



Welcome

The past year has seen significant headwinds for the securities-lending industry amid an unprecedented period of market volatility. As exceptional market conditions appeared to have eased as we close the first quarter of 2009, this provides a good opportunity to take stock and look to the year ahead.

I recently had the honour of co-chairing the recent 6th Annual PASLA/RMA Conference on Asian Securities Lending, which was held in Kuala Lumpur, Malaysia, in early March. The conference was well attended, and industry participants used the forum to debate and discuss topical issues that were having an impact on the industry – the changes in risk management views and perceptions of securities lending, the increasing rise of lending regulations and short-selling restrictions globally, and the trends and opportunities in various markets across Asia.

Three consistent themes were heard throughout the conference. First: the crisis has created greater awareness in all markets and regulators of the varied functions that securities lending supports in modern capital markets, from settlement efficiency, pricing and trading liquidity, to alternative investment strategies. Second: the fundamental soundness and value proposition of securities lending as a programme for incremental yields remains undiminished, but participants also demand that lending programmes provide greater clarity and granularity on their programme's risks and mitigants. Third: borrowers and agent lenders have to work harder than ever to address institutional lenders' heightened concerns on counterparty and reinvestment risks, and to amend existing guidelines and policies to the rapidly changing market environment.

This focus plays to our strengths at Citi. With our unparalleled global reach and expertise in lending in 37 markets worldwide, we are uniquely placed to develop and structure scalable and flexible lending programmes to assist clients in maximising yield within a robust risk management framework based on, and consistent with, each client's specific investment guidelines.

We look forward to working with every client to tailor lending solutions that meet their unique requirements on risk and reward.

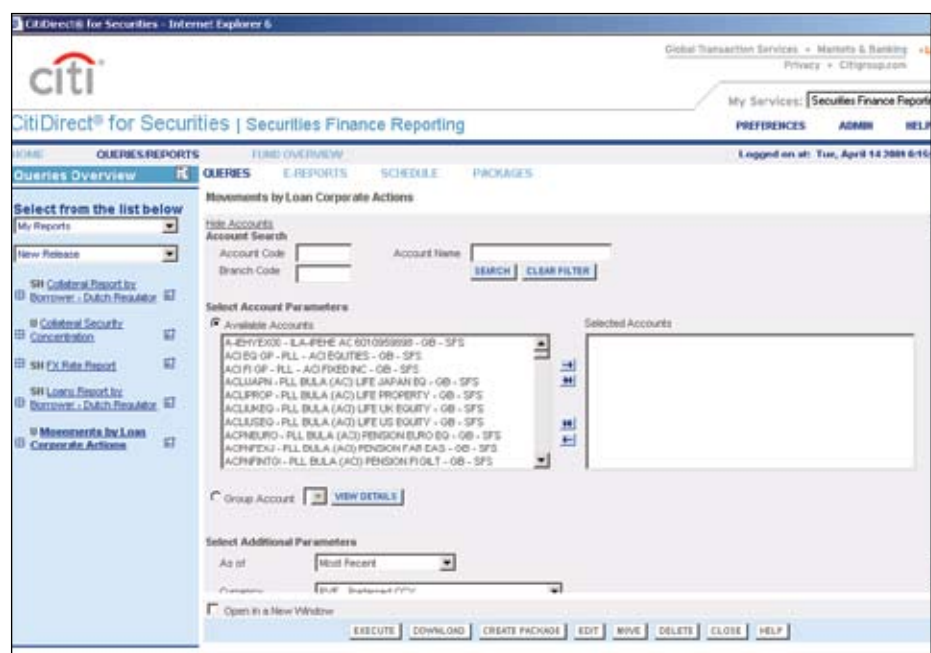
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Product Development

Throughout the first quarter of 2009, we have continued to develop our suite of reports delivered via Securities Finance Reporting (SFR) to meet specific client demands. These new reports include:

- a report to facilitate month-end mandatory reporting to regulators,
- a report that compares loan currencies with a selected currency,
- a report showing all new loans and indicating if a loan is related to a Corporate Action, thus allowing special processing on the client-side,
- a collateral concentration report that lists the top 10 securities (by value and percentage of total) held as collateral.

These reports can be made available to any lender. Should you have any questions on the breadth of reporting available via SFR, or have new reporting requirements not currently met via SFR, please contact your Securities Finance product relationship manager or Eugene Amusin at +44 207500 4706 or eugene.amusin@citi.com.



US equities¹

News

US mutual stock funds fell an average of 9.30 per cent in the first quarter, trimming steeper losses after the Treasury disclosed economic-rescue efforts that ignited a rally in March. The decline was the third in a row for funds that invested in US equities and followed a record 24 per cent drop in the fourth quarter, according to data compiled by Morningstar Incorporated.

