2006

Third Quarter Letter

Scion Value Fund – A Series of Scion Funds, LLC

Scion Qualified Value Fund – A Series of Scion Qualified Funds, LLC

SCM Qualified Value Fund LTD.

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Dear Fellow Investors:

The loss for an investment in the Scion Value Fund during 2006 thus far amounted to 17.36%, net of all expenses. An initial investment in the Scion Value Fund at its inception on November 1, 2000 and held through September 30th, 2006 shows a gain of 135.30%, net of performance allocations and expenses.

	S&P 500 Index Return[2]	SVF Gross Return[3]	SVF Net Return[4]
2000[1]	-7.45%	+8.20%	+6.61%
2001	-11.88%	+55.44%	+44.67%
2002	-22.10%	+16.08%	+13.10%
2003	+28.69%	+50.71%	+40.81%
2004	+10.88%	+10.77%	+8.86%
2005	+4.91%	+7.81%	+6.49%
2006 9M	+8.53%	-17.36%	-17.36%
Since Inception	+3.21%	+208.00%	+135.30%

[1]Inception Nov 1 2000; data for 2000 covers Nov-Dec only
[2]Includes re-invested dividends
[3]Return before 20% performance allocation and after expenses
[4]Return after 20% performance allocation and expenses

An investment in the Scion Value Fund at inception on November 1, 2000 that was subsequently transferred to the Scion Qualified Value Fund at its inception March 1, 2003 would have a net gain of 140.17%. The loss for such an investment during the first three quarters of 2006 amounted to 15.96% net.

	S&P 500 Index Return[2]	SVF-SQVF Gross Return[3]	SVF-SQVF Net Return[4]
2000[1]	-7.45%	+8.20%	+6.61%
2001	-11.88%	+55.44%	+44.67%
2002	-22.10%	+16.08%	+13.10%
2003	+28.69%	+51.58%	+41.50%
2004	+10.88%	+10.20%	+8.40%
2005	+4.91%	+8.21%	+6.81%
2006 9M	+8.53%	-15.96%	-15.96%
Since Inception	+3.21%	+211.53%	+140.17%

[1]Inception Mar 1 2003; data for 2000-2002 covers the SVF only
[2]Includes re-invested dividends
[3]Return before 20% performance allocation and after expenses
[4]Return after 20% performance allocation and expenses

The SCM Qualified Value Fund is a Cayman Islands investment vehicle that feeds into the domestic Scion Qualified Value Fund. The portfolios of these two funds are therefore identical. The returns may vary slightly due to different expense ratios.

Within reason, I attempt to keep the Scion Value Fund and the Scion Qualified Value Fund *pari passu* in terms of portfolio composition. This cannot be an exact process, and as a practical matter I expect there will be minor variability between the two portfolios.

Last year, Scion Capital launched new investment funds with a dedicated pan-Asian investment strategy. These funds are open to all investors. Please direct initial inquiries to either our CFO Dan Nero or myself.

<u>2006 Performance Attribution</u>

	Stocks, Bonds and Bank Debt	Credit Derivatives	Equity Index Puts	SVF-SQVF Gross Return
2006 9M	-0.01%	-15.42%	-1.69%	-16.42%

<u>Our Unique Position</u>

Never before have I been so optimistic about the portfolio for a reason that has nothing to do with stocks. This year the portfolio is down, but our performance so far is solely due to our credit default swap positions. It all comes back to the market's tolerance for risk, which this year has risen to unprecedented heights while mine has remained constant. As a result, credit spreads, also known as risk premiums, have fallen across nearly every asset class. Most ironically, this has been true for securities backed by subprime residential mortgages, despite fundamental deterioration in the performance of these mortgages. Were Long-Term Capital executing its strategy the last three years, its managers would be the toast of Wall Street.

Of course it is no surprise to you that the Funds are on the other side of that strategy. So today, as homebuilders turn to discounts and promotions, and as for sale signs multiply across the United States, the Funds are in a unique position.

