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On-loan activity

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- U.S. ☐
- European ⇧

Corporate bonds
- U.S. ⇩
- European ⇧

Global equities
- U.S. ⇧
- European ⇧
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Key: ⇧ Up ⇩ Down ☐ No change

U.S. equities

Our U.S. desk in New York saw overall average balances were up 8.03 per cent for November, with average specials in demand down 2.42 per cent.

Earlier in November, stocks rallied, with the Dow Jones Index breaking the 12,300 mark for the first time. Tame inflation data from the Consumer Price Index (CPI) and Producer Price Index (PPI) reports earlier in the month, along with lower oil prices down to USD55-plus a barrel, helped drive the advance. Other reports, including the Philadelphia Federal Fund's manufacturing index, the Industrial Production number, and capacity utilisation data, all showed gains, reinforcing the argument that the economy is on solid footing despite the weakness in the housing market.[1]

Later in the month, amid concerns of a weak dollar (falling to a 20-month low against the Euro and rising oil prices to USD63-plus a barrel), the Dow Jones Index sold off. The market tried to rally after a stronger Gross Domestic Product (GDP) number outweighed a decline in new-home sales and a weaker-than-expected index from The National Association of Purchasing Management – Chicago, but the comeback was short lived. The Dow gave up more ground as the Institute for Supply Management (ISM) survey manufacturing index fell below 50, which indicated that economic activity in the manufacturing sector contracted for the first time after 41 consecutive months.[2]

Active stocks

- Shares of the New York Stock Exchange Group (NYX) were in demand, trading as low as -25.00 per cent.
- Neurometrix (NURO) was in demand, bid as low as 0.00 per cent, as it was added to the threshold list recently.
- US Airways (LCC), amid a hostile USD8-billion hostile takeover bid, was in demand, trading as low as 4.50 per cent.
- La-Z-Boy (LZB) traded as low as negative 8.50 per cent ahead of record date 24 November.
- Greenhill (GHL) was in demand bid at 0.00 per cent, ahead of record date 22 November.
- Owens Corning (OC) was in demand, trading as low as 0.75 per cent.
- Shares of NYMEX Holdings (NMX), a recent Initial Public Offering, were in demand, trading as low as -6.00 per cent.
- Braskem (BAK) was in demand, trading as low as 0.25 per cent.
- Shares of Crucell (CRXL) were in demand, trading as low as 0.25 per cent.

Sectors in demand in November included autos, Exchange-Traded Funds (ETFs) and Real Estate Investment Trusts (REITs). Some drivers for this demand included asset valuations, downgrades, interest-rate volatility, commodity prices and supply issues.

[1]Source: Bloomberg L.P., November 2006; *Wall Street Journal (WSJ)*, 16 November 2006.

[2]Source: Bloomberg L.P., November 2006; *WSJ*, 27, 30 November, 1 December 2006.

U.S. cash and money markets

Our U.S. desk in New York saw a growing divergence between the monetary policy makers' views, and the traders in the fixed income markets. While the Federal Reserve Bank (FRB) remains focused towards higher inflation and potential for further interest-rate increases, the market has continued to price in the increasing probability of an interest-rate decrease during the first half of 2007. By the end of November, the fed funds futures markets indicated that there was a 12 per cent chance of a rate cut of 25 basis points (bps) at the 31 January 2007 Federal Open Market Committee (FOMC) meeting, a 44 per cent probability that the first cut would occur at the 21 March 2007 meeting and a 100 per cent probability that the cut would occur by the 9 May 2007 meeting. While the inflation continued to show growth levels outside of what might be deemed optimal by the FRB, recent decreases in energy prices have helped to slow the rate of growth, and market consensus is that the slowdown in economic activity, especially in the housing sector, will be the catalyst for future monetary policy decisions. We have determined that the current yield curve continues to offer value over a three-month time span with room to add duration, and we have continued to add fixed-rate investments within this maturity range. Credit spreads have continued to contract slightly, with Asset-Backed Commercial Paper (ABCP) now providing premiums to fed funds in the 5 to 7 bps range, and bank obligations generating premiums of 3 to 5 bps. We will continue to seek value along the short-term curve by maintaining our weightings in these asset classes within the investment portfolios.

