



FINANCIAL MARKET ANALYSIS

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June 25, 2012

Mixed week for stocks as Eurozone hopes tempers growth concerns

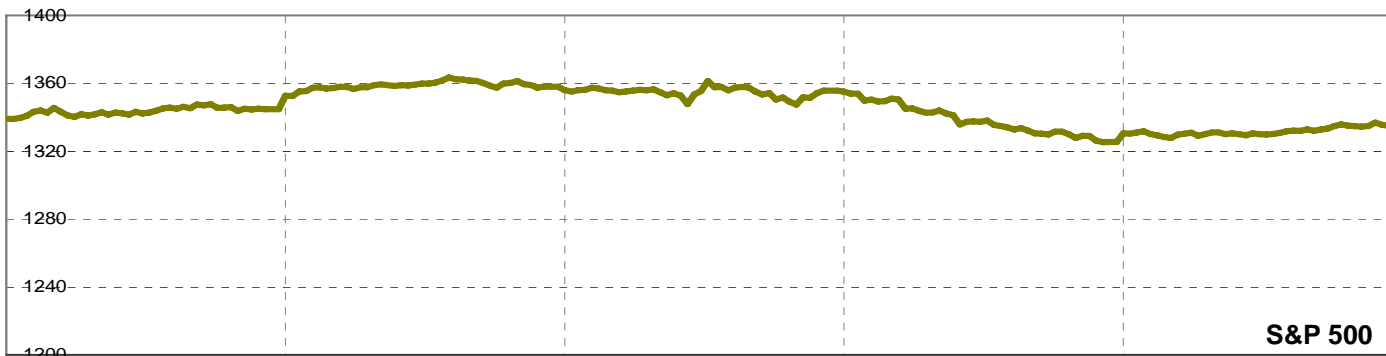
Equity market action was mixed last week. Concerns of an imminent Greek exit from the Eurozone eased following the recent elections, but focus soon shifted to the state of the global economy after the Federal Reserve cut its economic forecast for the US and as reports pointed to slower manufacturing activity in the US and China. The S&P ended the week -0.6% lower at 1,335.02, though the Stoxx Europe index managed to eke out a 0.68% gain to close at 219.58. The week ahead sees the EU Summit (Thursday/Friday) as the key highlight. Greek political leaders want to re-negotiate Greece's loan agreement but expectations are low however and chances of disappointment remain high. Eurozone data includes Consumer Confidence (Thursday) and CPI (Friday). Auctions to watch are Italian bonds and Spanish bills (Tuesday), Italian bills/bonds (Wednesday/Thursday). In the UK, Housing data is due on Monday, followed by GDP revision and Current Account on Thursday. In the US, we have New Home Sales (Monday), Consumer Confidence (Tuesday), Durable Goods (Wednesday), GDP revision (Thursday), Chicago PMI and University of Michigan (Friday). Fed speakers include Pinalto and Fisher (Thursday) and Bullard (Friday). Data in Asia include Industrial Production from Taiwan (Monday), Singapore (Tuesday), Japan and Korea (Friday); CPI from Singapore (Monday) and Japan (Friday); Hong Kong Trade (Tuesday); and China official Manufacturing PMI (Sunday).

| | Jun 22 Close | Last week's return | YTD Return | YTD return (USD) |
|----------------------------|-----------------|-----------------------|---------------|---------------------|
| S&P 500: | 1335.02 | -0.58% | +6.16% | +6.16% |
| Stoxx Europe: | 219.58 | +0.68% | -2.75% | -5.73% |
| Nikkei 225: | 8798.35 | +2.67% | +4.06% | -0.41% |
| MSCI Asia ex Japan: | 397.84 | -0.65% | +1.29% | +1.29% |

In this issue:

- *US economy: Additional attempts at accommodation may be needed*
- *Europe economy: Another underwhelming summit likely*
- *Asia Pacific ex Japan equities: Omens for dividends remain good*

