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Welcome

Over the last several years, the United States and Canada have been engaged in extensive discussions on withholding tax implications associated with securities transactions. Citi has been carefully following those discussions with cautious optimism and we are pleased to inform our clients that, as of 21 September 2007, Treasury Secretary, Hank Paulson, and Canada Finance Minister, Jim Flaherty, signed the Fifth Protocol to the US-Canada Income Tax Treaty of 1980, which may become effective after ratification by the legislatures of both countries. The effect of this treaty, if ratified, will enable investors to benefit from a more advantageous tax treatment that will facilitate cross-border transactions.

Under the current law, all rebate payments on cash collateral pledged against the return of securities by a US borrower from a Canadian beneficial owner are subject to a 10 per cent withholding tax. This tax has limited the economic benefit of offshore securities lending transactions for Canadian beneficial owners.

Among other changes, the protocol, if ratified, will eliminate the aforementioned withholding tax and open the door for Canadian beneficial owners to lend their securities to US borrowers in exchange for cash collateral. These clients will benefit from expanded securities lending opportunities with Citi's network of US borrowers, as well as the performance enhancement that may result from accepting cash as collateral. At Citi, we are uniquely positioned to capitalise on this treaty and better serve our clients, in Canada, the US and abroad.

US Equities

Overall average balances were down 19.95 per cent for the month.

News

Earlier in the month, the Dow extended its rally after record oil prices buoyed energy producers. Stocks continued the rally as Countrywide Financial Corporation secured new credit lines and investors speculated that financing for businesses and takeovers would become more plentiful. Towards the middle of the month, stocks had changed little amid the market's renewed concerns over the health of the consumer¹.

Following the Federal Reserve's decision to cut rates and the resulting celebratory rally, which was the biggest increase since March,

the Dow traded in a narrow range towards the end of the month. Financials and energy companies experienced downward pressure after the International Monetary Fund (IMF) noted that rising credit costs may lead to protracted economic turmoil. At month end, the Dow was within striking distance of historic highs, thanks largely to the Federal Reserve interest rate cut and stronger expectations going forward².

Active Stocks

- Franklin Electric (FELE)
- Ishares (EEM)
- Dendreon (DNDN)
- Luquidmetal (LQMT)
- Raser (RZ)

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.

Corrigendum. Please note that in the last issue of Market Monitor the text reading "The Dow lost ground late in the month sliding to 105.00 from 112.60 in July as the Conference Board's poll of consumer confidence in August dropped sharply after this month's financial-market turmoil" should have read "Late in August, the Conference Board's poll of consumer confidence fell to 105.0 from 112.6 in July, in part due to the month's financial-market turmoil. The Dow also lost ground."

¹ Source: Bloomberg L.P. at www.bloomberg.com, accessed on 12, 13 and 14 September 2007; *Wall Street Journal (WSJ)*, 12, 13, 14 September 2007.

² Source: Bloomberg L.P. at www.bloomberg.com, accessed on 24, 25, 26, 26, 27 and 28 September 2007; *Wall Street Journal (WSJ)*, 24, 25, 26, 27, 28 September 2007.

US Cash and Money Markets

As expected, the Federal Open Market Committee (FOMC) cut the federal funds target rate by 50 basis points (bps) to 4.75 per cent on 18 September, sighting concerns over the tightening credit conditions in certain sectors of the fixed-income markets and the potential for these conditions to impair the general economy. The FOMC also cut the discount rate by an additional 50 bps to 5.25 per cent.

In its statement following the meeting, the FOMC stated that the rate cut was

intended to encourage moderate growth over time and mitigate any harmful effects to the economy by the developments in the financial markets³. While stating that inflation continued to remain a concern, the severity of this concern had lessened and the FOMC was willing to monitor future developments and take actions "as needed to foster price stability and sustainable economic growth"³. The market has priced in additional cuts at future FOMC meetings, with the probability of a cut at the 31 October meeting in the 50 to 75 per cent range.

