

Cazenove Absolute Return Fund Company

Cazenove Absolute UK Dynamic Fund

Short report for the year ended 30 September 2010

Cazenove Absolute Return Fund Company

Cazenove Absolute Return Fund Company ("CARFCo" or "the Company") is an umbrella company comprising two sub-funds which have their own investment objectives and policies. Its investment and borrowing powers and restrictions are prescribed by the Financial Services Authority's ("FSA") Collective Investment Schemes Sourcebook ("COLL") and the Open-Ended Investment Companies Regulations 2001 (as amended) ("the OEIC Regulations").

This report relates to the Cazenove Absolute UK Dynamic Fund ("the Fund") only.

Cazenove Absolute UK Dynamic Fund

Authorised Corporate Director's ("ACD's") investment report

Investment objective and policy

The objective of the Cazenove Absolute UK Dynamic Fund is to achieve absolute returns through targeted investment strategies independent of United Kingdom market conditions or indices.

The ACD will seek to achieve its investment objective by investing in a concentrated portfolio of companies (usually between 30 to 60 companies both on the long side and the short side of the portfolio) predominantly incorporated in the United Kingdom or in companies which derive a significant proportion of their revenues or profits from this country or which are primarily operating in this jurisdiction. Investments will be made primarily in companies and other securities which are constituents of the FTSE All-Share Index with a bias towards medium sized and smaller companies. The Fund may also invest in securities listed on the Alternative Investment Market and in equity related transferable securities, such as preferred shares, debentures, warrants (warrants may not exceed more than 5 per cent of the total assets of the Fund) and convertible securities or in derivatives thereof. As the Fund has an absolute return objective it will not be managed against any index.

Whilst the Fund will mainly invest in equities, it may also invest in debt securities (such as bonds and notes of any maturity which are transferable securities), where this is deemed appropriate in the market conditions prevailing at that time. Any such securities will be rated investment grade by Moody's or S&P, or if not rated, deemed by the investment manager to have at least an equivalent rating and will be issued by the United Kingdom government or companies incorporated in the United Kingdom or in companies which derive a predominant proportion of their revenues or profits from this country or which are principally operating in that jurisdiction. The Fund may also invest in short-term securities which are rated investment grade (such as certificates of deposit, bankers' acceptances and commercial paper) for temporary defensive purposes.

The Fund will seek to achieve its investment objective and policy through the use of various investment strategies including the use of derivatives to obtain long and synthetic short positions principally through contracts for differences.

The Fund may also use forward foreign exchange transactions, interest rate and government bond futures, and other exchange traded and off exchange traded derivative contracts for the purposes of efficient portfolio management and/or meeting the investment objectives of the Fund. Such derivative contracts have the potential to significantly increase the Fund's risk profile.

The ACD employs a risk management process that seeks to control the volatility of Fund returns.

The Fund may at any time have substantial holdings in ancillary liquid assets.

Performance

The Fund delivered a return of -1.14% (P1 GBP Accumulation share class) over the year.

Market review

The first year of the Fund's life can broadly be split into four phases that match the four calendar quarters of the year from fourth quarter 2009.

Fourth quarter 2009 - this was our investment phase which coincided with a strong period for equities overall. Given that we operate a broad portfolio with a small and mid cap bias and a fully populated long and short book we needed to be very careful how we invested the Fund's capital in the period. In a strong equity market it would have been straightforward to populate the short book rapidly but we could have easily overpaid for illiquid long positions or ended up with an imbalanced portfolio. Hence we took a little longer than expected to get the Fund fully invested, but this process was complete by the end of 2009.

First quarter 2010 - Our Dynamic long/short strategy that we have been running successfully since mid 2005 and which forms the basis of this portfolio has historically been long the FTSE 100, short mid caps and long small caps. In the first quarter, and to some extent most of the first half of 2010, this was fundamentally the wrong positioning. Highly valued mid cap growth stocks led the way in the first quarter and we were generally short here while our deeper value and more defensive long holdings lagged markedly. We also suffered a number of stock-specific headwinds which are part and parcel of stock picking in the smaller companies arena.

