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THE ABSOLUTE FUND

Rated AA by Standard & Poor's

Results

Share Class (Principal series)	NAV	May 2011			Year-to-date		
		Fund (%)	Cash (%)*	FT World†	Fund (%)	Cash (%)*	FT World†
Class A - US\$	US\$138.47	(0.17)	+0.02	(2.09)	+1.99	+0.10	+6.89
Class B - £	£150.32	(0.13)	+0.06	(0.79)	+2.11	+0.28	+1.66
Class C - Euro	Eur134.68	(0.08)	+0.09	+1.04	+2.03	+0.38	+0.04

*Citigroup 3-Month Eurodeposits – Source: Citigroup

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

A Ponzi Scheme to make Mr Madoff Proud

Almost exactly a year on from the last wobble, a run of disappointing economic data from around the world has caused investors to fret again about authenticity of the recovery. Policymakers and politicians have been quick to attribute the slowdown to one-off and temporary factors, chief amongst them March's earthquake and tsunami in Japan. This assurance appeared to work in May, limiting the fall in the local currency FT World Share Index to just 1.3%. However, further evidence that economic growth is faltering and that house prices in the US have resumed their decline has caused share prices to tumble again in June and many stock market indices are now down for the year. A sense of déjà vu is understandable. Last year the US Federal Reserve rode to the rescue with its announcement of QE2, the flood of manufactured liquidity turning a loss of 7% in the FT World Share Index at the end of June into a gain more than 10% by the end of the year. However, with QE2 set to end at the end of this month and the Federal Reserve talking down the prospects of QE3 (at least for now), there is no guarantee of a similar bail-out.

The US Treasury bond market has, in any case, become a giant Ponzi scheme. Whilst other governments, notably in the UK, seek to address the excesses of past decade or more and impose fiscal discipline, the Obama administration continues to spend. It has only been able to do this because the dollar remains the world's reserve currency, the notion of the US government defaulting on its debts is virtually unthinkable and, most importantly, because the Federal Reserve has been printing money to buy US\$600bn of Treasury bonds. Indeed, the Federal Reserve recently surpassed China as the biggest investor in US debt. Of course, Mr Madoff's Ponzi scheme was exposed when the flow of money from investors reversed. Despite the political horse-trading about the US debt ceiling and the threat

of technical default, the US Treasury bond market isn't going to collapse like Mr Madoff's scheme. However, bond yields could rise sharply when the Federal Reserve ceases to be the main buyer of Treasury bonds and the US economy is currently in no state to absorb higher borrowing costs.

One of the main causes of the strength in equity markets which we have certainly underestimated since 2008's financial crisis has been the recovery in corporate profitability. This has been achieved almost entirely by cutting costs as companies have preferred to hoard cash instead of investing or hiring. However, with scope for further cost-savings now extremely limited, top-line growth likely to remain elusive and margins under pressure from rising commodity costs, just about the only ways in which companies can maintain or increase their return on equity are through acquisition or by buying their own shares. Seduced by fee-hungry investment bankers and their own egos, it seems that corporate decision-takers will never learn! The majority of corporate mergers destroy rather than enhance shareholder value and many of the companies which are leveraging their balance sheets to boost shareholder returns will become raw material for managers of Distressed Securities funds in a few years time. One of the most satisfying aspects of managing the Absolute Fund is the ability to play and profit from all stages of the cycle of corporate boom and bust. As regular readers will recall, we have recently increased the Absolute Fund's allocation to merger arbitrage funds to take advantage of the takeover boom (but without making directional market bets).

Charles Hovenden & Andrew Wheeler
21st June 2011

Performance Review

It had to happen sooner or later but we are still disappointed to break our run of successive profitable months which begun in July last year. The decline of only 1.3% in the local currency FT World Share Index suggests that May was not a particularly difficult month but flatters to deceive. In fact, there were violent reversals to recent trends in industry sector performance with commodity and financial stocks suffering steep falls whilst long-neglected shares in defensive sectors such as pharmaceuticals and food returned to favour. As a consequence, the main indices of hedge fund performance were down by almost as much as stock markets in May. Of course, and with the benefit of hindsight, it is easy to say that managers should have been positioned for such a change and, indeed, it is consistent with our long-held view that the cocktail of quantitative easing and negligible interest rates was creating a bubble in cyclical and speculative shares. The problem with bubbles, however, is that it is very hard to know when they will burst and, as we have seen within the Absolute Fund, any manager who has been persevering with the perfectly sensible but contrarian stance of being long of quality, defensive shares and short of cyclical companies has endured miserable returns over the last two years.

