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Trident Investment Management, LLC
Opportunities Funds Commentary

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MONTHLY UPDATE

Performance Discussion

December provided some respite from the market carnage of most of the year. The S&P index rallied 1.06% and the Nikkei was up 4.17%, but Europe suffered with the MSCI Europe index down 4.22%. The bond markets globally rallied with the yield on the U.S. 10-year Treasury dropping 0.71% to end at 2.21%, a record low for this cycle. Oil suffered falling an incredible 20.10% on the month to end at $44.60 a barrel. Gold however, rallied rising 7.97% to end the month at $884.3 an ounce. The U.S. dollar suffered depreciating over 6% against a basket of major currencies. Credit markets globally performed better with most continuing to rally off the depressed levels hit in November (all figures in U.S. dollars).

Our funds had a strong December, largely due to our positions in short-dated fixed income. Our equity positions also helped with both our long gold stock positions and short retailer positions performing. Credit overall hurt us as spreads narrowed further in December. Given the extreme market conditions over the course of 2008, we are very happy indeed to report that we finished the year with a handsome gain for our investors.

Entering 2009, things seem murky, at least for the short run. The longer-term fundamentals now are very much in place. Policymakers appear to be waking up to the magnitude of the world's problems, but are far from implementing or even formulating a comprehensive policy response. What is remarkable is that so many of the measures that have been enacted so far have all been driven by the exigencies of the moment rather than being part of an overall plan to address the issues. Unfortunately, we seem to be no closer today to adopting the "right" policy mix which suggests that at least the first half of 2009 might be characterized by continued volatility and market turmoil. The fundamentals, which are truly dismal, have long ceased to matter especially since by most objective measures, virtually the entire U.S. financial system is bankrupt. The only sure factor driving markets currently appears to be the continued likelihood of government handouts.

We have continued with our core long positions in short-dated fixed income and our short positions in the equity and credit instruments of retailers and other consumer-sensitive stocks. The trend seems very much in our favor still, and we need considerable action from the Obama presidential team in regard to economic policy before things are likely to change.

Market Outlook & Portfolio Strategy

The economic news in December was absolutely dismal, not just in the U.S. but the world over. Virtually every country reported a significant slowdown in activity. Consumer spending in the U.S. for December was the worst since the Second World War with retailers reporting the bleakest Christmas season they had experienced. Conditions in the U.K. were actually worse than in the U.S. Most developing countries, including China, reported huge declines in exports and overall economic activity. Both the magnitude and the speed of the decline in global economic activity have been unprecedented.

The impetus for the market improvement in the face of the unpleasant backdrop came from the U.S. Federal Reserve which announced that it would peg official U.S. rates between 0% and 0.25%. To put things in perspective, Japan took several years after its bubble burst to drop rates to comparable levels. As things stand, the U.S. has the lowest official interest rates in the world with the Fed Funds overnight rate trading on average below the 0.10% which they are at in Japan! The Fed has also announced its intention to buy longer-dated, mortgage backed

securities directly to reduce mortgage lending rates. They are also considering direct purchases of 10-year Treasuries to further reduce rates along the entire yield curve. Most other central banks in the world cut rates too, though none have taken them to the extreme levels that now prevail in the U.S.

Not to be outdone, U.S. President-elect Obama and his team have announced equally dramatic policy measures that they intend to implement as soon as they take office. In particular, Obama intends to press for a massive fiscal stimulus that might amount to about $800 billion over a period of two years. The U.S. fiscal deficit, according to the Congressional Budget Office, is expected to exceed $1 trillion even before the stimulus is enacted which represents almost 7% of GDP. Huge fiscal deficits are going to be the norm in the U.S. going forward. Again, while other countries have adopted limited fiscal measures to stabilize growth, few have even considered a stimulus rivaling the U.S'. Superficially at least, it appears that the U.S. policymakers have finally understood the nature of the crisis they are dealing with.

The problem with the above measures is that they operate through the current economic structure which we believe to be totally broken. The bank capital injections under the Troubled Assets Relief Program (TARP) by the Treasury, the moves by the Federal Reserve to purchase or guarantee junk assets held by financial firms, the willingness to provide bailouts to auto firms even when they are controlled by private equity investors, and the consideration being given to expanding bailout efforts all suggest that U.S. policy makers believe that the current system is viable and is just in need of some short-term help. Reality however, is sharply different.

The fundamental logic behind capitalism is that free markets will generally do a better job at capital allocation than a government driven, centrally planned system. The experience of the U.S. over a period longer than a century, especially in the time leading up to and following the Great Depression convinced policymakers that some tweaking was necessary for the efficient functioning of this capitalist model.

