



Q2 | 13

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

Standpoint

Global Market Analysis by Regional Consumer Banks

GCG Outlook	2
Regional analyses	3
Behold the new form of bail-in	10
Asset allocations	11

The War of Currencies Will Not Take Place

Over the past few months, many observers, analysts and political leaders across the world have voiced their growing concerns with regards to rampant competitive devaluations policies and the toxic consequences they could have on the global economy and on international cooperation.

"A "Currency War" is defined by the use of macro policies that are expected to have a bigger impact on foreign demand than on domestic demand"

Steven Englander, Citi Global Head of G10 FX Strategy

Japan has recently polarised critics over the consequences that its aggressive monetary policy could have on the global economy, but Japan is far from being a loose warrior. Indeed, the way Governments in Developed Countries now discuss the need to get an immediate boost from the export sector is striking. In the UK, BoE's next governor has already

raised the possibility of more easing after the latest 375 billion pounds of government bond purchases comes to an end. Also, the US Fed has tripled the size of its balance sheet since 2007, which brought USDJPY from 110 down to a low of 75; and in the Euro Area, Mario Draghi pledged to do "whatever it takes" to save the Euro. Japan is basically just doing what others have done for years. The statement published by the G7 on exchange rates in February can be seen as a diplomatic exercise aiming on the one hand at reassuring markets about the members' "longstanding commitment to market determined exchange rates" and on the other hand to restate their commitment to their economic activity "... our fiscal and

Opinions, forecasts, and weightings expressed by Citigroup Global Consumer Group Investments may not be attained or suitable for all investors. Past performance is no guarantee of future results. There are additional risks associated with international investments, including foreign, political, currency and economic factors to consider. Please contact your financial professional to determine what is suitable for your individual situation



RCB 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.

At the latest asset allocation meeting, the Global Investment Committee (GIC) has decided to increase to overweight its position in US equities and high-yield bonds.

This has been funded through removing the position in gold and reducing exposure to municipal and investment grade corporate bonds.

The GIC believes that the medium-term outlook for equities is gradually brightening and sees the current weakness as an opportunity to add more risk assets. As the risk of increasing interest rates has become greater, the GIC reduced positions in municipal and investment grade bonds which would be negatively impacted by such a move. The GIC also removed the small position in gold as gold prices are forecast to be on sidelines due to the generalized dollar strength.

The GIC now maintains overweight in equities, with overweights in US, and 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 positions in both high-yield and emerging market debt(both developed and emerging). The GIC has no more exposure to commodities.

Global equities	
Market	Market outlook
	Positive
US	Positive
Europe	Positive
Japan	Positive
Latin America	Neutral
Asia Pacific	Neutral
Eastern Europe	Neutral

Global fixed income	
Market	Market outlook
	Negative
Global Government	Negative
Global Investment Grade	Positive
Developed High Yield	Positive
Emerging Market Debts	Positive

Global currencies	
Currency	Outlook
Euro	Negative
Yen	Negative
British Pound	Negative

Data Source: Citigroup Global Markets Inc. Weighting provided by Citi EMEA Consumer Bank as of January 2013.

monetary policy have been and will remain oriented towards meeting our respective domestic objectives using domestic instruments, and that we will not target exchange rates ". The first interesting feature of this statement is basically that it emanates from the G7 whilst the driver of the international economic cooperation since the global credit crisis downturn back in 2008 has been the G20, a forum that recognizes the key role of Emerging Markets in the global economic recovery. Then, although the focus on "domestic objectives" could be interpreted as a threat to the pillars of international trade by opening the door to protectionist policies, Citi analysts see there an intention to determine the "rules of engagement". In other words, no market manipulation will be performed to openly devalue currencies through outright purchase of foreign-currency denominated assets but aggressive monetary expansion will continue as it aims at boosting domestic economic activity without affecting the rest of the world.

"The fact that the US, the UK and the ECB don't go on the record as seeking to weaken their currencies through expansionary monetary policy does not alter the reality that a weaker currency is a key and inevitable part of the transmission mechanism of more expansionary monetary policy when the exchange rate is market determined."

Willem Buiter, Citi Chief Economist

However, there is no policy that won't affect the rest of the world. Irrespective of the type of monetary instruments implemented, they all drive nominal and real rates lower, which results in a weakening of the currency. So, why does the US for example see itself as innocent while others see it as engaging in currency wars? From a US perspective its policies are intended to stimulate the economy by directly boosting domestic demand, but other countries see the spill over effects as large and negative relative to the impact on US activity. Historically, recoveries in Developed Countries and in the US in particular have not been driven primarily by exports; they have been driven by domestic demand. Based on data of the World Bank, the share of exports in the US GDP increased from 13% in 2008 to 14%

in 2011, while the US Fed balance sheet almost tripled over the period. Similarly, exports currently amount to 15% of Japan's GDP. From a micro perspective, Citi analysts estimate that a 10% devaluation of the local currency would boost earnings by 2% in the US, 3.5% in the Euro Area and 5% in Japan and UK. Competitive devaluation in Developed Countries through monetary expansion would require colossal further easing to generate a visible effect as exports represent a marginal share of the GDP and also because everyone is doing it at the same time. Citi analysts think on the other hand that coordinated massive injections of liquidity can generate significant asset prices inflation that can turn into a positive wealth effect and boost domestic demand across Developed Countries. The logic is that domestic asset price inflation makes households feel wealthier and encourage spending. History indeed shows indeed a much stronger relationship between asset prices and domestic consumption than between weaker currency and exports boost in Developed Countries.