Yes, other funds have begun to attempt to execute this strategy. The Financial Times recently ran an article describing the inverse-LTCM trade that hedge fund managers are starting to employ. But man oh man are they the overconfident big boys diving head first into the shallow end of the pool. Despite our mark-to-market losses, we're short the mortgage portfolio everyone would want if they knew what they were doing.

After all, it is not possible to short mortgages themselves. It is only possible to derivatively short mortgage tranches which are part of large mortgage pools. These pools are professionally managed, and not all that run these portfolios are idiots. Even the idiots may have heard by now that the housing market, and in particular the subprime borrower, is in trouble. These managers can make use of tools such as interest rate swaps, mortgage insurance, and more substantial overcollateralization, and they have certainly done so.

This is a point worth emphasizing. Even during March 2005-September 2005, when the housing and mortgage industry was most complacent and home prices were peaking, I found most mortgage pools and their subordinate tranches to be totally unworthy as short candidates. Good luck to all those hedge funds finding the right stuff in 2006. The story has been out for some time, and the structurers of mortgage backed securities as well as the ratings agencies are not exactly clueless regarding the risk. Sooner or later, one of the big boys should really read a prospectus – probably not something they've done in a very long time.

The Perfect Strategy?

So I launch a hedge fund that will only short mortgages via credit default swaps. Milton's Opus II is the name. I explode upon the scene and pick up shorts with drive-by inaccuracy. I buy protection on every BBB-rated tranche under the sun and on the run during a very short period of time- say, the last two weeks of the month. Thanks to the pressure my spree put on the market and thanks to how supportive my own buying has been of my positions, I post a 3% month for that first month. The perfect hedge fund number, don't you think? That number will surely be of benefit as I seek out more capital. Actually, no, I did no such thing. Never would I do such a thing. I leave such behavior to others. I have left such behavior to others.

Counterparties

Counterparty relations are no picnic. There does not exist on Wall Street such a creature that will forgo an opportunity to act in its self-interest. For nearly all, it is not a question of ethics but rather one of fiduciary duty or job preservation. My eyes were wide open to this back when we first entered the credit derivatives market. Using no small amount of strategy and patience, Scion Capital negotiated very favorable ISDAs with all eight of our counterparties. At the time, however, in the interest of investor comfort, we allowed the appointment of the counterparty as the marking agent for valuation and collateral call purposes. Of course, this is a bit like buying stock from a short seller and allowing the short-seller to decide how my position is marked.

Perhaps we were too worried about appearances, and we should have done differently. This is a situation that has deteriorated as our counterparties – the global dealers that are household names – have refused to invest in the technology and the human capital required to manage their back offices properly in the face of exponential growth of the credit derivatives market. These dealers may not recognize the terminology in my accusation, as "cost center" is apparently the proper dealer term for back office infrastructure. Our tireless CFO Dan Nero continues to battle for our rights. And thanks to the ISDAs we negotiated, we long ago captured the key hill in this battle. Our rights to have our positions collateralized by the counterparty are our single most significant protection against counterparty failure. Our diversification among counterparties is also a significant protection. We have taken other measures as well, and so ultimately the problems with pricing do not impair our contractual rights in the event of default.

But short of deciding to mark our own book, the marks used will continue to come from the counterparties, as no third party agent offers the comprehensive coverage necessary to mark our credit derivatives portfolio.

Where Our Housing Short Stands

I never expected our mortgage short to work within one year. Mortgages by their nature tend to be good for at least the first year. Even in the event of missed payments from the start, it may take a year for these to appear in the form of a write-off. I knew full well we would be subject to the vagaries of a liquidity-drunk and overconfident market in the meantime. At the end of the day, we have the contractual right to receive cash when these tranches deteriorate to the requisite level, and that is a right that grows more valuable every single day.

