

DIAMOND AGE RUSSIA FUND

MONTHLY LETTER TO INVESTORS – MARCH 2011



Tōhoku Earthquake Special

“Safety is not found in the absence of *risk* but in the presence of God.” *Colossians 2:16*

After a near straight-line flat return over the first quarter 2011, investors might be wondering if **Diamond Age** has adopted a new low-vol “capital preservation” strategy. And although it may appear that on or around January 1st, the Investment Advisor abandoned his pursuit of generating outsized performance, like the six month +57.77% return 2H 2010 or the +210.72% return since calling the market bottom just 25 months ago in March 2009; this is not the case.

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 & Touche – Cayman Islands
Tax Consultants	Ernst & Young – Russia and Cyprus
Legal Counsel	Campbells – Cayman Islands
Base Currency	US Dollar
Hurdle Rate	US Dollar 3-month LIBOR + 50 bps
Inception Date	18 February 2005 at US\$100 per share
Dealing Day	Friday
Min. Subscription	US\$100,000
Bloomberg Ticker	DIAMRUS KY <Equity> <Go>

Historical Performance

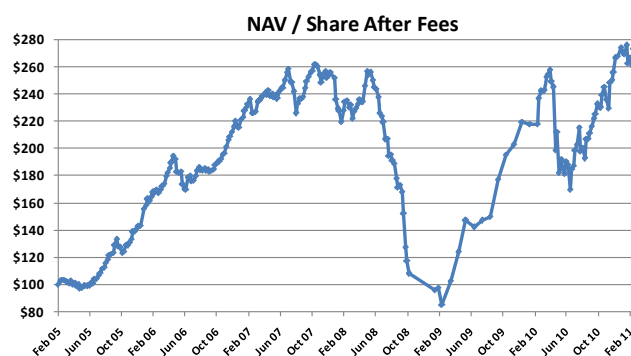
	2005	2006	2007	2008	2009	2010	2011
Jan	-	13.67%	1.29%	-10.44%	-11.34%	-0.79%	0.50%
Feb	2.24%	2.73%	5.70%	2.75%	-11.37%	0.03%	-3.09%
Mar	-0.27%	4.05%	-0.29%	-3.48%	20.53%	11.16%	1.30%
Apr	-2.54%	8.80%	1.88%	3.03%	20.86%	1.02%	
May	-0.51%	-3.78%	-0.71%	9.17%	18.71%	-21.49%	
Jun	1.84%	-1.67%	2.88%	-7.02%	-3.28%	-2.00%	
Jul	7.77%	0.37%	1.75%	-13.09%	3.37%	7.72%	
Aug	8.76%	2.33%	-4.69%	-8.69%	1.93%	-4.96%	
Sep	12.64%	0.01%	5.07%	-10.76%	18.41%	12.14%	
Oct	-6.56%	3.70%	4.99%	-35.75%	10.24%	6.31%	
Nov	7.49%	5.36%	-2.96%	n/a	3.66%	-0.13%	
Dec	7.33%	9.49%	0.80%	n/a	8.34%	16.66%	
Year	43.27%	53.70%	16.26%	-57.73%	103.00%	21.92%	-1.35%

Current Asset Allocation

Asset Class	Long	Short	Gross	Net
Equities	138.2%	13.3%	151.5%	124.9%
Bond	0.0%	54.0%	54.0%	-54.0%
Commodities	48.8%	0.0%	48.8%	48.8%
FX	0.0%	0.0%	0.0%	0.0%
Total All	187.0%	67.3%	254.3%	119.7%
Leverage	154.3%			

NAV Data

Fund Price (W/Avg), Main Class	Bid \$257.96; Offer \$264.19
Designated Investment Share Class	\$68.35
Total Assets (AUM)	\$31,994,030



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For the period, the Fund advanced a fractional +1.30% and was down an unremarkable (1.35%) YTD at month end. But behind these benign numbers a powerful event in the Pacific Ocean kept pants in chairs. Syrians, Yemenis and Bahrainis; even Libya's own "Mad Dog" were washed from the headlines in the wake of the 9.0 Tōhoku earthquake, ensuing tsunami, and Fukushima Dai-ichi nuclear meltdown, which sent the world's third largest economy into crisis.

Sector Allocation	
Sovereign Debt	21.27%
Commodities	19.18%
Financials	13.33%
Metals and Mining	7.98%
Real Estate	5.70%
Agriculture	4.34%
Coal	4.33%
Shipping	3.59%
Information Technology	3.14%
Gas Utilities	3.10%
Oil - Integrated	3.03%
Conglomerate	2.97%
Construction/Infrastructure	2.85%
E & P	2.28%
Media	1.65%
Industrials	1.26%
Total	100%

- Credit market shorts which accounted for a full short -54.00% of gross AUM, rallied aggressively in the wake of the crisis in Japan. The "flight to quality" trade (risk aversion for the safety of bonds) was expensive and like the earthquake itself, wholly unforeseen. These large short positions were covered at losses.
- Commodities which represented a substantial long 48.8% of gross AUM were crushed on the back of developments in Japan. On an intra-month basis (and curious to the Investment Advisor) soft commodities were of the hardest hit with corn -15.66%, wheat -18.97%, soy -5.70% and world sugar -12.22% before recovering. Industrial metals and other hard assets were also hammered on the view that Japan's 8% of global GDP would grind to a halt (a perception which the Fund does not share), with copper -6.65%, platinum -6.01%, and palladium -11.82% down intra-month before recovering. The only winner at the time in a sea of red was the Fund's massive slug (at one point 23.42% of AUM) of Brent ICE crude futures. The Fund sold half of the position, at large profit the day after the earthquake at \$112.65/bbl but maintains a still significant 12.08% weight @ \$117.36/bbl month end (see the February Bracketville: Manama Madness Edition, which details the case for crude in *context of MENA unrest*).
- FX cross-rate shorts were fortunately covered prior to Tōhoku but were re-initiated on March 31st at higher levels to (20.88%) of gross AUM.
- "Risk assets" such as emerging market equities (excluding oil and gas stocks, i.e. "Russia" 55% of the index) were beaten down.
- Performance in the short run was adversely affected.



The Diamond Age response was proactive, deliberate, and decisive.

- 1) On March 17th the Fund added another 35% weight to existing soft commodities at very near the bottom of the trough.
- 2) On March 22nd the Fund re-initiated long bond shorts consistent with the original and still valid fundamental investment rationale, at high prices.
- 3) The Fund added significant weight to natural gas exposure March 17th and to coal exposure via Mongolian Mining (975 HK) on March 22nd on the perception that these would be primary beneficiaries of the Fukushima Dai-ichi nuclear crisis.
- 4) On March 31st the Fund shorted slow-growth low-rate GBp, USD, and EUR against long positions in high-growth, rising rate, inflationary, commodity-centric, inflationary currencies AUD, SGD, KRW.

5) The Fund held the line, sold nothing, increased leverage, recouped the entire intra-month drop, and recorded a modest gain for the month.

