Citi Research

Equities

16 January 2015 | 32 pages

Strategy

Western Europe

European Portfolio Strategist

Welcome to Planet QE = Align With Liquidity

- **Doves drive done deal** — Citi economists continue to expect QE to be announced on 22nd January by the ECB. This should include a programme to purchase sovereign debt. Size likely around €600bn. Welcome to planet QE, Europe.

- **Doing nothing is not an option** — The ECB needs to arrest the drop in inflation expectations. As ECB President Draghi noted in his December press conference, "not pursuing its price stability mandate would be illegal".

- **What will QE do** — Our economists expect QE to help stabilise/improve inflation expectations and to have a positive impact on financial conditions and hence GDP in coming quarters. QE, to us, is therefore akin to a nominal GDP (and EPS) put.

- **Previously on Planet QE** — In the 3m ahead of previous QE announcements, risk assets = negative returns vs +30% average equity returns post-announcement. Financials should do better after than before vs Defensives the other way round.

- **QE strategies** — We see 4: 1) extending search for "reasonable and secure" yield = equity asset class, eg European DY above BBB and most 10-year government bond yields for first time in 50 years & UK equities never cheaper vs US gilts in 100 years & = Insurance, Telecoms, Banks, Autos, 2) spread squasher, eg High Yield credit, 3) nominal GDP put beneficiaries = operating leverage, Cyclicals/Financials over Defensives, pick-up in de-equitisation and 4) stocks with FX kickers.

- **Big debate/spread squasher** — European sectors are trading with the widest valuation spread (on price/book) in the last 30 years, apart from 1999-2000. Value spreads usually normalise, but few investors are willing or able to be contrarian and value opportunities (Financials, Commodities, Utilities) carry various visible risk. We back ECB over OPEC to deliver a supportive macro environment and so continue to prefer Financials to Commodity sectors. But, at some point this year it is not impossible that QE is delivering improving macro (real or expected) and commodity prices are stabilising. Then, it could get interesting…

- **Align with liquidity via barbell strategy** — In a QE world/region, investors should align with liquidity. This is why we are running a barbell strategy. Both ends of the barbell attempt to combine attractive fundamentals with liquidity support/optionality from ECB QE (top-down liquidity) or from corporate re-leveraging (bottom-up QE).

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Welcome to Planet QE = Align With Liquidity

An oil price collapse. A shock move from the SNB driving one of the world's largest equity markets down c15% in 2 trading sessions (CHF). Negative yields for 5-year German/Japanese and 10-year Swiss government bond yields.

It has been a highly-charged start to 2015, and all of this ahead of likely ECB QE announcements next week. This report focuses on what ECB QE means for investors amongst the pick-up in volatility more broadly across financial markets.

Previous QE episodes have been positive for risk assets, with equity returns averaging 30% in the 7 QE programmes since the 2008-09 financial crisis. We expect ECB QE also to be supportive for risk assets. Additionally, we continue to expect QE to extend the search for “reasonable and secure” yield in European equities. If ECB QE is an effective nominal GDP put, as we expect, then the investment case for operating leverage, Cyclicals/Financials over Defensives and de-equitisers is enhanced, in our view.

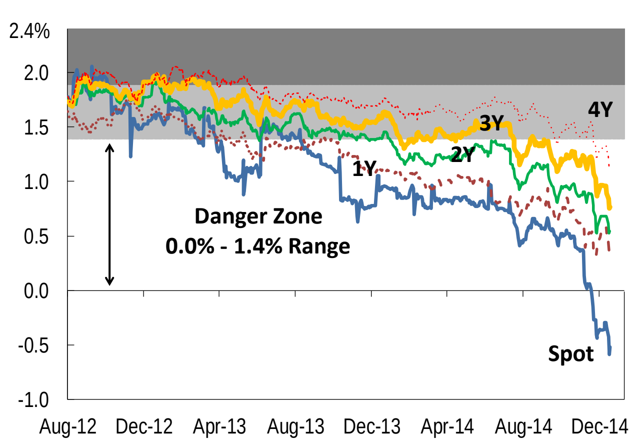
But, investors should also ask themselves whether ECB QE could help to narrow extreme intra-market valuation spreads. It has historically paid equity investors to raise exposure to cheap sectors when spreads have been wide. This would now suggest owning Financials, Commodity sectors & Utilities. Few investors are positioned this way at the moment.

Overall, we think that in a QE world/region, investors should align with liquidity. This is why we are running a barbell strategy. Both ends of the barbell attempt to combine attractive fundamentals with liquidity support/optionality from ECB QE (top-down liquidity) or from corporate re-leveraging (bottom-up QE).

Don't fight the ~~Fed~~ ~~BoE~~ ~~BoJ~~ ECB

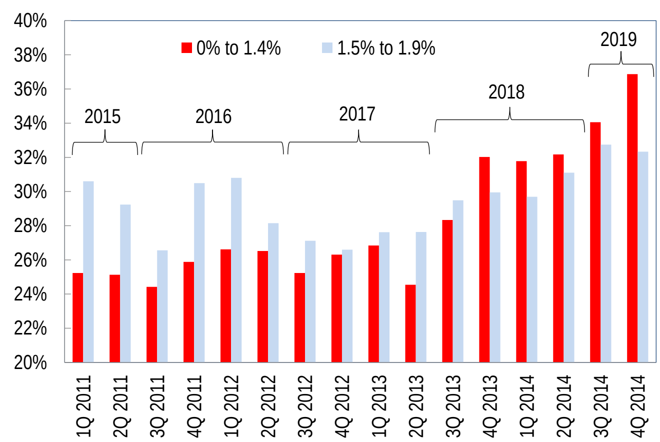
Citi’s European Economics team expects QE to be announced on 22nd January. This will include a programme to purchase sovereign debt. The continued drop in medium-term inflation expectations (Figure 1, Figure 2) and the need for the Eurosystem to increase its balance sheet size (Figure 3) restrict the number of credible alternative policy options, according to our economists.

Figure 1. Euro 1-year Inflation Swaps, spot and forwards



Source: Citi Research

Figure 2. SPF: Aggregate probability distribution: 5Y HICP

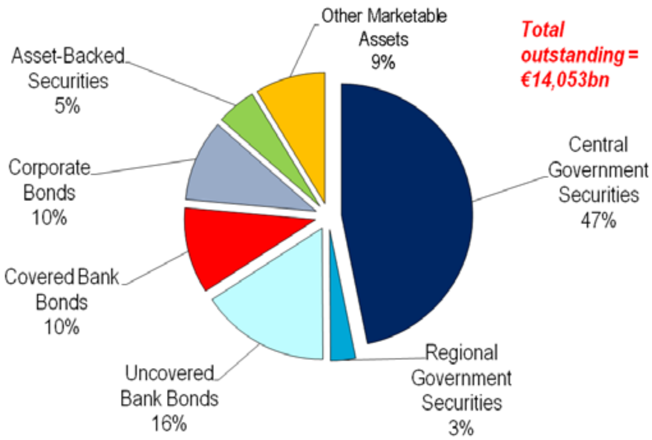


Source: Citi Research

Our colleagues have €600bn as their baseline for ECB QE1, but they also suggest that this will not be the last QE programme that the ECB announces in the next

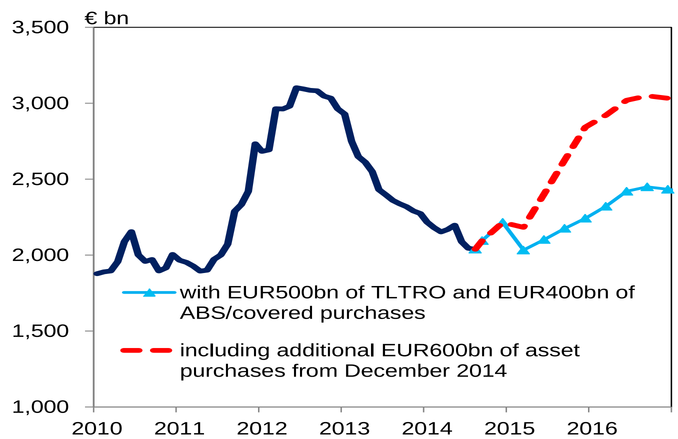
couple of years. Please see [ECB QE: Done Deal, But Details Uncertain] for the latest report from Citi economists on likely events next week.

