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

Standpoint

Global Market Analysis From Regional Consumer Bank

Back to Normal?

Oddity of the calendar and the market cycle, back in December as risk aversion was reaching record levels, the main theme of our editorial focused on the Fear Factor and the importance of differentiating the correct assessment of risks from pure fear. What a relief to see 3 months later, at the time of writing the following Standpoint, that the world is still holding on! Even better, headlines tell us that Greece is saved, Europe deficits will improve, inflation is decreasing in Emerging Markets and last but not least, US GDP has grown faster than expected. This relief is also visible on the markets. More significant than the equity rally, volatility (represented by the VIX index) has reached in March its lowest level since 2007. Similarly, when we look at the daily movements of the Eurostoxx600, absolute daily changes of more than 2% have occurred only 2 times during the first quarter of the year, while during the last 4 months of 2011, such extreme daily movements occurred almost every 3 days on average. So, are we finally back to normal?

"Longer-dated bonds have been very much the canary in the coalmine these past few years, moving before equity markets did. But bond yields that don't move at all are an altogether more disturbing phenomenon"

Richard Cookson, CIO Citi Private Bank

The starting point of the broad market rally has been the decision of the European Central Bank (ECB) to launch its 3-year Long Term Refinancing Operation (LTRO) for

GCG outlook

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

Our Market Outlook reflects our assessment of each asset class independently of other asset classes. The Global Investment Committee (GIC) has reduced their underweight position in global equities. They removed their underweight to continental European equity markets (now neutral) and established an overweight position to the UK market. These positions were funded by a reduction in US Treasuries and UK gilts, where yields are low. While the crisis in the Eurozone has yet to be resolved, recent actions by the European Central Bank has stabilised the situation. With low valuations throughout Europe, investors are at least paid to take the risk in these equity markets. Overall, they remain cautious about equities as growth and corporate profits are falling. In view of the still uncertain macro environment, the GIC believes that investors are likely to continue favouring less volatile assets.

Global equities

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

Global fixed income

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

Data Source: Citigroup Global Markets Inc. Weighting provided by Citi EMEA Consumer Bank as of April 2012.

a total of 1 Trillion Euros in a context of better-than-expected economic activity in the US and government/private sector agreement on a Greek debt haircut. The sharp decreases in Euro Periphery (ex-Greece) government yields and among European Financials credit spreads suffice to demonstrate that investors and banks in particular have well received the message of contagion prevention conveyed by the massive monetary intervention of the ECB. However, our analysts see the indifference in the triple-A European bond market (notably in German Bunds) as a major anomaly. Equity prices and bond yields tend to move together as higher yields and prices signal anticipations of higher rates, inflation and economic growth in the future. During the 2 periods of Quantitative Easing initiated by the US Fed over the last 4 years, both equity prices and US treasury yields had increased, illustrating investor's expectations of economic activity revival. What government bonds markets are telling us today is that the Euro Area's potential economic growth rate has fallen. In this respect, what we see today is quite similar to the type of yields/equity prices decorrelation periods that Japan experienced over the last 20 years.

"More than half of fiscal tightening in the Euro Area remains to be done in 2012 and 2013. In Italy, tightening has barely started"

Willem Buiter, Chief Economist Citi

What it would take to see bond yields increase and recorrelate with equity prices is pretty simple: GDP growth expectations should improve. The opinion of our economists is pretty clear; the Euro Area has entered into a deep recession which will last for an extended period of time. Austerity programs across the region already weight heavily on the domestic economic activity whilst our analysts estimate that the largest chunk of these programs still needs to be implemented. In the same time the absence of credit demand in the private sector combined with financial repression on the supply side doesn't leave side much room for alternative growth engine alternative for the region.

"Housing starts have leapt ahead of building permits during the winter, suggesting payback as groundbreaking only takes place once"

Steven Wieting, US Economist Citi

Back in 2009, Europe had largely beneficiated of the global economic rebound; can this be the case again? Notwithstanding the Chinese slowdown, the US economy has shown signs of surprising strength over the last 2 quarters. Although our analysts anticipate positive GDP growth in the US this year, they don't think that the recent pace of growth is sustainable. They think that a large part of the positive surprises came from one-off effects such as inventory growth and, more importantly, unusually good weather conditions during the winter. For example, they estimate that weather-sensitive employment has been a cumulative 98,000 above trend from December to February. They believe that this is the kind of particular condition that typically tends to disappear after a while.

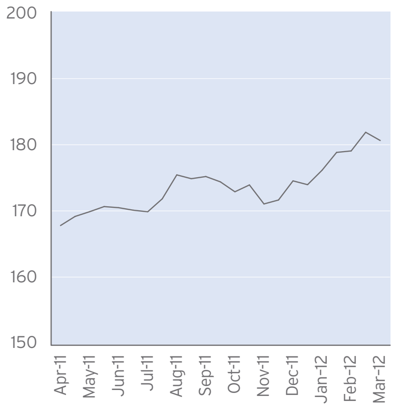
Sluggish growth, low yields, ultra loose monetary policy, Quantitative Easing, financial repression, fiscal austerity, record unemployment, default developed sovereign are still some of the features that define the global economic context. Important steps have been made on the monetary side, but they will require proper response on the fiscal side to remain on the path towards normality. For investors, this will mean cautiousness, patience and judicious diversification.