U.S. corporate bonds

In November our U.S. desk in New York saw overall average balances down 2.94 per cent for the month while average special balances were down 5.17 per cent.

49 per cent of Standard & Poor's U.S. corporate debt has below-investment-grade credit ratings, up from a low of 28 per cent in 1992. This is a record high since data collection started in 1980, reflecting a decline in credit quality and a rise in demand for high-risk assets.[3]

Corporate bonds with the lowest credit ratings gained approximately 33 per cent this year, according to a Merrill Lynch index. According to Chicago-based Research Incorporated, hedge funds, armed with over USD110 billion of new money from institutional investors, are purchasing the highest-yielding corporate bonds, as they perceive the economy to be strong enough to reduce defaults without accelerating inflation.[4]

Standard & Poor's upgraded Brazil's long-term credit ratings to "positive" from "stable" after Latin America's top economy cut some of its external liabilities. Brazil's long-term debt, which was last increased in February 2006, is currently rated BB, two levels below investment grade.[5]

To secure financing for next year, Argentina issued USD500-million seven-year, dollar-denominated bonds yielding 8.03 per cent. The average spread on Argentina-dollar bonds over similar U.S. Treasuries has fallen 296 bps from 504 bps in December 2005. The country's economic recovery, which has bolstered revenue from taxes, has led Standard and Poor's to increase the country's long-term credit rating two times this year.[6]

Issues in demand from our U.S. desk

- Ford 7.45 per cent July 2031 (CUSIP 345370CA6), were in demand, and bid at 4.75 per cent.
- Century 9.5 per cent January 2049 (CUSIP 156503AG9), traded as low as 0.75 per cent.
- WCI 9.125 per cent May 2012 (CUSIP 92923CAG9), traded as low as –1.25 per cent.
- Abitibi 8.375 per cent April 2015 (CUSIP 003669AJ7), bid at 3.00 per cent.
- Ford 6.5 per cent 25 January 2007 (CUSIP 345397TX1), were in demand and bid at 5.00 per cent.
- Turkey 30s 11.875 per cent January 2030 (CUSIP 900123AL4), traded at 3.00 per cent.
- Movie Gallery 11.0 per cent May 2012 (CUSIP 624581AB0), bid at –2.50 per cent.

[3]Source: Bloomberg L.P., 8 November 2006.

[4]Source: Bloomberg L.P., 14 November 2006.

[5]Source: Bloomberg L.P., 22 November 2006.

[6]Source: Bloomberg L.P., 30 November 2006.

U.S. issuance and credit

The U.S. ABCP market has continued its rapid growth. Outstanding issuance through month-end November 2006 totalled USD1.025 trillion, currently up from USD848 billion on 1 January 2006.[7]

Global top-tier credit trends have remained relatively stable as upgrades outpaced downgrades in November. Three most notable upgrades that affected Citigroup's "Approved List", the companies approved for reinvestment, are Societe Generale Bank and Caja Madrid. Standard & Poor's upgraded the long-term ratings of Societe Generale Bank to AA from AA-. The increase reflects an improvement in Societe Generale's business profile and current risk management.[8] Caja Madrid had both short- and long-term credit ratings upgraded from Standard & Poor's to AA- and A1+, respectively. Caja Madrid, currently ranked as Spain's fourth-largest bank, benefited from continued solid asset performance, as well as a healthy financial profile stemming from organic growth and efficiency gains.[9]

Standard & Poor's raised the short-term ratings of Austria's Erste Bank to A-1 from A-2 during November. The rating upgrade is significant because Erste Bank now has all three major Nationally Recognised Statistical Rating Organisations (NRSROs) ratings in the top tier. The increase was attributed to the groups' improved profitability and economic risk profile pertaining to its operations in Central and Eastern Europe (CEE).[10]

[7]Source: www.federalreserve.gov, November 2006.

[8]Source: www.ratingsdirect.com, 15 November 2006.

[9]Source: www.ratingsdirect.com, 29 November 2006.

