Market Insights

June, 2011

The price of complacency

The European crisis is still spreading. That is a big headache for risky asset markets, which are also seeing growth in most of the world's biggest economies slowing more than expected – even before QE2 ends. Already firmly overweight core fixed income markets, the Global Investment Committee has switched another two points from equities to fixed income.

Level three portfolios are now 10% underweight equities. We have further increased our exposure to long-dated US investment-grade bonds. We think US government bond yields have further to fall, and investment-grade spreads are still comparatively generous.

We've also further reduced our sub-investment-grade bond overweight. A rise in equity volatility that currently looks too low is likely to mean higher spreads. Yields on some peripheral European government bonds are strikingly high, but we can't put a meaningful price on them, and the crisis is spreading. We stay almost completely flat peripheral Europe.

Tactically, we have also scaled back our equity exposure to Japan slightly; by two percentage points. That still leaves us heavily overweight. We are putting part of the money into the rest of developed Asia, though this merely reduces what was an extreme underweight.

We have also scaled back our Russian and South African exposures. Although the former market is very cheap, it is likely to struggle as commodity prices continue falling.

We stay completely flat US and European financials equities.

The dollar is likely to continue its bounce, especially against the euro, driven by falling commodities and headline inflation; a rise in risk aversion; and the world's hate of it.

Asset Classes

	-2	-1	0	1	2
Core Equities					
Dev. large cap		■			
Dev. small cap		■			
Emerging mkt		■			
Core Fixed Income					
Dev. sovereign				■	
Dev. invest-grade					■
Dev. high-yield				■	
Emerging mkt		■			
Focus asset classes					
Core Europe fixed income					■
Peripheral Europe fixed income	■				
US Trust Preferreds (TruPs)				■	
Municipal bonds				■	
Japan equities					■
Japan sovereign fixed income		■			
Core Europe equities				■	
S. Africa/Russia equities				■	
US/Europe financial equities	■				
Asia ex Japan equities	■				
Italy equities				■	

Arrows indicate change from 28 March, 2011
-2 = very underweight, -1 = underweight, 0 = neutral, 1 = overweight, 2 = very overweight.

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Investment Products: Not FDIC Insured • No Bank Guarantee • May Lose Value

The price of complacency

The European crisis is still spreading. That is a big headache for risky asset markets, which are also seeing growth in most of the world's biggest economies slowing more than expected – even before QE2 ends. Already firmly overweight core fixed income markets, the Global Investment Committee has switched another two points from equities to fixed income.

The use of the phrase "soft patch" when trying to explain weaker economic numbers has increased sharply

We introduced our soft-patch index in the previous Quadrant (Lead Balloons, 13 May). The index was a light-hearted attempt to show how those of a cheery economic and market disposition would reach for the phrase "soft patch" when trying to explain economic numbers whose striking weakness didn't fit with their optimistic view of the world. Calculating the index is simple: we simply used Google to search for the phrase and stripped out all those occasions when it was applied to some other area of human ingenuity, such as the Chelsea Flower Show, or BMX biking. The table below updates the numbers to 25 May. You can see that use of the phrase (together, by the way, with its close cousin, "mid-cycle slowdown") has increased sharply.

Figure 1. People are still talking about the economy's "soft patch"

Month	"Soft Patch" entries
Jan-10	19
Feb-10	27
Mar-10	17
Apr-10	8
May-10	9
Jun-10	36
Jul-10	102
Aug-10	95
Sep-10	122
Oct-10	61
Nov-10	76
Dec-10	55
Jan-11	38
Feb-11	27
Mar-11	44
Apr-11	499
May-11	802

Source: Citi Private Bank using Google News as at 25 May, 2011.

NOTE: "Soft Patch" entries are the total number of articles published in that month referencing the term "soft patch" in discussions of the economy.

The views of Citi and its Global Investment Committee are distinct from and may differ from the views of our sub-advisors, which provide Citi with various services including portfolio advice and acting as sub-advisor for advisory products, some of which follow portfolio allocations determined by the sub-advisors. We will continue to offer products using the services of sub-advisors. The views in this publication are those of the Global Investment Committee. Vis-à-vis the strategic allocation: Overweight means up to 10% greater; Neutral: no change to the strategic allocation; Underweight: up to 10% below.

Economies do wax and wane: the problem is that two of the most important countries in the global economy are slowing with uncommon speed

Well, the optimists may be right: economies do wax and wane. The problem, as we see it, is that two of the most important countries in the global economy, namely the US and China (Japan's problems are already well known), are slowing with uncommon speed. There seems, in other words, to be something altogether more worrying at work than a mere slowdown to be shrugged off. And the travails of Europe aren't a mere cyclical slowdown: they are structurally awful and getting worse.

Restructuring of some of the European countries worst affected by the debt crisis is pretty much inevitable, we think

Consider Europe first. The European Central Bank seems intent on scotching any suggestion that Greece or any of the other heavily indebted countries will default, partly, one assumes, because it holds so much of their debt on its balance sheet. Of the 75 billion euros of peripheral bonds that it has bought during the past year, some EUR40 billion to EUR50 billion is Greek debt. Not surprisingly, the ECB says austerity and asset sales are the only solution. But there is no way Greece will manage to raise anything like the EUR50 billion that it says it will, let alone the EUR250 billion that some wide-eyed optimists say could be raised. And to condemn two generations or more to no growth at all is going to be politically impossible. The demonstrations in Spain last weekend weren't the first and they won't be the last. Restructuring of some of the worst-affected countries is pretty much inevitable, we think.

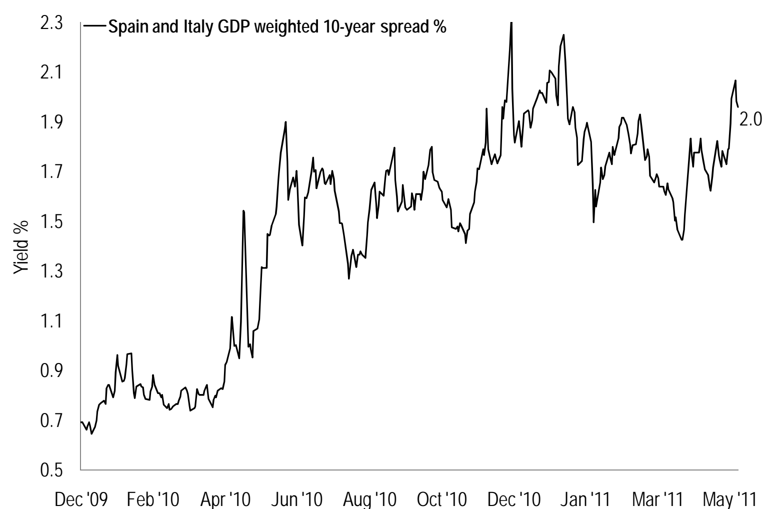
Figure 2. Portuguese, Irish and Greek yields have only gone one way - up

Source: Citi Private Bank using Bloomberg as at 25 May, 2011. NOTE: GDP = gross domestic product

The big question is: which are the worst affected countries? And the answer to that question is potentially becoming more worrying again

The big question is: which are the worst affected countries? The answer to that question is potentially becoming more worrying again. Yields on Greek, Irish and Portuguese bonds have gone only one way – up – since the crisis erupted in earnest last spring. For a while recently, it looked as though investors would give Spain, and especially Italy, the benefit of the doubt. But Spain, in particular, is being sucked into the maelstrom anew. As figure 3 shows, the extra yield demanded by investors for buying bonds issued by Italy and Spain compared to similar-maturity bonds issued by Germany has started to widen again. As CIRA's excellent strategists Matt King and Hans Peter Lorenzen have been arguing, investors have increasingly dismissed the worsening travails (probably wrongly) of Portugal, Ireland and Greece. Spain, and particularly Italy, are something else entirely.

