DIAMOND AGE RUSSIA FUND

MONTHLY LETTER TO INVESTORS – APRIL 2010

"After morphing into a regional dislocation, the Greek crisis is now going global," Mohamed El-Erian, **CEO PIMCO**

Diamond Age is up 188% since its restructuring in February 2009, but posted a modest +1.02% return in April. The return is slightly below the benchmark although the Fund remains well ahead of this year's Russian stock indices and MSCI EME benchmark. The Fund's 2010 YTD result is +11.44% and trailing twelve months (TTM) with 97.64% increase.

Bloomberg ticker	Name	TTM %	YTD %
DIAMRUS KY Equity	**Diamond Age**	**97.64%**	**11.44%**
MXMU Index (benchmark)	**MSCI EM Europe**	**75.36%**	**6.41%**
RTSI$ Index	RTS Russian Index	88.85%	8.88%
INDEXCF Index	MICEX Russian Index	56.03%	4.82%
MXEF Index	MSCI Emerging Markets	53.91%	3.09%

International Business Partners and Terms

Investment Advisor	*Diamond Age Capital Advisors, Ltd.*
Administrator	*CIBC Bank and Trust Co. (Cayman)*
Russian Custodian	*CitiGroup – ZAO Citibank (Russia)*
Auditors	*Deloitte & Touche – Cayman Islands*
Tax Consultants	*Ernst & Young – Russia and Cyprus*
Legal Counsel	*Turner & Roulstone – Cayman Islands*
Base Currency	*US Dollar*
Hurdle Rate	*US Dollar 3-month LIBOR + 50 bps*
Inception Date	*18 February 2005*
Dealing Day	*Friday*
Min. Subscription	*$100,000*
Bloomberg Ticker	*DIAMRUS KY <Equity> <Go>*

Current Asset Allocation

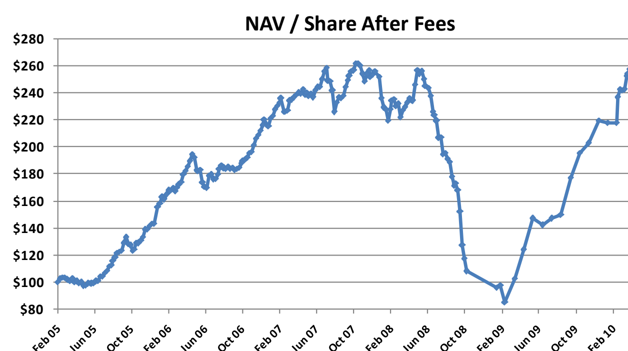
	Long	Short	Gross	Net
RTS Equities	29.1%		29.1%	29.1%
Non-RTS Equities	18.0%		18.0%	18.0%
FSU Equities	24.7%		24.7%	24.7%
International	63.3%	9.5%	72.8%	53.8%
Equities	135.1%	9.5%	144.6%	125.6%
Ukraine	0.0%		0.0%	0.0%
Georgia	0.0%		0.0%	0.0%
Bonds	0.0%	0.0%	0.0%	0.0%
Bond		14.9%	14.9%	-14.9%
Commodities	7.7%	3.0%	10.7%	4.7%
Equity			0.0%	0.0%
FX			0.0%	0.0%
Derivatives	7.7%	17.9%	25.6%	-10.2%
Total All	**142.8%**	**27.4%**	**170.2%**	**115.4%**
Leverage	**70.2%**			

Current and Historical Performance

	2005	2006	2007	2008	2009	2010
Jan	-	13.67%	1.29%	-10.44%	-11.34%	-0.79%
Feb	2.24%	2.73%	5.70%	2.75%	-11.37%	0.03%
Mar	-0.27%	4.05%	-0.29%	-3.48%	20.53%	11.16%
Apr	-2.54%	8.80%	1.88%	3.03%	20.86%	**1.02%**
May	-0.51%	-3.78%	-0.71%	9.17%	18.71%	
Jun	1.84%	-1.67%	2.88%	-7.02%	-3.28%	
Jul	7.77%	0.37%	1.75%	-13.09%	3.37%	
Aug	8.76%	2.33%	-4.69%	-8.69%	1.93%	
Sep	12.64%	0.01%	5.07%	-10.76%	18.41%	
Oct	-6.56%	3.70%	4.99%	-35.75%	10.24%	
Nov	7.49%	5.36%	-2.96%	n/a	3.66%	
Dec	7.33%	9.49%	0.80%	n/a	8.34%	
Year	**43.27%**	**53.70%**	**16.26%**	**-57.73%**	**103.00%**	**11.44%**