[10]Source: www.ratingsdirect.com, 17 November 2006.

U.S. treasury and agency

Our New York desk in November reported that the month of November for the U.S. Treasury and Agency desk was a carbon copy of October's market activity. Balances remained robust with utilisation rates extremely high, and spreads virtually unchanged. The repo market, still feeling some negative effects from the recent Securities Exchange Commission (SEC) investigation on questionable trading practices by a small group of primary dealers, was once again devoid of off-the-run specials. On average, treasury overnight financing averaged 2 bps higher than fed funds for the month and overnight agencies funded 3 bps higher. This rate pressure, which has been present since September, has continued to compress spreads and is likely to remain in place through December. Term-treasury general collateral (GC) traded at the fed funds target rate of 5.25 per cent to year-end. This implies that rebate rates will remain historically high for the remainder of the year. The year-end turn (from 30 December to 2 January) traded at 4.90 per cent indicating some spread widening, at least at the very end of the year.

The current 10-year note was the only on-the-run issue that traded special, averaging 4.73 per cent (approximately 50 bps) below the fed funds level. USD13-billion 10-year notes and USD19-billion 3-year notes settled during the quarterly refunding on 15 November. Moreover, the U.S. Treasury will reopen the 10-year note on 15 December, which will have the effect of decreasing potential special value as a result of increased supply.

Four large primary dealers had their fiscal year-end in November, and most other non-Japanese firms will follow suit in December. Despite the added SEC scrutiny, the need to generate revenue attributable to 2007 for repo traders will more than likely create enough incentive for trading to begin in earnest in January. Spreads should begin to widen early next year.

Asia-Pacific equities[11]

Japan

Our desk in Hong Kong saw overall average balances were up 7.46 per cent for the month of November.[12]

Stocks declined over the three quarters of the month with the Nikkei falling to a low of 15,725.94 points on 20 November before recovering some of the losses at the end the month at 16,274.33 points. For during November, the Nikkei lost 0.80 per cent, the biggest drop since May. The Toppix fell 0.90 per cent in the same period.

Japan's factory output rose 1.60 per cent, led by auto manufacturers, semiconductors and electronics products. Machinery orders fell a seasonally adjusted 7.40 per cent in September from the previous month, as announced on 10 November by the Japanese Cabinet Office. On 16 November, the Bank of Japan kept its key interest rate unchanged. GDP expanded at an annual rate of 2.00 per cent, as stated by the Tokyo-based Cabinet. Consumer spending, which accounts for more than half of the economy, fell 0.70 per cent, twice as much as the expected 0.30 per cent drop.

Active stocks in demand

- Privee Investment (6673547) traded at an average 9.05 per cent.
- Tobishima Corp (6893000) traded at an average 7.27 per cent.
- Eneserve Corp (6280624) traded at an average 6.30 per cent.
- Myojo Foods Co Ltd (6613316) traded at an average 6.23 per cent.
- Invoice Inc (6439266) traded at an average 6.18 per cent.
- Altech Co (6042028) traded at an average 6.15 per cent.
- Japan Medical Dyna (6136705) traded at an average 5.93 per cent.
- Tokyu Construction (6689351) traded at an average 5.70 per cent.
- Pacific Golf Group (BOPLMI2) traded at an average 5.50 per cent.
- Pia Corporat-anion (6430946) traded at an average 5.47 per cent.
- Silver Seiko Ltd (6808305) traded at an average 5.45 per cent.
- Tokai Pulp & Paper Co Ltd (6895664) traded at an average 5.33 per cent.
- Suntelephone Co (6830483) traded at an average 5.31 per cent.
- Tsutsunaka Plastic (6906953) traded at an average 5.31 per cent.
- Kyoto Kimono Yuzen (6174578) traded at an average 5.31 per cent.
- 1st Baking Co (6250144) traded at an average 5.17 per cent.
- Keihin Co Ltd (6487340) traded at an average 5.14 per cent.
- Kinki Sharyo Co (6493002) traded at an average 5.08 per cent.
- Sagami Chain Co (6767343) traded at an average 5.07 per cent.
- Tomy Company Ltd (6046923) traded at an average 5.06 per cent.
- Showa Rubber Co (6805588) traded at an average 5.06 per cent.
- Livedoor Auto Co Ltd (6141709) traded at an average 5.06 per cent.
- Impress Holdings inc (96289018) traded at an average 5.06 per cent.
- Rock Field Co Ltd (6745747) traded at an average 5.06 per cent.
- Kabuki Theatrical Corporation (6480703) traded at an average 5.06 per cent.
- Yorozu Corp (6986977) traded at an average 5.03 per cent.