Figure 3. Spanish and Italian debt spreads are widening again



Source: Citi Private Bank using Bloomberg as at 25 May, 2011. NOTE: GDP = gross domestic product

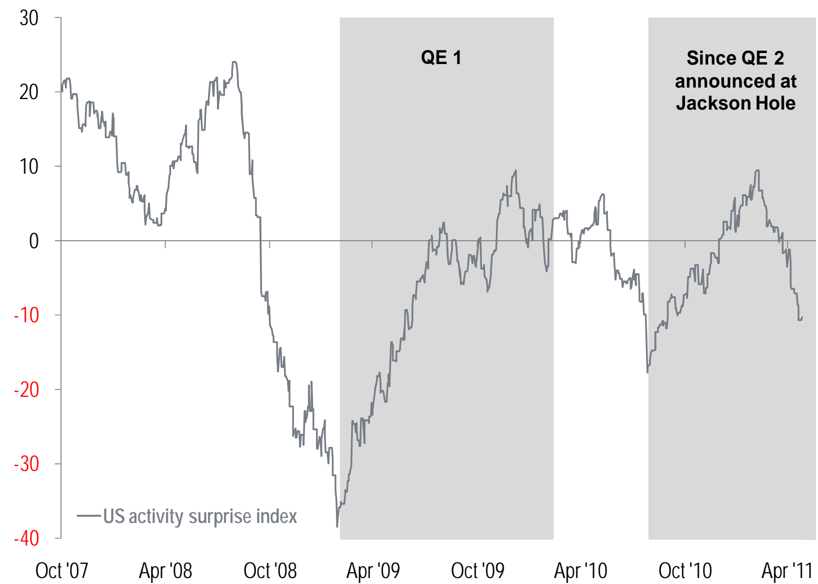
Spain's bond market is as large as that of Portugal, Greece and Ireland put together, and Italy's is the world's third-largest

You can see why. Spain's bond market is as large as that of Portugal, Greece and Ireland put together, and Italy's is the world's third-largest. If Italy really gets into trouble, risky assets would be eviscerated and the world would have a recession. It would probably be a deep one, too, since countries' powers to borrow and spend would be pretty much non-existent: it was after all, all that debt which got us into trouble in the first place. This isn't a prediction, merely a warning of what could happen were the worst to happen. Little wonder, then, that markets reacted badly when Standard & Poor's, one of the three big credit-rating agencies, said on 20 May that it might further downgrade Italy's debt. We have had almost no peripheral debt of any description in any of our portfolios for at least a year. We still can't put a meaningful price on it.

As we've been warning for a while, US activity surprise numbers have been crumbling

All of this is bad enough, you might have thought. But there's more. Figure 4 is one we've used before: an activity surprise index for the US. The idea behind an activity surprise index is simple: it merely tells you whether, on balance, economic activity as recorded by all of the relevant numbers is faster or slower than the consensus expected. The chart really doesn't need any explanation. As we've been warning might well happen for a while – and positioning in favour of long-dated core fixed income markets – the numbers have been crumbling. Since the index turned on 10 March, 2011, US Treasuries of more than 10 years' maturity have, for example, returned 6%, and global equities, measured in local currencies, have returned -1.4%.

Figure 4. The US activity surprise index has been falling even before the end of QE2

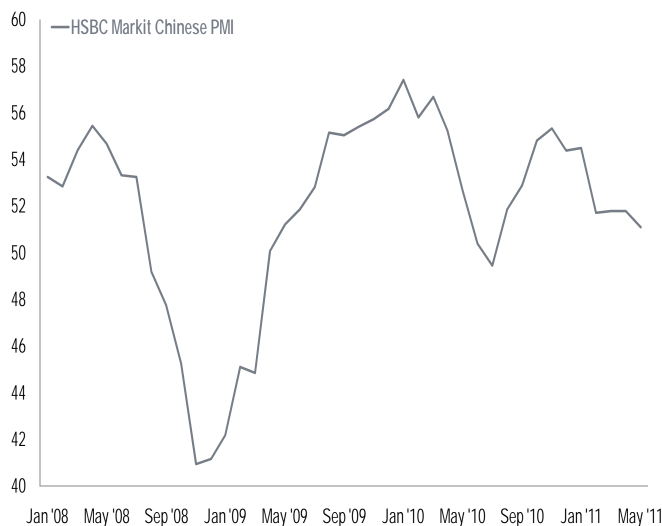


Source: Citi Private Bank using HSBC as at 25 May, 2011.

Strikingly – and worryingly - this slowdown has occurred before the end of the Federal Reserve's second round of quantitative easing

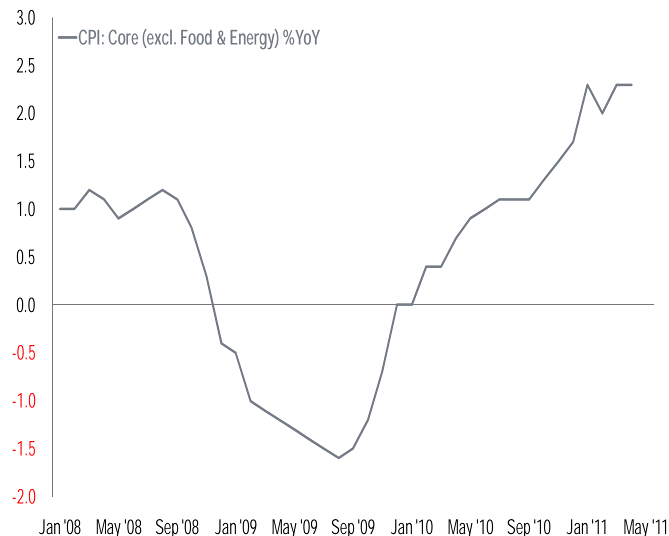
Strikingly – and worryingly - this slowdown has occurred before the end of the Federal Reserve's second round of quantitative easing, or QE2. As we've said repeatedly, if the first round is a good guide – and, to be honest, there isn't much reason to think otherwise - then activity is likely to slow even more once the Fed stops printing money on June 30. And (again assuming the end of the first round is any guide) bond yields, equity markets, growth and inflation expectations are likely to fall. An economy where the private sector continues to pay off its debts is an economy which faces very strong headwinds indeed.

Figure 5. China's PMI still shows growth, but it's slowing



Source: Citi Private Bank using Citi Investment Research & Analysis, HSBC Markit data as at 25 May, 2011

Figure 6. But China's core inflation rate isn't slowing yet

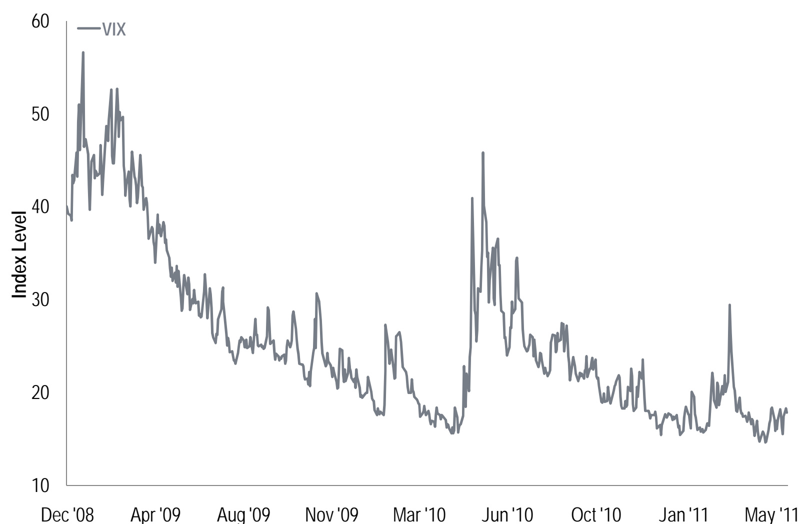


Source: Citi Private Bank using Citi Investment Research & Analysis and CEIC. Data through to 30 April, 2011.

Alas, China, too, is slowing more sharply than most had expected

Alas, China, too, is slowing more sharply than most had expected. At a shade over 51, China's manufacturing purchasing managers index (PMI) still signals economic expansion (anything over 50 signals expansion); but it is clear that growth is slowing sharply. Unfortunately, inflation, particularly core inflation (i.e., stripping out energy and food) isn't. Inflation is a lagging indicator, so it may be that the People's Bank of China, the country's central bank, has almost done enough. The snag is that there is no iron law which says that inflation must show up in the price of consumer goods. In China it has also been manifested these few years past in rapidly rising house prices. Although the rises have slowed and volumes have dwindled, the Chinese authorities will want to make sure both of these genies are stuffed right back into their bottles. So the trade-off between slowing growth and rising inflation is likely to keep getting worse unless and until they think that inflation of both sorts are a non-issue.

Figure 7. Implied volatility is off its lows, but still extraordinarily low



Source: Citi Private Bank using Bloomberg as at 25 May, 2011.

True, equity markets have been under a little pressure lately, but investors have been remarkably sanguine

True, equity markets have been under a little pressure lately, but investors have been remarkably sanguine. You can see this in the extraordinarily low level of implied volatility – especially for US equity markets. Implied volatility is best thought of as the price of insurance. A low number means that investors and traders are willing to sell insurance cheaply and thus it is as good an indication as you could wish for of complacency or nervousness. Although it is off its lows, implied volatility is still extraordinarily low, largely because equities have remained relatively strong: there is a very strong inverse correlation between the two.

