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MONTHLY UPDATE

Trident Investment Management, LLC
Opportunities Funds Commentary

August 31, 2007

Performance Summary

There was carnage in both the equity and credit markets in the first two weeks of August with equities falling significantly and credit spreads widening. The credit markets, and in particular the commercial paper market, virtually locked up heading into the last weeks of August. The central banks responded to the credit problem with large injections of emergency funds. The U.S. Federal Reserve in particular, cut its discount rate, which is the penalty rate at which banks can borrow directly from the Fed's discount window, by 0.5%. This change caused a dramatic reversal in markets, and equities and credit rallied strongly from the lows. The S&P Index ended August up 1.5% but the MSCI Europe index was still down 1.38% and the Nikkei down 3.92%. The credit markets, despite the late rally, also finished the month down substantially. Sovereign bonds rallied with the 10-year U.S. Treasury falling in yield 0.21% to end the month at 4.53%. Oil fell with WTI crude finishing at $74.04 a barrel, a loss of 4.59%. The U.S. dollar was almost unchanged on the month (all figures in U.S. dollars).

Market Outlook & Portfolio Strategy

The problems in the commercial paper market in August arose from issues that were similar to those that faced the Bear Stearns credit hedge funds in June and July. The commercial paper (CP) market has typically been the arena for larger companies to obtain short-term financing for working capital needs. Asset Backed Commercial Paper (ABCP) is a variant of commercial paper that is collateralized by assets which typically are short-term or revolving in nature. While regular commercial paper is usually issued directly by the company, ABCP is often issued by a conduit which is a special purpose company that holds the assets in question and in turn borrows against them by the issuance of ABCP. While most of the conduits in the past typically funded shorter-term assets such as trade receivables with the issuance of ABCP, there has been a trend in the last few years to use the ABCP market as a source of financing even for longer term assets. That is, the conduit has a portfolio of longer maturity assets and finances them with very short-term ABCP. When the ABCP comes dues, the conduit "rolls over" the ABCP or issues more short-term ABCP to fund the payback of the maturing securities, requiring thus that it tap the markets on a constant basis. Of course, if the commercial paper market refuses to provide financing to such roll-over transactions at reasonable terms, the maturing securities cannot be paid off. Therefore, most conduits maintain some backup credit lines with banks to ensure that an emergency source of liquidity is available to pay out maturing ABCP. In theory, these credit lines should be rarely used and even if used, should not be necessary for very long because the assets, if short-term, should mature quickly and allow payback of the credit lines. Even when longer-term, if the assets are sufficiently liquid, they should be quickly saleable with the proceeds being used to pay back the loans.

More recently, the ABCP market has evolved into being a funding vehicle for extremely illiquid and opaque, long-term assets. Specifically, numerous conduits have been created that hold Collateralized Debt Obligations (CDOs) and other complex credit derivatives with longer maturities, even as they fund these very short term in the ABCP market. Losses in some of these conduit assets in August and the inability to raise cash by selling their assets at their mark-to-fantasy valuations resulted in a generalized loss of confidence in the entire ABCP market. Investors in these conduits simply refused to roll-over maturing CP at any rational price. The most high profile of these problems was in Europe where IKB, a German bank suffered significant losses in a conduit that it had set up due to its sub-prime holdings. These losses, on which IKB made good, meant that the bank itself was short of capital requiring that other German banks, and in particular its largest stockholder, Sachsen Landesbank, mount a rescue operation. Many other conduits in the ABCP market do not have recourse to their issuer and have no hope of being rescued in the event of losses. Moreover, the CDOs and other toxic products held in these portfolios meant that their valuations were suspect, especially when it came to potentially liquidating the same to pay off CP holders. As such, investor aversion to these products became widespread and quickly morphed into a worldwide crisis with conduits in Europe, Australia, Canada and the U.S. all being unable to roll-over their funding and requiring an immediate and large call on banking system credit lines. The liquidity injections by the central banks in response to this problem were massive. The European Central Bank injected emergency funds that were comparable in size to its injections in the weeks following September 11, 2001. The Fed cut its discount rate by 0.5%. In addition, the affected markets' central banks decided to accept virtually any collateral against loans they provided to the banking system effectively becoming the lender of last resort against their toxic securities.

Remarkably, these emergency measures by the central banks have convinced many market participants that the worst may be behind us. Their bullish view is that the Fed and other central banks, will stabilize markets with their aggressive rate cuts and willingness to provide liquidity support. Unfortunately, this analysis represents a fundamental misunderstanding of the current situation. We can get a better perspective on markets today by appealing to the age-old practice of using canaries in coal mines.

Coal mines have always been dangerous places to work. Miners already had to contend with longer-term respiratory and other health issues from working in these mines. However, a much more immediate issue for a miner was to ensure that the air in the mine was clean and breathable. Carbon monoxide and methane gases are often present in coal mines and are both highly poisonous and even worse can lead to catastrophic mine explosions. A frequent practice in the mining industry therefore, was to take a caged canary into the mine. Canaries have very sensitive metabolisms and react visibly and quickly to traces of poison gas. When even small quantities of noxious fumes, and especially carbon monoxide, were breathed in by the canary, it would stop chirping, sway noticeably on its perch and fall. This was the signal for the miners to exit the mine as rapidly as possible to avoid being trapped.

