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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, DC 20549**

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**FORM 10-Q**

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**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended June 30, 2011

OR

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 001-34569

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**Ellington Financial LLC**

(Exact Name of Registrant as Specified in Its Charter)

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**Delaware**  
(State or Other Jurisdiction of  
Incorporation or Organization)

**26-0489289**  
(I.R.S. Employer  
Identification No.)

**53 Forest Avenue, Old Greenwich, Connecticut 06870**  
(Address of Principal Executive Office) (Zip Code)

**(203) 698-1200**  
(Registrant's Telephone Number, Including Area Code)

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Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of "large accelerated filers" "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer  Accelerated Filer   
Non-Accelerated Filer  Smaller Reporting Company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

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Class	Outstanding at August 10, 2011
Common Shares Representing Limited Liability Company Interests, no par value	16,507,381

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FORM 10-Q

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## PART I. FINANCIAL INFORMATION

## Item 1. Consolidated Financial Statements (unaudited)

## ELLINGTON FINANCIAL LLC

CONSOLIDATED STATEMENT OF ASSETS, LIABILITIES AND SHAREHOLDERS' EQUITY  
(UNAUDITED)

	<u>June 30, 2011</u>	<u>December 31, 2010</u>
	<i>Expressed in U.S. Dollars</i>	
<b>ASSETS</b>		
Cash and cash equivalents	\$ 45,437,323	\$ 35,790,818
Investments, financial derivatives and repurchase agreements:		
Investments at value (Cost – \$1,203,146,096 and \$1,232,484,311)	1,201,857,332	1,246,066,560
Financial derivatives - assets (Cost – \$136,936,637 and \$208,958,359)	125,712,267	201,335,372
Repurchase agreements (Cost – \$22,437,500 and \$25,683,750)	22,437,500	25,683,750
Total investments, financial derivatives and repurchase agreements	<u>1,350,007,099</u>	<u>1,473,085,682</u>
Deposits with dealers held as collateral	20,397,115	20,394,065
Receivable for securities sold	553,564,172	799,142,581
Interest and principal receivable	7,318,245	5,909,317
Other assets	364,396	—
<b>Total Assets</b>	<u>\$ 1,977,088,350</u>	<u>\$ 2,334,322,463</u>
<b>LIABILITIES</b>		
Investments and financial derivatives:		
Investments sold short at value (Proceeds – \$542,110,655 and \$775,781,612)	\$ 540,155,406	\$ 775,145,098
Financial derivatives – liabilities (Net Proceeds – \$4,255,004 and \$17,718,129)	10,987,654	21,030,329
Total investments and financial derivatives	<u>551,143,060</u>	<u>796,175,427</u>
Reverse repurchase agreements	801,901,000	777,760,260
Due to brokers – margin accounts	116,505,413	166,409,207
Payable for securities purchased	117,933,004	184,012,894
Accounts payable and accrued expenses	2,426,071	2,485,263
Accrued base management fee	1,448,634	1,524,818
Accrued incentive fees	—	1,421,500
Interest and dividends payable	877,576	861,382
<b>Total Liabilities</b>	<u>1,592,234,758</u>	<u>1,930,650,751</u>
<b>SHAREHOLDERS' EQUITY</b>	<u>384,853,592</u>	<u>403,671,712</u>
<b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY</b>	<u>\$ 1,977,088,350</u>	<u>\$ 2,334,322,463</u>
<b>ANALYSIS OF SHAREHOLDERS' EQUITY:</b>		
Common shares, no par value, 100,000,000 shares authorized; (16,507,381 and 16,498,342 shares issued and outstanding)	\$ 376,024,478	\$ 394,918,033
Additional paid-in capital – LTIP units	8,829,114	8,753,679
<b>Total Shareholders' Equity</b>	<u>\$ 384,853,592</u>	<u>\$ 403,671,712</u>
<b>PER SHARE INFORMATION:</b>		
Common shares, no par value	<u>\$ 23.31</u>	<u>\$ 24.47</u>

See Notes to Consolidated Financial Statements

**ELLINGTON FINANCIAL LLC**  
**CONSOLIDATED CONDENSED SCHEDULE OF INVESTMENTS**  
**AT JUNE 30, 2011**  
**(UNAUDITED)**

<u>Current Principal/ Notional Amount</u>	<u>Description</u>	<u>Rate</u>	<u>Maturity</u>	<u>Value</u> <i>Expressed in U.S. Dollars</i>
<b>Long Investments (312.29%) (a) (b) (n)</b>				
<b>Mortgage-Backed Securities (311.08%)</b>				
<b>Agency Securities (215.24%)</b>				
<b>Fixed Rate Agency Securities (200.72%)</b>				
<b>Principal and Interest - Fixed Rate Agency Securities (188.20%)</b>				
\$ 73,049,127	Government National Mortgage Association Pool	5.00%	4/40	\$ 79,458,047
35,464,407	Federal National Mortgage Association Pool	5.00%	4/41	37,897,044
34,304,838	Federal National Mortgage Association Pool	4.50%	2/41	35,548,389
29,484,563	Federal National Mortgage Association Pool	5.00%	4/41	31,488,592
27,461,188	Federal National Mortgage Association Pool	4.50%	11/40	28,456,656
26,115,071	Federal Home Loan Mortgage Corporation Pool	4.00%	11/40	26,100,790
22,490,913	Government National Mortgage Association Pool	4.50%	3/41	23,759,542
22,793,553	Federal Home Loan Mortgage Corporation Pool	4.00%	1/41	22,834,510
21,264,590	Federal National Mortgage Association Pool	5.00%	5/41	22,723,208
19,772,046	Federal National Mortgage Association Pool	5.00%	6/41	21,109,748
19,149,303	Federal Home Loan Mortgage Corporation Pool	4.50%	3/41	19,813,544
18,038,359	Federal National Mortgage Association Pool	5.00%	3/41	19,264,404
16,993,309	Federal Home Loan Mortgage Corporation Pool	5.00%	4/41	18,123,099
16,041,894	Federal National Mortgage Association Pool	5.00%	2/41	17,172,346
15,944,209	Federal National Mortgage Association Pool	4.50%	12/40	16,522,186
14,921,445	Federal Home Loan Mortgage Corporation Pool	4.00%	12/40	14,913,285
13,600,930	Federal National Mortgage Association Pool	5.00%	4/41	14,521,118
13,639,982	Federal National Mortgage Association Pool	4.50%	7/41	14,119,513
12,561,032	Government National Mortgage Association Pool	5.50%	8/39	13,872,089
11,453,093	Federal National Mortgage Association Pool	4.50%	1/41	11,879,005
11,304,560	Federal National Mortgage Association Pool	4.00%	11/40	11,310,301

See Notes to Consolidated Financial Statements

ELLINGTON FINANCIAL LLC  
CONSOLIDATED CONDENSED SCHEDULE OF INVESTMENTS  
AT JUNE 30, 2011 (CONTINUED)  
(UNAUDITED)

<u>Current Principal/ Notional Amount</u>	<u>Description</u>	<u>Rate</u>	<u>Maturity</u>	<u>Value</u> <i>Expressed in U.S. Dollars</i>
<b>Principal and Interest - Fixed Rate Agency Securities (188.20%) (continued)</b>				
\$ 10,701,765	Federal Home Loan Mortgage Corporation Pool	4.00%	1/41	\$ 10,707,618
9,988,714	Federal National Mortgage Association Pool	5.00%	11/40	10,673,877
9,814,736	Government National Mortgage Association Pool	5.00%	7/40	10,639,020
9,995,877	Federal National Mortgage Association Pool	4.50%	3/41	10,364,475
10,207,709	Federal Home Loan Mortgage Corporation Pool	4.00%	2/41	10,213,291
8,913,033	Federal National Mortgage Association Pool	5.50%	10/39	9,673,775
9,269,248	Federal Home Loan Mortgage Corporation Pool	4.50%	2/41	9,590,775
9,206,501	Federal National Mortgage Association Pool	4.00%	1/41	9,222,684
8,781,029	Federal Home Loan Mortgage Corporation Pool	4.00%	3/41	8,788,575
7,937,671	Federal National Mortgage Association Pool	5.00%	11/40	8,482,145
7,124,125	Federal National Mortgage Association Pool	5.50%	7/39	7,723,275
6,991,495	Federal National Mortgage Association Pool	5.00%	5/41	7,444,850
6,632,710	Federal Home Loan Mortgage Corporation Pool	6.00%	4/39	7,305,827
6,787,528	Federal National Mortgage Association Pool	5.00%	4/41	7,246,747
6,662,469	Federal National Mortgage Association Pool	5.00%	8/40	7,094,489
6,793,515	Federal National Mortgage Association Pool	4.50%	4/41	7,044,026
5,608,425	Federal National Mortgage Association Pool	5.50%	7/39	6,080,102
5,645,258	Federal National Mortgage Association Pool	5.00%	11/40	6,011,317
5,961,134	Federal Home Loan Mortgage Corporation Pool	4.00%	12/40	5,971,846
5,937,062	Federal National Mortgage Association Pool	4.00%	2/41	5,953,064
5,601,850	Federal Home Loan Mortgage Corporation Pool	4.00%	5/41	5,599,662
5,495,280	Federal Home Loan Mortgage Corporation Pool	4.00%	1/41	5,505,155
5,095,254	Federal National Mortgage Association Pool	4.50%	4/41	5,282,346
5,003,615	Federal National Mortgage Association Pool	4.50%	5/41	5,189,686

See Notes to Consolidated Financial Statements

**ELLINGTON FINANCIAL LLC**  
**CONSOLIDATED CONDENSED SCHEDULE OF INVESTMENTS**  
**AT JUNE 30, 2011 (CONTINUED)**  
**(UNAUDITED)**

<u>Current Principal/ Notional Amount</u>	<u>Description</u>	<u>Rate</u>	<u>Maturity</u>	<u>Value</u> <i>Expressed in U.S. Dollars</i>
<b>Principal and Interest - Fixed Rate Agency Securities (188.20%) (continued)</b>				
\$ 4,837,548	Federal National Mortgage Association Pool	5.00%	6/40	\$ 5,166,350
4,959,482	Federal Home Loan Mortgage Corporation Pool	4.50%	2/41	5,131,514
4,596,562	Federal Home Loan Mortgage Corporation Pool	4.00%	1/41	4,594,048
3,803,363	Federal National Mortgage Association Pool	5.00%	3/41	4,049,988
3,425,863	Federal National Mortgage Association Pool	5.00%	4/41	3,657,644
2,745,804	Federal National Mortgage Association Pool	5.00%	6/41	2,929,859
2,241,194	Federal National Mortgage Association Pool	5.00%	11/40	2,391,424
4,640,142	Other Federal National Mortgage Association Pools	6.00%	9/39 - 2/40	5,098,532
1,203,951	Other Federal Home Loan Mortgage Corporation Pool	6.00%	5/40	1,325,380
1,154,368	Other Government National Mortgage Association Pool	5.50%	3/41	1,271,969
				<u>724,312,751</u>
<b>Interest Only - Fixed Rate Agency Securities (1.36%)</b>				
17,771,554	Other Federal National Mortgage Association	5.00% - 5.50%	10/39 -10/40	2,914,381
7,108,495	Other Federal Home Loan Mortgage Corporation	5.50%	1/39	1,302,298
11,329,698	Other Government National Mortgage Association	5.50%	3/36	1,010,353
				<u>5,227,032</u>
<b>TBA - Fixed Rate Agency Securities (11.16%) (c)</b>				
25,000,000	Federal National Mortgage Association Pool (30 Year)	3.50%	7/11	23,917,969
17,000,000	Federal National Mortgage Association Pool (30 Year)	4.00%	7/11	17,003,320
2,000,000	Other Federal Home Loan Mortgage Corporation Pools (30 Year)	3.50% - 5.00%	7/11	2,016,093
				<u>42,937,382</u>
<b>Total Fixed Rate Agency Securities (Cost \$766,423,393)</b>				<u>772,477,165</u>

See Notes to Consolidated Financial Statements

ELLINGTON FINANCIAL LLC  
CONSOLIDATED CONDENSED SCHEDULE OF INVESTMENTS  
AT JUNE 30, 2011 (CONTINUED)  
(UNAUDITED)

Current Principal/ Notional Amount	Description	Rate	Maturity	Value Expressed in U.S. Dollars
<b>Floating Rate Agency Securities (14.52%)</b>				
<b>Principal and Interest - Floating Rate Agency Securities (14.52%)</b>				
\$ 10,699,967	Federal National Mortgage Association Pool	5.11%	5/38	\$ 11,284,491
10,271,133	Federal National Mortgage Association Pool	5.71%	1/38	10,897,649
8,267,587	Federal National Mortgage Association Pool	5.24%	12/35	8,709,915
8,194,173	Federal National Mortgage Association Pool	5.24%	2/38	8,653,286
4,375,839	Federal National Mortgage Association Pool	5.54%	7/37	4,687,380
3,506,820	Federal National Mortgage Association Pool	5.68%	4/36	3,726,899
3,417,121	Federal Home Loan Mortgage Corporation Pool	2.82%	7/34	3,585,672
2,413,869	Federal National Mortgage Association Pool	5.47%	9/37	2,555,899
1,689,299	Other Federal National Mortgage Association Pool	4.97%	10/33	1,792,423
<b>Total Floating Rate Agency Securities (Cost \$55,553,517)</b>				<u>55,893,614</u>
<b>Total Agency Securities (Cost \$821,976,910)</b>				<u>828,370,779</u>
<b>Private Label Securities (95.84%)</b>				
<b>Principal and Interest - Private Label Securities (95.58%)</b>				
537,488,752	Various	0.25% - 9.35%	5/19 -1/47	367,857,921
<b>Total Principal and Interest - Private Label Securities (Cost \$375,177,074)</b>				<u>367,857,921</u>
<b>Interest Only - Private Label Securities (0.26%)</b>				
76,057,033	Various	0.50% - 0.65%	9/47	978,632
<b>Total Interest Only - Private Label Securities (Cost \$669,676)</b>				<u>978,632</u>
<b>Residual Certificates - Private Label Securities (0.00%)</b>				
216,439,901	Various	—	6/37	—
<b>Total Residual Certificates - Private Label Securities (Cost \$586,455)</b>				<u>—</u>
<b>Total Private Label Securities (Cost \$376,433,205)</b>				<u>368,836,553</u>
<b>Total Mortgage-Backed Securities (Cost \$1,198,410,115)</b>				<u>1,197,207,332</u>
<b>Commercial Mortgage Loans (1.21%) (o)</b>				
5,000,000	Various	5.75%	11/12	4,650,000
<b>Total Commercial Mortgage Loans (Cost \$4,735,981)</b>				<u>4,650,000</u>
<b>Total Long Investments (Cost \$1,203,146,096)</b>				<u>\$1,201,857,332</u>

See Notes to Consolidated Financial Statements

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**ELLINGTON FINANCIAL LLC**  
**CONSOLIDATED CONDENSED SCHEDULE OF INVESTMENTS**  
**AT JUNE 30, 2011 (CONTINUED)**  
**(UNAUDITED)**

<u>Current Principal/ Notional Amount</u>	<u>Description</u>	<u>Rate</u>	<u>Maturity</u>	<u>Value</u> <i>Expressed in U.S. Dollars</i>
<b>Repurchase Agreements (5.83%) (d)</b>				
\$ 15,168,750	Bank of America Securities Collateralized by Par Value \$15,000,000 U.S. Treasury Note, Coupon 1.75%, Maturity Date 5/16	(0.15)%	7/11	\$ 15,168,750
5,143,750	Bank of America Securities Collateralized by Par Value \$5,000,000 U.S. Treasury Note, Coupon 2.00%, Maturity Date 4/16	(0.12)%	7/11	5,143,750
2,125,000	Nomura Securities International Inc. Collateralized by Par Value \$2,000,000 U.S. Treasury Note, Coupon 3.63%, Maturity Date 2/21	0.00%	7/11	2,125,000
<b>Total Repurchase Agreements (Cost \$22,437,500)</b>				<b><u>\$ 22,437,500</u></b>
<b>Investments Sold Short (-140.35%)</b>				
<b>TBA - Fixed Rate Agency Securities Sold Short (-134.59%) (c) (e)</b>				
\$ (138,700,000)	Federal National Mortgage Association Pool (30 Year)	5.00%	7/11	\$(147,347,078)
(117,900,000)	Federal National Mortgage Association Pool (30 Year)	4.50%	7/11	(121,989,656)
(106,000,000)	Government National Mortgage Association Pool (30 Year)	5.00%	7/11	(114,836,094)
(35,700,000)	Federal Home Loan Mortgage Corporation Pool (30 Year)	4.50%	7/11	(36,882,563)
(25,500,000)	Federal National Mortgage Association Pool (30 Year)	5.50%	7/11	(27,580,840)
(26,900,000)	Federal Home Loan Mortgage Corporation Pool (30 Year)	4.00%	7/11	(26,881,086)
(22,500,000)	Government National Mortgage Association Pool (30 Year)	4.50%	7/11	(23,748,047)
(13,500,000)	Government National Mortgage Association Pool (30 Year)	5.50%	7/11	(14,858,438)
(2,500,000)	Federal National Mortgage Association Pool (30 Year)	6.00%	7/11	(2,746,289)
(1,000,000)	Other Federal Home Loan Mortgage Corporation Pool (30 Year)	6.00%	7/11	(1,098,359)
<b>Total TBA - Fixed Rate Agency Securities Sold Short (Proceeds -\$519,948,719)</b>				<b><u>(517,968,450)</u></b>
<b>U.S. Treasury Securities Sold Short (-5.76%)</b>				
(15,000,000)	U.S. Treasury Note	1.75%	5/16	(15,025,625)
(5,000,000)	U.S. Treasury Note	2.00%	4/16	(5,075,771)
(2,000,000)	U.S. Treasury Note	3.63%	2/21	(2,085,560)
<b>Total U.S. Treasury Securities Sold Short (Proceeds -\$22,161,936)</b>				<b><u>(22,186,956)</u></b>
<b>Total Investments Sold Short (Proceeds -\$542,110,655)</b>				<b><u>\$(540,155,406)</u></b>

See Notes to Consolidated Financial Statements



**ELLINGTON FINANCIAL LLC**  
**CONSOLIDATED CONDENSED SCHEDULE OF INVESTMENTS**  
**AT JUNE 30, 2011 (CONTINUED)**  
**(UNAUDITED)**

	<u>Primary Risk Exposure</u>	<u>Notional or Number of Contracts</u>	<u>Range of Expiration Dates</u>	<u>Value Expressed in U.S. Dollars</u>
<b>Financial Derivatives - Assets (32.66%)</b>				
<b>Swaps (32.66%) (f)</b>				
<b>Long Swaps:</b>				
Credit Default Swaps on Asset Backed Indices (Cost \$274,320) (g)	Credit	\$ 11,550,316	6/36	\$ 467,684
Interest Rate Swaps (h)	Interest Rates	5,000,000	7/21	4,916
<b>Short Swaps:</b>				
Credit Default Swaps on Asset Backed Securities (i)	Credit	(88,747,270)	6/34 - 12/36	69,828,936
Credit Default Swaps on Asset Backed Indices: (j)	Credit			
ABX.HE AAA 2006-2 Index		(69,197,340)	5/46	34,355,640
Other		(42,262,489)	8/37 - 10/52	20,100,074
Interest Rate Swaps (k)	Interest Rates	(87,960,000)	6/16 - 6/21	955,017
<b>Total Swaps (Cost \$136,936,637)</b>				<u>125,712,267</u>
<b>Total Financial Derivatives - Assets (Cost \$136,936,637)</b>				<u>\$ 125,712,267</u>
<b>Financial Derivatives - Liabilities (-2.86%)</b>				
<b>Swaps (-2.76%)</b>				
<b>Long Swaps:</b>				
Credit Default Swaps on Asset Backed Indices (Proceeds - \$4,427,996) (g)	Credit	\$ 13,314,333	8/37 - 7/45	\$ (5,031,909)
<b>Short Swaps:</b>				
Interest Rate Swaps (k)	Interest Rates	(203,500,000)	4/14 - 4/21	(5,366,758)
Credit Default Swaps on Corporate Bond Indices (l)	Credit	(19,700,000)	6/15	(220,124)
<b>Total Swaps (Net Proceeds -\$4,255,004)</b>				<u>\$ (10,618,791)</u>
<b>Futures (-0.10%) (m)</b>				
<b>Short Futures:</b>				
Eurodollar contracts	Interest Rates	(245)	9/11 - 9/12	(368,863)
<b>Total Futures</b>				<u>(368,863)</u>
<b>Total Financial Derivatives - Liabilities (Net Proceeds -\$4,255,004)</b>				<u>\$ (10,987,654)</u>

See Notes to Consolidated Financial Statements

**ELLINGTON FINANCIAL LLC**  
**CONSOLIDATED CONDENSED SCHEDULE OF INVESTMENTS**  
**AT JUNE 30, 2011 (CONCLUDED)**  
**(UNAUDITED)**

- (a) See Note 2 and Note 9 in Notes to Consolidated Financial Statements.
- (b) At June 30, 2011, the Company's long investments guaranteed by the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation, and the Government National Mortgage Association represented 133.80%, 47.66%, and 33.78% of shareholders' equity, respectively.
- (c) To Be Announced ("TBA") securities settle on a forward basis. At settlement the purchaser generally receives agency pass-through mortgage certificates with original maturity dates typically between 15 and 30 years.
- (d) In general, securities received pursuant to repurchase agreements were delivered to counterparties in short sale transactions.
- (e) At June 30, 2011, the Company's short investments guaranteed by the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation, and the Government National Mortgage Association represented 77.87%, 16.85%, and 39.87% of shareholders' equity, respectively.
- (f) The following table shows the Company's swap assets by dealer as a percentage of shareholders' equity:

<u>Dealer/Parent Company</u>	<u>Percent of Shareholders' Equity</u>
Affiliates of Morgan Stanley	15.76%
Affiliates of Credit Suisse	5.25%

- (g) For long credit default swaps on asset backed indices, the Company sold protection.
- (h) For long interest rate swap contracts, a floating rate is being paid and a fixed rate is being received.
- (i) For short credit default swaps on asset backed securities, the Company purchased protection.
- (j) For short credit default swaps on asset backed indices, the Company purchased protection.
- (k) For short interest rate swap contracts, a fixed rate is being paid and a floating rate is being received.
- (l) For short credit default swaps on corporate bond indices, the Company purchased protection.
- (m) Each contract represents a notional amount of \$1,000,000.
- (n) The table below shows the Company's long investment ratings from Moody's, Standard and Poor's, or Fitch, as well as the Company's long investments that were unrated but affiliated with Fannie Mae, Freddie Mac, or Ginnie Mae. Ratings tend to be a lagging credit indicator; as a result, the credit quality of the Company's long investment holdings may be lower than the credit quality implied based on the ratings listed below. In situations where an investment has a split rating, the lowest provided rating is used. The ratings descriptions include ratings qualified with a "+", "-", "1", "2", or "3".

<u>Rating Description</u>	<u>Percentage of Shareholders' Equity</u>
Unrated but Agency-Guaranteed	215.24%
Aaa/AAA/AAA	1.94%
Aa/AA/AA	3.96%
A/A/A	8.29%
Baa/BBB/BBB	6.09%
Ba/BB/BB or below	75.56%
Unrated	1.21%

- (o) Maturity date may be extended through November 4, 2015.

See Notes to Consolidated Financial Statements

ELLINGTON FINANCIAL LLC  
CONSOLIDATED CONDENSED SCHEDULE OF INVESTMENTS  
AT DECEMBER 31, 2010  
(UNAUDITED)

Current Principal/ Notional Amount	Description	Rate	Maturity	Value <i>Expressed in U.S. Dollars</i>
<b>Long Investments (308.68%) (a) (b) (n)</b>				
<b>Mortgage-Backed Securities (308.68%)</b>				
<b>Agency Securities (224.28%)</b>				
<b>Fixed Rate Agency Securities (204.19%)</b>				
<b>Principal and Interest - Fixed Rate Agency Securities (190.72%)</b>				
\$ 93,295,863	Federal Home Loan Mortgage Corporation Pool	4.00%	12/40	\$ 92,661,743
75,287,233	Government National Mortgage Association Pool	5.00%	4/40	80,769,084
41,442,106	Federal National Mortgage Association Pool	5.00%	8/40	43,659,906
31,028,699	Federal Home Loan Mortgage Corporation Pool	4.00%	12/40	30,805,680
29,866,978	Federal Home Loan Mortgage Corporation Pool	4.50%	9/40	30,664,986
27,828,661	Federal National Mortgage Association Pool	4.50%	11/40	28,596,123
25,015,628	Government National Mortgage Association Pool	4.50%	5/40	26,108,107
24,330,982	Federal Home Loan Mortgage Corporation Pool	5.00%	8/40	25,551,333
20,673,398	Federal National Mortgage Association Pool	5.00%	11/40	21,782,978
20,370,123	Federal National Mortgage Association Pool	3.50%	11/40	19,453,468
17,517,469	Federal Home Loan Mortgage Corporation Pool	5.00%	9/40	18,396,079
17,826,955	Federal Home Loan Mortgage Corporation Pool	4.50%	11/40	18,297,698
16,317,610	Federal National Mortgage Association Pool	5.00%	10/40	17,234,201
16,073,130	Federal National Mortgage Association Pool	4.50%	12/40	16,526,442
15,061,281	Federal Home Loan Mortgage Corporation Pool	4.00%	12/40	14,957,734

See Notes to Consolidated Financial Statements

ELLINGTON FINANCIAL LLC  
CONSOLIDATED CONDENSED SCHEDULE OF INVESTMENTS  
AT DECEMBER 31, 2010 (CONTINUED)  
(UNAUDITED)

<u>Current Principal/ Notional Amount</u>	<u>Description</u>	<u>Rate</u>	<u>Maturity</u>	<u>Value</u> <i>Expressed in U.S. Dollars</i>
<b>Principal and Interest - Fixed Rate Agency Securities (190.72%) (continued)</b>				
\$ 14,673,788	Federal National Mortgage Association Pool	4.00%	11/40	\$ 14,601,566
14,052,718	Federal National Mortgage Association Pool	4.00%	12/40	14,007,706
14,085,775	Federal National Mortgage Association Pool	3.50%	1/41	13,451,365
11,888,330	Federal National Mortgage Association Pool	4.50%	9/40	12,208,758
11,073,845	Government National Mortgage Association Pool	5.00%	6/40	11,859,396
11,018,284	Federal National Mortgage Association Pool	4.50%	7/25	11,573,502
9,886,839	Government National Mortgage Association Pool	5.00%	7/40	10,523,305
9,534,263	Federal National Mortgage Association Pool	5.50%	10/39	10,238,159
9,622,371	Federal National Mortgage Association Pool	4.50%	8/25	10,110,256
9,696,958	Federal Home Loan Mortgage Corporation Pool	4.50%	11/40	9,953,019
9,185,172	Government National Mortgage Association Pool	5.00%	4/40	9,836,745
8,436,119	Federal Home Loan Mortgage Corporation Pool	4.50%	10/40	8,648,340
7,945,384	Federal Home Loan Mortgage Corporation Pool	6.00%	4/39	8,632,535
8,224,296	Federal Home Loan Mortgage Corporation Pool	5.00%	8/40	8,636,796
7,307,028	Federal National Mortgage Association Pool	5.00%	7/40	7,690,077
7,188,742	Government National Mortgage Association Pool	5.00%	8/40	7,698,694
7,203,182	Federal Home Loan Mortgage Corporation Pool	4.00%	11/40	7,166,041
6,726,472	Federal National Mortgage Association Pool	5.00%	8/40	7,087,494
6,193,991	Government National Mortgage Association Pool	5.00%	7/40	6,592,729

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**ELLINGTON FINANCIAL LLC**  
**CONSOLIDATED CONDENSED SCHEDULE OF INVESTMENTS**  
**AT DECEMBER 31, 2010 (CONTINUED)**  
**(UNAUDITED)**

<u>Current Principal/ Notional Amount</u>	<u>Description</u>	<u>Rate</u>	<u>Maturity</u>	<u>Value</u> <i>Expressed in U.S. Dollars</i>
<b>Principal and Interest - Fixed Rate Agency Securities (190.72%) (continued)</b>				
\$ 5,820,187	Federal National Mortgage Association Pool	6.00%	12/38	\$ 6,326,725
6,262,042	Federal Home Loan Mortgage Corporation Pool	4.00%	12/40	6,218,991
6,095,615	Federal National Mortgage Association Pool	4.00%	11/40	6,063,708
6,097,159	Federal Home Loan Mortgage Corporation Pool	4.00%	12/40	6,065,721
5,703,267	Federal National Mortgage Association Pool	4.50%	8/25	5,988,876
5,433,049	Federal National Mortgage Association Pool	5.00%	11/40	5,722,953
5,093,029	Federal National Mortgage Association Pool	4.50%	8/25	5,348,078
5,082,202	Federal National Mortgage Association Pool	4.50%	12/40	5,222,360
4,812,155	Federal National Mortgage Association Pool	4.50%	11/40	4,944,865
4,377,082	Federal National Mortgage Association Pool	5.50%	11/39	4,689,291
4,636,881	Federal Home Loan Mortgage Corporation Pool	4.00%	1/41	4,605,002
4,394,322	Federal Home Loan Mortgage Corporation Pool	4.00%	12/40	4,371,664
4,003,459	Government National Mortgage Association Pool	5.00%	7/40	4,261,182
3,611,892	Federal National Mortgage Association Pool	4.50%	12/40	3,711,501
3,217,875	Federal Home Loan Mortgage Corporation Pool	5.00%	9/40	3,383,294
3,355,673	Federal Home Loan Mortgage Corporation Pool	4.00%	12/40	3,338,370
2,931,882	Federal National Mortgage Association Pool	4.50%	9/25	3,074,124
2,779,368	Federal Home Loan Mortgage Corporation Pool	4.00%	8/40	2,765,037
2,157,241	Federal Home Loan Mortgage Corporation Pool	4.00%	12/40	2,146,118
5,210,008	Other Federal National Mortgage Association Pools	6.00%	9/39 - 2/40	5,664,713
				<u>769,894,618</u>

See Notes to Consolidated Financial Statements

ELLINGTON FINANCIAL LLC  
CONSOLIDATED CONDENSED SCHEDULE OF INVESTMENTS  
AT DECEMBER 31, 2010 (CONTINUED)  
(UNAUDITED)

<u>Current Principal/ Notional Amount</u>	<u>Description</u>	<u>Rate</u>	<u>Maturity</u>	<u>Value</u> <i>Expressed in U.S. Dollars</i>
<b>TBA - Fixed Rate Agency Securities (13.47%) (c)</b>				
\$ 25,000,000	Government National Mortgage Association (30 Year)	4.00%	1/11	\$ 25,152,344
25,000,000	Federal National Mortgage Association (30 Year)	4.00%	2/11	24,796,875
4,650,000	Federal National Mortgage Association (30 Year)	3.50%	1/11	4,440,387
				<u>54,389,606</u>
<b>Total Fixed Rate Agency Securities (Cost \$828,147,519)</b>				<u>824,284,224</u>
<b>Floating Rate Agency Securities (20.09%)</b>				
<b>Principal and Interest - Floating Rate Agency Securities (20.09%)</b>				
15,366,349	Federal National Mortgage Association Pool	5.84%	12/36	16,265,797
12,274,343	Federal National Mortgage Association Pool	5.68%	1/38	13,025,532
11,853,952	Federal National Mortgage Association Pool	5.10%	5/38	12,475,639
10,983,637	Federal National Mortgage Association Pool	5.22%	12/35	11,567,895
8,928,303	Federal National Mortgage Association Pool	5.76%	10/36	9,392,064
8,641,078	Federal National Mortgage Association Pool	5.22%	2/38	9,127,052
4,123,128	Federal National Mortgage Association Pool	5.69%	4/36	4,379,549
3,012,020	Federal National Mortgage Association Pool	5.50%	9/37	3,172,898
1,608,406	Federal National Mortgage Association Pool	6.06%	1/38	1,686,469
<b>Total Floating Rate Agency Securities (Cost \$80,166,989)</b>				<u>81,092,895</u>
<b>Total Agency Securities (Cost \$908,314,508)</b>				<u>905,377,119</u>

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**ELLINGTON FINANCIAL LLC**  
**CONSOLIDATED CONDENSED SCHEDULE OF INVESTMENTS**  
**AT DECEMBER 31, 2010 (CONTINUED)**  
**(UNAUDITED)**

<u>Current Principal/ Notional Amount</u>	<u>Description</u>	<u>Rate</u>	<u>Maturity</u>	<u>Value</u> <i>Expressed in U.S. Dollars</i>
<b>Private Label Securities (84.40%)</b>				
<b>Principal and Interest - Private Label Securities (82.97%)</b>				
\$ 482,838,475	Various	0.32% - 53.41%	6/18 - 2/51	\$ 334,908,926
<b>Total Principal and Interest - Private Label Securities (Cost \$321,067,655)</b>				<u>334,908,926</u>
<b>Interest Only - Private Label Securities (1.43%)</b>				
127,239,018	Various	0.50% - 5.24%	4/35 - 9/47	5,780,515
<b>Total Interest Only - Private Label Securities (Cost \$2,490,766)</b>				<u>5,780,515</u>
<b>Residual Certificates - Private Label Securities (0.00%)</b>				
225,639,768	Various	—	6/37	—
<b>Total Residual Certificates - Private Label Securities (Cost \$611,382)</b>				<u>—</u>
<b>Total Private Label Securities (Cost \$324,169,803)</b>				<u>340,689,441</u>
<b>Total Mortgage-Backed Securities (Cost \$1,232,484,311)</b>				<u>1,246,066,560</u>
<b>Total Long Investments (Cost \$1,232,484,311)</b>				<u>\$1,246,066,560</u>
<b>Repurchase Agreements (6.36%) (d)</b>				
\$ 25,683,750	Credit Suisse First Boston	0.00%	1/11	\$ 25,683,750
	Collateralized by Par Value \$27,000,000 U.S. Treasury Note, Coupon 2.63%, Maturity Date 11/20			
<b>Total Repurchase Agreements (Cost \$25,683,750)</b>				<u>\$ 25,683,750</u>

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ELLINGTON FINANCIAL LLC  
CONSOLIDATED CONDENSED SCHEDULE OF INVESTMENTS  
AT DECEMBER 31, 2010 (CONTINUED)  
(UNAUDITED)

Current Principal/ Notional Amount	Description	Rate	Maturity	Value <i>Expressed in U.S. Dollars</i>
<b>Investments Sold Short (-192.02%)</b>				
<b>TBA - Fixed Rate Agency Securities Sold Short (-185.71%) (c) (e)</b>				
\$ (136,500,000)	Federal National Mortgage Association (30 Year)	4.50%	1/11	\$(140,093,789)
(113,000,000)	Government National Mortgage Association (30 Year)	5.00%	1/11	(120,168,438)
(114,500,000)	Federal National Mortgage Association (30 Year)	4.00%	1/11	(113,900,664)
(62,000,000)	Federal National Mortgage Association (30 Year)	5.00%	1/11	(65,172,656)
(63,000,000)	Federal Home Loan Mortgage Corporation (30 Year)	4.00%	1/11	(62,547,188)
(40,000,000)	Federal Home Loan Mortgage Corporation (30 Year)	4.00%	2/11	(39,593,750)
(35,000,000)	Federal National Mortgage Association (15 Year)	4.50%	1/11	(36,698,047)
(33,000,000)	Federal Home Loan Mortgage Corporation (30 Year)	5.00%	1/11	(34,613,906)
(30,000,000)	Government National Mortgage Association (30 Year)	5.00%	2/11	(31,842,188)
(27,500,000)	Federal Home Loan Mortgage Corporation (30 Year)	4.50%	1/11	(28,174,609)
(24,500,000)	Government National Mortgage Association (30 Year)	4.50%	1/11	(25,432,148)
(25,000,000)	Government National Mortgage Association (30 Year)	4.00%	1/11	(25,171,875)
(16,000,000)	Federal Home Loan Mortgage Corporation (30 Year)	5.50%	1/11	(17,052,500)
(7,500,000)	Federal National Mortgage Association (30 Year)	6.00%	1/11	(8,152,734)
(1,000,000)	Federal National Mortgage Association (30 Year)	5.50%	2/11	(1,068,203)
<b>Total TBA - Fixed Rate Agency Securities Sold Short (Proceeds -\$750,520,119)</b>				<u>(749,682,695)</u>
<b>U.S. Treasury Securities Sold Short (-6.31%)</b>				
(27,000,000)	U.S. Treasury Note	2.63%	11/20	(25,462,403)
<b>Total U.S. Treasury Securities Sold Short (Proceeds -\$25,261,493)</b>				<u>(25,462,403)</u>
<b>Total Investments Sold Short (Proceeds -\$775,781,612)</b>				<u><u>\$(775,145,098)</u></u>

See Notes to Consolidated Financial Statements



**ELLINGTON FINANCIAL LLC**  
**CONSOLIDATED CONDENSED SCHEDULE OF INVESTMENTS**  
**AT DECEMBER 31, 2010 (CONTINUED)**  
**(UNAUDITED)**

	<u>Primary Risk Exposure</u>	<u>Notional or Number of Contracts</u>	<u>Range of Expiration Dates</u>	<u>Value</u> <i>Expressed in U.S. Dollars</i>
<b>Financial Derivatives - Assets (49.88%)</b>				
<b>Swaps (49.88%) (f)</b>				
<b>Long Swaps:</b>				
Credit Default Swaps on Asset Backed Indices (Cost \$4,032,984) (g)	Credit	\$ 74,128,336	6/36 - 7/36	\$ 3,566,639
Interest Rate Swaps (h)	Interest Rates	\$ 5,000,000	12/20	46,757
<b>Short Swaps:</b>				
Credit Default Swaps on Asset Backed Securities (i)	Credit	\$(127,088,962)	6/34 - 12/36	102,851,109
Credit Default Swaps on Asset Backed Indices: (j)	Credit			
ABX.HE AAA 2007-1 Index		\$(108,594,843)	8/37	60,648,862
Other		\$ (92,449,044)	8/37 - 2/51	32,473,731
Interest Rate Swaps (k)	Interest Rates	\$ (60,000,000)	12/15 - 12/20	1,748,274
<b>Total Swaps (Cost \$208,958,359)</b>				<u>201,335,372</u>
<b>Total Financial Derivatives - Assets (Cost \$208,958,359)</b>				<u>\$ 201,335,372</u>
<b>Financial Derivatives - Liabilities (-5.21%)</b>				
<b>Swaps (-4.99%)</b>				
<b>Long Swaps:</b>				
Credit Default Swaps on Asset Backed Indices (Proceeds -\$17,559,397) (g)	Credit	\$ 37,588,800	8/37 - 12/49	\$ (17,941,713)
Interest Rate Swaps (h)	Interest Rates	\$ 10,000,000	11/15 - 11/20	(215,277)
<b>Short Swaps:</b>				
Interest Rate Swaps (k)	Interest Rates	\$ (83,750,000)	10/14 - 12/15	(1,461,228)
Credit Default Swaps on Asset Backed Indices (j)	Credit	\$ (4,434,787)	7/36	(336,263)
Credit Default Swaps on Corporate Bond Indices (l)	Credit	\$ (19,700,000)	6/15	(185,847)
<b>Total Swaps (Net Proceeds -\$17,718,129)</b>				<u>(20,140,328)</u>
<b>Futures (-0.22%) (m)</b>				
<b>Short Futures:</b>				
Eurodollar contracts	Interest Rates	(400)	3/11 - 9/12	(890,001)
<b>Total Futures</b>				<u>(890,001)</u>
<b>Total Financial Derivatives - Liabilities (Net Proceeds -\$17,718,129)</b>				<u>\$ (21,030,329)</u>

See Notes to Consolidated Financial Statements

**ELLINGTON FINANCIAL LLC**  
**CONSOLIDATED CONDENSED SCHEDULE OF INVESTMENTS**  
**AT DECEMBER 31, 2010 (CONCLUDED)**  
**(UNAUDITED)**

- (a) See Note 2 and Note 9 in Notes to Consolidated Financial Statements.
- (b) At December 31, 2010, the Company's long investments guaranteed by the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation, and the Government National Mortgage Association represented 102.88%, 76.12%, and 45.28% of shareholders' equity, respectively.
- (c) To Be Announced ("TBA") securities settle on a forward basis. At settlement the purchaser generally receives agency pass-through mortgage certificates with original maturity dates typically between 15 and 30 years.
- (d) In general, securities received pursuant to repurchase agreements were delivered to counterparties in short sale transactions.
- (e) At December 31, 2010, the Company's short investments guaranteed by the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation, and the Government National Mortgage Association represented 90.44%, 45.08%, and 50.19% of shareholders' equity, respectively.
- (f) The following table shows the Company's swap assets by dealer as a percentage of shareholders' equity:

<u>Dealer/Parent Company</u>	<u>Percent of Shareholders' Equity</u>
Affiliates of Morgan Stanley	19.22%
Affiliates of Credit Suisse	9.07%

- (g) For long credit default swaps on asset backed indices, the Company sold protection.
- (h) For long interest rate swap contracts, a floating rate is being paid and a fixed rate is being received.
- (i) For short credit default swaps on asset backed securities, the Company purchased protection.
- (j) For short credit default swaps on asset backed indices, the Company purchased protection.
- (k) For short interest rate swap contracts, a fixed rate is being paid and a floating rate is being received.
- (l) For short credit default swaps on corporate bond indices, the Company purchased protection.
- (m) Each contract represents a notional amount of \$1,000,000.
- (n) The table below shows the Company's long investment ratings from Moody's, Standard and Poor's, or Fitch, as well as the Company's long investments that were unrated but affiliated with Fannie Mae, Freddie Mac, or Ginnie Mae. Ratings tend to be a lagging credit indicator; as a result, the credit quality of the Company's long investment holdings may be lower than the credit quality implied based on the ratings listed below. In situations where an investment has a split rating, the lowest provided rating is used. The ratings descriptions include ratings qualified with a "+", "-", "1", "2", or "3".

