

# Newsletter

## General Market Review July 2007

### Economic Review

Analysts predicted a moderate rebound in retail sales during the month after witnessing a steep decline in June, with total sales up by 0.3%, led by a rebound in furniture, electronics and building materials. The headline CPI (Consumer Price Index) moved up only 0.1% in July. While oil prices have increased, retail gasoline prices have declined. Housing starts hit a new cycle low in July (forecast of 1,380k). Permits ran below starts in June, which is typically a sign that starts will decline the following month. Consumer sentiment, according to the University of Michigan Consumer Sentiment Survey, rebounded to 90.4 for July, up from 85.3 in June and 88.3 in May. Industrial Production edged up by 0.2% in July. A drop in utility output, a function of unseasonably cool weather in July, depressed the headline, while manufacturing output, which excludes weather sensitive utilities, increased sharply in July.

Sources: CS Research & Analytics

## Absolute Invest Ltd.

### Portfolio Description

Absolute Invest is an investment company, which invests in a variety of absolute return-oriented management styles. These investment strategies are focussing on globally diversified and industrialized financial markets. The investment company was established to respond to investors who desire an attractive, well-diversified portfolio of alternative investments in US Dollar values, which can be actively allocated across different investment styles and strategies throughout the universe of alternative investments.

### Investment Performance as of July 31, 2007

		Monthly Return	Year to Date Return	Inception*) To Date (Nov 2000)	Average Annual Return	Annual Standard Deviation	Sharpe Ratio
Absolute Invest NAV (USD)	380.57	6.52%	21.47%	70.44%	8.33%	6.10%	0.49
Share price (USD)	345.75	1.39%	22.39%	46.71%	5.83%	7.81%	0.06
S&P 500 Index (USD)	1455.27	-3.17%	2.61%	1.61%	0.24%	13.62%	Neg.

Past performance is no guarantee of future results. Performance figures are estimated net of management and performance fees and are subject to change.

\*) Absolute Invest has paid out CHF 9 (= US\$ 7.36 or ca. 2.70 %) on June 30, 2004 due to a par value repayment. This Special Dividend is not included in the above numbers.

## Investment Review

### Absolutissimo and Conferre

Absolutissimo's July performance benefited from the strong outperformance of its largest position, Penta Japan Fund, which gained approximately 28% this month. Penta's performance was aided by the positive move in the Asian markets and the negative performance of the Japanese market, as they are positioned long and short accordingly. Somewhat surprisingly, the fund made money in the long equity book, short book and options book. The longs and options drove performance, with the longs up 19% and the options up 10%. During the month, an unusually large number of stock-specific events across the long portfolio generated significant upswings in the company's valuations. The fund's two largest positions, a financial services firm and a construction company, were up more than 60% and 40%, respectively, on what Penta described as a re-rating "by the market of their relative positioning ... in their respective markets." Unfortunately, thus far in August, the entire gain for these stocks has been nearly erased. Penta rolled some of their options to higher strikes and recently sold others to reduce the overall exposure. The fund entered July with a gross and net exposure of 225% long and 76% short, which is conservative in comparison to the past. Penta has struggled during the first few weeks in August, and the manager has reduced exposure due to his stance, which is somewhat "less bullish" than in the past. In contrast to Penta's gains, Nightwatch and Vardon delivered notably poor performances, down 9% and 8%, respectively. The loss at Nightwatch was primarily the result of poor quarterly results from its largest position, which declined 16% on the day of their earnings miss. The miss was due largely to a few big contracts getting pushed out. The manager still has strong conviction in the name. Vardon's loss was disappointing because we believe the manager has a strong short side; after talking to the manager throughout the month, it is difficult to find fault with their logic. One of their positions in a toy retailer is down 15% thus far in August. The company's sales were light, earnings were slightly less than consensus and the stock was oversold. The turnaround story remains intact and reviews of new products have been positive. Further, the company's products are gaining traction at Wal-Mart and Target. The fund was very long biased going into a sharp sell-off in nearly all U.S. consumer stocks. The manager has indicated that he wouldn't have changed much, even with the benefit of hindsight.