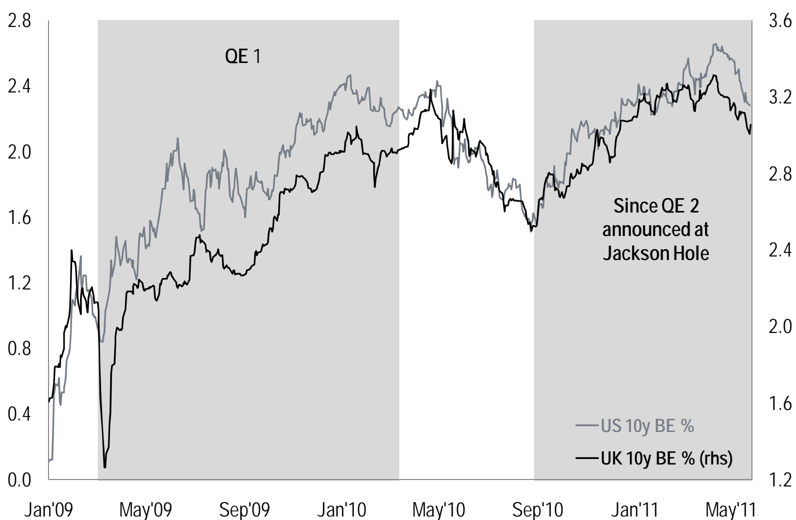
Many argue that equities are strong because bond market yields are meagre for two reasons

Many have been arguing that the strength of equities reflects the lack of available alternatives, mainly those on offer in the bond market, where the yields available are decidedly meager and unappetizing for two main reasons: the first is that once the Fed stops buying government bonds at the end of June, yields are likely to rise; the second that the real yields available on government bonds are negative because of rising inflationary pressures.

We think that both of those worries are wrong

We think that both of those worries are wrong. First, when the Fed finished its first round of QE, as we have repeatedly stressed, yields didn't rise, they fell. That was partly because, without the support of all that extra liquidity, economic growth started to crumble. And it was also wrong for a second reason: inflation expectations fell, helped by falling commodity and energy prices.

Figure 8. US and UK 10-year breakevens fell after QE1 and are falling again



Source: Citi Private Bank using Bloomberg as at 25 May, 2011.

All that is needed in most of the developed world for headline inflation to fall is for commodity prices - especially energy prices - to stop rising

Commodity and energy prices have already been falling again, adding support for core government-bond and thus long-dated corporate credit, yields on higher-quality municipal bonds and so forth. Investors don't – or shouldn't – care about present inflation, but about future inflation. And all that is needed in most of the developed world for headline inflation to fall is for commodity prices - especially energy prices - to stop rising. That seems an increasingly likely prospect given how much China is slowing too (and that that the Middle Kingdom currently snaffles up almost 43% of global demand for industrial commodities) and, partly as a result, the drubbing which commodity markets have received of late.

Figure 9. The returns expected from US equities over the next 10 years aren't much

Source: Citi Private Bank using GFD, 25 May, 2011.

It is true that some stock markets are quite cheap and some are very cheap, but US equities are not

On our sums, while it is absolutely true that some stock markets are quite cheap and some are very cheap, US equities aren't: either on their own or compared with bonds. Quite the contrary. We compared current prices with the past 10 years of earnings. This gives a multiple of about 21 for US shares, compared with the long-term average of just under 15. Combine this with niggardly dividend yields and the implied prospective return over the next 10 years is a scant 4.3%. That gives an implied equity risk premium - the extra amount you'd earn buying stocks rather than government bonds – of about 1.2%. That's really not much. Indeed, apart from some stock markets in the emerging world, you'd be hard-pressed to find a lower implied equity risk premium. US stocks that come under pressure are likely to mean that other equity markets will continue to struggle for now, however cheap they are and however much we like them in the long term. That's partly why we are further paring back our exposure to other markets.

Heightened risk aversion and falling commodity prices and breakeven rates are likely to have another effect: a continued bounce in the dollar

Heightened risk aversion and falling commodity prices and breakeven rates are likely, we think, to have another effect: a continued bounce in the dollar. Part of the reason for the euro's rise against the dollar, despite the region's manifest and increasing problems, was that the ECB targets headline inflation rather than the core inflation targeted by the Fed (and, seemingly, the UK's Monetary Policy Committee). As we said earlier, if commodity prices merely stop rising, then headline inflation in the euro zone will fall and relative interest-rate expectations will drop more than in the US. Figure 10 shows how elevated relative euro zone rate expectations have become.

Figure 10. The expectation that the US and euro zone will raise rates has gone up

Source: Citi Private Bank using Bloomberg as at 25 May, 2011.

Figure 11. The dollar is starting to bounce back

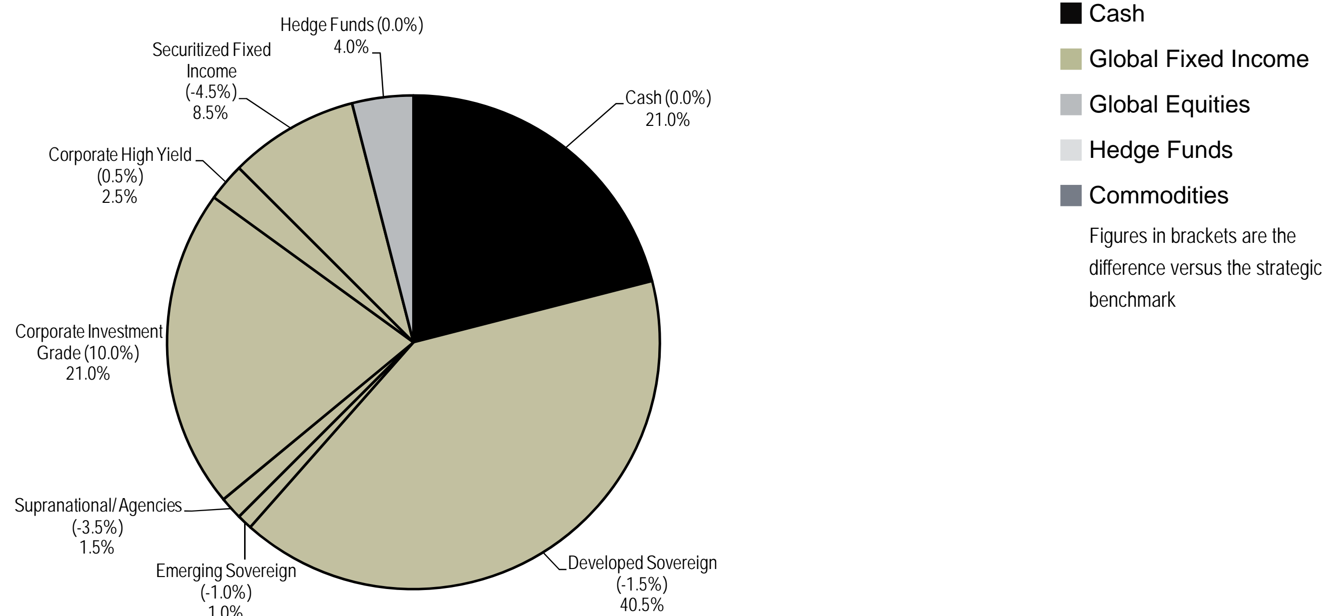
Source: Citi Private Bank using Bloomberg as at 25 May, 2011. NOTE: DXY = US dollar index

We would expect the dollar bounce to continue, at least for now

Combined with a reduction in headline inflation expectations and heightened risk aversion and we would expect the dollar bounce shown in Figure 11 to continue, at least for now, and especially since investors and traders are still very short the greenback. All things equal, that bounce is likely to continue until the US economy slows sufficiently that the Fed starts muttering about QE3. So expect a continued rise in the DXY (the broadest tradable US dollar index) and a fall in the LDXY and the ADXY (Latin American and Asian currencies against the dollar).

Citi's Tactical Allocations: Portfolio Risk Level 1

Seeks liquidity management and capital preservation*



Figures in brackets are the difference versus the strategic benchmark

Core positions

- The largest tactical overweight remains corporate investment-grade fixed income, with a 10% overweight position versus the strategic benchmark. This position is evenly distributed regionally.
- The overweight to corporate high-yield has been reduced to 0.5% from 1%. This weight was switched to securitized fixed income, reducing the underweight in that asset class to 4.5%.
- Supranational, developed sovereign and emerging sovereign all remain unchanged, with underweight positions of -3.5%, -1.5%, and -1% respectively.
- Within developed sovereign, there are significant underweights to peripheral Europe (-3.5%) and Japan (also -3.5%). These positions are partially offset with overweights in municipal bonds (2%) and core Europe (2%).

