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Trident Investment Management, LLC
Opportunities Funds Commentary

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MONTHLY UPDATE

Performance Discussion

The market euphoria from March continued through April. The S&P 500 index was up 9.4%, the MSCI Europe Index up 14.6% and the Nikkei, up 8.9%. Oil rallied finishing up 2.9% ending at $51.12 a barrel. Gold however, fell 3.4% to end at $888.2 an ounce. Bond yields in the short end of the yield curve were largely unchanged, but the long end sold off with yields on the 10-year U.S. Treasury rising 0.456% to end at 3.121%. Credit markets in general, rallied with spreads of especially the worst credits coming in substantially (all figures in U.S. dollars).

Our spate of poor performance from March continued in April with virtually all of our positions going against us. Our biggest losses came from our short positions in credit, especially from our positions in highly-levered, consumer sensitive companies. Our longs in gold and gold stocks did not help performance either nor did our positions in short-dated fixed income. While our short positions in U.S. Treasuries achieved with curve steepener options helped, their impact was not material to our performance, nor was the performance in our long equity positions in Canada and Japan. The only consolation we take in the month's performance is that our overall risk levels are relatively low – even the correlated hit we took on all of our positions on the month generated manageable losses. What is encouraging is that in the last week of April, the euphoria about the future was beginning to wane, especially in the debt markets. We now have excellent levels to add to our portfolio risk and expect to do so as markets again begin to price in reality.

Market Outlook & Portfolio Strategy

The bullish sentiment in April was occasioned by a spate of news that the markets chose to interpret bullishly. At the start of the month, the Financial Accounting Standards Board (FASB) caved in to political pressure and relaxed the accounting rules relating to mark-to-market valuations of securities. The new methodology embodied by Rule FAS 157-e does not completely eliminate the mark-to-market requirements, but waters them down so significantly that for all practical purposes they have ceased to exist. The new FASB rule allows a holder of an illiquid asset that has lost value to take the position that the market in the asset is no longer active and that the sporadic transactions in the same are "distressed" and hence not reflective of the true value of the security. This asset can then be valued by the holder using his own estimate of fair value with no attention being paid to market prices.

The FASB also changed the rules regarding losses produced by securities that were other-than-temporarily-impaired (OTTI) or securities whose fair values are less than their carrying costs for good reasons. Under the old rules, OTTI losses were required to be passed entirely through earnings for the security holder. Under FAS 115-a, the new rule, a holder of an OTTI debt security can separate credit-related losses due to impaired cash flows, from other losses caused by market price

declines for example. Only the former, which represents the actual impairment to date, would be shown as a reduction to earnings. If markets believed that the asset in question was toxic with little chance of repayment and its market price fell dramatically, this reduction in value would not be a credit-related loss and hence would not affect earnings. Instead such losses would be shown as part of other comprehensive income, a category that is generally not considered to be part of the operations of the firm. Of course, the holder of the security needs to hold it long enough to ensure that the market-related losses do not matter. If the holder were to sell an OTTI security today, it would have to sell it at market prices so that both the credit-related and market-related losses would all be recognized. Under previous rules, the holder had to assert that it would hold the security for a period that was long enough to ensure that only the credit impairments mattered which typically meant holding to maturity. Under the new rules, the holder only has to state that it does not intend to sell the security and that it is more likely than not to hold the security over the required period.

In more simple terms, the FASB modifications allow holders of toxic securities which have become completely illiquid to dream up their own prices for the same. They also provide holders of even the obviously impaired securities the flexibility to shield their earnings from much of these losses, at least in the short term. Finally, they permit a wider class of holders to take advantage of these gimmicks.

The FASB changes are nothing other than a capitulation to the pressure exerted by both the U.S. government and the financial lobby. It must be remembered that the U.S. financial firms were among the most aggressive in calling for mark-to-market rules when it came to rising markets. With bubble valuations for assets, most of which were available for sale and frantically traded, market participants booked huge earnings and "earned" gargantuan bonuses. In these heady days both the regulators and market participants preached the mantra of market efficiency. Unfortunately, the very same crew has now argued, and successfully with the FASB, that markets are in fact inefficient. It must be remembered that mark-to-market rules have done little to create the current problem. Abandoning these rules at the current juncture ensures even less transparency in financial statements. The FASB nevertheless decided to change the rules despite obvious conflicts of interest that arise from holders marking their securities at their own fantasy prices. What is more puzzling however is that the regulators have done little to oppose the FASB change. In fact, they do not appear to have even attempted a detailed study of these illiquid markets with a view to coming up with industry-wide, standardized methodologies to deal with them.

There is ample research in economics that traces the conditions under which markets may break down as they have for most toxic financial assets. The seminal work in this regard was by George Akerlof, a Noble prize winning economist at the University of California, Berkeley. Akerlof in a classic 1967 paper titled "the Market for Lemons" considered the market for used cars.

