Standpoint

Q3 | 2014
Global Market Analysis by Citi GCB EMEA

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Climbing the Wall of Worry

After a first quarter characterized by contrarian markets and resurging economic and geopolitical uncertainties, lots of people suddenly realizing markets had not suffered a real correction in 2 years started to fear a bubble burst or a market crash but what the second quarter delivered was a gentle rebound.

"So far this year markets have been a little dull giving us one of the most frustrating scenarios for traders and speculators, and creating generalized dissatisfaction."

Frustration indeed: speculators want to see more volatility which remains stubbornly low; portfolio managers are unhappy because they are lagging their performance targets; economists are puzzled by a global economy hesitating between strengthening and stagnation; investors sitting on too much cash are irritated because the market refuses to go down; And low volumes are weighing on brokers' commissions. Yet, the Morgan Stanley Capital International (MSCI) World Index and S&P500 Index have reached record levels, the Nasdaq is a few points away from its 2000 all-time high and even the European Stoxx600 index has doubled from its 2009 lows. Equity prices are high and volatility is low, everyone should be happy. Conversely, bearing mind the well-known investment principle which commands to sell high and buy low, investors are getting nervous.

Although the current relationship between markets performance and the context in which they evolve might seem awkward, this is not an unusual situation. What we are actually observing is the building up of a typical "wall of worry". The concept of wall of worry is used to describe a stock market trend that remains bullish even as negative market uncertainties prevail. Interpreting this from a pessimistic

Citi Outlook

Our Market Outlook reflects Citi analysts assessment of each asset class independently.

The Global Investment Committee ('GIC') made no changes to recommended portfolio weightings at its latest asset allocation meeting. The Committee decided to maintain its existing overall equity/bond asset allocation. The allocation remains overweight risk assets and underweight interest rate risk. The GIC maintains overweight in equities, with overweights in US, Japan, Asia ex-Japan and Europe. This is offset with an underweight in fixed income, concentrated in a heavy underweight in developed sovereign bonds. Within its fixed income portfolio, the GIC now has small overweight position in high-yield while positions in emerging market debt are underweight and investment grade corporate bonds are neutral.

The committee noted the widening risks to global oil supplies as insurgents threatened Iraq's export recovery. However, this new threat seemed to fall short of the worst-case risks posed in Ukraine. Notably, the Ukraine conflict remained not fully resolved. The ECB recently acted and committed to additional easing going forward but the course of policy in Japan and among many EM central banks is more uncertain.

Global equities

Market	Outlook
	Positive
US	Positive
Europe	Positive
Japan	Positive
Latin America	Negative
Asia Pacific	Positive
Emerging Europe	Negative

Global fixed income

Market	Outlook
	Negative
Global Government	Negative
Global IG Corporate	Neutral
Developed High Yield	Positive
Emerging Market Debts	Negative

Global currencies

Currency	Outlook
Euro	Positive
Yen	Negative
British Pound	Positive

Data Source: Citigroup Global Markets Inc. Weighting provided by Citi EMEA Consumer Bank as of July 2014

angle, someone can say that a wall of worry is not healthy because prices rise despite risks and uncertainties.

"Most investors find it difficult to identify whether the stock market is indeed in a bull phase and is climbing over the wall of worry or whether fear is justified and the bull market is nearing an end."

This is basically what has happened so far this year: Fed taper, Chinese slowdown, deflation risks in Europe and falling current accounts in Emerging Markets have not derailed the bull market trend. In 2013 already the US fiscal cliff, Euro Area triple-dip and the yields shock had paved the way of stellar equity returns (32% for the S&P500). Taking a step further backwards and looking at the trend of equities over the last 50 years, it semms that up until 2000, the trend is a smooth and continuously rising line, a remarkable series of all-time highs. However, moving back into these past decades, many of us will remember that the market trend has not always been smooth and these periods have carried their share of crises, uncertainties and worries.

Citi analysts see the recent past performance and events magnified by a near term lens effect, and, obviously they don't know what will happen in the near future. On the other hand, when they look further into the past they know today what happened back then, if got rid of the sentiment around these events they find good ex-post explanations for the positive outcome that followed.

"Through the lens of markets history, today always appears as the worst time to invest."

A bull market can keep on climbing a wall of worry under two conditions: risks have to be priced into equities, and the concerns need to be surmounted. In this case, markets don't rise despite uncertainties, but because risks have been recognized, priced and addressed. A good illustration could be the recent measures taken by the European Central Bank to fight deflation risks in the Euro Area, which if unaddressed could lead to a crisis like Japan has experienced during the last 25 years. Importantly, Citi analysts see that despite near term concerns, the conditions which have driven the bull market so far such as the ample global monetary support, the low inflation context and the ongoing global economic recovery are still in place though some factors such as less attractive valuations would not support repeated stellar returns.

"The sustainability of a bull market is in danger when risks are no longer recognized and priced."

What history also shows us is that a bull market never follows a straight line and has limits. Typically, investors' greed is the most common cause for the collapse of a wall of worry. Markets become blind and fail to recognize and effectively price risks which can generate asset bubbles. Risks are ignored and concerns are inadequately addressed. In such a situation, valuations are irrational and the wall of worry gives room to a wave of euphoria. In that regards, the current awareness of a wall of worry is a sign of market health. Citi analysts concede that some sort of a downturn, pullback, correction or whatever term one cares to use for a sudden decline in stock prices is inevitable, though impossible to time, the markets' wall of worry continues to build up offering windows of opportunity and rewarding patient and disciplined investors. However investors must also recognize that if the world is a safer place in general to invest than a few years ago, it is also a different place. The market opportunities of the past are not necessarily those that will generate excess returns in the near future or in the long term. Catching these future drivers requires adequate portfolio allocation rotation flexibility.

