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MONTHLY UPDATE

Trident Investment Management, LLC
Opportunities Funds Commentary

March 31, 2006

Performance Summary

Global equity markets resumed their upward move in March. The S&P 500 rose 1.3%, the Nikkei rose 5.7% and the MSCI Europe Index was up 3.5% (in U.S. dollars). The equity market rallies were led by commodity sectors with many commodity markets themselves moving to new highs. Gold, copper, silver and oil all rose to multi-year highs with oil in particular being up 6.0% to end March at $67.93 U.S. a barrel. Globally, the only casualties in March were the bond markets. U.S. 10-year Treasury yields rose 0.30% on the month to end at 4.85%, the highest yields since May 2004.

Market Outlook & Portfolio Strategy

Economic data from the world suggest that the global expansion remains firmly on track. Japanese growth and inflation figures continue to surprise on the upside, European growth remains resilient, and the U.S. growth engine continues to chug along, powered largely by continued high prices for real estate. Growth in developing countries, and especially China, has started accelerating again, and this despite rising oil prices. If anything, the rising commodity markets of late seem increasingly well supported by solid demand fundamentals causing many observers to argue that we might be still in the early stages of a multi-year bull market in commodities.

The robust economic performance in the developed world over the past few years has been largely concentrated in countries that have been experiencing real-estate booms. The U.S., U.K. and Australia and to a lesser degree, Spain, all of which have buoyant real estate markets, have grown strongly. Germany and Japan, where housing has been stagnant, have shown relatively anemic results. The developing countries and particularly China have also experienced real estate booms although here the growth impact has been more limited in comparison to the export sectors of these economies.

The real estate market today is of pivotal importance in the U.S. It generates, along with associated industries, most of the U.S jobs, fuels consumption and contributes a huge chunk of stock market earnings. The boom in real estate has been largely engineered by the U.S. Federal Reserve (the Fed). The Fed responded to the wealth destruction that resulted from the bursting of the technology bubble with easy monetary policy, encouraging a move of liquidity to the “safer” real-estate sector which saw steady price appreciation. The attacks of 9/11 engendered further Fed easing and reinforced in the minds of market participants that housing prices would continue to rise and that easy credit could be counted on for the foreseeable future. As such, this resulted in an orgy of risk taking in the real estate arena.

For consumers real estate represents both a form of saving as well as consumption. Homeowners in the U.S., thanks to an array of sophisticated financial products, can literally have their cake and eat it too where it comes to their homes. They can cash in on home price appreciation by using home equity loans, taking out new mortgages etc. even while they benefit from actually living (thus consuming) their homes. The percentage of equity that homeowners have in their homes has dwindled over the last few years to record low levels, and first-time homebuyers in particular, are now able to “buy” homes with no equity whatsoever. In fact, with record low mortgage rates and ample availability of credit, the carrying costs of a house today in the U.S. are no different as a percentage of income, than they were about 20 years ago when rates were almost three times as high. This reflects the enormous increase in mortgage debt needed to pay for the now much-more-expensive homes

The consumer’s aggressive move into real estate is entirely rational. Over the past few years, anyone who purchased a house with zero money down using a creative mortgage could structure his after-tax, monthly payment to be the same as or less than that of a comparable rental. Any appreciation in home values could be extracted through refinancing thus giving the consumer a “free option”. Even worse, *in a number of U.S. states, banks are not permitted to attach consumer assets other than the house in the event of a mortgage default*. That is, mortgages are secured only by the physical property, and not the consumer’s earnings. If the level of equity in the house was low, the consumer could respond to any fall in home prices by defaulting on the mortgage and moving to a rental unit, with no adverse credit consequences. Not surprisingly, such states (California in particular) have experienced among the strongest real estate markets in the country.

The price dynamics in real estate have resulted in a large percentage of housing demand today being investment demand rather than demand from those who want to live in the property. By some estimates, over 30% of all housing demand is for investment reasons. While this is not in itself worrisome, the nature of the "investors" should be. Most of the new investors in real estate are those who believe firmly that prices can only go up. As such, homes are being bought even with significant negative cash carrying costs and no prospects for rental, because the entrenched expectation is that these properties can be "flipped" within eighteen months for a quick profit. The longer the price appreciation continues in housing, the more self-reinforcing the imprudent behavior in the arena becomes. And it is not just the investing public that has been swept up in this mania. The financial system is caught up in this too and is using every bit of legerdemain to create credit for real-estate at a faster pace than even the Fed's easy policies would warrant.

Over the last six years, there has been an explosion in real-estate lending at the banks. Over a third of bank assets in the U.S. are in real estate loans, and this remains the single fastest growing part of their balance sheets. Most banks in the U.S. will lend only when loan to value ratios are at or below 80%. While it is certainly true that housing appraisals are wildly inflated, the limitation of lending to 80% of even the inflated value suggests that the banks should have a reasonable cushion in the event of a real estate problem. However, prospective home purchasers who cannot put up the 20% down-payment on a house, and this would include most purchasers in the U.S. today, can opt to purchase mortgage insurance for a monthly premium from companies such as MGIC, PMI and Radian in the U.S. The mortgage insurance company guarantees the borrower's down-payment to the bank while looking to the premiums paid by the borrower as compensation for taking this risk.

