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THE ABSOLUTE FUND

Rated AA by Standard & Poor's

Results

Share Class (Principal series)	NAV	September 2011			Year-to-date		
		Fund (%)	Cash (%)*	FT World†	Fund (%)	Cash (%)*	FT World†
Class A - US\$	US\$135.49	(0.51)	+0.02	(9.23)	(0.20)	+0.18	(12.93)
Class B - £	£147.20	(0.52)	+0.06	(5.13)	(0.01)	+0.52	(12.49)
Class C - Euro	Eur132.24	(0.51)	+0.11	(2.60)	+0.32	+0.81	(12.69)

*Citigroup 3-Month Eurodeposits – Source: Citigroup

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

The 'Wrong' Kind of Volatility

September was seemingly yet another highly volatile and ultimately grim month in financial markets, dominated entirely by the twists and turns in euro-land's financial crisis, by growing fears of double-dip recession on both sides of the Atlantic and by mounting evidence that the Chinese economy could be heading for a 'hard' landing. Investors sometimes say to us that they thought that volatility was meant to be good for hedge funds. Accepting that we are risking comparison with British Rail's infamous excuse in 1991 about 'the wrong kind of snow', it depends on the kind of volatility. The volatility experienced over the last two months is unprecedented in our careers but has also been accompanied by record highs in price correlation. Instead, the kind of volatility which we prefer is the 'micro' kind in which prices of individual shares and bonds move independently according to company-specific factors, thus providing attractive entry points and profitable exit points for our managers. In this environment, correlations are, by definition, much lower and this is when our managers can thrive.

Goaded by their counterparts in the US and the UK, euro-zone politicians do at last seem to have stopped behaving like ostriches and now recognise the urgent need to address the twin problems of sovereign debt and undercapitalised banks. The existing €440bn European Financial Stability Fund ("EFSF"), conceived only a year ago, is now simply no longer big enough and a safety net several times larger is needed to restore confidence. We suspect that the guardians of the euro will attempt to stun financial markets with the headline size of their rescue plan, which is promised before next month's G20 summit in Cannes. This may prompt a sharp rally in share prices. However, the real challenge will lie in the plan's detail and implementation. Unlike in the US or UK, there are 17 member states involved, each of

which will be keen to protect national interests. Already we have seen Finland demand collateral to participate in Greece's second bail-out loan, whilst Germany is known to be vehemently opposed to increasing the current size of the EFSF and France doesn't want to use taxpayer money to prop up its banks (where else does she think the money is going to come from?). The core problem of too much debt caused by years of fiscal profligacy remains and it is hard to see how much of Europe can escape deep recession. We have considerably reduced the Absolute Fund's investments in European equity long/short funds, not because we have lost confidence in the abilities of our managers (although returns have been collectively disappointing so far this year) but because we believe that there is still significant risk of a disorderly break-up of the euro-zone.

The irony amidst the mayhem is that the balance sheets of companies, unlike those of many governments and individuals, are generally in good shape. Despite this, bond and share prices have been pummeled indiscriminately. In particular, it is now possible to buy the debt of companies which can endure even a deep recession at yields of more than 10%. With interest rates certain to stay close to zero throughout next year, this is an opportunity which is unlikely to last for long. The key is to have the cash (and courage) to exploit it and a number of our credit-focussed managers are doing just that.

Charles Hovenden & Andrew Wheeler
21st October 2011

Performance Review

September was the fifth month in a row in which equity markets have fallen and the destruction of wealth suffered by many investors over the last three months, in particular, has been terrible. Over the last quarter, both the UK's FTSE 100 and the US's S & P 500 indices of leading shares were down by 14% and the main French and German indices fell by 25%. At the end of September, the FTSE stood at a level it first attained in 1997 and 26% below its all-time peak at the end of 1999. Investors promised that equities are the best long-term investment must be questioning just how long the long-term is. As all readers will know, the Absolute Fund pursues a highly hedged and conservative investment strategy but not even we have been able to withstand entirely the highly correlated dislocations in corporate bond and equity markets over the last few months. We hate losing money in any circumstances. The difference between us and most of our peers, however, is that we have limited the declines in the prices of the three main share classes of the Absolute Fund over the last three months to between 1.5% and 1.8% (the HFR Funds of Hedge Funds Index is down by 5%). We are approximately break-even year-to-date whereas the HFR index is again down by 5% and the FT World Share Index has dropped by 12%. We have also made money for investors over what we would call the long-term with sterling-based investors in our strategy up by just over 70% since the start of 1999.

