THETA
CAPITAL MANAGEMENT B.V.

Quarterly Letter

Q4 2010

February 2011

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Table 1 Performance Theta Funds.

	Q4 2010	YTD 2010
Theta Multistar Medium Volatility Class A	6.48%	+8.69%
Theta Deep Value	7.80%	+9.45%
Theta Legends Fund	7.70%	+10.08%
HFR Fund of Funds Index	3.38%	+5.78%
MSCI World Index	8.70%	+9.87%

Introduction

The Theta funds had a strong fourth quarter and all three funds outperformed their peers by a significant margin. The drivers behind the returns of our funds are quite diverse and differ for each fund. We will describe the return drivers in further detail at the individual fund sections below.

Simply looking at the figures understates how difficult it was to make money during the year. 2010 has had some ferocious sell-offs, particularly in May and June followed by a solid recovery culminating in a very strong December. Not only worries with regards to the sovereign debt of Greece, Ireland, Portugal and Spain rattled markets, but also concerns about the business climate in the US (the SEC lawsuit against Goldman Sachs filed in April being the clearest signal of this) and inflation in Emerging Markets (the various tightening measures in China being the most prominent here) frightened markets at various stages during the year.

A concrete example of this volatility and how difficult it was to trade a hedged book during 2010 can be seen in the different performances of the main US banks index (the BKX) and the core EU bank sector. After the BKX rallied sharply the first part of the year, there was a significant selloff in the period April-August to leave the index flat for the year by the end of August. However, thereafter the index rallied once again to end the year 20% higher. By contrast, the EU bank sector ended the year down 25%. Interestingly, during the period of maximum concern on European sovereign risk (from June to October) the European bank sector significantly outperformed the US sector by over 15% as a result of EU policy measures and mixed US data. Therefore being long well capitalised US banks vs being short continental European banks with serious balance sheet issues would have lead to serious underperformance in exactly that period but not for the whole of 2010.

Graph 1: Outperformance European banks during the European sovereign crisis.

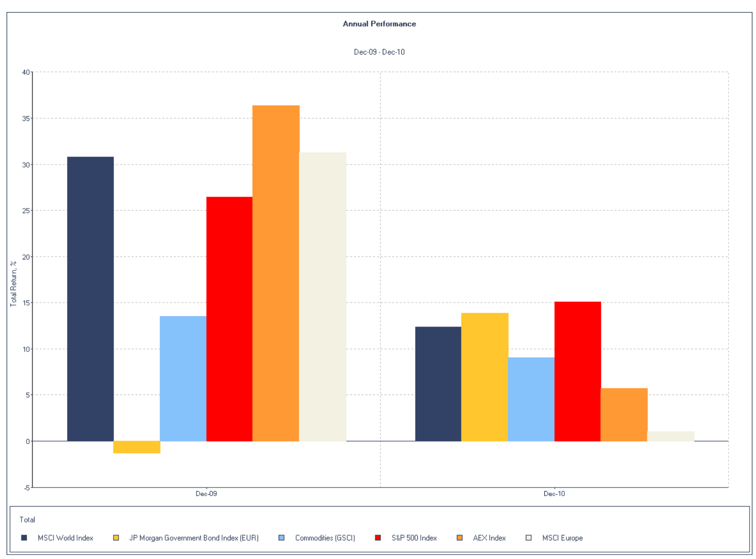
Source: Lansdowne, Bloomberg

We are satisfied with the quality of our portfolios right now and look forward to seeing some of that quality translate into good returns in 2011. One indication is for example that out of the 22 funds in our Medium Volatility Fund, 11 are in some form or another closed to new investors after raising sufficient capital in 2010 from investors.