Figure 3. Eurosystem – Eligible Market Assets, €bn, 2Q-14



Source: ECB, Citi Research

Figure 4. Euro-system Total Assets Including Projections (€ bn)

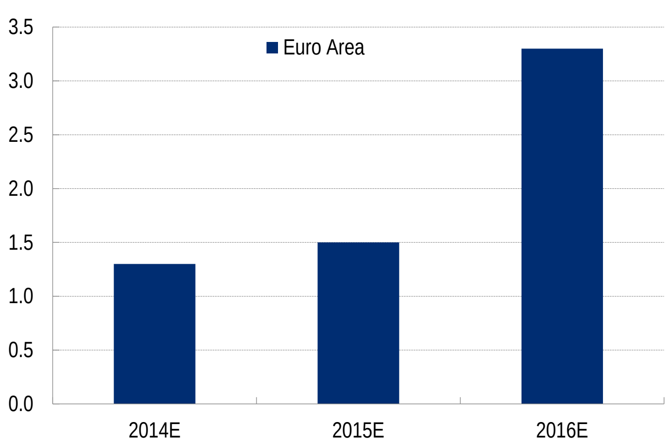


Source: ECB, Citi Research

ECB's primary objective is to help the ECB deliver on their (inflation) mandate. Not doing anything "would be illegal", according to ECB President Mario Draghi, reflecting comments he made during the December press conference.

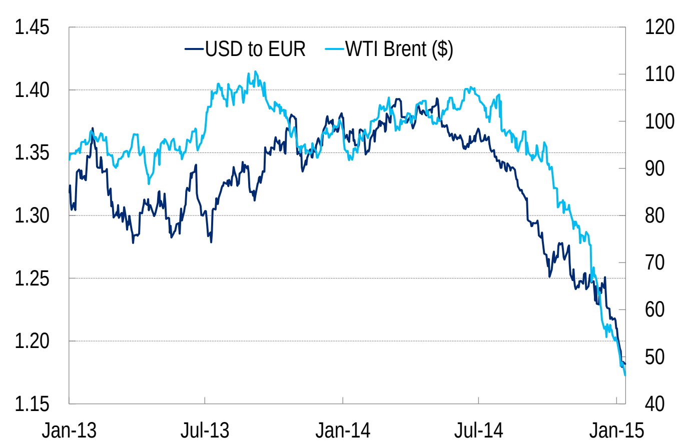
Our economists expect the ECB's efforts to help to stabilise/improve inflation expectations over the next few quarters and to also have a positive impact on financial conditions, especially through normalising NFC corporate loan spreads across the Eurozone, inflation expectations and asset prices (eg house prices).

Figure 5. Citi Euro Area Nominal GDP Growth, 2014-16E



Source: Citi Research

Figure 6. Dollar/Euro and WTI Brent



Source: DataStream, Citi Research

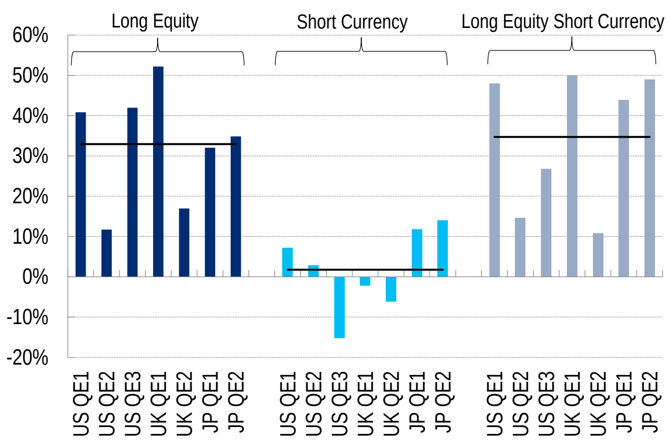
The positive correlation between financial conditions and GDP growth suggest that ECB QE amounts to an effective nominal GDP growth put, in our view. Indeed, our economists think that 2014 marks the low point for nominal GDP growth in the Euro Area and from a modestly higher 1.5% this year (1.2% GDP growth, 0.3% CPI) nominal GDP growth is likely to rise above 3% in 2016. This would clearly support the growth in EPS, expected by analysts.

This pick-up in nominal GDP has 3 big supports: 1) QE's positive impact on financial conditions and a c1% net gain to nominal GDP over 2-years as modeled by our economists, 2) euro depreciation, especially vs US$; our colleagues in the Asset Allocation team expect euro/US$ parity in 1H16 which implies significant further weakness from current levels, and 3) sharply lower oil prices, which while disinflationary in the near-term should help support consumption through the coming quarters; additionally, GDP growth tends to rise more sharply in years with a fall in CPI, according to recent analysis by our economists, which suggests that low CPI in 2014-15E should help higher GDP growth both this year and next.

Previously on Planet QE

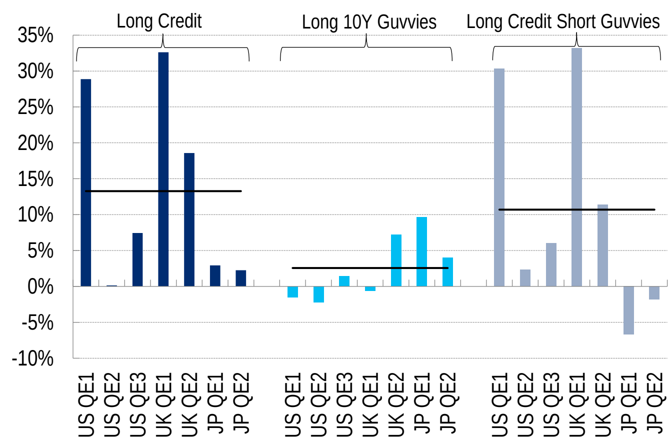
Next, we consider what has previously occurred during QE programmes in the post-financial crisis era. This analysis is restricted by only 7, soon to be 8, data points.

Figure 7. Asset Returns During QE – Equities



Source: DataStream, Citi Research

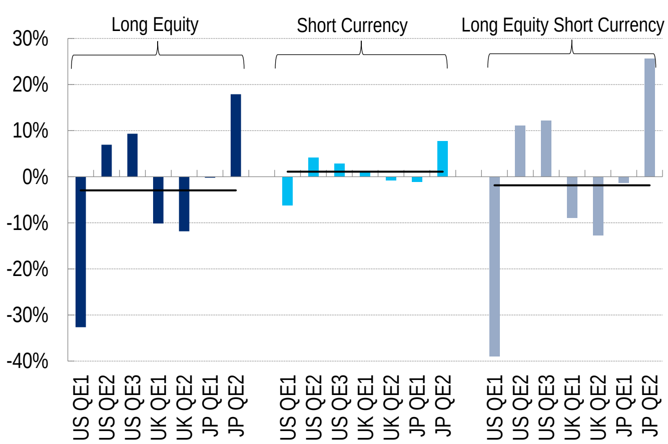
Figure 8. Asset Returns During QE – Fixed Income



Source: DataStream, Citi Research

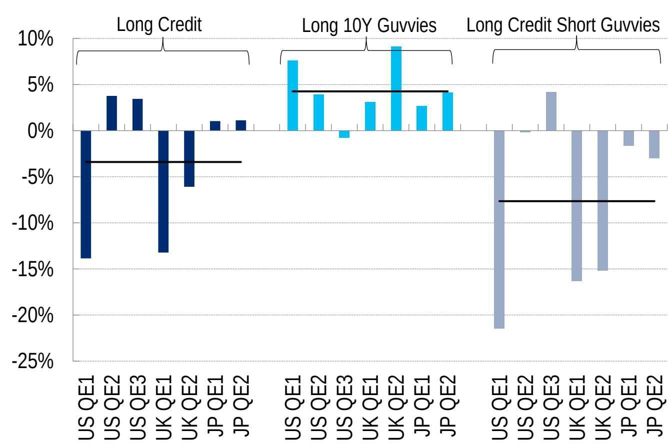
The clear conclusion from previous QE programmes in the US, UK and Japan is that risk assets have performed well post QE announcement, but not before.

Figure 9. Asset Returns During 3 Months Before QE – Equities



Source: DataStream, Citi Research

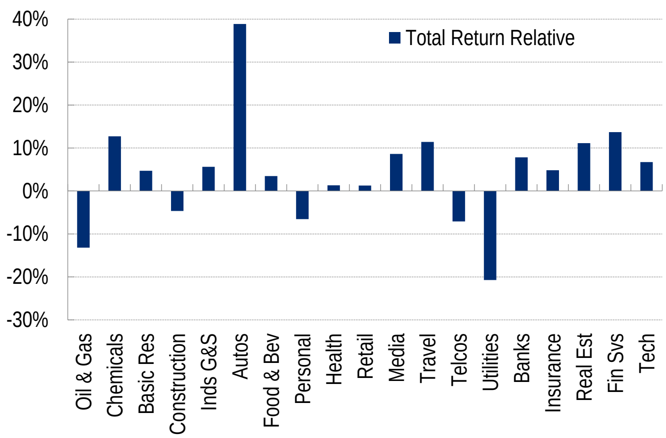
Figure 10. Asset Returns During 3 Months Before QE – Fixed Income



Source: DataStream, Citi Research

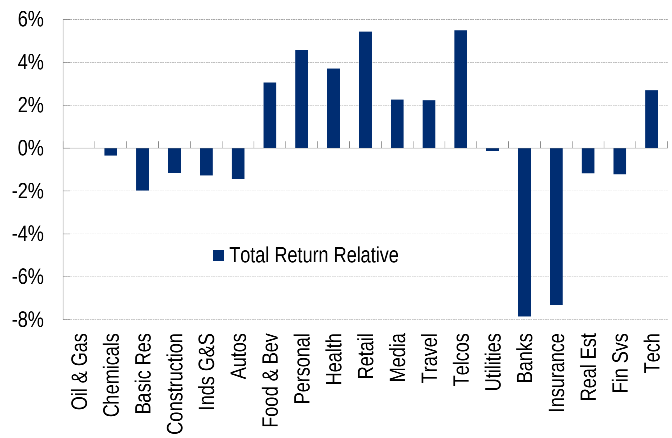
The average equity return post QE announcement in the previous QE periods is over 30%, with credit also performing well. By contrast equity returns averaged -3% returns in the 3 months ahead of QE announcements. Credit also registered negative returns in this period with government bond yields the best performing of these three asset classes.