Europe

Fixed income

Periphery still in need for more financial support

Citi analysts have revised their GDP growth expectations for the Euro Area to the upside to -1.2% for 2012, mainly caused by an increase of their forecast for Germany where indicators have come out stronger than expected during the first quarter. On the other hand, Citi analysts continue to think that Periphery countries will endure deeper recessions than what the respective governments are anticipating, which will lead these countries to miss their deficit and debt reductions targets. Citi analysts think that even after the recent debt restructuring, Greece's fiscal position remains unsustainable and further restructuring is likely. Portugal and Ireland will probably need a second bailout, including a haircut for Portugal. Citi analysts are also anticipating further deterioration in Spain where declines in houses prices will probably add to weakness in the balance sheets of banks and households while unemployment is likely to overshoot 25% over the next 12 months. In such a context, they think the Spanish deficit will exceed 6% of the GDP this year, largely above the government's target. On a positive note, Citi analysts observe that the larger 3-year LTRO program of the ECB has proven rather efficient in its target to bring government yields lower. Net purchases of EMU government bonds by Spanish and Italian banks exceeded Ð60bn in December and January. Going forward, they expect the ECB will cut rates below 1% in Q3 while one or more extra ultra-long LTRO could be implemented if EMU strains increase. Citi analysts underweigh Government bonds as strains remain in the periphery while ESM expansion could drive Bunds to the upside. On the other hand, ample ECB liquidity is favorable to corporate bonds as spreads still have much room for further narrowing on balance sheet improvements.



Citi Euro BIG (EUR)

Data source: Bloomberg as of 31 December 2011.

Equities

Going North and Dividend

In general, Citi analysts think that European equities offer an interesting exposure to some of their favorite equity themes such as dividend growth and strong balance sheet quality. Not only Europe dividend yields are currently 3.6%, which is 15% above the long run average, but also strong free cash flows and record low debt/earnings ratios suggest that European companies have wide room for further dividend growth and other shareholders-friendly policies.

More specifically, Citi analysts observe that if the theme of the European Convergence that prevailed during the last decade led Southern equity markets to outperform Northern markets of the so-called "Old Europe", it appears that the new prevailing theme of European Divergence has driven northern markets to outperform southern for the last 3 years. Citi analysts believe that this trend is likely to continue. Over the last 3 years, the increasing economic divergences between Northern and Southern Europe have driven earnings of Northern companies to outperform Southern earnings by more than 40%. Given that Citi analysts expect a deep recession in many Southern European countries going forward, this will mean continued weaker earnings trends for the "South" relative to the "North" of Europe which in the end is likely to generate equity underperformance too. Citi analysts observe that synchronized global liquidity and troughing economic expectations have driven European equities to rally hard from their 2011 lows. However, interestingly the rally has not simply been driven by a reversal of risk appetite which would have seen the most risky themes such as Greek or Spanish equities outperform. Instead, they see that the rally has been mostly beneficiary to high quality stocks and markets such as German equities.

DJ Stoxx 600

Data source: Bloomberg as of 31 December 2011.

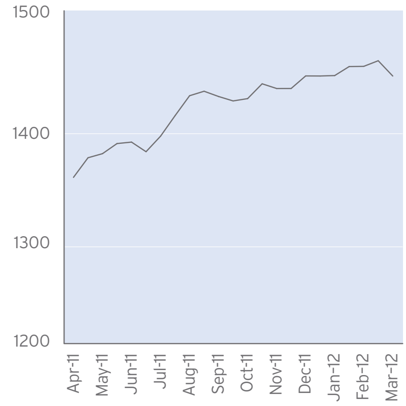
North America

Fixed income

Anticipating modestly higher rates

Economic growth is continuing at a modest pace, sustained by increasing employment, supportive policies and a mild winter. Citi analysts forecast GDP growth of 2.1% for 2012. The Federal Reserve's (Fed's) new communications strategy has been a notable success in anchoring rates through a period of rising investor confidence and better economic news. Although policymakers do no appear predisposed to additional quantitative easing (QE), the chance that growth could disappoint official projections this year has kept alive the option for reserve-neutral mortgage backed securities (MBS) purchases. Competitive pressures and economic slack have checked underlying inflation but rising oil and gasoline prices are pushing up the headline measures. Fed officials however view this as a greater threat to growth than inflation, as long as inflation expectations are checked.

