

DIAMOND AGE RUSSIA FUND

MONTHLY LETTER TO INVESTORS – JUNE 2009



"Timing, degree and conviction are the three wise men of life." R.I. Fitzhenry

Within days of the: *"Far from a dead cat bounce..."* proclamation, the Moscow **Diamond Age** branch office was encircled with pitchforks and torches. By classic definition, Russian stocks promptly *swanned off* into a bear market as the MICEX dropped by greater than 20% in three weeks from the YTD high on June 1st. Doubtless the timing on this pronouncement gave pause for some embarrassment. But drawing ourselves back up off the turf and with no less conviction than four short weeks ago; **Diamond Age** maintains that the 2009 – (2014?) bull market has only just begun.

From the perspective of the Fund investor, it does not much feel like the bear is back. *Mishka* merely snored noisily in his sleep as for the month of June, the **Diamond Age Russia Fund** gave back a digestible -3.28% (vs. a steep decline of -14.3% for MSCI Russia, -9.3% for the RTS, and -8.4% for MSCI EME).

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	Last business day of the month
Min. Subscription	\$100,000
Bloomberg Ticker	DIAMRUS KY <Equity> <Go>

Historical Performance

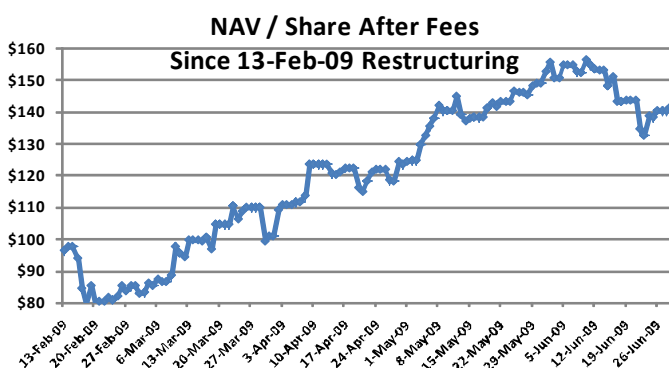
	2005	2006	2007	2008	2009
Jan	-	13.67%	1.29%	-10.44%	-11.34%
Feb	2.24%	2.73%	5.70%	2.75%	-11.37%
Mar	-0.27%	4.05%	-0.29%	-3.48%	20.53%
Apr	-2.54%	8.80%	1.88%	3.03%	20.86%
May	-0.51%	-3.78%	-0.71%	9.17%	18.71%
Jun	1.84%	-1.67%	2.88%	-7.02%	-3.28%
Jul	7.77%	0.37%	1.75%	-13.09%	
Aug	8.76%	2.33%	-4.69%	-8.69%	
Sep	12.64%	0.01%	5.07%	-10.76%	
Oct	-6.56%	3.70%	4.99%	-35.75%	
Nov	7.49%	5.36%	-2.96%	n/a	
Dec	7.33%	9.49%	0.80%	n/a	
Year	43.27%	53.70%	16.26%	-57.73%	31.43%

Current Asset Allocation

	Long	Short	Gross	Net
Equities	52.9%	0.0%	52.9%	52.9%
Russian Large Caps	35.3%		35.3%	35.3%
Russian Second Tier	4.8%		4.8%	4.8%
FSU (CIS)	8.3%		8.3%	8.3%
International	4.5%		4.5%	4.5%
Bonds	0.5%	0.0%	0.5%	0.5%
Ukraine	0.3%		0.3%	0.3%
Georgia	0.2%		0.2%	0.2%
Derivatives	8.3%	36.0%	44.3%	-27.7%
Bond		16.2%	16.2%	-16.2%
Commodities	8.3%	1.7%	10.0%	6.6%
Equity		14.4%	14.4%	-14.4%
FX		3.7%	3.7%	-3.7%
Cash	2.3%	0.0%	2.3%	2.3%
Total All	64.0%	36.0%	100.0%	28.0%
Leverage				79.3%

NAV Data

Fund Price (W/Avg), Main Class	Bid \$136.42; Offer \$142.21
Designated Investment Share Class	Bid \$83.16; Offer \$83.16
Total Assets (AUM)	\$22,032,816



DIAMOND AGE
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The primary driver of this most exemplary performance was superior security selection, but significant components of positive attribution analysis include: core hedging strategies of both currency risk (short USD) and commodity exposure (long Brent / short gold); bond positions, uncorrelated assets (grain futures and agricultural assets) as well as a meaningful short equity weight (via derivative hedging) of approximately 36% reduced to 14% mid-month.

