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Welcome

The PASLA & RMA Fourth Annual Conference on Asian Securities Lending was held in Shanghai from 6 - 8 March, and was attended by over 300 industry participants. The major theme of the conference was the continued development and introduction of securities lending frameworks in the major markets across Asia, with a specific focus on the markets of Malaysia, India, Taiwan, Philippines, Indonesia and China.

In keeping with this Asian market theme, Citigroup will be launching an agency domestic equity-lending programme for Australia in April 2007. Australia possesses a well developed securities lending market, and clients will benefit by enjoying enhanced financing opportunities for Australian securities. For further information, please refer to the product update below.

U.S. equities

Our U.S. desk in New York saw overall average balances were down 7.77 per cent for February, with average specials in demand up 9.36 per cent.

Early in the month, helped by a strong productivity number and a lower-than-expected unit-labour-cost number, the Dow set a new intraday record high, topping 12,700 points. Fuelled by upgrades in the auto-sector and deal news, including the first-ever Initial Public Offering (IPO) of a U.S.-listed hedge fund, Fortress Investment Group (FIG), the market was marginally higher.¹

February ended with a drastic 3.30 per cent sell-off in the Dow, as a steep decline in China's Shanghai market, down over 9.00 per cent in one day, spilled over into the U.S. markets. This was the largest one-day percentage decline for the Dow in nearly four years.²

¹ Source: Bloomberg L.P., 7, 9 February 2007; Wall Street Journal (WSJ), 7, 9 February 2007; and Reuters, 7, 9 February 2007. ² Source: WSJ, 28 February 2007.

Active stocks in demand

- True Religion (TRLG) traded at -10.00 per cent.
- Mohawk (MHK) traded at -1.00 per cent.
- Accredited Home (LEND) traded at 1.00 per cent.
- Shares of Fortress Investment (FIG), a recent IPO, traded as low as -1.00 per cent.
- Allied Capital (ALD), ahead of record on 2007, and a proxy vote on 23 February 2007, trading as high as -20.50 per cent.

Sectors in demand in February included autos, Exchange-Traded Funds (ETFs) and household and consumer products. Some drivers for this demand included asset valuations, downgrades, interest-rate volatility, commodity prices and supply issues.

Product update

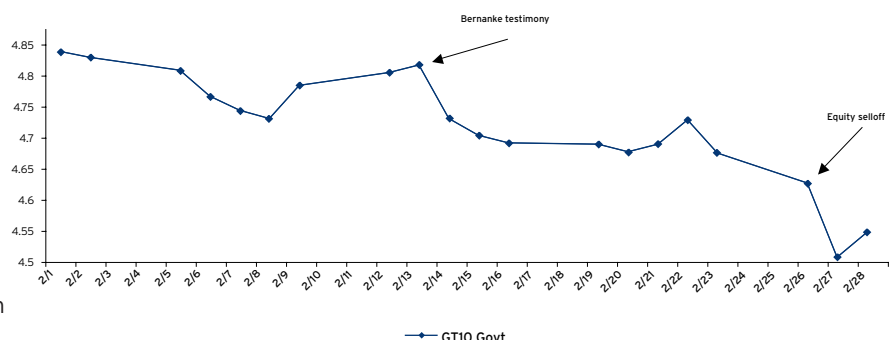
Citigroup is delighted to announce that in April 2007, Global Transaction Services' Securities Finance division will launch an agency domestic equity-lending programme in Australia. This enables us to compete in the local lending arena with domestic entities providing a service to our local client base. In addition, by our lending desks covering the earlier time zone, our clients will benefit from opportunities arising in other markets within the Asia-Pacific region. For further information, please refer to the contacts listed on the last page of this market monitor.

U.S. cash and money markets

In early February, markets remained fairly quiet while they awaited the semi-annual Humphrey-Hawkins testimony to Congress by Federal Reserve Bank (FRB) Chairman Bernanke on 14 February. Viewed as being a bit more dovish than expected, a market rally followed the testimony.

The biggest jolt in the market came during the last couple of days in February as a result of the volatility in the equities markets. The two-year note yield decreased to 4.60 per cent after peaking at 4.95 per cent, and the ten-year note yield dropped to 4.51 per cent, having begun the month at 4.83 per cent, as shown in the graph opposite.