Citi analysts believe the move higher in rates is likely to continue but expect them to come about only slowly. While they see fair value for 10-Year Treasuries closer to 3%, their target is for 10-Year Treasury yields to reach is 2.50%. With interest rates starting to move sooner rather than later, Citi analysts believe high-grade corporate bond spreads could hit 160 bps and perhaps move a bit tighter into the 150s – although they note that there are plenty of risks in the second half of the year that could reverse any gains yet to come. For now they are sticking with their 160 bps target, but continue to watch the rates market for an indication of greater upside in the near term.



Citi US BIG

Data source: Bloomberg as of 31 December 2011.

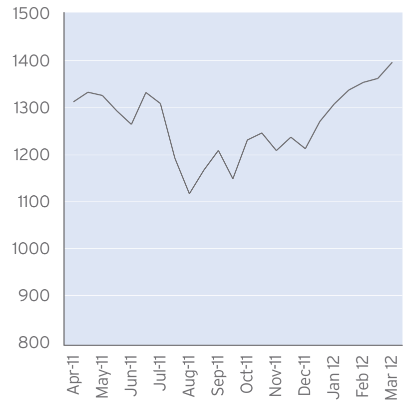
Equities

Remaining constructive for the full-year

The strong run up in the US equity market this year call for a degree of caution in the near term. Citi analysts note that the Citi Economic Surprise Index (CESI) has begun to slide, and historically, a rolling over of the CESI typically mean both a slippage in equity prices and a meaningful pickup in bond yields. However, Treasury yields have been relatively benign as Federal Reserve (Fed) policy and continued money flows into bond funds have kept rates low, and thus things have been far from normal. Investors have also yet to witness any clear negative numbers to generate new growth concerns as mild weather has allowed some growth to be pulled forward from spring. This suggests that some payback is likely further out.

Nonetheless, Citi analysts continue to hold a constructive view on the equity market for the full year, given attractive valuations and depressed corporate earnings expectations, and have retained their end-2012 targets of 1,425 for the S&P 500 index and 13,550 for the Dow Jones Industrial Average. Some margin pressures a re expected as employment growth and commodity price weakness are likely to impact corporate margins negatively. Election outcome uncertainty may also hamper stock price trends.

In terms of sectors, Citi favours Food & Staples Retailing, Food Beverage & Tobacco, Diversified Financials, Insurance, Semiconductors & Semi Equipment, Technology Hardware & Equipment, Telecoms and Utilities, and is neutral on Consumer Services, Media, Household & Personal Products, Energy, Regional Banks, Real Estate, Healthcare Equipment & Services, Commercial Services & Supplies and Transportation.



S&P 500 Index

Data source: Bloomberg as of 31 December 2011.

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

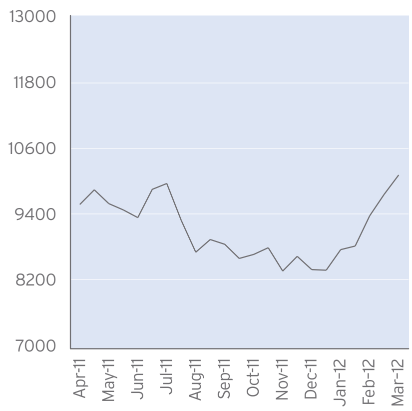
Japan equities

Raising forecasts.

Citi analysts are again revising up their 2012 growth forecast, and now expect 1.5% growth, versus 1.2% in the February forecast and 1.0% in the January forecast. This latest revision reflects the upward revision to Q4 GDP, the further yen depreciation and tentative signs of a pickup in manufacturing activity. They also revise up inflation forecasts (CPI) from -0.3% to 0.0% for 2012 on the back of higher energy prices and the yen depreciation. Moving forward, Citi analysts expect Japanese exports to return to a growth trajectory as the global economy recovers, but note that given the deterioration in price competitiveness there is a risk that the pace of growth will be slower than previously anticipated.

The rapidly weakening of the yen against the dollar led Citi analysts to raise forecast with regards to Japanese equities. Deterioration in Japan's balance of trade has been confirmed and the BoJ has taken additional monetary easing steps, which in our view has intensified weak-yen momentum. Citi analysts revise their forex assumptions in favor of a weaker yen and revise up earnings, TOPIX and Nikkei 225 forecasts.

Citi analysts continue to think that the market is likely to maintain an uptrend through to the end of Q2 at the earliest, as 1) foreigners are likely to continue to invest in Japanese equities, 2) we are heading toward spring, when Japanese equities tend to perform best, and 3) leading indicators continue to improve.



NIKKEI 225 Index

Data source: Bloomberg as of 31 December 2011.