Was the "June swoon" a launch into the selloff, widely anticipated by the Moscow smart-money collective? We think not... here is why:

As previously detailed in recent letters to investors, the prolongation of any broad market rally for Russian capital markets is predicated on continued a) oil pricing advances, b) improvement of the credit markets c) global demand for commodities, e.g. Russian exports ~ *shipping oracle*, and d) Rouble stability.

Oil: For the month of June crude advanced a powerful +5.77% to \$69.30/bbl as US inventories contracted for the fourth week in a row -6.8MM/bbl (API). For the quarter WTI rose +41%, the largest quarterly advance since 1990. ... **Diamond Age** is not alone in this assessment, (see oil futures chart curve below to \$90.14/bbl).

Credit: Russia is the least levered major economy in the world. Public debt as a co-efficient of GDP stands at a niggardly 5.9%. Compare to Switzerland 44.2%, India 58.3%, America 60.8%, Germany 64.9%, or Japan 170.1%. Russian Eurobond 28's have traded all the way back to 145.

High yield spreads have contracted for the fifth straight month and Russian corporates continue to appreciate. Indicative of the market, Sberbank-15s advanced a thumping +11.93% in June following +7.93% in May (*the Fund owns Sberbank Preferreds at 0.37, + 108% since April 13*). From 63 cents on the dollar in December, the bonds have nearly clawed all the way back to par (chart below).

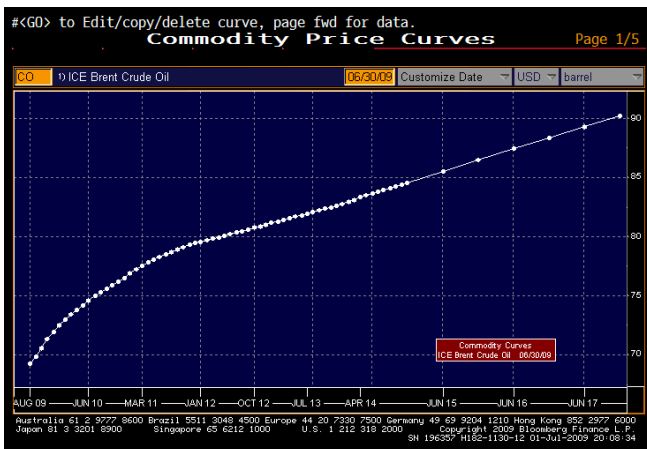
Diamond Age special situation recovery stories continue to generate stellar returns. The Fund's Ukrainian Sovereign Eurobond position rallied from 70 cents on the dollar in February to 97 cents. The Fund also purchased Bank of Georgia-9's in February at a miserly 45 and the position has advanced +62% in just two months to 73 (see charts next page).

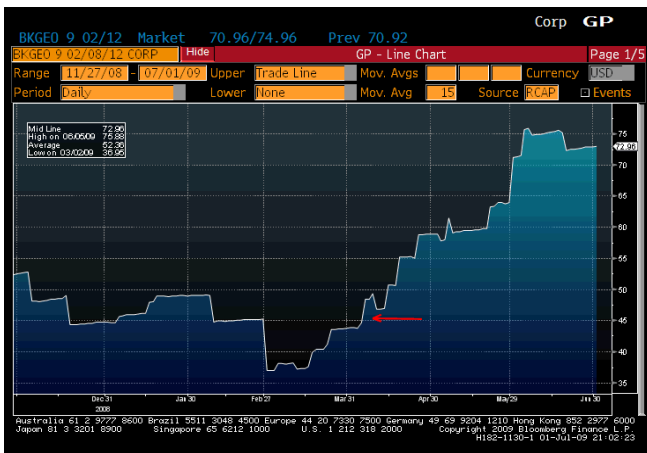
Shipping oracle (commodity demand): For the month of June the Baltic Dry Index continued an unprecedented ascent +7.53%...+386% YTD. The Merrill Lynch global commodity index ("MLCITR") featured in May Letter to Investors, advanced another +8.66% in June on the back of a +9.55% move in the prior period. From coal to building supplies, base metals to forest products; cargo and transport costs are rising. This constructive barometer for global GDP bodes well for Russian export pricing and further recovery in Russian capital markets.

