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MONTHLY UPDATE

Trident Investment Management, LLC
Opportunities Funds Commentary

April 30, 2008

Performance Summary

April 2008 was when wild optimism returned to the global markets, despite facts that suggested that more concern might be in order. Equity markets finished up with the S&P500 up 4.87%, the MSCI Europe Index up 5.47% and the Nikkei up 10.57%. The oil market had one of its biggest up moves yet, with WTI Crude rising 12.24% to end at $113.46US a barrel. Amazingly, in the face of this oil move, retailers were among the strongest performers in the equity markets. Gold did not mirror the move in oil but was instead down 6.12% to end at $865.1 an ounce. The bond markets sold off with both short and long term yields rising globally. The two year U.S. Treasury yield in particular rose 0.67% to end at 2.258%, as did the 10-year rising 0.32% to end at 3.73%. Despite this, credit tightened with the credit spreads on many of the financial companies coming in. Finally, the U.S. dollar rallied, appreciating 0.87% on the month (all figures in U.S. dollars).

We had a rough month in April breaking a multi-month winning streak. Our funds were down on average about 5%. We suffered reversals in virtually every one of our positions. Our longs in gold contributed to our losses, as did our short position in credit. We lost money also in our short stock positions in financials and retailers. Finally, our investments in short-dated bonds, taken with options, also hurt us. While the losses on each of these individual themes were much as we had expected, what was unusual was the breakdown in the correlations that we had anticipated. Even as the bond markets sold off and the dollar appreciated anticipating a more hawkish U.S. Federal Reserve, the credit and equity markets rallied despite the huge increase in oil prices. We believe these moves are not justified by fundamentals. Nevertheless, we expect them to continue in the near-term until the facts re-assert themselves.

Market Outlook & Portfolio Strategy

The market action in April can partially be explained by the bailout of Bear Stearns by the U.S. Federal Reserve. Market participants believe now that any insolvent financial institution, whether regulated by the Fed or not, has a backstop in the form of a Fed put. The Fed has actively encouraged such a belief of late, frequently suggesting that they could substantially increase their lending to financial firms at the discount rate, against collateral that the firms themselves would deem of little value. Thus, most financial institutions can obtain liquidity on any toxic assets they may have at close to 100% of face value and that too at interest rates substantially below what the free market would lend to them at. Moreover, such lending is being done to brokerage houses over which the Fed exercises virtually no regulatory authority. Thus, any profits firms might make in the near term from such lending would accrue to its stockholders and management. Any losses would, of course, be the responsibility of the Fed and ultimately the taxpayer. We have now a wonderful system of crony capitalism characterized by privatized profits and socialized losses.

The Fed's generous credit lines have done little to alter the basic issues that have led to the current mess. Markets have started to price in reality. The housing market with its excess inventory, still inflated home prices and declining demand cannot be made to go up again under any normal lending regime. The bubble in housing was created by grossly negligent lending in the 2004-2007 period. Reflating the bubble would require even more lax lending standards than the last few years – something that few institutions can do today with or without Fed support. The credit markets which had gleefully swallowed up every derivative invented over the last few years has finally begun to appreciate the value or lack thereof in these toxic securities. Short of outright government purchases of these instruments at fanciful prices, no amount of persuasion can take us back to 2005. The destruction of bank and broker capital is also a reality as is their decline in longer-term revenues – we cannot go back to the heady days when easy money could be earned by credit alchemy alone.

The above facts are more than obvious to the financial institutions themselves. In a somber earnings season, virtually every financial company's results were worse than the Wall Street intelligentsia had expected. Few firms were willing to opine that a bottom was near – if anything, most were convinced that we were likely to remain in a credit and housing morass for several quarters to come. However, virtually all firms suggested that they were well prepared for the continued problems because of their "strong capital positions" and "adequate reserves". While the macro reality is obvious, most firms refuse to come clean about their actual situations, and understandably so since by a variety of metrics most of them would be bankrupt.

The morbid analogy one is forced to draw on when looking at our financial firms today is that of a patient with cancer that has metastasized and is terminal. Under such circumstances, it is simply too painful to accept the reality – if anything, the patient tries to believe he will be a survivor with spontaneous remission or pins his hopes on experimental drugs that will work. And while it is true that hope does help and occasionally may even have a placebo effect leading to a cure, one can hardly count on such an outcome. The consulting doctor in such a situation should be the realist who makes sure that the patient receives the right treatment, however painful it might be, while accepting the reality that there is no miracle cure. Unfortunately, our financial doctors (read the Wall Street analysts) are themselves in collective denial. They have a tendency to accept the optimistic pronouncements delivered by management of a company's prospects, even though the macro environment may not be conducive to such forecasts. For many of the larger banks, brokerage houses and financial insurers, a continuation of the credit stresses will almost certainly result in bankruptcy. While government action could stave off such an outcome, the reality is that most of these firms are in a parlous state. But even a simple analysis of these risks is lacking from Wall Street. If anything, analysts are compounding their mistakes by cheerleading fatuous "solutions" that serve no purpose other than hiding the truth about the mortality of our terminal patients.