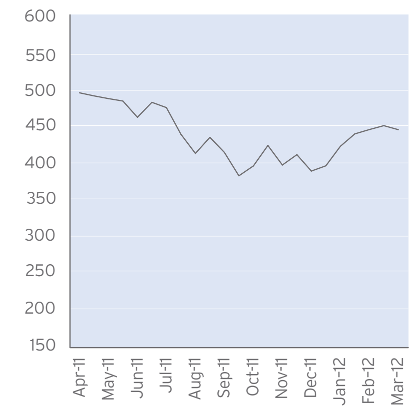
Asia-Pacific equities

Potential for markets to head higher by year-end

The 4Q11 corporate earnings results season saw more misses than surprises and only 36% of companies came in as expected. It is however very different if we look at sales/top lines, where more companies beat and 62% came in as expected. Citi analysts are not saying that earnings do not matter, rather, they are only part of the equation and a more important element, in their view, is asset turn. Over the last decade, companies with the best stock returns have tended to be those with the lowest margins but highest asset turns. Asset turn improved again in 2011 – assets grew by 10%, sales by 19%.

Asia ex Japan markets have also tended not to reward earnings growth but revisions. After 26 months of downgrades, revisions have begun to turn upwards. What could help in the future is that Asian export prices, which had been falling by 2.4% p.a. since 1993, have been rising by an annualized rate of 3.3% since 2009. The market has also not been paying up for earnings. The MSCI Asia ex Japan index (MXASJ) was trading at 12.7x price-to-earnings as of March 19, 2012, versus the average of 15.5x it has historically traded at in year 3 of the market cycle. Earnings are 19% above their prior peak, but the market is 22% below. If the market had followed earnings higher, MXASJ would be above the prior peak.

Citi analysts forecast the MXASJ at 575 by end-2012. In terms of markets, they prefer North Asia – Hong Kong, Korea and Taiwan. Sectorwise, they prefer Banks, Energy, Industrials, IT and Real Estate.



MSCI Asia Pacific Ex-Japan

Data source: Bloomberg as of 31 December 2011.

CEEMEA and Latin America

CEEMEA equities

Poor Earnings Growth Outlook

Citi analysts consider that despite renewed overall optimism due to the progresses achieved since the beginning of the year in the Euro Area sovereign crisis and the positive economic surprises in the US during the first quarter, growth perspectives in CEEMEA remain relatively sluggish as GDP growth in countries like Hungary and Czech Republic are expected to hover around recession levels while Turkey is likely to experience a sharp slowdown (from 8.5% GDP growth in 2011 against 2.5% expected in 2012). Citi analysts think that the generally low domestic consumption growth observed across the region is likely to be increasingly constrained by higher fiscal pressure in some countries while exports should continue to weaken as a result of by the lingering recession in the Euro Area and the risks of hard landing of the Chinese economy. Citi analysts also observe that inflation has surprised to the upside recently mostly in consequence of higher oil prices, improved economic data and higher yields in the US, and exchange rates depreciation policies (Turkey). Citi analysts expect inflation expectations to drive Treasury yields higher in the region while they expect most of Central Banks to keep rates on hold in the near term.

CEEMEA equities have largely participated to the broad risk rally during the first quarter of the year as improvements achieved with regards to the Greek sovereign default and the intervention of the European Central Bank removed some of the contagion fears that had been prices in equity markets. Although default contagion scenarios are being priced out, Citi analyst think that the poor prospects of earnings per share growth (-1.7% for 2012) limit the scope for further outperformance of CEEMEA equities, leading Citi analysts to underweight the regions' equities.

MSCI EM EMEA

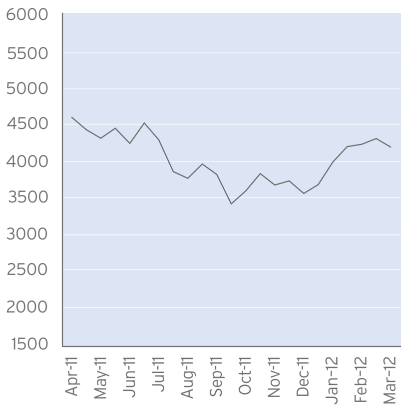
Data source: Bloomberg as of 31 December 2011.

Latin America equities

High sensitivity to global factors

With the notable exception of Brazil, most of the Latin America economies have surprised to the upside over the last few months. Citi analysts indeed observe that recent data turned out more positive in Chile, Peru, Mexico and Columbia. Citi analysts also observe that inflation expectations have risen in most countries under the influence of rising fuel prices, higher food prices and delayed impact of weaker currencies in the last quarter of 2011. Citi analysts think that these factors and, more recently, the rise in yields that has been consecutive to the rise in US yields are likely to maintain pressure on many rates markets in Latin America given the high sensitivity of Monetary Policy to global factors among Latin America economies. Citi analysts think the Central Bank in Brazil will stay on the path on monetary loosening, but rather through currency depreciation than interest rates cuts (Selic to target 9%). They expect GDP growth to accelerate steadily, reflecting the increasing impacts of monetary, credit, and fiscal stimuli already applied to the economy.

The absence of meaningful risk shocks, still sluggish growth in the G8 and rising commodity prices imply further strengthening of exchange rates in real effective terms across the region. Finally, Citi analysts expect continued growth in credit, albeit more slowly than in 2011. In this context, they think equity prices are likely to continue to rise in USD terms (reflecting additional appreciation of Latin currencies) and CDS spreads should tighten further. Citi analysts have a preference for Brazilian equities because of loosen monetary policy, high sensitivity to global markets, attractive valuations and high dividend yields relative to Latam average.



