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Trident Investment Management, LLC
Opportunities Funds Commentary

June 30, 2009

MONTHLY UPDATE

Performance Discussion

The euphoria of the last two months abated in the equity markets in June. The S&P Index was unchanged, the MSCI Europe Index was down 1.3% but the Nikkei was up 4.6%. Commodities were mixed with gold down 5.4% to end the month at $926.6 an ounce and oil up 5.4% to end at $69.90 a barrel. Long dated fixed-income markets sold off, with the U.S.10-year yields raising 0.07% to end at 3.5%. The U.S. dollar strengthened marginally on the month with the U.S. Dollar Index appreciating 0.99%. The credit markets were relatively quiet with most credit categories largely unchanged (all figures in U.S. dollars).

Our funds suffered in June with about 70% of the losses coming from our positions in fixed income. Our positions in the U.S. 2-year – 10-year curve steepeners hurt performance as two year rates rose significantly. The remainder of our losses came from our long positions in gold and oil. Our equity and credit shorts did not affect our performance materially on the month.

We made a few changes in our portfolio. We cashed in our yield-curve steepener options in the U.S., many of which were significantly in the money and very close to expiry. We re-deployed about 50% of the cash so raised in purchasing longer-dated, out of the money, U.S. yield-curve steepeners where we now see better opportunity. Our actions have resulted in a reduction in our delta exposure but an increase in our notional exposure. As such, we have less cash deployed than before, but retain our profit potential for the longer term.

Market Outlook & Portfolio Strategy

In last month's letter, we discussed the very high total leverage in the U.S. and the impossibility for the country to either live with higher nominal interest rates or low nominal growth without having an explosive increase in its debt levels. We showed that if nominal GDP grew only 1% with the fiscal deficit at 13% of GDP (as projected for 2009), the total credit to GDP ratio would rise an incredible 21% – an increase in debt of almost $3 trillion. It is clear that a deflationary recession in the U.S. will mean explosive debt growth and very likely outright debt defaults, at least in private sector debt. An inflationary outcome for the economy will boost nominal GDP and might allow the debt to continue to be serviced and/or paid down, although the debtholders are still going to lose as they will be paid in funds that have considerably less purchasing power. Unfortunately, June did little to provide us with clarity on the outcomes.

The markets in June received a host of conflicting data that left participants guessing as to the state of the economy and future central bank action. The payroll numbers for May, released in early June, remained awful since the U.S. economy lost 322,000 jobs. However, markets chose to view these data positively since they came after several months of job losses in excess of 500,000. In fact, so bullish was the market reaction that expectations of a Fed rate hike and an exit from the current low levels of interest rates started to be priced in. This in turn led to a dramatic flattening in the U.S. yield curve as short rates rose and long rates held steady. Data from later in the month suggested that economic conditions were far from robust and markets have once again started to have concerns about the green shoots of recovery. The Fed was unequivocal in its assessment after its meeting in June that any recovery was likely to be tepid at best and that rates were likely to remain low for an extended period of time.

With the data being inconclusive, market pundits have gone into overtime debating each other. We have some that argue that inflation is simply not possible for the U.S. economy given the low level of employment and capacity utilization. Yet others argue that the current level of growth could lead to a deflationary outcome and that further stimulus will be essential. Unfortunately, most of these discussions vastly simplify the central issues facing the U.S. and the global economies today. A more thorough examination of the structural problems facing the world will allow us to at least formulate the central questions that global policymakers should be asking and then to handicap the outcomes.

The world today may be in a serious recession but the nature of the recession is very different across the various regions. To understand these differences, it is instructive to study the breakdown of GDP across the world:

	EU27 (incl. UK)	US	Japan	China
Total GDP (US$ trillions)	18.0	14.3	4.4	4.3
As a percentage of GDP:				
Consumption	57.3	70.3	56.9	36.4
Investment	21.6	15.4	19.8	42.1
Government	20.7	19.4	21.6	13.7
Exports	41.3	12.0	17.6	39.7
Imports	40.9	17.1	15.9	31.9
Net Exports	0.4	-5.1	1.7	7.8

