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Trident Investment Management, LLC
Opportunities Funds Commentary

May 31, 2010

MONTHLY UPDATE

Performance Discussion

May was a disastrous month for most markets as they began to digest the steady stream of bad news that they had been receiving for several weeks. The S&P 500 was down 8.2%, the MSCI Europe Index was down 5.7% and the Nikkei was down 11.7%. Gold decoupled from the equity markets and was actually up 3.1% to end at $1,216.2 an ounce. Most industrial materials sold off, as did oil with the latter being down 14.1% to end at $73.97 a barrel. Not surprisingly, the fixed-income markets were strong given the market turmoil. The U.S. 10-year Treasury rallied 37 basis points to end at 3.29%. The credit markets sold off, but not materially, given the concerns shown by equities (all figures in U.S. dollars).

Our funds finished May in the black. Our returns came mainly from our long positions in Australian short-dated fixed income and our shorts in some equity indices that hedge our long positions in gold and energy. Our energy long holdings hurt while the gold positions were flat. Though our U.S. curve steepeners subtracted from performance, the gains in credit helped more than overcome this deficit. The turn we believed had started in the markets in April intensified in May – we are looking for this to continue for the next few months.

Protecting capital in a world of fiscal irresponsibility

To say that the investment climate is risky today would be something of an understatement. The real estate and credit crisis of 2007-2008 which primarily affected the developed world had two far-reaching consequences. First, it forced the public to recognize that home prices would not always go up and as such, refinancing homes could not be counted on as a steady source of income. In fact, the collapse in home prices made insolvent a large fraction of households in the U.S., Spain, Ireland and some other countries. Next, the deterioration in the real-estate associated credit meant severe problems for much of the global financial system and a huge decline in overall loan extension. This in turn, resulted in a precipitous decline in global economic activity.

The resolution for the crisis engineered by policymakers in 2009 essentially involved putting sovereign balance sheets at risk. Governments in the U.S., the U.K. and to a lesser degree in Europe, rushed to provide virtually unconditional bailouts for failed financial firms, generous unemployment compensation for laid-off workers and payment relief for underwater homeowners. The cost of these measures to the sovereigns has been immense. The U.S. fiscal deficit for 2009 was about 12% of GDP, a record for peacetime. The deficits of Spain and Greece match or exceed the U.S.' levels with Portugal, Ireland and Iceland all at record levels as well. Markets rejoiced at these aggressive bailout measures. Equities rallied dramatically from March 2009, even as credit spreads tightened almost to pre-crisis levels. The fixed-income markets virtually ignored significant increases in sovereign debt with rates remaining close to all-time lows in most sovereign markets in 2009.

The bond markets have become much more concerned about sovereign risk in 2010. While most of the developed world is weighed down by huge amounts of debt, their policy choices for dealing with the debt are very different. The U.S., the U.K. and Japan are all exceptionally indebted, but still retain flexibility over the monetary policies they follow. As such, these nations have to varying degrees resorted to printing money and monetizing their debt, which, to make things more palatable is generally referred to as 'quantitative easing'. The U.S. Federal Reserve thus, has purchased outright over $1.5 trillion in Treasury and mortgage debt with a corresponding increase in the supply of U.S. high powered money. Indebted countries in the European Union (EU) do not have the same policy choice available to them because they cannot conduct independent monetary policy. Decisions relating to interest rates and quantitative easing come under the purview of the European Central Bank (ECB) which reflects the interests of all of the member Euro countries rather than just the indebted ones. The ECB rightly perceives quantitative easing as a fiscal measure to bail out profligate borrowers which is outside of their monetary domain and is technically not even something that they can engage in by their charter. This means however, that any market concerns about the more indebted Euro nations lead to higher interest rates for them. The increase in the debt service burden for these countries makes them even more risky prompting even higher rates, subjecting them to a vicious feedback loop.

