

Trident Investment Management, LLC Opportunities Funds Commentary

June 30, 2006

Performance Summary

Markets had a volatile second quarter with huge moves especially in the commodity arena. Gold rose nearly 23% to US\$728, only to fall back to US\$616, for a gain of 4% on the quarter. Collectively equity markets suffered, the S&P 500 was down 1.44%, the Nikkei 225 was off 9.08% and the MSCI Emerging Markets was 4.35% lower. But, Europe bucked the trend, as the MSCI Europe rose 1.22%. The U.S. dollar fell against most major currencies, dropping 2.85% against the yen and 5.55% against the euro. Prices for U.S. Treasuries continued their downward march, as yields on 10-year Notes rose 0.29% to end the quarter at 5.14%. The market fragility suggests that a major shift in the investment paradigm might be in the offing.

Market Outlook & Portfolio Strategy

To make sense of the market moves, there's a need for perspective to understand the difficult environment. The U.S. is engaged in a war with mounting casualties in Iraq, there is no easy resolution to the impasse with Iran's over nuclear technology, North Korea is blackmailing Asia with its threats of developing nuclear weapons, and the war against terrorism seems far from over. Ideologically, the world is even more problematic. U.S. style democracy and economic liberalization, which firmly took hold in the early 90s, appears to have lost its cachet. Latin American countries, such as Venezuela and Argentina, have repudiated the U.S. economic model but still remain democracies. On the other hand, Russia has embraced a capitalist economic framework within a Putin dictatorship. The countries of the Middle East, which control the world's oil supplies, operate with an uneasy compromise on both dimensions.

In an economic sense, it is both the best and the worst of times. The standard of living for most of the world has never been higher. The U.S., the U.K. and Australia are in the midst of a spending boom. Much of the developing world has joined in with more muted real estate and consumption booms. Even Japan has ended its deflationary spiral. It is the worst of times in the sense that global imbalances have never been higher. World debt levels are at all time highs and show no signs of declining. Trade and fiscal deficits are out of control in virtually all countries in the world, except Canada and Russia. Today, the U.S. has the highest trade deficit on record and a fiscal deficit that continues to balloon.

The wave towards globalization in the 90s has allowed very few to benefit from a global reduction in wages, outsourcing and high asset prices. The majority have faced an environment of job insecurity, static or declining standards of living and no prospects for future improvement. In the last several years, which have been boom times for most global economies, the distribution of wealth has been skewed with the wealthiest gaining at the expense of the poor.

We see an unprecedented level of risk taking in markets, with capital flowing to virtually every market in the world. Globally, equities are near all-time highs, commodities have had a tremendous run up, credit spreads are tight and assets, such as real estate and art are hitting records. The markets seem to be signaling that conditions have never been better.

The high level of risk taking can be explained by the explosive growth in debt over the last few years. The U.S. penalized savers and encouraged borrowers and debt creation by cutting rates in the wake of the Asian crisis of 1997-98. Investors took on debt to invest in technology and telecommunications infrastructure and when much of that was written off in 2000-2002, even more was created to fuel the real estate boom. In both the tech bubble and now the real estate bubble, there is one constant – the equity holders keep cashing out in record numbers.

MONTHLY UPDATE

In the tech bubble, a good example was Gary Winnick, chairman of Global Crossing, which went bankrupt in 2002. During its brief life, the company lost an estimated US\$7 billion, while Winnick managed to cash out to the tune of over US\$600 million, thanks to his confidence in the company's prospects and the faith of his team of confidence men from the financial industry.

Today, the real estate situation is similar, except that there are more Winnicks and it's on a smaller scale. Californians who buy a house with zero down and finance through an adjustable rate mortgage would classify as Winnicks who become the new cheerleading candidates for a team staffed by our financial institutions, politicians and many of the world's central banks.

The problem with having little or no equity in an investment is that the equity holder behaves more like an option holder than a prudent manager. An option holder does not suffer the downside of bad decisions, but can benefit from a huge upside that high risk decisions might bring. This is reflected in more risk taking than would be warranted under the circumstances. For example, where the owner has no equity in a house, he benefits through refinancing if the price goes up, but loses little if the price falls, since he can walk away from his investment. Under this structure everyone is motivated to buy a home.

