Theta Deep Value Fund

THETA
CAPITAL MANAGEMENT B.V.

DE LAIRESSESTRAAT 180
1075 HM AMSTERDAM
THE NETHERLANDS
T +31 20 5 722 733
F +31 20 5 722 744
I WWW.THETACAPITAL.COM

Quarterly Investor Letter – Q3 2007

Theta Capital Management
November 2007

Dear investor,

The Theta Deep Value Fund (the Fund) had its best quarter since inception, generating a return of **10.5%** in the third quarter of 2007. This brings the performance to **25.3%** since January this year and to **36.3%** since inception of the Fund in July 2006. Performance is comfortably above our target range of 15-20% per annum over a five-year investment horizon. Note that when marketing the Fund, we cautioned potential investors that returns during the first year could be rather modest, due to the fact that many of the positions in underlying hedge funds were still in the ramp-up phase and, almost by definition, unlocking *deep value* may take some time. We reiterate that returns of the Fund are expected to be lumpy rather than smooth, and one should evaluate the Fund's performance on a medium-term horizon of 3-5 years.

Theta Deep Value Fund - Performance (Series July 2006)

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	2006
Net Performance							-1.68%	1.19%	-0.75%	3.17%	2.90%	3.83%	**8.83%**
Cumulative Performance							-1.68%	-0.51%	-1.26%	1.87%	4.82%	8.83%	

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	2007
Net Performance	-0.08%	6.60%	1.12%	1.36%	0.99%	2.80%	6.47%	1.26%	2.52%				**25.27%**
Cumulative Performance	8.74%	15.91%	17.21%	18.81%	19.99%	23.34%	31.32%	32.97%	36.33%				

Note: As the fund's independent administrator provides an official NAV on a quarterly basis, monthly numbers are estimates provided by the manager.

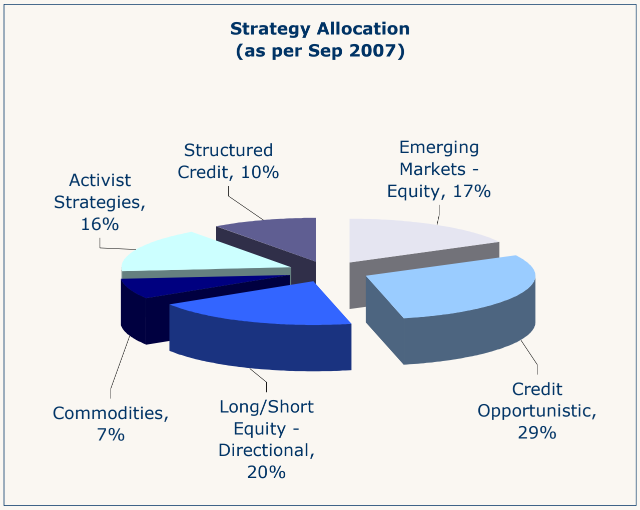
That being said, we are satisfied to see that, in spite of extreme volatility and dislocated markets creating a challenging environment for hedge funds, our rather concentrated portfolio (15 hedge funds) managed to navigate these markets without one single down month during this quarter. An important driver of this success has been our short exposure to the US subprime mortgage markets through an investment in the Paulson Credit Opportunities funds, which generated a return of more than 100% in third quarter alone (see below). Year-to-date, the Paulson funds have contributed about two thirds of the Theta Deep Value Fund's performance, significantly more than both the fund manager and ourselves would have expected. At the same time, it is our experience that portfolio performance in any given year tends to be driven by a limited number of managers. The problem is, *ex ante*, you never know which ones…Therefore, we try to diversify our Fund across investment horizons (the moment that deep value translates into actual performance).

Although not as spectacular, performance of the other funds has also been satisfactory, particularly in Emerging Markets Equity and Commodities. On the back of the market turmoil, Long/Short Equity and Activist managers had a more challenging summer although losses remained modest. A good example is our investment in two funds with a distressed ABS/CDO strategy which, due to a lack of distressed opportunities until this summer, are only now starting to call our committed capital and put it to work in opportunities arising from the market turmoil.

