November 11, 2011

Dear Investor:

The Diamondback Offshore Fund, Ltd. ("Offshore Fund") had a -9.08% net loss in the third quarter of 2011. Diamondback Partners, LP ("Onshore Fund") experienced a -8.99% net loss in the same period. We will refer to both funds collectively in this letter as the "Fund."

Diamondback Offshore Fund, Ltd. (Estimated and Unaudited)

Investment Type	Third Quarter 2011	YTD 2011 Annual Return	Inception To Date (unless otherwise noted, from 7/1/2005)
Tranche E, Sub-Tranche One Investment Performance[1]	-9.29%	-9.29%	-9.29% (from 8/1/11)
Tranche C, Sub-Tranche One Investment Performance[2]	-9.08%	-6.28%	27.30% (from 11/1/08)
Tranche A, Sub-Tranche One Investment Performance[3]	-9.08%	-5.67%	71.12%
S&P 500 Index[4] Performance	-13.87%	-8.69%	8.17%

Diamondback Partners, LP (Estimated and Unaudited)

Investment Type	Third Quarter 2011	YTD 2011 Annual Return	Inception To Date (unless otherwise noted, from 7/1/2005)
Type Eleven Investment Performance[1]	-9.22%	-9.22%	-9.22% (from 8/1/11)
New Type One Investment Performance[2]	-8.99%	-6.18%	26.39% (from 11/1/08)
Type One Investment Performance[3]	-8.99%	-5.58%	70.93%
S&P 500 Index[4] Performance	-13.87%	-8.69%	8.17%

See "Important Disclosure Information," beginning on page Error! Bookmark not defined..

PAST PERFORMANCE IS NOT NECESSARILY INDICATIVE OF FUTURE RESULTS.

Summary of Quarterly Performance

The third quarter saw a continuation of the headwinds of the second quarter – only more so. The European contagion, the limping U.S. economy and the debt-ceiling debate in Congress continued roiling the markets as the quarter began. The political stalemate over the debt ceiling seemed to be enough to quash any rational decision-making in the market. Then came August and Standard & Poor's downgrade of U.S. credit, which took care of whatever rationality was left.

The Fund's performance suffered from these macro forces and the accompanying fear and misperceptions that weighed on the market throughout the quarter. Neither rational thought nor the rare positive economic indicator could calm the headwinds. What started as another Greek debt crisis spread quickly to France, Italy, and Spain – all major economies. And while oil prices fell only modestly during the quarter, concerns about the potential impact of a 2008-like recession on prices had a multiplier effect on oil-related stocks. Some of them fell 20% to 60% during the quarter.

The first few days of August epitomized the quarter's challenges. Gross exposure in the Equities strategy was at an intra-quarter peak of approximately 210% of assets under management ("AUM"), with approximately 30% net long. On Thursday, August 4, with uncertainty swirling in Europe, we reduced gross exposure in the Equities strategy to approximately 199%, with approximately 18% net long. By the end of the day, the Fund's return was down -3.43%[5] month-to-date ("MTD"). The next day, we reduced gross exposure in the Equities strategy to approximately 186%, although we raised net exposure to approximately 30% in the expectation that short-term relief for Italian sovereign credit would stabilize the market. It didn't, and the Fund was down -4.42%[5] MTD by day's end.

That night Standard & Poor's issued its U.S. credit downgrade. By the end of the day Monday, August 8, the Fund had a return of -7.95%[5] MTD. As a reference point, the S&P 500 was down more than 13% for the quarter. We had taken gross exposure in the Equity strategy down to approximately 150% and net exposure down to approximately 25%. Given the severity of the market's reaction to the downgrade, we believed we needed to take off as much risk as we could to protect capital. By the end of the quarter we had taken gross exposure in the Equities strategy down to approximately 123% and net to approximately 4%.

Whipsawing persisted throughout the quarter. Because of our aggressive efforts at de-risking, we missed the snapback (and temporary) rally at the end of August. Although we had taken risk down, we were able to generate alpha in the Equities strategy in September, as the S&P 500 fell from 1,219 to 1,131. We finished the quarter with a -5.76% gross return contribution from Equities strategy.