"From the perspective of many EM policymakers, currency wars have yielded loss of monetary independence. As advanced economies' policy loosens further, EM central banks' will see their options even more constrained."

David Lubin, Citi Head of Emerging Markets Economics

Emerging Markets are significantly more sensitive to exchange rates movement than Developed Markets. Large FX movements generated by external factors are seen as undesirable by policymakers since they interfere with the transmission mechanism of monetary policy; they drive up commodity prices; they impact trade; and they have undesirable political economic effects. Commodity and asset inflation sensitiveness are probably the most important weaknesses of Emerging Markets. Indeed, although a 20% rise in home prices would be welcome in the US, it would probably not be the case in China or many other countries where asset prices are already high relative to activity and income. Citi analysts think that chances of FX intervention are more likely in countries running current account deficits, output gaps and where inflation tolerance is higher.

Europe

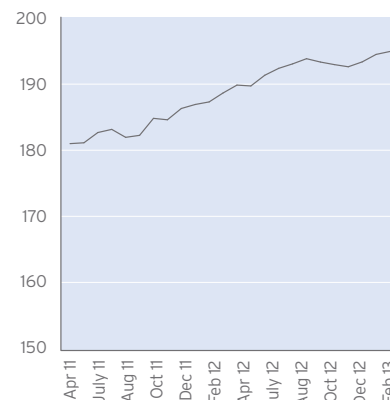
Fixed income

Italy and Cyprus drive spreads higher

Despite a start of the year marked by risk appetite increases, yields declined across the major core sovereign markets in recent weeks, reminding investors that the path to higher rates will not be linear. Citi analysts believe that core rates are likely to be range-bound near term as recession, political instability in Italy and two more ECB rate cuts this year are likely to weigh heavily on Core European yield curves. The outcome of the Italian election may have been pretty much a worst-case scenario from a market perspective, according to Citi analysts. As the Italian parliament convenes, prospects of forming a lasting government with capacity to tackle now more than €2tr in public debt and rekindling growth may seem slim. They continue to expect Italian government bonds underperformance relative to

Spanish over the medium term as they expect risk to be priced differently by investors. Citi analysts view the assistance measures for Cyprus as a localised affair without large capital repercussions at the wider EMU level although they recognize the near term blow brought to investor confidence.

Citi analysts observe that credit market remained rather indifferent to the revival of the Euro Area sovereign crisis. Volumes are perhaps somewhat lacklustre for the time of year, inflows into credit are slowing and the apathy of many market participants is evident. So in the absence of a significant pickup in issuance, the excess volumes of cash still sitting in credit are keeping spreads well supported, according to Citi analysts. They remain underweight peripheral corporates, which are likely to suffer from both idiosyncratic and sovereign-related issues.



Citi Euro BIG (EUR)

Data source: Bloomberg as of 29 March 2013.

Equities

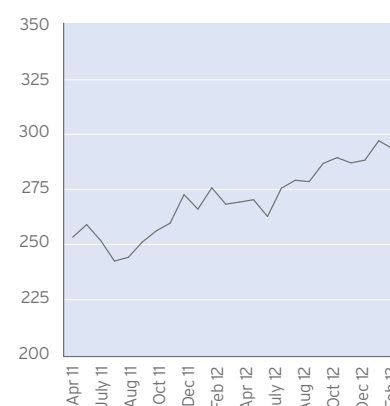
Positive Sentiments Persist

European equities delivered strong returns during the first quarter of the year bringing the MSCI Europe Index close to its 2008 record levels. A survey ran by Citi analysts shows that investors are more confident that macro and political risks will stay low. Despite recent events in Europe (e.g. Italian elections, Cyprus), the chance of euro break-up, the highest profile macro risk, has declined materially according to the survey as policy action appears to be trumping political risk for now.

Modest nominal global GDP growth including a 2H13 pick-up in US growth and a pick-up in EPS-boosting M&A and buybacks could support modest single-digit earnings growth in 2013E, according to Citi analysts. However, recession in the Euro Area and near-record margins suggest that big

earnings gains are unlikely. Citi's analysts expect 10-15% earnings growth in 2013E and 2014E. European companies with exposure to EM growth should generally be at an advantage compared to more domestic companies over the next few years.

Citi analysts also point out that the rally has seen the European market re-rate to levels approaching average/fair value. Dividend yields are still above the long term average, but look less extreme than they have in 18 months. The re-rating has been most aggressive for those countries trading at the cheapest valuations; the spread between the cheapest vs. most expensive countries on a yield basis has tightened over the past 6 months. Currently, all developed European countries are trading at, or below their own 5yr forward dividend yield average



DJ Stoxx 600

Data source: Bloomberg as of 29 March 2013.

which gives room for decent (double-digit) compound future returns. Citi analysts continue to prefer cheaper Nordic countries to uncertain periphery markets.

