Q4 | 11

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

Standpoint

Global Market Analysis by Regional Consumer Banks

The value of time

During the 3rd quarter of this year, the Euro Area sovereign crisis experienced a significant acceleration as the global economic backdrop deteriorated markedly. In the early days of the sovereign crisis, Citi analysts were considering that time was a key positive feature in the resolution of the crisis. Indeed, back in early 2010, the context of a strong rebound in global economic activity favoured a scenario under which banks would be able to build up capital to be in a better position in a few years' time to withstand write-downs on periphery exposure and the Euro Periphery countries would have achieved sufficient primary budget surpluses so that a sizeable restructuring would return them to a sustainable fiscal path. At that time, Citi's Chief Economist Willem Buiter was already forecasting a debt restructuring for Greece, but the base case was for a 40% haircut by the end of 2014. Citi analysts now think that the deterioration of the economic context makes the "time" option no longer valid as the outstanding debt level continues to increase while the GDP is contracting in the periphery countries and probably also in the whole Euro Area. They think that the longer it will take for EU-leaders to bring a decisive solution to the crisis, the higher the pain will be for the world economy. Citi analysts now expect the Greek sovereign to engage in substantial debt restructuring between December 2011 and, at the latest, the end of 2012. This will be followed by Ireland and Portugal, mainly because of political contagion. Depending on the timing of the restructuring and the targeted debt-to-GDP ratios (60% which is the reference value of the Stability and Growth Pact or 80% which is close

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 decreased its overall position in global equities from neutral to underweight. Correspondingly, the position in fixed income has been raised from neutral to overweight. Plummeting global economic growth expectations and some very large existential questions (will the euro survive, for example) make it hard to imagine any sustainable rally in equities for the time being. As with government bond yields, equities could rise if growth expectations bounce back. But equities are likely to come under pressure according to Citi analysts if growth expectations and corporate earnings forecasts were to fall further. Longer-dated corporate credit still looks a better alternative than either government bonds or equities in this environment. The GIC has also completely excised Japanese Government Bonds (JGBs) from its portfolio in favour of emerging market debt, which it believes offer better value at a time of falling interest rates.

Global equities

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

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	Negative	Underweight
Emerging Market Debt	Positive	Overweight

Alternative investments

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

Global currencies

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

to the current euro area average ex Greece), Citi analyst expect a haircut of 67% or 54%, respectively, assuming uniform haircuts on all creditors, IMF excluded. Under that scenario, the European Financial Stability Fund (EFSF) would have to be enlarged in order to absorb the likely contagion effect on other Sovereigns and to permit to European Banks to find adequate recapitalization sources.

Evolving in different time frames

As the clock is ticking increasingly faster for political leaders, the major problem for investors is that financial markets and political action evolve in different time frames, with the political response tending to lag far behind the markets' imperatives. Just a recent example to illustrate this dichotomy: on September 29, the German Bundestag approved the expansion of the EFSF that had been proposed by the Troïka (European Union, ECB and IMF) back in July while some other EU-Members Parliaments still have not ratified the plan. During this period, the MSCI World Index dropped by 20%, 5-Year CDS Spreads on Germany doubled from 60 bps to 120 bps and 10-Year Bunds yields fell to an absolute record of 1.6%. Obviously, the financial and economic world has changed and the key concern for investors is probably not whether a solution to the crisis exists, but rather how fast the appropriate solution can be decided and implemented by political leaders.

Managing time is managing risks

We understand it; the way the increasingly precious resource of "time" will be handled by political leaders will have a major impact on financial markets' volatility and on economic risks. Citi analysts therefore think it is also crucial for investors to have an appropriate understanding and management of the "time" factor in their investment strategy. Time is similar to a telescope that distorts the perception an investor has of events and facts in function of how the telescope is used. A very interesting illustration of that is the deleveraging process among companies and households in the US. In the aftermath of the 2008 crisis, the private sector has stepped into a broad reduction process of debt exposure. Anyone looking at this process from a short-term perspective will see the negative impacts it has on the economic activity as companies do not invest and households do not consume enough to boost the economic activity. Those looking at it from a longer term perspective will actually probably see a healthier economic activity based on stronger companies and lower credit dependence. For example, when looking at China, in the short term Citi analysts see the likely slowdown of the economic activity in the near term from 10% to 8.5% GDP growth and in the long term see the economy that is likely to surpass the US as first economy of the planet as expected by Citi analysts by 2020.

The "time" spectrum can also be applied to the perception investors may have of asset classes, and more particularly to those considered as a "safe-haven" in periods of high volatility. In the near term, getting a yield of 2% on a 30-Year US Treasury bill or paying US$1,650/oz of gold can appear to some investors as the least risky investment to do. But with a longer term view these assets can also understandingly appear as the most inflated and crowded assets in financial markets, hardly the definition of a "safe-haven" investment. At all times, but even more so in periods of uncertainties, investors should make sure that their investment strategy is in line with the time frame they are considering as a proper management of "Time" can bring much added value to investors' portfolios.