Looking ahead, we maintain our cautious stance towards credit in all shapes and forms as we believe it will take considerably more time for the market to change its perception of risk in terms of leverage, liquidity and valuations. In fact, it could well be that we are currently only seeing the early stages of a *credit crunch*, which is an economic condition in which loans and investment capital are difficult to obtain. In such a period, banks and other lenders become more reluctant to extend loans, so the price of borrowing rises, often to the point where deals simply do not get done. We note however that such periods of volatility tend to create significant investment opportunities and, given the long-term nature of our fund and the way we are positioned (a.o. with two managers in distressed CDO space) we expect to benefit from the environment. At the same time, we see interesting opportunities in emerging markets and Theta Deep Value has significant exposure there.

Portfolio Allocation

Strategy Allocation	Sep-07
Emerging Markets - Equity	**17%**
Montpelier Fund	
Greater Europe Deep Value Fund	
Credit Opportunistic	**29%**
Paulson Credit Opportunities Funds	
Camulos Special Situations Fund	
CQS Directional Opportunities Fund	
Long/Short Equity - Directional	**20%**
Ecofin Special Situations Fund	
CIM Special Situations Fund	
Sector Speculare III	
Commodities	**7%**
Red Kite Metals Fund	
Red Kite Prospect Fund	
Activist Strategies	**16%**
Focus Capital Investors	
Marwyn Neptune Fund	
Pershing Square	
Structured Credit	**10%**
Eidesis Special Opportunities Fund	
ZAIS Matrix V	
Total	**100%**



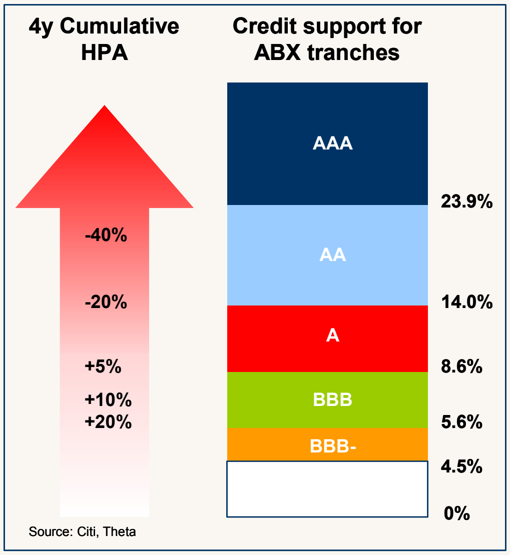
We believe our eclectic mix of hedge fund managers in a portfolio which is concentrated by *number* of hedge funds but well-diversified across markets, regions, investment strategies and time horizons, is well positioned to deliver its target return of 15-20% per annum over a five-year investment cycle.

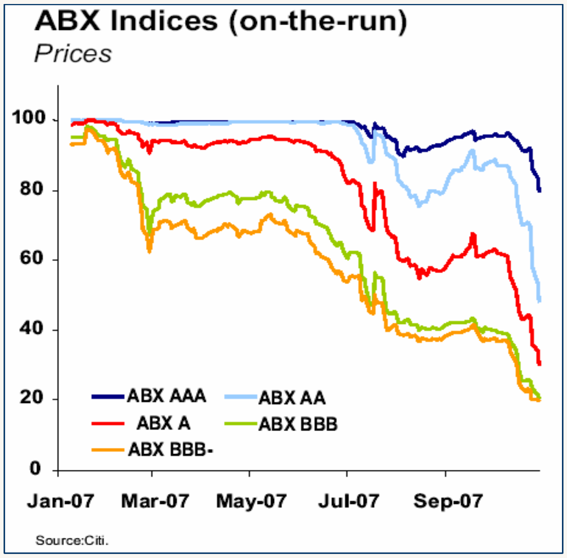
Second Quarter 2007 Performance Review

Paulson Credit Opportunities Fund I & II (Credit Opportunistic) generated returns of +117% and +104% respectively in the third quarter. Prices of subprime mortgage securitizations declined materially as credit performance deteriorated on the back of falling house prices, mortgage rate resets and rising delinquencies. Because the Paulson funds made such a large contribution to our portfolio's performance, it makes sense to describe the short position that the Paulson funds took in the US subprime mortgage-backed securities in more detail.

