Q3 | 11

Europe | North America | Japan | Asia Pacific | Latin America

Standpoint

Global Market Analysis by Regional Consumer Banks

When Expectations turn into Illusions

Volatility increased and risky assets underperformed in the second quarter of this year – with the MSCI World loosing up to 8,3% between May and June. This volatility is a sign that investors are currently struggling on one hand with a high level of optimism that has fueled a period of strong market performances, and on the other hand, economic data that have been less and less supportive during the last quarter.

One of the most important indicators that Citi analysts track is the evolution of "Economic Surprises". An economic surprise is measured by the difference between the actual level of economic indicators and the expected level of those indicators. History indeed shows a strong correlation between the short-term performances of financial markets and the trend of economic surprises as bonds yields and stocks prices tend to increase when economic surprises are positive, and vice versa.

Despite the relative underperformance of equities during the second quarter, Citi analysts have observed a decoupling between equities, bonds yields and economic surprises. Economic surprises have indeed collapsed, Triple-A bonds yields have melted but equity prices have been remarkably resilient relative to the extent of deterioration in the economic indicators. Citi's Global Investment Committee sees in that decoupling a sign of excessive optimism among equity investors. The large divergence between investors' sentiments and economic data leads one to wonder to which extent market resilience is being driven by fundamental expectations or by investors' illusions.

Illusion #1: "US Quantitative Easing is an economic success"

Citi outlook

A snapshot of Citi's global market views across a select group of asset classes, regions and currencies over the next three to six months.

Our Market Outlook reflects our assessment of each asset class independently of other asset classes. The Global Investment Committee (GIC) has maintained its defensive stance in 2011. But the GIC has reduced its overweight in US Treasuries, which acted as a hedge against recent adverse global news. Given the specific pressures on the Japanese government, the GIC recommends underweighting exposure to Japanese Government Bonds (JGBs). Central banks globally have begun to normalize policy from an extremely loose stance, and the GIC believes that the long end of the curve should offer positive returns even in the scenario that rates tighten a bit faster than anticipated. The global economy may face some headwinds with the end of the Federal Reserve's Quantitative Easing program (QE2). Earnings growth is slowing, making developed equities still a weak bet (other than cheap Japan). The GIC also continues to favour Investment Grade Credit as a prudent way to express exposure to risk, but feels that in the short term, equities of Hong Kong, Singapore, Taiwan and Korea may offer better risk/reward trade off.

Global equities

Market	Market outlook	Portfolio allocation
	Negative	Underweight
US	Negative	Underweight
Europe	Negative	Underweight
Japan	Positive	Overweight
Latin America	Negative	Underweight
Asia Pacific	Positive	Overweight
Eastern Europe	Positive	Overweight

Global fixed income

Market	Market outlook	Portfolio allocation
	Positive	Overweight
US Treasuries	Positive	Overweight
US High Grade Corporate	Positive	Overweight
Core Euro Government Bonds	Positive	Overweight
Euro High Grade Corporate	Positive	Overweight
Japan Investment Grade	Negative	Underweight
High Yield	Positive	Overweight
Emerging Market Debt	Negative	Underweight

Alternative investments

Market	Market outlook	Portfolio allocation
	N/A	Neutral
Hedge Funds	Neutral	Neutral

Global currencies

Market	Outlook vs USD	Outlook vs EUR
	Negative	Positive
Euro	Positive	
Yen	Negative	Negative
Sterling	Positive	Negative
US Dollar		Negative

Data Source: Citigroup Global Markets Inc. Weightings provided by Citigroup Global Wealth Management and Citigroup Global Consumer Group Investments as of December 2005.

An investor looking at the performance of his portfolio over the last two years may perceive the Quantitative Easing (QE) programs of the US Federal Reserve (Fed) as a major success as equities posted strong performances during the two periods of QE. However, supporting the performance of financial markets was not among the objectives of the QE programs. The objectives were to revive Households Credit flows, to support Real Estate prices and to bring down unemployment. Over the period, outstanding Households Credit continuously contracted, Real Estate prices remained at the same level as at the trough of the Subprime crisis in April 2009, and the unemployment rate remained stubbornly higher than 9%. Citi analysts recognize the important role of the QE program in helping banks, companies and households to repair their balance sheets, in restoring liquidity flows and in supporting the competitiveness of the US economy (through a weaker US dollar), but they think that the expectations of a strong economic recovery boosted by successful QE programs is an illusion.

Illusion #2: "Developed Markets' Debt crisis is contained"

What the development of the Greek crisis in May-June has shown us is that 18 months after the outburst of the crisis, continuous political debates, billions of euros of financial support and several austerity programs, no sustainable political or fiscal solution has been found. At the same time, thinking that the debt crisis is concentrated on Greece or even the Euro Periphery countries is a mistake. Citi analysts evaluate that the necessary fiscal adjustment to bring the level of US debt to 60% of the GDP by 2030 is similar to the fiscal adjustment required in Greece, but the fiscal programs implemented in the US are not even half the size of the fiscal programs implemented in Greece (as a percentage of GDP). Obviously the status of the US dollar as a world currency and the size of the US Treasury market make this burden more bearable for the US. But Citi analysts think that the belief that the US debt burden can be addressed, moreover in an election year, without consequences on economic activity is an illusion.

