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Welcome

Welcome to the mid-year edition of Market Monitor. This year has seen a continuing trend towards increased breadth and flexibility in our lending and financing capabilities in support of our client base and our borrowers. Last month we started lending in Turkey and we are expanding our Securities Lending networks to include new markets such as Israel and Russia which would extend our lending capability to 37 markets. We have also been approached by lenders wanting to extend their relationship into Prime Brokerage type services, as UCITS 3 allows fund managers to diversify their investment models.

As our cash balances grow, we are seeing many opportunities for yield enhancement as clients periodically review their investment parameters and adapt them to market opportunities. Steady growth is also present in our equity and fixed income lending activity, with a notable pick up in the number of gilts trading special and a busy dividend season on the equity side.

With our continued commitment to invest in our people, infrastructure and technology, combined with balance sheet flexibility, we are pleased to remain at the forefront of providing lending solutions and heightening market awareness. As part of this initiative, we are continuing with our series of roundtable events, having already had client sessions in Dublin, Milan and Amsterdam, with further roundtables planned for Edinburgh and Stockholm. Please feel free to contact us if you would like more information about these upcoming events.

US equities

Our US desk in New York saw that during May overall average balances were up 21.22 per cent for the month with average specials in demand up 51.30 per cent.

News

Early in the month the Dow set another record high, closing at 13,362 points after the Federal Reserve Bank (Fed) left interest rates unchanged at its most recent policy meeting. The Central Bank made very few changes to its post meeting statement other than saying that its predominant policy concern continues to be that inflation will fail to moderate. Later that week, the Dow fell over 1.00 per cent as US retail sales came in lower than expected in April, signalling weakness in the economy at the start of the second quarter. However, the Dow rebounded after that recent slide as tame Producer Price Index (PPI) numbers and the weak retail sales figures reinvigorated investors' hopes that the Fed will cut interest rates later in the year¹.

Mid-month the Dow had another record week, as tame inflation data bolstered Wall Street's hopes for an interest rate cut in the near future. With the lower-than-expected Consumer Price Index (CPI) numbers out earlier in the week, many investors saw that as bullish for the economy and suspect that the reasons for the Fed to tighten have largely disappeared².

Another record towards the end of the month for the Dow, closing at 13,633 points, despite China's latest move to curb a sizzling stock market by tripling taxes on stock trades. The Fed minutes came in more or less as expected. It mentioned housing and inflation worries but said that the risks seem to be fading a bit as capital spending recovers and price pressures ease³.

Active Stocks

- Trina Solar (TSL)
- Indymac Bancorp (IMB)
- American Home (AHM)
- Novastar (NFI)
- Pool Corp (POOL)

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

¹ Bloomberg L.P., Wall Street Journal(WSJ), Reuters 9, 10, 11 May 2007

² Bloomberg L.P., WSJ, Reuters 15, 17, 18 May 2007

³ Bloomberg L.P., WSJ 30 May 2007

US issuance and credit

Moody's continued its JDA Analysis and upgraded a number of Banks on our Approved List. Of particular note, a variety of Japanese Banks experienced long-term ratings upgrades to the "double A level" from the high single A level⁴.

Other actions taken in May 2007 included the suspension, from our list, of Bank of Montreal, Harris Bank Corporation and Unicredito Italiano. Bank of Montreal and its subsidiary Harris Bank Corporation experienced a USD680 million natural gas trading loss. Currently, Standard & Poor's (S&P) has placed the credit ratings of the two on watch negative⁵. Unicredito Italiano was also suspended from the Approved List due to the proposed merger with Capitalia, which is likely to cause a ratings downgrade⁶.

We will continue to monitor both situations and their impending ramifications on the credit ratings.

⁴ www.moody's.com/jda, May 2007

⁵ www.standardpoors.com, May 2007

⁶ www.standardpoors.com, May 2007

US cash and money markets⁷

The money market yield curve changed dramatically during the month of May. The one-month versus one-year spread moved from a six basis point (bps) inversion at the start of the month, to a seven basis point positive spread by month's end (see graph below). The positive curve is certainly not indicative of near-term future rate cuts. However the Federal Funds futures market continues to price in the probability, albeit reduced from previous levels, of a 25 bps ease before year-end.

The very front end of the curve remained stable with one-month LIBOR at 5.32 per cent for the entire month. However, longer term yields continued to grind higher. The benchmark two-year US Treasury note increased almost 30 bps to end the month 4.92 per cent, a level not seen since January.

