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MONTHLY UPDATE

Trident Investment Management, LLC
Opportunities Funds Commentary

November 30, 2006

Performance Summary

After six months of trading in a tight range against most currencies, the U.S. dollar in November finally came under significant selling pressure. It fell 3.77% against the euro, 1.01% against the yen and 3.84% against the Swiss franc. Gold rose by 6.53% to US$652.90 per ounce, driven in large part by concerns about the dollar. Oil rose as well by 4.16%, to US$63.13 per barrel of West Texas Intermediate crude. The dollar's fall was in part induced by concerns about U.S. growth. Accordingly, U.S. 10-year Treasury yields fell by 0.14%, ending the month at 4.46%. The U.S. equity markets remained oblivious to concerns about growth and the dollar with November once again proving a strong month. The S&P 500 was up 1.9%. Other equity markets did not fare as well thanks to the dollar's weakness: the MSCI Europe Index was down 0.46% and the Nikkei declined 0.76% (all returns in U.S. dollars).

Market Outlook & Portfolio Strategy

As 2006 draws to a close, it is clear that most of the imbalances that existed at the start of the year for the U.S. have only gotten worse. The U.S. housing market is in a free-fall especially in the most speculative areas such as Florida. And, despite a massive decline in new construction, sales have fallen even more and so inventories have risen. Moreover, the U.S. is on track this year to post the first national decline in nominal home prices since the Great Depression. The trade deficit hovers around US$750 billion a year and has exceeded the "crisis" threshold of 6% of GDP for several quarters now. Consumers still persists in spending borrowed money with the savings rate remaining near all-time lows. Even the fall in oil prices since August has done little to improve their financial situation. And the economy is finally showing some signs of a more serious slowdown with the housing decline beginning to affect the broader economy. The political situation is hardly better. The Democrats took both the House and the Senate in the midterm elections, raising the possibility that the country could be in a political limbo for the next two years. The situation in Iraq has deteriorated alarmingly, eroding the popularity of President Bush and very likely necessitating some major policy shifts. And North Korea claimed to have conducted a nuclear test, even as Iran continues its uranium enrichment.

Asia is in much better shape than the U.S., although its reliance on exports to the U.S. continues. The Chinese investment to GDP ratio still hovers around 50% and much of the investment remains focused on the export sector. Chinese reserves exceeded US$1 trillion thanks to the country's policy of keeping its exchange rate pegged at an artificially weak level. The authorities there continue to tighten policy, albeit very slowly, but such action is having a much bigger effect on domestic consumption rather than on exports. The situation is similar in Japan. The economy there has performed reasonably of late, but much of the growth has come from exports. Consumer spending remains relatively anemic and this is particularly surprising given the good job market and improving housing fundamentals in the country.

Europe has been the surprise of 2006 with economic conditions in the region proving much better than expected. The euro is at its strongest level against the yen since its introduction, and despite this the economies of Germany and France have been booming. Consumer spending in the region has been robust as has even the export sector.

The good economic performance in the world has meant that most global central banks remain on the path of raising rates. Even U.S. economic performance, while slowing, remains reasonable, suggesting that the U.S. Federal Reserve is hardly ready to cut rates unless a serious slowdown occurs. Despite the relatively hawkish stance of the central bankers, leverage continues to increase globally with the issuance of bonds and exotic credit derivatives hitting new records. Moreover, the weakening of the U.S. economy relative to the rest of the world makes the U.S. dollar vulnerable to a very significant sell-off that could be heightened by the scale of the country's external imbalances. Despite this risk, many market participants globally are still invested in the "carry" trade of borrowing in low-yielding currencies such as the yen and the Swiss franc, while purchasing securities in higher-yielding areas primarily in the dollar bloc. Both the Bank of Japan and the Swiss National Bank recently indicated that rate rises were imminent and expressed particular concern about the scale of the carry trade and the amplified effect their rate hikes might have.

Thus, in the face of the largest trade imbalances, the largest reserve accumulations and the most leverage we have seen in history, there continues to be a remarkable appetite for risk with credit spreads being the lowest we have ever observed. In fact, such is the willingness to take risk, that merger activity is hitting all time records with companies taking on even more debt and the banks only too happy to provide them with more leverage. This raises the issue of what exactly markets believe – after all, the risks we have discussed have been raised often by the media and the question becomes whether markets are efficient from the perspective of fully valuing these facts.

The assumption of efficient markets which characterizes most of the academic literature in finance is precisely that – an assumption. Moreover, the concept of market efficiency defines what prices must be in a static market equilibrium and provides no guidance about how and when markets will move to ensure that prices reach the predicted equilibrium. The task of adjusting prices to reflect reality is assumed to be performed by arbitrageurs who transact to capture the profits that would arise by moving prices to the right levels. A core element of this reasoning is that it presumes that there are no interests that run counter to the profit-maximizing arbitrageurs and that a move to fundamentals will occur unopposed

If markets are truly efficient, as the academic establishment would have you believe, then prices will move virtually instantaneously to reflect reality. Based on the price action of the last few years then, the inevitable conclusion that one must draw is that the global imbalances we have highlighted just do not matter. There must be some non-obvious reasons why the massive U.S. imbalances do not trigger the huge dollar adjustment that common sense would dictate. Some respectable academics have argued thus, that the U.S. trade deficit is not worrisome because the U.S. has non-measurable, overseas assets which create capital flows back to fund the same. These unobservable assets are like dark matter (such as black holes) in space since they are not captured in the official statistics except through inexplicable capital inflows. I am not making any of this up! Yet others (including many Fed members) argue that the world saves too much and that the U.S. remains the only destination for the global savings glut. To put things in perspective, the efficient market ideologues (including Alan Greenspan himself) were inventing equally fanciful arguments to justify valuations during the technology bubble!

