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## Welcome

Warmest greetings to our clients and friends around the world. It has been a tumultuous ride in the global markets since I last had the pleasure of welcoming everyone to Citi's Securities Finance market analysis. We have all been inundated with articles analysing what went wrong, what corrective measures are needed to turn things around and what can ensure a secure and profitable future. There are those who predict a long drawn-out future of continuing turmoil, and those who confidently predict that the worst is behind us.

Throughout this period of change and uncertainty, one reality that has been made absolutely clear is our essential interdependence on one another. The global nature of our economy has never been more evident than when the financial markets started to crumble. The contagion spread at an unanticipated pace and soon became endemic around the globe.

I have had the opportunity of working with our clients around the world and have been able to witness that we all share the same concerns and are affected by the same realities. Although geographic, national and political realities appear to divide us, we actually remain closely connected and interdependent on one another.

It seems poignant that as I prepare these remarks it is "Earth Day" and I am further reminded of our common residence on this planet and the consequences we share based upon the earth's health and stability. Earth Day is intended to inspire awareness and appreciation for the earth's environment. As we are all fundamentally connected to the condition of our earth; so we are connected in our economic dealings. We must take care of the environment in order to ensure our continued survival as a species. We need to take care of our global economy to ensure the functioning and prosperity of our separate and collective societies. We need to make the prudent decisions today that will position us for economic prosperity in the future.

Because we all have so much in common, this market analysis, based on our shared interest in the Securities Finance markets, is of great value. There has been, and continues to be, significant opportunity to generate revenue by lending securities. Despite the challenges we face, and the new levels of uncertainty, we at Citi remain committed to working with lenders to help them create opportunity and to structure programmes, consistent with their tolerance for risk, designed to achieve their objectives.

## US equities<sup>1</sup>

### News

Stocks climbed as companies continued to report stronger-than-forecast results, though new data offered mixed signals on an economic recovery.

Securities-lending spreads across most eight of the twelve analysed indices grew during the week, ending 24 April. The Health Care Sector saw its spreads increase the most, at 2218.2 per cent or 26 basis points (bps) from the prior week, while Standard and Poor's (S&P) 500's spreads decreased the most, at -2.3 per cent or -4 bps during the week ending 24 April.

Borrowing demand for US financials is up, while demand for other US equities is down slightly. US stocks posted the biggest monthly gain in nine years as companies

from Wells Fargo & Co. to Marriott International Incorporated and Ford Motor Company beat profit estimates, spurring speculation that the recession is easing. The S&P 500 soared 9.4 per cent this month for the steepest rally since March 2000.

### Active stocks

- Citigroup (C)
- Equity One Inc (EQY)
- Gen Mtrs Corp (GM)
- Trina Solar (TSL)
- Sequenom Inc (SQNM)
- First Solar (FSLR)

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.

<sup>1</sup> CNN.com, accessed on 30 April 2009; *Wall Street Journal (WSJ)*, accessed on 30 April 2009; [astec.analytics@sungard.com](mailto:astec.analytics@sungard.com), accessed on 30 April 2009; [www.bloomberg.com](http://www.bloomberg.com), accessed on 30 April 2009.

## US cash and money markets<sup>2</sup>

Economic data releases remained consistently weak for the most part, confirming the market consensus that the slowdown in growth would be prolonged. The only silver lining was that there were some signs that the rate of decline was slowing. Housing showed some signals of improvement, as did consumer spending.

The Federal Reserve continued to implement its quantitative easing plan by purchasing Treasury, agency and MBS securities throughout the month.

At the Federal Open Market Committee (FOMC) meeting on 29 April, the FOMC reiterated its position that they viewed the risk of deflation greater than the risk of inflation and that they expected short-term rates to remain extremely low for an extended period of time.

There was some hope that they might announce an increase in the amount of US Treasury security purchases as part of the Quantitative Easing plan, but they maintained the target at USD300 billion.

Overall conditions in the short-term money markets continued to show improvement as evidenced by a continual decrease in the Libor rates. One-month Libor decreased by 9 bps to 0.41 per cent and three-month Libor decreased by 17 bps to 1.00 per cent.

Credit ratings of financial institutions continued to come under pressure with several downgrades issued during the month.

<sup>2</sup> www.bloomberg.com, accessed on 5 May 2009.

## US corporate bonds

### Current news<sup>3</sup>

Companies have sold about USD14.7 billion of bonds this week, compared with USD10 billion the previous week, Bloomberg data shows. And sales this year total about USD469 billion, compared with USD353 billion during the same period in 2008.

Look out, stock market: corporate bonds are exploding – for now. With the credit market tightening and investors not as excited about stocks, bonds are becoming more popular among investors worldwide.