Geographic Dispersion	
Russia	58.1%
US	23.4%
Ukraine	5.2%
Turkey	4.8%
Kazakhstan	3.0%
Georgia	2.1%
Egypt	2.0%
Azerbaijan	1.5%
China	0.0%
Finland	0.0%
Korea	0.0%
Norway	0.0%
Poland	0.0%
Singapore	0.0%
Sweden	0.0%
Taiwan	0.0%
Uzbekistan	0.0%
Total	100%

Currency Allocation	
RUB	43.7%
USD	43.5%
UAH	4.5%
TRY	3.0%
KZT	2.1%
GEL	1.7%
EGP	1.5%
MNT	0.0%
HKD	0.0%
EUR	0.0%
KRW	0.0%
NOK	0.0%
PLN	0.0%
SGD	0.0%
SOM	0.0%
SEK	0.0%
TWD	0.0%
Total	100%

*not including designated Investments



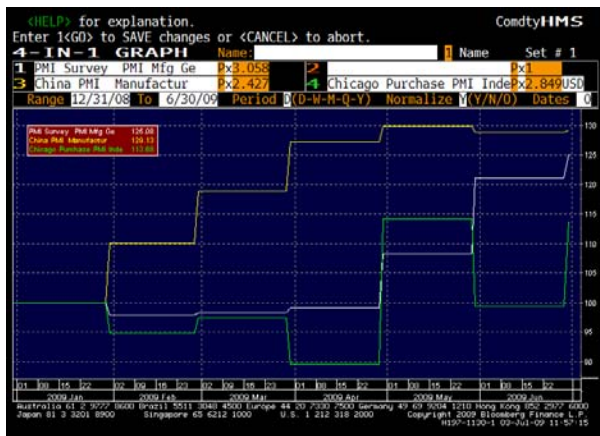


Rouble: +14.74% YTD and unchanged month over month. The Fund maintains short USD dollar position hedged against long Rouble non-deliverable forward contracts (NDFs). The US government is net debtor of \$11.4 trillion, (\$37,000 for every man, woman, and child in America). In the next fiscal year, the US will add \$1.8 trillion more to the deficit. The Central Bank of China (second largest US creditor) fears the US may simply print dollars to pay down borrowings with cheap currency. The resulting inflation will serve as a catalyst for further price appreciation for Russian hard assets and natural resource exports. The falling dollar (and soon falling Euro), strong capital inflows, powerful trade surplus, and firm commodity prices imply continued Rouble appreciation.

With oil price, credit markets, commodity demand, and strong rouble, all remain firmly on track; still bearish? In understanding the investment climate in Moscow, the investor may wish to frame the "case for Russia" against a backdrop of global macro bellwethers.

Global equities: Broad based, world-spanning rally. Dow Jones Stoxx 600 Index best quarterly gain this decade; virtually mirroring the return of the MSCI World and the NASDAQ. Emerging markets were even stronger.

Resurgence of powerhouse economies: Chinese Manufacturing Index rose for the fourth straight month with expansionary June PMI of 53.2. (Chart with US Chicago Purchasing Manufactures Index and German Manufacturing Index YTD advance below). *Bespattered with mire, Japan remains in contraction.*



Metals and mining: Base metals associated with infrastructure and construction, are climbing. Spurred by an unanticipated increase in global demand, copper (leading bellwether of future economic activity); has soared +62% YTD.

The LME index of six nonferrous metals advanced +25% in Q2 alone, the best performance since 2003: Lead +69%, Zinc +28%, Platinum + 32%, Palladium +37%, Nickel + 27% YTD. Rio Tinto's successful \$15.2B share sale, Xstrata's \$40B USD proposed merger with Anglo American, and Australian (BHP Billiton), Chinese (Aluminium Corp of China) and Brazilian (Vale SA) hunting are positive signals for the Russian metals industry (large 12-15% of index weights and 22-27% of exports).