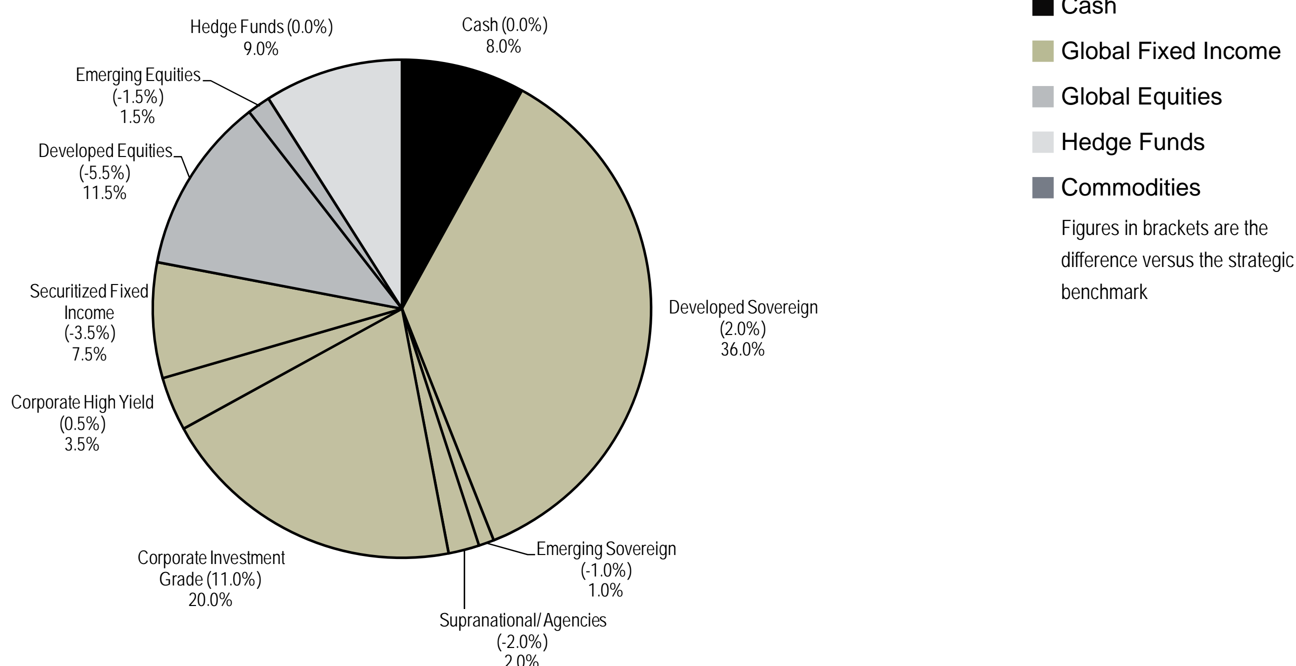
* *Risk Levels 1 and 2* are designed for investors with a short time horizon (defined as 3-5 years) who are seeking to maintain purchasing power, preserve capital, meet income needs and achieve the consistent real growth of wealth. These portfolios include assets that may be considered illiquid.

Strategic = benchmark; Tactical = the Citi Private Bank Global Investment Committee's current view; and Active = the difference between Strategic and Tactical.

See the appendix for full Strategic and Tactical tables.

Citi's Tactical Allocations: Portfolio Risk Level 2

Seeks income generation and capital preservation*



Core positions

- The underweight position to equities has been reduced by a further 1%, and now stands at -7%.
- The position in Japanese equities was cut by 1% to a 3.5% overweight. This was partially redistributed in to Asia ex Japan equities, moving that to a 0.5% underweight.
- North American equities remain heavily underweight (-6.5%), while Europe remains less underweight at -2%. Within Europe, there are overweights to Germany and Italy, more than offset by underweights to other countries (primarily peripheral countries).
- Emerging equities has been reduced further to a 1.5% underweight (by 0.5%), driven by a reduction in the overweight in Russia by 0.5%.
- The overweight in corporate high-yield was reduced from 1% to 0.5%. This weight was switched to securitized, reducing the underweight to 3.5%.
- Corporate investment-grade has been further increased (by 1%) to a 11% overweight position.
- Underweights remain to supranational (-2%) and emerging sovereign (-1%), while developed sovereign has a 2% overweight position. Within developed sovereign, overweights to core Europe (4%) and municipals (2%) are partially offset with underweights to peripheral Europe (-3.5%) and Japan (-3%).

**Risk Levels 1 and 2* are designed for investors with a short time horizon (defined as 3-5 years) who are seeking to maintain purchasing power, preserve capital, meet income needs and achieve the consistent real growth of wealth. These portfolios include assets that may be considered illiquid.

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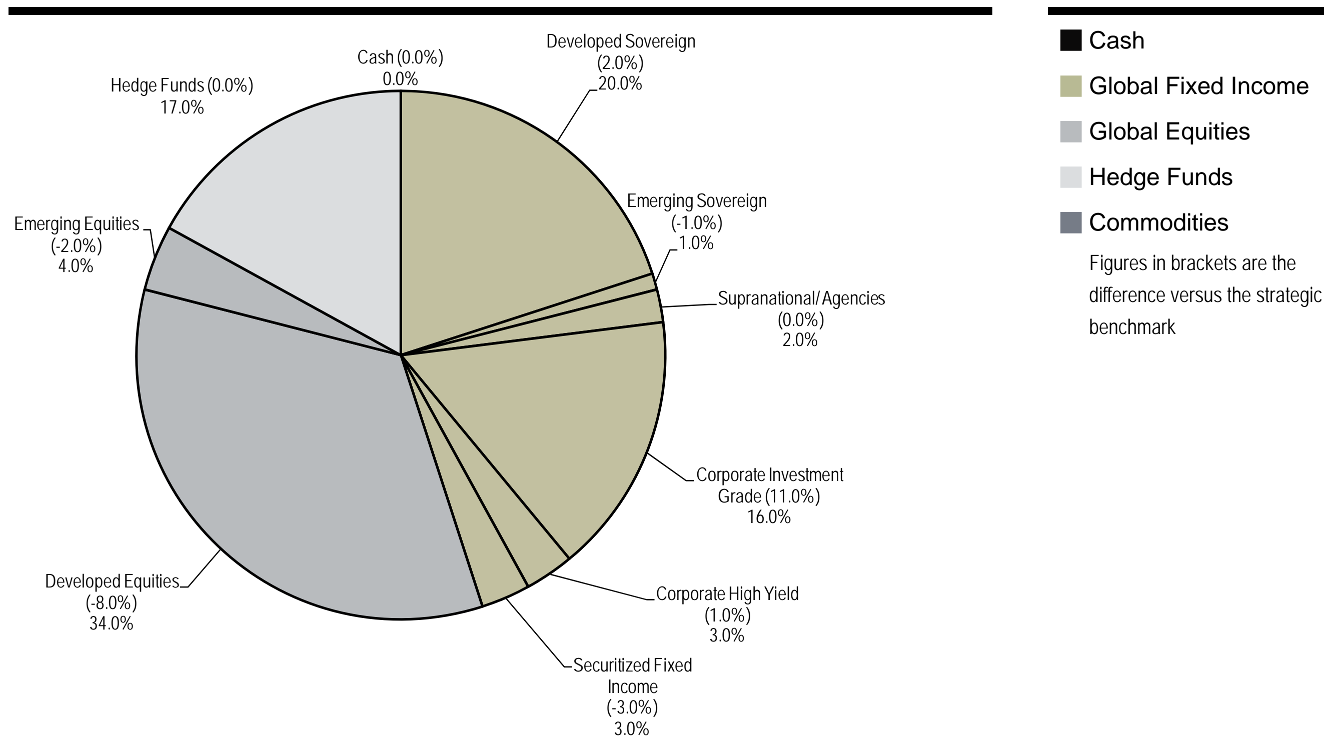
Citi's Tactical Allocations: Portfolio Risk Level 3

Seeks modest capital appreciation and, secondly, capital preservation*



Core positions

- The underweight position to equities has been reduced by a further 2%, and now stands at -10%.
- The position in Japanese equities was cut by 2% to a 4% overweight. This was partially redistributed in to Asia ex Japan equities, moving that to a 1.5% underweight.
- North American equities remain heavily underweight (-7%), while Europe remains slightly less underweight at 6%. Within Europe, there are overweights to Germany and Italy, more than offset by underweights to other countries (primarily peripheral countries).
- Emerging Equities has been reduced further to a 2% underweight (by 1%), driven by a reduction in the overweight in Russia from 1% to 0.5%
- The overweight in corporate high-yield was reduced from 2% to 1%. This weight was switched to securitized, reducing the underweight to 3%.
- Corporate investment-grade has been further increased (by 2%) to a be a 11% overweight position.
- The underweight remains in emerging sovereign (-1%), while developed sovereign has a 2% overweight position. Within developed sovereign, overweights to core Europe (3.5%) and municipals (1.5%) are partially offset with underweights to peripheral Europe (-2.5%) and Japan (-2.5%)