MSCI EM Latin America

Data source: Bloomberg as of 31 December 2011.

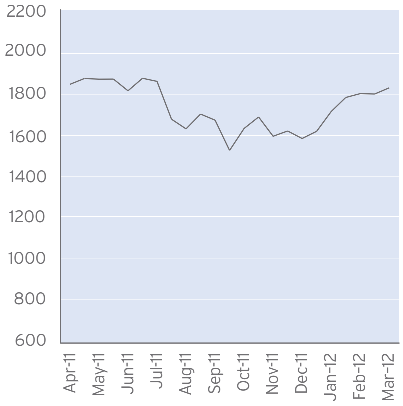
Global REITs and commodities

Real Estate Investment Trusts (REITs)

Seeking earnings and NAV growth in a slower growth environment

Citi analysts believe the US REIT sector may be positioned to continue to benefit from a number of key tailwinds in 2012, albeit not as strong as they were in 2011. These include: 1) Reasonable and growing dividends – Dividends remain reasonable (approximately 4%) and are backed by the lowest payout ratios on record. With cash flow growth likely to remain positive, dividends look positioned to continue to grow; 2) Better balance sheets and cost of capital advantage – US REITs have strong access to attractively priced debt and equity capital especially relative to when we headed into the 2008 recession, limiting dilutive equity raises. Low interest rates also act as a strong support for US REITs and direct property pricing which should keep cap rates flat to down and also makes dividend yields and implied cap rate more attractive; 3) Solid earnings drivers – The sector's cash flow growth is expected to remain positive (+10% in 2012) with positive re-financings, continued internal growth and increased external growth activities; and 4) Limited new supply – New construction levels, while off the lows, remain depressed.

Conversely, the sector would undoubtedly be negatively impacted by a market sell-off, retrenching funds flow and widening credit and capital costs which have all raised the sector's downside risks. Given the upside and downside risks, Citi analysts hold a more subdued flat to +10% total return outlook for 2012, translating to MSCI US REIT index levels of 740-820 versus +5-15% for 2011. In terms of investment strategy, they are focused on companies that can increase earnings and net asset value (NAV) even in a slow growth environment. They also favour mid- to larger-cap companies that can benefit from having better access to capital, high quality portfolios, stable fundamentals and growth opportunities. Within the sector, they prefer Multifamily, Malls and Lodging and disfavour Office, Shopping Centres and Healthcare.



EPRA/NAREIT Global Index

Data source: Bloomberg as of 31 December 2011.

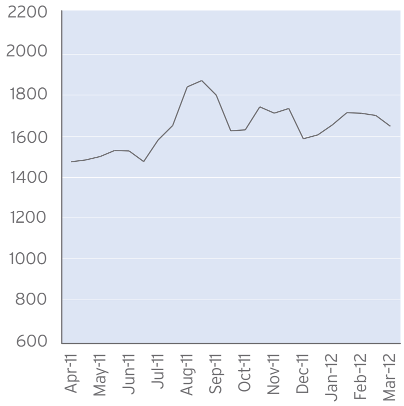
Commodities

Oil price forecasts raised on supply risks

Citi analysts expect the impact of production outages and supply risks to continue lifting commodity prices in the energy and key grains sectors, and believe the spectre of further policy rate cuts, liquidity programs and monetary easing in China, Europe and possibly the US, could potentially buoy precious and industrial metals markets in 2H12. Improving macroeconomic conditions have also provided a tailwind for asset markets and may induce further price appreciation on upside surprises.

Oil price shocks resulting from the Iranian oil embargo and related risk premia remain a significant concern. All eyes are now on Saudi Arabia's ability to perform its historical swing supplier role. Saudi Arabia recently escalated its rhetoric, but even taking its capacity figures of 11.8-m b/d at face value, its current production of nearly 10-m b/d leaves little manoeuvring room when facing even a temporary disruption of the 17-18-m b/d of oil that transits through the Straits of Hormuz. Citi analysts have raised their oil price forecasts and now expect WTI prices to average US$106/bbl in 2012 (previously US$100/bbl) and Brent prices to average US$124/bbl in 2012 (previously US$110/bbl).

Citi analysts believe the macro-financial conditions that have driven gold's outperformance as a financial safe haven since 2009 may shift to supporting a more moderate rally in 2012. Lower inflation expectations and a stronger USD exert bearish pressure on nominal gold prices, while some positive economic news and other initiatives may cause world central banks to delay more quantitative easing (QE) efforts despite historically low real interest rates. Additionally, still unresolved debt issues in the Eurozone could prompt investors to sell their gold holdings for liquidity purposes. In an environment of negative real interest rates, Citi analysts expect gold's 'store-of-value' characteristic to keep it supported at US$1,650-1,850/oz during 2012, with prices averaging US$1,710/oz for the year.



