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

MONTHLY UPDATE

Trident Investment Management, LLC
Opportunities Funds Commentary

March 31, 2007

Performance Summary

Equity markets started poorly in March, but reversed course early in the month to stage an impressive recovery. The S&P 500 finished up 1.12% in U.S. funds, the MSCI Europe Index was up 2.15% but the Nikkei was down 1.35%. The currency markets, which had shown signs of concern early in the month, stabilized although the dollar still ended the month slightly weaker with the trade-weighted dollar depreciating 0.77% on the month. Emerging markets and other risk assets resumed their upward march with the MSCI Emerging Markets Index up 2.07%. Gold was down 1.44% while oil was up 4.46%. Remarkably, the sub-prime credit markets also strengthened with spreads on BBB-rated asset-backed securities narrowing by over 5% from their widest levels of early March.

Market Outlook & Portfolio Strategy

The return to bullishness in the equity and credit markets masks the troubling reality in the U.S. economy and in particular the housing market. There is no doubt now that the housing market in the U.S. is in a free-fall. Inventories of unsold houses continue to climb and there is little hope that there will be much improvement on this front barring a substantial improvement in sales over the spring selling season. Early indications from March suggest that the selling season is proving to be less than robust. In particular, the problems in the credit markets have resulted belatedly in an attempt by lenders to tighten credit standards at least to the point of not making loans that are guaranteed to default within the first few months. Anecdotally, it appears that even such a modest "tightening" has resulted in such a large drop-off in loan volumes that some lenders are actually reversing their new lending guidelines for fear of seeing a wholesale collapse of their borrowers.

In the face of virtually incontrovertible evidence of borrower distress, we continue to have pundits who just three months ago argued that there would be no housing problem, now saying that the sub-prime woes will not spread to the broader U.S. economy. Their argument runs along the lines that the sub-prime borrowers make up only a small fraction of the housing market and that any problems there would mean a small increase in foreclosures which would be of minor overall economic significance. This reasoning may be justifiable from a superficial perspective. The sub-prime market makes up anywhere from 10% to 15% of the overall housing loan market valued at about $11 trillion or about $1.65 trillion. With a 15% delinquency rate and a 50% foreclosure rate, the foreclosed loans would make up less than $125 billion. Even with 60% loss ratios in foreclosure, the total losses would be less than $75 billion spread out over three or more years -- which would subtract less than 1% of GDP, an inconsequential amount, over that period. The main problem with this argument is that it focuses on the sectors of the economy that are currently facing difficulties rather than looking at the conditions that caused the problems in the first place.

The malaise facing the U.S. credit market and by extension the economy today is not that the sub-prime borrowers are in trouble, but that there is just too much debt. The ratio of total credit to GDP in the U.S. ranges from about 340% to 450% depending on how broad a definition of credit one chooses to use. Even the lower bound represents a ratio that dwarfs almost anything seen in human history. In fact, when considering the size of the economy, the amount of nominal debt beggars comprehension. Much of the incremental debt over the last few years has been assumed for purchasing real estate, with home mortgage debt as a percentage of GDP increasing from 47% in 1996 to almost 77% in 2006. Mortgage debt over this period has increased about three times as fast as GDP. While some of the rise can be attributed to creditworthy U.S. consumers reaching to buy even more expensive homes, the bulk of it has come from a widening of the borrower base due to easy lending guidelines. That is, many borrowers have been allowed to take on much more debt than prudence would have dictated, and borrowers who might not have had access to credit at all, have been given loans.

The strong housing and employment markets until mid-2006, have also provided an upward bias to credit quality. Any borrower distress until 2007 simply meant a refinancing of the underlying property with better terms or an equity withdrawal to make payments. Even a foreclosure sale was typically not painful for the lender since properties were sold at or above loan value, limiting lender losses. Not surprisingly, even the worst of the borrowers did not actually default on their mortgage payments until mid-2006, and this despite the fact that delinquencies (read, problems with making timely payments) ran at very high levels throughout this period. A sub-prime borrower is one whose credit history, income levels or other factors suggest that he might have trouble making payments on loans. With the favourable credit environment of the last few years, it is instructive to consider just who lenders deem to be a sub-prime borrower.