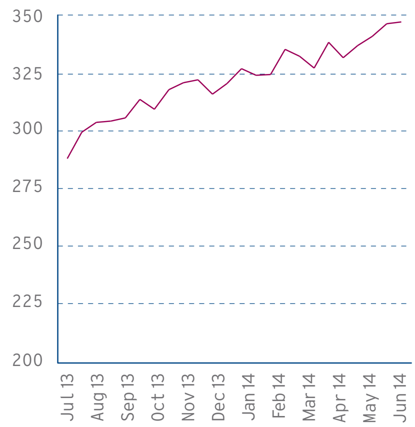
Europe and North America

Europe equities

"Whatever it takes", act 2

Citi analysts now expect 1.2% Euro Area GDP growth this year and 1.8% in 2015, with the peripheral economies likely to offer the biggest GDP growth improvements. Having said that, private sector credit growth remains anaemic and together with evidence that inflation is still subdued, the ECB recently lowered its benchmark refinancing rate to a new record low of 0.15%. Moreover, the ECB cut its deposit rateto -0.10% from 0.00%, becoming the first major central bank to drop one of its main rates below zero. These announcements provide additional stimulus, but Citi analysts doubt it is enough to prevent a continued inflation undershoot. Assuming that headline inflation eases further in the summer, and that disinflationary headwinds from poor credit availability and the strong euro persist, the ECB is likely to do more but is probably done with rate cuts given the change in forward guidance. Citi analysts still expect the ECB to launch a fully-fledged Quantitative Easing, possibly in Dec-14. Citi analysts estimate that €1 trillion QE could boost real GDP by 0.7% in total over the next three years.

Earnings in Europe have disappointed over the past couple of years. Now, an improving macro backdrop leads Citi analysts to believe that 10% EPS growth in 2014 is possible, suggesting that the onslaught of EPS downgrades may finally be abating. In terms of valuations, Europe has sharply re-rated since 2011-12, from 10x to 17x on a trailing P/E basis. While absolute valuations are less attractive than before, but they are not yet expensive. Furthermore, net flows to European equities also have turned sharply higher over the past few quarters. In terms of sector strategy, financials/cyclical are preferred over defensives as they are most likely to benefit from economic/operating leverage.



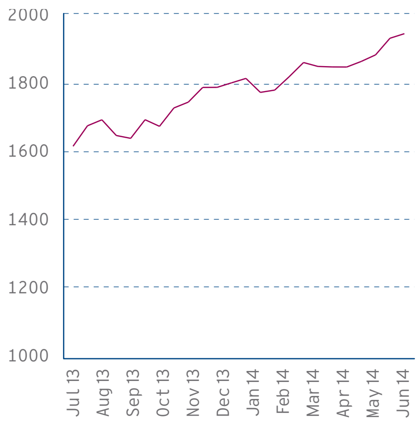
DJ Stoxx 600

Data source: Bloomberg as of 30 June 2014

North America equities

Fundamentals Bounce Back

The winter weakness took a bigger bite out of 1Q growth than previously thought. But now the economy is rebounding sharply, setting up for solid growth through the rest of 2014 (2.3%) and into 2015 (3.1%) back in line with earlier expectations. The bounce back in growth, especially in private domestic demand, may continue to drive down the unemployment rate to 6% late this year. This may set the stage for rate hike preparations in the spring of 2015, with modest tightening beginning in the summer although the US Fed signalled its concern about the lack of growth momentum in terms of number of active people at work. Citi analysts see two-way risks here: Continued low inflation could delay tightening, while a faster recovery and wage gains could speed up the interest rate hike. Earnings growth is a key element of the 2014 investment story, but expectations had been too high and are now resetting to a more reasonable level in our view. Citi analysts forecast Earnings Per Share to rise by slightly less than 7% this year, below consensus estimates of 9%. With the rerating of US equities largely done, this EPS growth is likely to drive the S&P 500 higher in 2014. Citi analytsts still believes in the long run bull story likely supported by an ongoing improvement in earnings revisions. However, a choppier ride is anticipated through the rest of 2014 as sentiment looks stretched and further Fed tapering may be a challenge. In this environment, a preference for large caps and growth appears appropriate. In terms of sector selection, Citi analysts have now turned their preferences to cyclicals against defensive despite an unfavourable start of the year



S&P 500 Index

Data source: Bloomberg as of 30 June 2014

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Global Sovereign and Corporate Bonds

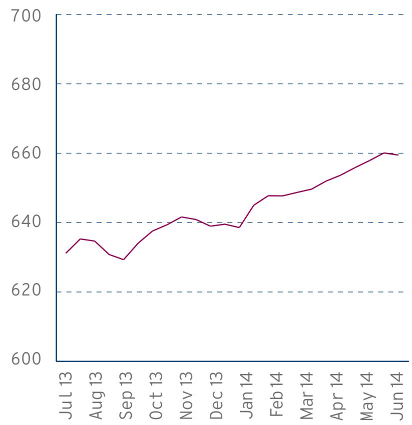
Global Sovereign Bonds

Don't chase the rally

Sovereign bonds have achieved stronger returns than expected during the first half of the year, particularly at the long end of the curve. Risk-free curves have bull-flattened and 10-year US Treasury yields declined by about 60bp through the end of May despite improving fundamentals and continued Fed tapering. The US is still battling a hangover from disappointing first quarter results, which has depressed real rates. Other factors have contributed to the rally. The Russia/Crimea crisis fostered safe haven demand, and, more recently, substantial short covering inhibited yields given that so many market participants were positioned for higher rates.