Markets today are much more concerned about the solvency of the countries in Europe that cannot engage in money printing. There is no doubt that an unbounded increase in the borrowing rates for these countries will force them into default. This outcome can be avoided by restoring market confidence in these countries (as reflected through lower rates) or by multilateral support from other nations and institutions such as the International Monetary Fund to substantially reduce their borrowing requirements. While the risks for the countries are clear, what markets have not quite recognized is that countries that engage in quantitative easing are no less risky. When countries fund huge government deficits with money printing, and we have a long history of Latin American economies which did, the end result has inevitably been very high inflation or in many cases hyperinflation. The erosion of the country's currency that inevitably goes hand in hand with high inflation effectively represents a "soft" default. This occurs because the erosion of the currency's purchasing power has meant that lenders have got repaid much less in real terms than their original loan amount.

With the huge risks in the sovereign debt markets of the developed world, and their importance for all the markets such as those for housing and equities, investors face some unpalatable alternatives when looking to safeguard their portfolios. We believe that gold represents an excellent investment opportunity under these circumstances and will take up our reasons for our view in detail below.

The Link between Gold and Money

Through history, governments have always sought the ability to create and control fiat money without restraint. Fiat money is that which comes into existence purely by government decree and as such, its acceptance as a monetary unit rests entirely in the confidence that the government commands. When given such latitude, most governments have inevitably increased their expenditures and importance and financed the same by money creation. Put differently, by debasing money (which ultimately creates inflation), governments are able to engineer a transfer of wealth from savers in the private sector to themselves outside the normal channels of taxation. When continued without limit, these actions resulted in the debasement of the fiat money in terms of purchasing power, and in extreme cases necessitated the repudiation of the entire monetary unit along with considerable attendant turmoil. Countries have long recognized the costs of such policies and attempted to prevent their governments and their banks from creating money without limits. Typically, this was done by explicitly linking the currency to some unit of purchasing power which the government was required to provide in lieu of the currency unit if required. That is, holders of the monetary unit were given a promise by the government that they could exchange their currency for an explicit amount of goods. Since the government could not create such goods without limit, there was a bound on the amount of currency they could print.

Gold enjoys the status of being an almost ideal purchasing power metric to back a currency. In physical terms, it is well suited for such a role because it is scarce enough to retain its value and durable enough that it does not spoil or tarnish. Also, the metal has been used as a store of value over the centuries and has almost always been accepted as a medium of exchange. As such, many currencies in the modern era were explicitly backed by gold and were thus on the so called "gold standard". The gold standard was not an archaic invention that is no longer applicable in our modern times. Rather it was an explicit acknowledgement of the fallibility of banks and governments and their tendency to engage in ruinous money creation. The earliest currency units were minted in gold and silver so that actually holding the currency was a guarantee of value. Paper money in fact, arose from the trading of certificates that guaranteed the ownership of a certain amount of gold in custody with a reputable bank – those who accepted the paper were obtaining the right to take possession of that gold at the bank.

The Post War Global Monetary System

Most of the developed world operated on the Bretton Woods system, which is a modified version of the gold standard, in the post World War II era. The Bretton Woods system set the price of gold in terms of U.S. dollars with the other major countries of the world pegging their currencies to the US dollar at agreed-upon rates. The U.S. held about 60% of the world's gold reserves at the end of the War and gold's price was set in dollars to be $35 an ounce.

The advantage of the Bretton Woods system was that it allowed nations to avoid the need to provide an explicit gold backing for their currencies. But since currencies were linked to the U.S. dollar, the convertibility to gold was maintained, via the two step process of exchanging the currency for U.S. dollars and then exchanging the latter for gold. For the Bretton Woods system to function efficiently over the long term it had to be able to accommodate strong global growth with the corresponding need for more global currency in circulation. Since money could be created for the world only by the creation of U.S. dollars, the U.S. by necessity had to run a balance of payments deficit. The longer the U.S. ran such deficits, the more questionable the sustainability of this system became. In fact, the U.S. faced a significant conflict between the domestic objectives of not running payments deficits and the international need for it to do the same. The problem faced by the U.S. (or by any country with such a reserve currency) is referred to as Triffin's Dilemma after Robert Triffin who pointed this out in 1960.