Figure 11. Average Sector Returns During 7 Previous QE Periods



Source: DataStream, Citi Research

Figure 12. Average Sector Returns During 3 Months Before QE Periods



Source: DataStream, Citi Research

We extend this analysis to a sector level to show which sectors delivered the best average relative returns post-QE announcement and in the 3-months ahead of announcement. The broad conclusion here is that Financials (including Autos) delivered average outperformance, with mixed average relative returns from Defensives and Commodity sectors. In the prior period, Financials underperformed while Defensives outperformed and Commodity sectors did neither. This suggests, with the caveat of still only 7 periods to analyse, that the biggest turnaround in pre- and post-QE announcement has been between Financials and Defensives.

Investment implications

So, what should investors focus on ahead of next week's likely QE announcement from the ECB? We see 4 key investment implications: 1) extend search for "reasonable and secure" yield, 2) QE as a spread squasher, 3) nominal GDP put beneficiaries and 4) FX kickers.

#1 – Yield Trade

The search for yield has been a dominant force in financial markets over the past few years. This powerful investment theme has been underpinned by central bank liquidity since the 2008-09 financial crisis, with additional support from the rise of multi-asset investors and the continued success of income investors within equities.

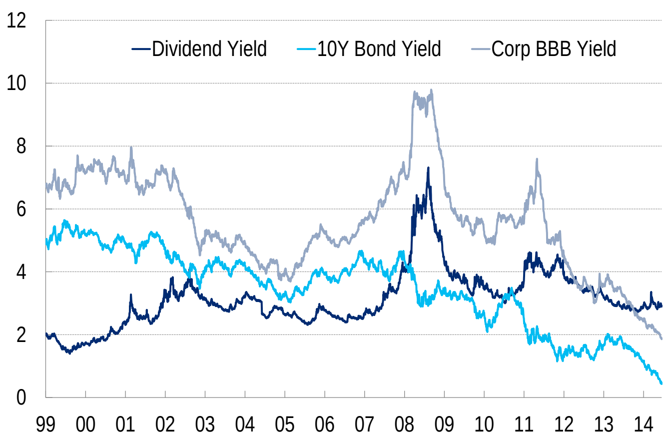
High yield on its own has not been enough. Investors have regularly placed security of coupon ahead of coupon size, eg negative government bond yields. But, high/reasonable yields, which are deemed secure have provided the strongest returns to investors, eg most peripheral government bonds since mid-2012.

The search for yield has driven European bond yields to historic lows. Now, equities yield (DY) more than both BBB-rated corporate bond yields and the majority of

European 10-year bond yields. This is the first time that this has happened in over 50+ years. Equities have quickly become the default yield/income asset class.

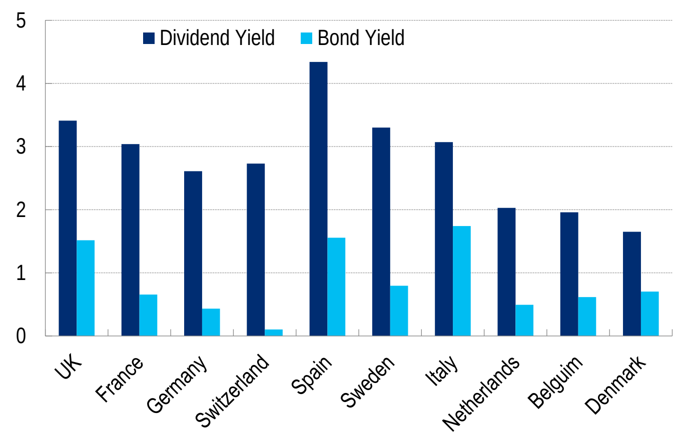
If this yield/coupon is secure then it is likely that the "reasonable and secure" yield offered by equities presents the highest return opportunities to investors over the coming 1-2 years. This is why ECB QE is so important. If QE genuinely provides a nominal GDP and earnings put, then it is more likely that European companies will honour their dividend commitments and also deliver reasonable growth on top of that. It is hard to see equities underperforming in this scenario and this remains our base case and why we target 15-20% returns this year.

Figure 13. European DY Higher Than BBB and Most EU 10-Year BYs



Source: DataStream, Citi Research

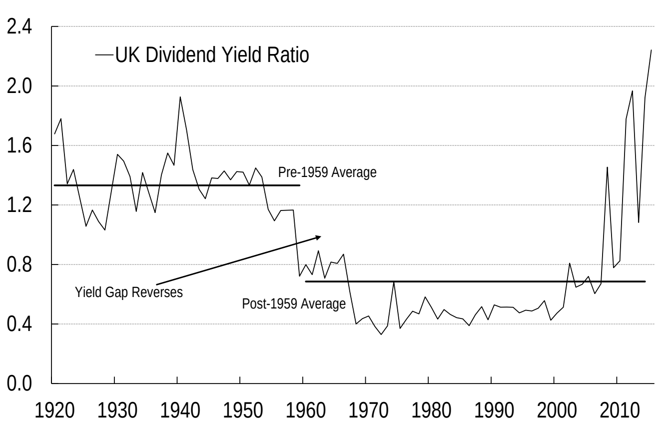
Figure 14. Country DY & BY Spread = Historically Wide



Source: DataStream, Citi Research

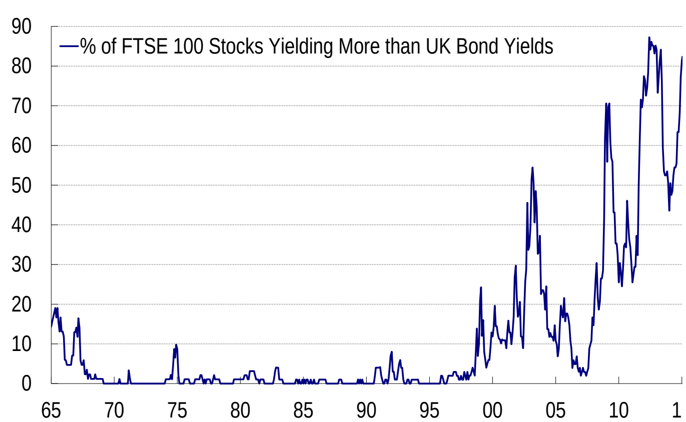
To sell equities, one of the following scenarios is needed: 1) earnings recession, 2) widespread dividend cuts, 3) European/global deflation/recession, and 4) systemic shock. We continue to find these scenarios unlikely.

Figure 15. Long-Term DYR Hits 100 Year Highs



Source: DataStream, Citi Research

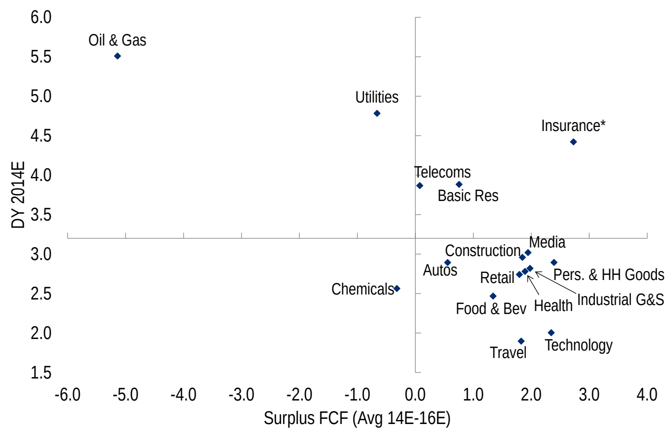
Figure 16. % FTSE 100 Stocks Yielding More Than Gilts



Source: DataStream, Citi Research

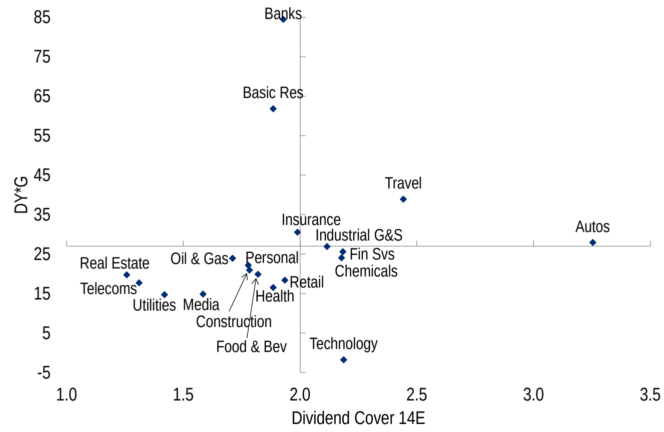
Recent market moves have taken UK relative valuations to record post-1920 wides. UK dividend yields have never been so high relative to UK gilt yields. That is worth repeating: on this basis UK equities have never been this cheap relative to UK gilts in the last 100 years. Over 80% of FTSE 100 stocks yield more than 10-year UK gilt yields. Equity markets provide a deep pool of yield pick-up candidates.

