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Welcome

I last had the pleasure of providing a welcome to the *Market Monitor* back in October 2007. At that time I selected the developments in the Canadian market as the central topic for my welcome. I again feel compelled to focus my remarks on the changes abreast in Canada. Although the Canadian market is both sophisticated and developed from a securities lending perspective, it is worthy of our attention because recent changes to the tax laws have paved the way for even greater enhancements.

Elimination of Canadian withholding tax on interest¹

The Canadian government has eliminated the Canadian withholding tax on interest that is paid or credited to non-residents of Canada who deal at "arm's-length". It does not cover money loans between related parties or interest on certain types of convertible debt or "participating" interests. Since this is a change to Canadian statutory law, rather than to a tax treaty, it applies to all non-resident lenders of money and is not limited to residents of countries that have a tax treaty with Canada. This tax-law change is effective for interest paid on or after 1 January 2008, and covers interest-paid debt obligations issued, and loan agreements entered into, before that date.

Application to cross-border securities loans

As a result of these changes, the rebate payment on cash collateral pledged against the return of securities by a US borrower of securities from an unrelated Canadian lender will no longer be subject to Canadian withholding tax. Canadian lenders of securities are now able to lend their securities to non-resident borrowers in exchange for cash collateral instead of government securities. In addition, since borrow fees (implicit or explicit) paid by Canadian borrowers of securities are treated as interest for Canadian tax purposes, there is no longer a Canadian withholding tax on borrow fees paid to unrelated non-resident lenders.

Status of protocol of US-Canada tax treaty¹

The protocol to the tax treaty between the United States and Canada has not yet entered into force. This protocol will eventually eliminate withholding on cross-border payments of interest, even if the parties are related. The exemption for related parties will be phased in at reduced rates (7, 4 and 0 per cent) over a three-year period. This treaty provision will not be effective until after both countries have ratified the protocol and exchanged instruments of ratification. The United States is not expected to act on this protocol until the fall of 2008. Until the protocol enters into force, the applicable treaty rate for payments of interest between US- and Canadian-related parties will remain 10 per cent.

The Canadian tax-law changes have opened up meaningful opportunities for Canadian lenders and borrowers of securities. The additional proposed changes will create even greater opportunity in the case of related parties. Canadian beneficial owners and lending agents continue to be busy at work enhancing their lending programmes by incorporating the benefits made possible by the recent tax-law changes.

¹ Canada Revenue Agency, 2008.

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Canada equities

News¹

The S&P/TSX Composite Index was volatile intra-month, declining 6.5 per cent over 10 trading sessions from 5 March to 19 March, yet settled in on 31 March, down roughly 1.4 per cent for the month. Analysts and investors polled by Bloomberg attributed a significant amount of the month's volatility and late rebound to quarter-end window dressing by institutional investors who were

profit-taking. Several composite members were active during the month, largely tied to the Fed's 0.75 benchmark interest-rate reduction on 18 March to 2.25 per cent.

Bank stocks including, Toronto-Dominion Bank, Royal Bank of Canada and Bank of Nova Scotia rebounded during the last two weeks of the month on expectations that lower borrowing costs would boost lending opportunities. Research in Motion was

volatile on concern that continued pressure on bank earnings would affect a large segment (10 per cent) of their user base, namely financial services employees.

On 26 March, Thomson Corp. and Reuters Group Plc shareholders approved the friendly merger of the two companies, with 99 per cent and 100 per cent of shareholders, respectively, supporting the move. The deal is expected to settle on

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Canada equities continued

17 April and would give the combined entity over one-third of the global financial data market share.

Active stocks

- Research in Motion: RIM CN
- Royal Bank of Canada: RY CN
- Barrick Gold Corp: ABX CN
- Manulife Financial Corp: MFC CN
- Potash Corp. of Saskatchewan: POT CN

¹ www.bloomberg.com, accessed on 18, 31 March 2008; *Wall Street Journal (WSJ)*, 18, 31 March 2008.

US equities

Overall average balances were down 1.38 per cent for the month.

News

Early in the month, after the Dow hit a 52-week low on 10 March, the Federal Reserve (Fed) announced a plan to allow banks and bond dealers to swap mortgage-backed securities for highly liquid treasuries. On Tuesday 11 March, stocks posted their biggest one-day point gain in more than five years after gaining 416 points. The rally did not have much of a follow-through, as disappointing retail-sales data and worrisome news about Bear Stearns renewed investors' fears about Wall Street's credit crisis, holding the Dow to just modest gains.

