Fund (%)	Cash (%)*	FT World†
Class A - US\$	US\$137.92	(0.40)	+0.02	(1.55)	+1.58	+0.12	+5.23
Class B - £	£149.75	(0.38)	+0.06	+0.93	+1.72	+0.34	+2.61
Class C - Euro	Eur134.25	(0.32)	+0.10	(2.38)	+1.70	+0.48	(2.35)

\*Citigroup 3-Month Eurodeposits – Source: Citigroup

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

## Mistaking Insolvency for Illiquidity

Greece is bust! We're sure that to every reader we are simply stating the glaringly obvious but in Brussels and Luxembourg euro-crats remain in denial, determined to employ every means and fudge possible to keep Greece afloat in the euro. From a unilateral standpoint, the economic case for Greece to free itself from the straightjacket of the euro and to restructure its debts (i.e. default) is irrefutable. Greece's budget deficit in 2010 was 11% of GDP and total government debt was about €330bn or 143% of GDP. For comparison, the maximum ratios specified under 1992's Maastricht Treaty for euro membership were 3% and 60% respectively. Greece's unemployment rate already stands at 15% and will only rise again as the austerity measures insisted on by the IMF and EU as conditions of their first €110bn bail-out package cause the Greek economy to contract further. Tax revenues will fall and welfare costs will increase. It's a vicious circle. Greece is being expected to carry out the impossible to stave off the inevitable. Bail-outs pretend the problem is one of illiquidity (self-financing is impossible with 2-year Greek government bonds yielding more than 30%) instead of one of insolvency. There is no way out and default is a certainty – it's just a matter of whether it is orderly or disorderly.

The creation of the euro was first and foremost a political project (a step towards full European integration) instead of one founded in economics. Applying the same monetary policies to fiscally-disciplined countries like Germany and to countries which are congenitally less so was always a recipe for disaster. Before the euro, discipline was imposed by financial markets which demanded much higher interest rates on debt denominated in drachma, punts and escudos. Given access to debt at German interest rates it is no surprise that borrowings and deficits have ballooned in many other countries. The dilemma for the EU is that any kind of Greek default will trigger

huge losses for banks across the eurozone with French banks particularly at risk. In the wake of 2008's financial crisis, banks in the US and UK rushed to raise new capital to repair battered balance sheets. However, European banks largely remained on the sidelines. A Greek default would decimate the already less than robust capital ratios of many European banks, severely restricting their capacity to lend and could thus derail the economic recovery. No wonder European politicians are so anxious to avoid a default but it's Catch 22.

The lack of decisive action to resolve the Greek situation is an unhelpful backdrop against which to invest, with investor sentiment swinging sharply between despair and elation. In our opinion, it was vaguely ridiculous that stock markets experienced their sharpest rally in two years in the last week of June as Greece received a €12bn tranche of its bailout loan, money that will have been used up by the end of August. With the European sovereign debt crisis still having the potential to be a new 'Lehman', our first objective remains to protect the capital of the Absolute Fund's investors and we take comfort from the knowledge that the Absolute portfolio is largely hedged. In such circumstances, we will be content if we can continue to grind out returns averaging 0.5% per month which will equate to performance of 5-6% for the whole of 2011. Whilst this may not sound like very much, it will be substantially ahead of cash deposits, which is our second objective. For higher returns, we need some of the 'macro' uncertainty to dissipate and for the economic outlook to become clearer (whether it be expansion, stagnation or recession). In time this will happen and it will allow the proven stock-picking skills of our chosen managers to shine through.

Charles Hovenden & Andrew Wheeler  
20th July 2011



ABSOLUTE  
FUND MANAGERS LLP

## Performance Review

Much as we would like to make 0.5-0.75% every month for investors, there are times when it is just as important to restrict losses to the smallest possible. For much of June, fears about a Greek debt default, the impasse over raising the US debt ceiling, the end of QE2, faltering economic growth and a Chinese hard landing weighed heavily on markets, the FT World Share Index falling 5.2% from the level at which it started the month. However, the remarkable rally in the last week of June as Greece averted (postponed) default left the Index down by just 1.6% for the month. The abrupt change in investor sentiment for the second month in succession once again left many of the cleverest investors wrong-footed. Over the last two months, the HFR Fund of Hedge Funds Index is down by 2.5% and the Absolute Fund is down by 0.5%. We remain interested only in absolute returns and we are not going to proclaim how good our performance is in relative terms. However, we are investing in the same universe as our peers and are not Madoff-ian magicians. Most importantly, we remain up for the year (the HFR Index is down) and in easy striking distance of April's all-time highs.