Given that a future cut is by no means a certainty, if your cash collateral guidelines permit it, we will concentrate purchases of new investments in the 30 to 60 day maturity horizon.

³ Source: Bloomberg L.P. at www.bloomberg.com, accessed on 18 September 2007.

US Corporate Bonds

Overall average balances were down 17.06 per cent for the month.

Current News

Black Rock Inc., the largest publicly traded asset manager in the US, plans to sell 10-year notes in its debut offering of US corporate bonds. The debt will include a "poison put" that would allow investors to sell the bonds back at 101 cents on the dollar if there were a change of control and a cut to below investment grade by both Moody's and Standard and Poor's, according to the filing with the Securities and Exchange Commission. Moody's gave the notes its fifth-highest rating of A1. Citi, Morgan Stanley, and Wachovia Corp. are managing the sale⁴.

Turkey hired Citi and HSBC Holdings for a sale of dollar-denominated bonds maturing in 2018. Moody's Investors Service rates Turkey's bonds at Ba3, three levels below investment grade⁵.

Tyco Electronics sold USD2.05 billion in bonds after abandoning a sale in July, joining at least 23 issuers in offering debt since the Federal Reserve cut interest rates. To attract buyers Tyco included a provision that will cause the interest rate on the bonds to rise if its ratings drop. Such investor protection was not part of the earlier proposed sale⁶.

Issues in Demand

- Masonite (CUSIP 575379AE2)
- Beazer (CUSIP 07556QAQ8)
- Bon-Ton Stores (CUSIP 09776NAB8)
- AMR Corp (CUSIP 001765ACO)
- Yankee Acquisition (CUSIP 984756AD8)

⁴ Source: Bloomberg L.P. at www.bloomberg.com, accessed on 11 September 2007.

⁵ Source: Bloomberg L.P. at www.bloomberg.com, accessed on 26 September 2007.

⁶ Source: Bloomberg L.P. at www.bloomberg.com, accessed on 20 September 2007.

US Issuance and Credit

We removed Northern Rock Plc (Aa3/A-/A-) from our Investor List as liquidity issues and negative credit news surrounded the company. Northern Rock who relies mainly on the capital markets instead of deposits as its chief liquidity source needed emergency funding from the Bank of England in order to meet short-term liquidity demands. Through September 2007, depositors have removed GBP2 billion pounds from accounts, approximately eight per cent of the total deposit base. Standard & Poor has lowered the long-term ratings twice during the month to A- and still has the bank on negative watch⁷. Moody's has placed the Aa3 long-term rating on negative watch as well⁸ US Treasury and Agency.

The US government and agency trading environment edged slightly closer to normal in September when compared to the wildly erratic market conditions that existed in August.

The spread between US Treasury general collateral (GC) and Fed funds open narrowed from 57 bps in August to 24 bps in September. Despite the fact the "month over month" spread had dropped by more than 50 per cent, it was significantly wider than the September 2006 spread of just one bp. The spread for agency general collateral was eight bps, which was also much wider than normal.

Treasury GC over quarter-end (28 September to 30 September) was projected to trade in the high three per cent range for much of September. This "three handle" overnight financing level never materialised; however, overnights did average 4.10 per cent, which equated to a spread-to-funds of 115 bps for the weekend.

The current US Treasury issues were actively traded throughout the month. The entire curve continued to trade at a premium. The spreads were as follows:

Issue	Average Spread (bps)
• CT 2-year	35
• CT 3-year	45
• CT 5-year	40
• CT 10-year	45
• CT long bond	30

The treasury GC term market is pricing in an approximately 75 per cent probability that the Federal Reserve will reduce the overnight Fed funds rate to 4.50 per cent during the 31 October FOMC meeting.

