# Nedgroup Investments Target Return Fund Plc

Directors' Report and Financial Statements
for the year ended 30 September 2010

NEDGROUP INVESTMENTS

# CONTENTS

# CORPORATE INFORMATION

**Directors**
A V Lodge
T A Wiltcher
A E Barber
C D Parish

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**Registered Office**
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IM2 4RW

**Administrator**
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Isle of Man
IM1 4LE

**Fiduciary Custodian**
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PO Box 119
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Admiral Park
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**Auditors**
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Heritage Court
41 Athol Street
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Isle of Man
IM99 1HN

**Sponsoring Broker**
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*Fortis Prime Fund Solutions (IOM) Limited changed its name to ABN AMRO Fund Services (IOM) Limited on 1 July 2010

# DIRECTORS' REPORT
For the year ended 30 September 2010

The Directors present their annual report and the audited financial statements for the year ended 30 September 2010.

**Principal Activity**

Nedgroup Investment Target Return Fund Plc ("the Fund") is a collective investment scheme managed in the Isle of Man and operates with seven sub funds ("Classes") (2009: four). The Fund is a Full International Scheme under the Collective Investment Schemes Act 2008, and the Institutional US$ Class shares are listed on the Irish Stock Exchange.

**Results and Dividends**

The financial results of the Fund for the year ended 30 September 2010 are set out in the Statement of Total Return. The net expense and capital losses for the year amounted to a loss of US$5,848,738 (2009: US$44,201,642).

No dividend is proposed (2009: nil).

**Directors and Directors' Interests**

The Directors who served during the year and to date are as follows:

A V Lodge
T A Wiltcher
A E Barber *
C D Parrish *
H L Jones (Resigned 15 January 2010)
* Independent non-executives directors

None of the Directors had any interests in the shares of the Fund during the year and to date.

A V Lodge and T A Wiltcher are Directors of Nedgroup Investments (IOM) Limited (the Manager). H L Jones was also a Director of Nedgroup Investments (IOM) Limited.

**Auditors**

As a company incorporated under the Isle of Man Companies Act 2006, the Company is not required to prepare audited financial statements. Notwithstanding this, the members have resolved to have the financial statements for the year end 30 September 2010 audited and consequently our Auditors KPMG Audit LLC, being eligible, have expressed their willingness to continue in continue in office.

# STATEMENT OF DIRECTORS' RESPONSIBILITIES

in respect of the Directors' Report and Financial Statements
for the year ended 30 September 2010

The Directors are responsible for preparing the Directors' Report and the financial statements in accordance with applicable law and regulations. In addition, the Directors have elected to prepare the Group and Parent Company financial statements in accordance with UK Accounting Standards.

In preparing these financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;

- make judgements and estimates that are reasonable and prudent;

- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Group and Parent Company will continue in business.

The Directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the Parent Company and to allow for the preparation of financial statements. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Group and to prevent and detect fraud and other irregularities.

The Directors are responsible for the maintenance and integrity of the corporate and financial information included on the Company's website. Legislation governing the preparation and dissemination of financial statements may differ from one jurisdiction to another.

On behalf of the Board

**A V Lodge**
Director

21 January 2011

# REPORT OF THE INVESTMENT ADVISOR

For the year ended 30 September 2010

**Market Commentary**

2010 has been characterised by very choppy markets, compared to the one-way rally that occurred from the market lows in March 2009 through to the end of that year. In only one month this year has the MSCI World Equity Index moved by less than 1%, and in no fewer than 4 months the move has been greater than 6%. Yet for all this movement, the overall gain for the past 12 months is 7.31%, compared to a gain of 30.79% in 2009, and has been matched by the performance of the JP Morgan Government bond index which has returned 7.38% over the same recent 12 month period.

At the time of writing, the US Federal Reserve ("the Fed") has agreed to another round of quantitative easing – QE2 – that euphemism for printing money that just two years ago would have filled every Central Banker and economist with dread. The Fed's first experiment with bond buying occurred between January 2009 and March of this year and saw it purchase roughly $1.7 trillion in government and mortgage debt. Continued economic stagnation, particularly in the employment and housing markets, has prompted a new planned $600 billion of government bond purchases. This is in addition to the $35 billion a month the Fed has already announced it would spend to replace maturing mortgage bonds that are sitting on its balance sheet. This combined total of $900 billion in US government bond purchases through June of next year is roughly equal to the US government's total projected borrowing needs over that period. Not to be outdone, the European sovereign debt crisis is accelerating, with Ireland having agreed to a European and IMF bailout and with the markets now targeting Portugal, Italy and Spain as the next dominoes to fall.

In normal circumstances, this would be an ideal environment for skilled investors to make money: such volatility usually results in assets becoming mispriced, which astute managers – especially those in the absolute return space – can take advantage of. However, frustratingly, almost the reverse has been true. Our monthly investment commentaries have referred to the "risk-on, risk-off" nature of the market as investor sentiment has flip-flopped from fear to relief and back again. In this environment, fundamentals have been all but ignored; bottom-up stock selectors have generally fared far worse than those with a more top-down approach. This has been true in the long-only world as well as among hedge funds.