Europe

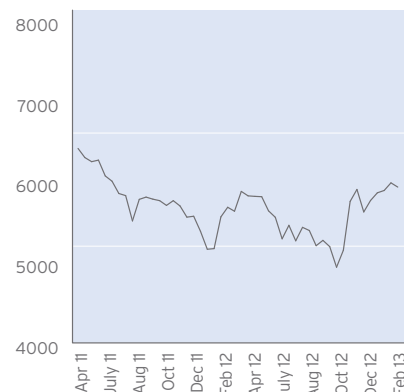
UK Equities

The UK economy continues with the struggle to reign in the still very high private sector debt that was amassed during the period leading up to the financial crisis. While down from the peak of almost 230% of Private Sector Debt to GDP to just under 210%, the UK is still significantly above the Euro Area average of 165% and the US level of 160% - in fact, even Japan after the boom in debt leading up to the mid 1990s has now de-levered to the tune of 160% Private Sector Debt to GDP.

Of course in most advanced economies much of this debt has just changed hands to the public sector and it will take a number of years before more sustainable debt levels are achieved - particularly in the UK where it is particularly challenging due to the sluggish to almost nonexistent GDP

growth which is dragged down by lack of demand from Europe and the aforementioned debt mountain. Consequently the path back to fiscal sustainability will be longer and tougher than expected and this has started to feed through to the sovereign credit ratings.

Citi strategists are relatively neutral on the equity market outlook for UK equities as attractive valuations are balanced with negative earnings momentum, poor manufacturing data and a subdued growth outlook. Fortunately, following an expansion of the Bank of England's remit, Citi analysts expect monetary stimuli through a variety of channels, including QE, credit easing and forward guidance.



UKX Index - Last Price

Data source: Bloomberg as of 29 March 2013.

North America

Fixed income

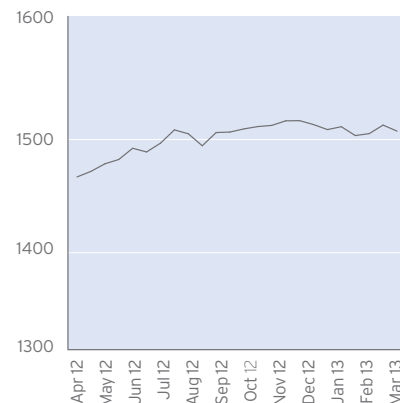
US Treasuries rates may remain range-bound as sluggish growth prospects, political uncertainties, and the US fiscal debate weigh heavily on the yield curve. As uncertainties dissipate, rates will likely seek higher ground later this year to reflect lower tail risks and improving growth prospects.

While credits are still poised to outperform within fixed income universe this year, Citi analysts believe that the credit cycling is likely turning, with increasing signs that corporates are re-levering across regions and sectors. Furthermore, valuations are less compelling now as yields trade near historic lows and spreads hover around post-crisis tights.

US High yield returns have been more resilient than investment grade securities due to better carry and resumed fund inflows as a result of improved

risk appetites. Actually the high yield fund outflows that occurred from late January through February received much attention. However, the outflows were driven primarily by ETFs, which tend to attract more fast money and more shorting interest than the broader market. In addition, those outflows have partially reversed since then.

Thus Citi analysts believe that credit spreads may tighten only modestly from here and expect low single digit returns from investment grade bonds below historical average and project 7% and 5% returns for high yield and leveraged loans this year, respectively.



Citi US BIG

Data source: Bloomberg as of 29 March 2013.

Equities

Fed may begin to taper pace of asset purchase in 2H13

Citi analysts continue to expect economic growth of 2.1 % this year and picking up further in 2014 to 2.8%. Support for expansion has improved with widespread hiring, more effective monetary accommodation as reflected in buoyant financial markets, and the rippling effects of reviving housing. But fiscal drag may likely check upside momentum now that the full budget sequester is going into effect. Slow implementation is expected to further delay the larger fiscal drag, while the recovery's underlying momentum may also be buffering the impact of deficit reduction.

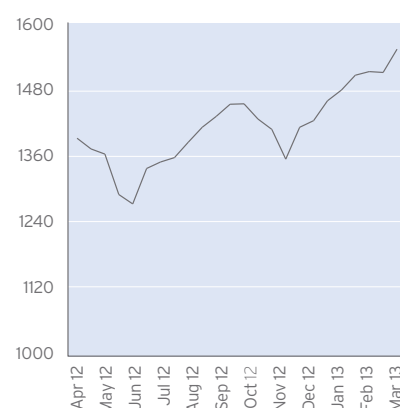
The Federal Reserve's (Fed) aggressive forward guidance and open-ended bond-buying have yielded the longest stretch of accommodative financial conditions since the late-1990s. The drag from fiscal restraint and policymakers' high bar for

satisfactory job growth will likely sustain QE at an elevated pace through 1H13 but may begin to taper the pace in 2H13. High unemployment and low inflation suggest no start to exit strategies through 2014.