### Issues in demand

- Mohegan Tribal Gaming (CUSIP 608328AP5)

- MGM Mirage (CUSIP 552953BB6)
- NTK Holdings (CUSIP 62941EAB7)
- Lamar Media (CUSIP 513075AG6)

<sup>3</sup> www.bloomberg.com, accessed on 30 April 2009; WSJ, 14 April 2009.

## US Treasury and agency

The US Treasury market typically experiences wider-than-normal spreads during the second half of April and into May. This shortage of Treasury collateral usually occurs upon collection of federal tax receipts soon after the 15 April personal income-tax deadline in the United States.

However, the playing field has changed dramatically this year. The influx of additional Treasury collateral issued to fund the various stimulus programmes has had a profound effect on this phenomenon.

Depending on how you look at it, there was or was not a collateral shortage this season. If you looked at nominal general collateral (GC) and Fed funds rates, they were soft. GC averaged about 8 bps below the upper

Fed funds target rate (0.25 per cent) in the latter part of the month. Fed funds averaged about 9 bps below the upper target range.

So, if you look at the spread between GC and Fed funds, there was no collateral shortage. GC actually traded above fed funds after 15 April. As mentioned earlier, GC normally trades at a much wider spread below Fed funds during the last two weeks of April. This season, the “Seasonal Collateral Shortage” did not generate a shortage of collateral. Instead, we had overall soft funding.

The 300 bps TMPG fail charge is set to begin on 1 May. Once an issue begins failing, the repo market will use negative-rate trades more actively. Currently in the Repo

market, a negative-rate trade executed on the brokers’ screens requires a guaranteed delivery. If the seller does not deliver, he/she owes the buyer the equivalent repo rate.

The market has no fail charge now (April). To this point, securities lenders were not privy to negative rebates since the only recourse when failed was dropping the dealers’ rebate rate to 0 per cent. When the new fail charge begins on 1 May, negative rates will trade differently.

We expect that securities lenders may be able to command rebate rates below 0 per cent if the market commands it. There will be more information regarding how the 300 bps fail-charge affects the repo/securities-lending market in next month’s commentary.

## Asia-Pacific equities

### China

China’s GDP growth bottomed in the first quarter of this year at a rate of 6.1 per cent year-on-year. After seasonal adjustment, the economy actually expanded by about 5 per cent annualised over the depressed

fourth quarter, which only recorded less than 1 per cent SAAR growth. Most importantly, stimulus investment has translated into a rebound in industrial production growth to 8.3 per cent year-on-year in March. This eases a major drag on

the economy and offsets some impact of trade shrinkage.

### Hong Kong

Given Hong Kong’s re-exports of mainland origin accounts for 60 per cent of its total

exports, the slower pace of decline in China exports will likely be reflected in Hong Kong's exports data. This would also be in line with the tentative signs of slowing in export declines seen across the region. The jobless rate rose further to 5.2 per cent, although at a slower pace of decline. Better-than-expected performance in the stock market may help to sustain the employment over the sector, but employment in trade, retail sales and real estate will continue to suffer.

#### India

Incremental macro data has been mixed, but veering towards positive. Pick-up in cement dispatches and port traffic, and continued healthy trends in telecom subscribers, auto and retail sales, indicate that a recovery would be broad-based. While incremental macro data appears to be stabilising, the key concern is the financing of the government's fiscal deficit. Late last month, the RBI announced the borrowing calendar for 1HFY10. This involves gross borrowing of

INR2.4 trillion, which is based on the interim budget's central government deficit target of 5.5 per cent of GDP.

#### Singapore

While manufacturing and services plunged in the recent figures, construction was the only bright spot in the economy, growing a robust 25.6 per cent year-on-year on increased public sector demand. As the result, the Ministry of Trade and Industry revised its forecast range for 2009 GDP growth to -6 per cent to -9 per cent from -2 per cent to -5 per cent previously.

#### South Korea

The Bank of Korea expects Korea will restore a positive quarter-on-quarter GDP growth of 0.2 per cent in early 2009. Industrial production picked up by 6.8 per cent in the recent figures, led by both high-tech and no-tech sectors. The inventory/shipment ratio also showed a clear sign of improvements. Year-on-year export growth rose from -27.1 per cent in

January/February to -22 per cent in March. The contrast between the relative strength in Korea's exports and the weakness in Japan or Taiwan also continues, supporting the common belief that weak Korean won significantly benefits Korean exports.