General Markets Update

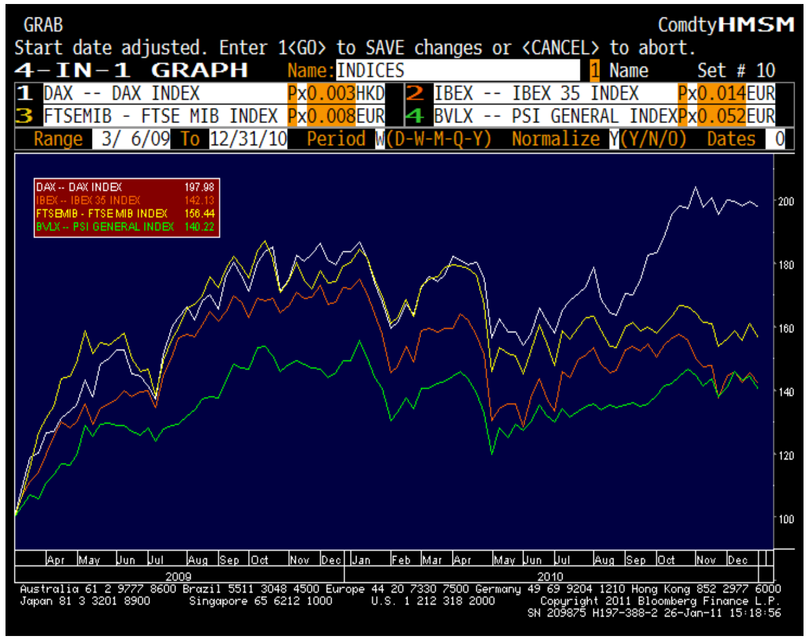
We will keep this part brief as you will have no doubt seen many reviews by now. After 2009 when everything moved up regardless of underlying fundamentals, 2010 saw far more diversification and lower returns across asset classes as can be seen in the two graphs below. We think, based on the feedback from our managers, that this is a pattern that will continue in 2011 (and beyond).

Graph 2: Returns diminished during 2010.



Look for example at the performance difference between the German market and the rest of Europe: since the lows of the market in March 2009, these indices moved more or less in line. However, in the second half of 2010 Germany clearly started to outperform the other European indices. These differences provide a rich picking ground for our experienced, active managers.

Graph 3: The recent outperformance of Germany



Source: Bloomberg

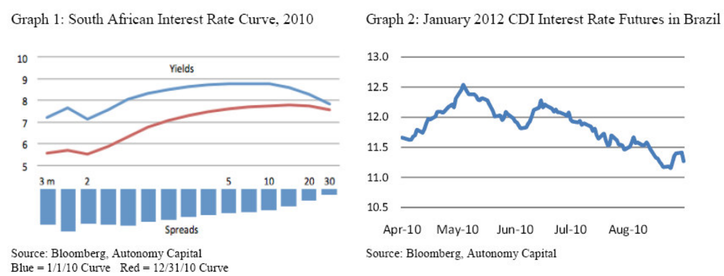
Theta Multistar Medium Volatility

The Medium Volatility Fund rose 6.48% over the quarter, bringing the full year return to +8.69%. Since inception of the Medium Volatility Strategy on January 1, 2002, the annualized return is 4.5% vs. 4.4% for the HFR FOF index and 0.3% for the MSCI World.

There was only one fund that lost money during the fourth quarter which was one of our global macro managers who detracted 0.08% from performance. It is satisfying that the strong performance of the fund was so well spread across different strategies and funds.

The allocation to global macro managers generated around 2.8% for the portfolio, around half of which was from our discretionary commodity traders. One of our discretionary global macro managers with significant exposures to various emerging markets returned more than 26% for the year after another strong fourth quarter. Their view at the start of the year was that rates would remain lower for longer as monetary policy would need to remain loose due to likely calls for fiscal constraint after 2009's massive fiscal stimulus packages. This was not a consensus view at the beginning of 2010 and interest rate curves were pricing in rate hikes in the second half of 2010 and 2011 (see graph below). The manager generated significant returns during 2010 on various interest rate positions in South Africa, Brazil and Mexico.