The sub-prime borrowers in the U.S. are analogous to the canaries in the coal mines. These borrowers were in full song when the credit markets were good and despite their parlous finances they borrowed and spent with wild abandon. Unfortunately, they are also the first to suffer when the credit air changes for the worse – they lack the resources to anticipate such changes much like the canary, not to mention their (financial) constitutions are much more delicate than that of our bird. It is important to note that the changing of credit market conditions was not due to the sub-prime borrower. In the boom years, numerous questionable credit instruments were created where the lender had little chance of getting repaid. Reality is finally catching up with these products and the resultant losses are affecting the credit climate – the sub-prime borrowers are the first to be badly affected. In fact, in past credit crunches, sub-prime and other low income borrowers have unfailingly signaled forthcoming problems.

The U.S. policymakers and pundits have responded to the current housing and credit crises with a fatuous set of proposals. First, most members of the Fed and the Treasury secretary all maintained that the sub-prime problems were "contained" whatever that might mean. When canaries in coal mines stop chirping do miners really argue that the poison gas is confined to the birds? After the sub-prime problems failed to be contained and spread to other sectors of the economy, the sages have suggested even better policy alternatives. A popular suggestion is to let Fannie Mae and Freddie Mac (which already insure housing loans in the trillions) bail out the sub-prime sector by purchasing sub-prime loans since they had easier access to financing. This is tantamount to replacing our sick canary with a new one which is older and which has an even more delicate constitution. It might get our original canary out of the mine alive, but it is unlikely to solve the overall problem of the poison gas. Another brilliant alternative is to bail out the sub-prime borrowers with tax breaks, new loans and the like so as to contain the problem. This is equivalent to enclosing our canary in a cage with filtered fresh air. It might keep our bird alive but does not recognize that the problem is not with the canary in the first place.

The remarkable thing in all the policy proposals is that hardly anyone is willing to acknowledge reality. When there is poison gas in a mine, the goal is to get the miners out and have as few casualties as possible. Some casualties, even if only canaries, are virtually certain. Mine overseers should focus on the risks to miners' lives from poison gas levels as shown by the canaries rather than the birds themselves. Our overseers in the credit world – the rating agencies and the Federal Reserve – however, persist in denying the facts. The rating agencies have recently downgraded numerous sub-prime CDOs and ABCP deals by several notches. However, most of the CDOs (even the downgraded ones) are still of investment grade although many of them will default. And many of them are held by our pension, money market and other "safe" funds. An important issue that will soon come to the fore is exactly who the rating agencies serve – the bondholders and the public or the crooked issuers. The Fed is equally to blame.

They failed in the last few years to prevent an orgy of irresponsible lending and now that the bad loans have come to roost, they appear to be ready to support the unethical lenders at the expense of the public. In fact, the discount rate cut in late August was widely spoken of as a measure to save Countrywide Financial, one of the largest and most aggressive mortgage lenders in the U.S., which is the poster child for the credit excess of the last few years.

We believe that policymakers need to focus now more than ever on exactly what they are trying to achieve. There is no way that one can undo the mistakes of the past few years or miraculously take the housing market back to its glory days of 2005. And unpalatable though this may sound, it is no longer possible to have the financial system and the real economy escape unscathed from the current credit and housing bust. A clear recognition of the problems in the U.S., and more generally the world, with credit and real estate will mean that many of the more aggressive lenders should be allowed to fail. A credit crunch is sure to result but the thrust of policy should be to contain such a crunch and ensure that credit continues to flow to the most worthy borrowers. Policies should be aimed at containing the fallout from the credit crunch and the failures of lending institutions rather than trying now to prevent them. In our mine context, the poison gas is in the mine and the focus should be on saving the miners and clearing out the gas rather than dealing with the chirpiness of the canaries. Unfortunately, policymakers, especially in the U.S., appear a long way from seeing this reality not to mention formulating policies to deal with it.

Our funds performed strongly in August though not quite to July's standards. We remain in virtually all of our key holdings - short credit spreads, short real estate stocks, short lenders and long defensive staples companies. We believe that a dramatic easing of monetary policy is highly likely in the current setting and are also positioned aggressively in the sovereign fixed-income markets to profit when that occurs. We have recently added to our long positions in gold and gold stocks because such an easing should send the metal soaring to over $800 per ounce. We are in a truly exciting environment now for our style of investing. Markets are finally being forced to deal with a reality which we had anticipated and positioned for. Goldilocks is waking up and the bears do not look friendly.

Performance Summary

Trident Global Opportunities Fund

Performance as at August 31, 2007

1 Mth.	3 Mth.	6 Mth.	1 Yr.	2 Yr.	3 Yr.	5 Yr.	10 Yr.	YTD	Since Inception (Feb. ‘01)
12.5%	43.5%	35.9%	37.1%	20.1%	14.3%	9.2%	N/A	40.4%	8.0%

CI Global Opportunities Fund

Performance as at August 31, 2007

1 Mth.	3 Mth.	6 Mth.	1 Yr.	2 Yr.	3 Yr.	5 Yr.	10 Yr.	YTD	Since Inception (Mar. ‘95)
12.9%	47.9%	42.2%	44.2%	23.0%	16.1%	9.0%	14.3%	51.6%	18.5%

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