

AUSTRALIAN

RESEARCH



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Australian Managed Investments

Structured Products

Note: This report is based on the Draft PDS provided to Aegis on **12 July 2007**, together with other information provided by Citigroup.

Citi MLI – S&P/ASX 200 (Series 2007-09)

Performance linked to the S&P/ASX 200 Index with insulation against volatility and market timing risk and the safeguard of capital protection at maturity



Offer Overview

Product Summary

Citi MLI – S&P/ASX 200 (Series 2007-09) (*MLI* or the *Product*) is being issued by Citigroup Global Markets Australia Pty Limited (*CGMA* or the *Issuer*). MLI provides exposure to the growth prospects of Australian equities through a return linked to the S&P/ASX 200 Index (the *Index*) with the safeguard of a capital guarantee at maturity. The return at maturity is equal to the average performance of the Index from the Issue Date to each quarterly Observation Date during the five-year term multiplied by a fixed participation rate of between 180% and 220% (the *Market Linked Performance*). Quarterly observations will not take into account negative index valuations, and the exact participation rate will be determined on the Issue Date. The methodology smooths the Index performance and removes a large degree of volatility and market timing risk at maturity. Returns to investors will be in the form of capital upon exit. MLI is not designed to provide income during the term. CGMA's obligation to provide a capital guarantee at maturity is managed through a zero coupon bond (*ZCB*) structure. The capital-protected term is five years; however, investors may redeem early through a monthly liquidity facility. MLI is structured as a deferred purchase agreement (*DPA*); at maturity, investors will take receipt of shares in the Commonwealth Bank of Australia (the *Delivery Asset*) or may redeem in cash.

Offer Details

Offer Closes	14-Sep-07
Issue Date	19-Sep-07
Maturity (years)	19-Sep-12 (5 years)
Min. Investment	A\$5,000
Liquidity	Monthly
Distributions	None

Risk/Return Profile



Fees (paid to advisors), incl. GST, %

Up-front	2.2
Ongoing	0.3

Note: All advisor fees are paid by the investor. The fee levels above represent maximum levels that may be charged by advisors. The actual fee level will depend on the commercial relationship between the investor and the advisor.

Investment View

Investor Suitability

Aegis regards MLI as most suited to investors who remain positive about the longer-term prospects of Australian equities, but, after four years of strong growth, believe volatility and market timing risks are increasing. Such investors may include those who are saving for life's milestones, such as super fund trustees and retirees, who wish to retain exposure to growth, but have no tolerance for a loss on their initial investment. As noted above, the averaging methodology will smooth returns of the Index, generating out- and under-performance relative to the Index in certain market environments. The relative performance characteristics of the methodology are detailed in Section 4. Aegis recommends investors familiarise themselves with its impact. Investors should note that MLI does not provide an entitlement to dividend income. While historical backtesting indicates MLI has generally performed in line with the S&P/ASX 200 Price Index, it has underperformed the S&P/ASX 200 Accumulation Index. Investors should, therefore, carefully consider the risk-return trade off—the benefit of reduced volatility and market timing risk at maturity at the cost of potentially lower returns relative to an investment that provides an entitlement to dividend income.

Recommendation

Aegis has issued MLI a **Recommended** rating. Aegis believes MLI is effective in achieving its intended outcomes: exposure to Australian equities growth while greatly reducing volatility and market timing risk at maturity. Structurally, fees are very low and the ZCB structure is well suited to the intended performance outcomes.

The investment opinion in this report is current as at the date of publication. Investors and advisers should be aware that over time the circumstances of the issuer and/or product may change which may affect our investment opinion.

SWOT Summary

Strengths

- Market timing and correction risk at maturity is largely removed due to the averaging methodology.
- Backtesting indicates MLI has generally performed in line with the Index; however, investors in MLI would have received the additional benefit of capital protection and reduced pricing risk at maturity.
- Total fees are highly competitive, equating to 0.3% to 0.4% per annum. Aegis has relied on statements from CGMA regarding fee levels.
- Under the ZCB structure, volatility and correction risk are borne by the call option issuer, whereas under the alternative constant proportion portfolio insurance (CPPI) capital protection structure, these are borne by the investor.