Figure 17. High DY & Surplus Free Cash Flow



Source: Citi Research

Figure 18. High DY*G & High Dividend Cover



Source: Citi Research

Rather than buying the highest yielding stocks and sectors in European equity markets, we have previously suggested that investors follow look for the combination of "reasonable and secure" yield.

We have suggested 4 strategies which are exposed to this theme: 1) high DY and strong balance sheets, 2) high DY and surplus FCF, 3) high DY*G and decent dividend cover and 4) surplus FCF and strong balance sheets. Here, we highlight 2) and 3) at a sector level.

Three sectors — Telecoms, Insurance, Basic Resources — have higher-than-market DY and also surplus FCF, which we calculate as average 2014-16E FCFY less DY. Sectors such as Media, Construction and Personal & Household Goods, as well as several other sectors, have reasonable yields and also surplus FCF too.

Basic Resources qualifies due to a high 2016E FCF yield estimate, which some investors may be wary of. But, our sector teams see positive support in both Telecoms and Insurance.

Citi's Telecoms team, Simon Weeden et al, published a report this week highlighting their expectations for continuing underlying improvement European mobile revenue trends, helped by an FX tailwind.

Citi's Insurance team, Farooq Hanif et al, have also published a report this week highlighting positive dynamics in their sector with strong free cash generation at its core and with the sector "now entering a period of delivery, with stronger dividends and more proactive capital management".

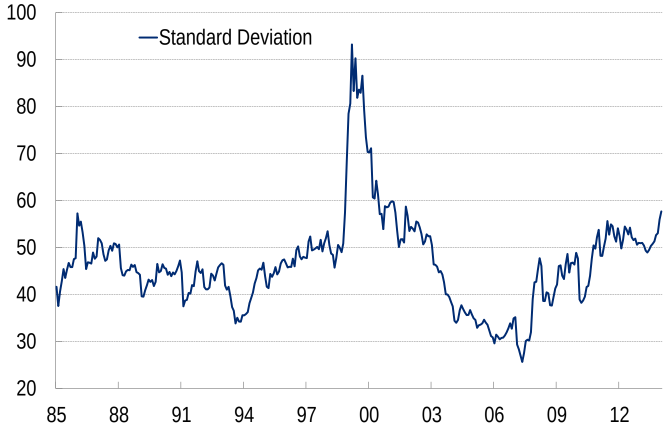
European sectors with a high DY*G score (current DY x 2-year dividend CAGR) and decent dividend cover include Banks, Basic Resources, Travel & Leisure and Autos, with Insurance, Industrials and Financial Services not too far away. Greater confidence in the growth outlook should benefit those sectors which are not currently being rewarded for future growth expectations, eg Banks. ECB QE is likely to help here via broader buy-in to its effective role as a nominal GDP put.

#2 – Spread Squasher

Various QE programmes have been successful at reducing various risk premia across financial markets, ie squashing spreads. Within Europe, the best example of this is the sharp reduction in core-peripheral government bond spreads since

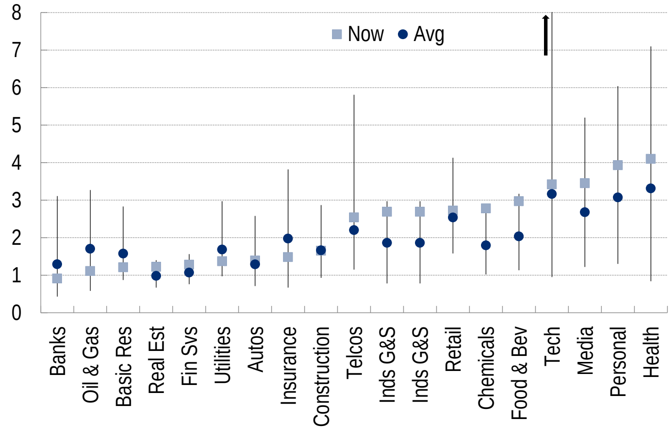
Draghi's "whatever it takes" bumble bee speech in mid-2012. Credit spreads have also tightened significantly compared with the 2009 and mid-2012 wides, but our credit strategists still see better value in Euro HY than in Euro investment grade.

Figure 19. European Sectors – Price/Book Standard Deviation



Source: DataStream, Citi Research

Figure 20. Sectors – P/Book Absolute Range, 30Years



Source: MSCI, Factset, Citi Research

Within the equity market, there is some contradictory evidence on valuation spreads. For example, the spread between sector P/E or DY spreads is not particularly wide, but the spread using price/book has only been wider during the late 1990s TMT boom (same at a country level).

The price/book spread should interest value investors and mean reverters. The previous two valuation spread peaks (December 1986, February 2000) were good times to be buying the cheapest sectors in Europe and selling the most expensive. Running this as a long/short strategy, the four cheapest/expensive sectors would have made 20% and 50% returns respectively in the two periods.

To implement this strategy now means buying or Overweighting a mix of Financials and Commodity sectors, with Utilities in the reserve slot. This feels like an uncomfortable mix of sectors for many investors right now.

There are two main challenges to this group of sectors: 1) fundamentals, 2) marginal buyers.

On fundamentals, earnings momentum for these four sectors (or five with Utilities) is very weak in absolute and relative terms. Commodity price weakness is a key part of this with earnings momentum being stronger generally in Banks. These sectors all present a case for offering reasonable yields, but there are broader concerns over the security of these yields both in Commodity sectors (oil price) and Banks (deflation, regulation).

With plenty of macro risks in circulation and investor sentiment still fragile, stocks/sectors who do not offer "delivery", ie attractive fundamentals, continue to struggle to perform. Being cheap has not been enough to attract investor capital and net buyers.

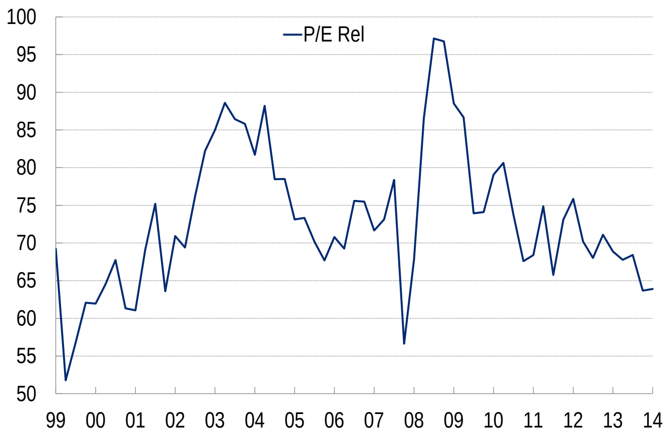
This brings us to the second challenge — marginal buyers. This group is made up of the following groups: 1) mutli-asset, 2) income, 3) low risk/quant, 4) bond market (credit, corporates), 5) central banks and 6) sovereign wealth. These groups tend to

seek risk-adjusted returns or real returns rather than be a slave to an equity benchmark. They are less incentivised to be contrarian or to buy deep value and out of favour stocks and sectors than benchmarked investors would be.

One way of thinking about this is consider how the bond market buys equity. Credit investors increasingly are looking to equity as a way of owning liquid reasonable coupons. Elsewhere, corporates are using generous terms on debt funding to retire relatively expensive equity funding. Both bond-sponsored purchases of equity are more likely to be risk-adjusted and skewed towards attractive and visible (surplus) FCF than towards the hope of recovery in years X-Y.

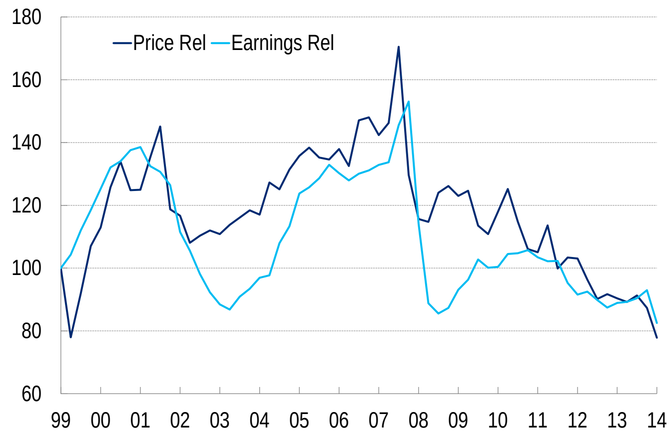
We therefore conclude that valuation alone is not enough. Cheap sectors need to show improvements or delivery (Figure 21) to attract more net buyers. We see the following scenario as providing that outcome across Financial and Commodity sectors: 1) ECB QE succeeding initially in delivering a pick-up in nominal GDP through 2015-16E, 2) stabilising commodity prices or rising commodity prices post supply adjustments or clear and viable commitments by big Oil to defend their dividends via reduced costs/capex and balance sheet use.