TAKING STOCK



| Monday Jun 18 | Tuesday Jun 19 | Wednesday Jun 20 | Thursday Jun 21 | Friday Jun 22 |
|---|--|--|--|--|
| S&P: +0.14% STOXX: -0.67% Nikkei: +1.77% MSCI Asia ex Japan: +1.42% | S&P: +0.98% STOXX: +1.90% Nikkei: -0.75% MSCI Asia ex Japan: +0.38% | S&P: -0.17% STOXX: +0.59% Nikkei: +1.11% MSCI Asia ex Japan: +0.57% | S&P: -2.23% STOXX: -0.43% Nikkei: +0.82% MSCI Asia ex Japan: -1.40% | S&P: +0.72% STOXX: -0.69% Nikkei: -0.29% MSCI Asia ex Japan: -1.57% |
| <p>US: The NAHB housing market index for Jun was 29 vs. 28 in May, the highest since May '07. Index of current single family home sales was 32, higher than May's 30 and the highest since Apr '07.</p> <p>EU: Final Greek election results – New Democracy Party secured 29.7% of votes while the leftist Syriza party trailed behind with 26.9 and PASOK managed to get just 12.3%. New Democracy and PASOK won combined 162 seats, including the 50-seat bonus that New Democracy Party should get for coming first.</p> <p>EU: The final count for election results in France puts President Hollande's Socialist Party and affiliates on 314 parliamentary seats in the National Assembly, giving him a comfortable margin over the 289 required for a majority in the 577-seat lower house.</p> <p>EU: According to the Bank of Spain, Spain's bad loans ratio was 8.72% in Apr vs. 8.37% in Mar. Such troubled loans stood at €152.bn.</p> <p>EU: UK Rightmove house prices increased 2.4% YoY in Jun vs. 2% YoY in May.</p> <p>AP: Hong Kong's unemployment rate fell to 3.2% s.a. in Mar-May from 3.3% s.a. previously.</p> <p>AP: The Reserve Bank of India left all rates unchanged – repo rate at 8%, reverse repo rate at 7% and the cash reserve ratio at 4.75%.</p> | <p>US: May housing starts increased to 708K (-4.8% MoM) vs. 744K in Apr, below market expectations of 722K. May building permits rose by 7.9% MoM to 780K from 723K in Apr, well above market expectations of 730K, its highest reading since Sep '08.</p> <p>EU: German Jun ZEW survey revealed a sharp fall in the headline investor sentiment indicator, to -16.9 from +10.8 in May, far worse than market expectations of an easing to +4.0. The current conditions sub-indicator eased to 33.0 from 44.1 in May, lower than market expectations of 39.8.</p> <p>EU: The French INSEE business survey revealed a slight easing of its headline manufacturing industry sentiment gauge, to 92 in Jun, from 93 in May, in line with the market consensus. The overall composite indicator which incorporates the manufacturing, services, retailing and building sectors, also revealed a decline, to 90 from 91 in May.</p> <p>EU: UK CPI declined -0.1% MoM in May. The annual rate fell to 2.8% from 3.0% in Apr, marking the lowest inflation rate since Nov '09. But ex-food, alcohol, energy and tobacco, CPI rose to 2.2% YoY from 2.1% YoY in Apr.</p> | <p>US: The Federal Open Market Committee left the Fed funds rate unchanged around a 0.25-0.00% range, reiterating that economic conditions – including low rates of resource utilization and a subdued outlook for inflation over the medium run – are likely to warrant exceptionally low levels for the Fed funds rate at least through late-2014. The Fed extended Operation Twist through year-end. Fed officials also downgraded their assessments of the economic outlook and reintroduced an easing bias into their policy statement.</p> <p>EU: German PPI fell -0.3% MoM (+2.1% YoY) in May (Apr 0.2% MoM, 2.4% YoY).</p> <p>EU: UK May claimant count unemployment rose 8.1K (Apr -12.8K), though the unemployment rate held steady at 4.9%. The ILO-based measure fell -51K in Feb-Apr, but the unemployment rate also unchanged at 8.2%. Average earnings growth was 1.4% YoY, vs. consensus expectations of 0.8%.</p> <p>JP: Real exports rose 0.6% MoM in May after 3.8% MoM in Apr, leaving the Apr-May average 3.1% above the 1Q12 average (1Q12 1.6% QoQ). Real imports increased 5.0% MoM (Apr 2.7% MoM), leaving the Apr-May average 5.4% above the 1Q12 average (1Q12 1.1% QoQ). The customs clearance trade balance stood at a -¥907.3bn deficit before seasonal adjustment (Apr -¥522bn), and at -¥657.2bn after s.a. (Apr -¥512bn).</p> <p>AP: Taiwan exports fell -3.0% YoY in May after -3.5% YoY in Apr, slightly beating market expectations of -3.7% YoY.</p> | <p>US: Initial jobless claims for the week ending 16 Jun fell -2K to 387K (Consensus 383K). The 4-week average rose to 386.3K from 382.8K.</p> <p>US: Existing home sales fell -1.5% MoM in May (Apr +3.4%). The month's supply rose to 6.6 from 6.5.</p> <p>US: Philadelphia Fed index fell to -16.6 in Jun, lowest since Aug '11 (May -5.8).</p> <p>US: May leading economic indicators rose 0.3% (Apr -0.1%, Consensus +0.1%).</p> <p>US: Markit manufacturing PMI was 52.9 in Jun vs. 54 in May.</p> <p>EU: Eurozone Jun flash composite PMI held steady at 46.0.</p> <p>EU: Eurozone Jun prelim consumer confidence fell to -19.6 from -19.3 in May.</p> <p>EU: UK May retail sales was 1.4% MoM vs. -2.4% in Apr.</p> <p>AP: Hong Kong headline CPI fell further to 4.3% YoY in May (Apr 4.7% YoY).</p> <p>AP: Taiwan CBC kept policy rates unchanged – discount rate remains at 1.875%, rate of accommodations with collateral and without collateral remain at 2.25% and 4.125% respectively.</p> <p>AP: China Jun flash HSBC manufacturing PMI fell to 48.1 from 48.4 in May.</p> <p>Others: Moody's repositioned the ratings of 15 banks and securities firms with global capital markets operations. The long-term senior debt ratings of 4 firms were downgraded by 1 notch, 10 firms were downgraded by 2 notches and 1 firm was downgraded by 3 notches.</p> | <p>EU: The European Central Bank confirmed that it is easing collateral requirements in terms of credit-rating thresholds and widen eligibility for asset-/mortgage-backed securities.</p> <p>EU: The Jun German Ifo survey showed a fall in its headline business climate indicator to 105.3 from 106.9 in May, vs. market expectations of 105.9. The current conditions sub-indicator rose to 113.6 from 113.2 in May, whilst the expectations sub-index fell to 97.3 from 100.8 in May.</p> <p>EU: Italian consumer confidence fell by 1.2pts in Jun to 85.3, the lowest since the series began in 1996.</p> <p>AP: Malaysia May CPI eased to 1.7% YoY (Apr 1.9%), in line with market expectations.</p> <p>AP: Taiwan's unemployment rate rose to a five-month high of 4.25% s.a. in May, up from 4.19% s.a. in Apr. Wage data showed that average monthly working hours in Apr fell to 173.9 hours, down 14.5 hours from Mar but up 2.7 hours from a year ago. Industrial production declined by -0.21% YoY in May, vs. -1.8% YoY in Apr and market expectations of -2.5% YoY.</p> |