Weaknesses

- No entitlement to dividends under the ZCB/call options, which is in contrast to CPPI. There are however potentially higher direct costs (fees) and indirect costs (lower participation) in a CPPI structure.
- Backtesting indicates that due to the lack of dividends, MLI has generally underperformed the S&P/ASX 200 Accumulation Index.
- Lack of transparency with respect to fees and early redemption value due to the exotic, over-the-counter (OTC) call options.
- The Delivery Asset is distinctly different to the Index, which may provide investors with less flexibility in choosing the timing of a CGT event at, or shortly after maturity.

Opportunities

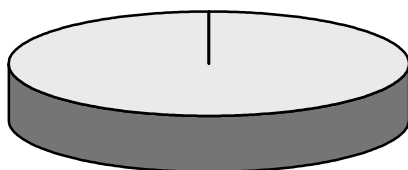
- Well suited to investors wishing to retain exposure to the growth prospects of Australian equities but who are concerned about increasing volatility and market timing risk.
- The likelihood of outperforming the Index increases if the Initial Index Level dips or if the performance of the Index moderates or declines towards the end of the term.

Threats

- The likelihood of underperforming the Index increases if the Initial Index Level is high or if the performance of the Index accelerates towards the end of the term.

Portfolio Diversification

By Strategy



S&P/ASX 200 Index

Product Fees (paid by investors)

	Product	Sector Avg.*
Base Fees, % of Assets		
Up-front ¹	2.2	1.8
Ongoing ²	0.7	1.7
Exit ³	0.3	0.1
Average, p.a.	1.1	2.0

*Based on Structured Products reviewed by Aegis over the last 12-month period.
 1. Assumes maximum advisor commission. Actual commissions may be less, and possibly nil.
 2. Includes 0.3% p.a. advisor commission and an estimated 0.35% p.a. MER.
 3. If sold on market, brokerage costs may be incurred.

Total Fees, % of Expected Total Return*

	Product	Sector Avg.*
Up-front	3.4	2.7
Ongoing	5.0	13.7
Exit	0.4	0.2
Total	8.8	18.1

*Based on expected returns of 13% p.a. over a 5-year term.

Performance Fees

There are no performance fees.

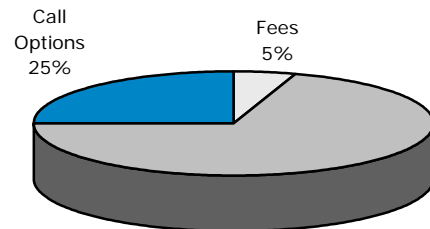
Indirect Fees

Total product fees are indirectly incurred by investors through the pricing of the call options (see below).

Fee Commentary

Fees paid to CGMA are implicit in the pricing of the call options and, hence, reflected in the participation rate. The cost to investors represents the opportunity cost of a lower participation rate than would otherwise be determined in the absence of a margin/fee to CGMA. Given the exotic, OTC nature of call options, Aegis has been unable to independently price them and has, therefore, relied on statements from CGMA regarding the fee level. CGMA states the total MER for the 5-year term is expected to be 1.5% to 2.0%, the equivalent of 0.3% to 0.4% p.a. Notwithstanding the static nature of MLI, Aegis regards the fee level as highly competitive.

By Financial Instrument



ZCB
70%

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2. Structure

On Issue Date, total product fees for the five-year term are deducted from the application amount. Total fees are expected to range from 5.0% to 5.5%, of which 3.65% is paid to advisors (and which can be rebated) and from 1.5% to 2.0% to CGMA. The remaining 95% of the application amount is notionally invested in two asset classes: an estimated 70% to the ZCB and 25% to the call options.

The funds notionally invested in the ZCB essentially represent a 'deposit' and will earn interest and grow over the five-year term to be equal to the application amount, thus providing 100% capital protection at maturity. The call options provide the capital growth component of MLI. The pricing of the call options will be determined on the Issue Date. This, in turn, will determine the participation rate at a specific level within the expected range of 180% to 220%. Once the participation rate is set, it will be fixed for the investment term.