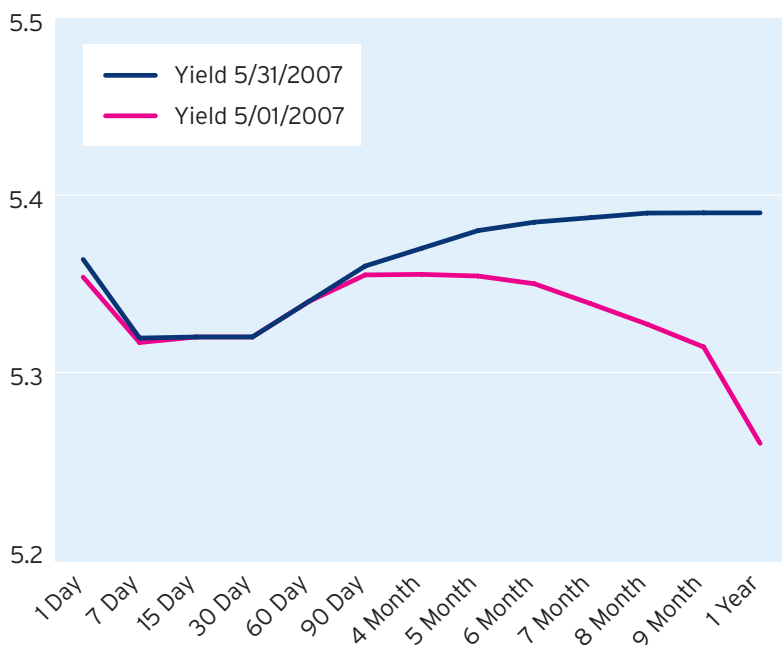
The ten-year note, while experiencing only a 25 bps monthly increase, ended the month at 4.95 per cent, a level which it had

not reached since early August of last year. The primary catalyst behind the move to higher rates continued to be the inherent strength in the US economy and continued growth in job creation. In addition, the historically low credit spread that the market is experiencing, is extremely conducive towards private sector debt issuance, and a glut of corporate paper continued to pour into the market. Much of this issuance has been driven by the increase in merger and acquisition activity, and particularly privatisations through leveraged buyouts.

We continue to believe that monetary policy will be on hold for the foreseeable future and should the money market curve steepen enough, we would look to extend the weighted average maturities of the cash collateral investment portfolios by increasing the fixed rate duration of maturing investments.

⁷ Bloomberg L.P., May 2007

Single Market Changes



Source: Bloomberg L.P., 1 June 2007.

US corporate bonds

Our US desk in New York saw that during May overall average balances were up 4.71 per cent for the month while average special balances were up 2.25 per cent.

Current News

Indymac Bancorp Inc., the second largest independent US mortgage lender, announced that it plans to sell USD200 million of senior subordinated debt to finance asset growth and to fund a stock buy back plan. They also plan on issuing USD500 million in non-cumulative preferred stock. Indymac's debt is currently Baa3 rated by Moody's and BBB- by (S&P)⁸.

US high yield risk premiums declined to a record low. This has been fuelled partly on recent speculation that the economy is accelerating, bolstering the ability of companies to meet their debt payments. Risk premiums on these high-yield bonds narrowed to 242 bps on average recently, based on Merrill Lynch & Co's high-yield index. The spread is half the average of about 500 bps over the past 5 years and is down from more than 1000 bps in 2002⁹.

High-yield bonds have returned approximately 4.80 per cent this year, including reinvested interest, heading for their best annual performance since 2003. Also, high-yield bond sales total about USD77 billion as companies such as Ford Motor and Rite Aid Corp. sold debt. The record was set last year with over USD148 billion issued¹⁰.

Issues in Demand

- Graham Packaging (CUSIP 38470RAD3)
- Core Labs (CUSIP 21868FAB9)
- Umbrella (CUSIP 904201AA8)
- NTK Holdings (CUSIP 62941EAB7)
- Wise (CUSIP 977255AC2)

⁸ Bloomberg L.P., 9 May 2007

⁹ Bloomberg L.P., 30 May 2007

¹⁰ BloombergL.P., 30 May 2007

US Treasury and agency

The May balances on our US Treasury and Agency desk in New York were unchanged from April. The collateral shortage in the repo markets has continued throughout the month. There has been significant demand for treasury collateral for both specific issues and general collateral (GC).

Overnight Treasury financing averaged an incredible 5.13 per cent for May. This equates to 12 bps to Fed funds. This spread is ten bps better than April, 13 bps better than the March spread of zero and one bp

better than the May 2006 spread of 12. The Treasury refunding occurred on 15 May. On that day, the Fed settled 14 billion 3-year notes, 13 billion 10-year notes and reopened 5 billion of the current long bond. Also, the Fed has decided to discontinue the issuance of the three-year note going forward.

