

Securities Finance *Market Monitor*

Issue 27, for the Month Ending July 31, 2004

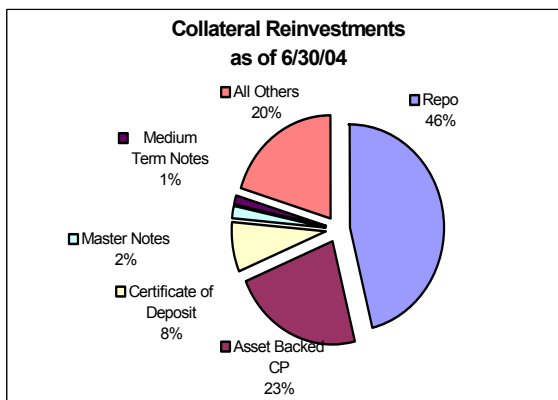
Money Markets Recap

As expected, the FED raises rates to 1.25%

The month began with a new Federal Funds target rate of 1.25% having been put in place on the previous afternoon, ending a slightly longer than 2 year run of historically low rates, and a 4 year stretch since the last time that there was a rate increase. The statement that followed the announcement on June 30th indicated that while the FOMC would be prepared to act more aggressively if called for, it would take significantly stronger inflation reports in order to get them to do so. That not being the case, we can expect a series of 25 basis point increases at each scheduled meeting going forward until the target has reached neutrality. Given that neither the members of the Committee or any of the market pundits can clearly identify what the neutral rate of interest is, it is anyone's guess as to where the Federal Funds target is going over the next couple of years, although the futures markets continue to indicate a stop out rate somewhere near 4.00%.

Chairman Greenspan's testimony to the U.S. Congress in mid July did nothing anything to clear things up, but was rather a reiteration of the FOMC statement on monetary policy. There were some expectations that Mr. Greenspan might have been a bit more dovish in his comments, and a result the yield on the 2 year note backed up 25 basis points in the days following his testimony. The economic and inflation reports that ensued were for the most part benign, and the short-term yield curve did not offer any premium above the expectations for the 25 basis point consecutive increases at the August 10th and September 21st meetings.

Given that scenario, the reinvestment portfolios will be managed extremely conservatively and will most likely become quite liquid going into the August meeting date. After that date the excess liquidity should be put to work in short duration investments.



US Government Markets Commentary

Foreign purchases of UST starts to decrease

Foreign net purchases of U.S. financial assets totaled \$56.4 billion in May, down 25.8 percent since in April, and the smallest reading since October 2003. A total of \$21.9 billion of Treasuries were purchased, reflecting noticeably less demand due to the curtailment of foreign exchange intervention by Asian central banks. Net foreign official purchases of Treasuries fell to \$14.6 billion, the lowest this year. Japan last intervened in March, when foreign investor appetite for Treasuries peaked at \$61.5 billion. Still, U.S. debt products were the main attraction for foreign investors in May, while equities remain out of favor.

US Government securities on-loan balances rose 10 percent in July. While this increase is certainly larger than our normal historical volatility patterns, it is too early to make assumptions or project future trends. Across most portfolios, spreads fell sharply to 19 basis points on average, reflecting less lending activity for "on-the-run" treasury issues. Securities lending activity is a lagging indicator of macro-economic trends. Of course we will watch the activity at the Fed concerning global demand for US Treasuries and analyze this versus our own performance models.

US Equity/Bond Markets Commentary

Fed move has modest impact on US Corporates

The US equity portfolios saw demand drop by 2.2 percent for the month of July. This could be expected as the overall markets slumped due to a variety of factors. The two biggest economic concerns; oil prices and the raising of rates by the FED had a small impact on loan balances. The energy sector continued to generate the most lending activity and generated the highest spreads. On average most portfolios have seen spreads in a range of 18-25 gross basis points. This has not changed over the past 3 months. With continued economic concerns and the lack of an IPO pipeline in the markets, we expect loan balances to remain at current levels with slightly declining spreads.

Corporate bond utilization increased 9% in July. This increase cannot be interpreted as the result of specific shifts in the market, yet. However, considering the recent interest rate hike and the overall sluggishness of the bond lending volumes as of late, this is a data point we will follow in the coming months. Corporate bond spreads fell slightly, but the good news is that overall, spreads have remained in the 22-30 basis point range on average.