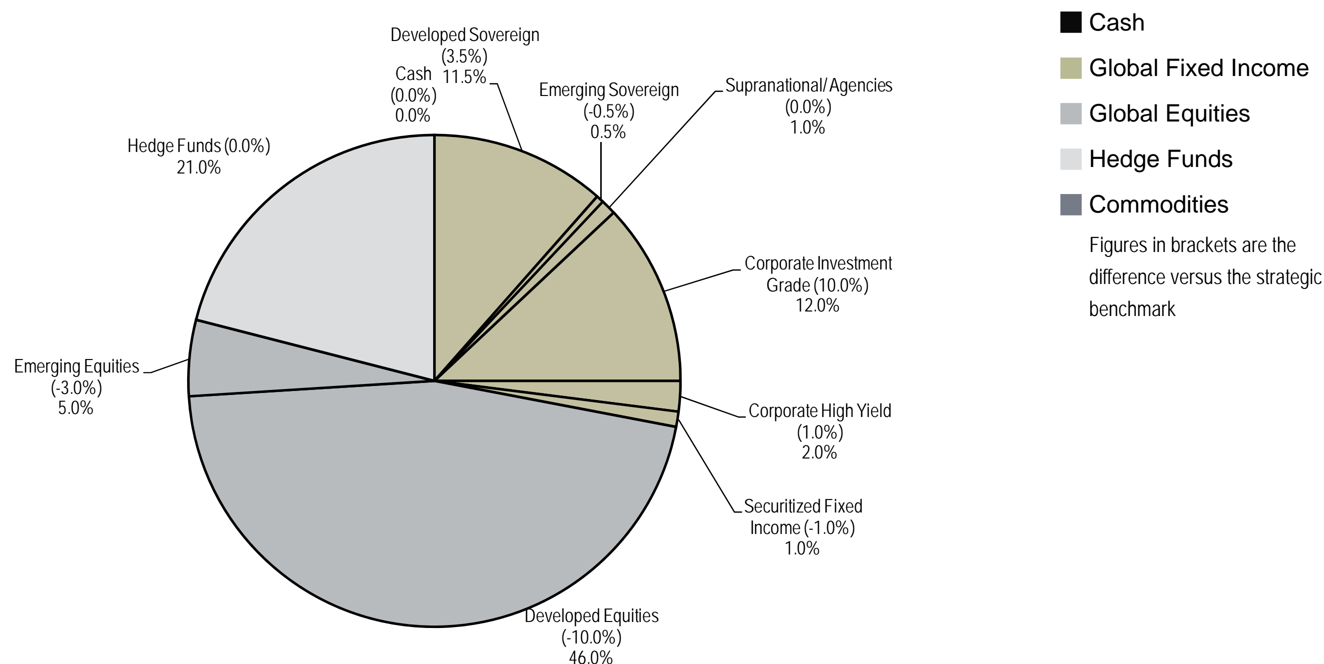
**Risk Level 3*, which includes an allocation to illiquid assets, is designed for investors who have a time horizon of 5-10 years and who seek modest wealth enhancement.

Strategic = benchmark; Tactical = the Citi Private Bank Global Investment Committee's current view; and Active = the difference between Strategic and Tactical.

See the appendix for full Strategic and Tactical tables.

Citi's Tactical Allocations: Portfolio Risk Level 4

Seeks long-term growth of capital with moderate volatility*



Core positions

- While the position in fixed income is neutral, there are overweights position in both developed corporate fixed income (+1%) and developed corporate high-yield (+3.5%). Both these positions are broadly spread geographically
- These positions are offset with underweights in developed sovereign fixed income (-2%), supranational/agencies (-1%), emerging sovereign (-0.5%) and securitized fixed income (-1%).
- In particular, the underweight in developed sovereign fixed income is made up of underweight positions in non-core Europe (-1%) and US (-1.5%) offset by a overweight in core Europe (+0.5%)
- Within the neutral position in global equities, developed is overweight by 4%, offset by a -4% position in emerging.
- The overweight to developed equities is driven by large overweights to Japan (8%) and core Europe (7%). These overweights were offset by underweights in the US (-2.5%), non-core Europe (-5%) and Asia ex Japan (-3.5%).
- The underweight to emerging equities is broadly spread geographically.

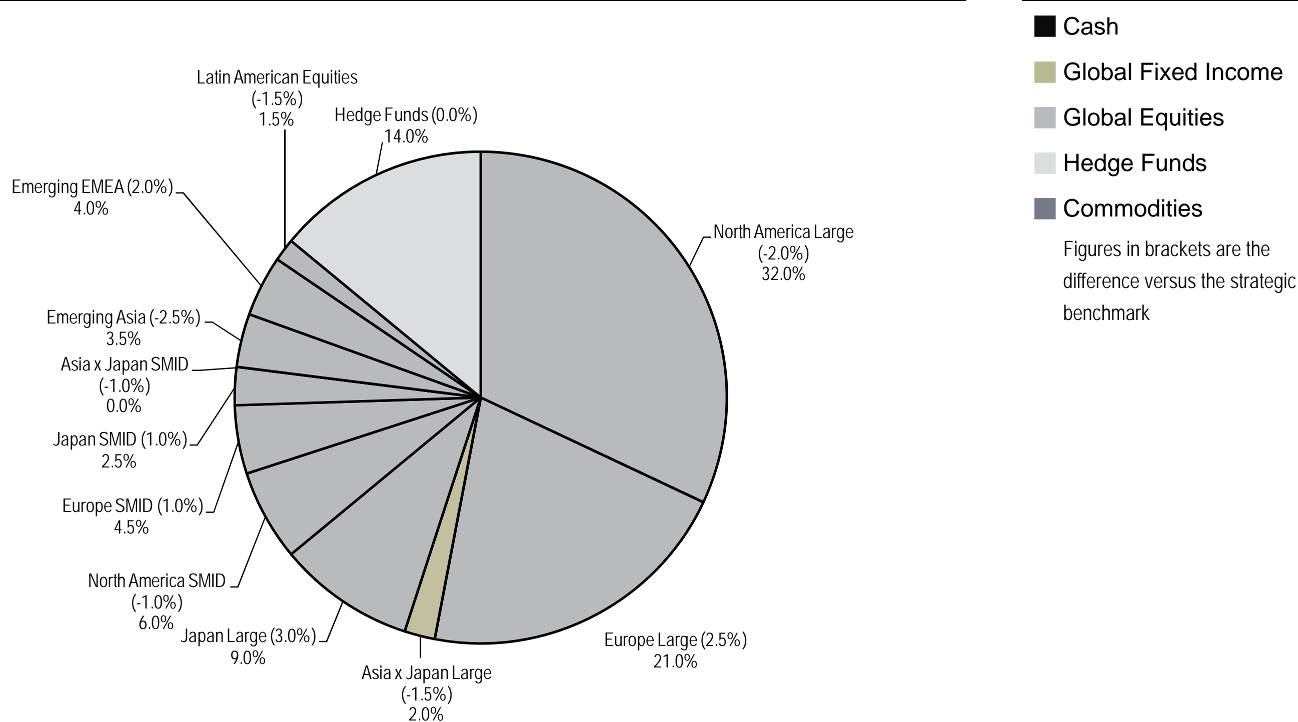
*_Risk Levels 4 and 5_, which also include an allocation to illiquid assets, are designed for investors who have a time horizon that extends beyond 10 years and who are willing to accept more volatility in exchange for greater potential wealth enhancement.

Strategic = benchmark; Tactical = the Citi Private Bank Global Investment Committee's current view; and Active = the difference between Strategic and Tactical.

See the appendix for full Strategic and Tactical tables.

Citi's Tactical Allocations: Portfolio Risk Level 5

Seeks maximum long-term growth of capital*



Core positions

- The position in Japanese equities was cut by 1% to a 4% overweight. This was redistributed in to Asia ex Japan equities, moving that to a 2.5% underweight.
- North American equities remain underweight (-3%), while Europe remains overweight at 3.5%. Within Europe, there are overweights to Germany, France and Italy, more than offset by underweights to other countries (primarily peripheral countries).
- Emerging equities has been reduced further to a 2% underweight (by 1%), driven by a reduction in the overweights to Russia and South Africa

**Risk Levels 4 and 5*, which also include an allocation to illiquid assets, are designed for investors who have a time horizon that extends beyond 10 years and who are willing to accept more volatility in exchange for greater potential wealth enhancement.

Strategic = benchmark; Tactical = the Citi Private Bank Global Investment Committee's current view; and Active = the difference between Strategic and Tactical.

See the appendix for full Strategic and Tactical tables.