<u>Rating Description</u>	<u>Percentage of Shareholders' Equity</u>
Unrated but Agency-Guaranteed	224.28%
Aaa/AAA/AAA	6.81%
Aa/AA/AA	13.91%
A/A/A	4.46%
Baa/BBB/BBB	6.00%
Ba/BB/BB or below	53.22%
Unrated	0.00%

See Notes to Consolidated Financial Statements

**ELLINGTON FINANCIAL LLC**  
**CONSOLIDATED STATEMENT OF OPERATIONS**  
**(UNAUDITED)**

	Three Month Period Ended June 30, 2011	Three Month Period Ended June 30, 2010	Six Month Period Ended June 30, 2011	Six Month Period Ended June 30, 2010
<i>Expressed in U.S. Dollars</i>				
<b>INVESTMENT INCOME</b>				
Interest income	\$ 16,651,827	\$ 10,798,629	\$ 32,500,608	\$ 22,715,250
<b>EXPENSES</b>				
Base management fee	1,448,633	1,107,969	2,929,606	2,212,252
Incentive fee	—	—	612,192	482,715
Share-based LTIP expense	37,926	774,037	75,435	1,500,200
Interest expense	1,602,593	872,609	3,145,865	1,679,404
Professional fees	358,126	491,267	911,576	902,136
Compensation expense	403,817	210,000	651,367	500,000
Insurance expense	190,564	285,000	357,127	560,000
Agency and administration fees	249,377	175,024	489,006	346,195
Custody and other fees	220,363	153,132	515,764	258,923
Directors' fees and expenses	66,747	52,581	140,735	133,386
Total expenses	4,578,146	4,121,619	9,828,673	8,575,211
<b>NET INVESTMENT INCOME (LOSS)</b>	<b>12,073,681</b>	<b>6,677,010</b>	<b>22,671,935</b>	<b>14,140,039</b>
<b>NET REALIZED AND UNREALIZED GAIN (LOSS) ON INVESTMENTS AND FINANCIAL DERIVATIVES</b>				
<b>Net realized gain (loss) on:</b>				
Investments	(11,021,007)	8,525,150	(2,785,296)	12,315,083
Swaps	7,452,698	(788,380)	11,191,970	7,219,852
Futures	(347,432)	(288,200)	(718,908)	(1,025,880)
Purchased options	—	—	—	(580,860)
	(3,915,741)	7,448,570	7,687,766	17,928,195
<b>Change in net unrealized gain (loss) on:</b>				
Investments	(4,301,806)	(7,269,056)	(13,552,278)	(7,053,478)
Swaps	(5,380,002)	(2,655,407)	(7,542,971)	(12,881,161)
Futures	202,288	(469,987)	521,138	(1,348,675)
Purchased options	—	—	—	541,668
	(9,479,520)	(10,394,450)	(20,574,111)	(20,741,646)
<b>NET REALIZED AND UNREALIZED GAIN (LOSS) ON INVESTMENTS AND FINANCIAL DERIVATIVES</b>	<b>(13,395,261)</b>	<b>(2,945,880)</b>	<b>(12,886,345)</b>	<b>(2,813,451)</b>
<b>NET INCREASE (DECREASE) IN SHAREHOLDERS' EQUITY RESULTING FROM OPERATIONS</b>	<b>\$ (1,321,580)</b>	<b>\$ 3,731,130</b>	<b>\$ 9,785,590</b>	<b>\$ 11,326,588</b>
<b>NET INCREASE (DECREASE) IN SHAREHOLDERS' EQUITY RESULTING FROM OPERATIONS PER SHARE:</b>				
Basic and Diluted	\$ (0.08)	\$ 0.30	\$ 0.58	\$ 0.92

See Notes to Consolidated Financial Statements

**ELLINGTON FINANCIAL LLC**  
**CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY**  
**(UNAUDITED)**

	Three Month Period Ended June 30, 2011	Three Month Period Ended June 30, 2010	Six Month Period Ended June 30, 2011	Six Month Period Ended June 30, 2010
	<i>Expressed in U.S. Dollars</i>			
<b>CHANGE IN SHAREHOLDERS' EQUITY RESULTING FROM OPERATIONS</b>				
Net investment income (loss)	\$ 12,073,681	\$ 6,677,010	\$ 22,671,935	\$ 14,140,039
Net realized gain (loss) on investments and financial derivatives	(3,915,741)	7,448,570	7,687,766	17,928,195
Change in net unrealized gain (loss) on investments and financial derivatives	(9,479,520)	(10,394,450)	(20,574,111)	(20,741,646)
Net increase (decrease) in shareholders' equity resulting from operations	<u>(1,321,580)</u>	<u>3,731,130</u>	<u>9,785,590</u>	<u>11,326,588</u>
<b>CHANGE IN SHAREHOLDERS' EQUITY RESULTING FROM SHAREHOLDER TRANSACTIONS</b>				
Shares issued in connection with incentive fee payment	61,219	48,272	203,369	275,689
Dividends paid	(6,756,952)	(3,091,417)	(28,882,514)	(18,546,036)
Share-based LTIP awards	37,926	774,037	75,435	1,500,200
Net increase (decrease) in shareholders' equity from shareholder transactions	<u>(6,657,807)</u>	<u>(2,269,108)</u>	<u>(28,603,710)</u>	<u>(16,770,147)</u>
Net increase (decrease) in shareholders' equity	<u>(7,979,387)</u>	<u>1,462,022</u>	<u>(18,818,120)</u>	<u>(5,443,559)</u>
<b>SHAREHOLDERS' EQUITY, BEGINNING OF PERIOD</b>	<u>392,832,979</u>	<u>292,888,432</u>	<u>403,671,712</u>	<u>299,794,013</u>
<b>SHAREHOLDERS' EQUITY, END OF PERIOD</b>	<u><u>\$384,853,592</u></u>	<u><u>\$294,350,454</u></u>	<u><u>\$384,853,592</u></u>	<u><u>\$294,350,454</u></u>

See Notes to Consolidated Financial Statements

**ELLINGTON FINANCIAL LLC**  
**CONSOLIDATED STATEMENT OF CASH FLOWS**  
**(UNAUDITED)**

	Six Month Period Ended June 30, 2011	Six Month Period Ended June 30, 2010
<i>Expressed in U.S. Dollars</i>		
<b>INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS:</b>		
<b>NET INCREASE (DECREASE) IN SHAREHOLDERS' EQUITY</b>		
<b>RESULTING FROM OPERATIONS</b>	\$ 9,785,590	\$ 11,326,588
<b>Cash flows provided by (used in) operating activities:</b>		
Reconciliation of the net increase (decrease) in shareholders' equity resulting from operations to net cash provided by (used in) operating activities:		
Change in net unrealized (gain) loss on investments and financial derivatives	20,574,111	20,741,646
Net realized (gain) loss on investments and financial derivatives	(7,687,766)	(17,928,195)
Amortization of premiums and accretion of discounts (net)	(5,249,519)	(3,197,557)
Purchase of investments	(1,611,306,332)	(1,197,262,915)
Proceeds from disposition of investments	1,611,907,045	1,032,332,961
Proceeds from principal payments of investments	51,972,572	66,373,369
Proceeds from investments sold short	939,340,941	721,847,421
Repurchase of investments sold short	(1,193,782,745)	(519,186,218)
Payments made to open financial derivatives	(94,317,675)	(167,814,104)
Proceeds received to close financial derivatives	170,997,519	130,603,829
Proceeds received to open financial derivatives	13,087,106	39,865,010
Payments made to close financial derivatives	(20,735,291)	(29,218,557)
Shares issued in connection with incentive fee payment	203,369	275,689
Share-based LTIP expense	75,435	1,500,200
(Increase) decrease in assets:		
(Increase) decrease in repurchase agreements	3,246,250	—
(Increase) decrease in receivable for securities sold	245,578,409	(271,452,941)
(Increase) decrease in deposits with dealers held as collateral	(3,050)	(7,172,282)
(Increase) decrease in interest and principal receivable	(1,408,928)	4,927,232
(Increase) decrease in other assets	(333,255)	(534,005)
Increase (decrease) in liabilities:		
Increase (decrease) in due to brokers - margin accounts	(49,903,794)	13,257,911
Increase (decrease) in payable for securities purchased	(66,079,890)	329,572,335
Increase (decrease) in accounts payable and accrued expenses	348,429	963,979
Increase (decrease) in incentive fee payable	(1,421,500)	(2,274,530)
Increase (decrease) in interest and dividends payable	16,194	(100,676)
Increase (decrease) in base management fee payable	(76,184)	(29,053)
Net cash provided by (used in) operating activities	<u>14,827,041</u>	<u>157,417,137</u>
<b>Cash flows provided by (used in) financing activities:</b>		
Offering costs paid	(438,762)	(594,362)
Dividends paid	(28,882,514)	(18,546,036)
Reverse repurchase agreements, net of repayments	24,140,740	(131,808,301)
Net cash provided by (used in) financing activities	<u>(5,180,536)</u>	<u>(150,948,699)</u>
<b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	9,646,505	6,468,438
<b>CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD</b>	35,790,818	102,863,164
<b>CASH AND CASH EQUIVALENTS, END OF PERIOD</b>	<u>\$ 45,437,323</u>	<u>\$ 109,331,602</u>
<b>Supplemental disclosure of cash flow information:</b>		
Interest paid	<u>\$ 3,129,671</u>	<u>\$ 1,698,889</u>
Shares issued in connection with incentive fee payment (non-cash)	<u>\$ 203,369</u>	<u>\$ 275,689</u>
Share-based LTIP awards (non-cash)	<u>\$ 75,435</u>	<u>\$ 1,500,200</u>
Aggregate TBA trade activity (buys + sells) (non-cash)	<u>\$11,055,413,893</u>	<u>\$ 6,089,897,901</u>

See Notes to Consolidated Financial Statements

**ELLINGTON FINANCIAL LLC**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**June 30, 2011**  
**(UNAUDITED)**

**1. Organization and Investment Objective**

Ellington Financial LLC was formed as a Delaware limited liability company on July 9, 2007 and commenced operations on August 17, 2007 upon the completion of its initial private capitalization. EF Securities LLC, a wholly owned consolidated subsidiary of Ellington Financial LLC, was formed as a Delaware limited liability company on October 12, 2007 and commenced operations on November 30, 2007. EF Mortgage LLC, a wholly owned consolidated subsidiary of Ellington Financial LLC, was formed as a Delaware limited liability company on June 3, 2008 and commenced operations on July 8, 2008. EF CMO LLC, a wholly owned consolidated subsidiary of EF Mortgage LLC, was formed as a Delaware limited liability company on June 3, 2008 and commenced operations on July 8, 2008. Ellington Financial LLC, EF Securities LLC, EF Mortgage LLC and EF CMO LLC are hereafter collectively referred to as the “Company.” All inter-company accounts are eliminated in consolidation.

On October 14, 2010, the Company closed its initial public offering of its common shares representing limited liability company interests, or common shares, pursuant to which it sold 4,500,000 common shares to the public at a public offering price of \$22.50. The Company raised approximately \$101.3 million in gross proceeds, resulting in net proceeds of approximately \$94.7 million after deducting underwriting discounts and other offering costs. The Company’s common shares trade on the New York Stock Exchange under the symbol “EFC.”

The Company is a specialty finance company that acquires and manages mortgage-related assets, including residential mortgage-backed securities, or “RMBS,” backed by prime jumbo, Alt-A and subprime residential mortgage loans, RMBS for which the principal and interest payments are guaranteed by a U.S. government agency or a U.S. government-sponsored entity, mortgage-related derivatives, commercial mortgage-backed securities, or “CMBS,” commercial mortgage loans and other commercial real estate debt, as well as corporate debt and equity securities and derivatives. The Company may also opportunistically acquire and manage other types of mortgage-related and financial asset classes, such as residential whole mortgage loans, asset-backed securities, or “ABS,” backed by consumer and commercial assets and non-mortgage-related derivatives.

Ellington Financial Management, LLC (“EFM” or the “Manager”) is a registered investment advisor that serves as the Manager to the Company pursuant to the terms of the Third Amended and Restated Management Agreement effective August 2, 2011 (the “Management Agreement”). EFM is an affiliate of Ellington Management Group, L.L.C., an investment management firm and also a registered investment advisor. In accordance with the terms of the Management Agreement, the Manager implements the investment strategy and manages the business and operations on a day-to-day basis for the Company and performs certain services for the Company, subject to oversight by the Board of Directors.

**2. Significant Accounting Policies**

(A) *Basis of Presentation:* The Company’s unaudited interim consolidated financial statements have been prepared in conformity with generally accepted accounting principles in the United States of America for investment companies, ASC 946, *Financial Services—Investment Companies* (“ASC 946”), for interim financial information. ASC 946 requires, among other things, that investments be reported at fair value in the financial statements. The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All inter-company balances and transactions have been eliminated. The preparation of consolidated financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Interim results are not necessarily indicative of the results that may be expected for the entire fiscal year.

(B) *Valuation:* The Company applies ASC 820-10, *Fair Value Measurement and Disclosures* (“ASC 820-10”), to its holdings of financial instruments. ASC 820-10 establishes a three-level valuation hierarchy for disclosure of fair value measurements. The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. The three levels are defined as follows:

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- Level 1—inputs to the valuation methodology are observable and reflect quoted prices (unadjusted) for identical assets or liabilities in active markets,
- Level 2—inputs to the valuation methodology other than quoted prices included in Level 1 are observable for the asset or liability, either directly or indirectly, and
- Level 3—inputs to the valuation methodology are unobservable and significant to the fair value measurement.

A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement. The inputs or methodology used for valuing securities are not necessarily an indication of the risk associated with investing in these securities.

*(C) Securities Transactions and Investment Income:* Securities transactions are generally recorded on trade date. Realized and unrealized gains and losses are calculated based on identified cost. Interest income, which includes accretion of discounts and amortization of premiums on mortgage-backed securities, including investments in mortgage loans, or "MBS," and U.S. Treasury holdings, is recognized over the life of the investment using the effective interest method. For purposes of determining the effective interest rate, management estimates the future expected cash flows of its investment holdings based on assumptions including, but not limited to, prepayment and default rate assumptions. These assumptions are reevaluated not less than quarterly and require the use of a significant amount of judgment. Principal write-offs are generally treated as realized losses.

*(D) Cash and Cash Equivalents:* On the Consolidated Statement of Cash Flows the Company has revised prior period classifications to conform to current period presentation. Cash and cash equivalents include amounts held in an interest bearing overnight account and money market funds. As of June 30, 2011, all cash was held in an interest bearing account at the Bank of New York Mellon Corporation. As of December 31, 2010, 70% and 30% of cash and cash equivalents were held in the JP Morgan Prime Money Market Premier Fund and an interest bearing account at the Bank of New York Mellon Corporation, respectively.

*(E) Financial Derivatives:* The Company enters into various types of financial derivatives. The two major types utilized are swaps and futures.

*Swaps:* The Company may enter into various types of swaps, including interest rate swaps, credit default swaps, and total return swaps. The primary risk associated with the Company's interest rate swap activity is interest rate risk. The primary risk associated with the Company's total return swap activity has been equity market risk. The Company did not have any total return swaps outstanding as of June 30, 2011. The primary risk associated with the Company's credit default swaps is credit risk.

The Company is subject to interest rate risk exposure in the normal course of pursuing its investment objectives. To help mitigate interest rate risk, the Company enters into interest rate swaps. Interest rate swaps are contractual agreements whereby one party pays a floating rate of interest on a notional principal amount and receives a fixed rate on the same notional principal, or vice versa, for a fixed period of time. Interest rate swaps change in value with movements in interest rates.

The Company enters into credit default swaps. A credit default swap is a contract under which one party agrees to compensate another party for the financial loss associated with the occurrence of a "credit event" in relation to a "reference amount" or notional amount of a credit obligation (usually a bond or loan). The definition of a credit event often varies from contract to contract. A credit event may occur (i) when the underlying reference asset(s) fails to make scheduled principal or interest payments to its holders, (ii) with respect to credit default swaps referencing mortgage/asset backed securities and indices, when the underlying reference obligation is downgraded below a certain rating level or (iii) with respect to credit default swaps referencing corporate entities and indices, upon the bankruptcy of the underlying reference obligor. The Company typically writes (sells) protection to take a "long" position or purchases (buys) protection to take a "short" position with respect to underlying reference assets or to hedge exposure to other investment holdings.

The Company enters into total return swaps in order to take a "long" or "short" position with respect to an underlying referenced asset. The Company is subject to market price volatility of the underlying referenced asset. A total return swap involves commitments to pay interest in exchange for a market-linked return based on a notional amount. To the extent that the total return of the security, group of securities or index underlying the transaction exceeds or falls short of the offsetting interest obligation, the Company will receive a payment from or make a payment to the counterparty.

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Swaps change in value with movements in interest rates or total return of the referenced securities. During the term of swap contracts, changes in value are recognized as unrealized gains or losses. When the contracts are terminated, the Company will realize a gain or loss equal to the difference between the proceeds from (or cost of) the closing transaction and the Company's basis in the contract, if any. Periodic payments or receipts required by swap agreements are recorded as unrealized gains or losses when accrued and realized gains or losses when received or paid. Upfront payments paid/received by the Company to open swap contracts are recorded as an asset and/or liability on the Consolidated Statement of Assets, Liabilities and Shareholders' Equity and are recorded as a realized gain or loss on the termination date. The Company may be required to deliver or receive cash or securities as collateral upon entering into swap transactions.

The Company's swap contracts are generally governed by ISDA trading agreements, which are separately negotiated agreements with dealer counterparties. Changes in the relative value of the swap transactions may require the Company or the counterparty to post or receive additional collateral. Typically, a collateral payment or receipt is triggered based on the net change in the value of all contracts governed by a particular ISDA trading agreement. Collateral received from counterparties is included in Due to brokers—margin accounts on the Consolidated Statement of Assets, Liabilities and Shareholders' Equity. Collateral paid to counterparties is included in Deposits with dealers held as collateral on the Consolidated Statement of Assets, Liabilities and Shareholders' Equity. Entering into swap contracts involves market risk in excess of amounts recorded on the Consolidated Statement of Assets, Liabilities and Shareholders' Equity.

*Futures Contracts:* A futures contract is an agreement between two parties to buy and sell a financial instrument for a set price on a future date. The Company enters into Eurodollar futures contracts to hedge its interest rate risk. Initial margin deposits are made upon entering into futures contracts and can be either cash or securities. During the period the futures contract is open, changes in the value of the contract are recognized as unrealized gains or losses by marking to market on a daily basis to reflect the market value of the contract at the end of each day's trading. Variation margin payments are made or received periodically, depending upon whether unrealized gains or losses are incurred. When the contract is closed, the Company records a realized gain or loss equal to the difference between the proceeds of the closing transaction and the Company's basis in the contract.

Derivative instruments disclosed on the Consolidated Condensed Schedule of Investments include: credit default swaps on asset backed securities, credit default swaps on asset backed indices, credit default swaps on corporate bond indices, interest rate swaps, and Eurodollar futures contracts.

Swap assets are included in Financial Derivatives—Assets on the Consolidated Statement of Assets, Liabilities and Shareholders' Equity. Swap liabilities are included in Financial Derivatives—Liabilities on the Consolidated Statement of Assets, Liabilities and Shareholders' Equity. In addition, swap contracts are summarized by type on the Consolidated Condensed Schedule of Investments. Unrealized depreciation on futures contracts is included in Financial Derivatives—Liabilities on the Consolidated Statement of Assets, Liabilities and Shareholders' Equity. For interest rate swaps, credit default swaps and futures, notional amounts reflected on the Consolidated Condensed Schedule of Investments represent approximately 114%, 69%, and 80%, respectively, of average monthly notional amounts of each such category outstanding during the six month period ended June 30, 2011. For interest rate swaps, credit default swaps, and futures, notional amounts reflected on the Consolidated Condensed Schedule of Investments represent approximately 318%, 133%, and 38%, respectively, of average monthly notional amounts of each such category outstanding during the year ended December 31, 2010. The Company uses average monthly notional amounts outstanding to indicate the volume of activity with respect to these instruments.

*(F) Short Sales:* When the Company sells securities short, it typically satisfies its security delivery settlement obligation by obtaining the security sold from the same or a different counterparty via repurchase agreement. The Company generally is required to deliver cash or securities as collateral to the repurchase agreement counterparty. A gain, limited to the price at which the Company sold the security short, or a loss, unlimited as to dollar amount, will be recognized upon the termination of a short sale if the market price is less than or greater than the proceeds originally received.



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*(G) Reverse Repurchase Agreements and Repurchase Agreements:* The Company enters into reverse repurchase agreements with third-party broker-dealers whereby it sells securities under agreements to be repurchased at an agreed-upon price and date. Interest on the value of repurchase and reverse repurchase agreements issued and outstanding is based upon competitive market rates at the time of issuance. The Company accounts for reverse repurchase agreements as collateralized borrowings. When the Company enters into a reverse repurchase agreement, the lender establishes and maintains an account containing cash and securities having a value not less than the repurchase price, including accrued interest, of the reverse repurchase agreement. The Company enters into repurchase agreement transactions with third-party broker-dealers whereby it purchases securities under agreements to resell at an agreed-upon price and date. In general, securities received pursuant to repurchase agreements are delivered to counterparties of short sale transactions. Assets held pursuant to repurchase agreements are reflected as assets on the Consolidated Statement of Assets, Liabilities and Shareholders' Equity. Repurchase and reverse repurchase agreements that are conducted with the same counterparty may be reported on a net basis if they meet the requirements of ASC 210-20, *Balance Sheet Offsetting*. There are no repurchase and reverse repurchase agreements netted in the consolidated financial statements.

Reverse repurchase agreements are carried at their contractual amounts, which the Company believes is the best estimate of fair value. At June 30, 2011, the Company's open reverse repurchase agreements had remaining terms that ranged from 7 to 237 days and had interest rates ranging from 0.19% to 2.50%. At June 30, 2011, approximately 79% of open reverse repurchase agreements were with four counterparties. At December 31, 2010, the Company's open reverse repurchase agreements had remaining terms that ranged from 13 to 178 days and had interest rates ranging from 0.27% to 2.60%. At December 31, 2010, approximately 77% of open reverse repurchase agreements were with four counterparties.

The Company follows the provisions of ASC 860-20, *Sales of Financial Assets*, which requires an initial transfer of a financial asset and a repurchase financing that was entered into contemporaneously or in contemplation of the initial transfer to be evaluated as a linked transaction unless certain criteria are met, including that the transferred asset must be readily obtainable in the marketplace. As of June 30, 2011 and December 31, 2010, the Company did not have any material seller financing. No transactions are accounted for as linked transactions at June 30, 2011 and December 31, 2010.

*(H) Purchased Options:* The Company has entered into options primarily to help mitigate overall market risk. When the Company purchases an option, an amount equal to the premium paid is recorded as an asset and is subsequently marked-to-market. Premiums paid for purchasing options that expire unexercised are recognized on the expiration date as realized losses. If an option is exercised, the premium paid is subtracted from the proceeds of the sale or added to the cost of the purchase to determine whether the Company has realized a gain or loss on the related investment transaction. When the Company enters into a closing transaction, the Company will realize a gain or loss depending upon whether the amount from the closing transaction is greater or less than the premiums paid. The Company had no purchased options outstanding as of June 30, 2011 and December 31, 2010.

*(I) When-Issued/Delayed Delivery Securities:* The Company may purchase or sell securities on a when-issued or delayed delivery basis. Securities purchased or sold on a when-issued basis are traded for delivery beyond the normal settlement date at a stated price or yield, and no income accrues to the purchaser prior to settlement. Purchasing or selling securities on a when-issued or delayed delivery basis involves the risk that the market price or yield at the time of settlement may be lower or higher than the agreed-upon price or yield, in which case a realized loss may be incurred.

The Company transacts in the forward settling To Be Announced MBS ("TBA") market. The Company typically does not take delivery of TBAs, but rather settles with its trading counterparties on a net basis. The market value of the securities that the Company is required to purchase pursuant to a TBA transaction may decline below the agreed-upon purchase price. Conversely, the market value of the securities that the Company is required to sell pursuant to a TBA transaction may increase above the agreed upon sale price. As part of its TBA activities, the Company may "roll" its TBA positions, whereby the Company may sell (buy) securities for delivery (receipt) in an earlier month and simultaneously contract to repurchase (sell) similar, but not identical, securities at an agreed-upon price on a fixed date in a later month (with the later-month price typically lower than the earlier-month price). The Company accounts for its TBA transactions (including those related to TBA rolls) as purchases and sales. As of June 30, 2011, total assets included \$42.9 million of TBAs as well as \$520.0 million of receivable for securities sold relating to unsettled TBA sales. As of December 31, 2010, total assets included \$54.4 million of TBAs as well as \$753.0 million of receivable for securities sold relating to unsettled TBA sales.

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As of June 30, 2011, total liabilities included \$518.0 million of TBAs sold short as well as \$43.4 million of payable for securities purchased relating to unsettled TBA purchases. As of December 31, 2010, total liabilities included \$749.7 million of TBAs sold short as well as \$54.7 million of payable for securities purchased relating to unsettled TBA purchases. On a net basis, as of June 30, 2011, the Company held a net short position in TBAs of \$475.1 million while at December 31, 2010, the Company held a net short position in TBAs of \$695.3 million.

*(J) Offering Costs/Placement Fees:* Offering costs and placement fees are charged against shareholders' equity. Costs associated with the Company's public offering of common shares, which closed on October 14, 2010, were offset against the proceeds of the offering and charged against shareholders' equity as of December 31, 2010.

*(K) LTIP Units:* Long term incentive plan units ("LTIP units") have been issued to the Company's dedicated officers, independent directors as well as the Manager. Costs associated with LTIP units issued to dedicated officers and independent directors are amortized over the vesting period in accordance with ASC 718-10, *Compensation—Stock Compensation*. Costs associated with LTIP units issued to the Manager are amortized over the vesting period in accordance with ASC 505-50, *Equity-Based Payments to Non-Employees*. The vesting period for units issued to officers and independent directors under the Ellington Incentive Plan for Individuals (the "Individual LTIP") is typically one year. The vesting period for units issued to the Manager under the Ellington Incentive Plan for Entities (the "Manager LTIP") occurred over a three year period that ended in August 2010. The cost of the Manager LTIP units fluctuated with the price per share until the vesting date, whereas the cost of the Individual LTIP units is based on the price per share at the initial grant date.

*(L) Dividends:* Dividends payable are recorded in the consolidated financial statements on the ex-dividend date.

*(M) Shares Repurchased:* Common shares that are repurchased by the Company subsequent to issuance decrease total number of shares outstanding and issued.

*(N) Earnings Per Share ("EPS"):* Basic EPS is computed using the two class method by dividing net increase (decrease) in shareholders' equity resulting from operations after adjusting for the impact of long term incentive plan units deemed to be participating securities, by the weighted average number of common shares outstanding calculated excluding long term incentive units. Because the Company's long term incentive plan units are deemed to be participating securities and the Company has no other equity securities outstanding, basic and diluted EPS are the same. See Note 8 for EPS computations.

*(O) Income Taxes:* The Company intends to be treated as a partnership for U.S. federal income tax purposes. In general, partnerships are not subject to entity-level tax on their income, but the income of a partnership is taxable to its owners on a flow-through basis.

The Company follows the provisions of ASC 740-10, *Income Taxes* ("ASC 740-10"), which requires management to determine whether a tax position of the Company is more likely than not to be sustained upon examination by the applicable taxing authority, including resolution of any related appeals, based on the technical merits of the position. The tax benefit to be recognized is measured as the largest amount of benefit that is greater than fifty percent likely of being realized upon ultimate settlement which could result in the Company recording a tax liability that would reduce shareholders' equity. The Company did not have any additions to its unrecognized tax benefits resulting from tax positions related either to the current period or to 2010, 2009, 2008 or 2007 (its open tax years), and no reductions resulting from tax positions of prior years or due to settlements, and thus had no unrecognized tax benefits since inception. The Company does not expect any change in unrecognized tax benefits within the next fiscal year.

The Company may take positions with respect to certain tax issues which depend on legal interpretation of facts or applicable tax regulations. Should the relevant tax regulators successfully challenge any such positions, the Company might be found to have a tax liability that has not been recorded in the accompanying consolidated financial statements. Also, management's conclusions regarding ASC 740-10 may be subject to review and adjustment at a later date based on factors including, but not limited to, further implementation guidance from the Financial Accounting Standards Board ("FASB"), and ongoing analyses of tax laws, regulations and interpretations thereof.

*(P) Subsequent Events:* The Company applies the provisions of ASC 855-10, *Subsequent Events*, in the preparation of its consolidated financial statements. This standard establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued.

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*(Q) Recent Accounting Pronouncements:* On May 12, 2011, the FASB issued ASU No. 2011-04, *Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. generally accepted accounting principles (“U.S. GAAP”) and International Financial Reporting Standards (“IFRS”) (“ASU 2011-04”)*. This ASU represents the completion of the joint project on fair value of the FASB and International Accounting Standards Board (“IASB”). The objective of the project was to bring together as closely as possible the fair value measurement and disclosure guidance issued by the two boards. Many of the changes in the U.S. final standard represent clarifications to existing guidance. The standard also includes new required quantitative disclosures about unobservable inputs for all Level 3 fair value measurements, as well as qualitative disclosures about the sensitivity inherent in recurring Level 3 fair value measurements. ASU 2011-04 is effective for interim and annual periods beginning after December 15, 2011. The Company is evaluating the impact of the adoption of ASU 2011-04.

On April 29, 2011, the FASB issued ASU No. 2011-03, *Transfers and Servicing— (Topic 860), Reconsideration of Effective Control for Repurchase Agreements (“ASU 2011-03”)*. This modifies the criteria for determining when repurchase agreements and other similar transactions would be accounted for as financings (secured borrowings/ lending agreements) as opposed to sales (purchases) with commitments to repurchase (resell). ASU 2011-03 is effective prospectively for new transfers and existing transactions that are modified in the first interim or annual period beginning on or after December 15, 2011. The Company does not expect the adoption of ASU 2011-03 to have a material impact on its consolidated financial statements.

In January 2010, the FASB issued ASU No. 2010-6 *Fair Value Measurements and Disclosures—(Topic 820), Improving Disclosures about Fair Value Measurements (“ASU 2010-6”)*. This amends Subtopic 820-10 to require new disclosures for transfers in and out of Levels 1 and 2 and reporting gross activity in Level 3 fair value measurements, and clarifies the level of detail of existing disclosures. The new disclosures and clarifications are effective for interim and annual reporting periods beginning after December 15, 2009, with the exception of reporting certain gross activity in Level 3 fair value measurements which is effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years. Adoption of ASU 2010-6 did not have a material impact on the Company’s consolidated financial statements.

### **3. Valuation**

The following is a description of the valuation methodologies used for the Company’s financial instruments.

Level 1 valuation methodologies include the observation of quoted prices (unadjusted) for identical assets or liabilities in active markets, often received from widely recognized data providers.

Level 2 valuation methodologies include the observation of (i) quoted prices for similar assets or liabilities in active markets, (ii) inputs other than quoted prices that are observable for the asset or liability (for example, interest rates and yield curves) in active markets and (iii) quoted prices for identical or similar assets or liabilities in markets that are not active.

Level 3 valuation methodologies include (i) the use of proprietary models that require the use of a significant amount of judgment and the application of various assumptions including, but not limited to, prepayment and default rate assumptions, and (ii) the solicitation of valuations from third parties (typically, broker-dealers). Third-party valuation providers often utilize proprietary models that are highly subjective and also require the use of a significant amount of judgment and the application of various assumptions including, but not limited to, prepayment and default rate assumptions. The Manager utilizes such information to assign a good faith valuation (the estimated price that would be received to sell an asset or paid to transfer a liability in an orderly transaction at the valuation date) to such financial instruments. The Manager has been able to obtain third-party valuations on the vast majority of the Company’s financial instruments and expects to continue to solicit third-party valuations on substantially all of the Company’s financial instruments in the future to the extent practical.

The Manager uses its judgment based on its own models, the assessments of its portfolio managers, and third-party valuations it obtains, to determine and assign fair values to the Company’s Level 3 financial instruments. Because of the inherent uncertainty of valuation, estimated values may differ significantly from the values that would have been used had a ready market for the financial instruments existed, and the differences could be material to the consolidated financial statements.

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The table below reflects the value of the Company's Level 1, Level 2, and Level 3 financial instruments at June 30, 2011:

<u>Description</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
<b>Assets:</b>				
<b>Investments at value-</b>				
U.S. Treasury and Agency residential mortgage-backed securities	\$ —	\$ 823,143,747	\$ 5,227,032	\$ 828,370,779
Private label residential mortgage-backed securities	—	—	357,894,063	357,894,063
Private label commercial mortgage-backed securities	—	—	10,942,490	10,942,490
Commercial Mortgage Loans	—	—	4,650,000	4,650,000
<b>Total investments at value</b>	<u>—</u>	<u>823,143,747</u>	<u>378,713,585</u>	<u>1,201,857,332</u>
<b>Financial derivatives-assets-</b>				
Credit default swaps on asset backed securities	—	—	69,828,936	69,828,936
Credit default swaps on asset backed indices	—	54,923,398	—	54,923,398
Interest rate swaps	—	959,933	—	959,933
<b>Total financial derivatives-assets</b>	<u>—</u>	<u>55,883,331</u>	<u>69,828,936</u>	<u>125,712,267</u>
<b>Repurchase agreements</b>	<u>—</u>	<u>22,437,500</u>	<u>—</u>	<u>22,437,500</u>
<b>Total investments, financial derivatives-assets and repurchase agreements</b>	<u>\$ —</u>	<u>\$ 901,464,578</u>	<u>\$ 448,542,521</u>	<u>\$ 1,350,007,099</u>
<b>Liabilities:</b>				
<b>Investments sold short-</b>				
U.S. Treasury and Agency residential mortgage-backed securities	\$ —	\$ (540,155,406)	\$ —	\$ (540,155,406)
<b>Financial derivatives-liabilities-</b>				
Credit default swaps on corporate indices	—	(220,124)	—	(220,124)
Credit default swaps on asset backed indices	—	(5,031,909)	—	(5,031,909)
Interest rate swaps	—	(5,366,758)	—	(5,366,758)
Unrealized depreciation on futures contracts	(368,863)	—	—	(368,863)
<b>Total financial derivatives-liabilities</b>	<u>(368,863)</u>	<u>(10,618,791)</u>	<u>—</u>	<u>(10,987,654)</u>
<b>Total investments sold short and financial derivatives-liabilities</b>	<u>\$(368,863)</u>	<u>\$(550,774,197)</u>	<u>\$ —</u>	<u>\$ (551,143,060)</u>

Investments under the U.S. Treasury and Agency residential mortgage-backed securities Level 3 category are investments in Agency interest only RMBS securities. There were no transfers of financial instruments between Level 1, Level 2, or Level 3 during the six month period ended June 30, 2011.