Making decisions based on macro events is generally not consistent with the Fund's overall model, in which portfolio managers operate within sectors to diversify the Fund's risk. Industrials are typically not correlated with Healthcare, for example, and our model relies on each sector's portfolio managers – working with bottom-up analysis – trading in individual names.

In the third quarter, however, correlations increased. With European political leaders scrambling to resolve their debt crises and with the safety of U.S. credit being called into question, de-risking took place in numerous markets at a near-manic pace. We believed the best tactic was to de-leverage in manageable increments in the days and weeks following the Standard & Poor's downgrade.

In the current low-interest environment, we believe economic cycles are much shorter than we've been accustomed to. We generally have looked out one to one-and-a-half years and sought sustainable correlations between macro events and market movements. But investors' compressed time horizons now give rise to greater and near-constant volatility. In August the VIX reached its highest point since the second quarter of 2010. Equity mutual-fund net outflows surpassed $90 billion in the third quarter, one of the largest quarterly outflows recorded. The pace of de-leveraging is reducing asset values in general, and we haven't seen sustainable growth since before the 2008 crisis.

Contribution to Q3 2011 Gross Return by Strategy[6, 7]	
Strategy	**Gross Return**
Equities	-5.76%
Convertibles	-0.30%
Credit	-2.71%
Macro	0.40%
Other	-0.29%
TOTAL*	**-8.66%**

* Profit and loss ("P&L") from positions held at Lehman (see also page **Error! Bookmark not defined.**) is excluded from the above table as it is no longer a contributor to the Tranche A/Sub-Tranche 1/Series 1 Gross Return. Included in "Other" are items that include, among other things, P&L attributable to Outside Investments (as defined in the Monthly Exposure Summary), and expenses incurred by the Diamondback Master Fund, Ltd. and Diamondback Fixed Income Master Fund, Ltd. (collectively referred to as the "Master Fund") and the Funds, including, but not limited to, prime broker interest income/expense, audit fees and legal fees.

Equities strategy

As mentioned above, the Equities strategy contributed -5.76% to the Fund's gross return in the third quarter. Of that, -3.14% of the Fund's gross return was attributable to Equities performance of the Center Book[8]. Macro influences were substantial in the quarter, and we thought it prudent to take down risk, which we're always prepared to do. We believe the Fund's losses would have been much worse otherwise.

By keeping gross low firm-wide, we missed some of the market's late-August rally (which was negated by September's drop). But we were focused on the Fund's primary objectives at that time of capital preservation and risk reduction.

Diamondback Gross Equity Return[9] vs. S&P 500 Index[4] Return Q3 2011		
Portfolio	**Longs**	**Shorts**
Diamondback Gross Equity Return[9]	-24.89%	26.25%
S&P 500 Index[4] Return	-13.87%	n/a
Excess Return[10]	**-11.02%**	**12.38%**

Energy

The Energy sector had a -2.40% contribution to the Fund's gross returns in the quarter. The sector exemplified the macro impact on third-quarter results. As the quarter began, the Master Fund's core holdings were reporting good earnings, beating estimates and raising expectations. Our strategy was working, and energy saw a positive 1.38% return for July. We recognized, however, that the drivers of second-quarter volatility (U.S. unemployment, Congress' debt ceiling negotiations and the Greek sovereign debt crisis) were unresolved and remained a potential overhang for the sector's performance. As a result, during July we sought to trim some winning positions and reduce net exposure when opportunities presented themselves.

The market's reaction to Standard & Poor's U.S. credit downgrade and the worsening European financial crisis made it clear by early August that systematic and macro risks were overwhelming positive energy fundamentals. De-risking spread rapidly. We determined that further macro instability could cause Energy equities to disconnect with fundamentals and that, therefore, material downside risk remained. With a lack of macro clarity and with persistent volatility in August and September, we believed our best option was to reduce both gross and net exposure more aggressively. Between July 31 and Sept. 30, we reduced Energy's gross exposure from 66.3% to 24.4% of AUM; we reduced net exposure from 22.8% long to 5.4% long.

Oil outperformed the broader market during the quarter, with the spot Brent price falling only 8% versus the S&P 500's 14% drop. Despite this relative performance – which was consistent with our fundamental analysis and expectations – energy equities declined sharply. The key energy market proxies, XLE[11] and OIH[12], fell 22% and 32%, respectively. Our negative performance in the sector was driven primarily by losses in a South American integrated oil name, a North American gas E&P name with above-average balance-sheet leverage, and a North American drilling company exposed to WTI/Brent differential risk and reduced North American drilling activity.

