

On-loan activity

Government bonds

- U.S.
- European

Corporate bonds

- U.S.
- European

Global equities

- U.S.
- European
- Asian

Key: Up Down No change

Welcome



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Welcome to the first edition of *Market Monitor* for 2007. In response to client demand, the core focus this year for Citigroup will be to continue the development of securities lending and borrowing into new markets. In 2006 we implemented new lending capabilities in Taiwan, South Africa, the Czech Republic and Hungary, and we plan to build on this momentum in 2007 where we will be looking to offer securities lending and borrowing solutions in Poland, Russia, Israel, Malaysia and Brazil. By keeping close to where the borrowers see future demand, other markets may be added to this list as the year progresses.

Citigroup is currently in the process of implementing Equilend, designed to process equity and fixed-income securities transactions on a global basis. The Equilend platform increases efficiency for the industry and all participants by standardising, centralising and automating front- and back-office processes.

There are many development initiatives underway. For example, increased reporting capabilities, which will allow clients to manipulate data and formulate their own reports. We will keep you informed of these over the year.

We would like to have your comments on this newsletter so please feel free to contact us with your suggestions.

U.S. equities

Our U.S. desk in New York saw overall average balances were up 2.85 per cent for the month, with average specials in demand up 6.83 per cent.

Earlier in December, stocks rallied. Better-than-expected retail sales, strong earnings in the financial sector and tame Consumer Price Index (CPI) helped drive the rally. Other reports including data from the Labour Department showed a decline in labour costs and a rise in productivity, which helped ease inflation concerns. November's jobs report and lower oil prices at around USD62 a barrel helped to maintain the rally.¹

With better-than-expected economic data late in December, the Dow broke the 12,500 mark for the first time. The Chicago Purchasing Managers Index number came in above its break-even level to 52.40 from 49.90 in November. Existing home sales rose in excess of 0.60 per cent in November, 1.45 per cent higher than estimates.

Consumer confidence also surprised to the upside, rising to 109.00 in December from 105.30 the previous month. Year-end window dressing, as fund managers added winning stocks to their portfolios, also helped fuel the gains.²

Active stocks in demand

- Novagold (NG) traded as low as 2 per cent ahead of a cash tender, which expired on 6 December 2006.
- Shares of NYMEX Holdings (NMX), a recent Initial Public Offering (IPO) traded as low as -6.00 per cent.
- Shares of NYSE Group (NYX) traded as low as -25.00 per cent.
- New River Pharmaceuticals (NRPH) traded as low as -3.75 per cent.
- Shares of Crucell (CRXL) traded as low as 0.25 per cent.
- Winnebago (WGO) traded as low as 3.25 per cent, ahead of record date 8 December 2006.
- Siliconware (SPIL) traded as low as -0.50 per cent.
- Shares of Sadia (SDA) traded as low as 0.00 per cent.

- Allied Capital (ALD), ahead of record on 22 December 2006, traded at 0.00 per cent.
- Superior Industries (SUP), ahead of record on 5 January 2007, traded at -1.00 per cent.
- Simpson Manufacturing (SSD), ahead of record on 4 January 2007, traded at 0.00 per cent.
- Tel Com De Sao Paulo ADR (TSP) traded as low as 0.00 per cent.
- Shares of Mannatech (MTEX) traded as low as 0.50 per cent.

Sectors in demand in December included autos, Exchange Traded Funds (ETFs), and Real Estate Investment Trusts (REITs). Some drivers of this demand included asset valuations, downgrades, interest-rate volatility, commodity prices and supply issues.

¹ Source: Bloomberg L.P., 5, 8, 11, 13, 15 December 2006; *Wall Street Journal* (WSJ), 5, 8, 11, 13, 15 December 2006.

² Source: Bloomberg L.P., 26, 28, 29 December 2006; WSJ, 26, 28, 29 December 2006.