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The table below reflects the value of the Company's Level 1, Level 2, and Level 3 financial instruments at December 31, 2010:

<u>Description</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
<b>Assets:</b>				
<b>Investments at value-</b>				
U.S. Treasury and Agency residential mortgage-backed securities	\$ —	\$ 905,377,119	\$ —	\$ 905,377,119
Private label residential mortgage-backed securities	—	—	338,839,441	338,839,441
Private label commercial mortgage-backed securities	—	—	1,850,000	1,850,000
<b>Total investments at value</b>	<b>—</b>	<b>905,377,119</b>	<b>340,689,441</b>	<b>1,246,066,560</b>
<b>Financial derivatives-assets-</b>				
Credit default swaps on asset backed securities	—	—	102,851,109	102,851,109
Credit default swaps on asset backed indices	—	96,689,232	—	96,689,232
Interest rate swaps	—	1,795,031	—	1,795,031
<b>Total financial derivatives-assets</b>	<b>—</b>	<b>98,484,263</b>	<b>102,851,109</b>	<b>201,335,372</b>
<b>Repurchase agreements</b>	<b>—</b>	<b>25,683,750</b>	<b>—</b>	<b>25,683,750</b>
<b>Total investments, financial derivatives-assets and repurchase agreements</b>	<b>\$ —</b>	<b>\$ 1,029,545,132</b>	<b>\$ 443,540,550</b>	<b>\$ 1,473,085,682</b>
<b>Liabilities:</b>				
<b>Investments sold short-</b>				
U.S. Treasury and Agency residential mortgage-backed securities	\$ —	\$ (775,145,098)	\$ —	\$ (775,145,098)
<b>Financial derivatives-liabilities-</b>				
Credit default swaps on corporate indices	—	(185,847)	—	(185,847)
Credit default swaps on asset backed indices	—	(18,277,976)	—	(18,277,976)
Interest rate swaps	—	(1,676,505)	—	(1,676,505)
Unrealized depreciation on futures contracts	(890,001)	—	—	(890,001)
<b>Total financial derivatives-liabilities</b>	<b>(890,001)</b>	<b>(20,140,328)</b>	<b>—</b>	<b>(21,030,329)</b>
<b>Total investments sold short and financial derivatives-liabilities</b>	<b>\$ (890,001)</b>	<b>\$ (795,285,426)</b>	<b>\$ —</b>	<b>\$ (796,175,427)</b>

There were no transfers of financial instruments between Level 1, Level 2, or Level 3 during the year ended December 31, 2010.

At December 31, 2010, the Company held money market investments that are included in cash and cash equivalents on the Consolidated Statement of Assets, Liabilities and Shareholders' Equity and are considered Level 1 financial instruments.

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The tables below include a roll-forward of the Company's financial instruments for the three month periods ended June 30, 2011 and 2010, respectively (including the change in fair value), for financial instruments classified by the Company within Level 3 of the valuation hierarchy.

**Level 3—Fair Value Measurement Using Significant Unobservable Inputs:**

**Three Month Period Ended June 30, 2011**

	<u>Beginning Balance as of March 31, 2011</u>	<u>Accreted Discounts / Amortized Premiums</u>	<u>Realized Gain/(Loss)</u>	<u>Change in Net Unrealized Gain/(Loss)</u>	<u>Purchases</u>	<u>Sales</u>	<u>Transfers In and/or Out of Level 3</u>	<u>Ending Balance as of June 30, 2011</u>
<b>Assets:</b>								
<b>Investments at value-</b>								
U.S. Treasury and Agency residential mortgage-backed securities	\$ 4,298,160	\$ (326,936)	\$ 97,393	\$ (158,414)	\$ 2,471,946	\$ (1,155,117)	\$ —	\$ 5,227,032
Private label residential mortgage-backed securities	354,681,940	3,671,436	3,380,108	(15,999,987)	89,832,304	(77,671,738)	—	357,894,063
Private label commercial mortgage-backed securities	13,083,485	148,163	125,553	(1,230,947)	1,405,580	(2,589,344)	—	10,942,490
Commercial Mortgage Loans	4,675,000	46,142	—	(71,142)	—	—	—	4,650,000
<b>Total investments at value</b>	<u>376,738,585</u>	<u>3,538,805</u>	<u>3,603,054</u>	<u>(17,460,490)</u>	<u>93,709,830</u>	<u>(81,416,199)</u>	<u>—</u>	<u>378,713,585</u>
<b>Financial derivatives- assets</b>								
Credit default swaps on asset backed securities	90,382,805	—	2,627,724	(1,489,650)	27,971	(21,719,914)	—	69,828,936
<b>Total financial derivatives- assets</b>	<u>90,382,805</u>	<u>—</u>	<u>2,627,724</u>	<u>(1,489,650)</u>	<u>27,971</u>	<u>(21,719,914)</u>	<u>—</u>	<u>69,828,936</u>
<b>Total investments and financial derivatives-assets</b>	<u>\$467,121,390</u>	<u>\$3,538,805</u>	<u>\$6,230,778</u>	<u>\$(18,950,140)</u>	<u>\$93,737,801</u>	<u>\$(103,136,113)</u>	<u>\$ —</u>	<u>\$448,542,521</u>

All amounts of net realized and change in net unrealized gain (loss) in the table above are reflected in the accompanying Consolidated Statement of Operations. The table above incorporates changes in net unrealized gain (loss) for both Level 3 financial instruments held by the Company at June 30, 2011, as well as Level 3 financial instruments disposed of by the Company during the three month period ended June 30, 2011. For Level 3 financial instruments held by the Company at June 30, 2011, change in net unrealized gain (loss) of \$(16.6) million and \$(1.5) million, for the three month period ended June 30, 2011 relate to investments and financial derivative-assets, respectively.

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**Level 3—Fair Value Measurement Using Significant Unobservable Inputs:**
**Three Month Period Ended June 30, 2010**

	Beginning Balance as of March 31, 2010	Accreted Discounts / Amortized Premiums	Realized Gain/(Loss)	Change in Net Unrealized Gain/(Loss)	Purchases	Sales	Transfers In and/or Out of Level 3	Ending Balance as of June 30, 2010
<b>Assets:</b>								
<b>Investments at value-</b>								
Private label residential mortgage-backed securities	\$234,944,268	\$3,155,804	\$ 9,654,774	\$(2,744,250)	\$94,980,740	\$(94,472,719)	\$ —	\$245,518,617
<b>Total investments at value</b>	<u>234,944,268</u>	<u>3,155,804</u>	<u>9,654,774</u>	<u>\$(2,744,250)</u>	<u>94,980,740</u>	<u>\$(94,472,719)</u>	<u>—</u>	<u>245,518,617</u>
<b>Financial derivatives- assets</b>								
Credit default swaps on corporate bonds	4,547,488	—	(4,560,582)	803,011	393,489	(1,183,406)	—	—
Credit default swaps on asset backed securities	119,540,520	—	3,365,728	(6,216,478)	3,817,848	(7,082,327)	—	113,425,291
Other swaps	323,021	—	335,312	(323,021)	—	(335,312)	—	—
<b>Total financial derivatives- assets</b>	<u>124,411,029</u>	<u>—</u>	<u>(859,542)</u>	<u>\$(5,736,488)</u>	<u>4,211,337</u>	<u>\$(8,601,045)</u>	<u>—</u>	<u>113,425,291</u>
<b>Total investments and financial derivatives-assets</b>	<u>\$359,355,297</u>	<u>\$3,155,804</u>	<u>\$ 8,795,232</u>	<u>\$(8,480,738)</u>	<u>\$99,192,077</u>	<u>\$(103,073,764)</u>	<u>\$ —</u>	<u>\$358,943,908</u>
<b>Liabilities:</b>								
<b>Financial derivatives- liabilities</b>								
Credit default swaps on asset backed securities	\$ (6,944,815)	\$ —	\$(1,086,884)	\$ 2,689,816	\$ 5,341,883	\$ —	\$ —	\$ —
<b>Total financial derivatives- liabilities</b>	<u>\$ (6,944,815)</u>	<u>\$ —</u>	<u>\$(1,086,884)</u>	<u>\$ 2,689,816</u>	<u>\$ 5,341,883</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>

In January 2010, the FASB issued ASU No. 2010-6 *Fair Value Measurements and Disclosures*—(Topic 820), *Improving Disclosures about Fair Value Measurements*, which became effective for fiscal years beginning after December 15, 2010. As a result certain classifications in the above table have been conformed to the current period presentation.

All amounts of net realized and change in net unrealized gain (loss) in the table above are reflected in the accompanying Consolidated Statement of Operations. The table above incorporates changes in net unrealized gain (loss) for both Level 3 financial instruments held by the Company at June 30, 2010, as well as Level 3 financial instruments disposed of by the Company during the three month-period ended June 30, 2010. For Level 3 financial instruments held by the Company at June 30, 2010, change in net unrealized gain (loss) of \$(0.2) million, \$(5.7) million and \$2.7 million for the three month period ended June 30, 2010 relate to investments, financial derivative-assets and financial derivative-liabilities, respectively.

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**Level 3—Fair Value Measurement Using Significant Unobservable Inputs:**
**Six Month Period Ended June 30, 2011**

	Beginning Balance as of December 31, 2010	Accreted Discounts / Amortized Premiums	Realized Gain/(Loss)	Change in Net Unrealized Gain/(Loss)	Purchases	Sales	Transfers In and/or Out of Level 3	Ending Balance as of June 30, 2011
<b>Assets:</b>								
<b>Investments at value-</b>								
U.S. Treasury and Agency residential mortgage- backed securities	\$ —	\$ (419,807)	\$ 97,393	\$ (150,203)	\$ 6,854,766	\$ (1,155,117)	\$ —	\$ 5,227,032
Private label residential mortgage-backed securities	338,839,441	7,320,793	14,556,334	(22,637,757)	186,259,638	(166,444,386)	—	357,894,063
Private label commercial mortgage-backed securities	1,850,000	230,972	897,963	(1,478,534)	16,750,783	(7,308,694)	—	10,942,490
Commercial Mortgage Loans	—	60,981	—	(85,981)	4,675,000	—	—	4,650,000
<b>Total investments at value</b>	<u>340,689,441</u>	<u>7,192,939</u>	<u>15,551,690</u>	<u>(24,352,475)</u>	<u>214,540,187</u>	<u>(174,908,197)</u>	<u>—</u>	<u>378,713,585</u>
<b>Financial derivatives- assets</b>								
Credit default swaps on asset backed securities	102,851,109	—	5,308,298	(4,740,333)	403,551	(33,993,689)	—	69,828,936
<b>Total financial derivatives- assets</b>	<u>102,851,109</u>	<u>—</u>	<u>5,308,298</u>	<u>(4,740,333)</u>	<u>403,551</u>	<u>(33,993,689)</u>	<u>—</u>	<u>69,828,936</u>
<b>Total investments and financial derivatives-assets</b>	<u>\$443,540,550</u>	<u>\$7,192,939</u>	<u>\$20,859,988</u>	<u>\$(29,092,808)</u>	<u>\$214,943,738</u>	<u>\$(208,901,886)</u>	<u>\$ —</u>	<u>\$448,542,521</u>

All amounts of net realized and change in net unrealized gain (loss) in the table above are reflected in the accompanying Consolidated Statement of Operations. The table above incorporates changes in net unrealized gain (loss) for both Level 3 financial instruments held by the Company at June 30, 2011, as well as Level 3 financial instruments disposed of by the Company during the six month period ended June 30, 2011. For Level 3 financial instruments held by the Company at June 30, 2011, change in net unrealized gain (loss) of \$(17.5) million and \$(9.9) million for the six month period ended June 30, 2011 relate to investments and financial derivative-assets, respectively.



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**Level 3—Fair Value Measurement Using Significant Unobservable Inputs:**
**Six Month Period Ended June 30, 2010**

	<u>Beginning Balance as of December 31, 2009</u>	<u>Accreted Discounts / Amortized Premiums</u>	<u>Realized Gain/(Loss)</u>	<u>Change in Net Unrealized Gain/(Loss)</u>	<u>Purchases</u>	<u>Sales</u>	<u>Transfers In and/or Out of Level 3</u>	<u>Ending Balance as of June 30, 2010</u>
<b>Assets:</b>								
<b>Investments at value-</b>								
Private label residential mortgage-backed securities	\$210,363,731	\$5,938,803	\$11,899,982	\$ 4,344,547	\$158,225,948	\$(145,254,394)	\$ —	\$245,518,617
<b>Total investments at value</b>	<u>210,363,731</u>	<u>5,938,803</u>	<u>11,899,982</u>	<u>4,344,547</u>	<u>158,225,948</u>	<u>(145,254,394)</u>	<u>—</u>	<u>245,518,617</u>
<b>Financial derivatives- assets</b>								
Credit default swaps on corporate bonds	8,475,895	—	(2,281,392)	(2,650,145)	1,713,374	(5,257,732)	—	—
Credit default swaps on asset backed securities	95,199,131	—	11,470,519	(15,155,697)	38,112,949	(16,201,611)	—	113,425,291
Other swaps	257,212	—	335,312	(257,212)	—	(335,312)	—	—
<b>Total financial derivatives- assets</b>	<u>103,932,238</u>	<u>—</u>	<u>9,524,439</u>	<u>(18,063,054)</u>	<u>39,826,323</u>	<u>(21,794,655)</u>	<u>—</u>	<u>113,425,291</u>
<b>Total investments and financial derivatives-assets</b>	<u>\$314,295,969</u>	<u>\$5,938,803</u>	<u>\$21,424,421</u>	<u>\$(13,718,507)</u>	<u>\$198,052,271</u>	<u>\$(167,049,049)</u>	<u>\$ —</u>	<u>\$358,943,908</u>
<b>Liabilities:</b>								
<b>Financial derivatives- liabilities</b>								
Credit default swaps on asset backed securities	\$(10,547,540)	\$ —	\$(1,657,578)	\$ 3,881,292	\$ 8,339,356	\$ (15,530)	\$ —	\$ —
<b>Total financial derivatives- liabilities</b>	<u>\$(10,547,540)</u>	<u>\$ —</u>	<u>\$(1,657,578)</u>	<u>\$ 3,881,292</u>	<u>\$ 8,339,356</u>	<u>\$ (15,530)</u>	<u>\$ —</u>	<u>\$ —</u>

In January 2010, the FASB issued ASU No. 2010-6 *Fair Value Measurements and Disclosures*—(Topic 820), *Improving Disclosures about Fair Value Measurements*, which became effective for fiscal years beginning after December 15, 2010. As a result certain classifications in the above table have been conformed to the current period presentation.

All amounts of net realized and change in net unrealized gain (loss) in the table above are reflected in the accompanying Consolidated Statement of Operations. The table above incorporates changes in net unrealized gain (loss) for both Level 3 financial instruments held by the Company at June 30, 2010, as well as Level 3 financial instruments disposed of by the Company during the six month-period ended June 30, 2010. For Level 3 financial instruments held by the Company at June 30, 2010, change in net unrealized gain (loss) of \$3.4 million and \$(16.0) million for the six month period ended June 30, 2010 relate to investments and financial derivative-assets, respectively.

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**4. Financial Derivatives**

Gains and losses on the Company's derivative contracts for the three and six month periods ended June 30, 2011 are summarized in the tables below:

**June 30, 2011:**

<b>Derivative Type</b>	<b>Primary Risk Exposure</b>	<b>Net Realized Gain/(Loss) for the Three Month Period Ended June 30, 2011</b>	<b>Change in Net Unrealized Gain/(Loss) for the Three Month Period Ended June 30, 2011</b>	<b>Net Realized Gain/(Loss) for the Six Month Period Ended June 30, 2011</b>	<b>Change in Net Unrealized Gain/(Loss) for the Six Month Period Ended June 30, 2011</b>
<b>Financial derivatives - assets</b>					
Credit Default Swaps on Asset Backed Securities	Credit	\$ 2,627,724	\$ (1,489,653)	\$ 5,308,298	\$ (4,740,333)
Credit Default Swaps on Asset Backed Indices	Credit	3,819,732	1,095,929	(1,225,909)	1,974,050
Interest Rate Swaps	Interest Rates	(384,944)	(1,637,426)	(652,031)	(835,100)
		<u>6,062,512</u>	<u>(2,031,150)</u>	<u>3,430,358</u>	<u>(3,601,383)</u>
<b>Financial derivatives - liabilities</b>					
Credit Default Swaps on Asset Backed Indices	Credit	2,441,507	(207,888)	8,862,730	(217,059)
Credit Default Swaps on Corporate Bond Indices	Credit	(49,797)	339	(99,594)	(34,277)
Interest Rate Swaps	Interest Rates	(1,001,524)	(3,141,303)	(1,001,524)	(3,690,252)
		<u>1,390,186</u>	<u>(3,348,852)</u>	<u>7,761,612</u>	<u>(3,941,588)</u>
<b>Futures contracts</b>					
Short Eurodollar contracts	Interest Rates	(347,432)	202,288	(718,908)	521,138
<b>Total</b>		<u>\$ 7,105,266</u>	<u>\$ (5,177,714)</u>	<u>\$ 10,473,062</u>	<u>\$ (7,021,833)</u>

Gains and losses on the Company's derivative contracts for the three and six month periods ended June 30, 2010 are summarized in the tables below:

**June 30, 2010:**

<b>Derivative Type</b>	<b>Primary Risk Exposure</b>	<b>Net Realized Gain/(Loss) for the Three Month Period Ended June 30, 2010</b>	<b>Change in Net Unrealized Gain/(Loss) for the Three Month Period Ended June 30, 2010</b>	<b>Net Realized Gain/(Loss) for the Six Month Period Ended June 30, 2010</b>	<b>Change in Net Unrealized Gain/(Loss) for the Six Month Period Ended June 30, 2010</b>
<b>Financial derivatives - assets</b>					
Credit Default Swaps on Asset Backed Securities	Credit	\$ 3,365,728	\$ (6,216,478)	\$ 11,470,519	\$ (15,155,697)
Credit Default Swaps on Asset Backed Indices	Credit	(2,827,979)	634,325	(4,292,659)	1,657,183
Credit Default Swaps on Corporate Bond Indices	Credit	2,189	(1,395)	2,189	(1,395)
Credit Default Swaps on Corporate Bonds	Credit	(4,560,582)	803,011	(2,281,392)	(2,650,145)
Other Swaps	Credit	335,312	(323,021)	335,312	(257,212)
Interest Rate Swaps	Interest Rates	(125,261)	—	(125,261)	(109,332)
		<u>(3,810,593)</u>	<u>(5,103,558)</u>	<u>5,108,708</u>	<u>(16,516,598)</u>
<b>Financial derivatives - liabilities</b>					
Credit Default Swaps on Asset Backed Securities	Credit	(1,086,884)	2,689,816	(1,657,578)	3,881,292
Credit Default Swaps on Asset Backed Indices	Credit	6,216,783	(539,333)	6,523,782	(265,095)
Credit Default Swaps on Corporate Bond Indices	Credit	(929,642)	1,283,806	(1,003,740)	1,145,978
Total Return Swaps	Equity Market	(280,600)	98,728	(853,876)	87,798
Interest Rate Swaps	Interest Rates	(897,444)	(1,084,866)	(897,444)	(1,214,536)
		<u>3,022,213</u>	<u>2,448,151</u>	<u>2,111,144</u>	<u>3,635,437</u>
<b>Futures contracts</b>					
Short Eurodollar contracts	Interest Rates	(288,200)	(469,987)	(1,025,880)	(1,348,675)
<b>Total</b>		<u>\$ (1,076,580)</u>	<u>\$ (3,125,394)</u>	<u>\$ 6,193,972</u>	<u>\$ (14,229,836)</u>

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As of June 30, 2011, the Company is party to credit derivatives contracts in the form of credit default swaps on mortgage/asset backed securities and indices, or "ABSCDS." As a seller of credit protection via ABSCDS, the Company receives periodic payments from protection buyers, and is obligated to make payments to the protection buyer upon the occurrence of a "credit event" with respect to underlying reference assets. Written credit derivatives held by the Company at June 30, 2011 and December 31, 2010, respectively, are summarized below:

<b>Single Name and Index Credit Default Swaps (Asset Backed Securities)</b>	<b>Amount at June 30, 2011</b>	<b>Amount at December 31, 2010</b>
Fair Value of Written Credit Derivatives, Net	\$ (4,564,225)	\$ (14,375,074)
Fair Value of Purchased Credit Derivatives Offsetting Written Credit		
Derivatives with Third Parties <sup>(1)</sup>	\$ 5,031,909	\$ 18,286,216
Notional Amount of Written Credit Derivatives <sup>(2)</sup>	\$(24,864,649)	\$(111,717,136)
Notional Amount of Purchased Credit Derivatives Offsetting Written Credit		
Derivatives with Third Parties <sup>(1)</sup>	\$ 13,314,333	\$ 43,721,319

<sup>(1)</sup> Offsetting transactions with third parties include purchased credit derivatives which have the same reference obligation.

<sup>(2)</sup> The notional amount is the maximum amount that a seller of ABSCDS would be obligated to pay, and a buyer of credit protection would receive upon occurrence of a "credit event." Movements in the value of credit default swap transactions may require the Company or the counterparty to post or receive collateral. Amounts due or owed under an ABSCDS contract may be offset against amounts due or owed on other ABSCDS contracts with the same ISDA counterparty.

Unless terminated by mutual agreement by both the buyer and seller, ABSCDS contracts typically terminate at the earlier of the (i) date the buyer of protection delivers the reference asset to the seller in exchange for payment of the notional balance following the occurrence of a credit event or (ii) date the reference asset is paid off in full, retired, or otherwise ceases to exist. Implied credit spreads may be used to determine the market value of swap contracts and are reflective of the cost of buying/selling protection. Higher spreads would indicate a greater likelihood that a seller will be obligated to perform (i.e., make payment) under the swap contract. In situations where the credit quality of an underlying reference asset has deteriorated, credit spreads combined with a percentage of notional amounts paid up front (points up front) are frequently used as an indication of ABSCDS risk. ABSCDS credit protection sellers entering the market would expect to be paid a percentage of the current notional balance up front (points up front) approximately equal to the fair value of the contract in order to write protection on the reference assets underlying the Company's ABSCDS contracts. Stated spreads at June 30, 2011 on ABSCDS contracts where the Company wrote protection range between 9 and 442 basis points on contracts that were outstanding at this date and were unchanged from December 31, 2010. However, participants entering the market at June 30, 2011 and December 31, 2010 would likely transact on similar contracts with material points upfront given these spreads. Total net up-front payments received relating to ABSCDS contracts outstanding at June 30, 2011 and December 31, 2010 were \$4.2 million and \$13.5 million, respectively.

### 5. Base Management Fee and Incentive Fee

The Company has engaged the Manager to manage the assets, operations and affairs of the Company and pays various management fees associated with that arrangement. Effective August 2, 2011, the Board of Directors approved a Third Amended and Restated Management Agreement between the Company and the Manager. The Base Management Fees and Incentive Fees payable under the agreement are detailed below.

#### **Base Management Fees**

The Manager receives an annual base management fee in an amount equal to 1.50% per annum of the Company's shareholders' equity as of the end of each fiscal quarter (before deductions for base management fees and incentive fees payable with respect to such fiscal quarter). The base management fee is payable quarterly in arrears.

*Summary information*—For the three month periods ended June 30, 2011 and 2010, the total base management fees incurred by the Company were \$1.4 million and \$1.1 million, respectively. For the six month periods ended June 30, 2011 and 2010, the total base management fees incurred by the Company were \$2.9 million and \$2.2 million, respectively.

### ***Incentive Fees***

The Manager is entitled to receive a quarterly incentive fee equal to the positive excess of (i) the product of (A) 25% and (B) the excess of (1) Adjusted Net Income (described below) for the Incentive Calculation Period (which means such fiscal quarter and the immediately preceding three fiscal quarters) over (2) the sum of the Hurdle Amounts (described below) for the Incentive Calculation Period, over (ii) the sum of the incentive fees already paid or payable for each fiscal quarter in the Incentive Calculation Period preceding such fiscal quarter.

For purposes of calculating the incentive fee, “Adjusted Net Income” for the Incentive Calculation Period means the net increase in shareholders’ equity from operations, after all base management fees but before any incentive fees for such period, and excluding non-cash equity compensation expenses for such period as reduced by any Loss Carryforward (as described below) as of the end of the fiscal quarter preceding the Incentive Calculation Period.

For purposes of calculating the incentive fee, the “Loss Carryforward” as of the end of any fiscal quarter is calculated by determining the excess, if any, of (1) the Loss Carryforward as of the end of the immediately preceding fiscal quarter over (2) the net increase in shareholders’ equity from operations (expressed as a positive number) or net decrease in shareholders’ equity from operations (expressed as a negative number) for such fiscal quarter. There were no Loss Carryforwards as of the end of any fiscal quarter in 2010 or at March 31, 2011.

For purposes of calculating the incentive fee, the “Hurdle Amount” means, with respect to any fiscal quarter, the product of (i) one-fourth of the greater of (A) 9% and (B) 3% plus the ten-year U.S. Treasury rate for such fiscal quarter, (ii) the sum of (A) the weighted average gross proceeds per share of all our common share issuances up to the end of such fiscal quarter, with each issuance weighted by both the number of shares issued in such issuance and the number of days that such issued shares were outstanding during such fiscal quarter, using a first-in first-out basis of accounting (i.e., attributing any share repurchases to the earliest issuances first) and (B) the result obtained by dividing (I) retained earnings attributable to common shares at the beginning of such fiscal quarter by (II) the average number of common shares outstanding for each day during such fiscal quarter, and (iii) the average number of common shares and LTIP units outstanding for each day during such fiscal quarter. For purposes of determining the Hurdle Amount, issuances of common shares (a) as equity incentive awards, (b) to the Manager as part of its base management fee or incentive fee and (c) to the Manager or any of its affiliates in privately negotiated transactions, are excluded from the calculation. The payment of the incentive fee will be in a combination of common shares and cash, provided that at least 10% of any quarterly payment will be made in common shares.

*Summary information*—There were no incentive fees incurred for the three month periods ended June 30, 2011 and 2010. Total incentive fees incurred for the six month periods ended June 30, 2011 and 2010, were \$0.6 million and \$0.5 million, respectively.

### **6. Long-Term Incentive Plan Units**

In connection with its initial offering in 2007, the Company established the Manager Long-Term Incentive Plan (the “Manager LTIP”) and the Individual Long-Term Incentive Plan (the “Individual LTIP”). Pursuant to the terms of the Manager LTIP, the Company issued 375,000 long-term incentive plan units to its Manager. Pursuant to the terms of the Individual LTIP, each year since inception the Company has issued annual awards to its independent directors and, beginning in 2010, issued awards to certain of its dedicated officers.

As of August 17, 2010, LTIP units awarded to the Manager were fully vested and fully expensed. LTIP units held pursuant to the Manager LTIP are generally exercisable by the holder at any time after vesting. Each LTIP unit is convertible into one common share. During the three month period ended June 30, 2010, expense recognized related to the Manager LTIP was approximately \$0.8 million and during the six month period ended June 30, 2010, expense recognized related to the Manager LTIP was approximately \$1.5 million. There is no cash flow effect from the issuance of the Manager LTIP units. Since inception, the aggregate expense associated with the Manager LTIP was \$8.6 million.

Individual LTIP units in the amount of 3,750 units were granted to the Company’s independent directors on each of August 17, 2007, December 31, 2008, October 1, 2009 and October 1, 2010. Excluding the October 1, 2010 award, these grants have fully vested. The vesting period for awards issued to directors under the Individual LTIP has generally been one year from the date of grant. In addition, on December 15, 2010, the Company issued a total of 2,500 LTIP units to certain of its dedicated officers. The vesting period for this grant is also one year from the date of grant. LTIP units held pursuant to the Individual LTIP are generally exercisable by the holder at any time after vesting. Each LTIP unit is convertible into one common share. Costs associated with the Individual

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LTIP are measured as of the grant date and expensed ratably over the vesting period. The total expenses associated with the Individual LTIP units awarded to the independent directors for the three month periods ended June 30, 2011 and 2010, were \$0.02 million and \$0.02 million, respectively. The total expenses associated with the Individual LTIP units awarded to the independent directors for the six month periods ended June 30, 2011 and 2010, were \$0.05 million and \$0.05 million, respectively. The total expense associated with the Individual LTIP units awarded to the Company's dedicated officers for the three month period ended June 30, 2011 was approximately \$0.01 million and the total expense associated with the Individual LTIP units awarded to the Company's dedicated officers for the six month period ended June 30, 2011 was approximately \$0.02 million. Unrecognized expense related to unvested Individual LTIP units awarded to independent directors was \$0.02 million at June 30, 2011 and \$0.07 million at December 31, 2010. Unrecognized expense related to unvested Individual LTIP units awarded to certain of the Company's dedicated officers was \$0.03 million at June 30, 2011 and \$0.05 million at December 31, 2010. Since inception, 7,500 common shares were issued in connection with the conversion of Individual LTIP units awarded to independent directors at the direction of the three award holders and \$0.2 million was transferred from the share-based LTIP awards to common shares in shareholders' equity.

If all of the LTIP units that have previously been issued were to be fully vested and exchanged for common shares as of June 30, 2011 and December 31, 2010, the Company's issued and outstanding common shares would increase to 16,892,381 and 16,883,342 shares, respectively, resulting in shareholders' equity per share of \$22.78 and \$23.91 at June 30, 2011 and December 31, 2010, respectively.

Detailed below is a roll-forward of the Company's LTIP units outstanding for the three month periods ended June 30, 2011 and 2010, respectively.

### *Three Month Periods Ended June 30, 2011 and June 30, 2010:*

	Three Month Period Ended June 30, 2011			Three Month Period Ended June 30, 2010		
	Manager	Director/ Employee	Total	Manager	Director/ Employee	Total
LTIP Units Outstanding (3/31/2011, 3/31/2010, respectively)	375,000	10,000	385,000	375,000	5,000	380,000
Granted	—	—	—	—	—	—
Exercised	—	—	—	—	—	—
LTIP Units Outstanding (6/30/2011, 6/30/2010, respectively)	<u>375,000</u>	<u>10,000</u>	<u>385,000</u>	<u>375,000</u>	<u>5,000</u>	<u>380,000</u>
LTIP Units Vested and Outstanding (6/30/2011, 6/30/2010, respectively)	375,000	3,750	378,750	250,000	1,250	251,250

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Detailed below is a roll-forward of the Company's LTIP units outstanding for the six month periods ended June 30, 2011 and 2010, respectively.

*Six Month Periods Ended June 30, 2011 and June 30, 2010:*

	<u>Six Month Period Ended</u> <u>June 30, 2011</u>			<u>Six Month Period Ended</u> <u>June 30, 2010</u>		
	<u>Manager</u>	<u>Director/ Employee</u>	<u>Total</u>	<u>Manager</u>	<u>Director/ Employee</u>	<u>Total</u>
LTIP Units Outstanding (12/31/2010, 12/31/2009, respectively)	375,000	10,000	385,000	375,000	7,500	382,500
Granted	—	—	—	—	—	—
Exercised	—	—	—	—	(2,500)	(2,500)
LTIP Units Outstanding (6/30/2011, 6/30/2010, respectively)	<u>375,000</u>	<u>10,000</u>	<u>385,000</u>	<u>375,000</u>	<u>5,000</u>	<u>380,000</u>
LTIP Units Vested and Outstanding (6/30/2011, 6/30/2010, respectively)	375,000	3,750	378,750	250,000	1,250	251,250

## 7. Common Share Capitalization

On August 17, 2007, in connection with the initial offering of common shares of the Company, 12,500,000 shares were issued with no par value. In addition, 50 shares were issued to the Manager for the initial formation of the Company. On October 14, 2010, in connection with the closing of the initial public offering of common shares of the Company, 4,500,000 common shares were issued at a price of \$22.50 per share.

The following tables set forth the dividend distributions authorized by the Board of Directors relating to the six month periods ended June 30, 2011 and 2010, payable to shareholders and LTIP holders:

*Six Month Period Ended June 30, 2011*

	<u>Dividend Per Share</u>	<u>Dividend Amount</u>	<u>Record Date</u>	<u>Payment Date</u>
First Quarter	\$0.40	\$6,756,952	June 1, 2011	June 15, 2011
Second Quarter	\$0.40	\$6,756,952	September 1, 2011	September 15, 2011

*Six Month Period Ended June 30, 2010*

	<u>Dividend Per Share</u>	<u>Dividend Amount</u>	<u>Record Date</u>	<u>Payment Date</u>
First Quarter	\$0.25	\$3,091,417	May 18, 2010	June 15, 2010
Second Quarter	\$0.15	\$1,854,849	September 1, 2010	September 15, 2010

Dividends are declared and paid on a quarterly basis in arrears.

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Detailed below is a roll-forward of the Company's common shares outstanding for the three month periods ended June 30, 2011 and 2010:

*Three Month Periods Ended June 30, 2011 and June 30, 2010:*

	<u>Three Month Period Ended June 30, 2011</u>	<u>Three Month Period Ended June 30, 2010</u>
Common Shares Outstanding (3/31/2011, 3/31/2010, respectively)	16,504,742	11,983,695
Share Activity:		
Shares issued in connection with incentive fee payment	2,639	1,975
Director LTIP units exercised	<u>—</u>	<u>—</u>
Common Shares Outstanding (6/30/2011, 6/30/2010, respectively)	<u>16,507,381</u>	<u>11,985,670</u>

Detailed below is a roll-forward of the Company's common shares outstanding for the six month periods ended June 30, 2011 and 2010:

*Six Month Periods Ended June 30, 2011 and June 30, 2010:*

	<u>Six Month Period Ended June 30, 2011</u>	<u>Six Month Period Ended June 30, 2010</u>
Common Shares Outstanding (12/31/2010, 12/31/2009, respectively)	16,498,342	11,972,113
Share Activity:		
Shares issued in connection with incentive fee payment	9,039	11,057
Director LTIP units exercised	<u>—</u>	<u>2,500</u>
Common Shares Outstanding (6/30/2011, 6/30/2010, respectively)	<u>16,507,381</u>	<u>11,985,670</u>

As of June 30, 2011 and December 31, 2010, related parties of the Company owned approximately 20.6% of common shares and LTIP units outstanding.

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### 8. Earnings Per Share

The components of the computation of basic and diluted EPS were as follows:

	<u>Three Months Ended June 30,</u>		<u>Six Months Ended June 30,</u>	
	<u>2011</u>	<u>2010</u>	<u>2011</u>	<u>2010</u>
<b>Net increase in shareholders' equity resulting from operations</b>	\$ (1,321,580)	\$ 3,731,130	\$ 9,785,590	\$ 11,326,588
Net increase (decrease) in shareholders' equity resulting from operations available to common share and LTIP holders:	(1,321,580)	3,731,130	9,785,590	11,326,588
Net increase (decrease) in shareholders' equity resulting from operations - common shares	(1,291,458)	3,616,464	9,562,518	10,977,895
Net increase (decrease) in shareholders' equity resulting from operations - LTIPs	(30,122)	114,666	223,072	348,693
<b>Dividends Paid:</b>				
Common Shares	(6,602,952)	(2,996,417)	(28,224,164)	(17,976,035)
LTIPs	(154,000)	(95,000)	(658,350)	(570,000)
Total dividends paid to common share and LTIP holders	(6,756,952)	(3,091,417)	(28,882,514)	(18,546,035)
<b>Undistributed earnings:</b>				
Common Shares	(7,894,410)	620,047	(18,661,646)	(6,998,140)
LTIPs	(184,122)	19,666	(435,278)	(221,307)
Total undistributed earnings attributable to common share and LTIP holders	\$ (8,078,532)	\$ 639,713	\$(19,096,924)	\$ (7,219,447)
Weighted average shares outstanding (basic and diluted):				
Weighted average common shares outstanding	16,506,453	11,984,824	16,503,940	11,981,338
Weighted average participating LTIPs	385,000	380,000	385,000	380,566
<b>Basic earnings per common share:</b>				
Distributed	\$ 0.40	\$ 0.25	\$ 1.71	\$ 1.50
Undistributed	(0.48)	0.05	(1.13)	(0.58)
	<u>\$ (0.08)</u>	<u>\$ 0.30</u>	<u>\$ 0.58</u>	<u>\$ 0.92</u>
<b>Diluted earnings per common share:</b>				
Distributed	\$ 0.40	\$ 0.25	\$ 1.71	\$ 1.50
Undistributed	(0.48)	0.05	(1.13)	(0.58)
	<u>\$ (0.08)</u>	<u>\$ 0.30</u>	<u>\$ 0.58</u>	<u>\$ 0.92</u>

The Company pays quarterly dividends in arrears. Dividends paid in the table above relate to the respective period's prior period earnings.