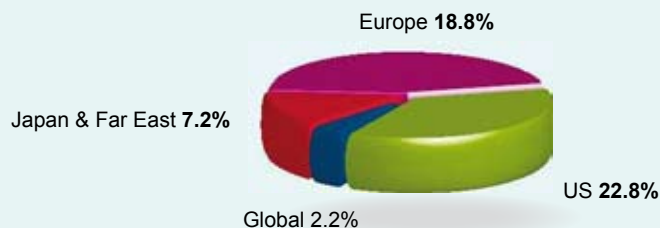
In May, we made money in only two-sub-strategies: Distressed Securities (+0.05%) and Asian Equity Long/Short (+0.04%). We dropped basis points of performance in each of the other six, the worst being European equity long/short in which we lost just 0.06%. At underlying fund level, we made money in 19 out of 40 investments which is no mean achievement in the circumstances. Both USLS6 and USLS7 lost money on their long investments but made much bigger gains on their shorts. Distressed Securities fund DIS benefitted as Mexican satellite

operator Satmex emerged from bankruptcy. EELS7 has been a disappointing investment so far this year but, as we wrote in January's Monthly Report, we expect this to be one of our more volatile investments in terms of monthly returns. In 2010 EELS7 was up by more than 30%. However, we have decided to redeem from USLS9 after May's loss took the cumulative peak-to-trough loss since May last year to 12%, which breaches our stop-loss limit. It's vital to have strong risk management controls when making investments which are blatantly contrarian to consensus and sentiment. USLS9's manager was, in our judgement, guilty of intellectual stubbornness in persevering for so long and in such size in his investments in US house-building stocks.

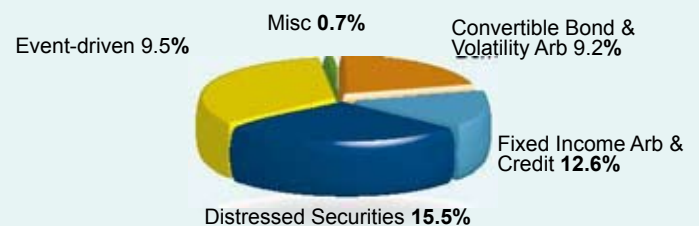
Following our fund research trip to Asia last month and after completing final due diligence checks, we made an investment in JELS3 on 1st June. This is exactly the kind of fund we like to discover and invest in. The fund itself is small (currently only about US\$20m in size) although its manager can draw on the resources and infrastructure of the much bigger JELS3 group, it has an excellent track record (+16% in 2008, +11% in 2009, +12% in 2010, +12% YTD in 2011) and it has never been marketed. Elsewhere, our quest for another merger arbitrage fund continues and we are arranging meetings with all of the Absolute Fund's European equity long/short managers as we seek to work out why their returns have been so disappointing when compared with those of their US counterparts. As always, the pipeline of new funds which are strong candidates for inclusion in the Absolute Fund's portfolio is both long and diversified so we will have no trouble in replacing any incumbent funds from which we decide to redeem.

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

Equity Long/ Short (50.9%)



Arbitrage & Other (47.4%)



Biggest 5 Holdings as at 31st May 2011

Name of Fund	Size %	Strategy	May (%)	Year-to-date (%)
CBA1	4.4	Convertible Bond Arbitrage	+0.1	+2.2
JELS1	4.0	Japanese Equity Long/Short	+0.7	+3.6
USLS6	3.1	US Equity Long/Short	+3.6	+21.0
ED1	2.8	Event-driven	+1.1	+8.1
DIS5	2.8	Distressed Securities	+0.0	+4.2

Best 3 Funds in May

Name of Fund (size)	Strategy	May %	YTD %
USLS6 (3.1%)	US Equity L/S	+3.6	+21.0
USLS1 (2.6%)	US Equity L/S	+3.0	+4.4
DIS2 (2.5%)	Distressed Secs	+2.8	+10.3

Worst 3 Funds in May

Name of Fund (size)	Strategy	May %	YTD %
EELS7 (2.3%)	European Equity L/S	(3.4)	(5.5)
USLS9 (2.2%)	US Equity L/S	(3.3)	(5.7)
EELS4 (2.2%)	European Equity L/S	(2.0)	+0.2

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)								2.11
Annual Rate of Return	5.75			Sharpe Ratio (@ 3% risk free)				0.84	Biggest Monthly Loss				(6.45)
Standard Deviation	3.27			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\$89.6m/£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)

Investment Manager: Absolute Fund Managers LLP
 Marquis House, 67/68 Jermyn Street
 London SW1Y 6NY
 Telephone: **+44 (0) 20 7925 8078**
 Contact: **Andrew Wheeler**

Administrator: Northern Trust International Fund
 Administration Services (Ireland) Ltd.
 George's Court, 54 -62 Townsend Street
 Dublin 2, Ireland
 Telephone: **+353 1 670 0660**
 Contact: **Darran Walsh**

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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