U.S. cash and money markets

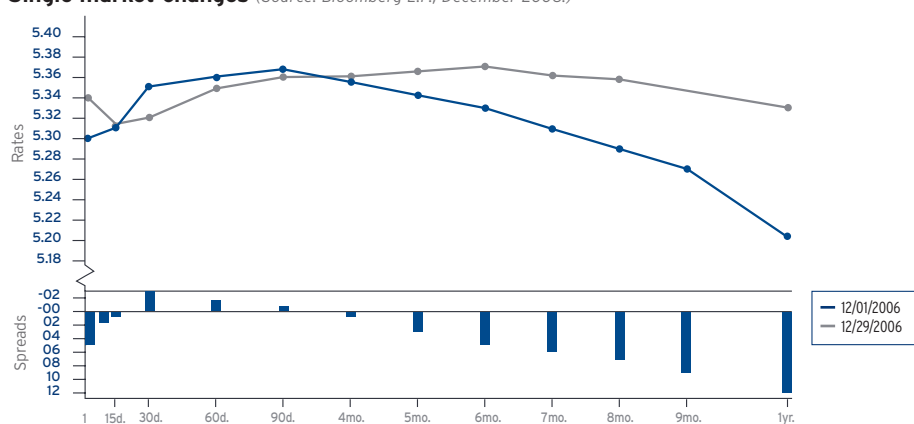
Our U.S. desk in New York saw that, while the economic data released during the month offered some mixed signals, the overall direction of the market was a closing of the divergence between the view expressed by the monetary policy makers (with a risk of further firming of rates in 2007) and the traders in the fixed-income markets (easing of rates sometime in the first half of 2007).

In previous issues of this newsletter, we have mentioned the fact that despite the view of the Federal Open Market Committee (FOMC) that the perceived inflation risks led to a decision to maintain a bias towards policy firming (higher interest rates), the market had continued to price in an increased probability of lower interest rates by early-to-mid 2007. At the start of December, the probabilities for a 25-basis-point (bps) rate cut in the Fed funds target rate from 5.25 per cent to 5.00 per cent were 26.00 per cent by the end of January, 72.00 per cent by late March and 100.00 per cent by early May. By the end of December, those probabilities had dropped to 2.00 per cent, 12.00 per cent and 37.00 per cent,

respectively. Indicators that the service portion of the U.S. economy remained robust, and that the fall in the housing market would not be too severe, were the primary drivers of the change in market sentiment. It is unlikely that we will see the market consensus change to become totally in line with the FOMC's view, but it is possible that we will continue to see the yield curve continue to flatten from the steep inversion it exhibited at the beginning of December, as shown in the graph below.

More pertinent to the cash-collateral management process was the seasonal corporate credit spread-widening available on a limited basis late in December. Commercial paper (CP), which typically offers yields of about 7 to 10 bps above the Fed funds rate, was offered in the 30- to 60-day maturity zone at premiums in excess of 20 bps. We had structured several of the portfolios that purchased CP to have added liquidity at that time in order to take advantage of the spread-widening opportunity, and those portfolios will exhibit some moderate yield enhancement over the short-term.

Single market changes (Source: Bloomberg L.P., December 2006.)



U.S. corporate bonds

As seen by our U.S. desk in New York, in December, overall average balances were down 3.08 per cent for the month, while average special balances were down 10.51 per cent.

Citadel Investment Group LLC sold USD500 million five-year notes, which is the first-ever corporate bond issuance by a hedge fund. These notes yielding 6.34 per cent are about 190 bps above similar maturing Treasuries. The average spread on bonds with similar credit ratings is about 122 bps.³

Ford Motor Co's finance unit sold USD3 billion in bonds, more than two times the amount that was planned, to help raise money to pay for the elimination of in excess of 40,000 jobs and the closing of nine factories. Their 10-year note is yielding 8.25 per cent, which is 373 bps over U.S. Treasuries with similar maturities. Ford also sold USD4.5 billion convertible bonds, 50 per cent more than was expected.⁴