Figure 21. P/E Relative of Cheapest 4 P/Book Sectors



Source: DataStream, Citi Research

Figure 22. Price & Earnings Relative of Cheapest 4 P/Book Sectors

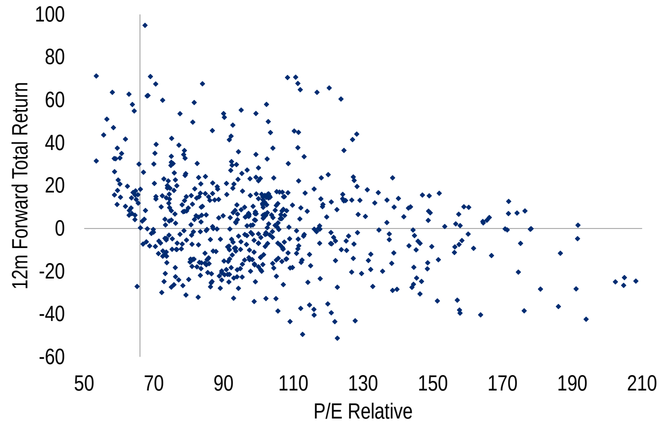


Source: DataStream, Citi Research

It is not inconceivable that these two scenarios co-exist at some point this year. Combined with negative net positioning and cheap valuations means that this could lead to some aggressive share re-pricing.

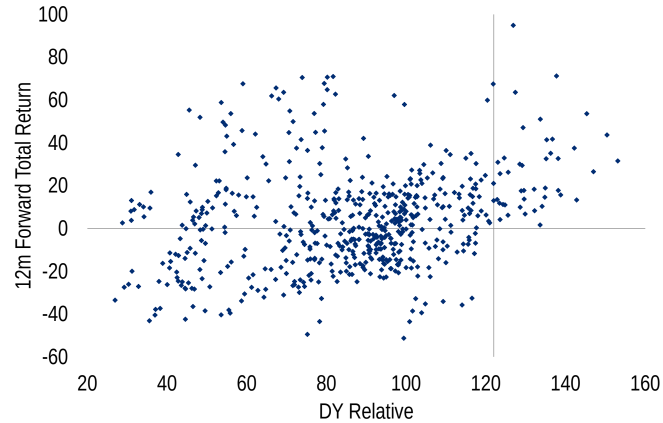
Figure 23 and Figure 24 show one part of this group — UK Mining. Although not directly impacted by ECB QE, we note that when the P/E relative has been below current levels or the DY relative has been above current levels in the last 50 years then the 12-month forward return has been positive with a “win ratio” of 98% and 100% respectively.

Figure 23. UK Mining P/E Relative vs 12m Forward Total Return (50y)



Source: DataStream, Citi Research

Figure 24. UK Mining DY Relative vs 12m Forward Total Return (50y)



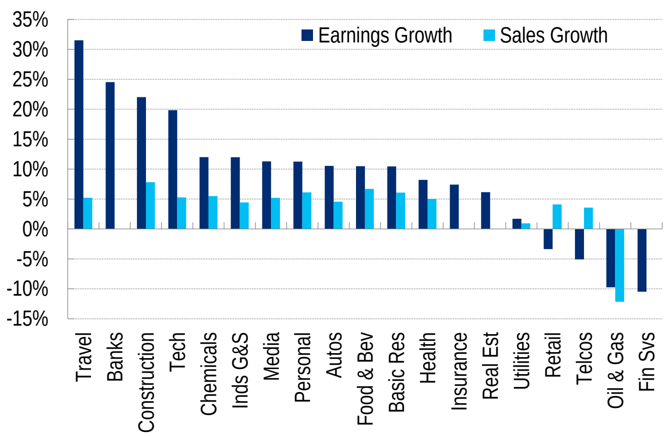
Source: DataStream, Citi Research

Last, we note, with interest, analysis from our colleagues in Citi's Asset Allocation team, Jeremy Hale et al, who show that on a weekly RSI, "Brent oil is more probably oversold than any asset class in history bar AUD/USD in 1976". Catching a falling knife is always a high-risk pastime, but at some point the oil price is likely to stop falling…isn't it?

#3 – Nominal GDP

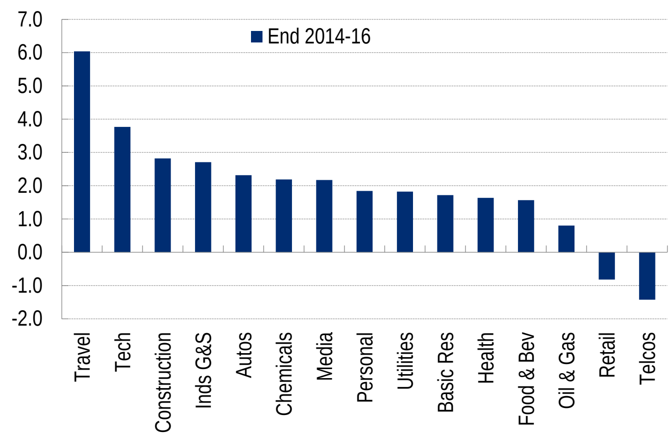
Our third ECB QE theme is to look at the beneficiaries of the nominal GDP put which we think that QE represents. Here, we see three key beneficiaries: 1) operating leverage, 2) Cyclicals (including Financials) vs Defensives and 3) de-equitisers. We have already highlighted high DY*G sectors which should also benefit as the market places greater weight on this nominal GDP put.

Figure 25. Sectors – CAGR (End14-16E)



Source: Citi Research

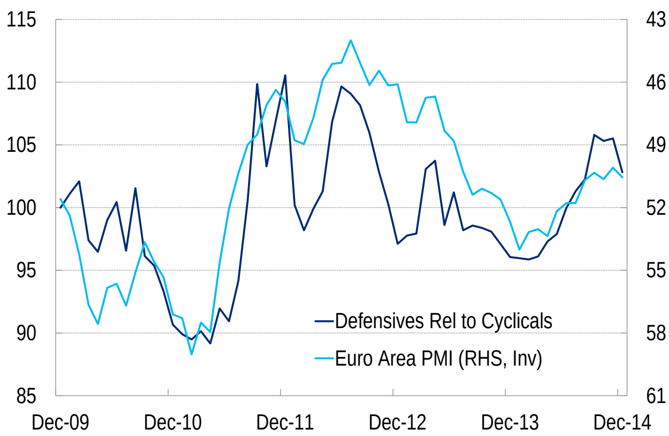
Figure 26. Op. Leverage – Sectors ex Financials (EPS/Sales CAGR)



Source: Citi Research

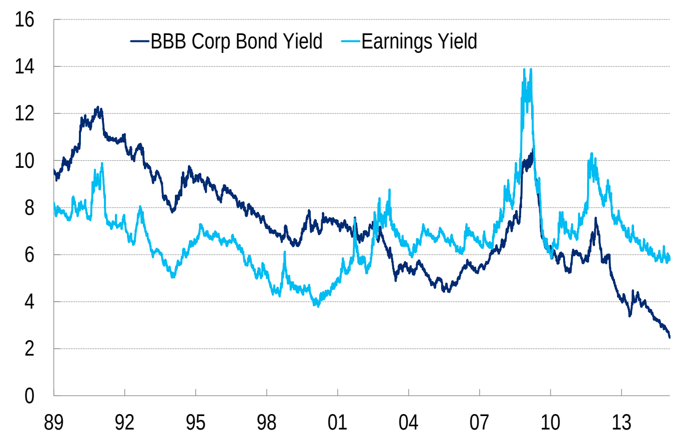
Figure 25 and Figure 26 show the operating leverage of European sectors, simply comparing 2014-16E earnings and sales CAGRs. Unsurprisingly, Cyclical sectors have greater operating leverage than Defensive sectors. Our Telecoms team would argue that this underplays the emerging operating leverage in many of their stocks.

Figure 27. Euro Area PMI & Defensives vs Cyclicals/Financials Rel.



