

## Trident Investment Management, LLC Opportunities Funds Commentary

October 31, 2007

### Performance Summary

October was a rough month in the global credit markets. Most credit spreads suffered, with some such as the lower-grade real estate related credits hitting new cycle lows. The equity markets, however, rallied despite the rout in credit. The S&P 500 Index was up 1.59%, the MSCI Europe Index up 4.55% and the Nikkei was down 0.29%. The U.S. dollar continued to make new lows against most global currencies, with the dollar depreciating 1.60% for the month. Even as the dollar fell, oil and gold rallied. West Texas Intermediate crude was up 17.46% per barrel and gold was up 6.04% per ounce, both to multi-year highs. The sovereign fixed-income markets remained relatively quiet with the U.S. 10-year treasury yield falling 0.12% to 4.47% (all figures in U.S. dollars).

### Market Outlook & Portfolio Strategy

The credit market celebration that started after the U.S. Federal Reserve cut its discount rate in mid-August became more of a wake in October. The reality of the disaster in U.S. real estate began to sink in, with defaults and foreclosures hitting cycle highs. Banks reporting their earnings were finally forced to acknowledge the bleak outlook. The scale of losses suffered in the third quarter dwarfed even pessimistic analyst estimates and the companies themselves forecast a period of tighter credit and cautious lending that they expected to persist at least through 2008. A credit crunch is hardly the news needed to revive a real-estate market beleaguered with almost a year's worth of inventory. The credit market, much of whose obligations are highly leveraged to real estate, had one of its worst months since the telecommunications debacle of 2001-2002.

The earnings releases from the financial companies for the third quarter were a litany of woe. The losses in consumer loans, real estate both sub-prime and prime, and merger/takeover lending have been large for virtually every financial institution that has reported. What is much more stunning is that there was virtually no area that was left unscathed. Despite the pronouncements of the Wall Street pundits the problems with housing are not contained and have undeniably spread to the broader economy. In last month's letter we noted many of the Wall Street brokerage houses, while suffering significant losses, had nevertheless doctored their earnings to avoid taking the much greater hits that one could have reasonably expected based on their holdings and leverage. Not surprisingly, their banking and insurance brethren resorted to more of the same legerdemain. Some digging through their financials has convinced us that their problems should get dramatically worse in short order simply because many of the key players in this pyramid game are rapidly reaching the limits of manipulation.

The axe should most likely fall first on the mortgage and credit insurers. The mortgage insurers (MGIC, PMI Group and Radian Group) all typically insure the down-payment of the homebuyer. As such, they are in a first-loss position in the event of a mortgage default where the value of the property is inadequate to pay off the loan. The beneficiary of the insurance they provide is the bank providing the mortgage loan. The bank files a claim for a mortgage insurance payment when the homeowner defaults, but to recognize that the homeowner is even delinquent will take the bank a minimum of two months or more. The claims paid out by the insurance companies in the third quarter, therefore, are largely based on losses incurred in the second quarter rather than the difficult days of August. Even these losses however, were shocking. In fact, some of the insurers reported claims more than twice what they had expected, and further believed that things could only get worse. Given that virtually all of the mortgage insurers have insurance risk in force (which represents potential payments) of over ten times their equity capital, they are in a precarious position. Moreover, their capital supports other businesses such as credit insurance as well where the implied leverage is even greater. With their models for future risk having failed to predict the entire real-estate downturn and the losses incurred to date, it is a travesty that these insurers continue to carry ratings of A or better by the credit rating agencies. A downgrade of the group to BBB or below is imminent and could trigger a wholesale collapse in the industry, which is already anticipated by these companies' stocks and credit spreads. However, a wholesale bankruptcy of this industry is not priced in nor well understood by the actual beneficiaries of these companies' insurance which are the banks and the government sponsored agencies such as Fannie Mae.