NAV Data

Fund Price (W/Avg), Main Class	Bid $239.71; Offer $244.79
Designated Investment Share Class	$71.41
Total Assets (AUM)	$29,350,906



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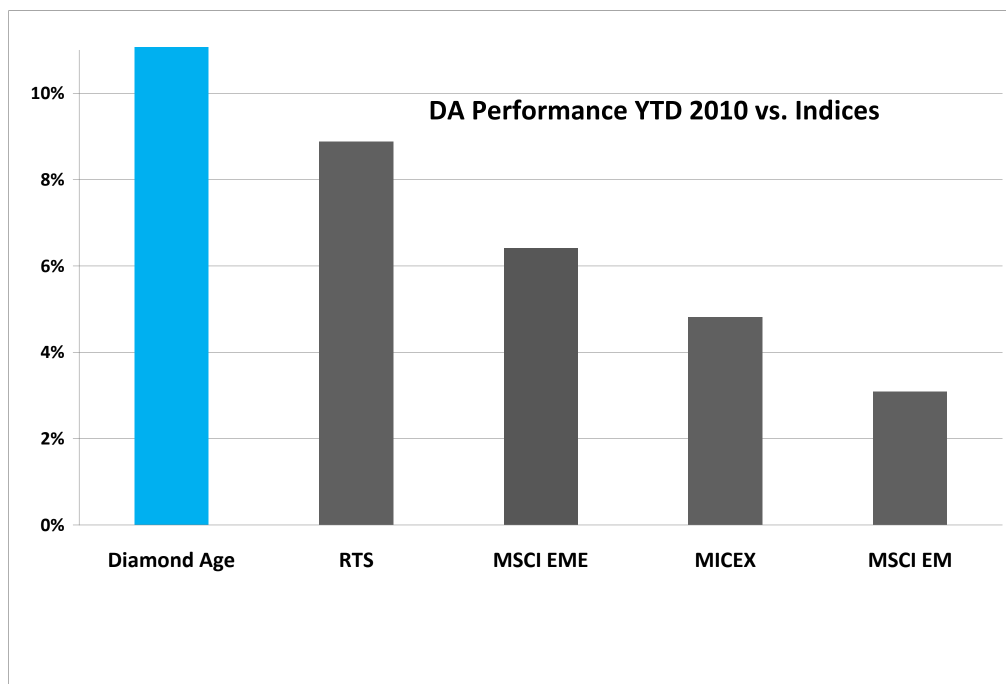


While finishing the month comfortably higher than the benchmark MSCI Emerging Markets Europe and Russian stock indices (RTS and MICEX) YTD, external developments depressed Russia-related investments and pushed risk assets lower from mid-April highs

It is not the policy of this monthly letter to investors to look beyond the end of the calendar reporting period. However it would seem inappropriate at the time of this writing Sunday May 9th, not to address events which are likely to be of greatest concern to the readers. In these exceptional times it would be a disservice not to detail concrete steps, which have already been taken to position investor capital, in advance of the current market depression of uncertain magnitude. In this newsletter the content will address three perhaps damaging dislocations "in progress" without perfect adherence to the usual month-end time line.

One: Greece and Euro contagion

Calmly, the Investment Advisor sees events unfolding as described in prior publications here but with significantly greater and more destructive global reverberations. On December 16th, 2009 and well in anticipation of the impending Euro collapse, **Diamond Age** initiated the Fund's single largest position, a 17.4% Euro short X-rate long Rouble 90 day non-deliverable forward (NDF) and continuously rolled this position forward until April 30th.

