

Securities Finance Market Monitor

Issue 22, for the month ending February 29, 2004

Money Markets Recap

Greenspan comments on US Federal Agencies

February 2004 was highlighted by talk rather than activity, and in particular by the talk of the Chairman of the Federal Reserve, Mr. Alan Greenspan. On the 11th and 12th of the month, Mr. Greenspan gave his semi annual "Humphrey-Hawkins" testimony to the U.S. Congress. In his testimony he was broadly neutral with regard to outlook.

Following the testimony to the House of Representatives on the 11th, (the testimony to the Senate on the 12th was identical) the medium term and longer end of the market rallied a fair amount. The two-year note improved 10 basis points and the 10-year note improved about the same. It appeared to be more of a short covering rally than anything else, given the neutral nature of the text, and the pent up short positions were more a variable of the upcoming Treasury refunding, than of expectations of bearish testimony. Needless to say, that there was no volatility in the very short end of the yield curve where we tend to operate for securities lending reinvestment.

On the 24th of the month, Mr. Greenspan testimony to the Senate Banking Committee regarding what he perceives as the risks associated with certain of the government sponsored enterprises (GSE'S), in particular, the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac).

He is especially concerned with the amount of debt and the fact that it carries an implicit guarantee of the U.S. Government despite the explicit statement on their offering documents to the contrary. Mr. Greenspan went on to suggest that the Congress create a new regulator of the GSE's with similar authority to bank regulators, and that the GSE's need to be restricted as to how much debt they can issue and much in the way of investment assets they can hold. Surprisingly, the reaction in the market to this reinforced testimony was quite subdued. GSE debt in the 5 year sector widened by only 1 basis point against treasuries, and in the short end, discount notes actually tightened by a point or two against t-bills.

The very next day the Chairman appeared before the House Budget Committee to give testimony on the economy and fiscal policy. The Chairman expressed the view that the current deficit did not portend any serious negative impact on either inflation or interest rates, but that the continuation of large deficits would eventually cause both to move higher. He suggested that the preferred method of deficit reduction would be to reduce spending as opposed to increase taxes, which could severely stunt economic growth. Mr. Greenspan then opined that the Congress must act quickly to adjust the future benefits that would be derived from the entitlement

programs of Social Security and Medicare. Given the current U.S. demographics, the numbers are staggering. Shortfalls in the nature of tens of trillions of dollars by the year 2075 are being predicted, and clearly at some point are going to have to be addressed.

US Government Markets Commentary

UST/Agency activity remains subdued

US Treasury debt issuance increased 11% during the 4th quarter 2003. Despite the increased supply, auctions of Treasury security securities continued to attract investors looking for attractive yields and a high quality, risk free investment.

The US Treasury and Agency on-loan balances rose by 1.2% vs. last month. Overall, volumes have increased 10.3% over the past 5 months, which is encouraging news. On the other hand, rebate rates have remained unchanged for the last six months. This static intrinsic value is the result of the increased liquidity created by foreign central banks that have maintained an active presence in the Treasury markets over the past year.

While general collateral spreads remain at 4-8 basis points below Fed Funds, we would expect to see continued demand for select issues that support hedging strategies by borrowers.

US Government Issues Trading Special

Cusip	Maturity	Spread Range (bps)		Market Commentary
		Low	High	
912828FM5	5/15/1930	85	100	Supply/Demand
912828BV1	1/15/2009	80	100	On the run Treasury
912828BR0	11/15/2013	25	50	On the run Treasury
912827GN7	11/15/2005	40	80	Supply/Demand
912828BR0	11/15/2013	25	50	On the run Treasury

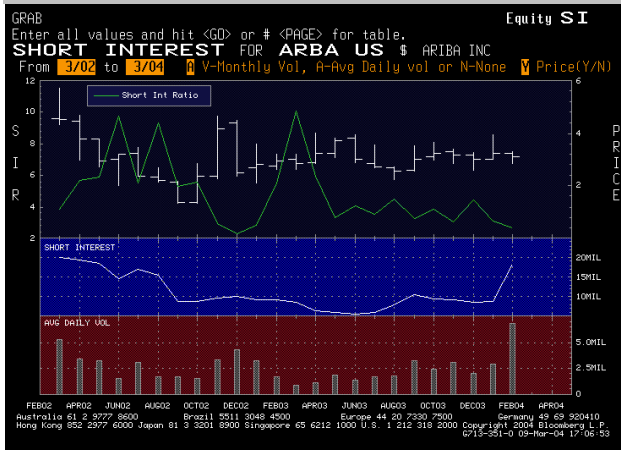
For charts above and below: Source: Citibank, N.A. February 2004.