And something else... on March 25th, Diamond Age bought Komatsu (6301 JP) and Mitsui Ltd (8031 JP) of Japan to 7% of gross AUM.

Komatsu (6301 JP) Infrastructure and Construction (Japan)



Simple story: Komatsu makes the heavy industrial machinery required to move the earth. This means graders, back ho's, hydraulic excavators,

bulldozers, engineering equipment, wheel loaders, forklifts, and giant dump trucks. The Fund is a proponent of the commodity-super cycle*[^]. At \$32B in market cap, Komatsu is the second largest player in the construction and mining equipment industry after Caterpillar (CAT US) \$70B, and has a 20% revenue share world-wide. Importantly, the company has the #1 position in the sector in Russia and the former Soviet Union. The Fund purchased shares in the aftermath of the Tōhoku earthquake, in part due to its perception that Komatsu will be a primary beneficiary of the rebuilding of Japan post earthquake, tsunami and nuclear meltdown.

Geographic Dispersion	
Russia	26.37%
United States	25.45%
Canada	6.94%
Australia	5.99%
Kazakhstan	4.27%
Thailand	2.91%
Georgia	2.81%
Japan	2.72%
Guinea	2.25%
United Kingdom	2.08%
Norway	2.07%
Hungary	1.95%
Ukraine	1.86%
Singapore	1.60%
Cyprus	1.54%
Philippines	1.52%
Ireland	1.42%
Sweden	1.38%
Mongolia	1.26%
South Korea	1.26%
Turkey	0.99%
Turkmenistan	0.86%
Finland	0.50%
Total	100%

- **The Investment Advisor sees a continuum of the broad-based global cyclical recovery first articulated, published, and traded on here in March 2009**
- **Lead by emerging markets, the Investment Advisor's perception is that there is growing demand for construction machinery on the back of urbanisation and industrialisation on scope and scale never before witnessed since the dawn of man; and the commodity super-cycle*[^] which Diamond Age has been yamming on about for the past many months**
- **Infrastructure and construction build out in China, Russia, India, and elsewhere in EM accelerates at unprecedented levels**
- **Post-2011 Tōhoku earthquake, ensuing tsunami, and Fukushima Dai-ichi nuclear crisis, Japan, the world's third largest economy, will undertake the largest infrastructure and construction build out since the end of the Second World War**
- **Yen sensitive (80% revenues overseas) but has offset via higher demand, cost control, price increases and overseas manufacturing**
- **No sign that China worries are impacting company growth there and the "street" still too conservative on EM demand**
- **Komatsu trades at 18.26x current, 13.28x '12 P/E, 2.49x '11 book, with higher growth 21% 5Y EPS CAGR**
- **Caterpillar trades at 25.69x current, 17.72x '12 P/E, 6.49x '11 book, with slower growth 13% 5Y EPS CAGR**

Komatsu's number one position in Russia/FSU is built on construction and machinery demand which is gathering strength lead by (unsurprisingly) metals and mining 40%, oil and gas 20%; but also federal and municipal government spend 40%. This is government funding earmarked for social projects, housing, highways, hospitals, but also the 2012 APEC Summit, the 2014 Sochi Olympics*⁺⁺, and the 2018 FIFA World Cup*^{***} 13 cities hosting 16 venues, with 3 renovated, 13 newly constructed.

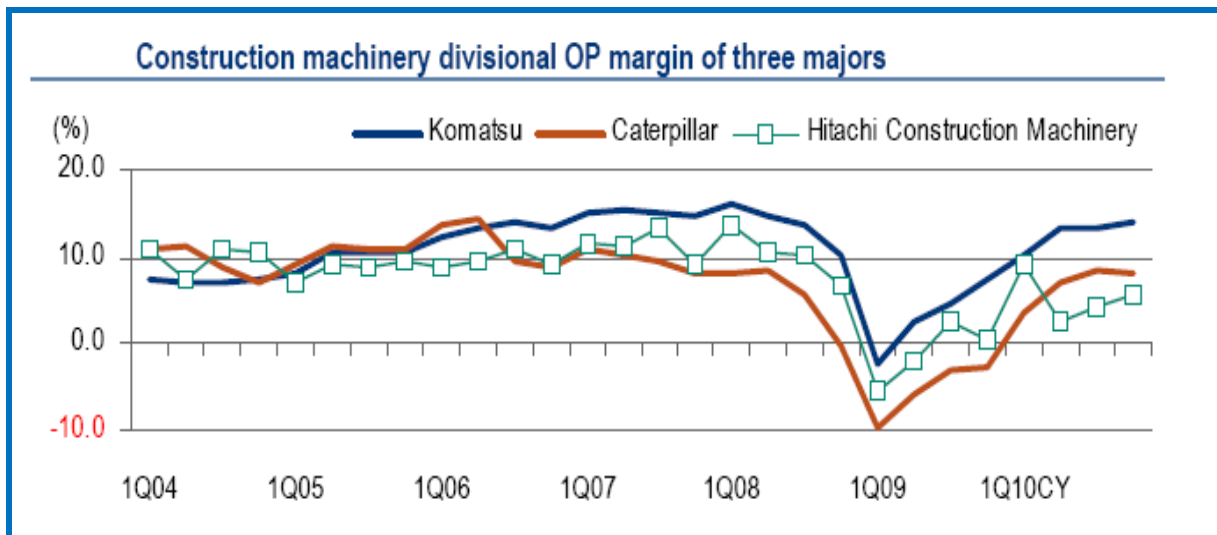
This means stadiums; train stations, alpine resorts, aero ports, "Gorki Gorod," ice skating centres, roads, ski lifts, an Olympic village, and additionally **significant associated private market spend** on hotels, restaurants, tourism and services. Living in the real world and on the ground in Moscow, it must be acknowledged that perhaps as much as 50% of all government monies designated for projects like the World Cup, Olympics, mass transit and

sadly, even medical equipment for hospitals, will simply be stolen; but on the other hand, a great deal of money will actually be spent.

The play reminds of scene eleven in the Oscar winning motion picture Braveheart where Edward I “the Long Shanks” King of England orders his archers to fire into the thickest meaty scrum in the centre of battle field.

Longshanks: “Archers.” English Commander: “I beg pardon, sire. Won't we hit our own troops?” Longshanks: “Yes... but we'll also hit some of theirs as well... Fire.”

Additionally Russia’s now all-but-certain ascension to the World Trade Organisation (WTO) **** ~ will serve as near and present catalyst powerful uplift for long-debased FDI as a co-efficient of the economy. Much of this foreign direct investment will be focused on extractive industries and thus Komatsu’s very wheel-house. **Note: actual Foreign Direct Investment for 2009 may have amounted to as little as \$3B to \$4B USD (vs. \$15.9B official) while capital flight is estimated to be >10x that number as \$50B USD.*****#**



Komatsu has the highest profit margin of the global leaders approaching 15%

Komatsu has been doing business in Russia since 1968 and now has operations in Russia, Kazakhstan, Turkmenistan, Kyrgyz Republic, Uzbekistan, Armenia, Tajikistan and Byelorussia. The firm has 10 CIS sales offices vs. four for Caterpillar and only one for Hitachi.