The current Treasury issues traded moderately special throughout the month. The ten-year averaged 70 bps and the five-year averaged 40 bps. The long bonds

averaged just 30 bps. The bonds were trading with more of a premium earlier in the month but lost their bid after the five billion of new issuance at the refunding on 15 May.

The term treasury GC markets have begun to discount the notion of a Fed move for the remainder of 2007. The term markets are pricing in just a 10 per cent chance of a 25 bps move by the November meeting.

Asia-Pacific equities¹¹

Our Asia-Pacific desk in Hong Kong saw that China's market continued to rise through the month of May ignoring a series of warnings at home and abroad that a sharp correction was due. Hong Kong stocks fell, led by Mainland companies, after the People's Bank of China told banks to set aside more money as reserves. China's main stock market index fell by 6.50 per cent on 30 May after the government tripled the tax on trading shares. The decline was the biggest since 27 February but unlike then it had little impact on other stock markets. Indeed, the S&P 500 climbed to 1530.23 points, a record close that surpassed the high set in March 2000. New rules allowing the suspension of A shares during the trading day after large price moves related to media reports or market rumours look set to heighten problems arising from the difference between Hong Kong and mainland exchanges. In China, consumer price inflation fell to 3.00 per cent in the 12 months to April.

In Japan industrial production was weak, falling by 0.10 per cent in April, which left output 2.30 per cent higher than a year before. In April, Japan's industrial production unexpectedly fell for a second month as the slowest economic growth in the United States in four years reduced demand for Toyota Motor Corporation and Honda Motor cars.

Australian hospital operator, Healthscope, launched a AUD2.8 billion takeover bid for Symbion Health, backed by two private equity firms, in a deal which would create the country's biggest healthcare company.

Thailand's current account surplus widened to a record, as rising overseas demand boosted exports and sliding confidence curbed imports of machinery and raw materials. The surplus increased to USD2.26 billion from USD1.12 billion. Mounting anti-government protests and escalating violence in Thailand's south are hurting consumption and investment.

Telecom Corporation, New Zealand's biggest telephone company, may return NZD1.1 billion to investors from the sale of its Yellow Pages directories unit, in the nation's largest stock buy-back.

Australia

Balances in Australia were up 6.02 per cent from the month of April.

Tight Stocks

- Platinum Australia NPV (SEDL 6292652)
- Riverdale Mining (SEDL 6932657)
- Copperco Ltd (SEDL 6151441)

Hong Kong

Balances were up a modest 3.13 per cent.

Tight Stocks

- Dynasty Fine Wines (SEDL B05M185)
- China East Airline (SEDL 6171375)
- Geely Automobile (SEDL 6531827)

Japan

Balances were up 6.90 per cent for the month of May.

Active Stocks

- Privee Investment (SEDL 6673547)
- Tobishima Corporation (SEDL 6893000)
- Tokyo Kikai Seisak (SEDL 6895039)
- Tokyu Construction NPV (SEDL 6689351)
- Fudo Tetra Corporation (SEDL 6355005)

Singapore

Balances were down 3.39 per cent as several names were recalled from the market.

Active Stocks

- Wilmar International Limited (SEDL B17KC69)
- Hyflux (SEDL 6320058)
- Yanlord Land Group (SEDL B17KMY7)

South Korea

Korean Balances were up by 60.05 per cent.

Active Stocks

- Hankuk Glass Industries (SEDL 6407746)
- Korean Air Terminals (SEDL 6496476)

Taiwan

Balances in Taiwan were up 4.68 per cent during the month of May, despite the approaching dividend season.

Active Stocks

- Asia Optical Company (SEDL 6295866)
- Phoenix Precision (SEDL 6533957)
- Shin Kong Financial Holdings (SEDL 6452586)
- Synnex Tech International (SEDL 6868439)

Thailand

Balances continued to fall, down 44.28 per cent for the month of May.

Active Stocks

- Bangkok Dusit Medical (SEDL B013SQ9)
- Tisco Bank (SEDL 6365101)

¹¹ Bloomberg L.P., May 2007

Client solutions update

Turkey is Citi's latest new market offering clients securities lending solutions. Demand for Turkish stocks has been very strong. Utilisation levels are around 80 per cent with average rates being 3.10 per cent. Citi has implemented strong controls to ensure clients' securities that still benefit from the Non Resident Investor Fund (NRIF)¹² status are not lent thus protecting this status. Our next new market, Israel, is currently in the review stages and is expected to launch in July. If you have Israeli securities please contact one of the names mentioned at the end of the newsletter.

Citi has been invited to participate in an International Securities Lending Association (ISLA) committee that will

focus on opening emerging markets to lending. This is seen as a key development of ISLA's role in the industry. The advantage of ISLA's involvement in opening new lending markets, which has historically been handled individually by agent lenders, is its potential ability to work with local regulators and securities commissions to help and advise with legislation to allow offshore lending.