The deterioration is in fact already substantial. For example, the vast majority of our portfolio is short Moody's Baa2-rated and Baa3-rated subordinated tranches of subprime mortgage pools issued during 2005. The credit support under these tranches is that portion of the pool that must be written off before we can start collecting cash. A key data point that we use to monitor the pools for deterioration is the sum of those portions of the pool that are either at least 60 days delinquent, bankrupt, in foreclosure, or now fully repossessed by the lender, also known as real estate owned (REO). We further make this data useful by calculating a ratio of these problem mortgages divided by the amount of the credit support. At quarter end, these ratios on our portfolio are as follows.

	(Total Delinquent + Bankrupt + Foreclose + REO) / Total Credit Support	(60+ Days Delinquent + Bankrupt + Foreclose + REO) / Total Credit Support	(Bankrupt + Foreclosed + REO) / Total Credit Support
2005 Baa2	1.58	1.15	0.79
2005 Baa3	1.99	1.47	1.01

Such ratios greater than one are significant, and in fact these ratios have risen rapidly in the last couple of months. The positions we are short are now effectively undercollateralized by performing mortgages. I expect that rising delinquencies and defaults will continue to drive these ratios higher. As most of the mortgages underlying the tranches we are short face interest rate resets six to twelve months from now – along with a reported $1 trillion in other mortgages during 2007 - these mortgages have not yet entered their highest risk period.

Still, this leaves open the question of the loss severity that the lenders face when they go to sell these foreclosed properties. Again, in our favor, these loss severities have been rising at a rapid rate this year, from 10-15% at the beginning of the year to 30-45% recently. We can measure this severity by looking directly within the monthly servicer reports for those pools which the Funds are short.

For example, let's take PPSI 2005-WLL1, an early 2005 mortgage pool.

	Current Month Loss Severity	Three Month Average Severity	Twelve Month Average Severity
September 2006	63.53%	42.03%	34.29%
August 2006	29.75%	28.48%	29.00%

This PPSI deal is a particularly nasty example, but yes, nasty examples exist among our shorts. The market in subprime mortgages is melting down right now. Shorts on 2005 tranches are both more likely to pay off and closer to paying off than 2006 deals. Home prices did not appreciate during the last year, so home price appreciation is no reason to shun 2005 vintage mortgages. Yet many rushing into the market now favor 2006 vintage shorts, driving recent prices higher. Why? Well, whatever such players say, the real reason is protection on 2006 vintage tranches is on the run and readily available. The good shorts from 2005 vintages – those in our portfolio - are not being offered.

I should reiterate that we are not betting on housing Armageddon. Yes, national housing prices fell nearly 3% in August, and this year will mark the first year since the Great Depression that national housing prices fall. And I do not believe this will be a one year blip. Yet our investment in these mortgage shorts was and is a rational investment shorting the absolute worst quality among borrowers and their mortgages during the most extreme credit bubble ever seen in the housing industry. The Funds have paid more for the right to do this. Much more than we would have paid were we betting on housing Armageddon.

I would caution against reading too much into what is widely reported. Most news stories on housing and mortgage issues are not specific to the worst 5% or so of loans made during 2005 - the slice that is most relevant to the Funds. Too, I should note that equity markets need not fall for these securities to work to our advantage. Recently the Dow Jones Industrials have scaled all-time highs. But the fundamentals on those positions we are short are rapidly deteriorating, and during 2007, the reward for our patience should be made clear in the Funds' performance.

The Rest of the Portfolio

I nearly forgot to write this section. Actually, that's a bit of a joke. I know a few investors have wondered whether I spend too much time on the derivatives book. Not hardly. The fact is, I spend nearly all my time on stocks and other long-oriented analysis. The Funds are blessed with a very capable back office that maintains the derivatives book, as well as analyst David Chu, whose time is now dedicated to monitoring the mortgage pools and other credits that we are short. My biggest burden with respect to this portfolio is in selecting and transacting in these derivatives, and I last purchased credit derivatives in May. By and large, the bulk of my purchase activity tailed off in late 2005. Long stock investments are my focus, as they have always been.