Golds US$/troy oz.

Data source: Bloomberg as of 31 December 2011.

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Currencies

Euro

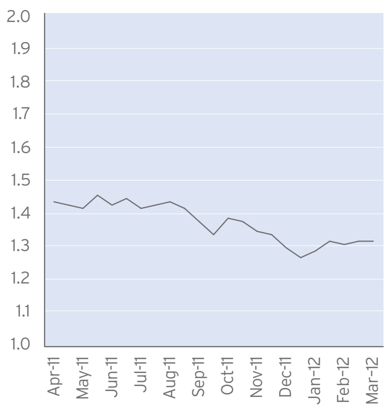
With the latest Greece rescue in the rear-view mirror and the LTRO feeding the convergence trade in European fixed income, the Euro might seem prime to rally. However, Citi analysts observe that it hasn't yet as markets have turned to focus on rate differentials, which have hurt Euro against the US Dollar. Citi analysts think that the recent shift in the Fed funds curve illustrates that money markets have now mostly priced out the possibility of a third round of Quantitative Easing in the US. According to them, this is likely to provide some backing to the USD, at least in the short term, while in the same time, further disappointment in the in industrial readings in Europe could quickly refocus investors' attention to the lack of European growth and the potential for further accommodation from the ECB. In consequence, Citi analysts forecasts EUR/USD at 1.25$ in the 6-12 months.

Yen

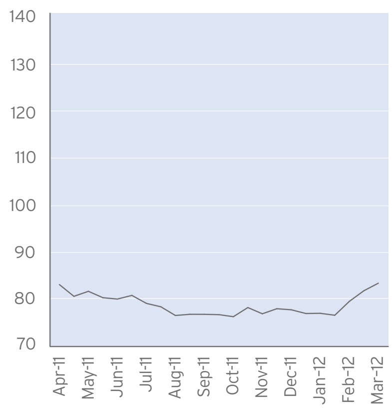
After a sharp fall in February and early March, JPY has shown signs of stabilizing in the last days of March. Citi analysts observe that the fundamental driver continues to be US interest rates direction. According to them, a further increase of the 2-year Treasury yield to the level of 45bps would be likely to trigger a new acceleration of the USD/JPY to 85. The rise in USD/JPY over the past two months has generated fears to see Japanese long-term investors, such as life insurers, starting to remove their FX hedges of US Treasuries in particular. While Citi analysts don't rule out the possibility that life insurance companies buy USD/JPY for their 'trading' position, they don't think they would make a shift in their core investment policy that would lead to an aggressive reduction to their FX hedge ratios this year. On the other hand, Citi analysts warn that if US rates were to be reverting, the FX market might get caught very long of USD/JPY right as Japanese investors would come in to hedge or reduce foreign asset positions in the near term. However, under the base case scenario, Citi analysts forecast USD/JPY at 80¥ over a 6-12 months period.

Pound sterling

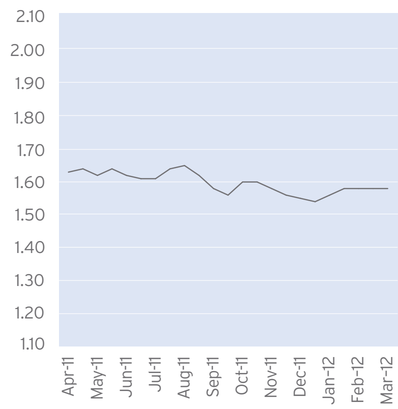
Citi analysts think GBP is an indirect beneficiary of European Central Bank's LTRO because it should help support growth and reduce UK financial system risk. However, with UK rates not showing nearly the same degree of resilience as US rates, Citi analysts think that GBP upside should be limited, particularly against the USD. Indeed, ongoing fears about the weakness of the UK recovery, the need to keep going with a restrictive fiscal policy and the associated need for easy money (Citi analysts still expect a further increase to the UK QE2 program) all act as a drag on the currency, according to Citi analysts. Tight fiscal policy and easy money is normally currency unfriendly and policymakers probably see stable GBP at competitive levels as part of the policy package. Citi analysts think that GBP could continue to follow EUR lower across the board and forecast EUR/GBP at 0.81£ over a 6-12 months period and GBP/USD at 1.53$ over the same period.



Euro-Dollar (USD/EUR)
Data source: Bloomberg as of 31 December 2011.



Dollar-Yen (JPY/USD)
Data source: Bloomberg as of 31 December 2011.



Pound-Dollar (USD/GBP)
Data source: Bloomberg as of 31 December 2011.

ENERGY 2020: North America, the New Middle East?