Ontario plans to sell USD1 billion of a 10-year global bond. The spread to U.S. Treasuries with similar maturities is approximately 40 bps.⁵

Hybrid bond sales are increasing as more investors are seeking higher yields and protection from leveraged buyouts, which can hurt credit ratings. Approximately USD26 billion of hybrids, which have characteristics of equities and bonds, have been issued in the last four months alone. New issuance is up over 55 per cent from 2005.⁶

High-yield bonds, measured by Banc of America Securities High-Yield Bond Index, were up over 11 per cent, year-to-date, reflecting cyclically low default rates below 1 per cent, narrowing the spreads to Treasuries. The rapidly growing credit-derivatives market also helped to compress spreads. This cheap financing was a major factor driving the buyout surge this year.⁷

Issues in demand

- Metaldyne (CUSIP 591160AB2): 0.00 per cent.
- JLG Industries (CUSIP 466210AB7): 0.00 per cent.
- Bre Properties (CUSIP 05564EBH8): 0.75 per cent.
- United Airlines (CUSIP 909317AZ2): 4.25 per cent.
- Liberty (CUSIP 530718AC9): 4.875 per cent.
- Maytag (CUSIP 57859HBU7): 4.50 per cent.
- WCI (CUSIP 92923CAG9): -1.00 per cent.
- Movie Gallery (CUSIP 624581AB0): -2.00 per cent.
- Century (CUSIP 156503AG9): 1.00 per cent.
- Abitibi (CUSIP 003669AJ7): 3.00 per cent.

³ Source: Bloomberg L.P., 7 December 2006.

⁴ Source: Bloomberg L.P., 11 December 2006.

⁵ Source: Bloomberg L.P., 20 November 2006.

⁶ Source: Bloomberg L.P., 21 December 2006.

⁷ Source: *Barron's Online*, 25 December 2006.

U.S. issuance and credit

The U.S. asset-backed commercial paper (ABCP) market reached another milestone during 2006, as year-end outstandings were USD1.052 trillion, up 26.52 per cent from USD831 billion in 2005. As of year-end 2006, U.S. ABCP outstanding accounted for 53.70 per cent of all U.S. CP issued, up from 50.6 per cent in 2005.⁸

Global credit trends finished strong at year-end as no significant downgrades occurred in the banking sector during

the month of December 2006. A few notable downgrades in the corporate sector included Home Depot and Anheuser Busch. Home Depot was downgraded by Standard & Poor's (S&P) to A+/A1 and by Fitch to A+/F1.⁹ Both Nationally Recognised Statistical Rating Organisations (NRSROs) cited the recent U.S. USD5-billion debt deal and the subsequent share buyback plan as the primary cause of the downgrade.

S&P downgraded Anheuser Busch Companies Incorporated's long-term ratings to A from A+.¹⁰ S&P referred to an increased leverage target and aggressive share buyback in 2007 as the cause.

⁸ Source: www.federalreserve.gov, December 2006.

⁹ Source: www.ratingsdirect.com, December 2006; www.fitchratings.com, December 2006.

¹⁰ Source: www.ratingsdirect.com, December 2006.

U.S. treasury and agency

The month of December was more or less a continuation of November with regards to overnight treasury repo, as seen by our U.S. desk in New York. Except for the year-end turn, which averaged 4.90 per cent, overnight treasuries averaged greater than or equal to the Fed funds target of 5.25 per cent. The average overnight general collateral (GC) rates for treasuries and agencies were 5.23 per cent and 5.29 per cent.

However, if you discount the year-end turn, treasuries averaged 5.27 per cent. This mirrors the November average.

The outstanding balances continued to hover at approximately 100 per cent of the lendable inventory throughout most of the month. We did experience a modest reduction in lendable inventory as a result of year-end recalls, which is not unusual. We expect to get those securities back out on loan on the first business day of January.