Korea

Overall-average balances were up 15.47 per cent for the month. November was easily the Kospi's best month of the year as the index ended the month on a seven-week rally. The index closed at 1,432.21 points, the highest close since 12 May. There was a greater-than-expected jump in overseas sales for the month of November that sparked growth. Korean investors were optimistic after reports that U.S. incomes rose 0.40 per cent in October and personal spending increased 0.20 per cent.

Samsung Electronics Co had significant gains after U.S. growth exceeded estimates and the Korean government's report that exports would rise more than previously forecast. South Korean exports are expected to increase by 15.00 per cent to USD326 billion, from USD284 billion last year, due in large part to the sale of LCD panels, chips and other electronics.

The Korean won continues to grow against the dollar and is already up 7.80 per cent on the year. The currency advanced to 927.00 won to the dollar this month, the strongest it has been since 24 October 1997. The Vice Finance Minister expects export growth to increase factory production, which rose 2.60 per cent this month. Construction companies, led by Daewoo Engineering, led among industry groups with a 3.20 per cent gain. Analysts expect the steel, automaking, construction and retail industries to drive Korean earnings by 10.00 per cent for next year.

Active stocks in demand

- Boryung Pharmaceuticals (6112716) traded at an average 4.94 per cent.
- Hanmi Pham Co. (6146083) traded at an average 4.68 per cent.
- Hankuk Paper Mfg (6408578) traded at an average 4.67 per cent.
- Ottogi Corp (6658373) traded at an average 4.63 per cent.
- Woongjin Thinkbig (6172505) traded at an average 4.45 per cent.
- Tae Young Corp (6871738) traded at an average 4.33 per cent.
- STX Corp (6743310) traded at an average 4.17 per cent.

Hong Kong

Our Asia desk in Hong Kong saw overall-average balances were up 1.80 per cent for November.

Hong Kong's Hang Seng Index experienced both a record high of 19,260.30 points and the largest single-day drop of 564.48 points since 12 September 2001 in the month of November. Hong Kong's economic growth grew by 6.80 per cent in the third quarter of 2006, which mainly came from the financial sector as both the Bank of China and the Bank of East Asia (the second and third largest banks in Hong Kong) attracted investors. Overall, the Hang Seng has gained 29.00 per cent in 2006. On 28 November, the Hang Seng dropped 564.48 points due to concern that consumer spending in the U.S. and Japan would be down during the holiday season. Wal-Mart reported on 25 November that sales at U.S. stores open at least a year were down 0.10 per cent this month, the worst performance in a decade for the world's leading retailer. The Hang Seng corrected itself the next day and closed the month of November at 18,960.48.

Active stocks in demand

- Shanghai Real Estate (6201830) traded at an average 6.11 per cent.
- China Everbright (6455143) traded at an average 5.68 per cent.
- Tsingtao Brewery (6905808) traded at an average 5.50 per cent.
- F E Consortium Intl (6331555) traded at an average 4.91 per cent.
- K Wah Intl (6480082) traded at an average 4.81 per cent.
- Ishare/Xinhua (B04V406) traded at an average 4.47 per cent.
- Grande Holdings (6381260) traded at an average 4.45 per cent.

Taiwan

In November, our Asia desk noted that overall-average balances were up 19.55 per cent for the month.