**Fund Commentaries**

The Target Return Fund Participating Class was created in December 2009 after "locked-up", "gated" or otherwise liquidity impaired hedge funds in the portfolio were moved into the Target Return Fund Restricted Class. In anticipation of the changes, the liquid holdings in the portfolio were replaced with holdings in absolute return funds regulated under the UCITS III framework. The purpose of these changes was to create a liquid vehicle which could be managed efficiently, without the problems created by a large group of illiquid holdings. More importantly, the move created at least partial liquidity for clients who would be able to redeem their holdings of the Participating Class with seven day's notice on a weekly dealing cycle going forward.

**Target Return Fund Participating Class**

Since the creation of the Participating Class, performance has been disappointing. In the 12-month period through September (which includes two months prior to the fund split), the fund has lost -4.65% while performance since the separation of the restricted assets in December 2009 has been -2.67%. Over the same time period, the HFRX Global Hedge Fund Index has risen by 4.10% and 2.45%, respectively. In perhaps a better comparison given the new focus of the fund and due to the low representation of convertible arbitrage, distressed and other fixed income strategies in the UCITs hedge fund space, there are now indices which track the performance of this specific peer group. Nara Capital in Switzerland calculates the return of their UCITS Alternative Index Global over the same period to be 1.22% with the UCITS Fund of Funds index underperforming the overall index, falling by -2.64% over the past 12 months.

Clearly this has been a difficult period for fund of funds products, both in the UCITS space and in the broader hedge fund arena.

Target Return Fund Participating Class has maintained a cautious approach since its creation. Asset allocation has reflected a bias towards the Relative Value category, which includes Equity Market Neutral and Volatility Arbitrage funds. The other significant exposure has been to Opportunistic funds, which include Global Macro and Equity Long/Short funds. There has also been a limited amount of exposure to Event-Driven funds, but this category is small by default: most event-driven strategies are illiquid in nature and cannot easily be wrapped within the UCITS structure.

TRF has also lagged of late due to the specific under-performance of one of its macro managers, the AVIVA Tactical Asset Allocation Fund, which has struggled to navigate the volatility of the last six months, losing almost 20% of its value and down almost 12% over the past year. The fund enjoyed a very strong run through 2009, and we highlighted it several times in our investment commentaries. But this came to an end this year, particularly in the panic surrounding the Greek debt crisis in March. The Managers had allowed their negative fixed income exposure to become too large, and as they attempted to limit the impact of their positions, the fund was subject to the 'whipsawing' of the market swings from fear to greed. The inability of the macro managers to navigate the current economic landscape was a disappointment during 2010, in contrast to how well they performed in 2008.

**Target Return Fund Restricted Class**

Many hedge fund strategies were adversely affected by the financial and economic crisis of 2008, with funds forced to suspend, extend their dealing notice or lockup periods or liquidate. In response, our Fund was suspended and the notice period extended to better align with the liquidity of the underlying investments. As market conditions became clearer over the latter part of 2009 it was evident that some of the underlying investments would not be able to provide liquidity in line with their agreed terms and conditions. Those assets incapable of realisation in line with the terms when the Fund initially invested in them were transferred to a Restricted Class on 3 December 2009.

The Restricted Class has returned -3.50% since inception through to the period ended 30 September 2010. There has been continued performance deterioration in some of the asset based lending (ABL) managers during 2010 but the news was not all bad; with initially less concentration in ABL and greater exposure to rebounding Asian markets, the TRF Restricted Class has generally performed in line with the unimpaired Participating Class.

At the end of September the Restricted Class held approximately 10% of its value in cash. By the end of the reporting period just under 27% of the original number of shares transferred to the side-pocket had been redeemed and their proceeds returned to the Participating Class. Since its creation five of the impaired assets transferred to the Restricted Class had been redeemed completely by the end of September.

Our liquidity analysis indicates that almost two-thirds of the remaining funds comprising the Restricted Class (representing approximately 51% of current asset by value) are currently making repayments in some form. We are in regular communication with the managers of all the funds in an attempt to maintain an accurate repayment forecast but we must caution that there is often very little certainty from the managers that both the amounts and the timelines will be realised. Current expectations are for an additional 7% of the remaining portfolio balance to be repaid before the end of 2010 with 17% to be received by the end of December 2011. The balance is not expected until 2012 and beyond and will remain at risk of mark-to-market and actual losses in a slow-growth economic environment.

Nedgroup Investments (IOM) Limited
**Manager**

# REPORT OF THE INDEPENDENT AUDITORS

KPMG Audit LLC To the Members of NEDGROUP INVESTMENTS TARGET RETURN FUND PLC

We have audited the financial statements of Nedgroup Investments Target Return Fund plc for the year ended 30 September 2010 which comprise Statement of Total Return, the Balance sheet and the related notes. These financial statements have been prepared under the accounting policies set out therein.

This report is made solely to the Company's members, as a body. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

**Respective responsibilities of Directors and Auditors**

The Directors' responsibilities for preparing the financial statements in accordance with applicable law and UK Accounting Standards are set out in the Statement of Directors' Responsibilities on page 3.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the financial statements give a true and fair view. We also report to you if, in our opinion, the Company has not kept proper accounting records, or if we have not received all the information and explanations we require for our audit.