Given this, I cannot claim to be devoid of frustration. In a way, we are like the boy in the toy store who wishes the objects of his affection were just a tad cheaper. The difference is, we can afford nearly anything but just know better. The Funds hold quite a bit of cash. This last occurred back in the 2001-2002 era. Back then, the wait was not too long before notable opportunities presented themselves. Today, we're staring at a couple years of rising futility. I am fully aware that this is not true at many other hedge funds, many of which are doing just fine this year, even beating the indices. Simply put, they're invested. It's a good year to be long. Such facts have no bearing on my analytical conclusions with respect to individual company valuations.

Take Nordstrom, a higher-end retailer benefiting from most every macro trend today. Its 11.5% pre-tax margin in 2005 surpassed 10% for the first time since the company went public in 1971, and its net margins rose from 1.5% to greater than 7% in the last four years. Net income is five times what it was in 2001, and return on equity rose nearly fourfold. Similar stories abound, though not necessarily all to this degree.

If this is not a peak in a dramatic debt-fueled economic boom, well, it certainly looks like one. Over half the S&P's earnings are derived from financial businesses benefiting directly from global liquidity being as it is. Another huge chunk of S&P earnings come from retailers, and yet another huge chunk from commodity-related and heavy industrial companies. With remarkable synchronicity, nearly every such group is experiencing historically high margins.

Too, competitive threats are both manifest and underappreciated. Analyzing a Cisco in a world with a Huawei, a Whirlpool in a world with a Haier, a Microsoft in a world with a Google – well, this is a special challenge. It would be the definition of bad analysis to inadequately account for all competitive threats, yet at current prices, the market has done so. Of course, public securities are further supported by the prices that leveraged investors such as private equity firms and hedge funds can and must pay, rather than what is rational for a cash account long investor to pay.

A Scion portfolio will be a concentrated portfolio, though, and I have generally thought that in any market environment I should be able to spot the handful of investments that will make all the difference. Such a belief guides me and the Scion analysts as we scrub the markets in search of true value. By true value, I mean those rewards independent of the risk and leverage that binds so much of today's market together.

I would emphasize that our long portfolio has been conservatively managed from the get go. Like any portfolio manager, I do make mistakes now and then, but the long performance of the portfolio, stripped of all derivatives losses, since the inception of the derivative short portfolio has been satisfactory, especially in light of the minimal risks taken.

While the incentive for any hedge fund manager is to get invested, even overinvested, in the wake of a substantial decline in performance, this I will not do. I would rather await the proper opportunities, and continue to practice the conservative investing that has served me well for years. The high water mark and the other realities of this business do not tempt me to take on additional risk, nor will I ever be tempted. Conservatism rules the day here at Scion.

Asia

The Funds have roughly a 12% allocation in Asia, lower than in the past. I expect this will grow in the near term.

Energy

The Funds rode the boom in commodity prices primarily by being invested in unique energy-related securities before they were widely discovered. Earlier this year, the Funds' exposure to energy was reduced, and today energy-related positions are less than 10% of assets and largely concentrated in one position. It has recently become popular to bail on energy themes as oil prices retrace some of their gains. It does appear to me that this is creating opportunities.

Why not Short?

I have been asked whether our difficulty finding acceptable longs means we should adapt and focus more on shorting. We have shorted just a couple handfuls of times in the history of the funds. As I have described previously, I do not like the math of shorting stocks, nor the risks. It is simply a better use of time, over the long run, to focus on finding great longs. Certainly during the last year there is an industry or two that we could have profitably shorted. Moreover, we were right on top of the fundamentals, and we perhaps should have shorted but for some stubbornness on my part.

At this point, nearly all of the situations where our insight may have led to a successful short have passed us by. Few such situations are on the radar today, unless I assume significant disruptions of the consumer and residential real estate. The credit default swap portfolio has that covered in spades.