Illusion #3: "Strong Performance of US equities"

Over the last few months, US stocks and indices have been praised for their strong performance, in absolute terms and relative to other regions. In local currency terms, the S&P 500 index is indeed up 2.3% year-to-date June 23, while the MSCI Europe index is down 3% over the same period. However, Citi analysts argue that this outperformance is more the result of US dollar weakness than the consequence of fundamental performance. Indeed, corrected for Trade Weighted US dollar weakness, US stocks are actually down 2.6% year-to-date. More interestingly, in euro terms, the performance of the S&P 500 index is -5.1%, which means that by neutralizing the currency effect, European stocks actually outperformed US stocks. As such, thinking that stock markets can perform in the absence of sound fundamental support is also an illusion.

Citi analysts have not revised their expectations in terms of global economic activity and do not envisage recession scenarios in 2011 and 2012. But they think that, driven by continuously disappointing economic data, investors may have to bring down their expectations with regards to economic developments and abandon the excessive illusions that may have driven investment decisions over the last couple of months.

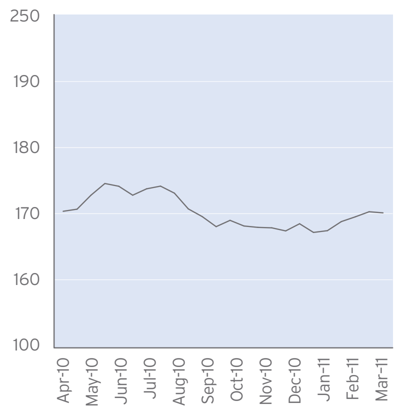
Europe

Fixed income

Prefer Triple-A Core Europe to Periphery

Citi analysts have revised to the downside their GDP forecast for 2011 by 0.1 points to 2.0% and their 2012 forecast by 0.2 points to 1.4%. The revisions were made to take into account lower export growth (reflecting smaller gains in global demand) and lower domestic demand (due to fiscal and monetary tightening). Unless the economic slowdown is much sharper than expected or inflation falls substantially in coming months, Citi analysts expect the European Central Bank (ECB) to continue hiking policy rates to 1.75% by end-2011 and 2.00% by mid-2012.

In the Sovereign bonds sector, Citi analysts avoid periphery bonds as confidence continues to wane as speculation about a potential peripheral restructuring sends short-term periphery bond yields and credit default swaps to record highs. On the other hand, they have an overweight stance on core Europe, particularly Triple-A Bunds which, barring the need to fully recapitalise the banking sector, are likely to receive a safe haven bid. Citi analyst also see potential for corporate bonds to continue to benefit from improving corporate balance sheets on the back of lower expenses and growing earnings as real interest rates remain attractive despite a hawkish monetary policy by the ECB



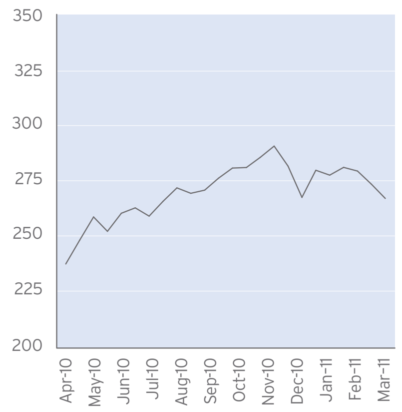
Citi Euro BIG (EUR)
Data source: Bloomberg as of June 30, 2011.

Equities

Bad image but better fundamentals

With the deepening of the debt crisis in Greece and the Periphery countries, Europe has received a lot of bad press over the last 12 months. However, although absolute performances year-to-date can be somewhat frustrating, the MSCI Europe outperformed US and Global Emerging equities in US dollar terms. While growth is slow and the Periphery is staggering towards a debt restructuring, which is still the base scenario envisage by Citi analysts, core countries are showing the fastest growth rates in a decade. European companies that have faced moribund domestic markets for much of the last decade have gone out and built world leading positions in many growth markets. Yet Citi analysts think that the companies, sectors and markets have not been rewarded with growth ratings. They view this as an opportunity not only for European investors but also for global investors looking for growth and value.

Citi analysts are underweight on European equities given the likelihood of a further increase in risk aversion due to the debt crisis and its potential impact on banks' balance sheets. But over the longer term, they think that relatively cheap multiples and a weaker euro may provide a tailwind to export-oriented markets such as France and Germany. Citi analysts avoid financials given concentrated exposures to peripheral sovereign debt and prefer "Global Winners" (firms which have acquired leading positions in their sector during the last decade), dividend growers and companies exposed to emerging markets' economic growt



DJ Stoxx 600
Data source: Bloomberg as of June 30, 2011.