European Equity Long/Short (+0.05%) and US Equity Long/Short (+0.01%) were our only two profitable sub-strategies in June although this was almost entirely due to investments in USLS6 (+5.4%) and EELS7 (+3.1%) respectively. Indeed, the two US equity long/short funds, USLS12 and USLS5, to which we submitted redemption notices at the end of May rewarded us with losses of 3.7% and 2.6% in their final month in the Absolute Fund portfolio. These are two very different funds. USLS5 is managed by two highly-experienced and likeable individuals but has simply not made any money for us in two years. One factor may be that the fund has grown in size from US\$185m when we invested in 2009 to close to US\$1bn. It is time to move on. We wrote about

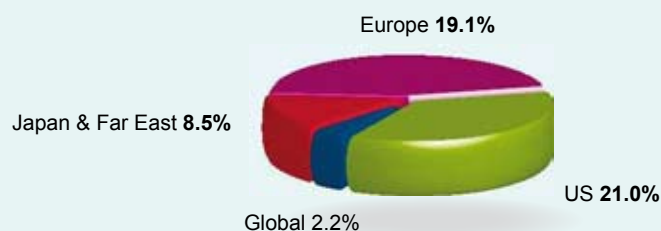
'intellectual stubbornness' of USLS12's manager in last month's report and, having lost 11% of the money we invested only 15 months ago, we simply have to recognise this as a bad investment decision. Fortunately, mistakes like this are rare but we are also experienced and humble enough to know that it won't be the last. Fixed Income and Credit was the worst of our strategies in June but our five underlying investments lost only a total of 0.11%. In a month when some of the best known hedge funds in the world suffered hefty losses, we regard this as a qualified success.

Looking back at the first half of the year, we have made money in eight out of nine sub-strategies. The most profitable has been US Equity Long/Short (despite USLS12 and USLS5), due in no small part to the exceptional performance of USLS6 (+27.6%), but with USLS2 (+17.4%), USLS7 (+6.8%) and USLS1 (+5.2%) also making notable contributions. The most disappointing sub-strategy, not because we have lost money but because our return on invested capital has been so poor, has been European Equity Long/Short. It remains a conundrum to us why we find it relatively easy to find great investment talent in the US but much harder on our doorstep. The only loss-making sub-strategy in the first half of the year was Short-bias Equity (-0.11%) which we exited at the end of March. Capital preservation in times of stress remains as important to us as ever but this defining feature of the Absolute Fund will be derived from more cost-effective sources going forward.

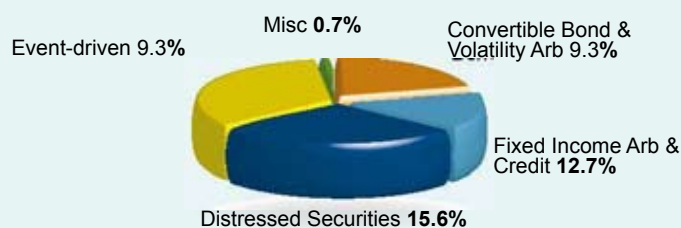
With the laggards purged from and replaced in the Absolute Fund's portfolio, we are looking forward to the second half of the year with considerable confidence that we should be able to deliver competitive returns.

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

### Equity Long/ Short (50.8%)



### Arbitrage & Other (47.5%)



## Biggest 5 Holdings as at 30th June 2011

Name of Fund	Size %	Strategy	June (%)	Year-to-date (%)
CBA1	4.4	Convertible Bond Arbitrage	(0.3)	+1.9
JELS1	4.1	Japanese Equity Long/Short	(1.0)	+2.5
USLS6	3.4	US Equity Long/Short	+5.4	+27.6
ED1	2.9	Event-driven	(0.2)	+7.8
DIS5	2.8	Distressed Securities	(1.1)	+3.1

## Best 3 Funds in June

Name of Fund (size)	Strategy	June %	YTD %
USLS6(3.4%)	US Equity L/S	+5.4	+27.6
EELS7 (2.4%)	European Equity L/S	+3.0	(2.6)
JELS3 (1.2%)	Japanese Equity L/S	+2.0	+2.0

## Worst 3 Funds in June

Name of Fund (size)	Strategy	June %	YTD %
USLS12 (2.2%)	US Equity L/S	(3.7)	(9.2)
USLS5 (2.0%)	US Equity L/S	(2.6)	(5.5)
FIA5 (2.5%)	Fixed Income Arb	(2.3)	+3.1

## 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)							1.72
<b>Annual Rate of Return</b>	<b>5.68</b>			<b>Sharpe Ratio (@ 3% risk free)</b>				<b>0.82</b>	<b>Biggest Monthly Loss</b>				<b>(6.45)</b>
<b>Standard Deviation</b>	<b>3.27</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\$87.4m/£54.4m  
**No. of Holdings:** 40  
**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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