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Trident Investment Management, LLC
Opportunities Funds Commentary

September 30, 2009

MONTHLY UPDATE

Performance Discussion

The bull move in equity markets continued in September, though the month has traditionally been one of the worst for equities. The S&P 500 was up 3.6%, the MSCI Europe Index was up 2.6% and the Nikkei was down 3.4%. Commodities also did well with gold up 5.9% to end at $1,007.7 an ounce and oil was down 0.6% to end at $70.9 a barrel. Credit markets tightened with credit spreads hitting levels seen before the collapse of Lehman Brothers. Amazingly, with all this euphoria, U.S. Treasuries rallied also with yields on the 10-year Treasury down 0.1% to end at 3.3%. The U.S. dollar was the only victim of bearish action on the month with the U.S. Dollar Index depreciating 1.9% (all figures in U.S. dollars).

Our funds were down in September, with our credit and fixed income positions being responsible for most of the losses. Our credit investments suffered, as some companies which we believe to be virtually bankrupt saw big rallies in their bond instruments. Our bearish position on U.S. Treasuries, expressed primarily through curve steepeners on the 2-year-10 year sector of the swap curve, also hurt performance. We have only marginally adjusted our portfolio over the month. Specifically, we rolled some of our curve steepener options out to longer maturities. Markets expect the Fed to raise rates significantly next year, and project a dramatic flattening of the U.S. yield curve, which we believe to be unlikely given the circumstances making longer-dated steepeners extremely compelling.

A Reality Check on Recovery

The U.S. continues to face a rather depressing economic outlook despite the euphoria in financial markets. The housing market remains in crisis mode though this would not be apparent looking at market action of the last few months. Several indicators demonstrate this reality. First, U.S. residential foreclosures continue to climb to new records, even as the slump in commercial property intensifies setting the stage for another banking crisis. Second, the employment situation remains dismal with over 14.5 million officially unemployed and only 2.4 million permanent jobs open since July. This represents a ratio of applicants to jobs of over 6.0, the worst since at least 2000 when the government started tracking these figures. Finally, bank credit continues to decline in one of the worst post-war contractions as does consumer credit. In fact, consumer credit declined by about 4.4% annualized in September, capping a six month slide, the longest since 1991. Consumer confidence, which had showed some "improvement" of late, moved from crisis levels earlier this year to levels seen at the depths of previous recessions.

To be fair, some of the US data has been more positive. Thanks to the Cash-for-Clunkers auto program, overall retail sales even ex autos have proved better than expectations. However, these improvements are on the month-to-month sales figures with the year-on-year data still showing significant contraction. Overall retail sales in September for example were down 5.7% over 2008, an especially poor result given that in the same month in 2008 we were in the depths of the financial turmoil with the potential collapse of the system looming. The other bullish data on the economy come from the supply side where there has been some stabilization if not outright improvement both in inventory and survey data. Inventories in most sectors of the U.S. economy were drawn down to very low levels during the last year, and these declines have slowed or even reversed. The survey data such as those collected by the Institute for Supply Management from corporate purchasing managers have also shown improvement from levels that prevailed earlier this year. These figures are typically very volatile and are heavily driven by sentiment, which in turn is influenced by market action and media reports. Moreover, similar surveys conducted on smaller businesses, which have generally been an important channel for job creation, have been much less positive. Even if we concede that sentiment may have improved significantly, it cannot be relied upon to sustain a recovery when cash and credit are both hard to come by.

A Financial Asset Bubble?

The macro data suggest at best that the U.S. economy might be stabilizing at low levels, and this too after more than $10 trillion in bailouts and stimulus. The same conditions prevail in much of the developed world. The virtual bankruptcy of the financial systems in the developed countries along with the exceptional leverage of their consumers make it difficult for policymakers to induce a new cycle of debt-fuelled economic growth. The unstated mission of the policy leadership therefore is to engender asset price inflation so as to provide a basis for renewing leverage and thence consumption. The primary asset whose rise in value would induce consumption is housing. However, home prices are already too high relative to affordability and inventories remain at multi-decade highs. As such, the only assets whose values can be inflated relatively easily in the short run are financial assets.