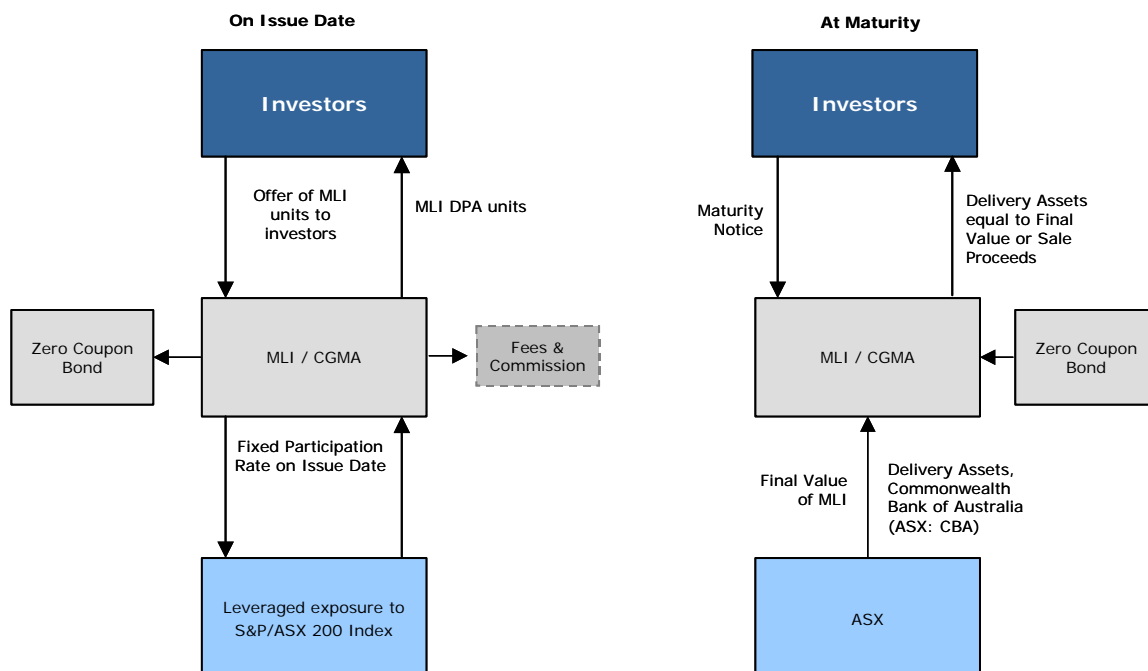
At maturity, investors will receive 100% of their initial investment plus the Market Linked Performance multiplied by the participation rate. The calculation method to determine the Market Linked Performance is detailed in Section 4.

Investors should note the above represents the pay-off calculation at maturity. During the term, the value of MLI will be equal to the value of the ZCB plus the fair market/economic value of the call options, as determined by CGMA and subject to Index performance. The fair market value of the call options will be subject to the typical determinants of option pricing, such as market volatility, interest rates and time to maturity.

During the investment term, CGMA will not be publishing an active redemption price. For investors wishing to redeem early, CGMA will provide an indicative redemption value on request.

MLI is structured as a DPA, wherein an investor will accept the physical delivery of the Delivery Assets at maturity or receive the sale proceeds by disposing of the Delivery Asset through the use of an agency sale arrangement provided by Citigroup.

Investment Structure



Key Exposure

Underlying Exposure: Performance linked to the S&P/ASX 200 Index. Return at maturity is determined by the Market Linked Performance calculation.

Currency Exposure: None

Exit Details

Exit Facility: At maturity, investors will redeem an equivalent value of the investment return in the form of the Delivery Asset.

Liquidity: Monthly

Holder Early Redemption: If an investor redeems prior to maturity, the redemption value will be equal to the value of the ZCB plus the fair market value of the call options, less any costs incurred by CGMA in unwinding the call options.

Issuer Early Redemption: An early redemption may occur in the event of an early maturity event, wherein investors will redeem the fair economic value of the investment minus any costs or losses as a result of the early termination.