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

North America

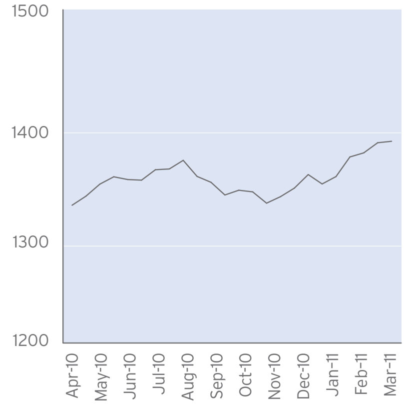
Fixed income

Weakening recovery means delay in rate hikes and no reduction in the Fed's balance sheet

The Federal Reserve (Fed) may face some difficult choices in 3Q11. As planned, its extraordinary intervention in the securities markets (quantitative easing or "QE2") was brought to an end. This enhances the Fed's credibility as it had repeatedly promised to do so. But the numerous economic data releases coming in below expectations have undercut its message that the US economy is now fully able to grow without this exceptional support. This softness has led Citi analysts to push back their forecast for the first policy rate hike to 3Q12. The US economy is expected to grow 2.5% in 2011 and just 2.8% in 2012, fast enough to reduce unemployment only to 8.5% in 3Q12.

This economic softness has also led Citi analysts to lower their forecast for the level of the 10-year Treasury rate to just 3.35% in 4Q11, though this still represents a rise from current levels. The anticipated rise should occur from a mild acceleration in economic activity in 2H11.

This somewhat more sombre economic backdrop has not lessened Citi analysts' preference for investment grade corporate credit. Although yield spreads to sovereign bonds have narrowed considerably over the last year, as corporate default rates have continued to fall and corporate balance sheets have strengthened from earnings growth, Citi analysts believe these trends may have further to go.



Citi US BIG

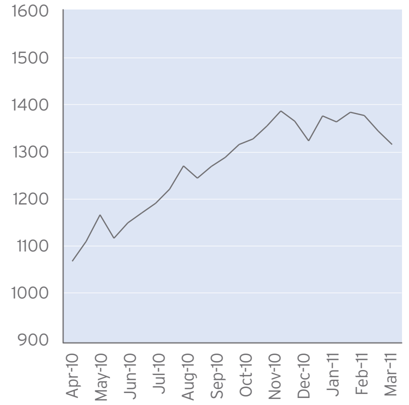
Data source: Bloomberg as of June 30, 2011.

Equities

US stocks could benefit from a positive fiscal surprise

In line with softening economic numbers and the end to the Federal Reserve's quantitative easing program (QE2), US equity markets have been under some pressure over 2Q11. Citi analysts continue to forecast the S&P 500 index finishing the year at 1,400 and view current investor positioning as potentially overly bearish, providing a contrarian support to valuations. However, they also see significant headwinds for US stocks in the form of margin pressures from a maturing corporate earnings recovery and from potential reductions in earnings forecasts in the wake of lowered economic growth expectations.

One potential bright spot for investors could be positive developments in the US fiscal challenge. The next few months will likely see contentious discussions, with brinksmanship around the US debt ceiling (the US Treasury can only issue debt to an aggregate amount approved by Congress; that amount has been reached and the Treasury Department has warned that by August 2 it will be unable to make payments to all those to whom it owes money, including interest to bondholders). While the threat of default from this confrontation has irritated credit rating agencies enough for both S&P and Moody's to issue warnings on the US's AAA rating, the outlines of an agreement, perhaps some US$2 trillion in fiscal consolidation over a 10-year period, could substantially reassure markets that the fiscal overhang is beginning to dissipate.



S&P 500 Index

Data source: Bloomberg as of June 30, 2011.

In terms of sectors, Citi favours Energy, Tech Hardware, Food & Beverage and Diversified Financials, and is neutral on Regional Banks, Software & Services, Utilities and Telecoms.

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

Japan and Asia Pacific

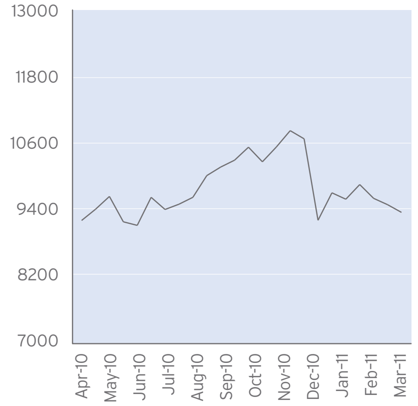
Japan equities

Earnings momentum to recover rapidly after the slowdown

Japanese corporate earnings momentum slowed down following the earthquake but Citi analysts expect a turnaround in momentum in the second half of this year, as supply chain disruptions are resolved and reconstruction demand materializes.

Going by price-to-earnings, price-to-book and return on equity measures, Japanese equities are an attractive lot. However, Citi analysts remain cautious in the near term, but grow more optimistic in the medium term. While the undervaluation of Japanese equities is expected to be rectified in time, there remain potential short-term risks, such as taking longer than expected to overcome the nuclear crisis, growing uncertainty over the burden that financial institutions may have to bear due to the nuclear accident compensation, and concerns of a global economic slowdown.

Citi's end-2011 fair-value estimates for TOPIX and Nikkei 225 currently stand at 920 and 10,300 respectively. Non-nuclear energy is seen as a long-term theme and therefore sectors related to energy, in addition to Consumer Staples, are preferred. Citi analysts are underweight Utilities and Financials given poor visibility regarding the nuclear crisis and compensation.



NIKKEI 225 Index

Data source: Bloomberg as of June 30, 2011.