There are a number of observations we can make about the world from the table above. The country that invests the most as a percentage of GDP in the world today is China. The investment ratio of 42.1% coupled with a trade surplus of 7.8% implies a savings rate of 49.9%, a staggeringly high figure. Moreover, the Chinese government at 13.7% spends much less as a percentage of GDP than the developed world. Japan and the EU do not save as much as China, but nevertheless save over 20% of GDP. The total level of consumption is higher in Japan and in Europe, being around 57% of GDP, which we could use as a rough norm for a developed economy. Governments in both these regions are more socialistic in their approach and the percentage of GDP they spend on their citizens, which is over 20%, reflects that structure. In this context, the U.S. is very clearly the major outlier. Consumption makes up over 70% of U.S. GDP, the investment ratio of 15.4% is the lowest in the above group and the savings ratio is even lower at 10.2% of GDP leading to the trade deficit of 5.1%. Many would argue that an investment ratio of about 15% is almost a requirement to keep the capital stock of the country from deteriorating which means that the U.S.' savings rate is too low to fund its own needs.

On the trade front, we can see that the EU is largely in balance with the trade surplus with the rest of the world being just 0.4%. While trade is important as represented by the high percentage of GDP that exports and imports represent, much of this trade appears to be between EU members themselves. Japan's prowess as an exporter is reflected by its trade surplus of 1.7% of GDP. However, Japan's figures pale in comparison to China's. Both China's export and import ratios dwarf those of Japan. The country exports almost as much as the EU does as a percentage of GDP and these exports are true exports from China to the rest of the world, unlike for the EU. China is a saving and exporting powerhouse and its spendthrift, consuming counterpart in the world is the U.S.

From the figures, it is very clear what the pattern of world growth over the last decade has been. U.S. consumption has been an important locomotive for growth and the continued willingness of the U.S. to take on more debt has served as fuel for this engine. Chinese economic growth has been driven by exports and it is very likely that much of the investment boom that occurred in the country was geared to the export sector as well. The country over this period had little in the way of government expenditure relative to the developed world. While Japan has also benefited from U.S. growth, the data suggest that the country's policies have not been a prime determinant of the current global economic conditions. And the EU, at least superficially, seems to be completely outside the producer-consumer dynamic that locks China to the U.S. Most of these conclusions seem obvious and totally consistent with what observers have been pointing out for several years. Things get more interesting when we consider what might happen going forward.

The U.S. consumer today faces many headwinds. First, he has trouble finding a job with U.S. unemployment approaching 10%, a situation that seems to be irreversible at least in the short run. Next, he cannot borrow against his house since it is worth much less already than what he owes on his mortgage, nor can he get unsecured credit easily because he does not have the income needed to service, let alone pay down, such loans. Finally, he is already drowning in debt to the point where interest costs eat up a considerable portion of his income. Keeping the U.S. consumer going is a challenge under the circumstances. Low interest rates cannot spur more consumer borrowing given the latter's precarious balance sheet. What is needed is substantial government stimulus aimed directly at improving consumer income either by job creation or direct transfer payments.

The U.S. faces a deeper problem even if it were to provide more income support to its consumers. Given the uncertainties faced in the economy, it is entirely rational for U.S. consumers to save much more. This is in fact what we have observed over the last few months where savings rates have spiked up sharply. It is not clear that even additional stimulus monies will be spent quickly by consumers because the impact on purchasing power and confidence, engendered by the housing collapse and the credit turmoil, is significant and cannot be reversed for several months or years. If we accept that a consumer revival is not imminent in the U.S., the question then becomes just how U.S. and hence global growth can be sustained going forward.

It is unlikely that we can have a private-sector investment boom in the U.S. given the weak consumer. Also, a policy of beggar-thy-neighbor currency devaluation to boost trade cannot work given the size of the U.S. economy. Thus, at least for the near term, any U.S. led growth will require an ambitious program of expenditure by the U.S. government to boost both consumption and investment. Unfortunately, the U.S. does not appear to be in particularly good shape to embark on such a spending spree given first that its government expenditures are already quite high by global standards and next that its total debt levels are very high as well. Any deficit expenditures that might cause an increase in rates will have to be monetized because the country simply cannot handle any sustained increase in interest rates. This means that the U.S.' trading partners who are already awash in U.S. dollar reserves will be required to accept increasing amounts of dollars. Any unwillingness to do that will mean a maxi-devaluation of the world's primary reserve currency.