The current issues were back in play during December. The repo market seems to be shaking off the effects of the latest Securities and Exchange Commission (SEC) scrutiny and began to trade in earnest as the month progressed. The 10-year note lead the way, averaging 160 bps, and the long bonds averaged an impressive 90 bps. Surprisingly, the current two-year note, which has been dormant of late, averaged 35 bps. This increased trading activity for currents bodes well for the off-the-run sector.

European government bonds

Our European desk in London saw GC balances increase throughout the first half of December, as we were able to benefit from demand for termed euro-sovereign debt and a good supply of CP issuance. As expected, the European Central Bank (ECB) hiked interest rates by 25 bps to 3.50 per cent. The move was fully priced in, providing a good spread environment between GC and reinvestment for clients participating in full reinvestment programmes. We expect demand to increase significantly in January as broker-dealers start financing their European equity dividend activity.

DBR 3-and-a-quarter July 2015 (DE0001135283) traded up to 100 bps as pressure built in the approach to the December futures contract. Going forward we are seeing premium rates for DBR 3-and-a-quarter January 2009 (DE0001135101) and DBR 3-and-a-half January 2019 (DE0001135291)

into the March contract (20 March 2007), with these issues trading at 20 bps and 25 bps, respectively.

Spanish government bonds remained well bid throughout December, and we expect to continue to see demand at least into February with this paper required over January's month-end.

In the gilt market we saw activity at the start of December in UKT 5 March 2008 (GB0031734154), which traded on open at around 20 bps. We also saw demand in term for UKT 8 December 2015 (GB0008881541), which traded between 5 bps and 25 bps through GC between January and March

The sterling market still appears split on further rate activity from the Bank of England, with LIBOR suggesting another 25-bps rise most likely in February and currently fully priced in for March.

European money markets

As expected the ECB increased rates by 25 bps on 7 December to 3.50 per cent. Following this, euro short-term rates traded in a range of 3.55 to 3.65 per cent, except at year-end where rates lifted to over 3.70 as banks tidied up their balance sheets. The futures market is now pricing in an expected further increase on 25 bps in either February or March.

UK rates remained unchanged in December at 5.00 per cent. Much of the data during December pointed towards higher rates, but some of the Bank of England's Monetary Policy Committee members are reportedly unconvinced. The futures market is looking for an increase of 25 bps in February. Short-term rates traded in a narrow band between 5.05 and 5.10 per cent.

European equities

Our European desk in London saw that during December overall balances were down 11.00 per cent for the month. This is mainly a result of brokers and hedge funds returning long positions over year-end.

The Bank of New York agreed to buy Mellon Financial Corp for USD16.5 billion. The combined company will have USD16.6 trillion in assets under custody.

UK¹¹

The pound is poised for the biggest annual advance since 1990, as it became the world's third-most-popular reserve currency and the Bank of England lifted interest rates to the highest in five years.

Europe¹²

During December, European stocks climbed to a six-year high, as earnings improved and takeovers increased.

Active Stocks

Relative value and merger and acquisition news

- Euronext agreed a merger with NYSE, backed by institutional investor services.
- Gallaher was acquired by Japan Tobacco Inc for GBP7.5 billion.
- Rank Group Plc agreed to sell Hard Rock Chain to The Seminole Tribe for USD965 million.
- Statoil agreed to acquire Norsk Hydro for GBP28 billion.

- Premier Foods agreed to buy RHM Plc for EUR1.2 billion.
- Givaudan agreed to purchase a unit of ICI (Quest International) for GBP1.2 billion.
- Grupo Ferrovial purchased BAA for USD19 billion.
- Iberdrola agreed to purchase Scottish Power for GBP11.6 billion.
- Abertis agreed to buy 32 per cent of Eutelstat Communications for EUR1.07 billion.
- Porsche AG/Volkswagen AG – speculation surrounding a takeover
- Kerself raised up to EUR5 million in rights offer.
- Sonaecom plans a capital increase with a rights issue.
- Cap Gemini raised up to EUR500 million in share sale.
- Medvir plans to raise SEK225 million in share sale.
- Credit Agricole plans to sell shares to raise EUR4 billion.
- Active Biotech plans to raise SEK240 million in share sale.
- Banaca Italease raised EUR300 million in rights offer.
- BBVA plans to raise EUR3 billion in share sale.
- DIC Asset AG plans to raise EUR191.8 million in share sale.