On a positive note, the sector's second-largest energy position, an integrated pipeline name, outperformed XLE[11] by 900 basis points and the S&P 500 by 80 basis points. Key drivers of this outperformance included the anticipation of the name's E&P spin-off and the announcement that a prominent activist investor had acquired a large stake.

We believe that year-to-date oil price strength is supported by fundamentals and that most energy names already reflect global recessionary conditions and a significant decline in non-OECD activity. Our focus remains on determining which names offer the best risk-reward potential versus market consensus and our own commodity expectations. We continue to manage the risk that persistent volatility and the sovereign crises will cause energy fundamentals to deteriorate further.

Financials

For the Financials sector, the third quarter proved to be even more challenging than the fourth quarter of 2008 and the first quarter of 2009. As a result, the sector saw a -0.65% contribution to Equity gross returns.

We entered the third quarter optimistic that resolution of the Basel capital-standards issue would be a catalyst for financial stocks. It wasn't. Instead, concerns lingered about, among other things, the unfriendly regulatory environment. Three factors compounded those concerns: one, fears about the impact of the debt-ceiling debacle on financial-services firms' balance sheets; two, fast-accelerating fears of the European debt crisis' impact on U.S. financial institutions' exposure to European financial firms; and three, pessimism about financial-services firms' growth prospects in a recessionary global economy.

The Fund's performance at the beginning of July was positive because the flow of publicly released performance information during earnings season generally substantiated our fundamental views on both the long and short sides. However, the challenging U.S. economy was dampening interest in financial-services stocks, to the detriment of our slight long bias. At the end of July, our analysis of the gloomy European sovereign-debt situation suggested that a more cautious approach to multinational financial companies was appropriate, so we reduced what were then major exposures to all but one name. That approach generally limited the Master Fund's long-exposure losses. However, we experienced significant losses in the one large long position we hadn't reduced, even though we believed the name's near-low historic valuation would trump perceived exposure to events in Europe.

Financial-services stocks tied to the capital markets also began to feel pressure from lower asset levels, slowing trading volumes and perceived higher asset risk. In that context, we experienced some losses in asset-manager stocks.

Things got more difficult in August, which saw the market abandon financial-services names in a panic. Stock sales were seemingly random, and sellers executed them without regard for valuation or medium- to long-term views. We managed risk more aggressively in that environment by reducing aggregate exposure significantly. We also added to short positions where we believed there was genuine (rather than perceived) exposure to the many issues. We added asset-manager shorts where we believed equity AUM compression and asset outflows would affect earnings. We also added to short positions in brokerages, believing the difficult environment would negatively affect trading, asset-management and issuance. Lastly, we rotated long exposure into U.S.-centric regional banks in the belief that those names were attractively valued, had no direct exposure to Europe and had stable annuity-earnings components.

September was no less challenging. Because valuations were often at levels never before seen, we began to cover shorts in the belief that Financials would outperform the market. This view did not play out, as the S&P 500 continued to outperform the Master Fund's shorts. Our view that regional banks were defensive longs also didn't play out. We stayed long fixed-income asset managers, believing that municipal and Treasury bond appreciation would enhance these names' performance. The market ignored this analysis and continued to sell off financial-services names.

As the quarter ended, we believed we were positioned to generate positive returns in Financials in the fourth quarter. Because none of the third quarter's macro issues had been solved or even mitigated, the Master Fund's net equity exposure in Financials ranged from flat to short. We had a slight bias toward Financials' outperformance because of compressed valuations. The Master Fund's longs were defensive, as we still favored names with annuity earnings and low global exposure; shorts were levered to lower asset levels, asset flows and market activity levels.

Contributions to Gross Returns by Sector Book[6, 7, 13] for Q3 2011	
Sector Book	**Gross Returns**
Consumer	0.13%
Energy	-2.40%
Financials	-0.65%
Healthcare	-0.20%
Industrials[14]	-1.40%
Insurance	-0.56%
TMT[15]	-0.38%
Utilities	-0.30%
TOTAL	**-5.76%**

Industrials

The Industrials sector faced challenges similar to those of the other larger sectors during the third quarter: high volatility, rapid de-risking and the dearth of company-specific opportunities. Generating alpha was extremely challenging, and, as in the second quarter, we tended to move overall sector exposure rather than trade positions in specific names. Although we believed that tactic was absolutely necessary, it still didn't prevent a -1.40% contribution to the Fund's Equity gross returns.

