

Diamond Age Russia Fund



Monthly Letter to Investors – February 2014

The “Shattered Hopes Edition: Russia gets even cheaper”

In February, the Fund was able to outperform the continued collapse of the Russian stock market. While in January the RTS Index dropped 9.99% and the MSCI Russia Index tumbled 10.12%, February brought no relief. The RTS Index fell by another 2.59% in February, while the MSCI Russia Index fared no better, with a 2.40% drop. However, the Fund outperformed and was down only marginally by 0.85%.

In the January Letter to Investors the Investment Advisor outlined several compelling reasons why its portfolio had a long bias stance at such valuations. Precisely the same rationale applies to the current month on a 12-month horizon, while the Investment Advisor would also like to emphasize the following: due to a significant rouble devaluation since the start of the year, some companies will be massive winners, and some companies will be massive losers. It is obviously the Fund’s task to buy long the former and to sell short the latter. As just one example...

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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%	
<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%	
<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%	
<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%	-22.63%
<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 \$85.34; Offer \$86.27								
<i>CUSIP</i>	<i>G2863P 10 9</i>	Designated Investment Share Class		\$63.05								
<i>Bloomberg Ticker</i>	<i>DIAMRUS KY <Equity> <Go></i>	Total Fund Assets (AUM)		\$9,695,723								
		Total Firm AUM		\$239,273,901								
		Long		173.7%								
		Short		0.0%								
		Gross		173.7%								
		Net		173.7%								
		Leverage		73.7%								

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...NLMK (one of Russia's largest steel-making companies with an international asset / production facility dispersion) estimates that each rouble to US dollar devaluation will result in an extra EBITDA gain of US\$75 million. Not bad, especially given that the company doesn't have to do anything to achieve this result. This might not be great for the country in the long run, or for the average Russian, but it could be very profitable for a large number of companies.

As a side note to this month's Letter to Investors, the Investment Advisor would like to remember something rather interesting from exactly two years ago. The then Prime Minister Vladimir Putin was running for his third term as Russia's President, and the elections were scheduled for the beginning of March 2012. Two days prior to the Election Day, the Investment Advisor received a telephone call from the Russian edition of Forbes magazine, with a request to write an article looking at the Russian stock market through the prism of the Presidential elections, or, to put it another way, looking at the Presidential elections through the prism of the Russian stock market. The Investment Advisor had only one night to think about, write and finalize the draft, but it was ready for the on-line version of Russian Forbes the next morning. With the benefit of hindsight, looking back from 2014 to 2012... how naïve the Investment Advisor was then!!! We re-post the Investment Advisor's article in the Russian Forbes from March 2012 right now, below. President Putin did NOT listen.

Sector Allocation	
Financials	19.68%
Gas Utilities	12.86%
Telecoms	9.80%
Oil - Integrated	8.90%
Metals and Mining	8.43%
Industrials	5.67%
Electrical Utilities	4.51%
Media	4.39%
Conglomerate	4.04%
Fisheries	3.46%
Real Estate	3.29%
Construction/Infrastructure	3.25%
Consumer Durables	3.10%
Chemicals	2.35%
Retail	1.45%
Agriculture	1.22%
Information Technology	1.09%
Oil field service	0.36%
Total	100%

A contract with the opposition – or how to drive up the stock market

The Chief Executive Officer of Diamond Age Capital Advisors gives advice to Russia's presidential candidate

March 2, 2012

<http://www.forbes.ru/investitsii-column/tsennye-bumagi/79658-kontrakt-s-oppozitsiei-ili-kak-putin-mog-zastavit-rasti-fond>

On the eve of International Women's Day this year, the Kremlin will almost certainly present a welcome gift to every Russian woman: an encore from Mr. Putin. The hopes and aspirations of millions of Russian women will come true, just like in the famous song about "someone like Putin" (<http://youtu.be/uWasqyZmQrM>).



But what would have happened if Russia had held a "fair and honest" presidential election? I don't think anyone has any doubt – Vladimir Putin would still have won. Anyone who is familiar with "practical politics", or can at least imagine what it is, will tell you that in the upcoming elections there is no alternative to Mr. Putin.

And not because there are no any worthy candidates among Russia's population of 140 million, but for the simple reason that there is no politician in Russia who even remotely approaches Putin in popularity. Vladimir Putin was able to become and remain popular among Russians, he is able to capitalize on his popularity by winning the elections, and he can then implement everything that in his view is necessary.

Given the lack of institutionalized government in the mould of western democracies, a change of power along western lines does not and never will exist in Russia as long as our modern institutions of state power meet the hopes and aspirations of the people, and the people – all of them – do not require an institutional process in the real meaning of the term. In the meantime, more than 50% of the Russian people honestly and frankly want “someone like Putin.”

In December 2011, the Russian stock market fell by 10% against a positive external background when Western markets were going up! “Corrupt” Western media showed “Russia under a tsunami of demonstrations” – and as we know, that unnerves investors. Fund managers in Boston, London, Frankfurt, and Hong Kong don’t like to ask questions and wait for answers – they sell first, then start asking questions only after the next CNN report from Moscow.

The weakness of the Russian market after the parliamentary elections proved to be an excellent buying opportunity! But Western investors, as well as major Russian investment companies, followed their herd instinct and headed for the exit – driven largely by CNN, BBC World Service, Euronews, FT, WSJ and The Economist.

In 1998, some of these media featured investors who held views on Russia such as: “We’d rather eat nuclear waste than invest in Russia again.”

But since then, Gazprom’s market capitalization has increased by factor of 50. The company Mail.ru owns a significant stake in Facebook. St. Petersburg and its suburbs have become Russia’s Detroit. Russia is the third largest creditor nation in the world.

Of course, the long years of Vladimir Putin’s rule have been, are being, and will be accompanied by massive corruption throughout the country, corruption on a cosmic scale. Mr. Putin will tell you that himself.

But the people really want Putin. Only a small proportion does not. What does Mr. Putin have to do to keep the wolves well fed and the sheep safe? As the English saying goes, he’ll have to reinvent himself politically. If he is highly popular, he should provide political patronage to at least part of the so-called liberal reformers such as Alexei Kudrin and Mikhail Prokhorov... and even to some extent Alexei Navalny. It will let off steam on Bolotnaya Square, and the safety and security of Putin’s circle will be assured – the only requirement is a new “contract.”

And if, at least to some extent, a new “contract” is signed, that, multiplied by Russia’s WTO membership, will ensure more sustainable growth while improving the economy’s overall efficiency and investment climate. Corporate profits will rise, multiples will become more attractive to investors compared to their current levels – which are at their lowest for years – and valuations will increase. So now is the time to buy! Just give us a new “contract.”

By the way, just in case no one has noticed – the Russian stock market has risen by 25% since the beginning of the year. Is this perhaps because it is precisely this scenario of a new “contract” which the market has been anticipating?

True, during this period the external background was also positive, with the S&P500 rising 9%. But here in Russia you can feel that sentiment has improved significantly. To a large extent, this is because the possibility of a new “contract” will help avoid fulfilling the prophecies of the Holy Fool in Mussorgsky’s opera “Boris Godunov” (http://youtu.be/hRWj_p6iwM): “And darkness will fall, a gloomy, impenetrable darkness. Sorrow, sorrow, weep, weep, O starving people of Russia...”.

Give us a new “contract” – and watch the Russian stock market rise by 50% in 2012, with good forecasts for the next 5 years.

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