Directional (long/short)

- Antena 3 recorded its worst rating in 13 years in September with very thin supply.
- Premiere AG reported a second-quarter net loss of EUR138.8 million (USD178 million).
- Sacyr Vallhermoso – volatile stock in thin supply.
- Option continues to be a major recall name.
- Tiscali – volatile stock in thin supply.
- Conergy continues to be a major recall name.
- Geophysique – volatile stock in thin supply.

Convertible bonds issued

- Actelion
- Tandberg Data
- Karstadt
- Sogecable
- Intralot

Sectors and markets in demand

Sectors in demand included Spanish utilities, ETFs and REITs, South Africa and emerging markets.

¹¹ Source: Bloomberg L.P., December 2006.

¹² Source: Bloomberg L.P., December 2006.

Asia-Pacific equities¹³

China

Shanghai's benchmark index rose 4.20 per cent on the final day of trading to a high of 2,675.47 points, rounding off a dramatic comeback performance by the world's best-performing key market this year, as noted by our desk in Hong Kong. The rise was led by heavyweights ICBC and Bank of China, the latter temporarily suspended from trading after rising the 10.00 per cent daily limit. China ranked fifth-best performing index against all indexes, behind Peru, Cyprus, Venezuela and Vietnam.

The yuan rose to its highest level against the US dollar, bringing it close to parity with the Hong Kong dollar. The mainland currency has risen 3.30 per cent this year and 5.70 per cent since the revaluation in July 2005.

Hong Kong

Balances were down 3.28 per cent for the month of December, as seen by our desk in Hong Kong.

Starting the month at 18,960.48 points, the index marginally increased throughout the month of December before gaining momentum in the second half of the month, increasing dramatically on the 22 December to an all-time high on the 28 December of 20,001.91, before settling back to finish the year off at 19,964.72 points.

China Petroleum and Chemical Corp (Sinopec), Asia's largest crude-oil refiner, saw its share price rise as much as 6.99 per cent after an announcement of a CNY5-billion windfall from the central government to compensate for losses due to price controls.

The handout was unexpected by the market as the management had earlier stated a CNY10-billion subsidy the

company received a year earlier was a one-off event. It was a bumper year for IPOs in Hong Kong, thanks to Chinese companies taking advantage of global bullish sentiment about mainland stocks. Fifty-six companies raised HKD333 billion in 2006, more than double the HKD165 billion raised by 57 companies in 2005, according to the stock exchange. The frenzied pace of equity fund-raising by mainland companies in Hong Kong is expected to continue in 2007.

Active stocks in demand

- Citic Ka Wah Bank (6484493) traded at an average 5.85 per cent.
- China Everbright (6455143) traded at an average 5.63 per cent.
- Angang Steel Co Ltd (6015644) traded at an average 4.12 per cent.
- Maanshan Iron & Steel (6600879) traded at an average 3.86 per cent.
- Golden Eagle Retail (B10S7ML) traded at an average 3.50 per cent.

Asia-Pacific equities (continued)

Japan

Balances were down 4.00 per cent from November as year-end rebalancing occurred, as seen by our desk in Hong Kong.

The Nikkei started the month at 16,274.33 and declined slightly to a low of 16,265.76 points on 5 December before a steady rise to end the month at 17,225.83 points.

Japan's industrial production rose to a record high last month, buoyed by overseas demand for the nation's cars and consumer electronics. Factory output rose a seasonally adjusted 0.70 per cent from October, the Ministry Economy, Trade and Industry announced on 28 December. Overall shipments increased 1.60 per cent to a record high in November from October, the trade minister stated.