⁷ Source: www.ratingsdirect.com, accessed on 26 September 2007

⁸ Source: www.moody.com, accessed on 26 September 2007

Asia-Pacific Equities⁹

Markets	Change %
• Australia	22.36
• Hong Kong	16.46
• Japan	19.33
• Korea	-0.89
• New Zealand	-14.29
• Singapore	8.18
• Thailand	182.89
• Taiwan	29.02

Regional

While Asian markets are still shadowed by global turmoil, Asian asset prices, especially stocks and currencies, generally recovered from recent dents. Investment is improving gradually and may strengthen going forward, especially in Southeast Asia and Korea. Asian financial markets are becoming more politics-proof, increasingly correlating with each other.

Australia and New Zealand

Stronger-than-expected momentum in the second and third quarter has lifted the base for Australian shares to extend to a record level. The pace of business investment has exceeded expectations and is well supported by the elevated level of profits among mining companies and the associated need for increased infrastructure spending.

Households and mortgage rates are now rising in response to the strains on liquidity and higher funding costs for banks and other lenders. So far, the rise in lending rates has been modest, but it follows the 25 bps increase in rates in August by the Reserve Bank of Australia. More generally, the income position of households remains sound and the saving rate has risen one percentage point in the last 12 months. House prices are rising moderately and the last employment data was a surprise because it was higher than expected.

- Geodynamics (SEDOL 6546218)
- Copperco Limited (SEDOL 6151441)
- Eastern Star Gas (SEDOL 6328041)
- Marion Energy Ltd (SEDOL 6182872)
- Melbourne It (SEDOL 6193410)

Japan

The yen has appreciated sharply in August following a series of negative news items on the US sub-prime loan problems. While the yen's appreciation was broad based and recorded a nine per cent rise on a trade-weighted basis, the gains were notable versus high-yielding currencies like the Australian dollar and New Zealand dollar, with a 19 per cent and 23 per cent gain, respectively.

Real exports have experienced a sustained upwards movement since 2005, albeit with notable regional differences. Exports to the US are weakening while those to Asia are stagnant and exports to other regions continue to rise. Weaker real exports to the US are mainly attributable to the decreasing motor-vehicle-related and consumer-goods exports reflecting the slowing economy. Moderating intermediate materials exports and a sharp drop of parts exports caused the levelling off of real exports to Asia during 2007.

The Bank of Japan left policy rates unchanged at 0.5 per cent. As in previous meetings in July and August, the decision was made by an eight - to - one majority vote. Obviously, external factors such as the financial markets turmoil and the increasing downside risk to the US economy have dissuaded policymakers from hiking interest rates.

- Tobishima Corp (SEDOL 6893000)
- Kimura Chem Plants (SEDOL 6492485)
- Tokyo Kikai Seisak (SEDOL 6895039)
- Niws Co Hq Ltd (SEDOL 6513784)
- Fujita Kanko Inc (SEDOL 6356923)

China

Despite continuous policy efforts, structural distortions deteriorated as the economy experienced faster growth in Gross Domestic Product (GDP), investment, trade surplus and Consumer Price Index (CPI). Meanwhile the central bank has continued in its efforts to tighten domestic spending. In addition, capital account control eased but currency appreciation remained very slow early this year and in August. Financial reforms and liberalisation continue, but rapidly growing equity prices pose increasingly greater risks to the markets and economy.

Hong Kong

Interest rates are in a down-cycle. Hong Kong banks have partially followed the recent US Federal Reserve's rate cut. China began a trial programme to allow individual investors to invest directly in Hong Kong's stock market. Outflows of Chinese funds to Hong Kong through the Qualified Domestic Institutional Investor (QDII) programme are also gathering momentum.

Renminbi (RMB) appreciation boosts Hong Kong's economy and the financial market, while inflation remains moderate despite faster RMB appreciation.

- Dynasty Fine Wines (SEDOL B05M185)
- Brilliance China (SEDOL 6181482)
- F E Consortm Intl (SEDOL 6331555)
- Shanghai Prime Mac (SEDOL B121881)
- China East Airline (SEDOL 6171)

Korea

Rising interest rates and a weak housing market have weakened domestic demands. Indicators were mixed in July and consumption and construction activities rebounded from their recent sluggishness while facility investment remains weak.

