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## Welcome

As the European dividend season draws to a close, the ability of an agent bank to develop its product features and functions becomes more important for lenders to maximise revenue opportunities from a securities-lending programme.

Product development is one of Citi's key differentiators. This, allied with a high-touch service ethos and a flexible approach to cash-collateral reinvestment parameters, distinguishes Citi from other providers. Among the many examples, the following serve as highlights of the areas in which Citi product managers are working to find innovative ways of enhancing value for clients:

### **Advanced Pooling of Lendable Assets**

As global asset managers bring together the assets of investors with different tax, accounting and regulatory profiles in single pools, to increase investment flexibility, Citi's role of securities-lending agent is being transformed to meet the changes in fund structures. We have developed capabilities to lend securities on behalf of each unique investor type in a tax transparent vehicle.

### **New markets**

Citi already lends in 37 markets. New markets currently being analysed include Brazil, Malaysia and Poland.

### **Central Counterparties (CCP)**

As a member of various industry bodies, Citi is taking a leading role in articulating the position of agent lender banks. This is constructively critical of the merits of those securities-lending CCP models that are based on the structure used for cash equity markets, where both sides of a transaction must put up margin to the CCP thorough clearing members.

### **Customised collateral solutions**

Respecting the wishes of lender clients, Citi is ready to structure bespoke solutions that allow collateral to be held with third-party International Central Securities Depositories (ICSDs).

### **Lending structures for intermediaries**

This facilitates financing transactions for intermediaries who appoint Citi as their lending agent to lend portfolios in Asia versus local cash collateral.

### **FDIC Insured Custody and Trust Accounts**

Through Citibank's participation in the FDIC Temporary Liquidity Guaranty Program, we are able to offer a fully FDIC insured alternative to cash collateral investment to our securities lending clients. Rather than investing cash collateral in traditional money market type instruments, the cash collateral remains in an FDIC insured non interest bearing transaction account that receives compensation.

For more information on these and other initiatives, please contact me at [david.j.allen@citi.com](mailto:david.j.allen@citi.com) or contact your Securities Finance relationship manager.

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

### News

Securities-lending spreads were mixed, decreasing in 7 out of 12 indices during the week of 26 June. Loan balance increased in 9 out of the 12 indices during the period.

US stocks rose the most in three weeks as the Federal Reserve curtailed its intervention into financial markets, better-than-estimated earnings at Bed Bath & Beyond Inc. lifted retailers and Lennar Corp. triggered gains by homebuilders.

The Standard & Poor's (S&P) 500 Index rose 2.2 % to 920.74 on 25 June. The Dow Jones

Industrial Average added 179.79 points, or 2.2%, to 8,479.65. Equities extended their gain after the Treasury sold USD27 billion in securities at a lower-than-forecast yield.

A separate report today showed consumers grew more confident in June, underscoring that the worst of the recession had passed.

US stocks rose the most in three weeks on 25 June after the Federal Reserve, in a sign that financial markets were improving, said one emergency-lending programme would be eliminated and two others cut back.

### Active stocks

- Citigroup (C)
- Equity One Inc (EQY)
- General Motors Corp (GM)
- Trina Solar (TSL)
- Sequenom Inc (SQNM)
- First Solar (FSLR)
- Alliance Data Syst (ADS)

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> www.bloomberg.com, accessed on 25 and 26 June 2009; SunGard Financial Systems, received 30 June 2009.

## US cash and money markets<sup>1</sup>

Money market yields continued to decline during June, but at a significantly lesser pace than they had during the previous month. The three-month Libor rate, which had declined 35 basis points (bps) in May, slid another 5.5 bps in June to end the month at 0.595 %.

Economic data releases continued to indicate further contraction in the US economy. However, most of the data pointed to a slowdown in the rate of decline.

Evidence of the changing rate of decline led the market participants to begin to consider when the Federal Open Market Committee (FOMC) might begin to remove some of the policy accommodation currently in place.