Asia Pacific equities

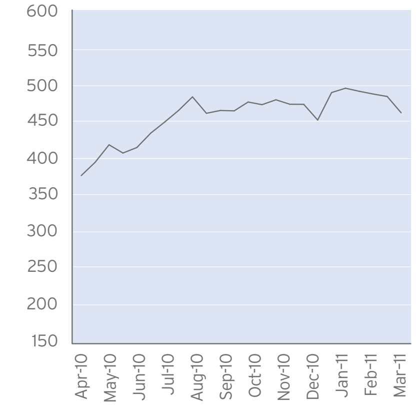
Growth moderation does not equate to earnings moderation

Citi analysts think that inflation remains a concern in the region, but some Asian emerging market central banks are likely to moderate their hawkish stance on interest rates given the ongoing Eurozone debt crisis and expectations for the US Federal Reserve to only commence rate hikes in 2012. The likely exceptions to this are the People's Bank of China, the Reserve Bank of India and Bank of Thailand, which are grappling with high inflation, and are expected to continue their aggressive stand by raising rates going forward.

Asian credit spreads have widened as Europe's sovereign debt crisis progresses, with growing uncertainty about how its policymakers will respond. But good quality oversold names may be worth taking a look at, given the high carry available.

From an industry perspective, austerity measures are expected to remain a near-term overhang for China's property sector. This may deter real money from buying aggressively, though Citi analysts remain selectively positive on the sector as the financial profiles of property developers remain relatively healthy. Away from the Chinese property names, there have been a slew of Chinese industrial sector names, including some State-Owned Enterprises (SOEs) that have issued USD bonds in Asia, both in terms of dated bonds as well as corporate perpetuals, offering an opportunity to diversify out of the property sector in China.

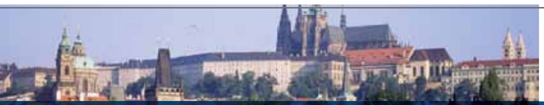
Citi anlaysts also like Asian banks, given their balance sheet strength when compared to some of their European rivals, and the supportive regulatory environment they operate in. It makes a compelling argument for some of the regional banks to call their capital securities as has been the case with some of them.



MSCI Asia Pacific Ex-Japan

Data source: Bloomberg as of June 30, 2011.

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

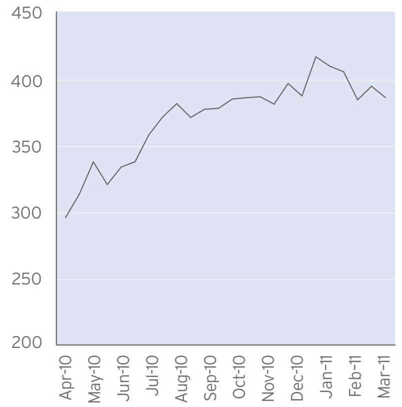


CEEMEA and Latin America

CEEMEA equities

Staying constructive
Surveying the macro data in CEEMEA, Citi analysts remain constructive on the region as a whole. Industrial production, having softened late last year, is rebounding in many regional economies. Retail sales were weak on average in the first quarter but have since bounced back to an average growth rate of 6%, the best pace since 2008, albeit well below pre-crisis levels. Consumer/business confidence have also picked up nicely to a multi-year high. Citi analysts expect CEEMEA economies to grow faster in 2011 than in 2010 with the exception of Turkey. On the inflation front, developments have been mixed. Inflation pressures have decreased somewhat, thanks to lower energy and food prices while many economists argue that slower global economic activity will in turn ease inflationary pressures. However, Citi analysts observe that core CPI continues to surprise to the upside in CEEMEA contrary to other emerging regions as real rates remain extremely low and central banks keep their focus on currency competitiveness. They therefore expect a greater focus on inflation-fighting among some emerging market central banks, which could lead to higher interest rates. The risk of adverse interest rate developments is probably more of a risk in Turkey than elsewhere in CEEMEA.

Corporate earnings trends are more mixed, with upgrades in Russia/Poland and downgrades in Turkey/South Africa. As a whole, valuations do not appear particularly stretched across the region. Citi analysts are overweight on Russia and Turke.



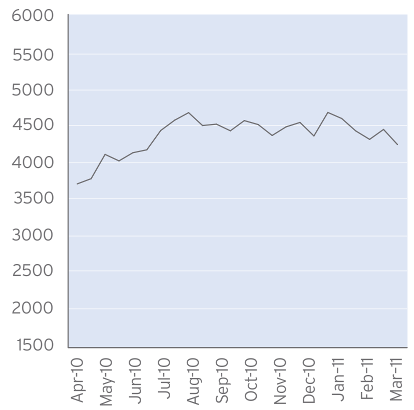
MSCI EM EMEA
Data source: Bloomberg as of June 30, 2011.

Latin America equities

The region should eventually rerate
Citi strategists believe Latin American equity markets may be poised for a repeat of summer 2010 when, in the face of US growth fears, emerging markets investors flocked to domestic growth (especially consumer) sector plays. The MSCI Emerging Markets (EM) Latin America Index outperformed, rising sharply from the May low to the late-August suggestion by the Fed Chairman that QE2 was coming; developed markets rose little and the S&P 500 Index actually fell over the same time period. A full replay of last year's experience is unlikely, with Consumer Staples already being the most expensive sector within emerging markets.

