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Trident Investment Management, LLC
Opportunities Funds Commentary

March 31, 2008

MONTHLY UPDATE

Performance Summary

From the perspective of global markets, the first two months of 2008 were exceptionally action-packed and volatile. Amazingly March topped both months giving us the scariest ride yet. Global equity markets ended March down, but swung wildly over the month. The S&P 500 was down just 0.43%, but intra-month was down as much as 4.3%. The MSCI Europe Index was down 1.4% and the Nikkei was down 7.25%, though both suffered more intra-month. The U.S. dollar finished down 2.59% against its trading partners. Commodities had a wild ride too. Gold finished the month down 5.97%, but oil was up 0.16%. Credit markets were equally volatile with most major credit spread hitting lifetime wides early in the month only to reverse in the latter half. Treasuries rallied on all this turmoil with the yield on the 10-year Treasury note down 0.10% (all figures in U.S. dollars).

Market Outlook & Portfolio Strategy

The U.S. financial system took center stage in March. The brokerage industry ran into serious difficulties with the fifth-largest firm in the industry, Bear Stearns, nearly being forced to file for bankruptcy. The U.S. Federal Reserve, engineered a massive bailout for the firm changing market sentiment from despair to euphoria in a matter of hours. Our take on the events is simply the French expression: plus ca change, plus c'est la meme chose – the more things change, the more they stay the same.

I wrote at length to all of you last September about the problems facing the brokerage industry. To recapitulate, the brokers as a group operate with eye-popping leverage. Total Asset/Total Equity ratios are typically well in excess of 30 times for virtually all of them. Moreover, these firms also have huge off-balance-sheet exposures that are not fully disclosed in their financial statements so that the actual leverage they operate with is likely much higher than even the 30X level. While high leverage is problem enough, the brokers have the additional issue that they all hold large amounts of toxic assets that are both illiquid and much less valuable than their carrying costs would suggest. These assets are not marked to market, but are instead "marked to fantasy" by being classified as Level 3 assets for which the firm is free to dream up its own valuations. The Level 3 assets typically represent over 2X the total equity capital of the brokerage firms and a 25% decline in the value of these assets would wipe out over half their equity capital. Finally, much of the brokers' earnings over the last few years has come from fixed income and in particular from structured finance (read CDOs, CLOs, CPDOs etc.). These earnings have shrunk dramatically since the markets for these products has collapsed. The markets have come to realize the risk in the brokerage industry and the brokers' debt has suffered as a consequence. However, an unfortunate accounting quirk allows the brokers to actually pass through the reduced value of their own debt as a magical boost to their earnings. So, in sum the brokerage houses have too much leverage, too many bad assets that are worth a lot less than disclosed, collapsing earnings and a bleak revenue outlook for the future. With so much leverage, much of it short term, the industry is highly susceptible to changes in market sentiment and Bear Stearns was the first casualty of this market shift.

The loss of confidence in Bear Stearns in early March stemmed from the market's perception that the firm was overly exposed to the fixed income and mortgage markets which have been at the epicenter of the credit crisis. In a matter of two days, there was an exodus of clients and capital from the firm to the point where it was hours away from filing for Chapter 11 bankruptcy protection. A Bear bankruptcy would have created chaos in the financial markets because of its considerable off-balance-sheet exposure to other brokerage houses as a counterparty – by some measure, this exceeded $10 trillion. Not surprisingly, the other brokers suffered in March too, with Lehman Brothers, another firm exposed to the mortgage market being punished during the Bear run. While Bear Stearns and Lehman were in the market spotlight in March, it should be noted that all of the major brokers were and still are in virtually the same situation and are highly vulnerable to changes in market sentiment.

