

# Newsletter

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## General Market Review December 2005

After three months of strong industrial activity, the December ISM (Institute for Supply Management Composite Index) fell to 54.2, substantially below both the forecast of 57.5 and November's ISM of 58.1. Analysts attribute the reduction to a "multiple ordering" problem that likely inflated the ISM over the last three months, with purchasing managers doubling up on orders out of concern over supply shortages after hurricanes Katrina and Rita. While momentum has clearly slowed from the swift pace of the post-Katrina period, an ISM of 54.2 has been roughly consistent with the 3.0% real GDP growth in recent years. In line with this historical experience, analysts predict that a 3.0% growth in real GDP should be expected for the fourth quarter of 2005, revised downward from an earlier forecast of 3.7%.

The U.S. labour market continues to tighten as the unemployment rate fell to a cycle low of 4.9% in December. The U.S. payroll survey also points to a healthy job market with the two-month trend for job growth at 207,000. While December had a weaker than expected 108,000 rise in payrolls, this was offset by a substantial upward revision to November jobs (now 305,000, versus the 215,000 initially reported). Retail sales are expected to rise 1.0% for the month, driven by an incentive-induced gain in vehicle sales (17.2 million vehicles in December versus 15.7 million vehicles in November) and decent sales of general merchandise during the Christmas holiday.

Source: CSFB Research & Analytics

## Absolute Private Equity Ltd.

### Portfolio Description

Absolute Private Equity focuses its investment strategy mainly on the private equity market. Absolute Private Equity commits its money to private equity funds, which pursue investment strategies differing by industry, geographic region and stage of financing. The asset class of private equity is characterized by a long investment horizon. From the time of capital commitment, through the investment cycle and up to the realization period, between three to seven years elapse. In order to maximize the returns on capital invested for its shareholders, Absolute Private Equity employs a cash management strategy through a portfolio of absolute return strategies, which targets investments in non-traditional funds that can generate immediate returns. The capital within the absolute return part will be allocated to the private equity portion, as soon as the underlying private equity funds call committed capital for investments.

**Investment Performance as of December 31, 2005**

		Performance December 2005	Performance year to date	Performance since Inception
Absolute Private Equity NAV (USD)	USD 68.60	2.07%	15.33%	28.95%
Share price (USD)	USD 59.65	0.76%	38.72%	5.54%
Premium (Discount)	-13.05%			
Morgan Stanley World Equity	1'257.78	2.14%	7.56%	-3.64%
JP Morgan Global Government Bond Index	358.659	0.68%	3.68%	30.60%

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

**Private Equity Review**

As the buyout market begins to overheat, distressed players in the private equity market are anticipating the arrival of the next distressed investing cycle. Generally, the buyout industry experiences a period of three to five years when banks are willing to issue significant amounts of debt and the companies carrying the debt can support it. Once the macro-economy begins to change, companies with heavy debt loads begin to struggle, offering a period of increased opportunity for distressed investors.

The debt markets have been willing participants in this heightened period of buyout activity, building leverage to levels that have not been seen since the last distressed cycle early this decade. For example, large U.S. companies are carrying an average debt load of 5.4x EBITDA, which is near the 1997 high of 5.7x. In addition mid-market companies are highly leveraged at 4.6x EBITDA, close to the 1997 high of 4.8x. Note also that as leverage has risen, the quality has begun to fall, indicating a greater chance of default. Roughly 41% of all high-yield bonds issued this year rated B- or lower. This figure is well ahead of the 38% recorded in 1998, prior to the most recent distressed cycle. While default rates currently remain in the low single digits, credit rating agencies expect rates to rise over the next year, having indicated that default rates are at an unsustainable cyclical low.