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Product Leverage

Used:	Leveraged exposure to the Index is inherent in the call options and is reflected in the participation rate. The expected participation rate range equates to a leverage of 80% to 120%. Investors should note that leverage is not applied to the point-to-point performance of the Index. Rather, it is applied to returns that have been calculated using the averaging methodology. For example, if the Index consistently grew at a CAGR of 2.0% per quarter, the total return over the five-year term would be 50%. Under the averaging methodology, the equivalent performance would be 23.4%. The application of a 200% participation rate, for example, would then generate a total return of 46.8%. Aegis notes that the averaging process, by reducing volatility, reduces the cost of the call options and, hence, increases the participation rate.
Cost (incl. Fees):	The cost of leverage is not separately disclosed. If there is a cost of leverage to investors, then it is implicit in the margin between the fair market value of the call options and the actual pricing of the call options. The cost to investors would, therefore, represent the opportunity cost of a lower participation rate than would otherwise be determined in the absence of a profit margin to CGMA.
Recourse:	n/a

Capital Protection

Method:	Notional ZCB. In the context of the investment objective of MLI, the benefit of a ZCB structure relative to CPPI is that the former is not adversely impacted by volatility or a market correction. That is, the ZCB structure does not expose the investor to being less than 100% exposed to the underlying strategy as a consequence of deleverage events. The disadvantage of the ZCB structure in the case of MLI is that it does not provide an entitlement to dividend income.
Conditions:	Investment must be held to maturity.
Cost:	Opportunity cost embedded in the ZCB.
Counterparty Risk:	The risk Citigroup Inc. fails in its obligation to provide the capital guarantee at maturity.

Tax

Disclaimer:	Tax consequences depend on individual circumstances. Investors must seek their own taxation advice. The following comments show Aegis' expectation of tax for ordinary Australian taxpayers, but cannot be considered tax advice.
Capital gains:	At maturity, if the value of redemption proceeds exceeds the investor's cost base, a capital gains tax (CGT) event will occur. The CGT event is likely to occur upon the sale of the Delivery Asset or at maturity if investors retrieve sale proceeds. Investors are likely to be eligible for the CGT discount if the investment is held for greater than 12 months.
Distributions:	MLI is not designed to provide income during the investment term.

Legal Structure

Wrapper:	Deferred purchase agreement
Custodian/Trustee:	None
Issuer:	Citigroup Global Markets Australia
Offer Document:	The PDS for this product will not be lodged with the Australian Securities Investment Commission (ASIC) and is not required by the <i>Corporations Act 2001</i> to be lodged with ASIC.

Returns

Capital vs. Income:	Capital return-based product, with capital return (if any) received at maturity. Historical backtesting over the 15-year period, from June 1992 to June 2007, indicates an average rolling five-year return of 8.2% per annum, with a maximum of 22.0% per annum and a minimum of 1.8% per annum. MLI generally performed in line with the Index. However, investors in MLI would have received the additional benefit of capital protection and a lower sensitivity to market volatility risk and market timing risk at maturity.
Income Frequency:	There is no income provided during the investment term.
Foreign Currency Risk:	None

Investor Leverage

Available:	No
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Risks	Refer to pages 14-15 of the PDS.
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3. Management & Corporate Governance

Board of Directors

The directors of CGMA are not directly involved in this product; however, they are involved in determining CGMA's overall strategy and policies, which are reflected in MLI. Aegis considers the board of CGMA to be highly experienced and to have excellent depth.

Management Team

The role of CGMA management is largely limited to product origination, specifically creating and executing the investment strategy. With the derivative structures of MLI entered into on day one, the management team will have limited involvement in the product beyond the Issue Date.

Aegis regards the management team of CGMA as having sufficient experience to create MLI. The team has been responsible for issuing around 30 structured investment products over the past three to five years, several of which have been based on the averaging methodology incorporated in MLI.