We read the Directors' Report and any other information accompanying the financial statements and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the audited financial statements. Our responsibilities do not extend to any other information.

**Basis of opinion**

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgments made by the Directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Group's and Company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

**Opinion**

In our opinion the financial statements give a true and fair view, in accordance with UK Accounting Standards of the state of the Group and Parent Company's affairs as at 30 September 2010 and of the Group's net income for the year then ended.

**KPMG Audit LLC**
Chartered Accountants

Heritage Court
41 Athol Street
Douglas
Isle of Man
IM99 1HN

## STATEMENT OF TOTAL RETURN

For the year ended 30 September 2010

| | Notes | 2010 US$ | 2009 US$ |
|---|---|---|---|
| **Income** | | | |
| Interest | 2(d) | 881 | 21,173 |
| Dividends | 2(d) | 1,549,005 | 513,628 |
| Other income | | 264,045 | 26,544 |
| | | 1,813,931 | 561,345 |
| **Expenses** | | | |
| Management fee | 3 | 1,261,985 | 2,455,580 |
| Other expenses | | 32,769 | 223,863 |
| Directors' fees | | 15,805 | 15,919 |
| Administration fee | 3 | 103,186 | 184,967 |
| Audit fees | | 17,200 | 17,113 |
| Custodian fee | 3 | 28,286 | 57,498 |
| | | **1,459,231** | **2,954,940** |
| **Net income/(expenses) for the year** | | **354,700** | **(2,393,595)** |
| **Net realised and unrealised loss on financial assets and financial liabilities at fair value through profit or loss** | | | |
| Movement in unrealised depreciation of financial assets and financial liabilities | | (1,369,522) | (22,244,412) |
| Net realised loss on disposal | | (4,833,916) | (19,563,635) |
| **Net loss on financial assets and financial liabilities at fair value through the profit or loss** | | **(6,203,438)** | **(41,808,047)** |
| **Total return** | | **(5,848,738)** | **(44,201,642)** |

There were no recognised gains and losses other than those reported in the Statement of Total Return, therefore a Statement of Total Recognised Gains and Losses has not been prepared.

The Directors consider that all results derive from continuing activities.

The notes on pages 11 – 23 form an integral part of these financial statements.

# BALANCE SHEET

For the year ended 30 September 2010

| | Notes | 2010 US$ | 2009 US$ |
|---|---|---|---|
| **Current assets** | | | |
| Investments | 6,8 | 65,400,529 | 117,758,114 |
| Due from brokers | | 247,031 | 7,816,887 |
| Bank balances | | 4,926,360 | 6,755,749 |
| **Current assets** | | **70,573,920** | **132,330,750** |
| **Current liabilities** | | | |
| Accrued expenses | | 163,722 | 293,580 |
| Due to broker | | 78,060 | 2,734,426 |
| **Current liabilities** | | **241,782** | **3,028,006** |
| **Net assets** | | **70,332,138** | **129,302,744** |
| **Net assets attributable to holders of participating redeemable preference shares** | | **44,989,470** | **129,302,644** |
| **Net assets attributable to holders of restricted shares** | | **25,342,568** | **-** |
| **Net assets attributable to holders of management shares** | | **100** | **100** |
| | 7 | **70,332,138** | **129,302,744** |

These financial statements were approved by the Board of Directors on 21 January 2011 and signed on their behalf.

**A V Lodge**
Director

**T A Wiltcher**
Director

The notes on pages 11 to 23 form an integral part of these financial statements.

## 1. General

The Fund operates with seven classes (2009: four), the US Dollar Participating Class, the Sterling Participating Class, the Euro Participating Class ("the Participating Classes"), the US Dollar Restricted Class, the Sterling Restricted Class, the Euro Restricted Class ("the Restricted Classes"), and the US Dollar Institutional Class, and maintains a separate funds account for each class.

The Participating Classes and the Restricted Classes were established on 3 December 2009 following the segregation of assets with restricted liquidity. Assets with restricted liquidity were transferred to a separate portfolio representing the Restricted Classes, all other assets held represent the Participating Classes. Shares equivalent to the value of segregated assets were cancelled and new shares in the Restricted Class issued, with the remaining shares re-designated Participating Class Shares. Shares in the Restricted Classes have no dealing rights attached to them.

Upon redemption, shareholders are only entitled to their proportion of the net assets relating to their particular shares. The assets of any class may be exposed to the liabilities of other classes within the umbrella. As at the 30 September 2010 the Directors were not aware of any such existing or contingent liability (2009: none).

The Fund was re-registered under the Isle of Man Companies Act 2006 on 28 April 2009.

## 2. Accounting policies

### (a) Basis of preparation

These financial statements have been prepared in accordance with the historical cost convention as modified by the revaluation of financial assets and financial liabilities at fair value through the profit or loss, and in accordance with UK Accounting Standards.

### (b) Participating redeemable preference shares and restricted shares

Participating redeemable preference share are issued by the Fund and allocated to whichever Sub-Fund is selected by the investor. Shareholders were allocated Restricted Shares on 1 December 2009.