#### Taiwan

A month-on-month comparison showed exports rebounding by 6.8 per cent in March. In addition, the Manufacturing Business Climate Index (BCL) increased for the second month and service BCI also improved for the first time since early 2008. Consumer sentiment finally improved in April, as consumers turned slightly less bearish on the inflation outlook, household financial situation, overall economic situation and investment prospects. Meanwhile, the benchmark Taiex jumped 14.3 per cent in March and has increased 25.9 per cent this year (up to 20 April).

## European equities

#### News<sup>4</sup>

Overall balance was up by 42 per cent since March. This is due to rising prices and increased demand from the borrowers.

European stocks climbed for a second day, led by banks and raw-material producers, as investors speculated government measures to rescue lenders and revive the economy were working.

Hypo Real Estate Holding AG surged 14 per cent as the German government offered to buy the property lender. HSBC Holdings Plc, Europe's largest bank, jumped 8.5 per cent after Wells Fargo & Co., the second-biggest US home lender, reported first-quarter earnings that were more than double the average analyst estimate. BHP Billiton Ltd. led basic resources companies higher as a document obtained by Bloomberg News said the Japanese government will propose a USD154 billion stimulus for its economy.

The Dow Jones Stoxx 600 Index, the benchmark index for European shares, has risen for five straight weeks on the speculation that the US Federal Reserve's plan to buy Treasuries and bonds backed by mortgages and Treasury Secretary Timothy Geithner's pledge to finance the purchase of toxic assets would pull the global economy out of its first recession since World War II.

"We really believe that the worst is over," said Roger Groebli, Singapore-based head of financial market analysis at LGT Capital Management. Measures by governments and central banks "will bear fruit," he said in a Bloomberg Television interview.

The S&P 500 Index rose 2.4 per cent as Wells Fargo's results and the speculation that US banks would pass government stress tests boosted confidence in the financial system.

The UK's FTSE 100 increased 1.5 per cent as the Bank of England left its benchmark interest rate unchanged and said it would continue buying government bonds as it continued to fight the deepest recession since 1980.

France's CAC 40 Index rallied 1.8 per cent and Germany's DAX added 3.1 per cent.

Hypo Real Estate rallied 14 per cent to 1.37 euros. The German bank-rescue fund, Soffin, bid 1.39 euros a share, or about EUR290 million (USD382 million), for the lender. The government aims to acquire all of the outstanding shares with the offer, which is 16 per cent above yesterday's closing price of 1.20 euros.

HSBC rallied 8.5 percent to 474 pence. Deutsche Bank AG, Germany's biggest lender, gained 10 per cent to 36.95 euros.

#### Main UK and European names in focus

- Segro PLC (SGRO LN)
- Lafarge (LG FP)
- William Hill (WMH LN)
- Seat-Pagine (PG IM)
- Wolesley (WOS LN)
- Banco De Sabadell (SAB SM)
- Lundin Mining Corp (LUMI SS)
- Land Securities (LAND LN)
- Afren (AFR LN)

#### Relative value, merger, convertible bond and directional news

- Liberty International (LII LN)
- 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)
- Peter Hambro (POG LN)

<sup>4</sup> www.bloomberg.com, accessed 9 April 2009.

## European government bonds

Government GC balances climbed through the month as the spread between AAA government bonds and the rest continued to widen, opening up opportunities to lend German/French/Dutch against Italian/Belgian government collateral.

Borrowers have also been pledging increasing amounts of euro government T-bills as they accessed various Central Bank liquidity schemes, helping push GC balances up across the board.

In the gilt market UKT 5 09/07/14 (GB0031829509) traded up to 30 bps as availability dried up due to the Bank of England's gilt repurchase facility. The facility has seen the Bank buy back approximately GBP35 billions' worth of gilts in total, including some 30 per cent of the UKT 5 09/07/14.

The Bank also announced the programme would be extended to repurchase GBP125 billions' worth of gilts, corporate bonds

and commercial paper up GBP50 billion from GBP75 billion. Continued purchasing of a narrow band of gilts should result in more specials; however, this needs to be measured against the overall reduction in availability as clients use this facility.

## European money markets

European unemployment ticked up to 8.9 per cent during March, the highest in more than 3 years. Spain recorded the highest level of unemployment at 17.4 per cent, reflecting the downturn in the country's building industry. Lending to euro-area companies and households declined for a second month, extending the worst drop since records began 18 years ago.

On the positive, euro Libor rates have continued to fall, an indication that money-market confidence is improving. We have also seen a strong rally in Euro equity markets.

The European Central Bank (ECB) is expected to reduce rates further when they meet on 7 May; however, the bigger question is whether they will adopt some form of quantitative easing to further stem the recession.

**For further information, please contact your Citi representative.**

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