Alignment of Interest

Aegis considers the interests of investors and management to be aligned. CGMA receives an up-front fee for its product origination and execution role. The absolute amount of the fee is dependent on the dollar value of applications. It is therefore in CGMA's best interests to create a product with an attractive investment proposition. While there is no ongoing fee paid to CGMA, Aegis does not regard this as a potential misalignment of interest, as CGMA will have limited involvement in the product beyond the Issue Date.

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4. Investment Process

Product Philosophy

MLI is designed to provide exposure to the growth prospects of Australian equities, but in a manner that significantly reduces volatility and market timing risk. The targeted investor is one who remains positive about the longer-term prospects of Australian equities, but, after four years of exceptionally strong and sustained growth, believes volatility and market timing risk are significant.

The rationale for the quarterly averaging methodology with the 0% floor is essentially two-fold. First, by capturing positive Index performance over the full five-year investment term, rather than just on a point-to-point basis, the methodology smoothes returns. As such, the methodology removes a large degree of volatility and market timing risk at maturity from the performance. For targeted investors, this provides the comfort that they are insulated from market correction and volatility risk at maturity. Second, the averaging methodology permits a significantly higher participation level to Index performance than would otherwise be the case. It achieves this by lowering the volatility of returns and, hence, the cost of the call options. So, while the averaging methodology may materially reduce returns relative to a point-to-point calculation in a rising market environment, the high participation rate largely offsets the impact.

The ZCB capital protection structure is integral to the other structural components of MLI. Nevertheless, in comparison to the alternative CPPI method, it provides performance outcomes that are consistent with the overall design of MLI. That is, the ZCB structure is not adversely impacted by volatility or a market correction. In contrast, under the CPPI structure, significant volatility or a correction increases deleverage risk and, hence, the risk of being significantly less than 100% exposed to the underlying investment and potentially for a significant period of the investment term.

Return Calculation Methodology

The return at maturity is calculated using the following methodology:

- The five-year term is divided into 20 quarterly Observation Dates, starting 19 December 2007 and ending 19 September 2012;
- The Initial Index Level is equal to the closing level of the S&P/ASX 200 Index on the Issue Date of 19 September 2007;
- For each Observation Date, the return is equal to the Index Level on the particular date less the Initial Index Level on 19 September 2007. For example, on the fourth Observation Date on 19 September 2008, the return is equal to the Index Level on that date less the Initial Index Level on 19 September 2007. This process continues over the 20 quarterly observation periods to maturity on 19 September 2012;
- If on any Observation Date, the Index Level is less than the Initial Index Level (a negative observation), then the return for that quarter is set at a floor of 0%. That is, the methodology excludes any negative quarterly returns;
- At maturity, the returns of the 20 Observation Dates are summed and divided by 20 to provide an average figure. This figure represents the Index performance; and
- The Index performance is then multiplied by the participation rate. The resulting figure is the total return at maturity.

Figure 1 provides a worked example of the calculation methodology, assuming five Observation Dates. Under the averaging methodology, the return at the end of the term is 140 points above the Initial Index Level compared to 100 on a point-to-point basis. The running average highlights the smoothing impact and how volatility and market timing risk are reduced.

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Figure 1. Market Linked Performance Calculation

Observation	Index Level	Observation Return	Running Average	X Participation Rate (200%)
0	6,000	0		
1	6,100	100	100	
2	6,150	150	125	
3	5,900	0	83	
4	6,000	0	63	
5	6,100	100	70	
End			70	140

Source: Aegis Equities Research

Scenario Analysis

The charts below are designed to illustrate the performance characteristics of the averaging methodology relative to a point-to-point calculation in certain market environments.

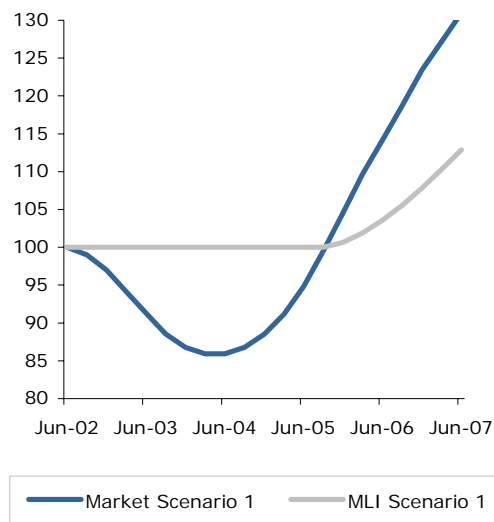
In all scenarios, the absolute performance of MLI, and the performance relative to point-to-point returns, depends on the following:

- The initial entry level;
- The path taken; and
- The final exit level.