The sector's performance was relatively flat in the early part of the quarter; in fact, the Industrials book was profitable until the end of July. But as European debt fears escalated and the U.S. debt-ceiling debate raged, market volatility picked up. We spent the next two months reducing gross equity exposure actively and continuously. During the month of August we cut Equities' Industrial gross in half, as capital preservation became our primary objective.

One 10-day period puts the extent of the volatility into focus. From July 26 to August 8 (the period preceding and just after Standard & Poor's' downgrade), the Industrials book had three separate days in which its dollar-value P&L swing was five to seven times the typical daily average – and we *reduced* gross on each of those days. In hindsight, a quicker and more dramatic reduction in net equity exposure in the sector would have helped to reduce losses, but volatility and correlations were spiking so quickly that it was impossible to get in front of them.

Though we frequently moved the portfolio as a unit, we didn't stray too far from our core strategy of fundamental analysis with a trading bias. The largest individual losses were from names in whose fundamentals we had strong convictions. We tended to be long those names and generally maintained those positions during the quarter. We did see positive results from positions in large-cap liquid names that serve as proxies for the Industrials sector. But as an indication of our trading bias' relatively small contribution, the largest individual profit was from a liquid futures contract linked to the S&P 500.

It's worth noting that different Industrials portfolio managers' navigation of the macro forces varied greatly in the quarter – another indication of the challenging environment. The sector's largest portfolio made up two-thirds of the sector's gross but accounted for less than half the sector's overall loss in the quarter. In fact, that portfolio was profitable in September, after volatility declined and net turned short. But the 10 critical mid-quarter days had a profound impact on the sector's overall performance. The intense de-risking, along with smaller Industrials portfolios' negative performance during the rest of the quarter, kept the sector's overall results down.

Healthcare

With a -0.20% contribution to the Fund's gross equity returns, Healthcare was among the stronger sectors in a weak quarter. The relative performance was consistent with Healthcare's overall performance compared with that of the broader market. The XLV[16] fell 10.4% in the quarter, compared with the overall S&P's 13.9% drop. It was difficult to produce alpha, although that wasn't the sector's only challenge in the quarter.

Healthcare was until recently a relatively "safe" sector that offered a stable alternative to more cyclical sectors. But Healthcare has become much more volatile in light of shifting political winds and significant changes in the industry.

Four key factors weigh on Healthcare: one is that the congressional super committee's recommendation on spending cuts isn't due until November 23. Though healthcare figures to be in the crosshairs, the full impact won't be known until well after January 1, 2012. Two, the ongoing partisan debate over healthcare reform, particularly mandatory healthcare, is calling into question even the changes that have already been implemented. Three, uncertainty over the 2012 presidential election makes it impossible to gauge the long-term future of U.S. healthcare policy. Four, in part because of factors one through three, insurers are forcing consumers to absorb a greater share of healthcare costs.

We believe these macro factors will continue to put pressure on Healthcare profits. This is particularly true of home healthcare providers, many of whom have had government reimbursement levels cut, and biotech and med-tech companies that depend in part on the National Institutes of Health for funding. The NIH budget doubled between 1998 and 2003 and has been relatively flat since then. It is expected to be cut – or at least constrained – in the coming years.

We attempted to manage uncertainty in the third quarter by keeping the Healthcare book relatively small and net exposure near zero, while maintaining an active trading bias. The Healthcare book's long positions suffered with the market's severe and rapid downturn during the quarter. Standard &

Poor's' August downgrade of U.S. credit didn't affect Healthcare as directly as other sectors, but its impact couldn't be avoided. We were particularly hurt by long positions in names specializing in diseases and treatment of kidney and gastrointestinal disorders. We believed that these names' fundamentals were sound, but the market's rapid unwinding overwhelmed them, and share prices fell by much as 30% during the quarter.