From Diamond Age January 2010 Monthly Letter to Investors

"Based on in-house analysis of the overwhelmingly constructive body of fundamental data coming from the United States, coupled with generally weak EU growth and country-specific "PIIGS" drivers of Euro currency depreciation; Diamond Age was increasingly concerned that a short-term USD rally was already underway by early December 2009."

Sector Allocation	
Metals and Mining	17.80%
Financials	15.82%
Real Estate	15.58%
Shipping	12.69%
Bond Derivatives	8.75%
Commodities	6.30%
Agriculture	4.95%
Construction/Infrastructure	4.57%
Coal	4.36%
Oil - Upstream E & P	4.04%
Trading House	2.48%
Media	1.66%
Meat Products	1.00%
Total	**100%**

"Greek CDS (credit default swap) premium vaults past peak crisis pricing levels. Greece, Ireland, and Spain represent 16-17% of EU GDP (Italy and Portugal another 14%) …and PIIGS will never have wings."

So what did the Investment Advisor say in December 2009 about this "high conviction trade" that the investment community did not?

"Profits to be made however and this is a high conviction trade. The Fund takes to unpopular view that the Euro weakens to $1.20/EUR year end vs. "Street" consensus $1.40-$1.50/EUR and the Fund is stacking its money against it."

"Why? Because a) US GDP V' shaped recovery will continue to surprise to the upside (more than double the Euro zone growth) with a 5% 1H 2010 target (5.7% Q4 '09). b) The EURO is 25% overvalued vs. the USD in domestic PPP and in efficient markets (US/EU) buying power is medium run equaliser. c) The EU leadership is lacking both the will and the administrative organs to demonstrate cohesion and effective management of the regions poly-headed hydras. d) Because Ireland, Greece and Spain represent 16-17% of EU GDP (Italy and Portugal another 14%)…

Diamond Age published and disseminated this view in the January letter to investors with a brazen target of $1.20 / Euro and then covered this large short the day before IMF package was approved at the end of April. At the time in-house analysis concluded that the great rump of the short trade had been realised and that post bailout, the trade risk (in the short term) was that there would be a relief bounce and short covering. But the predicted EU/IMF joint €110bn package for Greece did not lead to the expected short-covering and the Fund promptly then re-initiated ½ the position on May 4th. On May 6th the Euro fell to $1.25.

And today?

What is playing out in the currency markets is not less than what the Fund predicted last year. After the 2008 crisis global governments essentially nationalised huge amounts of private debt via various mechanisms. The banks that were not nationalised or shuttered completely, were recapitalised with artificially low rates and steep yield curves which allowed the survivors the earn their way out of insolvency (which is just what might happen to many if they were forced to mark-to-market their portfolios).

Private sector obligations were transferred to the public sector giving birth to the current sovereign crisis (bad cards just being re-dealt to new hands). The recent incarnation of the credit crisis was brought forward, by this fact, being in a slow motion making by itself, based on structural deficiencies of the EU and its single currency, such as a) differences in labour productivity, b) savings rates, cultures, etc. across member states, c) relatively low labour mobility and d) member state non-compliance to ECB debt limits as percentage of their GDP, resulting from a single monetary policy and different budgetary policies. The nationalisation of private debts only fast-forwarded the process.

AFTER: December 2009 "short" RED arrow and January 2010 letter to investors GREEN line (chart left)

Consequences…and here is where the Investment Advisor may have underestimated the magnitude of the Greek malaise? The consequences other then the obvious decline of the Euro and slow-down of already modest Euro zone growth expectations are (in the very best of the Fund's estimation) still largely unpredictable as was the case in 2008.

As can be witnessed in Brussels, Berlin, Beijing and elsewhere however, one has to pause to believe that collective and responsible decisions are being taken by global central banks and co-operating governments. There is surprisingly a mostly united front now working to effectively halt the spread of contagion, with resolve and on a large scale. Now the fear should be that these measures too, will eventually create further long-term structural problems which may play out in future …*but more on that later*.