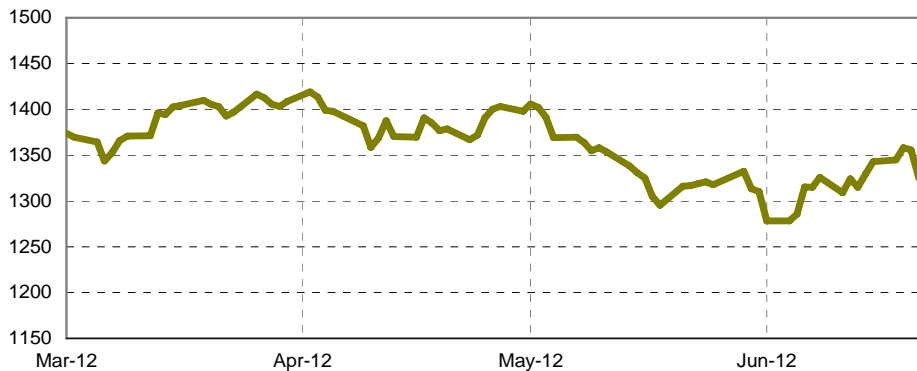
Over the Weekend
Jun 23 and Jun 24

Others: --

Please note: Citi analysts' comments are in italics. Source: Bloomberg, Reuters, Associated Press, CIRA

US/NORTH AMERICA

S&P 500 (1/3/2012 to 22/6/2012)



Source: Bloomberg

Economic Outlook

Additional attempts at accommodation may be needed

The Federal Reserve (Fed) took modest new easing steps last week but signalled an increased likelihood that additional attempts at accommodation may be needed. With some signs of slowing exaggerated and financial conditions still somewhat supportive, officials want time to sort through uncertainties without committing to possibly more costly measures.

Fed officials' downgrading of medium-term forecasts suggests that an extension of forward rate guidance could be considered soon if unemployment stalls. A policy rule that has tracked earlier guidance now prescribes a late 2014 funds rate of minus 0.3%, down from 0.5%.

While recent housing activity was boosted by mild winter weather, the improvements have continued into the peak housing season, suggesting some upside to the housing outlook. Also, prices seem to be stabilizing and becoming less of an impediment to home buying. But tight mortgage credit continues to constrain first time buyers and remains a key policy concern. Broader housing recovery may require further improvement in the overall economy and especially in the labour market.

The Week Ahead

25/6

- **New home sales** likely rose in May (360K) coinciding with the rise in permits of single family homes.

26/6

- **Consumer confidence** was likely little changed in June at 65.0, in contrast to the large initial drop in the Michigan sentiment index.

27/6

- **Durable goods orders** likely rose in May (0.5%) with core capital goods accounting for the bulk of the increase.

28/6

- **Initial jobless claims** for the week ending June 23 were probably virtually unchanged at 385K.
- Citi analysts look for another downward revision to **1Q12 real GDP growth**, to 1.7% from 1.9%.

29/6

- **Personal consumption** was likely tepid in May (0.1%).
- Citi analysts expect the **Chicago purchasing managers' index** to rebound somewhat in June to 54.0, after a two-month, ten-point decline.
- Citi analysts look for an upward revision to **Reuters/Michigan Sentiment** for June (76.0).

Equities

International investors continue to remain buyers of US equities

| | Last week's close | Last week's return | YTD return |
|---------|-------------------|--------------------|------------|
| S&P 500 | 1335.02 | -0.58% | +6.16% |
| DJIA | 12640.78 | -0.99% | +3.46% |
| Nasdaq | 2892.42 | +0.68% | +11.03% |

The continued focus on European fiscal challenges and the memory of a financial crisis in the US arguably have left investors fearful. But while outflows from US equity mutual funds have climbed to almost US\$500 billion since 2007 (versus more than US\$995 billion flowing into bond funds), Americans still have roughly US\$4.3 trillion in US equity funds (modestly less than at the 2007 peak) and another US\$1.5 trillion in international funds, suggesting that the feared mass exodus has not occurred.

Furthermore, international investors have continued to buy US stocks and now own about 13% of the publicly traded US market, almost twice the level seen a decade ago.

Indeed, the S&P 500 has gained 44% since mid-June 2009, while the Russell 2000 has tacked on 47% and the Nasdaq Composite has soared more than 56%. Hence, being out of the stock market has carried a fairly hefty opportunity cost and may explain why individual investors are not such unwilling owners.

Source: CIRA

Bonds

Preference for high-grade corporates and emerging market debt

| | Jun 22 2011 | Jun 15 2011 | Jun 8 2011 |
|------------|-------------|-------------|------------|
| 2-yr Try: | 0.303% | 0.270% | 0.266% |
| 5-yr Try: | 0.754% | 0.672% | 0.712% |
| 10-yr Try: | 1.674% | 1.577% | 1.635% |

Treasuries: Citi analysts expect yield curves to flatten, and for gains to be potentially generated in the intermediate- to longer-dated maturity range.

High-grade corporates: Remains one of the top pick as solid fundamentals and a positive technical backdrop could continue to boost total returns.

High-yield corporates: Despite recent impressive returns, Citi analysts believe risk aversion due to disappointing US economic data and increasing concerns in the European periphery may likely slow the rally. As such, they selectively favour high single B issuers and double B credits with improving fundamentals.

EMD: Increased corporate bond issuance in emerging markets may present opportunities to pick up yield while benefiting from stronger domestic growth.

Currencies

USD: USD strength likely near-term, outlook likely flat over the 6-12 month horizon

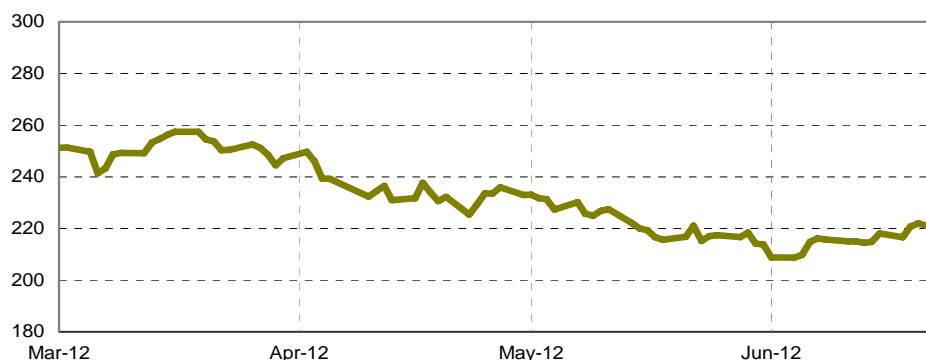
| | June 2012 forecasts | |
|--|---------------------|--------|
| | EURUSD | USDCAD |
| | 1.25 | 1.02 |

USD strength continues to be Citi analysts' central forecast over the near term given heightened risk aversion, related financial market volatility, falling commodity prices and weakening global growth expectations. They anticipate further USD strength relative to G10 majors with EUR/USD likely falling towards 1.20 and AUD/USD likely below 0.95. In the emerging market space, they believe most of the recent USD gains are likely to be retained over the next 0-3 months, at least.