From an equity perspective, new highs for the Dow Jones and the S&P 500 are met with deep concerns about the sustainability of the advance and questions regarding any opportunity for more appreciation.

According to Citi's latest client survey, US investors seem most focused on 4 issues: 1) Corporate margins sitting near previous highs; 2) Valuation continues to come up as being relatively high; 3) Potential Fed policy reversal as many believe that all of the gains in stock prices have been "liquidity" driven; and 4) Allegedly frothy investor sentiment.

Citi analysts continue to believe that 2H13 may prove more challenging as political



S&P 500 Index

Data source: Bloomberg as of 29 March 2013.

drama in the form of another debt ceiling fight or elections in Germany could be problematic. In the interim, the S&P 500 could exceed our year-end 2013 target of 1,615 before slipping in the second half.

Japan and Asia Pacific

Asia-Pacific equities

Inflation remains benign

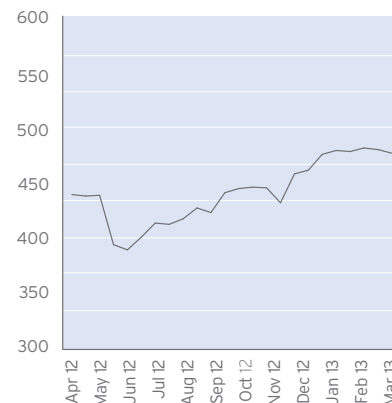
Citi analysts think it is the wide divergence in domestic demand dynamics that is the main differentiating factor in both policy responses and asset performance – Thailand and Philippines are leading the domestic demand resurgence while Korea's domestic demand is lagging, partly due to cyclical policies staying too tight for too long.

Asia's headline inflation has begun to surprise on the upside, but core inflation remains more benign, allowing some central banks to ease further – Philippines to deter PHP appreciation and reduce sterilization costs & India to support moribund growth; or, in the case of Indonesia and Thailand, to keep rates low for longer than warranted. Korea is an exception, resisting a cut (so far) despite JPYKRW decline.

One market concern is that the US dollar will rally, which has historically been

negative for Asian markets, and inflation would also rise. Well, history suggests that one of the two will happen, but not both. The reason for the relationship between inflation and the US dollar is that Asia is a net importer of many commodities. Whenever the US dollar has been strong, commodity prices have been weak and hence input costs for Asia ex have fallen.

Another common perception is that inflation is bad for stocks. However, Citi analysts find a rather weak relationship between interest rates (long rates) and valuations. Asian stock markets tend to be more asset-intensive than their US and European counterparts, with a shift in manufacturing base to the East. In an inflationary environment, the replacement cost of book assets goes up. Hence, given the more asset-intensive nature of Asia-ex, investors here tend to benefit from asset-lighter stock markets. Also, the consumer sector is quite small in Asia ex versus other



MSCI Asia Pacific Ex-Japan

Data source: Bloomberg as of 29 March 2013.

markets. While consumers tend to lose out, inflation is actually a relative positive for the manufacturing sector with more room to pass through price increases.

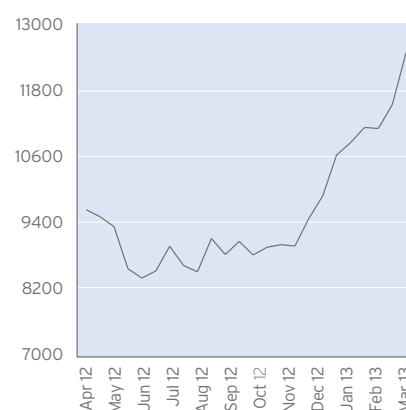
Japan equities

Monetary Policy Big Bang

The first policy easing measures under Governor Kuroda were bold, decisive and represent a clear break from the past, according to Citi analysts. The policy board of the Bank of Japan (BoJ) indeed decided on major upgrades to JGB and equity ETF purchases along with the introduction of monetary base targeting. The measures far exceeded market expectations and got the thumbs up not only from the Japanese PM but from rating agencies (Moody's and S&P), IMF President Christine Lagarde and senior Fed officials. In fact, the net annual asset purchases by the BoJ comprise nearly 15% of nominal GDP, significantly larger than any recent QE operation globally. The measures equally reflect a clear determination of the new BoJ Governor to cement his credibility with the financial markets. The fact that

he established a 2 year time frame by which to achieve his 2% inflation target and was able to get unanimous support from his board for the measures (which was not expected), has gone a very long way in establishing his credentials. Citi analysts think this could increase investor confidence in the BoJ's "regime change" and thus lead more investors to return to the Japanese market. Indeed BoJ's newly announced decision caused a great reaction among foreign investors. And as foreign investors could remain net buyers, Japanese equities may continue to rise.

In these monetary policy circumstances, Citi analysts believe that sectors such as real estate, land transport and any of the warehousing & transport sectors that have high weightings of real estate to total assets are likely to outperform.



NIKKEI 225 Index

Data source: Bloomberg as of 29 March 2013.