So while it is impossible to predict the future in all its ramifications, it is proper to share with the reader the perceptions of the Investment Advisor, and to spell out the decisive steps which have been taken, based on solid research and fundamental analysis.

While never shy to take a position in the public domain and defend it; it may nevertheless seem cavalier to step in with further predictions when the chips are already in the bag. But **Diamond Age** is not in it for the chips…the Fund's investors are in it for the money, so this is the forward view: <u>the Euro loses either way and $1.20 may have been too conservative.</u>

AFTER: December 2009 "short" RED arrow and January 2010 letter to investors GREEN line, present YELLOW arrow (at the time of this writing Sunday, May 9th)

Why? If Greece is allowed to default then the television audience will set market rates, rioting will escalate and the Euro may drop further. If Greece is propped up and allowed to misbehave, the rest of the miscreants will stand in queue to be coddled in similar fashion and the Euro may drop even further. In the estimation of the Investment Advisor, it would be best to allow Greece to default, take the short-term brunt upfront, impose draconian austerity measures and make it as difficult as possible to others to follow suit. This describes a policy of containment with pain concentrated at the source of the wound, such that minimal infection is spread to the rest of the body.

But Greeks and "Greek-like" neighbour states will not likely adopt and adhere to strident austerity measures nor embrace a Calvinist work ethic any time soon. Thus the Fund will stay short the Euro and in fact increase the short position on any meaningful relief bounce. But here is where the razor meets the beard: does this mean a sharp free fall in global GDP, a double dip with the commiserate decline in consumption e.g. falling demand for Russian-related commodities and materials? In a word NO.

It likely means that the living standards for the average Greek citizen will continue to decline in real terms (along with the standards of Europeans as a whole…as have the living standards of the average American fallen as a whole vs. the R.O.W.). In reverse of the Euro, commodity-linked currencies and "petro dollars" will continue to appreciate against the G-7 basket. For the Fund this is merely more-of-same 2005 Fund launch mantra of: "one directional, long duration, transfer of money, wealth, power and prestige from West to East." In fact this is what has been written here for five years and now one might make the case that commodities themselves have evolved into the currency of choice. This gives support to the idea that metals pricing appreciation may persist even in an environment of moderating global GDP growth.

Geographic Dispersion	
Russia	27.68%
USA	12.00%
Kazakhstan	8.62%
China	8.18%
Ukraine	6.68%
Norway	5.36%
Georgia	3.72%
Thailand	2.73%
Finland	2.49%
Singapore	2.48%
South Korea	2.46%
Sweden	2.44%
Denmark	2.25%
United Kingdom	2.09%
Australia	1.76%
Hungary	1.70%
Switzerland	1.54%
Turkey	1.15%
Cyprus	1.15%
Brazil	1.00%
UAE	0.93%
Ireland	0.85%
Turkmenistan	0.74%
Total	**100%**

Euros aside, let us take a moment to look at more important drivers of commodity asset revaluation. In the simplest terms: Agriculture has the lowest commodity burn intensity rate. Industrialisation has the highest commodity burn intensity rate. One unit of industrialisation GDP output uses 2.9x the commodity inputs as one unit of agricultural GDP output. This is why a nation with smaller GDP but higher rate of industrialisation can be a larger commodity consumer, than a nation of higher GDP but lower rate of industrialisation (China vs. Japan).

The developed world is already industrialised. Almost 40% of the world's labour force is agricultural producing only 2% of the world's GDP. 75% of global GDP growth (not GDP but GDP growth) is driven by developing economies in the rapid stages of industrialisation and representing the highest commodity intensity burn rate per unit of GDP. This is why nations of huge agrarian populations in the rapid process of industrialisation (China, India, Brazil, Thailand, Vietnam, African nations and others) will continue to drive commodity demand even if the developed world double dips (e.g. a Greek inspired Euro zone contagion which ushers in a second wave recession), a view of which the Fund ascribes zero credit.