The most egregious solution being suggested for the housing mess is one that involves a sharply expanded role for the Government Sponsored Enterprises (GSEs) which are Fannie Mae and Freddie Mac. These two GSEs are already highly exposed to housing and are dangerously levered at that. Fannie Mae for example, has two main lines of business. The first is to insure the pooled securitizations of the so-called "conforming" loans, which are mortgages whose terms fit Fannie's guidelines for insurability. Fannie Mae has equity capital of less than $39 billion (as of 1Q2008) but insures over $2.5 trillion of these securitizations. This insurance is definitely not riskless. In a housing market that is experiencing its worst conditions since the Great Depression, losses on this insured portfolio are likely to surpass anything the company has seen in its history. In addition to this insurance, Fannie also purchases mortgage securities to boost returns, often buying the very securities it insures. The purchased mortgages total over $700 billion giving Fannie a balance sheet (ex insurance but with some other miscellaneous assets) of almost $850 billion. Thus, even a simple calculation ((2500+700)/39) suggests that Fannie is over 80X leveraged on its $39 billion of capital. Such leverage is already frightening in the best of times when there is no credit risk and only interest rate risk to manage. But with the credit dimension playing a new and important role that there is little history for, one would have to be very concerned about the potential risks in a Fannie Mae.

The one obvious conclusion that can be drawn about Fannie and Freddie (whose situation is essentially the same) is that their capital levels would have to be much higher than in the past simply because of the higher risks in the business. The managements of both companies have, so far, consistently underestimated the scale of the real estate mess and their losses. Yet they are moving these firms towards playing a bigger role in the purchased mortgage market, even as the traditional capital markets firms have withdrawn. They are also growing their insured portfolio citing the higher fees they now receive for their insurance as a major positive while paying scant attention to the massive portfolio of securities they have already insured. And numerous politicians, some members of the Fed and virtually all of the analysts on Wall Street believe that a further, significant expansion in the role of these firms is warranted, along with a relaxation of the capital constraints they have faced from their regulator. These firms truly epitomize the new capitalism that the U.S. has espoused. They have a sliver of capital and are "private" only to the extent that their profits accrue to stockholders. Their managements and stockholders have no incentive to be prudent and in fact, have every incentive to take even more risk given their limited exposure. Their ultimate losses (and make no mistake, they are going to be gargantuan) are going to be borne by the taxpayer either directly through higher taxes, or indirectly through sharply higher inflation that reduces the real value of their claims.

The Fed's liquidity facilities and the numerous policies that have been suggested and/or implemented of late have done little to change reality though they may have slowed the onset of the inevitable. The banks themselves fully recognize the frailty of the financial system. Despite the heroic efforts of the Fed, LIBOR spreads over Fed Funds rates remain close to their highs. That is, banks are unwilling to lend to each other, perhaps because they fully understand the risks on their books they are hiding from the public. However, they have no qualms about borrowing from the Fed at the discount rate. Put differently, the banks understand their own risks – but the Fed, the supposed bank examiner, surely does not!

The problems in the financial companies have masked a couple of critical recent changes in the global markets that make us considerably more concerned about longer-term stability. We had hoped that the U.S. would coordinate with its trading partners to agree on a policy mix that would reduce some of the major imbalances the world economy faces. The imbalances specifically have to do with the over-consumption in the US as measured by its trade deficit – the country has became the de facto consumption engine for the world with this consumption being funded primarily by increased leverage. The U.S. has to have a prolonged consumer slowdown with a weak dollar even as its trading partners have to adopt more pro-domestic-consumption policies and sharply appreciating currencies. Monetary policy would also have to be relatively tight in the U.S. to allow for the higher inflation that would result from a weaker dollar as well as to counter any speculative attack on the currency. Such a policy mix would allow the U.S. to make its consumption adjustment gradually while hopefully counting on its export sector to offset some of the pain, with the reverse being true for its trading partners. The situation in the last few months has changed in a way that makes the need for coordinated action even more critical, even as the political environment makes such action less likely.