One of the earliest adjustments to the laissez faire capitalism ideal came with the 1890 passage of the Sherman Antitrust Act. This Act limited cartels and monopolies giving the government the right to sue companies for monopolistic behavior which would be treated as a felony. The protections were strengthened by the 1914 Clayton Act that allowed any persons or businesses (rather than just the government) injured by monopolistic practices to sue for relief. Subsequent experience, along with a rich body of economic theory, suggested that some industries that were natural monopolies with increasing returns to scale, needed to be actively regulated to permit the scale economies while limiting the higher prices that a monopoly would attempt to charge. Most U.S. observers would accept that these anti-trust measures did work. The U.S. after all, did build one of the most advanced telecommunications infrastructures in the world after the Second World War even though this was done by AT&T, a regulated monopoly. The breakup of the steel companies and the railroads hardly impaired the country's competitiveness. And the US was at the helm of financial innovation despite the fact that its brokerage industry was dotted by numerous smaller firms.

A particular focus after the market problems of the 1930s was the banking system. U.S. policymakers understood that capitalism required that bad businesses fail but, when the business in question is a bank which operates with leverage, a single failure could lead to a catastrophic loss of confidence in the system and trigger a chain of failures. The thrust of U.S. policy therefore was to limit both the scope of the banks' activities as well as their size. The limiting of scope came with the Glass Steagall Act enacted in 1933 which set up the Federal Deposit Insurance Corporation to guarantee bank deposits and prevent bank runs. Since the burden of the guarantee fell on the taxpayer, the government mandated a separation of the relatively risky brokerage businesses from traditional banking which they felt was easier to regulate and more vital to the public interest. Moreover, banks in the U.S.

were limited in size in that they were allowed to gather deposits only in their home state. While numerous banks argued, quite rightly, as to the efficiencies of a national branch network, the limiting of banks to individual states meant that a bank failure could prove relatively manageable without putting the whole system at risk.

With the progressive adjustments made to capitalism over decades, one could have argued that the U.S. had the ideal economic system in the world in the post War period leading up to the 1970s. It seemed to combine the best elements of a market approach with well-designed regulation designed to protect society. And there is no doubt that the system worked. One needs only to look at U.S. growth rates and the country's record of innovation during the post war period to recognize that society was well served.

The move to "freer" markets with a systematic dismantling of the protections put in place early in the twentieth century started during the Reagan presidency and accelerated dramatically during the Clinton era. Reagan appointed Alan Greenspan to be the Chairman of the Federal Reserve and it appears that the latter was ideologically biased against learning from history. Greenspan appeared to have disagreed with virtually any kind of interference in markets. He was a major critic of the U.S. anti-trust laws and in an essay, Antitrust (published around 1961 in Ayn Rand's Capitalism: the Unknown Ideal), condemned the U.S.' antitrust statutes as a jumble of economic irrationality and ignorance driven by naïve and unrealistic economic theories. In fact, Greenspan believed that monopolies reflected managerial skill and productive efficiency and deserved praise, rather than condemnation. Greenspan also did not believe in the restrictions limiting bank branches or in the Glass Steagall Act and felt that economic self-interest would allow them to be self-regulating. He was instrumental in making possible the repeal of the interstate banking laws in 1995 and of the Glass Steagall Act in 1999.

The progressive relaxation of the restrictions on banks meant that the 1980s and 1990s were characterized by a rash of bank mergers. With the hodge-podge of information systems that had to be integrated in such mergers, coupled with the complexity of the loan books that each of the banks had, what we saw repeatedly was a merger followed by huge charges taken by the merged bank to allow for "restructuring" typically followed by a release of these restructuring charges as earnings over the next few years. As the banks grew larger, the pressure to generate earnings growth meant an increasing reliance on securitization of loans and quick booking of profits rather than the patient, longer-term approach of a traditional lender. Unfortunately, the one thing that was all too obvious was that the banks were not any more efficient. They were just much more creative at financial wizardry especially when it came to their own statements. Also, the worst elements of a monopoly were realized by the growth in the banks. These effects were not felt at the consumer level but ironically, at the FDIC level. The larger the banks, the more certain it became that the FDIC could not let any depositors lose, not just those with $100,000 or less in the bank as mandated by their charter because of concerns about a generalized run. As such, the FDIC went from being an entity that just guaranteed small deposits for the public across the banking system, to one that now essentially guarantees all deposits at the largest banks because they are perceived to be "too big to fail".