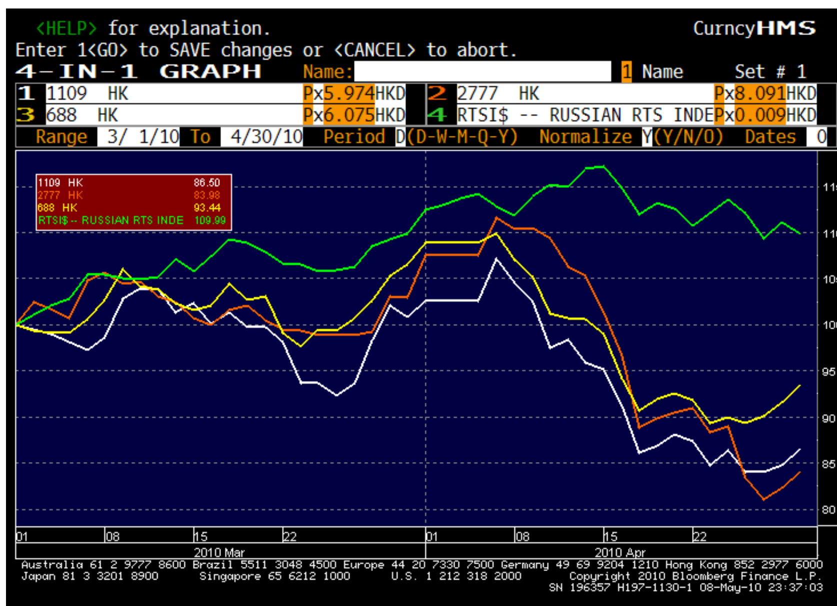
And at the risk of been labelled irresponsible, the Investment Advisor has steadfastly maintained from March 2009 that the world is squarely in the saddle of a marked V' shaped recovery. Riding higher on the haunches of powerful economic growth, inventory restocking, industrial demand, global infrastructure capex, government spending and supported by overwhelmingly constructive fundamental data from San Francisco to Shanghai; the roadmap is clear. Just this month market maven Nouriel Roubini told the media at "A Night with the Bears" that "the bear market was not over yet!" Yet…what can he mean? The S&P 500 has advanced 75% since he last called for the next big leg down on the market in the same March of 2009. What is the very definition of a bear market? To be clear, this is not a bear market, not an L' shaped recovery, there is no such thing as the "New Normal" and most certainly there will be no "double dip" recession. There, it has been said…again.

As contrarians the Fund will now likely looking to BUY Russia-related "Greek" assets here *in nibblets* and is busily dusting through the tomes at the Bank of Cyprus ("BOC GA") and other depressed names looking for possible attractive entry points.

Two: China bubble fears.

Again as with the Greek contagion and Euro crisis; the Investment Advisor sees events unfolding in China as have been largely anticipated here. To the best extent possible, the Fund has taken meaningful steps to position investor capital in advance of these events and associated market gyrations.

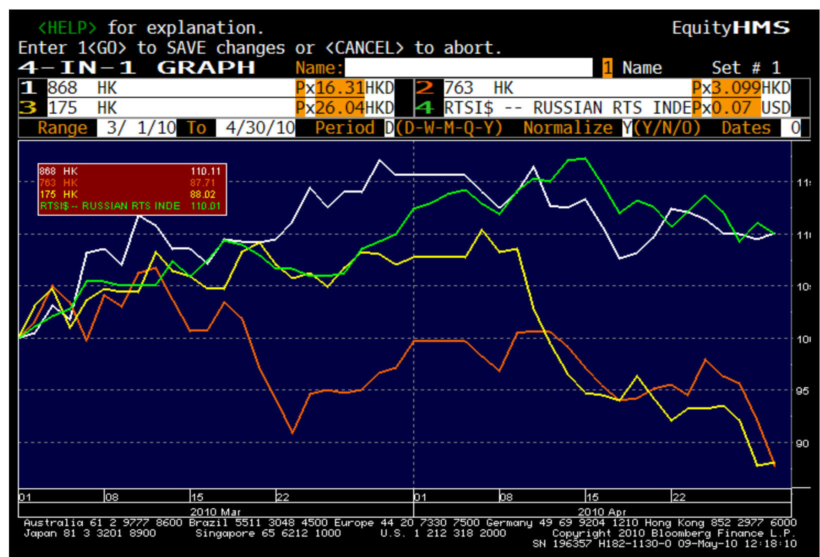
As recently as month-end February, China was the second largest long exposure in the Fund (after Russia) with a 10% of total AUM. Well in advance of the Bank of China's measures to curb inflation, restrain the credit bubble, increase loan-reserve requirements, and prohibit "third-mortgage" applications, **Diamond Age** was researching the real-estate glut and spiralling vacancy rates of coastal mainland cities.



