CI Investments
2 Queen Street East, Twentieth Floor
Toronto, Ontario M5C 3G7
www.ci.com
Telephone: 416-364-1145
Toll Free: 1-800-268-9374
Facsimile: 416-364-6299

Trident Investment Management, LLC
Opportunities Funds Commentary

August 31, 2009

MONTHLY UPDATE

Performance Discussion

Bullishness was rampant in the global equity markets in August. The S&P 500 was up 3.4%, the MSCI Europe Index up 4.8% and the Nikkei up 1.3%. Commodities were mixed with oil up 0.7% to end at $69.96 a barrel, and gold down 0.3% to end at $951.25 an ounce. Remarkably, the bond market did well too, with yields on the U.S. 10-year Treasury being down 8.2 basis points to end at 3.4%. The credit markets also performed well with credit spreads continuing to tighten. Finally, the U.S. Dollar Index depreciated 0.2% on the month (all figures in U.S. dollars).

Our funds continued to suffer in August though not as much as in July. About half our losses came from our short positions in consumer stocks, with the other half being made up of our short positions in U.S. Treasuries through curve steepener options. The rest of our positions in foreign exchange, short-dated fixed income and gold did not affect our performance materially. We have not made any significant changes to our portfolio in August. We have slowly started to add to some of our core ideas.

Market Outlook & Portfolio Strategy

The initial move up in markets from the lows set in March 2009 through June was driven by a belief that conditions in the global economy and financial system were not as bad as suggested by valuations. The euphoria since June though has occurred because market participants have come to believe that global growth will resume strongly, consistent with the historical experience of emerging from a normal recession. In fact, investors believe there is more reason to be bullish this time because of the record low levels of interest rates, the high levels of global fiscal stimulus and the dramatic growth in China. Some observers are calling for huge increases in global growth because of the "unprecedented" drawdown in inventories that has been observed over the last several months, which should mean a mad scramble for new product as demand returns. At face value, this thinking is accurate and explains why markets have ignored any bad news of late. After all, if one knows for sure that a strong recovery has started, any bad news is very likely noise that needs to be ignored.

The problem with the above view is that it relies on U.S. economic history over the last few decades but there is no historical parallel for our current Great Recession. The recession we are in was engendered by the bursting of a real estate and credit bubble which together give it fundamentally different characteristics, even from the most directly comparable period which would be that of the Great Depression of the 1930s. In our communications over the last few months we have discussed the debt levels in the U.S. and the country's extraordinary reliance on the consumer. In this letter, we will consider just why a recovery of the type markets expect may be all but impossible.

The Current Recession in Historical Context

The classic recessions of the last several decades in the U.S. have typically been engineered by the U.S. Federal Reserve which raised rates to rein in incipient inflation. As booms created pricing pressures, a rise in interest rates had the desirable effect of reducing investment and possibly consumption due to asset market corrections. These in turn meant lower demand and higher unemployment which led to increased saving and further reduced investment, with all of these effects working to create a significant slowdown. Typically, recessionary periods were characterized by high levels of savings with significant pent-up demand that represented purchases which had to be postponed because of the economic conditions.

The end of a classic recession was generally signaled by the Federal Reserve cutting rates and providing more plentiful credit for the economy. The lower rates stimulated investment as projects postponed due to inadequate returns at the margin became more attractive. Easier credit also stimulated consumption due to a reduction in savings and/or an increase in borrowing. Faced with increasing demand, the corporate sector would increase inventories and employment leading thus to a virtuous cycle of growth. Asset markets typically bottomed when future Fed rate cuts were highly likely since the rate cuts signified the start of an expansionary phase in the economy. Also, since the improvement in final demand was what precipitated more hiring, unemployment typically came down with a lag. Of course, the nature and strength of the recovery depended considerably on just how much under-investment occurred during the recession and how much pent-up consumer demand existed.