Graph 4: Interest rate curves in Southafrica and Brazil.



Source: Autonomy Capital

In our global macro allocation, we have two discretionary commodity managers. Both funds had a good fourth quarter and this allocation contributed around 1.5% to performance in 2010. As mentioned in our previous letters, we think a sizeable allocation to active traders in the commodity space is interesting for a number of reasons. Commodity prices are not only driven by supply/demand factors (and storage levels across virtually all commodities are much lower at the beginning of 2011 as compared to the same time last year) but also by very considerable flows of (passive) investments from investors looking for exposure. These fund flows are driven by a desire to have exposure to what is perceived scarce commodities and possibly (much) higher prices in the near future, but also by investors looking for hard assets and a protection against possible inflation after all the stimulus programs we have seen over the last two years. The combination of these factors means that active, experienced managers are able to generate outsized returns due to a combination of directional and relative value trades. If we look at the prospects for 2011, we think these managers are in an excellent position to generate good returns.

During 2010, we fully redeemed two Global Macro managers which was in line with our view at the beginning of 2010 to slowly reduce this allocation. Looking forward to 2011, we will continue to reduce the size of our Global Macro bucket and have put in a full redemption for one of our funds where we are less convinced of the manager’s capability to generate consistent returns going forward.

Our Event Driven funds had an excellent year, contributing around 3.7% for the full year. The Event Driven allocation is, by its very nature, diverse but just to give an idea of where returns were generated in 2010 we will list a couple of investments:

- M&A activity combined with investments in specific Financials which moved sharply higher as investors became more convinced about the strength of the recovery
- A couple of company specific events in Europe where the long-term involvement of the managers is starting to pay off and some of these significantly undervalued stocks moved higher as investors started to look more closely at the fundamentals.

- Various Emerging Markets instruments which moved sharply higher during the year. One example would be the Argentinean GDP warrants which appreciated as forecasts for Argentinean GDP growth rose from 3-4% at the beginning of the year to 8%+ currently.
- Lehman debt (across a wide variety of structures) which rallied as there was more clarity on the payout path for these various entities.

During 2010, we added one fund to our Event Driven (ED) allocation, no other changes were made during the year. We will redeem one of our ED managers in the first half of 2011 and we are finishing our work on a couple of other managers in this space where we are keen to allocate.

Our Equity Hedge (EH) allocation had a decent year, contributing around 1.3% for the year. 2010 was a difficult year for our long/short equity funds given the very significant moves seen in the market which meant that it was difficult to run a hedged book. As the year progressed, it was interesting to see how the focus of managers shifted from a focus on Emerging Markets growth to Developed Market recovery/normalisation. As it became clearer that monetary conditions in developed markets would remain loose for longer, certain companies that were overlooked in the initial rally came much more into focus. On the short side, the focus of managers remains on the peripheral European countries that will continue to suffer from the austerity measures needed to comply with the rescue packages as well as more idiosyncratic ideas thrown up as a result of the recent rally.

We added two funds to our EH book in 2010 and did not redeem. We have put in one redemption for one fund in 2011 and also here have identified several excellent replacements.