The results of the banking de-regulation have not been good, despite the accolades that the sycophantic media heaped upon Greenspan, the "maestro". The early 1990s were characterized by a rash of bank failures with Citicorp being virtually bankrupt. These problems were followed in short order by a sequence of crises, each of which was deemed to be a once-in-a-century event despite occurring with alarming frequency. We had thus the 1994 Mexico and Latin America crisis, followed by the 1997 Asian crisis and the 1998 Russian and Long Term Capital Management (LTCM) crisis. Of course the banks were heavily involved in all of these crises and on each occasion Greenspan came to their rescue with rate cuts, penalizing the US saver. In fact, Greenspan actually argued for the relaxation of the Glass Steagall Act in 1998 just weeks after the LTCM crisis because he felt that the banks knew

how to "manage risk". But continuing on, we had the tech bubble and telecoms lending crisis of 2000 (triggered by the maestro's excessively low interest rates of 1999) followed by the Enron collapse (aided by none other than our friendly bankers at Citi, Merrill and others). These in turn, were followed by a damning regulatory report on Fannie Mae and Freddie Mac (the largest financial firms in the U.S. in terms of balance sheet) in 2004 suggesting that the management were committing fraud in earnings reporting, and have now culminated in the real estate and credit crises of 2007-2008 with the whole system's solvency in question. We had more than ample warning about the rot in the financial system. Unfortunately, no one chose to pay attention, due to a combination of ideology, distorted incentives and very possibly good, old-fashioned corruption. Our regulators at the Federal Reserve had the tools necessary to forestall the crisis, but indubitably did the worst job of any central bank in recent times, while opining sanctimoniously to other countries about the need for proper regulation and transparency.

When one reflects on the measures that have been adopted since the start of the crisis in 2007, it is clear that policymakers globally are still in a reactionary mode with little attention being paid to coming up with a genuine solution. To recapitulate events in the U.S., the Federal Reserve set the ball rolling by cutting rates aggressively in late 2007. They also facilitated the takeover of failed mortgage lender, Countrywide, by Bank of America. The belief then, was that the crisis would be contained by the Fed assisted by Fannie Mae and Freddie Mac which would purchase even more home loans and toxic assets. Also in late 2007, the government introduced policies to allow for refinancing of certain home loans at better rates through the Federal Housing Administration. Come January 2008, the problems with the bond insurers surfaced, followed shortly after by the problems at Bear Stearns. The Fed galloped to the rescue of Bear Stearns, promising to guarantee a huge amount of the firm's most toxic debt on its takeover by JP Morgan. But then, the obvious problems at Fannie and Freddie surfaced, so much so that the Treasury had to put these firms into conservatorship. But then came the failure of Lehman, the near failure of Merrill, Lynch and its merger with Bank of America, the near failure and subsequent bailout of AIG (which the Fed said it would never do at first) and finally the passage of the TARP bill designed to buy undervalued assets and provide liquidity for the banks. Immediately after passage of the TARP, Treasury Secretary Paulson opted to inject capital directly into banks rather than purchase assets, but the injections were done in a particularly perverse fashion where the Treasury did not get management control and where much of the money injected was actually used to pay bonuses to these companies' staff. By November 2008, Paulson appeared to completely abandon the idea of purchasing assets at all. If all this were not enough, the problems with the automakers surfaced necessitating yet another bailout for them, not to mention bailouts for their financial arms as well.

There have been even more bailouts albeit in a disguised fashion that is not apparent to the taxpayer. Virtually every financial firm, however incompetently run, now appears to have the ability to be deemed a bank and issue debt under the aegis of the FDIC (yes the same FDIC which was supposed to guarantee only deposits and have little to no losses). Even worse, the Fed has put in place so many facilities to lend against toxic assets that financial firms deposit with it, that it actually has no ability to conduct monetary policy. This is because the only assets the Fed now has on its balance sheet are toxic and illiquid. The central bank cannot sell such securities in an open-market operation to adjust rates. The Fed has been forced to resort to "borrowing" from the Treasury's balance sheet to even conduct rudimentary market operations. In fact, in a truly amazing twist, the Fed has refused to provide details on the assets it holds to the public, and was sued in November 2008 by Bloomberg News to force them to reveal the same under the Freedom of Information Act. The whole 2007-2008 period feels like an extended financial version of the Rocky Horror Picture Show, a freaky cult film from 1975, minus of course the great music. The picture is still in theatrical release as a "midnight movie" where die-hard cultists come dressed in full costume and actually participate in the film, mouthing the dialogue and the songs. Few people outside the cult understand this phenomenon. In our financial horror show, the cult members are of course our policymakers, the Wall Street intelligentsia and a host of academics and professional investors. Not surprisingly, the public is totally clueless about their financial machinations.

The problems in the financial system keep taking new and unusual turns as this crisis continues. The latest casualty was a high profile hedge fund run by Ponzi-genius Bernard Madoff. Madoff was one of the icons of the securities business, having founded Madoff Securities, one of the largest market-makers in U.S. stocks. However, he also ran one of the most successful hedge funds in history which had a truly unbelievable track record with few if any down months. The track record was unbelievable because it really was fake – what Madoff had been doing for years is running an elaborate Ponzi scheme through his "hedge fund". Investors in Madoff's funds (and every smart bank, broker and fund-of-funds was in that list it seems) are likely to lose close to $50 billion. Most of them had no idea as to how Madoff generated his returns – many even suspected that he might be doing something illegal such as front-running customers for profit, but chose not to consider the risks because of the glorious "track record". Amazingly, Madoff's securities business was supposed to have been tightly regulated and as such, his hedge fund should have been scrutinized carefully by regulators, especially since they had received many well-researched communications suggesting that the fund was, in fact, a fraud.