Contrary to media speculation, recent copper appreciation (chart above) not linked to stockpiling in China but rather true demand/consumption and global inventories are not high. LME “stocks” (inventories) have declined from recent peak of 545,000 in February to 317,000 at the end of May (Reuter’s reports inventories at 283,175 tonnes at present).

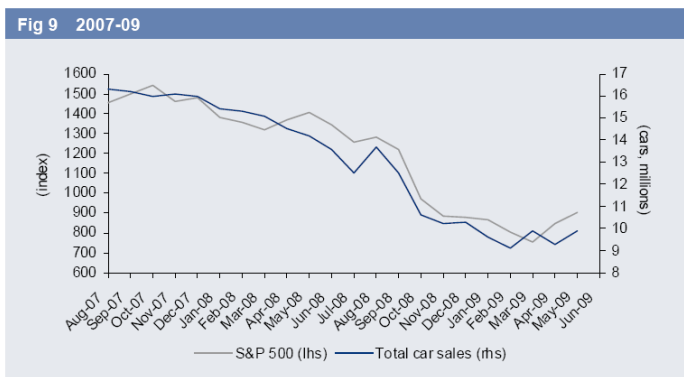
Leading indicator: American auto sales data for 2009 signal recovery and positive outlook for global recovery. Chrysler has successfully emerged from bankruptcy and General Motors (world #2 automaker) is expected to within weeks. More importantly Ford (world #4 automaker), reported a moderate (11%) decline in YoY sales on June 30th, its smallest slide in more than a year. For the industry including heavyweights Toyota #1, Volkswagen #3 and Honda #5, sales declines have slowed and industry experts predict improvements in Q3 and Q4 (chart below).

Lastly, positive fund flows: Emerging market equity funds received record inflows of \$26.5B USD for the quarter ending June 30. So why the selling?

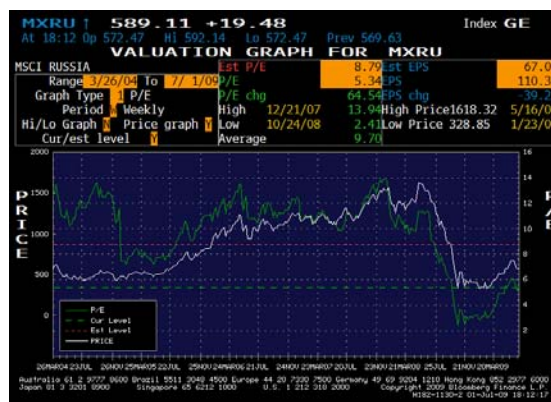
Absent of any meaningful developments on the economic front, Citigroup’s downgrade of Russia, “That Was Then, This Is Now,” June 2nd received considerable attention as managers were looking for a reason to sell. Citi curiously cited *fundamental valuations* of MSCI Russia as the rationale and driver of share price depreciation. With MSCI Russia trading at 5.34x earnings, (historical mean of 9.70x), and at a >60% discount to BRIC’s composite, this seems a stretch. After recovering from the 1998 Russian financial crisis, MSCI Russia has never traded below 5x earnings other than in the Q4 freefall of 2008 and was trading at nearly 14x just a year and one half ago (green line in chart below).

Citigroup’s Rouble call was even less convincing: “the Citi FX team expects the rouble to continue to appreciate in the short-term versus both the USD and the USD/EUR basket on the back of strength in the oil price and a return of capital flows;” - *agreed* but inexplicably, they went on to forecast 33.0/1USD for 6-12 months and 35.8/1USD in the long term representing a fall of 13%.

Industry Sector	
Sovereign Debt	16.51%
Oil - Integrated	14.77%
Equity Derivatives	14.77%
Financials	10.36%
Commodities	10.26%
Telecoms	7.90%
Electrical Utilities	7.49%
Gas Utilities	6.15%
Currency Derivatives	3.79%
Construction/Infrastructure	2.46%
Oil - Upstream E & P	2.15%
Consumer Staples	2.15%
Agriculture	1.24%
Transportation	0.0%
Metals/Mining	0.0%
Retail	0.0%
Information Technology	0.0%
Real-estate	0.0%
Machinery/Industrials	0.0%
Consumer Staples	0.0%
Beverages	0.0%
Consumer Durables	0.0%
Healthcare	0.0%
Media	0.0%
Foods	0.0%



