

Trident Investment Management, LLC

Opportunities Funds Commentary

July 31, 2006

Performance Summary

Markets were very volatile in July as they grappled with a combination of slowing economic data and higher inflation. The S&P 500 was up 0.62% on the month, the Nikkei down 0.31% and the MSCI Europe Index up 1.57%. Gold had a volatile month rising 2.85% on the month to \$647 an ounce. Oil was very strong thanks to Middle East tensions, rising to \$77.40 a barrel of WTI. The dollar was fractionally stronger although the volatility was very significant within the month. Bonds rallied with the U.S. 10-Year Treasury yield falling 0.16% to end at 4.98% (all figures in U.S. dollars).

Market Outlook & Portfolio Strategy

The economic data coming out over the last month have only served to increase the uncertainties for markets. In the U.S., growth has been cooling from its earlier torrid pace. The U.S. housing market appears to have gone into reverse with several of the most extended sub-markets showing actual price declines over the last month, even as inventories of unsold homes continue to balloon. The mortgage refinancing boom has virtually ended thanks to higher interest rates, and the effects of this are being felt to a limited degree with discretionary expenditures appearing to slow. A host of companies geared to the consumer have warned that high oil prices and limited income growth have begun to squeeze their customers. Despite the apparent economic weakness, inflation has begun to accelerate. Companies are beginning to pass through higher costs into prices, especially in the commodity and intermediate goods areas. Wages and other employment cost indexes have begun to rise suggesting that inflationary pressures continue to build. Finally, the long dormant rent component of the Consumer Price Index has also started to rise pushing even the core CPI to 2.5%, well above the Federal Reserve's comfort zone of 0% to 2%.

This backdrop, presents the Fed with a dilemma. A focus on growth would suggest an extended pause in the rate hiking cycle, while the very apparent inflation pressures would argue for a more dramatic increase in rates. After its last meeting, the Fed indicated that it might pause in its rate hikes to get a clearer sense of economic conditions. The central bank's concerns about growth should be an ominous sign for foreign creditors of the U.S. With the country already the world's biggest borrower by far, the main concern for its creditors should be the value of the U.S. dollar in which most of their loans are denominated. A slowing U.S. economy is likely to prompt a dovish Fed reaction, while growth that is stable or stronger should add to the inflationary momentum. The Fed, in its current rate hike cycle, has been very slow to act in the face of rampant inflation in virtually all asset prices, the biggest trade deficit in history (which itself is a reflection of domestic inflation) and even a dramatic rise in its own, much-doctored CPI measures. It is hard to conceive of this Fed acting in an anticipatory fashion to quell future inflation. If growth were to slow dramatically, interest rates are likely to be cut quickly, and were inflation to accelerate, the Fed would still probably be "behind the curve" or in a reactionary mode. Conditions, thus, at least from an interest rate perspective, are ripe for longer-term dollar depreciation.

The Fed's clear concerns with domestic growth, highlight its almost total lack of focus on the structural imbalances and particularly the trade deficit. Much of U.S. growth has come from consumption with the housing market and ancillary activities serving as the locomotive. Since 1997, the U.S. has also been the global growth engine with its relative growth being among the highest in the world. A consequence of this has been the high and rising U.S. trade deficit, which at almost 7% of GDP is at an unsustainable if not crisis level. This rise in the deficit has been accompanied by a gargantuan build-up of dollar reserves by most of the U.S.' major trading partners, and especially by China whose reserves are now approaching \$1 trillion.

The ultimate resolution of the trade situation will require much slower U.S. growth, at least relative to its trading partners, as well as a substantial pickup in U.S. exports. This would require accommodative policies overseas with a significant slowdown in the U.S., possibly accompanied by a meaningful depreciation in the U.S. dollar. Unfortunately, few countries in the world are implementing policies designed to accelerate near-term growth and greater import absorption. In fact, high growth countries such as China are growing largely because of their exports and are actually moving to slow growth because of the high domestic inflation it is creating. With a potential domestic growth slowdown looming, many of these countries are looking to their exports to stay strong or even pick up rather than moving to buy more U.S. goods. The only ray of sunshine here would be Japan where domestic lending is picking up and the country is emerging from deflation. However, there has been little impact due to this on the country's imports from the US.

