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MONTHLY UPDATE

Trident Investment Management, LLC
Opportunities Funds Commentary

December 31, 2006

Performance Summary

The U.S. dollar reversed some of its losses in November to trade higher in December with the trade-weighted dollar being up 0.84%. Equities remained strong with the S&P500 up 1.40%, the Nikkei up 5.90% and the MSCI Europe Index up 3.69%. Gold declined 2.28% on the month. Oil declined also and was down 5.52%. The U.S. Treasury market suffered in December with 10-year yields rising 0.24% to end the month at 4.70%. Credit overall remained well-behaved with credit spreads in the aggregate hardly moving on the month, although there was some weakness in the sub-prime arena.

Market Outlook & Portfolio Strategy

In looking back at 2006, it is clear that this was a year in which the macro structural environment got substantially worse. The U.S. trade deficit has increased to more than $700 billion, the country's savings rate is plumbing new depths and consumer leverage has reached new highs. If this were not enough, the war in Iraq is proving more of a disaster than even pessimistic observers had anticipated while the impasse with Iran over uranium enrichment does not seem close to solution. At a time where decisive leadership is necessary both on the political and economic fronts, the U.S. President faces an antagonistic Congress which is likely to disagree with him on most policy issues. Globally, the situation is better, but not when it comes to the imbalances. China continues to build reserves selling its exports at prices that few if any competitors can match. Japan also continues to grow its bilateral surplus with the U.S. and is being helped in this process by a substantial decline in the yen for 2006.

Even with the dramatic increase in the scale of the structural problems, markets were remarkably strong in 2006. Equities remained in vogue with the most risky markets posting huge gains. Thanks to the reserve-accumulating nations in Asia and the Middle East, the trade-weighted U.S. dollar declined just 8.25% with the bulk of the decline happening against the Euro. In fact, against the stronger Asian currencies, the dollar's decline barely compensated for the interest rate differentials. With this global "stability", the financial system has continued to engage in debt creation at a pace that beggars description. A helpful influence for markets was the decline in the price of oil which got market participants believing that this would substantially boost U.S. consumer incomes and thus U.S. and global growth. Thus, in 2006, markets faced strong corporate earnings and low global unemployment rates coupled with strong, global growth and low inflation. This environment was largely priced in even in 2005. However, markets in 2006 have embraced the view that this perfect environment will persist indefinitely with no Pandora in sight to open up a box of unpleasant truths.

We would argue that much of the corporate earnings growth and the job gains we have seen so far are likely to prove at best short-lived and at worst, illusory. If anything, we believe strongly that we have reached the point of no return as far as the global economy is concerned and that a period of instability and violent asset corrections can be expected. To understand our view, it would help to consider the current environment from a longer-term perspective.

The Chinese today have an economy whose main engines for growth are exports and a domestic investment boom that is largely geared to exports. True capital costs in China are virtually zero because most of the domestic lending is still done by state-owned banks whose decisions tend to be governed by political edict and patronage rather than an objective longer-term return projection. Not surprisingly, investment as a percentage of GDP in China is running at close 50% - a stratospheric value even when placed in the context of China's, or any other developing country's, history. Examples abound of bad investments such as steel mills that are unprofitable, even on a variable cost basis, from the first day of operation. The output from China's inefficient investment boom is being foisted on the world economy at prices that render most of the world uncompetitive thanks to an artificially low exchange rate maintained by the country. Chinese goods today are displacing equivalent goods produced domestically even in low-wage countries such as India. In fact, an oft-cited complaint in these countries is that the landed cost of many Chinese goods is actually lower than the cost of the raw materials and transportation for the domestic manufacturer.

The Chinese growth model ensures that there will be pricing pressure in all areas of manufacturing where they compete. This depresses manufacturing earnings and wages in countries which compete with China and will lead to job losses if not outright shrinkage of these sectors. The offset to this is a windfall boost to consumers, whose purchasing power is increased by the lower prices, assuming that such consumers of course, have the means necessary for such expenditures.

The rapid growth of India as an exporter of software and other services thanks to modern communications technologies has served as another structural change to the world economy. While India cannot compete with China in manufacturing overall, it has an edge where it comes to the provision of software consulting and other knowledge-based services. Low Indian wages are being reflected in the global marketplace by a move of numerous business services to the country from other less competitive regions. This in turn has meant a slow erosion of services jobs from these regions, with the only gain being in the form of increased profitability for companies who are making the move.

The world's wealthier countries are thus faced with the fact that their job losses in manufacturing and increasingly in services are structural and that these jobs can never be recovered. The strategies that have been adopted to deal with this reality have differed substantially across the world. Core Europe (German, France, the Netherlands) and Japan, which both have aging populations and high wages have responded largely by socializing the problem. Thus, Europe's labour laws and their relatively generous social benefits are designed to provide a social safety net that will give labour a chance to adapt. European corporations faced with punishing restrictions in the Continent have been quick to invest overseas to escape these regulations but incentives and management culture are such in Europe that these changes take place at a relatively glacial pace at least relative to the U.S. Japan, which faces the same problem, even as it has faced domestic deflation, has socialized the problem to an even greater degree. Moreover, Japanese corporate culture is much more forgiving of low levels of profitability and so, companies there have retained workers through a deflationary bust allowing slow labor force attrition through retirement. Moreover, companies there have continued to invest aggressively, and some would argue successfully, despite the low level of domestic demand and the low initial returns to such investment.