As an EM hedge against the significant long book of Russia related real-estate and property developers (#3 largest sector and 15.58% of gross AUM), the Fund initiated large short positions in equity linked derivatives on mainland property developers China Resource Land (2777 HK), Guangzhou R&F (1109 HK), China Overseas (688 HK) and Renhe Commercial (1387 HK) representing 7.5% of AUM before the bubble pricking scenario came to the front, which indeed is being playing out now.

"SHORTS" IMPLEMENTED: Chinese mainland coastal city property "shorts" WHITE, RED, GOLD as EM hedge vs. Russia-related real-estate holdings [see RTS Index] GREEN. Total real-estate book now #3 largest sector with 15.58% of gross AUM (trailing two month chart)

Concurrently, the Fund sold 75% of long Russia-related China positions via equity linked derivatives including Geely Auto (175 HK), Xinyi Glass (868 HK), and ZTE Corp (763 HK) at meaningful profit. Thus in two short months, geographic allocation transformed from net long 10% China to net short (5%) China. *For better or worse, the Fund is still long one Chinese name, (1138 HK) China Shipping Development.*



"LONGS" LIQUDATED: Same slide as above but illustrates "long" Chinese holdings WHITE, RED, GOLD which were liquidated at meaningful profit vs. Russian market [see RTS Index] GREEN. In just 60 days portfolio construction Δ net long 10% China to net short (5%) China (trailing two month chart)

Further and consistent with the view that any slowdown in Chinese real-estate development could cause a material drop in demand for base metals associated with property building, the Fund rolled out of its May copper futures at profit and did not re-initiate.

Three: Rotation out of steel and metals back into energy?

Prior to month-end April there appeared to begin an important rotation out of Russian steel and metals back into the oil and gas space which had underperformed the market for three quarters. This was on the updraft of crude moving from and holding above $80.00/bbl June Brent, global max production 85,000,000/bbl/d vs. current global demand 86,000,000/bbl/d rendering OPEC discipline somewhat less important and an associated drop of global inventories on rising global GDP forecasts, increasingly lead by USA.

The Fund had been buying Brent ICE futures since early 2009 but has almost always struggled to find Russian stocks (company shares) which were attractive. Specifically, the Fund did not wish to own Rosneft, Surgutneftegaz, Lukoil, Gazpromneft, TNK BP, Transneft, Bashneft, Tatneft, Kazmunaigaz E&P or really any of the big index names for company specific and Russia specific reasons. The Fund also wanted to avoid natural gas names for natural gas specific, Gazprom specific, Novatek specific and Russia specific reasons.

What to do? **Diamond Age** initiated a 7.2% allocation to non-Russian International Caspian basin and "Russian" regional E&P companies where the Investment Advisor has experienced some historical success on the M&A front.

As with Hurricane Hydrocarbons which changed its name to PetroKazakhstan 2003 and sold out to China's CNOOC 2006, the Fund has also been involved with other regional CIS energy players: Imperial Energy to ONGC India, Nelson Resources to Lukoil, Arawak Energy to Vitol, Burren Energy to ENI and Max Petroleum (did not own).

At mid month the Fund invested in five names which are all acquisition and consolidation candidates excluding DGO LN.