The Standard & Poor's (S&P) 500 Index fell 12 per cent in the first three months of the year. The index plunged 25 per cent this year through 9 March, before surging 18 per cent during the rest of the month, the biggest rally of its kind since 1982, according to S&P.

Funds holding technology stocks, such as Google Inc. and Apple Inc., were the top

gainers, and those with financial stocks pared some of their losses at the end of the quarter as US Treasury Secretary Timothy Geithner expanded a plan to buy distressed mortgage debt. "It's been a roller coaster," said Russel Kinnel, director of fund research at Morningstar, in an interview. "The sectors tell a lot of the story. Tech and telecom: good. Financials and real estate: really, really bad."

Stock funds last made money in the second quarter of 2008, when the average gain was 0.35 per cent. They fell 39 per cent in 2008, the worst year for the S&P 500 in seven decades.

From January through March, the top-performing diversified US stock fund was the USD175.6 million Van Kampen Equity Growth Fund, which rose 8.4 per cent,

according to Chicago-based Morningstar. The research firm examined the returns of US-based mutual funds with more than USD100 million in assets.

Active stocks

- Citigroup (C)
- Equity One Inc (EQY)
- Ford (F)
- Gen Mtrs Corp (GM)
- Trina Solar (TSL)

Sectors in demand included: autos, subprime lenders and exchange-traded funds. Some drivers of this demand included: asset valuations, downgrades, commodity prices and supply issues.

¹ www.bloomberg.com, accessed on 2 April 2009.

US cash and money markets²

The employment situation in the US weakened for the fourteenth consecutive month.

Payrolls decreased by over 500,000 jobs for the fourth consecutive month. The unemployment rate rose to over 8 per cent and there is a strong consensus that a double-digit unemployment rate is quite possible in the next few months.

While economic data such as this would usually trigger an immediate and strong response in monetary policy, the fact that the benchmark Federal Funds target rate is already at 0.00 per cent makes traditional monetary easing somewhat more difficult.

In this regard, on 18 March the Federal Open Market Committee (FOMC) officially announced the initiation of a "quantitative

easing" programme in which it would purchase USD300 billion of US Treasury securities, concentrated in the 2- to 10-year sector of the yield curve over the next six months.

They also announced an increase of up to USD750 billion in the amount of government-sponsored enterprise (GSE) mortgage-backed securities (MBS) that they would purchase, raising the limit on that programme to USD1.25 trillion, and doubling to USD200 billion the amount of GSE debt that they would purchase this year.

In addition, they announced the launch of the Term Asset Backed Securities Loan Facility (TALF), which is designed to expand the amount of bank credit available for

consumer loans such as automobile and credit card loans.

In its statement, the FOMC made it clear that they expect a prolonged period of exceptionally low short-term interest rates. While these actions did not have a significant impact on the money-market yield curve, there was a more notable impact on short-term government rates. For the month, the yield on 91-day T-bills declined by about 15 basis points (bps), and the yield on 3-month agency discount notes dropped by about 20 bps.

² www.bloomberg.com, accessed on 6 April 2009.

US corporate bonds

Current news³

Corporate bonds are the favourite asset class for financial advisers in 2009, a new survey of nearly 1,500 IFAs shows. A total of 83 per cent of advisers said they would be recommending corporate bond investments to investors this year, while 67 per cent said they would recommend UK equities, and 65 per cent income funds.

Global equities are the next popular asset class, with 58 per cent of advisers saying they would recommend them. Fifty-one per cent favour multi-manager funds, 50 per cent favour US equities, 40 per cent like European equities and just over a third will recommend cash.

The survey was conducted among 1,430 advisers by Gartmore, M&G, Newton and Schroders at their Joint Investment Forum event.

Issues in demand

- Mohegan Tribal Gaming (CUSIP 608328AP5)
- MGM Mirage (CUSIP 552953BB6)
- NTK Holdings (CUSIP 62941EAB7)
- Lamar Media (CUSIP 513075AG6)

³ www.citywire.co.uk, "Corporate bonds are advisers' top pick for 2009," by Daniel Grote, accessed on 1 March 2009.

US Treasury and agency

The increase in treasury issuance continues to put a damper on spreads. The FOMC announced its plan to buy back Treasury issues as part of its statement on 18 March, commenting: "The Federal Open Market Committee has announced that the Open Market Trading Desk will begin a Treasury purchase programme of up to USD300 billion to help improve conditions in private credit markets."⁴

There are two schools of thought regarding this announcement, as it pertains to spreads for treasuries on loan. Either that these Treasury purchases will eventually reduce supply and create "scarcity value" resulting in wider spreads; or that the overwhelming increase in Treasury supply will prevent spreads from increasing either for general collateral or specific issues.