These trends, though, appear to have mostly receded. The promise of improving fundamentals and healing developed economies imply that core rates are poised to gradually rise during the second half, though the magnitude will differ. This was punctuated on June 5 by the ECB, which announced aggressive policy measures to combat growth concerns and ensure price. Short rates are poised be anchored near zero in the Eurozone and Japan long after the Bank of England and Federal Reserve initiate rate hikes next year. It is notable that the ECB is the first major central bank to cut its deposit rate below zero (to minus 0.1%).

Historically wide spreads in longer-dated benchmarks are a testament to a divergence in growth prospects. Citi analysts expect these trends to persist. But even as 10-year yields gravitate towards 3.0% later this year in the US and UK, they continue to believe that disinflationary pressures will keep



Citigroup World Government Bond Index

Data source: Bloomberg as of 30 June 2014

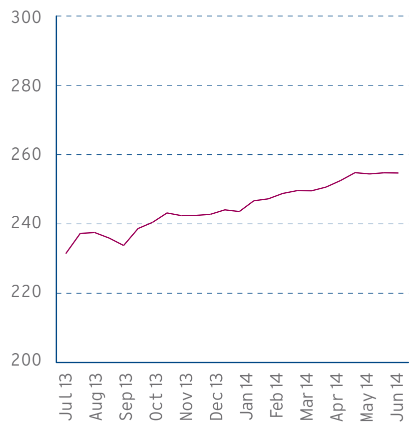
rates low across the Eurozone. This should help foster outperformance by German Bunds and other Eurozone sovereigns, and bolster gains across regional credit markets.

Corporate Bonds

Investment Grade demand expected to slowdown

Citi analysts observe that investment grade (IG) corporate credit continues to benefit from a relentless quest for yield, notwithstanding less attractive valuations. Indeed, historically low yields have not dissuaded investors: US high grade funds have attracted $22.5 billion of inflows this year. In Europe, high grade fund inflows total about €8.2 billion. Citi analysts expect demand to remain fairly solid, and for potential quantitative easing by the ECB to bolster risk appetites, supporting further gains. They caution that declining risk-free rates (not spread compression) has been the main driver of performance this year. Corporate securities in the US and Europe have gained 5.5% and 4.1%, respectively, YTD. That said, when these returns are adjusted for the shift in rates, these securities generate only slightly better than 1.0%. While Eurozone rates are likely to remain well-anchored, US rates are poised to rise more meaningfully later this year. Therefore, they continue to favor EUR credits over USD and GBP, financials over non-financials, and BBB-rated credits vs. higher quality names.

High yield (HY) debt also outperformed during the first half of the year. Low rates, benign volatility and strong investor demand have supported gains. Despite some modest widening, spreads (to worst) in the US and Europe are relatively unchanged. HY bond fund inflows remain robust with over $5 billion in new assets this year ($2.1 billion in May). While HY valuations have become less compelling, favourable conditions are poised to persist. Citi analysts expect default rates to remain



Citigroup World Corporate Bond Index

Data source: Bloomberg as of 30 June 2014

low due to stable fundamentals. They favour Europe over US HY credits. While US HY is more vulnerable to an upward shift in domestic rates, potential ECB QE will foster greater demand for high-yielding European credits

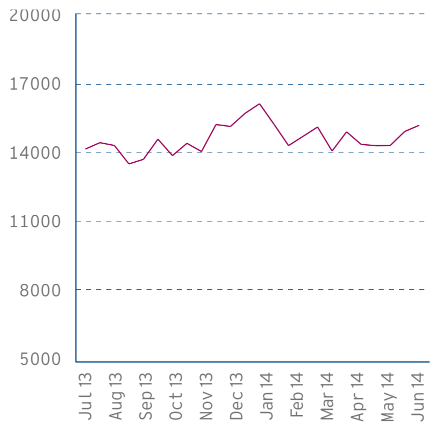
Japan and Asia Pacific

Japan equities

Economic sustainability requires more monetary support

Real GDP grew a solid 5.9% QoQ annualised in the 1Q. Frontloaded demand ahead of the consumption tax hike pushed up household spending strongly, but private capex also rose decently, probably reflecting the sharp rebound in corporate profits. 2Q GDP may shrink by around 5% annualised amid payback to frontloaded demand, but a moderate uptrend in the economy could resume, bringing full year growth to 1.4%. Meanwhile, Citi analysts continue to believe that actual inflation may undershoot the BoJ's optimistic forecasts and that activity could be weaker than expected by the BoJ, leading to additional monetary easing in this autumn or later. However, it appears that the BoJ (and to a lesser extent the Ministry of Finance) are more convinced that the sales tax hikes may not depress activity in a way that threatens the escape from deflation and the closing of the output gap than earlier expected.