Active stocks in demand

- Privee Investment (6673547) traded at an average 9.05 per cent.
- Tottori Bank (6892171) traded at an average 6.00 per cent.
- Tokai Pulp & Paper Co Ltd (6895664) traded at an average 6.00 per cent.
- Tokyu Construction (6689351) traded at an average 5.84 per cent.
- Doshisha Co (6235992) traded at an average 5.50 per cent.
- Kabu.Com Securities (B067ML9) traded at an average 5.00 per cent.
- Mitsubishi Motor Co (6598446) traded at an average 4.35 per cent.
- Sankyu Inc (6775380) traded at an average 4.29 per cent.

South Korea

Korean positions in December fell 24.97 per cent as the record date approached and borrowers unwound expensive stock, as seen by our desk in Hong Kong. The Korea Composite Stock Price Index (KOSPI) started at 929.35 points, declining to hit a low of 1376.98 points on 12 December 2006. The KOSPI then eroded away all these losses to end the month at 930.00 points on the back of better-than-expected export numbers.

South Korea posted a record current-account surplus last month, driven by exports of semiconductors, ships and cars, and cheaper oil cut the country's import bill. The surplus widened to USD4.24 billion, compared to USD2.06 billion in November last year, the Bank of Korea declared. The USD788 billion economy has advanced for 14 consecutive quarters, the longest stretch of growth since before the 1997 Asian Crisis.

Active stocks in demand

- Samsung Elec Mech (6771689) traded at an average 4.25 per cent.
- Samsung SDI (6771645) traded at an average 4.00 per cent.
- Woong Jin Coway (6173401) traded at an average 3.81 per cent.
- Daewoo Securities (6249658) traded at an average 3.79 per cent.

Taiwan

For December, balances were up 10.73 per cent on the back of a strong market.

Taiwan's TWSE Index started the month at 7,567.72, rising marginally before falling to a low of 7,450.30 on the 13 December. The index then recovered to end up at a high of 7,823.72 points on the last day of trading.

On 28 December, the southern regions of Taiwan were hit by an earthquake registering 7.1 on the Richter scale. Telecommunications with the U.S. and Canada through the Luzon Straights were nearly all severed, and international calls, roaming services and Internet access had come to a halt.

Active stocks in demand

- Phoenixtec Power (6685508) traded at an average 5.34 per cent.
- Synnex Tech International (6868439) traded at an average 5.00 per cent.
- Shin Kong Financial Holdings (6452586) traded at an average 4.65 per cent.
- Faraday Technology (6186045) traded at an average 4.00 per cent.
- Ichia Technologies (6207139) traded at an average 4.00 per cent.

Thailand

Our desk in Hong Kong saw that despite December's turmoil, balances were up 7.77 per cent on November.

Thai exports surged at their fastest annual rate in nine months, boosting the current account surplus to its biggest in more than six years.¹³ Thailand's Set slumped 15 per cent on 19 December, after the government imposed a one-year lock-up for 30.00 per cent of new investment funds coming from overseas. It was the biggest one-day drop since Iraq invaded Kuwait in 1990. The index rebounded 11.00 per cent on 20 December, after the government eased the restriction, which still applies to bonds and property. The lock-up, which was imposed after the baht gained 16.00 per cent for the year, caused the Thai currency to decline 3.30 per cent in the week ending on 20 December. The Bank of Thailand will monitor trading in the baht and review the impact of its tough capital control measures in the middle of January.

Active stocks in demand

- Phoenixtec Power (6685508) traded at an average 5.34 per cent.
- Synnex Tech International (6868439) traded at an average 5.00 per cent.
- Shin Kong Financial Holdings (6452586) traded at an average 4.65 per cent.
- Faraday Technology (6186045) traded at an average 4.00 per cent.
- Ichia Technologies (6207139) traded at an average 4.00 per cent.

¹³ Source: Bloomberg L.P., December 2006.

¹⁴ Source: World Business Section, *South China Morning Post*, 30 December 2006.

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