The ultimate result will most likely be a combination of the two scenarios. While on one hand it is true the Fed will eventually purchase 300 billion treasuries, on the other hand 47 billion in net new treasury issuance settled on 16 March, with more to follow.⁵

Currently, Treasury general collateral (GC) is trading at or higher than Fed Funds open on a daily basis. We don't expect this to change in the near future as a direct result of the Fed purchases. However, we do expect to see the occasional "special issue" as the Fed siphons some specific issues out of the market.

The 31st of March was an exceptionally difficult quarter-end (also the Japanese year-end) for funding. Most repo desks

began to pare down their balances two weeks prior to quarter-end. Some returned all their balances, claiming there was no room on their balance sheet for non-netted borrows. The dealers who were actively borrowing over "the turn" were well positioned to demand higher rates for securities loans. It was the typical supply-and-demand scenario. There was strong demand for the use of the dealer's balance sheet from the securities-lending community, but a limited supply of dealers with whom to transact business.

⁴ www.bloomberg.com, accessed on 6 April 2009.

⁵ ICAP Wrightson

Asia-Pacific equities

Negative data has narrowed significantly, growth declines are moderating for most countries, with month-on-month rebounds in Korea and Singapore. China data is mixed, with fiscally driven growth in full swing, while trade data is weakening. Economic weakness, prompting Asia FX depreciation pressures, need to be counter-balanced by more aggressive monetary/quantitative and fiscal easing in the US, which would weigh on the US dollar.

China

Investment and credit are growing strongly. Efforts to promote consumer demand are showing progress, as the "Home Electronics Go Rural" programme has boosted sales, while PCs and autos have been added to the discount list for rural residents.

Prior to the dramatic narrowing in China's trade surplus in February, its foreign currency reserves reportedly have declined by a notable USD30 billion in January, while trade and FDI inflows amounted about to USD37 billion.

Hong Kong

Plunging trade prospects and subdued business sentiment likely weighed on GDP growth severely in the first quarter of 2009.

Fiscal support announced so far appears restrained, while consumer demand is expected to soften on a rising unemployment rate and conservative household spending.

The seasonally adjusted unemployment rate rose to 5 per cent in December 2008 to February 2009, the highest since May 2006.

Since the beginning of the global financial crisis last summer, cumulative job losses have reached 33,800.

India

Recent incremental data indicates mixed trades. While the pick-up in auto sales in February does provide a beacon of hope, indicators across sectors – real estate, retail, cement dispatches, freight and port traffic – continue to be worrying. Though official growth estimates are still in the 7 per cent-plus range, policy officials are not recognising the collateral damage of the global financial crisis and downturn to India's growth trajectory.

Singapore

An unprecedented GDP contraction of nearly 10 per cent year-on-year in the first quarter of this year on a sharp synchronised decline in both manufacturing and services saw non-oil domestic exports decline by 29.4 per cent in January to February vs. 17.8 per cent in the fourth quarter of 2008.

Retail sales dropped 12.2 per cent in January vs. 2.5 per cent in the fourth quarter of 2008. A clear casualty of plummeting tourist arrivals and consumer belt-tightening, job layoffs mount.

The FY09 Budget announced in late January took on an unambiguously expansionary slant, with large deficit

on USD8.7 billion or 3.5 per cent of GDP vs. 0.8 per cent of GDP in FY08. Rather than issuing bonds, the deficit will be financed by the savings of the present government, as well as USD4.9 billion of the principal sum of the estimated SGD400 to 600 billion of fiscal reserves.

South Korea

January industrial activity data showed a clear rebound in high-tech exports and construction activities, and currently available data suggested that activities were at least not worsened in February. The weakness of the Korean won would be a contributor to Korea's outer-performance in tech exports compared with Japan and Taiwan.

Taiwan

Despite rising domestic equity prices, economic fundamentals continued to deteriorate in early 2009.

Exports contracted by 37.2 per cent year-on-year in January to February, down from 24.7 per cent year-on-year in the fourth quarter of 2008 and +8 per cent year on year in the third quarter of 2008.

Domestic demand also weakened further as private investment collapsed amid high spare capacity and businesses cutting down in expense.

Private consumption appeared resilient on government's dispatch of consumption vouchers and lower commodity tax on motor vehicles.

European equities

Overall balance was up by 11 per cent from February. This is due to rising prices and increased demand from the borrowers.

News

European equities pause after five days of gains⁶

European equities paused for breath on Tuesday, breaking a five-day winning streak that had added almost 10 per cent to the FTSE Eurofirst 300 index.

Bayer, the German pharmaceuticals and plastics maker, fell after the US Food and Drug Administration raised concerns over its blood-thinning drug Xarelto, developed with Johnson & Johnson. Its shares closed down 10.3 per cent at EUR32.69.