Taiwan's Taiex index grew at a remarkable pace for the month of November and reached a six-year high of 7,567.72. This was largely due to better-than-expected estimates on the growth of the U.S. economy, which grew at an annual rate of 2.20 per cent compared to the original forecast of 1.60 per cent. There was a brief halt to the growth when investors were pessimistic about consumer demand in the U.S. prior to the release by the U.S. Federal Reserve. However, this was short-lived and the Taiex closed the month of November at the highest price in six years. The biggest gainers in the Taiex were semiconductor and electronics companies. Higher-than-expected earnings from Wal-Mart and Target, two of the world's largest retailers, coupled with lower oil prices, made big electronics exporters an attractive buy. The Carlyle Group is in talks with Advanced Semiconductor Engineering Incorporated to buy out the world's largest chip packager. The Taiwan dollar has risen on speculation that North Korea would agree to return to the six-nation talks over its nuclear weapons programmed, thereby easing security risks in the region.

Active stocks in demand

- Asia Optical Co (6295866) traded at an average 5.54 per cent.
- Silitech Technology (6740117) traded at an average 5.00 per cent.
- Shin Kong Financial Holdings (6452586) traded at an average 4.65 per cent.
- Largan Precision Co (6451668) traded at an average 4.09 per cent.
- Ichia Technologies (6207139) traded at an average 4.00 per cent.

Australia

For the month of November, overall-average balances were up 100.32 per cent.

November was an up-and-down month for the Australian Stock Exchange (ASX) 200 Index. Australian stocks closed the month a half-point shy of the record, and the index rose 1.50 per cent this month. Energy and raw material stocks contributed to more than a half of the growth for the index. Woodside Petroleum led among oil producers after crude oil prices grew to a two-month high. On 28 November, investors became concerned that metal prices would cause other investors to look to other markets. As a result BHP Billiton suffered and the ASX 200 fell by 61.30 points or 1.10 per cent. The biggest hit to the ASX 200 was on 20 November, as investors sold off the remaining shares of Telstra following the Australian government's buyout of the telecommunications company. Imports rose by 906 million in October with a large increase in consumer imports. This suggests that retailers are expecting a good holiday shopping season, even though many economists are not so sure.

Active stocks in demand

- Shares of Aim Resources Ltd (6089070) traded at an average 5.06 per cent.
- Shares of Jabiru Metals Ltd (6207430) traded at an average 4.98 per cent.
- Shares of Fortescue Metals (6086253) traded at an average 4.88 per cent.
- Shares of Senetas Corp (6269571) traded at an average 4.0 per cent.

[11]Source: Bloomberg L.P., November 2006.

[12]Source: Citigroup Global Markets Limited, November 2006.

European money markets

Our European desk in London saw that The European Central Bank (ECB) kept interest rates on hold this month at 3.25 per cent. Following the results of a number of surveys and economic statistics, the market is still pricing in a rise of 25 bps on 7 December. The ECB still believes tightening is necessary, and there is probably room for another 25 bps rise in early 2007. The market speculation in London is how much consideration the ECB will take with the EUR/USD exchange rate and its impact on European exporters. Euro short-term rates traded in a narrow range between 3.30 and 3.33 per cent.

As expected, the MPC increased rates by 25 bps on 9 November to 5.00 per cent. The speculation in the market of future rate movements is now more finely balanced, with some looking for a further 25 bps rise in the first quarter of next year and others feeling that rates had now reached the top and would probably stay unchanged for some time. The GBP/USD exchange rate, reaching almost 2.00 dollars to the pound, could also impact future decisions. GBP short-term rates traded between 4.95 per cent and 5.10 per cent during November.

European equities

Our European desk in London saw overall balances up by 8.00 per cent for November. This is mainly a result of structured long-term GC trades and buoyant market conditions.