MONTHLY UPDATE

The credit insurers, the largest of which are MBIA and Ambac, have similar problems although their losses will most likely take longer to realize. These two companies alone insure about \$1.5 trillion of bonds and other credit derivatives with total claims paying ability between the two of them in the order of a little over \$20 billion. These companies also reported significant losses for the third quarter, although these losses arose not from cash payments but from a marking-to-market of their risk as measured by a valuation adjustment made to bonds they insured. The companies maintained that their adjustments were not relevant to their longer-term solvency since they had insured “zero risk” bonds and that they would not have to pay out any claims ultimately. Unfortunately, that is tantamount to saying that they believe that the credit markets are completely wrong in pricing the risk of the toxic derivatives that have been insured to AAA by these companies and that somehow their internal models are preferable to market pricing.

The adjustments made by these companies to their insured bonds are inadequate by any stretch of the imagination. To put things in perspective, the Swiss bank UBS recognized a mark to market loss of over \$1 billion on what they classified as super-AAA Collateralized Debt Obligations. Others such as Merrill Lynch have written down AAA credit derivatives by what appears to be a staggering 20% or more, and even then markets are beginning to fear this may be inadequate. A similar mark-to-market of the credit insurers’ risk based on their risk exposure to CDOs alone would put both companies virtually out of business. These companies are continuing to write insurance at an astonishing pace due to their AA or higher ratings – another example of how the rating agencies are being exceptionally negligent in the performance of their duties. We believe, however, that substantial downgrades of all the companies in the industry are virtually certain. A downgrade below certain thresholds could trigger a collateral requirement against insurance written and is certain to force the bankruptcy of these entities within a very short period.

Finally, numerous global banks have significant exposure to off-balance sheet vehicles called Structured Investment Vehicles (SIVs). A SIV can best be described as a quasi-bank. The SIV is set up with assets that include loans, collateralized debt obligations (CDOs) and other credit derivatives. It funds the purchase of these loans from the originators with commercial paper, often of varying credit grades, sold to the public. The commercial paper is very short-term in nature and is rolled over typically every three months. However, the loans the SIV holds are generally of much longer duration. It is in this respect that the SIV is like a bank – it takes on the banks traditional role of funding short-term and lending long-term. However, it does not have stable deposits for funding nor does it do the credit monitoring that a traditional bank would do on a loan it originated. However, a SIV typically has backup lines of credit from the banks in case it cannot roll over its commercial paper. This obviously represents significant risk to the banks because the assets of the SIV are very illiquid and these lines are likely to be drawn on in times of market turmoil.

The credit problems of the last few months have resulted in a shut-down of the asset-backed commercial paper market and many of the SIVs have been forced to draw on bank credit lines. The unfortunate problem when these earlier undisclosed credit lines are drawn on is that the bank has to reflect the true risk of these loans by setting aside capital against them. Any SIV losses become losses to the lenders to the SIV. This would represent another body blow to the financial system. The SIV exposure of the commercial banks is considerable, but until very recently the disclosure of these off-balance sheet obligations was non-existent. Once the credit lines were drawn on however, the banks were forced to make some limited disclosure, which gives reason for considerable alarm regarding their health.

In sum then, the credit market disaster, the rout in credit and mortgage insurers and the SIV exposure and earnings woes of financial firms in October are harbingers of things to come. We can reasonably expect that a credit crunch is in full force in the U.S. today, that serious defaults of several pivotal insurance companies is highly likely and that the real estate market should remain in the doldrums with no end to the decline in sight. Policies to address these problems are going to inflict considerable pain and extended delays in a response are only going to make the problems worse. Such an environment truly begs for strong leadership and decisive action.