One major development of 2Q11 was the opening of the Mercado Integrado Latinoamericano (MILA), combining trading of the Chilean, Peruvian and Colombian stock markets. Trading got off to a slow start after its May 30 launch, seeing less than US$1 million total volume per day in its first days due to: 1) lack of clarity on some operational and tax issues; 2) political risk associated with a new, market hostile president in Peru; and 3) little price activity in the broader equity markets. In time, perhaps over the next six months, Citi believes liquidity – the ultimate determinant of MILA's success – should rise.

Citi analysts feel that MILA promotes an economically beneficial, higher level of Andean integration. Adjusted for free float, MILA's market cap of US$118 billion ranks it behind Brazil and Mexico and tenth among emerging markets. Citi equity strategists believe that over time, MILA will benefit smaller, illiquid stocks disproportionately.



MSCI EM Latin America
Data source: Bloomberg as of June 30, 2011.

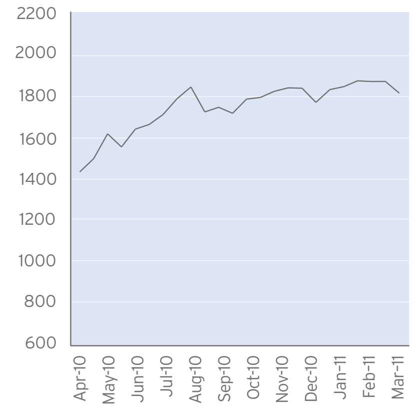
Global REITs and commodities

Real Estate Investment Trusts (REITs)

US REITs appear on track to deliver positive total returns in 2011
US REITs look to be working towards their third consecutive year of positive returns and outperformance versus the broad market. Implied cap rates for the sector have consistently declined since hitting over 10% back in March 2009 and now sit around 6%. The move has been driven and supported by improving fundamentals; significant capital moving back into real estate, both direct and through the public stocks; and low interest rates/capital costs.

Earnings for 1Q11 were also solid, coming in ahead of Citi's expectations with guidance ranges being held steady or raised in most cases and general optimism from REIT landlords. The optimism is being driven by improving fundamentals, a strengthening financing market and an accelerating investment landscape. Overall core Funds From Operations (FFO) growth came in at 6.7% versus the 4.7% Citi analysts expected. Of the companies under Citi's coverage, 33 companies beat expectations, only 20 have missed, and 13 were in-line. Fundamentals have generally been modestly ahead of expectations despite a negative impact from bad weather which had impacted leasing and led to increased costs. Year-over-year same-store net operating income growth came in at 2.8% versus 1.9% in the fourth quarter. Occupancy levels were up 60 bps over last year to 92.4%, and down 30bps sequentially, better than the normal seasonal declines.

Citi analysts also note that a number of ingredients seem to be signalling a potential return of the US REIT leveraged buyout: there is increased capital looking to get placed into real estate, the financing environment is strong with higher levels of leverage being attained and interest rates remain exceptionally low – making a leveraged carry trade attractive. The biggest limiting factor may be US REIT valuations as a whole which appear modestly ahead of private market values given the sector's access and cost of capital advantage.



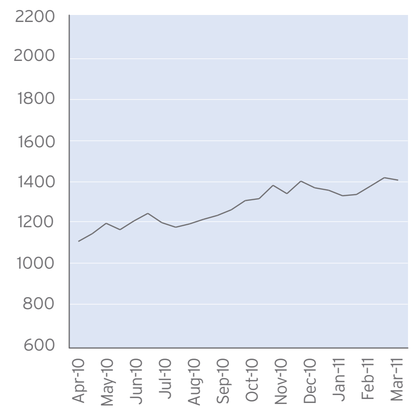
EPRA/NAREIT Global Index
Data source: Bloomberg as of June 30, 2011.

Commodities

Support seen for commodity prices over the medium to longer term
Risk aversion in general is likely to remain elevated in the near term given lingering concerns pertaining to the health of the global economy (with signs of slowing in the US and China). This is further compounded by prospects of a reduction of liquidity given the end of the US Federal Reserve's second round of quantitative easing (QE2) and potential monetary policy tightening in both the emerging and developed world. Such an environment puts commodity prices in a vulnerable position, Citi analysts say, especially considering that investment demand for commodities has grown substantially in recent years and net long speculative positioning is still at historically high levels. But over the medium to longer term horizon, they expect commodity prices to be supported by: i) an ongoing global economic recovery with strong emerging market growth; ii) a weak USD; and iii) the prospect of higher demand for commodities for inflation protection.

Although downside risks stemming from concerns about US and Chinese economic growth and higher US oil inventories persist, the potential for significant falls from early May levels is likely to be limited. Ongoing tensions in the Middle East and North Africa (MENA) could lend support to oil prices over the medium term. Citi forecasts the West Texas Intermediate (WTI) crude oil price to average US$102.30/bbl in 2011 and US$108.90/bbl in 2012.