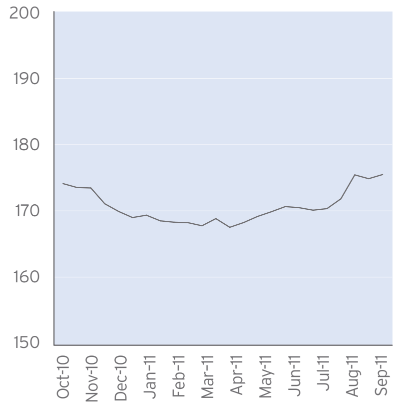
Europe

Fixed income

Risks of recession in 2012

Citi analysts have revised down their GDP forecast for the Euro Area from 1.7% to 1.6% for 2011 and from 0.6% to -0.2% for 2012 mainly reflecting the impact of additional fiscal tightening and tighter financing conditions, largely a consequence of expected debt restructuring in the periphery countries. For 2012, Citi analysts expect Italy and Spain to join the bailout countries (Greece, Ireland and Portugal) in recession. In contrast, Germany and most other core countries are likely to show continued growth, though at a weaker pace. In this environment, Citi analysts think the European Central Bank is likely to cut rates back to 1.0% by year-end and likely put in place additional non-standard measures.

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. Citi analysts expect large haircuts on the Greek debt as well as on the Irish and Portuguese debt no later than the end of 2013. On the other hand, they have an overweight stance towards core Europe, particularly Triple-A bunds which, barring the need to fully recapitalise the banking sector, are likely to receive a safe haven bid. In the corporate bonds sector, spreads have widened and may offer opportunities. Citi analysts observe that spreads do not tend to stay at these levels for very long, though they also recognize that when spreads are here they can potentially go much wider temporarily. Citi analysts think corporate bonds offer good value, but in the absence of policy intervention it is unlikely that negative sentiment in markets will turn around in the near term.



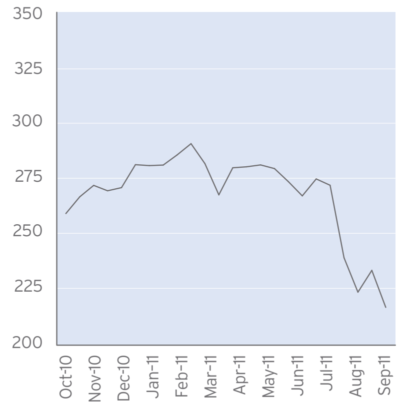
Citi Euro BIG (EUR)
Data source: Bloomberg as of 30 September 2011.

Equities

Priced for "doom" scenario

Europe has been one of the worst performers during the third quarter of this year due to ongoing sovereign issues and increasing growth concerns. Bearing in mind the risks related to an increasingly challenging macroeconomic and fiscal backdrop, Citi analysts observe that metrics and valuations of European stocks have rarely been as compelling as they are today. Citi analysts highlight that 62% of European stocks under their coverage now appear priced for "no growth" against the 6-year average of 47%. Considering that this figure reached 81% at the end of 2008, extremes have not been reached yet, but stocks prices are getting increasingly closer. They think that stocks priced for "no growth in perpetuity" in particular could react positively if there is evidence that macro events are stabilizing.

Citi analysts also observe that from a valuation point of view, core Europe now trades at not that much above book value while US stocks, in contrast, trades at twice book value. Similarly, the cyclically adjusted price-to-earnings (PE) ratios of the US are 19x while Europe's core countries trade on a cyclically adjusted PE of 10x. The difference in valuations has rarely been wider. The difference also translates to an implied equity return for the US of a touch under 6% compared with about 13% for Europe. Citi analysts note that, on average, valuation differentials on this scale have typically resulted in an excess performance of European shares of some 14% on a 12 months period.



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

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

North America

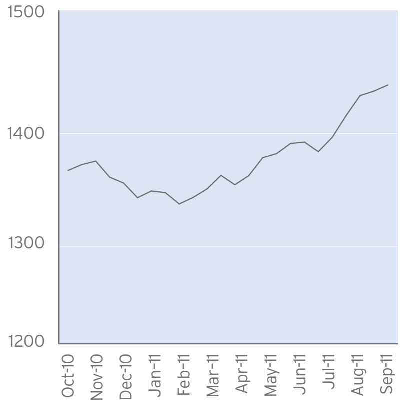
Fixed income

Operation Twist to benefit longer-dated Treasuries

Deteriorating financial conditions and lingering policy uncertainties continue to weigh on business confidence. Citi analysts expect the US economy to GDP grow 1.7% in 2011 and 1.9% in 2012, with unemployment likely to remain high over the medium term. Enhanced monetary accommodation is likely to persist through 2013, but new fiscal supports for growth are expected to be limited.

The Federal Reserve (Fed) announced a new maturity extension program (Operation Twist) on September 21. Starting in October, the Fed will begin selling up to US$400 billion of shorter-term (3-month to 3-year) Treasury securities in order to buy longer-term (6-year to 30-year) Treasury debt. Extending maturities should result in lower long-term rates among Treasury bonds and other high-quality financial assets (such as corporate debt), as well as bank loans. Given the Fed's pledge to keep the funds rate at its current level, sales of short-term securities by the Fed to finance longer-dated purchases is unlikely to have any impact at the front end of the curve. Moreover, the front end continues to be the most liquid part of the Treasury market and tends to be in highest demand during periods of high market volatility.

Anaemic growth prospects and falling inflation expectations are expected to anchor bond yields and support flatter yield curves. Within the US credit space, Citi analysts continue to favour high-grade corporate bonds, particularly long-duration, which they believe could outperform. Prospects



Citi US BIG

Data source: Bloomberg as of 30 September 2011.

may be further enhanced should a US recession be avoided, especially considering that markets have broadly discounted an extended period of below-trend growth.