In contrast, for point-to-point returns, only the initial entry and final exit levels are required.

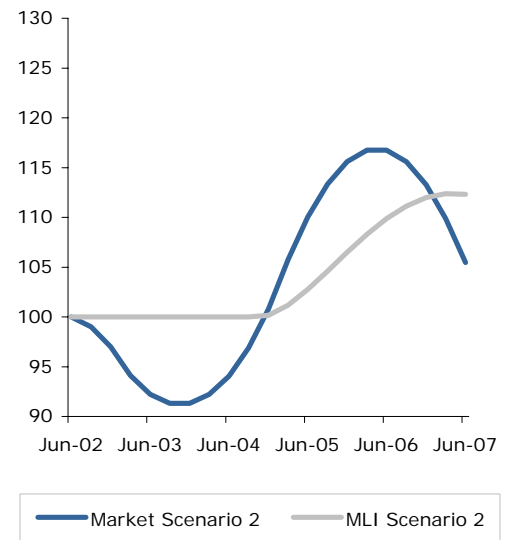
Figures 2 and 3 illustrate that negative returns at the start followed by strong returns do not necessarily lead to out-performance of MLI relative to the market. It is dependent on where the Index finishes. If the Index ends below its five-year peak, as in Figure 3, MLI may outperform.

Figure 2. Down Up Scenario



Source: CGMA/Aegis Equities Research

Figure 3. Down Up Down Scenario

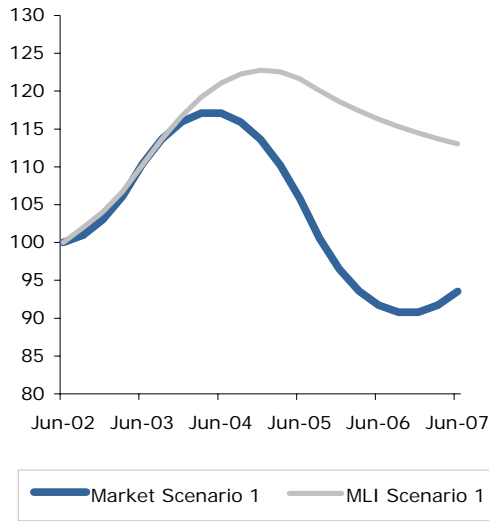


Source: CGMA/Aegis Equities Research

Figures 4 and 5 below illustrate that positive returns at the start followed by a decline do not necessarily mean that MLI will outperform the market. If there is strong performance at the very end, as in Figure 5, the market may outperform MLI.

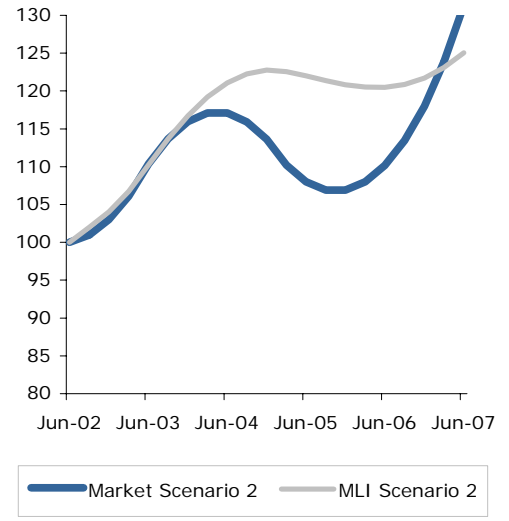
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Figure 4. Up Down Scenario