Vivendi, the French media and telecoms conglomerate, dropped 1.2 per cent to EUR18.99. It was downgraded by Morgan Stanley to "equal weight" from "overweight." Nokia, the world's largest mobile phone handset maker, fell 3.1 per cent to EUR8.71 as it said it would cut costs to counter a sharp fall in global demand for cell phones. Goldman Sachs cut its price target for Nokia to EUR9.60 from EUR10.01.

Europe's banks, which had spearheaded recent gains for the continent's bourses, finished the day narrowly higher. Confidence in a sustained rally for the beleaguered sector, however, was knocked.

Mark Sartori, head of European equities at Fox-Pitt Kelton, said some of the weakness in the banking and insurance sectors was a natural pullback from a "rally fuelled by short covering" and that "no long-term money had returned to the financial sector".

French banks Société Generale and Natixis were among the better performers, rising 3.9 and 9.8 per cent, respectively. Swiss Re, one of the world's biggest reinsurers, rose 3.2 per cent to CHF15.38, while Germany's Allianz was the second biggest riser in the Dax, gaining 2.4 per cent to EUR59.90.

Dutch insurer Aegon, meanwhile, fell 2 per cent to EUR2.45. However, Christopher Hitchings, analyst at Keefe, Bruyette & Woods, raised his price target for Aegon shares. The FTSE Eurofirst 300 Index ended down 0.7 per cent to 715.83. The German Xetra Dax Index lost 1.4 per cent to 3,987.77, while the French CAC 40 fell 0.9 per cent to 2,767.28.

Vinci, the French construction company, had an early bounce, but fell back 0.5 per cent to EUR28.80. Goldman Sachs raised its price target for Vinci from EUR27 to EUR32.4, and changed its recommendation from "neutral" to "buy".

Shares in ArcelorMittal, the steel group, fell 11.8 per cent to EUR12.66 after a warning from US steelmaker Nucor about its earnings knocked the sector.

Voestalpine fell 7.5 per cent to EUR10.35, and Norsk Hydro shed 3.8 per cent to NOK22.70.

Main UK and European names in focus

- William Hill (WMH LN)
- Seat-Pagine (PG IM)
- Wolesley (WOS LN)
- Banco De Sabadell (SAB SM)
- Land Securities (LAND LN)
- Peter Hambro (POG LN)

Relative value, merger, convertible bond, directional news

- Swedbank (SWEDA SS)
- Peter Hambro (POG LN)
- Luxottica (LUX IM).
- Infineon (IFX GY)
- Hypo Real Estate (HRX GR)
- Erste Bank (EBS AV)
- DSV A/S (DSV DC)
- Banco De Sabadell (SAB SM)
- Commerzbank (CBK GY)
- Volkswagen (VOW GR)

⁶ www.ft.com, accessed on 17 March 2009.

European government bonds

European government GC balances fell again in March as de-leveraging continued and quarter-end balance sheet restrictions began to bite hard.

GC bids rose spectacularly as broker-dealers attempted to deter new business over the turn. Many reported several other securities-lending agents paying exorbitant levels, presumably in order to finance committed investments in pooled funds that they are currently unable to sell.

There were no gilt specials again this month with very little appetite to borrow GC positions.

As with Euro governments, the bids for gilt GC positions increased through the month as we approached quarter-end.

The Bank of England once again cut the interest rate by 50 bps to 0.50 per cent as it desperately attempted to stimulate the economy. To this end plans were finally unveiled for the initial stages of "Quantitative Easing", with several reverse auctions taking place in March that saw the bank purchase gilts from financial institutions.

While the auctions have so far proved popular (the bank receiving a vast surplus in the bid-to-cover ratio), it is difficult to

say whether this money is likely to flow into the credit space as intended.

Evidence so far suggests that Pension funds are likely (and in most cases obliged) to re-purchase gilts, most likely extending tenors or switching into index-linked government bonds.

Time will tell, as this quantitative easing measure develops over the next couple of months.

European money markets

The global financial crisis has pushed Europe into the worst recession since World War II.

Inflation has dropped to the lowest on record as the economic slump intensified across the region, adding to concerns that deflationary pressures are emerging. Consumer and business confidence have also reached record lows, with unemployment above 8 per cent.

The spotlight has been on some countries within the Euro-zone more than others.

Ireland had its AAA credit rating cut one notch by S&P to AA+. S&P cited the deterioration of Ireland's public finances. Meanwhile, Spain was forced to rescue its first major bank in 16 years.

The European Central Bank (ECB) is expected to reduce rates further, but the debate is more intense as to whether the ECB will adopt quantitative easing and in what mode.

For further information, please contact your Citi representative.

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