The proceeds of the issue and the income arising are credited to each Sub-Fund which also bears expenses attributable to that Sub-Fund. Joint expenses are allocated to each continuing Sub-Fund. Upon redemption shareholders are only entitled to their proportion of the net assets held in the Sub-Fund to which their Shares have been allocated.

The participating redeemable preference shares are redeemable at the holder's option and are classified as financial liabilities. The participating redeemable shares are carried at the redemption amount that is payable at the balance sheet date if the holder exercises the right to out the shares back to the Fund.

**2. Accounting policies (continued)**

Shares in the Restricted Classes have no dealing rights attached to them.

**(c) Financial assets and financial liabilities at fair value through profit or loss**

As the Fund's business is investing in financial assets and liabilities that are managed and their performance evaluated on a fair value basis in accordance with the Fund's documented investment strategy, such financial assets and liabilities are designed at fair value through profit or loss on initial recognition.

All investment securities are initially recognised at fair value on their trade date. Financial assets at fair value through profit or loss are subsequently re-measured at fair value based on bid-market prices from quoted and unquoted sources. Investments in unquoted funds are valued based on most recently published net asset value available to the Manager from the relevant funds. Financial instruments that are not traded in an active market (for example over-the-counter derivatives) are subsequently re-measured using valuation techniques.

Gains and losses arising from changes in the fair value of securities are recognised in the Statement of Total Return. Realised gains and losses on sale are also included in the Statement of Total Return.

The Fund derecognises a financial asset when the contractual rights to the cash flows from the financial asset expire or it transfers the financial asset and the transfer qualifies for derecognition in accordance with FRS 26.

A financial liability is derecognised when the obligation specified in the contract is discharged, cancelled or expired.

Derivatives are recognised at fair value through profit and loss on the trading date on which a derivative contract is entered into and are subsequently re-measured at their fair value. Fair values are obtained from quoted market prices in active markets, and valuation techniques, including recent market transactions and discounted cash flow models as appropriate.

A forward currency contract is a contract to purchase or sell a specified amount of foreign currency at an agreed future date at an exchange rate determined on the date the contract is made. The contracts are valued at the forward rate and the Company's equity therein, representing unrealised gains or losses on the contracts, is included in net current assets. Realised and unrealised gains and losses are recorded in the Statement of Total Return and taken to the Capital Reserve.

All derivatives are carried as assets when fair value is positive, and as liabilities when fair value is negative. Subsequent changes in the

# NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 September 2010 (continued)

**2. Accounting policies (continued)**

fair value of any derivative instrument are recognised immediately in the Statement of Total Return.

**(d) Income**

Investment income is accounted for on the ex-dividend date or its equivalent and interest income is accounted for on the accruals basis.

**(e) Cash and cash equivalents**

Cash and cash equivalents comprise cash balances held at banks together with bank overdrafts.

**(f) Cash flow statement**

As the Fund is an open ended collective investment scheme and investments are highly liquid and valued at market value, there is no requirement to report a cash flow statement in accordance with Financial Reporting Standard 1 Cash Flow Statements. Changes in net assets are presented in the Reconciliation of Movements in Shareholders' Funds in note 7.

**(g) Foreign exchange**

Transactions in foreign currencies are translated into the base currency of the relevant share classes at the exchange rate ruling at the date of the transaction. Foreign currency assets and liabilities are translated into the base currency of the Fund at the exchange rate ruling at the balance sheet date. Realised and unrealised gains or losses on translation are included with realised and unrealised gains/(losses) on investments in the Statement of Total Return.

Share Capital and Share Premium transactions are translated into US Dollar at the rate of exchange ruling at the date of the transaction. The statement of total return, assets and liabilities are translated into dollars at the rates of exchange ruling at the balance sheet date and aggregated to provide a statement of total return and balance sheet for the Fund. The adjustment in US Dollars arising from the consolidation of the currency Sub-Funds is classified separately in the balance sheet under the heading of "currency adjustment reserve" which has no effect on the value of the net assets allocated to individual currency Sub-Funds. The exchange rates used in the preparation of these financial statements were $1 = £0.6326 and $1 = €0.7347 as at 30 September 2010 (2009: $1 = £0.6282 and $1 = €0.6853).

**3. Fees**

The Manager will be paid a periodic fee equal to 1.75% per annum of the net asset value of the Participating Classes, a fee equal to 0.75% per annum of the net asset value of the Restricted shares and a fee equal to 0.75% per annum of the net asset value of the Institutional Dollar Class, such fees to be calculated on each Dealing Day, accrued and paid at the end of each month.

**3. Fees (continued)**

The Manager is entitled to an initial charge on the issue of Shares up to a maximum of 5% of the Offer Price. The Manager may waive this initial charge in whole or in part and may pay or allow the same to such persons as it sees fit.

A V Lodge and T A Wiltcher are Directors of the Fund and also Directors of the Manager and do not receive a fee. A E Barber and C D Parrish receive a fee of £5,000 each (2009: £5,000 each). H L Jones was also a Director of the Fund and the Manager and did not receive a fee. He resigned on 15 January 2010.

