Diamond Age Russia Fund

Monthly Letter to Investors – October 2012

In October, the Fund had a slightly negative performance of 1.85%, having gained almost +2% intra-month and been affected by a global sell-off in the last week of the month ending October 26th, which was the last valuation date in October due to the Fund's weekly valuations each Friday. Nevertheless, the Fund's portfolio was better protected than the "pure Russia" indices, such as the RTS Index, which dropped 2.33%, and MSCI Russia, which fell 2.65% in the same time period.

The better relative performance is attributable to a superior and favourable to the current market conditions security selection (not only in Russia and CIS, but globally, among Russia- and CIS-related investment universe companies), small but very targeted short positions (5% of the portfolio), and a significant gain on a tactical Rosneft trade, related to the Investment Advisor's short-term view on the benefits of its TNK-BP acquisition.

International Business Partners and Terms

Investment Advisor	*Diamond Age Capital Advisors Ltd.*
Administrator	*CIBC Bank and Trust Co. (Cayman) Ltd.*
Russian Custodian	*Citigroup – ZAO Citibank (Russia)*
Auditors	*Deloitte – Cayman Islands*
Tax Consultants	*Ernst & Young – Russia and Cyprus*
Legal Counsel	*Campbells – Cayman Islands*
Base Currency	*US Dollar*
Advisory Fee	*2% per annum*
Performance Fee	*20% of profits above hurdle rate*
Hurdle Rate	*US Dollar 3-month LIBOR + 50 bps*
Inception Date	*18 February 2005 at US$100 per share*
Dealing Day	*Friday*
Subscriptions#	*Weekly*
Redemptions	*Monthly, 14-day notice*
Min. Subscription	*US$100,000*
ISIN	*KYG2863P1090*
CUSIP	*G2863P 10 9*
Bloomberg Ticker	*DIAMRUS KY <Equity> <Go>*

Historical Performance

	2005	2006	2007	2008	2009	2010	2011	2012
Jan	-	13.67%	1.29%	-10.44%	-11.34%	-0.79%	0.50%	20.43%
Feb	2.24%	2.73%	5.70%	2.75%	-11.37%	0.03%	-3.09%	2.83%
Mar	-0.27%	4.05%	-0.29%	-3.48%	20.53%	11.16%	1.30%	-3.75%
Apr	-2.54%	8.80%	1.88%	3.03%	20.86%	1.02%	2.42%	-3.62%
May	-0.51%	-3.78%	-0.71%	9.17%	18.71%	-21.49%	-13.14%	-21.98%
Jun	1.84%	-1.67%	2.88%	-7.02%	-3.28%	-2.00%	-4.88%	0.42%
Jul	7.77%	0.37%	1.75%	-13.09%	3.37%	7.72%	6.17%	0.38%
Aug	8.76%	2.33%	-4.69%	-8.69%	1.93%	-4.96%	-26.65%	-2.52%
Sep	12.64%	0.01%	5.07%	-10.76%	18.41%	12.14%	-30.60%	2.13%
Oct	-6.56%	3.70%	4.99%	-35.75%	10.24%	6.31%	22.32%	**-1.85%**
Nov	7.49%	5.36%	-2.96%	n/a	3.66%	-0.13%	-22.84%	
Dec	7.33%	9.49%	0.80%	n/a	8.34%	16.66%	4.55%	
Year	**43.27%**	**53.70%**	**16.26%**	**-57.73%**	**103.00%**	**21.92%**	**-55.48%**	**-11.70%**

NAV Data, Current Asset Allocation

Fund Price (W/Avg), Main Class	Bid $104.88; Offer $105.27
Designated Investment Share Class	$63.90
Total Fund Assets (AUM)	$ 13,218,552
Total Firm AUM	$208,820,084

Asset Class	*Long*	*Short*	*Gross*	*Net*
Equities	121.3%	4.6%	125.9%	116.7%
Derivatives	0.0%	0.0%	0.0%	0.0%
Commodities	0.0%	0.0%	0.0%	0.0%
FX	0.0%	0.0%	0.0%	0.0%
Total All	**121.3%**	**4.6%**	**125.9%**	**116.7%**
Leverage	**25.9%**			

