

Global Securities Finance Market Monitor

Issue 43, for the Month Ending November 30, 2005

>> Money Markets Recap

November started off as expected with the FOMC implementing a twelfth consecutive 25 basis point increase in the federal funds rate, to a new target level of 4.00%. There was no substantive change in the language that accompanied the rate hike announcement, and therefore the expectations of an additional increase of 25 basis points on December 13th remained fully priced in short-term markets. The economic data released throughout the first half of the month did nothing to alter the consensus, although the benign inflation reports generated a short-lived rally along the yield curve. The yield on the 2 year U.S. Treasury note fell by more than 25 basis points, but then gave back almost all of it during the last week of the month. The 10 year note was able to hold on to a bit more of its gains, rallying from 4.65% to 4.40% and then ending the month at 4.50%.

The bigger story of the month was the easy confirmation of Ben Bernanke as the replacement for Alan Greenspan, and what that will mean for the markets. In the minutes of the November 1st FOMC meeting that were released three weeks later, it was implied that a change in the language regarding policy accommodation would be in order in the near future. It seemed to make sense that the outgoing Chairman would want to "clean the slate" for the incoming Chairman, rather than leave him boxed in to the language that had been prevailing for the past 18 months. That is not to say that the market is not expecting Mr. Bernanke to continue to tighten rates, and in fact, possibly move past neutral to a restrictive policy, if he feels that inflation pressures remain persistent. The risks to this change are that less certainty about policy could imply increased volatility and a steepening of the curve. Also if market participants continue to expect stable inflation and slower growth, any evidence of inflationary pressure or a highly resilient economy could push yields significantly higher.

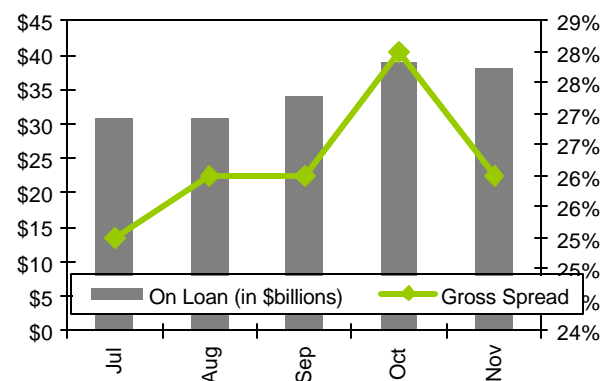
>> US Government Markets Commentary

The repo market for the month of November began with the FOMC's widely expected 25 basis point

increase of the fed funds rate from 3.75% to 4.00% during the November 1st meeting. The language in the feds statement indicated that the measured pace of continued tightenings would be the norm for the very near future.

The average overnight financing rate of treasury and agency general collateral was 3.96% and 4.00% respectively for November. The repo term markets traded with a full 25 basis points priced in for the Dec 13th and Jan 31st FOMC meeting and approximately a 50% chance of another 25 basis point tightening during the March 28th meeting.

The November treasury refunding brought \$21 billion new 3yrs, \$13 billion new 5yrs and \$13 billion new 10yr treasury notes to the market. The current 10yr, true to form, traded with nearly a 375 basis point scarcity premium leading up to the Tuesday the 15th refunding on. Also, the 5yr note traded with a 75 basis point premium and the 3yr note averaged 50 basis points of premium for that same time frame. The gross spread from a securities lending perspective is the difference between the investment rate and the rebate rate on loaned securities. As observed in the graph, the gross spread increased from October to November on average fell two basis points while balances remained flat month-over-month.



The focus in repo for the weeks to come will be on the perceive treasury collateral shortage that may or may not materialize in mid to late December and year-end "4-day turn" financing. (Dec 30th- Jan 2nd)

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As of the writing, overnight treasury general collateral is priced at 3.50% for the "turn".

>> Equity/Bond Markets Commentary

US Equity/Bond Markets

The Dow Jones Industrial Average closed November at 10805.9 compared to its closing of 10440.1 on October 31. Housing starts increased more than expected giving rise to concerns that the Fed will raise the effective interest rate at least two more times.

International Equity/Bond Markets

Crude oil futures saw a drop for the fourth season. Europe's largest oil company, BP, remarked that oil prices above \$55 per barrel would be "unsustainable". Light, sweet crude oil settled at \$57.32 per barrel. The FTSE 100 closed November at 5423.20.

Domestic Specials

Calpine (CUSIP 131347106) was in demand in the month of November as possible bankruptcy.

Parlux (CUSIP 701645103) Parlux Fragrances Inc., directional short in November.

International Specials

In Australia, **Brambles (sedol 6120009)** was in demand throughout November as the company announced plans to sell off nearly half of its business. The proceeds were used to buyback shares in the market. This put pressure on the borrow which drove fees up for the month.

IPO's: The French power company **Electricite de France (sedol B0NJJ17)** debuted on the Paris Bourse on November 18. The shares were in demand throughout November with increased demand at the end of the month due to the announcement of the company's addition to the CAC-40 index in December.

There was directional interest in **Volkswagen (sedol 5497102)** in November as short-sellers continued to bet against the recovery plan for the auto maker.

Levels on the borrow increased from GC to 75 basis points fee during the month.

>> FYI – Lending Terms

Frequently used Securities Lending terms:

"Iffies"

A borrowing arrangement that arises when a broker dealer is uncertain as to whether or not a stock will be delivered to him. If the dealer does not receive the stock, he may fail on his necessary deliveries. In this case, the dealer will arrange an "iffy" with the custodian: the custodian will deliver the stock through DTC. If the broker needs the stock, he borrows it, if not, he returns the stock through DTC.¹

"ADRs"

American Depositary Receipts represent shares of foreign stocks. Trustees buy shares of foreign securities, holding them on deposit outside of the US. The trustee can then issue ADRs for purchase in the US. This allows funds that are otherwise not allowed to purchase foreign securities the ability to purchase foreign securities through a US channel.²

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¹ Souder, Frank. [Securities Lending](#). Greenwich, CT: 1994

² Souder, Frank.