Over 6-12 months, their base case is that risk appetite recovers, probably supported by additional central bank liquidity injections. This could then take some steam out of the USD rally.

EUROPE

STOXX (1/3/2012 to 22/6/2012)



Source: Bloomberg

Economic Outlook

Another underwhelming summit likely

On June 28/29, the Heads of State and Heads of Government (HoSHoGs) of all 27 EU countries will hold a Council meeting in Brussels. Citi analysts believe that the HoSHoGs could agree on a "pact for growth" which aims to complement the "fiscal compact". An agreement of the European leaders to go ahead in forming a "banking union" is likely, but details are not expected in that respect. While probably providing a commitment for further fiscal and political integration, Citi analysts do not expect that the Council will provide a roadmap for that journey yet.

While there is broad agreement among the Euro Area HoSHoGs that further fiscal and monetary integration is warranted, there are substantial differences regarding the speed and the procedure for more integration. As Angela Merkel repeatedly said, Germany favours a gradual approach under which fiscal and political integration with the transfer of sovereignty from national governments to EU institutions takes place first, before going ahead with measures to mutualise debt. In contrast, France wants to have a swift increase in common funding tools but has huge problems in giving up sovereignty to EU institutions.

The Week Ahead

26/6

- **France:** Household confidence is expected to have fallen slightly to a five-month low in June (89), reflecting some renewed concerns about Greece and the continued deterioration of the domestic economic environment amid reports of widespread potential job losses.

27/6

- **Germany:** Falling prices for oil and other commodities probably helped to reduce **import prices** on a monthly comparison in May (-1.0% MoM, +1.8% YoY).

28/6

- **Norway:** The **registered jobless rate** is seen rising 0.1 point to 2.4% in June.

29/6

- **Euro Area:** After declining for two consecutive months, Citi analysts expect the **inflation rate** to remain unchanged at 2.4% YoY in June.
- **Germany:** After slippage in April, Citi analysts expect a recovery in **retail sales** in May (0.4% MoM).

Equities

Edging back to risk

| | Last week's close | Last week's return | YTD Return |
|----------|-------------------|--------------------|------------|
| STOXX | 219.58 | +0.68% | -2.75% |
| FTSE 100 | 5513.69 | +0.64% | -1.05% |
| DAX | 6263.25 | +0.54% | +6.19% |

European equities look cheap on most valuation measures, and a lot of bad news appears priced in. On average, European equities are cheaper than 85% of the time in the past 25-100 years.

However, given current macro risks, valuation by itself is probably not attractive enough for most investors to turn aggressive buyers of equities at this point. While a significant fall in corporate earnings expectations is probably priced in, a global recession and corporate earnings collapse is probably not. But from here, Citi analysts think that bears probably have to back global recession.

Overall, valuation should provide support to European equities. But, additional support, likely through various central banks' policy actions, may be needed to drive share prices higher. Citi analysts believe investors could potentially start to position for this by using the recent sell-off to raise exposure to structural themes and add risk in a measured way. They prefer risk strategies that also have exposure to quality/fundamental support.

Source: CIRA

Bonds

Favour German Bunds

| | Jun 22 2011 | Jun 15 2011 | Jun 8 2011 |
|------------|-------------|-------------|------------|
| 2-yr Try: | 0.135% | 0.068% | 0.043% |
| 5-yr Try: | 0.642% | 0.511% | 0.445% |
| 10-yr Try: | 1.581% | 1.437% | 1.329% |

German Bunds remain Citi's favoured government market given the substantial growth undertow from periphery countries and the likelihood of additional European Central Bank (ECB) easing later this year.

In the UK, the greater risk to Gilts are a weakening of the government's position and a reversal of fiscal tightening; something that Citi analysts think could likely trigger a rapid response from ratings agencies and the markets. Assuming that does not happen, they see the combination of fiscal restraint, weak growth and quantitative easing as supportive for Gilts.

Currencies

EUR: Downward pressures remain
GBP: Rally to slow but more upside vs. EUR likely to come

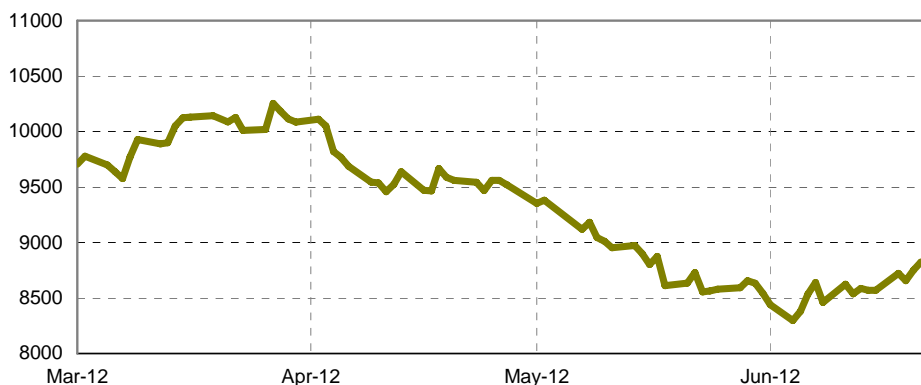
| June 2012 forecasts | | |
|---------------------|--------|--------|
| GBPUSD | USDCHF | EURGBP |
| 1.58 | 0.96 | 0.79 |

Citi analysts forecast more downside for EUR/USD over the medium term, with 1.20-1.25 likely the new trading range, though lower rates are not being ruled out given the ongoing EMU crisis and thus the prospect of further substantial easing by the European Central Bank. There is however risk that the Federal Reserve could respond to a tightening of financial conditions emanating from Europe by easing/entering QE3. This might generate unexpected EUR strength.