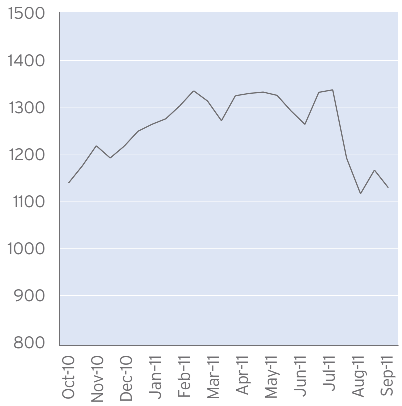
Equities

Year-end targets lowered to reflect macro headwinds

Citi analysts have reviewed their end-2011 targets for the S&P 500 index and the Dow Jones Industrial Average (DJIA) and believe that their initial projections are no longer supported by the economic and sentiment as global economic data disappoints and confidence has decreased markedly. They have consequently lowered their earnings growth forecasts and they think the consensus will also proceed to further downwards revision, which is likely to weigh on stocks' performances. Given the volatility related to European sovereign debt issues as well as uncertainty about the super committee's recommendations in November and the need to increase employment, Citi analysts believe that equity risk premiums are likely to stay elevated.

Thus far, healthy corporate credit conditions remain in place and can still support capital investment and job growth but weaker equity prices of late may restrain consumer spending. Credit conditions are the major risk to Citi analysts' end-2011 targets, while other risks of government policy errors, economic nationalism and exogenous shocks remain. But Citi analysts are of the view that much of these concerns seem to be priced into stocks now and believe the US equity market may be poised for a fourth quarter rally, possibly due to some bipartisan jobs program in the US, central bank efforts in Europe and the US, as well as more evidence which suggest that a global recession is not developing.

In terms of sectors, Citi favours Food & Beverage, Diversified Financials, Insurance, Semiconductors & Semi Equipment, Tech Hardware and



S&P 500 Index

Data source: Bloomberg as of 30 September 2011.

Telecoms, and is neutral on Consumer Services, Food & Staples, Regional Banks, Commercial Services & Supplies, Transportation, Software & Services and Utilities.

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

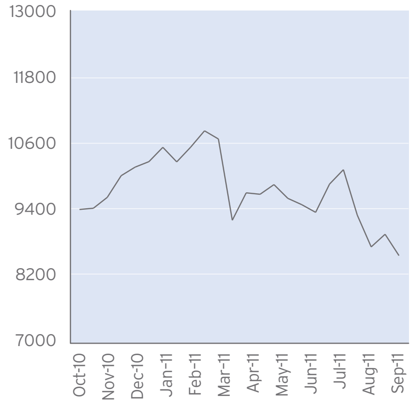
Japanese equities appear extremely undervalued

Stock prices appear to have priced in a rapid economic downturn. TOPIX fell below 750 in September. As a result, the TSE1 price-to-book (PB) ratio has fallen to 0.93x, same levels as during the Lehman shock in 2008. But despite the cheap valuations of Japanese equities, investors have been showing a lack of interest.

Citi analysts view Japanese equities as extremely undervalued and believe a correction of the undervaluation is likely to occur once risk aversion subsides. At the same time, concerns of a global economic slowdown could put downward pressure on Japanese equities. But even if this were to happen, Citi analysts believe there may be less downside risk for Japanese equities than for other regions as current low valuations and the purchasing of ETFs by the Bank of Japan (BoJ) could lend support.

Citi's end-2011 fair-value estimates for TOPIX and Nikkei 225 currently stand at 920 and 10,300 respectively. Upside risk factors could be greater-than-anticipated growth in emerging countries, especially China. Downside risks could be a worsening of problems at nuclear power plants, prolonged concern about power supply if reactors currently down for regular inspections are not restarted, and intensification of the European sovereign debt crisis.

Citi analysts see non-nuclear energy as a long-term theme and therefore favour sectors that are related to energy. On the other hand they disfavour the utilities sector due to uncertainty about how the nuclear accident and compensation issues will be resolved.



NIKKEI 225 Index

Data source: Bloomberg as of 30 September 2011.

Asia-Pacific equities

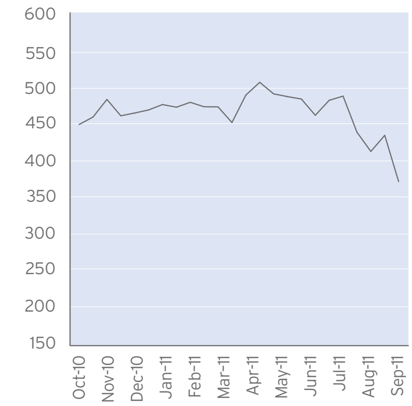
Strong USD does not bode well for Asian equities

The US dollar has rallied recently, and as Citi analysts have previously highlighted, a strong US dollar has typically not been a good thing for Asia ex Japan equities. As the US dollar rallies, liquidity gets tighter, export prices weaken, return on equity (ROE) and corporate earnings begin to fall. There have been four occasions since 1973 where the US dollar has rallied by more than 15%, and on each occasion, Asian equity markets have fallen (on average by 35%).