The Fed has been extremely explicit in its intent to create financial asset inflation and its intentions have been mirrored to a large extent by other global central banks in the developed world. It has embarked on over a trillion dollars of mortgage and Treasury buying, even as it continues to provide banks with funds at virtually zero cost. Even though most developed countries' banks are essentially bankrupt, they are happy to borrow at zero interest rates and park these funds in longer-dated government bonds in order to earn the spread. Ownership of sovereign paper does not require much capital. Banks are required by international capital rules to set aside capital mainly against default risk which for most developed market government

instruments is deemed to be zero. The interest rate risk from the mismatch between assets and liabilities is largely ignored where it comes to capital requirements. The nexus between central banks and the banking system with this purchase of government bonds represents monetization of government debt in much of the developed world on a scale only seen in the hyperinflationary economies of Latin America over the last few decades. The driving down of government yields has now boosted the bid for risky assets to the point where their valuations have no relationship to underlying fundamentals. Thus, we have a genuine bubble again, and this time in financial markets where we would argue that there is rampant overvaluation not just of stocks and credit instruments, but also of many government bond instruments.

Financial asset bubbles have two major problems. First, their benefit is often concentrated on the narrow slice of the population that actually owns these assets. Second, and more important, they tend to have a lifespan that is relatively limited. Fundamentals reassert themselves and force valuations down to reality; repeated episodes of the same make it impossible to continue the bubble.

The current bubble in U.S. and by extension global, financial assets is almost certain to have a relatively short existence. Due to the very high consumer debt levels and poor employment prospects, any sustainable economic recovery seems unlikely and the economic stability we observe might well be temporary. A renewed slowdown will impose more serious strains on the U.S. government and spell doom for the U.S. dollar and bond markets as well as the levitating equity markets. In fact, just removing some of the extraordinary monetary stimulus that serves as the fuel for the current bubble could itself cause its collapse. Even worse, creating this asset bubble has squandered governmental resources to the point where future policy choices to deal with the reckoning are going to be limited.

The Opportunity in Australia

The situation that persists in the U.S. and to a lesser degree in the UK, Spain, Ireland and a few other major countries is not universal. Some countries, specifically Australia, which are superficially in a similar situation, have more policy choices if the current situation degenerates into a full-blown global downturn. Australia presents attractive investment opportunities today to protect against a global slowdown.

Australia has a population of about 21 million with an annual GDP of about US$1 trillion. It is similar to the U.S. in that it has had a major real estate bubble fuelled by leverage. Since 1985, home prices in Sydney for example have risen by about 4% a year in real terms, which means that after inflation, the cost of a house has gone up over 123%. Moreover, the banks in

Australia have lent aggressively against real estate with many willing to lend over 90% of the value. The result of all this has been an explosion in household mortgage debt with the ratio of mortgage debt to GDP rising from just 18% in 1990 to over 87% today. This has occurred even though mortgage interest on the homeowner's primary residence in Australia is not tax deductible as in the U.S. The homeowner typically has a mortgage with variable interest rates – any fixed rate loan has its rate fixed pegged only for three to five years after which it becomes variable. As such, any increase in official rates (as happened through the first half of 2008) means an immediate increase in mortgage payments.

The real estate market is symptomatic of a more general increase in the country's indebtedness; the total debt to GDP ratio in Australia now is a record 174%. Every period of strong growth in Australia has also meant a substantial increase in overall indebtedness, especially for households. Thus, one could reasonably conclude that the country's growth has largely been due to increased debt. The strong economy of the last several years and an overly strong exchange rate have also meant a significant increase in the country's trade deficit to about 4% of GDP today, a surprising fact given that most of the country's exports are commodities which have enjoyed robust pricing in world markets for the last several years.

There are two major differences between Australia and the U.S. The Australian economy, despite the country's indebtedness, is not as reliant on the consumer. Consumption makes up only 56% of GDP with investment making up 27% as opposed to the U.S. where the ratios are over 70% and 15% respectively. The government has been more fiscally responsible than the U.S.' to the point where Australia has virtually no government debt. The gross government debt to GDP ratio for Australia is under 10% with net debt actually being negative – that is, the government actually has a surplus when its assets are offset against its liabilities!