Komatsu is a global titan and currently the FSU co-efficient of revenues is only about 6% but expected to more than double to 13% of global sales in five years. And the investment case is of course predicated on world-wide construction spend, commodity demand, and the rebuilding of Japan. Sales globally are anticipated to increase a monster +35% '11 YoY according to company management projections on back of (“surprise”) China +40-45%, South East Asia +40-45%, and now Japan +30% (vs. +8% pre - Tōhoku earthquake). '08A to '12E 4Y EPS CAGR = 38.45%.

For the March period Komatsu was the #4 best equity line item: +11.89%

Security	KOMATSU LTD	Country	JAPAN	TTM High Date	3/31/2011
Ticker	6301.jp equity	Sector	Industrial	TTM High	2,858.00
Price Local	2,823.00	Industry	Machinery-Constr&Mining	TTM Low	1,571.00
Price USD	\$33.583	Exchange	Tokyo	YTD Return	14.90%
Currency	JPY	Dividend	\$0.40	TTM Return	44.61%
Base F(x)	84.06	Current Yield	1.19%	% to HWM	42.40%
Market Cap (MM)	\$33,539.58	ADV - 30D	9,407,847	Date HWM	10/16/2007
ASO (MM)	999	Free Float	95.21%	Short Interest Ratio	
EPS '12	6.98	P/E '12	15.54	EV/EBIT '12	11.25
EPS '11	6.12	P/E '11	18.87	EV/EBIT '11	14.15
EPS '10	5.04	P/E '10	56.53	EV/EBIT '10	54.65
EPS '09	0.80	P/E '09	13.38	EV/EBIT '09	26.02
EPS '08	1.84	P/E '08	13.50	EV/EBIT '08	13.52
Price to Book	3.24	Operating Margin	4.68	ROA	5.33
Price Revenues	1.66	Pretax Margin	4.65	ROE	16.80
Price FCF	16.60	Net Margin (5y avg)	6.27	ROC	3.19
P/EBITDA	11.31	LT CAGR	19.78%	ANR Con	4.41
BVPS	871.06	PEG Ratio	0.79	ANR Tgt	3,138.46
Rev '12	\$24,452.25	Total Debt	\$6,037.80	HDS 1	JAPAN TRUSTEE SERVIC (5.27%)
Rev '11	\$22,098.47	Total Cash	\$912.00	HDS 2	MASTER TRUST BANK OF (4.89%)
Rev '10	\$15,437.61	Enterprise Value	\$39,507.40	HDS 3	TAIYO LIFE INSURANCE (4.21%)
Rev '09	\$20,200.57	Debt Assets	29.93%	HDS 4	NIPPON LIFE INSURANC (3.33%)
Rev '08	\$19,693.73	Debt Equity	66.88%	HDS 5	KOMATSU LTD (3.05%)

Mitsui (8031 JP) Conglomerate (Japan)

Mitsui is a multi-tentacled, old-school Japanese zaibatsu 財閥 with controlling interests in hundreds of affiliated companies involved in steel, oil, cement, gold, chemicals, shipbuilding, insurance, paper, recycling, agriculture, textiles, real-estate, consumer electronics, coal, natural gas, infrastructure and construction. The Fund purchased shares of Mitsui and Co. in the aftermath of the Tōhoku earthquake, in part as it is its perception that, like Komatsu, the company will be a primary beneficiary of the rebuilding of Japan, post tsunami and Fukushima Dai-ichi nuclear crisis.

The focus here for Mitsui is on LNG and coal imports from Russia to Japan, as the country seeks to make up the shortfall in nuclear energy output, for both the short and medium term.

Zaibatsu were originally industrial-financial cliques which acted as part holding company and part socio-political force. A member of the Big Four (along with Mitsubishi, Sumitomo, and Yasuda) which once controlled 30% of the nation's economy at the start of the Second World War; Mitsui traces its origins back to the Edo Period (founded by Mitsui Takatoshi 1622–1694), and was fabric of the ruling shogun and daimyo elite. Characterised by vertical monopolies with banking arms, it is difficult to rank and filter Mitsui vs. global comps and **Diamond Age** views the business as essentially a conglomerate, something like General Electric (GE US).



In the context of the Russian investment case, Mitsui was the first Japanese company to trade with Russia dating back to the time of Tsarina Elizabeth I in 1744. The importance of the Russian market has expanded over times and in the just the past 24 months, the company has announced 12 new CIS-related business ventures and currently manages extensive Russian investments in:

- **Oil: (Sakhalin II) with partners Gazprom (OGZD LI), Mitsubishi Heavy Industries (7011 JP), and Royal Dutch Shell (RDNA NA)**
- **LNG: (Sakhalin II)**
- **Automotive: Formed a 50/50 JV with RU automaker Sollers (SVAV RU) to assemble passenger cars in Vladivostok starting 2012**
- **Automotive: makes spare parts for local market with technology from Toyota Motor (7203 JP)**
- **Agriculture: exporting Russian grain from the Russian Far East to Asia from June 2010. Plans to build a modern grain terminal on Russia's Pacific shore in Primorsky Krai**
- **Coal: buying up to 75% stake in a large Siberian coal deposit from Sergei Pugachev for \$3B USD through a consortium**
- **Finance: Agreed to buy 14.9% stake in Russia's largest instant payment system Qiwi in January 2011**

The Fund invests in Mitsui based on global (as well as Russian) exposure to infrastructure, agriculture, energy and commodities (especially coal, iron ore, and LNG), but even more so with focus on EM and specifically post Tōhoku Japanese energy requirements (electricity).

Value. While the Fund does not buy cheap assets based on low multiples, it has been nearly 30 years since one could buy in the bluest of Japanese blue-chips at near book value, and 5.74x '11 price to earnings (with the Nikkei 225 trading at 17.6x), and a dividend yield of 3.3% (with the Nikkei 225 at 1.8%). Debt-to-equity ratio has been halved since 2008 to 64%, ROE has doubled to 18%, and the company is experiencing significant EPS growth.