The dilemma today is just which policies should be adopted to deal with what most policymakers would concede, at least privately, is a major crisis in both the credit and real estate markets. Aggressive monetary policy with dramatically lower interest rates might serve to boost sentiment near term. However, it is unlikely that lower interest rates alone will stop the onset of a credit crunch – there was simply too much toxic waste created over the last few years in the banking system to avoid this. Supplementary fiscal policy with loan forgiveness, corporate bailouts and tax cuts might all be

necessary – much like Japan required in the 1990s, except that we believe that the scale of the U.S. problem is much larger. The U.S. is different from Japan in another critical aspect. Japan in the 1990’s ran a trade surplus even with an appreciating currency and zero interest rates. Were the U.S. to cut rates dramatically, this could trigger a destabilizing fall in the U.S. dollar, a dramatic rise in oil and gold prices even from current levels, and ultimately significant inflation with possibly a collapse in bond prices. This would result in a stagflationary environment with weak growth, high inflation and poor credit fundamentals – and cripple the financial system.

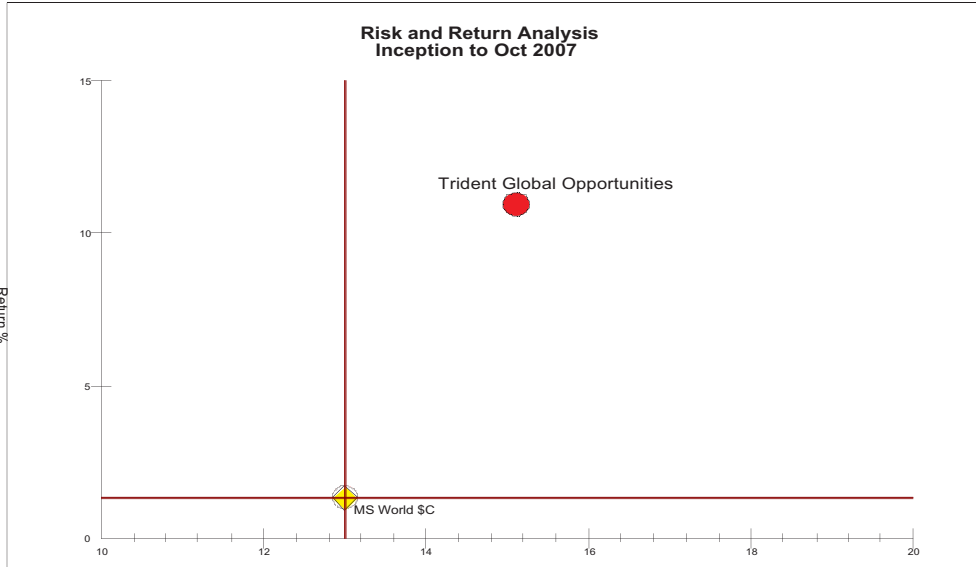
The only policy mix for the current situation that has high probability of success is one that would require the cooperation of the rest of the world. The policy mix involves four steps. First, all of the U.S. trading partners would have to agree to a significant revaluation of their currencies against the U.S. dollar, either immediately or over a period of a few months. Second, the U.S. Federal Reserve would have to give up on rate cuts and in fact clamp down on credit growth to prevent a full-scale collapse in the U.S. dollar following such an announcement. That is, U.S. monetary policy would be committing to a “stable dollar” policy once the currency adjustment was announced. Third, the U.S. consumer would have to tighten his belt with sharply lower consumption and imports increased saving. This would permit longer-term reduction of the trade deficit as long as the rest of the world continues to show reasonable growth. Finally, the U.S. would use fiscal policy to deal with the job losses and credit and financial system disruptions that would be created. Tax cuts, some bailouts, retraining programs and the like would be suggested. This policy mix simply acknowledges what is already fact: that the U.S. cannot continue to consume vastly more than it produces and that it needs to focus on paying back much of the debt it has already assumed. This policy mix has a high likelihood of success, at least in theory. In practice, adopting such a policy mix would be political suicide, especially during an election year.