The main driver of GBP strength has been a less dovish monetary policy committee, causing the market to price out QE expectations. But given expectations for growth to be anaemic, Citi analysts believe extra stimulus may be forthcoming and continue to expect QE to be expanded further. Coupled with higher risk aversion, they see GBP/USD trading near 1.58 in the short to medium term. With EUR/USD likely to fall faster, Citi analysts forecast EUR/GBP around 0.78 in the near term.

JAPAN

Nikkei 225 (1/3/2012 to 22/6/2012)



Source: Bloomberg

Economic Outlook

BoJ Tankan preview

Citi analysts expect the June Bank of Japan (BoJ) Tankan corporate survey, to be published on July 2, to reveal tepid business confidence at manufacturers, resilience in business conditions at non-manufacturers and relatively solid business investment plans. While they think that the Tankan survey itself is unlikely to have an immediate impact on monetary policy, they expect the BoJ to take additional action in the months to come. The business confidence diffusion index (DI) at large manufacturers is expected to dip to -5 in June from -4 in March. The business confidence DI for large non-manufacturers may however stay unchanged at +5, as reconstruction demand from the earthquake and continued resilience in consumer spending probably supported business conditions. Private capex plans are likely to remain relatively firm despite tepid business confidence at large manufacturers. However, there is a risk that investment plans are postponed if the external environment worsens further.

The Week Ahead

28/6

- **Retail sales** probably increased 3.0% YoY and 0.2% MoM in May (Apr +5.7% YoY, -0.4% MoM).

29/6

- **Nominal household spending** probably increased 3.0% YoY and fell -0.4% MoM in May (Apr +3.2% YoY, -0.9% MoM) while **real spending** likely rose 2.6% YoY and dropped -0.1% MoM (Apr +2.6% YoY, -0.8% MoM).
- The **unemployment rate** probably declined to 4.5% in May (Apr 4.6%).
- **Nationwide core CPI** (ex fresh food) likely dropped -0.1% YoY in May, the first negative reading since January '12. **Headline nationwide CPI** likely rose 0.2% YoY (Apr +0.4% YoY), while **CPI ex food and energy** probably dropped -0.6% YoY (Apr -0.3% YoY).
- **Industrial production** may have decreased -2.7% MoM in May after a 0.2% MoM slide in April.
- May **housing starts** probably stood at 882K (+7.0% YoY) on a seasonally adjusted annualized basis (Apr 896K, +10.3% YoY). On a MoM basis, housing starts likely fell -1.5% (Apr +5.7%).

Equities

Rallies in range bound markets

| | Last week's Close | Last week's return | YTD return |
|---------------|-------------------|--------------------|------------|
| Nikkei | 8798.35 | +2.67% | +4.06% |
| Topix | 750.92 | +3.35% | +3.06% |

Since the post-Lehman low in March 2009, TOPIX has been rallying and pulling back between 700 and 1,000. Broadly speaking, there have been four rallies and four pullbacks. Rallies have had an average duration of 4.3 months and added an average 16.8%. Citi analysts studied metrics that may lead TOPIX, including foreigner net buying of Japanese equities, the revision index, the evaluated margin gain/loss ratio, margin long position, margin short position, and the short ratio. They found that foreigner net buying of Japanese equities and the evaluated margin gain/loss rate tend to work as leading metrics.

In the four rallies, Securities, Other Financials, and Transport Equipment were in the top five in both average and median values. Outperforming in all four rallies were Machinery, Wholesale, Non-ferrous Metals, and Other Financials. In the rally from March to August 2009, companies with low price-to-book ratios and degraded balance sheets outperformed substantially. The effectiveness of price-to-earnings ratios as a metric has intensified as the reliability of profit forecasts has increased as the economy normalized. The impact of balance sheet health on share price performance has diminished as awareness of bankruptcy risk has receded.

Source: CIRA

Bonds

Some JGB underperformance around the fiscal year-end expected

| | Jun 22 2011 | Jun 15 2011 | Jun 8 2011 |
|-------------------|-------------|-------------|------------|
| 2-yr Try: | 0.103% | 0.102% | 0.102% |
| 5-yr Try: | 0.223% | 0.233% | 0.190% |
| 10-yr Try: | 0.830% | 0.853% | 0.856% |

Ongoing downgrades to Japan's growth outlook and continued expectations of Bank of Japan (BoJ) bond purchases are supporting JGBs. The divergence between Japanese yields and the other major markets looks overstretched, however, and Citi analysts think that there may be potential for some JGB underperformance around the fiscal year-end. But with policy rates likely to remain near zero for a long time and the BoJ maintaining its duration commitment, Citi analysts believe that calls for a fiscally driven bear-market are premature.

Currencies

JPY: USD/JPY likely to trade sideways

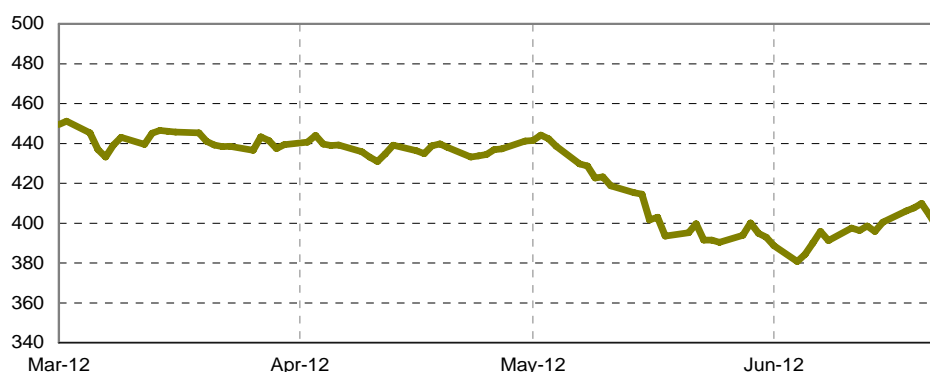
| | June 2012 forecast | |
|--|--------------------|--------|
| | USDJPY | EURJPY |
| | 80 | 100 |
| | | AUDJPY |
| | | 76.4 |

USD/JPY has basically traded sideways around the 80 mark since the beginning of May, and Citi analysts expect this trend to continue for the next several months. Considering that JPY typically benefits in risk-off periods, weaker risk appetite globally could lead to more downward pressure on USD/JPY. But a decline in the cross to much below 80 could prompt greater political pressure on the Bank of Japan to add further stimulus/intervention. By itself, anticipation of such a policy response could limit the amount of downside.