With the volume of new issuances in the corporate bond market on the decline, it is difficult to expect to see a rise in loan utilizations in the near term.

Specials Lending Activity

US Corporate Bond/Equity

Allied Capital Corp. CUSP-01903Q108 this large finance company announced that it has completed the purchase of a majority ownership stake in Advantage Sales & Marketing Inc. The Company's investment in Advantage totals approximately \$257 million in debt and equity securities, including closing costs.

Level 3 Communications, Inc. CUSIP-52729N100 today announced its second quarter results. Consolidated revenue was \$918 million for the second quarter compared to \$899 million for the first quarter 2004. Communications revenue was \$391 million versus \$389 million for the previous quarter, and information services revenue was \$503 million compared to \$494 million for the previous quarter. Shares have traded special for months.

Non-US Bond/Equity

United Kingdom

One to watch is **Marks & Spencer group (3127489)**; they are fighting to stave off a possible hostile takeover by announcing the sale of their banking unit to HSBC and 650 job cuts. While borrowing has been limited, there is a strong expectation of increased activity in the near future.

Japan

Q8383 Tottori Bank - Tottori Bank announced they will sell a 7 billion Yen convertible bond. This is an illiquid security with Brokers driving the lending fees as high as 750 basis points.

Hong Kong

6109893 Yanzhou Coal - An announcement of a share placement sparked interest as Yanzhou coal announced they are planning to raise up to \$162 million USD. Shares traded at 150 basis point fee.

FYI - Understanding Short Interest

The Short Interest table provides an interesting measure of Wall Street sentiment by monitoring the actions of those who sell stocks short. The hypothetical stock data on the table is given for the four most recent months.

Short sellers expect share prices to fall. They seek to profit from this expectation by selling now and buying later, at lower prices. Specifically, they sell shares they don't yet own. They do this by arranging, through their brokers, to borrow stock to deliver to the buyers. Eventually the short sellers will have to return shares to the accounts from which they were borrowed. They do this by going back into the stock market and purchasing stock to deliver to the original lender. This method of trading will be profitable

only if the stock sells at a lower price in the future, when the short seller must buy i.e., ("cover the short").

Short Interest

Month	Shares (Mil)	% Outs.	% Float	Days
02/08/04	17.228	1.273	1.286	4.309
01/08/04	18.032	1.333	1.346	4.643
12/08/03	17.514	1.294	1.307	5.449
11/09/03	12.952	0.957	0.967	3.426

The **Shares** column represents the total number of shares, in millions that have been sold short. The **%Outs** column tells us what percent of the total number of shares the short interest represents. The **% Float** column shows the percent of the float represented by the short interest. The Float is the number of shares that are available to the public for trading. Finally, the **Days** column shows how many days it would take for all short sellers to fully cover their positions (buy enough shares to pay back all their loans of stock) at current levels of trading volume.

Scan each column up and down to see how short sellers have acted over the four-month period. If the short interest has been increasing over that period, it means that they have been turning increasingly bearish on the stock.

You may be tempted to avoid any stock with a large short interest. But remember: eventually, every short seller *must* become a buyer in order to cover the short position. That could put upward pressure on the stock price if any good news surfaces, creating a "short squeeze" as short sellers rush to cover their positions before the stock moves so high as to wipe out their potential profits. Indeed, if the stock moves high enough, short sellers will lose money if they wind up paying more to cover than they received when they sold short. Note, too, that a conventional (long) buyer cannot possibly lose more than the amount of the initial investment. There's no comparable limit on how much a short seller could lose, since there's no limit on how high a stock could rise above the proceeds of the short-sale.

Citibank Securities Finance Contacts:

Alejandro Berney	US	1-212-657-1075
Thad Garrison	US	1-212-657-4032
Victoria Bright	UK	44-207-500-5467
Paul O'Brien	SG	65 6328-5350
Tony Evans	US	1-212-657-9522

© 2004 Citibank, N.A. **Sources:** Moody's Investors Services, Forbes, Scudder Mutual Funds, Reuters, and Bloomberg. For additional information please contact: thad.garrison@citigroup.com.

This newsletter is provided by Citibank solely as a service to its clients. The information contained herein is for informational purposes only. The information contained herein does not constitute a recommendation by Citibank to take any action, and Citibank is not providing any investment, tax or legal advice to any client. Under no circumstances is the information contained herein to be considered or used as an offer to sell, or a solicitation of any offer to buy, any security.