Continued global expansion, a high-tech recovery, a shipbuilding boom and strong demand from oil exporting countries have boosted exports. Strength in exports based on both tech-and non-tech-heavy industries continued in August. Finally, the Bank of Korea (BOK) emphasised a balance stance at its September Monetary Policy Committee (MPC) meeting. The BOK extends its tightening stance throughout the second half of 2007 based on a favourable growth outlook and continued liquidity concerns.

- Hanmi Pham Co (SEDOL 6146083)
- Daiyang Metal (SEDOL 6167675)
- Hyundai Autonet (SEDOL 6539036)
- Kumho Electric (SEDOL 6497844)
- Han Jin Transport (SEDOL 6407780)

Singapore

The subprime crisis and slower US growth have so far not materially affected prospects. The financial sector is seeing slower merger and acquisition deals and public offerings, while property transactions have quietened somewhat. Otherwise, overall growth remains largely intact. Inflation pressure is increasing given rising residential rent, transport costs and a tighter labour market. Inflation in July came in at 2.6 per cent, a 12-year high.

Prime Minister Lee announced sweeping policy changes, particularly to the Central Provident Fund (CPF) and Housing Development Board (HDB), to address an ageing population and widening income gap.

- Hyflux (SEDOL 6320058)
- Yanlord Land Group (SEDOL B17KMY7)
- China Hongxing Spo (SEDOL B1WN188)
- Creative Technology (SEDOL 6207582)
- Sinomem Technology (SEDOL 6648880)

Taiwan

A referendum for a United Nations bid increases tension across the Taiwan Strait as well as between Taipei and Washington.

Thailand

There has been a waning in the political risk premia after the 58 per cent approval rating of the plebiscite on the draft constitution. Meanwhile, the US Federal Reserve's rate-easing has increased the likelihood of a rate cut to protect a tentative chance of a recovery in domestic demand from a possible collapse in export growth in the second half of 2007. Moreover, a strong baht and lacklustre demand have accorded easing flexibility. The government is expected to adopt a change in fiscal policy to increase spending in order to reduce hefty cash deficits and the fiscal deficit of two per cent of GDP.

- Bangkok Dusit Medi (SEDOL B013SQ9)
- Land & Houses (SEDOL 6581930)
- Thoresen Thai Agen (SEDOL 6561879)
- Amata Corp (SEDOL 6592943)
- Siam City Cement (SEDOL 6806387)

⁹ Source: "Asia economic Outlook and Strategy", Citi Global Equities Online, 24 September 2007.

Client-Solutions Update

The results are in: Citi voted most improved lender in International Securities Finance's (ISF's) Equity Lending Survey Awards 2007¹⁰

We are pleased to have been awarded "Most Improved Lender, 2007" in the acclaimed ISF awards. We believe this is a reflection of our dedicated efforts to deliver superior equity-lending services to our clients across all our markets. We would like to thank all our clients for their continued support. Of particular note was our progress in emerging markets, where we topped the market development category this year and came second in the market knowledge (emerging markets) category.

Over the past year, we have focused our attention on understanding the needs of the broker-dealer community as well as the business objectives of our investor clients, and, as substantiated by the ISF survey, we are making tremendous progress.

We have:

- Expanded our network of global lending markets to include Turkey, Hungary, the Czech Republic, South Africa and Taiwan.
- Recruited a wide range of experienced industry professionals to better serve the evolving needs of our clients.

- Enhanced our solution set to improve our clients' revenue opportunities, including tri-party solutions, fixed-income programmes, collateral flexibility and Equilend distribution.
- Committed to continuing to provide our clients with the equity-lending services they require to succeed today and in the future.

Thank you for making 2007 an award-winning year for Citi's Global Transaction Services business.



From left: Craig MacDonald (ISF Editor)
Jonathan Lombardo



From Left: Brian Staunton, Patrick Avitabile

¹⁰ Source: "The Pillars Crumble", *International Securities Finance (ISF)*, pp. 29, 30, 34, 38 and 39, September 2007.