With one or two exceptions, all markets have historically shown negative returns during those periods. Markets such as China, Hong Kong and Malaysia have been outperformers while India, Indonesia, Korea and Taiwan have been underperformers.

When it comes to sectors, anything to do with reflation, i.e. commodities, industrials, real estate and consumer discretionary tends to do poorly. On the other hand, health care, utilities, consumer staples, telecoms and utilities have been relative outperformers.

The good news however, is that the US dollar usually rallies when Asia ex Japan is trading above 2x price-to-book (PB). On a trailing basis, the region is on 1.5x price-to-book value (P/BV), as of September 23. The 1998 low was 0.9x and the low during the 2008 global financial crisis was 1.3x. It appears that the market is pricing in a recession even thought Citi analysts see little/no evidence that we are about to go into recession. Within Asia, Citi analysts continue to maintain their preference for the North Asian markets of Hong Kong, Korea and Taiwan, along with the banking, energy, industrials, information technology and real estate sectors.



MSCI Asia Pacific Ex-Japan

Data source: Bloomberg as of 30 September 2011.

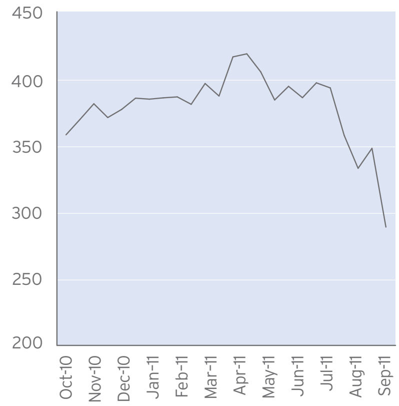
CEEMEA and Latin America

CEEMEA equities

Mounting fiscal pressure

Citi analysts have cut their GDP forecast for emerging Europe to 3.8% in 2011 from their previous estimate of 4.3%, and to 2.3% in 2012 from 3.4%. As the deteriorating macro outlook is likely to further dampen investment and private consumption, they also think that the inflation outlook has become slightly more benign and have reduced their CPI forecasts for 2011 and 2012 by 1 percentage point. The deteriorating growth outlook in the developed countries is also likely to put additional pressure on the fiscal positions of Eastern European governments. Hungarian authorities have already acknowledged such risk and have come up with additional tightening measures. In Poland, the government has downplayed fiscal risks related to slowing GDP and Citi analysts believe that they are unlikely to introduce any tightening measures during the election period. In the Czech Republic, the central government budget is based on optimistic assumptions, but this is likely to be manageable and may not reverse the recent S&P rating upgrade as the government has been successful in approving its consolidation measures and long-term fiscal and structural reforms. In Russia, lower oil prices induced by a global slowdown are likely to weigh on GDP given the high reliance of the Russian economy on oil exports. On the other hand, Citi economists think that lower commodity prices are likely to ease inflationary pressures in Turkey.

Among CEEMEA markets, Citi analysts are now overweight on Turkish equities after a tough summer. With corporate earnings forecasts already under pressure in Turkey for some time, Citi analysts think that we may start seeing forecast upgrades in Turkey sooner than elsewhere. Russian equities appear attractive on a valuation basis, even under an earnings slowdown scenario, but the Russian market carries a lot more sensitivity to oil prices.



MSCI EM EMEA

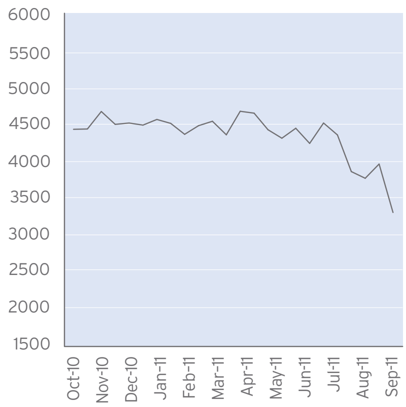
Data source: Bloomberg as of 30 September 2011.

Latin America equities

Unwinding of carry trades

The Brazilian central bank surprised investors by cutting the Selic rate by 50 bps to 12% on August 30th, triggering a large sell-off in emerging market (EM) currencies. The Brazilian real, with the highest real interest rate in the EM world, was a favoured "carry currency" and it now appears that the central bank may be targeting an overtly lower value for the real by cutting interest rates. This however does not address the real cause of high real rates in Brazil – the huge size of the public sector. Moreover, the surprise rate cut may have considerably diminished market confidence in the quality and predictability of Brazilian monetary policy, especially when rates were being cut when inflation (7.2%) was well above even the upper-end of the target range (6.5%). According to policymakers, rates were cut because of: i) slowing global growth; and ii) recent modest action to cut government spending.

Citi analysts believe this move may impact confidence and currency stability of the region. They now forecast GDP of the region to grow by 4.0% in 2011 and 4.1% in 2012. On the corporate side, Citi analysts observe that capex levels remain healthy, but growth is decelerating. After a surge in regional merger and acquisition (M&A) in 2010 to $94bn, the annualized rate for 2011 suggests a large decline in activity to around $60bn due to macro uncertainty. Although companies in the region are increasing dividends and buyback activity, which demonstrates commitment to shareholders, lower investment rates could result in further uncertainty and lower long-term growth. Within the region Citi analysts prefer Brazil, where the market appears overly pessimistic.



MSCI EM Latin America

Data source: Bloomberg as of 30 September 2011.

