



Monthly Letter to Investors – May 2014

In May, the Fund's NAV jumped +13.23% and easily outperformed its salient benchmark by 205 basis points after the MSCI EME Index only rose by 11.17%.

The Investment Advisor is pleased to report that in May 2014, the firm's total assets under management ("AUM") once again reached US\$238 million, exactly 100% more than its pre-crisis peak of US\$119 million in May 2008 and only a notch below the all-time-high of \$276 million reached in December 2013. The firm's other strategy, called the Diamond Age Atlas Fund, which was launched in July 2012, returned +19% in May, while it was up a remarkable +21% over the full 2013 calendar year. The Investment Advisor is also pleased to report that according to the new ranking of Russian hedge funds compiled by SPEAR's Russia, the Diamond Age Atlas Fund came third out of the 33 different funds and fund managers which were ranked for their performance and Sortino ratio. In fact, the Diamond Age Atlas Fund is actually number one in its investment universe since the first two funds have completely different mandates and do not invest in Russia. *...Continued on the next page*

International Business Partners and Terms		Historical Performance										
<i>Investment Advisor</i>	<i>Diamond Age Capital Advisors Ltd.</i>		2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
<i>Administrator</i>	<i>CIBC Bank and Trust Co. (Cayman) Ltd.</i>	Jan	-	13.67%	1.29%	-10.44%	-11.34%	-0.79%	0.50%	20.43%	12.19%	-21.96%
<i>Russian Custodian</i>	<i>Citigroup – ZAO Citibank (Russia)</i>	Feb	2.24%	2.73%	5.70%	2.75%	-11.37%	0.03%	-3.09%	2.83%	-4.34%	-0.86%
<i>Auditors</i>	<i>Deloitte – Cayman Islands</i>	Mar	-0.27%	4.05%	-0.29%	-3.48%	20.53%	11.16%	1.30%	-3.75%	-13.84%	-16.25%
<i>Tax Consultants</i>	<i>Ernst & Young – Russia and Cyprus</i>	Apr	-2.54%	8.80%	1.88%	3.03%	20.86%	1.02%	2.42%	-3.62%	-3.98%	-5.16%
<i>Legal Counsel</i>	<i>Campbells – Cayman Islands</i>	May	-0.51%	-3.78%	-0.71%	9.17%	18.71%	-21.49%	-13.14%	-21.98%	-2.35%	13.23%
<i>Base Currency</i>	<i>US Dollar</i>	Jun	1.84%	-1.67%	2.88%	-7.02%	-3.28%	-2.00%	-4.88%	0.42%	-7.18%	
<i>Advisory Fee</i>	<i>2% per annum</i>	Jul	7.77%	0.37%	1.75%	-13.09%	3.37%	7.72%	6.17%	0.38%	5.60%	
<i>Performance Fee</i>	<i>20% of profits above hurdle rate</i>	Aug	8.76%	2.33%	-4.69%	-8.69%	1.93%	-4.96%	-26.65%	-2.52%	-4.91%	
<i>Hurdle Rate</i>	<i>US Dollar 3-month LIBOR + 50 bps</i>	Sep	12.64%	0.01%	5.07%	-10.76%	18.41%	12.14%	-30.60%	2.13%	12.45%	
<i>Inception Date</i>	<i>18 February 2005 at US\$100 per share</i>	Oct	-6.56%	3.70%	4.99%	-35.75%	10.24%	6.31%	22.32%	-1.85%	5.63%	
<i>Dealing Day</i>	<i>Friday</i>	Nov	7.49%	5.36%	-2.96%	n/a	3.66%	-0.13%	-22.84%	-1.76%	-3.06%	
<i>Subscriptions</i>	<i>Weekly</i>	Dec	7.33%	9.49%	0.80%	n/a	8.34%	16.66%	4.55%	9.38%	5.92%	
<i>Redemptions</i>	<i>Monthly, 14-day notice</i>	Year	43.27%	53.70%	16.26%	-57.73%	103.00%	21.92%	-55.48%	-5.12%	-1.43%	-30.42%
<i>Min. Subscription</i>	<i>US\$100,000</i>	NAV Data, Current Asset Allocation										
<i>ISIN</i>	<i>KYG2863P1090</i>	Fund Price (W/Avg), Main Class		Bid \$77.22; Offer \$77.58								
<i>CUSIP</i>	<i>G2863P 10 9</i>	Designated Investment Share Class		\$58.69								
<i>Bloomberg Ticker</i>	<i>DIAMRUS KY <Equity> <Go></i>	Total Fund Assets (AUM)		\$8,804,567								
		Total Firm AUM		229,393,173								
		Long		143.8%								
		Short		0.0%								
		Gross		143.8%								
		Net		143.8%								
		Leverage		43.8%								



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You can review this publication via the following link (below) and in the attached PDF file. You can also read an interview with the Investment Advisor on the last page of this publication.

<http://pbwm.ru/articles/rejting-rossiyskih-hedzh-fondov-spear-s-russia>

In this monthly Letter to Investors, the Fund would like to expand on the “Chinese” chapter of the Russian economy and what it means for the future of Russia, its economy and its companies. In the first part of this analysis the Investment Advisor will cite his long-standing Moscow-based “sell-side” colleague Kingsmill Bond, Chief Strategist, Sberbank Investment Research. In the second part the Investment Advisor will outline his thoughts on how China’s middle class will develop over the next 10 years, and what this might mean for Russia and the rest of the world.