Appendix

Citi's strategic and tactical allocations

Citi Private Bank Global Investment Committee as of 21 April, 2011

Citi's strategic and tactical allocations: portfolio risk level 1

Seeks liquidity management and capital preservation*

Classification	Strategic	Tactical	Active
Cash	**21.0%**	**21.0%**	**0.0%**
Global Fixed Income	**75.0%**	**75.0%**	**0.0%**
Developed Sovereign	**42.0%**	**40.5%**	**-1.5%**
North America	**11.0%**	**14.0%**	**3.0%**
Europe	**16.0%**	**15.0%**	**-1.0%**
UK	2.0%	2.0%	0.0%
Core Europe	6.0%	8.0%	2.0%
Periphery Europe	6.0%	2.5%	-3.5%
Other	2.0%	2.5%	0.5%
Asia x Japan	**0.5%**	**0.5%**	**0.0%**
Far East x Japan	0.5%	0.5%	0.0%
Japan	**11.0%**	**7.5%**	**-3.5%**
Global Inflation Linked	**3.5%**	**3.5%**	**0.0%**
US	1.5%	1.5%	0.0%
UK	1.0%	1.0%	0.0%
Euro-Zone	1.0%	1.0%	0.0%
Emerging Sovereign	**2.0%**	**1.0%**	**-1.0%**
Emerging Asia	**0.5%**	**0.5%**	**0.0%**
Emerging EMEA	**0.5%**	**0.0%**	**-0.5%**
Latin American	**1.0%**	**0.5%**	**-0.5%**
Supranational/Agencies	**5.0%**	**1.5%**	**-3.5%**
Corporate Investment Grade	**11.0%**	**21.0%**	**10.0%**
North America	**6.5%**	**12.5%**	**6.0%**
Europe	**4.5%**	**7.0%**	**2.5%**
UK	4.0%	5.0%	1.0%
Europe x UK	0.5%	2.0%	1.5%
Asia	**0.0%**	**1.5%**	**1.5%**
Corporate High Yield	**2.0%**	**2.5%**	**0.5%**
North America	**1.5%**	**2.5%**	**1.0%**
Europe	**0.5%**	**0.0%**	**-0.5%**
Latin America	**0.0%**	**0.0%**	**0.0%**
Asia	**0.0%**	**0.0%**	**0.0%**
Securitised Fixed Income	**13.0%**	**8.5%**	**-4.5%**
MBS/Covered Bonds	**12.5%**	**8.5%**	**-4.0%**
ABS	**0.5%**	**0.0%**	**-0.5%**
Global Equities	**0.0%**	**0.0%**	**0.0%**
Developed Equities	**0.0%**	**0.0%**	**0.0%**
Hedge Funds	**4.0%**	**4.0%**	**0.0%**
Commodities	**0.0%**	**0.0%**	**0.0%**
Total	**100.0%**	**100.0%**	**0.0%**

**Risk Levels 1 and 2* are designed for investors with a short time horizon (defined as 3-5 years) who are seeking to maintain purchasing power, preserve capital, meet income needs and achieve the consistent real growth of wealth. These portfolios include assets that may be considered illiquid.

Strategic = benchmark; Tactical = the Citi Private Bank Global Investment Committee's current view; and Active = the difference between Strategic and Tactical.

Citi's strategic and tactical allocations: portfolio risk level 2

Seeks income generation and capital preservation*

Classification	Strategic	Tactical	Active
Cash	**8.0%**	**8.0%**	**0.0%**
Global Fixed Income	**63.0%**	**70.0%**	**7.0%**
Developed Sovereign	**34.0%**	**36.0%**	**2.0%**
North America	**9.0%**	**13.0%**	**4.0%**
Europe	**13.0%**	**14.0%**	**1.0%**
UK	2.0%	2.0%	0.0%
Core Europe	5.0%	9.0%	4.0%
Periphery Europe	4.5%	1.0%	-3.5%
Other	1.5%	2.0%	0.5%
Asia x Japan	**0.5%**	**0.5%**	**0.0%**
Far East x Japan	0.5%	0.5%	0.0%
Japan	**9.0%**	**6.0%**	**-3.0%**
Global Inflation Linked	**2.5%**	**2.5%**	**0.0%**
US	1.0%	1.0%	0.0%
UK	0.5%	0.5%	0.0%
Euro zone	1.0%	1.0%	0.0%
Emerging Sovereign	**2.0%**	**1.0%**	**-1.0%**
Emerging Asia	**0.5%**	**0.5%**	**0.0%**
Emerging EMEA	**0.5%**	**0.0%**	**-0.5%**
Latin American	**1.0%**	**0.5%**	**-0.5%**
Supranational/Agencies	**4.0%**	**2.0%**	**-2.0%**
Corporate Investment Grade	**9.0%**	**20.0%**	**11.0%**
North America	**5.5%**	**15.0%**	**9.5%**
Europe	**3.5%**	**5.0%**	**1.5%**
UK	3.0%	3.5%	0.5%
Europe x UK	0.5%	1.5%	1.0%
Asia	**0.0%**	**0.0%**	**0.0%**
Corporate High Yield	**3.0%**	**3.5%**	**0.5%**
North America	**2.0%**	**3.5%**	**1.5%**
Europe	**1.0%**	**0.0%**	**-1.0%**
Securitised Fixed Income	**11.0%**	**7.5%**	**-3.5%**
MBS/Covered Bonds	**10.5%**	**7.5%**	**-3.0%**
ABS	**0.5%**	**0.0%**	**-0.5%**
Hedge Funds	**9.0%**	**9.0%**	**0.0%**
Commodities	**0.0%**	**0.0%**	**0.0%**

Classification	Strategic	Tactical	Active
Global Equities	**20.0%**	**13.0%**	**-7.0%**
Developed Equities	**17.0%**	**11.5%**	**-5.5%**
North America Large	**8.0%**	**3.0%**	**-5.0%**
US (Value)	3.5%	1.5%	-2.0%
US (Growth)	3.5%	1.5%	-2.0%
Canada	1.0%	0.0%	-1.0%
Europe Large	**4.0%**	**3.0%**	**-1.0%**
UK	1.0%	0.0%	-1.0%
Germany	0.5%	1.0%	0.5%
France	1.0%	1.0%	0.0%
Switzerland	0.5%	0.0%	-0.5%
Scandinavia	0.5%	0.0%	-0.5%
Spain	0.5%	0.0%	-0.5%
Italy	0.0%	1.0%	1.0%
Asia x Japan Large	**1.0%**	**0.5%**	**-0.5%**
Australasia	1.0%	0.5%	-0.5%
Japan Large	**1.0%**	**3.0%**	**2.0%**
Developed Small & Mid Cap	**3.0%**	**2.0%**	**-1.0%**
North America SMID	**1.5%**	**0.0%**	**-1.5%**
Europe SMID	**1.0%**	**0.0%**	**-1.0%**
UK	0.5%	0.0%	-0.5%
Europe x UK	0.5%	0.0%	-0.5%
Japan SMID	**0.5%**	**2.0%**	**1.5%**
Asia x Japan SMID	**0.0%**	**0.0%**	**0.0%**
Emerging Equities	**3.0%**	**1.5%**	**-1.5%**
Emerging Asia	**1.5%**	**0.5%**	**-1.0%**
China	0.5%	0.0%	-0.5%
India	0.0%	0.0%	0.0%
South Korea	0.5%	0.0%	-0.5%
Taiwan	0.5%	0.5%	0.0%
Emerging EMEA	**0.5%**	**0.5%**	**0.0%**
Russia & Eastern Europe	0.5%	0.5%	0.0%
Latin American	**1.0%**	**0.5%**	**-0.5%**
Brazil	0.5%	0.0%	-0.5%
Mexico	0.5%	0.5%	0.0%
Total	**100.0%**	**100.0%**	**0.0%**

* *Risk Levels 1 and 2* are designed for investors with a short time horizon (defined as 3-5 years) who are seeking to maintain purchasing power, preserve capital, meet income needs and achieve the consistent real growth of wealth. These portfolios include assets that may be considered illiquid.

Strategic = benchmark; Tactical = the Citi Private Bank Global Investment Committee's current view; and Active = the difference between Strategic and Tactical.

Citi's strategic and tactical allocations: portfolio risk level 3

Seeks modest capital appreciation and, secondly, capital preservation*

Classification	Strategic	Tactical	Active
Cash	**0.0%**	**0.0%**	**0.0%**
Global Fixed Income	**35.0%**	**45.0%**	**10.0%**
Developed Sovereign	**18.0%**	**20.0%**	**2.0%**
North America	**5.0%**	**8.5%**	**3.5%**
Europe	**7.0%**	**8.0%**	**1.0%**
UK	1.0%	1.0%	0.0%
Core Europe	2.5%	6.0%	3.5%
Periphery Europe	2.5%	0.0%	-2.5%
Other	1.0%	1.0%	0.0%
Asia x Japan	**0.0%**	**0.0%**	**0.0%**
Australasia	0.0%	0.0%	0.0%
Far East x Japan	0.0%	0.0%	0.0%
Japan	**4.5%**	**2.0%**	**-2.5%**
Global Inflation Linked	**1.5%**	**1.5%**	**0.0%**
US	0.5%	0.5%	0.0%
UK	0.5%	0.5%	0.0%
Euro zone	0.5%	0.5%	0.0%
Japan	0.0%	0.0%	0.0%
Emerging Sovereign	**2.0%**	**1.0%**	**-1.0%**
Emerging Asia	**0.5%**	**0.0%**	**-0.5%**
Emerging EMEA	**0.5%**	**0.5%**	**0.0%**
Latin American	**1.0%**	**0.5%**	**-0.5%**
Supranational/Agencies	**2.0%**	**2.0%**	**0.0%**
Corporate Investment Grade	**5.0%**	**16.0%**	**11.0%**
North America	**3.0%**	**13.0%**	**10.0%**
Europe	**2.0%**	**3.0%**	**1.0%**
UK	1.5%	2.0%	0.5%
Europe x UK	0.5%	1.0%	0.5%
Asia	**0.0%**	**0.0%**	**0.0%**
Corporate High Yield	**2.0%**	**3.0%**	**1.0%**
North America	**1.5%**	**3.0%**	**1.5%**
Europe	**0.5%**	**0.0%**	**-0.5%**
Securitised Fixed Income	**6.0%**	**3.0%**	**-3.0%**
MBS/Covered Bonds	**5.5%**	**3.0%**	**-2.5%**
ABS	**0.5%**	**0.0%**	**-0.5%**
Hedge Funds	17.0%	17.0%	0.0%
Commodities	0.0%	0.0%	0.0%
Precious Metals	**0.0%**	**0.0%**	**0.0%**
Gold	0.0%	0.0%	0.0%
Silver	0.0%	0.0%	0.0%
Industrial Metals	**0.0%**	**0.0%**	**0.0%**
Agriculture	**0.0%**	**0.0%**	**0.0%**
Energy	**0.0%**	**0.0%**	**0.0%**
Oil	0.0%	0.0%	0.0%
Gas	0.0%	0.0%	0.0%