The Administrator receives a fee of 0.13% per annum (2009: 0.10%) of the Net Asset Value of the Participating Classes of the Fund and 0.12% of the Net Asset Value of the Restricted Classes.

The Fund pays to the Custodian a fee of 0.07% of the Net Asset Value of the fund per annum (2009: 0.04%).

**4. Taxation**

The Fund is subject to taxation in the Isle of Man at the rate of 0% on retained profits. (2009: 0%)

**5. Share capital and reserves**

The authorised share capital of the Fund is divided into 100 Management Shares of $1.00 each and 1,000,000,000 Participating Shares of US$0.01 each. The Fund was registered under the Isle of Man Companies Acts 1931-2004 until the 28 April 2009 when it was re-registered under the Isle of Man Companies Act 2006. Prior to re-registration the authorised share capital of the Fund was divided into 100 Management Shares of $1.00 each and 1,000,000,000 Unclassified Shares of US$0.01 each.

Unclassified Shares were issued either as Participating Redeemable Preference Shares ("Shares") or Nominal Shares. Shares were issued and redeemed at prices based on the value of the net assets of the Sub-Fund in which they had been designated at the time of issue or redemption. On redemption of Shares by the Fund, Nominal Shares were issued to the Manager for cash at par on the basis of one Nominal Share for each Share redeemed. Nominal Shares would subsequently be converted and reissued as Shares.

This procedure was carried out in order to comply with the Companies Act 1931-2004; however, upon re-registration there is no longer a requirement to issue or hold Nominal Shares. Therefore, following re-registration the balance of Nominal Shares in issue was cancelled and the amount owing from the Manager in respect of such shares waived.

Since re-registration all shares have been issued as Participating Redeemable Preference Shares ("Shares"). Shares are issued and redeemed at prices based on the value of the net assets of the Sub-Fund in which they had been designated at the time of issue or redemption. Upon redemption of a Share the premium payable is debited to the share premium account of the appropriate Sub-Fund.

**5. Share capital and reserves (continued)**

Should the share premium be fully utilised the premiums on redemption will be charged against other realised reserves.

Restricted Class Shares were issued on 1 December 2009 following the segregation of assets with restricted liquidity. Restricted Class Shares have no dealing rights.

On a poll Participating Shareholders are entitled to one vote for each share held at class meetings only. Holders of Management Shares are entitled to one vote in respect of all Management Shares held. On a show of hands every shareholder who is present shall have one vote. The Fund at a General Meeting may declare dividends on the Participating Shares but no dividend shall exceed the amount recommended by the Directors (if any). No dividends may be declared on the Management Shares.

On a winding up the assets available will be applied: firstly, in the repayment pari passu to the holders of Participating Shares of sums up to the nominal amount paid up thereon: secondly, in the repayment pari passu to the holders of Management Shares of sums up to the nominal amount paid up thereon: thirdly, in the payment to holders of Participating Shares of each class, such payment being made in proportion to the nominal amounts paid up on such Shares.

| | Notes | 2010<br>US$ | 2009<br>US$ |
|---|---|---|---|
| **(a) Authorised share capital** | | | |
| 100 Management shares of 1 dollar each | | 100 | 100 |
| 1,000,000,000 Unclassified shares of 1 cent each | | 10,000,000 | 10,000,000 |
| | | 10,000,100 | 10,000,100 |

# NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 September 2010 (continued)

**5. Share capital and reserves (continued)**

| | Notes | 2010 US$ | 2009 US$ |
|---|---|---|---|
| **(b) Issued share capital** | | | |
| Management shares of 1 dollar each | | | |
| Issued and fully paid | | 100 | 100 |
| **Redeemable shares:** | | | |
| Participating Redeemable Preference Shares | | | |
| of 1 cent each | | | |
| As at 1 October 2009/2008 | | 524,781 | 934,164 |
| Issued during the year | | 68,235 | 79,105 |
| Redeemed during the year | | (410,581) | (488,488) |
| As at 30 September | | 182,435 | 524,781 |
| Restricted shares of 1 cent each | | | |
| As at 1 October 2009/2008 | | - | - |
| Issued during the year | | 244,836 | - |
| Redeemed during the year | | (66,124) | - |
| As at 30 September | | 178,712 | - |
| Nominal shares of 1 cent each | | | |
| As at 1 October 2009/2008 | | - | 231,179 |
| Issued during the year | | - | 355,736 |
| Redeemed during the year | | - | (586,915) |
| As at 30 September | | - | - |
| Total issued share capital as at 30 September 2010 | | 361,247 | 524,881 |
| **Redeemable shares:** | | | |
| Number of Participating redeemable preference shares | | | |
| As at 1 October 2009/2008 | | 52,478,050 | 93,416,410 |
| Issued during the year | | 6,823,453 | 7,910,512 |
| Redeemed during the year | | (41,058,141) | (48,848,872) |
| As at 30 September | | 18,243,362 | 52,478,050 |

# NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 September 2010 (continued)

## 5. Share capital and reserves (continued)

| | Notes | 2010 US$ | 2009 US$ |
|---|---|---|---|
| **(b) Issued share capital (continued)** | | | |
| Number of Restricted shares | | | |
| As at 1 October 2009/2008 | | - | - |
| Issued during the year | | 24,483,569 | - |
| Redeemed during the year | | (6,612,438) | - |
| As at 30 September | | 17,871,131 | - |
| **Nominal shares:** | | | |
| Number of Nominal shares | | | |
| As at 1 October 2009/2008 | | - | 23,117,963 |
| Issued during the year | | - | 35,573,577 |
| Redeemed during the year | | - | (58,691,540) |
| As at 30 September | | - | - |
| **(c) Share premium** | | | |
| As at 1 October 2009/2008 | | 119,221,732 | 215,907,765 |
| Relating to issue of shares | | 46,376,724 | 84,941,929 |
| Relating to redemption of shares | | (99,334,961) | (181,627,962) |
| As at 30 September | | 66,263,495 | 119,221,732 |
| **(d) Capital reserve** | | | |
| As at 1 October 2009/2008 | | 38,571,620 | 80,379,667 |
| Movement in unrealised appreciation of financial assets And financial liabilities at fair value through profit or loss | | (1,369,522) | (22,244,412) |
| Net realised (loss) on disposal of financial assets and Financial liabilities at fair value through profit or loss | | (4,833,916) | (19,563,635) |
| As at 30 September | | 32,368,182 | 38,571,620 |
| **(e) Revenue reserve** | | | |
| As at 1 October 2009/2008 | | (23,629,291) | (21,235,696) |
| Net income/(expenses) for the year | | 354,700 | (2,393,595) |
| As at 30 September | | (23,274,591) | (23,629,291) |
| **(f) Currency adjustment reserve** | | | |
| As at 1 October 2009/2008 | | (5,386,198) | (5,386,198) |
| Movement during the year | | - | - |
| As at 30 September | | (5,386,198) | (5,386,198) |

# NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 September 2010 (continued)

### 6. Investments

| | Notes | 2010 US$ | 2009 US$ |
|---|---|---|---|
| Cost at 30 September | | 68,217,063 | 119,207,669 |
| Revaluation | | (2,816,534) | (1,449,555) |
| Valuation at 30 September | | 65,400,529 | 117,758,114 |

Included in the 2010 figures above are the investments with a value of US$22,841,796 (2009: $36,007,781) that are subject to restricted liquidity and comprise the Restricted Class Sub-Funds (2009: were transferred to Sub-Funds with restricted dealing terms subsequent to the year end).

Redemption notices have been issued to all underlying investments comprising the Restricted Class Sub-Funds and as cash is received proceeds are periodically transferred to the Participating Class Sub-Funds from where shareholders may elect to remain invested or redeem.

### 7. Reconciliation of movement in shareholders' funds

| | Notes | 2010 US$ | 2009 US$ |
|---|---|---|---|
| Shareholders' funds | | | |
| As at 1 October 2009/2008 | | 129,302,744 | 270,830,981 |
| Net income/(expenses) for the year | | 354,700 | (2,393,595) |
| Net decrease from the redemption of shares | | (53,121,868) | (97,326,595) |
| Movement in unrealised depreciation of financial Assets and financial liabilities through profit or loss | | (1,369,522) | (22,244,412) |
| Net realised (loss) on disposal of financial assets and Financial liabilities through profit or loss | | (4,833,916) | (19,563,635) |
| Currency adjustment reserve | | - | - |
| As at 30 September | | 70,332,138 | 129,302,744 |

### 8. Financial instruments and risk exposure

In accordance with FRS29, this note details the way in which the Fund manages risks associated with the use of financial instruments. The day to day risk management of the Fund is undertaken by the Investment Advisor. Investment in the Fund carries with it a degree of risk including, but not limited to, the risks referred to below.

The Fund, in the normal course of business, enters into investment transactions in a variety of derivative and non-derivative financial instruments. The value of these financial instruments in the financial statements approximates their fair value.

**8. Financial instruments and risk exposure (continued)**

The holding of such instruments gives exposure to market price risk, currency risk, interest rate risk, credit risk and liquidity risk. This note represents information about the Fund's exposure to each of the above risks, the Fund's objectives, policies and processes for measuring and managing risk, and the Fund's management of capital. Further quantitative disclosures are included throughout these financial statements.

The Board of Directors has overall responsibility for the establishment and oversight of the Fund's risk management framework. The Board has appointed the Investments Committee of the Manager and Investment Advisor as responsible for developing and monitoring the Fund's risk management policies. The Investment Committee meets monthly and reports regularly on its activities.

The Investment Committee's risk management policies are established to identify and analyse the risks faced by the funds they advise on using appropriate risk analysis techniques, to set appropriate risk limits and controls, and to monitor risks and adherence limits. Risk management policies and systems are reviewed regularly to reflect changes in market conditions and funds' activities. The Investment Committee, through its training and management standards and procedures, aims to develop a disciplined and constructive control environment in which all employees of the Manager and Investment Advisor understand their roles and obligations.

**Market price risk**

The Fund's financial assets and future cash flows are susceptible to market price risk arising from uncertainties about future values of instruments. Ongoing risk controls and systems after investment include qualitative and quantitative analysis.