Some positives mitigated those results. A few names we were short in the home healthcare and extended-care space fell 40% to 50% during the quarter. We also were short several biotech and med-tech names that depend in part on NIH funding. These names' share prices fell 25% to 35% during the quarter.

We still view Healthcare as a defensive sector, as we believe its intra-month volatility typically is not as severe as that of other sectors. Standard & Poor's' downgrade was just another macro factor on top of those unique to Healthcare in the third quarter – primarily the effects of the U.S. government's growing intervention. Those effects have resulted in what may be a new status quo.

TMT

The third quarter saw TMT (the subsectors of technology, media and telecom) come under broad pressure along with the rest of the market. Share prices in the technology subsector had actually peaked earlier – and started to fall earlier – than some of the more cyclically-sensitive subsectors. As a result, the back half of the quarter actually saw a recovery in selected names. But overall TMT made a -0.38% contribution to Equity gross returns in the quarter.

Concerns about Europe and a double-dip U.S. recession stoked fears of a prolonged economic slowdown and lower earnings projections. We believe the sector's negative performance can be tied to the resulting de-risking, as the media and consumer-related subsectors generally are highly correlated to GDP expectations.

As in the two previous quarters, we favored names – on the long side – with identifiable catalysts or relatively lower susceptibility to a slower global economy. The Master Fund's largest long position in the sector remains a large-cap, diversified internet name, and we saw signs that support our thesis, including management's strategic review of the company and several parties' interest in buying all or part of the business.

Despite these positives, the position took a significant hit in the first half of the quarter, primarily due to the market's unfavorable perception of the resolution of the name's dispute with a material subsidiary. The share price fell around 15% during the quarter, which had a significant negative impact on the sector's P&L. It became apparent late in the quarter that the resolution was more favorable than originally thought. We added to the long position at the lower prices, and we expect to see value unlocked in the coming months.

We also remained long a large-cap U.S. media name with a diversified portfolio of properties. During the quarter the name received a favorable court ruling that will permit it to convert to an asset-backed security structure. We believe this name will unlock value by shedding non-core assets and buying back shares. Despite the positive factors, the name was down 20% in the quarter. We attribute this to overall market conditions, de-risking and fears of a looming recession (especially as the name has a large e-commerce component), rather than to anything specific to the name's businesses.

The video-game subsector also pushed the sector's P&L down, particularly a key long that fell 20% during the quarter. As in other subsectors, de-risking – not anything name-specific – was the primary catalyst. We retain this position and believe the subsector will perform well over the next six months, as the holiday shopping season is in front of us and market expectations are tempered.

The one long position in which name-specific factors triggered a loss was a large global media company whose series of gaffes during the quarter derailed a major acquisition. This had a negative impact on the name and on the sector's P&L.

Given the quarter's macro environment, we were more successful with short positions. We achieved gains by shorting a key video-distribution name whose strategic missteps reduced subscriber estimates during the quarter. We believe this name has become attractive at its current stock price. We also had success shorting a mid-cap printer of promotional and marketing material. The name's revenue and margin growth hit a wall, and management lowered expectations for the next two years as it repositions its business. The name also has significant exposure to small businesses in Europe, which we believe will be a drag for the foreseeable future.

Insurance

The Insurance sector's contribution to third-quarter gross returns in Equities was -0.56%. Early in the quarter we began to take down gross exposure meaningfully (both year-over-year and quarter-over-quarter), as we were positioned incorrectly for the massive rally in U.S. Treasuries. The sector became a macro proxy for interest rates, and fundamental stories became meaningless. Our conviction about our best ideas waned as we realized that we faced the possibility of near-zero interest rates for a decade or longer. As the 10-year U.S. Treasury yield crossed 2% we repositioned the portfolio significantly. We believed that even the thought of near-zero long-term interest rates would prevent our current ideas from generating alpha.

We took net exposure to zero early in the quarter, and it fluctuated between zero and 10% short through the remainder of the quarter. We sold long positions in domestic life insurance and offset positions in global reinsurance and South American insurance with short positions in domestic property-and-casualty insurance, domestic mortgage insurance, domestic title insurance and European insurance. At quarter's end we remained net long global reinsurance and South American insurance, while we were net short European insurance and roughly flat in domestic property-and-casualty insurance. We added a small net short in domestic life insurance.