Gold prices are likely to remain buoyed by safe-haven demand given ongoing risks stemming from the Eurozone sovereign debt crisis, US fiscal concerns, as well as global inflation fears. However, the end of QE2 and the gradual removal of ultra-easy monetary policies by major central banks may weigh on gold prices over the medium term. Moreover, the growth in investment demand for gold from 4% to 40% of total demand for gold in the past 10 years leaves the metal vulnerable to any sudden change in investor sentiment. Citi forecasts gold prices to average US$1,493.40/oz in 2011 and US$1,424.90/oz in 2012.

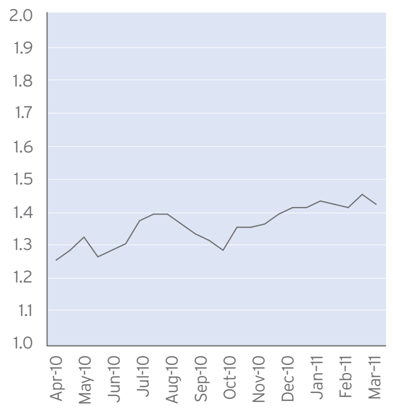


Golds US$/troy oz.
Data source: Bloomberg as of June 30, 2011.

Currencies

Euro

Having reached almost 1.50 in early May, EUR/USD has subsequently corrected back to a low so far just above 1.40 before bouncing. Citi analysts think lower commodity prices, reduced risk appetite, some easing in EUR-US interest rate differentials and ongoing periphery concerns may yet see EUR/USD pull back to the medium-term trend around 1.35 over the next couple of months. But, longer term, they expect USD trend weakness to persist. In their view, the main drivers of the 26% trough to peak appreciation in EUR/USD after June 2010 have been rate differentials. An important factor here has been the separation of policy towards the periphery countries' debt problems (liquidity and bailout funds) from policy rate expectations. So long as this separation seems sustainable, and European Central Bank (ECB) tightening is expected, Citi analysts think the EUR is likely to remain strong against the USD over the longer term. Citi analysts forecast EUR/USD at 1.47 over the next 6-12 months.

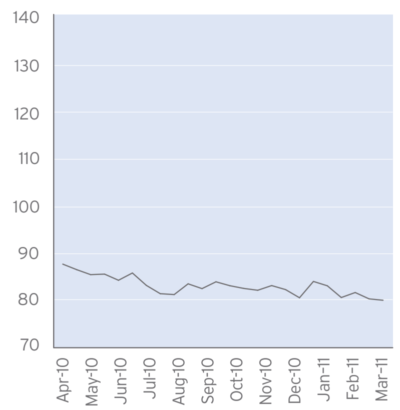


Euro-Dollar (USD/EUR)

Data source: Bloomberg as of 31 March 2011.

Yen

USD/JPY has been range-bound for the last few quarters (except immediately after the earthquake in March) and Citi analysts' forecasts anticipate this trend to continue in the short term. On the downside, the market may well continue to believe that selling below 80 is risky given the risk of (further) official intervention to sell JPY against an unfavourable macro background in the Japanese economy. On the upside, the drivers of a trend rise in USD/JPY, particularly a bear flattening in the US yield curve, continue to be absent. Over the 0-3 months horizon, weaker risk appetite and no Federal Reserve (Fed) action on flattening the curve are positive for the JPY and could keep USD/JPY close to current levels. Over 6-12 months, Citi forecasts show the Fed beginning to raise policy rates and this could generate some upside in USD/JPY to the top of the range or even a little higher as the cost of hedging overseas bond portfolios rises. Citi analysts forecast USD/JPY at 83 over 6-12 months.

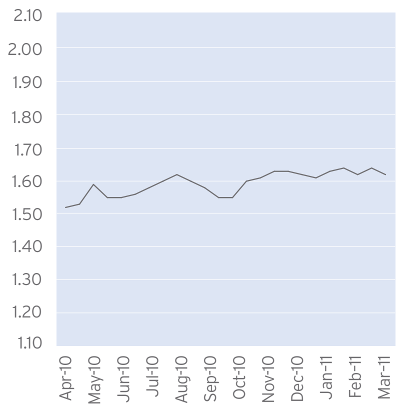


Dollar-Yen (JPY/USD)

Data source: Bloomberg as of 31 March 2011.

Pound sterling

GBP has been trading mainly sideways against the average of the USD and EUR in the second quarter of the year. A positive for the GBP is that it looks cheap. Citi analysts' fair value estimates are GBP/USD 1.74 and EUR/GBP 0.71. This cheapness shows up in a general perception that the UK is now a lower-cost centre than historically. One or all of several phenomena usually follow from this. Exports rise, the currency appreciates or the inflation rate accelerates. For now, Citi analysts observe that we are getting more of the first and last mainly because the Monetary Policy Committee continues to allow above-target inflation to persist without raising interest rates. Citi analysts think that real appreciation is inevitable in the medium term as the UK economy emerges "re-balanced" in the long term with a lower fiscal deficit, current account surplus and lower consumption/higher exports investment. They forecast EUR/GBP at 0.85 and GBP/USD at 1.73 in the next 6-12 months.



Pound-Dollar (USD/GBP)

Data source: Bloomberg as of 31 March 2011.