On the flipside, more sluggish export growth and import flows related to tight domestic energy markets could be negative for JPY. USD/JPY is however unlikely to move much higher until short-term interest rates in the US rise materially. Citi analysts expect some widening in US-Japan rate differentials over the course of this year which could push USD/JPY slightly higher. However, it is only when the Federal Reserve is closer to hiking rates do they expect USD/JPY to make a more decisive shift towards 85 or beyond.

ASIA PACIFIC EX JAPAN

MSCI Asia ex Japan (1/3/2012 to 22/6/2012)



Source: Bloomberg

The Week Ahead

25/6

- **Singapore:** May CPI likely moderated to 5.2% YoY (0.3% MoM s.a.).

26/6

- **Hong Kong:** Citi analysts forecast single digit trade growth in May of 1.8% YoY for exports and 2.3% for imports; narrowing the expected trade deficit to HK\$38.1bn.
- **Singapore:** Industrial production is likely to rise 8.1% YoY (Apr -0.3%), which implies a 3.9% MoM s.a. expansion (Apr -3.4%).

27/6

- **Taiwan:** Both the May leading and coincident index probably slowed to 0.2% MoM s.a.

28/6

- **Thailand:** Manufacturing production likely grew 1.1% YoY in May.

29/6

- **Korea:** May industrial production likely continued to slow on MoM terms, (0.5% MoM, 0.1% YoY).

1/7

- **China:** The June manufacturing PMI (CFLP) likely slid by 0.8ppt to 49.6.

Economic Outlook

China 2H12 Outlook: A rebound in the making

Economic growth appears to have stabilized, although at a low level. 2Q12 growth may fall to 7.3% YoY in the absence of a strong lift from June. Meanwhile, inflation is likely to stay below 3% in the next few months, creating room for further policy easing. Citi analysts expect the government to fully utilize this room under the current policy mix, which could facilitate a growth rebound in 3Q12. They have however trimmed their 2012 GDP growth forecast to 7.8% from 8.1% to reflect anaemic domestic activity in 2Q12 and further weakening of EU demand.

Unless the sovereign debt problem in Europe escalates to a full-blown economic and financial crisis and results in a deep recession in the continent, Citi analysts think the Chinese government does not have the appetite to introduce a 2008-09 type of stimulus. Instead, they expect two more rate cuts to boost demand; two more reserve requirement ratio (RRR) cuts to bring money growth to 14%; expansionary fiscal policy within the limit of the budget; and targeted property policy easing to prevent an investment slump.

Equities

Omens for dividends remain good

| | Last week's close | Last week's return | YTD Return |
|--------------------|-------------------|--------------------|------------|
| MSCI Asia ex Japan | 397.84 | -0.65% | +1.29% |

On a fundamental basis, dividends work well in Asia since they are the easiest way for the majority shareholder/family to distribute profits amongst themselves and minority shareholders. Dividends also work since, to pay dividends, one needs to have profits, and because, as an investment theme, it is still relatively overlooked. In Asia, a mere 1.8% of funds are income funds versus 11% in the US and 18% in Europe. The Asian dividend pay-out ratio has gone from 26% in 2000 to 35% by 2011.

Corporate gearing in Asia remains low and well below historic averages. Capex to sales is set to hit a 22-year low in 2012 which leaves plenty of free cash flow. Investors tend to believe that dividends are as volatile as earnings, but historically that has not been the case. Looking at the amount of dividends paid versus secondary stocks issued, the differential is the widest in favour of dividends and has been positive since 2004. In 2000 only 5% of stocks in Asia had a dividend yield which exceeded bond yields, and by 2011 that percentage had risen to 45%. Moreover, the overall level of participation is quite high. The percentage of companies that paid dividends has risen from 72% in 2000 to 93% in 2011.

Source: CIRA

Bonds

Prefer Philippines bonds

Asian rates have sold off sharply on improved global growth, back-up in US yields, and for a few markets (e.g. Thailand), additional supply. Within the bond space, Citi analysts still like PHP bonds relative to others – the belly of the curve has been relatively resilient, with the back end sold off sharply (partly on the big turnaround shift in expectations about BSP's policy action) – to the point that 10yr PHP bonds are now trading slightly higher in yields (pre-tax) to 10yr Indonesia bonds. Indeed, Citi analysts still prefer the Philippines given lower foreign positioning, solid fiscal position, benign inflation risks, ample domestic liquidity, and rating upgrade prospects.

Currencies

AUD: Under pressure EM Asia: A flat CNY

| June 2012 forecasts | | |
|---------------------|--------|--------|
| AUDUSD | NZDUSD | USDSGD |
| 0.96 | 0.74 | 1.27 |

Citi analysts expect the pace of AUD depreciation to slow but continue to look for a move back to parity in the 6-12 month horizon. Concerns around China's slowing economy have continued to come to the forefront, while prices of key commodities produced in Australia have also remained depressed and AUD does not appear to have fully responded to this. Moreover, there is still risk of further rate cuts by the Reserve Bank of Australia.