Citi analysts expect the rebound in Japan EPS to continue as further benefits from cost-cutting and a weaker yen feed through. Citi analysts forecast a 25% EPS growth in 2014 compared to the bottom-up consensus of +18% and stronger than anywhere else. As the market gets a better picture, the valuation of Japanese equities may rebound. Even if TOPIX reaches Citi analyst's end-2014 target of 1,350, the cyclically adjusted price-to-earnings ratio (CAPE) would be around 13.6x, which is in the middle of its historical range. However, these targets will be impossible to achieve should additional easing be postponed. Sector wise, Citi analysts prefer financials, machinery and auto



NIKKEI 225 Index

Data source: Bloomberg as of 30 June 2014

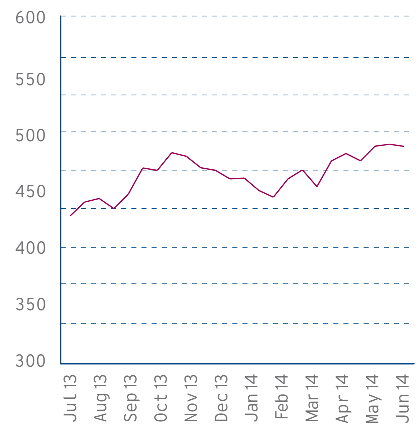
related sectors. Financials benefit directly from Abenomics, which tries to get Japan out of deflation mainly through asset price increases. Auto related and machinery sectors are likely to be supported by the yen depreciation.

Asia Pacific equities

Reforms in India, Government support in China

Amongst the 3 EM regions, Asia continues to look the most attractive given fewer current account issues, stronger currencies and better credit scores. Citi analysts continue to expect Asia to show the strongest GDP (6.2% in 2014) within EM and inflation remains well anchored at 3.5% in 2014. Indeed, the export rebound is strengthening across the board, especially exports to the US. But, the lingering growth challenges in China still mean that the rebound is not strong by historical context. However, Citi analysts think the Chinese government will scale up policy supports unless export growth accelerates amid better US data. In particular, the People's Bank of China may likely maintain adequate liquidity to lower the borrowing cost, and the government to take more measures to prevent a property market crash. Nonetheless, optimism for structural reforms has risen in both India and Indonesia following favourable political developments, raising hopes that the slowdown in both is temporary.

Citi analysts 2014 EPS growth for the region stands at 8-10%, slightly below consensus forecast of 12%. Korea at 19% has the highest forecast EPS growth rate with the China, Hong Kong, the Philippines and Malaysia at sub 10%. In terms of valuation, both the price to earnings and price to books are trading at or close to one standard deviation below the mean and we have now witnessed the longest period of de-rating in Asian equities since 1975. Generally the more northerly markets (which Citi analysts prefers) are



MSCI Asia Pacific Ex-Japan

Data source: Bloomberg as of 30 June 2014

cheaper vs those in South East, Singapore being the exception.

In terms of sector, the more cyclical sectors such as Energy and Technology are preferred.

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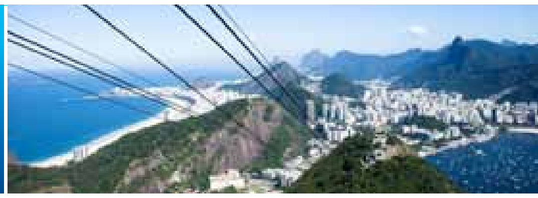
Emerging Europe and Latin America



Emerging Europe equities

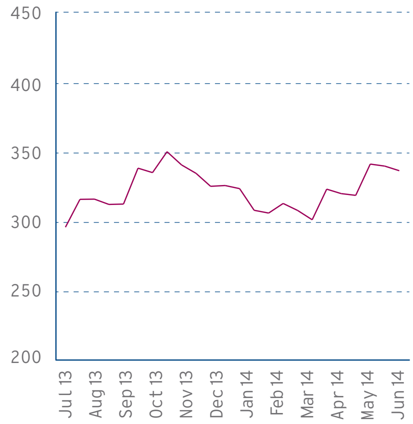
Geopolitical deadlock

As EM equities struggled to keep up the pace with DM, EM Europe were no different from this general trend. MSCI EM Europe Index lost 6,6% in Q1 and was one of the worst performing indices overall.

Investors' fears regarding the negative effect of the QE3 tapering on EM and especially the ones with large current account deficits (in EM Europe represented by Turkey – the second biggest market in the region after Russia) and increased geopolitical risk in the region (Ukrainian crisis impacted the biggest market in the region – Russia) can be mostly blamed for this underperformance. China hard landing fears also can be mentioned here.

Citi analysts within EM continue to favor EM Asia over EM Europe and LatAm, the underweight of EM Europe mostly attributed to Turkey, a country with the largest current account deficit among the so called "fragile five" group (Brazil, India, Indonesia, Turkey and South Africa). As the year progresses and the monetary policy of some of the major central banks becomes less accommodative, Citi analysts see the potential weakness in EM with current account deficits as a risk for EM Europe going forward.

Within EM Europe Citi analysts are neutral on Russia. Although the market is attractively valued (2014 est. P/E of 4,4x) they think that it is too early to buy. The recent political turmoil made a very challenging backdrop for the Russian economy, creating significant downside risk to the economic performance. As a result Citi analysts downgraded their GDP forecast for 2014 from 2,6% to 1,0%. Challenging economic prospects will likely result in earnings disappointment.



MSCI EM EMEA

Data source: Bloomberg as of 30 June 2014

Moreover, valuations of Russian stocks can be somewhat justified and remain in place for a while because of weaker sentiment towards Russia, less foreign buying of Russian assets and higher political risk premium.