Most American observers take the view that the world has no alternative but to continue to fund U.S. debt and accumulate U.S. dollars. However, when one considers the U.S. situation, it is unclear what benefit, if any, the rest of the world will have from continuing with a policy of dollar support. Were U.S. debt proceeds to be directed to investment projects designed to boost U.S. competitiveness, the

world would be financing its own future competition. And if the new expenditures were focused on boosting consumption outright, it is unclear why the other countries in the world should not spend these funds to boost their own domestic consumption, especially since U.S. consumers are already much better off than their brethren overseas. And this is where the heart of the problem lies. Most regions of the world are in better economic shape than the U.S. and are more capable of undertaking their own deficit financed expenditures. They simply do not need the U.S. to spend more money at their expense.

Were countries outside the U.S. to adopt a coordinated fiscal stimulus to boost growth, this would fundamentally alter the global economic model that has been in place for at least the last three decades. The Asian countries, led by Japan, have largely relied on exports to the rest of the world and particularly the U.S. to drive their growth. In the last decade, China has also based its growth on exports as the figures above reflect. As such, the world has evolved into a trading pattern where the U.S. is the major downstream customer or one that buys high value-added traded goods. The manufacturing centers of Japan and China are producers for the U.S., and at the same time, importers from the upstream commodity producers such as Brazil and the oil nations of the Middle East. If the trade patterns so entrenched over the last several years need to change with Asia becoming more of a downstream importer of goods and the U.S. becoming more of an exporter, we should expect a wrenching adjustment in the economies of the affected countries. In particular, the U.S. needs to rebuild its manufacturing sector, a large part of which has been decimated by competition from imports. U.S. wages will have to fall to be more aligned with those of its major Asian trading partners, and U.S. consumption will have to decline as well. Asia has to change even more dramatically. While Japan has arguably made some of these changes already due to the steady appreciation of the yen over the last several years, the Chinese have not seriously attempted to move to a less export-oriented economic model, though they may soon be forced to. Any such adjustment by the Chinese will mean a change in the composition of their economy with a big fall in the savings rate and an offsetting increase in consumption. It will almost certainly also mean a significant revaluation of their currency against the U.S. dollar. Such an adjustment is virtually impossible in the near-term without significant government intervention both to boost consumption and to deal with the fallout from a sharply appreciating exchange rate on the export sector.

An adjustment by the U.S.' major trading partners to an economic model that is more consumption and less export driven with a significant devaluation of the U.S. dollar will be possible only with significant coordination across countries. Any unilateral action without coordination is likely to penalize the country that moves first to adopt the right policy mix because of a classic Prisoner's Dilemma issue. To understand this, assume the two countries that are considering a major currency revaluation against the U.S. are Japan and China. The payoff matrix from Japan's perspective based on China's and its own actions is as below:

Payoffs to Japan

Japan \ China	Revalue	Do Nothing
Revalue	↓	↓↓↓
Do Nothing	↑	↓↓

To explain the matrix above, if China and Japan were both to revalue against the U.S., they would both hurt as growth slows and their economies adjust to the new reality. If they do nothing, the status quo would not change and they would suffer even more in the long run due to problems in the U.S. If Japan

was to revalue, however, and China did not, Japan would suffer disproportionately. If the situation were reversed, Japan would of course benefit. The problem with this setup is that if Japan were aware that China would revalue, the best strategy for it would be to do nothing since it benefits more in such a situation. Again, if Japan knew that China would not revalue, it would still be in its interest to do nothing. As such, no matter what China does, Japan would do nothing. Since China would face the same set of choices, it would gravitate towards doing nothing also, so that the net result is that they would both lose by doing nothing and thus adopting the wrong policies vis a vis the U.S. The preferable outcome would be for both countries to revalue against the U.S. except that this outcome cannot occur without agreement and coordination among the two countries on the policies that they will adopt. This is a classic example of a so-called Nash (of A Beautiful Mind fame) equilibrium in this strategic game.