### 9. Risks

The Company may be exposed to various types of risks, including market price risk, interest rate risk, and credit risk. Market price risk is the risk of decline in value of the investments held by the Company for a number of reasons, including changes in prevailing market and interest rates, increases in defaults, increases in voluntary prepayments for investments subject to prepayment risk, and widening credit spreads. Interest rate risk is the risk associated with the effects of the fluctuations in the prevailing level of market interest rates. Credit risk includes the risk of principal loss as well as the risk that a counterparty will be unable to pay amounts in full when due. Since 2007, the U.S. residential mortgage market has experienced severe dislocations and liquidity disruptions. Over the same period mortgage loans have experienced increased rates of delinquency, foreclosure and loss, although the rate of increase has slowed. While more recently the mortgage market has experienced some improvement and stability relative to the 2007-2009 period, home prices remain depressed and relative illiquidity in private label mortgage related assets persists.

The Company invests in credit sensitive MBS and ABS. MBS are affected by interest rates and prepayment rates, each of which are influenced by a variety of economic, geographic, social and other factors. Maturities on MBS represent stated maturity dates. Actual maturity dates may differ based on prepayment rates. The Company may invest in, or sell short, various interest rate derivative instruments and futures contracts primarily for the purpose of hedging its mortgage-backed securities portfolio against changes in value caused by changes in prevailing market interest rates. Should interest rates move unexpectedly, the Company may not achieve the anticipated benefits of the hedging instruments and may realize a loss. Further, the use of such derivative instruments involves the risk of imperfect correlation in movements in the price of the instruments, interest rates and the underlying hedged assets.



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The Company transacts in various financial instruments including swaps, futures contracts and options. With these financial instruments, the Company is exposed to market risk in excess of the amounts recorded on the Consolidated Statement of Assets, Liabilities and Shareholders' Equity.

Under current market conditions, many of the Company's portfolio securities may be considered illiquid. This may result in certain securities being disposed of at a price different from the recorded value since the market price of such securities generally is more volatile than that of more liquid securities. This may result in the Company incurring greater losses on the sale of some portfolio securities than under more stable market conditions. Such losses can adversely impact the Company's shareholders' equity. In addition, if the Company is required to liquidate all or a portion of its portfolio quickly, it may realize significantly less than the value at which it previously recorded its investments. There can be no assurance that the Company could purchase or sell a portfolio investment at the price used to calculate the Company's shareholders' equity. A decline in market value of the Company's assets may have particular material adverse consequences in instances where the Company has borrowed money based upon the market value of those assets. A decrease in market value of those assets may require the Company to post additional collateral or otherwise sell assets at a time when it may not be in the best interest of the Company to do so.

Because the Company borrows under reverse repurchase agreements based on the estimated fair value of the pledged instruments, the Company's ongoing ability to borrow under its reverse repurchase facilities may be limited and its lenders may initiate margin calls in the event of adverse changes in the market. A decrease in market value of those assets may require the Company to post additional collateral or otherwise sell assets at a time when it may not be in the best interest of the Company to do so.

The Company is party to a tri-party collateral arrangement under one of its ISDA trading agreements whereby a third party holds collateral posted by the Company. Pursuant to the terms of the arrangement the third party must follow certain pre-defined actions prior to the release of the collateral to the counterparty or to the Company. Deposits with dealers held as collateral on the Consolidated Statement of Assets, Liabilities and Shareholders' Equity includes, at June 30, 2011 and December 31, 2010, collateral posted by the Company and held by a third party custodian in the amount of \$6.7 million and \$9.0 million, respectively.

As of June 30, 2011, investments with an aggregate value of approximately \$921.1 million were held with dealers as collateral for various reverse repurchase agreements. In addition, as of June 30, 2011, the Company holds an investment with a value of approximately \$1.6 million which was received to satisfy collateral requirements for various reverse repurchase agreements. The investments held as collateral include securities in the amount of \$17.5 million that were sold prior to period end but for which such sale had not settled as of June 30, 2011.

The following table details the percentage of such collateral held by counterparties who hold greater than 15% of collateral for various reverse repurchase agreements. In addition to the below, unencumbered investments, on a settlement date basis, of approximately \$194.9 million were held in custody at the Bank of New York Mellon Corporation.

<u>Dealer</u>	<u>% of Total Collateral on Reverse Repurchase Agreements</u>
Morgan Stanley	25%
Bank of America	21%
Credit Suisse Group	16%

The following table details the percentage of collateral amounts held by dealers who hold greater than 15% of the Company's Deposits with dealers held as collateral account as of June 30, 2011:

<u>Dealer</u>	<u>% of Total Deposits with Dealers Held as Collateral</u>
Citigroup	45%
JP Morgan Chase	24%

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The following table details the percentage of collateral amounts held by dealers who hold greater than 15% of the Company's Due to brokers-margin accounts as of June 30, 2011:

<u>Dealer</u>	<u>% of Total Due to Brokers - Margin Accounts</u>
Morgan Stanley	59%
Credit Suisse Group	17%

The following table details the percentage of amounts held by dealers who hold greater than 15% of the Company's Receivable for securities sold as of June 30, 2011:

<u>Dealer</u>	<u>% of Total Receivable for Securities Sold</u>
Royal Bank of Scotland	49%
Bank of America	16%

The following table details the percentage of amounts held by dealers who hold greater than 15% of the Company's Payable for securities purchased as of June 30, 2011:

<u>Dealer</u>	<u>% of Total Payable for Securities Purchased</u>
Bank of America	27%
Citigroup	22%
JP Morgan	21%

The Company is party to various derivative contracts generally governed by ISDA trading agreements with dealer counterparties. The Company's ISDA trading agreements, which are separately negotiated agreements with each dealer counterparty, typically contain provisions allowing, absent other considerations, a counterparty to exercise rights, to the extent not otherwise waived, against the Company in the event the Company's shareholders' equity declines over time by a predetermined percentage or falls below a predetermined floor. Such rights often include the ability to terminate (i.e., close out) open contracts at prices which may favor the counterparty, which could have a material adverse effect on the Company.

The Company's purchases and sales of TBA securities are typically governed by Master Securities Forward Transaction Agreements with dealer counterparties. These agreements are separately negotiated with each dealer counterparty and include provisions for margin maintenance, mark-to-market, and other items.

## **10. Contingencies and Commitments**

The Company provides current directors and officers with a limited indemnification against liabilities arising in connection with the performance of their duties to the Company.

In the normal course of business the Company may also enter into contracts that contain a variety of representations, warranties and general indemnifications. The Company's maximum exposure under these arrangements, including future claims that may be made against the Company that have not yet occurred, is unknown. However, based upon experience, the Company expects the risk of loss associated with such contracts to be remote.

## 11. Financial Highlights

### Results of Operations for a Share Outstanding Throughout the Periods Ended June 30, 2011 and 2010:

	<b>Three Month Period Ended June 30, 2011</b>	<b>Three Month Period Ended June 30, 2010</b>	<b>Six Month Period Ended June 30, 2011</b>	<b>Six Month Period Ended June 30, 2010</b>
Beginning Shareholders' Equity Per Share (3/31/11, 3/31/10, 12/31/10 and 12/31/09, respectively)	\$ 23.80	\$ 24.44	\$ 24.47	\$ 25.04
Net Investment Income	0.73	0.56	1.37	1.18
Net Realized/Unrealized Gains (Losses)	<u>(0.81)</u>	<u>(0.24)</u>	<u>(0.78)</u>	<u>(0.24)</u>
Results of Operations <sup>(1)</sup>	(0.08)	0.32	0.59	0.94
Dividends Paid <sup>(2)</sup>	(0.41)	(0.26)	(1.75)	(1.55)
Share-Based LTIP Awards	<u>—</u>	<u>0.06</u>	<u>—</u>	<u>0.13</u>
Ending Shareholders' Equity Per Share (6/30/11, 6/30/10, 6/30/11 and 6/30/10, respectively) <sup>(3)</sup>	<u>\$ 23.31</u>	<u>\$ 24.56</u>	<u>\$ 23.31</u>	<u>\$ 24.56</u>
Shares Outstanding, end of period	16,507,381	11,985,670	16,507,381	11,985,670

(1) Calculated based on average common shares outstanding and can differ from the calculation for EPS (See Note 8).

(2) Dividends paid include dividends paid on common shares and LTIP units. For the three month periods ending June 30, 2011 and 2010, dividends totaling \$0.40 and \$0.25, respectively, per common share and LTIP unit outstanding were declared and paid. For the six month periods ending June 30, 2011 and 2010, two dividends totaling \$1.71 and \$1.50, respectively, per common share and LTIP unit outstanding were declared and paid. Dividends paid of \$0.41 and \$0.26 per share for the three month periods ending June 30, 2011 and 2010, respectively, and dividends paid of \$1.75 and \$1.55 per share for the six month periods ending June 30, 2011 and 2010, respectively, above reflect the impact of dividing the total dividend payment, inclusive of LTIP units, by average common shares outstanding, exclusive of LTIP units.

(3) If all LTIP units previously issued were vested and exchanged for common shares as of June 30, 2011 and 2010, shareholders' equity per share would be \$22.78 and \$23.80, respectively.

#### Total Return:

The Company calculates its total return two ways, one based on its reported net asset value and the other based on its publicly-traded share price. This latter return is considered a market based return, and is only computed for periods following the completion of the Company's October 2010 initial public offering, since the Company's shares were not publicly traded before such time. The following table illustrates the Company's total return for the periods presented based on net asset value:

#### Net Asset Based Total Return for a Shareholder: <sup>(1)</sup>

	<b>Three Month Period Ended June 30, 2011</b>	<b>Three Month Period Ended June 30, 2010</b>	<b>Six Month Period Ended June 30, 2011</b>	<b>Six Month Period Ended June 30, 2010</b>
Total Return before Incentive Fee	(0.37)%	1.50%	2.42%	4.31%
Incentive Fee	<u>0.00%</u>	<u>0.00%</u>	<u>(0.16)%</u>	<u>(0.17)%</u>
Total Return after Incentive Fee	<u>(0.37)%</u>	<u>1.50%</u>	<u>2.26%</u>	<u>4.14%</u>

(1) Total return is calculated for all shareholders' equity accounts taken as a whole for each period. Total Return is calculated assuming reinvestment of all distributions at shareholders' equity per share during the period.

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**Supplemental Information—Net Asset Based Total Return for a Shareholder assuming conversion of all LTIP units: <sup>(1)</sup>**

	<b>Three Month Period Ended June 30, 2011</b>	<b>Six Month Period Ended June 30, 2011</b>
Total Return before Incentive Fee	(2.64)%	0.09%
Incentive Fee	0.00%	(0.16)%
<b>Total Return after Incentive Fee</b>	<b>(2.64)%</b>	<b>(0.07)%</b>

(1) Total return is calculated assuming all LTIP units had been converted into common shares at June 30, 2011. Total return represents all shareholders' equity accounts outstanding for the entire period. LTIP units outstanding at June 30, 2011 totaled 385,000 and represent 2.28% of total shares and LTIP units outstanding as of that date.

**Market Based Total Return for a Shareholder:**

For the three and six month periods ended June 30, 2011, the Company's market based total return was (7.01)% and 1.86%, respectively, and assumes the reinvestment of dividends.

**Net Investment Income Ratio to Average Shareholders' Equity: <sup>(1)</sup>**

	<b>Three Month Period Ended June 30, 2011</b>	<b>Three Month Period Ended June 30, 2010</b>	<b>Six Month Period Ended June 30, 2011</b>	<b>Six Month Period Ended June 30, 2010</b>
Net Investment Income <sup>(2)</sup>	12.43%	9.08%	11.73%	9.70%

(1) Average shareholders' equity is calculated using month end values.

(2) Includes all items of income and expenses on an annualized basis except for incentive fee expense which is included on a non-annualized basis.

**Expense Ratios to Average Shareholders' Equity: <sup>(1)(2)</sup>**

	<b>Three Month Period Ended June 30, 2011</b>	<b>Three Month Period Ended June 30, 2010</b>	<b>Six Month Period Ended June 30, 2011</b>	<b>Six Month Period Ended June 30, 2010</b>
Operating expenses before incentive fee and interest expense	(3.06)%	(4.42)%	(3.10)%	(4.33)%
Incentive fee	0.00%	0.00%	(0.15)%	(0.16)%
Interest expense	(1.65)%	(1.19)%	(1.61)%	(1.13)%
<b>Total Expenses</b>	<b>(4.71)%</b>	<b>(5.61)%</b>	<b>(4.86)%</b>	<b>(5.62)%</b>

(1) Average shareholders' equity is calculated using month end values.

(2) Ratios are annualized except for the incentive fee which is not annualized.

**12. Subsequent Events**

On August 2, 2011, the Company's Board of Directors approved a dividend in the amount of \$0.40 per share payable on September 15, 2011 to shareholders of record as of September 1, 2011. On August 4, 2011, the Company's Board of Directors approved the adoption of a \$10.0 million share repurchase program.

**Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations**

*In this quarterly report on Form 10-Q, except where the context suggests otherwise, “EFC,” “we,” “us” and “our” refer to Ellington Financial LLC and its subsidiaries, our “Manager” refers to Ellington Financial Management LLC, our external manager, and “Ellington” refers to Ellington Management Group, L.L.C. and its affiliated investment advisory firms.*

**CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS**

When used in this quarterly report on Form 10-Q, in future filings with the Securities and Exchange Commission (“SEC”) or in press releases or other written or oral communications, statements which are not historical in nature, including those containing words such as “believe,” “expect,” “anticipate,” “estimate,” “plan,” “continue,” “intend,” “should,” “may” or similar expressions, are intended to identify “forward-looking statements” within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, and, as such, may involve known and unknown risks, uncertainties and assumptions.

Forward-looking statements are based on our beliefs, assumptions and expectations of our future performance, taking into account all information currently available to us. These beliefs, assumptions and expectations are subject to risks and uncertainties and can change as a result of many possible events or factors, not all of which are known to us. If a change occurs, our business, financial condition, liquidity and results of operations may vary materially from those expressed in our forward-looking statements. The following factors are examples of those that could cause actual results to vary from our forward-looking statements: changes in interest rates and the market value of our securities; the impact of the downgrade of the long-term credit ratings of the U.S., Fannie Mae and Freddie Mac; market volatility; changes in the prepayment rates on the mortgage loans underlying our agency securities; our ability to borrow to finance our assets; changes in government regulations affecting our business; our ability to maintain our exemption from registration under the Investment Company Act of 1940, as amended (the “Investment Company Act”); and risks associated with investing in real estate assets, including changes in business conditions and the general economy. These and other risks, uncertainties and factors, including the risk factors described under Item 1A of our Annual Report on Form 10-K for the fiscal year ended December 31, 2010 as filed with the SEC, could cause our actual results to differ materially from those projected in any forward-looking statements we make. All forward-looking statements speak only as of the date on which they are made. New risks and uncertainties arise over time and it is not possible to predict those events or how they may affect us. Except as required by law, we are not obligated to, and do not intend to, update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

**Executive Summary**

We are a specialty finance company that acquires and manages mortgage-related assets, including residential mortgage-backed securities, or “RMBS,” backed by prime jumbo, Alt-A and subprime residential mortgage loans, RMBS for which the principal and interest payments are guaranteed by a U.S. government agency or a U.S. government-sponsored entity, mortgage-related derivatives, commercial mortgage-backed securities, or “CMBS,” commercial mortgage loans and other commercial real estate debt, as well as corporate debt and equity securities and derivatives. We also may opportunistically acquire and manage other types of mortgage-related and financial asset classes, such as residential whole mortgage loans, asset-backed securities, or “ABS,” backed by consumer and commercial assets and non-mortgage-related derivatives. We are externally managed and advised by our Manager, an affiliate of Ellington. Ellington is also a registered investment advisor with a 16-year history of investing in a broad spectrum of mortgage-backed securities, or “MBS” and related derivatives.

We completed our initial capitalization in August 2007, pursuant to which we sold 12,500,000 common shares for aggregate net proceeds of approximately \$239.7 million.

On October 14, 2010, we closed our initial public offering of common shares pursuant to which we sold 4,500,000 common shares to the public at a public offering price of \$22.50 per share. We raised approximately \$101.3 million in gross proceeds, resulting in net proceeds to us of approximately \$94.7 million, after deducting underwriting discounts and other offering costs.

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Our primary objective is to generate attractive, risk-adjusted total returns for our shareholders. We seek to attain this objective by utilizing an opportunistic strategy to make investments, without restriction as to ratings, structure or position in the capital structure, that we believe compensate us appropriately for the risks associated with them rather than targeting a specific yield. Our evaluation of the potential risk-adjusted return of any potential investment typically involves weighing the potential returns of such investment under a variety of economic scenarios against the perceived likelihood of the various scenarios. Potential investments subject to greater risk (such as those with lower credit ratings and/or those with a lower position in the capital structure) will generally require a higher potential return to be attractive in comparison to investment alternatives with lower potential return and a lower degree of risk. However, at any particular point in time, depending on how we perceive the market's pricing of risk both generally and across sectors, we may favor higher-risk assets or we may favor lower-risk assets, or a combination of the two in the interests of portfolio diversification or other considerations.

As of June 30, 2011, we believe that our non-Agency RMBS strategies represented the primary drivers of our risk and return, and we expect that they will continue to do so over the near term. We additionally expect CMBS and commercial mortgage loans to represent a growing component of our strategy. We continue to maintain a highly leveraged portfolio of Agency RMBS to take advantage of opportunities in that market sector and to maintain our exclusion from regulation as an investment company under the Investment Company Act. As discussed below in "—Liquidity and Valuation," financing for non-Agency RMBS has become more readily available, but currently we employ only low levels of leverage with respect to the non-Agency RMBS in our portfolio. We currently finance our purchases of Agency RMBS and non-Agency RMBS using reverse repurchase agreements, or "reverse repos," which we account for as collateralized borrowings. Unless we acquire very substantial amounts of whole mortgage loans, we expect that we will always maintain some core amount of Agency RMBS to maintain our exclusion from regulation as an investment company under the Investment Company Act.

Our strategy is intended to take advantage of opportunities in the current credit environment. We intend to adjust our strategy to changing market conditions by shifting our asset allocations across various asset classes as credit and liquidity trends evolve over time. We believe that this strategy, combined with Ellington's experience, will help us generate more consistent returns on our capital throughout changing market cycles.

As of June 30, 2011, our outstanding borrowings under reverse repurchase agreements were \$801.9 million and our debt-to-equity ratio was 2.08 to 1. Our debt-to-equity ratio does not account for liabilities other than debt financings. Of our total borrowings outstanding, approximately 75.3% or \$604.0 million relates to our Agency holdings with the remaining related to our non-Agency holdings.

We opportunistically hedge our credit risk and interest rate risk; however, at any point in time we may choose not to hedge all or a portion of these risks, and we will generally not hedge those risks that we believe are appropriate for us to take at such time, or that we believe would be impractical or prohibitively expensive to hedge.

We believe that we have been organized and have operated so that we have qualified, and will continue to qualify, to be treated for U.S. federal income tax purposes as a partnership and not as an association or a publicly traded partnership taxable as a corporation.

## **Trends and Recent Market Developments**

### ***Market Disruption in RMBS***

We commenced operations in August 2007 in the midst of challenging market conditions which affected both (i) the credit performance and valuations of assets we targeted at that time (especially non-Agency RMBS) and (ii) the cost and availability of financing for those assets (primarily, reverse repos and securitizations). After reviewing the market conditions that existed at that time, we decided to deploy a relatively modest amount of our capital in late 2007 and also began to adapt the strategy for the portfolio in light of market conditions.

In early 2008, as credit availability diminished and valuations of non-Agency RMBS came under significant pressure, we began slowly purchasing primarily senior tranches of non-Agency RMBS while simultaneously aggressively hedging the credit risk in these securities through a combination of single name credit default swaps referencing primarily mezzanine tranches of non-Agency RMBS, positions with respect to certain vintages and tranches of the ABX indices and selected other hedges. The market for non-Agency RMBS was impacted by several significant events during the first quarter of 2008, including the forced liquidation of

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several multi-billion dollar RMBS portfolios by heavily leveraged investors and the failure of Bear Stearns & Co. in March 2008. These market events also severely restricted the financing available for non-Agency RMBS, as many lenders curtailed their lending against these types of securities.

Poor credit performance of non-Agency RMBS and limited availability of financing for such assets continued throughout 2008 and into 2009, influenced by many market events including the bankruptcy of Lehman Brothers in September 2008. Meanwhile, home price declines and increases in loss severities upon default continued through the second quarter of 2009. Since the second quarter of 2009, market conditions have begun to modestly improve as witnessed by the increased availability of financing for non-Agency assets and the improved performance across several sectors of the residential mortgage-backed securities markets.

### ***Recent Developments***

Starting with the announcement of the Public-Private Investment Program, or “PPIP,” sponsored by the federal government, towards the end of the first quarter of 2009, and along with the general improvements in most global financial markets since that time, liquidity and prices have improved in the RMBS markets, presumably reflecting, among other things, market participants’ pricing better economic scenarios into, and demanding lower target returns on, their investments.

Meanwhile, there have also been modest improvements in fundamental factors affecting RMBS since the second half of 2009, including slowing or modest reversals in many regions of both declining home prices and increasing loan loss severities upon default. However, these improvements seem to have been somewhat undercut by the large overhang of shadow inventory in the housing market. This inventory overhang is the result of the substantial number of homeowners who remain delinquent on their outstanding mortgages and foreclosures that are stalled in court. There also exist many homes that were built prior to the housing crisis, especially in 2006 and 2007, in locations that are no longer considered desirable. See “Credit Quality” below.

### ***Non-Agency Securitization Market***

In April 2010, a \$238 million non-Agency RMBS securitization was completed, marking the first such securitization (other than re-securitizations) since August 2008. The securitization was backed by high quality prime jumbo mortgage loans that had been originated by CitiMortgage Inc. in 2009 and 2010. While the completion of this transaction represents a milestone for the potential return to health of the non-Agency residential securitization market, the prospects for the securitization market are still extremely uncertain, as the respective roles and requirements of sponsors, investors, underwriters, regulators, policy-makers, and rating agencies all continue to be re-evaluated. A second non-Agency securitization was completed on February 18, 2011 in the amount of \$290 million. Like the April 2010 securitization, this securitization is backed by prime jumbo mortgage loans and marks another good sign for the potential return of the non-Agency mortgage securitization market. We are optimistic about the eventual return of the securitization market and believe that its return will create additional investment opportunities for us.

### ***Government Sponsored Enterprise (“GSE”) Update***

During 2008, there were increased market concerns about Fannie Mae’s and Freddie Mac’s ability to withstand future credit losses associated with securities held in their investment portfolios, and on which they provide guarantees, without the direct support of the Federal Government. In September 2008 Fannie Mae and Freddie Mac were placed into the conservatorship of the Federal Housing Finance Agency, or “FHFA,” their federal regulator, pursuant to its powers under The Federal Housing Finance Regulatory Reform Act of 2008, a part of the Housing and Economic Recovery Act of 2008. As the conservator of Fannie Mae and Freddie Mac, the FHFA controls and directs their operations and may (i) take over their assets and operate them with all the powers of their shareholders, directors, and officers and conduct all their business; (ii) collect all obligations and money due to them; (iii) perform all of their functions which are consistent with the conservator’s appointment; (iv) preserve and conserve their assets and property and (v) contract for assistance in fulfilling any function, activity, action or duty of the conservator. In addition to the FHFA becoming the conservator of Fannie Mae and Freddie Mac, (i) the U.S. Treasury and FHFA entered into preferred stock purchase agreements with Fannie Mae and Freddie Mac pursuant to which the U.S. Treasury ensures that each of Fannie Mae and Freddie Mac maintains a positive net worth; (ii) the U.S. Treasury established a secured lending credit facility for Fannie Mae, Freddie Mac, and the Federal Home Loan Banks to serve as a liquidity backstop; and (iii) the U.S. Treasury initiated a program to purchase RMBS issued by Fannie Mae and Freddie Mac.

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In December 2009, the U.S. Treasury ended the secured lending credit facility and the RMBS purchase program, but contemporaneously lifted the cap on assistance to be provided to Fannie Mae and Freddie Mac pursuant to the preferred stock purchase program, thereby effectively providing nearly unlimited support for Fannie Mae and Freddie Mac through 2012.

In August 2010, the Obama administration hosted a major conference on the future of housing finance, which included a discussion regarding the future of Fannie Mae and Freddie Mac, with the intended goal of developing a comprehensive housing finance reform proposal for delivery to Congress by January 2011. Additionally, during the conference, the Obama administration stated that it was committed to ensuring these entities have adequate resources to meet their financial commitments. On February 11, 2011 the U.S. Treasury released a White Paper entitled “Reforming America’s Housing Finance Market.” This is the first step in what is likely to be a major change in the future role of the GSEs in the housing finance market. Major tenets of the plan include: (1) private markets, subject to strong oversight and standards for consumer and investor protection, will become the primary source of mortgage credit and bear the burden for losses, and (2) banks and other financial institutions will be required to hold more capital to withstand future recessions or significant declines in home prices, and will be required to adhere to more conservative underwriting standards that require homeowners to hold more equity in their homes. While the exact fate and role of Fannie Mae and Freddie Mac remain uncertain, each has been mandated to reduce its MBS portfolios by at least 10% per annum. Each began divesting its security holdings in 2009 and together they have liquidated over \$286 billion from the beginning of 2010 through the first quarter of 2011, adding a meaningful amount of supply to the market.

While lawmakers agree that additional reform is needed, they are divided on just how to proceed. Several bills have been introduced by members of Congress with the intention of moving the reform effort forward. Proposals under the legislation introduced range from raising guarantee fees the GSEs will charge for mortgage-backed securities they insure, to formalizing the reduction in size of the GSEs’ portfolios, to reducing the compensation of Fannie Mae and Freddie Mac’s senior executives to bring their compensation in line with the wages of federal banking regulators, among others. More recently, proposals have emerged that would combine Fannie Mae and Freddie Mac or create similar entities, which would leave the government (or GSEs) with a role in housing finance as significant as its pre-crisis role. With speculation abounding over what forms the recommendations may ultimately take, mortgage finance analysts are predicting resolution will take place over a very long timeline. Few expect Congress to enact any legislation on U.S. housing reform until at least 2013. We continue to monitor the evolving status of these discussions and proposals, but the ultimate impact of any resulting legislation or policies is uncertain and may create opportunities for us or have adverse consequences for us and our industry.

### *Regulatory Reform*

On July 21, 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act, or the “Dodd-Frank Act,” was passed by Congress. This legislation aims to restore responsibility and accountability to the financial system through new supervisory and advisory bodies, including the new Consumer Financial Protection Bureau. The Dodd-Frank Act tasks many agencies with issuing a variety of new regulations, including rules related to mortgage origination and servicing, securitization and derivatives. It remains unclear how this legislation may impact the borrowing environment, investing environment for Agency RMBS and interest rate swaps and other derivatives as regulators are still working to determine how the Dodd-Frank Act will be implemented. Progress has been slow on many aspects of the legislation and it may be some time before these regulations cause significant changes in the securities and derivatives markets.

The derivatives market, and the credit derivatives market in particular, has been a significant focus for legislators and market regulators in considering additional regulations. Title VII of the Dodd-Frank Act, entitled the Wall Street Transparency and Accountability Act of 2010, or “Title VII,” provides for new federal regulations of the swaps market and sweeping changes to its structure with an effective date for certain of its provisions beginning on July 16, 2011. Proposed changes contemplated in Title VII include mandatory central clearing, exchange trading margin requirements and real-time reporting of certain swap transactions. In addition, certain market participants may incur registration, disclosure and reporting requirements as swap dealers, major swap participant, commodity trading advisors or commodity pool operators. However, the provisions of Title VII that will have the most fundamental impact on the swaps activity have not been finalized. We are not able at this time to predict the impact any final regulations might have on our business. Proposed regulations could have positive, adverse or mixed consequences for our



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business. For example, the proposed measure that would require that certain derivatives be traded on regulated exchanges or through clearinghouses could benefit us by substantially reducing our derivatives counterparty-related risks, but conversely, could also reduce some of the market inefficiencies that we believe create opportunities for us. Such changes might also impact the amount of collateral that we are required to post against our derivatives positions, which could affect our liquidity and the amount of capital that we have available for our non-derivative investment activities. Further, as the swap markets move towards greater standardization, it is unclear what costs firms might incur in entering into swaps to hedge specific risks that may not be sufficiently addressed in standardized swaps. Such changes may lead us to re-evaluate our derivatives strategy in particular and our investment strategy overall. No assurance can be given that any final regulations will not impact our business in a material and adverse way.

### *Foreclosures*

During the third quarter of 2010, several large banks suspended foreclosures and foreclosure sales in a number of states, and some public officials have called for nationwide foreclosure moratoria. Most banks have since resumed foreclosure proceedings. However, the attorneys general from all 50 states have launched a joint investigation into foreclosure practices and mortgage servicers' involvement in those practices. The suspensions and investigations relate to two concerns. The first concern relates to the allegedly pervasive signing, by mortgage servicers and their agents, of foreclosure-related affidavits without actually having properly validated the information in the affidavits ("robo-signing"). The second concern relates to the standard of proof required for a mortgage servicer to demonstrate that it has proper standing to foreclose on behalf of a mortgage note holder. Delinquent borrowers have begun filing lawsuits requesting, and certain judges have begun requiring, mortgage servicers to produce the actual mortgage notes to prove their right to foreclose. Because many mortgages have been transferred and assigned multiple times through the origination, warehouse and securitization processes, and by means of varying assignment procedures, mortgage servicers are frequently having difficulty furnishing complete documentation. This leads to stalled or suspended foreclosure proceedings, and ultimately additional foreclosure-related costs. Foreclosure-related suspensions and investigations also slow the pace of liquidations, and thereby likely increase loan loss severities in the longer term as a result of property deterioration, amplified legal and other costs, and other factors. Servicers have maintained that most of these problems are process-oriented and can be largely fixed in the near term; however, certain factors delaying foreclosure, such as borrower lawsuits and judicial scrutiny, are outside of servicers' control and have slowed and will likely continue to slow foreclosure processing in both judicial and non-judicial states. One of the biggest risks overhanging the RMBS market has been uncertainty around the timing and ability of servicers to remove delinquent borrowers from their homes and ultimately liquidate properties to pass cash through to securitization trusts. This risk is very difficult to quantify and has been magnified by some court cases that have been in the news recently.

A settlement draft related to the ongoing investigation was released in mid-March 2011. In April 2011, fourteen of the largest mortgage servicers involved in the investigations entered into consent decrees with the Office of the Comptroller of the Currency, the Department of Justice, the Federal Reserve, the Office of Thrift Supervision and the Federal Deposit Insurance Corporation. The consent decrees implement some of the improvements proposed in the draft settlement agreement including ending dual-tracking, which occurs when servicers continue to pursue foreclosure during the loan modification process, and establishing a single point of contact for borrowers during the foreclosure process. The servicers also agreed to review loans that went into foreclosure in 2009 and 2010, improve their foreclosure, loan modification and refinancing procedures, hire additional staff, upgrade information management systems and provide better oversight over third party service providers such as attorneys and vendors. In May 2011, five of the servicers offered to settle the state and federal investigations for \$5 billion. The settlement was not accepted. Recent unofficial reports have suggested that the states are seeking settlement payments in the range of \$20 to \$25 billion but a settlement agreement has not been reached and negotiations continue.

During the first quarter of 2011, a particular bank foreclosure case relating to improper documentation was widely publicized. The State Supreme Court of Massachusetts upheld a lower court decision invalidating two foreclosures by U.S. Bancorp and Wells Fargo in Massachusetts. The lower court had ruled that since the lender failed to bring the assignment of the mortgage up to date until after the foreclosure sale, the foreclosures were invalid, and the Massachusetts Supreme Court agreed. While the Massachusetts Supreme Court did confirm that the purchaser of a mortgage note has an equitable right to obtain an assignment of the mortgage, at the same time it ruled that—in contrast to the law in most jurisdictions—the transfer of the mortgage note does not automatically transfer the mortgage itself. This ruling, along with any other similar rulings that may be issued in other jurisdictions, will create additional obstacles in the foreclosure process and thereby—at the very least—lengthen what is generally already an extremely

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protracted foreclosure process. Of additional note, the Massachusetts court did not address general questions of good title for bona fide third-party purchasers of improperly foreclosed properties. Future rulings in this area could have significant effects on the real estate and financial markets in general and on RMBS in particular.

### *Labor Market*

On August 5, 2011, the U.S. Department of Labor reported that, as of July 2011, the U.S. unemployment rate was 9.1%. While it is difficult to quantify the relationship between the unemployment rate and the housing and mortgage markets, we believe that continued unemployment at such levels could contribute to further increases in mortgage delinquencies and decreases in home prices.

### *Prepayment Rates*

Mortgage prepayment rates are sensitive to changes in interest rates, conditions in financial markets, lender competition and other factors, none of which can be predicted with any certainty. In general, when interest rates rise, it is relatively less attractive for borrowers to refinance their mortgage loans and, as a result, prepayment rates tend to decrease. Conversely, when interest rates fall, prepayment rates tend to increase. Prepayment rates can affect our RMBS in a number of ways. Faster-than-expected prepayment rates will generally adversely affect RMBS valued at a premium to par value, because the valuation premium will amortize faster than expected, and the above-market coupon that such premium securities carry will be earned for a shorter period of time. Conversely, slower-than-expected prepayment speeds will generally benefit RMBS valued at a premium, because the above-market coupon that such premium securities carry will be earned for a longer period of time. Similarly, faster-than-expected prepayment rates generally benefit RMBS valued at a discount to par value. However, to the extent that faster prepayment rates are due to lower interest rates, the principal payments received from prepayments will tend to be reinvested in lower-yielding assets which may reduce our income in the long run.

### *Credit Quality*

The deterioration of the U.S. housing market as well as the economic downturn that began in 2007 have caused U.S. residential mortgage delinquency rates to remain at high levels for various types of mortgage loans, including subprime mortgage loans and option ARMs. For the month of July 2011, delinquency rates on subprime mortgage loans and option ARMs averaged 38.8% and 43.3%, respectively, compared to 40.5% and 43.5% for the month of March 2011. In May 2011, the composite S&P/Case-Shiller 20-city index, a broad measure of U.S. home prices increased 1.02% from the prior month and was 4.51% lower than in May 2010. Loss severities upon default increased steadily through the first half of 2009 as a result of, among other things, additional servicing costs, delays in loan foreclosure, continuing home price declines and lack of incentive for mortgage servicers to minimize costs. The second half of 2009 and all of 2010 exhibited some stabilization or improvement of these measures of credit quality. More recently, however, the increasing supply of unsold homes as a result of foreclosure delays has put renewed downward pressure on home pricing. If this trend continues, we would expect to see further increased delinquency and loss rates on RMBS, especially in the subprime and option ARM sectors.

### *Liquidity and Valuations*

Since 2007, as a result of the overall conditions in the credit markets, including reductions in value of various types of RMBS and other factors, available leverage on RMBS assets has decreased significantly, which contributed to the significant rise in market yields on these types of assets, and continues to negatively affect the liquidity of RMBS. Since 2009, as the credit markets have improved, overall liquidity and pricing of these assets has improved as well, but by historical standards liquidity and available leverage are still relatively low.

Over the past year, many investment banks have resumed making term financing available for non-Agency RMBS. The return of financing availability and the stabilization of borrowing costs have somewhat improved liquidity in the market for these securities.

Since the onset of the financial crisis, the deterioration in credit quality of non-Agency RMBS, in conjunction with the reduced liquidity in the overall RMBS market, has led to greater price volatility in non-Agency RMBS, making it more difficult to accurately value these assets. However, conditions are much better today than in early 2009, as improved liquidity and increased demand for securities is evident in firmer asset pricing across most RMBS sectors.

*Sales of MBS held by the U.S. Treasury, the Federal Reserve and Other Sellers*

In March 2011, in view of the general improvement in the U.S. economy, the U.S. Treasury Department announced plans to begin selling its \$142 billion portfolio of mortgage-backed securities purchased during the financial crisis. The U.S. Treasury's investments are primarily 30-year, fixed-rate mortgage securities guaranteed by either Fannie Mae or Freddie Mac that were purchased in late 2008 and 2009. The U.S. Treasury is aiming to sell off about \$10 billion each month, with additional reductions in its portfolio coming from principal paydowns (which have been averaging \$3 - \$5 billion per month). We do not expect that these sales will have a material impact on our business. The Federal Reserve also holds a large portfolio of Agency guaranteed mortgage-backed securities. It is unknown when the Federal Reserve will begin selling its holdings of Agency RMBS.

The Federal Reserve also holds a portfolio of non-Agency mortgage-backed securities that it acquired from American International Group ("AIG") as part of the government bailout of AIG in 2008. The mortgage-backed securities are part of an entity called Maiden Lane II, capitalized by the Federal Reserve with approximately \$20 billion and one of several such entities created during the crisis to hold such assets. The Federal Reserve has been selling these assets in pre-announced auctions over time as market conditions warrant. To date, sales generating proceeds to the Federal Reserve of approximately \$4.7 billion have been completed. Reportedly, these sales represented an average dollar price of \$47, indicating the related face value sold was approximately \$10 billion. Initially, the Federal Reserve held weekly (or occasionally more frequent) auctions to sell securities, but given the adverse impact on the overall non-Agency RMBS markets that occurred following the sales by the Federal Reserve as well as other larger sellers in the market, the Federal Reserve reduced the frequency of the auctions to monthly. On June 30, 2011, the Federal Reserve hosted a conference call in which it announced that it had no immediate plans to continue selling the securities that are part of the Maiden Lane II portfolio. Because the Federal Reserve is not a forced seller and can sell these securities as it sees fit, it remains to be seen how and when the Federal Reserve will liquidate these remaining mortgage holdings from its portfolio.