A much simpler position to adopt is that markets are not always efficient and that they need not be for extended periods of time. Most markets have a few large participants who are willing to stake vast amounts to prevent a move to fundamentals. Witness for example the willingness of both the Japanese and the Chinese central banks to accumulate reserves to peg their currency at artificially low levels. These non-profit-maximizing participants thus oppose any move to fundamentals, even changing the laws for transacting in these markets to achieve their goal. The fact that the desired price adjustment does not occur then is not a reflection of fundamentals but rather one of manipulation. The more such manipulation occurs, the more likely it is that the underlying imbalances will get worse ultimately resulting in a major crash.

The stock markets remain among the most inefficient of the liquid, global markets. The deviation of stock prices from fundamentals is a fact of investing. The reason for this is that the stock market is a positive sum game. Any rise in stocks means that participants collectively make money. The investment community profits since it is net long, Wall Street profits since transaction volumes pick up in bull markets as does merger activity, banks benefit from their lending for margin, and the public gains from an increase in its wealth. With so many accrued benefits, a big market decline that might be needed to return to fundamentals is extremely unpopular and is likely to be fought tooth and nail by the vested interests.

As such, it is not surprising that "analysts" in Wall Street can justify a "buy" in virtually any stock. The obvious facts such as crooked management, financial engineering to doctor earnings and fairy tales about future prospects are glossed over, while irrelevant factors are highlighted to generate a bull case. Consider for example a company like Fannie Mae. The company has not been able to provide audited financials for the last several years which means that analysts have no accurate information on which to base any investment recommendation. The media have seized upon the problems with the company's previous management and its regulators have detailed the problems in the firm in several hundred pages of publicly available analysis. Greenspan himself has highlighted the systemic risk that companies like Fannie Mae pose because of their huge mortgage portfolios, and powerful members of the Senate Finance Committee are pushing for a bill to ensure that Fannie Mae's obligations, which are not insured by the government today, can never become the responsibility of the taxpayer. Well, with all of these facts most analysts continue to have the company as a "strong buy" with reasoning that reflects a more vivid imagination that Baron Munchausen.

Most stock market bull runs inevitably end in destabilizing crashes as valuations reach levels that even a credible public recognizes as being unsustainable. In the short-term the effects of a major market correction are felt only indirectly by the banking system which typically does not own much (or any) stock in its balance sheet, thanks to a strict regulatory framework that precludes this. However, banks faced with a negatively sloped yield curve environment and creative financial engineers in their midst have recently gone on such a credit binge that many of the so-called bonds in their portfolios actually have much more risk than most equities. The ballooning of the Credit Default Obligation and Swap (CDO and CDS) markets have ensured a level of collective risk in the banking system that dwarfs anything that we saw in the days of Long Term Capital Management. Unfortunately, these markets are anything but efficient. They have grown so rapidly in part because they allow simultaneously both for regulatory arbitrage as well as for doctoring earnings. Specifically, by purchasing instruments that have AAA ratings despite their limited history and lack of stress testing, banks can set aside very little capital against them and still comply with the Basle II capital requirements. By keeping many of these instruments off-balance-sheet, they need not disclose them to investors, nor need they mark them to market unless they want to – an ideal outcome! The fact that credit spreads are so tight is hardly a reflection of market efficiency – in fact it is an obvious sign of just how inefficient the credit market has truly become.

Unfortunately, the credit markets' inefficiencies have permitted the stock markets' excesses to continue for much longer than anyone could have imagined. And it has truly affected investor psyche. Witness, for example, the current wave of takeovers in the Real Estate Investment Trust (REIT) space led by none other than the "smart" private-equity investors. The most recent takeover of Equity Office Properties was one where a tax-efficient REIT was taken over at a pre-tax yield on its properties of roughly 4%. Any investor could do better by purchasing U.S. Treasuries which yield anywhere from 5.25% to 4.5%. The bet in this takeover is that rents will rise considerably and that inflation will fall due to slowing economic growth, permitting the Fed to cut rates. The efficient market has decided that such financial alchemy is entirely possible.

We believe that the markets are pricing in an environment that is improbably benign and far from the realities that we are faced with. The significant sell-off in the U.S. dollar that occurred in the last week of November might be the first sign that fundamentals might re-assert themselves. A rise in the yen and the Swiss franc against the dollar could result in a massive unwinding of the popular carry trade with far-reaching consequences. In particular, an unwinding will certainly force a repricing of global risk with a dramatic widening in credit spreads. This, in turn, should reduce the speculative fever and wreak havoc on risky assets such as junk bonds and equities. Such an outcome will also trigger problems in numerous financial institutions which are exposed to bridge loans, sub-prime lending and other high-risk activities.

The fund had a strong showing in November, reversing a slump that has lasted much longer than we had expected. Our short positions in the U.S. dollar were the primary driver of our performance. We remain very short in credit and in financial stocks and expect to profit handsomely if the dollar rout of late November results in wider market consequences. We have lived for a long time with markets that believed in Santa Claus – it is time he filled our performance stocking.

Performance Summary

Trident Global Opportunities Fund

Performance as at November 30, 2006

1 Mth.	3 Mth.	6 Mth.	1 Yr.	2 Yr.	3 Yr.	5 Yr.	YTD	Since Inception (Feb. '01)
1.8%	-3.0%	-10.3%	3.5%	1.9%	2.9%	1.9	-0.6%	2.7%

CI American Opportunities Fund

Performance as at November 30, 2006

1 Mth.	3 Mth.	6 Mth.	1 Yr.	2 Yr.	3 Yr.	5 Yr.	YTD	Since Inception (Oct. '99)
1.7%	-3.4%	-10.9%	2.6%	1.4%	0.8%	0.1%	-0.4%	4.6%