We sold domestic life insurance names whose share prices had fallen after the devastating earthquake and tsunami in Japan and after worries grew about perpetually low long-term interest rates. The subsector contributed a disappointing loss in the quarter. Although we believed the names we owned could mitigate interest rates' effect on their businesses through the use of hedges, product re-pricing and lowering crediting rates overwhelmed the stocks. First, with the macro environment becoming ever more unsettled, fear over whether assumptions embedded in GAAP accounting for long-term interest rates were still appropriate cast a cloud over the sector. Second, the overall sector's selloff engendered concerns regarding capital and EPS weakness; together with interest-rate sensitivity, these are always concerns for domestic life insurance companies when the market sells off so quickly. Taking these factors this into account, we decided to cut the losses in the subsector. We anticipated negative earnings announcements in October and ended the quarter with a small short position in this subsector.

Global reinsurance names – with a few exceptions – continued their selloff in the quarter, and this subsector experienced a loss for the second consecutive quarter. Reinsurance pricing remained soft, except for global catastrophe rates, and it was another quarter filled with domestic catastrophes. Hurricane Irene, for example, wreaked havoc in the northeastern United States, and fears about crop insurance grew as the Texas drought worsened. In the middle of the quarter, a name which is one of the largest Master Fund holdings in the sector took advantage of all-time low valuations and bid for a competitor. The deal was not received well, as the putative acquirer had a higher-multiple business mix than the intended target. To reduce risk, we pared the Master Fund's exposure to the acquirer, even though we don't believe the deal will be consummated. Except for that surprise situation, which overwhelmed other subsector gains, the global reinsurance portfolio performed well. The Master Fund's largest position in this subsector was up about 30% for the year at the end of the quarter. We intend to hold that position.

Net long sector positions in South America also contributed substantially to the quarter's loss. The Brazilian Real currency depreciated by about 15% in September, and this risk remained un-hedged until late in the month. We hedged investments with positions outside of Brazil and therefore remained exposed to a fluctuation in the Brazilian Real, where we had a bullish stance. The Master Fund is now short an index in Brazil as a hedge against a Brazilian long position, and exposure to the Brazilian Real is limited.

Short positions in domestic property-and-casualty insurance were the sector's one bright spot, although losses on domestic property-and-casualty longs erased some of the Fund's gains. The rotation out of domestic life insurance and into less macro-sensitive domestic property-and-casualty names hurt performance further, as the property-and-casualty names – rather than serving as a defense – sold off after the life insurance sell-off. As we headed into the fourth quarter we covered some of the shorts, since this defensive subsector appears to have sold off more than the fundamentals warranted. We expect pricing to start outpacing loss costs and inflation soon.

Consumer

We ran net short in the Consumer sector for much of the quarter, with the unsettled European environment working somewhat to our advantage. When it became clear that the European environment was deteriorating, we increased the Master Fund's short exposure to names whose revenue depended heavily on international – and primarily European – markets. Those names' share prices declined more sharply than the broader market during the quarter.

On the long side, our strategy didn't change much from that of the second quarter. We were long branded domestic market-share leaders, primarily names targeted to consumers in upper demographics, whose discretionary spending is not as closely tied to macroeconomic vagaries or the stagnant job market. Though those names also slid in August with the broader market, their share prices finished the third quarter close to or higher than their July levels. We also added exposure to big-box retailers whose multiples fell into recession-like troughs that we believed did not reflect a burgeoning turnaround.

These three tactics primarily drove the sector's 0.13% contribution to the Fund's equity gross returns in the quarter.

Gains in the sector were offset by losses from long positions in economically sensitive names whose results are closely tied to the U.S. job market and, in some cases, the housing sector. We believe the names suffered from a perception that the unsettled European environment would lead to a recession in the United States. Those fears receded somewhat in the latter part of the quarter, but, like the broader market following Standard & Poor's' U.S. credit downgrade, the names had already been adversely affected. At quarter's end their share prices were still short of July levels.

Utilities

The Utilities sector had a -0.30% contribution to the Fund's equity gross returns in the quarter. As the quarter began, core holdings exhibited our belief that forward power/capacity prices do not reflect impending EPA regulations and subsequent coal plant retirements. Supporting this view, the EPA on July 6 finalized the stringent Cross-State Air Pollution Rule to reduce sulphur dioxide and nitrogen oxide emissions. That ruling, coupled with positive sell-side commentary, served as a catalyst for names levered to unregulated generation, and through most of July key positions outperformed the XLU[17], a relevant sector index.