Source: Haver, DataStream, Citi Research

Figure 28. European BBB & Earnings Yield Gap = De-equitisation



Source: DataStream, Citi Research

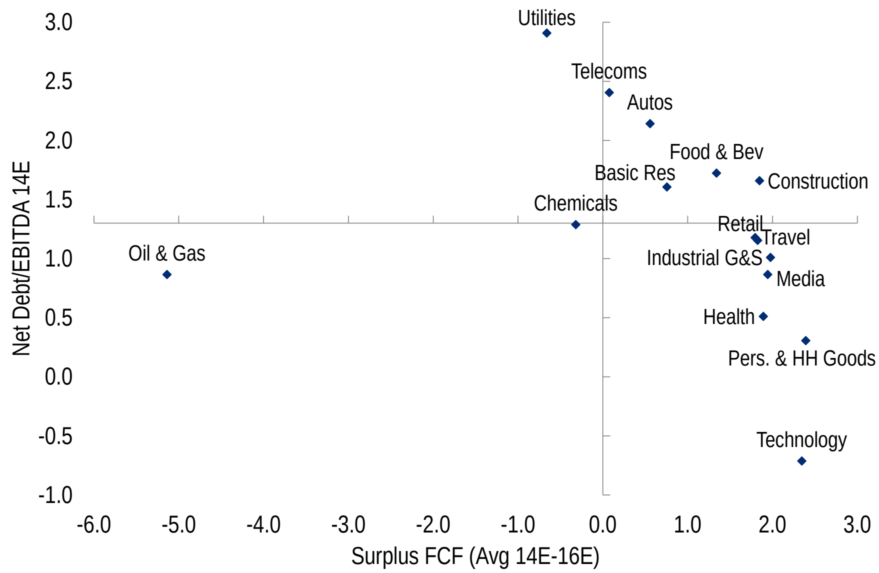
This is consistent with Figure 27 which shows the relationship between Euro Area PMIs and Defensive relative to Cyclicals' (including Financials) total relative returns over the past 5 years. The relationship is reasonable. It suggests that Cyclicals should outperform if ECB QE turns out to be a nominal GDP put and also underpins PMIs in the region. This is our base case and why we skew our sector strategy towards Cyclicals, mainly via a Financial bias which we believe is more directly benefitted by prospective ECB actions.

ECB QE should also underpin the rationale and increase the incentive for companies to de-equitise. This remains a long-running theme of ours (since 2003) and manifests itself in share shrinkers and corporate M&A. We expect a pick-up in both areas in a QE world. Figure 28 shows the debt/equity funding arbitrage in Europe is now at its widest.

This suggests that CEOs/CFOs should seriously consider what the bond market, and indirectly what ECB President Draghi, can do for them. Greater conviction in domestic growth, which we think that QE brings, is likely to see more corporates use their de-equitisation option, as we have seen in the US over the last few years.

One way of getting exposure to this theme, we believe, is to own stocks/sectors which have strong balance sheets and surplus FCF. These qualities are often present in rolling share shrinkers, eg Next. And, with a mix of modest growth and attractive funding opportunities, we think that the recent pick-up in M&A continues in 2015-16 and this strategy also provides a form of hedge to this since predator companies are likely to be looking for someone else's unlevered surplus FCF.

Figure 29. Surplus Free Cash Flow & Strong Balance Sheet



Source: Citi Research

European sectors with surplus FCF and strong balance sheet are not hard to find. Technology, Personal & Household Goods and Health Care stand out.

Figure 30. Surplus Free Cash Flow & Strong Balance Sheet Screen

RIC	Stock	>€10bn Market Cap	FCFY (Avg 14E-16E)	DY (Avg 14E-16E)	>200bps Surplus FCF (Avg 14E-16E)	<1 NetDebt/EBITDA 14E
SAPG.DE	SAP	54761	5.42	1.63	3.79	0.1
RB.L	Reckitt Benckiser	45354	4.66	2.51	2.15	0.5
CFR.VX	Richemont N	39596	4.57	1.84	2.72	-1.7
ABBN.VX	ABB	38990	6.40	3.80	2.59	0.0
LVMH.PA	LVMH	36137	4.94	2.65	2.29	0.8
ASML.AS	ASML Hldg	33350	2.97	0.91	2.06	-1.4
ERICb.ST	Ericsson B	31237	5.26	3.12	2.14	-1.7
PHG.AS	Philips Electronics	22524	6.06	3.40	2.66	0.5
CONG.DE	Continental	19775	6.09	2.35	3.74	0.6
HNKG_p.DE	Henkel Pref.	16746	11.97	1.53	10.43	0.1
ASSAb.ST	Assa Abloy B	15058	3.98	1.71	2.27	0.5
MICP.PA	Michelin	14333	7.55	3.90	3.65	0.3
NXT.L	Next	13891	5.47	2.59	2.88	0.6
RYA.I	Ryanair Holdings	13639	4.12	0.00	4.12	-0.3
AHLN.AS	Ahold Kon.	12920	6.71	3.17	3.54	0.6
SKYB.L	BSKyB	12131	6.77	3.62	3.15	0.0
RWEG.DE	RWE	10995	14.06	4.39	9.67	0.9
LEGD.PA	Legrand	10982	5.54	2.89	2.65	0.9
MRCG.DE	Merck KGAA	10865	5.44	1.26	4.19	-0.3
ITV.L	ITV	10667	5.61	1.87	3.73	0.1
ADEN.VX	Adecco R	10371	6.78	3.00	3.78	0.9
KGF.L	Kingfisher	10104	5.49	3.45	2.04	-0.4

Source: Citi Research

Figure 31. Surplus Free Cash Flow & Strong Balance Sheet Screen

RIC	Stock	>€5bn Market Cap	FCFY (Avg 14E-16E)	DY (Avg 14E-16E)	>200bps Surplus FCF (Avg 14E-16E)	<1 NetDebt/EBITDA 14E
BRBY.L	Burberry Group	9513	4.92	2.40	2.53	-0.7
CAPP.PA	Cap Gemini	9406	5.77	2.19	3.58	-0.8
VLOF.PA	Valeo	8437	5.46	2.40	3.07	0.3
PNDORA.CO	Pandora	8155	6.25	1.86	4.38	-0.1
ALUA.PA	Alcatel-Lucent	8051	2.08	0.04	2.04	0.2
EXHO.PA	Sodexo	8042	5.90	2.66	3.24	0.8
YAR.OL	Yara International	7685	5.57	2.88	2.69	0.2
NZYMb.CO	Novozymes	7668	3.67	1.06	2.61	-0.3
BEIG.DE	Beiersdorf	6980	3.84	1.07	2.77	-2.8
SOON.VX	Sonova N	6935	3.67	1.62	2.05	-0.7
DELB.BR	Delhaize Group	6720	7.26	2.62	4.64	0.2
DAST.PA	Dassault Systemes	6705	3.75	0.97	2.78	-1.0
ICAG.L	IAG	6554	3.83	1.80	2.04	0.4
G1AG.DE	GEA Group	6432	4.45	2.39	2.06	-1.5
SGE.L	Sage Group	6427	6.09	2.85	3.24	0.8
KNIN.VX	Kuehne+Nagel	6399	8.40	3.25	5.14	-1.4
TW.L	Taylor Wimpey	5347	7.60	5.51	2.09	-0.2
SCHN.S	Schindler P	5147	4.55	2.10	2.45	-2.1
AGGK.L	Aggreko	5080	6.51	2.13	4.38	0.8
ATOS.PA	Atos	5080	6.48	1.24	5.24	-0.5
RAND.AS	Randstad	5003	5.28	3.18	2.10	0.8

Source: Citi Research

Some investors may want to add a DY hurdle to these stocks screens to look for companies with reasonable DY, surplus FCF and strong balance sheets.

#4 – FX Kicker

Our 4th ECB QE strategy is to position in line with Citi's view that €/US$ is heading towards parity in 1H16. This is a still significant move in addition to the weakness over the last six months. We, therefore, look for companies with attractive fundamentals — surplus FCF, operating leverage, decent earnings CAGR — which also have a strong balance sheet and then more than 20% sales exposure to the US, which may present an FX kicker. This strategy could also be attractive for US$ investors unable to hedge but looking for exposure in the region.