From Kingsmill Bond:

“Asia is growing in importance for Russia. After five years of rapid growth, 22% of Russian exports in 2013 were to Asia, 33% of imports were from Asia, and 11% of hydrocarbons were sent directly to Asia. Plenty of growth is yet to come. Russia’s share of imports from China is in line with global peers, but its share of exports is comparatively low. Asian banks have made 9% of international loans to Russia, and Asian investors own only 3% of the identified foreign equity free float. The Power of Siberia pipeline is one of a number of deals that we expect to increase Russia’s links with Asia. By 2025, we expect Russia to be sending 24% of its hydrocarbon exports directly to Asia, and we believe that infrastructure and financial links will develop.

The Asian pivot is not a new investment theme. The dramatic increase in imports from Asia can be dated back to the mid-1990s and the major shift in exports to Asia to 2009. Having an alternative to the West should provide some support for the Russian markets both as a source of new capital and as a reason for the West to repair relations.

Two main plays on the shift – contractors and facilitators. Contractors are companies like Gazprom, InterRAO UES or RusHydro for which the investment impact of ties to Asia is a complex balance between new capex and higher sales. As a rule, the NPV of new projects tends to be limited. Facilitators are the main beneficiaries. Facilitators are companies like Globaltrans, TMK, or Mostotrest that should benefit from increased economic activity.

Some companies may receive Asian capital in the form of debt (e.g. Novatek), asset sales (e.g. Mechel) or equity sales (e.g. VTB). The investment impact of this is very stock-specific, but Mechel could be a primary beneficiary.

In all the enthusiasm about the rise of the new, it is important not to forget the old. Europe accounts for 64% of Russian exports, 51% of imports, 54% of the foreign-held equity free float and 75% of international bank loans to Russia.”

The above is a good outline, but it might be difficult – for a portfolio investor – to see clear multiple investment opportunities off that “Chinese” theme. Instead, let’s go back to the Investment Advisor’s multi-year thesis about the rising Chinese investment and consumer demand... This thesis is only getting stronger, and it will have a profound global effect on many countries and their economies around the globe, including Russia.

100 to 150 million people. What do these numbers tell you? The entire population of Russia in the next 10 years?

We have yet other definitions.

Sector Allocation	
Oil - Integrated	14.90%
Financials	14.12%
Telecoms	13.01%
Gas Utilities	9.46%
Metals and Mining	5.64%
Chemicals	4.88%
Industrials	4.79%
Consumer Durables	4.70%
Fisheries	4.64%
Construction/Infrastructure	4.62%
Media	3.28%
Oil field service	2.56%
Electrical Utilities	2.39%
Retail	2.21%
Conglomerate	1.99%
Agriculture	1.63%
Real Estate	1.48%
E & P	1.40%
Airlines	1.23%
Foods	1.09%
Total	100%

How children aged 5 to 15 are being brought up in Russia? How and what do Russian young men and women aged 15 to 25 study? What will they become? Depending on what they will become will depend what Russia will become in 10, 20, 30 years from now.

The USA welcomes students from all over the world. They are classified as “foreign students”, and in many US universities, the proportion of foreign students has already reached 50%. U.S. universities enrolled nearly 100,000 Chinese students between 2009 and 2012, and Chinese students now comprise about a quarter of all foreign students in the United States. At the University of Minnesota alone, more than 1,000 Chinese students have enrolled since the school opened a recruiting office in Beijing in 2009. Chinese students currently make up more than 40 percent of the university’s foreign student population.

Geographic Dispersion	
Russia	67.04%
South Korea	8.09%
Ukraine	7.89%
Thailand	4.64%
Turkey	4.62%
Kazakhstan	4.41%
Europe	2.80%
Guinea	0.51%
Total	100%

According to the 2012/2013 Open Doors Report, China sent 235,597 students to study in the United States last year, making it the biggest contributor of students. This was an increase of 21 percent from the previous year.

We only cite hard numbers about Chinese students who go to study in the US, and their annual increase. Young men and women from China also study in Canada, the UK, Switzerland, France, Germany and many other western countries.

Let’s talk about the key implication of these trends.

During the next ten years, the most dynamic economic growth, even a boom, will occur among the exponentially growing China’s middle class. According to economists and demographers this segment – the Chinese middle class – will reach 100 to 150 million people in ten years. Only in ten years from now. Just think about it.

And then calculate how many Chinese will receive higher education in the US in the next 10 years. If the annual growth rate of those studying in the US from China remains at 20% for the next 10 years, then over 6 million young Chinese men and women will have received higher education in the US alone – and that’s not counting other countries! They will return to China well-educated and equipped with American experience in studying, living and – for many – working in the US. With strong English language skills, and more. With “American values”. We believe that this number could well be multiplied by a factor of three, in order to estimate how many Chinese students will study in other western countries excluding the US – this is about another 18 million people. So, about 25 million Chinese will have received western higher education within the next ten years. And they will be a locomotive of the Chinese middle class, numbering 100 to 150 million.

Please refer to previous Letters to Investors outlining implications of mass-urbanization process in China, combined with the middle class consumer basket equaling many multiples of the same, typical for poorer people in rural areas. Russia will definitely want to help in satisfying this future wall of demand. And that’s how the Fund will be investing in the next 10 years – among other strategies, it will be searching for Russian and other companies which stand to benefit from this demand from the Chinese middle class, projected to equal the entire population of Russia.

<http://www.iie.org/en/Research-and-Publications/Open-Doors/Data/International-Students/Leading-Places-of-Origin/2011-13>

<http://studyinthestates.dhs.gov/2014/01/number-of-chinese-students-studying-in-the-united-states-increases>

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