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

Global REITs and commodities

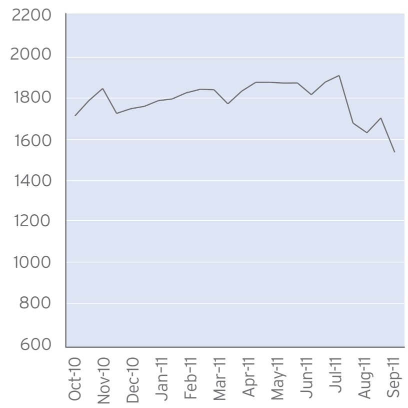
Real Estate Investment Trusts (REITs)

Fed's commitment to low rates to lend support to US REITs

While Citi analysts are fully cognizant of the current macro risks (European debt crisis, risk of US double dip recession etc.), they believe US REITs could potentially provide a combination of the following: 1) reasonable dividend yields with room for potential upside given low payout ratios; 2) better balance sheets with access to multiple sources of attractively priced capital especially relative to when we headed into the 2008 recession, thus potentially limiting dilutive equity raises; and 3) decent earnings drivers through modest internal growth combined with external activities, even in a slower growth environment as new supply is likely to continue to remain muted.

In addition, the Federal Reserve's commitment to keep interest rates low for the next couple of years, while potentially fuelling another bubble, act as strong support for US REITs and direct property pricing which should keep cap rates flat to down and make REIT yields more attractive.

Overall, Citi analysts maintain a positive stance on US REITs. They believe US REITs' near-term fate relative to the broad market is tied to the macro environment and credit conditions, and more modest outcomes in economic growth and credit may likely point to US REITs holding their own rather than significantly outperforming or underperforming. In terms of investment strategy, while it has been tempting to go all value/risk or also into what has become a crowded large cap/liquid trade, they continue to back a balanced investment strategy to manage risk/return, especially in the current volatile risk on/risk off market environment.



EPRA/NAREIT Global Index

Data source: Bloomberg as of 30 September 2011.

Within the US REITs space, they prefer lodging, multifamily/student housing, regional malls, and mixed office/industrial and disfavour shopping centers, healthcare, and office.

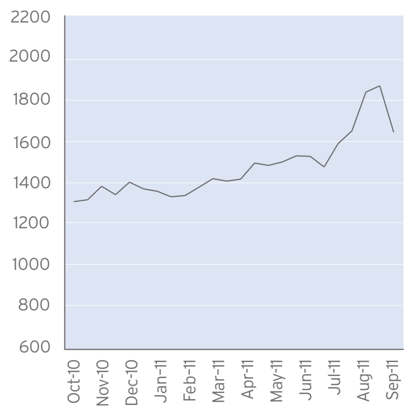
Commodities

Uncertain economic landscape likely to keep commodity prices under pressure

The economic uncertainty surrounding Europe's banking sector, sovereign debt issues and a potential slowdown in US growth, has halted the commodity "bull-run cycle" that began in late 2010, in Citi analysts' opinion. While China and emerging market demand is expected to provide price support, reduced inflows into the asset class as well as heightened levels of volatility is likely to keep commodities under pressure for the time being.

The combination of demand destruction and strong supply growth is likely to put pressure on oil prices. Citi analysts are of the view that International Energy Agency (IEA), Organization of the Petroleum Exporting Countries (OPEC) and Energy Information Administration's (EIA) demand growth assumptions remain too optimistic given macroeconomic headwinds facing the US, Europe and China. For example, EIA's forecast for global oil demand growth is basically unchanged for 2011, at around 1.37 m b/d, but revised down from 1.64 m b/d to 1.39 m b/d for 2012. Citi analysts expect modest incremental global demand growth of 1 m b/d in 2011 and 2012. Meanwhile, supply has loosened substantially and is likely to remain so into 2012. Saudi/Gulf Co-operation Council (GCC) production is more than making up for the Libyan shortfall and it appears that Libyan production could come back online in 4Q11. Citi forecasts the West Texas Intermediate (WTI) crude oil price to average US$89.70/bbl in 2011 and US$71.80/bbl in 2012.

On the flipside, the rise in global financial tensions has boosted safe-haven demand for Gold. Citi analysts' near-term price forecast for gold is US$2,000/oz, driven by market uncertainty and loose monetary policies. However, they expect those tensions and concerns to dissipate over time and do not believe



Golds US$/troy oz.

Data source: Bloomberg as of 30 September 2011.

that jewellery demand (which can be quite price sensitive) will be able to make up for the loss of investment demand when sovereign financial tension eases. Citi forecasts gold prices to average US$1,590/oz in 2011 and US$1,650/oz in 2012.

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

Currencies

Euro

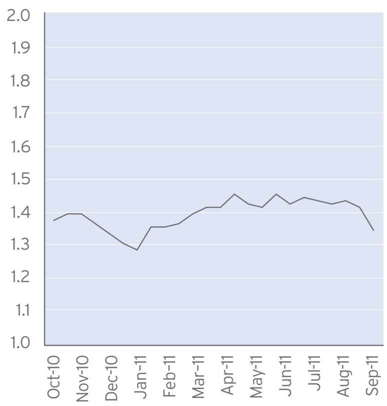
Citi analysts think that in the near term, the monetary policy stance of the European Central Bank (ECB) and the political reluctance of European policymakers to take decisive steps in the face of the fiscal and debt crisis in the Euro Area are likely to continue to weigh on the euro. They observe that the ECB has adopted a more balanced view between inflation risks and downbeat growth as Mr Trichet said that rates increases were now off the agenda. Citi analysts also believe that in the face of growing risks in the banking sector, non-standard measures are likely to be announced in 4Q11, though they think that the slowdown in the ECB's bond purchase programme after the resignation of Mr Stark is a sign that the ECB is willing to keep a relative hawkish stance in order to preserve its credibility as a stability-oriented central bank. Given the prospect of continued hesitations and lack of decisive political actions in a worsening fiscal context, Citi analysts forecast EUR/USD at 1.25 over a 12-month horizon.