A used car can be of poor quality (a "lemon") or in good condition (a "peach"). Assume a used car that would be worth $100 if a peach, and $50 if a lemon. Assume initially that half the cars in the market are lemons, with the other half being peaches. A buyer in this market would have

to accept that there is a 50% chance a used car he purchases will be a lemon. As such, he might offer $75 (0.5 * $50 + 0.5 * $100) for a used car reflecting the odds of its being a lemon. The problem with the buyer's price is that any seller of a peach is guaranteed to get less than his car is worth, while the lemon sellers are assured of the reverse. As such, sellers of good used cars, assuming they know that their cars are peaches, refuse to sell in this market with the $75 price, while lemon sellers proliferate. This in turn skews the distribution of cars further towards the lemons until finally the market is dominated entirely by lemons. That is, no more peaches will be sold in this market. Thus, the information asymmetry between buyers and sellers, which comes about because sellers know the value of their car but the buyers do not, results in a complete breakdown of the market for good used cars. It is important to note that the market for peaches breaks down because of the lack of information buyers have about the quality of a car for sale. If the buyer was fully aware of the exact quality of the car, he would pay a fair price and there would be no market breakdown either in the market for peaches or lemons.

The banks' arguments regarding toxic asset valuations might superficially be likened to the market for lemons. If the legacy assets held by banks are all, in fact, peaches, they would indeed be unwilling to sell at lemon prices. And a mark-to-market regime that relied on pricing peaches with lemon prices would be incorrect. But if the market for toxic assets has broken down because of an information asymmetry problem, the correct solution would not be to suspend mark-to-market rules. More information and transparency will address the market breakdown in this situation. A number of simple mechanisms can be adopted to reduce the information asymmetry between buyers and sellers and ensure more reasonable prices. In particular, sellers of good legacy assets can provide guarantees on the floor valuations of the assets they sell since they know them to be peaches. Buyers can be provided with detailed information regarding the assets in question so that they can make informed decisions. In fact, since many of these legacy assets were publicly traded to begin with, there was arguably enough information right from the beginning to ensure that buyers knew what they were getting into – that is in fact the whole point of prospectuses and other regulatory filings. One would expect the regulators in this case to be forcing the banks and other holders to provide much more information about their asset holdings and characteristics so that the information asymmetries can be reduced and market functioning will resume.

But information asymmetries are not the only reason for market breakdowns. In our lemon market, assume that participants were given news that an imminent government ruling would require expensive upgrading of used cars. In this scenario, the buyers would simply stay away until they had further clarity on the ruling and the upgrade costs which means that transaction volumes for both peaches and lemons would plummet. The market breakdown then would occur even where both buyers and sellers have identical information and normal conditions will not return until the uncertainties have been resolved. In this case it cannot be argued that the markets are inefficient. If anything, they are efficient and the prices reflect the uncertainties facing the market.

The situation in the toxic financial asset market today is more akin to the one above where participants are gripped with uncertainty about the future. It is very likely that prices for toxic assets are low as are transaction volumes because of the current economic environment which is the worst since the Great Depression. Under most reasonable scenarios of continued U.S. economic contraction, these toxic assets will be worth next to nothing. We believe in fact that markets are being quite efficient in assuming a range of optimistic outcomes that might fail to transpire. To agree with the banks that market prices for their assets are incorrect, one would have to believe that banks somehow know more than the markets do about the future – history on this subject has generally favored the markets. As such, it would make little sense to suspend mark-to-market rules here because the markets are efficient and the prices are right given the uncertainties.

The best that policymakers can do in the above situation is to ring-fence the toxic assets whose valuations are in question into a separate "bad bank" whose risk of loss is entirely borne by existing stock and bond holders of the bank while trying to ensure that the rest of the bank (the "good" bank) can continue to function. An outright guarantee by taxpayers of bad assets does not make sense because it would reward the banks for poor judgment and excessive risk taking – after all, there is a high likelihood given the uncertainties that the assets will be worth nothing. Again, an attempt to leverage potential purchasers of toxic assets via a Public Private Investment Partnership makes even less sense since the banks are already levered and the market prices are correct. In addition, to the extent that there are information asymmetry issues, the Fed has to work to promote more transparency in reporting. While transparency may not help much, given the conditions, it cannot hurt. Unfortunately, the Fed seems to be doing everything to obfuscate and prevent market efficiency rather than promote the same. This is especially ironic since the influential head of the Federal Reserve Bank of San Francisco is Janet Yellen, a distinguished economist, who is married to the very same George Akerlof of lemon fame!

The policy of obfuscation unfortunately seems to be extending to all spheres of the U.S. banking system with active government support for the same. Another scandal for April was the release of the sordid details pertaining to the takeover of Merrill Lynch by Bank of America. It should be remembered that the deal was to close in mid December and by then, it was already apparent to the management of Bank of America that Merrill was sustaining losses that were much higher than what they had deemed reasonable in September when the deal was first announced. A Material Adverse Clause (MAC) in the deal terms would have permitted Bank of America to abandon the Merrill deal since the asset they were going to purchase had deteriorated so much in value. Given that the deterioration was well known to the bank's management, it was, in fact, their fiduciary responsibility to inform their stockholders of this before the deal was put to a vote.