Latin America equities

Reforming Countries Better Positioned

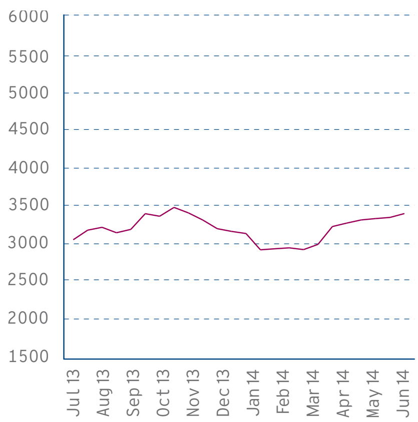
Citi analysts are expecting Latin America (LatAm) to grow 1.9% in 2014 and 2.8% in 2015.

Within the region, they have lowered their 2014 GDP growth forecast for Mexico to 3%, because of slower growth in 1H14. However, a recovery is expected in 2H14, while keeping our GDP growth forecast for 2015 unchanged at 4%.

Citi analysts are maintaining our bearish view on activity growth in Brazil, expecting GDP to expand 1.3% this year and 1.8% in 2015 as the net effect of the World Cup is expected to be only modest. Whilst no more hikes to the Selic rate is anticipated in 2014, there is a possibility for 150bps of additional increases during next year.

Meanwhile, LatAm's external debt ratios are moderate. Interestingly, the country with the highest stock of external debt (public and private) is Chile, with 43.5% of GDP. In Argentina and Venezuela, the outlook remains challenging for the authorities, as activity weakens and inflation escalates. While EMEA and Asia trade one standard deviation below their historic valuations, LatAm is not cheap vs its past levels and continues to trade at an 8% premium to the emerging markets (EM) index. Yet compared with their peaks in late 2007, LatAm's earnings are 38% lower. When valuations are high and EPS revisions weak, the liquidity machine needs to do the heavy-lifting. But looking at the growth rates of the asset side of the central bank balance sheets in LatAm, they are underperforming those in the rest of EM.

Historically, underperforming liquidity growth means weaker stock markets, which is what we are seeing. A weaker



MSCI EM Latin America

Data source: Bloomberg as of 30 June 2014

current account and capital flow leave LatAm at a disadvantage. Within the region, Citi analysts prefer Mexico as it stands out on structural reforms, market-oriented policy and linkage to a US manufacturing renaissance.

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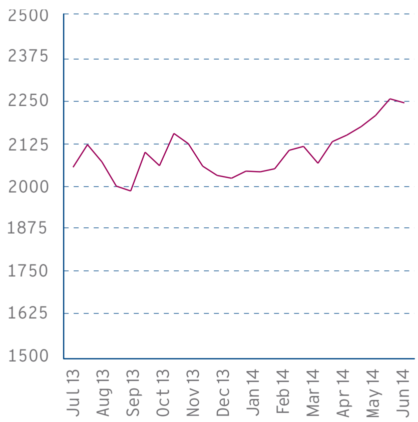
Global REITs and Commodities

Real Estate Investment Trusts (REITs)

Inflows remain strong

Over the months of May and June, the Citi REIT team has travelled across the US with investors seeing a multitude of different property types and assets, and meeting with senior and local management teams and local leasing and capital markets brokers. Overall, fundamentals across property types and markets appear solid. While supply is definitely increasing, it is coming off a very low base which remains extremely low by any historical standard. Supply is also low versus current vacancies and obsolescence. On top that, demand is strengthening. Add in very accommodative capital markets in terms of access and cost, and overall capital chasing real estate, and "it's a good time to be in the real estate business". The most difficult thing for companies has been buying assets, which is why most have focused on development and redevelopment as a way to create value. The biggest worry is how long can it last, and what impact will rising interest rates have.

Citi analysts also observe that strong performance has been achieved on the back of strong inflows. US registered dedicated real estate mutual funds have seen $8.2bn of inflows in the first half of 2014. This follows $6bn of inflows in 2013. Japanese registered dedicated mutual funds have experienced approx. $3.4bn of US market inflows in 2014 so far following $5.9bn of inflows in 2013. Assets under management from Japan funds now total $61bn: $34bn in US only focused funds and $28bn in Global focused funds. The Global focused funds have approximately



EPRA/NAREIT Global Index
Data source: Bloomberg as of 30 June 2014

55% exposure to the US, and Citi analysts estimate in aggregate the Japan registered mutual funds have now approx. $48bn exposure to the US REIT sector.

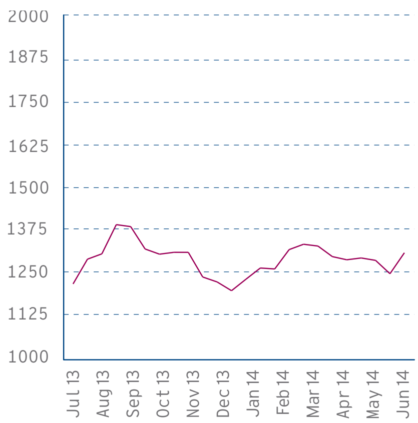
Commodities

Volatile Oil Prices on the back of Geopolitical tensions

Commodities have performed well during the first half of the year. However, a major lingering question is whether this outperformance will continue through the rest of the year as demand for commodities is still relatively slack given the slowdown in emerging markets for the rest of 2014 and 2015.