Federal Fund futures contracts for late 2009 and early 2010 began to show the pricing in of an increased probability of a change in policy and higher short-term rates (see graph below).

In response, the statement following the 23 and 24 June FOMC meeting reiterated the view of the FOMC that it expected economic conditions would be likely to warrant "exceptionally low levels of the federal funds rate for an extended period".

The statement also reiterated that the FRB NY remained committed to its previously announced programmes for purchasing US Treasury, agency and agency mortgage-backed securities.



There had been some anticipation of pressure on the overnight rate going into the quarter end, especially in light of a special assessment by the FDIC on balances held on 30 June. And there was some late day trades as high as 7.00 %. But the pressure failed to materialise in a significant way. The federal funds effective rate for the month end was 0.22 %. This was only 4 bps above the average for the month.

The market continues to anticipate Chairman Bernanke's 15 July semi-annual testimony on monetary policy for any clues about the timing of any future change in course.

<sup>1</sup> www.bloomberg.com, www.federalreserve.gov, and www.icap.com, accessed on 7 July 2009.

## US corporate bonds<sup>1</sup>

### Current news

Companies sold USD1.4 billion of high-yield debt on 30 June, bringing June sales to USD16.8 billion, and Q2 sales to USD50.1 billion, according to Bloomberg data.

Sales of investment-grade and high-yield debt totalled USD340.4 billion in the quarter.

Companies are seeking to refinance debt in the bond market as sales of leveraged

loans decline. Issuance dropped to USD32.9 billion this year, compared with USD176.4 billion for the same period in 2008 and USD537.3 billion the prior year.

A lack of dealer inventory of corporate bonds and plenty of available funds from corporate bond investors have combined to prompt a situation where there is minimal new issue concession on bonds compared to where outstanding bonds are trading.

### Issues in demand

- Mohegan Tribal Gaming (CUSIP 608328AP5)
- MGM Mirage (CUSIP 552953BB6)
- NTK Holdings (CUSIP 62941EAB7)
- Lamar Media (CUSIP 513075AG6)
- Blockbuster Inc (CUSIP 093679AC2)

<sup>1</sup> www.bloomberg.com, accessed on 26 June and 1 July 2009.

## US Treasury and agency

The 300bps TMPG/SIFMA Fails Charge has proven to be a success. The programme has accomplished the primary goal of minimising delivery fails.

In addition, the trading range for treasury issues has been widened by 300 bps. Throughout June, every current issue, with

the exception of the long bond, has traded with a negative rebate at some point during the month.

Moreover, there were several days when the current 10-year averaged -3 % prior to the reopening on 15 June. The original issue size of the 10-year in 15 May was 22

billion. The issue had been in great demand in the Repo market in early June.

As previously mentioned, the issue was reopened on 15 June, an additional 19 billion was issued. Upon their reopening, the issue ceased to trade with a negative rebate for about a week as the market absorbed the additional issuance.