Following the announcement of their second quarter results and the general weakness of the specialty finance and real estate sectors, we marked down Kodiak to the depressed book value of 9.22. The mark down resulted in a 26% decline in the value of the position and resulted in a \$1.3 million loss to the portfolio. We had kept the position at cost since the initial investment, in line with Western Reserve's mark. Until last month, this seemed to be Copyright, 2007 Cadogan Management, LLC broadly in line with the company's peers on a price to book basis. During July, many of Kodiak's peers were sold off sharply and many traded to book and below. Therefore, we marked our position to book value of 9.22 per share. Unfortunately, subsequent events have forced us to further question the value of our investment. In early August, we had a Saturday morning call with the CEO of Kodiak, during which we learned that the company had \$84 million of exposure to recently defaulted American Home Mortgage. If this is a complete loss, which is likely, this would result in a \$3.7 hit to book value. Compounding this issue, we also learned that the company has \$50 million of exposure to C-Bass. The C-Bass position is worth \$2.20 per share of book value. Furthermore, these two new problems exacerbate existing concerns over whether deals will ultimately go through on Novastar and Accredited, which are worth a combined \$91 million and \$4.0 per share. Combined with the potential for problems with the various homebuilders, it is easy to see that this company is in trouble. The banks agreed, and they have issued a margin call for the company's \$47 million in repurchase agreement. The warehouse lines are secure but the company is in need of cash. Kodiak's Vice Chairman is in the process of talking to several prospective investors about a recapitalization that could potentially save the company, and he thinks that if they can survive, we could be left with an entity that is earning its historical run rate of \$0.75 per share. The opportunity now lies in the fact that there is \$250 million of

cash in CDO II that has to be invested. He now has the chance to buy securities at 80 and below for which he would have been paying par or below. We are hopeful that we emerge from this with something more than zero, but we feel the probability of that is low. We remain watchful of the situation and will continue to keep you informed of the developments. Currently, the Conferre fund has approximately a \$3.7 million investment in Kodiak, which represents a 7% allocation. On the positive end of the spectrum, several of our positions produced very solid returns. Our short position in Radian performed well during the month and has done considerably better thus far in August. The Radian short benefited from the same macro factors that hurt Kodiak. Throughout July, the Radian positions (short stock, long puts and long CDS) contributed \$2.8 million of performance. The company's problems began with the July 25th earnings release; numbers came in considerably lower than street expectations, but the stock held up better than we would have hoped. During the earnings call, analysts asked about the status of C-Bass and the management team communicated that everything was fine. By July 31st, the situation at C-Bass had gone from being relatively stable to a potential zero. To make matters worse, Radian, alongside MGIC, had just given C-Bass another \$50 million to complete the deal with Fieldstone, which is now also a zero. This pushed the stock down 16% on the last day of the month and increased the value of all three legs of the trade significantly. So far in August, Radian's situation has continued to erode, culminating with MGIC suggesting that they may seek to back out of the merger. This news led the rating agencies to suggest downgrading Radian in the event that the merger did not close. The downgrade would make it considerably harder for Radian to continue to write new business, which they need in order to pay out the expected future losses. We continue to feel that there is a real chance that the situation could deteriorate to the point of default, but in line with MAST we have reduced the exposure to the name by covering the short equity position, selling the puts and selling \$20 million of the notional exposure via CDS. Our position in Copyright, 2007 Cadogan Management, LLC Radian is now \$30 million notional CDS, which we bought at an average spread of 40. Most recently, we sold a piece at 900. As of this writing, the positions have added more than 10% to this month's performance, and this contribution has already compensated for whatever loss we may ultimately have in Kodiak.

Source: Cadogan Management, LLC

#### CQS Directional Opportunities Fund

The CQS Directional Opportunities Fund produced a net return to its investors of -8.34% in July, bringing the calendar year-to-date net return to -1.29%. During the month, substantial mark-to-market losses were incurred in long equity, long credit and structured credit positions while curve steepener and longer dated credit protection positions generated strong returns.