Given the potential fallout from a Bear bankruptcy, the Federal Reserve engineered a grand bailout. It brokered a purchase of the troubled firm by JP Morgan Chase while taking over a record $30 billion of the assets from Bear onto its own books. Moreover, it introduced a scheme for lending directly at the discount rate to the brokerage industry against virtually any collateral they were willing to provide. Bear Stearns as of November 30, 2007 had about $12 billion in equity capital and about $400 billion in assets – a leverage ratio of about 33X which is average for the industry. The Fed purchased $30 billion of toxic securities (very likely with Level 3 valuations) from Bear using the firm's own optimistic valuations for these assets. These were by no means fair market prices since neither JP Morgan nor anyone else wanted these securities at those prices. Yet, even with some of the worst junk taken off Bear's books by the Fed, JP Morgan appeared a reluctant purchaser and in fact, was the only institution even willing to consider the purchase at short notice. And this is for a purchase where the total price paid was virtually nothing especially in the context of JP Morgan's gargantuan balance sheet and market value. This bailout (which the Fed insists is not one at all) displays everything that is wrong with the U.S. financial system today – JP Morgan which is a large bank cum broker that is among the biggest players in structured finance has little confidence in the asset valuations of a large brokerage competitor and needs a huge, public injection of funds (which is what the Fed backstop of Bear assets is) to even consider a purchase of the firm for almost nothing.

It should be noted that the brokerage industry is not regulated by the Fed at all. The Fed has turned on the spigot of discount window lending against iffy collateral to support the brokers despite the fact that it has no power to either regulate or even influence the actions of the borrowers in question. And even more amazingly, the Fed has foisted the problems of an unregulated industry onto the regulated banking system by engineering this takeover while using a considerable amount of its own assets to ensure that it happened. This is history-making intervention that has taken the Fed far outside its traditional central banking role.

The rationale cited by the members of the Fed as well as by the pundits on Wall Street is that the U.S. faced a systemic financial crisis and that decisive, radical action was essential to prevent a total collapse. Now let us keep in mind that Bear Stearns is only the fifth-largest of the brokerage houses and that it has a balance sheet that is considerably smaller in total than most major banks. This one institution's potential failure required action that has not been taken since the Great Depression. The

worrisome part of this intervention is that it only deals with the symptoms of the financial system's disease rather than the actual causes. As things stand, it appears that this bailout is likely to be the first of several.

The root cause of the problems in the financial system is the excessive and irresponsible use of leverage. For the last several years, our banks and brokers have engaged in a lending binge that has seen no parallel in human history. They have done so moreover, with the active encouragement of the Fed which constantly praised the "financial innovation" in the capital markets. When capital markets forced an end to the party last year, there was pain everywhere in the system as can be expected. The problems with the sub-prime lenders, the credit and mortgage insurers and the real-estate focused banks were all inevitable outcomes of a decade of excess. Many of the financial innovations of the last several years have proved to be nothing other than confidence tricks worked with complex products designed with the extremely simple aim of parting investors from their money. However, the brokerage houses, the rating agencies, the Fed and virtually all the politicians insist that the price declines for unpalatable assets in the financial markets are temporary and that they are being driven by liquidity issues. As such, the policy thrust so far has been to cut rates and inject more liquidity into the financial system by the Fed's lending more against increasingly doubtful collateral. Also, the Fed and others have been exhorting the financial companies to raise more capital so as to boost market confidence and prevent a vicious cycle of loan losses, depleted capital and reduced lending which in turn would lead to further loan losses. We believe however, that many of the asset price declines are likely permanent and have more to do with investors balking at purchasing bad assets. We are perhaps returning slowly to normality today after living for several years in an environment of fantasy.