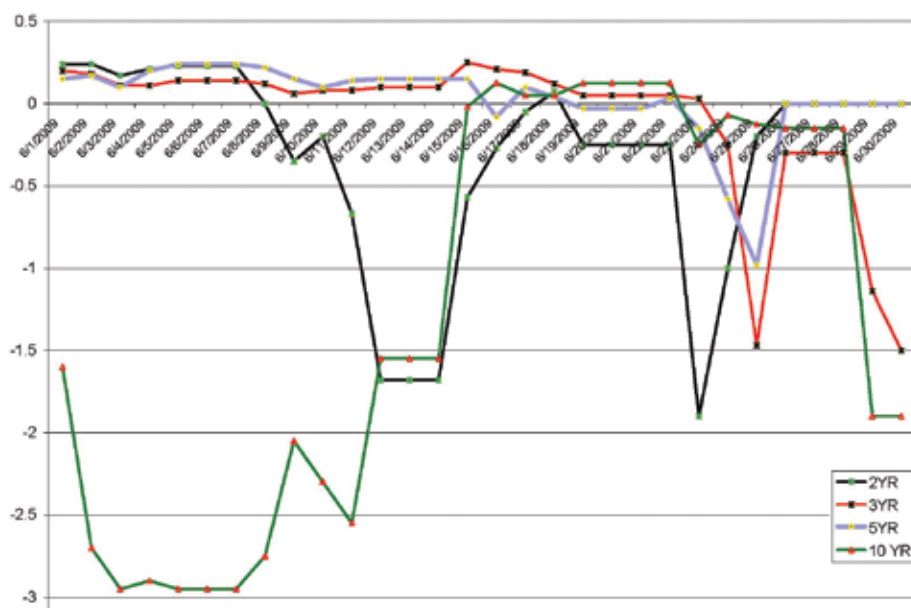
However, towards the end of the month, the issue again traded deep in negative territory. On 15 July, the issue will be reopened at which time another 19 billion will be issued.<sup>1</sup>

Despite the pending July 10-year reopening, the issue is trading with a negative rate through August on term.

Treasuries were in great demand over the "Turn" (quarter-end trade, 30 June to 1 July).

Also, general collateral, which normally trades close to the high end of the Fed Funds range of 0.25 %, traded at 0. We have never seen general collateral trade negative. However, it's possible that the "Fails Charge" may change that.

<sup>1</sup> Wrightson ICAP.



## Asia-Pacific equities

The recession in the developed world is advancing. But China's economic momentum is gathering, supporting the region's upturn. In emerging markets, China has continued to surprise on the upside, with the latest data showing fixed-asset investment growth, industrial production, credit expansion and retail

sales as stronger than expected, even as exports disappoint.

### China

The torrent of credit and liquidity alongside massive fiscal stimulus have largely washed away deflationary pressures in China. In the three months through to May, China's

consumer price index rose every month on a seasonally adjusted basis, totalling 2.3% annualised. Stabilising inflation is positive for stocks, as profitability may improve when pricing firms. This could support stock performance after the liquidity boom slows down.

## Hong Kong

An expanded fiscal package provides a modest boost to aggregate demand through reducing business costs and supporting household consumption. The government recently unveiled an additional HKD16.7 billion's worth of relief package on top of the HKD8.4 billion approved in the 09/10 budget, boosting the total announced stimulus package for the current fiscal year to HKD25.2 billion. Unemployment rate paused for the first time since the start of the current crisis and stayed at 5.3% in March to May.

## Singapore

Singapore's openness has allowed it to disproportionately benefit from moderating

recession in the US and China's resilient domestic demand. Singapore has not only been the most open economy in Asia, but it has also seen the greatest increase in its degree of openness in Asia. The Employment Outlook Survey by Manpower Inc. supports a less negative outlook on the labour market. Out of 697 employers surveyed, a net 5% expected to increase headcount in Q3 09, from a net 43% who expected to reduce headcount in Q2 09.

## Korea

Industrial production growth was strong, and domestic demand indicators such as consumer goods sales and construction activities showed modest strength. In May, a significant decline in exports from

USD30.4 to USD28.1 billion led by non-tech sectors and G3 economies.

## Taiwan

The government lowered official GDP forecast to -4.25% in May, reflecting slow progress of the global outlook and extended contraction for global trade. However, the government predicted that real GDP would turn positive quarter-on-quarter in the coming quarter.

## European equities

### News

Securities-lending activities showed some deceleration after a busy first half of the year. Overall balances are slightly down, in line with the 4% decrease in the MSCI Pan-Euro Index seen during June.

Corporate actions across the region, especially the UK, continue to prevail in the markets as companies sought various means of fund raising. This phenomenon has been the mainstay of the financial services industry, but we are now beginning to see similar trends in industries as varied as leisure and media.