In terms of the actual policy response, our authorities remain in a state of overall denial, perhaps because they actually do appreciate the scale of the overall financial problem. In official parlance, the sub-prime issues are no longer “contained” but are still having a “limited” effect on the overall economy. And in an amazing twist, rather than even trying to deal with the problem, key officials are suggesting measures that could be right from a confidence trickster’s play book.

The most specific measure that the U.S. Treasury has floated of late has related to the SIV problem at the banks. Secretary Paulson along with some of the largest banks has endorsed the creation of a “super-SIV”. The super SIV vehicle would be set up by a consortium of banks with capital contributed by the banks to buy risky mortgage securities and other assets. In particular this vehicle would buy the illiquid instruments that the regular SIVs might be forced to unload possibly forcing a catastrophic writedown of these assets for the financial system. The whole plan is misguided in that its only aim is to allow the banks and Wall Street to avoid recognizing losses on toxic waste that they have dumped into investor portfolios and which they are belatedly being forced to take on their own books. The banks would still be lending to this super-SIV and so, would still suffer the risks of the underlying assets. However, they may not need to set aside the required capital against the super SIV loans since they are made to this “external” vehicle. The whole super SIV proposal is still shrouded in mystery, but the entire exercise reeks of cronyism. The most vocal exponent of this is Citigroup, which, not surprisingly, has considerable amounts at risk with the regular SIVs. The Fed moreover, appears to have blessed this proposal. Consider the implications of all this: the regulatory authorities for the financial system are trying to find ways to fool the public in regard to the banks’ true risks and permit the banks to continue with their irresponsible practices. If this is what regulation has come to, we are a long way off from solving the problems that plague the markets.

In sum, the world has turned out of late much as we had anticipated. We are continuing with our major bets. We believe that the death knell has already sounded for the credit and mortgage insurers and remain short both their stocks and their credit. The real estate market has gone from weak to weaker and the losses have started. Real estate lenders are beginning to show huge losses and several of the smaller ones are already in serious trouble. The fund remains short numerous banks focused on real estate and sub-prime consumer lending, as we expect a rash of bankruptcies soon. We also still have our long positions in gold and gold stocks, defensive U.S. multinationals and shorts in the U.S. dollar and consumer discretionary stocks. The trend has started, and for now the trend is our friend.

Performance Analysis Inception* to Oct 07	Return %	Standard Deviation %	Annualized Sharpe Ratio	Annualized Alpha %	Beta	Up Capture Ratio	Down Capture Ratio	Negative Months (%total)
<b>Trident Global Opportunities</b>	10.94	15.12	0.72	12.27	-0.08	0.13	-0.79	46.25
<b>MS World \$C</b>	1.30	13.00	0.10	0.00	1.00	1.00	1.00	47.50



Performance Analysis Inception* to Oct 07	Best 3 months	Worst 3 months	Best 1 Year	Worst 1 Year	Best 3 Year	Worst 3 Year	Best 5 Year	Worst 5 Year
<b>Trident Global Opportunities</b>	43.5%	-7.5%	74.3%	-11.6%	21.9%	0.6%	13.5%	1.3%
<b>MS World \$C</b>	6.3%	-9.4%	13.5%	-14.7%	30.7%	-29.9%	14.8%	-4.8%

\*Inception Feb 2001

### Performance Summary at October 31, 2007

#### Trident Global Opportunities Fund

1 Mth.	3 Mth.	6 Mth.	1 Yr.	2 Yr.	3 Yr.	5 Yr.	10 Yr.	YTD	Since Inception (Feb. '01)
15.7%	36.3%	66.8%	74.3%	31.7%	21.9%	13.5%	N/A	70.0%	10.9%

#### CI Global Opportunities Fund

1 Mth.	3 Mth.	6 Mth.	1 Yr.	2 Yr.	3 Yr.	5 Yr.	10 Yr.	YTD	Since Inception (Mar. '95)
16.8%	43.8%	85.0%	93.7%	38.6%	25.1%	15.4%	16.0%	93.0%	20.5%

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