The mortgage insurance business has become very competitive over the last few years with premiums being at all time lows. And this is not hard to understand. In an environment of rising home prices, there is no loss to insurance – any default by the borrower results in a rapid sale by the insurance company typically at the same or higher prices than the mortgage face value resulting in no net losses to the insurer. In fact, loss ratios in the mortgage insurance space are about the lowest ever and not surprisingly, so are premiums. Unfortunately, what is not apparent to regulators or the rating agencies is that these mortgage insurers are insuring vast quantities of systemic real-estate price risk with virtually no capital. Not even one of these investment grade companies can sustain a decline in national home prices of any magnitude, and in fact, not even one of them has ever survived even a recessionary environment! Were a national home price decline to occur, the insurers would default on their guarantees and the banks would, overnight, suffer much bigger losses than they had bargained for, leading to a banking crisis that would dwarf what we observed in the late 1980s.

The main argument against the above bleak scenario that is advanced by the real estate industry and by its Wall Street shills is that a national home price decline is highly unlikely. In fact, since the Great Depression of the 1930s, there have been regional home price declines but never national declines. This argument is entirely accurate but ignores the economic context. In the decade of the 1970s, when inflation was soaring, real estate was a poor investment since it failed to keep up with inflation. In fact, from 1973, real estate rose about 2-3% a year in an environment where inflation was running in the mid-teens. In real terms therefore, real estate experienced a dramatic decline over the decade. Today, the prevailing wisdom is that inflation is dead. Were the declines of the 1970s to occur today in real terms, nominal declines of over 10% in real estate on a national basis cannot be ruled out.

Another equally plausible argument is that the central banks have become so adept at managing shocks to the economy that any serious decline in real estate would be met by appropriate monetary policy action. Thus, several analysts argue for a stabilization of real estate prices or a minor decline that should result in little to no problem for either borrowers or the financial system. What such arguments ignore is that purchasing real estate is a long-term commitment that requires that the buyer have confidence about his long-term prospects. Such is the volume of new construction and the paucity of non-investment demand for housing today that rental yields are very depressed all over the U.S. With rental yields still low and bond yields rising, housing inventories are rising rapidly. Some argue that the inventory/sales ratio is still relatively low, but the ratio of inventories to the total number of U.S. households, which is a better metric for true housing demand, is at all time highs. We thus have a toxic combination of continued construction, rising inventories and overly leveraged owners – hardly a benign backdrop for housing. Unfortunately, if confidence in the market is shattered, there will be carnage wrought on the homeowner and it would be unlikely that easier monetary policy could solve the problem. Witness for example the problem with Japan after its real estate boom of the late 1980s ended – it suffered a 15-year decline in housing prices and consumer confidence despite all of the government's best efforts.

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We believe that the real estate market now is past its peak especially in the U.S. We are substantially short the U.S. market, with the bulk of our shorts being concentrated in the financial stocks most exposed to the real estate market. We dislike home lenders, mortgage insurers, real estate investment trusts (REITs) and most housing related credit. We are in the blowoff stage now of a truly epic bubble in real estate and the problems in the space have already started even if the markets still choose to ignore them. We believe that events should come to a head in the second half of this year as high oil prices and higher rates start biting at leveraged homeowners.

We have kept our significant long positions in gold and gold stocks, as well as our long positions in Asian currencies and some selected Asian equities including Japan. We believe that the U.S. housing market problems that will soon be apparent could catalyze a disorderly selloff in the U.S. dollar. The Fed then will be faced with a truly painful choice – easing to deal with the domestic problems of growth, or raising rates to defend the dollar. Our portfolio should profit under either situation since the markets ascribe virtual certainty to a Goldilocks world where none of the all-too-apparent problems will surface.

Our portfolios started off March very badly with the routs in gold and other metals and the rally in U.S. financials. By month end, the trends that were apparent at the start of the year had resumed and the portfolios began to perform better. We ended the first quarter of 2006 up just over 2% on our funds. We believe that our strong performance of the last two weeks of March should continue for our portfolios – the world is starting to make sense and the more it does, the better our performance should get.

Fund Performance

Trident Global Opportunities Fund

Performance as at March 31, 2006

1 Mth.	3 Mth.	6 Mth.	1 Yr.	2 Yr.	3 Yr.	5 Yr.	YTD	Since Inception (Feb. '01)
0.2%	2.2%	-0.3%	4.0%	1.2%	5.3%	2.2	2.2%	3.6%

CI American Opportunities Fund

Performance as at March 31, 2006

1 Mth.	3 Mth.	6 Mth.	1 Yr.	2 Yr.	3 Yr.	5 Yr.	YTD	Since Inception (Oct. '99)
-0.4%	1.6%	-0.4%	3.4%	-0.7%	4.7%	-0.2%	1.6%	5.4%