ZKM LI	**Zhaikmunai**	**Kazakhstan**
PTR LN	**PetroNeft Resources**	**Ireland**
VGAS LN	**Volga Gas PLC**	**UK**
AOIL SS	**Alliance Oil**	**Sweden**
DGO LN	**Dragon Oil**	**Turkmenistan**

Ex Dragon 51.51% owned by the Emirates National Oil Company all are potentially in play. The space can be divided into poorly capitalised underperformers, potentially going for a fractional % of reserve value such as: Roxi Petroleum, Caspian Energy, JKX Oil, Tethy's Petroleum, Urals Energy, Malka Oil, Regal Petroleum, Transmeridian, BMB Munai, etc. while better capitalised names will likely go for premiums (the former).

Shares in such individual holdings represent significantly higher leverage (and commensurately higher risk) than oil futures. For example, a $5.00/bbl oil move = a 6% move for Brent Ice Future but greater sensitivity translates into 15-35% price move for this basket of shares. A modest consideration is that "International" E & P companies have *some* insular advantages vs. Russian dodgy comps.

Ranked by most risk/highest upside to least risk/lowest upside

PTR LN PetroNeft Resources

Pro: Sept 2009 successful cap raise, sick, crazy cheapest comp trading 1.6x earnings and 0.60x EV/EBITDA and $0.22/boe, strong hands JP Morgan, Macquarie. Excellent resources and located in largest unexplored territory of Western Siberia. Same dirt as Malka (not much of a company) with ½ the valuation. $30MM in cash and fully funded. >100% to prior market peak

Con: <$200MM M-cap, poor liquidity, up huge, weak hands RAB Capital 8.82% may be a future seller

VGAS LN Volga Gas PLC

Pro: Baring Vostok Capital owns 58.66%. Near time horizon large hit discoveries to drive share price. Positive operating cash flow and no funding difficulties, $33.6MM cash balance vs. $14Mm capex programme, cheap as T.J., trading only 4x P/E, 2.0 EV/EBITDA, $1.25/boe, >70% to prior market peak

Con: massive share price move +300% TTM, <$350MM M-cap

ZKM LI Zhaikmunai

Pro: upstream production to grow >250% YoY, $0.30/boe – cheap on reserve basis, Kazstory Service 27%, 5,000 employees in Kazakhstan and involved in >100 oil projects, Franklin Templeton is #3 largest holder (also Blackrock, Julius Baer, and other credible owners). Well funded B-/B3 credit (positive watch), developing massive Chinarevskoye deposit in Kazakhstan, decent $1.7B M-cap, good liquidity >100% to prior market peak

Cons: higher debt and lower earnings

AOIL SS Alliance Oil

Pro: bigger and well followed vs. regional E & P comps, $2.5B m-cap, good liquidity, also cheap trading 2.9x EV/EBIDTA, 4.8x P/E, $1.26/boe, "Swedish" company , tiny debt 13.37% debt to assets…basically for this part of the world a *normal* company

Con: crowded trade (not really too crowded) and lack of immediate drivers other than oil price, only 30% below prior pre-crisis spike

DGO LN Dragon Oil

Pro: Least risk. Largest company with best liquidity $4B USD M-cap. Safe money international portfolio investors are moving to name 49% of free float

Con: crowded trade (quite crowded) expensive to peers 9.8x earnings, because of 51% Emirates National and thus limited upside. Nearing pre-crisis highs. Least risk and smallest upside