The Dow then plummeted as investors turned their attention to developments in the financial sector. Bear Stearns executives had tried to reassure markets all week that the firm's financial position was solid, but were ultimately forced to seek help. Using rarely exercised powers under a Depression-era law, the Fed approved a 28-day loan

of an underdetermined size. The loan was made via JPMorgan Chase, but the risk is being borne by the Fed, which will incur a loss if Bear Stearns defaults.¹

By mid-month, US stocks were on the brink of the broadest bear market in four decades as investors ignored the strongest buy signals in years. The retreat by all 10 industries in the Standard and Poor's (S&P) 500 Index pushed the measure down 19 per cent since its 9 October record and 14 per cent since the start of the decade. The last six times the index has fallen by 20 per cent, only once, on Black Monday in 1987, has the sell-off been so encompassing. Investors are not acting on traditional buy signals attributable to the worst housing slump since the Great Depression, USD200 billion in mortgage related losses, and the bailout of Bear Stearns by the Federal Reserve and JPMorgan Chase. The S&P 500 was within 1 per cent of the 20 per cent threshold that typically defines a bear market.²

This volatility is the most in 70 years,

according to an S&P study of daily price swings in the S&P 500. The index has advanced or declined 1 per cent or more on 28 days this year. That is 52 per cent of the trading sessions so far, which is the highest proportion since 1938, according to one S&P index analyst.³

Active stocks

- American Capital: ACAS
- Braskem: BAK
- E-Trade Financial: ETFC
- Ihop Corp: IHP
- Loopnet: LOOP

Sectors in demand included: autos, subprime lenders and exchange-traded funds (ETFs). Some drivers of this demand included: asset valuations, downgrades, commodity prices and supply issues.

¹ www.bloomberg.com, accessed on 10-14 March 2008; *WSJ*, 10-14 of March 2008.

² www.bloomberg.com, accessed on 3 March 2008; *WSJ*, 3 March 2008.

³ www.bloomberg.com, accessed on 18-20 March 2008; *WSJ*, 18-20 March 2008.

US cash and money markets

Economic data early in the month continued to support the existing market expectations that short-term interest rates would be lowered at the upcoming 18 March Federal Open Market Committee (FOMC) meeting, if not before. The employment situation report early in the month was significantly weaker than had been expected, leading the Fed funds futures market to price in an increased probability that there would be at least 100 basis points (bps) of adjustment to the Fed funds target rate.

To address the ever-increasing need for liquidity in the market for certain asset classes, on 11 March the Federal Reserve Bank (FRB) announced the establishment of a "Term Securities Lending Facility" (TSLF)¹ that would permit the US primary dealers to exchange their inventories of assets, including AAA-rated residential

mortgage-backed securities, for US Treasury securities on a temporary basis. The FRB set the size of the facility at USD200 billion, but later stated that they were open to increase that number if necessary. The first auction under this new facility would be executed on 27 March for next day settlement.

The hostile credit conditions in the market took on a whole new dimension on the morning of Friday 14 March, as Bear Stearns announced that it was facing a liquidity crisis and had arranged a massive amount of emergency financing from its clearing bank, JPMorgan Chase, with a backstop from the FRB of New York. By the time the markets opened for business on the 17 March, Bear Stearns had been sold to JPMorgan Chase for a tiny fraction of its previous market value and "book value", the FRB

had lowered the discount rate by 25 bps and the FRB had established yet another liquidity facility called the "Primary Dealer Credit Facility". This was the broadest facility of all, as it would permit the primary dealers direct access to financing by the FRB NY against any investment-grade fixed-income security that could be priced. The next day the FOMC announced a cut of 75 bps in the Fed funds target rate to 2.25 per cent and an additional 75 bps cut in the discount rate to 2.50 per cent.

Despite all of the efforts to liquefy the market, the spread between the Fed funds rate and one-month LIBOR continues to be extremely wide.

¹ www.federalreserve.gov/newsevents/press/monetary/20080311a.htm, accessed on 2 April 2008.

US corporate bonds

Overall average balances were up 31.32 per cent for the month.