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The rationale for the trade was explained in greater detail in the September 2012 Letter to Investors (http://www.diamondage.ru/newsletter/Eng_DA_Sep_12.pdf), which also directly suggested that "the Fund stands ready to unload this position should the Investment Advisor feel that the run-up in the stock is done and the medium-term upside is thus very limited". Indeed, the Fund disposed of this position soon after the end of the October reporting period, on November 6th, having initiated it on September 19th – an atypical short holding period. And yet, as can be seen from the chart below, the Fund exited this position at or just near the very "local top" – purchased at US$6.5450 and sold at US$8.0050, which represents a +22.06% capital gain within 48 days, on an M&A-related investment idea.

Sector Allocation	
Financials	22.42%
Metals and Mining	16.39%
Telecoms	7.92%
Oil - Integrated	7.45%
Gas Utilities	6.18%
Agriculture	5.68%
Conglomerate	5.23%
Coal	3.97%
Media	3.77%
Fisheries	3.47%
Industrials	2.92%
Consumer Durables	2.67%
Airlines	2.54%
Chemicals	2.39%
Construction/Infrastructure	2.32%
Electrical Utilities	1.70%
Real Estate	1.51%
Foods	1.47%
Total	**100%**

Elsewhere in the world, the "soup du jour" does not taste as sour as the markets are pricing it, which represents an excellent medium- to long-term opportunity.

The so called "Fiscal Cliff" should be averted, as bi-partisan agreements are likely to be reached prior to year-end. President Obama's deck of cards seems to be very strong after his re-election, as he agreed with his opponents in the "Debt Ceiling" debacle on a number of extensions and his stronger say in what could be cut on the expenditures side, should everyone fail to come to an agreement. So, come January 1st, if no agreement is reached, the USA will automatically become a dream socialist democratic state, where taxes are going up for everybody, thus enabling enough funds for public schools, etc., and at the same time expenditures are automatically cut in those areas, where Republicans want it the least. With the lost election, the Republicans are now facing a double-whammy of (1) being blamed by the electorate, the markets and the rest of the world for not being able to agree with the Democrats on anything, thus driving the country towards the fiscal cliff as had already happened with the debt ceiling and reduction of America's prized top credit rating, and (2) having taxes go up for everybody, while expenditures to be cut in those areas where the Democratic President, not the Republicans, had the most say. With a strong deck of cards and a second term, President Obama invites Republicans to the challenge – and the Investment Advisor believes that the Republicans have no choice but to cooperate, thus avoiding the fiscal cliff and the resulting disruptions to the US and global economy. The Investment Advisor's outlook on this subject can be viewed in Russian at the following link, which is a video of a recent live broadcast on RBC, a Russian business channel (in cooperation with Bloomberg TV and CNN):

http://rbctv.rbc.ru/archive/dialog_demura/562949985119232.shtml

Half-way around the globe, but materially important: China is likely to have a V-shaped economic recovery with no hard landing. The most recent (November) HSBC Flash Purchasing Managers Index hit a 13-month high of 50.4, supported by an increase in new export orders, while employment in the manufacturing sector contracted at a slower rate. Overall growth is likely to pick up strongly in the fourth quarter, with the Chinese government already pouring in US$150 billion via an infrastructure stimulus package and providing tax breaks and subsidies to small firms. Nomura forecasts that growth will pick up to 8.4% in the last quarter of the year from 7.4% in the previous three months. Although there is almost no basis for a rapid increase in growth on the mainland in the next few months, at least the risk of a hard landing is receding by the day, which is great news for global markets, including commodities and Russia-related assets, and which is not yet priced in by the markets. Maintaining 7.5% to 8% economic growth with no hard landing in China should be extremely supportive of Russia-related equities, including the Fund's 16% allocation to the Metals and Mining sector.