Management has revised up its FY11 net profit estimate sharply from Y320bn to Y370bn (up 147% YoY), and increased its annual dividend forecast from Y40 to Y47 (payout ratio at 23%). FY EPS CAGR is 20% for a PEG rate of 0.27. It is increasingly difficult to find high quality

Security	MITSUI & CO LTD	Country	JAPAN	TTM High Date	4/12/2010
Ticker	8031 jp equity	Sector	Consumer, Cyclical	TTM High	1,665.00
Price Local	1,514.00	Industry	Distribution/Wholesale	TTM Low	991.00
Price USD	\$18.011	Exchange	Tokyo	YTD Return	12.90%
Currency	JPY	Dividend	\$0.25	TTM Return	-3.65%
Base F(x)	84.06	Current Yield	1.39%	% to HWM	49.1%
Market Cap (MM)	\$32,943.41	ADV - 30D	12,262,640	Date HWM	10/29/2007
ASO (MM)	1,829	Free Float	96.46%	Short Interest Ratio	
EPS '12	9.06	P/E '12	5.71	EV/EBIT '12	9.24
EPS '11	8.60	P/E '11	6.01	EV/EBIT '11	11.05
EPS '10	6.99	P/E '10	7.39	EV/EBIT '10	38.46
EPS '09	0.97	P/E '09	55.23	EV/EBIT '09	15.20
EPS '08	1.97	P/E '08	27.22	EV/EBIT '08	18.21
Price to Book	1.25	Operating Margin	3.53	ROA	5.33
Price Revenues	0.64	Pretax Margin	6.29	ROE	2.60
Price FCF	8.09	Net Margin (5y avg)	5.02	ROC	3.36
P/EBITDA	7.37	LT CAGR	15.49%	ANR Con	4.82
BVPS	1,214.28	PEG Ratio	0.37	ANR Tgt	1,995.83
Rev '12	\$145,055.85	Total Debt	\$37,320.58	HDS 1	MASTER TRUST BANK OF (8.81%)
Rev '11	\$132,990.51	Total Cash	\$11,792.16	HDS 2	JAPAN TRUSTEE SERVIC (8.35%)
Rev '10	\$44,174.98	Enterprise Value	\$59,936.01	HDS 3	MITSUBISHI UFJ TRUST (5.39%)
Rev '09	\$55,306.09	Debt Assets	42.24%	HDS 4	SUMITOMO MITSUI BANK (2.1%)
Rev '08	\$50,387.33	Debt Equity	145.50%	HDS 5	NIPPON LIFE INSURANC (1.92%)

growth stories which have not already made powerful strides back to pre-crisis high water marks. At 1,473 JPY, Mitsui would require an additional 109% advance to find its way back to the 2007 high.

***^ Commodity "Super-cycle". October 2010 Monthly Letter to Investors: Even better, we see your super-goldilocks and raise "Super-Cycle" (a term not heard from since May 2008) back to the lexicon of Russian hedge fund investing. Last month, the world's attention was on the fate of 33 miners trapped in the world's largest copper mine, Escondida, Chile where 20 years of digging have left a hole the size of downtown Manhattan. The mine which accounted for 10% of global production in 2007 has since dropped output by 25%. As consumption of industrial metals in China, India, and other high-growth economies advances, production and output capacity are falling below demand. The best resources in the world (like oil) have been developed and the costs/risks of maintaining global production will only escalate.**

The confluence of industrialisation, urbanisation, EM population growth, resurgent demand, rising extraction costs and scarcity of resources indicate that commodities have entered into a period of a "super-cycle": a decades-long period of higher prices driven by the emerging middle classes, rising living standards, and eventually American-style individual consumption levels in a one directional shift in power, prestige, and demand moves from West to East. Not restricted to base metals only, there is a finite level of oil and other commodity resources in the earth and an unlimited growth in population with associated unlimited growth in demand.

Not exclusively, but this paradigm remains very much driven by the China story. China quadrupled its copper consumption since 1995, growing from 10% of global demand to 40% in 15 years. With Chinese demand expecting to double again by 2020, the implications are clear. Greater than 700MM of China's 1.3 billion people live in the rural interior representing greater than 75% of the land mass and the area the NPC is stridently committed to developing over the next 15 years. Over this period, the country will need to develop 150-200 mass transit systems, 50,000 skyscrapers, and high-density urban apartments for a minimum of 400 million people.

Komatsu's 2011 YoY China business is expected to grow at 40-45% YoY.

Imagine the end market doubling for just about everything from electricity, consumer durables to cars, construction, and most importantly commodity intensity burn-rate. Rural agrarians have a 70% lower commodity burn-rate than urbanites. August Letter to Investors: This means rebar (read metallurgical coal), electricity (read thermal coal), oil, gas, copper, industrial glass, infrastructure spend and still greater, unending demand for materials and basic resources. August YoY electricity demand in China grew at 18%! Not nuclear, not solar, not wind; this is all about coal.

Illustration: Just this month, China bought the entirety of a Peruvian mountain in Morococha, estimated to contain up to \$50B in copper ore deposits for a niggardly \$810MM (nice trade), part of \$11B in pending Chinese mining investments in Peru alone. But the investment is not without its expenses. The Chinese plan to relocate the entire indigenous population living on the peak (three villages and some 4,681 villagers) and completely level the mountain. Not in Marin County!

As India with 1.1B people, a higher population growth rate, significantly less developed infrastructure, and an even higher percentage of the population living in the agricultural interior ramps up, we anticipate a multiplier effect significantly beyond current estimates. It is not by accident that COMEX December Copper futures represent one of the largest line items in the portfolio. Consider: "Hoarding," real and present.

****+Sochi Olympics. Russia was awarded the 2014 Winter Olympics which, like the World Cup is a massive economic stimulus for the economy and essentially requires the creation of a world-class Olympic venue from scratch. "None of the stadiums are constructed as of now, and there is a massive spending budget," said Vladimir Osakovsky, an economist at Moscow-based Aton Capital. "Everything has to be constructed, and a lot of steel will be used there." Again powerful benefit to current asset allocation as shares of Evraz, which specializes in long steel products including rails and beams for buildings, jumped 7.6 percent on the news. All infrastructure and material plays stand to benefit with significant build up over the next four years.**

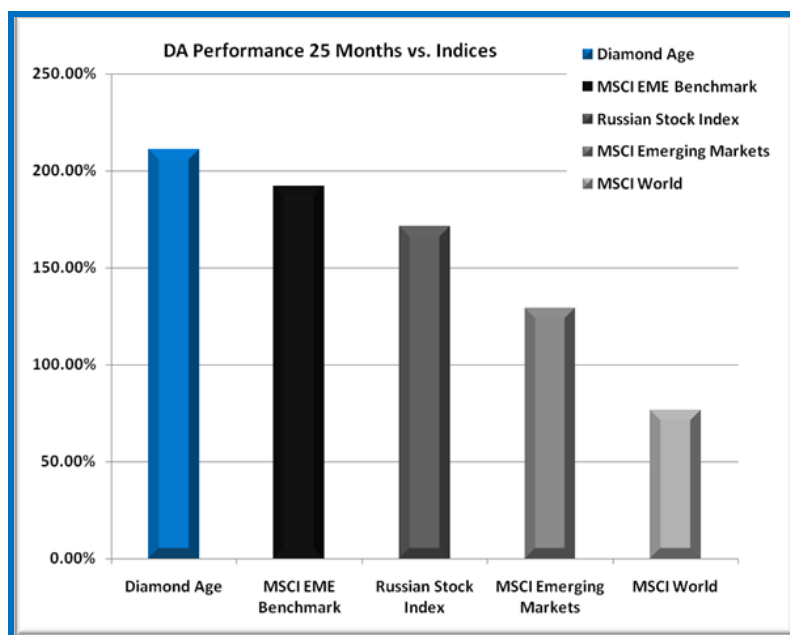
*****` World Cup. Russia was awarded the 2018 World Cup which will be played in 13 cities and 16 stadiums throughout the country. More than a publicity victory, the World Cup means \$25B (official) and up to \$50B (Vedomosti) invested in aero ports, rail systems, facilities, roads, sewers, security, and infrastructure by the government alone. Additional hundreds of millions will be pumped into the economy from the private sector in building non-existent three star hotels, in addition to restaurants, travel ventures, hopefully parking lots, and other service facilities.**

“We have a lot to do -- stadiums, airports, roads,” Prime Minister Putin said. “But this presents us with a challenge, and this is the advantage of our bid. It means the development of world football, but also the development of roads and transportation infrastructure for our country.”