Although Citi analysts are modestly upgrading its Brent price forecast to US$104/bbl in 2014, they still remain bearish. On one hand, the Ukraine crisis continues to escalate, with the market starting to become concerned that sanctions on energy exports could be a real possibility. This is supporting prices even as the physical market reflects seasonal softness. However, the supply side is bolstered by an ongoing increase from Iraq. After a dismal performance in the last 12 months, the base metals complex looks to have troughed and aside from aluminium, Citi analysts hold a relative bullish view on the rest of the industrial commodities on the back of likely Chinese economic stimulus.

With regards to precious metals, continued strong Chinese retail jewellery demand on one hand, and investor demand for gold and gold-backed financial products on the other hand, are expected to remain strong during 2014, acting to tighten the physical gold market, though it is clearly sensitive to sharp rallies as seen in mid-March. On the supply side, Citi analysts expect gold mine production growth to stall this year, largely on weaker South African production. Essentially, Citi analysts see a stabilization in gold prices through this year, with the physical



Golds US$/troy oz.
Data source: Bloomberg as of 30 June 2014

market providing a floor to further downside moves, and prices are expected to average US$1,320/t.

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Currencies

Euro

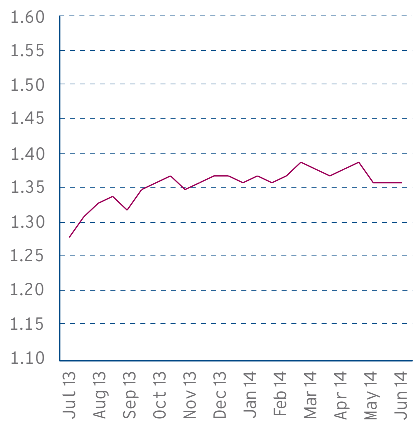
The EUR continues to face downside pressures following the June ECB meeting that saw it cut rates and introduce a range of stimulus measures including the prospect of QE to follow should inflation continue to remain at the current very low levels. The easing in policy comes as disinflation in the euro zone gathers pace, in part, fuelled by the stronger euro amid a fragile recovery. The strength of the euro has equally, in part, being by the strong inflows into European assets as markets seek to correct their underweight position from the time of the euro zone debt crisis and supported by the positive balance of payments currently running at between +3.5 - 4.0% of GDP. EUR's support has also come from rising euro zone short term rates resulting from the credit squeeze within the European banking system. The ECB's easing measures are likely to help weaken the euro, which in turn may likely help stem disinflation risks. Citi analysts forecast EURUSD at 1.35 in the next 6 to 12 months.

Yen

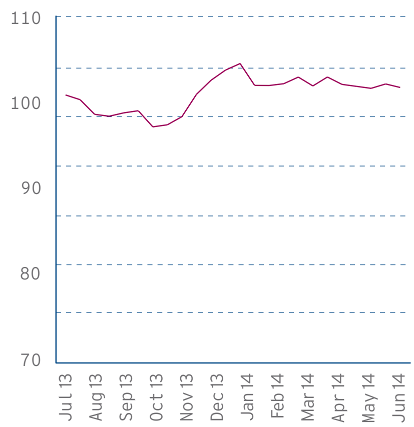
Citi analysts think that USDJPY medium term upside largely depends on BoJ easing. Yen weakness appears to have waned and the currency may strengthen a bit more in the short term as the Bank of Japan (BoJ) likely remains on the sidelines for the time being. This represents a shift in sentiment from earlier this year as markets (and Citi analysts) expected the central bank to carry out another round of easing measures by mid 2014. Without further BoJ easing, USD/JPY is unlikely to push higher especially with consensus positioning already skewed towards yen shorts. Weaker data prints post the April tax hike likely provide the rationale for easing, though a delay in extra liquidity additions to 2H14 means the timetable for further Yen weakness may likely be pushed back to later this year. Delayed expectations on BoJ easing should keep USDJPY trading range bound over the next couple of months. However, once there is a clearer picture on the timing of easing from the BoJ, we expect USDJPY to trade to the 108-110 level.

Pound Sterling

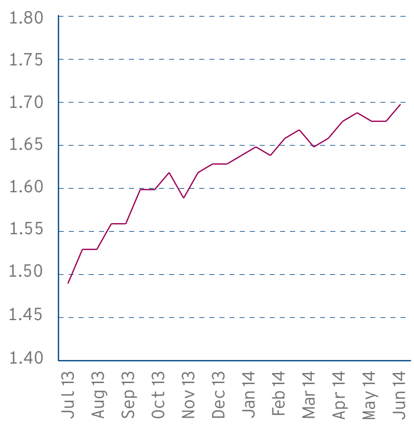
Among the European currencies, Sterling seems to have the most positive story and Citi analysts continue to expect further strength against the G3. Data prints out of the UK remain stellar and labour market slack is being absorbed more quickly than the Bank of England (BoE) had anticipated late last year. Although the overall tone of recent BoE Inflation report/press conference slightly surprised on the dovish side, the BoE did revise their growth forecasts higher and their unemployment rate forecast lower. However, the MPC for now seems to be sticking to its fairly generous assumption that labour market slack may persist for a further extended period and that tightening is likely to be "gradual". Against this backdrop, Citi analysts still hold above-consensus GDP forecasts and also expects policy rate hikes before year-end whereas the BoE and markets see the first rate hike in 1Q15. If Citi analysts expectations are realized, this could turn even more supportive for GBP. Citi analysts forecasts GBPUSD to reach 1.77 in the next 6 to 12 months.