Too, while our long portfolio is putting up a goose egg this year, this was bound to happen at some point and therefore does not disturb me. The results are a reflection of my conservative nature with longs, and my patience. This has served me and the Funds well in the past, and I would still put our risk-adjusted long-term stock-picking record up against most anybody in most any environment. I see little reason to change strategy with respect to equities.

Index Puts

Our experience with equity index puts has not been a good one, especially now that indices are surpassing or approaching all-time highs. Given how close we are to fruition in our housing short, and by extension our corporate credit shorts, I do not feel much need to own a further removed short on the same thesis. Presently, the Funds hold roughly $2 million in puts, and they are focused on the Russell 2000 Index.

Side Pockets

The Funds contain three investments that have been side pocketed.

Livedoor

Livedoor is a Japanese financial services and internet company that has been in the headlines due to allegedly fraudulent efforts to inflate earnings back a couple years back. This sort of thing passes smell tests in the United States all the time. Fannie Mae, for instance, still cannot file its financials. In Japan, Livedoor is a national scandal. The Funds took this position in the wake of the scandal, and when the stock was delisted, we side pocketed the investment. At our purchase price, the company appeared undervalued by at least 50%. Other hedge funds are involved here, and there is an activist effort underway to maximize the value of this investment. I remain optimistic that the outcome will be satisfactory.

Symetra

Symetra is the former Safeco Life & Investments that was taken private by a consortium led by Berkshire Hathaway and White Mountains Insurance at slightly above one times book value and less than six times earnings. The business is doing well, right in line with expectations. The time horizon for liquidity is finite, but unknown. Other co-investors in the deal have limited time horizons as well. For now, I am confident the value accretion will reward our patience.

Blue Ocean Re

Blue Ocean Re was founded in the wake of last year’s devastating hurricane season. As capacity in the retrocessional insurance space dried up, Blue Ocean Re stepped in with supply at market-clearing prices that bore no resemblance to those of the prior year. To help guide and protect this investment, I took a position on the board of directors of Blue Ocean Re. Results during this first year of existence have certainly not been troubling.

Administrative Matters

Scion Capital continues to employ Spectrum Global Fund Administration as the third party administrator for the Funds. For capital account balances, please contact Laura Gillen at lgillen@sgfallc.com or at (312) 602-5636.

Of course, Dan Nero and I both stand ready to accept any questions you may have regarding your investment.

Sincerely,

Michael J. Burry, M.D.

Scion Capital Analysts at September 30, 2006

David Chu - Analyst

David Chu serves as a security analyst for Scion Capital, LLC. Prior to joining Scion Capital in September 2004, he consulted for various hedge funds in the San Francisco Bay Area and worked as a research associate at Abacus Capital Investments, LLC, analyzing public equity investment opportunities. David began his career at Goldman, Sachs & Co., in the Leveraged Structured Finance Group, where he executed high yield financings, leveraged recapitalizations and project finance transactions. He then moved to Equinox Capital Pte Ltd., a private equity firm in Singapore, where he focused on direct investments in Southeast Asia. At Equinox, he conducted extensive field-level due diligence and financial analysis on acquisitions in the manufacturing, food, and banking sectors, specializing in distressed and bankruptcy situations. David has also worked at CrossWorlds Software, an enterprise applications integrations company, in the corporate finance group. David received a B.S. degree in Business Administration, magna cum laude, in Finance and International Business from Georgetown University and earned an M.B.A. degree from Harvard Business School.

Michel A. Del Buono – Analyst

Dr. Del Buono serves as a securities analyst for Scion Capital, LLC. Prior to joining Scion Capital in July of 2004, he was an Engagement Manager at McKinsey & Co, San Francisco, in the Corporate Finance & Strategy practice. Michel's focus was on working with Industrial & Energy clients on various aspects of investment strategy such as course-changing investments or M&A transactions, as well as conducting due diligence for major Private Equity firms on over $1B of LBO transactions. Michel received his Bachelor's of Science degree in Systems Engineering with High Honors from the University of Virginia, and he holds three graduate degrees: an M.Phil. in Economics from the University of Cambridge, UK; an M.Sc. in Engineering-Economic Systems from Stanford University; and a Ph.D. in Management Science & Engineering, also from Stanford University.