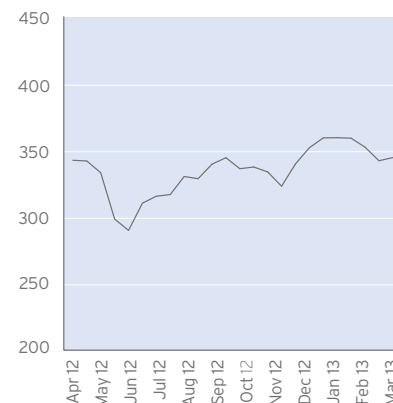
Emerging Europe and Latin America

Emerging Europe equities

Renewed Euro Area Crisis Contagion Fears

Emerging Europe equities underperformed significantly during the first quarter of the year. The underperformance of Emerging Europe equities region was driven by Central European countries and Russia in particular as these markets were directly hurt by the Cyprus crisis. On the opposite side, Turkish equities ranked among the world's best performing markets in the first 3 months of the year. Citi analysts observe that this underperformance also occurs at a time when economic fundamentals in the region showed some signs of improvement. They indeed observe that Purchasing Managers' Indices have increased in all countries in the region while exports data also slightly picked up during the

period. However, Citi analysts believe that a persistently fragile Euro Area will keep CE European activity weak. Private sector deleveraging and generally weak external demand will be the main forces behind weak activity, but in some cases – Hungary, South Africa, Russia, Turkey – uncertainties about the quality of policymaking will also help cap potential growth. Citi analysts expect CE European countries to deliver 2.6% GDP growth this year against 5.1% for MENA countries. In turn, they think that below trend GDP growth combined with corporate deleveraging will cap EPS growth in the region to 3.4% which is far below the 13.9% EPS growth expected for Emerging Markets. Citi analysts also believe that the sensitivity of CE European countries Euro Area sovereign crisis as illustrated by the sell-off in the region after the Italian



MSCI EM EMEA

Data source: Bloomberg as of 29 March 2013

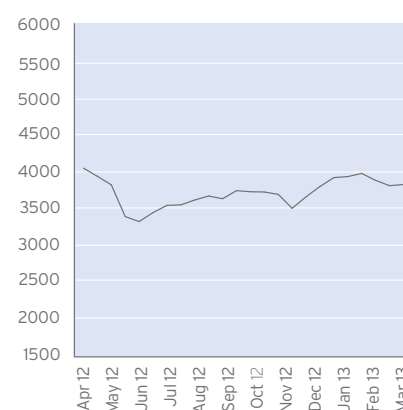
elections and the Cyprus bail-in will continue to weigh on the trend although they estimate that fears of contagion towards Russian banks are overdone.

Latin America equities

Continue to Lag Behind

Whether from a bond or from an equity perspective, Latin America continued to underperform significantly during the first quarter of the year. According to Citi analysts, Latam economies remove are particularly sensitive to the aggressive monetary policies ran in Developed Countries. Central Banks' balance sheet expansion in the US, UK, Japan and Europe tend to hurt smaller economies that see their currency appreciate which in turn squeezes the profitability of heavy commodity export sectors in the region. Citi analysts think that going forward, Latam Central Banks will focus on FX intervention and sterilization while restraining from large interest rates hikes despite increasing inflation pressures. Brazil seems to be the country in the region

where inflation pressures are the most sensitive. Citi analysts observe that Brazilian equities offered poor returns over the last few months while earnings proved relatively strong and continue to strengthen on the back of an improving GDP growth trend. They think that this de-correlation between returns and earnings growth is largely due to a higher sensitivity of investors to macro factors such as inflation, interest rates, and exchange rate. Citi analysts think that macro and policy uncertainty will continue to overshadow improving micro in the near term. On the other Mexico seems to be the only country to enjoy a greater margin for currency appreciation. Also Mexican equities continued to benefit from economic reforms which boost their ability to deliver strong returns. Citi analysts



MSCI EM Latin America

Data source: Bloomberg as of 29 March 2013

warn that going forward this broad reform beta factor could decrease and selectivity between sectors and companies really benefiting from the reforms should increase.

Global REITs and commodities

Real Estate Investment Trusts (REITs)

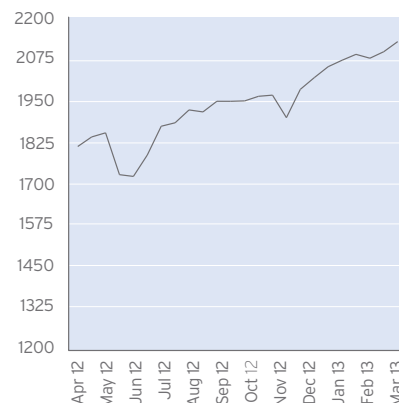
Updates on Citi's 18th annual Global Property CEO conference

Citi hosted its 18th annual Global Property CEO conference in early-March 2013. During the conference, Global Property CEOs expressed a positive outlook on the Real Estate Investment Trust (REIT) sector. CEOs expected REIT shares to continue rising, resulting from recent short and medium performance, increasing availability of low cost capital, and positive fundamentals and opportunities for external growth predominantly through redevelopment and development.