U.S. Government ten-year note



Source: Bloomberg L.P., 2 March 2007

U.S. issuance and credit

The U.S. sub-prime mortgage-lending market dominated headlines in February. Asset-Backed Securities (ABS), which are collateralised by such loans, are a staple of the ever-growing ABS market, and are often used as investment vehicles by securities lending agents, including ourselves when investing clients' cash collateral, in accordance with agreed upon investment guidelines

While the headlines predominantly concerned the deterioration in pricing of the lower-rated (BBB-rated and lower) subordinated debt, we increased our surveillance of the market in light of the chance for any "bubble up" activity that might affect the shorter-dated senior AAA-rated sector of that market. On a conference call arranged with S&P analysts, we were given comfort that any potential changes in the AAA ratings were extremely unlikely. S&P's research, "A More Stressful Test of a Housing Market Decline on U.S. RMBS"³, covered this subject in great detail.⁴

³ Source: S&P, 15 May 2006.

⁴ Source: www.ratingsdirect.com, February 2007.

U.S. treasury and agency

Our U.S. treasury and agency desk in New York saw balances and utilisation percentages remained stable during February, with just one bp spread between overnight treasury financing and fed funds. Both treasury general collateral (GC) and fed funds averaged 5.25 per cent. The U.S. Treasury refunding occurred on 15 February. The FRB settled 16-billion 3-year notes, 13 billion 10-year notes and the 9 billion of the 30-year bond.

At the beginning of February, the treasury GC term markets discounted any notion of a change in the fed funds rate in either direction in the near future. However, after the extremely weak durable-goods number on 27 February, the treasury term bids quickly began reflecting an ease to 5.00 per cent during the third quarter of this year.

U.S. corporate bonds

Our U.S. desk in New York saw overall average balances were up 1.89 per cent for February, with average specials in demand up 5.92 per cent.

According to Standard & Poor's (S&P), the default rate for global corporate bonds ended the 2006 year at a 25-year low. The expanding economy and investor's demand for debt made it easier for companies to meet interest payments. With default rates so low, risk premiums have been pushed down. The spread on high-yield bonds to U.S. Treasuries narrowed to 257 basis points (bps) recently, the lowest in ten years.⁵

The UK plans to sell USD-denominated bonds. This is the second bond sale in the U.S. currency in four years. The last was the USD3-billion five-year bonds back in 2003. It is expected to take place in the second week of March.⁶

According to S&P, U.S. companies will refinance approximately USD328 billion of debt this year. Low interest rates and low interest-rate volatility has been providing a favourable environment for refinancing and new issuance is expected to be strong during 2007 and 2008.⁷

Issues in demand

- **GM Corp** (CUSIP 370442AZ8): -0.50 per cent.
- **Movie Gallery** (CUSIP 624581AB0): -2.00 per cent.
- **Metaldyne** (CUSIP 591160AB2): 1.75 per cent.
- **JLG Industries** (CUSIP 466210AB7): 1.00 per cent.
- **WCI** (CUSIP 92923CAG9): 0.00 per cent.

⁵ Source: Bloomberg L.P., 1 February 2007.

⁶ Source: Bloomberg L.P., 22 February 2007.

⁷ Source: Bloomberg L.P., 20 February 2007.

European government bonds

European Government GC balances increased through February as broker-dealers continued to finance their European equity dividend activity. Demand for Spanish government debt also remained strong throughout the month.

A few of January's specials in the European repo market continued to trade at special levels into February, with the DBR 3.25 July 2015 (DE0001135283) trading as high as 150 bps. BTPS 3.00 January 2010 (IT0003799597) quickly fell back to GC during the first week of the month, but was replaced by activity in a few (illiquid) Greek government issues. GGB 5.90 October 2022 (GR0133002155) traded up to 150 bps, while GGB 4.50 September 2037 briefly moved to around 30 bps. There is no open activity yet as we approach the March futures contracts. However, the DBR 3.5 January 2016 (DE0001135291), the Cheapest To

Deliver (CTD) issue in the ten-year Bund contract, continues to attract interest in term and trades at approximately 30 bps through GC to 20 March (settlement date).

Just one gilt traded special through the month with volatility in the UKT 5 March 2008 (GB0031734154), which jumped between GC and 70 bps through the last few weeks of the month.

The Monetary Policy Committee held rates at February's meeting, following their surprise rate hike in January. LIBOR levels suggest the market is expecting a 25-bps hike at the next meeting in March. However, we have seen volatility throughout February with new data seemingly influencing investor's opinion on the bank's decision; and, by the end of the month, sentiment appeared to swing in favour of no move by the Bank of England on 8 March.