Global policymakers today are acting without coordination and the net result of this is that critical measures that need to be implemented to deal with global structural imbalances are not being proposed or implemented. The U.S. has paid little attention to the potential for a dollar collapse and instead has focused on deficit spending with further monetization of debt issuance. Even worse, it continues to foster a bailout culture that is completely at odds with its capitalist ideology not to mention its own history. The countries in the rest of the world, while worried about the rising level of U.S. debt, have been unwilling to accept a major revaluation of their respective currencies against the U.S. dollar, a step that would go a long way towards righting the imbalances faced today. It would be correct to conclude that the global economic situation is a total mess.

Markets have greeted with euphoria the near-term unwillingness of policymakers to adopt difficult measures. This reaction has actually worked to make the problems worse. The U.S. dollar remains remarkably stable if not strong despite the daunting issues the U.S. faces. The improvements in the credit and equity markets have allowed numerous financial firms to unshackle themselves from post-bailout compensation restrictions by simply paying back government capital injections using proceeds from government guaranteed debt. Many of these firms are back to running their usual Ponzi schemes with their strategists even now arguing in the media that the markets are cheap given the recovery that is imminent, and that there is no alternative to the U.S. dollar. The oft-touted recommendations are to purchase banks for their franchise values (whatever that might mean) and retailers because of the expected rebound in consumption. The "efficient" markets of the U.S. capitalist system seem to be doing an excellent job of pricing in everything but reality. It is hard to believe, almost two years after the financial crisis started, that Wall Street retains its political power and compensation structure. Even worse, the same policymakers who caused the problem by their negligence are avoiding all blame while actually hindering any new regulatory or incentive changes that will bring about more ethical corporate behavior in the financial sector. It is up to the rest of the world to deliver the unpleasant message that things are actually different now. The longer the world waits to do this, the more painful it will be when notice does get sent.

Our discussion should suggest that the world is a much more complex place that is not easily characterized by simple inflation and deflation choices. The U.S., the U.K., and several countries continue to pile on debt even as the Chinese continue to build more capacity – a set of policy moves that will virtually guarantee deflation and debt defaults. The status of the primary reserve currency, the U.S. dollar, is in question and if it were devalued, the results would very likely be inflationary for the U.S., if not the world, no matter what the level of capacity utilization. To understand why, note that virtually all commodities in the world are dollar denominated – a devaluation of the U.S. dollar will mean almost overnight a huge increase in global prices and U.S. import prices in particular. The extent to which the

U.S. relies on imports for its consumption will mean a general rise in U.S. prices, a move that can be thwarted only by a continued rise in unemployment which any U.S. government is likely to oppose with deficit expenditures and monetization. A deflation with debt default and recession is highly unpalatable even in countries, most recently like Argentina, which understand the perils of inflation. While uncertainties abound near-term, we believe strongly that inflation will be the ultimate result.

The news over the last several weeks suggests that countries outside the U.S. are getting more worried about the status of the U.S. dollar as a global reserve currency. The Chinese have made repeated official statements regarding the need for reserve alternatives. Their sentiments have been echoed less publicly by numerous other countries. The BRIC (Brazil, Russia, India and China) countries recently had a summit in Russia to discuss economic arrangements between themselves, a meeting the U.S. was not allowed to attend even as an observer. China continues to set up swap arrangements with many of its trading partners forcing denomination of all its trade with them in renminbi rather than dollars. The warning signs are very much there for market participants to see.

We have done little to alter our overall positions in the last month, and in fact, have added to some of our core bets which now provide even more attractive payoffs. We retain our bearish bias on the U.S. consumer and on U.S. credit. The U.S. debt markets, especially at longer maturities, are exceptionally overvalued as well, and we retain our strong short bias through curve steepener options. Market action over the last month, while decidedly against us, has only provided us with better potential payoffs on our positions. Some pain we hope will mean more gain.

Performance Summary at June 30, 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)
-4.1%	-1.0%	1.3%	19.1%	64.2%	37.9%	23.4%	N/A	1.3%	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)
-4.7%	-1.3%	0.4%	24.0%	66.0%	40.6%	23.1%	13.0%	0.4%	21.6%

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