Leonie Foong – Analyst

Leonie Foong serves as a security analyst for Scion Capital, LLC. Prior to joining Scion Capital in July 2006, she was a Senior Associate at The Carlyle Group’s Asia Buyout Group (2001-2004). Leonie was one of two pioneer investment professionals responsible for building Carlyle’s presence in Southeast Asia and worked closely with Carlyle’s Managing Director to devise and execute Carlyle’s strategy and criteria for investment opportunities. On the deal evaluation and execution side, Leonie’s activities included in-depth financial and business due diligence, structuring deals, arranging debt financing and negotiating with bankers and vendors. Leonie accumulated significant transaction experience within the Retail/Consumer, Electronics Manufacturing and Healthcare Distribution sectors. Prior to joining The Carlyle Group, Leonie was an Investment Banking Analyst at Goldman Sachs (Singapore, 1999-2001), focusing on M&A advisory work in Asia. At Goldman, Leonie worked on a number of high profile telecom mergers. Leonie graduated with a MEng (First Class Honors and Top of her class) degree in Engineering, Economics and Management from Oxford University, U.K. She received both the Maurice Lubbock Prize for best performance in Engineering, and the Nind Prize for best performance in Management Studies. In 2006, Leonie received her M.B.A. with honors from Harvard Business School where she was a Fulbright Scholar.

Jin Woo Jo - Analyst
Jin Woo Jo serves as a security analyst at Scion Capital, LLC's Hong Kong office. Prior to joining Scion Capital in May of 2005, he was a Vice President at Cambridge Capital Partners, a $200 million middle market buyout fund in Chicago. Jin Woo started his career at The Boston Consulting Group where he advised large Asian conglomerates, financial institutions and multinational companies on a variety of strategic initiatives including merger and acquisition, restructuring, and business development. Subsequently, he worked at UBS Capital Asia Pacific Ltd., a $1 billion leveraged buyout fund under the UBS AG. At UBS Capital, Jin Woo was responsible for evaluating, executing and monitoring private equity investments in the Asia Pacific region. He also worked at the Chicago office of the Corporate Finance Services Group in GE Capital Corporation, originating acquisition-financing opportunities for private equity sponsors and corporations in the Midwest and Canada. Jin Woo graduated with a BA with Honors in Psychology and minor in Business and Administration from Seoul National University in Korea. He holds an MBA with Honors in Finance and Accounting from the University of Chicago School of Business.

Bo L. Shan – Analyst
Bo Shan serves as a securities analyst for Scion Capital, LLC. Bo received a B.A. with Honors in Economics from The University of Chicago in June 2005. He began working for Scion as a summer intern in 2003 and continued as a part-time analyst during his senior year of college. Bo has also completed internships at Goldman Sachs, The Pritzker Organization, Texas Pacific Group, and Blum Capital. Bo was born in Beijing, China and speaks both English and Mandarin.

Patrick Yau – Analyst
Patrick Yau serves as a security analyst at Scion Capital, LLC's Hong Kong office. Prior to joining Scion Capital, LLC in June 2005, he was a Vice President with Morgan Stanley Private Equity in Hong Kong, where he evaluated and executed investment opportunities throughout Asia, with a primary focus on Greater China and Southeast Asia. Patrick's activities at Morgan Stanley included financial and business due diligence, business development and structuring of investment deals. Prior to joining Morgan Stanley, he was an Assistant Vice President at Newbridge Capital in Singapore, where he evaluated numerous transactions throughout Asia during and after the Asian Financial Crisis. Prior to joining Newbridge Capital, he was a financial analyst in the investment banking division of Donaldson Lufkin & Jenrette Securities Corp. in New York, where he was involved in transactions relating to private equity, IPOs, high yield offerings and M&A. Patrick received a B.S. degree with Honors in Economics from The Wharton School at the University of Pennsylvania.