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## THE ABSOLUTE FUND

Rated AA by Standard &amp; Poor's

## Results

Share Class (Principal series)	NAV	October 2011			Year-to-date		
		Fund (%)	Cash (%)*	FT World†	Fund (%)	Cash (%)*	FT World†
Class A - US\$	US\$135.72	+0.17	+0.02	+10.68	(0.04)	+0.20	(3.63)
Class B - £	£147.56	+0.25	+0.07	+6.82	+0.23	+0.59	(6.53)
Class C - Euro	Eur132.54	+0.23	+0.12	+6.47	+0.54	+0.93	(7.04)

\*Citigroup 3-Month Eurodeposits – Source: Citigroup

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

## Perennially behind the Curve

We'd love to write about something else but the eurozone soap opera continues to be the utterly dominant influence on financial markets. After five consecutive months of losses (and a cumulative decline of 17% in the local currency FT World Share Index), stock markets were due a bounce and the promise from European leaders to come up with a comprehensive plan to tackle the crisis before the G20 Cannes summit provided the catalyst. We find it hard to reconcile, however, the content of what was announced with the biggest monthly gain in the FT World Share Index since April 2009 and, staggeringly, the best month for the US's S&P Composite Index since December 1991. Of course, advances such as these acquire their own self-fulfilling momentum as cash-heavy investors are forced to jump on the bandwagon in fear of underperforming their peers. Perhaps part of the rally can also be attributed to the fact that politicians from the eurozone's seventeen member states managed to reach any sort of agreement at all.

We wrote last month that we were expecting a package to be announced that would stun financial markets, just as the US did when launching TARP to underpin its own banks in 2008. However, even in this respect we were disappointed. The three main elements of the European rescue plan were that the size of the European Financial Stability Fund ("EFSF") would be 'leveraged' from €440bn to €1trn, that banks in the eurozone needed to raise €106bn to fresh capital to bullet-proof their balance sheets and that the loss for investors in Greek government bonds in a 'voluntary' restructuring would increase from 20% to 50%. However, it had been widely voiced that the EFSF needs to be increased to €2trn in size to have the desired impact and even now it is struggling to raise money from investors. Similarly, the amount of new capital to be raised by banks looks suspiciously low and is only half what many commentators were expecting. Moreover, an

unintended consequence is that some banks will choose to shrink rather than raise fresh capital to comply with the new rules, thus choking off the supply of credit in already fragile economies. Finally, the restructuring of Greek debt is designed to reduce the country's debt to 120% of GDP by 2020, merely twice the figure permitted under the Maastricht criteria for a country to adopt the euro. It's a joke. Demonstrating how hopelessly behind the curve the eurozone's policymakers continue to be, the spotlight in Europe has already shifted with the bond markets of Italy, Spain and even France moving now in the crosshairs. Yields in Italy's €1.9trn bond market have recently breached the critical 7% level whilst France is suffering the ignominy of having to pay almost 2% more than Germany to borrow.

With no end in sight to the eurozone's woes, we are certainly sleeping easier having significantly cut back the Absolute Fund's aggregate exposure to European equity long/short funds at the end of October. We are confident that we can re-deploy the money more profitably and more safely in other strategies and geographic regions. In this respect, the pipeline of potential new investments at various stages of our due diligence process is excitingly strong. The last few months have also provided telling data points in terms of performance and ruthlessly exposed any shortcomings in risk management. The discipline of displacement to prevent dilution of our fund research work means that competition for places within the Absolute Fund's portfolio is as intense as it has ever been and we are determined to translate this into attractive returns for investors in the Absolute Fund.

Charles Hovenden & Andrew Wheeler  
21st November 2011

## Performance Review

We are not overly disappointed that the Absolute Fund's performance in October compares so unflatteringly with the gains in stock market indices or even with peer-group returns (the HFR Funds of Hedge Funds Index was up by 1.4%). The vastly superior performance of the Absolute Fund in the preceding five months can be attributed to precisely the same reason and that is that we are striving to provide an investment which is genuinely hedged. The bottom line is that most share classes of the Absolute Fund are up year-to-date (albeit only modestly) and, even after October's extraordinary rally, the FT World Share and HFR indices are still down by 5% and 4% respectively. Additionally, share prices of the Absolute Fund are just 2% below their all-time highs (set in April this year for the US\$ and £ share classes) whilst the FT and HFR indices are still respectively 20% and 12% adrift of their October 2007 peaks. We are bound to lose money from time to time but keeping all investments in the Absolute Fund as close as possible to their highest ever values at all times is simply our obsession.