Source: CGMA/Aegis Equities Research

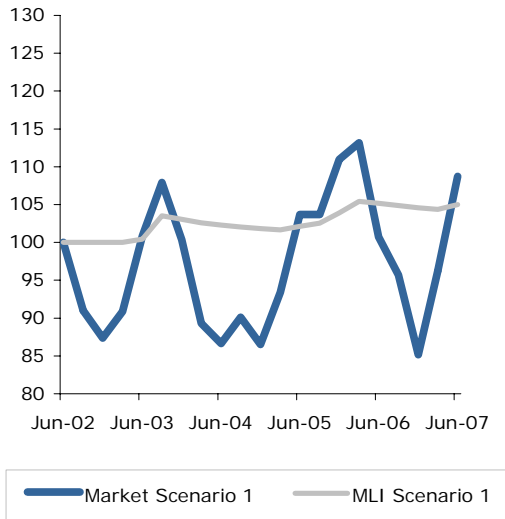
Figure 5. Up Down Up Scenario



Source: CGMA/Aegis Equities Research

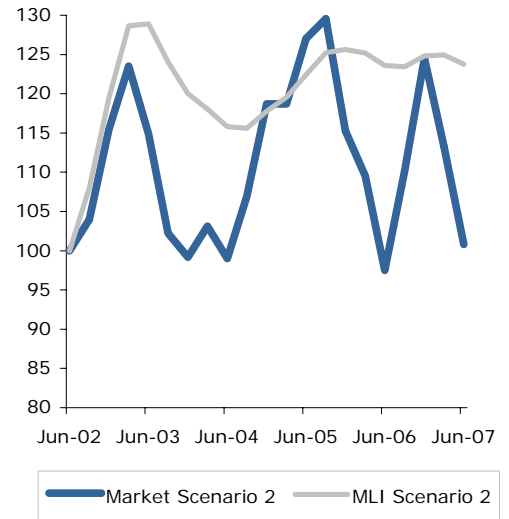
Figures 6 and 7 illustrate a volatile market environment. In a volatile environment, the relative performance of MLI depends on entry and exit levels as well as the paths taken to get there.

Figure 6. Volatile Market Scenario



Source: CGMA/Aegis Equities Research

Figure 7. Volatile Market Scenario



Source: CGMA/Aegis Equities Research

5. Performance Analytics

The performance of MLI has been historically backtested based on 15 years of the Index performance. The analysis is on a pre-fees basis. The key conclusions are as follows:

- MLI generally performed in line with the Index (periods of out- and under-performance are noted below). However, investors in MLI would have had the additional benefit of capital protection and a lower sensitivity to volatility and timing risk at maturity;
- Periods in which MLI outperformed the Index were typically in an environment where the Index was characterised by sustained growth after entry with a declining or moderating growth towards the end of the five-year term;
- Periods in which MLI underperformed were typically in an environment where the Index was characterised by moderating/declining growth after entry with increasing growth towards the end of the five-year term;
- MLI returns varied significantly over particular periods. While the averaging methodology smoothes returns over the term, the methodology is very sensitivity to the Index level on the Issue Date. Market timing risk at the inception of the investment term is high; and
- MLI consistently underperformed the S&P/ASX 200 Accumulation Index. On no occasion did the accumulation index generate a negative return over a rolling five-year period. Investors should note, however, that the ability to receive dividend income would necessitate a different investment strategy to that of MLI – either a naked exposure to the S&P/ASX 200 Accumulation Index or a capital-protected exposure through the CPPI method. Both alternative strategies have pros and cons relative to the MLI strategy.

Figure 8 is based on 15 years of the Index performance. It illustrates the rolling five-year performance (annualised) of MLI and the Index (based on a point-to-point calculation). Figure 9 presents the same analysis but replaces the Index with the S&P/ASX 200 Accumulation Index. The accumulation index assumes the payment and reinvestment of dividend income.