The rise in U.S. government expenditures during the Lyndon Johnson era as the nation embarked on the Vietnam war led to the first serious challenge to the Bretton Woods system. As inflation in the U.S. increased, there was a significant outflow of gold as market participants exchanged dollars for gold. The U.S. Congress repealed the explicit gold backing for the U.S .dollar in March 1968, even though gold remained pegged at $35 an ounce. In November 1968, the U.S. abandoned its attempt to peg the gold price and the latter was allowed to float freely in the private markets. The U.S. however, remained willing to transact at the old pegged price of $35 an ounce with official foreign accounts. Unfortunately, the increase in inflation in the U.S. over the period made this official peg increasingly untenable. Foreign governments converted their dollar holdings to gold at the official rate and depleted U.S. gold reserves, understanding that an abandonment of the peg was inevitable. In August 1971 the U.S. abandoned gold sales altogether. The Smithsonian Agreement of December 1971 did away with the fixed exchange rates of the Bretton Woods system. Thus, from 1971, most of the developed world (with some exceptions such as Switzerland) has been operating with floating exchange rates and fiat money.

The Role of Gold in a world of Fiat Money

In the world of floating exchange rates and fiat money, gold has no explicit role in terms of either backing the currency or limiting the issuance of money by the government. However, to the extent that an active market for gold exists, the price of gold can serve as an important barometer for monetary policy since it unambiguously reflects the purchasing power of a monetary unit. Thus, in an inflationary time where a country's currency depreciates, gold retains its inherent value, and its price rises in terms of the devaluing monetary unit. Unfortunately, the gold litmus test for policy is generally unwelcome for monetary authorities who have typically attempted to suppress any sustainable rise in gold.

New gold production annually has usually run below the demand for gold arising from jewelry and other real uses. Since virtually all of the gold mined to date is still extant, the incremental demand for gold over production is being met by a recycling of existing stocks. The primary providers in the recycling market have been the global central banks which have been steady sellers of gold over the last several decades. The charitable interpretation of the thinking behind the central banks' action was that gold held in reserve was a non-earning asset and as such, was better disposed of. This logic is almost certainly true in a strongly growing world with stability and high investment returns – holding gold in reserve may make little sense in this context.

The world today has changed however, in some fundamental ways. The economic conditions are not stable, the fiscal situations of most the developed countries are untenable, and a grand exercise in monetization of debt has already started and should continue in the near future. Consequently, there is logic to owning gold, especially for anyone who is not indebted and wishes to retain the purchasing power of his assets. Gold makes particular sense in fact for central banks of countries which have had responsible monetary policies along with pegged exchange rates. Such institutions have had large accumulations of foreign reserves thanks to money-printing by their trading partners.

The counter-argument to gold which is presented all too often is that with low growth and declining wages, there is unlikely to be global inflation, and in fact, we could see actual deflation. Under such circumstances, gold will most likely

fall precipitously according to this argument. Unfortunately, this reasoning ignores the fundamental reason why gold played such an important role in backing currencies in the first place. The gold standard existed so that the public would have confidence in the monetary unit and to prevent the governments from engaging in actions that would destroy this trust. Low inflation may help in keeping the trust, but is no guarantee of the same. Importantly, uncertainty about government policy itself can trigger a huge increase in gold demand as we discuss below.

The U.S. in 1933 was in the middle of the Great Depression, with inflation also very low. Given the high unemployment the country was expected to print money to boost growth. The fact that the U.S. was on a gold standard, meant that any such measure would mean a debasing of the currency in terms of gold. Americans realizing this increasingly started exchanging their dollars for gold which in turn had the effect of contracting the money supply even further. Thus, expectations of irresponsible government policy in a time of depression caused a sharp increase in gold demand in 1933. Franklin Roosevelt in 1933, forcibly seized the gold held by Americans by requiring that they turn in all their holdings, with some limited exceptions for jewelry, artistic and dental work, for a set payment of $20.67 an ounce of gold. Congress also unilaterally required that all contracts where payments were set in gold be restruck in terms of fiat money. Once the gold seizure was complete, the President repriced gold at $35 an ounce, thus subjecting those Americans that had held gold to a punitive tax of 40%. The small burst of inflation created by Roosevelt's move did create a bit of a boom, even with unemployment at over 15%. However, the economy shortly afterwards slipped back into a recession within what was already a depression! The simple point which we are trying to make here is that even with a depression and outright deflation, the uncertainty of policy at the time resulted in a 75% increase in gold prices! The public used gold when they were allowed to guard against the uncertainty of economic policy even though all the signs then suggested deflation. The concerns about the unsustainability of high unemployment and the belief that the government would do something irresponsible on the monetary side to deal with these problems were enough to generate huge demand for gold. Sadly Roosevelt denied the gold-bugs of 1933 the protection that gold might have offered for their wealth.