The U.S. response to the global threats posed by China and India has been starkly different from that of either Europe or Japan. The U.S., true to its corporate culture, has embraced such change actively with corporations leading the charge to boost their profitability in what is obviously a challenging operating environment. Normally, this should have resulted in significant job losses and a recession that should have permitted an improvement in U.S. competitiveness because of falling prices for labour, rentals, education and other non-traded elements that determine operating costs. However, the Federal Reserve and other U.S. policymakers have chosen to deal with this structural inevitability with a sequence of rate cuts and hyper-easy money that has led to a credit and asset boom.

The impact of an asset boom on consumers is all too easy to see. The first of the recent U.S. asset booms was in technology with the NASDAQ bubble of 1999-2000. This in turn fostered an investment and a consumption boom. When the bubble deflated from 2000 to 2003, the impact on the consumer should have been significant. Instead, the Fed responded with even easier money leading to the now all-encompassing real-estate bubble. The deliberate creation of this bubble by the Fed cannot be denied. The initial increases in real-estate prices when coupled with what markets assumed were going to be permanently low interest rates meant an increase in real-estate leverage. This in turn, fostered even greater increases in prices of the underlying assets allowing for even more leverage and lender profitability. This financially induced profitability has contributed considerably to U.S. job growth. By some estimates, over 50% of all U.S. jobs were created in construction and related industries over the last five years. The benign job market conditions and rising wealth as measured by housing prices have boosted consumer spending dramatically with retailers, auto manufacturers and other related industries benefiting.

This virtuous cycle has gone parabolic in the last two years and importantly, has not been accompanied by a corresponding increase in the earnings power of the underlying assets. Thus for example, in many areas of California and Florida, real estate prices, both residential and commercial, have soared to the point where monthly carrying costs for owners vastly exceed the underlying rental yields for the properties. A house in Santa Cruz county in California, for example, that involves a monthly owner outlay of $5000 or more, can be rented for as little as $1500. The only justification for purchase would be price appreciation or substantial rental inflation. Over the last few years purchasers have been rewarded with the rate of real-estate price appreciation being far in excess of the rate of income growth. This has encouraged more debt-financed, real-estate speculation and a corresponding increase in leverage in the financial system. Unfortunately, there has also been considerable new construction in response to higher prices resulting now in an inventory glut, declining prices and an over-leveraged consumer.

We are poised now to enter the "vicious phase" of this U.S. leverage cycle where declining home prices, crushing debt burdens and lack of job growth are going to be the drivers for one of the greatest busts in human history. We believe that it has already started in the sub-prime market where defaults are increasing dramatically.

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The behavior of financial markets when faced with the world's realities is hard to fathom. Market participants seem obsessively focused on short-term issues even though the longer-term problems are so gargantuan now that they are undeniable. In 1999 companies without earnings, track records and business models were being touted by Wall Street with Alan Greenspan himself providing support by talking of improved productivity and of investing being like purchasing a lottery ticket on company success. Today, companies with leverage so vast that the whole financial system is at risk are being hailed as the new role models for the U.S. Consider for example that both Goldman Sachs and Morgan Stanley have balance sheets close to or greater than $1 trillion! And this is before one includes all the off-balance-sheet obligations that dwarf anything that Long Term Capital Management had on its books. There is no doubt that the financial system cannot withstand even a normal recession any more, not to mention an outright shock – the scale of the problem is simply too big.

The first months of 2007 are going to be critical in determining the timing of the financial problem the world is going to face. Market participants have taken comfort in the fact that the U.S. housing market is stabilizing. They may receive a rude wakeup call in the spring when housing resumes a downward slide. Given that credit spreads in the sub-prime market have already started to widen, a further slowdown in housing could trigger a huge bout of risk aversion akin to what happened in April and early May 2006. This should lead in turn to a U.S. dollar problem with its attendant global consequences. The banks and other U.S. lenders are already struggling with a flat yield curve and difficult operating conditions. Any worsening of housing prices should cause a collapse in their profitability and necessitate drastic policy action.

We do not expect a good year for markets in general in 2007. We feel that our funds are particularly well positioned to profit from the difficult environment we expect. We have aggressive short positions in credit, financials and the U.S. dollar. The difficult conditions we experienced in the second half of 2006 were largely a consequence of the precipitous decline in energy prices. This triggered a short-term relief rally in markets despite the fact that most analysts spent the time from 2003 denying the fact that energy prices mattered at all. Economic data since July 2006 suggest that the impact from housing is muting any benefits even of dramatically lower oil prices stemming from one of the warmest winters on record so far. We are now entering a period where global growth expectations can break decisively downwards – were this to happen in the current market climate of hopeless optimism, we fully expect to have a banner year.

Performance Summary

Trident Global Opportunities Fund

Performance as at December 31, 2006

1 Mth.	3 Mth.	6 Mth.	1 Yr.	2 Yr.	3 Yr.	5 Yr.	YTD	Since Inception (Feb. '01)
0.7%	2.5%	-4.7%	0.1%	2.8%	2.3%	2.1	0.1%	2.8%

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