News

Early in the month, Mattel Inc. and Philips Electronics led USD9.59 billion in bond sales as the risk of companies defaulting on debt rose to a record and yields over benchmark rates climbed toward new highs. Bond sales fell as concern that the US is entering a recession sapped demand and widened spreads above Treasuries, matching the record set in October 2002 when the collapse of WorldCom Inc. and the prospect of war in Iraq sent investors to the safety of government debt. These spreads rose after a report showing US home foreclosures reached a record and concern grew that

Ambac Financial Group Inc., the second largest bond insurer, would lose the AAA rating it stamped on USD556 billion of debt. Overall yields also rose 21 bps to 5.75 per cent, the largest weekly increase in almost four years.¹

Later in the month, credit-default swaps on the brokerage firms had soared on concern that more firms aside from Bear could face cash shortages. The Federal Reserve made its first emergency weekend rate cut in three decades and said it would be the lender of last resort to the 20 firms that buy Treasury securities directly from it and agreed to provide up to USD30 billion to JP Morgan Chase to help finance the purchase of Bear Stearns after a run on the firm forced an

emergency bailout. The cost to protect the bonds of securities firms from default recently dropped from the highest on record as the Federal Reserve's willingness to back a purchase of Bear Stearns fuelled optimism the central bank won't let a major broker collapse.²

Issues in demand

- Cit Group (CUSIP 125581AE8)
- Bancolumbia (CUSIP 05968LAA0)
- Charter Comm (CUSIP 161175AG9)
- First Data Corp (CUSIP 319963AN4)
- Abitibi (CUSIP 003672AAO)

¹ www.bloomberg.com, accessed on 7 March 2008.

² www.bloomberg.com, accessed on 17-18 March 2008; WSJ, 17-18 March 2008.

US Treasury and agency

The month of March was volatile for US Treasuries. Demand for Treasury collateral was strong and demand exacerbated mid-month by the market fears leading up to the Bear Stearns bailout by the federal government. The market turmoil drove treasury general collateral (GC) rates below 1 per cent for more than a week. Treasury and agency GC for March averaged 93 and 24 bps, respectively. The new quarter is shaping up to be significantly different for spreads in the near term. The Federal Reserve, concerned about the lack of liquidity in the

market, has devised three plans to bolster liquidity (please see the grid below):

- 1) Primary Dealer Credit Facility (PDCF);
- 2) Term Securities Lending Facility (TSLF); and
- 3) Term Auction Facility (TAF).

The new Fed liquidity facilities will succeed in providing liquidity to banks and primary dealers. However, the Fed's success will ultimately result in reduced demand for US Treasury collateral and the spreads to which we have become accustomed are expected

to narrow. It remains to be seen how tight the US Treasury GC spread to agencies and Fed funds will become. Spreads may become quite narrow for the near future.

The Federal Reserve reduced the overnight rate by 75 bps to 2.25 per cent during the 18 March meeting. The Fed funds futures are pricing at an 88 per cent chance of a 25 bps ease during the April 30 FOMC meeting and a 12 per cent chance of a 50 bps ease.