******~ WTO Entry.** *Yes, it is true and after 14 years of delays, Russia will gain WTO admission in 2011. It is anticipated that membership will contribute 2 to 3 percentage points per year to GDP as FDI bolsters domestic manufacturing, service industries diversify the economy and exports surge. Subsidised and inefficient state-backed industries will attract strategic multinationals with technology and capital. Or they will fail and be replaced with stiff, stronger, faster, more competitive new entrants. In the 9 years following China’s admission to WTO in 2001, real GDP grew at >9% per year. Similarly in the 15 years following Japanese integration into the global economy in 1945, real GDP grew at greater than 9% per year. Integration standouts of Poland, Brazil, Korea, and India illustrate the potential economic benefit of WTO ascension for Russia.*

******# FDI and capital flight.** *2010 figures not yet available but the BBC estimates \$50B in 2009 capital flight. Despite the powerfully positive reversal in Russian capital markets, foreign investment in Russian stocks and bonds declined -37.7% in 2009, even as equity markets advanced >100%. FDI is falling off a cliff and not specific to the 2008 crisis. Total Foreign Direct Investment amounted to just \$15.9B USD in 2009, down -41% YoY and down -77% from 2006 levels of \$70.1B. A look behind the numbers reveals a much darker investment picture. Of the \$15.9B, the 26.1% from Cyprus is Russian offshore money. So is substantially all of the 10.1% from Switzerland, 6.2% BVI, 1.9% Luxembourg, 3.5% Byelorussia, and 1.8% Ukraine. Most of the 10.1% USA and the 4.0% UK FDI is Russian diaspora, as is certainly most of the 33.7% “other.” While one will never know with any degree of certainty, the possibility exists that there is no more than \$3B to \$4B USD in foreign direct investment in 2009 (about the size Wendy’s Burgers WEN US) vs. perhaps \$50B in capital flight.*

How are we doing?



Name		25 Months
Diamond Age	(DIAMRUS KY)	210.72%
MSCI EME Benchmark	(MXMU)	191.91%
Russian Stock Index	(MICEX)	171.37%
MSCI Emerging Markets	(MXEF)	129.11%
MSCI World	(MXWO)	76.58%

Swimmingly! Investors are now up more than 210% in a little more than two years since calling the market bottom in March 2009. **Diamond Age** is one of only three funds tracked on Bloomberg to have retaken the pre-2008 financial crisis high water mark (accomplished December 2010), as was the second best performing of all Russia funds for the last six months of 2010 +57.77% 2H '10. Net return to investors is 10% higher than the benchmark, 23% higher than the Russian stock market, 63% higher than emerging markets and 175% higher than world equities.

Diamond Age is specifically constructed not to replicate a stock index or mirror a Russian ETF. It is being managed to generate meaningful wealth creation for investors; with global, diversified, performance returns commiserate with the risk of investing in Russia-related assets, the risk-trade, commodities, and emerging market equities. This investment mandate involves significant unhedged risk.

March performance attribution:

- **Equities: 138.2% gross AUM top stocks for March: 1. Enka Insaat (ENKAI TI) Turkey – Construction +5.11%, 2. short Mail.ru Group (MAIL LI) Russia – Media (8.63%), 3. CTC Media (CTCM US) Russia – Media +9.63%, 4. Komatsu Ltd. (6301 JP) Japan – Construction +15.81%, 5. Charoen Pokphand Foods (CPF TB) Thailand – Agriculture +4.60%, 6. Hyundai Mipo Dockyard (010620 KS) South Korea – Industrials +4.49%, 7. International Container (ICT PM) Philippines – Ports +4.92%, 8. Gazprom (OGZD LI) Russia – Gas +9.59%, 9. short Frontline (FRO NO) Norway – Shipping (10.39%), 10. Noble Group (NOBL SP) Singapore – Conglomerate +4.83%**
- **Commodities: 48.8% gross AUM: May ICE Brent Crude (COK1) 11.93%, April Comex Platinum (PLJ1) 5.29%, May Copper (HGK1) 9.08%, June Palladium (PAM1) 6.98%**
- **Soft commodities sub set: 15.49% gross AUM: May Corn (C K1) 4.64%, May Sugar #11 (SBK1) 3.96%, May Soybeans (S K1) 3.38%, May Wheat (W K1) 3.52%**
- **Credit Markets: short (-54.00%) gross AUM: short Australian 10Y bond futures (XMM1) (15.23%), Canadian 10Y bond futures (CNM1) (17.64%) and US 10Y bond futures (TYM1) (21.22%)**
- **FX derivatives: short (20.89%) AUM slow growth, low rate currencies – the USD, Euro and GBP – and long inflationary, fast growth, high-rate, commodity centric currencies – Australian Dollar, Korean Won and Singapore Dollar currency derivatives (90 days NDF's) X-rate trades**

Outlook:

Inflation and credit market shorts

With nary a friend in the world the Fund's 2011 inflation concerns, first published in August of 2010 with the "two rate world" scenario and later in the December "EM inflation threat to current portfolio construction"; are now near consensus.

Not merely the non-core food and energy inputs. EM inflation is also real



wages, real-estate, mortgages, and other inputs. Despite persistently high unemployment, output gaps and low capacity utilisation, DM inflation grows as well.

NEW YORK (CNNMoney) -- When news broke that Pimco's Total Return Fund (**PTTRX**) had slashed its U.S. Treasury holdings to zero, investors were left wondering why the world's biggest bond fund would bail out of the safe haven.

"Everything you buy and hold must have value," said Pimco CEO Mohamed El-Erian at a market outlook event hosted by Thomson Reuters Thursday. "In our estimation there was better value elsewhere."

In just two months time, **Pimco cut its exposure** to U.S. government debt to zero. "When we looked at what was available, there were Treasury-like instruments that had better value," said El-Erian.