Dexia, a Franco-Belgian bank, recently announced its plans to speed up the liquidation of its approximately \$8.8 billion portfolio of subprime and Alt-A RMBS. The sale of this portfolio, while smaller than the Maiden Lane II portfolio, could put further technical pressure on subprime RMBS and lead to more liquidations by European financial firms if the European Central Bank begins to pressure those institutions to dispose of U.S. RMBS.

These and other sales of non-Agency RMBS have had a significant impact on the overall non-Agency RMBS markets in the second quarter of 2011. In many non-Agency RMBS sectors securities prices have declined 10 to 30% since March 31, 2011. For companies that hold such securities on a leveraged, unhedged basis, this could lead to significant book value declines and financial weakness, and potentially more selling. On the other hand, the price declines may also offer an attractive buying opportunity for investors with buying power seeking higher yields within this asset class.

*Non-Agency Market: Notable Events*

On June 29, 2011, Bank of America announced an agreement to pay \$8.5 billion to settle claims on certain mortgage-backed securities sponsored by Countrywide Financial, which Bank of America had purchased in 2008. The settlement agreement follows an ongoing dispute between the bank and a group of 22 investors, including the Federal Reserve Bank of New York, who have demanded compensation for faulty loan underwriting and improper loan servicing. The agreement is subject to investor and court approval and the details of the settlement are still subject to change. The \$8.5 billion would cover 530 trusts with a current balance of \$177 billion, representing approximately 5% of the current balance outstanding. The allocation of the settlement amount would be determined by an algorithm and would be managed by Bank of New York Mellon Corp. Bank of America also agreed to improve its mortgage servicing practices and to cure certain mortgage loan documentation problems. On July 5, 2011, a group of investors challenged the proposed settlement in a filing with the New York State Supreme Court. Given the uncertainty of the amount and structure of any final settlement, it is unknown at this time what the impact on our portfolio will be. This pending settlement, along with the postponement of the Federal Reserve's Maiden Lane II sales announced just a day later, had a positive impact on the non-Agency RMBS markets following the end of the second quarter, and security prices have generally recovered somewhat in the wake of these developments.

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### *Agency MBS Market*

In November of 2010, the Federal Reserve announced that it would buy \$600 billion in long-term U.S. Treasury bonds, in an attempt to help maintain low long-term interest rates (“Quantitative Easing 2” or “QE2”). The program ended on June 30, 2011.

Banks and other financial institutions have shown continued demand for Agency RMBS, with the result that valuations in the most liquid Agency RMBS sectors remain strong. Since the second half of 2010, the largest banks have, in aggregate, increased their Agency RMBS holdings by approximately \$84 billion. These same banks had generally reduced their RMBS holdings in the first half of 2010 in anticipation of the implementation of Basel III bank capital rules; however as the timelines for implementation of Basel III bank capital rules have been extended, and as Federal Reserve policy (through QE2 and otherwise) has seemingly favored continued holding of Agency RMBS, the trend has reversed.

### *U.S. Long-Term Credit Rating Downgrade*

On August 5, 2011, Standard and Poor’s (“S&P”), one of three major credit rating agencies, downgraded the long-term sovereign credit rating of the U.S. one notch from AAA to AA+. In its announcement, S&P also noted that its outlook on the U.S. credit rating was “negative.” However, S&P affirmed the short-term credit rating of the U.S. of A-1+, its highest rating in that category. S&P took these actions in light of its conclusion that the fiscal consolidation plan that Congress and the Obama Administration recently agreed to fell short of what would be necessary to stabilize the government’s medium-term debt dynamics. On August 08, 2011, S&P also downgraded the long-term credit ratings of Fannie Mae and Freddie Mac, from AAA to AA+, given their direct reliance on the U.S. government. Because of the unprecedented nature of these actions, market participants are evaluating the potential impact on the financial markets and their businesses. At this time it is unclear what the ultimate impact will be.

### **Critical Accounting Policies**

Our unaudited interim consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States for investment companies. In June 2007, the AICPA issued Amendments to ASC 946-10 (“ASC 946”), *Clarification of the Scope of the Audit and Accounting Guide Investment Companies and Accounting by Parent Companies and Equity Method Investors for Investments in Investment Companies*. ASC 946 was effective for fiscal years beginning on or after December 15, 2007 with earlier application encouraged. After we adopted ASC 946, the FASB issued guidance which effectively delayed indefinitely the effective date of ASC 946. However, this additional guidance explicitly permitted entities that early adopted ASC 946 before December 31, 2007 to continue to apply the provisions of ASC 946. We have elected to continue to apply the provisions of ASC 946. ASC 946 provides guidance for determining whether an entity is within the scope of the AICPA Audit and Accounting Guide for Investment Companies, or the “Guide.” The Guide provides guidance for determining whether the specialized industry accounting principles of the Guide should be retained in the financial statements of a parent company, of an investment company or of an equity method investor in an investment company. Effective August 17, 2007, we adopted ASC 946 and follow its provisions which, among other things, requires that investments be reported at fair value in the financial statements. Although we conduct our operations so that we are not required to register as an investment company under the Investment Company Act, for financial reporting purposes, we have elected to continue to apply the provisions of ASC 946.

Certain of our critical accounting policies require management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Interim results are not necessarily indicative of the results that may be expected for the entire fiscal year. We believe that all of the decisions and assessments upon which our consolidated financial statements are based were reasonable at the time made based upon information available to us at that time. We rely on our Manager and Ellington’s experience and analysis of historical and current market data in order to arrive at what we believe to be reasonable estimates. See Note 2 to the consolidated financial statements for a complete discussion of our significant accounting policies. We have identified our most critical accounting policies to be the following:

**Valuation:** We adopted a three-level valuation hierarchy for disclosure of fair value measurements on January 1, 2008. The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. Financial instruments include securities, derivatives and repurchase agreements. A financial instrument’s categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement. The inputs or methodology used for valuing securities are not necessarily an indication of the risk associated with investing in these securities.

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The following is a description of the valuation methodologies used for our financial instruments:

Level 1 valuation methodologies include the observation of quoted prices (unadjusted) for identical assets or liabilities in active markets, often received from widely recognized data providers.

Level 2 valuation methodologies include the observation of (i) quoted prices for similar assets or liabilities in active markets, (ii) inputs other than quoted prices that are observable for the asset or liability (for example, interest rates and yield curves) in active markets and (iii) quoted prices for identical or similar assets or liabilities in markets that are not active.

Level 3 valuation methodologies include (i) the use of proprietary models that require the use of a significant amount of judgment and the application of various assumptions including, but not limited to, prepayment assumptions and default rate assumptions, and (ii) the solicitation of valuations from third-parties (typically, broker-dealers). Third-party valuation providers often utilize proprietary models that are highly subjective and also require the use of a significant amount of judgment and the application of various assumptions including, but not limited to, prepayment assumptions and default rate assumptions. Our Manager utilizes such information to assign a good faith valuation (the estimated price that would be received to sell an asset or paid to transfer a liability in an orderly transaction at the valuation date) to such financial instruments. Our Manager has been able to obtain third-party valuations on the vast majority of our assets and expects to continue to solicit third-party valuations on substantially all of our assets in the future to the extent practical. Our Manager uses its judgment, based on its own models, the assessments of its portfolio managers, and third-party valuations it obtains, to determine and assign fair values to our Level 3 assets. We believe that third-party valuations play an important role in ensuring that our Manager's valuation determinations are fair and reasonable. Our Manager's valuation process is subject to the oversight of the Manager's investment and risk management committee as well as the oversight of the independent members of our Board of Directors. Because of the inherent uncertainty of valuation, these estimated values may differ significantly from the values that would have been used had a ready market for the financial instruments existed, and the differences could be material to the consolidated financial statements.

See the notes to our consolidated financial statements for more information on valuation.

***Securities Transactions and Investment Income:*** Securities transactions are recorded on trade date and commercial mortgage loan transactions are generally recorded on settlement date. Realized and unrealized gains and losses are calculated based on identified cost. Interest income, which includes accretion of discounts and amortization of premiums on mortgage-backed securities, including investments in mortgage loans, or "MBS," and U.S. Treasury holdings, is recognized over the life of the investment using the effective interest method. For purposes of determining the effective interest rate, management estimates the future expected cash flows of its investment holdings based on assumptions including, but not limited to, prepayment and default rate assumptions. These assumptions are reevaluated not less than quarterly and require the use of a significant amount of judgment. Principal write-offs are generally treated as realized losses.

### **Recent Accounting Pronouncements**

Refer to the notes to our consolidated financial statements for a description of relevant recent accounting pronouncements.

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### Financial Condition

The following table summarizes our investment portfolio as of June 30, 2011 and December 31, 2010. For more detailed information about the investments in our portfolio, please refer to the Consolidated Condensed Schedules of Investments as of these dates contained in our consolidated financial statements.

	June 30, 2011					December 31, 2010				
	Current Principal	Fair Value	Average Price <sup>(1)</sup>	Cost	Average Cost <sup>(1)</sup>	Current Principal	Fair Value	Average Price <sup>(1)</sup>	Cost	Average Cost <sup>(1)</sup>
Non-Agency RMBS <sup>(2)</sup>	\$ 522,250,752	\$ 356,915,431	\$ 68.34	\$ 362,768,961	\$ 69.46	\$ 477,838,475	\$ 333,058,926	\$ 69.70	\$ 319,230,565	\$ 66.81
Non-Agency CMBS and Commercial Mortgage Loans	20,238,000	15,592,490	77.05	17,144,094	84.71	5,000,000	1,850,000	37.00	1,837,090	36.74
Total Non-Agency MBS and Commercial Mortgage Loans	542,488,752	372,507,921	68.67	379,913,055	70.03	482,838,475	334,908,926	69.36	321,067,655	66.50
Agency RMBS: <sup>(3)</sup>										
Floating	52,835,808	55,893,614	105.79	55,553,517	105.14	76,791,216	81,092,895	105.60	80,166,989	104.40
Fixed	689,612,692	724,312,751	105.03	717,651,119	104.07	746,954,061	769,894,618	103.07	773,976,214	103.62
Total Agency RMBS	742,448,500	780,206,365	105.09	773,204,636	104.14	823,745,277	850,987,513	103.31	854,143,203	103.69
Total Non-Agency and Agency MBS and Commercial Mortgage Loans	\$1,284,937,252	\$1,152,714,286	\$ 89.71	\$1,153,117,691	\$ 89.74	\$1,306,583,752	\$1,185,896,439	\$ 90.76	\$1,175,210,858	\$ 89.95
Agency Interest Only RMBS	n/a	\$ 5,227,032	n/a	\$ 5,377,235	n/a	n/a	\$ —	n/a	\$ —	n/a
Non-Agency Interest Only and Residual RMBS	n/a	\$ 978,632	n/a	\$ 1,256,131	n/a	n/a	\$ 5,780,515	n/a	\$ 3,102,148	n/a
TBAs:										
Long	\$ 44,000,000	\$ 42,937,382	\$ 97.58	\$ 43,395,039	\$ 98.63	\$ 54,650,000	\$ 54,389,606	\$ 99.52	\$ 54,171,305	\$ 99.12
Short	(490,200,000)	(517,968,450)	105.66	(519,948,719)	106.07	(728,500,000)	(749,682,695)	102.91	(750,520,119)	103.02
Net TBAs	\$ (446,200,000)	\$ (475,031,068)	\$ 106.46	\$ (476,553,680)	\$ 106.80	\$ (673,850,000)	\$ (695,293,089)	\$ 103.18	\$ (696,348,814)	\$ 103.34
Other:										
Repurchase Agreements	\$ 22,437,500	\$ 22,437,500	\$ 100.00	\$ 22,437,500	\$ 100.00	\$ 25,683,750	\$ 25,683,750	\$ 100.00	\$ 25,683,750	\$ 100.00
Short Treasury Securities	\$ (22,000,000)	\$ (22,186,956)	\$ 100.85	\$ (22,161,936)	\$ 100.74	\$ (27,000,000)	\$ (25,462,403)	\$ 94.31	\$ (25,261,493)	\$ 93.56
Total Net Investments		\$ 684,139,426		\$ 683,472,941			\$ 496,605,212		\$ 482,386,449	

(1) Represents the dollar amount per \$100 of current principal of the price or cost for the security.

(2) Excludes Interest Only and Residual Securities.

(3) Excludes Interest Only Securities and TBAs.

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The following table summarizes our financial derivatives portfolio as of June 30, 2011 and December 31, 2010. For more detailed information about the investments in our portfolio, please refer to Consolidated Condensed Schedules of Investments as of these dates contained in our consolidated financial statements.

	June 30, 2011		December 31, 2010	
	Notional Value	Fair Value	Notional Value	Fair Value
<b>Long Mortgage Related Derivatives: <sup>(1)</sup></b>				
CDS on RMBS and CMBS Indices	\$ 24,864,649	\$ (4,564,225)	\$ 111,717,136	\$ (14,375,074)
<b>Total Long Mortgage Related Derivatives</b>	<b>24,864,649</b>	<b>(4,564,225)</b>	<b>111,717,136</b>	<b>(14,375,074)</b>
<b>Short Mortgage Related Derivatives: <sup>(2)</sup></b>				
CDS on RMBS and CMBS Indices	(111,459,829)	54,455,714	(205,478,674)	92,786,330
CDS on Individual RMBS and CMBS	(88,747,270)	69,828,936	(127,088,962)	102,851,109
<b>Total Short Mortgage Related Derivatives</b>	<b>(200,207,099)</b>	<b>124,284,650</b>	<b>(332,567,636)</b>	<b>195,637,439</b>
<b>Net Mortgage Related Derivatives</b>	<b>\$(175,342,450)</b>	<b>\$119,720,425</b>	<b>\$(220,850,500)</b>	<b>\$181,262,365</b>
<b>Derivatives on Corporate Securities (Debt and Equity):</b>				
Short CDS on Corporate Bond Indices	\$ (19,700,000)	\$ (220,124)	\$ (19,700,000)	\$ (185,847)
<b>Total Derivatives on Corporate Securities (Debt and Equity)</b>	<b>\$ (19,700,000)</b>	<b>\$ (220,124)</b>	<b>\$ (19,700,000)</b>	<b>\$ (185,847)</b>
<b>Interest Rate Derivatives:</b>				
Long Interest Rate Swaps <sup>(3)</sup>	\$ 5,000,000	\$ 4,916	\$ 15,000,000	\$ (168,520)
Short Interest Rate Swaps <sup>(4)</sup>	(291,460,000)	(4,411,741)	(143,750,000)	287,046
Short Eurodollar Futures <sup>(5)</sup>	(245)	(368,863)	(400)	(890,001)
<b>Total Net Interest Rate Derivatives</b>		<b>\$ (4,775,688)</b>		<b>\$ (771,475)</b>
<b>Total Net Derivatives</b>		<b>\$114,724,613</b>		<b>\$180,305,043</b>

<sup>(1)</sup> Long mortgage-related derivatives represent transactions where the Company sold credit protection to a counterparty.

<sup>(2)</sup> Short mortgage-related derivatives represent transactions where the Company purchased credit protection from a counterparty.

<sup>(3)</sup> For long interest rate swaps, a floating rate is being paid and a fixed rate is being received.

<sup>(4)</sup> For short interest rate swaps, a fixed rate is being paid and a floating rate is being received.

<sup>(5)</sup> Notional value represents number of contracts where each contract represents a notional amount of \$1,000,000.

As of June 30, 2011, our portfolio of non-Agency MBS, including CMBS, increased to \$368.8 million from \$340.7 million at December 31, 2010, and our Agency holdings, excluding TBAs, decreased to \$785.4 million at June 30, 2011 from \$851.0 million at December 31, 2010. Our non-Agency portfolio continues to be primarily comprised of seasoned sub-prime, senior prime and seasoned manufactured housing holdings. We began investing in CMBS in the fourth quarter of 2010 and expect to continue to take advantage of the opportunities we believe are present in this sector of the MBS market. We modestly increased our leverage ratio to 2.08 to 1 as of June 30, 2011 from 1.93 to 1 as of December 31, 2010, given the continued improvement in financing availability and terms. We typically finance our purchases of Agency RMBS, excluding TBAs, but beginning in the fourth quarter of 2010 we have allocated a portion of our cash holdings to the outright purchase of Agency RMBS. As of June 30, 2011 and December 31, 2010, we held \$118.3 million and \$113.5 million, respectively, in Agency whole pools, on a settlement date basis, that were not subject to reverse repurchase agreements. Our Agency RMBS portfolio continues to be comprised primarily of thirty year fixed whole pool pass-through certificates.

As of June 30, 2011, the construction of our derivatives portfolio remained centered around providing interest rate and credit risk protection to our MBS investment portfolio. Our financial derivatives consist of interest rate derivatives, which we use to hedge our interest rate risk, and credit derivatives, which we use primarily to hedge credit risk, but also in some cases as a means to assume credit risk. Currently, our long synthetic credit positions (e.g., credit default swaps where we have sold protection) primarily reference the PrimeX (prime jumbo) indices, while our short synthetic credit positions (e.g., credit default swaps where we have purchased protection) consist primarily of ABSCDS referencing the ABX (subprime) indices associated with RMBS issued in 2006 and 2007 together with single name ABSCDS referencing RMBS issued in 2004 and 2005.

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We actively invest in the TBA market. TBAs are forward-settling Agency RMBS where the mortgage pass-through certificates to be delivered are “To-Be Announced.” Because we generally use TBAs to hedge risks associated with our long Agency RMBS (and to a lesser extent to hedge our long non-Agency RMBS), we generally carry a net short TBA position. At June 30, 2011 and December 31, 2010, our Consolidated Statement of Assets, Liabilities and Shareholders’ Equity include TBA-related assets (TBAs and receivables for TBAs sold short) and TBA-related liabilities (TBAs sold short and payables for TBAs purchased). Open TBA purchases and sales involving the same counterparty, the same underlying deliverable Agency pass-throughs, and the same settlement date are reflected in our consolidated financial statements on a net basis.

As of June 30, 2011, total assets included \$42.9 million of TBAs as well as \$520.0 million of receivable for securities sold relating to unsettled TBA sales. As of December 31, 2010, total assets included \$54.4 million of TBAs as well as \$753.0 million of receivable for securities sold relating to unsettled TBA sales.

As of June 30, 2011, total liabilities included \$518.0 million of TBAs sold short as well as \$43.4 million of payable for securities purchased relating to unsettled TBA purchases. As of December 31, 2010, total liabilities included \$749.7 million of TBAs sold short as well as \$54.7 million of payable for securities purchased relating to unsettled TBA purchases.

Our net short TBAs (both long and short positions) decreased to \$475.1 million as of June 30, 2011 from \$695.3 million as of December 31, 2010. The aggregate value of our other Agency RMBS as of June 30, 2011 and December 31, 2010, was \$785.4 million and \$851.0 million, respectively. As a result, as of June 30, 2011 and December 31, 2010, on a net basis, our net Agency RMBS positions (including TBAs) were long positions of \$310.3 million and \$155.7 million, respectively. The increase in our net Agency RMBS positions is mainly due to the decrease in the proportion of our interest rate hedges consisting of short TBA positions, as opposed to interest rate swaps. As market conditions change, we continuously re-evaluate our overall net Agency RMBS position and our associated hedges.

We generally do not settle our purchases and sales of TBAs. If, for example, we wish to maintain a short position in a particular TBA as a hedge, we may “roll” the short TBA transaction. In a hypothetical roll transaction, we might have previously entered into a contract to sell a specified amount of 30-year FNMA 4.5% TBA pass-throughs to a particular counterparty for a specified settlement date. As this settlement date approaches, because we generally do not intend to settle the sale transaction, but we wish to maintain the short position, we enter into a roll transaction whereby we purchase the same amount of 30-year FNMA 4.5% TBA pass-throughs (but not necessarily from the same counterparty) for the same specified settlement date, and we sell the same amount of 30-year FNMA 4.5% TBA pass-throughs (potentially to yet another counterparty) for a later settlement date. In this way, we have essentially “flattened out” our 30-year FNMA 4.5% TBA pass-through position for the earlier settlement date (i.e., offset the original sale with a corresponding purchase), and established a new short position for the later settlement date, hence maintaining our short position. By rolling our transaction, we maintain our desired short position in 30 year FNMA 4.5% securities without settling the original sale transaction.

In the case where the counterparty from whom we purchase (or to whom we sell) for the earlier settlement date is the same as the counterparty to whom we sell (or from whom we purchase) for the later settlement date, and when these purchases/sales are transacted simultaneously, this pair of simultaneous purchases or sales is often referred to as a “TBA roll” transaction.

In some instances, to avoid taking or making delivery of TBA securities, we will “pair off” an open purchase or sale transaction with an offsetting sale or purchase with the same counterparty. Alternatively, we will “assign” open transactions from counterparties from whom we have purchased to other counterparties to whom we have sold. In either case, no securities are actually delivered, but instead the net difference in trade proceeds of the offsetting transactions is calculated, and a money wire representing such difference is sent to the appropriate party.



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For the six month period ended June 30, 2011, as disclosed on our consolidated statement of cash flows, the aggregate TBA activity, or volume of closed transactions based on the sum of the absolute value of buy and sell transactions, was \$11.1 billion as compared to \$6.1 billion for the six month period ended June 30, 2010. Our TBA activity has principally consisted of: (a) sales (respectively purchases) of TBAs as hedges in connection with purchases (respectively sales) of certain other RMBS assets (especially fixed rate Agency whole pools); (b) TBA roll transactions (as described above) effected to maintain existing TBA short positions; and (c) TBA “sector rotation” transactions whereby a short TBA position in one TBA security is replaced with a short position in a different TBA security. Since the Company has actively turned over its portfolio of fixed rate Agency whole pools, the volume of TBA hedging transactions has also been correspondingly high. Moreover, the Company’s fixed rate Agency whole pool portfolio is typically larger in gross size than the Company’s equity capital base, and so the Company tends to hold large short TBA positions relative to its equity capital base at any time. Finally, the entire amount of short TBA positions held at each monthly TBA settlement date is typically rolled to the following month, and since the amount of short TBA positions tends to be large relative to the Company’s equity capital base, TBA roll transaction volume over multi-month periods can represent a multiple of the Company’s equity capital base.

We have entered into reverse repos to finance some of our assets. As of June 30, 2011 and December 31, 2010, indebtedness outstanding on our reverse repos was approximately \$801.9 million and \$777.8 million, respectively. Approximately 75.3% or \$604.0 million of our outstanding indebtedness under reverse repos is secured by Agency RMBS with the remaining secured by non-Agency RMBS as of June 30, 2011. Our reverse repos bear interest at rates that have historically moved in close relationship to LIBOR. We account for our reverse repos as collateralized borrowings. See the discussion in “—Liquidity and Capital Resources” below for further information on our reverse repos.

In connection with our derivative and TBA transactions, in certain circumstances we may require that counterparties post collateral with us. When we exit a derivative or TBA transaction for which a counterparty has posted collateral, we may be required to return some or all of the related collateral to the respective counterparty. As of June 30, 2011 and December 31, 2010, our derivative and TBA counterparties posted an aggregate value of approximately \$116.5 million and \$166.4 million, respectively as of each date, of collateral with us. This collateral posted with us is reflected as “Due to brokers-margin accounts” on our Consolidated Statement of Assets, Liabilities, and Shareholders’ Equity.

### **Shareholders’ Equity**

As of June 30, 2011, our shareholders’ equity decreased by approximately \$18.8 million to \$384.9 million from \$403.7 million as of December 31, 2010. This decrease principally consisted of a decrease for dividends paid of approximately \$28.9 million offset by a net increase in shareholders’ equity resulting from operations for the six month period ended June 30, 2011 of approximately \$9.8 million.

As of December 31, 2010, our shareholders’ equity increased by approximately \$103.9 million from December 31, 2009. This increase consisted of net proceeds from the issuance of shares of approximately \$94.7 million in our October 2010 initial public offering, net increase in shareholders’ equity resulting from operations for the year ended December 31, 2010 of approximately \$40.6 million, a decrease for dividends paid of approximately \$33.9 million, an increase for common shares issued in connection with incentive fee payments of approximately \$0.5 million and an increase for share-based LTIP awards of approximately \$2.0 million.

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### Results of Operations for the Three Month Periods Ended June 30, 2011 and 2010

The table below presents the net increase (decrease) in shareholders' equity resulting from operations for the three month periods ended June 30, 2011 and 2010.

	Three Month Period Ended June 30,	
	2011	2010
Investment income—Interest income	\$ 16,651,827	\$ 10,798,629
Expenses:		
Base management fee	1,448,633	1,107,969
Incentive fee	—	—
Interest expense	1,602,593	872,609
Other operating expenses	1,526,920	2,141,041
Total expenses	4,578,146	4,121,619
Net investment income	12,073,681	6,677,010
Net realized and unrealized gain (loss) on investments	(15,322,813)	1,256,094
Net realized and unrealized gain (loss) on financial derivatives	1,927,552	(4,201,974)
Net increase (decrease) in shareholders' equity resulting from operations	\$ (1,321,580)	\$ 3,731,130
Net increase (decrease) in shareholders' equity resulting from operations per share	\$ (0.08)	\$ 0.30

### Summary of Net Increase (Decrease) in Shareholders' Equity from Operations

Our net increase (decrease) in shareholders' equity from operations ("net income" or "net loss") for the three month periods ended June 30, 2011 and 2010 was a net loss of \$1.3 million and net income of \$3.7 million, respectively. The decrease in our operating results period over period was primarily driven by net realized and unrealized losses in our non-agency RMBS holdings for the three month period ended June 30, 2011. For the three month period ended June 30, 2011, these losses were partially offset by net realized gains in our credit derivatives which we use to hedge credit risk and an increase in net investment income period over period, driven by a larger portfolio of investment holdings. Total return based on changes in "net asset value" or "book value" for our common shares after incentive fee was (0.37)% for the three month period ended June 30, 2011 as compared to 1.50% for the three month period ended June 30, 2010. Total return on our common shares is calculated based on changes in net asset value per share or book value per share and assumes reinvestment of dividends.

### Net Investment Income

Net investment income was \$12.1 million for the three month period ended June 30, 2011 as compared to \$6.7 million for the three month period ended June 30, 2010. Net investment income consists of interest income less total expenses. The period-over-period increase in net investment income was primarily due to higher interest income, as a result of a larger portfolio of investment holdings.

### Interest Income

Interest income was \$16.7 million for the three month period ended June 30, 2011 as compared to \$10.8 million for the three month period ended June 30, 2010. Interest income includes coupon payments received and accrued on our holdings, the net accretion and amortization of purchased discounts and premiums on those holdings and interest on our cash balances, including those balances held by our counterparties as collateral. The period-over-period increase in interest income was due to our larger portfolio of RMBS holdings, resulting from net capital raised in our October 2010 initial public offering as well as our relative increased use of leverage since the end of 2010.

### Base Management Fees

Base management fees increased to \$1.4 million for the three month period ended June 30, 2011 from \$1.1 million for the three month period ended June 30, 2010. The increase in base management fees was due to our higher net asset value (shareholders' equity) during the current quarter which serves as the basis for fee determination. Our higher net asset value is largely due to the completion of our October 2010 initial public offering, in which the Company raised net proceeds of approximately \$94.7 million.

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### Interest Expense

Interest expense includes interest on funds borrowed under reverse repos and interest on our counterparties' cash collateral held by us. We had average borrowed funds of \$911.9 million and \$449.5 million for the three month periods ended June 30, 2011 and 2010, respectively. Our total interest expense, inclusive of interest expense on our counterparties' cash collateral held by us, was \$1.6 million for the three month period ended June 30, 2011 as compared to \$0.9 million for the three month period ended June 30, 2010. Our total weighted average borrowing costs under our reverse repos was 0.64% for the three month period ended June 30, 2011 as compared to 0.72% for the three month period ended June 30, 2010. For the three month period ended June 30, 2011, 79.0% of our average borrowings were related to our Agency holdings and 21.0% were related to our non-Agency holdings. For the comparable three month period ended June 30, 2010, 71.3% of our average borrowings were related to our Agency holdings while 28.7% were related to our non-Agency holdings.

The tables below show our average borrowed funds, interest expense, average cost of funds, average one-month LIBOR and average six-month LIBOR under our reverse repos for the three month periods ended June 30, 2011 and 2010.

### Agency Securities

	<b>Average Borrowed Funds</b>	<b>Interest Expense</b>	<b>Average Cost of Funds</b>	<b>Average One-Month LIBOR</b>	<b>Average Six-Month LIBOR</b>
For the Three Month Period Ended June 30, 2011	\$720,197,539	\$ 528,110	0.29%	0.20%	0.42%
For the Three Month Period Ended June 30, 2010	\$320,311,434	\$ 251,191	0.31%	0.31%	0.63%

### Non-Agency Securities

	<b>Average Borrowed Funds</b>	<b>Interest Expense</b>	<b>Average Cost of Funds</b>	<b>Average One-Month LIBOR</b>	<b>Average Six-Month LIBOR</b>
For the Three Month Period Ended June 30, 2011	\$191,748,451	\$ 941,796	1.96%	0.20%	0.42%
For the Three Month Period Ended June 30, 2010	\$129,158,612	\$ 561,838	1.74%	0.31%	0.63%

### Agency and Non-Agency Securities

	<b>Average Borrowed Funds</b>	<b>Interest Expense</b>	<b>Average Cost of Funds</b>	<b>Average One-Month LIBOR</b>	<b>Average Six-Month LIBOR</b>
For the Three Month Period Ended June 30, 2011	\$911,945,990	\$1,469,906	0.64%	0.20%	0.42%
For the Three Month Period Ended June 30, 2010	\$449,470,046	\$ 813,029	0.72%	0.31%	0.63%

### Incentive Fees

In addition to the base management fee, our Manager is also entitled to a quarterly incentive fee if, and in proportion to the extent that, our performance (as measured by adjusted net income, as defined in the management agreement) over the relevant calculation period exceeds a defined return hurdle for the period. Incentive fees were not earned for either the three month period ended June 30, 2011 or the three month period ended June 30, 2010. For each of the three month periods the return hurdle (after taking into account any relevant loss carryforward) was not exceeded and as a result, no incentive fees were incurred. The return hurdle for each calculation period was based on a 9% annual rate.

### Other Operating Expenses

Other operating expenses consist of professional fees, compensation expense related to our dedicated officers, share-based LTIP expense, insurance expense, and various other operating expenses necessary to run our business. Other operating expenses exclude interest expense. Other operating expenses for the three month period ended June 30, 2011 were \$1.5 million as compared to \$2.1 million for the three month period ended June 30, 2010. The decline in other operating expenses was primarily due to a reduction in expenses related to the 2007 issuance of LTIPs to our Manager. These LTIPs became fully vested in August 2010, and as a result, from that point forward, have no further expense associated with them.

### **Net Realized and Unrealized Gains and Losses on Investments**

During the three month period ended June 30, 2011, we had net realized and unrealized losses on investments of \$15.3 million as compared to gains of \$1.3 million for the three month period ended June 30, 2010. Net realized and unrealized losses on investments of \$15.3 million for the three month period ended June 30, 2011 resulted principally from realized and unrealized losses on our non-Agency MBS holdings of \$13.7 million, and realized and unrealized losses on our TBAs and U.S. Treasuries of \$18.8 million, partially offset by net realized and unrealized gains on our Agency RMBS of \$17.3 million. During the three month period ended June 30, 2011, valuations in the non-Agency RMBS market were negatively impacted by the Federal Reserve's decision to begin selling assets from its Maiden Lane II portfolio, and from the difficulty of the market to absorb the supply from the ensuing sales (see "Trends and Recent Market Developments" above). Concern for the creditworthiness of several European countries also, we believe, had the impact of dampening valuations in many "risk asset" sectors, including non-Agency RMBS, over the current three month period. Conversely, as market participants increased their appetites for U.S. government-backed and GSE debt over the current three month period, valuations in the Agency RMBS sector strengthened, but the resulting drop in interest rates negatively affected the value of our short TBA and U.S. Treasury holdings. Throughout 2010 and the three month period ended June 30, 2011, our TBAs were held on a net short basis. Net realized and unrealized gains on investments of \$1.3 million for the three month period ended June 30, 2010 resulted principally from net unrealized gains on our non-Agency RMBS.

### **Net Realized and Unrealized Gains and Losses on Financial Derivatives**

For the three month period ended June 30, 2011, we had net realized and unrealized gains on our financial derivatives of \$1.9 million as compared to net realized and unrealized losses of \$4.2 million for the three month period ended June 30, 2010. Our financial derivatives consist of interest rate derivatives, which we use primarily to hedge our interest rate risk, and credit derivatives, which we use primarily to hedge credit risk, but also in some cases as a means to assume credit risk. We also use certain non-derivative instruments, such as TBAs and U.S. Treasuries, to hedge interest rate risk. During the three month period ending June 30, 2011, we recognized net realized and unrealized gains on our credit derivatives and net realized and unrealized losses on our interest rate hedges. Our credit derivatives are primarily in the form of credit default swaps where we have purchased credit protection on non-Agency RMBS. Our credit derivatives generated net realized and unrealized gains of \$8.2 million for the three month period ended June 30, 2011, offsetting some of the losses recorded on our non-Agency MBS holdings. Our interest rate derivatives are primarily in the form of short positions in interest rate swaps, which we use to protect against potential increases in interest rates. The benchmark five-year swap rate decreased to 2.03% at June 30, 2011 from 2.47% at March 31, 2011, and as a result, our interest rate derivatives generated net losses in the amount of \$6.3 million for the three month period ended June 30, 2011. For the three month period ended June 30, 2010, our interest rate derivatives generated a net loss of \$2.9 million and resulted principally from a decrease in rates during that period. The five year swap rate decreased to 2.05% at June 30, 2010 from 2.73% at March 31, 2010. For the three month period ended June 30, 2010, we had net realized and unrealized losses on our credit derivatives of \$1.3 million. Net realized and unrealized losses on our credit derivatives for the three month period ended June 30, 2010 resulted principally from our short synthetic positions in corporate bond indices and from total return swaps (which we have also used from time to time to hedge credit risk), a portion of which were terminated during the period.

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### Results of Operations for the Six Month Periods Ended June 30, 2011 and 2010

The table below presents the net increase (decrease) in shareholders' equity resulting from operations for the six month periods ended June 30, 2011 and 2010.

	Six Month Period Ended June 30,	
	2011	2010
Investment income—Interest income	\$ 32,500,608	\$22,715,250
Expenses:		
Base management fee	2,929,606	2,212,252
Incentive fee	612,192	482,715
Interest expense	3,145,865	1,679,404
Other operating expenses	3,141,010	4,200,840
Total expenses	9,828,673	8,575,211
Net investment income	22,671,935	14,140,039
Net realized and unrealized gain (loss) on investments	(16,337,574)	5,222,413
Net realized and unrealized gain (loss) on financial derivatives	3,451,229	(8,035,864)
Net increase (decrease) in shareholders' equity resulting from operations	\$ 9,785,590	\$11,326,588
Net increase (decrease) in shareholders' equity resulting from operations per share	\$ 0.58	\$ 0.92

### Summary of Net Increase (Decrease) in Shareholders' Equity from Operations

Our net increase in shareholders' equity from operations ("net income") for the six month periods ended June 30, 2011 and 2010 was \$9.8 million and \$11.3 million, respectively. The decrease in net income period over period was primarily driven by an increase in net realized and unrealized losses on investments and financial derivatives, partially offset by higher net investment income, due to a larger portfolio of investment holdings. Total return based on changes in "net asset value" or "book value" for our common shares after incentive fee was 2.26% for the six month period ended June 30, 2011 as compared to 4.14% for the six month period ended June 30, 2010. Total return on our common shares is calculated based on changes in net asset value per share or book value per share and assumes reinvestment of dividends.

### Net Investment Income

Net investment income was \$22.7 million for the six month period ended June 30, 2011 as compared to \$14.1 million for the six month period ended June 30, 2010. Net investment income consists of interest income less total expenses. The period-over-period increase in net investment income was primarily due to higher interest income, as a result of a larger portfolio of investment holdings which was partially offset by higher total expenses.

### Interest Income

Interest income was \$32.5 million for the six month period ended June 30, 2011 as compared to \$22.7 million for the six month period ended June 30, 2010. Interest income includes coupon payments received and accrued on our holdings, the net accretion and amortization of purchased discounts and premiums on those holdings and interest on our cash balances, including those balances held by our counterparties as collateral. The period-over-period increase in interest income was due to our larger portfolio of RMBS holdings, resulting from net capital raised in our October 2010 initial public offering as well as our relative increased use of leverage since the end of 2010.

### Base Management Fees

Base management fees increased to \$2.9 million for the six month period ended June 30, 2011 from \$2.2 million for the six month period ended June 30, 2010. The increase in base management fees was due to our higher net asset value during the current period which serves as the basis for fee determination. Our higher net asset value is largely due to the completion of our October 2010 initial public offering, in which the Company raised net proceeds of approximately \$94.7 million.

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### Interest Expense

Interest expense includes interest on funds borrowed under reverse repos and interest on our counterparties' cash collateral held by us. We had average borrowed funds of \$875.9 million and \$481.0 million for the six month periods ended June 30, 2011 and 2010, respectively. Our total interest expense, inclusive of interest expense on our counterparties' cash collateral held by us, was \$3.1 million for the six month period ended June 30, 2011 as compared to \$1.7 million for the six month period ended June 30, 2010. Our total weighted average borrowing costs under our reverse repos was 0.64% for the six month period ended June 30, 2011 as compared to 0.66% for the six month period ended June 30, 2010. For the six month period ended June 30, 2011, 79.7% of our average borrowings were related to our Agency holdings and 20.3% were related to our non-Agency holdings. For the comparable six month period ended June 30, 2010, 75.9% of our average borrowings were related to our Agency holdings while 24.1% were related to our non-Agency holdings.

The tables below show our average borrowed funds, interest expense, average cost of funds, average one-month LIBOR and average six-month LIBOR under our reverse repos for the six month periods ended June 30, 2011 and 2010.