The dynamics of a recession produced by the bursting of an economic bubble, however, are markedly different from the case above. There is no set pattern of recovery from such a recession since the initial conditions that characterize a classic recovery may not even be applicable. As a case in point, consider the technology bubble of 1998-2000 in the U.S. that was largely created by overly easy Fed policy juxtaposed with the growing popularity of the Internet. The free availability of credit from 1998 meant that firms invested on a gargantuan scale in projects of questionable value, even though much of the investment was done with equity rather than debt financing. The bursting of the technology bubble in 2000 and the Fed's rate cuts that followed in 2001 did not generate a huge increase in corporate investment. In fact, corporate investment remained notably weak in the years following 2001, and was not the engine for growth over the period. However, consumption picked up with a vengeance as did investment in real estate – these proved to be the drivers of growth. Interestingly, the savings rate did not increase appreciably during the recession of 2000-2002 and the consumer continued to increase spending over the entire period – a fact that makes this recession already anomalous in the context of U.S. history. Unfortunately, the increase in consumption came because of increased debt levels with little real job growth over the period. The recovery post 2001 has often been characterized as a jobless recovery. To put things in perspective, U.S. payrolls actually fell by 0.4% in 2002 and 0.3% through mid 2003.

MONTHLY UPDATE

When considering the emergence from the current recession engendered by the real estate and credit crises of 2007-2008, the prospect of a "job-loss recovery" seems all too real, notwithstanding markets' happy perception to the contrary. The initial response to the crises by the Fed was to cut rates dramatically, but this failed to stop the collapse in the credit markets. The U.S. government had to step in with massive injections of funds to halt the destruction of the financial system and the Fed supported this effort by direct purchase or guarantee of over $10 trillion in toxic assets in the economy. Policymakers argue that their prompt actions somehow pulled the economy from the brink. However, it is not clear that these huge expenditures have made the average U.S. person any better off. Consider the following facts:

- Unemployment in the U.S. is still rising. Since December 2007, the U.S. economy has lost a total of 6.9 million jobs. Nationwide employment is the lowest since March 2000. The unemployment rate of 9.7% is the highest observed since the depths of the recession of 1980-1981. The unemployment rate where part-time and marginally attached workers are counted (U-6) is a staggering 16.8%.
- Total consumer credit is shrinking. From 2007 to July 2009 consumer credit has declined from $2.56 trillion to $2.47 trillion. While the reduction may not seem significant, it represents one of the steepest declines of the post-war period.
- Wage income shows little growth. Worker compensation as measured by the employment cost index grew at about 3% in 2008 and 2% in 2009. Adjusted for inflation (core CPI change) of 2.5% in 2008 and 1.6% in 2009, real compensation has been stagnant.
- Household wealth has been significantly reduced. About $14 trillion of household net worth has been wiped off since the peak in 2007 due to the housing and credit market corrections. Equity percentage ownership in the home nationally was at an all-time low of 41.4%. Since over 30% of households do not even have a mortgage those who do have only about 16% equity in their homes.

From the above, it appears that the average American is significantly worse off since the bailouts began. What is more worrisome is that from this starting point, it is unclear how the 70% of the U.S. economy that is made up by the U.S. consumer can serve as an engine for U.S. or global growth. In fact, the U.S. consumer has not faced such headwinds since the Great Depression and any supposed "stabilization" in the economy at current levels is no cause for celebration. Moreover, with the consumer in this situation, it is unclear why any firm should invest aggressively, even with lower rates. Any rational firm should wait for more tangible signs of consumer revival before embarking on any new projects which suggests in turn that investment is unlikely to pick up except perhaps in the very short run as inventories adjust to fluctuating levels of final demand. Also, net exports are unlikely to be a major driver for U.S. growth because the U.S. has too large an economy to export its way out of the current problem. This means that the only hope for medium-term U.S. growth is from government expenditure.