Mike Duke, CEO of Wal-Mart, is now saying that U.S. inflation is “very serious” and that Wal-Mart is already seeing “cost increases starting to come through at a pretty rapid rate.” Food and energy? How about: “soaring labour costs in China” and around the world, retail prices will start increasing at Wal-Mart and other comps in June. Developed markets “import” emerging markets inflation with food, clothes, manufactured goods, and there is no “Chinese wall.” Like the illusionary no-smoking section in four or five restaurants in the whole of Russia, the smoke pays no heed to the “air wall.”

Inflation headlines like these are dime a dozen, the rate cycle has long-ago turned, yields trend higher, bond prices fall. Credit market shorts to 54% gross AUM reinitiated March 22nd.

EM inflation food chain thesis from January 2011 Letter to



Investors is employed. Asset allocation favours (in order): 1) things that can be eaten: agri-bulks and soft commodities, 2) things that can be used: coal, oil, gas, rubber, cement, bricks, 3) things that are permanent, hard assets and base metals,... 4) cautious on equities, 5) short paper assets like Fx, and especially 6) short long dated bonds.

“In March, U.S. spent 8x monthly tax receipts, including maturing treasuries. The treasury netted \$128B in tax receipts, but paid \$1.05 trillion: \$49.8B Social Security, \$47.4B Medicare, \$22.58B Medicaid, and \$37.9B in defence. However, the U.S. paid out the most for maturing U.S. treasuries, equalling \$705.3B. In order to stay afloat with only \$128.18B, it had to spend \$72.5B from its balance of cash, which ended the month at only \$118.1B, and sell \$18B worth of TARP assets. But most importantly, the U.S. treasury had to sell \$786.5B in new treasury bonds.”

“The U.S. government is the largest ponzi scheme in world history. US can only fund government expenditures and pay off maturing debt plus interest, by issuing larger amounts of new debt. Americans are lucky that we have been blessed with record low interest rates for an unprecedented amount of time, but NIA believes that as we roll over U.S. treasuries in the future, we will have to refinance them at much higher interest rates. Interest will become the government's largest expenditure. Failure to enact QE3 (by another name), could literally see the 10-year bond yield double from 3.52% to north of 7%, overnight as without it, there would be such a short fall in buyers.” NIA National Inflation Association

Natural resources

Don't believe what you read. There is no end of Chinese commodity demand and post-Japanese air pocket; copper may advance 20% to 30% in 2011 on biggest mine shortages since 2004. Chinese GDP will “slow” to 9.5% in 2011 from 10% in 2010. This is not an Asia story but rather worldwide high intensity burn-rate for commodities. Chicago PMI in March grew at the fastest rate in 20 years. The US economy is “getting better month by month,” Warren Buffet. Broad-based cyclical recovery expands and so with it associated demand for commodities.

Adding to the copper trade is the fact that supply is being cut short as output falls and recovery costs rise for the world's largest copper producers. Production at the Escondida mine in Chile, the worlds largest, will drop by as much as 10% this year according to BHP Billiton (BHP AU), the world's largest miner. World #2 Rio Tinto is “struggling to maintain supply” because of declining ore grades and delays in mine expansions. Freeport-McMoRan (FCX US), the largest publicly traded copper producer, said in January that it would produce less metal in 2011... as did Anglo American (AGL SJ) and Kazakhmys (KAZ LN). The Fund maintains large weights in crude oil, palladium and platinum futures to 35% of gross AUM.

Race for African resource theme

After selling meaningful positions at large profits in Riversdale (RIV AU) Mozambique and Sundance Resources (SDL AU) Cameroon; the Fund still maintains a significant weight in Bellzone Mining (BZM LN) Guinea, while looking to continue populate its “race for African resources” theme with new entrants. In March, China’s Minmetals Resources Ltd. (1208 HK) bought Equinox Minerals (EQN AU) for \$6.3B AUD giving it control of Africa’s largest copper mine. The sale represents China’s largest ever mining purchase in Africa and the race advances. This boosted Equinox shares 28% on the day.

Executive Summary

Diamond Age maintains that the confluence of industrialisation, urbanisation, EM population growth, resurgent demand, rising extraction costs and scarcity of resources indicate that commodities have entered into a period of a “super-cycle”: a decades-long period of higher prices driven by the emerging middle classes, rising living standards, and eventually American-style individual consumption levels in a one directional shift in power, prestige, and demand moves from West to East.

Unwavering in its perception since March 2009, the Fund maintains that we are in the midst of a post-crisis global recovery which is largely consistent with historical post-crisis recoveries. Investment climate for “Russia” maybe fairly characterised by world-wide growth, inventory restocking, urbanisation, industrialisation, and associated demand for raw materials.

Important to note that while inflation is an important driver of paper asset price depreciation, it does not mean the end of natural resource and materials consumption, or indeed pricing of the underlying commodities which may well serve as an inflation hedge. Understanding that during the inflationary “Great Bear” Market in the 1970’s, stocks and paper assets were devastated and commodity prices and hard assets made new highs; and 40 years later to this day still all time high prices.

Diamond Age remains long and leveraged to Russia-related assets, the risk trade, basic materials, and agriculture. The Fund plans to continue reducing its exposure to emerging market equities. The Fund is short long dated bond futures; short G7 and safe haven Fx. Largest holdings include short June Aussie -15.23%, Canadian -17.64%, 10Y Bond futures -21.22%, long May Brent ICE crude futures 11.93%, May Comex Copper futures 9.08%, short Mail.ru (MAIL LI) Russia -7.98%, long Charoen Pokphand (CPF TB) Thailand 7.41% and Sberbank Preferreds (SBERP03 RX) Russia 10.68%.

Favoured stock sectors remain metals, financials, industrials, coal, construction, real-estate, and agriculture. As such the Fund has zero exposure to defensive sectors of healthcare, consumer staples, telecommunications, food retail or electrical utilities.

Diamond Age Capital Advisors Ltd. receives sub-advisory counsel from Eighth Continent Capital Pte. Ltd.; a partnership which represents a continuity of investment advice dating back to initial Diamond Age Russia Fund inception February 2005. Content of this Letter to Investors provided by Eighth Continent Capital Pte. Ltd. in cooperation with Diamond Age Investment Advisors Ltd.

Addendum I: other Japanese names

The Investment Advisor also looked at and the Fund used to own until 2007:

- Asahi Glass (5201 JP) but prefer Trakya Cam (TRKCM TI) Turkey at this juncture. May revisit depending on Japanese response.