Euro-Dollar (USD/EUR)
Data source: Bloomberg as of 30 June 2014



Dollar-Yen (JPY/USD)
Data source: Bloomberg as of 30 June 2014



Pound-Dollar (USD/GBP)
Data source: Bloomberg as of 30 June 2014

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Guest Corner

What to Expect From a World Cup

by Marcelo Kfoury and Leonardo Porto, Citi Investment Research

When it was announced that Brazil would be the host of 2014 World Cup, everyone was expecting a huge social support and strong positive economic impacts. However, and contrary to these preliminary expectations, the sentiment is that the World Cup could be a liability to the federal government with chances to modify the presidential election results. In this piece Citi analysts analyze the economic impacts of the World Cup, considering what was expected in the early stages of the event.

Impacts on Economic Activity

It is very difficult to have a clear assessment about the net effect of hosting a FIFA World Cup in terms of economic growth. Tendencias, a Brazilian economic consultancy firm, released a report in 2010, trying to measure the impacts not only of the 2014 FIFA World Cup but also related to the 2016 Summer Olympics Games. Overall, according to that piece, from 2010 to 2016 the GDP would grow 0.19p.p. higher than the basic scenario. More recently, the feeling is that the net effect in growth would be modest. Most of the local houses, including ourselves, are not including any effect of the World Cup in our growth scenarios. Citi analysts are forecasting 2014 GDP growth to reach 1.3%.

Infrastructure investments

Citi analysts have only disaggregated data for investments up to 2012, and at that time the increase in infrastructure investments were almost insignificant. According to Moody's report, the investments in infrastructure associated to the FIFA World Cup from 2010 to 2014 will likely represent just 0.7% of the total investment in this period. Moreover, so far the most visible investments were done in airports and stadiums. In terms of urban mobility, 36% of the initial cost has been disbursed up to February 2014, which does not mean that this amount of the projects are completed, because the cost of them may have increased in regards to the original plan.

Retail sales

According to Tendencias, the literature does not show significant impact on the retail sales during mega sporting events. The international evidence is that there is positive impacts in some sectors more involved with visitors, but for the overall retail sales it depends on the side effects in other sectors/months. Regarding the number of foreign visitors to Brazil because of the 2014 World Cup, previous estimates were around 600k. Most recently, according Jose Wagner Ferreira from Academia Brasileira de Eventos e Turismo, the number of tourists will be at most 300k.

Inflation

According to a study of the Central Bank of Brazil the effects on inflation from hosting a mega event start when the host is announced and continues until 6 years after the event. It found that the two mega events (2014 World Cup and 2016 Olympic Games) would have a cumulative impact of 2.0 percentage points in CPI inflation along the period from 2007 to 2017. Citi analysts expect that the items that will most likely be affected by World Cup are airfare, hotel and restaurants.

Political effects

Prior to June 2013, the assessment of Dilma's government was at 57%. During the episode of the protests in June/July, her approval rate fell to 30%, level in which her reelection is under severe risk. It is very difficult to anticipate that such huge unrest will occur again and will have the same effect in her popularity, but Citi analysts think that the World Cup will likely produce more downside than upside effects in the incumbent federal government. However, her approval rate has been falling since February, hovering around 35%. Popular approval of the World Cup also decreased significantly. In November 2008, one year after the announcement that Brazil would host the championship, the approval of the 2014 FIFA World Cup was 79%. In the latest poll, collected in April 2014 by Datafolha, the World Cup approval has dropped to 48%. Moreover, the delays in the stadiums, which ended up costing significantly more than previously estimated, and also the disappointment with the absence of legacy of the event have majored the risk for the federal government.

Forecasts may not be attained. Past performance is no guarantee of future results. There are additional risks associated with foreign investments.

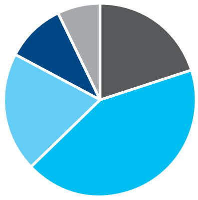
Final Word

Asset allocations

Defensive

Seeking primarily capital preservation over time and only willing to accept very minor portfolio value fluctuations from month to month.

Euro-tilted model portfolios



- EUR Cash **20%**
- EUR Government Bonds **43%**
- EUR Corporate Bonds **20%**
- European Equities **10%**
- Global Equities **7%**

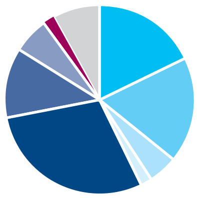
Income-oriented

Seeking growth of wealth over time but unwilling to accept significant fluctuations in the value of portfolio from month to month.

- EUR Government Bonds **33%**
- EUR Corporate Bonds **25%**
- EUR High Yield Bonds **6%**
- European Equities **18%**
- Global Equities **13%**
- Global REITs **5%**

Growth and income

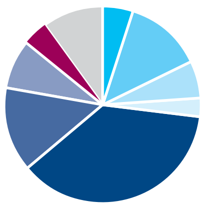
Seeking long-term capital growth foremost but unwilling to accept significant losses on value of portfolio over the medium term.