In the context of private equity, this distressed cycle is likely to differ significantly from the last. Although distressed investing requires a specialized skill set, competition in the space has increased substantially and the market has become much more global. Distressed private equity players typically follow one of two strategies: (i) buy equity in troubled companies, often intervening before bankruptcy (i.e., Littlejohn & Co.); or (ii) buy debt of distressed companies for pennies on the dollar, with the intent to gain control during bankruptcy and convert debt to an equity stake (i.e., Matlin Patterson). In 2005, seven firms following such distressed investing strategies have closed on approximately \$6 billion, with another 12 firms currently raising \$10 billion plus. While some are established distressed players, others are either buyout investors that are novices to the distressed industry, or hedge funds that are shifting into control-oriented strategies. Moreover, U.S. investors intending to invest internationally will likely face fierce competition from local investors with in-depth knowledge of their respective markets. These markets typically present more challenges to outsiders, requiring specific knowledge of political and legal landscapes that often change abruptly.

Source: PE Interactive

## Private Equity Investments as of December 31, 2005

Private Equity Funds	Investment Focus	Commitments USD	Market Value of Investments USD	% of Commitments	% of Absolute Private Equity Assets
Clarity Partners	Software & technology companies in telecom, media and internet	10'000'000	5'111'868	51.12%	0.69%
Bay Partners	Early stage investment in US technology companies	8'000'000	3'730'544	46.63%	0.51%
GRP II	Start-up and venture capital in the US and EU	15'000'000	9'802'684	65.35%	1.33%
AC Private Equity Invest	Private Equity with focus on Southern Europe	10'000'000	9'164'476	91.64%	1.24%
Warburg Pincus international Partners, LP and affiliates	Venture capital, buyouts and recapitalizations in a broad range of industries world wide	200'000'000	164'377'664	82.19%	22.33%
Warburg Pincus Private Equity VIII	Venture & growth capital and buyouts in a broad range of industries	25'000'000	21'269'118	85.08%	2.89%
PAI III Europe	Focus on buyouts, lesser extent growth capital, in Western Europe	24'450'558	19'870'013	81.27%	2.70%
CSFB Fund VII Investor, LP	Venture & growth capital and buyouts in a broad range of industries	140'000'000	100'358'544	71.68%	13.63%
CSFB Middle Market Value Investor, LP	Focus on middle market buyouts in the US	74'925'000	51'677'227	68.97%	7.02%
DLJ Merchant Banking Partners III	Buyout in a broad range of industries mainly in the US	15'000'000	9'005'956	60.04%	1.22%
Matlin Patterson Global Opportunities Partners "	Investments into distressed companies world-wide	50'000'000	41'927'156	83.85%	5.70%
Terra Firma Capital Partners	Heavy-asset based and out-of-favour European companies with a potential for active value creation	90'967'454	52'112'146	57.29%	7.08%
DLJ Venture Partners II	Venture & growth capital in a broad range of industries world-wide	7'111'396	6'373'452	89.62%	0.87%
ADM Maculus Fund, L.P	Distressed assets and undervalued situations in Asia	15'000'000	15'968'799	106.46%	2.17%
Lightyear Fund I L.P.	Private Equity with focus in the financial services industry	5'000'000	4'350'623	87.01%	0.60%
Wayzata Opp. Fund	Private Equity, with focus in distressed debt	10'000'000	3'500'000	35.00%	0.48%
<b>Total</b>		<b>700'454'408</b>	<b>518'600'270</b>	<b>74.04%</b>	<b>70.44%</b>

**Overall Allocation Overview as of December 31, 2005**

	Asset Value (USD)	In % of Total Assets
Private Equity Investments	518'600'270	70.44%
Absolute Return Strategies	144'775'958	19.67%
Cash	72'813'916	9.89%
<b>Total Net Assets</b>	<b>736'190'144</b>	<b>100.00 %</b>

**Private Equity Investments Review**

The total commitments as of December 31, 2005 stand at USD 700 million, of which USD 518.6 million have been invested. This represents 74.04% of committed capital and 70.44% of total net assets. During December USD 23.4 million were called for new investments. Unrealized gains of USD 2.8 million were attributable to AC PE Invest and CSFB Fund VII. Distributions of total USD 24.34 came from CSFB MMV, Matlin Patterson GOP, DLJ MB III, WPIP, WPIP LLC, CSFB Fund VII and Lightyear Fund I, recallable ROC from Lightyear Fund I, CSFB MMV and Matlin Patterson GOP for an amount of USD 940'429.

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