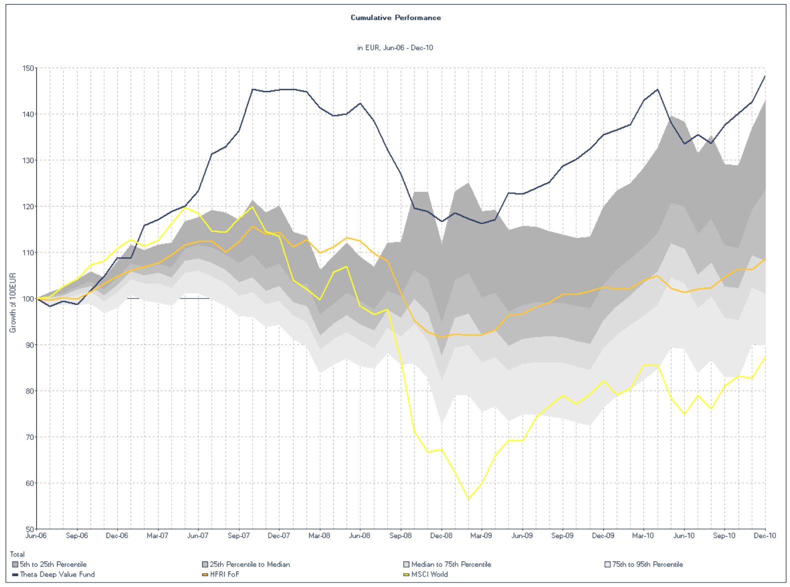
Our Relative Value (RV) book had a good year, contributing around 3% for the full year. Performance was driven by one of our more specialized, aggressive funds who benefited from a wide variety of strategies which generated around 31% for the full year. The fund investes in equities in both DM and EM, (equity) derivatives, convertibles, distressed, ABS, (structured) credit and macro themes.

We made no changes to our allocation to relative value during the year and although we have recently approved a new fund that we could add to this space (given our underweighting versus the HFR Index), we are in no hurry given the quality of our portfolio overall.

Theta Deep Value

The Deep Value Fund (TDV) gained 7.8% over the quarter to end the year at +9.5%. Since the inception of TDV, the fund has returned 47% for investors vs. 8% for the HFR FoF index and -12% for the MSCI World. This has translated into an annualized return for TDV of 9.1% vs -3.0% for the MSCI World and +1.9% for the HFR FOF index.

Graph 5: performance Deep Value since inception



Source: Theta Capital, MPI Stylus

Returns of TDV continue to be driven by idiosyncratic events in our managers' portfolios rather than overall market direction which can be seen by the low correlation (0.5) of TDV against the MSCI World since inception. In the previous quarterly we described three funds and showed what we believe represents significant embedded value in their investment portfolios. Two of these three (Paulson Recovery and Pershing Square) were amongst the top-three contributors of TDV during the year and we were pleased to see some of this value unlocked.

The most notable change to the portfolio during 2010 was the redemption in the first quarter of our base metals trader which was (partly) replaced by an active trader in the energy complex. This switch worked well. Looking forward, we have identified a couple of distressed/event driven funds that fit the TDV mandate and there might be one more allocation during the year.

Looking forward to 2011, we see excellent opportunities for TDV. We have several smaller allocations to idiosyncratic sovereign opportunities (European Divergence, Iceland, China) which we have described previously.

Paulson Recovery is well positioned for a (modest) economic recovery and he is very clear about his views on the market: "…. Now that these companies have repaired their capital structures, their equity offers substantial upside appreciation relative to downside risk as we move toward economic normalization. This is the part of the cycle where we want to have long event exposure and <u>do not want to be under-invested"</u> (emphasis is the manager's)

Pershing Square continues to identify good opportunities for its activist strategy and in the fourth quarter they invested in some new ones such as JCPenney and Fortune Brands. Fortune already announced, about one month after the investment by Bill Ackman, that they would split up the company in three parts as suggested by the Pershing team. Furthermore, there is still very significant upside in holdings such as GGP which successfully emerged from bankruptcy in the fourth quarter.

CQS Directional Opportunities Fund is able to find a whole range of opportunities that other funds are not able or willing to invest in. The fund can do so because it has a stable investor base with stringent liquidity requirements. For example, the fund invests in short-dated long credit positions including first-to-default credit baskets, as well as equity and mezzanine tranches which offer excellent returns for those investors able to understand these instruments.

The Sector Speculare funds disappointed in 2010 but we think these funds could generate good returns going forward. The returns will be lumpy but given the current level of the oil price the near-term outlook for the oil & gas sector is promising, whether it is in the Exploration and Production or in Services. As an example of the potential upside of Sector Speculare, during the second half of 2010 Sector had a major hydrocarbon discovery on one of its projects in the North Sea. Although the investment has been partly revalued to reflect this discovery, a look at the share price development of the listed partner of Sector on this projects suggests there is still very considerable upside from current levels and the contribution of Sector to TDV in the near future could be considerable.