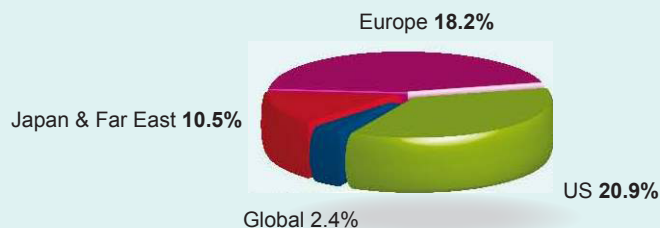
Very sharp rallies in stock markets are every bit as challenging for the Absolute Fund's strategy as steep falls. As we noted in the previous page, cash-heavy investors, fearful of underperforming their benchmarks and peers, are left scrambling to catch up and this can lead to even bigger rises in so-called higher 'beta' and more speculative shares. For example, whilst the US's S&P Composite Index rose by 11% in October, the smaller company Russell 2000 Index was up by 15%. Similarly, the Morgan Stanley Emerging Markets Index, down by 23% in August and September, bounced by 13% in October. The outperformance of lower quality shares resulting from this behaviour makes short-selling particularly difficult and managers can suffer exaggerated

losses in short investments. We no longer hold any dedicated short-only funds but our 5% aggregate allocation to three defensively-positioned funds was disproportionately costly in October, reducing overall performance by 0.3%. We are kicking ourselves about the timing of our investment into USLS9 at the beginning of October. Although USLS9's manager is first and foremost a short-seller, the fund pursues a 'balanced' investment strategy and net market exposure has varied between -20% and +40%. The fund has also made money every year for investors since it was launched in 2003 and so this was an exciting discovery. However, USLS9 had made huge returns in August (+5%) and September (+9%) as key 'short' themes in China and solar energy paid off and we should have been wary of a rebound and delayed our investment. Prior to October, USLS9's biggest monthly loss was less than 4% but the fund is still up by 14% year-to-date. A good investment badly timed – mea culpa.

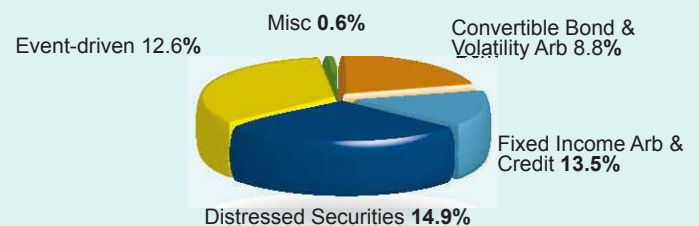
There were no stand-out winners amongst underlying funds in October but this was not surprising given that we only allocate to managers who combine long and short investments and restrict net market exposure. Nevertheless, 28 out of 40 underlying funds were profitable which represents a satisfactory ratio. Event-driven and European equity long/short tied as the two most successful sub-strategies, each contributing +0.21% to overall performance. We will be adding another event-driven fund at the end of this month as the healthy state of corporate balance sheets (in marked contrast to those of governments and many individuals) will continue to spur mergers, spin-offs and other supposedly shareholder value-enhancing actions, providing a fertile opportunity set.

## Asset Allocation by Strategy (as at 31st October 2011)

### Equity Long/ Short (52.0%)



### Arbitrage & Other (50.4%)



## Biggest 5 Holdings as at 33rd October 2011

Name of Fund	Size %	Strategy	October (%)	Year-to-date (%)
JELS1	4.3	Japanese Equity Long/Short	+0.4	(0.3)
USLS4	4.1	US Equity Long/Short	+0.9	+41.6
CBA1	3.4	Convertible Bond Arbitrage	+2.0	+0.4
FIA1	3.1	Fixed Income Arbitrage	+0.1	+3.8
ED1	3.1	Event-driven	+2.1	+5.5

## Best 3 Funds in October

Name of Fund (size)	Strategy	October %	YTD %
EELS5 (2.5%)	European Equity L/S	+3.7	+1.0
EELS2 (2.6%)	European Equity L/S	+3.6	+9.5
DIS2 (2.8%)	Distressed Secs	+3.5	+13.9

## Worst 3 Funds in October

Name of Fund (size)	Strategy	October %	YTD %
USLS9 (1.2%)	US Equity L/S	(9.3)	+13.6
USLS3 (1.3%)	US Equity L/S	(4.6)	+1.9
CBA3 (2.7%)	Convertible Bond Arb	(4.6)	(1.6)

## 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	<b>15.05</b>
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	<b>12.77</b>
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	<b>3.72*</b>
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	<b>2.57</b>
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	<b>9.21</b>
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	<b>8.29</b>
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	<b>6.99</b>
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	<b>4.33</b>
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	<b>7.95</b>
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)	<b>(8.87)</b>
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	<b>7.45</b>
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	<b>1.74</b>
2011	0.94	0.98	0.18	0.13	(0.13)	(0.38)	0.19	(1.38)	(0.52)	0.25			<b>0.23</b>
<b>Annual Rate of Return</b>	<b>5.40</b>			<b>Sharpe Ratio (@ 3% risk free)</b>				<b>0.73</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\$81.3m/£50.4m  
**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
<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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