Structured credit remains a significant component of the portfolio with long positions in synthetic equity tranches, CDO equity and first-to-default baskets. The equity component of the portfolio has an average maturity of four years and references principally bespoke portfolios of US and European credits. These positions are constructed using fundamental research to select portfolios of credits where it is believed the probability-weighted cost of default is outweighed by the income received for underwriting such risks. In July, as credit market concerns heightened, CDO equity came under extreme pressure causing significant mark-downs of the Fund's positions. We review the fundamental credit characteristics of names within the structured credit portfolio on an active basis. Given our assessment of these fundamentals and the relatively short-dated tenor of these structures, we retain a positive outlook for these positions over the medium term.

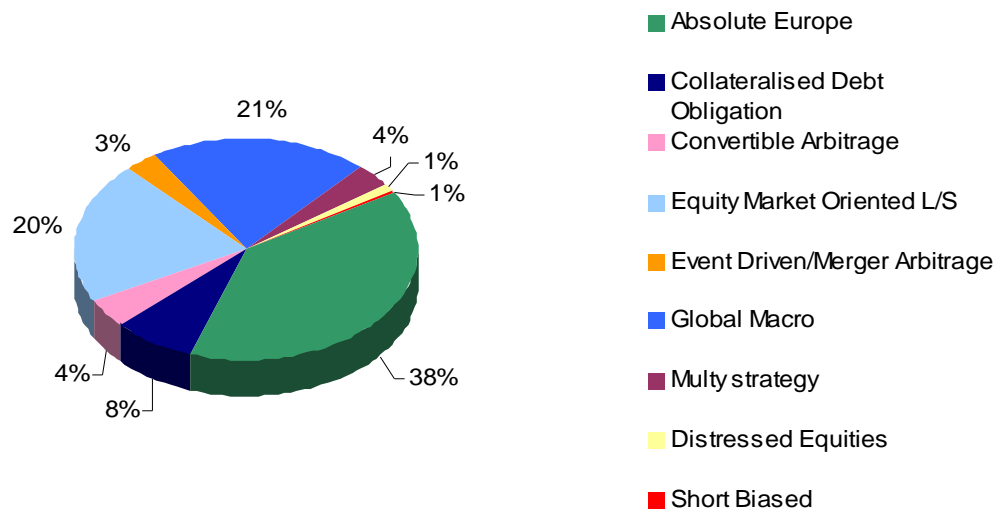
Concerns in credit markets also negatively impacted long single-name credit positions causing further mark-to-market losses. The Fund is retaining these positions and we continue to believe in the fundamentals underpinning these credits. In order to protect the Fund's current long credit bias in a spread-widening environment, long-dated credit curve steepeners were added over the past several months. These steepener positions made very strong gains in July and served, in part, to offset losses elsewhere in the Fund's portfolio.

Equity markets sold off rapidly at the end of July and losses were incurred in several of the Fund's long single-name positions. We continue to believe there is value in the names selected and the Fund continues to hold these positions. Clearly, we are always very disappointed to have to report any loss to investors. However, the mark-downs incurred last month were in line with the Fund's risk management expectations and we retain a high level of confidence in the positive medium-term outlook for the portfolio as it currently stands. We believe the recent volatility is likely to provide many compelling and ultimately lucrative investment opportunities and look forward to being able to report more positive returns in the future.

As you may have heard from various media reports, recent market conditions have made it more challenging to source reliable valuations for some asset classes from brokers and other market data providers, although the majority of the Fund's portfolio continues to be readily priced. The continued investment in our operational infrastructure has, through this time, helped us to derive effective valuations for the more challenging positions, and we have worked with the administrators to try to use valuations that we believe to be fair.

Source: CQS LLP

**Strategy Allocation as of June 30. 2007**



Bloomberg	ABSI SW <equity>
Swiss	
security number	1'138'774

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