The main determinant of a borrower's creditworthiness is his credit score with the most widely used such metric being the Fair Isaac Corporation or FICO score. The FICO score is by definition a backward looking metric. It measures punctuality of payment in the past, the amount of revolving credit as a percentage of total credit limits, the length of credit history and types of credit used as well as recent changes in the amount of credit obtained. Bankruptcies, foreclosures and other factors are also incorporated into the score. The FICO score however, explicitly excludes income and tax history, borrower assets, as well as many types of debt that are not of the revolving variety. As such, the FICO analysis is one tool that can be used to analyze the likelihood that a person will pay his bills, but is by no means the only determinant. Many lenders understand the limited nature of the FICO scoring system but nevertheless qualify borrowers for mortgage or other loans based simply on FICO scores. A sub-prime borrower for many lenders is simply one whose FICO score falls below 620. The problem with such a classification is that it ignores the borrower's ability to pay based on his income, assets and most importantly, his total debt level and debt servicing costs.

In general, borrowers are not sub-prime by choice but by circumstance. A high-quality (good FICO score) borrower can deteriorate to a sub-prime level because of a lost job, a family illness or other eventualities. In a strong overall economy or an easy credit environment, such a transition can be delayed or avoided. With a recession, this deterioration is all but inevitable. Observers who consider the size of the overall sub-prime market without paying attention to the overall levels of debt in the household sector are focusing on the wrong issues. Such a focus is popular since it allows for very happy conclusions that are inevitably wrong. Analysts with a similar limited view argued in 1997 that Thailand was too small to cause any problems in Asia, that a Russian debt default would not result in any market problems because of the small amounts involved and that Long Term Capital was too small a hedge fund to cause financial system turmoil. With such a distinguished forecasting record, the Wall Street consensus today loudly opines that the sub-prime problems are contained. Unfortunately, the debt disease in housing has started causing casualties – the most at-risk groups (sub-prime) are simply the ones that are feeling the effects most quickly.

The U.S. Federal Reserve in a thankless position today. The potential economic problems from housing are undeniable. However, the long economic expansion we have enjoyed so far is finally making itself felt in the inflation statistics. Wages are rising as is overall core inflation. And this is happening even with an economy that has been slowing over the last several months. Despite signs of imminent economic weakness, the trade deficit still remains at virtually all-time highs giving further proof that domestic inflation is forcing a continued reliance on imports. In its March meeting, the Fed suggested that it would wait for further clarity on the economic front before deciding on what to do with rates. The statement was not surprising given the complex tradeoffs it faces.

The combination of slowing growth, rising inflation and extreme indebtedness limits the Fed's future policy flexibility. A rate hike to deal with inflation that possibly spikes up over the next few months could trigger a bigger credit market problem and tip the housing market and economy into outright recession. A rate cut to deal with a slowing economy could engender a sharp rise in inflation, a major US dollar and bond market sell-off and the attendant financial sector problems. The Fed is navigating a minefield here but unfortunately, with a blindfold. That said, *there is no doubt that the ultimate outcome that the Fed wants is inflation!*

With high debt levels, an outright recession and/or deflation will guarantee an environment of soaring debt defaults, financial system distress, rising unemployment and a long-term credit crunch. There is no doubt that various policymakers will be made to shoulder blame and a huge shift is political priorities will result. Such an outcome would hardly be conducive to U.S. dollar strength. An environment of *stagflation* with slower growth, higher inflation and a weaker dollar is one that is probably the most desirable now for the U.S. It is by no means benign, but one that is perhaps the best of the available alternatives. Higher inflation prompting a weak dollar would shift the terms of trade in the U.S.' favour and possibly allow for a gradual improvement in its trade situation. Slower growth would serve to depress imports also making this a virtuous cycle. And finally, if managed properly, such an adjustment might be so gradual that policymakers would not fear the blame that might arise from a rapid change in market conditions.

