

Why the dollar's decline shouldn't worry US stock investors
PAGE 3

Commercial real estate still has room to run
PAGE 11

Equity rally prompts decision to rebalance our model portfolios
PAGE 13



The View

Drivers, Passengers and Roadkill



June 2006 | The Investment Outlook of The Citigroup Private Bank

Successful investing begins with learning to differentiate the things that matter from the things that don't. For most of the past 40 years, what mattered most to investors around the globe were US capital and fiscal flows, the state of the US economy and the US Federal Reserve. Those were the drivers that dominated the Group of Seven industrialized nations as well as the countries within their sphere of influence. Global companies whose business models were aligned with growth in the US economy were able to profit by going along for the ride as passengers, if you will, of the Fed and US market forces.

But now the cast of global players has expanded to include Russia and many of the former Soviet Union's satellite states in Eastern Europe, and, most important, China and India. Since 1989, with an economic wobble here and a currency crisis there, these states have emerged as headliners on the world stage, dramatically changing the flow of capital around

CONTINUED ON INSIDE COVER

CITIGROUP GLOBAL WEALTH MANAGEMENT

Citigroup Investment Research • The Citigroup Private Bank • Smith Barney

Drivers, Passengers and Roadkill



By Clark Winter
Chief Global Investment Strategist
Citigroup Global Wealth Management

CONTINUED FROM COVER ...

the globe. The Fed, once the world's monetary center, is now but one player, albeit an important one, among many. The European Central Bank has become a power with which to be reckoned, while the People's Bank of China is becoming another potentate.

As the rules of the road change, some global companies will end up passengers of the new drivers of the global economy and the others, who are going along for the ride with Fed policy, will become their roadkill. For one, the economic centers of entire industries have relocated. Steel, textiles, electronics and even energy were once oriented in a single direction: toward the large industrial and consumer markets of the West. These markets still may be the largest and most attractive, but they are no longer the only ones. Increasingly, the new consumers, those based in China, India and other parts of the developing world, are now dictating where and how goods are sold—and who stands to profit.

Industries that have not paid attention to similar shifts in the economy in the past have paid the ultimate price. In the 1950s and 1960s, when the US textile industry was centered in the New England states and American industry meant factories in the Northeast and Midwest, the shift of textile mills to the cheaper labor of the South decimated local economies in the North. Now, when factories and mills move overseas, it puts the national economy in danger of a prolonged slump. Europe, despite a well-trained workforce and steady product innovation, has seen its manufacturing lead usurped first by Japan, then by South Korea and now by China. The US's global lead in software has been challenged by talent in India, which has moved up the innovation curve. Other industries on the cusp of change are aircraft, as Brazil enters the lower end of the passenger market, computer makers and perhaps even biotechnology.

We've seen that the leaders of the most successful countries and companies focus more on innovation, quality and moving up the value chain than on mere cost cutting. These nations and firms are redefining their roles as drivers. But with the emergence of double-digit gross-domestic-product growth in some of the developing economies, there are new challenges for the right to sit in the driver's seat. A new set of passengers also will emerge, and there could be more roadkill up ahead. ■

At a Glance

A summary of our investment outlook across 28 regions, asset classes and currencies
Details on our 12-month outlook can be found on the pages that follow.

GLOBAL ASSET-CLASS WEIGHTINGS

EQUITIES	OVERWEIGHT
FIXED INCOME	UNDERWEIGHT
CASH	NEUTRAL
HEDGE FUNDS	NEUTRAL

Bullish: Returns are expected to be significantly higher than the long-term trend
Neutral: Returns are expected to be around the long-term trend
Bearish: Returns are expected to be significantly lower than the long-term trend

DATA SOURCE: Citigroup Global Wealth Management Investment Strategy Committee, GWM Investment Research and CitiFX

EQUITIES 12-MONTH OUTLOOK

US Large-Cap	BULLISH
US Mid-Cap	NEUTRAL
US Small-Cap	NEUTRAL
Europe	BULLISH
Japan	BULLISH
Asia Pacific	NEUTRAL
Emerging Markets	NEUTRAL
Latin America	NEUTRAL
Europe	NEUTRAL
Asia Pacific	NEUTRAL

FIXED INCOME 12-MONTH OUTLOOK

US (Trsys & high-grade)	NEUTRAL
US High Yield	BEARISH
Europe	NEUTRAL
UK	NEUTRAL
Japan	NEUTRAL
Emerging Markets	BEARISH

CURRENCIES 12-MONTH OUTLOOK*

Euro	BULLISH
Yen	BULLISH
Pound	BULLISH
Australian Dollar	BULLISH
Canadian Dollar	BULLISH

*Versus the US dollar

HEDGE FUNDS 12-MONTH OUTLOOK

Relative-value and event-driven	NEUTRAL
Macro and managed futures	NEUTRAL
Equity long/short	NEUTRAL