European Money Markets

While the European Central Bank (ECB) maintains its rhetoric for higher rates, the view of the market is that a hike is unlikely given the strength of the euro and the fallout from the global credit squeeze. Economic data releases during the month indicates slowing growth, as the market events take their toll on consumer and business confidence.

Inter-bank lending rates remain high relative to the ECB repo rates, as cash remains king: the current spread to three-month LIBOR is 78 bps.

The desk has been able to maintain the increase in revenues from last month, as the flight to quality continues and spreads between our government bond and our non-government reverse repo and cash re-investment remain high.

European Equities

Overall balances were flat on the month.

News

Pensions are going for hedge funds¹¹

Company executives responsible for the operation of final salary pension schemes still favour a significant exposure to return-seeking assets-including hedge funds, equities, property and private equity-despite recent changes in investment conditions. More than four in five of the companies represented at a recent Watson Wyatt seminar said the ideal proportion of return-seeking assets in their pension schemes, which have combined assets of more than GBP70 billion, was more than 40 per cent given their current funding position.

EU Financial Services Commissioner defends hedge funds' role in subprime crunch¹²

European Union Financial Services Commissioner Charlie McCreevy has defended hedge funds in relation to the fallout from the US subprime mortgage market collapse, the Independent Ireland

is reporting. "As much [as] people want to demonise hedge funds, they are not the cause of the difficulties in the market," said McCreevy. "Our prudential framework and bank risk controls have prevented hedge-fund failures from triggering wider systemic disruption."

The move comes at the same time as a report commissioned by French President Nicolas Sarkozy, which states that France should join a German initiative asking the European Union's executive arm to propose measures boosting hedge-fund transparency.

Berlin has been pushing for the creation of a code of conduct for hedge funds within the Group of Eight (G8) club of industrialised nations, even though regulators show little appetite for imposing tougher rules on the industry. McCreevy is considered a general critic of regulation in financial markets.

Active Stocks

Relative value and merger and acquisition news¹³

- LSE (LSE LN)
- Gaz De France (GAZ FP)
- Hypo Real Estate (HRX GR)
- Iberdrola (IBE SM)
- Banca Popolare (BPM IM)
- Sacyr Valleherm (SYV SM)

Directional and convertible bond news

- Banca Italease (BIL IM)
- IKB Deutsche (IKB GR)
- Alliance & Leic (QIA GR)
- Brad & Bingley (BB LN)
- Northern Trust (CGY GR)
- Tiscali (TIS IM)
- Premier (PRE GR)
- Option (OPTI BB)
- Metrovacesa SA (MVC SM)

Sectors and markets in demand included ETFs and emerging markets.

¹¹ Source: www.isfmagazine.com, accessed on 5 September 2007.

¹² Source: www.isfmagazine.com, accessed on 6 September 2007.

¹³ Source: Equity Finance Desk, Citigroup Global Markets Limited (CGML), September 2007.

European Government Bonds

While short-term lending rates stabilised following the ECB's reserve management, continued uncertainty in the global money markets has seen inter-bank lending rates widen to over 75 bps (three-month LIBOR) in the Eurozone.

Demand for European government GC increased; however, balances reduced through the month for clients unable to invest in the unsecured market as the spread between government repo and tri-party suffered continued pressure.

The gilt market yielded several specials this month, including UKT 5 03/07/12 (GB0030468747), UKT 5 03/07/08 (GB0031734154)

and UKT 5 3/4 12/07/09 (GB0003042636) and UKT 4 3/4 06/07/10 (GB00B0330274), with the latter trading as high as 70 bps.

The spread between government GC and LIBOR dislocated to almost 100 bps, hugely benefiting the yield for clients investing down the credit curve.

As expected MPC members maintained the interest rate at 5.75 per cent, judging it too soon to assess the consequences of the turmoil in the credit markets.

For further information, please contact your Citi representative.

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