On December 17, 2008, Ken Lewis, the Chairman and CEO of Bank of America, informed then-Treasury Secretary Hank Paulson that the firm was considering invoking the MAC to abandon the Merrill deal. Testimony provided by Ken Lewis to the New York State Attorney General and minutes from the bank's Board meetings suggest that the management of the bank

was pressured to go through with the merger by both Paulson and Fed Chairman Bernanke. It appears also that the government promised more aid to the bank if the merger occurred to make up for the losses sustained by Merrill Lynch. These promises were not committed to writing since that would have triggered public disclosure. Rather than resign to avoid explicitly acting against their fiduciary responsibility, Ken Lewis and the Board chose to proceed with the merger without informing stockholders of the precarious state of Merrill Lynch. The consequence of this has been of course the virtual collapse of Bank of America since. Amazingly, even with this disaster, Ken Lewis has still not been ousted from the firm nor has the Board. It seems that a total violation of fiduciary responsibility is not of much consequence in today's America.

The part that is hard to understand in the Bank of America mess is just what regulators are supposed to be doing. Is their job to uphold the laws of the country or is it to ensure that favored managements in the financial system remain in charge? Are stockholders' rights to be protected or are managements supposed to operate companies at the directive of regulators? What sense is there in having a non-nationalized banking system if it is going to be run by the government without transparency anyway? And who in his right mind will invest in this mess when the rules of corporate governance seem to be in such flux?

The policies of obfuscation ultimately highlight the one serious problem that everyone just seems desperate to ignore. The whole financial system in the U.S. is undeniably insolvent notwithstanding any results obtained by "stress tests" that the Treasury might choose to administer. Mark-to-market transparency will just not work in this context since it would require accepting the sorry state of the financial system and dealing with the gargantuan bailout bill. Numerous regulators and lawmakers are at fault for creating this mess, or at least ignoring its warning signs. A massive cleansing of the financial leadership is essential but the financial oligarchs at least for now are firmly in control. As such, the approach has been to tamper with several decades of financial rules and regulations to hide the unpleasant truth from the public. The complexity of the current financial system would stun even a Yoda, but the retrograde measures that have been implemented virtually guarantee that no one can understand the true state of affairs.

In sum, we have moved in April to more opacity in financial statements, more explicit government intervention and more bailouts. Shareholders in U.S. companies can now be assured of financial statements that are incomprehensible. Their chosen managements who are supposed to run their firms in their interests can be expected to value their jobs more than their fiduciary duties. You would think that these developments should have depressed any shareholder-owner. But in the bizarre world we live in, the shareholders, steadily being deprived of even the most basic rights, rejoiced! They did so perhaps because they were told that there were "green shoots of recovery" in the economy. The Wall Street and policymaker consensus seems to believe that the global economy has bottomed and growth will resume in the second half of 2009. To agree with this, one would have to believe that the greatest decline in home prices since the Great Depression and the biggest credit crisis in human history will result in the shortest U.S. recession of the post-war period.

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MONTHLY UPDATE

We have retained most of our positions from last month despite our losses during April. While our losses were significant, they were well within bounds we had anticipated. We believe strongly that the supposed economic recovery will be much worse than expected and that the massive run-up in consumer stocks and credit will be unwarranted. If anything, we are starting to add to our high conviction ideas in the belief that reality will soon sink in. A slowdown in the U.S. will trigger even more government expenditure and more quantitative easing by the Fed – actions that will increase the risks of a dollar and/or a bond market crisis. We continue to be long gold and gold stocks, and have started to build a position in oil and other commodity stocks in expectation of such a problem. Unfortunately for the Fed, were a recovery to materialize, the bond markets should suffer forcing the Fed to more quantitative easing. And were the economy to weaken, the fiscal deficits are going to increase further demanding even more quantitative easing. This makes the Fed largely powerless in the current situation – its policies of dollar printing are here to stay in most reasonable scenarios for the economy. When the markets realize this, we should enter the next leg of this unfinished crisis.

Finally, on a happier note, I am very pleased to announce the appointment of W. Mason Rees as Chief Operating Officer. I have known Mason for over 17 years first having met him when he was at Merrill Lynch as an institutional salesperson. Mason will be responsible for Investor Relations, Marketing and Administration. He comes to us with a distinguished pedigree. He has over 25 years of experience with hedge funds starting with Merrill Lynch where he worked for over 20 years in institutional equity sales and research. Subsequently, Mason was a Partner at Altrinsic Global Advisors, a fund management company in Stamford CT, and then at Bear Stearns where he was responsible for coordinating and growing the firm's largest hedge-fund client relationships. I feel very fortunate that Mason has decided to join us. I have no doubt that all of you as investors will concur with me once you have had a chance to interact with him.

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)
-3.0%	-3.6%	9.3%	34.8%	62.5%	33.9%	22.1%	N/A	-0.8%	15.1%

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)
-2.9%	-3.5%	8.5%	39.8%	68.1%	36.2%	23.9%	13.5%	-1.3%	21.8%

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