The financial industry is highly leveraged as well. Many of our highest risk institutions are too big to fail and will need governmental support if disaster strikes. With that downside, it is not surprising that firms like Fannie Mae aggressively acted to boost leverage and fabricate financial information to increase management payouts. Unfortunately, the same is also true of the investment industry. When mutual fund managers are paid on relative performance the cost of not participating in an imprudent investment is one's job, but participating with the herd ensures job security. A herd infected with the "moral hazard" disease is not one to be joined. The hedge fund industry, which used to be relatively small and immune from such an agenda, is increasingly becoming "institutionalized," which is to say that prudent risk-taking has been replaced by the need to follow the herd investing.

What we have now is a number of leveraged or option-compensated principals in stocks and real estate investments. In turn, these are being touted by brokers, and bought by fund managers, who are both in some situations. In this situation, a rise in rates that increases the cost of leverage to the players has unexpected effects. It signals deterioration in business conditions, especially in leveraged sectors. However, being option holders they actually take more risk because being prudent worsens their condition and guarantees no payoff.

When a rate increase is introduced into the leveraged world, we have the consequences of "moral hazard" gone wild. Consider that real estate lending remains the single largest growth area for banks; even though rates are rising and home inventories are at all time highs. General Motors is trying to boost sales incentives at a time when selling a car at full price loses the company money. These cars, as well as credit cards and housing loans are targeted at consumers who are sure to feel significant pain if either housing or the economy cools. When facing these risks, companies such as mortgage and credit insurers, are growing their risk portfolios even faster. This behavior is not induced by courage, but by "moral hazard" in its worst form.

Today, investors belong to one of two opposing camps. The Kool-Aid group – to which most subscribe – believes that markets fully discount all the global risks and the current situation is stable, if not sustainable. This group is excited by a plethora of micro investment opportunities. The pessimistic group, represented by a minority of investors including ourselves, believes that markets have mispriced risks and that a global realignment is long overdue. The changes we anticipate include a substantial depreciation of the U.S. dollar against most major currencies, especially in Asia and a dramatic slowdown in the U.S. housing market and consumer spending. We believe there will be significant financial problems arising from the housing market and consumer credit distress which, should feed into more credit problems and a substantial widening of spreads.

Ultimately, this will produce a major shift in central bank thinking toward promoting inflation to inflate away debts, rather than reining in credit and risking a depression. In the medium term, we feel stagflation is certain, especially in highly-leveraged economies such as the U.S., Australia and the U.K. The inequities in income distribution are fundamentally altering the political landscape in much of the developing world. Most of Latin America has drifted left and several large economies in Asia, such as India, have left-wing governments as well. Slower growth raises the possibility of more global political change, accompanied by radical socialist policies, such as nationalization of resources or aggressive taxation.

As a result we expect numerous macro investment opportunities that we can aggressively exploit. If correctly forecast, the scale of global imbalances is such that the macro adjustments are going to be very large, which sets the stage for much bigger investment returns. The polarized investor base suggests that periods of significant market volatility are to be expected. With such a divergence of opinion, any small shift in sentiment can generate large market moves.

Fund Performance

Trident Global Opportunities Fund

Performance as at June 30, 2006

1 Mth.	3 Mth.	6 Mth.	1 Yr.	2 Yr.	3 Yr.	5 Yr.	YTD	Since Inception (Feb. '01)
-5.2%	2.7%	4.9%	11.4%	4.5%	6.1%	3.0	4.9%	4.0%

CI American Opportunities Fund

Performance as at June 30, 2006

1 Mth.	3 Mth.	6 Mth.	1 Yr.	2 Yr.	3 Yr.	5 Yr.	YTD	Since Inception (Oct. '99)
-5.7%	3.8%	5.5%	12.5%	2.9%	3.3%	1.4%	5.5%	5.8%

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