By Edward L Morse, Managing Director and the Head of Global Commodities Research, Citigroup Global Markets

For the first time since 1949, the US has become a net petroleum product exporting country and has edged out Russia as the world's largest refined petroleum exporter. A simple explanation would point to lower demand and a struggling economy which requires less imported energy. But, that would only get you half the answer. US demand has fallen by some 2 million barrels per day (m b/d) since its peak in 2005 in part due to the recession but also due to a structural change due to demographic changes, policies on fuel efficiencies and the mass-commercialization of technologies. The more exciting part of the answer is on the supply side as the US has become the fastest growing oil and natural gas producing area of the world and is now the most important marginal source for oil and gas globally. Add to this steadily growing Canadian production and a comeback in Mexican production and you get to a higher growth rate than all of the Organization of the Petroleum Exporting Countries (OPEC) can sustain.

Five incremental sources of liquids growth could make North America the largest source of new supply in the next decade: oil sands production in Canada, deepwater in the US and Mexico, oil from shale and tight sands, natural gas liquids (NGLs) associated with the production of natural gas, and biofuels. Putting these together, North America as a whole could add over 11-m b/d of liquids from over 15-m b/d in 2010 to almost 27-m b/d by 2020-22.

The shale gas production boom that propelled the fundamental change in the natural gas markets in the US could begin to transform other sectors including power generation and transportation. Other incremental gains could come from LNG exports with North America acting as the swing supplier for the world. But the most momentous change looks likely to be in the re-industrialization of America based on dramatically lower cost feedstock than is available anywhere in the world, with the possible exception of Qatar.

The economic consequences from this supply and demand revolution are potentially extraordinary. We estimate that the cumulative impact of new production, reduced consumption and associated activity may increase real GDP by 2.0 to 3.3%, or US$370-US$624 billion (in 2005 $) respectively. US$274 billion of this comes directly from the output of new hydrocarbon production alone, while the rest is generated by multiplier effects as the surge in economic activity drives higher wealth, spending, consumption and investment effects that ripple through the economy. This potential re-industrialization of the US economy is both profound and timely, occurring as the US struggles to shake off the lingering effects of the 2008 financial crisis.

The reduced vulnerability of North America – and the world market – to oil price spikes also has deep consequences geopolitically, including the reduced strategic importance to the US of changes in oil- and natural gas-producing countries worldwide. Pressures towards isolationism in the US will likely grow, with consequences for global stability that can only just begin to become understood.

It is unclear what the political consequences of this might be in terms of American attitudes to continuing to play the various roles adopted since World War II – guarantor of supply lanes globally, protector of main producer countries in the Middle East and elsewhere. A US economy that is less vulnerable to oil disruptions, less dependent on oil imports and supportive of a stronger currency will inevitably play a central role globally. But with such a turnaround in its energy dependence, it is questionable how arduously the US government might want to play those traditional roles.

Whether the increase in production results in the US reducing its imports or whether net exports grow doesn't matter much to world balances. Either way, North America is becoming the new Middle East. The only thing that can stop this is politics – environmentalists getting the upper hand over supply in the US, for instance; or First Nations impeding pipeline expansion in Canada; or Mexican production continuing to trip over the Mexican Constitution, impeding foreign investment or technology transfers – in North America itself.

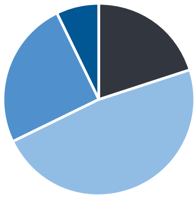
Final word

Asset allocations

Euro-tilted model portfolios

Defensive

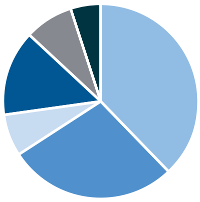
Seeking primarily capital preservation over time and only willing to accept very minor portfolio value fluctuations from month to month.



- EUR Cash **20%**
- EUR Government Bonds **48%**
- EUR Corporate Bonds **25%**
- European Equities **7%**

Income-oriented

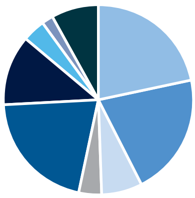
Seeking growth of wealth over time but unwilling to accept significant fluctuations in the value of portfolio from month to month.



- EUR Government Bonds **38%**
- EUR Corporate Bonds **28%**
- EUR High Yield Bonds **7%**
- European Equities **16%**
- Global Equities **6%**
- Global REITs **5%**

Growth and income

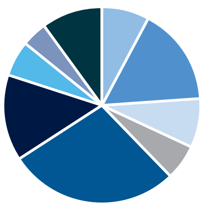
Seeking long-term capital growth foremost but unwilling to accept significant losses on value of portfolio over the medium term.



- EUR Government Bonds **22%**
- EUR Corporate Bonds **21%**
- EUR High Yield Bonds **7%**
- Emerging Market Debt **4%**
- European Equities **25%**
- US Equities **7%**
- Pacific Equities **4%**
- Emerging Markets Equities **2%**
- Global REITs **8%**

Growth oriented

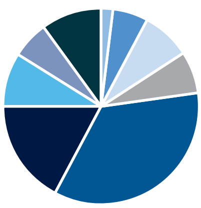
Seeking long-term capital appreciation and willing to tolerate measured medium-term volatility in order to enhance longer-term performance.