A residential mortgage-backed security (RMBS) is a bond whose coupon payments and principal payments are backed by a large pool of residential mortgage loans. Losses in the underlying mortgage pool will translate into losses for holders of the RMBS, with the amounts depending on the investor's position in the RMBS capital structure. Lower rated tranches (BBB and unrated) will bear the first losses and holders of the AAA-tranche will be hit last. The left hand side of the diagram below shows an example capital structure of the ABX index, which consists of about 20 individual RMBS transactions. If cumulative losses in the underlying mortgage pools exceed 4.5%, the BBB- tranche will incur losses and if losses exceed 5.6% the whole tranche will be wiped out and the investor will have lost its principal. The Paulson funds took a short position in BBB-rated tranches of individual RMBS (we only use the ABX index to illustrate our case), which means that they pay an annual coupon in return for which they are compensated for any losses of principal on these tranches. From the outset, Paulson expected these RMBS tranches to be wiped out completely.

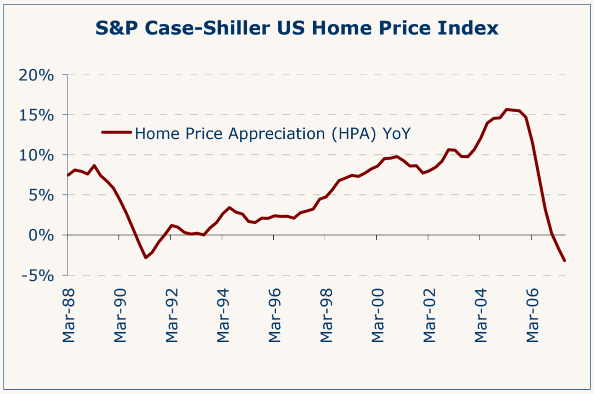
Exhibit 1 **Falling house prices and rate resets crease losses in US mortgage markets**





Over the summer, the US mortgage market came under severe pressure from falling house prices (wiping out home equity of highly levered mortgage borrowers) and resets of mortgage rates to higher levels (sometimes increasing by 50%). New issuance of mortgages has effectively come to a standstill, putting additional pressure on house prices and the ability of borrowers to repay or refinance their loans. Currently, US house prices are actually *falling* year-on-year, as illustrated by Exhibit 2 below.

Exhibit 2 **US house prices falling off a cliff**



Through the mechanism described above, house prices impact losses on RMBS. The red arrow in Exhibit 1 shows that, even with house prices rising 5% in the next 4 years, the BBB tranche of the ABX would be wiped out completely! Note that Paulson expects home prices to *fall 15% to 25% in the coming years*, and anticipates losses on the RMBS they are short to settle in the 12%-15% range (which implies losses all the way up to the AA tranche). In line with this view, prices of mortgage-backed bonds have fallen materially. The right hand chart of Exhibit 1 shows that BBB-tranches of the ABX fell by 80% since January this year. Using modest leverage and proprietary research to identify individual RMBS securities to short, rather than the ABX index, the Paulson funds have generated even more spectacular returns this year. Going forward, the manager expects to hold the securities until they are written off, creating an additional 30-40% gain from September levels. In addition, the manager has entered into short positions in corporate credit, particularly financial institutions which are vulnerable to the current situation.

Camulos Special Situations Offshore Fund (Credit Opportunistic) was slightly down this quarter **(-2.2%)** but managed to be positive in August; a significant achievement, given that the fund has sizable investments in leveraged loans, awaiting more opportunities in distressed debt. This was partly the result of excellent trading skills of the fund's portfolio manager, Richard Brennan. In the Special Situations bucket, the fund owns debt and equity in a gas-fired power plant in Connecticut. The chronic undersupply and lack of interconnection makes this area a compelling location for power investment. Together with other investors, Camulos is also setting up an investment vehicle for consolidation in OEM suppliers for the automotive sector. The main theme is that OEM suppliers will migrate from providing multiple equipment parts to one car producer to providing only a few parts to many producers across the globe. Camulos will provide mezzanine capital (mostly with some equity kicker) and other investors will provide operational and strategic restructuring expertise. In addition, they are holding positions in Madagascar oil sands (together with a major oil company) , real estate development projects in Arizona, and aircraft finance.