Australia has managed to weather the bursting of its real estate bubble in 2007/2008 better than most countries. Because of strong commodity markets, the country's export sector was helped significantly through mid-2008, despite the appreciation of the Australian dollar. With strength in the economy, the Reserve Bank of Australia ("RBA"), the country's central bank, actually continued to raise rates through March 2008 to a high of 7.25%. In the dramatic financial turmoil of the latter half of 2008, policymakers moved rapidly to cut rates to stabilize the economy bringing them down to a low of 3% in early 2009. Given the floating rates paid on most mortgages, the rate cuts represented significant relief to households. Moreover, late in 2008 the Australian government provided direct support to housing by increasing first-time homeowner grants from A$7,000 to A$14,000 for established homes and A$21,000 for new homes purchased. These grants were rolled back to A$7,000 after September 30, 2009 and were thus a direct, short-term stimulus to pull forward housing demand. In addition, the government introduced various

schemes to promote the construction of new rental housing for low income households. The reactions to the Australian policies were predictable, especially given the low level of interest rates since late 2008. By the end of July 2009, more than 137,000 people had taken up the real estate grant so that home prices have actually started rising again in many housing segments. Also, the rise in commodity prices over the last six months has served to boost economic activity further to the point where the Australian economy may have actually resumed a growth path. As such, Australia is perhaps the only major developed country where the policy response may be viewed as having worked.

The economic results achieved have prompted the central bank to start an unwinding of monetary stimulus. The RBA has started raising rates and is expected to continue on this path through 2010. Interestingly, the rate hikes as priced into the bond markets are so aggressive that the Australian yield curve is actually expected to invert slightly in two years. That is, markets project that the central bank will raise rates over the next 24 months to the point where short rates will be higher than long rates. Even more amazingly, in a world where deflation talk is rampant, the Australian sovereign yield curve projects 2-year rates in 24 months to be at a staggering 6%. A country, therefore, with no net sovereign debt and robust commodity exports, whose real estate bubble has yet to be fully addressed, will be paying the highest interest rates in the developed world.

In isolation, the Australian yield curve does not seem anomalous. After all, the right medicines for a real estate bubble are higher interest rates and/or tighter credit. However, when we consider the global environment, the projected rates in Australia are unsustainable. The continuation of a real estate bubble is critically dependent on employment and not just low interest rates. Australia has been fortunate in that it has so far been spared the consequences of a protracted fall in commodity prices. The decline from July 2008 in commodities, while substantial, has nevertheless come from very high levels; the moves up in 2009 have restored prices to levels typically higher than those that prevailed in 2007. However, the improvements in the economy have driven the currency to new highs against those of most countries, serving effectively as a tightening of policy especially to the export sector. In this situation, a sustained downturn in the U.S. economy or in that of its major producer China will have seismic effects on Australia. This would result in a fall in commodity prices and Australian exports inexorably altering the domestic employment picture, which in turn will mean a real estate problem for the country given the households' exceptional leverage. This chain of events will almost certainly mean that the Australian central bank cannot continue to raise rates and may in fact be forced to cut them again.

We have recently been adding to our long position in Australian 2-year swaps (which are bond proxies) using options with 24 months to maturity. At 6%+ yields, these positions represent an

exceptional bargain. We believe that these positions are among the best hedges today in fixed income against any scenario of global deflation. In fact, even if the U.S. were to resort to monetization of all of its debt to create domestic inflation, the result for the rest of the world would be deflation caused by the reduced consumption of the world's largest economy. Paradoxically, even in a scenario of U.S. inflation, the Australian position might pay off handsomely. The only scenario where this idea would fail to work is if the world were to experience a synchronized global boom. We believe strongly that the latter is highly unlikely.

Summary

The last few months have been particularly challenging for us as we try to make sense of what can only be described as runaway bullish sentiment. The reality of the world economy, outside of a few areas such as Australia, is much worse than the markets suggest. Global policymakers have done little to address the key issues the world faces, but have pushed the problems out into the future. Markets have assumed that postponement is equivalent to resolution, and we believe strongly that the deferral will make the problems much worse. We are waiting for the markets to catch up with reality, which seems tantalizingly near.

Performance Summary at September 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)
-1.7%	-4.5%	-5.4%	11.9%	33.6%	39.1%	22.8%	N/A	-3.3%	14.0%

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)
-1.3%	-3.7%	-5.0%	11.3%	32.1%	42.5%	24.0%	11.4%	-3.4%	20.9%

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