- EUR Government Bonds **8%**
- EUR Corporate Bonds **16%**
- EUR High Yield Bonds **8%**
- Emerging Market Debt **6%**
- European Equities **32%**
- US Equities **10%**
- Pacific Equities **6%**
- 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 Government Bonds **2%**
- EUR Corporate Bonds **6%**
- EUR High Yield Bonds **8%**
- Emerging Market Debt **7%**
- European Equities **39%**
- US Equities **13%**
- Pacific Equities **9%**
- Emerging Markets Equities **6%**
- Global REITs **10%**

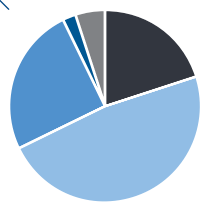
Forecasts may not be attained. **Past performance is no guarantee of future results.**
There are additional risks associated with foreign investments.

Spotlight on allocations

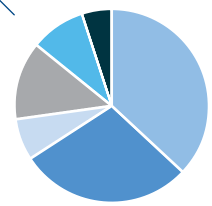
The suggested allocations are intended to be general in nature and are not to be construed as specific investment advice. Investors are encouraged to consult with their Financial Professional to determine their allocation needs based on their risk tolerance, suitability and goals.

Data Source: Citibank NA as of April 2012.

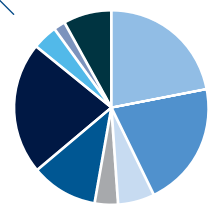
USD-tilted model portfolios



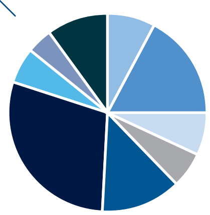
- USD Cash **20%**
- US Government Bonds **48%**
- US Corporate Bonds **25%**
- US Equities **2%**
- Global Equities **5%**



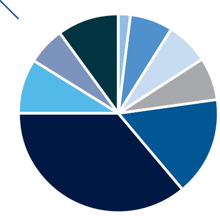
- USD Government Bonds **37%**
- US Corporate Bonds **29%**
- US High Yield Bonds **7%**
- US Equities **13%**
- Global Equities **9%**
- Global REITs **5%**



- US Government Bonds **22%**
- US Corporate Bonds **21%**
- US High Yield Bonds **6%**
- Emerging Market Debt **4%**
- European Equities **10%**
- US Equities **23%**
- Pacific Equities **4%**
- Emerging Markets Equities **2%**
- Global REITs **8%**



- US Government Bonds **8%**
- US Corporate Bonds **17%**
- US High Yield Bonds **7%**
- Emerging Market Debt **6%**
- European Equities **15%**
- US Equities **37%**
- Pacific Equities **6%**
- Emerging Markets Equities **4%**
- Global REITs **10%**



- US Government Bonds **2%**
- US Corporate Bonds **7%**
- US High Yield Bonds **7%**
- Emerging Market Debt **7%**
- European Equities **16%**
- US Equities **36%**
- Pacific Equities **9%**
- Emerging Markets Equities **6%**
- 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

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

Global growth is slowing and so are corporate profits. The European Central Bank's huge liquidity splurge has stabilised the Eurozone for now but it has not solved the underlying problems. Austerity is likely to cause a nasty recession in Europe and this is likely to lead to a miasma of political problems. Not the least of these is that Greece is more likely than not to leave the euro and default. An emerging global risk is the price of oil, as political tension in many oil-producing regions, not least the Middle East, is likely to endure. Persistently higher oil prices will eventually have a negative impact on growth..

Allocation to regional equity markets

- We have maintained our overweight allocation to Japanese equities and our underweight allocation to US equities and emerging market equities. We have raised European equities to overweight, within which UK and German equities are now overweight.

With low valuations throughout Europe, the GIC decided to take a neutral position in continental European equities and an overweight position in UK equities. Aside from low valuations, high dividend yields, a proactive central bank, an independent currency and stable sovereign credit rating make the UK a relatively attractive opportunity, in their view. US equities remain underweight. Not only are US equity valuations expensive, the GIC does not believe the US economy is as strong as most seem to think. They note that the loosest monetary and fiscal policy ever has produced the most anaemic recovery since the Second World War. Moreover, continued seasonal adjustment problems have flattered recent data. Meanwhile, China is also slowing. While authorities are likely to loosen policy, the GIC doubt the efficacy of this loosening in what they see as a post-bubble environment. That, they believe, is unlikely to be kind to emerging market assets.

Allocation to government and credit markets

- We have maintained our overweight allocations to investment-grade corporate bonds, high-yield corporate bonds and emerging market debt, and our underweight allocations to government bonds.

The GIC funded their European equity position by reducing their positions in US Treasuries and UK gilts, where yields are low. Overall, they believe bonds remain attractive compared to the expensive valuations of equities, especially in the US. Moreover, considering the still uncertain macroeconomic environment, they think investors are likely to continue favouring less volatile assets.

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