The **CIM Special Situations Fund** (Long/Short Equity - Directional) had a challenging quarter in the context of choppy markets and a junior natural resource sector that was experiencing something of a liquidity squeeze. This quarter, the fund lost **4.5%**. The fund has a concentrated portfolio of rather eclectic names in natural resources, technology and – once opportunities arise – distressed debt. In addition, its regional exposure is very broad: Algeria, Zambia, Kazachstan, UK, Singapore, Canada, Russia, Hong Kong. To enhance research coverage in Asia, CIM has recently opened a research effort in Jakarta, Indonesia. In July, several technology companies (VOIP/mobile services, mobile advertising) in the portfolio reported strong results and strategic plans which were well rewarded by the market. The fund manager sees a degree of sector rotation that is helpful to technology and unhelpful to the natural resources element of the portfolio. While metal prices are making new highs, the market is mostly looking at bigger producers, while CIM tends to focus on smaller businesses that are building value and capacity in preparation for a quantum leap. New investments in China include a solar panel manufacturer and the market leader in surveillance systems for financial services.

CQS Directional Opportunities Fund (Convertibles) lost a modest **2%** in the third quarter. Given the extreme credit market conditions and the fund's exposure to structured credit (CDO), we feel this result is satisfactory. The fund has positions in relatively short-dated bespoke CDO equity tranches of predominantly European credits, which are constructed using fundamental credit research. The manager expects volatility in loan prices to continue in the short term (which may result in further mark-to market declines in their CLO equity positions), but believes his positions are fundamentally sound and should produce solid returns in the medium term. Meanwhile, the long part of the book remains protected against a sustained credit widening environment with defensive hedges in the form of longer dated credit curve steepeners. Going forward, the fund will also focus on stressed opportunities in the property sector and ABS markets.

Greater Europe Deep Value Fund (Emerging Markets Equity) gained **4%** in the third quarter, bringing its year-to-date performance to +22.4%. We visited the manager in Moscow in October and have confirmed our strong conviction on their ability to generate strong returns from a friendly activist approach to deep value investing in predominantly Russia and the FSU countries. The firm has a dedicated team of investment professionals with private equity, real estate and equity research backgrounds. About 50% of the fund's portfolio is focused on consolidation in the Russian electricity sector and next year will see the final round of consolidation which should generate significant opportunities. The main return drivers in this strategy are: move from cost-price valuations to book-value valuations, tariff reform, and exit in the form of an IPO.

In addition, the fund invests in infrastructure development projects in the Sochi region at the Caspian Sea (where the 2014 Olympics will be held). The government is currently selling land combined with licenses for infrastructure and real estate development at extremely low prices. Within this theme, the fund has recently sold its stake in a local cement company whose stock price had a strong run-up on the back of very high local (Russia, Kazachstan) cement prices compared to Turkey or China.

Ecofin Special Situations Utilities Hedge Fund (Long/Short Equities - Directional) returned **+1.4%** this quarter. The fund currently has 28% in special situation investments and the remainder is in a global utilities long/short strategy with a low net exposure of around 30%. Going forward, as the deal pipeline translates into actual transactions, the fund can invest up to 75% in special situations. The fund's largest position is energy transmission company ITC which beat consensus forecasts in July and announced significant capex expenditure plans in various US states. Ecofin owns slightly less than 10% but received permission from the regulator to own up to 20% of the company, which clearly is a strategic energy asset to the US. Also, Ecofin has made an investment in a US solar energy firm, which should benefit from a recently approved set of federal incentives for renewable energy. Finally, their second largest (private) holding, Airtricity announced the sale of its US wind business to E.ON for an enterprise value of $1.4bln. The cash is likely to be used to execute the company's growth plan in Europe and increase shareholder value.