Security	ASAHI GLASS CO LTD	Country	JAPAN	TTM High Date	3/1/2011
Ticker	5201 jp equity	Sector	Industrial	TTM High	1,163.00
Price Local	1,041.00	Industry	Building Materials	TTM Low	764.00
Price USD	\$12.384	Exchange	Tokyo	YTD Return	9.69%
Currency	JPY	Dividend	\$0.17	TTM Return	-2.13%
Base F(x)	84.06	Current Yield	1.38%	% to HWM	19.1%
Market Cap (MM)	\$14,695.92	ADV - 30D	6,885,267	Date HWM	4/18/2007
ASO (MM)	1,187	Free Float	90.76%	Short Interest Ratio	
EPS '12	3.89	P/E '12	5.78	EV/EBIT '12	7.39
EPS '11	4.04	P/E '11	7.12	EV/EBIT '11	7.42
EPS '10	3.89	P/E '10	19.05	EV/EBIT '10	7.84
EPS '09	0.18	P/E '09	10.01	EV/EBIT '09	22.12
EPS '08	0.33	P/E '08	10.75	EV/EBIT '08	13.73
Price to Book	1.50	Operating Margin	17.78	ROA	5.33
Price Revenues	0.94	Pretax Margin	14.91	ROE	12.20
Price FCF	6.46	Net Margin (5y avg)	4.19	ROC	9.29
P/EBITDA	3.57	LT CAGR	4.92%	ANR Con	4.10
BVPS	693.68	PEG Ratio	1.17	ANR Tgt	1,207.33
Rev '12	\$16,761.28	Total Debt	\$6,449.16	HDS 1	MASTER TRUST BANK OF (6.08%)
Rev '11	\$16,192.02	Total Cash	\$1,096.32	HDS 2	JAPAN TRUSTEE SERVIC (5.52%)
Rev '10	\$14,724.57	Enterprise Value	\$20,517.06	HDS 3	MEIJI YASUDA LIFE IN (4.05%)
Rev '09	\$12,286.41	Debt Assets	34.49%	HDS 4	TOKIO MARINE & NICH (3.98%)
Rev '08	\$14,010.30	Debt Equity	71.60%	HDS 5	NIPPON LIFE INSURANC (2.89%)

And another name looked at and the Fund used to own until 2007:

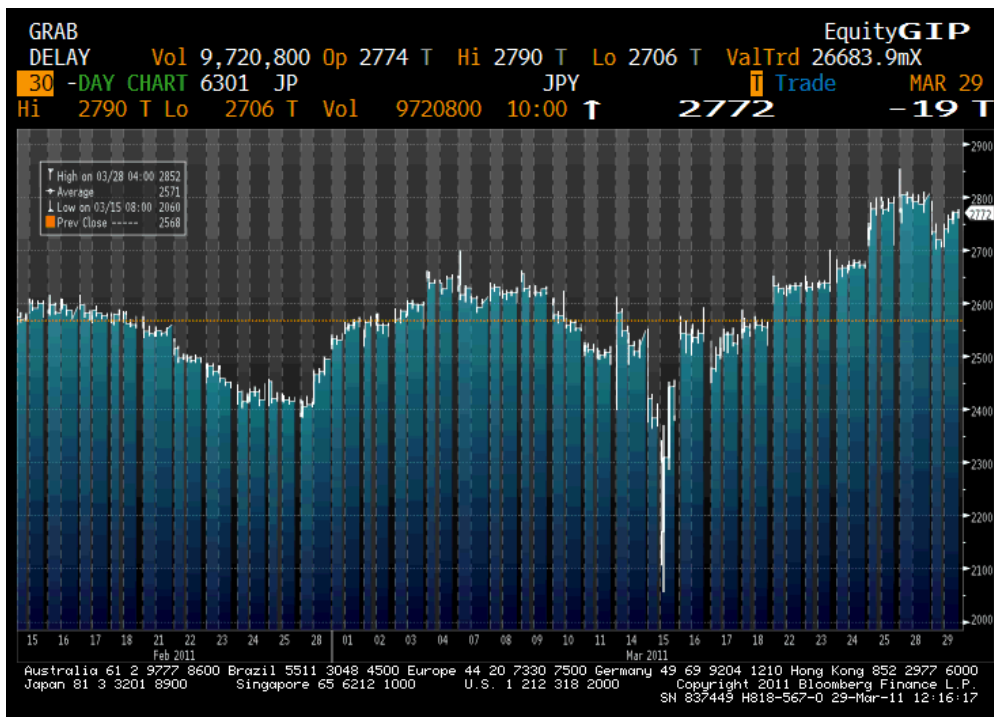
- Ishikawajima-Harima Heavy Industries (7013 JP) with multiple Russian JV's in attractive sectors but their large nuclear business unit represents too much uncertainty at this time.

Security	IHI CORP	Country	JAPAN	TTM High Date	2/21/2011
Ticker	7013 jp equity	Sector	Industrial	TTM High	226.00
Price Local	210.00	Industry	Machinery-Diversified	TTM Low	139.00
Price USD	\$2.498	Exchange	Tokyo	YTD Return	16.02%
Currency	JPY	Dividend	\$0.00	TTM Return	25.50%
Base F(x)	84.06	Current Yield	0.00%	% to HWM	69.4%
Market Cap (MM)	\$3,664.96	ADV - 30D	17,102,430	Date HWM	3/28/2007
ASO (MM)	1,467	Free Float	93.94%	Short Interest Ratio	
EPS '12	0.63	P/E '12	11.35	EV/EBIT '12	
EPS '11	0.56	P/E '11	12.88	EV/EBIT '11	11.61
EPS '10	0.48	P/E '10	14.96	EV/EBIT '10	13.85
EPS '09	-0.05	P/E '09	-147.34	EV/EBIT '09	27.45
EPS '08		P/E '08	49.29	EV/EBIT '08	-47.73
Price to Book	1.38	Operating Margin	3.79	ROA	5.33
Price Revenues	0.24	Pretax Margin	1.84	ROE	
Price FCF	8.96	Net Margin (5y avg)	0.56	ROC	3.50
P/EBITDA	3.04	LT CAGR		ANR Con	3.44
BVPS	152.09	PEG Ratio		ANR Tgt	219.29
Rev '12	\$15,622.51	Total Debt	\$4,299.63	HDS 1	JAPAN TRUSTEE SERVIC (3.87%)
Rev '11	\$15,068.12	Total Cash	\$1,017.57	HDS 2	TOSHIBA CORP (3.78%)
Rev '10	\$13,400.95	Enterprise Value	\$7,043.27	HDS 3	DAI ICHI LIFE INSURA (3.68%)
Rev '09	\$13,868.85	Debt Assets	30.59%	HDS 4	MASTER TRUST BANK OF (3.06%)
Rev '08	\$11,857.97	Debt Equity	190.27%	HDS 5	MIZUHO BANK LTD (2.98%)