The rises in the price of oil and food over the last several months have dramatically increased the strains on the world economy and its policymakers. The move up in the price of oil over the last several months is in large part due to supply issues. Demand for oil continues to be robust even as spare capacity has dwindled. The rise in oil prices, while painful, has been overshadowed of late by the rapid increases in food prices globally. Due to a combination of poor weather and limited inventories, prices of many staples such as rice have been rising so fast that many developing countries have outright bans on exports of their domestic crop. The price rises in oil and foodstuffs have shown up as a significant increase in global inflation. Most central banks, especially in the developing world take this increase in inflation very seriously. After all, food and energy make up over 30% of the CPI in most of these countries and a dramatic rise in the prices of these essentials typically leads to social unrest. The concept of "core" inflation that excludes food and energy is simply not used in most of the developing world since such a metric by ignoring the most important components of consumption would simply be of no use for policy.

In the U.S., policymakers typically focus on core CPI that conveniently excludes the fast-rising food and energy components. The core CPI concept was pioneered in the early 1970s by the then president of the Federal Reserve, Arthur Burns. The Burns Fed argued that oil and food prices were often volatile but over time proved relatively stable. As such, they suggested excluding these elements from CPI to focus on whether there was "real" inflation in the economy through wages and other items. The Fed's argument was theoretically sound then because it was predicated on the fact that the world faced an actual Arab oil embargo which had temporarily depressed supply and boosted oil prices. They expected oil prices to fall back once the embargo lifted, as they did eventually several years later. Unfortunately, in practice the Burns Fed was proved conclusively wrong in setting policy based on this core CPI metric – inflation accelerated to double digit levels by the end of the 1970s. Unfortunately, this policy lesson is not remembered at all. In fact, the core CPI concept, which has proved a totally flawed yardstick for policymaking, is what seems to have been carried over from the Burns Fed.

The Bernanke Fed of today continues to rely on the core CPI measure even though actual inflation is much higher. And even the theoretical basis for the use of core CPI does not exist today – oil prices are not rising due to supply shocks but are trending up due to steadily increasing demand and inadequate new supply. As such, the Fed is keeping real rates at negative levels given the actual rate of inflation. The foreign central banks, which never bought into the U.S.' creative inflation measurements, are recognizing the real inflation they face and have been steadily tightening policy. Together these actions suggest the markets are becoming even more vulnerable to a sudden change in sentiment. A sudden dollar collapse and U.S. bond market fall are highly likely with the attendant global repercussions.

The policies implemented globally so far suggest little to no coordination among decision makers. The election year dominates U.S. political thinking and food prices that of the populous developing countries. Everyone is blundering along, hoping the imbalances resolve themselves. Minor technical moves up in the U.S. dollar are hailed as signs of global stability as are changes in sentiment in the credit markets. This is akin to a terminal cancer patient having a better than normal day due to more powerful painkillers. Unfortunately, the treatment for the ailment is still painful and is best started early. Delays only make the treatment that much more risky and painful.

We continue to be extremely concerned about global market conditions despite the recent bullish euphoria. We remain in our key bets. We continue to be short the credits of many of the credit and mortgage insurers and several consumer lenders – we cannot see how many of these firms can survive. We are also short the stocks of companies exposed to discretionary U.S. consumption and have been increasing our exposure lately. The yield backup in the short-end in Australia, the U.K. and Europe we perceive to be excellent opportunities for increasing our long positions in the short-term bonds of these countries. The gold sell-off is providing us an opportunity to add to our long positions. We hope the dollar rally has some more room to run – we expect to be establishing new short exposure on that front as well.

A housing crisis is bad enough a problem to deal with. When combined with a credit crisis of an even greater magnitude it is a bigger challenge. Throw in oil prices at all time highs and food prices at all time highs and we have an explosive combination. And to cap it all, we have a political environment in the U.S. that is geared towards short-term electioneering and warmongering and policymakers who seem intent on boosting consumption and denying reality at all costs. The questions one needs to be asking now are what resolution of all this may occur. We are in a situation where even a theoretical, stable solution is hard to construct, let alone implement. Policymakers are far from discussing even a reasonable, theoretical solution to today's problems – in fact they continue to deny the obvious. As macro investors, we believe that this environment is ripe with opportunity.

Performance Summary at April 30, 2008

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)
-5.3%	1.0%	17.4%	95.9%	33.5%	27.1%	18.3%	N/A	5.6%	12.6%

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)
-4.7%	-0.9%	9.3%	102.1%	34.5%	27.4%	15.9%	15.2%	0.7%	20.5%