As Standard & Poor's U.S. credit downgrade and the European sovereign debt crisis weighed on the market, however, we recognized the need to reduce exposure to the Master Fund's higher-beta Utilities positions. During the quarter, Utilities' gross exposure remained at 2.8% of AUM, and net exposure ranged from 0.34% long to 0.32% short.

Negative performance in the sector was driven primarily by losses in an integrated power producer exposed to wholesale power pricing. Gains in the quarter resulted mostly from short hedges in other merchant generators and a long position in a pipeline utility exposed to the fast-evolving Utica shale opportunity.

Despite year-to-date underperformance in the Utilities sector, we believe we'll see certainty in the coming months regarding environmental regulation and coal plant retirements. We believe this will drive a material re-rating of merchant-exposed names.

Sector Book[13] Exposure for Q3 2011				
Sector Book	**LMV**	**SMV**	**NMV**	**GMV**
Consumer	6.4%	-7.4%	-1.0%	13.8%
Energy	8.3%	-5.3%	3.0%	13.6%
Financials	8.5%	-8.6%	-0.1%	17.1%
Healthcare	7.1%	-5.6%	1.5%	12.7%
Industrials[14]	4.9%	-7.6%	-2.7%	12.5%
Insurance	4.9%	-4.2%	0.7%	9.1%
TMT[15]	8.9%	-8.0%	0.9%	16.9%
Utilities	2.6%	-1.7%	0.9%	4.3%
TOTAL	**51.6%**	**-48.4%**	**3.2%**	**100.0%**

Credit strategy

The third quarter was extremely challenging for our Credit teams. Macro events and regulatory uncertainties caused spreads to widen. The hardest-hit areas – starting in July – were European Union and emerging-market sovereign and corporate debt. U.S. corporate spreads widened roughly 30% to 35% in August across investment-grade, crossover and hybrid credits, followed by an additional 10% to 20% widening in September.

Beyond suffering losses from generic spread-widening, there were outsized losses from certain idiosyncratic positions in Energy and Financial hybrids that accounted for more than two-thirds of the Credit strategy's -2.71% contribution to the Fund's gross returns.

The Credit portfolios' net-long bias exacerbated the overall negative returns. Shorts, primarily in the form of index shorts, provided little offset to the losses suffered in the longs. In the wake of these losses, we reduced Credit's gross exposure substantially. Entering the third quarter, Credit's gross exposure stood at $4.20 billion, with a net long of $1.25 billion. At the end of the quarter, the Credit portfolios had a gross exposure of $2.44 billion and were net short $0.18 billion.

It became apparent during the quarter that liquidity in OTC corporate and sovereign cash bond markets was declining. What's more, bid/ask spreads were widening as dealers de-risked and reviewed business lines in light of recent changes in financial regulations. Our view is that this environment may persist for a prolonged period. The weekly figure for net corporate bond positions at primary dealers dropped 22% to $77 billion, the lowest level since 2003. Although opportunities to make money will still exist, they will demand the ability to withstand greater mark-to-market volatility, which is not consistent with our approach to risk management. As a result, we intend to reduce our allocation to Credit strategies and to reallocate this capital to the Equity strategies as the capital becomes available.

Convertibles and Macro strategies

We reduced the Master Fund's Convertibles portfolios by nearly one-third over the quarter; performance was slightly negative and net exposure was virtually unchanged. This posture reflected a lack of opportunities going forward, along with anemic new issuance. We currently hold a relatively more concentrated portfolio of event-driven opportunities where we see near-term catalysts.

The Macro strategies contributed marginally positive returns for the quarter. We were successful in monetizing the moves in the U.S. Treasury yield curve by employing a series of flatteners. Long positions in the U.S. dollar also added marginally positive returns to P&L in the quarter.

*   *   *   *   *

The Fund started the fourth quarter of 2011 with approximately $3.3 billion in assets under management. We thank you for your confidence and continued support. Please feel free to contact either of us with any questions.

Very best regards,

Rich Schimel and Larry Sapanski
Co-Chief Investment Officers