Figure 32. Exploiting Expected EUR/USD Weakness – Three Ways

RIC	Stock	>€5bn Market Cap	>20 Sales Exposure to N.Am. (%)	>200bps Surplus FCF (Avg 14E-16E)	<1 NetDebt/EBITDA 14E
AHLN.AS	Ahold Kon.	12920	61	3.54	0.6
ALUA.PA	Alcatel-Lucent	8051	55	2.04	0.2
CAPP.PA	Cap Gemini	9406	21	3.58	-0.8
CONG.DE	Continental	19775	22	3.74	0.6
DAST.PA	Dassault Systemes	6705	29	2.78	-1.0
DELB.BR	Delhaize Group	6720	64	4.64	0.2
EXHO.PA	Sodexo	8042	39	3.24	0.8
LVMH.PA	LVMH	36137	23	2.29	0.8
MICP.PA	Michelin	14333	34	3.65	0.3
MRCG.DE	Merck KGAA	10865	32	4.19	-0.3
PHG.AS	Philips Electronics	22524	32	2.66	0.5
RAND.AS	Randstad Holding	5003	23	2.10	0.8
SAPG.DE	SAP	54761	39	3.79	0.1

RIC	Stock	>€5bn Market Cap	>20 Sales Exposure to N.Am. (%)	>2 Operating Leverage (End14-16)	<1 NetDebt/EBITDA 14E
ADSGn.DE	Adidas	11779	22	2.91	0.1
CAPP.PA	Cap Gemini	9406	21	2.16	-0.8
EXHO.PA	Sodexo	8042	39	2.23	0.8
LUX.MI	Luxottica	8848	57	2.17	0.8
MICP.PA	Michelin	14333	34	2.25	0.3
PHG.AS	Philips Electronics	22524	32	3.85	0.5
RAND.AS	Randstad Holding	5003	23	2.11	0.8
SOLB.BR	Solvay	6438	20	2.86	0.5

RIC	Stock	>€5bn Market Cap	>20 Sales Exposure to N.Am. (%)	>8% Earnings Growth (End14-16)	<1 NetDebt/EBITDA 14E
ALUA.PA	Alcatel-Lucent	8051	55	neg to pos	0.2
DAST.PA	Dassault Systemes	6705	29	8.39%	-1.0
EXHO.PA	Sodexo	8042	39	9.78%	0.8
LUX.MI	Luxottica	8848	57	10.66%	0.8
PHG.AS	Philips Electronics	22524	32	10.19%	0.5
RAND.AS	Randstad Holding	5003	23	9.12%	0.8

Source: Citi Research

Strategy outlook

We expect a significant ECB announcement, including prospective bond purchases, on 22nd January regarding QE. We see QE as an effective nominal GDP put and likely to also drive a further depreciation of the euro, especially against the US$. We see 4 main themes for investors to get align with ECB actions. Yield strategies suggest equities offer exceptional relative value. Within equities “reasonable and secure” yields could be offered by Insurance, Telecoms, Banks, Autos, according to our analysis and rationale. QE is also a spread squasher. There is a big spread within European sectors at the sector level. This raises a dilemma for investors who generally are not over-positioned in the cheap Commodity and Financial sectors. Here, a combination of QE and stable commodity prices could see both groups performing at the same time. It is likely at some point this year, perhaps even in the near-term. Should this happen, then it is not impossible to see some kind of repeat of March-April last year in terms of market rotation. Investors should at least consider this risk. If QE is an effective nominal GDP put then buying operating leverage, Cyclicals/Financials over Defensives and de-equitisers looks sensible. Finally, QE is likely to drive the euro still lower so own companies with decent fundamentals, strong balance sheets and an FX kicker.

Figure 33. Stocks Mentioned in the Report

RIC	Stock	Price	Rating	Currency
ABBN.VX	ABB	17.30	1	CHF
ADEN.VX	Adecco R	60.15	3	CHF
ADSGn.DE	Adidas	55.89	2	EUR
AGGK.L	Aggreko	15.22	2	GBP
AHLN.AS	Ahold Kon.	15.78	1	EUR
ALUA.PA	Alcatel-Lucent	2.73	1	EUR
ASML.AS	ASML Hldg	87.72	1	EUR
ASSAb.ST	Assa Abloy B	431.60	3	SEK
ATOS.PA	Atos	64.21	1	EUR
BEIG.DE	Beiersdorf	74.40	1	EUR
BRBY.L	Burberry Group	16.61	2	GBP
CAPP.PA	Cap Gemini	60.24	1	EUR
CFR.VX	Richemont N	70.15	1	CHF
CONG.DE	Continental	186.25	1	EUR
DAST.PA	Dassault Systemes	50.86	2	EUR
DELB.BR	Delhaize Group	67.19	1	EUR
ERICb.ST	Ericsson B	97.20	2	SEK
EXHO.PA	Sodexo	82.95	1	EUR
G1AG.DE	GEA Group	36.42	1	EUR
HNKG_p.DE	Henkel Pref.	94.97	2	EUR
ICAG.L	IAG	4.87	1	GBP
ITV.L	ITV	2.20	2	GBP
KGF.L	Kingfisher	3.14	2	GBP
KNIN.VX	Kuehne+Nagel	119.40	1	CHF
LEGD.PA	Legrand	42.31	2	EUR
LUX.MI	Luxottica	48.47	2	EUR
LVMH.PA	LVMH	133.45	1	EUR
MICP.PA	Michelin	76.83	1	EUR
MRCG.DE	Merck KGAA	84.67	2	EUR
NXT.L	Next	68.33	1	GBP
NZYMb.CO	Novozymes	267.80	2	DKK
PHG.AS	Philips Electronics	23.86	1	EUR
PNDORA.CO	Pandora	461.50	1	DKK
RAND.AS	Randstad Holding	41.39	2	EUR
RB.L	Reckitt Benckiser	54.25	1	GBP
RWEG.DE	RWE	23.78	3	EUR
RYA.I	Ryanair Holdings	9.52	1	EUR
SAPG.DE	SAP	57.28	1	EUR
SCHN.S	Schindler P	125.60	2	CHF
SGE.L	Sage Group	4.65	1	GBP
SKYB.L	BSKyB	9.20	1	GBP
SOLB.BR	Solvay	111.25	2	EUR
SOON.VX	Sonova N	121.20	3	CHF
TW.L	Taylor Wimpey	1.24	1	GBP
VLOF.PA	Valeo	114.15	1	EUR
YAR.OL	Yara International	387.50	2	NOK

Source: Citi Research. Prices as of 15th January 2015.

Valuation Tables

Figure 34. Pan-European Sector Weightings & Returns

As at Close 13 Jan 15	Mkt Cap	% of	Return Relative to Stoxx				Absolute Return			
Sector (No of Stocks)	(Euros m)	Stoxx	1m	3m	12m	Ytd	1m	3m	12m	Ytd
Oil & Gas (28)	453,862	6.3	-1	-18	-21	-4	3	-12	-16	-4
Chemicals (25)	360,721	5.0	1	5	2	2	5	13	10	3
Basic Resources (19)	201,444	2.8	0	-14	-11	-4	5	-7	-4	-3
Construction & Materials (20)	168,217	2.3	3	8	0	2	8	16	7	3
Industrial G&S (108)	752,660	10.5	1	3	-6	0	6	11	1	1
Automobiles & Parts (14)	224,343	3.1	2	14	1	3	7	22	8	3
Food & Beverage (25)	522,276	7.3	1	3	9	1	5	10	17	2
Personal & H'hold Goods (31)	522,323	7.3	2	5	10	1	6	13	18	2
Health Care (36)	919,643	12.8	1	2	17	4	6	9	25	5
Retail (28)	223,370	3.1	5	10	-6	2	10	18	1	3
Media (28)	197,715	2.7	2	9	5	1	7	17	13	2
Travel & Leisure (22)	124,201	1.7	3	16	11	1	8	25	19	1
Telecommunications (22)	333,185	4.6	0	8	5	1	4	16	13	2
Utilities (26)	305,093	4.2	-4	-6	8	-3	0	1	16	-3
Banks (49)	947,895	13.2	-6	-10	-15	-4	-2	-4	-9	-3
Insurance (39)	452,116	6.3	0	3	6	0	5	10	14	1
Real Estate (27)	126,041	1.8	4	8	18	3	8	16	26	4
Financial Services (30)	121,760	1.7	2	9	4	0	6	18	12	0
Technology (24)	245,318	3.4	1	6	3	-1	5	15	10	0
Stoxx - Pan Europe (600)	7,202,184	100.0	—	—	—	—	4	8	7	1
Pan Euro - Large Cap	5,759,550	80.0	0	-1	0	0	4	7	7	1
Pan Euro - Mid Cap	984,693	13.7	1	4	1	0	5	12	8	1
Pan Euro - Small Cap	457,941	6.4	2	5	-3	1	6	13	4	2
Stoxx ex UK (413)	4,895,228	68.0	—	—	—	—	3	8	7	1
EuroStoxx - Eurozone (294)	3,287,106	45.6	—	—	—	—	3	7	3	0

Source: Citi Research & DataStream

Figure 35. Pan-European Sector Relative Ratings

As at Close 13 Jan 15	P/E Relative to Stoxx				Yield Relative to Stoxx			
Sector	2013	2014E	2015E	2016E	2013	2014E	2015E	2016E
Oil & Gas	63	66	108	99	168	166	159	151
Chemicals	108	112	112	111	77	77	77	77
Basic Resources	82	85	85	75	119	117	129	132
Construction & Materials	118	118	111	107	89	89	85	85
Industrial Goods & Service	111	105	101	103	84	85	85	85
Automobiles & Parts	93	66	65	65	80	87	89	88
Food & Beverage	132	139	136	140	75	74	74	72
Personal & H'hold Goods	119	121	120	123	86	87	86	84
Health Care	115	119	122	126	86	84	81	78
Retail	103	118	120	122	98	82	77	78
Media	119	131	125	130	95	91	85	83
Travel & Leisure	146	135	109	102	54	57	69	70
Telecommunications	100	123	139	139	136	116	110	106
Utilities	79	92	100	113	155	144	135	128
Banks	91	84	68	65	109	115	129	144
Insurance	76	71	73	77	122	132	130	127
Real Estate	149	149	152	163	98	100	98	94
Financial Services	71	86	87	110	97	100	100	97
Technology	193	143	132	125	48	60	49	49
Stoxx - Pan Europe	100	100	100	100	100	100	100	100
Pan Euro - Large Cap	95	97	99	99	104	103	103	103
Pan Euro - Mid Cap	138	116	105	104	85	86	88	87
Pan Euro - Small Cap	111	116	107	105	84	86	87	88
Stoxx ex UK	105	103	99	100	97	97	94	95
EuroStoxx - Eurozone	104	101	96	95	99	99	95	96