Citi has been working closely with the Italian Central Securities Depository (CSD), Monte Titoli, as they re-launched their domestic fails coverage program for CSD members on 4 June. This has created opportunities for our lenders to improve revenues by lending into the programme

through Citi. In order to participate in this service, lenders would be required to accept Citi as a principal borrower as Citi is required by Monte Titoli to be the principal to the CSD borrowing member. Initially Citi will be lending Government bonds but we expect to expand this to equities in the near future.

¹² Before 2006 certain foreign investors in Turkey could apply for NRIF status; if approved their stock dividends would be exempt from withholding tax. When this exemption was removed effective Jan 1, 2006, stock purchased prior to the rule change retained the benefit. Turkey operates a FIFO approach to sales so as portfolios are traded eventually the stock still retaining the WHT benefit will diminish. Securities Lending transactions are not treated as a sale under Turkish legislation however Citi has been advised that this does not apply to stock that retains the NRIF status.

European equities

The May balances on our European equity desk in London were down by 5 per cent for the month; this was due to term trades unwinding.

European Stocks Rise to Highest Since 2000¹³.

European stocks rose to a six-and-a-half-year high after companies' earnings exceeded analysts' estimates and more than USD75 billion in takeovers boosted speculation of mergers in the media, building, auto and utilities industries.

Reuters Group jumped to a five-year high after Thomson Corporation offered USD17 billion to create the worlds biggest financial data company.

Hanson plc jumped after Heidelberger Cement AG bid USD16 billion in the biggest ever takeover in global building materials industry.

Auto stocks, the region's best performing shares this year, climbed to a record high after DaimlerChrysler announced the sale of its unprofitable US unit Chrysler.

E.ON & Iberdrola led utility shares to a record after E.ON said it will buy back USD9.4 billion in shares and Belgian billionaire Albert Frere bought a stake in Iberdrola SA.

Increase in demand for Emerging Market (EM) iShares (MSCI Emerging Markets Index) as investors seek to increase their EM exposure.

Active Stocks

Relative Value and merger and acquisition news

- A3TV (A3TV SM)
- Banco Popolare Di Verona (BPVN IM)
- Iberdrola (IBE SM)
- iShares

Directional & Convertible Bond News

- Altana (ALT GR)
- Tiscali (TIS IM)
- Conergy (CGY GR)
- Premier (PRE GR)
- Option (OPTI BB)

Sectors and markets in demand included: Spanish utilities, exchange-traded funds, Real-Estate Investment Trusts, South Africa and emerging markets.

¹³ Bloomberg L.P., May 2007

European money markets¹⁴

Throughout May we continued to see hawkish statements from almost every European Central Bank (ECB) member, which may indicate that they will opt for a 25 bps rise at the June meeting. May was a difficult month for tri-party repo, as several key investment banks approached their half-year end and were severely constrained by balance sheet issues. Once again therefore, even in the very shortest tenures, European Commercial Paper (ECP) yields comfortably outperformed tri-party returns.

Looking forward, both European money markets and economic commentators alike may see some upward pressure on the rates even after the priced-in June increase. With the ECB not due to meet in August and given the timing of recent rate changes, a September increase to 4.25 per cent appears far more likely than a consecutive July hike.

¹⁴ Bloomberg L.P., May 2007

European government bonds

European Government GC flows remained buoyant through May as the European Equity dividend season peaked. We have seen broker-dealers using their Fixed Income borrows to finance French baskets which paid dividends through the month. Demand for Spanish, Italian and Greek Government Debt continued. We expect Spanish assets to trade at a premium throughout next month and into July. The local Central Bank requires domestic financial institutions deposit collateral with them over month end, restricting coupon paying assets which significantly reduces the pool of eligible securities.

The Gilt market yielded several specials again this month with volatility in UKT 5 03/07/08 (GB0031734154), UKT 4 03/07/09 (GB0032785924), UKT 5 03/07/12 (GB0030468747) and UKT 4 09/07/16 (GB00BOV3WX43). UKT 5 03/07/12 proved the outstanding performer

peaking at 150 bps towards the end of the month. The four issues remain well bid in term so we can expect continued daily activity into next month.

The Monetary Policy Committee (MPC) hiked rates by 25 bps to 5.50 per cent in line with the market expectations. Minutes from the meeting suggested that whilst members discussed a 50 bps move all nine unanimously agreed on a new target rate of 5.50 per cent. In line with past months the market has priced in further immediate hikes, this has given us the opportunity to pick up higher yielding investments which have positively impacted our book yield.

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