### Agency Securities

	<u>Average Borrowed Funds</u>	<u>Interest Expense</u>	<u>Average Cost of Funds</u>	<u>Average One-Month LIBOR</u>	<u>Average Six-Month LIBOR</u>
For the Six Month Period Ended June 30, 2011	\$698,345,222	\$1,056,134	0.30%	0.23%	0.44%
For the Six Month Period Ended June 30, 2010	\$364,976,117	\$ 571,918	0.31%	0.27%	0.51%

### Non-Agency Securities

	<u>Average Borrowed Funds</u>	<u>Interest Expense</u>	<u>Average Cost of Funds</u>	<u>Average One-Month LIBOR</u>	<u>Average Six-Month LIBOR</u>
For the Six Month Period Ended June 30, 2011	\$177,591,182	\$1,751,956	1.97%	0.23%	0.44%
For the Six Month Period Ended June 30, 2010	\$116,049,436	\$1,010,120	1.74%	0.27%	0.51%

### Agency and Non-Agency Securities

	<u>Average Borrowed Funds</u>	<u>Interest Expense</u>	<u>Average Cost of Funds</u>	<u>Average One-Month LIBOR</u>	<u>Average Six-Month LIBOR</u>
For the Six Month Period Ended June 30, 2011	\$875,936,404	\$2,808,090	0.64%	0.23%	0.44%
For the Six Month Period Ended June 30, 2010	\$481,025,553	\$1,582,038	0.66%	0.27%	0.51%

### Incentive Fees

In addition to the base management fee, our Manager is also entitled to a quarterly incentive fee if, and in proportion to the extent that, our performance (as measured by adjusted net income, as defined in the management agreement) over the relevant calculation period exceeds a defined return hurdle for the period. Total incentive fees earned for the six month period ended June 30, 2011 were \$0.6 million as compared to \$0.5 million for the six month period ended June 30, 2010. For each of the three month periods ended March 31, 2011 and 2010, the return hurdle (after taking into account any relevant loss carryforward) was exceeded and as a result, we incurred incentive fee expense during such periods, and thereby in the six-month periods ending June 30, 2011 and 2010 that include those three-month periods. The return hurdle for each calculation period was based on a 9% annual rate.

### Other Operating Expenses

Other operating expenses consist of professional fees, compensation expense related to our dedicated officers, share-based LTIP expenses, insurance expense, and various other operating expenses necessary to run our business. Other operating expenses exclude interest expense. Other operating expenses for the six month period ended June 30, 2011 was \$3.1 million as compared to \$4.2 million for the six month period ended June 30, 2010. The decline in other operating expenses was primarily due to a reduction in expenses related to the 2007 issuance of LTIPs to our Manager, partially offset by increases in our other operating expenses that are related to being a company with publicly traded shares as well as those related to the growth in our net capital and assets held. LTIPs issued to our Manager became fully vested in August 2010, and as a result, from that point forward, have no further expense associated with them.

### **Net Realized and Unrealized Gains and Losses on Investments**

During the six month period ended June 30, 2011, we had net realized and unrealized losses on investments of \$16.3 million as compared to gains of \$5.2 million for the six month period ended June 30, 2010. Net realized and unrealized losses on investments of \$16.3 million for the six month period ended June 30, 2011 resulted principally from realized and unrealized losses of \$8.7 million on our non-Agency MBS holdings as well as net realized and unrealized losses on TBAs and U.S. Treasuries of \$19.1 million. These losses were partially offset by net realized and unrealized gains of \$11.6 million on our Agency RMBS. Throughout 2010 and the six month period ended June 30, 2011, our TBAs and U.S. Treasuries were held on a net short basis. During the six month period ended June 30, 2011, valuations in the non-Agency RMBS market were negatively impacted by the Federal Reserve's decision to begin selling assets from its Maiden Lane II portfolio, and from the difficulty of the market to absorb the supply from the ensuing sales (see "Trends and Recent Market Developments" above). Concern for the creditworthiness of several European countries, also, we believe, had the impact of dampening valuations in many "risk asset" sectors, including non-Agency RMBS, over the six month period. Conversely, as market participants increased their appetites for U.S. government-backed and GSE debt over the six month period, valuations in the Agency RMBS sector strengthened, but the resulting drop in interest rates over the six month period negatively affected the value of our short TBA and U.S. Treasury holdings. Net realized and unrealized gains on investments of \$5.2 million for the six month period ended June 30, 2010 resulted principally from net unrealized gains on our non-Agency RMBS as well as Agency RMBS partially offset by realized and unrealized losses on TBAs. Net gains on our Agency and non-Agency RMBS were \$25.5 million while losses on our TBAs were \$20.6 million.

### **Net Realized and Unrealized Gains and Losses on Financial Derivatives**

For the six month period ended June 30, 2011, we had net realized and unrealized gains on our financial derivatives of \$3.5 million as compared to net realized and unrealized losses of \$8.0 million for the six month period ended June 30, 2010. Our financial derivatives consist of interest rate derivatives, which we use primarily to hedge our interest rate risk, and credit derivatives, which we use primarily to hedge credit risk, but also in some cases as a means to assume credit risk. We also use certain non-derivative instruments, such as TBAs and U.S. Treasuries, to hedge interest rate risk. The benchmark five-year swap rate decreased to 2.03% at June 30, 2011 from 2.17% at December 31, 2010, and our interest rate derivatives generated a net loss in the amount of \$6.4 million. The bulk of this loss was incurred in the second three months of the period, when rates moved downward in contrast to the first three months of the period when rates increased. During the six month period we shifted away in part from TBAs to interest rate swaps for interest rate hedging purposes. For the six month period ended June 30, 2010, our interest rate derivatives generated a net loss of \$4.7 million and resulted principally from a decrease in rates during that period. The five year swap rate decreased to 2.05% at June 30, 2010 from 2.98% at December 31, 2009.

Our credit derivatives are primarily in the form of credit default swaps where we have purchased credit protection on non-Agency RMBS. For the six month period ended June 30, 2011, our credit derivatives generated net realized and unrealized gains of \$9.8 million, offsetting some of the losses recorded on our non-Agency RMBS holdings. These credit derivative gains were primarily related to our long and short synthetic credit positions in the PrimeX and ABX indices, respectively. For the six month period ended June 30, 2010, we had net realized and unrealized losses on our credit derivatives of \$3.3 million. Net realized and unrealized losses on our credit derivatives for the six month period ended June 30, 2010 resulted principally from our short credit default swaps on corporate bonds, single name ABS CDS and from total return swaps (which we have also used from time to time to hedge credit risk), a portion of which were terminated during the period.

### **Liquidity and Capital Resources**

Liquidity refers to our ability to meet our cash needs, including repaying our borrowings, funding and maintaining RMBS and other assets, making distributions and other general business needs. Our short-term (one year or less) and long-term liquidity requirements include acquisition costs for assets we acquire, payment of our base management fee and incentive fee, compliance with margin requirements under our repo, reverse repo, TBA and derivative contracts, repayment of reverse repo borrowings to the extent we are unable or unwilling to extend our reverse repos, and payment of our general operating expenses. Our capital resources primarily include cash on hand, cash flow from our investments (including monthly principal and interest payments received on our RMBS and proceeds from the sale of securities), borrowings under reverse repos and proceeds from equity offerings. We expect that these sources of funds will be sufficient to meet our short-term and long-term liquidity needs.

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We expect to continue to borrow funds in the form of reverse repos and we may increase the level of borrowings in the future. The terms of these borrowings under our master repurchase agreements generally conform to the terms in the standard master repurchase agreement as published by The Securities Industry and Financial Markets Association, or "SIFMA," as to repayment and margin requirements. In addition, each lender typically requires that we include supplemental terms and conditions to the standard master repurchase agreement. Typical supplemental terms and conditions include the addition of or changes to provisions relating to margin calls, requirements that all controversies related to the repurchase agreement be litigated in a particular jurisdiction and cross default provisions. These provisions may differ for each of our lenders.

The following summarizes our borrowings under reverse repos:

	Reverse Repurchase Agreements	
	Average Borrowed Funds During the Period	Borrowed Funds Outstanding at End of the Period
Six Month Period Ended June 30, 2011	\$ 875,936,404	\$ 801,901,000
Six Month Period Ended June 30, 2010	\$ 481,025,553	\$ 428,169,799

The difference between the average amounts borrowed during the six month period ended June 30, 2011 and the respective amount outstanding at the end of the period reflects our decreased investment holdings as well as our decreased use of leverage to acquire investments in Agency RMBS. During the six month period ended June 30, 2010, we reduced our holdings of Agency RMBS, resulting in a reduced amount of borrowings outstanding at the end of the period.

The following summarizes our borrowings under reverse repos by remaining maturity:

As of June 30, 2011		
Remaining Days to Maturity	Outstanding Borrowings	%
30 Days or Less	\$ 259,269,000	32.3%
31-60 Days	124,538,000	15.5%
61-90 Days	131,173,000	16.4%
91-120 Days	93,299,000	11.7%
121-150 Days	109,965,000	13.7%
151-180 Days	—	0.0%
181-360 Days	83,657,000	10.4%
	<u>\$ 801,901,000</u>	<u>100.0%</u>

We expect to continue to borrow funds in the form of reverse repos as well as other types of financing. As of June 30, 2011 and December 31, 2010, we had \$801.9 million and \$777.8 million, respectively of borrowings outstanding under our reverse repos. As of June 30, 2011, the remaining terms on our reverse repos ranged from 7 to 237 days, with an average remaining term of 77 days. As of December 31, 2010, the remaining terms on our reverse repos ranged from 13 to 178 days, with an average remaining term of 52 days. Our borrowings were with eight counterparties as of June 30, 2011 and were with seven counterparties as of December 31, 2010. At June 30, 2011 and December 31, 2010, we did not have an amount at risk under our reverse repos with a single counterparty greater than 10% of our shareholders' equity. Amount at risk represents the aggregate excess, if any, for each counterparty of the fair value of collateral held by such counterparty over the amounts outstanding under reverse repos. As of June 30, 2011 and December 31, 2010, our reverse repos had a weighted average borrowing rate of 0.70% and 0.65%, respectively. As of June 30, 2011, our reverse repos had interest rates ranging from 0.19% to 2.50%. As of December 31, 2010, our reverse repos had interest rates ranging from 0.27% to 2.60%. RMBS pledged as collateral under the reverse repos had an aggregate estimated fair value of \$921.1 million and \$886.4 million as of June 30, 2011 and December 31, 2010, respectively. The interest rates of our reverse repos have historically moved in close relationship to short-term LIBOR rates, and in some cases are explicitly indexed to short-term LIBOR rates and reset accordingly. It is expected that amounts due upon maturity of our reverse repos will be funded primarily through the



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roll over/re-initiation of reverse repos and, if we are unable or unwilling to roll over/re-initiate our reverse repos, through free cash and proceeds from the sale of securities.

Typically we have financed our holdings of Agency RMBS, however, as of June 30, 2011 and December 31, 2010, we held unencumbered Agency whole pools on a settlement date basis in the amount of \$118.3 million and \$113.5 million, respectively.

We held cash and cash equivalents of approximately \$45.4 million and \$35.8 million as of June 30, 2011 and December 31, 2010, respectively.

We may declare dividends based on, among other things, our earnings, our financial condition, our working capital needs and new opportunities. The declaration of dividends to our shareholders and the amount of such dividends are at the discretion of our Board of Directors. During the six month period ended June 30, 2011, we paid total dividends in the amount of \$28.9 million related to net income attributable to the year ended December 31, 2010 and the three month period ended March 31, 2011. In August 2011, our Board of Directors approved a dividend related to the second quarter of 2011 in the amount of \$0.40 per share, or approximately \$6.8 million. This dividend is payable on September 15, 2011 to shareholders of record as of September 1, 2011. During the six month period ended June 30, 2010, we paid total dividends in the amount of \$18.5 million related to net income attributable to the year ended December 31, 2009 and the three month period ended March 31, 2010.

In August 2011, our Board of Directors approved the adoption of a \$10.0 million share repurchase program. The program, which is open-ended in duration, allows the Company to repurchase common shares from time to time on the open market or in negotiated transactions. Repurchases are at the Company's discretion, subject to applicable law, share availability, price and the Company's financial performance, among other considerations.

For the six month period ended June 30, 2011, our operating activities generated net cash in the amount of \$14.8 million. Additionally, our reverse repo activity used to finance many of our investments (including repayments, in conjunction with the sales of investments, of amounts borrowed under our reverse repo agreements) provided net cash of \$24.1 million. Thus our operating activities, when combined with our reverse repo financing, provided net cash of \$38.9 million for the six month period ended June 30, 2011. Of this \$38.9 million, we used \$28.9 million to pay dividends and \$0.4 million for other non-operating activity-related uses, with the remaining \$9.6 million serving to increase our cash holdings from \$35.8 million as of December 31, 2010 to \$45.4 million as of June 30, 2011. For the six month period ended June 30, 2010, our operating activities provided net cash of \$157.4 million, but our reverse repo activity used to finance many of our investments (including repayments, in conjunction with the sales of investments, of amounts borrowed under our reverse repo agreements) used net cash of \$131.8 million. Thus our operating activities, when combined with our reverse repo financing activities, provided net cash of \$25.6 million for the six month period ended June 30, 2010. Of this \$25.6 million, we used \$18.5 million to pay dividends and \$0.6 million for other non-operating activity-related uses, with the remaining \$6.5 million serving to increase our cash holdings from \$102.9 million as of December 31, 2009 to \$109.3 million as of June 30, 2010.

Based on our current portfolio, amount of free cash on hand, debt-to-equity ratio and current and anticipated availability of credit, we believe that our capital resources will be sufficient to enable us to meet anticipated short-term and long-term liquidity requirements. However, the unexpected inability to finance our Agency RMBS portfolio would create a serious short-term strain on our liquidity and would require us to liquidate much of that portfolio, which in turn would require us to restructure our portfolio to maintain our exclusion from regulation as an investment company under the Investment Company Act. Steep declines in the values of our RMBS assets financed using reverse repos, or in the values of our derivative contracts, would result in margin calls that would significantly reduce our free cash position. Furthermore, a substantial increase in prepayment rates on our assets financed by reverse repos could cause a temporary liquidity shortfall, because we are generally required to post margin on such assets in proportion to the amount of the announced principal paydowns before the actual receipt of the cash from such principal paydowns. If our cash resources are at any time insufficient to satisfy our liquidity requirements, we may have to sell assets or issue debt or additional equity securities.

We are not required by our investment guidelines to maintain any specific debt-to-equity ratio, and we believe that the appropriate leverage for the particular assets we hold depends on the credit quality and risk of those assets, as well as the general availability and terms of stable and reliable financing for those assets.

## Contractual Obligations and Commitments

We are a party to a management agreement with our Manager. Pursuant to that agreement, our Manager is entitled to receive a base management fee, an incentive fee, reimbursement of certain expenses and, in certain circumstances, a termination fee. Such fees and expenses do not have fixed and determinable payments. For a description of the management agreement provisions, see Note 5 to our consolidated financial statements.

We enter into reverse repos with third-party broker-dealers whereby we sell securities to such broker-dealers at agreed-upon purchase prices at the initiation of the reverse repos and agree to repurchase such securities at predetermined repurchase prices and termination dates, thus providing the broker-dealers with an implied interest rate on the funds initially transferred to us by the broker-dealers. When we enter into a reverse repo, the lender establishes and maintains an account containing cash and securities having a value not less than the repurchase price, including accrued interest, of the reverse repo. We enter into repos with third-party broker-dealers whereby we purchase securities under agreements to resell at an agreed-upon price and date. In general, we most often enter into repo transactions in order to effectively borrow securities that we can then deliver to counterparties to whom we have made short sales of the same securities. The implied interest rates on the repos and reverse repos we enter into are based upon market rates at the time of initiation. Repos and reverse repos that are conducted with the same counterparty may be reported on a net basis if they meet the requirements of ASC 210-20, *Balance Sheet, Offsetting*. See “Liquidity and Capital Resources” for a summary of our borrowings on reverse repos.

As of June 30, 2011, we had an aggregate amount at risk under our reverse repos with eight counterparties of approximately \$121.4 million and as of December 31, 2010, we had an aggregate amount at risk under our reverse repos with seven counterparties of approximately \$114.1 million. Amounts at risk represent the aggregate excess, if any, for each counterparty of the fair value of collateral held by such counterparty over the amounts outstanding under reverse repos. If the amounts outstanding under repos and reverse repos with a particular counterparty are greater than the collateral held by the counterparty, there is no amount at risk for the particular counterparty. Amount at risk as of June 30, 2011 and December 31, 2010 do not include approximately \$2.2 million and \$2.4 million, respectively, of net accrued interest, defined as accrued interest on securities held as collateral less interest payable on cash borrowed.

Our swap and futures contracts are governed by trading agreements, which are separately negotiated agreements with dealer counterparties. Changes in the relative value of the swap and futures transactions may require us or the counterparty to post or receive collateral. Typically, a collateral payment or receipt is triggered based on the net change in the value of all contracts governed by a particular trading agreement. Entering into swap and futures contracts involves market risk in excess of amounts recorded on our balance sheet.

As of June 30, 2011, we had an aggregate amount at risk under our derivative contracts with seven counterparties of approximately \$20.5 million. As of December 31, 2010, we had an aggregate amount at risk under our derivatives contracts with eight counterparties of approximately \$18.7 million. Amounts at risk under our derivatives contracts represent the aggregate excess, if any, for each counterparty of the fair value of our derivative contracts including unsettled trade receivables and payables plus our collateral held directly by the counterparty less the counterparty’s collateral held by us. If a particular counterparty’s collateral held by us is greater than the aggregate fair value of the financial derivatives including unsettled trade receivables and payables plus our collateral held directly by the counterparty, there is no amount at risk for the particular counterparty.

We are party to a tri-party collateral arrangement under one of our ISDA trading agreements whereby a third party holds collateral posted by us. Pursuant to the terms of the arrangement, the third party must follow certain pre-defined actions prior to the release of the collateral to the counterparty or to us. Deposits with dealers held as collateral on the Consolidated Statement of Assets, Liabilities and Shareholders’ Equity includes, at June 30, 2011 and December 31, 2010 collateral posted by the Company and held by a third party custodian in the amount of approximately \$6.7 million and \$9.0 million, respectively.

We purchase and sell certain non-derivative securities, including TBAs, on a when-issued or delayed delivery basis. Since delivery for these securities extends beyond the typical settlement dates for most non-derivative investments, these transactions are more prone to market fluctuations between the trade date and the ultimate settlement date, and thereby are more vulnerable, especially in the absence of margining arrangements with respect to these transactions, to increasing amounts at risk with the applicable counterparties.

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As of June 30, 2011, in connection with our TBAs, we had an aggregate amount at risk with eight counterparties of approximately \$3.5 million. As of December 31, 2010, in connection with our TBAs, we had an aggregate amount at risk with four counterparties of approximately \$6.9 million. Amounts at risk in connection with our TBAs represent the aggregate excess, if any, for each counterparty of the net fair value of our TBAs plus our collateral held directly by the counterparty less the counterparty's collateral held by us. If a particular counterparty's collateral held by us is greater than the aggregate fair value of the TBAs plus our collateral held directly by the counterparty, there is no amount at risk for the particular counterparty.

### **Off-Balance Sheet Arrangements**

As of June 30, 2011 and December 31, 2010, we did not have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. Further, we have not guaranteed any obligations of unconsolidated entities nor do we have any commitment or intent to provide funding to any such entities. As such, we are not materially exposed to any market, credit, liquidity or financing risk that could arise if we had engaged in such relationships.

### **Inflation**

Virtually all of our assets and liabilities are interest rate sensitive in nature. As a result, interest rates and other factors influence our performance far more so than does inflation. Changes in interest rates do not necessarily correlate with inflation rates or changes in inflation rates. Our activities and balance sheet are measured with reference to historical cost and/or fair market value without considering inflation.

**Item 3. Quantitative and Qualitative Disclosures about Market Risk**

The primary components of our market risk at June 30, 2011 are related to credit risk, prepayment risk and interest rate risk. We seek to actively manage these and other risks and to acquire and hold assets that we believe justify bearing those risks, and to maintain capital levels consistent with those risks.

***Credit Risk***

We are subject to credit risk in connection with our assets, especially our non-Agency MBS. Credit losses on real estate loans can occur for many reasons, including, but not limited to, poor origination practices, fraud, faulty appraisals, documentation errors, poor underwriting, legal errors, poor servicing practices, weak economic conditions, decline in the value of homes, businesses or commercial properties, special hazards, earthquakes and other natural events, over-leveraging of the borrower on the property, reduction in market rents and occupancies and poor property management services, changes in legal protections for lenders, reduction in personal income, job loss and personal events such as divorce or health problems. Property values are subject to volatility and may be affected adversely by a number of factors, including, but not limited to, national, regional and local economic conditions (which may be adversely affected by industry slowdowns and other factors), local real estate conditions (such as an oversupply of housing), changes or continued weakness in specific industry segments, construction quality, age and design, demographic factors and retroactive changes to building or similar codes. For mortgage-related instruments, the two primary components of credit risk are default risk and severity risk. Market conditions since August 2007 have demonstrated substantial increases in both of these risks, but the second half of 2009 and all of 2010 experienced some perceived stabilization in default risk and severity risk and this led to an increase in values of certain non-Agency RMBS. Valuation trends in 2011, however, while still mainly driven by credit risk, have been somewhat more volatile. Large sellers (including the Federal Reserve) of non-Agency RMBS have increased the available supply of these securities, causing downward price pressure. More recently, however, announcements by the Federal Reserve to discontinue sales have allowed non-Agency RMBS prices to recover somewhat. Default rates have continued to decrease in 2011, hitting recent lows in April, and have since remained relatively flat. Should negative performance trends resume (including because the Home Affordable Modification Programs, or "HAMP," is not successful in curtailing the number of foreclosures, foreclosure suspensions result in higher costs, or for any other reason), some or all of the increase in value of these non-Agency RMBS may be reversed. On the other hand, to the extent that mortgage servicers increase their use of modifications involving principal forgiveness, which we believe are the modifications that have the greatest likelihood of success for delinquent mortgages, we believe that positive performance trends could continue.

***Default Risk***

Default risk is the risk that borrowers will fail to make principal and interest payments on their mortgage loans. We may attempt to mitigate our default risk by, among other things, opportunistically entering into credit default swaps on individual RMBS or MBS indices, whereby we would receive payments upon the occurrence of a credit event on the underlying reference asset or assets. We also rely on third-party mortgage servicers to mitigate our default risk, but such third-party mortgage servicers may have little or no economic incentive to mitigate loan default rates. Default risk in the MBS market, as measured by the amount of mortgage loans that are sixty days or greater delinquent, has stabilized as compared to 2009, but still remains at elevated levels.

***Severity Risk***

Severity risk is the risk of loss upon a borrower default on a mortgage loan underlying our RMBS. Severity risk includes the risk of loss of value of the property underlying the mortgage loan as well as the risk of loss associated with taking over the property, including foreclosure costs. We rely on third-party mortgage servicers to mitigate our severity risk, but such third-party mortgage servicers may have little or no economic incentive to mitigate loan loss severities. Such mitigation efforts may include loan modification programs and prompt foreclosure and property liquidation following a default. Loss severities increased consistently throughout the first half of 2009 due to, among other things, increased servicing costs, delays in loan foreclosure, continuing home price declines and lack of incentive for mortgage servicers to minimize costs. Loss severities stabilized in the second half of 2009 and throughout 2010. This stabilization, however, could prove to be temporary if the pace of property liquidations increases in the coming months, or should foreclosure moratoria lead to increased costs and substantial delays, or should the servicer be unable to take foreclosure and liquidation actions on delinquent mortgages, thereby delaying the ultimate pass through of cash to securitization trusts. Conversely, such stabilization may prove more permanent to the extent that mortgage servicers increase their use of modifications involving principal forgiveness. In order to stem heightened foreclosure activity, the government has taken steps to encourage principal forgiveness on defaulted mortgage loans. These steps may ultimately alleviate risk of foreclosure, but their success relies on effective implementation by mortgage loan servicers.

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### **Prepayment Risk**

Prepayment risk is the risk of change, whether an increase or a decrease, in the rate at which principal is returned in respect of mortgage loans underlying RMBS, including both through voluntary prepayments and through liquidations due to defaults and foreclosures. This rate of prepayment is affected by a variety of factors, including the prevailing level of interest rates as well as economic, demographic, tax, social, legal and other factors. Changes in prepayment rates will have varying effects on the different types of securities in our portfolio. We attempt to take these effects into account in making asset management decisions with respect to our assets. Additionally, increases in prepayment rates may cause us to experience losses on our interest only securities and inverse interest only securities, as those securities are extremely sensitive to prepayment rates. Prepayment risk was at elevated levels throughout the second half of 2008 and the first half of 2009. In the current low interest rate environment, one might typically expect an increase in prepayment levels/speeds; however, as mortgage originators have tightened their lending standards and have also made the refinancing process far more cumbersome, the current level of increase in prepayments is not what one would typically expect. Prepayment rates, besides being subject to interest rates and borrower behavior, are also substantially affected by government policy and regulation. Legislation directed at high loan-to-value borrowers increased prepayments over several classes of mortgage loans in the second half of 2009; however, these prepayments subsequently leveled off and we believe heightened prepayment levels are unlikely to resume as many borrowers who are eligible to refinance have already done so.

### **Interest Rate Risk**

Interest rates are highly sensitive to many factors, including governmental monetary and tax policies, domestic and international economic and political considerations and other factors beyond our control. We are subject to interest rate risk in connection with certain of our assets and liabilities. For some securities in our portfolio, the coupon yields on, and therefore also the values of, such securities are highly sensitive to interest rate movements, such as inverse floating rate RMBS, which benefit from falling interest rates, or certain deep discount floating rate RMBS, which benefit from rising interest rates. We selectively hedge our interest rate risk by entering into interest rate swaps, TBAs, Eurodollar futures, and other instruments. In general, such hedging instruments are used to offset the large majority of the interest rate risk we estimate to arise from our Agency RMBS positions. Hedging instruments may also be used to offset a portion of the interest rate risk arising from certain non-Agency MBS positions.

The following sensitivity analysis table shows the estimated impact on the fair value of our portfolio segregated by certain identified categories as of June 30, 2011, assuming a static portfolio and immediate shifts in interest rates from current levels as indicated below.

<u>Category of Instruments</u>	<u>Estimated Change in Fair Value for a Decrease in Interest Rates by</u>		<u>Estimated Change in Fair Value for an Increase in Interest Rates by</u>	
	<u>50 Basis Points</u>	<u>100 Basis Points</u>	<u>50 Basis Points</u>	<u>100 Basis Points</u>
Agency RMBS	\$ 6,727,601	\$ 11,462,582	\$(8,720,222)	\$(19,433,065)
Non-Agency RMBS, CMBS, and Commercial Mortgage Loans	3,798,794	7,682,397	(3,713,984)	(7,343,160)
U.S. Treasury Securities, Interest Rate Swaps and Futures	(8,861,280)	(18,024,460)	8,559,380	16,816,860
Mortgage-Related Derivatives	(967,050)	(2,118,679)	782,470	1,380,362
Repurchase Agreements and Reverse Repurchase Agreements	(594,404)	(728,935)	822,440	1,644,881
Total	<u>\$ 103,661</u>	<u>\$ (1,727,095)</u>	<u>\$(2,269,916)</u>	<u>\$ (6,934,122)</u>

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The preceding analysis does not show sensitivity to changes in interest rates for our derivatives on corporate securities (whether debt or equity-related), or other categories of instruments for which we believe that the effect of a change in interest rates is not material to the value of the overall portfolio and/or cannot be accurately estimated.

Our analysis of interest rate risk is derived from Ellington's proprietary models as well as third party information and analytics. Many assumptions have been made in connection with the calculations set forth in the table above and, as such, there can be no assurance that assumed events will occur or that other events will not occur that would affect the outcomes. For example, for each hypothetical immediate shift in interest rates, assumptions have been made as to the response of mortgage prepayment rates, the shape of the yield curve, and market volatilities of interest rates; each of the foregoing factors can significantly and adversely affect the fair value of our interest rate-sensitive instruments.

The above analysis utilizes assumptions and estimates based on management's judgment and experience, and relies on financial models, which are inherently imperfect; in fact, different models can produce different results for the same securities. While the table above reflects the estimated impacts of immediate interest rate increases and decreases on specific categories of instruments in our portfolio, we actively trade many of the instruments in our portfolio, and therefore our current or future portfolios may have risks that differ significantly from those of our June 30, 2011 portfolio estimated above. Moreover, the impact of changing interest rates on fair value can change significantly when interest rates change by a greater amount than the hypothetical shifts assumed above. Furthermore, our portfolio is subject to many risks other than interest rate risks, and these additional risks may or may not be correlated with changes in interest rates. For all of the foregoing reasons and others, the table above is for illustrative purposes only and actual changes in interest rates would likely cause changes in the actual fair value of our portfolio that would differ from those presented above, and such differences might be significant and adverse. See "Special Note Regarding Forward-Looking Statements."

### **Item 4. Controls and Procedures**

#### ***Disclosure Controls and Procedures***

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in the reports that we file or submit under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the SEC, and that such information is accumulated and communicated to our management as appropriate to allow timely decisions regarding required disclosures. An evaluation was performed under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended) as of June 30, 2011. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of June 30, 2011.

#### ***Internal Control Over Financial Reporting***

There have been no changes in our internal control over financial reporting that occurred during the last fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## **PART II. OTHER INFORMATION**

### **Item 1. Legal Proceedings**

Neither we nor our Manager is currently subject to any legal proceedings that we or our Manager considers to be material. Nevertheless, we, our Manager and Ellington operate in highly regulated markets that currently are under intense regulatory scrutiny, and Ellington and its affiliates have received, and we expect in the future that they may receive, inquiries and requests for documents and information from various federal, state and foreign regulators. These have included the inquiries and requests that are described in the risk factors included in Item 1A of our Annual Report on Form 10-K for the fiscal year ended December 31, 2010 under the caption "We or Ellington or its affiliates may be subject to regulatory inquiries or proceedings." Ellington has advised us that, at the present time, it is not aware that any material legal proceeding against Ellington and its affiliates is contemplated in connection with any of these

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inquiries or requests. However, we believe that the continued scrutiny of CDO market participants (including large CDO collateral managers such as Ellington) increases the risk of additional inquiries and requests from regulatory or enforcement agencies. Ellington and we cannot provide any assurance that these inquiries and requests will not result in further investigation of or the initiation of a proceeding against Ellington or its affiliates or that, if any such investigation or proceeding were to arise, it would not materially adversely affect our company.

### **Item 1A. Risk Factors**

For information regarding factors that could affect our results of operations, financial condition and liquidity, see the risk factors discussed under “Risk Factors” in Part I, Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2010. See also “Forward-Looking Statements,” included in Part I, Item 2 of this Quarterly Report on Form 10-Q. There have been no material changes from the risk factors previously disclosed in our Annual Report on Form 10-K for the year ended December 31, 2010.

### **Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

#### ***Unregistered Sales of Equity Securities***

On February 11, 2010, we issued 2,500 common shares in exchange for LTIP units held by one of our directors. This issuance was exempt from the registration requirements of the Securities Act based on the exemption provided by Section 4(2) of the Securities Act.

On February 17, 2010, we issued 9,082 common shares to our Manager as part of its incentive fee pursuant to our management agreement with our Manager. The issuance was exempt from the registration requirements of the Securities Act based on the exemption provided by Section 4(2) of the Securities Act.

On May 10, 2010, we issued 1,975 common shares to our Manager as part of its incentive fee pursuant to our management agreement with our Manager. The issuance was exempt from the registration requirements of the Securities Act based on the exemption provided by Section 4(2) of the Securities Act.

On October 1, 2010, we granted 1,250 LTIP units to Thomas Robards, 1,250 LTIP units to Ronald I. Simon, Ph.D., and 1,250 LTIP units to Edward Resendez as compensation for serving as directors. These grants were made pursuant to our 2007 Individual Incentive Plan and such grants were exempt from the registration requirements of the Securities Act based on the exemption provided in Rule 701 promulgated under the Securities Act.

On November 15, 2010, we issued 11,422 common shares to our Manager as part of its incentive fee pursuant to our management agreement with our Manager. This issuance was exempt from the registration requirements of the Securities Act provided by Section 4(2) of the Securities Act.

On December 15, 2010, pursuant to our 2007 Individual Incentive Plan, we granted 2,000 LTIP units to Lisa Mumford, our dedicated Chief Financial Officer, and 500 LTIP units to another employee of our Manager. The LTIP units are subject to forfeiture restrictions that will lapse one year from the date of grant. Such grants were exempt from the registration requirements of the Securities Act based on the exemption provided in Rule 701 promulgated under the Securities Act.

On December 31, 2010, we issued 1,250 common shares in exchange for LTIP units held by one of our directors. This issuance was exempt from the registration requirements of the Securities Act based on the exemption provided by Section 4(2) of the Securities Act.

On February 17, 2011, we issued 6,400 common shares to our Manager as part of its incentive fee pursuant to our management agreement with our Manager. This issuance was exempt from the registration requirements of the Securities Act based on the exemption provided by Section 4(2) of the Securities Act.

On May 3, 2011, we issued 2,639 common shares to our Manager as part of its incentive fee pursuant to our management agreement with our Manager. This issuance was exempt from the registration requirements of the Securities Act based on the exemption provided by Section 4(2) of the Securities Act.

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### ***Purchases of Equity Securities***

On August 8, 2011, the Company announced that its Board of Directors had approved the adoption of a \$10.0 million share repurchase program. The program, which is open-ended in duration, allows the Company to make repurchases from time to time on the open market or in negotiated transactions. Repurchases are at the Company's discretion, subject to applicable law, share availability, price, and the Company's financial performance, among other considerations.

### **Item 5. Other Information.**

On August 8, 2011, the Board of Directors of the Company approved the First Amendment to the Second Amended and Restated Operating Agreement of the Company (the "Operating Agreement Amendment") effective immediately. The Operating Agreement Amendment removes the first sentence of Section 2.3(b) regarding share repurchases which provided for a procedure for certain repurchases by the Company prior to the Company's initial public offering and listing on the New York Stock Exchange. A copy of the Operating Agreement Amendment is attached as Exhibit 3.2 to this quarterly report on Form 10-Q and is incorporated by reference herein.

### **Item 6. Exhibits**

<u>Exhibit</u>	<u>Description</u>
3.1	Second Amended and Restated Operating Agreement of Ellington Financial LLC (incorporated by reference to the registration statement on Form S-11 (No. 333-160562), filed on July 14, 2009, as amended).
3.2	First Amendment to Second Amended and Restated Operating Agreement of Ellington Financial LLC.
4.1	Form of Common Share Certificate of Ellington Financial LLC (incorporated by reference to the registration statement on Form S-11 (No. 333-160562), filed on July 14, 2009, as amended).
10.1	Third Amended and Restated Management Agreement effective August 2, 2011.
31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes – Oxley Act of 2002
31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes – Oxley Act of 2002
32.1*	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes – Oxley Act of 2002
32.2*	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes – Oxley Act of 2002
101	Submitted electronically herewith. Attached as Exhibit 101 to this report are the following documents formatted in XBRL (Extensible Business Reporting Language): (i) Consolidated Statement of Assets, Liabilities and Shareholders' Equity (Unaudited) at June 30, 2011 and December 31, 2010, (ii) Consolidated Statement of Changes in Shareholders' Equity (Unaudited) for the three and six month periods ended June 30, 2011 and June 30, 2010, (iii) Consolidated Statement of Cash Flows (Unaudited) for the six month periods ended June 30, 2011 and 2010, (iii) Notes to Consolidated Financial Statements (Unaudited). Users of this data are advised pursuant to Rule 406T of Regulation S-T that this interactive data file is deemed not filed or part of a registration statement or prospectus for purposes of sections 11 or 12 of the Securities Act of 1933, is deemed not filed for purposes of section 18 of the Securities and Exchange Act of 1934, and otherwise is not subject to liability under these sections.

\* Furnished herewith. These certifications are not deemed "filed" for purposes of Section 18 of the Securities Exchange Act of 1934, as amended.



**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

ELLINGTON FINANCIAL LLC.

Date: August 10, 2011

By: /s/ Laurence Penn  
Laurence Penn  
Chief Executive Officer  
(Principal Executive Officer)

Date: August 10, 2011

By: /s/ Lisa Mumford  
Lisa Mumford  
Chief Financial Officer  
(Principal Financial and Accounting Officer)

**EXHIBIT INDEX**

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\* Furnished herewith. These certifications are not deemed "filed" for purposes of Section 18 of the Securities Exchange Act of 1934, as amended.

**FIRST AMENDMENT TO THE  
SECOND AMENDED AND RESTATED  
OPERATING AGREEMENT  
OF  
ELLINGTON FINANCIAL LLC**

This First Amendment (the "Amendment") to the Second Amended and Restated Operating Agreement (the "Operating Agreement") of Ellington Financial LLC, a Delaware limited liability company (the "Company") shall be effective as of the 8th day of August, 2011 and is entered into by Ellington Financial LLC, a Delaware limited liability company (the "Company"), Ellington Financial Management, LLC, a Delaware limited liability company (the "Manager"), and any other Persons who are or hereafter become Members in the Company or parties hereto as provided in the Agreement.

**RECITALS**

**WHEREAS**, the Company, the Manager and the Members are parties to the Agreement; and

**WHEREAS**, pursuant to Section 17.3 of the Agreement, the Board of Directors desires to amend the Agreement in order to delete the first sentence of Section 2.3(b) of the Agreement in its entirety;

**AGREEMENT**

**NOW, THEREFORE**, the undersigned hereby agree as follows:

Section 1. Amendment of Section 2.3 of the Operating Agreement. The first sentence of Section 2.3(b) of the Agreement is hereby deleted in its entirety and Section 2.3 is hereby amended to read in its entirety as follows:

Section 2.3. Repurchase of Shares by the Company.