	Primary Dealer Credit Facility (PDCF)	Term Securities Lending Facility (TSLF)	Term Auction Facility (TAF)
Available to:	Primary Dealers	Primary Dealers	Depository Institutions
Participant is Borrowing:	Cash	General Collateral (GC) Treasuries	Cash
Acceptable Collateral:	Broad range of collateral including securities eligible for tri-party repo with Fed open mkt trading desk (e.g. Treasuries, Agencies, Agency MBS) as well as other debt securities as long as investment-grade and priced (e.g. Corporates, Munis, MBS, ABS, CDO's, CLO's, CBO's, MTN's, Auction Rate Notes, etc.) Similar to discount window (but only securities that are both investment grade and priced though)	First auction on Mar 27 will be Schedule 2 Collateral (includes OMO-eligible collateral such as Treasuries, Agencies, Agency MBS) plus AAA private label RMBS not on review for downgrade plus agency CMO's and AAA-rated CMBS NY Fed will announce eligible collateral day prior to each subsequent auction	Same collateral as for Discount Window (e.g. wide range including Treasuries, Agencies, Corporates, Munis, MBS, ABS, CP, and AAA CMBS, CMO's, CDO's and CLO's, etc) Note: for full range of eligible securities, please see Discount Window and PSR Collateral Margins Table http://www.frbdiscountwindow.org/discountmargins.cfm
Maximum Amount Available (total):	Unlimited	NY Fed will announce par value of offering amounts day prior to each auction (first auction on March 27 will be \$75B) NY Fed authorized to lend up to \$200B of Treasury securities through TSLF auctions	Fed will announce par value of offering amounts prior to each auction (latest 2 auctions have been \$50B) Most recent plan is to have \$100B in loans outstanding at any time
Maximum Amount Available (per dealer):	Unlimited (up to margin adjusted collateral they can deliver to Fed)	Up to 20% of par value of Treasury GC offered at that auction	Specified percent of announced offering amount (e.g. 10% of offering amount)
Term:	Overnight Loan Facility (can be renewed up to 120 days) (additional fees for usage of more than 30 out of 120 bus. days)	28-day term collateral exchange	28-day term ordinarily (may differ slightly based on holidays)
Rate:	Primary Credit Rate (i.e. Discount Rate) at the NY Fed (currently 25 bp above Fed Funds rate)	Auction Clearing (Stop-Out) Rate (i.e. Dutch Auction) (i.e. fixed rate determined via single price auction) represents lending fee rate participants are willing to pay to borrow a basket of Trsy GC (conceptually based on spread between GC rate of pledged collateral and Treasury GC financing rate)	Auction Clearing (Stop-Out) Rate (i.e. Dutch Auction) (i.e. fixed rate determined via single price auction) (subject to minimum bid rate based on a measure of the average expected overnight Fed Funds rate over the term of the credit being auctioned)
Auction Frequency:	Available Daily for Overnight Loan (not auction)	Competitive Bidding single price auctions held weekly (Thursdays at 2pm beginning Mar 27 unless otherwise noted)	Competitive Bidding single price auctions held every two weeks
Settlement:	Same Day	T+1 (next business day following auction)	T+3 (typically bid Monday, notified Tuesday, settles Thursday)
Website:	www.ny.frb.org/markets/pdcf.html	www.ny.frb.org/markets/tslf.html	www.federalreserve.gov/monetarypolicy/taf.htm

US issuance and credit

The global credit and liquidity crisis has continued to affect the ratings of a number of large financial institutions throughout the world. On 14 March 2008, the credit ratings of Bear Stearns were lowered by all three NRSRO's. Following the announcement of the sale to JPMorgan & Company, S&P upgraded the ratings to AA- long-term and A1+ short-term.¹ Moody's and Fitch kept the downgraded ratings of Baa1 P2 (Moody's) and BBB F3 (Fitch), but changed the rating direction from negative to positive, pending the closure of the JPMorgan deal.²

In March 2008, S&P downgraded the long-term ratings of Dresdner Bank AG to A from A+. They continued to place a negative outlook on the credit ratings.³

Corporate credit ratings were not immune from the global liquidity crisis as evidenced by the downgrade of CIT Group, Incorporated. CIT was downgraded by Moody's and S&P based on the limited ability to access the short-term commercial-paper markets. CIT subsequently tapped its USD7.5 billion credit lines to payoff debt for 2008.

Currently, the ratings have fallen to A3 P2 (Moody's) and A- A2 (S&P).⁴

¹ www.ratingsdirect.com, accessed 17 March 2008.

² www.moodys.com and www.fitchratings.com, both accessed 17 March 2008.

³ www.ratingsdirect.com, accessed 18 March 2008.

⁴ www.moodys.com and www.ratingsdirect.com, both accessed 18 March 2008.

Client-solutions update

In 2007, Citi's Securities Finance business expanded its global operation to enlist Canadian domiciled lenders and borrowers into Securities Finance. In particular, eight new trading counterparts based in Toronto were added to Citi's network of eligible borrowers. This expansion adds to Citi's existing trading capabilities in Melbourne, Hong Kong, London and New York.

The two-pronged supply-and-demand expansion marks a significant milestone for Citi's Securities Finance business, where beneficial owners and trading counterparts alike benefit from our enhanced capabilities. Plus, the rollout of Global Transaction Services' full suite of Securities and Fund Services products in Canada, including Global Custody, enables Canadian-domiciled

beneficial owners to benefit from Citi's breadth of service with securities-lending in 36 markets worldwide.

We welcome the opportunity to discuss our recent and future business enhancements. For further information, please refer to the contacts listed on the last page of *Market Monitor*.

European money markets

Economic data throughout the month provided further evidence of weakness in the euro region's economy. Confidence is waning as the slowdown in the US, the appreciation of the euro and the rise in the price of oil and other commodities take their toll.

