

Peer Group:

Fund-of-Hedge-Funds

Fund Manager/Adviser:

Charles Hovenden (since launch)

Location:

London

Launch Date: October 2001**Fund Size (July 2008):**

US\$52m

Group Contact No:

+44 20 7925 8070

Website:www.absolutefund.co.uk**S&P ID Number:** OS208593**Share class screened:**

A

**INVESTMENT STYLE**

Region: Global

Strategy: Multi-Strategy

Further information on S&P's fund coverage can be found at

www.funds.standardandpoors.com

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STANDARD & POOR'S OPINION (NOVEMBER 2008)

Absolute Fund Management is the smallest fund-of-hedge-funds (FOHF) manager we provide a rating for. It has one portfolio manager, Charles Hovenden (the CIO and largest shareholder), a head of marketing, Andrew Wheeler, and a data assistant.

Despite limited group resources, the Absolute Fund is one of the rare multi-strategy FOHFs with a positive year-to-September 2008 return (+0.2% on the sterling class). Hovenden's experience of previous periods of market turmoil (he is one of the more experienced FOHF managers with 23 years in total) has helped him come through the year relatively unscathed. His common sense also goes a long way towards making up for the lack of sophisticated risk management systems - he only invests in funds if he understands the strategy and has access to the portfolio manager, he does not invest more than 5% in any single fund, and he verifies performance with third parties.

Hovenden would like to see funds under management grow before adding to the team. However, funds were stable at review and most holdings are through small advisers in lots of around \$2m-\$3m, supporting the decision to focus on private clients rather than institutions. The team structure looks much more settled now than in the past. Andrew Wheeler has exercised 6.5% of his option on the group's equity. He does all the marketing, leaving Hovenden free to focus on investment.

Hovenden believes the current shakeout is likely to give way to some of the best opportunities ever seen in hedge funds. If he is right and takes full advantage, we feel the track record would go a long way towards making up for Absolute's limited resources as Hovenden has already proved to be among the most reliable FOHF managers at preserving capital. In the meantime, his experience and the more stable team background ensure the fund maintains its S&P A rating.

FUND MANAGER & TEAM

London-based Absolute Fund Management had about \$116m assets under management at the end of September 2008. Hovenden (CIO) is the largest active shareholder in the business. He is responsible for the group's investment management and has the support of a data assistant, Fred Gardner, who spends around half her time on research. Wheeler is the other active shareholder and is head of marketing. He has an investment background but concentrates on marketing and business management, leaving Hovenden free to focus on investment management.

Charles Hovenden - chemistry (Oxford University), worked as a private client portfolio manager and equity analyst at Rothschild for seven years and Bank von Ernst for four years. In 1995 he joined Banque Internationale à Luxembourg as a fund-of-funds manager. He launched Absolute Fund Management in October 2001.

Fred Gardner - assistant analyst - graduate (Oxford University), has over three years' experience as an assistant fund-of-hedge-funds analyst. She is responsible for quantitative screening, due diligence checks and the ongoing monitoring of holdings.

Andrew Wheeler - business studies (South Bank University), started as a private client fund manager with Fleming Investment management in 1986. From 1995 to 2001 he worked as multi-fund manager with Dexia Private Bank in Jersey. He was head of marketing at Deutsche Bank Private Banking, London, from 2001 to 2002. From 2003 to May 2007 he was executive director at the family investment office of Unigestion (UK) Limited. He joined Absolute Fund Management in June 2007.

PORTFOLIO CHARACTERISTICS

Turnover ratio (%)	25
No. of holdings	40
% in top 10	30.9

KEY HOLDINGS (01/09/08)

	%
Aristeia International	4.3
Rockhampton *	4.3
Carpathia	3.1
Cazenove European	3.1
Coast Value	3.0
Veritas HY Short-only	2.9
Asian Debt Fund	2.8
Tuckerbrook	2.8
Northwood	2.7
Odey European	2.7

* In key holdings a year ago

ALLOCATION BREAKDOWN (01/09/08)