CNY remains pivotal for EM Asia currencies. USD/CNY has basically flat-lined since end-December 2011 and recent weaker global trade volumes combined with domestic Chinese growth pressures suggest that USD/CNY is more likely to move sideways rather than trend further downwards in the near term. If so, this could constrain the upside potential in many EM Asia currencies.

WORLD MARKETS AT A GLANCE

| | Previous Week's Close | 52-Week High | 52-Week Low | Weekly Return | YTD Return | YTD Return (USD) |
|--|--------------------------|-----------------|----------------|------------------|---------------|---------------------|
| UNITED STATES | | | | | | |
| Dow Jones Industrial Average | 12640.78 | 13338.66 | 10404.49 | -0.99% | +3.46% | +3.46% |
| S&P 500 | 1335.02 | 1422.38 | 1074.77 | -0.58% | +6.16% | +6.16% |
| Nasdaq | 2892.42 | 3134.17 | 2298.89 | +0.68% | +11.03% | +11.03% |
| EUROPE | | | | | | |
| DJ Euro STOXX | 219.58 | 282.62 | 194.63 | +0.68% | -2.75% | -5.73% |
| FTSE 100 | 5513.69 | 6084.08 | 4791.01 | +0.64% | -1.05% | -0.54% |
| DAX | 6263.25 | 7523.53 | 4965.80 | +0.54% | +6.19% | +2.93% |
| JAPAN | | | | | | |
| Nikkei 225 | 8798.35 | 10255.15 | 8135.79 | +2.67% | +4.06% | -0.41% |
| TOPIX | 750.92 | 879.48 | 692.18 | +3.35% | +3.06% | -1.36% |
| ASIA | | | | | | |
| MSCI Asia ex Japan | 397.84 | 493.16 | 353.80 | -0.65% | +1.29% | +1.29% |
| Hong Kong Hang Seng | 18995.13 | 22835.03 | 16170.35 | -1.24% | +3.04% | +3.12% |
| Shanghai Composite Index | 2260.88 | 2826.96 | 2132.63 | -1.99% | +2.79% | +1.73% |
| Taiwan Weighted Index | 7222.05 | 8842.17 | 6609.11 | +0.93% | +2.12% | +3.31% |
| Korea KOSPI | 1847.39 | 2192.83 | 1644.11 | -0.58% | +1.19% | +1.03% |
| Mumbai Sensex | 16972.51 | 19131.70 | 15135.86 | +0.13% | +9.82% | +2.01% |
| Singapore Straits Times Index | 2828.09 | 3227.28 | 2521.95 | +0.61% | +6.87% | +8.62% |
| Kuala Lumpur Composite | 1603.07 | 1611.50 | 1310.53 | +1.51% | +4.73% | +3.93% |
| Thai Stock Exchange | 1152.91 | 1247.72 | 843.69 | -1.10% | +12.44% | +11.70% |
| Jakarta Composite Index | 3889.52 | 4234.73 | 3217.95 | +1.87% | +1.77% | -1.69% |
| Philippines Stock Exchange Index | 5120.07 | 5329.76 | 3715.01 | +3.84% | +17.11% | +20.75% |
| Australia All Ordinaries | 4093.80 | 4717.50 | 3829.40 | -0.32% | -0.42% | -2.32% |
| EMEA | | | | | | |
| Russia MICEX Index | 1347.15 | 1748.30 | 1241.62 | -2.04% | -3.93% | -7.14% |
| South Africa JSE All Shares Index | 34118.87 | 34808.92 | 28305.41 | +0.47% | +6.67% | +2.44% |
| Turkey ISE National 100 Index | 60451.41 | 64463.13 | 48600.16 | +3.39% | +17.92% | +22.61% |
| LATIN AMERICA | | | | | | |
| Mexico Bolsa Index | 39071.50 | 40050.21 | 31561.51 | +3.53% | +5.38% | +5.92% |
| Brazil Bovespa Index | 55439.50 | 68969.99 | 47793.49 | -1.19% | -2.32% | -11.45% |
| COMMODITIES | | | | | | |
| Gold | 1572.45 | 1921.15 | 1478.83 | -3.36% | +0.56% | +0.56% |
| Oil | 79.76 | 110.55 | 74.95 | -5.08% | -19.30% | -19.30% |
| FIXED INCOME | | | | | | |
| Citigroup World Government Bond Index | 622.33 | 627.29 | 581.01 | +0.03% | +2.15% | +2.15% |

Source: Bloomberg (As at June 22, 2012)