In sum, the Fed's current policies, even absent a trade deficit, increase the risks for U.S. dollar creditors by diminishing the chances for any interest rate support for the dollar going forward. Moreover, the U.S. trade imbalances suggest that a substantial fall in the US dollar is virtually certain in the medium-term. The confluence of these two factors makes for a toxic cocktail that might engender a disorderly collapse in the U.S. dollar. Amazingly, the dollar has so far remained stable with most market participants content to focus on short-term interest rate differentials rather than the unsustainability of the current situation. We believe strongly that a major dollar depreciation is highly likely even in the short term and as such, one of our biggest short positions remains in the U.S. dollar against both Europe and Asia.

A short-term trigger for a U.S. dollar fall would be a further slowdown in the U.S. economy removing any perception of interest rate support for the currency. Alternatively, extraneous events, most notably the tense situation in the Middle East with the Israeli invasion of Lebanon and the unrest that it has propagated in the region could undermine the U.S. position there further and possibly lead to an exodus of oil money from the U.S. dollar. A fall in the dollar in turn, could trigger a reinforcing growth slowdown in the U.S. as the country is deprived of cheap overseas financing. Whatever be the catalyst, we have no doubt that the Fed will respond to an environment of slower growth with easier monetary policy, exacerbating the dollar decline. In fact, we believe that the Fed will move much more aggressively to deal with slower growth even at the expense of higher inflation simply because the debt levels are so high that a U.S. recession with deflation could well lead to a systemic financial collapse. Our central case for the U.S. economy thus, is one of stagflation, where growth slows but inflation picks up. This would unambiguously keep the dollar weak, but would at least allow the U.S. to avoid the most painful consequences of its high-debt levels.

The implications of stagflation are hardly benign for the financial system, although they are probably preferable to outright deflation. The banks in the U.S. over the last few years have been aggressive real-estate lenders with mortgages being a huge part of their asset growth. Stagflation will represent a throwback to the thrift crisis of the 1970s because most mortgage borrowers will not prepay their loans in an environment of rising inflation. This in turn, will create mark-to-market capital losses on the banks' books and inevitably result in a credit crunch. Such a credit contraction would not necessarily be accompanied by massive credit losses and as such is likely to be much milder than one that would have been generated by an outright recession with deflation. We have no doubt that the lending cycle has already turned and that a credit crunch is starting especially in real estate. The recent comments by the chief executive of real-estate lender Countrywide Credit in his company's earnings conference call are instructive – he emphasized the prospect of a hard landing in real estate and his company's curtailment of lending, both due to higher risks and higher competition from other lenders. While his comments were forceful and unambiguous, most of the Wall Street “analyst” group failed to even report his remarks post the conference call preferring instead to tout their own Goldilocks scenarios for real estate. One should remember that the actual Goldilocks story was a cautionary tale without a happy ending – she was eaten by the three bears!

Given our views, we also have built up a large short position in financials and credit. We are short thrift stocks, real-estate credit derivatives and the stocks of banks that derive much of their profitability from real-estate or ancillary financing activities. With the obvious declines in the California real estate market (in fact, the chief economist of the California Board of Realtors was recently quoted as saying that she even regretted using the term “soft landing” in the housing price context) we have the amazing situation where big California lenders (think Bank of America and Wells Fargo) are hitting all time highs. Moreover, real estate credit has been tightening steadily virtually to all time low levels suggesting that irrationality runs deep in our financial markets.

The funds’ performance suffered a little in July, primarily due to the substantial tightening of credit spreads, and from moves against us in the U.S. dollar. We anticipate that these trends should reverse shortly and to our substantial benefit. The fundamentals are all going our way and markets should soon follow.

Fund Performance

Trident Global Opportunities Fund

Performance as at July 31, 2006

1 Mth.	3 Mth.	6 Mth.	1 Yr.	2 Yr.	3 Yr.	5 Yr.	YTD	Since Inception (Feb. '01)
-0.9%	-7.3%	-2.5%	9.4%	4.5%	6.4%	2.8	4.0%	3.7%

CI American Opportunities Fund

Performance as at July 31, 2006

1 Mth.	3 Mth.	6 Mth.	1 Yr.	2 Yr.	3 Yr.	5 Yr.	YTD	Since Inception (Oct. '99)
-1.1%	-7.6%	-2.3%	11.5%	6.3%	1.9%	1.2%	4.4%	5.5%

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