The Montpelier Fund continues to see good opportunities throughout the world. Right now, the fund has a sizeable allocation to Pakistan where the manager sees a compelling contrarian value case. One example are attractively valued and high quality banks with liquid and conservative balance sheets. These banks generate RoE in excess of 20%, pay out a high dividend and have loan to deposit ratios of about 60%. Net interest margins are a solid 5.5% to 7.5% and therefore have the liquidity and the capital to expand loan books when risk adjusted returns allow. All of these banks trade on PE-ratios of less than 10X. Furthermore, the fund has had one modest private equity holding which is the ex-Enron emerging market electricity generation and distribution business. This business struck a deal in which it will sell 80% of its operations, valuing the investment by Montpelier at a very substantial premium to the current marks which we should see coming through over the coming months.

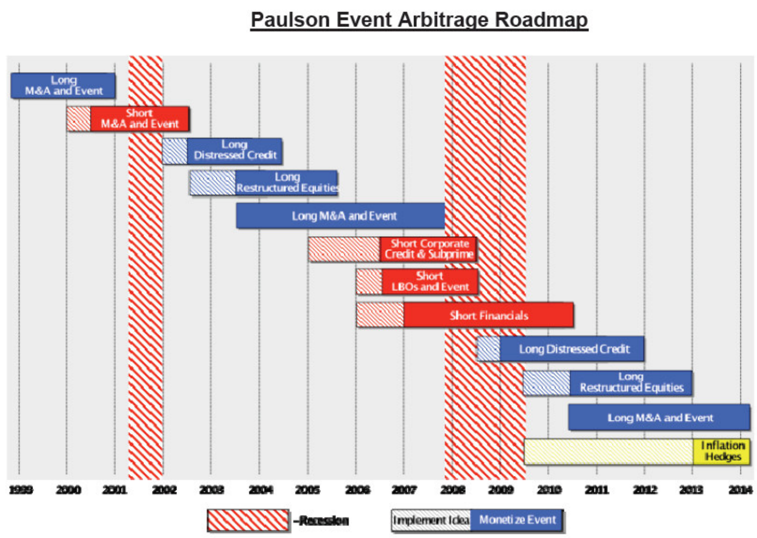
Theta Legends Fund

The Theta Legends Fund was up 7.7% for the quarter to end the first year at +10.08% for the Euro class (+11.25% for the US$ class). All funds were positive in these first 11 months and we are pleased to report such a strong result in what has been a difficult environment. In line with previous reports, we will describe one fund in further detail.

The Paulson Advantage funds invest in all event strategies including merger, distressed, bankruptcy, and restructuring opportunities. In 2010, the fund was up more than 17% as the fund benefited from a focus on restructuring financials, gold miners and development companies, and distressed credit.

John Paulson has a very clear view of how he would like this fund to be positioned which has led to excellent risk adjusted returns since inception. In 2006, the fund bought credit protection which drove returns in 2007. In 2008, the fund had a net short equity bias focusing on firms that could fail due to their exposure to credit losses. In late 2008 and early 2009, as credit markets bottomed, they switched to long distressed credit. From Q4 2008 through Q2 2009, Paulson went from having zero long credit exposure to being US$25bn long which drove returns in 2009. As high-yield bonds now trade at par and yields have fallen, the focus of the fund has very much shifted to restructuring equities as the driver of future returns. Graph 6 below illustrates how the fund moved from theme to theme, through this cycle.

Graph 6: Roadmap Paulson Event Arbitrage



Source: Paulson

Despite Paulson's broadly optimistic view, they are concerned about the impact quantitative easing could have on future inflation. Accordingly, they have put in place numerous portfolio strategies that could both protect capital and provide high absolute returns, if inflation becomes an issue in the future.