	Fund %
Cash/Net liabilities	5.0
Convertible arbitrage	9.0
Distressed	11.0
Equity market neutral	0.0
Fixed income arbitrage	12.0
Long/short equity	47.0
Long-only	0.0
Macro	0.0
Managed futures	0.0
Merger arbitrage	0.0
Other	16.0
Special situations	0.0

PERFORMANCE STATISTICS (ANNUALISED)

	3 Years	5 Years
Fund	4.8	5.2
Index**	7.0	10.9
Interest Rate [^]	4.8	3.6
R-Squared vs Index	0.3	0.3
Beta vs Index	0.1	0.1

[^] US T-Bill 90 Day Index!

**S&P Global 1200!

RISK STATISTICS

	5 Years
Standard deviation	2.3
Downside deviation	1.1
Maximum drawdown (%)	-1.4
Gaining months (%)	75.0
Sharpe ratio	0.7
Sortino ratio	1.5

THE ABSOLUTE FUND



MANAGEMENT STYLE

- The fund aims to preserve capital in all market conditions and achieve an annualised return of cash plus 4-6%. It focuses principally on long/short equities and arbitrage strategies, excluding CTAs and global macro funds because the team believes these strategies are difficult to analyse.

- Equity long/short is a significant allocation within the fund, but directionality is limited by only investing in funds that are no more than 30% net long and by always including an allocation to short-biased equity hedge and short-biased credit.

- The process combines top-down strategy allocation, subject to no more than 25% in any single strategy/region, with quantitative and qualitative fund selection (most added value). The team determines the macroeconomic view with input from hedge fund managers, external articles and sell-side research. If defensive, the allocation to managers with a short bias will increase.

- Fund selection starts with a quantitative screening. Attribution analysis is then undertaken to ensure that managers add value from shorting investments as well as

from going long. New ideas come from databases, prime brokers, third-party marketers and from the managers of existing holdings.

- Hovenden carries out onsite interviews with key team members and the track record is verified with the administrators or prime brokers. Start-ups are avoided and there is a preference for medium-sized hedge funds to ensure access can be gained with the manager rather than the investor relations team.

- The portfolio is diversified, with a target of around 40 equally weighted funds. A maximum of 5% is permitted in any one fund.

- There is ongoing monitoring of holdings including visiting at least annually. Fund managers are also telephoned between visits if there is exceptional performance or style drift. Sell disciplines include unexplained exceptional returns, lack of access to the manager and potentially better ideas.

- The fund has a 35-day notice period. Barings provides a credit line to meet redemptions.

PORTFOLIO & PERFORMANCE ANALYSIS (SEPTEMBER 2008)

The Absolute Fund is one of the rare multi-strategy FOHFs with a positive year-to-date return (+0.2% to 1 September 2008 on the sterling class, although the dollar class is down 0.8%), helped by allocations to short-biased equity and short-biased credit managers (9% and 4% respectively), and by avoiding hedge funds that use significant leverage to generate returns. However, Hovenden estimates the fund is likely to have been down 2.5% in September, which has been one of the worst ever months for hedge funds. He reports that this was a particularly difficult month for convertible arbitrage (the portfolio has about 9% invested with convertible arbitrage managers) and was made worse by prime brokers telling funds to rein in borrowings.

Hovenden is excited about the future. He thinks next year should present some strong opportunities in equity hedge, particularly in the US and Europe, in convertible arbitrage and in distressed. Heavy redemptions in the pipeline for convertible arbitrage funds (most of them have quarterly redemption notice periods) are likely to weigh on the strategy until well into the first quarter of 2009. However, after that Hovenden believes there may be a once-in-a-lifetime opportunity for the survivors. The fund currently has only one distressed manager, Southpaw Credit Opportunities (a 2.4% position). Hovenden expects to build up holdings in this area from around the middle of next year.

DISCRETE PERFORMANCE (CALENDAR YEARS)

	2004	2005	2006	2007	YTD 31/08/2008
	%	%	%	%	%
Fund	5.6	5.7	4.7	7.4	-0.8
Interest rate [^]	1.4	3.3	5.2	5.5	2.3

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