Yen

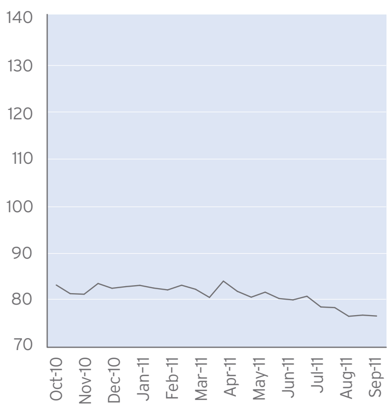
Citi analysts think that that the recent bounce higher in the USD/JPY from the post-intervention lows has been fueled more by a pickup in economic data and US interest rates rather than by recent announcements from the Ministry of Finance and the Bank of Japan. While Japanese authorities have threatened to intervene again, the US Federal Reserve's commitment to keep policy rates low right through to 2013 is a clear negative for USD/JPY. However, Citi analysts continue to see potential for further intervention at the 75 level, if it is deemed necessary. Longer-term, Citi analysts think that Japanese fundamentals may point to some JPY weakness eventually and they expect JPY to continue to weaken, although it may be difficult for the Japanese monetary authorities to clear the effect of corporate sell orders prior to financial half year-end. Citi analysts forecast the USD/JPY at 76 over a 12-month horizon.

Pound sterling

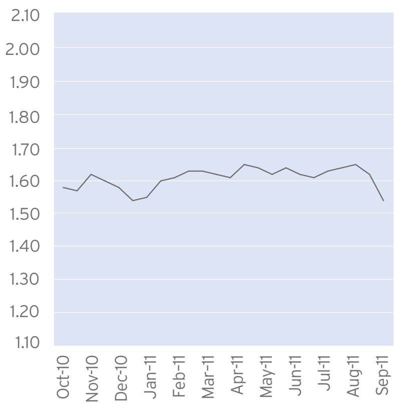
Citi analysts think that, over the past year, the GBP has suffered from the UK's relatively restrictive fiscal policy which, combined with heightened sovereign credit fears during the summer, has lead to significant weakness in August and September. Citi analysts believe fiscal austerity has dampened near-term growth prospects, though not as much as doing nothing and facing market pressures might have done. Citi analysts recognize that tight fiscal policy probably implies a desire by policymakers to see a low GBP and low interest rates. However, the combination of the EMU sovereign crisis and the US credit downgrade has apparently closed off the use of fiscal policy as a short-term demand management tool elsewhere, too. As such, the comparative disadvantage for GBP has been reduced. In the near term, Citi analysts expect GBP to remain weak as anaemic growth, deteriorating labour market, and stubbornly high inflation remains the key determinant of the GBP trend. Citi analysts forecast the GBP/USD at 1.51 over a 12-month horizon.



Euro-Dollar (USD/EUR)
Data source: Bloomberg as of 30 September 2011.



Dollar-Yen (JPY/USD)
Data source: Bloomberg as of 30 September 2011.



Pound-Dollar (USD/GBP)
Data source: Bloomberg as of 30 September 2011.

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

Metals and mining: panic provides

By Johan Pretorius, Director Metals & Mining sector for Citi Investment Research and Analysis (CIRA)

A surge of negative news flow and gloomy economic outlook have weighed heavily on equities, including mining sector stocks. Sentiment is deep in 'panic' territory and stocks look priced for a mild recession. Near-term volume growth, supportive long-term commodity price fundamentals, margin enhancement and a declining capex profile should result in strong cash generation for most miners. Comfortable balance sheets mean less risk than in 2008 and could result in attractive dividend yields when combined with strong cash generation.

Supportive long-term commodity price fundamentals

We see several factors that are likely to continue supporting commodity prices over the medium term. These include continued urbanisation and industrialisation of populous and fast-growing emerging markets, supply constraints caused by project and infrastructure delays, increasing mining complexity (particularly at new projects), rising project costs, loose monetary policies globally, potential for commodity-intensive fiscal stimulus in advanced economies, a weak USD, and potential for higher demand for commodities for inflation protection.

Our concerns

Earnings growth provided by commodity prices

Miners' operating profit grew 310% between 2002 and 2010, mostly benefiting from higher commodity prices. Sales volume growth contributed only 46%. It will likely be more challenging to continue growing shareholder value over the next decade as we forecast average commodity prices falling 27% in real terms. Miners with large exposures to iron ore, copper and coking coal will likely find it more challenging to grow revenue against the background of falling commodity prices.

