

ON LOAN ACTIVITY

Government Bonds

- U.S.
- European

Corporate Bonds

- U.S.
- European

Global Equities

- U.S.
- European
- Asian

On Loan Activity Key

Up Down No change

U.S. Corporate Bonds

In general balances were up two percent for the month while specials remained flat. Some issues in demand included: Blockbuster (093679AA6) which traded up to 600 bps special ahead of an exchange offer, and Abitibi-Consolidated (003669AJ7) which traded as much as 500 bps special as a directional trade.

With many expecting rates to stabilize, there has been some new supply of longer dated bonds as several money managers and funds became more comfortable extending the duration. That being said, some are remaining in shorter maturities until the Fed gives a clearer signal of what it will do.

Our Trading desks report the sectors in demand include: Automobiles, Airlines, Exchange Traded Funds, and Real Estate Investment Trusts (REITs). Drivers of this demand include: asset valuations, downgrades, interest rate uncertainty, commodity prices and supply issues.

Welcome

Citigroup is pleased to introduce its Securities Finance Market Monitor, a monthly newsletter, designed to keep you up to date with the global securities lending markets.

We hope you find the information informative and interesting. If you would like additional information or would like to discuss any aspect of this newsletter, please contact your Citigroup representative or one of the contacts listed overleaf.

U.S. Cash, Treasury and Agency Update

In May U.S. Treasury and Agency lending was the widest spread between overnight financing and Fed Funds. The average spread to funds-open and the overnight financing of both treasury and agency general collateral was 12 bps and three bps respectively. This spread was extraordinary considering the average for April was seven for treasuries and one for agencies and in March a paltry two for treasuries and zero for agencies. Spreads tend to widen for a short period of time, usually two to three weeks, after the personal tax deadline on 15 April. However, this time around, cheap financing continued throughout the entire month of May.

The Fed issued 21 billion new three-year notes and 13 billion new ten-year notes on the 15 May quarterly

refunding. Typically, for a few days or weeks leading into the refunding, the current issue, which becomes the "old" issue will trade at a premium. Hence, the ten-year traded with an average of 240 bps of intrinsic value and the three-year averaged 35 bps.

The repo term markets at month-end were pricing in a 70 percent chance of another 25 bps tightening during the 29 June Federal Open Market Committee (FOMC) meeting. If this hike were to occur, it would be the 13 consecutive tightening and would bring the Fed Funds rate to 5.25 percent. Although, there will be plenty of data throughout the month of June that can swing that percentage in either direction.

Product Development Update

Securities lending is well underway now in Taiwan since January 2006 with more lenders interested in lending their Taiwanese portfolio. We are looking at other Emerging Markets including Brazil, Chile and Eastern Europe. We are working with the

broker dealer community to assess the countries most in demand and prioritise the development.

Testing is underway to implement the Equilend platform, which will result in greater utilisation of specific portfolios.

Global Equities

Overall balances were up by nine percent for May, while specials were up by 18 percent primarily due to high loan volumes in European equities.

In Europe convertible bond issues that traded special included Deutz at 150 bps, Maurel ET Prom at 250 bps, and Socotherm at 500bps. Relative Value and Merger Acquisitions issues that traded special included Ducati at 400 bps, Abertis at 250bps and Mittal Steel at 800 bps. Specials as a result of Directional long/short trading strategies included Alitalia at 500bps, Antena 3 at 250bps and Option NV at 700bps.

The securities lending market in Japan is extremely buoyant. Japan is in a bull market as a result of the increase in investment of hedge funds. Development in the demand for highly liquid issues is the result of an investment in the market by volatility funds which focus on single stock options that are traded against the most liquid of names such as; JAL, Hamamatsu and Sankyu. Specials as a result of long/short funds included Sanyo Electric which trades at 350bps and Gulliver Internati has traded at 500 bps and Mizho Trust has traded at 350 bps.

We have seen greater interest in Hynex, a Korean issue that trades at 250 bps as a result of a directional strategy.

Recently the ban on Chinese companies issuing an Initial Public Offering (IPO) on the Hong Kong exchange was lifted. The first IPO is "Bank of China" is expected to become available in the market from early June. Although levels have not been set there is significant interest in borrowing the stock.

In Australia, Toll and Patrick was a hot M&A deal, which is nearly over, stock is currently trading at 100bps.

The RVGT01D is U.S. Treasury reverse repo overnight, which is a proxy for where general collateral is bid by the street. FFN6 is the July 30 day Fed Funds contract.

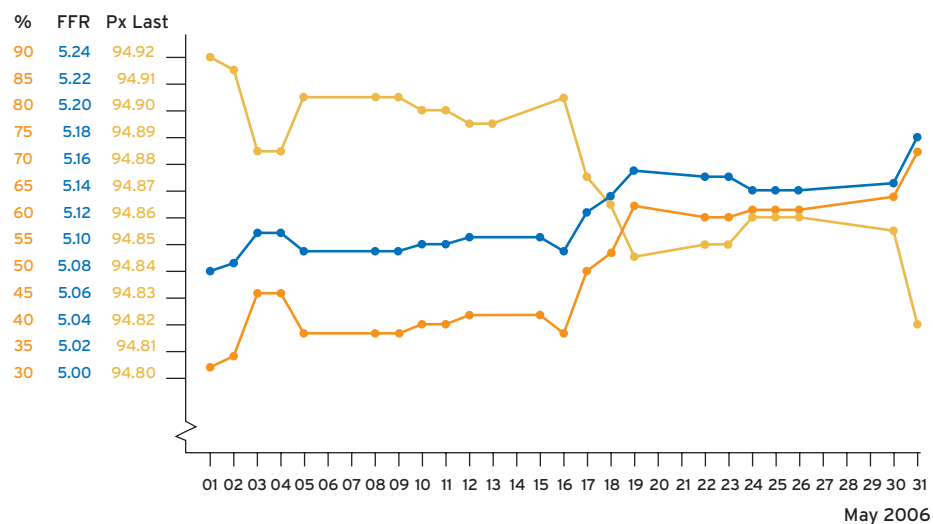
As expected, the Federal Open Market Committee (FOMC) increased the Fed Funds' target rate by 25 bps to 5.00 percent on 10 May. The statement issued following the meeting suggested that further rate increases may be necessary, but any further policy adjustments would be dependent upon the economic data released in the inter-meeting period. Volatility in energy prices continued to contribute to increased inflation concerns, and resulted in the markets moving towards higher yields throughout the month. The probability of an additional 25 bps rate increase on 29 June, as indicated by the July Fed Funds futures contract, increased from 35 percent at the start of the month to about 75 percent by the end of May.

U.S. Equities

Overall balances were flat for May with specials in demand down by five percent. This was partly due to heavy proxy voting taking some supply off the street. Some issues in demand included: Cracker Barrel (CBRL) where untendered shares traded as much as 1000 basis points (bps) special, and Novastar (NFI) which traded as much as 2200 bps special as a directional trade.

Sectors in demand include: Automobiles, Airlines, Exchange Traded Funds, and Real Estate Investment Trusts (REITs). Drivers of this demand include: asset valuations, downgrades, interest rate uncertainty, commodity prices and supply issues.

Federal Funds, Futures and Probability - 29 June Rate Hike



Source: Bloomberg, June 2006

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