(a) The Board of Directors shall have authority to cause the Company to conduct a capital reduction, including the repurchase of any number of issued and Outstanding Shares; *provided, however*, that the Company shall not purchase or redeem any Shares for cash or other property if any such purchase or redemption would be inconsistent with the requirements of Section 18-607 or Section 18-804 of the Act.

(b) Any Shares tendered and repurchased by the Company in accordance with this Section 2.3 shall be deemed to be authorized and issued, but not Outstanding and, subject to Section 2.1, may subsequently be Sold for due consideration.

Section 2. Counterpart Execution. This Amendment may be executed in one or more counterparts, each of which shall be deemed an original, and all of which together shall constitute one and the same instrument.

[Signature Pages Follow]

IN WITNESS WHEREOF, this Amendment to the Operating Agreement is executed as of the 8th day of August, 2011.

**ELLINGTON FINANCIAL LLC**

By: /s/ Laurence Penn  
Name: Laurence Penn  
Title: Chief Executive Officer and President

**ELLINGTON FINANCIAL MANAGEMENT LLC**

By: /s/ Lisa Mumford  
Name: Lisa Mumford  
Title: Chief Financial Officer

**CHIEF EXECUTIVE OFFICER, ON BEHALF OF THE MEMBERS, BY POWER OF ATTORNEY PURSUANT TO SECTION 1.4 OF THE OPERATING AGREEMENT**

By: /s/ Laurence Penn  
Name: Laurence Penn  
Title: Chief Executive Officer and President

**THIRD AMENDED AND RESTATED MANAGEMENT AGREEMENT**

This THIRD AMENDED AND RESTATED MANAGEMENT AGREEMENT is effective as of August 2, 2011 (this “Agreement”) by and between Ellington Financial LLC, a Delaware limited liability company (the “Company”), and Ellington Financial Management LLC, a Delaware limited liability company (the “Manager”).

**W I T N E S S E T H:**

WHEREAS, the Company is a specialty finance company that specializes in acquiring and managing various mortgage-related assets;

WHEREAS, the Company has retained the Manager to manage the assets, operations and affairs of the Company pursuant to that certain Amended and Restated Management Agreement, dated as of July 1, 2009 the (“Previous Management Agreement”); and

WHEREAS, the Company and the Manager desire to amend and restate the terms of the Previous Management Agreement as described herein on the terms and conditions hereinafter set forth.

**AGREEMENT**

NOW, THEREFORE, in consideration of the mutual agreements herein set forth, the parties hereto agree as follows:

**1. Definitions.**

(a) “Adjusted Net Income” means, for any Incentive Calculation Period, the excess, if any, of (i) the Company’s Net Income for such period over (ii) the Loss Carryforward, if any, as of the end of the fiscal quarter immediately preceding such period; provided that for the purpose of this definition of Adjusted Net Income only, Net Income: (i) shall be determined after deducting all Quarterly Base Management Fee Amounts incurred during such period (including Quarterly Base Management Fee Amounts for the last fiscal quarter of such period), (ii) shall be determined before determining the Quarterly Incentive Fee Amount for the last fiscal quarter of such period, and shall be adjusted by reversing any Quarterly Incentive Fee Amount charges for prior fiscal quarters during such period, (iii) shall be determined before any non-cash equity compensation expenses for such period (including any such expenses remaining to be charged with respect to such period and reversing any other such expenses previously charged during such period), and (iv) shall be adjusted to exclude one-time events pursuant to changes in GAAP, as well as non-cash charges after discussion between the Manager and the Independent Directors and approval by a majority of the Independent Directors in the case of non-cash charges.

(b) “Affiliate” shall mean, with respect to any Person, any Person controlling, controlled by, or under common Control with, such Person.

(c) “Agreement” has the meaning assigned in the first paragraph.

(d) “Base Management Fee Annual Rate” means 1.50%.

(e) "Board of Directors" means the Board of Directors of the Company.

(f) "CDO" means a collateralized debt obligation.

(g) "Change of Control" means the occurrence of any of the following:

(i) the sale, lease or transfer, in one or a series of related transactions, of all or substantially all of the assets of the Manager, taken as a whole, to any Person other than EMG Holdings or any of its Affiliates; or

(ii) the acquisition by any Person or group (within the meaning of Section 13(d)(3) or Section 14(d)(2) of the Exchange Act, or any successor provision), including any group acting for the purpose of acquiring, holding or disposing of securities (within the meaning of Rule 13d-5(b)(1) under the Exchange Act), other than EMG Holdings or any of its Affiliates, in a single transaction or in a series of related transactions, by way of merger, consolidation or other business combination or purchase of beneficial ownership (within the meaning of Rule 13d-3 under the Exchange Act, or any successor provision) of 50% or more of the total voting power of the voting capital interests of the Manager; or

(iii) the departure of Michael Vranos from senior management of Ellington, whether through resignation, retirement, withdrawal, Disability, death, or termination of employment with or without cause or for any other reason.

(h) "Code" means the Internal Revenue Code of 1986, as amended.

(i) "Common Shares" means the common shares, no par value per share, representing limited liability interests of the Company, but does not include any LTIP Unit.

(j) "Company" has the meaning assigned in the first paragraph; provided that all references herein to the Company shall, except as otherwise expressly provided herein, be deemed to include any Subsidiaries.

(k) "Company Account" has the meaning assigned in Section 5.

(l) "Confidential Information" means all non-public information, written or oral, obtained by the Manager in connection with the services rendered hereunder.

(m) "Compliance Policies" means the compliance policies and procedures of Ellington, as in effect from time to time.

(n) "Control" shall mean the possession, directly or indirectly, of the power to direct or cause the direction of the management or policies of another Person, whether by contract, voting equity, legal right or otherwise.

(o) "Cross Transactions" has the meaning assigned in Section 3(c).

(p) "Dedicated Officers" has the meaning assigned in Section 3(a).

(q) “Disability” occurs when a person is unable, due to a physical or mental condition, to perform the essential functions of his position with or without reasonable accommodation for six (6) months in the aggregate during any twelve (12) month period or based on the written certification by two licensed physicians of the likely continuation of such condition for such period, one selected by Ellington or its insurance carrier and the other selected by the person or his legal representative. This definition shall be interpreted and applied consistent with the Americans with Disabilities Act, the Family and Medical Leave Act, Section 409A of the Code and other applicable law.

(r) “Ellington” means Ellington Management Group, L.L.C., a Delaware limited liability company.

(s) “EMG Holdings” means EMG Holdings, L.P., a Delaware limited partnership.

(t) “Exchange Act” means the Securities Exchange Act of 1934, as amended, and the rules and regulations promulgated thereunder.

(u) “Expenses” has the meaning assigned in Section 9.

(v) “GAAP” means generally accepted accounting principles in effect in the U.S. on the date such principles are applied consistently.

(w) “Governing Instruments” means, with respect to any Person, the articles of incorporation and bylaws in the case of a corporation, the certificate of limited partnership (if applicable) and partnership agreement in the case of a general or limited partnership or the articles or certificate of formation and operating agreement in the case of a limited liability company.

(x) “Hurdle Amount” means, with respect to any fiscal quarter, the product of (i) one-fourth of the Hurdle Rate for such fiscal quarter, (ii) the Hurdle Price Per Share for such fiscal quarter, and (iii) the average number of Common Shares and LTIP units outstanding for each day during such fiscal quarter.

(y) “Hurdle Price Per Share” means, with respect to any fiscal quarter, the sum of (i) the weighted average gross proceeds per share of all Company Common Share issuances up to the end of such fiscal quarter, with each such issuance weighted by both the number of shares issued in such issuance and the number of days that such issued shares were outstanding during such fiscal quarter, using FIFO accounting (i.e., attributing any share repurchases to the earliest issuances first) and (ii) the result obtained by dividing (A) retained earnings attributable to our Common Shares at the beginning of such fiscal quarter by (B) the average number of Common Shares outstanding for each day during such fiscal quarter. For purposes of determining the Hurdle Price Per Share, issuances of Common Shares (i) as equity incentive awards to the Manager, any Affiliates of the Manager or of the Company, or any of the respective directors, officers, employees, managers, members, partners, consultants, agents or representatives of the foregoing or of the Company, (ii) to the Manager as part of any compensation or payments from the Company, such as pursuant to Section 8(c) or (iii) to the Manager or any of its Affiliates in a privately negotiated transaction with the Company in which



the purchase price and other terms of the transaction are not determined by a third party, shall be excluded from the calculation.

(z) "Hurdle Rate" means, with respect to any fiscal quarter, the greater of (i) 9% and (ii) 3% plus the Ten-Year U.S. Treasury Rate for such fiscal quarter.

(aa) "Incentive Calculation Period" related to any fiscal quarter means (i) if such fiscal quarter is a Transitional Fiscal Quarter, the period consisting of all Transitional Fiscal Quarters up to and including such Transitional Fiscal Quarter; and (ii) if such fiscal quarter is not a Transitional Fiscal Quarter, the period consisting of the four fiscal quarters ending with and including such fiscal quarter.

(bb) "Incentive Fee Rate" means 25%.

(cc) "Indemnitee" has the meaning assigned in Section 11(d).

(dd) "Indemnitor" has the meaning assigned in Section 11(d).

(ee) "Independent Directors" means the members of the Board of Directors who are not officers or employees of the Company, the Manager or Ellington and who are otherwise "independent" in accordance with the Company's Operating Agreement and, at any time during which any securities of the Company are listed on the New York Stock Exchange or another securities exchange, the rules of the New York Stock Exchange or such other securities exchange, as applicable, as may be in effect from time to time.

(ff) "Initial Public Offering" means the initial public offering of the Common Shares.

(gg) "Investments" means the investments of the Company.

(hh) "Investment and Risk Management Committee" has the meaning assigned in Section 7(d).

(ii) "Investment Company Act" means the Investment Company Act of 1940, as amended.

(jj) "Investment Guidelines" means the general criteria, parameters and policies relating to Investments as established by the Board of Directors, as the same may be modified from time-to-time.

(kk) "Last Appraiser" has the meaning assigned in Section 8(e).

(ll) "Loss Carryforward" means, as of the end of any fiscal quarter, the excess, if any, of (i) the Loss Carryforward as of the end of the immediately preceding fiscal quarter over (ii) the Company's Net Income for such fiscal quarter (expressed as a positive number) or Net Loss for such fiscal quarter (expressed as a negative number), as the case may be, provided that the foregoing calculation of Loss Carryforward shall be adjusted to exclude one-time events pursuant to changes in GAAP, as well as non-cash charges after discussion between the Manager

and the Independent Directors and approval by a majority of the Independent Directors in the case of non-cash charges.

(mm) "LTIP Unit" means a limited liability company interest which is designated as a LTIP Unit and which has the rights, preference and other privileges designated in the Company's Operating Agreement in respect of holders of LTIP Units.

(nn) "Manager" means Ellington Financial Management LLC, a Delaware limited liability company.

(oo) "Net Income" means, with respect to any period consisting of one or more consecutive fiscal quarters, the Company's net increase in shareholders' equity resulting from operations for such period calculated in accordance with GAAP (or such equivalent GAAP measure based on the basis of presentation of the Company's consolidated financial statements).

(pp) "Net Loss" means, with respect to any period consisting of one or more consecutive fiscal quarters, the Company's net decrease in shareholders' equity resulting from operations for such period calculated in accordance with GAAP (or such equivalent GAAP measure based on the basis of presentation of the Company's consolidated financial statements).

(qq) "Operating Agreement" means the Company's Amended and Restated Operating Agreement, originally dated as of August 17, 2007, and as amended from time to time.

(rr) "Person" means any individual, corporation, partnership, joint venture, limited liability company, estate, trust, unincorporated association, any federal, state, county or municipal government or any bureau, department or agency thereof and any fiduciary acting in such capacity on behalf of any of the foregoing.

(ss) "Previous Management Agreement" has the meaning set forth in the recitals to this Agreement.

(tt) "PORTAL" means The PORTAL<sup>SM</sup> Market, which is a subsidiary of The NASDAQ OMX Group, Inc.

(uu) "Principal Transaction" has the meaning assigned in Section 3(d).

(vv) "Quarterly Base Management Fee Amount" means, with respect to any fiscal quarter, the product of: (i) the Shareholders' Equity as of the end of such fiscal quarter, and (ii) one-fourth of the Base Management Fee Annual Rate.

(ww) "Quarterly Incentive Fee Amount" means, with respect to any fiscal quarter, the excess, if any, of (i) the product of (A) the Incentive Fee Rate and (B) the excess of (1) the Adjusted Net Income for the related Incentive Calculation Period over (2) the sum of the Hurdle Amounts for each fiscal quarter comprising the related Incentive Calculation Period, over (ii) the sum of the Quarterly Incentive Fee Amounts for each fiscal quarter, other than the final fiscal quarter, comprising the related Incentive Calculation Period.

(xx) "Records" has the meaning assigned in Section 6(a).

(yy) “Representatives” means collectively the Manager’s Affiliates, officers, directors, employees, agents and representatives.

(zz) “SEC” means the United States Securities and Exchange Commission.

(aaa) “Securities Act” means the Securities Act of 1933, as amended, and the rules and regulations promulgated thereunder.

(bbb) “Services Agreement” has the meaning assigned in Section 2(c).

(ccc) “Shareholders’ Equity” means, as of the end of any fiscal quarter, the shareholders’ equity of the Company calculated in accordance with GAAP (before deductions for Quarterly Base Management Fee Amounts payable with respect to such fiscal quarter, and before deductions for Quarterly Incentive Fee Amounts payable with respect to such fiscal quarter), *provided* that Shareholders’ Equity will be adjusted to exclude one-time events pursuant to changes in GAAP, as well as non-cash charges after discussion between the Manager and the Independent Directors and approval by a majority of the Independent Directors in the case of non-cash charges.

(ddd) “Split Price Executions” has the meaning assigned in Section 3(e).

(eee) “Subsidiary” means any subsidiary of the Company, any partnership, the general partner of which is the Company or any subsidiary of the Company and any limited liability company, the managing member of which is the Company or any subsidiary of the Company.

(fff) “Tax Preparer” has the meaning assigned in Section 7(f).

(ggg) “Ten-Year U.S. Treasury Rate” means, for any fiscal quarter, the average yield (expressed as a per annum rate) on U.S. Treasury securities adjusted to a constant maturity of ten years for the most recent week ending before (but not on) the beginning of such fiscal quarter that the Federal Reserve Board publishes in Federal Reserve Statistical Release No. H.15 (519) (currently published by the Federal Reserve at [www.federalreserve.gov/releases/h15/current](http://www.federalreserve.gov/releases/h15/current)). In the event Federal Reserve Statistical Release No. H.15 (519) is not published or is otherwise unavailable, the Manager will determine the Ten-Year U.S. Treasury Rate in good faith in consultation with the Board of Directors.

(hhh) “Termination Fee” means, with respect to any termination or non-renewal of this Agreement with respect to which payment of the Termination Fee is required under Section 13 of this Agreement, a termination fee equal to the amount of three times the sum of (i) the average annual Quarterly Base Management Fee Amounts paid or payable with respect to the two 12-month periods ending on the last day of the latest fiscal quarter completed on or prior to the effective date of such termination and (ii) the average annual Quarterly Incentive Fee Amounts paid or payable with respect to the two 12-month periods ending on the last day of the latest fiscal quarter completed on or prior to the effective date of such termination; *provided, however*, to the extent any portion of the above-referenced two 12-month periods includes any fiscal quarters prior to July 1, 2009 (“Prior Quarters”), for purposes of calculating the Termination Fee only: (a) the Quarterly Base Management Fee Amounts paid or payable with

respect to any Prior Quarter shall mean the sum of the base management fees paid or payable under the Previous Management Agreement with respect to such Prior Quarter and the special distributions paid or payable to the Manager with respect to such Prior Quarter pursuant to clause (i) of Section 5.5 of the Operating Agreement as in effect at that time and (b) the Quarterly Incentive Fee Amounts paid or payable with respect to any Prior Quarter shall mean the sum of the incentive fees paid or payable under the Previous Management Agreement with respect to such Prior Quarter and the special distributions paid or payable to the Manager with respect to such Prior Quarter pursuant to clause (ii) of Section 5.5 of the Operating Agreement as in effect at that time; and *provided further* that if two full 12-month periods have not elapsed under this Agreement and the Previous Agreement as of the last day of the latest fiscal quarter completed on or prior to the effective date of such termination, the Quarterly Base Management Fee Amounts and Quarterly Incentive Fee Amounts paid or payable for the second partial 12-month period shall be annualized for the purposes of calculating the Termination Fee.

(iii) "Transitional Fiscal Quarter" means a fiscal quarter ending on September 30, 2009, December 31, 2009, or March 31, 2010.

(jjj) "Treasury Regulations" means the Procedures and Administration Regulations promulgated by the U.S. Department of Treasury under the Code, as amended.

(kkk) "Valuation Notice" has the meaning assigned in Section 8(e).

## 2. Appointment and Duties of the Manager.

(a) *Appointment.* The Company hereby appoints the Manager to manage, operate and administer the assets, operations and affairs of the Company subject to the further terms and conditions set forth in this Agreement, and the Manager hereby agrees to use its commercially reasonable efforts to perform each of the duties set forth herein in accordance with the provisions of this Agreement.

(b) *Duties.* The Manager shall manage, operate and administer the Company's day-to-day operations, business and affairs, subject to the supervision of the Board of Directors, and shall have only such functions and authority as the Company may delegate to it, including, without limitation, the authority identified and delegated to the Manager herein. Without limiting the foregoing, the Manager shall oversee and conduct the Company's investment activities in accordance with the Investment Guidelines attached hereto as Exhibit A, as amended from time to time, and other policies adopted and implemented by the Board of Directors. Subject to the foregoing, the Manager will perform (or cause to be performed) such services and activities relating to the management, operation and administration of the assets, liabilities and business of the Company as is appropriate, including, without limitation:

(i) serving as the Company's consultant with respect to the periodic review of the Investment Guidelines and other policies and criteria for the other borrowings and the operations of the Company for the approval by the Board of Directors;

(ii) investigating, analyzing and selecting possible Investment opportunities and originating, acquiring, structuring, financing, retaining, selling, negotiating for prepayment, restructuring or disposing of Investments consistent with the Investment Guidelines;

(iii) with respect to any prospective Investment by the Company and any sale, exchange or other disposition of any Investment by the Company, including the accumulation of assets for securitization, conducting negotiations on the Company's behalf with sellers and purchasers and their respective agents, representatives and investment bankers, and owners of privately and publicly held real estate companies;

(iv) engaging and supervising, on the Company's behalf and at the Company's sole cost and expense, third party service providers who provide legal, accounting, due diligence, transfer agent, registrar, leasing services, master servicing, special servicing, banking, investment banking, mortgage brokerage, real estate brokerage, securities brokerage and other financial services and such other services as may be required relating to the Investments or potential Investments and to the Company's other business and operations;

(v) coordinating and supervising, on behalf of the Company and at the Company's sole cost and expense, other third party service providers to the Company;

(vi) serving as the Company's consultant with respect to (vi) arranging for any issuance of mortgage-backed securities from pools of mortgage loans or mortgage backed securities owned by the Company;

(vii) coordinating and managing operations of any joint venture or co-investment interests held by the Company and conducting all matters with any joint venture or co-investment partners;

(viii) providing executive and administrative personnel, office space and office services required in rendering services to the Company;

(ix) administering the Company's day-to-day operations and performing and supervising the performance of such other administrative functions necessary to the Company's management as may be agreed upon by the Manager and the Board of Directors, including, without limitation, the collection of revenues and the payment of the Company's debts and obligations and maintenance of appropriate computer services to perform such administrative functions;

(x) in connection with an Initial Public Offering and the Company's subsequent, on-going obligations under the Sarbanes Oxley Act of 2002 and the Exchange Act, engaging and supervising, on the Company's behalf and at the Company's sole cost and expense, third party consultants and other service providers to assist the Company in complying with the requirements of the Sarbanes Oxley Act of 2002 and the Exchange Act;

(xi) communicating on the Company's behalf with the holders of any of the Company's equity or debt securities as required to satisfy the reporting and other requirements of any governmental bodies or agencies or trading markets and to maintain effective relations with such holders;

(xii) counseling the Company in connection with policy decisions to be made by the Board of Directors;

(xiii) counseling the Company, and when appropriate, evaluating and making recommendations to the Board of Directors regarding hedging, financing and securitization strategies and engaging in hedging, financing, borrowing and securitization activities on the Company's behalf, consistent with the Investment Guidelines;

(xiv) counseling the Company regarding the maintenance of the Company's exclusion from status as an investment company under the Investment Company Act and monitoring compliance with the requirements for maintaining such exclusion and using commercially reasonable efforts to cause the Company to maintain such exclusion from status as an investment company under the Investment Company Act;

(xv) assisting the Company in developing criteria for asset purchase commitments that are specifically tailored to the Company's investment objectives and making available to the Company its knowledge and experience with respect to mortgage loans, real estate, real estate related securities, other real estate related assets, asset-backed securities, non-real estate related assets and real estate operating companies;

(xvi) furnishing such reports to the Company or the Board of Directors that the Manager reasonably determines to be responsive to reasonable requests for information from the Company or the Board of Directors regarding the Company's activities and services performed for the Company or any of its Subsidiaries by the Manager;

(xvii) monitoring the operating performance of the Investments and providing periodic reports with respect thereto to the Board of Directors, including comparative information with respect to such operating performance and budgeted or projected operating results;

(xviii) investing or reinvesting any money or securities of the Company (including investing in short-term investments pending investment in other Investments, payment of fees, costs and expenses, or distributions to the Company's shareholders), and advising the Company as to the Company's capital structure and capital raising;

(xix) causing the Company to retain, at the sole cost and expense of the Company, qualified independent accountants and legal counsel, as applicable, to assist in developing appropriate accounting procedures, compliance procedures and testing systems with respect to financial reporting obligations, including soliciting shareholders for required information to the extent provided by the provisions of the Code and the Treasury Regulations applicable to the Company, and to conduct quarterly compliance reviews with respect thereto;

(xx) causing the Company to qualify to do business in all applicable jurisdictions and to obtain and maintain all appropriate licenses;

(xxi) assisting the Company in complying with all regulatory requirements applicable to the Company in respect of the Company's business activities, including preparing or causing to be prepared all financial statements required under applicable regulations and contractual undertakings and all reports and documents, if any, required under the Exchange Act and the Securities Act;

(xxii) taking all necessary actions to enable the Company to make required tax filings and reports and compliance with the provisions of the Code, and Treasury Regulations applicable to the Company, including, without limitation, the provisions applicable to the taxation of the Company as a partnership, and not an association or publicly traded partnership taxable as a corporation, for U.S. federal income tax purposes;

(xxiii) handling and resolving all claims, disputes or controversies (including all litigation, arbitration, settlement or other proceedings or negotiations) in which the Company may be involved or to which the Company may be subject arising out of the Company's day-to-day operations, subject to such limitations or parameters as may be imposed from time to time by the Board of Directors;

(xxiv) using commercially reasonable efforts to cause expenses incurred by or on behalf of the Company to be commercially reasonable or commercially customary and within any budgeted parameters or expense guidelines set by the Board of Directors from time to time;

(xxv) advising on, and obtaining on behalf of the Company, appropriate warehouse and similar credit facilities or other financings for the Investments consistent with the Investment Guidelines;

(xxvi) advising the Company with respect to and structuring long-term financing vehicles for the Company's portfolio of assets, and offering and selling securities publicly or privately in connection with any such structured financing;

(xxvii) performing such other services as may be required from time to time for management and other activities relating to the Company's assets as the Board of Directors shall reasonably request or the Manager shall deem appropriate under the particular circumstances; and

(xxviii) using commercially reasonable efforts to cause the Company to comply with all applicable laws.

(c) *Services Agreement.* The Manager will maintain that certain services agreement, dated August 17, 2007, by and between the Manager and Ellington (the "Services Agreement") pursuant to which Ellington and its Affiliates will continue to provide the Manager the personnel, services and resources as needed by the Manager to enable the Manager to carry out its obligations and responsibilities under this Agreement, including due diligence, asset management and credit risk management. The Company will continue to be a named third party beneficiary of the Services Agreement.

(d) *Service Providers.* The Manager may engage Persons who are non-Affiliates, for and on behalf, and at the sole cost and expense, of the Company to provide to the Company acquisition, disposition, asset management, property management, leasing, financing, development, disposition of real estate and/or similar services customarily provided in connection with the management, operation and administration of a business similar to the business of the Company, pursuant to agreement(s) that provide for market rates and contain standard market terms.

(e) *Reporting Requirements.*

(i) As frequently as the Manager may deem necessary or advisable, or at the direction of the Board of Directors, the Manager shall prepare, or cause to be prepared, with respect to any Investment (A) reports and information on the Company's operations and asset performance and (B) other information reasonably requested by the Company.

(ii) The Manager shall prepare, or cause to be prepared, at the sole cost and expense of the Company, all reports, financial or otherwise, with respect to the Company reasonably required by the Board of Directors in order for the Company to comply with its Operating Agreement or any other materials required to be filed with any governmental entity or agency, and shall prepare, or cause to be prepared, at the sole cost and expense of the Company, all materials and data necessary to complete such reports and other materials including, without limitation, an annual audit of the Company's books of account by a nationally recognized independent accounting firm, currently PricewaterhouseCoopers LLP.

(iii) The Manager shall prepare regular reports for the Board of Directors to enable the Board of Directors to review the Company's acquisitions, portfolio composition and characteristics, credit quality, performance and compliance with the Investment Guidelines and policies approved by the Board of Directors.

(f) *Reliance by Manager.* In performing its duties under this Section 2, the Manager shall be entitled to rely on qualified experts and professionals (including, without limitation, accountants, legal counsel and other professional service providers) hired by the Manager at the Company's sole cost and expense.

(g) *Use of the Manager's Funds.* The Manager shall not be required to expend money in connection with any expenses that are required to be paid for or reimbursed by the Company pursuant to Section 9 of this Agreement in excess of that contained in any applicable Company Account or otherwise made available by the Company to be expended by the Manager hereunder.

(h) *Payment and Reimbursement of Expenses.* The Company shall pay all expenses, and reimburse the Manager for the Manager's expenses incurred on its behalf, in connection with any such services to the extent such expenses are payable or reimbursable by the Company to the Manager pursuant to Section 9.

**3. Dedication; Other Activities.**

(a) *Devotion of Time.* The Manager, through Ellington and its Affiliates, will provide a management team (including, without limitation, a chief executive officer and president, a chief operating officer, a chief financial officer, a chief investment officer, a controller, a legal officer and a secretary) along with appropriate support personnel, to deliver the management services to the Company hereunder. The members of such management team shall devote such of their working time and efforts to the management of the Company as the Manager deems reasonably necessary and appropriate for the proper performance of all of the Manager's duties hereunder, commensurate with the level of activity of the Company from time to time; *provided, however*, that the Manager (i) shall, no later than the effective date of a registration



statement filed by the Company with the Securities and Exchange Commission with respect to an Initial Public Offering, provide a dedicated chief financial officer who shall devote all or substantially all of his or her working time and efforts to his or her duties as the chief financial officer of the Company and (ii) shall have the right, but not the obligation, to provide a dedicated controller and a dedicated or partially dedicated internal legal counsel to the Company. If the Manager elects to provide a dedicated controller and/or a dedicated internal legal counsel to the Company, he or she shall devote all or substantially all of his or her working time and efforts to his or her duties as the controller or internal legal counsel. If the Manager elects to provide a partially dedicated internal legal counsel to the Company, such internal legal counsel shall be required to prioritize Company-related matters over non-Company matters. The dedicated chief financial officer provided by the Manager and any dedicated controller and dedicated or partially dedicated internal legal counsel that the Manager elects to provide, each of whom will be an employee of the Manager or one of its Affiliates, are referred to herein as “Dedicated Officers.” The Company shall have the benefit of the Manager’s reasonable judgment and effort in rendering services and, in furtherance of the foregoing, the Manager shall not undertake activities which, in its reasonable judgment, will materially adversely affect the performance of its obligations under this Agreement.

(b) *Other Activities.* Except to the extent set forth in clause (a) above, and subject to Ellington’s Compliance Policies, the Company’s conflicts of interest policy as it may exist from time to time, Ellington’s investment allocation policy as it may exist from time to time and the Company’s Investment Guidelines, nothing herein shall prevent the Manager, Ellington, EMG Holdings or any of their Affiliates or any of the officers, directors or employees of any of the foregoing, from engaging in other businesses or from rendering services of any kind to any other Person, including, without limitation, investing in, or rendering advisory services to others investing in, any type of real estate, real estate related investment or non-real estate related investment or other mortgage loans (including, without limitation, investments that meet the principal investment objectives of the Company), whether or not the investment objectives or policies of any such other Person are similar to those of the Company or in any way bind or restrict the Manager, Ellington, EMG Holdings or any of their Affiliates, officers, directors or employees from buying, selling or trading any securities or commodities for their own accounts or for the account of others for whom the Manager, Ellington, EMG Holdings or any of their Affiliates, officers, directors or employees may be acting.

(c) *Cross Transactions.* Cross transactions are transactions between the Company or one of its subsidiaries, on the one hand, and an account (other than the Company or one of its subsidiaries) that is managed or advised by the Manager, Ellington or one of Ellington’s other investment advisory affiliates, on the other hand (each a “Cross Transaction”). The Manager is authorized to execute Cross Transactions for the Company in accordance with applicable law and the Ellington Compliance Policies. The Company acknowledges that the Manager has a potentially conflicting division of loyalties and responsibilities regarding each party to a Cross Transaction. The Company may at any time, upon written notice to the Manager, revoke its consent to the Manager to execute Cross Transactions. In addition, unless approved in advance by a majority of the Company’s Independent Directors or pursuant to and in accordance with a policy that has been approved by a majority of the Company’s Independent Directors, all Cross Transactions must be effected at then-prevailing market prices.

(d) *Principal Transactions.* Principal transactions are transactions between the Company or one of its subsidiaries, on the one hand, and the Manager, Ellington, or any of their investment advisory affiliates (or any of the related parties of the foregoing, which includes employees of Ellington and their families), on the other hand (each a “Principal Transaction”). The Manager is only authorized to execute Principal Transactions with the prior approval of a majority of the Company’s Independent Directors and in accordance with applicable law. Certain Cross Transactions may also be considered Principal Transactions whenever the Manager, Ellington or any of their investment advisory affiliates (or any of the related parties of the foregoing, which includes employees of Ellington and their families) have a substantial ownership interest in of one of the transacting parties.

(e) *Split Price Executions.* The Manager is authorized to combine purchase or sale orders on the Company’s behalf together with orders for other accounts managed by the Manager, Ellington or any of their Affiliates and allocate the securities or other assets so purchased or sold, on an average price basis or other fair and consistent basis, among such accounts (collectively, “Split Price Executions”). The Company acknowledges that the Manager has a potentially conflicting division of loyalties and responsibilities regarding each party to a Split Price Execution.

(f) *Officers, Employees, Etc.* The Manager’s or its Affiliates’ members, partners, officers, employees and agents may serve as directors, officers, employees, agents, nominees or signatories for the Company or any Subsidiary, to the extent permitted by their Governing Instruments, as may be amended from time to time, or by any resolutions duly adopted by the Board of Directors pursuant to the Company’s Governing Instruments. When executing documents or otherwise acting in such capacities for the Company or such other Subsidiary, such Persons shall use their respective titles with respect to the Company or such Subsidiary.

(g) The Manager agrees to offer the Company the right to participate in all investment opportunities that the Manager determines, in its reasonable and good faith judgment based on the Company's investment objectives, policies and strategies, and other relevant factors, are appropriate for the Company, subject to the Company's Investment Guidelines and the exception that, in accordance with Ellington's Compliance Policies, the Company might not participate in each such opportunity but will on an overall basis equitably participate with the Manager's or any of its Affiliate's other clients in all such opportunities. While information and recommendations supplied to the Company shall, in the Manager's reasonable and good faith judgment, be appropriate under the circumstances and in light of the investment objectives and policies of the Company, they may be different from the information and recommendations supplied by the Manager or any Affiliate of the Manager to other investment companies, funds and advisory accounts. The Manager shall provide to the Company such information, recommendations and any other services, but the Company recognizes that it is not entitled to receive preferential treatment as compared with the treatment given by the Manager or any Affiliate of the Manager to any investment company, fund or advisory account other than any fund or advisory account which contains only funds invested by the Manager (and not any funds of any of its clients or customers).

(h) The Manager is authorized, for and on behalf, and at the sole cost and expense of the Company, to employ such securities dealers for the purchase and sale of investment assets of the Company as may, in the good faith judgment of the Manager, be reasonably necessary for the best execution of such transactions taking into account all relevant factors, including but not limited to such factors as the policies of the Company, price, dealer spread, the size, type and difficulty of the transaction involved, the firm's general execution and operational facilities and the firm's risk in positioning the securities involved. Consistent with this policy, the Manager is authorized to direct the execution of the Company's portfolio transactions to dealers and brokers furnishing statistical information, research and other services deemed by the Manager to be useful or valuable to the performance of its investment advisory functions. Such services may be used by the Manager in connection with its advisory services for clients other than the Company, and such arrangements may be outside the parameters of the "safe harbor" provided by Section 28(e) of the Exchange Act.

(i) The Company agrees to take all actions reasonably required to permit and enable the Manager to carry out its duties and obligations under this Agreement, including, without limitation, all steps reasonably necessary to allow the Manager to file in a timely manner any registration statement required to be filed by the Company or to deliver any financial statements or other reports required to be delivered by the Company. The Company further agrees to use commercially reasonable efforts to make available to the Manager all resources, information and materials reasonably requested by the Manager to enable the Manager to satisfy its obligations hereunder, including its obligations to deliver financial statements and any other information or reports with respect to the Company. If the Manager is not able to provide a service, or in the reasonable judgment of the Manager it is not prudent to provide a service, without the approval of the Board of Directors or the Independent Directors, as applicable, then the Manager shall be excused from providing such service (and shall not be in breach of this Agreement) until the applicable approval has been obtained.

#### **4. Agency; Authority.**

(a) The Manager shall act as the agent of the Company in originating, acquiring, structuring, financing and disposing of Investments, disbursing and collecting the Company's funds, paying the debts and fulfilling the obligations of the Company, supervising the performance of professionals engaged by or on behalf of the Company and handling, prosecuting and settling any claims of or against the Company, the Board of Directors, holders of the Company's securities or the Company's representatives or assets.

(b) In performing the services set forth in this Agreement, as an agent of the Company, the Manager shall have the right to exercise all powers and authority which are reasonably necessary and customary to perform its obligations under this Agreement, including the following powers, subject in each case to the terms and conditions of this Agreement, including, without limitation, the Investment Guidelines:

(i) to purchase, exchange or otherwise acquire and to sell, exchange or otherwise dispose of, any Investment in a public or private sale;

(ii) to execute Cross Transactions;

(iii) to execute Principal Transactions;

(iv) to execute Split Price Executions;

(v) to borrow and, for the purpose of securing the repayment thereof, to pledge, mortgage or otherwise encumber Investments;

(vi) to purchase, take and hold Investments subject to mortgages, liens or other encumbrances;

(vii) to extend the time of payment of any liens or encumbrances which may at any time be encumbrances upon any Investment, irrespective of by whom the same were made;

(viii) to foreclose, to reduce the rate of interest on, and to consent to the modification and extension of the maturity of any Investments, or to accept a deed in lieu of foreclosure;

(ix) to join in a voluntary partition of any Investment;

(x) to cause to be demolished any structures on any real estate Investment;

(xi) to cause renovations and capital improvements to be made to any real estate Investment;

(xii) to abandon any Investment deemed to be worthless;

(xiii) to enter into joint ventures or otherwise participate in investment vehicles investing in Investments;

(xiv) to cause any real estate Investment to be leased, operated, developed, constructed or exploited;

(xv) to cause the Company to indemnify third parties in connection with contractual arrangements between the Company and such third parties;

(xvi) to obtain and maintain insurance in such amounts and against such risks as are prudent in accordance with customary and sound business practices in the appropriate geographic area;

(xvii) to cause any property to be maintained in good state of repair and upkeep; and to pay the taxes, upkeep, repairs, carrying charges, maintenance and premiums for insurance;

(xviii) to use the personnel and resources of its Affiliates in performing the services specified in this Agreement;

(xix) to hire third party service providers subject to and in accordance with Section 2(d);

(xx) to designate and engage all third party professionals and consultants to perform services (directly or indirectly) on behalf of the Company or its Subsidiaries, including, without limitation, accountants, legal counsel and engineers; and

(xxi) to take any and all other actions as are necessary or appropriate in connection with the Company's Investments.

(c) The Manager shall be authorized to represent to third parties that it has the power to perform the actions which it is authorized to perform under this Agreement.

**5. Bank Accounts.** At the direction of the Board of Directors, the Manager may establish and maintain as an agent on behalf of the Company one or more bank accounts in the name of the Company or any other Subsidiary (any such account, a "Company Account"), collect and deposit funds into any such Company Account and disburse funds from any such Company Account, under such terms and conditions as the Board of Directors may approve. The Manager shall from time-to-time render appropriate accountings of such collections and payments to the Board of Directors and, upon request, to the auditors of Company.

**6. Books and Records; Confidentiality.**

(a) *Books and Records.* The Manager shall maintain appropriate books of account, records data and files (including without limitation, computerized material) (collectively, "Records") relating to the Company and the Investments generated or obtained by the Manager in performing its obligations under this Agreement, and such Records shall be accessible for inspection by representatives of the Company or any Subsidiary at any time during normal business hours upon one business day's advance written notice. The Manager shall have full responsibility for the maintenance, care and safekeeping of all Records.