After commodity prices, the cost of mining has been the biggest factor impacting miners' profitability. While commodity prices are up over 200% in nominal terms since the super cycle began in 2004, costs have also risen sharply. In many cases, costs have risen by +100% over the same period of time. Thus, while margins for most commodities have expanded, costs have been a continual dampener on margins and there are clear indications that cost pressures are structural issues rather than just a cyclical rise in costs due to high commodity prices.

Earnings momentum slowing or turning negative

Earnings upgrades have been due almost exclusively to higher commodity prices. However, commodity prices have now risen to historically high levels, which allow elevated margins for all miners and therefore pose downside risk if they revert to long-term average prices. A gloomy economic outlook has recently started taking its toll on earnings forecasts.

Peak margins leave room for downgrades

Citi's (and consensus) near-term commodity price forecasts are well above longer-term marginal costs of production and allow for elevated margins for the miners over the next five years. Hence we see commodity prices being almost exclusively demand-driven, with little production cost underpin in most cases. There could be downside risk to earnings forecasts if commodity prices and margins return to long-term average levels sooner than we anticipate.

Investment positives

Potential downgrades priced in Mining equities have derated significantly due to macro economic concerns and are now trading at attractive single-digit forward PE multiples using our base-case earnings forecasts. We believe equities may have led earnings forecasts lower. It could be that we are entering into a slow-growth environment, rather than a continuation of a supercycle, but even if we adjust our near-term earnings forecasts to reflect what we see as normalised margins, we still derive attractive implied PE multiples, which suggests the market is already pricing in significantly lower commodity prices.

Strong volume growth to drive earnings

We prefer earnings growth through sales volumes, rather than relying on higher commodity prices. We forecast robust average volume growth of 48% by 2020 for the miners covered. There could be downside risk to production volume forecasts, however, relating mainly to ongoing infrastructure constraints, potential for electricity shortages in South Africa, and delays relating to government red tape.

Longer-term margin enhancement

We believe long-term margins will benefit from increasing competitiveness of existing large-scale, low-cost mines in a steepening cost curve environment and focusing volume growth on attractive industries.

We believe long-term commodity prices could be significantly higher than average levels seen over the past 30 years. This is driven by the dramatic pace of sustainable operating and capital cost inflation, and shifts in the competitive landscape. China will likely continue to be structurally short of commodities, attracting higher-cost production to satisfy its rapidly growing needs. This could lead to steepening cost curves. Mining companies with existing large-scale, low-cost assets should become increasingly competitive as the marginal cost of production rises.

Comfortable balance sheets

Strong balance sheets allow miners to exploit cheap borrowing costs to fund projects or acquisitions in order to leverage shareholder returns. The combination of healthy cash generation and strong balance sheets could result in attractive cash returns to investors, in our view.

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

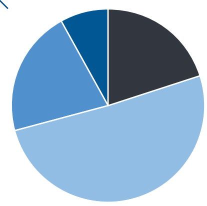
Final word

Asset allocations

Euro-tilted model portfolios

Defensive

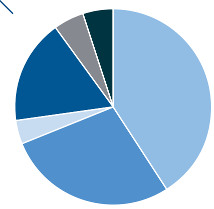
Seeking primarily capital preservation over time and only willing to accept very minor portfolio value fluctuations from month to month.



- EUR Cash **20%**
- EUR Government Bonds **51%**
- EUR Corporate Bonds **21%**
- European Equities **8%**

Income-oriented

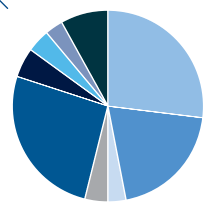
Seeking growth of wealth over time but unwilling to accept significant fluctuations in the value of portfolio from month to month.



- EUR Government Bonds **41%**
- EUR Corporate Bonds **28%**
- EUR High Yield Bonds **4%**
- European Equities **17%**
- Global Equities **5%**
- Global REITs **5%**

Growth and income

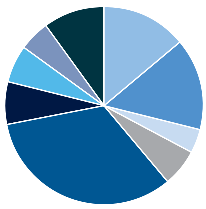
Seeking long-term capital growth foremost but unwilling to accept significant losses on value of portfolio over the medium term.



- EUR Government Bonds **27%**
- EUR Corporate Bonds **20%**
- EUR High Yield Bonds **3%**
- Emerging Market Debt **4%**
- European Equities **26%**
- US Equities **5%**
- Pacific Equities **4%**
- Emerging Markets Equities **3%**
- Global REITs **8%**

Growth oriented

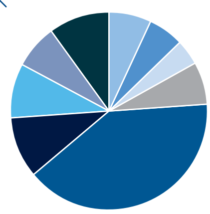
Seeking long-term capital appreciation and willing to tolerate measured medium-term volatility in order to enhance longer-term performance.



- EUR Government Bonds **14%**
- EUR Corporate Bonds **15%**
- EUR High Yield Bonds **4%**
- Emerging Market Debt **6%**
- European Equities **33%**
- US Equities **7%**
- 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 **7%**
- EUR Corporate Bonds **6%**
- EUR High Yield Bonds **4%**
- Emerging Market Debt **7%**
- European Equities **40%**
- US Equities **10%**
- Pacific Equities **9%**
- Emerging Markets Equities **7%**
- Global REITs **10%**

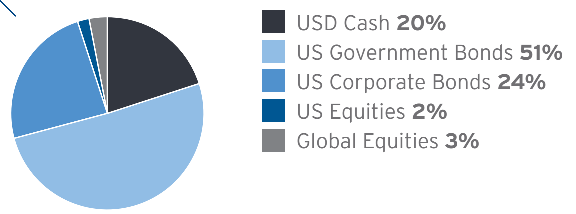
Forecasts may not be attained. **Past performance is no guarantee of future results.**
There are additional risks associated with foreign investments.