Paulson sees the largest upside in restructured equities and their largest exposure is in the banking sector. They have participated in the recapitalization of many banks which were in danger of failing and in nearly all cases, they bought equity from the banks directly or swapped preferred stock into equity, typically at a discount to the market price. In the case of the banks, Paulson expects both solid earnings growth (as provision expenses decline) as well as a normalization of multiples which should drive very significant share price gains. For example, in the case of JP Morgan, they are anticipating 2012 earnings of US$5.51 per share. Based on the year-end 2010 stock price, the bank is trading at on 7.7X FY2012 earnings whereas the historic multiple has been 12.3X. If you were to apply a 12X multiple to 2012 earnings, that would suggest a US$66.13 share price, or a 56% increase from the year end price.

Business Update

Our team has visited around 50 managers on-site during the fourth quarter during trips to NYC, London and Berlin. Our head of operations visited a multi-day conference on operational due diligence in Dublin. In January, we visited another 30 managers on a combined trip to NYC and a leading hedge fund conference in Miami.

Performance Summary

The following table shows the net returns of the Theta funds for the period ending 31 December 2010.

Table 2: net returns Theta funds since inception

	Theta Multistar Medium Volatility Fund - Class A	Theta Deep Value Fund	Theta Legends Fund	HFR Fund of Funds Index	MSCI World Index
October 2010	1.94%	1.86%	2.53%	1.40%	3.70%
November 2010	-0.18%	1.74%	0.47%	-0.05%	-2.30%
December 2010	4.64%	4.00%	4.59%	2.01%	7.29%
FY 2010	8.69%	9.45%	10.08%	5.78%	9.87%
Annual return					
2010	8.69%	9.45%	10.08%	5.78%	9.87%
2009	5.09%	16.06%	-	12.10%	22.07%
2008	-24.71%	-19.56%	-	-20.01%	-40.73%
2007	8.93%	33.37%	-	9.06%	2.32%
2006	9.58%	8.83%*	-	8.08%	12.22%
2005	11.76%	-	-	6.10%	12.89%
2004	6.80%	-	-	7.43%	9.62%
2003	12.77%	-	-	12.85%	23.46%
2002	8.06%	-	-	2.59%	-23.89%
Annualized statistics †					
Return	4.52%	9.14%	11.06%	4.40%	0.29%
Standard deviation	7.03%	9.34%	10.87%	5.41%	15.58%
Sharpe ratio	0.33	0.76	1.01	0.42	-0.025
Correlation to MSCI World	0.53	0.47	0.93	0.70	1.00
Beta to MSCI World	0.24	0.24	0.59	0.25	1.00

†Since inception date of the respective funds: January 2002 for Theta Medium Volatility, July 2006 for Theta Deep Value, February 2010 for Theta Legends, January 2002 for HFR Fund of Funds Index and MSCI World Index. All indices hedged into Euro. Before January 2004, performance of Theta Medium Volatility client portfolios.

* Inception date was July 1st, 2006

Performance Attribution Reports

Theta Multistar Medium Volatility Fund

Strategy allocation and performance attribution

Table 3: Allocation and attribution Medium Volatility Fund (net of fees and expenses)