- EUR Government Bonds **18%**
- EUR Corporate Bonds **18%**
- EUR High Yield Bonds **5%**
- Emerging Market Debt **2%**
- European Equities **29%**
- US Equities **12%**
- Pacific Equities **6%**
- Emerging Markets Equities **2%**
- Global REITs **8%**

Growth oriented

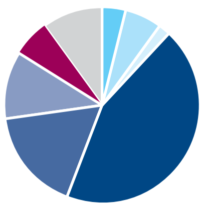
Seeking long-term capital appreciation and willing to tolerate measured medium-term volatility in order to enhance longer-term performance.



- EUR Government Bonds **5%**
- EUR Corporate Bonds **13%**
- EUR High Yield Bonds **6%**
- Emerging Market Debt **3%**
- European Equities **37%**
- US Equities **14%**
- Pacific Equities **8%**
- Emerging Markets Equities **4%**
- Global REITs **10%**

Aggressive Growth

Seeking long-term capital appreciation and can accept potentially large losses on portfolio over the near-to-medium term in order to maximise long-term performance.



- EUR Corporate Bonds **4%**
- EUR High Yield Bonds **6%**
- Emerging Market Debt **2%**
- European Equities **44%**
- US Equities **17%**
- Pacific Equities **11%**
- Emerging Markets Equities **6%**
- Global REITs **10%**

Forecasts may not be attained. Past performance is no guarantee of future results. There are additional risks associated with foreign investments.

The suggested allocations are intended to be general in nature and are not to be construed as specific investment advice. Investors are encouraged to consult with their Financial Professional to determine their allocation needs based on their risk tolerance, suitability and goals.

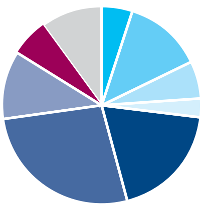
Spotlight on allocations

Global model portfolios

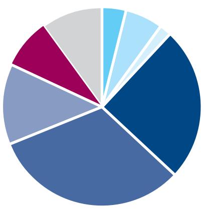
- Cash **20%**
- Developed IG Government Bonds **43%**
- Global IG Corporate Bonds **20%**
- Global Equities **17%**

- Developed IG Government Bonds **32%**
- Global IG Corporate Bonds **25%**
- High Yield Bonds **6%**
- European Equities **7%**
- US Equities **12%**
- Global Equities **13%**
- Global REITs **5%**

- Developed IG Government Bonds **18%**
- Global IG Corporate Bonds **18%**
- High Yield Bonds **5%**
- Emerging Market Debt **2%**
- European Equities **15%**
- US Equities **22%**
- Pacific Equities **9%**
- Emerging Markets Equities **3%**
- Global REITs **8%**



- Developed IG Government Bonds **5%**
- Global IG Corporate Bonds **13%**
- High Yield Bonds **6%**
- Emerging Market Debt **3%**
- European Equities **19%**
- US Equities **27%**
- Pacific Equities **11%**
- Emerging Markets Equities **6%**
- Global REITs **10%**



- Global IG Corporate Bonds **4%**
- High Yield Bonds **6%**
- Emerging Market Debt **2%**
- European Equities **25%**
- US Equities **32%**
- Pacific Equities **13%**
- Emerging Markets Equities **8%**
- Global REITs **10%**

About the Citi Asset Allocation Process

The Citibank tactical portfolio allocations are based on the work of the Global Investment Committee (GIC) of Citi Private Bank. The membership of the committee is comprised of experienced investment specialists from across Citi. The GIC deliberates on the macroeconomic and financial market environment in order to formulate an outlook across multiple asset classes and is responsible for maintaining tactical model portfolios based on this outlook. The tactical weights that are applied to the Citibank portfolios are aligned to the decisions of the GIC.

Allocation to bond and equity markets

The Global Investment Committee (GIC) has decided to maintain positions across asset classes with an overall Overweight stance in Global equities.

Overall the GIC now stays overweight on equities, neutral on commodities and underweight on fixed income.

The GIC believes that medium term outlook for equities remains favourable though short term risks have increased on the back of geopolitical tension in Eastern Europe and in the Middle East. Overall, equities continue to offer better risk/reward than credit this year while both returns are likely to be below last year's gains as the attractiveness of valuations has somewhat deteriorated.

Allocation to regional equity markets

The GIC maintained its overweight in US, Europe and Japan and Asia ex-Japan. Emerging Market equities continue to be underweight.

Within the equity universe, the GIC has the largest overweight positions to US equities with a brightening outlook given signs of growing corporate capital expenditure combined with improving housing and job markets feed through into economic growth although the Fed's taper process could generate periods of volatility. Exposure to Asian equities has been maintained on the basis of valuation not reflecting the strong earnings growth momentum in the region.

And the GIC believes that Japan may resume grinding higher even though at a slower pace supported by new political leadership taking a more aggressive stance on fiscal and monetary policy. Also the GIC maintains its position in Europe equities given still attractive valuations and improving monetary support from the ECB. Meanwhile the GIC is now Underweight in Emerging Europe and Latin America equities, and suggest selectiveness with regards to country allocation.

Allocation to government and credit markets

The GIC is heavily underweight sovereign bonds, with US Treasuries bearing the brunt of the underweight, and Emerging Market debt on the back of increasing yields and currency risks. They have small overweight position in High yield bonds. Investment grade allocation of the GIC are now neutral on the basis of narrower spreads capping the scope for gains in a period of rising yields.

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Important Disclosure

"Citi analysts" refers to investment professionals within Citi Research ("CR"), Citi Global Markets Inc. ("CGMI") and voting members of the Citi Global Investment Committee.

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