Tobias Levkovich, Citi's Chief US Equity Strategist presented an optimistic view on the US housing environment and overall equity markets. Focusing on residential real estate, Levkovich noted that the annual pace of single-family housing starts per US household fell

from a level of 1.6% during 2007-08 to below 0.5% in 2009; a level only previously reached during the Great Depression and World War II. The level is only just above 0.5% now. Levkovich observed that it appears to be a good time to buy a house in the US, with the Composite NAR Housing Affordability Index close to the all time highs of 2012 and the ratio of median single family home sale price to median asking rent price at 20 (annualized), well below the historical average.

Conference participants took part in a survey, responding to the question "What do you expect the total return for REITs will be in 2013?" The results show 49% of respondents predicting that REITs will be up 0-10% in 2013, and ~28% expecting 10-20%. Less than 20% of respondents believe there will be a negative movement. This year's survey



EPRA/NAREIT Global Index

Data source: Bloomberg as of 29 March 2013

responses were less optimistic than in 2012, when approximately 90% of respondents thought 2012 REIT returns would be up 0-20%. The actual 2012 total REIT return was +17.8%.

Commodities

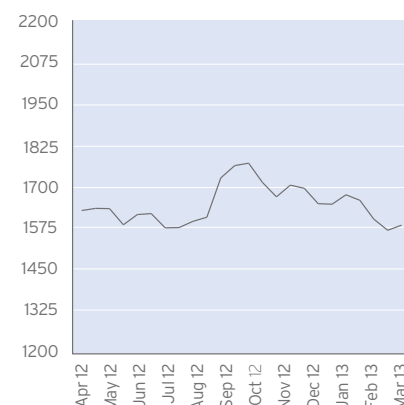
The US Dollar's trajectory is likely to be a key driver

Gold continues to trade as a risk asset rather than a risk hedge, with price levels at their lowest since July 2012 as inflation concerns remain distant, while a more positive US economic outlook supports further dollar strength. Gold exchange-traded fund (ETF) holdings have seen substantial net redemptions since the beginning of 2013, while net managed money long gold positions on COMEX have more than halved since November 2012. With the USD trajectory being the key driver of gold returns, Citi analysts see a generalized strengthening of USD to the end of 2013, thereby capping the upward potential for gold (along with other commodity prices). However, any downward move in gold may also be limited by low growth and zero interest rate environments. Furthermore, 2012 saw significant central bank buying 'on dips' and Citi analysts expect the same

trend to occur in 2013, thereby also limiting further downward movements.

The 'bear' case for oil this year remains intact. Brent has been trading at under US\$110 a barrel, and the spread between the first and second month is rapidly collapsing, reflecting greater weakness in the North Sea market. WTI is trading slightly below the level at which it opened 2013, and crude oil inventories have been growing in counter-seasonally. Overall signs are that global supply will outpace demand by as much as 50%, with global demand languishing at fewer than one million barrels a day.

Concerns over the outlook for China have dampened base metals prices. Recent Chinese Government pronouncements regarding the property market add to the sense that manufacturing growth will be muted in 2013, leading to a reassessment of China's base metals demand outlook. China's policy



Golds US\$/troy oz.

Data source: Bloomberg as of 29 March 2013

measures are likely to act as a significant disincentive to property investment and therefore residential construction activity, in turn reducing the demand for copper and other industrial metals.

Currencies

Euro

The Euro weakened markedly in the last 2 months of the first quarter after Italian elections and Cyprus' banks crisis ignited fears of new escalation in the Euro Area sovereign crisis. Citi analysts believe that the agreement reached will be far less compelling for the Euro than any of the two worst possible outcomes – disorderly bank failures in Cyprus or Cyprus dropping off the euro zone map. They think the resolution should give the euro a little support, but the support is unlikely to be big or permanent as the negative impact will be reinforced by the lingering political crisis in Italy. Citi analyst think it would require a strong positive surprise in terms of economic performance to see a sustainable rebound of the Euro, which is not the favoured scenario at the moment. Citi analysts target 1.25\$/€ in a 6 to 12 months' time horizon.

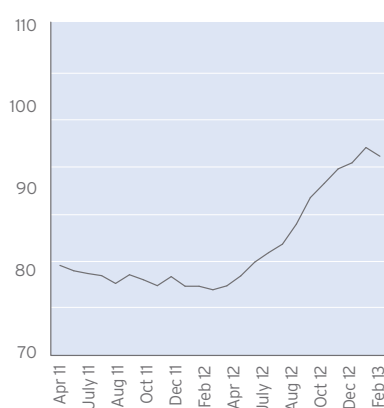


Euro-Dollar (USD/EUR)

Data source: Bloomberg as of 29 March 2013

Yen

The new Bank of Japan leadership has just taken over the helm. So far, they have simply repeated their previous intentions of achieving inflation and implementing additional monetary easing. Citi economists expect additional easing and an extension of the maturity of JGBs purchased. Citi analysts think that over the long term JPY appears particularly vulnerable to a combination of higher inflation and disappointing economic outcomes. Indeed, the fiscal situation will force the BoJ to maintain low rates to prevent debt servicing from running up sharply which is likely to encourage capital outflow. Citi analysts target 105¥/\$ in a 6 months' time horizon.