Unfortunately, the Madoff story is not the last chapter in the fund management mess. Numerous supposedly transparent and liquid funds with wunderkind managers and great risk management have suspended redemptions after massive losses. The super-smart (and politically well connected) managers at Cerberus Management who chose to buy auto and mortgage finance companies at the market peak in late 2006 and early 2007 are nursing huge losses and not surprisingly, are in the bailout camp. The world's biggest bond fund manager speaks cheerily about how he invested massively in Fannie Mae bonds in anticipation of a government bailout, which in fact, did occur. Of course, the worrisome question is why the largest, long-term bond investor should be investing in an insolvent company when the existence of a federal guarantee was not assured. Is this really how the efficient asset allocation of U.S. style capitalism is supposed to work?

In sum, what is very clear is that the current framework for the U.S. financial system is inadequate or even worse, totally broken. Pumping more taxpayer money into the current system will do little to solve the problems the country faces and could arguably, create even more issues later. The measures implemented so far are fundamentally inconsistent with the free market principles that the U.S. has long embraced. Every incompetent financial firm is being granted a new lease on life at the expense of the taxpayer who was the victim of the financial scam in the first place. Our "new new" capitalism truly rewards failure!

Policymakers and managements with demonstrated incompetence still make up most of the group that is formulating the measures to deal with the crisis and they are effectively holding the country to ransom. We are warned of dire consequences if bailout funds do not continue to flow and if more of these mismanaged financial firms are allowed to go bankrupt. Numerous commentators argue that the worst mistake committed in 2008 was letting Lehman Brothers fail with few even asking why any economic system should be such that it cannot handle the failure of a hyper-leveraged, badly managed firm of questionable social value. What we need is a new generation of more capable policymakers who have more faith in the resilience of the U.S. economy and its citizens. A good first step towards this end would be to restructure the management of the Fed which has failed in its primary duties of regulating the banking system and conducting effective monetary policy. The next step would be to nationalize the majority of the U.S.' troubled banks and get rid of existing management. Abandoning more than a century of economic education to react to a difficult situation brought on by regulatory and corporate incompetence seems an absurd choice.

While the Obama team is faced with a crisis, I would argue that the U.S. has more than enough resources to deal with the near-term economic consequences. No matter what is done economic pain is unavoidable in the short run. However, the gargantuan misallocations of savings that the U.S. financial system has engendered over the years have imposed huge economic costs that we have not even begun to total up. And continued support of the current system, especially with constant changes of the rules, will surely mean unsustainably high costs in the future. For example, how

can any reasonable investor consider purchasing the stock of a firm whose financial statements are opaque and suggest insolvency? And given how governments have tinkered with short sales, no investor can prudently even short such a company either. Constant meddling with the financial system without a clear plan is a recipe that guarantees that the government will be the only investor left. But that would also signal the end of capitalism. Thus, the real question that the Obama team should be wrestling with is how best to set up a regulatory and incentive framework for the financial system so that it can operate in the public interest but with the efficiency of being a private enterprise. The U.S., and some of its partners in the boom such as the U.K., need to define the new framework before even a hint of true stability is possible.

While the U.S., the U.K. and several other countries such as Spain have numerous challenges to address in 2009, the unfortunate reality is that this financial crisis has swept up all the nations in the world. Canada for example, has not been forced to pump in new capital into its banks, but has nevertheless suffered because of concerns about the U.S. Many of the emerging markets are going to face a cyclical slowdown due to a reduction of exports to the developed world, but are not dealing with the structural, systemic crisis faced by the U.S. Yet their markets have suffered, in many cases much more than the U.S., thanks to the world's financial linkages. If courageous U.S. leadership is needed from President Obama to deal with the U.S.' problems, equally decisive leadership is needed from global leaders to create a better financial system where one country's problems do not so badly affect the world.

We have been very fortunate in 2008, but 2009 is likely to be challenging. A number of major changes are likely in policy in 2009 and we believe the effects on markets will be seismic. We remain in our core bets of being long gold and short-dated fixed income, short credit and short U.S. consumer-sensitive companies. President Obama will soon be writing the rule book for the financial markets for the next several years. We are waiting to understand the rules to decide how to play.

Performance Summary at December 31, 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)
1.8%	15.6%	17.6%	43.6%	64.8%	39.5%	23.8%	N/A	43.6%	15.9%

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)
1.6%	15.2%	23.5%	42.6%	72.8%	42.5%	22.5%	15.2%	42.6%	22.5%

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