Qualitative analysis – regular meetings with each utilised manager are conducted. There is a monthly process of summarising the performance drivers of each of the funds held in the portfolios. Anomalies in the returns, or deviations from expectations, are investigated, and contact is made with the manager. If this proves unsatisfactory, a review process is undertaken, potentially including an on-site meeting with the manager where required.

Changes in historic and expected correlations across strategies are monitored, and the impact this has on the portfolio's expected risk and return characteristics.

Each fund's risk profile is considered, and its marginal contribution to portfolio's net risk values calculated.

**8. Financial instruments and risk exposure (continued)**

**Market price risk (continued)**

If the investment portfolio valuation fell by 1% from the amount detailed in the financial statements as at 30 September 2010 it would have had the effect, with all other variables held constant, of reducing net capital return before taxation by US$654,005. An increase in the investment portfolio valuation would have an equal and opposite effect on the net capital return before taxation.

**Currency risk**

Currency risk is the risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates. Currency risk arises on financial instruments that are denominated in a currency other than the functional currency in which they are measured. The net asset values per share of the Fund are computed in U.S. Dollars whereas the investments of Fund may be acquired, valued and disposed of in other currencies. The U.S. Dollar value of the investments of the Fund designated in another currency may rise and fall due to exchange rate fluctuations in respect of the relevant currency.

At 30 September 2010 the Fund had the following currency exposure:

| | % of Net Assets |
|---|---|
| Sterling | 23.72% |
| Euro | 5.22% |

The Fund enters into forward currency contracts in order to hedge against foreign currency exchange rate risk. The amount of the contract represents the extent of the Fund's participation in these financial instruments. Market risks associated with forward contracts arise due to the possible movements in foreign exchange rates underlying these instruments. Other market and credit risks include the possibility that there may be an illiquid market for the contracts, that the change in value of the contract may not directly correlate with the changes in the value of the underlying currencies or that the counterparty defaults on its obligation to perform under the terms of the contract.

### 8. Financial instruments and risk exposure (continued)

As at 30 September 2010 the Fund held open forward contracts as set out below:

| Purchase Currency Contractual Amount | Sale Currency Contractual Amount | Date | Unrealised (loss)/gain US$ |
|---|---|---|---|
| **Sterling Class Participating** | | | |
| £4,390,951 | US$6,968,000 | 29/10/2010 | (63,422) |
| **Euro Class Participating** | | | |
| €1,336,902 | US$1,823,000 | 29/10/2010 | (2,559) |
| **US Dollar Participating** | | | |
| $3,160,000 | €2,500,000 | 12/10/2010 | (244,681) |
| $13,520,000 | £8,829,676 | 12/10/2010 | (365,977) |
| **Sterling Class Restricted** | | | |
| £6,239,209 | US$9,901,000 | 29/10/2010 | (90,117) |
| **Euro Class Restricted** | | | |
| €1,340,569 | US$1,828,000 | 29/10/2010 | (2,566) |

As at 30 September 2009 the Fund held open forward contracts as set out below:

| Purchase Currency Contractual Amount | Sale Currency Contractual Amount | Date | Unrealised (loss)/gain US$ |
|---|---|---|---|
| **Sterling Class** | | | |
| £20,479,379 | $32,724,000 | 31/10/2009 | 77,189 |
| **Euro Class** | | | |
| €3,988,912 | $5,814,000 | 31/10/2009 | (4,265) |
| **US Dollar Class** | | | |
| $2,412,000 | £1,454,172 | 30/10/2009 | (95,104) |
| $13,520,000 | €9,430,803 | 09/10/2009 | 240,485 |

Based on a 1% movement in Sterling and the Euro against US$ exchange rates, the effect on profit for the year would be as follows:

| | Sterling US$ | Euro US$ |
|---|---|---|
| 1% stronger against US$ | 33,490 | 4,910 |
| 1% weaker against US$ | (33,490) | (4,910) |

### Interest Rate Risk

The majority of the Fund's financial assets and financial liabilities are non-interest bearing. As a result, the Fund is not subject to significant amounts of risk due to fluctuations in the prevailing levels of market interest rates. Any excess cash and cash equivalents are invested at short term market rates.

The Fund's only interest bearing financial instrument is cash on deposit of US$4,926,360 (2009: US$6,775,749) which reprises in less than one month. If interest rates had increased by 10% over the period with all other variables remaining equal, it would have had the effect of increasing net revenue by US$88. If there had been a decrease in the interest rates of 10% then there would have been an equal and opposite effect in terms of net revenue return.

### Credit Risk

All of the Fund's financial assets are subject to credit risk and the maximum exposures to such risk are stated in the Balance Sheet. All investment funds in which the Fund invests are "principal's markets" in which they are fully subject to the risk of counterparty default. There is a significant amount of credit risk associated with these investments and the ability of the underlying fund to pay out redemption requests. The Fund manages this risk performing ongoing quantitative and qualitative reviews in order to approve and monitor counterparties. Details of any concentrations of credit risk by strategy are summarised below.