The month of June saw the first back-to-back weekly decline since March for the European stock index, Dow Jones Stoxx 600. Some recovery was seen during the last week of June after the markets were lifted by consolidation news in the telecommunications and constructions sectors (Vodafone and Grupo Ferrovial, respectively).

Hedge fund liquidations fell by 50% in Q1 09 from the record levels set in the prior quarter, according to data released

today by Hedge Fund Research (HFR), a leading provider of hedge fund industry data. Kenneth Heinz, President of HFR, said "We expect that the combination of the structural evolution and recent performance will continue to drive industry growth and change in 2009."<sup>1</sup>

This year's RMA/ISLA conference held in June was a success. There was a lot of interest in the regulatory requirements sessions, especially the Spanish one. The Spanish regulator said it had not seen the Spanish market's liquidity harmed by its ban on naked short selling and said its ban would remain in place. The UK seemed to take a less stringent stance, with Michael Tripp from the FSA commenting, "The FSA sees short selling as a legitimate market instrument and is very important to the financial markets. But we do recognise potential issues around short selling, where it can be abused and harm the markets."<sup>2</sup>

Citi was a sponsor of this event. Tim Douglas, Global Head, Securities Finance, Citi, participated in the panel discussion, Industry Leaders: Surviving the Crisis

and What's Next for the Market? Gareth Mitchell, Head of Fixed Income and Equity Trading for EMEA, took part in the Spanish Market panel discussion.

### Active stocks

- Raiffeisen (RIBH AV)
- Immofinanz (IIA AV)
- Renewable Energy (REC NO)
- Erste Bank (EBS AV)
- Sacyr Vallehermoso (SYV SM)
- Banco De Sabadell (SAB SM)
- Swedbank (SWEDA SS)
- Eniro (ENRO SS)
- Rio Tinto (RIO LN)
- Vedanta Resources (VED LN)
- Punch Taverns (PUB LN)
- Segro (SGRO LN)
- Speedy Hire (SDY LN)
- Travis Perkins (TPK LN)

<sup>1</sup> ISF, 16 June 2009.

<sup>2</sup> ISF, 29 June 2009.

## European government bonds

European government GC balances continue to climb as we finance European Govt T-Bills against loans. The widening spread between AAA-rated government debt and others in Europe, in particular Italian, Belgium and Irish debt, continues

to provide an opportunity to increase non-cash loan balances with a premium over GC levels.

We continue to observe demand to finance Japanese government bonds against Euro government GC from a

number of borrowers. In recent weeks, we have seen also an increased demand to finance Danish government bonds (DKK-denominated), particularly against UK government gilts, trading with a slight premium over GC levels.

We see little appetite to borrow gilt GC positions against delivery-by-value, with the real focus on continued demand to finance government-guaranteed certificates of deposits against gilt loans.

The Bank of England continues its asset-purchase facility, which has seen the bank

buy back almost GBP100 billion in gilts from banks and other financial institutions.

Of particular note in this month's purchases are the UKT 5 14 (GB0031829509), UKT 5 18 (GB00B1VWPC84) and UKT 4.75 20 (GB00B058DQ55), with total purchases now at 50% of UKT 5 14 and over 35%

in both UKT 5 18 and UKT 4.75 20 of total outstandings.

The effect of this purchasing activity on supply saw these issues trade up to 30bps and would expect to see this trend continue.

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## European money markets

The European Central Bank carried out its much-anticipated 1-year repo at 1%. The generous terms attracted 1,121 participants and EUR 442 billion.

The result was to almost double the cash in the system, which has inevitably caused short-dated rates to come off 20 to 40 bps.

However, it is debatable how much of this extra cheap cash will find its way into the economy.

On the data front, European economic confidence continues to rise, manufacturing contracted at a slower pace and retail sales showed signs of improving.

But with unemployment continuing to surge, a call of an economic recovery is still premature.

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

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