Autonomy Capital - C Class (Emerging Markets Debt) gained **8.3%** in the third quarter, bringing its year-to-date performance to 51%. The larger part of this performance results from the successful IPO of a real estate development company they purchased last year. The fund will aim to benefit from the growing use of securitization technology for consumer credit and mortgages in selected developing countries: Brazil, Mexico, Ukraine and, at a later stage, Turkey. To this end the manager has set up joint ventures with local partners in Brazil and the Ukraine. Expected transactions will comprise equity participations in local financial platform companies as well as underlying assets being securitized. The growth of the asset-backed, agro-backed and real estate-backed market has created new market participants: originators, servicers, structurers, and real estate investment trusts. Autonomy Capital – C Class will provide equity finance to a select group of platform companies, in some cases targeting an IPO. In addition, the fund has a sizable allocation to real estate in Brazil which will be restructured into a new dedicated Latin American Real Estate Fund.

The **Marwyn Neptune Fund's** (Activist Strategies) generated a return of **-3%** in the third quarter. The fund's approach is to establish an exchange-listed platform company, install new management with proven experience in the relevant sector and do follow-up acquisitions of companies and grow the business. Co-investors are some of the world's largest investment funds and hedge funds. In the third quarter, the fund manager has launched one new platform company and existing portfolio companies made 5 further acquisitions. In addition, they are aggressively recruiting individuals from a range of backgrounds in investment banking, accounting, industry and management consulting, to provide operational and strategic input to their platform companies.

Pershing Square (Activist Strategies) was up **+1%** in the third quarter, bringing the year to date performance to 12%. The fund has a concentrated portfolio of 15 positions in the food and beverage, restaurant, retail and financial services sectors. Investments where Pershing Square has been active include Plains Resources, Sears, Wendy's and McDonalds. Recently, the fund has taken a large stake in US discount retailer Target and has already had some success with its proposal to Target to sell off about $7 billion in credit card receivables. Furthermore, the fund is an active shorter with about 25% short equity and credit positions, predominantly in financial guarantors and bond insurance companies such as MBIA and Ambac.

These are poorly capitalized companies: against their credit exposure they have less than 0.04% of capital reserves. The main investment theme here is the blind confidence of market players in credit ratings which makes them extremely sensitive to a worsening credit environment. On the back of the credit crisis and eroding confidence in credit ratings and anything which is linked to them, this part of the portfolio has performed particularly well, causing the fund to post a positive return of 3% in the challenging month of August.

The **Montpelier Fund** (Emerging Markets Equity) returned **6%** in the third quarter, bringing the 2007 performance to 40%. The fund has positions in Pakistan, Indonesia, China, Russia, and the Middle East In the latter region, the fund focuses on companies who supply to the infrastructure build out, rather than invest in development projects directly. Project back-logs are at all time highs and shortages of skilled labor and capital equipment are enormous, creating healthy profit margins. The **Montpelier China Fund** (Emerging Markets Equity) generated a return of **32%** in the third quarter. The fund's investment strategy is to buy Hong-Kong listed subsidiaries of Chinese state-owned enterprises, which may benefit from assets being sold to them by their parent companies at favorable prices. To enhance global competitiveness, the Chinese government wants to "activate" these subsidiaries by enhancing their asset base and at the same time allow Chinese retail investors to buy their shares. This will be the largest privatization process ever to occur. To execute the strategy, Montpelier has set up a joint venture with a local partner called Nankai Capital Ltd. The bulk of the fund's exposure is in industries such as mining/metals, logistics, property and aviation. As the privatization process is progressing much more quickly than anticipated, the fund manager expects the bulk of the gains to be achieved in the 1-2 year framework rather than the 3-5 year period previously envisioned.

Sector Speculare III (Long/Short Equity – Directional) gained around **3%** this quarter, bringing the year-to-date performance to 4.5%, since launch date (April 2007). The fund focuses on pre-IPO equity situations in the oil and shipping sectors, most of which are still valued at cost. The fund is now almost fully invested with about 30% of the portfolio in exploration and production companies (Caspian, North Africa, Middle East and North Sea) and another 30% in oil services (diving vessels, heavy lift and seismic vessels). For all investments the aim is to double the investment in 3 years time. The manager focuses on proven exploration plays, manageable political risk and company management with a proven track record in execution. For example, their largest holding is a oil exploration company which is a joint venture with a team of highly experienced geologists and exploration experts from British Petroleum. Long lead/capital intensive projects and frontier exploration are avoided. Visiting the fund manager in Oslo in September and meeting with all management teams of the underlying portfolio companies confirmed our strong conviction in the potential for outsized returns. The manager has a hands-on strategic and operational approach to pre-IPO investing. Both the investment professionals of Sector Asset Management as well as the companies' management teams are seasoned professionals in their areas of expertise; oil exploration, production and services.