CURRENCY FORECASTS

| Currency | | 25-Jun-12 | Jun-12 | Sep-12 | Dec-12 | Mar-13 | Jun-13 | Sep-13 | Dec-13 | Mar-14 | Jun-14 |
|----------------------|--------|-----------|--------|--------|--------|--------|--------|--------|--------|--------|--------|
| G10-US Dollar | | | | | | | | | | | |
| Euro | EURUSD | 1.25 | 1.25 | 1.23 | 1.24 | 1.25 | 1.26 | 1.27 | 1.28 | 1.29 | 1.3 |
| Japanese yen | USDJPY | 80 | 80 | 80 | 80 | 80 | 81 | 82 | 83 | 84 | 85 |
| British Pound | GBPUSD | 1.56 | 1.58 | 1.58 | 1.58 | 1.58 | 1.59 | 1.61 | 1.62 | 1.64 | 1.65 |
| Swiss Franc | USDCHF | 0.96 | 0.96 | 0.97 | 0.97 | 0.97 | 0.97 | 0.97 | 0.96 | 0.96 | 0.96 |
| Australian Dollar | AUDUSD | 1.00 | 0.96 | 0.93 | 0.94 | 0.95 | 0.94 | 0.93 | 0.92 | 0.91 | 0.90 |
| New Zealand | NZDUSD | 0.79 | 0.74 | 0.72 | 0.72 | 0.73 | 0.72 | 0.69 | 0.67 | 0.64 | 0.63 |
| Canadian Dollar | USDCAD | 1.03 | 1.02 | 1.03 | 1.02 | 1.01 | 1.00 | 0.99 | 0.98 | 0.97 | 0.97 |
| Dollar Index | DXY | 82.46 | 82.40 | 83.20 | 82.77 | 82.35 | 81.89 | 81.39 | 80.90 | 80.42 | 80.05 |
| G10 Crosses | | | | | | | | | | | |
| Japanese yen | EURJPY | 100 | 100 | 99 | 99 | 100 | 101 | 104 | 107 | 109 | 111 |
| Swiss Franc | EURCHF | 1.20 | 1.20 | 1.20 | 1.20 | 1.21 | 1.21 | 1.22 | 1.23 | 1.24 | 1.25 |
| British Pound | EURGBP | 0.80 | 0.79 | 0.78 | 0.78 | 0.79 | 0.79 | 0.79 | 0.79 | 0.79 | 0.79 |
| Swedish Krona | EURSEK | 8.81 | 9.17 | 9.13 | 8.98 | 8.83 | 8.74 | 8.71 | 8.69 | 8.66 | 8.65 |
| Norwegian Krone | EURNOK | 7.48 | 7.65 | 7.67 | 7.60 | 7.54 | 7.50 | 7.50 | 7.50 | 7.50 | 7.50 |
| Norwegian Krone | NOKSEK | 1.18 | 1.20 | 1.19 | 1.18 | 1.17 | 1.17 | 1.16 | 1.16 | 1.16 | 1.15 |
| Australian Dollar | AUDNZD | 1.27 | 1.30 | 1.29 | 1.30 | 1.30 | 1.32 | 1.35 | 1.38 | 1.41 | 1.43 |
| Australian Dollar | AUDJPY | 80.2 | 76.4 | 74.7 | 75.2 | 75.7 | 76.1 | 76.2 | 76.3 | 76.4 | 76.4 |
| EM Asia | | | | | | | | | | | |
| Chinese Renminbi | USDCNY | 6.37 | 6.33 | 6.31 | 6.27 | 6.23 | 6.20 | 6.17 | 6.15 | 6.12 | 6.11 |
| Hong Kong Dollar | USDHKD | 7.76 | 7.76 | 7.75 | 7.75 | 7.76 | 7.76 | 7.76 | 7.75 | 7.75 | 7.75 |
| Indonesian Rupiah | USDIDR | 9524 | 9327 | 9316 | 9349 | 9382 | 9394 | 9382 | 9369 | 9357 | 9344 |
| Indian Rupee | USDINR | 56.6 | 54.4 | 54.2 | 54.5 | 54.8 | 54.5 | 53.5 | 52.5 | 51.5 | 51.0 |
| Korean Won | USDKRW | 1162 | 1174 | 1170 | 1156 | 1142 | 1117 | 1080 | 1042 | 1005 | 985 |
| Malaysian Ringgit | USDMYR | 3.19 | 3.14 | 3.12 | 3.08 | 3.03 | 3.00 | 2.99 | 2.97 | 2.96 | 2.95 |
| Philippine Peso | USDPHP | 42.7 | 43.1 | 42.8 | 42.5 | 42.2 | 41.9 | 41.8 | 41.7 | 41.6 | 41.5 |
| Singapore Dollar | USDSGD | 1.28 | 1.27 | 1.26 | 1.25 | 1.24 | 1.23 | 1.22 | 1.21 | 1.20 | 1.19 |
| Thai Baht | USDTHB | 31.9 | 31.7 | 31.7 | 31.1 | 30.5 | 30.2 | 30.1 | 30.0 | 30.0 | 30.0 |
| Taiwan Dollar | USDTWD | 30.0 | 29.9 | 30.1 | 29.6 | 29.1 | 28.7 | 28.6 | 28.4 | 28.3 | 28.2 |
| EM Europe | | | | | | | | | | | |
| Czech Koruna | EURCZK | 25.73 | 25.5 | 25.51 | 25.3 | 25.11 | 24.88 | 24.63 | 24.38 | 24.13 | 23.93 |
| Hungarian Forint | EURHUF | 288 | 297 | 293 | 290 | 287 | 286 | 287 | 288 | 289 | 290 |
| Polish Zloty | EURPLN | 4.27 | 4.45 | 4.50 | 4.40 | 4.30 | 4.21 | 4.12 | 4.03 | 3.95 | 3.90 |
| Israeli Shekel | USDILS | 3.92 | 3.87 | 3.91 | 3.92 | 3.94 | 3.94 | 3.93 | 3.92 | 3.91 | 3.88 |
| Russian Ruble | USDRUB | 33.2 | 31.3 | 31.4 | 31.7 | 32.0 | 32.1 | 32.1 | 32.1 | 32.2 | 32.1 |
| Russian Ruble | Basket | 36.9 | 34.8 | 34.7 | 35.1 | 35.5 | 35.8 | 36.0 | 36.2 | 36.4 | 36.5 |
| Turkish Lira | USDTRY | 1.82 | 1.85 | 1.87 | 1.88 | 1.89 | 1.89 | 1.88 | 1.87 | 1.86 | 1.85 |
| South African Rand | USDZAR | 8.43 | 8.41 | 8.46 | 8.47 | 8.49 | 8.53 | 8.59 | 8.66 | 8.72 | 8.80 |
| EM Latam | | | | | | | | | | | |
| Brazilian Real | USDBRL | 2.07 | 2.02 | 2.02 | 1.98 | 1.94 | 1.91 | 1.89 | 1.87 | 1.86 | 1.85 |
| Chilean Peso | USDCLP | 503 | 510 | 512 | 504 | 496 | 492 | 491 | 491 | 490 | 490 |
| Mexican Peso | USDMXN | 13.9 | 14.0 | 14.0 | 13.7 | 13.5 | 13.2 | 12.9 | 12.6 | 12.4 | 12.2 |
| Colombian Peso | USDCOP | 1791 | 1810 | 1814 | 1813 | 1811 | 1815 | 1825 | 1835 | 1845 | 1854 |

Source: CIRA, Bloomberg (As June 25, 2012; Forecasts as of May 23, 2012)

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