Where the policymakers have been correct is in urging financial companies to raise capital to shore up their balance sheets. However, the financial firms have not fully reflected their losses on their toxic holdings and as such their capital and equity levels are highly questionable. The quality of the managements of these companies is even more at issue – after all, these were the chieftains that presided over a decade of uncontrolled lending while making huge personal fortunes in the process. Any injection of new capital into such institutions should bring about, at the minimum, a wholesale revamping of management and an examination of the regulatory and accounting standards that permitted the manufacturing of what most would now accept were fictitious profits and capital. While unfettered capital markets can be relied on to force these adjustments simply by denying funds to problem institutions, the regulators have stepped in now to delay or prevent precisely these changes. Put differently, the financial system can be likened to a drunk whose performance on the job has deteriorated to the point where his employment is at risk and who no longer has any money left to buy alcohol. One way to avoid hangovers is to stay drunk! The Fed, who is an unusual policeman, is giving our drunk funds to buy more alcohol (cheap lending against bad collateral) while refusing to even acknowledge that he is drunk (permitting ridiculous valuations on rubbish assets). Market participants who might inject new capital into these institutions can be likened to employers who give jobs to these drunks relying on the police supervision to ensure sobriety. That of course raises the question of who the Fed and other regulators really serve? Is their role to protect the public interest or to keep in place incompetent if not dishonest managements? Unfortunately, all the evidence suggests that the Fed's actions are part of the problem now rather than the solution.

The additional important issue is that new capital in the financial system is best injected into a brand new institution that has no legacy problems. A clean bank can use all additional capital for lending and thus provide the maximum theoretical benefit to the real economy. The management of a problem bank that receives new capital however, has perverse incentives. The best case is that this new capital is more than adequate to plug existing losses with the remainder deployed carefully in lending over time. This would suggest less lending than a clean bank would undertake, a period of poor profitability and ultimately poor manager compensation. The worst case is that the additional capital with the Fed backstop will be wholly inadequate even to deal with current losses. This will mean that the management has only bought more time with no hope of compensation or even employment unless huge returns on new investments can be earned. As such, the incentive will be to take even more risk – after all, there is no downside to risk-taking in this situation.

In sum, the policy responses to the financial problems have been wrong-headed and arguably have set the stage for even bigger problems. The continued injection of public funds without corresponding oversight of the financial system has intensified the problem of moral hazard. Future, possibly larger, bailouts are almost inevitable. A global recognition of these policy failures could well result in a massive collapse of the U.S. dollar coupled with very high inflation if not hyperinflation.

Any sustainable policy intended to deal with the financials system's problems will have to accept that a reduction in leverage is inevitable and that this cannot happen without pain. The best policymakers can do is to limit the impact of the financial adjustment on the real economy. Substantial fiscal stimulus intended to prepare the real economy for a period of sharply reduced lending is what is required. Unfortunately, such measures should dramatically expand the fiscal deficit and will require hard choices relating to the continued expenditures in wars overseas. And even with such measures, there will be a meaningful retrenchment in consumer spending. The unfortunate truth is that much of the U.S. growth over the last decade has been a consequence of increased leverage. The strong increase in household expenditures especially since the bursting of the NASDAQ bubble can be traced largely to the assumption of mortgage debt and a willingness to extract and spend home equity created by a rising housing market. With less availability of credit, falling home prices, reduced consumption and more job losses are all inevitable. And while fiscal supports can help mitigate these problems, they cannot eliminate them. Unfortunately, no politician wants to deliver this unpleasant message to the public especially in an election year.

The hard reality that the U.S. economy faces and the continued policy focus on short-term palliatives are setting the stage for a continuation of the crisis conditions in the markets. The underlying issues have not been addressed with a well thought-out policy plan and for now, nothing seems forthcoming. Our core positions therefore, have not changed much. We remain short most U.S. financials and consumption-oriented stocks and credit. We also continue to remain long gold and gold stocks. We have trimmed our short positions in the U.S. dollar recently, expecting that some of the U.S.' trading partners might resort to intervention to stem the steady decline in the dollar. We are also building up a short position in long-maturity U.S. Treasuries expecting that the policy mix in place will ultimately lead to sharply higher

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inflation and a big rise in nominal yields. March will be remembered as a month where the Fed truly changed the rules of U.S. capitalism – we are now operating in a financial world where all the profits are of course, private, but all the risk is public.

Performance Summary at March 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)
1.7%	11.6%	43.4%	97.4%	43.7%	29.0%	19.3%	N/A	11.6%	13.6%

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)
-0.4%	5.7%	34.0%	103.1%	44.8%	29.2%	18.0%	16.1%	5.7%	21.1%

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