### Liquidity risk

Liquidity risk is the risk that the Fund will not be able to settle or meet its obligations in a timely manner or at a reasonable price. The primary source of the Fund's liquidity risk is from redemptions of its redeemable preference shares held by investors. Because the majority of the Fund's assets are not traded in active markets and are generally illiquid, the Fund may not be able to meet its obligations if forced to liquidate such illiquid assets.

| Strategy | Allocation in portfolio As at 30 September |
|---|---|
| Asset Backed Lending | 29.9% |
| Cash | 5.7% |
| Convertible arbitrage | 4.6% |
| Credit arbitrage | 0.3% |
| Distressed | 14.1% |
| Equity market neutral | 9.7% |
| Event driven | 6.4% |
| Fixed income arbitrage | 7.6% |
| Global Macro | 8.1% |
| Long/short global | 8.7% |
| Long/short US | 1.0% |
| Volatility arbitrage | 3.9% |

# NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 September 2010 (continued)

**Liquidity risk (continued)**

Furthermore, the values generated from such forced liquidations of its generally illiquid assets may be significantly less than their carrying amounts.

Under normal circumstances the Fund manages its liquidity risk by investing predominantly in funds that it expects to be able to liquidate at short notice. However, included in the balance sheet are investments with a value of US$22,841,796 that are subject to restricted liquidity (2009: 36,007,781)

The remainder of the portfolio has the following maturity profile.

| Dealing Terms | Proportion of Portfolio |
|---|---|
| Within 7 days | 89.54% |
| 150 days | 7.40% |
| 180 days | 3.06% |

Below is a maturity analysis of the financial liabilities:

| | 0-1 month US$ | 1-3 months US$ | 3-12 months US$ | Total US$ |
|---|---|---|---|---|
| Due to Broker | 78,060 | - | - | 78,060 |
| Participating redeemable Preference shares | 44,911,410 | - | - | 44,911,410 |
| Total | | | | 44,989,470 |

Participating redeemable preference shares are redeemed on demand at the holder's option.

During the year the fund manages its liquidity risk in various ways including increasing the notice requirement for redemption from 7 days to 65 days, changing the payment period from 5 to 10 days after the effective date of the redemption and limiting the aggregate amount of redemptions in any one redemption date to 5% of the net asset value. The Directors also have the ability under certain defined circumstances to suspend all dealing of shares and utilised these powers during the year in order to change the way in which the liquidity risk was managed.

**9. Related party transactions**

A V Lodge and T A Wiltcher, each a Director of the Fund, are also Directors of the Investment Manager. Investments include an investment of US$2,430,053 in Nedgroup Investments Premium Portfolio which is managed by the Investment Manager. H L Jones was also a Director of the Fund and the Investment Manager and resigned on 15 January 2010.

# SHAREHOLDERS' FUNDS BY CURRENCY CLASS

For the year ended 30 September 2010

| | Net asset value | 2010 Number of shares in issue |
|---|---|---|
| US$ Participating Class | US$15,972,599 | 12,906,130.56 |
| Sterling Participating Class | £4,336,724 | 3,640,163.80 |
| Euro Participating Class | €1,356,616 | 1,500,408.54 |
| US$ Restricted Class | US$13,651,629 | 11,115,253.85 |
| Sterling Restricted Class | £6,272,167 | 5,269,024.94 |
| Euro Restricted Class | €1,340,731 | 1,486,852.51 |
| Institutional US$ Class | US$20,348,461 | 196,658.90 |
| **Total participating redeemable preference shares in issue** | | **36,114,493.10** |

| Net asset value per share | Net asset value | 2009 Number of shares in issue | Net asset value per share |
|---|---|---|---|
| US$1.2376 | US$40,840,118 | 31,612,815.74 | US$1.2919 |
| £1.1914 | £20,438,177 | 16,263,138.66 | £1.2567 |
| €0.9042 | €3,951,628 | 4,151,720.68 | €0.9518 |
| US$1.2282 | US$ - | - | US$ - |
| £1.1904 | £ - | - | £ - |
| €0.9017 | € - | - | € - |
| US$103.4708 | US$49,942,373 | 450,375.16 | US$110.89 |
| | | **52,478,050.24** | |

**NOTICE IS HEREBY GIVEN** that the Annual General Meeting of the Company will be held on 1 March 2011 at First Floor, Samuel Harris House, St George's Street, Douglas, Isle of Man at 10.00am for the purpose of transacting the following business:

1. To approve the minutes of the previous Annual General Meeting of the Company held on 4 May 2010.

2. To ratify the acts of the Directors.

3. To consider and approve the Annual Report and Audited Financial Statements of the Company for the year ended 30 September 2010.

4. To re-appoint KPMG Audit LLC as auditors of the Company and to authorise the Directors to fix their remuneration.

5. To transact any other ordinary business of the Company.

Dated 21 January 2011

First Floor
Millenium House
Victoria Road
Douglas
IM1 1EU

On behalf of the Board

**AV Lodge**
Director

NOTE: In accordance with Article 27.00 (c) the holders of Participating Shares shall be entitled to receive notice of and attend (but not speak at) General meetings.

**Address**
First Floor, Samuel Harris House,
St George's Street, Douglas,
Isle of Man IM1 1AJ



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