Classification	Strategic	Tactical	Active
Global Equities	**48.0%**	**38.0%**	**-10.0%**
Developed Equities	**42.0%**	**34.0%**	**-8.0%**
North America Large	**19.0%**	**13.0%**	**-6.0%**
US (Value)	8.5%	6.0%	-2.5%
US (Growth)	8.5%	6.0%	-2.5%
Canada	2.0%	1.0%	-1.0%
Europe Large	**10.0%**	**8.0%**	**-2.0%**
UK	3.5%	2.0%	-1.5%
Germany	1.5%	2.0%	0.5%
France	1.5%	2.0%	0.5%
Switzerland	1.0%	0.0%	-1.0%
Benelux	0.5%	0.0%	-0.5%
Scandinavia	1.0%	0.0%	-1.0%
Spain	0.5%	0.0%	-0.5%
Italy	0.5%	2.0%	1.5%
Other	0.0%	0.0%	0.0%
Asia x Japan Large	**2.0%**	**1.0%**	**-1.0%**
Australasia	1.5%	0.5%	-1.0%
Far East x Japan	0.5%	0.5%	0.0%
Japan Large	**3.5%**	**6.0%**	**2.5%**
Developed Small & Mid Cap	**7.5%**	**6.0%**	**-1.5%**
North America SMID	**4.0%**	**3.0%**	**-1.0%**
Europe SMID	**2.0%**	**0.5%**	**-1.5%**
UK	0.5%	0.0%	-0.5%
Europe x UK	1.5%	0.5%	-1.0%
Japan SMID	1.0%	2.5%	1.5%
Asia x Japan SMID	0.5%	0.0%	-0.5%
Emerging Equities	**6.0%**	**4.0%**	**-2.0%**
Emerging Asia	**3.5%**	**2.0%**	**-1.5%**
China	1.0%	0.5%	-0.5%
India	0.5%	0.0%	-0.5%
South Korea	1.0%	0.5%	-0.5%
Taiwan	0.5%	0.5%	0.0%
Other	0.5%	0.5%	0.0%
Emerging EMEA	**1.0%**	**1.5%**	**0.5%**
Turkey	0.0%	0.0%	0.0%
Russia & Eastern Europe	0.5%	1.0%	0.5%
South Africa	0.5%	0.5%	0.0%
Other	0.0%	0.0%	0.0%
Latin American	**1.5%**	**0.5%**	**-1.0%**
Brazil	1.0%	0.5%	-0.5%
Mexico	0.5%	0.0%	-0.5%
Other	0.0%	0.0%	0.0%
Total	**100.0%**	**100.0%**	**0.0%**

* *Risk Level 3*, which includes an allocation to illiquid assets, is designed for investors who have a time horizon of 5-10 years and who seek modest wealth enhancement.

Strategic = benchmark; Tactical = the Citi Private Bank Global Investment Committee's current view; and Active = the difference between Strategic and Tactical.

Citi's strategic and tactical allocations: portfolio risk level 4

Seeks long-term growth of capital with moderate volatility*

Classification	Strategic	Tactical	Active
Cash	**0.0%**	**0.0%**	**0.0%**
Global Fixed Income	**15.0%**	**28.0%**	**13.0%**
Developed Sovereign	**8.0%**	**11.5%**	**3.5%**
North America	**2.0%**	**5.5%**	**3.5%**
Europe	**3.0%**	**4.0%**	**1.0%**
UK	0.5%	0.5%	0.0%
Core Europe	1.0%	3.0%	2.0%
Periphery Europe	1.0%	0.0%	-1.0%
Other	0.5%	0.5%	0.0%
Asia x Japan	**0.0%**	**0.0%**	**0.0%**
Japan	**2.0%**	**1.0%**	**-1.0%**
Global Inflation Linked	**1.0%**	**1.0%**	**0.0%**
US	0.5%	0.5%	0.0%
Euro zone	0.5%	0.5%	0.0%
Emerging Sovereign	**1.0%**	**0.5%**	**-0.5%**
Emerging Asia	**0.0%**	**0.0%**	**0.0%**
Emerging EMEA	**0.5%**	**0.0%**	**-0.5%**
Latin American	**0.5%**	**0.5%**	**0.0%**
Supranational/Agencies	**1.0%**	**1.0%**	**0.0%**
Corporate Investment Grade	**2.0%**	**12.0%**	**10.0%**
North America	**1.0%**	**11.0%**	**10.0%**
Europe	**1.0%**	**1.0%**	**0.0%**
UK	1.0%	1.0%	0.0%
Asia	**0.0%**	**0.0%**	**0.0%**
Corporate High Yield	**1.0%**	**2.0%**	**1.0%**
North America	**1.0%**	**2.0%**	**1.0%**
Europe	**0.0%**	**0.0%**	**0.0%**
Securitised Fixed Income	**2.0%**	**1.0%**	**-1.0%**
MBS/Covered Bonds	**2.0%**	**1.0%**	**-1.0%**
ABS	**0.0%**	**0.0%**	**0.0%**
Hedge Funds	**21.0%**	**21.0%**	**0.0%**
Commodities	0.0%	0.0%	0.0%
Precious Metals	**0.0%**	**0.0%**	**0.0%**
Gold	0.0%	0.0%	0.0%
Silver	0.0%	0.0%	0.0%
Industrial Metals	**0.0%**	**0.0%**	**0.0%**
Agriculture	**0.0%**	**0.0%**	**0.0%**
Energy	**0.0%**	**0.0%**	**0.0%**
Oil	0.0%	0.0%	0.0%
Gas	0.0%	0.0%	0.0%

Classification	Strategic	Tactical	Active
Global Equities	**64.0%**	**51.0%**	**-13.0%**
Developed Equities	**56.0%**	**46.0%**	**-10.0%**
North America Large	**25.5%**	**20.0%**	**-5.5%**
US (Value)	11.5%	9.0%	-2.5%
US (Growth)	11.5%	9.0%	-2.5%
Canada	2.5%	2.0%	-0.5%
Europe Large	**13.5%**	**10.0%**	**-3.5%**
UK	4.5%	1.5%	-3.0%
Germany	2.0%	2.5%	0.5%
France	2.0%	3.0%	1.0%
Switzerland	1.5%	0.0%	-1.5%
Benelux	1.0%	0.0%	-1.0%
Scandinavia	1.0%	0.0%	-1.0%
Spain	1.0%	0.0%	-1.0%
Italy	0.5%	3.0%	2.5%
Asia x Japan Large	**3.0%**	**1.0%**	**-2.0%**
Australasia	2.0%	0.5%	-1.5%
Far East x Japan	1.0%	0.5%	-0.5%
Japan Large	**4.5%**	**8.0%**	**3.5%**
Developed Small & Mid Cap	**9.5%**	**7.0%**	**-2.5%**
North America SMID	**5.0%**	**4.0%**	**-1.0%**
Europe SMID	**3.0%**	**0.5%**	**-2.5%**
UK	1.0%	0.0%	-1.0%
Europe x UK	2.0%	0.5%	-1.5%
Japan SMID	**1.0%**	**2.5%**	**1.5%**
Asia x Japan SMID	**0.5%**	**0.0%**	**-0.5%**
Emerging Equities	**8.0%**	**5.0%**	**-3.0%**
Emerging Asia	**4.5%**	**2.0%**	**-2.5%**
China	1.5%	0.5%	-1.0%
India	0.5%	0.0%	-0.5%
South Korea	1.0%	0.5%	-0.5%
Taiwan	1.0%	0.5%	-0.5%
Other	0.5%	0.5%	0.0%
Emerging EMEA	**1.5%**	**2.0%**	**0.5%**
Russia & Eastern Europe	0.5%	1.0%	0.5%
South Africa	0.5%	0.5%	0.0%
Other	0.5%	0.5%	0.0%
Latin American	**2.0%**	**1.0%**	**-1.0%**
Brazil	1.5%	1.0%	-0.5%
Mexico	0.5%	0.0%	-0.5%
Total	**100.0%**	**100.0%**	**0.0%**

**Risk Levels 4 and 5*, which also include an allocation to illiquid assets, are designed for investors who have a time horizon that extends beyond 10 years and who are willing to accept more volatility in exchange for greater potential wealth enhancement.