Guest corner

Navigating Opportunities in Water Sector Investing

By Deane M. Dray, CFA Director and sector leader of the industrials group for Citi Investment Research and Analysis (CIRA)

Water is a necessity to life and the c.$450 billion global water market has a powerful undercurrent

of defensive growth. Regardless of where we are in the economic cycle, a relatively predictable demand for water/wastewater can be tied to population growth. This gives water its defensive growth appeal. Yet the water sector also has a significant cyclical side. Municipal budget constraints and the propensity to defer infrastructure upgrades, as well as all the industrial demands for water (including power generation, chemical/petrochemical, semiconductor, food & beverage, etc.) together add a

cyclical element to the demand curve for all the equipment and services associated with the water sector. The implications are that water indeed has defensive growth properties, but it is certainly not 'non-cyclical'.

The natural resource with no substitute

Water intersects multiple industrial, geopolitical, and humanitarian agendas because it is a limited resource with steadily worsening supply/demand imbalances. Bear in mind that water is always a local

issue, seemingly in short supply where it is needed most, and frequently in over-abundance in locales where it is not needed (flooding being an extreme example). Water is actually denser than oil and is more expensive to pump through a pipeline. In light of the above, water's importance as a necessity to life has significant national and transboundary implications. There are more than 20 countries today that rely for more than half of their drinking water supply on rivers flowing out of a neighboring country. We see every reason to expect more border disputes to arise over water, with national security implications for many countries. The United Nations estimates that by 2030 about 50% of the global population will be living in water-stressed regions. Extrapolation of current trends suggests that about one-third of the global population will not have access to adequate drinking water by 2025. The global supply of fresh water is dwindling due to pollution, the draining of underground aquifers and, arguably, the impact of climate change too.

How we define the global water sector

We like to say there is no single 'water sector'. Instead, the water market is composed of at least 13 distinct subsectors, including the equipment and services for pumps, valves, water test, infrastructure (pipes, meters), filtration, water/wastewater treatment, industrial water treatment, residential water treatment, produced water treatment (from oil & gas drilling), automation/process controls, desalination, consulting/engineering services, and irrigation. The total addressed water markets of these 13 subsectors drive our bottom-up $450 billion estimate of the global water market. On our estimates, North America represents about $100 billion of the global market for water equipment and services.

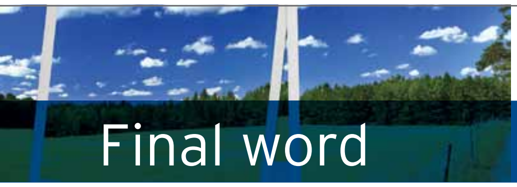
Making the case for 4-6% global water market growth

In deriving our water market growth estimates, we consider separately the dynamics of developed and developing markets. Combined, we see these markets offering attractive and mostly defensive 4-6% growth.

- Developed markets. The water/wastewater sector in developed markets, such as the US, faces an ongoing struggle to maintain its aging water infrastructure. Absent big Federal stimulus packages, we expect much of the sector to remain relegated to the 'break and fix' cycle of spending. We expect the water/wastewater sector, coupled with all the other water subsectors in the developed markets (such as power gen, food & beverage, industrial water, etc), to exhibit growth trends in the mostly steady 1x-2x GDP annual range.
- Developing markets. Developing markets are still building out their basic water treatment systems. China, for example, was treating only 52% of its wastewater as recently as 2006. We see this effort to build out basic water and wastewater infrastructure driving 8-10% underlying annual growth for at least the next five-plus years.

Investors should focus on the higher end of the water value chain

Among the water truisms investors need to understand is that not all water businesses have equal intrinsic value. The water sector has a discernable value chain, with commodity products (including basic pipes, pumps and valves) at the low end. This water sector infrastructure 'plumbing' has multiple suppliers, intense competition and little product differentiation. At the higher end of the water technology spectrum are the systems associated with water test, treatment, filtration and, importantly, desalination and reuse. These systems typically benefit from the highest growth, stronger pricing and the highest barriers to entry. It is at this high end where product and service differentiation and technological know-how matters. And this is where some of the best water sector investment opportunities lie, in our view.



Final word

Asset allocations

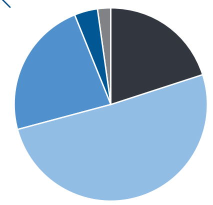
The suggested allocations are intended to be general in nature and are not to be construed as specific investment advice. Investors are encouraged to consult with their Financial Professional to determine their allocation needs based on their risk tolerance, suitability and goals.

Data Source: Citibank NA as of March 2011.

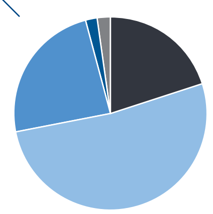
Euro tilted model portfolios | USD tilted model portfolios

Defensive

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



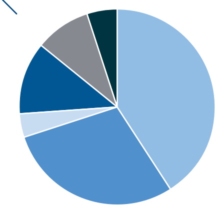
- EUR Cash **20%**
- EUR Government Bonds **51%**
- EUR Corporate Bonds **23%**
- European Equities **4%**
- Global Equities **2%**



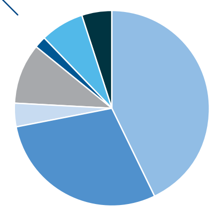
- USD Cash **20%**
- US Government Bonds **52%**
- US Corporate Bonds **23%**
- US Equities **2%**
- Global Equities **3%**