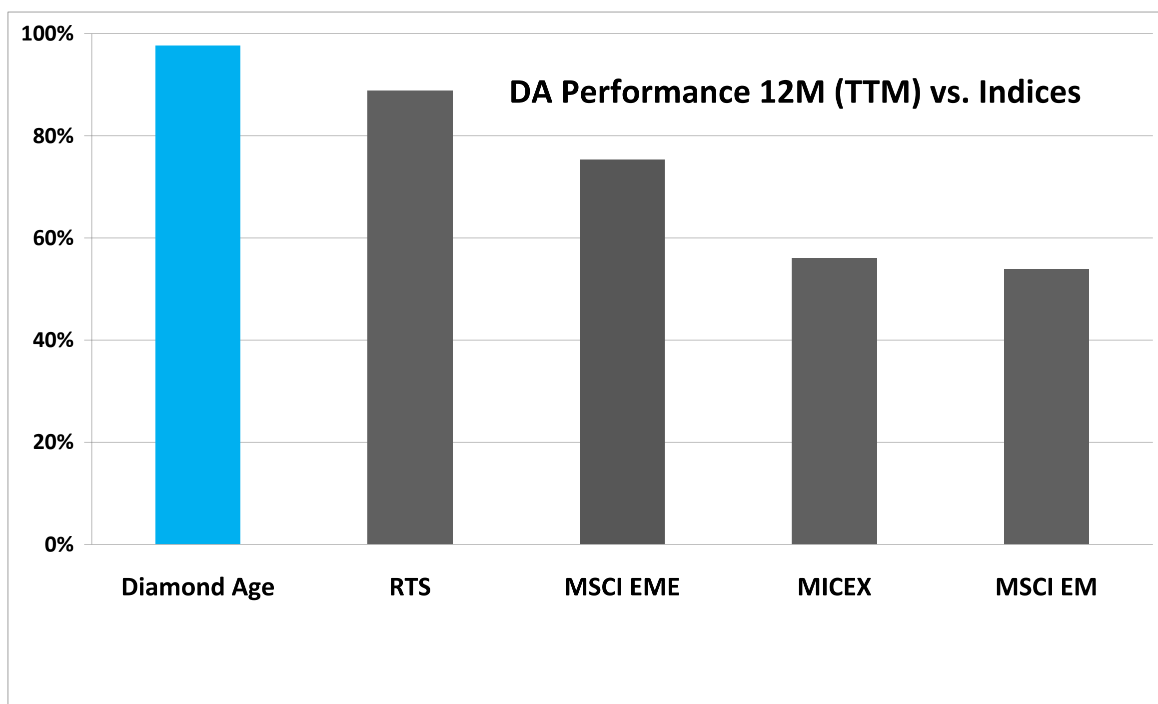
Reluctantly, the Investment Advisor also covered 10-Year treasury short on flight to quality bust (will re-initiate when wax hardens) and gold short on same movements. In the coming period the Fund may add to existing platinum future on falling confidence in G-7 currencies and central banks in general, coupled with ramp up in auto-related industrial demand lead by China. Lastly the Fund may increase oil exposure here < $80/bbl on previously cited fundamental valuations, global demand 85MM/bbl/d, global production 86MM/bbl/d, inventories, global GDP ramp up, and weak G-7 currencies.

To capsulate: the Fund astutely anticipated both the Euro/Greek risk as well as China tightening risk in the context of the **Diamond Age** portfolio; as well as the sector rotation out of metals, steels and industrials into energy. The Investment Advisor took pro-active and decisive steps to correctly position investor capital. Was it enough? No, it is never enough and all three major macro developments have had powerfully greater and more damaging reverberations for Russia-related and risk-assets than forecast.

None of these concrete actions are likely to insulate Fund NAV from the ranch style beating administered to global markets in just the past 10 trading sessions or even in the next reporting period. Because the core of portfolio construction is long and leveraged to the broad-based global cyclical recovery since early 2009, asset allocation is unfortunately in the very wheelhouse of the current correction. Metals, miners, financials, shippers, industrials, coal, and steel names are down >30% from the highs. Fund performance will be adversely impacted regardless of timely and decisive portfolio adjustments in advance of the storm (albeit less so, since such adjustments have been made). Russia and CIS allocations in particular have been of the hardest hit world-wide and industries of current Fund sector allocation of the most directly affected.

Consistent with the monthly letters to investors since October 2009, **Diamond Age** maintains a cautionary stance with well reasoned reservations but is still "willing to accept a 20% or perhaps even greater pullback of uncertain timing, in order to participate in further upside." **This 20% or perhaps greater pullback has arrived in the form of a giant air-pocket so passengers are advised to remain seated for the remainder of the flight.**

Diamond Age Performance Appendix - Trailing Twelve Months (TTM):



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