Many prominent economists have argued for much higher spending by the U.S. government to generate growth despite the current high levels of U.S. debt. There is some merit to this argument in that U.S. debt is only about 40% of GDP. However, if the government is to embark on an ambitious program of debt-financed expenditure it needs to protect its own solvency and raise debt that will be targeted to generating growth and employment. It cannot undertake to guarantee directly or indirectly the vast amount of private debt which represents another 335% of GDP. Doing so risks the prospect of a parabolic increase in debt and a host of new problems. There is ample historical evidence on this front that the U.S. can look to.

The Experience of Japan from 1991

Japan in 1991 faced a major economic crisis that arose from the bursting of their real estate bubble of the late 1980s. At that time, the country's government gross debt to GDP ratio was below 100% and in fact, the level of net debt was only about 13% (yes, thirteen percent) because of the huge assets the government owned. The Japanese also did not have the disadvantage of a huge trade deficit or an exceptionally leveraged consumer. The Japanese spent considerable funds to bail out their financial system which was arguably totally bankrupt post 1991, spending $100 billion in 1996 and a further $500+ billion in 1998 with the Obuchi plan. The funds so expended represented about 16% of 1998 GDP. The Japanese government, however, spent considerably more money on direct measures to boost consumption and employment such as infrastructure projects, consumption tax holidays and the like. Their logic was not without merit – after all, the Japanese consumer in 1991 was not very leveraged and the government believed that stabilizing employment would unleash more consumption and a resumption of growth.

The effects of Japan's actions since 1991 have been instructive to say the least. On the positive side, the Japanese government managed to keep the unemployment rate low with the latter rising from 2.1% in 1991 to just 5.0% in 2001. Their remaining banks are in good shape today, having managed to survive the numerous economic crises of the last several years. The Japanese economy has stagnated since 1991, but given the appreciation of the yen, Japanese citizens' living standards may have actually improved. Yet, most observers would argue that Japanese policy has been notably unsuccessful despite the positives. Japan's equity market has fallen over 70% from its highs of the late 1980s. The country's gross debt to GDP ratio has ballooned to 217% with the net debt ratio at 104%. Japan today is the most indebted developed country in the world. The government has been able to fund this debt thanks to its continued thrifty consumers and its strong export sector which continues to generate export earnings despite a currency that has strengthened considerably over the last fifteen years. Yet, the Japanese economy today cannot look forward to a period of strong growth without some major adjustments.

The Situation in the U.S. Today

With a fiscal deficit of 13%, total debt levels of 375% and over $10 trillion in financial sector support representing over 70% of GDP, an unbiased observer looking at the current situation of the

U.S. would be correct to conclude that the government has totally failed in its attempts to revive the economy. Were the U.S. to embark on a Japanese style stabilization of the real economy today, its starting conditions would be much worse than 1991 (or even 2009) Japan. With the benefit of Japanese history, it appears generating a sustainable U.S. recovery might be impossible without radical action – think outright debt defaults and/or massive currency depreciation with debt monetization. Viewed charitably, U.S. policy actions so far suggest that policymakers are attempting to create an asset market bubble to induce confidence, boost consumption and ultimately create sustainable longer-term growth. This approach has been repeatedly tried, most recently by the Maestro Alan Greenspan post the crisis of 9/11/2001. It should be totally discredited especially since the U.S., if not the world, is paying for the consequences of this misguided policy. A more cynical analysis would argue that U.S. policies reek of crony capitalism with favoured financial firms receiving taxpayer largesse for no ultimate benefit to the latter. In either event, the equity and credit market rallies that have followed the bailouts cannot be sustained – reality simply cannot catch up with the rosy expectations of market participants.