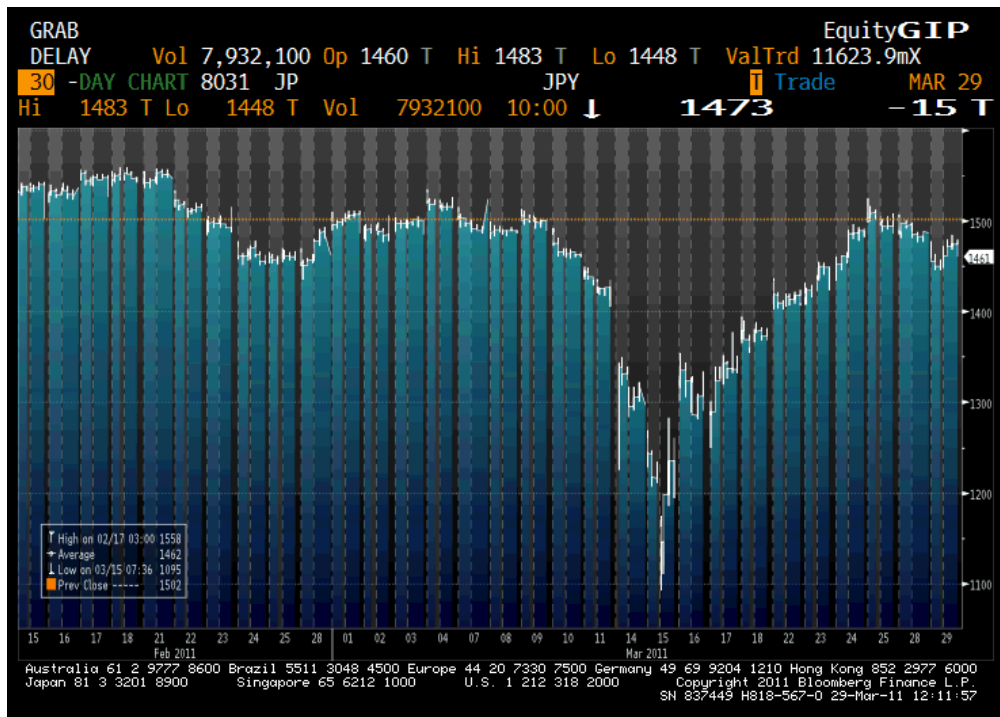
As well as:

- Mitsubishi Heavy Industries (7011 JP), which is the 1st Japanese company to enter the electrical power plant market of the former Soviet Union with large exposure to Russian chemicals, natural resources, and energy space (Sakhalin). But the Fund is not buying electrical utilities at this time and has maintained zero exposure since March 2009.
- A&D Corp (7745 JP) (Fund sold at loss many years ago and need to revisit).

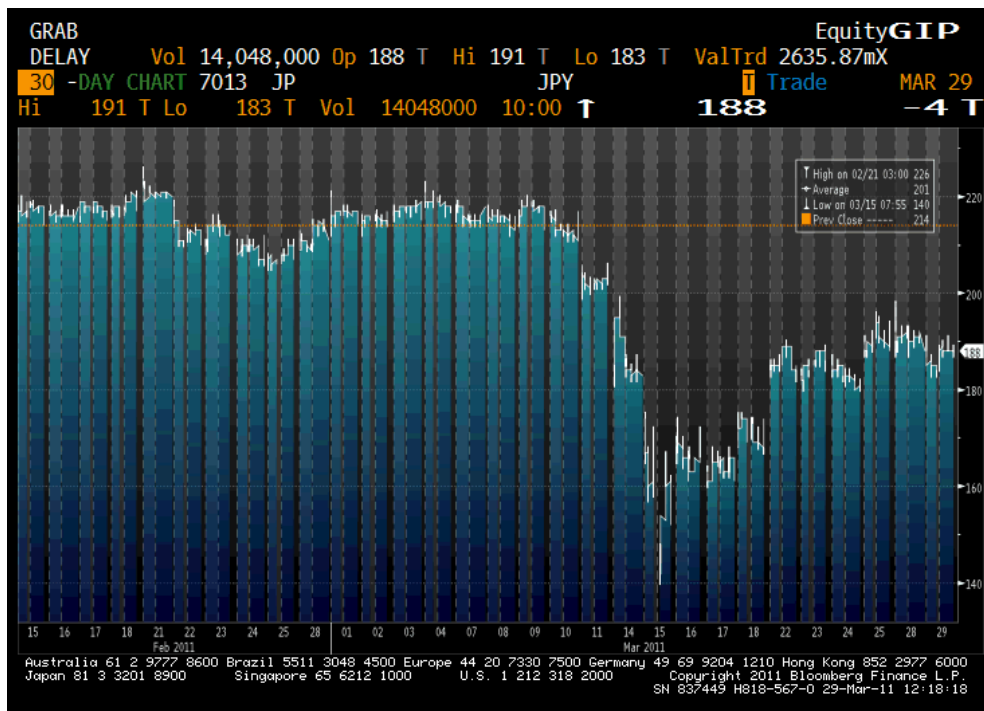
Addendum II: Japanese charts



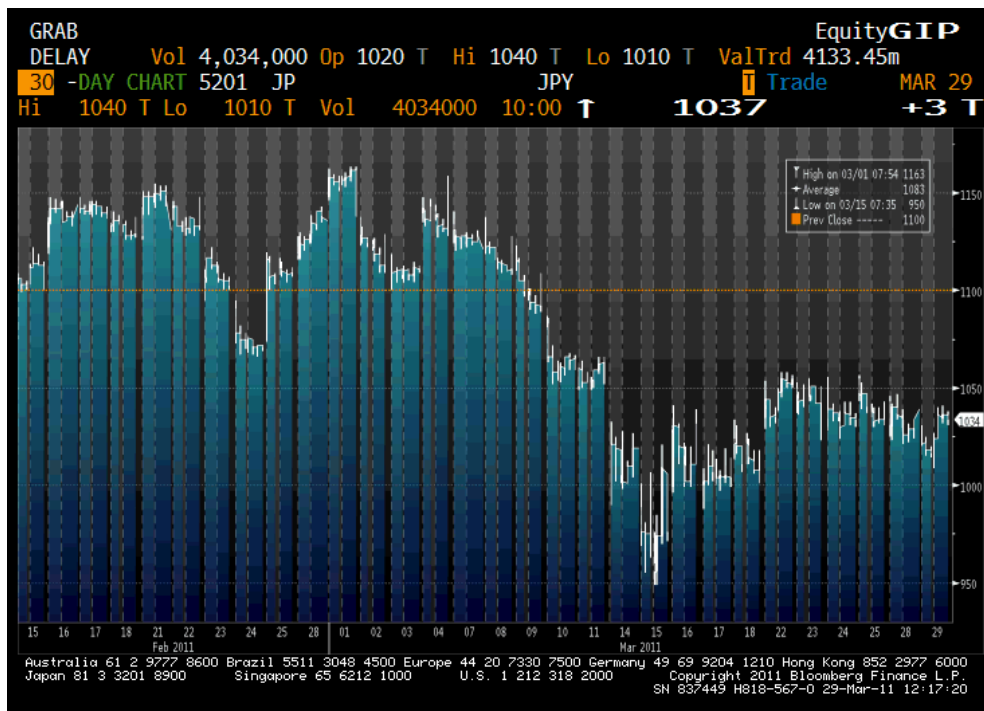
- Komatsu (6301 JP) 5Y and 30D



- Mitsui (8031 JP) 5Y and 30D



- Ishikawajima-Harima Heavy Industries (7013 JP) 5Y and 30D



- Asahi Glass (5201 JP) 5Y and 30D

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