Source: EcoWin



So what is left? Perhaps German Gref’s “second wave” of the Russian banking crisis, and the tide of rising NPL’s about to break the dyke, one reads about? It is true that in relative terms the percentage of non-performing loans has escalated from 1.8% October to 4.2% April to 10% of total loan book year end (CBR estimate). Well below prior EM crisis levels, this data must also be understood in context. As of April, some 830,000 Russians owed a paltry 136 billion roubles (\$4.3 billion) to banks, and the worst of the corporate restructuring/default story is behind. Gazprombank, the nation’s number #3 lender reports that Q1 NPL’s were flat to Q4 2008 further indicating that the worst of the restructuring is behind the industry. In the void of a functioning consumer banking system, the Russian population has the lowest debt/income level of any major country in the world. Capital adequacy ratios are generally high (18.1% vs. 8% international standards, chart next page) and aggressive loan loss provisioning by the major banks has thus far been more than adequate.

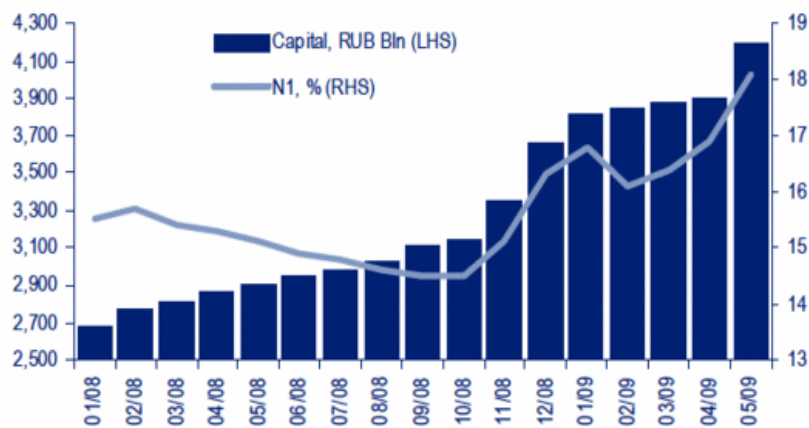
Of more serious consideration, Russian economic indicators continue to lag major emerging markets and the recession here will be deep and long-lived.

- Real Russian GDP contracted (9.8%) in Q1
- Inflation remains persistently high as CPI stood at +12.2% in May, (a slight decline from April)
- Industrial production declined (17.1%) in May, (a moderate increase from April)
- Retail sales decline steepened to (5.6%) in May, compared to an April (4.5%) decline
- Disposable incomes are dropping and unemployment rate stood at 9.9% in May (on par with US), but actually an improvement over the April reading of 10.2%
- CBR cut its benchmark lending interest rate by 50 bps to 11.5% and also lowered the repurchase rate by 50 bps to 10.5% (more cuts are anticipated and this may prove helpful in managing rouble strength and stimulating the domestic economy)
- Official GDP forecasts continue to decline from (6%) to revised (8%) 2009E, resulting from falling investment and waning consumer demand
- Russia forecasts budget deficit of 9% of GDP in CY09 and 5.5% of GDP in CY10, but this deficit can be easily financed by still buoyant (and now expanding) \$409B Forex Reserves
- The Russian auto industry (not alone) remains in crisis. Renault executives forced out of Avtovaz, GM pressured to sell investment in same, management pleading for bailouts. GAZ shares down (90%), Oleg Deripaska slashing jobs, orders down (66%). Sollers shares down (90%) also negotiating additional state subsidies, KamAZ net income declines (90%) YoY, shares down (80%). A successful WTO bid may be the final curtain for the ailing industry; but with Russia's bid conjoined with Byelorussia and Kazakhstan, the curtain call may be for another night

While neither dismissive of these hard economic realities nor certainly of the human suffering wrought by these most trying days; **Diamond Age** is sanguine, even energised. With restated certainty, there will be neither a straight-line retracement nor will all sectors and asset classes recover in tandem; but this is a time for making money.

Adequacy ratio tops 18% after raising capital

Bank's statutory capital and adequacy ratio (N1), %



Source: Central Bank

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