Income Oriented

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



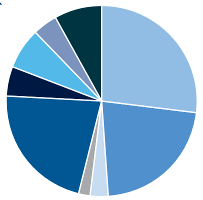
- EUR Government Bonds **41%**
- EUR Corporate Bonds **29%**
- EUR High Yield Bonds **4%**
- European Equities **12%**
- Global Equities **9%**
- Global REITs **5%**



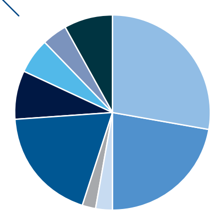
- USD Government Bonds **43%**
- US Corporate Bonds **29%**
- US High Yield Bonds **6%**
- US Equities **10%**
- Pacific Equities **2%**
- Global Equities **7%**
- Global REITs **5%**

Growth and Income

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



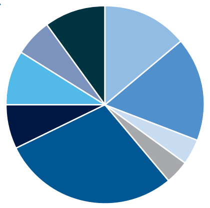
- EUR Government Bonds **27%**
- EUR Corporate Bonds **22%**
- EUR High Yield Bonds **3%**
- Emerging Market Debt **2%**
- European Equities **22%**
- US Equities **5%**
- Pacific Equities **7%**
- Emerging Markets Equities **4%**
- Global REITs **8%**



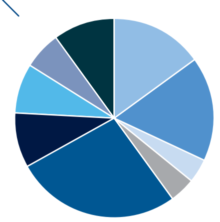
- US Government Bonds **27%**
- US Corporate Bonds **22%**
- US High Yield Bonds **5%**
- Emerging Market Debt **2%**
- European Equities **8%**
- US Equities **19%**
- Pacific Equities **5%**
- Emerging Markets Equities **4%**
- Global REITs **8%**

Growth Oriented

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



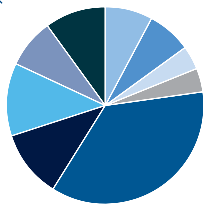
- EUR Government Bonds **14%**
- EUR Corporate Bonds **17%**
- EUR High Yield Bonds **4%**
- Emerging Market Debt **4%**
- European Equities **29%**
- US Equities **7%**
- Pacific Equities **9%**
- Emerging Markets Equities **6%**
- Global REITs **10%**



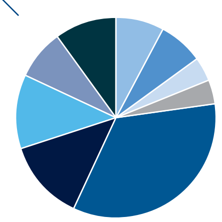
- US Government Bonds **14%**
- US Corporate Bonds **17%**
- US High Yield Bonds **6%**
- Emerging Market Debt **4%**
- European Equities **9%**
- US Equities **27%**
- Pacific Equities **7%**
- Emerging Markets Equities **6%**
- Global REITs **10%**

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 Government Bonds **8%**
- EUR Corporate Bonds **7%**
- EUR High Yield Bonds **4%**
- Emerging Market Debt **4%**
- European Equities **36%**
- US Equities **11%**
- Pacific Equities **12%**
- Emerging Markets Equities **8%**
- Global REITs **10%**



- US Government Bonds **8%**
- US Corporate Bonds **7%**
- US High Yield Bonds **6%**
- Emerging Market Debt **4%**
- European Equities **13%**
- US Equities **34%**
- Pacific Equities **10%**
- Emerging Markets Equities **8%**
- Global REITs **10%**

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

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There are additional risks associated with foreign investments.

Spotlight on allocations

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 & equity markets

- We have maintained our allocation to global equities at underweight and our allocation to global bonds at overweight.

Citi analysts believe that corporate earnings growth is likely to slow while risks have multiplied. As such, they believe that the market's assumptions for economic growth may be disappointed. The rally in US long-term government bonds looks to be moderately overdone, providing some prospects for appreciation there and support for bond portfolios generally. Citi analysts consequently foresee better risk-adjusted return prospects for global bonds than global equities.

Allocation to regional equity markets

- We have increased our allocation to Emerging Markets equities to overweight, maintained our overweight allocation to Japanese equities and our underweight allocation to US and European equities.

Citi analysts believe that the valuations for European stocks are no longer as cheap and the risks to the downside remain, or in the case of financials have gotten worse. Citi analysts are avoiding US financials as well and see potential for margin pressures to hurt stocks there. Japan is a special case, as the earthquake has made very low valuations even more attractive. The emerging markets could profit of a bounce in risk appetite if the Greek crisis eases.

Allocation to government and credit markets

- We have maintained our allocations to government bonds, investment-grade corporate bonds at overweight but reduced high-yield bonds to underweight. We have also maintained an underweight position in emerging market debt.

Corporate earnings and balance sheets are strong around the globe and Citi analysts forecast that default rates on corporate bonds may continue to remain at historically low levels. But the fundamental outlook for this asset class has become somewhat less compelling due to tight spreads and a softening global economy. Citi analysts are mildly overweight developed market (US and Europe, but underweight Japan) sovereign bonds and continue to disfavour emerging market bonds as valuations appear too rich.

Important Disclosure

"Citi analysts" refers to investment professionals within Citi Investment Research and Analysis, Citigroup Global Markets and voting members of the Global Investment Committee and Global Portfolio Committee of Citi Private Bank.

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