Dollar-Yen (JPY/USD)

Data source: Bloomberg as of 29 March 2013

Pound sterling

Sterling regained ground across the board after a strong weakening in the first 2 months of the year as investors pared back bets on imminent aggressive Quantitative Easing from the Bank of England. Citi analysts think Sterling could remain supported in the very near term as markets continue to pare back shorts and as the UK attracts a new wave of safe haven flows from the Eurozone. However, Citi analysts maintain the view that the pound will remain negatively correlated to risk appetite. In particular, Citi analysts note that the March budget did little to support the economy in the near term. In their view, this could keep concerns about further weakness of the UK economy and sterling firmly in place. Citi analysts target 1.42\$/£ in a 6 months' time horizon.



Pound-Dollar (USD/GBP)

Data source: Bloomberg as of 29 March 2013

Behold the new form of bail-in

Matt King, Citi Global Head of Credit Products Strategy

Cyprus' significance was always going to stem more from the precedent it created than from its size. In choosing a relatively conventional good bank, bad bank model, the authorities have done much to alleviate the damage that would have been caused by an arbitrary tax on uninsured depositors. But the very "success" of the solution now being adopted seems likely to lead to its replication elsewhere. While this may be good news for the sovereigns and for longer-term growth prospects, its negative repercussions for senior bank bondholders still seem far from being priced in.

The Cyprus model has three key features, which highlight the effective elimination of many of bondholders' supposed protections:

- Hasty implementation under national legislation: the rapid passage of new national laws effectively re-writes existing bankruptcy legislation, reducing bondholders' rights in the process.
- Application to all bonds by statute: Cyprus again demonstrates that, when backed into a corner, the authorities are willing to impose losses by statute on all bonds, even at senior level. This contrasts with the previous official EU line.
- Extremely low recoveries: the decision to move bonds to the bad bank, together with uninsured depositors and equity, is likely to result in extremely large losses.

Against this, of course, is the argument that Cyprus is unique. We disagree. Yes, the Cypriot banking system was

unusually large; yes, concerns over the Russian depositor base are unlikely to be a feature elsewhere; yes, losses for bondholders will likely be exacerbated by the unusually small proportion of the capital structure they represent.

But to us, the similarities with other countries are far stronger than the differences. First, almost all EU countries have banking systems that are outsized by global standards, and that might prove difficult to save should they get into difficulty.

Second, the likelihood of low recoveries for bank bondholders in the event of restructurings is something we have been writing about since 2008. Even without the formal application of bail-in and creation of good and bad banks, the tendency towards covered bond issuance by weaker banks, and the growth in both private and public sector repo (ECB and ELA) has led to far greater asset encumbrance than used to be the case historically.

How many one-offs make a trend?

Investors still seem reluctant to assume that the precedents being set will be applicable elsewhere. But the very fact that the market has responded so positively makes us think the very next bailout requiring approval from Brussels is likely to see elements of a similar model being requested. The fact that it was creditors like Germany, not the European Commission, that were pushing for the good bank, bad bank solution in Cyprus (as opposed to a deposit tax) is telling in this regard. So too is Djisselboem's statement that the "Cyprus bank restructuring plan

should be seen as a template for the rest of the Euro zone". The market seems to be coming around to this view, but is not completely there yet. Senior bank CDS has underperformed Main by 20bp since 14 March. And yet even quite conservative changes in default and recovery assumptions would justify spreads moving further still. An even cleaner way to position for this is in covered bonds versus senior. Covered bonds in the peripherals have been outperforming senior since January, but the difference to us still seems too tight given the complete lack of discussions anywhere about bail-in for covered bondholders, and the likelihood of extremely high recoveries there if it came to it versus extremely low ones on unsecured.

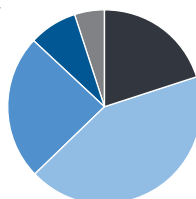
Alternatively, we still like old-style Tier 1 bonds versus senior here, or better still sub vs senior CDS. The CDS trade has the additional advantage that not only are losses at senior level becoming more likely, but sub CDS protection is likely to be rendered worthless in cases where bonds are completely converted to equity or wiped out, because of a lack of deliverables. With sub/senior relationships still trading pretty much in line with their long-term averages, this does not seem yet to be priced in. Conceivably it may take longer: as with many factors in the current outlook, we fear the potential for discontinuities even as the market fails to react today – a sort of "ball in a bowl" phenomenon. But even if it takes a while, we think the bail-in of bank bondholders on one small island today is ultimately likely to have significance far greater than its size suggests.

Asset allocations

Euro-tilted model portfolios

Defensive

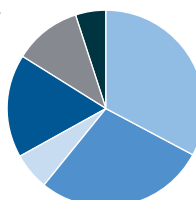
Seeking primarily capital preservation over time and only willing to accept very minor portfolio value fluctuations from month to month.