Eidesis Special Opportunities Fund and **Eidesis Structured Credit Fund** (Structured Credit/Distressed CDO's) had a blended return of **-0.6%** this quarter. The investment strategy of the Eidesis Special Opportunities Fund is to identify distressed opportunities in CDO's backed by corporate credit and, as opportunities in distressed CDO's are only just arising, the manager has only called 50% of our committed capital. We have invested the rest of our committed capital in the Eidesis Structured Credit Fund, which had a very tough quarter. The fund had a long position in CDX High Yield index, while shorting the equity and mezzanine tranches on the same pool. This trade should generate returns when concerns about rising defaults on corporate credits are reflected in pricing of the CDO tranches which would be hit first: the equity and mezzanine tranches. However, throughout the summer, the CDX index sold off dramatically while the less-liquid and lower-rated tranches held relatively well. This resulted in heavy losses for the fund. We acknowledge that the fundamental thesis behind the strategy remains intact and that when pursuing a deep value investment strategy one may encounter significant intermediate price volatility. Meanwhile, the fund maintains an overlay hedge that limits its market exposure for now and has proven to be effective in managing tremendous volatility during the third quarter.

The **Zais Matrix V Fund** (Structured Credit / Distressed CDO's) has so far called only 15% of our committed capital. This is invested in a CLO and several CDO's backed by asset-backed securities (ABS CDO's). Due to the market turmoil triggered by distress in the US subprime mortgage markets, the fund lost about 15% on these positions. Since we only have 15% of our capital at risk, the negative contribution to our portfolio is only **-0.15%.** As result of the violent credit markets throughout the summer and the manager's expectation of more forced selling by constrained investors, the manager will call additional capital in the next few quarters. Given broad based downgrades and defaults, the manager expects to find interesting risk/return profiles for assets even higher up the capital structure than initially anticipated.

Focus Capital (Activist Investing) generated a return of **-1.6%** in the third quarter, bringing the year-to-date performance to 43%. The fund has a friendly activist strategy with a concentrated portfolio of about 15 stocks in Switzerland, and with strong relationships with company management. The fund manager focuses on companies which are cash rich with ample capacity to self-finance growth and increase payout, and with little direct exposure to the US. The manager is an active shorter both in individual stocks as well as for portfolio hedging purposes. The modest loss in this quarter was partly the result of their hedging activity; basically, they were too cautious when the 50bps Fed rate cut was received with market euphoria and dramatic short covering.

Red Kite Metals Fund (Commodities) was down 9% this quarter and **Red Kite Prospect Fund** (Commodities) was up almost 20% this quarter, bringing the blended return for our portfolio to **+1%**. The large difference in performance between the Metals and the Prospect Fund is due to different movements in short dated and longer dated futures contracts. Metals were not immune from the pressure seen in equity and bond markets. Short selling was a key driver of metals pricing in August, predominantly at the front end of the futures curve, which usually indicates a lot of speculative money. The longer end of the metals futures curves have behaved more in line with fundamental supply/demand factors. The fund manager sees good opportunities in the copper market, as the market is too complacent about supply and any disruption in supply or stronger than expected demand may push prices considerably higher. We maintain our conviction on the manager as their presence in the physical commodities markets, especially in China, gives it considerable advantages when assessing short term demand in the copper market.

For more information, please contact us at:

Theta Capital Management B.V.
De Lairessestraat 180
1075 HM Amsterdam
The Netherlands

Telephone:	+31 (0) 20 5722733
Fax:	+31 (0) 20 5722744
E-mail:	info@thetacapital.com
Website:	www.thetacapital.com