Second quarter 2010 - the departure of the Fund's co-manager at launch, Neil Pegrum, was the major factor affecting performance in this quarter. We saw a significant withdrawal of assets from the Fund in late April. The headwind this created amounted to trading c40% of the net asset value against our positions in the last week of that month. Clearly we had to manage this liquidation process carefully, dealing across the market cap scale so as to avoid the portfolio becoming distorted. It would have been easy to sell all our larger more liquid positions but this would have left us a significantly more illiquid portfolio which was clearly not what investors sought at launch. While the bulk of liquidations came in over a very short period for this Fund, the impact of a high level of liquidations in the larger monthly dealing offshore fund which holds the

same portfolio was drawn out over both May and June. Hence the performance headwind lasted for most of the quarter. Third quarter 2010 – while the second quarter was challenging we maintained our investment strategy and continued to invest actively, meeting and visiting numerous potential investments. Crucially we maintained significant positions in our preferred positions despite lacklustre performance in the first half of the year. Many of these long positions delivered strongly in the third quarter such as Elementis, Filtrona, Booker, in the mid caps and Johnson Service, Scapa and e2v Technologies in the small caps. There has been a steady flow of mergers and acquisitions activity in the UK small and mid cap market this year as well and we benefited with approaches for Datacash, Intec Telecom Systems and Kewill in the quarter. We also saw some tentative signs that the twelve months upwards rerating of growth stocks was running out of steam. This trend began to benefit the short book too. Our meetings with many industrial companies have suggested to us that the momentum for the rest of 2010 remains strong, but we need to be careful with over ambitious earnings expectations for 2011.

Portfolio activity

We took new positions in the following initial public offerings (“IPOs”) in the year – CPP, EMIS, SuperGroup and Promethean World. All of these companies are UK based entrepreneurial led growth businesses that were valued at circa £400m at float. With the exception of Promethean World, where the initial valuation and market forecasts were too high, these have all been successful investments for the Fund. During the year we also took new positions in IMI, Tate & Lyle and British Airways at the upper end of the market cap scale and Andor Technology, XP Power and RM at the lower end. We exited our position in Yell, Reed Elsevier and Associated British Foods.

Outlook

The year has, in aggregate, been a solid one for UK equities but a disappointing one for the Fund. The direction of the global economy remains an unknown and the sceptre of the double dip and the impact of consequent central bank policy reaction creates a nervous market environment. Fundamentally equities remain modestly valued, particularly at the smaller end of the market cap spectrum, in comparison to other asset classes especially when yield is considered. However in our universe valuation extremities for value and growth prevail. For a long/short fund this should create a reasonable opportunity set and we continue to meet and visit a broad range of potential investments with this in mind.

Fund facts

	Accounting date	Distribution payment date
Interim	31 March	31 May
Final	30 September	30 November

Performance record

	30.09.10 p	30.09.09 p	Share price % change*	Total return % change* (net of tax)
P1 GBP Accumulation	99.37	100.52	(1.14)	(1.14)
P2 GBP Accumulation	99.79	100.54	(0.75)	(0.75)

* % change reflects net income reinvested.

Fund performance summary

Calendar year	Lowest price p	Highest price p	Distribution per share p
2010*			
P1 GBP Accumulation	91.56	101.35	0.4160
P2 GBP Accumulation	91.87	101.57	0.8225
2009**			
P1 GBP Accumulation***	98.65	102.24	0.0000
P2 GBP Accumulation***	98.66	102.32	0.0000

* To 30 September 2010.

** P1 and P2 GBP Accumulation shares were first issued on 7 September 2009 at a price of 100p.

*** The share class did not pay a distribution during the year.

Total expense ratio

A total expense ratio (“TER”) is shown which takes into account the management fee and all other operating expenses over the year and is expressed as a percentage of average daily assets over the same period (annualised).

	Excluding performance fee %	Including performance fee %
30 September 2010*		
P1 GBP Accumulation	1.67	1.67
P2 GBP Accumulation	1.17	1.17
30 September 2009		
P1 GBP Accumulation	1.75	1.89
P2 GBP Accumulation	1.26	1.39

*No performance fee was taken during the year.