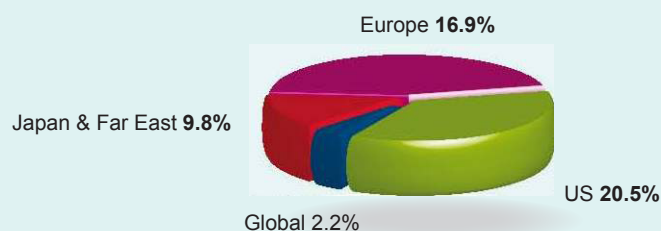
Many of our underlying managers performed admirably in September. Indeed, four of the Absolute Fund's eight sub-strategies were profitable and losses in another three were marginal. Instead, virtually all of the Absolute Fund's loss in September was due to investments in Distressed Securities funds. Although all of the Distressed funds which we hold have

'short' investments and are therefore hedged to a certain degree, they are all 'net long' in overall exposure and therefore susceptible to sharp sell-offs in corporate bond and equity markets. Additionally, the securities of companies in financial distress and undergoing or just exiting balance sheet restructuring tend to be owned by a relatively small number of specialist investors. This can lead to exaggerated movements in prices which may be wholly unrelated to a newly-restructured company's profitability and prospects. Although Distressed Securities has been an extremely profitable sub-strategy for the Absolute Fund over the years and our roster of managers is definitely best of breed, we had taken the decision during the summer to reduce the Absolute Fund's aggregate exposure from 15% to closer to 10%. This was because the prevailing low rate of corporate defaults is shrinking the opportunity set and also because we detected increased exposure in our managers' portfolios to post-bankruptcy equities (the prices of which can be particularly volatile). However, the cycle of redemption dates and notice periods meant that the reduction in exposure did not begin to become effective until the beginning of October.

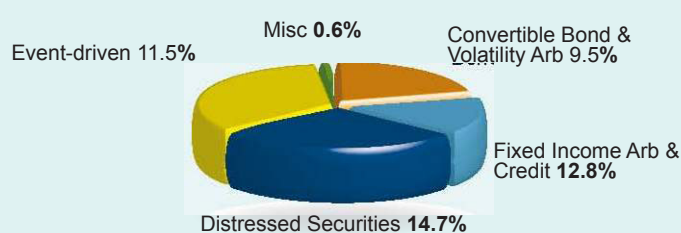
The last two months have provided the sternest test of managers' risk management controls since the demise of Lehman in 2008. The overwhelming majority of our managers have protected capital as we would have hoped and expected. However, a few have not and appropriate action has already been taken or reviews are underway. Fortunately, our pipeline of new funds which are potentially compelling candidates for inclusion in the Absolute Fund's portfolio is very strong and in this respect we have rarely been busier. We are irritated by our small loss over the last two months but excited about the future.

Asset Allocation by Strategy (as at 30th September 2011)

Equity Long/ Short (49.4%)



Arbitrage & Other (49.1%)



Biggest 5 Holdings as at 30th September 2011

Name of Fund	Size %	Strategy	September (%)	Year-to-date (%)
CBA1	4.3	Convertible Bond Arbitrage	(1.6)	(1.6)
JELS1	4.0	Japanese Equity Long/Short	(0.7)	(0.7)
USLS5	3.8	US Equity Long/Short	+3.5	+40.4
FIA1	2.9	Fixed Income Arbitrage	+0.3	+3.6
USLS1	2.9	US Equity Long/Short	+1.5	+9.8

Best 3 Funds in September

Name of Fund (size)	Strategy	September %	YTD %
USLS4 (1.3%)	US Equity L/S	+8.6	+6.9
ED3 (2.5%)	Event-driven	+5.0	+3.8
CBA3 (2.6%)	Convertible Bond Arb	+3.9	+3.2

Worst 3 Funds in September

Name of Fund (size)	Strategy	September %	YTD %
DS3 (1.4%)	Distressed Secs	(6.6)	(12.4)
DS6 (2.5%)	Distressed Secs	(4.7)	(7.6)
USLS7 (2.4%)	US Equity L/S	(4.3)	(4.8)

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)	(0.52)				(0.01)
Annual Rate of Return	5.42			Sharpe Ratio (@ 3% risk free)				0.74	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\$82.3m/£52.8m
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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 Telephone: **+44 (0) 20 7925 8078**
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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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