Thus, gold has an important role even in this world of fiat money. It represents the ultimate numeraire (or standard of value) on the basis of which all global currencies can be judged. Even with low inflation, if countries were to move to debase their currencies, gold might still gain reflecting the declining value of these currencies. That is, gold measures relative value in a world that is devoid of real yardsticks. As such, its valuation could well be driven almost entirely by perceptions of the values of currencies with actual global inflation playing no part in the same.

Gold Price Dynamics and Panic

While there is certainly a case that can be made now for owning gold at least as a diversification ploy, the nature of the gold market today makes the metal a truly compelling investment. The stock of gold in the world today is finite and small. Estimates put the total gold mined since the dawn of mankind to about 5 billion ounces, which if it were all put in one place, would fill a cube of about 67 feet per side. The total value of the gold at today's prices of about $1250 an ounce would be $6.2 trillion. The size of the global economy is about $58 trillion with total debt in the globe being much larger than that. In fact, the U.S. alone has over $55 trillion in public and private debt, so that even a conservative assessment would have to peg total global debt as being much more than $120 trillion. As such, the world has enough gold to support at best about 5% (and very likely much less) of the total credit that has been extended. Any move by governments or free markets to diversify into gold to guard against huge problems to be expected with our fiat system should result in a dramatic increase in gold prices.

The dynamics of a gold price increase in the context where it is a resource in very limited supply and thus exhaustible, have been well studied, albeit in limited settings as in a single country. A classic paper that analyzes these dynamics, Market Anticipations, Government Policy and the Price of Gold, was written in 1976 by Stephen Salant and Dale Henderson as part of research sponsored by the U.S. Federal Reserve. The paper considers the gold market when governments intervene with strategically timed sales to alter the metal's price trajectory. The threat of substantial gold sales ensures that the market price of gold remains lower than what would prevail without such sales. However, the lower

prices in themselves spur more demand and as such a faster depletion of stocks, which in turn leads to a more rapid increase in prices, though from the lower levels. When markets recognize that the remaining gold stock available for sale might not be enough to keep up with future demand, there is a swift speculative attack that depletes all available stocks. Put differently, when purchasers know there may not be any more gold to be had, they rush in to buy whatever is available knowing that the market will cease to function in an orderly manner afterward.

The conclusions of Salant and Henderson fit well with the experience of several developing countries that have had currencies backed by foreign reserves or gold. Their analysis is particularly relevant today for the developed world which is monetizing without bound while doing nothing to engender longer-term economic stability. Were markets to rebel at the emission of fiat money and purchase gold as a purchasing power hedge, we could expect by their analysis, a steady rise in the gold price. The current level of global gold production is still low. Even worse, many of the central banks which had previously been major sellers of gold from their reserves have actually started purchasing the metal. All indications in fact, suggest that market sentiment could shift and, as predicted by the above analysis, trigger a parabolic rise in the gold price. We believe therefore, that purchasing gold is one of the most compelling investments we can make today. The only major risk we have to guard against is the unilateral expropriation of our investment by governments.

Conclusion

Given our views we have added to our longs in gold and gold stocks. We have also added to our long positions in fixed income both in Australia and in other areas such as Norway where the fiscal situations are still under control and where the governments have substantial support for budgets from natural resource ownership and taxation.

We believe that we are rapidly approaching some kind of watershed event for the world. The reckoning from the crisis of 2007-2008 was successfully postponed by the aggressive actions taken in 2009 by governments. Unfortunately, the strains have begun to re-emerge and the time to deal with them properly might soon be upon us. We have had our party and the time has come (to paraphrase Lewis Carroll) to discuss cabbages, kings and whether pigs have wings.

Performance Summary at May 31, 2010

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)
0.8%	-1.4%	-5.2%	-10.8%	12.4%	37.7%	22.2%	N/A	-2.3%	12.6%

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)
0.6%	-1.4%	-5.2%	-10.7%	15.0%	39.9%	23.6%	7.2%	-2.2%	19.7%

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