European money markets

EUR rates again remained unchanged in February at 3.50 per cent, in keeping with the market consensus. Consequently, short-term EUR rates remained within the 3.50 to 3.60 per cent spread as in the previous month.

Comments made by European Central Banks' Jean-Claude Trichet suggest very strongly that there will be a 25-bps hike in the refinance rate at the next meeting on 8 March to 3.75 per cent.

European equities

During February, our European desk in London saw overall balances increase about 9.50 per cent, primarily due to increased demand for European equities.

News

Société Générale Securities Services (SGCC) has completed its acquisition of the securities services business of UniCredit Group. SGSS now has more than USD2.7 trillion (EUR2 trillion) in assets under custody.⁸

Europe⁹

European stocks slumped the most in three-and-a-half years after a plunge in the Chinese stock market rattled investor confidence and sparked a global slide in equities. Companies like BHP Billiton, Rio Tinto Group and Standard Chartered PLC, which generate a high proportion of sales in China, paced the drop.

Despite the over-buying in emerging markets by fund managers, confidence in the European economy unexpectedly rose in February for the first time in four

months as unemployment fell to a record low and inflation slowed.

Active stocks

Merger and acquisition news

- **Enel/Endesa:** there is speculation that Enel may increase its stake in Endesa Sa to almost 25 per cent, and there is also interest in the stock due to news of Endesa's special general meeting called for 20 March.
- **Sonaecom** made a USD14-billion bid for Portugal Tel.
- **EADS:** Daimler Chrysler sold a third of its stake in the Airbus parent company for EUR1.5 billion.

Convertible bonds issued

- Q Cells
- Tandberg Data
- Karstadt
- Sogecable
- Intralot

⁸ Source: www.isfmagazine.com, February 2007.

⁹ Source: Bloomberg L.P., February 2007.

Asia-Pacific equities¹⁰

Our Asia-Pacific desk in Hong Kong reports on three countries from the region, Australia, Hong Kong and Singapore, in this news bulletin. If you require additional information on a country within the Asia-Pacific region which has not been reported this month, please contact kerrie.lay@citigroup.com.

Australia

Our Asia-Pacific desk in Hong Kong saw balances in Australia were up 1.43 per cent for the month of February.

The Australian AS51 Index started the month at 5,773.40 points, rising to an all-time high of 6,044.00 points on 26 February before joining the global market decline and falling to end the month at 5,832.50 points on 28 February.

Active stocks

- **Platinum Australia** (SEDOL 6292652).
- **Fortescue Metals** (SEDOL 6086253).
- **Myob Limited** (SEDOL 6242862).
- **Riversdale Mining** (SEDOL 6932657).
- **G.U.D. Holdings** (SEDOL 6358004).

Hong Kong

Our Asian desk saw balances in Hong Kong were down 7.90 per cent for the month of February.

The Hang Seng Index started the month at 20,106.42 points, rising moderately to a high of 20,735.05 on 8 February before falling on the back of concerns of outflows of capital. The index regained some of the losses to hit another high of 20,809.23 points on 22 February before joining the global market decline, ending the month down to 19,651.51 on 28 March.

Active stocks

- **Shanghai Real Estate** (SEDOL 6201830).
- **Fortescue Metals** (SEDOL 6086253).
- **Geely Automobile** (SEDOL 6531827).
- **F E Consortium Intl** (SEDOL 6331555).
- **Comba Telecom Sys** (SEDOL 6651576).
- **Bank Of China Ltd** (SEDOL B154564).

Singapore

Balances in Singapore were up 12.34 per cent for the month of February, as reported by our Asian desk.

Singapore cut corporate taxes for the first time in three years, narrowing its gap over Hong Kong, amid government efforts to lure investment and spur job creation. The government plans to reduce the maximum tax rate paid by companies to 18.00 per cent from 20.00 per cent from the 2008 year of assessment. However, the goods and services tax will be increased two percentage points to 7.00 from July to make up for the lower collections from companies.

Active stocks

- **Wilmar International Ltd** (SEDOL B17KC69).
- **Noble Group** (SEDOL B01CLC3).
- **Mediating Ltd** (SEDOL 6194026).
- **Creative Technology** (SEDOL 6207582).
- **Utd Test and Assembly Ord Npv** (SEDOL 6731058).

¹⁰ Source: Bloomberg L.P., February 2007.

For further information, please contact your Citigroup representative.

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