Net asset value record

	Net asset value per share	
	30.09.10 p	30.09.09 p
P1 GBP Accumulation	99.50	100.53
P2 GBP Accumulation	99.93	100.56
	30.09.10	30.09.09
Total net asset value	£70,546,240	£122,915,819

Portfolio structure

Net position and leverage	Percentage of net assets	
	30.09.10 %	30.09.09 %
Long exposure	101.37	49.83
Short exposure	(60.44)	(25.65)
Net long exposure	40.93	24.18
Gross investment	161.81	75.48

Five largest long positions

As at 30.09.10		Percentage of net asset		As at 30.09.09		Percentage of net assets	
			%				%
Elementis			5.60	GlaxoSmithKline			6.12
Omega Insurance			4.41	Filtrona			3.76
GlaxoSmithKline			4.36	Omega Insurance			2.92
Filtrona			4.29	Reed Elsevier			2.71
Xaar			3.98	Legal & General			2.29

Ten largest net sector positions (five net long, five net short)

As at 30.09.10					As at 30.09.09				
Percentage of net assets					Percentage of net assets				
	Long %	Short %	Gross %	Net %		Long %	Short %	Gross %	Net %
Chemicals	8.60	-	8.60	8.60	Nonlife Insurance	7.09	-	7.09	7.09
Nonlife Insurance	7.78	-	7.78	7.78	Pharmaceuticals & Biotechnology	6.27	(2.13)	8.40	4.14
Electronic & Electrical Equipment	8.80	(2.21)	11.01	6.59	Media	5.28	(1.74)	7.02	3.54
Financial Services	8.64	(2.16)	10.80	6.48	General Financial	3.01	(0.37)	3.38	2.64
Pharmaceuticals & Biotechnology	7.21	(2.13)	9.34	5.08	Travel & Leisure	4.29	(1.90)	6.19	2.39
General Retailers	5.13	(6.53)	11.66	(1.40)	Mining	-	(0.46)	0.46	(0.46)
Household Goods & Home Construction	-	(1.99)	1.99	(1.99)	Industrial Transportation	-	(0.76)	0.76	(0.76)
Real Estate Investment & Services	-	(2.23)	2.23	(2.23)	Software & Computer Services	2.42	(3.61)	6.03	(1.19)
Mining	-	(3.36)	3.36	(3.36)	Industrial Engineering	-	(1.67)	1.67	(1.67)
Industrial Engineering	4.81	(8.88)	13.69	(4.07)	Aerospace & Defence	-	(1.79)	1.79	(1.79)

Risk factors

Equities

Funds investing in equities tend to be more volatile than funds investing in bonds, but also offer greater potential for growth. The value of the underlying investments in equity funds may fluctuate quite dramatically in response to activities and results of individual companies, as well as in connection with general market and economic conditions. The Cazenove Absolute UK Dynamic Fund will invest primarily in equities or derivatives thereof.

Liquidity consideration

The ACD's ability to invest and to liquidate the assets of a fund invested in or otherwise attributable to smaller companies may, from time to time, be restricted by the liquidity of the market for smaller company securities in which the relevant fund is invested. The Cazenove Absolute UK Dynamic Fund may invest significantly in smaller companies or in derivatives thereof.

Derivative instruments

The Fund may trade certain derivative instruments for hedging and for investment purposes, in both exchange-traded and over-the-counter ("OTC") markets. Such instruments may include forward foreign exchange contracts, futures, options, swaps, contracts for differences and repurchase and reverse repurchase agreements. The use of derivative and forward transactions for investment purposes involves special risks which may:

- significantly raise the risk profile of the Fund;
- increase the volatility of the Fund when taking additional market or securities exposure;

- depend on the ability of the ACD to predict movements in the prices of securities;
- place some reliance on the imperfect correlation between instruments and the underlying securities; and
- involve investing in instruments not traded on exchanges and not standardised, which in turn may involve negotiations on transactions on an individual basis.

The following generic risks are particularly relevant in terms of the use of derivatives and forward transactions in the Fund:

Position (market) risk: There is also a possibility that ongoing derivative transactions will be terminated unexpectedly as a result of events outside the control of the ACD, for instance, bankruptcy, supervening illegality or a change in the tax or accounting laws relative to those transactions at the time the agreement was originated. In accordance with standard industry practice, it is the Company's policy to net exposures against its counterparties.