(b) *Confidentiality.* The Manager shall keep confidential any and all non-public information, written or oral, obtained by it in connection with the services rendered hereunder and shall not disclose Confidential Information, in whole or in part, to any Person other than to its Affiliates, officers, directors, employees, agents or representatives who need to know such Confidential Information for the purpose of rendering services hereunder or with the consent of the Company, except: (i) to Ellington and its Affiliates; (ii) in accordance with the Services Agreement or any advisory agreement contemplated by Section 2 hereunder; (iii) with the prior written consent of the Board of Directors; (iv) to legal counsel, accountants and other professional advisors; (v) to appraisers, creditors, financing sources, trading counterparties, other counterparties, third party service providers to the Company, and others (in each case, both those actually doing business with the Company and those with whom the Company seeks to do business) in the ordinary course of the Company's business; (vi) to governmental officials having jurisdiction over the Company; (vii) in connection with any governmental or regulatory filings of the Company or disclosure or presentations to Company investors; or (viii) as required by law or legal process to which the Manager or any Person to whom disclosure is permitted hereunder is a party. If, failing the entry of a protective order or the receipt of a waiver hereunder, the Manager is, in the opinion of counsel, required to disclose Confidential Information, the Manager may disclose only that portion of such information that its counsel advises is legally required without liability hereunder; provided, that the Manager agrees to exercise its best efforts to obtain reliable assurance that confidential treatment will be accorded such information. Notwithstanding anything herein to the contrary, each of the following shall be deemed to be excluded from provisions hereof: any Confidential Information that (A) is available to the public from a source other than the Manager not resulting from the Manager's violation of this Section 6(b), (B) is released in writing by the Company to the public or to persons who are not under similar obligation of confidentiality to the Company, or (C) is obtained by the Manager from a third-party without breach by such third-party of an obligation of confidence with respect to the Confidential Information disclosed. The Manager agrees to inform each of its Representatives of the non-public nature of the Confidential Information and to direct such Persons to treat such Confidential Information in accordance with the terms hereof. The provisions of this Section 6(b) shall survive the expiration or earlier termination of this Agreement for a period of one year.

#### **7. Obligations of Manager; Restrictions.**

(a) *Internal Control.* The Manager shall (i) establish and maintain a system of internal accounting and financial controls designed to provide reasonable assurance of the reliability of financial reporting, the effectiveness and efficiency of operations and compliance with applicable laws, (ii) maintain records for each Company Investment on a GAAP basis, (iii) develop accounting entries and reports required by the Company to meet its reporting requirements under applicable laws, (iv) consult with the Company with respect to proposed or new accounting/reporting rules identified by the Manager or the Company and (v) prepare quarterly and annual financial statements as soon as practicable after the end of each such period as may be reasonably requested and general ledger journal entries and other information necessary for the Company's compliance with applicable laws and in accordance with GAAP and cooperate with the Company's independent accounting firm in connection with the auditing or review of such financial statements, the cost of any such audit or review to be paid by the Company.

(b) *Restrictions.*

(i) The Manager acknowledges that the Company intends to conduct its operations so as not to become regulated as an investment company under the Investment Company Act, and agrees to use commercially reasonable efforts to cooperate with the Company's efforts to conduct its operations so as not to become regulated as an investment company under the Investment Company Act. The Manager shall refrain from any action that, in its reasonable judgment made in good faith, (a) is not in compliance with the Investment Guidelines, (b) would cause the Company to fail to maintain its exclusion from status as an investment company under the Investment Company Act, or (c) would violate any law, rule or regulation of any governmental body or agency having jurisdiction over the Company or that would otherwise not be permitted by the Company's Operating Agreement. If the Manager is ordered to take any such action by the Board of Directors, the Manager shall promptly notify the Board of Directors of the Manager's judgment that such action would adversely affect such status or violate any such law, rule or regulation or the Operating Agreement.

(ii) The Manager shall require each seller or transferor of investment assets to the Company to make such representations and warranties regarding such assets as may, in the reasonable judgment of the Manager, be necessary and appropriate or as may be advised by the Board of Directors and consistent with standard industry practice. In addition, the Manager shall take such other action as it deems necessary or appropriate or as may be advised by the Board of Directors and consistent with standard industry practice with regard to the protection of the Investments.

(iii) The Company shall not invest in joint ventures with the Manager or any Affiliate thereof, unless (a) such Investment is made in accordance with the Investment Guidelines and (b) such Investment is approved in advance by a majority of the Independent Directors.

(c) *Board of Directors Review and Approval.* Subject to the terms of Ellington's Compliance Policies and the Company's conflicts of interest policy as it may exist from time to time, the Board of Directors will periodically review the Investment Guidelines and the Company's portfolio of Investments but will not review each proposed Investment; provided that the Company may not acquire any Investment, sell any Investment, or engage in any co-investment that, pursuant to the terms of the Compliance Policies or the Company's conflicts of interest policy, requires the approval of a majority of the Independent Directors unless such transaction has been so approved. If a majority of the Independent Directors determine in their periodic review of transactions that a particular transaction does not comply with the Investment Guidelines, then a majority of the Independent Directors will consider what corrective action, if any, is appropriate. The Manager shall be permitted to rely upon the direction of the Secretary of the Company to evidence approval of the Board of Directors or the Independent Directors with respect to a proposed Investment.

(d) *Investment and Risk Management Committee.* The Manager shall maintain its investment and risk management committee (the "Investment and Risk Management Committee"), which as of the date hereof consists of the Company's Chief Executive Officer and President, Chief Investment Officers, Chief Financial Officer and Chief Operating Officer. The

Investment and Risk Management Committee shall continue to advise and consult with the Manager with respect to the Company's investment policies, investment portfolio holdings, financing and leveraging strategies and the Investment Guidelines. The Investment and Risk Management Committee shall continue to meet as regularly as necessary to perform its duties, as determined by the Investment and Risk Management Committee, in its sole discretion.

(e) *Insurance.* The Manager, or Ellington on behalf of the Manager, shall obtain, as soon as reasonably practicable, and shall thereafter maintain "errors and omissions" insurance coverage and such other insurance coverage which is customarily carried by managers performing functions similar to those of the Manager under this Agreement with respect to assets similar to the assets of the Company, in an amount which is comparable to that customarily maintained by other managers or servicers of similar assets.

(f) *Tax Filings.* The Manager shall (i) assemble, maintain and provide to the firm designated by the Company to prepare tax returns on behalf of the Company and its subsidiaries (the "Tax Preparer") information and data required for the preparation of federal, state, local and foreign tax returns, any audits, examinations or administrative or legal proceedings related thereto or any contractual tax indemnity rights or obligations of the Company and its subsidiaries and supervise the preparation and filing of such tax returns, the conduct of such audits, examinations or proceedings and the prosecution or defense of such rights, (ii) provide factual data reasonably requested by the Tax Preparer or the Company with respect to tax matters, (iii) assemble, record, organize and report to the Company data and information with respect to the Investments relative to taxes and tax returns in such form as may be reasonably requested by the Company, (iv) supervise the Tax Preparer in connection with the preparation, filing or delivery to appropriate persons, of applicable tax information reporting forms with respect to the Investments and transactions involving the real estate (including, without limitation, information reporting forms, whether on Form 1099 or otherwise with respect to sales, interest received, interest paid, partnership reports and other relevant transactions); it being understood that, in the context of the foregoing, the Company shall rely on its own tax advisers in the preparation of its tax returns and the conduct of any audits, examinations or administrative or legal proceedings related thereto and that, without limiting the Manager's obligation to provide the information, data, reports and other supervision and assistance provided herein, the Manager will not be responsible for the preparation of such returns or the conduct of such audits, examinations or other proceedings.

#### **8. Compensation.**

(a) *Base Management Fee.* With respect to each fiscal quarter, the Manager shall receive a base management fee equal to the Quarterly Base Management Fee Amount. Within 45 days following the last day of each fiscal quarter, the Manager shall make available the quarterly calculation of the base management fee to the Company with respect to such quarter, and the Company shall pay the Manager the base management fee for such quarter in cash within 15 business days thereafter; *provided, however,* that such base management fee may be offset by the Company against amounts due to the Company by the Manager.



(b) *Quarterly Incentive Fee.* In addition to the base management fee, the Manager shall receive an incentive fee with respect to each fiscal quarter in an amount equal to the Quarterly Incentive Fee Amount.

(c) *Computation and Payment of Quarterly Incentive Fee.* Within 45 days after the end of each fiscal quarter, the Manager will compute the incentive fee with respect to such fiscal quarter, and the Company will pay the incentive fee with respect to such fiscal quarter within 15 business days following the delivery to the Company of the Manager's written statement setting forth the computation of the incentive fee for such fiscal quarter. Ten percent (10%) of each incentive fee payable to the Manager hereunder will automatically be paid by the Company in Common Shares, with the balance paid in cash, unless the Manager notifies the Board before the first day of the last calendar month of the quarter to which such incentive fee relates that the Manager elects to receive a greater percentage of the incentive fee for such quarter in Common Shares. Notwithstanding the foregoing, the Manager may not elect to receive Common Shares as payment of its incentive fee except in accordance with all applicable securities exchange rules and securities laws (including prohibitions on insider trading). The number of Common Shares to be received by the Manager will be based on the fair market value of such Common Shares. Common Shares delivered as payment of the incentive fee will be immediately vested; provided that the Manager agrees not to sell such Common Shares prior to one year after the date such shares are issued to the Manager, and provided further that such transfer restriction will immediately terminate if this Agreement is terminated for any reason.

(d) *Valuation of Incentive Fee Shares.* Common Shares payable as incentive fee shall be valued as follows:

(i) If such shares are traded on a securities exchange, the value of such shares shall be deemed to be the average of the closing prices of the shares on such exchange during the last calendar month of the quarter to which such incentive fee relates;

(ii) if such shares are actively traded over-the-counter, the value shall be deemed to be the average of the closing bid or sales price as applicable over the thirty (30) calendar day period ending three (3) calendar days prior to the date of issuance of such shares;

(iii) if such shares are traded on PORTAL, the value shall be deemed to be the average of the sales price reported on PORTAL over the thirty (30) calendar day period ending three (3) calendar days prior to the date of issuance of such shares; and

(iv) if there is no active public market for such shares and such shares are not traded on PORTAL, the value shall be the fair market value thereof, as reasonably determined in good faith by the Board of Directors of the Company.

(e) If at any time the Manager shall, in connection with a determination of fair market value made by the Board of Directors pursuant to clause (iv) of Section 8(d) above, (i) dispute such value in good faith by more than five percent (5%), and (ii) such dispute cannot be resolved between the Independent Directors and the Manager within ten (10) business days after the Manager provides written notice to the Company of such dispute (the "Valuation Notice"),

then the matter shall be resolved by an independent appraiser of recognized standing selected jointly by the Independent Directors and the Manager within not more than twenty (20) days after the Valuation Notice. In the event the Independent Directors and the Manager cannot agree with respect to such selection within the aforesaid twenty (20) day time-frame, the Independent Directors shall select one independent appraiser and the Manager shall select another independent appraiser within five (5) business days after the expiration of the twenty (20) day period, with one additional such appraiser (the "Last Appraiser") to be selected by the appraisers so designated within five (5) business days after their selection. Any valuation decision made by the appraisers shall be deemed final and binding upon the Board of Directors and the Manager and shall be delivered to the Manager and the Company within not more than fifteen (15) days after the selection of the Last Appraiser. The expenses of the appraisal shall be paid by the party with the estimate that deviated the furthest from the final valuation decision made by the appraisers and split by the parties if the difference between each of their estimates and the final valuation decision made by the appraisers is exactly the same.

(f) Notwithstanding the provisions of Sections 8(a), (8(b) and 8(c), in the event that the Company acquires or invests in (i) any equity of a CDO at issuance that is managed, structured or originated by Ellington, the Manager or any of their Affiliates, (ii) any investment fund, account or other investment that is managed, structured or originated by Ellington, the Manager or any of their Affiliates or (iii) a participating interest in the debt securities of an issuer of debt for which Ellington, the Manager or any of their Affiliates has received an origination fee, then in each such case the Quarterly Base Management Fee Amount and Quarterly Incentive Fee Amount payable by the Company to the Manager will in the aggregate be reduced by (or the Manager will otherwise rebate to the Company) an amount equal to the portion of any management fees, origination fees or structuring fees payable to the Manager, Ellington or their Affiliates that is allocable to the Company's equity investment or participating interest, as the case may be, in such CDO, investment fund, other investment or debt securities for the same periods.

**9. Expenses.** The Company shall bear all of its operating expenses, except those specifically required to be borne by the Manager under this Agreement. The expenses required to be borne by the Company include, but are not limited to:

(a) issuance and transaction costs incident to the acquisition, disposition and financing of Investments;

(b) legal, regulatory, compliance, tax, accounting, consulting, auditing, administrative fees and expenses and fees and expenses for other similar services rendered to the Company by third-party service providers retained by the Manager;

(c) the compensation and expenses of the Company's directors and the cost of liability insurance to indemnify the Company's directors and officers;

(d) the costs associated with the establishment and maintenance of any credit facilities and other indebtedness of the Company (including commitment fees, accounting fees, legal fees, closing costs, etc.);

- (e) expenses associated with securities offerings of the Company, including an Initial Public Offering;
- (f) expenses relating to the payment of distributions;
- (g) expenses connected with communications to holders of the Company's securities and in complying with the continuous reporting and other requirements of the Exchange Act, the SEC and other governmental bodies;
- (h) transfer agent, registrar and exchange listing fees;
- (i) the costs of printing and mailing proxies, reports and other materials to the Company's shareholders;
- (j) costs associated with any computer software or hardware, electronic equipment, or purchased information technology services from third party vendors that is used solely for the Company;
- (k) costs and out of pocket expenses incurred by directors, officers, employees or other agents of the Manager for travel on the Company's behalf;
- (l) the portion of any costs and expenses incurred by the Manager or its Affiliates with respect to market information systems and publications, research publications and materials that are allocable to the Company in accordance with the expense allocation policies of Ellington;
- (m) settlement, clearing, and custodial fees and expenses;
- (n) all taxes and license fees;
- (o) all insurance costs incurred with respect to insurance policies obtained in connection with the operation of the Company's business, including but not limited to insurance covering activities of the Manager and its employees relating to the performance of the Manager's duties and obligations under this Agreement;
- (p) costs and expenses incurred in contracting with third parties for the servicing and special servicing of assets of the Company;
- (q) all other actual out of pocket costs and expenses relating to the Company's business and investment operations, including, without limitation, the costs and expenses of acquiring, owning, protecting, maintaining, developing and disposing of Investments, including appraisal, reporting, audit and legal fees;
- (r) any judgment or settlement of pending or threatened proceedings (whether civil, criminal or otherwise) against the Company or any Subsidiary, or against any trustee, director or officer of the Company or of any Subsidiary in his capacity as such for which the Company or any Subsidiary is required to indemnify such trustee, director or officer by any court or governmental agency, or settlement of pending or threatened proceedings;

(s) the costs of maintaining compliance with all federal, state and local rules and regulations, including securities regulations, or any other regulatory agency, all taxes and license fees and all insurance costs incurred on the Company's behalf and the allocated costs of the wages, salaries and benefits incurred by the Manager with respect to internal audit staff in connection with Sarbanes-Oxley compliance initiatives provided that (A) the projected costs of such wages, salaries and benefits allocated to the Company shall be approved by the Board of Directors, (B) unless approved by the Board of Directors, the Company shall not bear the costs of such wages, salaries and benefits that exceed the amount approved in accordance with clause (A) and (C) the costs for any time spent by such staff on matters unrelated to the Company shall not be borne by the Company.

(t) expenses relating to any office or office facilities, including disaster backup recovery sites and facilities, maintained expressly for the Company and separate from offices of the Manager;

(u) the costs of the wages, salaries and benefits incurred by the Manager with respect to the Dedicated Officers described in Section 3(a) above; *provided* that (A) if the Manager elects to provide a partially dedicated in-house legal counsel to the Company rather than a fully dedicated in-house legal counsel, the Company shall be required to bear only a *pro rata* portion of the costs of the wages, salaries and benefits incurred by the Manager with respect to such in-house legal counsel based on the percentage of such counsel's working time and efforts spent on matters related to the Company and (B) the amount of such wages, salaries and benefits paid to the Dedicated Officers shall be subject to the approval of the Compensation Committee of the Board of Directors; and

(v) all other costs and expenses approved by the Board of Directors.

Other than as expressly provided above, the Company will not be required to pay any portion of the rent, telephone, utilities, office furniture, equipment, machinery and other office, internal and overhead expenses of the Manager and its Affiliates. In particular, the Manager is not entitled to be reimbursed for wages, salaries and benefits of its officers and employees, other than as described in Section 9(s) and 9(u) above.

Subject to any required Board of Directors approval, the Manager may retain, for and on behalf, and at the sole cost and expense, of the Company, such services of non-Affiliate third party accountants, legal counsel, appraisers, insurers, brokers, transfer agents, registrars, developers, investment banks, financial advisors, banks and other lenders and others as the Manager deems necessary or advisable in connection with the management and operations of the Company. The provisions of this Section 9 shall survive the expiration or earlier termination of this Agreement to the extent such expenses have previously been incurred or are incurred in connection with such expiration or termination.

**10. Expense Reports and Reimbursements.** The Manager shall prepare a statement documenting the operating expenses of the Company incurred during each fiscal quarter, and deliver the same to the Company within 60 days following the end of the applicable fiscal quarter. Such expenses incurred by the Manager on behalf of the Company shall be reimbursed by the Company within 60 days following delivery of the expense statement by the Manager; provided, however, that such reimbursements may be offset by the Manager against

amounts due to the Company from the Manager. The provisions of this Section 10 shall survive the expiration or earlier termination of this Agreement.

#### **11. Limits of Manager Responsibility; Indemnification.**

(a) Pursuant to this Agreement, the Manager will not assume any responsibility other than to render the services called for hereunder in good faith and will not be responsible for any action of the Board of Directors in following or declining to follow its advice or recommendations. The Manager, Ellington, EMG Holdings and their Affiliates, who may provide services hereunder or pursuant to the Services Agreement, their directors, officers, members, shareholders, managers, Investment and Risk Management Committee members, employees, agents successors and assigns will not be liable to the Company, any Subsidiary, any of their directors, officers, shareholders, managers, owners or partners except by reason of acts or omissions constituting bad faith, willful misconduct, gross negligence or reckless disregard of the Manager's duties under this Agreement, as determined by a final non-appealable order of a court of competent jurisdiction.

(b) The Company hereby agrees to indemnify, defend and hold harmless the Manager, Ellington, EMG Holdings and their Affiliates, officers, directors, members, shareholders, managers, Investment and Risk Management Committee members, employees, agents, successors and assigns (collectively, "Manager Indemnified Parties") from and against all liabilities, judgments, costs, charges, losses, expenses and claims, including attorneys' fees, charges and expenses and expert witness fees, of any nature, kind or description, arising out of claims by third parties caused by (i) acts or omissions of any Manager Indemnified Party not constituting bad faith, willful misconduct, gross negligence or reckless disregard of the Manager's duties under this Agreement or (ii) claims by the employees of the Manager relating to the terms and conditions of their employment with the Manager. For the avoidance of doubt, none of the Manager Indemnified Parties will be liable for (i) trade errors that may result from ordinary negligence, such as errors in the investment-decision process (e.g. a transaction was effected in violation of the Company's Investment Guidelines) or in the trade process (e.g. a buy order was entered instead of a sell order or the wrong security was purchased or sold or the security was purchased or sold at the wrong price) or (ii) acts or omissions of any Manager Indemnified Party made or taken in accordance with written advice provided to the Manager Indemnified Parties by specialized, reputable, professional consultants selected, engaged or retained by the Manager, Ellington, EMG Holdings and their Affiliates with commercially reasonable care, including without limitation counsel, accountants, investment bankers, financial advisers, and appraisers (absent bad faith, gross negligence, willful misconduct or fraud by a Manager Indemnified Party). Notwithstanding the foregoing, no provision of this Agreement will constitute a waiver or limitation of the Company's rights under federal or state securities laws.

(c) The Manager hereby agrees to indemnify the Company and its directors and officers with respect to all liabilities, judgments, costs, charges, losses, expenses and claims, including attorney's fees, charges and expenses and expert witness fees, of any nature, kind or description, arising out of (i) claims by third parties based on acts or omissions of the Manager constituting bad faith, willful misconduct, gross negligence or reckless disregard of the Manager's duties under this Agreement, as determined pursuant to a final, non-appealable order

of a court of competent jurisdiction or (ii) claims by the Manager's employees relating to the terms and conditions of their employment with the Manager.

(d) The party seeking indemnity ("Indemnitee") will promptly notify the party against whom indemnity is claimed ("Indemnitor") of any claim for which it seeks indemnification; provided, however, that the failure to so notify the Indemnitor will not relieve Indemnitor from any liability which it may have hereunder, except to the extent such failure actually prejudices the Indemnitor. The Indemnitor shall have the right to assume the defense and settlement of such claim; provided that, Indemnitor notifies Indemnitee of its election to assume such defense and settlement within (30) days after the Indemnitee gives the Indemnitor notice of the claim. In such case the Indemnitee will not settle or compromise such claim, and the Indemnitor will not be liable for any such settlement made without its prior written consent. If Indemnitor is entitled to, and does, assume such defense by delivering the aforementioned notice to Indemnitee, Indemnitee will (i) have the right to approve Indemnitor's counsel (which approval will not be unreasonably withheld or delayed), (ii) be obligated to cooperate in furnishing evidence and testimony and in any other manner in which Indemnitor may reasonably request and (iii) be entitled to participate in (but not control) the defense of any such action, with its own counsel and at its own expense.

(e) Reasonable expenses (including attorney's fees) incurred by an Indemnitee in defense or settlement of a claim that may be subject to a right of indemnification hereunder may be advanced by the Company to such Indemnitee as such expenses are incurred prior to the final disposition of such claim; provided that, Indemnitee undertakes to repay such amounts if it shall be determined ultimately by a court of competent jurisdiction that Indemnitee was not entitled to be indemnified hereunder.

(f) The Manager, Ellington, EMG Holdings and their Affiliates shall remain entitled to exculpation and indemnification from the Company pursuant to this Section 11 (subject to the limitations set forth herein) with respect to any matter arising prior to the termination of this Agreement and shall have no liability to the Company in respect of any matter arising after such termination unless such matter arose out of events or circumstances that occurred prior to such termination.

**12. No Joint Venture.** The Company and the Manager are not partners or joint venturers with each other and nothing in this Agreement shall be construed to make the Company and the Manager partners or joint venturers or impose any liability as such on either of them.

**13. Term; Termination.**

(a) *Term.* This Agreement shall remain in full force through December 31, 2011, unless terminated by the Company or Manager as set forth below, and shall be renewed automatically for successive one year periods thereafter, until this Agreement is terminated in accordance with the terms hereof.

(b) *Non-Renewal.* Either party may elect not to renew this Agreement at the expiration of the initial term or any renewal term for any or no reason by notice to the other party

at least 180 days, but not more than 270 days, prior to the end of the term. Upon a non-renewal of this Agreement by the Company pursuant to this section, the Company will pay the Manager the Termination Fee.

(c) *Termination by the Company for Cause.* At the option of the Company and at any time during the term of this Agreement, this Agreement shall be and become terminated upon 30 days' written notice of termination from the Board of Directors to the Manager, without payment of the Termination Fee, if any of the following events shall occur:

(i) the Manager shall commit a material breach of any provision of this Agreement (including the failure of the Manager to use reasonable efforts to comply with the Company's Investment Guidelines), which such material breach continues uncured for a period of 30 days after written notice of such breach;

(ii) the Manager in its corporate capacity (as distinguished from the acts of any employees of the Manager which are taken without the complicity of the board of directors or executive officers of the Manager) shall commit any act of fraud, misappropriation of funds, or embezzlement against the Company or shall be grossly negligent in the performance of its duties under this Agreement;

(iii) (A) the Manager shall commence any case, proceeding or other action (1) under any existing or future law of any jurisdiction, domestic or foreign, relating to bankruptcy, insolvency, reorganization or relief of debtors, seeking to have an order for relief entered with respect to it, or seeking to adjudicate it a bankrupt or insolvent, or seeking reorganization, arrangement, adjustment, winding-up, liquidation, dissolution, composition or other relief with respect to it or its debts, or (2) seeking appointment of a receiver, trustee, custodian, conservator or other similar official for it or for all or any substantial part of its assets, or the Manager shall make a general assignment for the benefit of its creditors; or (B) there shall be commenced against the Manager any case, proceeding or other action of a nature referred to in clause (A) above which (1) results in the entry of an order for relief or any such adjudication or appointment or (2) remains undismissed, undischarged or unbonded for a period of 90 days; or (C) the Manager shall take any action in furtherance of, or indicating its consent to, approval of, or acquiescence in, any of the acts set forth in clause (A) or (B) above; or (D) the Manager shall generally not, or shall be unable to, or shall admit in writing its inability to, pay its debts as they become due; or

(iv) upon a Change of Control of the Manager.

(d) *Termination by the Company Based on Performance.* The Independent Directors will review the Manager's performance annually at the Board's regularly scheduled meeting during the Company's third fiscal quarter, and, within 30 days after such Board meeting, this Agreement may be terminated upon the affirmative vote of at least two-thirds of the Independent Directors, or by the affirmative vote of the holders of at least a majority of the outstanding Common Shares, based upon unsatisfactory performance by the Manager that is materially detrimental to the Company or a determination by the Independent Directors that the management fees payable to the Manager hereunder are not fair, subject to the Manager's right to prevent such a termination by accepting a mutually acceptable reduction of such management

fees. The Board of Directors must provide at least 60 days', but not more than 120 days', prior notice to the Manager of any termination under this Section 13(d). Upon a termination of this Agreement pursuant to this Section 13(d), the Company will pay the Manager the Termination Fee.

(e) *Termination by Manager.*

(i) The Manager may terminate this Agreement effective upon 60 days prior written notice of termination to the Company in the event that the Company shall default in the performance or observance of any material term, condition or covenant in this Agreement and such default shall continue for a period of 30 days after written notice thereof specifying such default and requesting that the same be remedied in such 30 day period.

(ii) The Manager may terminate this Agreement in the event that the Company becomes regulated as an investment company under the Investment Company Act, with such termination deemed to occur immediately prior to such event.

(iii) Upon the termination of this Agreement pursuant to this Section 13(e), but in the case of a termination under clause (ii) only if the Manager was not at fault for the Company becoming regulated as an investment company under the Investment Company Act, the Company will pay the Manager the Termination Fee.

(f) *Survival.* If this Agreement is terminated pursuant to this Section 13, such termination shall be without any further liability or obligation of either party to the other, except as otherwise expressly provided herein.

**14. Action Upon Termination or Expiration of Term.** From and after the effective date of termination of this Agreement pursuant to Section 13 herein, the Manager shall not be entitled to compensation for further services under this Agreement but shall be paid all compensation accruing to the date of termination, reimbursement for all Expenses and the Termination Fee, if applicable. For the avoidance of doubt, if the date of termination occurs other than at the end of a fiscal quarter, compensation to the Manager accruing to the date of termination shall also include: (i) base management fees equal to the Quarterly Base Management Fee Amount for such final fiscal quarter, taking into account only the portion of such final fiscal quarter that this Agreement was in effect, and with appropriate adjustments to all relevant definitions and (ii) incentive fees equal to the Quarterly Incentive Fee Amount for such final fiscal quarter, taking into account any Net Income only for the portion of such final quarter that this Agreement was in effect, with appropriate adjustments to all relevant definitions. Upon such termination or expiration, the Manager shall reasonably promptly:

(a) after deducting any accrued compensation and reimbursement for Expenses to which it is then entitled, pay over to the Company all money collected and held for the account of the Company pursuant to this Agreement;

(b) deliver to the Board of Directors a full accounting, including a statement showing all payments collected and all money held by it, covering the period following the date of the last accounting furnished to the Board of Directors with respect to the Company and through the termination date; and



(c) deliver to the Board of Directors all property and documents of the Company provided to or obtained by the Manager pursuant to or in connection with this Agreement, including all copies and extracts thereof in whatever form, then in the Manager's possession or under its control.

15. **Assignment.** The Manager may not assign its duties under this Agreement unless such assignment is consented to in writing by a majority of the Company's Independent Directors. However, the Manager may assign to one or more of its Affiliates performance of any of its responsibilities hereunder without the approval of the Company's Independent Directors so long as the Manager remains liable for any such Affiliate's performance and such assignment does not require the Company's approval under the Investment Advisers Act of 1940.

16. **Release of Money or other Property Upon Written Request.** The Manager agrees that any money or other property of the Company or any Subsidiary held by the Manager under this Agreement shall be held by the Manager as custodian for the Company or any Subsidiary, and the Manager's records shall be clearly and appropriately marked to reflect the ownership of such money or other property by the Company. Upon the receipt by the Manager of a written request signed by a duly authorized officer of the Company requesting the Manager to release to the Company any money or other property then held by the Manager for the account of the Company under this Agreement, the Manager shall release such money or other property to the Company within a reasonable period of time, but in no event later than thirty (30) days following such request. The Manager, Ellington, EMG Holdings and their Affiliates, directors, officers, managers and employees will not be liable to the Company, any Subsidiary, the Manager or any of their directors, officers, shareholders, managers, employees, owners or partners for any acts or omissions by the Company in connection with the money or other property released to the Company in accordance with the terms hereof. The Company shall indemnify the Manager, Ellington, EMG Holdings and their Affiliates, officers, directors, Investment and Risk Management Committee members, employees, agents and successors and assigns against any and all expenses, losses, damages, liabilities, demands, charges and claims of any nature whatsoever which arise in connection with the Manager's release of such money or other property to the Company in accordance with the terms of this Section 16. Indemnification pursuant to this Section 16 shall be in addition to any right of the Manager to indemnification under Section 11.

17. **Notices.** Unless expressly provided otherwise in this Agreement, all notices, requests, demands and other communications required or permitted under this Agreement shall be in writing and shall be deemed to have been duly given, made and received when delivered against receipt or upon actual receipt of (a) personal delivery, (b) delivery by a reputable overnight courier, (c) delivery by facsimile transmission but only if such transmission is confirmed, or (d) delivery by registered or certified mail, postage prepaid, return receipt requested, addressed as set forth below:

The Company:                    Ellington Financial LLC  
    53 Forest Avenue – Suite 301  
    Old Greenwich, CT 06870  
    Attn: Laurence Penn, Chief Executive Officer  
    Facsimile: 203-698-0869

With a copy to:

Ellington Financial LLC  
53 Forest Avenue – Suite 301  
Old Greenwich, CT 06870  
Attn: Chief Operating Officer  
Facsimile: 203-698-0869

The Manager:

Ellington Financial Management LLC  
53 Forest Avenue – Suite 301  
Old Greenwich, CT 06870  
Attn: Michael Vranos, Chief Executive Officer  
Facsimile: 203-698-0869

with a copy to:

Ellington Management Group, L.L.C.  
53 Forest Avenue – Suite 301  
Old Greenwich, CT 06870  
Attn: General Counsel  
Facsimile: 203-698-0869

Any party may change the address to which communications or copies are to be sent by giving notice of such change of address in conformity with the provisions of this Section 17 for the giving of notice.

18. **Binding Nature of Agreement; Successors and Assigns.** This Agreement shall be binding upon and inure to the benefit of the parties hereto and their respective heirs, personal representatives, successors and permitted assigns as provided in this Agreement.

19. **Entire Agreement; Amendments.** This Agreement contains the entire agreement and understanding among the parties hereto with respect to the subject matter hereof and supersedes all prior and contemporaneous agreements, understandings, inducements and conditions, express or implied, oral or written, of any nature whatsoever with respect to the subject matter of this Agreement. The express terms of this Agreement control and supersede any course of performance and/or usage of the trade inconsistent with any of the terms of this Agreement. This Agreement may not be modified or amended other than by an agreement in writing signed by the parties hereto.

20. **Governing Law.** This Agreement and all questions relating to its validity, interpretation, performance and enforcement shall be governed by and construed, interpreted and enforced in accordance with the laws of the State of New York without giving effect to such state's laws and principles regarding the conflict of interest laws (other than Section 5-1401 of the general obligations Law of the State of New York).

21. **Indulgences, Not Waivers.** Neither the failure nor any delay on the part of a party to exercise any right, remedy, power or privilege under this Agreement shall operate as a waiver thereof, nor shall any single or partial exercise of any right, remedy, power or privilege preclude any other or further exercise of the same or of any other right, remedy, power or privilege, nor shall any waiver of any right, remedy, power or privilege with respect to any occurrence be construed as a waiver of such right, remedy, power or privilege with respect to any other occurrence. No waiver shall be effective unless it is in writing and is signed by the party asserted to have granted such waiver.

22. **Titles Not to Affect Interpretation.** The titles of sections, paragraphs and subparagraphs contained in this Agreement are for convenience only, and they neither form a part of this Agreement nor are they to be used in the construction or interpretation of this Agreement.

23. **Execution in Counterparts.** This Agreement may be executed in any number of counterparts, each of which shall be deemed to be an original as against any party whose signature appears thereon, and all of which shall together constitute one and the same instrument. This Agreement shall become binding when one or more counterparts of this Agreement, individually or taken together, shall bear the signatures of all of the parties reflected hereon as the signatories.

24. **Severability.** The provisions of this Agreement are independent of and separable from each other, and no provision shall be affected or rendered invalid or unenforceable by virtue of the fact that for any reason any other or others of them may be invalid or unenforceable in whole or in part.

25. **Principles of Construction.** Words used herein regardless of the number and gender specifically used, shall be deemed and construed to include any other number, singular or plural, and any other gender, masculine, feminine or neuter, as the context requires. All references to recitals, sections, paragraphs and schedules are to the recitals, sections, paragraphs and schedules in or to this Agreement unless otherwise specified.

26. **Use of Name.** The Company acknowledges that it has adopted its name through the permission of the Manager. The Manager hereby consents to the non-exclusive use by the Company of the name "Ellington Financial LLC" so long as the Manager serves as the manager of the Company. The Company agrees to indemnify and hold harmless the Manager, Ellington, EMG Holdings and their Affiliates from and against any and all costs, losses, claims, damages or liabilities, joint or several, including, without limitation, attorney's fees and disbursements, which may arise out of the Company's use or misuse of the name "Ellington Financial LLC" or out of any breach of or failure to comply with this Section 26.

[SIGNATURE PAGE FOLLOWS]

IN WITNESS WHEREOF, the parties hereto have executed this Agreement as of the date first above written.

**THE COMPANY:**

**ELLINGTON FINANCIAL LLC**

By: /s/ Laurence Penn

Name: Laurence Penn

Title: Chief Executive Officer and President

**THE MANAGER:**

**ELLINGTON FINANCIAL MANAGEMENT LLC**

By: /s/ Michael W. Vranos

Name: Michael W. Vranos

Title: Chief Executive Officer and  
President

**[Signature Page to Management Agreement]**

**INVESTMENT GUIDELINES OF ELLINGTON FINANCIAL LLC**

Capitalized terms used but not defined herein shall have the meanings ascribed thereto in that certain Third Amended and Restated Management Agreement, effective as of August 2, 2011, as may be amended from time to time (the "Management Agreement"), by and between Ellington Financial LLC (the "Company") and Ellington Financial Management LLC (the "Manager").

1. No investment shall be made that would cause the Company to fail to qualify as a partnership under the Internal Revenue Code of 1986, as amended;
2. No investment shall be made that would cause the Company to be regulated as an investment company under the Investment Company Act;
3. The Company shall not enter into Cross Transactions, Principal Transactions or Split Price Executions with the Manager or any of its Affiliates unless (i) such transaction is otherwise in accordance with these guidelines and the Management Agreement and (ii) the terms of such transaction are at least as favorable to the Company as to the Manager or such Affiliate (as applicable);
4. The Company shall use leverage as described in the registration statement on Form S-11 relating to the Initial Public Offering (the "IPO Registration Statement").
5. Any proposed investment that is outside those targeted or other asset classes or targeted platforms or opportunities mentioned or otherwise described in or contemplated by the IPO Registration Statement must be approved by at least a majority of the Independent Directors.
6. Any loan transaction to or from the Company, on the one hand, and the Manager and its affiliates, on the other hand, must be approved by at least a majority of the Independent Directors.

These investment guidelines may be changed by the Company's board of directors without the approval of its shareholders.

**CERTIFICATION OF CHIEF EXECUTIVE OFFICER PURSUANT TO SECTION 302  
OF THE SARBANES-OXLEY ACT OF 2002**

I, Laurence Penn, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Ellington Financial LLC;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) [language omitted in accordance with SEC Release No. 34-54942] for the registrant and have:

- (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
- (b) [Language omitted in accordance with SEC Release No. 34-54942.]
- (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
- (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

- (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
- (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 10, 2011

/s/ Laurence Penn

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Laurence Penn  
Chief Executive Officer  
(Principal Executive Officer)

**CERTIFICATION OF CHIEF FINANCIAL OFFICER PURSUANT TO SECTION 302  
OF THE SARBANES-OXLEY ACT OF 2002**

I, Lisa Mumford, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Ellington Financial LLC;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) [language omitted in accordance with SEC Release No. 34-54942] for the registrant and have:

- (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
- (b) [Language omitted in accordance with SEC Release No. 34-54942.];
- (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
- (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

- (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
- (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 10, 2011

/s/ Lisa Mumford

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Lisa Mumford  
Chief Financial Officer  
(Principal Financial and Accounting Officer)

**CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of Ellington Financial LLC (the "Company") on Form 10-Q for the quarter ended June 30, 2011, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Laurence Penn, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002, that to my knowledge:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: August 10, 2011

/s/ Laurence Penn

Laurence Penn  
Chief Executive Officer  
(Principal Executive Officer)



**CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of Ellington Financial LLC (the "Company") on Form 10-Q for the quarter ended June 30, 2011, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Lisa Mumford, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002, that to my knowledge:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: August 10, 2011

/s/ Lisa Mumford

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Lisa Mumford  
Chief Financial Officer  
(Principal Financial and Accounting Officer)