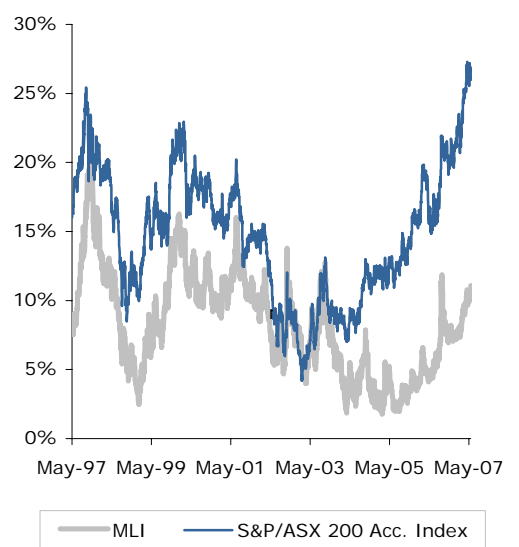
Key performance metrics include average return (per annum) 8.2% MLI, 8.7% Index, 14.7% S&P/ASX 200 Accumulation Index; minimum return (per annum) 1.8% MLI, 0.2% Index, 4.2% S&P/ASX 200 Accumulation Index; and maximum return (per annum.) 22% MLI, 18.3% Index, 27% S&P/ASX 200 Accumulation Index.

Figure 8. MLI Performance vs. ASX Price Index



Source: Aegis Equities Research

Figure 9. MLI Performance vs. ASX Accumulation Index



Source: Aegis Equities Research

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MLI materially outperformed the Index from approximately October 2002 to October 2003. Aegis attributes this to an Index performance profile characterised by a relatively low Initial Index Level, sustained solid growth in the first half to two thirds of the five-year term and a relatively significant decline in the latter part and at the end of the term.

MLI has materially underperformed the Index from around December 2004 to the latest date June 2007. Aegis attributes this to an Index performance profile characterised by a moderating growth in the initial period, a subsequent sustained downturn and, towards the end, a sharp upturn.

MLI has consistently underperformed the accumulation index. On only 3.7% of all observations did MLI outperform the accumulation index. Additionally, on no occasion did the accumulation index generate a negative return over a rolling five-year period.

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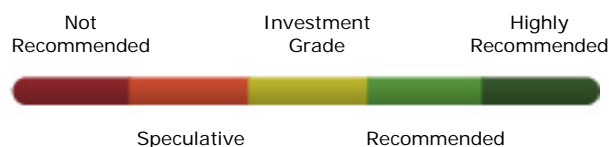
Appendix – Ratings Process

Aegis has developed a framework for rating investment product offerings in Australia. Our review process gives consideration to a broad number of qualitative and quantitative factors.

Essentially, the evaluation process includes the following key factors: product management and underlying portfolio construction; investment management, product structure, risk management, experience and performance; fees, risks and likely outcomes.

The Ratings

Our rating is based on the following scale:



Highly Recommended: indicates that Aegis believes this is a superior grade product that has exceeded the requirements of our review process across a number of key evaluation parameters and scored exceptionally in a number of categories. It has an attractive risk/return trade-off; however, we caution that the risk/return trade-off will not be suitable for all investors.

Recommended: indicates that Aegis believes this is an above average grade product that has exceeded the minimum requirements of our review process across a number of key evaluation parameters. It has an above average risk/return trade-off; however, we caution that the risk/return trade-off will not be suitable for all investors.

Investment Grade: indicates that Aegis believes this is a suitable product that has met the aggregate requirements of our review process across a number of key evaluation parameters. The product may provide unique diversification opportunities, but may not stand apart from its peers. It has an acceptable risk/return trade-off; however, we caution that the risk/return trade-off will not be suitable for all investors. In the previous five category rating system, this category was termed 'Approved'.

Speculative: indicates that Aegis believes this is a product that has a number of positive attributes; however, there are a number of risks that make investing in this product a speculative proposal. While Aegis does not rule out investing in this product, investors should be very aware of, and be comfortable with, the specific risks. The product may provide unique diversification opportunities; however, concerns over one or more features means that it may not be suitable for most investors.

Not Recommended: indicates that Aegis believes that despite the product's merits and attributes, it has failed to meet the minimum aggregate requirements of our review process across a number of key evaluation parameters. However, this does not mean that the product is without merit.

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The offer of the securities is made in the Product Disclosure Statement (PDS), and anyone wishing to acquire the securities should complete the application form in the PDS.

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