The considerable resources expended by the U.S. government to date have had little perceptible impact on consumer balance sheets or income. The U.S. is not in a fiscal position that will permit it to embark on any significant consumer-stimulus program without potentially creating huge bond market problems. We have long been bearish on the U.S. consumer, but have become even more concerned of late given the significant deterioration in his situation. The bleak outlook for the consumer has not stopped a remarkable rally in this sector since March 2009. In fact, many consumer stocks and credit instruments are now at levels that suggest that neither the real estate and credit crises nor the ensuing recession ever happened! The Wall Street pundits put out rosy forecasts for these companies as being cheap and tout the remarkable progress some of these firms have made with cost cutting, while ignoring the truly dramatic deterioration in their core businesses. While our short positions in consumer stocks and credit have hurt us considerably over the last few months, we believe that these represent some of the best prospects for profit looking forward.

Many U.S. retailers and consumer discretionary companies are highly leveraged. Their businesses typically involve high fixed costs and healthy gross margins but low net operating margins. This is because setting up and maintaining a store requires initial fixed costs and constant capital expenditures. In addition the store needs to maintain inventory to service customers. These costs can be recouped only if the store generates enough sales. Ensuring strong sales thus is a critical focus for retail managements.

The U.S. retail industry has been going through a wrenching adjustment since late 2008. Same-store sales are in decline across the industry with even the best of the value retailers such as Wal-Mart experiencing little growth in annual sales. Many department store chains and others who provide more expensive merchandise have seen same store sales declines exceeding 15% year on year. The initial response from the retail sector has been commendable in that most firms have moved aggressively to cut costs and inventory. However, the U.S. retail industry is characterized

by a clear dichotomy between stores with considerable debt and those with clean balance sheets. Few companies have moved to reduce debt in the recent improving environment and in fact, numerous heavily indebted firms are actually continuing to open new stores while issuing more debt. With this backdrop, it is unlikely that most of these leveraged retailers can emerge from this U.S. recession intact. We believe that the rallies in the stocks and credit of these companies are absurd and present one of the best shorting opportunities we have seen in recent memory.

Summary

So to sum up, we feel that markets are simply divorced from reality. The U.S. situation remains extraordinarily fragile with the consumer in particularly terrible shape. The government has squandered an opportunity to address the fundamental problems and has put the country on a footing that is considerably worse than that of Japan in 1991. Yet, with conditions this scary, markets continue to rejoice. Investors should recall that in 2006, and even in 2007 when the U.S. real estate and credit crises had started, markets chose to ignore the facts until it was too late. Ample credit convinced investors that every toxic derivative was in fact a gilt-edged investment. Today, the money printing going on in the U.S. and the rest of the world has simply ignited another boom in global markets with participants failing to remember the lessons of 2007-2008. Wall Street has been cheerleading this “recovery” and the incredible values in markets, but then, one must recall, they also touted every noxious derivative in 2006. The French said it best when they said “plus ca change, plus c’est la meme chose” (the more things change, the more they stay the same). We are expecting a return to an environment where markets begin once again to price in fundamentals. 2009 is setting up like 2006 for us so far – hopefully we can look forward to performance that mirrors our returns from the 2007/2008 period again.

Performance Summary at August 31, 2009

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)
-0.7%	-6.8%	-5.1%	18.9%	37.9%	37.7%	23.2%	N/A	-1.6%	14.3%

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)
-0.9%	-7.1%	-4.9%	21.5%	38.8%	40.6%	24.7%	11.8%	-2.1%	21.1%

Nothing herein should be read to constitute an offer or solicitation by Trident Investment Management, LLC or its principal to provide investment advisory services to any person or entity. This is not to be construed as a public offering of securities in any jurisdiction of Canada. The offering of units of the Trident Global Opportunities Fund are made pursuant to the Offering Memorandum only to those investors in jurisdictions of Canada who meet certain eligibility or minimum purchase requirements. Important information about the Funds, including a statement of the Fund’s fundamental investment objective, is contained in the Offering Memorandum. Obtain a copy of the Offering Memorandum and read it carefully before making an investment decision. These Funds are for sophisticated investors only. ®CI Investments and the CI Investments design are registered trademarks of CI Investments Inc.