A stagflationary environment, however, would wreak havoc over time on lenders, and importantly on the financial system. Banks and thrifts borrow short-term and lend longer-term. An inflationary bias to the economy would mean higher long bond yields and as such, would guarantee that virtually all fixed-rate mortgage loans originated would not be prepaid. An easy Fed that keeps short rates low to help the banks would exacerbate the inflation problem and thus increase pressure on the bond market and the dollar adding to the banks' woes. However, such an environment would not trigger significant credit problems immediately since nominal prices in the economy, especially for housing, might remain robust.

An important but oft-unspoken benefit of the stagflation scenario is that the onus of adjustment will inexorably be shifted to overseas economies. A dollar decline coupled with declines in U.S. bonds would mean huge losses for countries such as China that have been at the forefront of dollar reserve accumulation. And this would happen even as their domestic economies suffered due to sharply weaker exports to the U.S. A coordinated policy response, especially in Asia, will almost certainly be required because most of the Asian nations have growth models that are based on exports. Radical fiscal measures will be needed to jumpstart domestic consumption and services, while reorienting investment away from export sectors. However unpalatable all this might seem, the scale of U.S. consumption and dis-saving is such that this adjustment has to happen – the longer it is delayed, the more destabilizing it will be. The U.S. has a desperate need for a much weaker dollar and conditions today are reaching an inflexion point suggesting that future weakness may be imminent. The main question is at what point the world comes to the same view.

The stagflation outcome is really the Goldilocks scenario for the U.S. over the next few years since it at least presents the possibility for a gradual and orderly adjustment of the current global imbalances. Goldilocks in mid-life simply has to start paying for the sins of her youth. Absent such a controlled adjustment we could easily lurch into a global crisis that exceeds the Asian and Russian crises in severity. A mini-crisis may have already started with the U.S. sub-prime market being the early casualty.

All said, the financial markets never cease to amaze us, however predictable economic reality might be. Equities responded with wild bullishness when the Fed announced that it would wait to determine its next move on rates based on whether growth proved much weaker or inflation much stronger. It is widely believed now that next move is going to be a rate cut and that it will solve the difficulties in the U.S. economy. But let us take stock of what is actually happening. The U.S. economic problems have arisen mainly because of rates that were too low, lending standards that were too lax and a public that was too optimistic. The Fed had a significant role in all of these factors – it kept rates too low for too long, it failed in limiting lending excesses at the banks and both Alan Greenspan and Ben Bernanke parroted mantras of productivity growth and new paradigms while ensuring that the public believed that any market problem would be forestalled by action from the Fed. A central bank guilty of so many cardinal sins should have no credibility at all with the markets. With our major portfolio positions (shorts in U.S. credit, the U.S. dollar and U.S. lenders, and longs in gold and oil equities as well as non-export-oriented companies overseas) we are betting aggressively on that outcome.

CI Investments

MONTHLY UPDATE

Performance Summary

Trident Global Opportunities Fund

Performance as at March 31, 2007

1 Mth.	3 Mth.	6 Mth.	1 Yr.	2 Yr.	3 Yr.	5 Yr.	YTD	Since Inception (Feb. '01)
3.4%	6.8%	9.6%	4.6%	4.3%	2.3%	3.3%	6.8%	3.8%

CI Global Opportunities Fund

Performance as at March 31, 2007

1 Mth.	3 Mth.	6 Mth.	1 Yr.	2 Yr.	3 Yr.	5 Yr.	YTD	Since Inception (Feb. '01)
2.3%	9.0%	9.4%	3.2%	3.0%	-0.2%	0.3%	9.0%	16.0%

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.