For the market, however, economic data continued to take a back seat. The near collapse of Bearings sent shock waves through the market. In addition, with more and more banks hoarding cash, the resultant funding pressure prompted the European Central Bank (ECB) to add incremental funding in an effort to "support the normalisation of

the funding of the functioning of the euro money market". This included the first six-month operations, suggesting the ECB did not expect an improvement in the situation in the near term. Despite these efforts, spreads between inter-bank lending rates and the ECB repo rate have continued to widen.

European government bonds

Strong demand for European government GC continued through March. However, balances tailed off as we approached quarter-end as balance-sheet constraints across the market told. While balances dropped, spreads began to widen again – not quite back to November's highs, but LIBOR levels rose by around 30 bps (3 months) through the month offering good reinvestment opportunities in the short end. We also noted a tiering of Govt Debt within the Eurozone, with spreads

widening between AAA UK, Germany, France, Austria and the rest.

The gilt market yielded several specials this month, including UKT 4 09/07/16 (GB00BOV3WX43), UKT 4 03/07/09 (GB0032785924), UKT4 1/4 03/07/11 (GB00BOLNX641) and UKT4 3/4 09/07/15 (GB0033280339), which all traded up to 20-30 bps throughout the month. Several other sub-10-year gilts also increased in value, moving to 8-10 bps for most of March.

As expected, the Monetary Policy Committee (MPC) left rates on hold, following February's rate-cut of 25 bps. STG LIBOR rose through the month with market participants seemingly keeping cash in the very short end in anticipation of the bank announcing terms for further term-financing facilities and an increasingly more likely rate cut in April. This dislocation offered enhanced revenue opportunities as the demand to borrow gilt GC and cash continues to increase.

European equities

Overall balances have increased by 6 per cent for the month. This is due to increased longer-term trading.

News

Hedge-fund launches slowing¹

Hedge Fund Research (HFR) has released information indicating that hedge-fund launches and liquidations continued to slow in the fourth quarter of 2007. The hedge-fund information and performance data provider reported that in the fourth quarter 288 new funds launched and 154 funds liquidated.

In 2007 1,152 new funds were started while 563 funds liquidated. These figures compare to 1,518 funds launched and 717 funds liquidated in 2006. Equity hedge and fund of hedge funds saw the highest number of new launches, while event-driven strategies attracted the fewest number of new entrants. The average launch size was approximately USD30 million. The overall rate of hedge-fund attrition slowed to -5.95 per cent in 2007 from -8.28 per cent in 2006 and -11.40 per cent in 2005.

Kenneth Heinz, president of HFR commented: "In 2007, investors demonstrated a preference for established managers, as evidenced by the concentration of assets in the largest funds, with requirements for

institutional infrastructure likely constituting a higher hurdle for new fund launches." He continued: "Financial market volatility provided an opportunity for fund managers to clearly differentiate themselves from their competitors, and those that did so successfully attracted investor capital. Fewer launches in previous quarters likely contributed to the smaller number of liquidations as well."

HFR also revealed that the number of net new funds is at its lowest since 2001, and the average return for liquidated funds was down 5 per cent.

European stocks have worst start of year since 1987²

European stocks fell, capping the worst start to a year for the Dow Jones STOXX 600 Index since at least 1987, as concern deepened that losses in the credit markets would hurt economic and profit growth. The STOXX 600 tumbled 16 per cent this quarter as financial firms posted more than USD208 billion in losses related to the collapse of the US subprime mortgage market. "The purge isn't over," said Emmanuel Soupre, who heads the Neufilize OBC Asset Management France Opportunities and France Expansion funds at Neufilize in Paris, which has about

USD15.6 billion. He spoke in a Bloomberg Television interview: "It will last many months. We can't really rebound until we know the depth of the crisis. Investments that we can make are limited, especially when it comes to banks."

Active stocks

Relative-value and M&A news³

- TomTom (TOM2 NA)
- Hagemeyer (HGM NA)
- Banca Popolare (BPM IM)
- Sacyr Vallehermoso (SYV SM)
- Sabadell (SAB SM)
- Randstad (RAND NA)

Directional and convertible-bond news

- IKB Deutsche (IKB GR)
- Alliance & Leic (QIA GR)
- Brad & Bingley (BB LN)
- Tiscali (TIS IM)
- Bca Mps (BMPS IM)
- Air Berlin (ABI GY)

Sectors and markets in demand included: ETFs and emerging markets.

¹ www.isfmagazine.com, accessed on 19 March 2008.

² www.bloomberg.com, accessed on 31 March 2008.

³ Equity Finance Desk, Citi Global Markets Limited, March 2008.

For further information, please contact your Citi representative.

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