				Return contribution	
Strategy		**# of Funds**	**Allocation (% NAV)**	**Q4 2010**	**YTD 2010**
Equity Hedge			**28.91%**	**1.76%**	**1.40%**
	Equity Market Neutral	0	0.00%	0.00%	0.00%
	Fundamental Growth	1	0.00%	0.00%	-0.10%
	Fundamental Value	6	24.94%	1.66%	1.59%
	Technology/Healthcare	1	3.96%	0.10%	0.00%
Event-Driven			**30.50%**	**2.48%**	**3.33%**
	Activist	1	6.45%	1.11%	1.44%
	Distressed/Restructuring	3	11.35%	0.33%	0.89%
	Special Situations	2	12.70%	1.04%	1.00%
Macro			**30.04%**	**1.60%**	**2.11%**
	Commodity - Discretionary	2	8.14%	1.41%	1.35%
	Discretionary Thematic	4	21.90%	0.19%	0.76%
	Systematic Diversified	0	0.00%	0.00%	0.00%
Relative Value			**11.08%**	**0.63%**	**1.85%**
	Fixed Income - Asset Backed	1	3.58%	0.14%	0.43%
	Convertible Arbitrage	0	0.00%	0.00%	0.00%
	Fixed Income - Corporate	1	7.50%	0.49%	1.23%
	Multi-Strategy	0	0.00%	0.00%	0.10%
Total				**6.48%**	**8.69%**

Theta Deep Value Fund

Strategy allocation and performance attribution

Table 4 allocation and attribution Deep Value Fund (net of fees and expenses)

				Return contribution	
Strategy		**# of Funds**	**Allocation (% NAV)**	**Q4 2010**	**YTD 2010**
Equity Hedge			**22.6%**	**1.09%**	**0.76%**
	Energy/ Basic Materials	1	8.8%	0.63%	-0.09%
	Fundamental Growth	2	13.8%	0.54%	0.85%
	Fundamental Value	0	0.0%	0.00%	0.00%
	Technology/Healthcare	0	0.0%	0.00%	0.00%
Event-Driven			**40.1%**	**4.35%**	**5.20%**
	Activist	1	9.8%	1.18%	1.51%
	Distressed/Restructuring	3	18.2%	1.45%	1.70%
	Special Situations	1	12.1%	1.72%	2.08%
Macro			**20.8%**	**1.36%**	**1.51%**
	Commodity - Discretionary	1	5.8%	1.09%	0.76%
	Discretionary Thematic	4	11.3%	0.27%	0.76%
	Systematic Diversified	0	0.00%	0.00%	0.00%
Relative Value			**20.8%**	**1.00%**	**1.98%**
	Fixed Income - Asset Backed	1	6.5%	0.27%	0.66%
	Convertible Arbitrage	0	0.0%	0.00%	0.00%
	Fixed Income - Corporate	2	10.7%	0.73%	1.51%
	Multi-Strategy	1	3.5%	-0.09%	-0.28%
Total				**8.60%**	**9.45%**

Theta Legends Fund

Strategy allocation and performance attribution

Table 5 allocation and attribution Theta Legends Fund (net of fees and expenses)

Strategy		# of Funds	Allocation (% NAV)	Return contribution Q4 2010	Return contribution YTD 2010
Equity Hedge			**31.2%**	**2.3%**	**3.1%**
	Equity Market Neutral	0	0.0%	0.0%	0.0%
	Fundamental Growth	0	0.0%	0.0%	0.0%
	Fundamental Value	3	31.2%	2.3%	3.1%
	Technology/Healthcare	0	0.0%	0.1%	0.1%
Event-Driven			**18.0%**	**2.4%**	**2.3%**
	Activist	0	0.0%	0.0%	0.0%
	Distressed/Restructuring	0	0.0%	0.0%	0.0%
	Special Situations	1	18.0%	2.4%	2.3%
Macro			**28.1%**	**2.19%**	**3.8%**
	Commodity - Discretionary	0	0.0%	0.0%	0.0%
	Discretionary Thematic	1	16.2%	1.2%	1.0%
	Systematic Diversified	1	11.8%	1.0%	2.9%
Relative Value			**17.4%**	**0.8%**	**0.9%**
	Fixed Income - Asset Backed	0	0.0%	0.0%	0.0%
	Convertible Arbitrage	0	0.0%	0.0%	0.0%
	Fixed Income - Corporate	1	17.4%	0.8%	0.9%
	Multi-Strategy	0	0.0%	0.0%	0.1%
Total				**7.70%**	**10.1%**