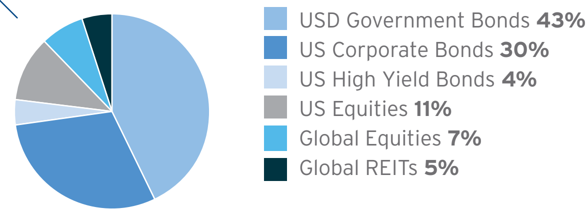
Spotlight on allocations

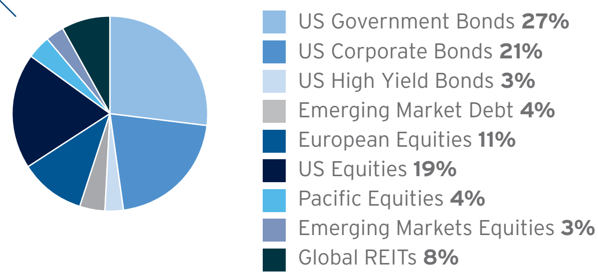
The suggested allocations are intended to be general in nature and are not to be construed as specific investment advice. Investors are encouraged to consult with their Financial Professional to determine their allocation needs based on their risk tolerance, suitability and goals.

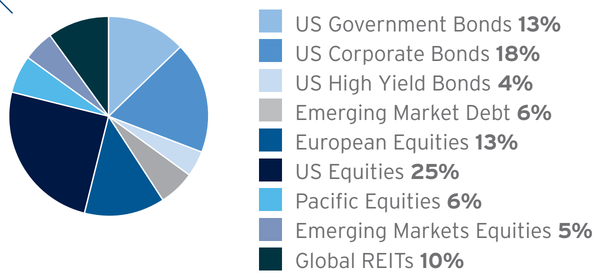
Data Source: Citibank NA as of 30 September 2011.

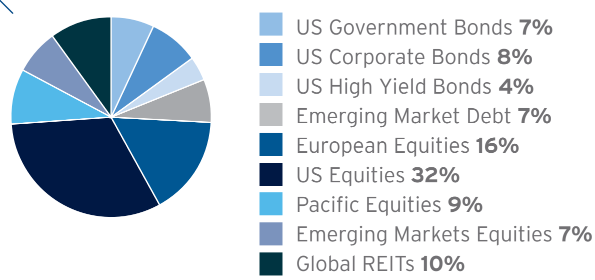
USD-tilted model portfolios











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 and equity markets

- We have decreased our allocation to global equities to underweight and increased our allocation to global bonds to overweight.

Citi analysts see better relative value in investment-grade corporate bonds and have further increased their position. Equities have been cut to underweight to fund this position as plummeting economic growth expectations have dampened the potential for any sustainable rally in equities at this juncture.

Allocation to regional equity markets

- We have maintained our overweight allocation to Japanese equities and our underweight allocation to US equities. European equities is now overweight, emerging markets equities is now underweight.

Citi analysts have trimmed their overweight position on Japanese equities. Valuations for Japanese stocks continue to be cheap relative to its own history and against its developed market peers, but the market could struggle against slowing global growth. Emerging markets are also unlikely to outperform as the global economy slows. Core European equities (Germany and France) have sold-off sharply this year. Citi analysts believe relatively cheap valuations may provide downside protection and upside potential in the event European policymakers get their act together.

Allocation to government and credit markets

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

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. They have completely excised Japanese government bonds from the portfolio in favour of emerging market debt, which appears to offer relatively better value at a time of falling policy rates.

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

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.

This document is based on information provided by Citigroup Investment Research and Analysis, Citigroup Global Markets, Citi Private Bank and Citigroup Alternative Investments. It is provided for your information only. It is not intended as an offer or solicitation for the purchase or sale of any security. Information in this document has been prepared without taking account of the objectives, financial situation or needs of any particular investor. Accordingly, investors should, before acting on the information, consider its appropriateness, having regard to their objectives, financial situation and needs. Any decision to purchase securities mentioned herein should be made based on a review of your particular circumstances with your financial adviser. Investments referred to in this document are not recommendations of Citibank or its affiliates.

Although information has been obtained from and is based upon sources that Citibank believes to be reliable, we do not guarantee its accuracy and it may be incomplete and condensed. All opinions, projections and estimates constitute the judgment of the author as of the date of publication and are subject to change without notice. Prices and availability of financial instruments also are subject to change without notice. Past performance is no guarantee of future results.

Subject to the nature and contents of the document, the investments described herein are subject to fluctuations in price and/or value and investors may get back less than originally invested. Certain high-volatility investments can be subject to sudden and large falls in value that could equal the amount invested. Certain investments contained in the document may have tax implications for private customers whereby levels and basis of taxation may be subject to change. Citibank does not provide tax advice and investors should seek advice from a tax adviser.

Investment products: (i) are not insured by the Federal Deposit Insurance Corporation; (ii) are not deposits or other obligations of any insured depository institution (including Citibank); and (iii) are subject to investment risks, including the possible loss of the principal amount invested.

GRA22274 10/11