- EUR Cash **20%**
- EUR Government Bonds **43%**
- EUR Corporate Bonds **24%**
- European Equities **8%**
- Global Equities **5%**

Income-oriented

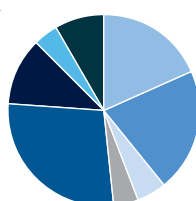
Seeking growth of wealth over time but unwilling to accept significant fluctuations in the value of portfolio from month to month.



- EUR Government Bonds **33%**
- EUR Corporate Bonds **28%**
- EUR High Yield Bonds **6%**
- European Equities **17%**
- Global Equities **11%**
- Global REITs **5%**

Growth and income

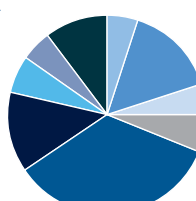
Seeking long-term capital growth foremost but unwilling to accept significant losses on value of portfolio over the medium term.



- EUR Government Bonds **18%**
- EUR Corporate Bonds **20%**
- EUR High Yield Bonds **5%**
- Emerging Market Debt **4%**
- European Equities **27%**
- US Equities **11%**
- Pacific Equities **4%**
- Global REITs **8%**

Growth oriented

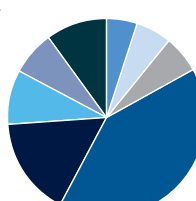
Seeking long-term capital appreciation and willing to tolerate measured medium-term volatility in order to enhance longer-term performance.



- EUR Government Bonds **5%**
- EUR Corporate Bonds **15%**
- EUR High Yield Bonds **5%**
- Emerging Market Debt **6%**
- European Equities **34%**
- US Equities **13%**
- Pacific Equities **6%**
- Emerging Markets Equities **5%**
- 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.



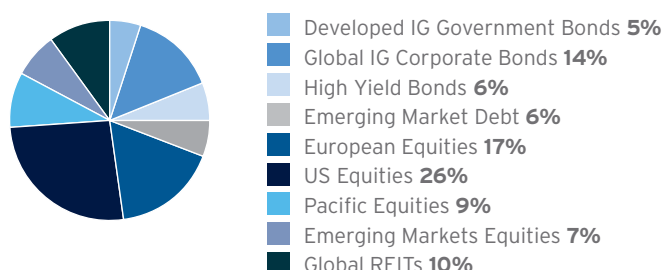
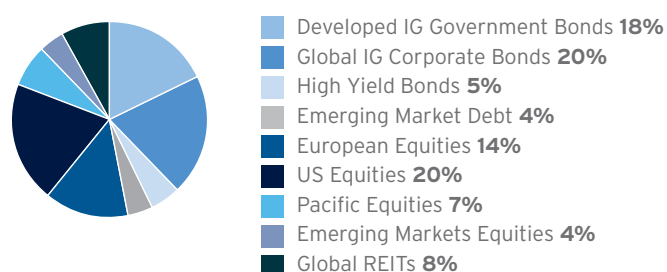
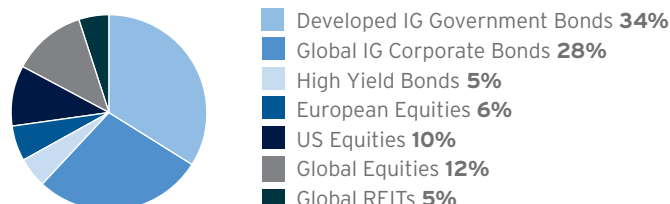
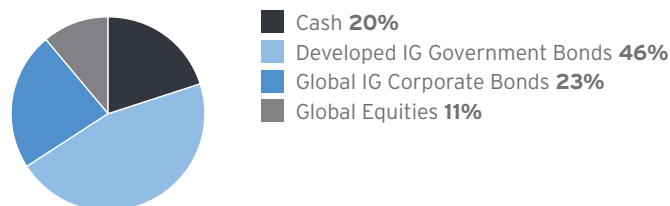
- EUR Government Bonds **0%**
- EUR Corporate Bonds **5%**
- EUR High Yield Bonds **6%**
- Emerging Market Debt **6%**
- European Equities **41%**
- US Equities **16%**
- Pacific Equities **9%**
- Emerging Markets Equities **7%**
- Global REITs **10%**

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 March 2013

Global model portfolios



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

- The Global Investment Committee (GIC) has decided to increase to overweight its position in US equities and high-yield bonds. This has been funded by reducing exposure to municipal and investment grade corporate bonds.

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 is likely brightening and equities may offer better risk/reward than credit this year while both returns are likely to be below last year's gains.

Allocation to regional equity markets

- The GIC recently moved to overweight in the US while remaining overweight in Europe and Japan. Emerging Market equities continue to be neutral.
- 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.
- And the GIC believes that Japan may continue to grind higher even 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. Meanwhile the GIC remains neutral position in emerging markets.

Allocation to government and credit markets

- The GIC is heavily underweight sovereign bonds and have small overweight positions in Investment grade bonds, High yield bonds and emerging market debts.
- As the GIC believe that the risk of increasing interest rates has become greater, it reduced positions in municipal and investment grade bonds which would be negatively impacted by such a move.

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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