Geographic Dispersion	
Russia	59.13%
Ukraine	10.70%
Kazakhstan	7.73%
Georgia	7.19%
South Korea	5.06%
Thailand	3.47%
Turkey	2.32%
Singapore	1.99%
Guinea	1.35%
China	1.06%
Total	**100%**

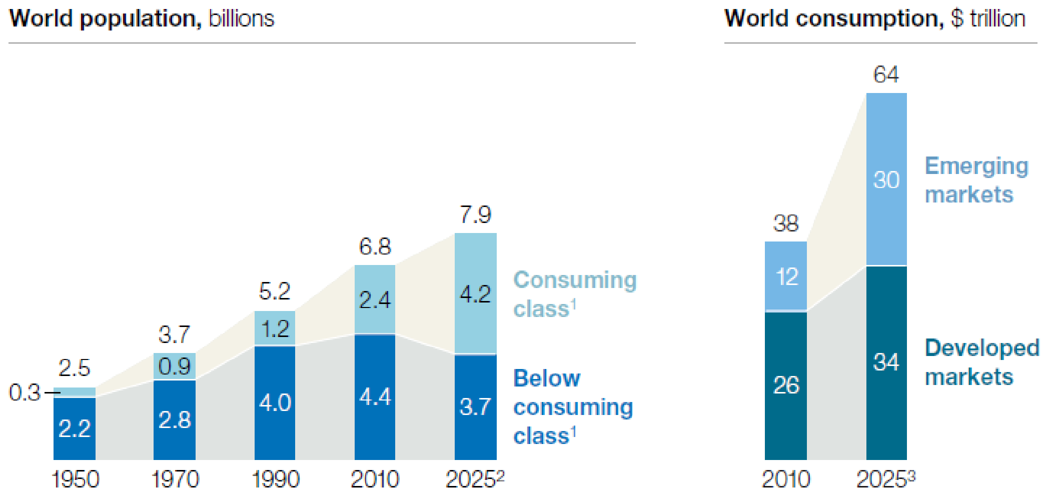
On a final note, the Investment Advisor would like to bring to the attention of its readers the following facts from a McKinsey & Company report called "Winning the $30 trillion decathlon", which can greatly enforce Russia's position as China's largest trading partner, and on which the Fund will capitalize in the months and years ahead.

By 2025, annual consumption in emerging markets will reach $30 trillion – the biggest growth opportunity in the history of capitalism.

The Industrial Revolution is widely recognized as one of the most important events in economic history. Yet by many measures, the significance of that transformation pales in comparison with the defining megatrend of our age: the advent of a new consuming class in emerging countries long relegated to the periphery of the global economy.

The two shifts bear comparison. The original Industrial Revolution, hatched in the mid-1700s, took two centuries to gain full force. Britain, the revolution's birthplace, required 150 years to double its economic output per person; in the United States, locus of the revolution's second stage, doubling GDP per capita took more than 50 years. A century later, when China and India industrialized, the two nations doubled their GDP per capita in 12 and 16 years, respectively. Moreover, Britain and the United States began industrialization with populations of about ten million, whereas China and India began their economic takeoffs with populations of roughly one billion. Thus the two leading emerging economies are experiencing roughly ten times the economic acceleration of the Industrial Revolution, on 100 times the scale – resulting in an economic force that is over 1,000 times as big.

By 2025, in only 12 years from now, the consuming class will swell to 4.2 billion people globally. Consumption in emerging markets will account for $30 trillion – nearly half the global total.



[1]Consuming class: daily disposable income is ≥$10; below consuming class, <$10; incomes adjusted for purchasing-power parity.
[2]Projected.
[3]Estimate based on 2010 private-consumption share of GDP per country and GDP estimates for 2010 and 2025; assumes private consumption's share of GDP will remain constant.

Source: Angus Maddison, founder of Groningen Growth and Development Centre, University of Groningen; Homi Kharas, senior fellow at Wolfensohn Center for Development at Brookings Institution; McKinsey Global Institute analysis

It is absolutely inconceivable, in the view of the Investment Advisor, that asset prices, tied to a cyclical global recovery, will not appreciate substantially over the years of the upcoming decade or more, in the view of the facts above and given a very easy monetary policy by central banks of major currency emitting countries. And from a current fundamental point of view, even a short-term market direction should be bullish for equities, with the forward 12 month earnings yield for the SPX versus the 10 year Treasury yield standing at 8.0% versus 1.65%.