In the UK during November, the pound climbed to its highest value since 1992 (when the UK left the Exchange-Rate Mechanism). This is due to speculation that the Bank of England would keep raising interest rates while the Federal Reserve lowered its benchmark.[13]

European stocks have their biggest rally in two months, triggered by takeover speculation and bolstered by data showing that the U.S. economy grew faster than initially reported without stoking inflation.[14]

Active stocks

Relative value and M&A news[15]

- Banche Poplari Unite agreed to purchase Banca Lombarda for EUR6.5 billion.
- BskyB bought 17.9 per cent of ITV for GBP940 million and in the process ruined merger talks with NTL/ITV.
- Danske Bank has agreed to buy Sampo for EUR4.05 billion.
- Derwent Valley agreed to acquire London Merchant Securities for GBP1 billion.
- Givaudan agreed to purchase a unit of ICI (Quest International) for GBP1.2 billion.
- Grupo Ferrovial purchased BAA for USD19 billion.
- Iberdrola agreed to purchase Scottish Power for GBP11.6 billion.
- The Gaz de France/Suez merger may collapse after courts delayed the deal for seven months.
- Abertis/Autostrade – the outcome of the merger will be decided in mid November 2006.
- Porsche AG/Volkswagen AG takeover speculation.
- Banca Italease plans to raise up to EUR300 million in rights offer.
- Sonaecom is planning capital increase with a rights issue.
- Scor plans to raise up to EUR377 million in share sale.
- BBVA plans to raise EUR3 billion in share sale.
- DIC Asset AG is selling shares to raise EUR191.8 million.
- Eurocastle Investment plan to raise EUR660 million in share sale.
- Banaca Italease plan to raise EUR300 million in rights offer.

Directional (long/short)[16]

- Antena 3 recorded its worst rating in 13 years in September.
- Premiere AG reported a second-quarter net loss of EUR138.8 million (USD178 million).
- Sacyr Vallhermoso – volatile stock in thin supply.
- Option continued to be a major recall name.
- Tiscali – volatile stock in thin supply.
- Conergy continued to be a major recall name.
- Geophysique – volatile stock in thin supply.

Convertible bonds issued

- Actelion
- Tandberg Data
- Karstadt
- Sogecable
- Intralot

Sectors and markets in demand

Sectors and markets we saw in demand included Spanish utilities, ETFs, REITs, South Africa and emerging markets.

[13]Source: Bloomberg L.P., November 2006.

[14]Source: Bloomberg L.P., November 2006.

[15]Source: Citigroup Global Markets Limited, November 2006.

[16]Source: Citigroup Global Markets Limited, November 2006.

European government bonds

Our European bond desk in London saw GC balances increase throughout November, as they were able to capitalise on continued borrower demand for termed euro-sovereign debt and a buoyant market for commercial paper issuance, providing good reinvestment opportunities. The expected rate hike at the European Central Bank's next meeting, on 7 December has been fully priced in, resulting in greater spreads for clients participating in full reinvestment programmes. Spanish government bonds remained well bid throughout November and saw some pressure through the last few days prior to month-end. We have already seen strong demand for this paper over the month-end period in January, which, along with July, is seen as the biggest month of the year for this trade.

The market yielded just 1 special as the Italian Treasury bought back 500m BTPS 4 1/2 03/07 (IT0003171946), the issue trading up to 70 bps but short-lived as supply quickly outstripped demand.

The gilt market remains quiet after the Monetary Policy Committee's (MPC's) expected rate hike on commercial bank reserves from 0.25 per cent to 5 per cent, citing its intention to manage CPI inflation in the mid term. The sterling market appears split on further rate activity from the bank with LIBOR suggesting another 25-bps move at some point during the first quarter of 2007. This dynamic provides good conditions to pick up yields on our sterling reinvestment book.

Product development

In response to growing client interest for new securities lending markets, Citigroup is delighted to announce this month two new markets (The Czech Republic and Hungary) where it has extended its lending capabilities, bringing its extensive securities lending solutions to 33 markets. After a thorough review of these markets, both were added with immediate effect.

Current lending rates are in the range of 50 to 60 bps and we expect to be able to obtain approximately 10.00 per cent portfolio utilisation.

During 2006, Citigroup launched its presence in South Africa as well as Taiwan, where it was the first agent in Taiwan to open a lending programme. As part of an ongoing strategy, Citigroup plans to launch additional new lending markets during 2007 with announcements to be made during the first quarter of 2007.

If you have any questions on any of Citigroup's new or existing markets, please refer to the contacts listed at the end of this newsletter.

For further information, please contact your Citigroup representative.

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