US Equity/Bond Markets Commentary

Equity lending activity begins to increase

The US equity markets started strong, but as February progressed the lack of any momentum from the holiday season became apparent and the markets retreated. The S&P 500 Index rose only 1.22% for the month of February. The encouraging sign is that February was the 5th consecutive month of positive returns. The 14.25% cumulative return is by no means, a sure sign of a recovery. Recent M&A announcements give investors hope that securities lending activity is expected to increase.

Specials Lending Activity



Short Interest Ratio for Ariba, Inc. Source: Bloomberg

Corporate Equity

Ariba Inc., - Ariba has acquired FreeMarkets Inc., with a target price of \$8.57. However, EBIT for 2003 has dropped 22% vs. 2002. Ariba faces a crowded field of B2B competitors that includes Oracle and Peoplesoft.

Sunrise Senior Living - An operator of assisted-living centers and nursing homes, reported Net income fell to \$16.5 million, or 67 cents per diluted share, from \$21.5 million, or 82 cents per diluted share, in the fourth quarter of 2002.

El Paso Corp @ 13 bps - Texas energy concern is burdened by about \$24 billion in consolidated debt at the end of the 2003 third quarter, El Paso has struggled to return to financial health after failed ventures in the merchant electricity and telecoms businesses in recent years.

Corporate Bonds

General Motors Senior Notes @ 38bps unsecured notes have traded special in large quantities as the Detroit auto maker faces continued concerns related to health care and pension liabilities.

Non-US Equity

Bco Sabadell (7095388) is set to sell a 1 for 4 rights issue at €10.83, currently trading at €19.00. The company also plans to sell additional shares in a bid to raise cash. Illiquid stock with majority on loan for the forthcoming dividend (record date 05/02/04).

Invensys (0807041) - Is said to be in talks with bankers to agree on a £500 million rescue share issue (thought to be a rights issue). Most stock taken down last week at +20-35 bps plus a re-rating of older loans.

Thai Farmers Bank (6888794)- Brokers expressed strong interest following announcement of a \$650mln share sale,

led to some interest with brokers taking stock at 1.50 bps fee.

FYI – Securities Finance Terminology

Repurchase Agreements, called Repos, are money market transactions in which one party sells securities to another while agreeing to repurchase those same securities at a specific price on a specific forward date. These transactions are similar to secured loans, with the lender of money receiving securities as collateral to protect it against borrower default. Repos are viewed by some market participants as purchases and sales and others as secured loans. Parties lending money are referred to as "buyers," while parties lending securities are referred to as "sellers." The terms "securities" and "collateral" are generally interchangeable. These distinctions become clear later when we analyze the hybrid nature of Repos.

One firm's Repo is another firm's **Reverse Repo**; both are the same transaction viewed from two different perspectives. It is common Street practice for both parties to view the transaction from the dealer's perspective. A dealer borrowing money is executing a Repo, while a dealer borrowing securities is executing a Reverse Repo.

Deliverable Repo. The investor receives possession of securities in some manner. Possession of the securities creates a "perfected lien," or valid ownership (on the collateral). The cash investor receives the rights of ownership. There are two forms of delivery, "delivery versus payment" and "tri-party delivery."

Tri-party Deliverable Repos. A dealer, cash lender and third party custodian bank enter into a tri-party agreement in which the custodian bank acts as the intermediary in the Repo transaction and holds the collateral on behalf of the buyer.

Segregation Repo. The cash lender receives a pledge of acceptable securities which are segregated within the dealer's own clearing account. It is also commonly referred to as Hold-in-Custody, Safekeeping, and Mixed Bag Repo.

Repos are executed for maturities of between one day and five years (occasionally longer under special circumstances), with most having maturities of one year or less. Many are executed on an overnight (one day) basis. Transactions involving international securities are often executed for periods of one week or longer.

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