Liquidity risk: Derivatives traded OTC may not be standardised and thus may involve negotiations on each contract on an individual basis. This may result in OTC contracts being less liquid than exchange traded derivatives.

Correlation risk: Derivatives do not always perfectly or even highly correlate or track the value of the securities, rates or indices they are designed to track. Consequently, the use of derivative techniques may not always be an effective means of, and sometimes could be counter-productive to, the Fund's investment objective. An adverse price movement in a derivative position may require cash payments of variation margin that might in turn require, if there is insufficient cash available in the portfolio, the sale of a Fund's investments under disadvantageous conditions.

Legal risk: There are legal risks involved in using derivatives which may result in loss due to the unexpected application of a law or regulation or because contracts are not legally enforceable or documented correctly.

Leveraged risk: Since many derivatives have a leverage component, adverse changes in the value or level of the underlying asset, rate or index can result in a loss substantially greater than the amount invested in the derivative itself. Certain derivatives have the potential for unlimited loss regardless of the size of the initial investment. If there is a default by the other party to any such transaction, there will be contractual remedies; however, exercising such contractual rights may involve delays or costs which could result in the value of the total assets of the related portfolio being less than if the transaction had not been entered.

Short sales

A short sale involves the sale of a security that the Fund does not own in the expectation of purchasing the same security at a later date at a lower price. To make delivery to the buyer, the Fund must borrow the security and later purchase the security to return to the lender. A short sale involves a risk of a theoretically unlimited increase in the market price of the security. Although a fund is prohibited under the FSA Rules from taking direct short positions in securities, it can employ certain derivative techniques such as using contracts for differences which may establish both “long” and “short” positions in securities. These positions may seek to take advantage of both rising and falling market values.

Portfolio concentration

This Cazenove Absolute UK Dynamic Fund may hold a higher concentration of stocks (usually 30-60 holdings on the long portfolio and 30-60 holders on the short portfolio) and as such may lack the diversity of traditional funds thus carrying increased risk. High portfolio concentration could mean that the Fund’s returns are more volatile when compared with a fund that invests in a wider range of companies.

Liabilities of the Company

Each Fund, under normal circumstances, is treated as a separate entity, with its own assets and liabilities. However, the Funds are not “ring-fenced” and, if the assets of any Fund are insufficient to meet the liabilities attributable to it, the excess liabilities may have to be met out of the assets of the other Funds. Shareholders are not liable for the debts of the Company. Shareholders are not liable to make any further payment to the Company after they have paid the purchase price of the shares.

Regulatory information and risk warnings

The contents of the ACD’s report are based upon sources of information believed to be reliable, however, save to the extent required by applicable law or regulations, no guarantee, warranty or representation (express or implied) is given as to its accuracy or completeness and Cazenove Investment Fund Management Limited, its directors, officers and employees do not accept any liability or responsibility in respect of the information or any recommendations expressed herein which, moreover, are subject to change without notice.

Nothing in this document should be deemed to constitute the provision of financial, investment or other professional advice in any way. Past performance is not a guide to future performance. The value of investments and the revenue from them can go down as well as up and an investor may not get back the amount invested and may be affected by fluctuations in exchange rates. The levels and bases of, and reliefs from, taxation may change. You should obtain professional advice on taxation where appropriate before proceeding with any investment. You should be aware that investments in higher yielding bonds issued by borrowers with lower credit ratings may result in a greater risk of default and have a negative impact on revenue and capital value. Revenue payments may constitute a return of capital in whole or in part. Revenue may be achieved by foregoing future capital growth. You should be aware of the additional risks associated with investment in emerging and developing markets.

Cazenove Investment Fund Management Limited can only promote its own products and services.

The long version of this report is available on written request to the Marketing Department, Cazenove Investment Fund Management, 12 Moorgate, London, EC2R 6DA.

AUTHORISED CORPORATE DIRECTOR

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The ACD is authorised and regulated by the Financial Services Authority

For more information

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