Strategic = benchmark; Tactical = the Citi Private Bank Global Investment Committee's current view; and Active = the difference between Strategic and Tactical.

Citi's strategic and tactical allocations: portfolio risk level 5

Seeks maximum long-term growth of capital*

Classification	Strategic	Tactical	Active
Cash	**0.0%**	**0.0%**	**0.0%**
Global Fixed Income	**0.0%**	**0.0%**	**0.0%**
Global Equities	**86.0%**	**86.0%**	**0.0%**
Developed Equities	**75.0%**	**77.0%**	**2.0%**
North America Large	**34.0%**	**32.0%**	**-2.0%**
US (Value)	15.5%	15.0%	-0.5%
US (Growth)	15.5%	15.0%	-0.5%
Canada	3.0%	2.0%	-1.0%
Europe Large	**18.5%**	**21.0%**	**2.5%**
UK	6.0%	5.0%	-1.0%
Germany	2.5%	5.0%	2.5%
France	3.0%	7.0%	4.0%
Switzerland	2.5%	0.0%	-2.5%
Benelux	1.0%	0.0%	-1.0%
Scandinavia	1.5%	0.0%	-1.5%
Spain	1.0%	0.0%	-1.0%
Italy	1.0%	4.0%	3.0%
Asia x Japan Large	**3.5%**	**2.0%**	**-1.5%**
Australasia	2.5%	1.0%	-1.5%
Far East x Japan	1.0%	1.0%	0.0%
Japan Large	**6.0%**	**9.0%**	**3.0%**
Developed Small & Mid Cap	**13.0%**	**13.0%**	**0.0%**
North America SMID	**7.0%**	**6.0%**	**-1.0%**
Europe SMID	**3.5%**	**4.5%**	**1.0%**
UK	1.0%	1.5%	0.5%
Europe x UK	2.5%	3.0%	0.5%
Japan SMID	**1.5%**	**2.5%**	**1.0%**
Asia x Japan SMID	**1.0%**	**0.0%**	**-1.0%**
Emerging Equities	**11.0%**	**9.0%**	**-2.0%**
Emerging Asia	**6.0%**	**3.5%**	**-2.5%**
China	2.0%	1.0%	-1.0%
India	1.0%	0.5%	-0.5%
South Korea	1.5%	1.0%	-0.5%
Taiwan	1.0%	0.5%	-0.5%
Other	0.5%	0.5%	0.0%
Emerging EMEA	**2.0%**	**4.0%**	**2.0%**
Russia & Eastern Europe	1.0%	2.5%	1.5%
South Africa	0.5%	1.0%	0.5%
Other	0.5%	0.5%	0.0%
Latin American	**3.0%**	**1.5%**	**-1.5%**
Brazil	2.0%	1.0%	-1.0%
Mexico	0.5%	0.5%	0.0%
Other	0.5%	0.0%	-0.5%
Hedge Funds	**14.0%**	**14.0%**	**0.0%**
Commodities	0.0%	0.0%	0.0%
Total	**100.0%**	**100.0%**	**0.0%**

**Risk Levels 4 and 5*, which also include an allocation to illiquid assets, are designed for investors who have a time horizon that extends beyond 10 years and who are willing to accept more volatility in exchange for greater potential wealth enhancement.

Strategic = benchmark; Tactical = the Citi Private Bank Global Investment Committee's current view; and Active = the difference between Strategic and Tactical

Asset Allocation Definitions

ASSET CLASSES	BENCHMARKED AGAINST
Global Equities	MSCI All Country World Index , which represents 48 developed and emerging equity markets. Index components are weighted by market capitalization.
Global bonds	Barclays Capital Multiverse (Hedged) Index , which contains the government-related portion of the Multiverse Index, which makes up about 14% of the larger index.
Hedge Funds	HFRX Global Hedge Fund Index, which is designed to be representative of the overall composition of the hedge fund universe. It comprises all eligible hedge fund strategies; including but not limited to convertible arbitrage, distressed securities, equity hedge, equity market neutral, event driven, macro, merger arbitrage and relative value arbitrage. The strategies are asset-weighted based on the distribution of assets in the hedge fund industry.
Commodities	Dow Jones-UBS Commodity Index , which is composed of futures contracts on physical commodities traded on U.S. exchanges, with the exception of aluminum, nickel and zinc, which trade on the London Metal Exchange (LME). The major commodity sectors are represented including Energy, Petroleum, Precious Metals, Industrial Metals, Grains, Livestock, Softs, Agriculture and ExEnergy.
Cash	Three-Month LIBOR, which is the interest rates that banks charge each other in the international inter-bank market for three-month loans (usually denominated in Eurodollars).
EQUITIES	
Developed Market Large Cap Equities	MSCI World Large Cap Index. This is a free-float-adjusted market-capitalization-weighted index designed to measure the equity market performance of the large-cap stocks in 23 developed markets. Large cap is defined as stocks representing roughly 70% of each market's capitalization.
US Equities	Standard & Poor's 500 Index. Widely regarded as the best single gauge of the US equities market, this capitalization-weighted index includes a representative sample of 500 leading companies in leading industries of the US economy. Although the S&P 500 focuses on the large-cap segment of the market, with over 80% coverage of US equities, it is also an ideal proxy for the total market.
Europe, ex-UK Equities	MSCI Europe ex-UK Large Cap Index. A free-float-adjusted market-capitalization-weighted index designed to measure large-cap stock performance in each of Europe's developed markets, except for the United Kingdom.
United Kingdom Equities	MSCI UK Large Cap Index. A free-float-adjusted market-capitalization-weighted index designed to measure large-cap stock performance in the United Kingdom.
Japan Equities	MSCI Japan Large Cap Index. A free-float-adjusted market-capitalization-weighted index designed to measure large-cap stock performance in Japan.
Asia Pacific ex-Japan Equities	MSCI Asia Pacific ex-Japan Large Cap Index. A free-float-adjusted market-capitalization-weighted index that is designed to measure the performance of large-cap stocks in Australia, Hong Kong, New Zealand and Singapore.
Developed Marked Small and Mid Cap Equities	MSCI World Small Cap Index. A capitalization-weighted index that measures small-cap stock performance in 23 developed equity markets.
Emerging Markets Equities	MSCI Emerging Markets Index. A free-float-adjusted market-capitalization-weighted index designed to measure equity market performance of 22 emerging markets.
BONDS	
Developed Sovereign	Citi World Government Bond Index (WGBI). Consists of the major global investment grade government bond markets and is composed of sovereign debt, denominated in the domestic currency. To join the WGBI, the market must satisfy size, credit, and barriers-to-entry requirements. In order to ensure that the WGBI remains an investment-grade benchmark, a minimum credit quality of BBB-/Baa3 by either S&P or Moody's is imposed. Index is rebalanced monthly.
Emerging Sovereign	Citi Emerging Market Sovereign Bond Index (ESBI). Includes Brady bonds and US dollar-denominated emerging market sovereign debt issued in the global, Yankee, and Eurodollar markets, excluding loans. It comprises debt in Africa, Asia, Europe and Latin America. We classify an emerging market as a sovereign with a maximum foreign debt rating of BBB+/Baa1 by S&P or Moody's. Defaulted issued are excluded.
Supranationals	Citi World Broad Investment Grade Index (WBIG) - Government Related - A subsector of the WBIG, this index includes fixed rate investment grade agency, supranational and regional government debt, denominated in the domestic currency. Rebalanced monthly.
Corporate Investment Grade	Citi World Broad Investment Grade Index (WBIG) – Corporate. Corporate - A subsector of the WBIG, this index includes fixed rate global investment grade corporate debt within the finance, industrial and utility sectors, denominated in the domestic currency. Rebalanced monthly.
Corporate High Yield	Barclays Global High Yield Corporate Index. Provides a broad-based measure of the global high-yield fixed-income markets. It is also a component of the Multiverse Index and the Global Aggregate Index.
Securitised	Citi World Broad Investment Grade Index (WBIG) – Securitised. A subsector of the WBIG, this index includes global investment grade collateralized debt denominated in the domestic currency, including mortgage-backed securities, covered bonds (pfandbriefs) and asset-backed securities. Rebalanced monthly.

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