Source: Citi Research & DataStream

Figure 36. Pan-European Sector Growth

As at Close 13 Jan 15		Earnings Growth %			Net Dividend Growth %	
Sector	2014E	2015E	2016E	2014E	2015E	2016E
Oil & Gas	-1.8	-32.9	22.5	3.9	5.9	2.8
Chemicals	0.8	9.6	13.8	5.1	10.6	8.4
Basic Resources	-0.1	9.7	28.0	3.4	21.2	11.7
Construction & Materials	4.0	17.1	16.6	5.1	5.3	8.7
Industrial Goods & Service	10.2	13.6	10.7	6.0	10.9	8.3
Automobiles & Parts	45.9	12.5	12.6	13.9	12.4	7.3
Food & Beverage	-1.0	12.4	9.3	4.5	9.6	6.6
Personal & H'hold Goods	1.8	10.9	9.8	7.0	9.1	6.4
Health Care	0.2	7.5	8.2	2.5	6.8	5.1
Retail	-8.8	7.8	10.0	-11.2	3.2	10.0
Media	-4.9	14.4	7.9	0.9	2.5	6.8
Travel & Leisure	12.6	36.2	19.5	10.6	33.1	10.2
Telecommunications	-15.9	-2.5	12.3	-10.0	3.9	5.0
Utilities	-10.3	0.9	-0.8	-2.4	3.2	2.8
Banks	11.7	35.6	17.8	11.9	22.7	21.3
Insurance	11.6	6.6	7.3	14.4	8.1	5.9
Real Estate	4.4	7.4	4.7	7.5	7.4	4.5
Financial Services	-13.4	7.9	-11.3	8.7	9.3	6.2
Technology	40.9	18.1	19.0	32.2	-10.5	7.8
Stoxx - Pan Europe	4.1	9.6	12.3	5.2	10.0	8.7
Pan Euro - Large Cap	2.1	7.4	12.2	4.9	9.6	8.8
Pan Euro - Mid Cap	24.0	21.4	12.5	6.2	12.4	7.5
Pan Euro - Small Cap	-0.8	19.3	13.9	7.8	11.3	9.5
Stoxx ex UK	5.8	13.8	11.8	5.0	7.2	9.6
EuroStoxx - Eurozone	7.7	14.8	13.4	4.9	6.2	9.5

Source: Citi Research & DataStream

Figure 37. Pan-European Sector Ratings

As at Close 13 Jan 15		Price/Earnings				Net Dividend Yield		
Sector	2013	2014E	2015E	2016E	2013	2014E	2015E	2016E
Oil & Gas	10.4	10.6	15.8	12.9	5.30	5.51	5.84	6.00
Chemicals	18.1	17.9	16.3	14.4	2.44	2.56	2.84	3.07
Basic Resources	13.7	13.7	12.5	9.7	3.75	3.88	4.71	5.26
Construction & Materials	19.7	19.0	16.2	13.9	2.81	2.96	3.11	3.39
Industrial Goods & Service	18.5	16.8	14.8	13.3	2.66	2.82	3.13	3.39
Automobiles & Parts	15.5	10.6	9.4	8.4	2.54	2.89	3.25	3.49
Food & Beverage	22.1	22.3	19.8	18.1	2.36	2.47	2.70	2.88
Personal & H'hold Goods	19.8	19.4	17.5	16.0	2.71	2.89	3.16	3.36
Health Care	19.1	19.1	17.8	16.4	2.71	2.78	2.97	3.12
Retail	17.2	18.9	17.5	15.9	3.09	2.74	2.83	3.11
Media	19.9	20.9	18.3	16.9	2.99	3.02	3.09	3.30
Travel & Leisure	24.3	21.6	15.8	13.3	1.71	1.90	2.52	2.78
Telecommunications	16.6	19.7	20.2	18.0	4.30	3.87	4.02	4.22
Utilities	13.2	14.7	14.6	14.7	4.90	4.78	4.94	5.07
Banks	15.1	13.5	10.0	8.5	3.43	3.84	4.71	5.72
Insurance	12.7	11.4	10.7	10.0	3.85	4.41	4.76	5.04
Real Estate	24.8	23.8	22.2	21.2	3.11	3.34	3.59	3.75
Financial Services	11.9	13.7	12.7	14.3	3.07	3.34	3.65	3.88
Technology	32.2	22.8	19.3	16.2	1.52	2.00	1.79	1.93
Stoxx - Pan Europe	16.7	16.0	14.6	13.0	3.16	3.33	3.66	3.98
Pan Euro - Large Cap	15.8	15.5	14.4	12.9	3.28	3.44	3.77	4.10
Pan Euro - Mid Cap	23.0	18.5	15.3	13.6	2.70	2.87	3.22	3.47
Pan Euro - Small Cap	18.5	18.6	15.6	13.7	2.66	2.86	3.19	3.49
Stoxx ex UK	17.5	16.5	14.5	13.0	3.07	3.22	3.45	3.79
EuroStoxx - Eurozone	17.4	16.1	14.1	12.4	3.14	3.29	3.49	3.83

Source: Citi Research & DataStream

Figure 38. Pan-European Country Weightings & Returns

	Mkt Cap	% of	Relative Return to Stoxx*				Absolute Return*			
	(Euros m)	Stoxx	1m	3m	12m	YTD	1m	3m	12m	YTD
Austria	20,718	0.3	-6	-7	-30	-3	-4	-1	-26	-4
Belgium	132,053	1.8	3	6	16	2	6	13	22	1
Denmark	168,171	2.3	0	2	14	4	3	8	20	3
Finland	105,020	1.5	-1	1	8	0	2	7	13	-1
France	1,054,285	14.7	1	-1	-2	0	3	5	3	-1
Germany	958,400	13.3	0	5	-2	1	3	12	3	0
Greece	12,343	0.2	0	-19	-39	4	3	-14	-36	3
Ireland	57,707	0.8	-2	7	0	-1	1	13	5	-2
Italy	256,250	3.6	-4	-10	-8	-3	-1	-5	-3	-3
Netherlands	313,078	4.4	0	4	3	0	3	10	8	0
Norway	74,683	1.0	3	-17	-16	1	6	-12	-11	0
Portugal	16,564	0.2	-2	-16	-34	2	0	-11	-31	2
Spain	360,687	5.0	-6	-9	-6	-4	-4	-3	-1	-5
Sweden	326,695	4.5	-3	1	-1	-1	0	7	4	-2
Switzerland	1,032,717	14.4	1	5	10	3	3	11	16	2
UK	2,306,955	32.1	1	-3	0	-2	4	3	5	-3
Stoxx - Pan Europe	7,196,328	100								

Source: Citi Research & DataStream. *Note: Country returns use MSCI indices.

Figure 39. Pan-European Country Relative Ratings

As at Close 13 Jan 15	Price/Earnings				Net Dividend Yield			
Country	2013	2014E	2015E	2016E	2013	2014E	2015E	2016E
Austria	101	11481	76	71	84	74	129	128
Belgium	145	126	120	127	74	87	76	87
Denmark	153	133	117	112	51	58	60	68
Finland	219	123	123	125	92	130	97	93
France	101	105	97	96	106	102	104	102
Germany	88	87	89	90	84	87	86	86
Greece	29	359	97	70	28	72	103	111
Ireland	151	125	115	110	46	47	46	45
Italy	151	105	92	87	102	105	114	120
Netherlands	118	108	101	98	66	67	83	86
Norway	68	71	81	82	174	165	121	122
Portugal	1273	114	99	94	128	123	115	110
Spain	104	101	104	98	166	151	105	107
Sweden	92	96	99	109	114	113	109	110
Switzerland	110	113	109	112	86	86	89	89
UK	91	94	102	101	106	107	112	110
EuroStoxx - Eurozone	104	101	96	95	99	99	95	96
Stoxx ex UK - Europe ex UK	105	103	99	100	97	97	94	95
Stoxx - Pan Europe	100	100	100	100	100	100	100	100

Source: Citi Research & DataStream

Figure 40. Pan-European Country Growth

As at Close 13 Jan 15	Earnings Growth %			Dividend Growth %		
Country	2014E	2015E	2016E	2014E	2015E	2016E
Austria	-99.1	16,465.7	19.9	-7.0	91.7	7.7
Belgium	19.6	14.9	6.5	23.6	-3.7	25.0
Denmark	20.1	24.5	17.4	20.5	13.5	22.9
Finland	85.8	9.2	10.8	48.8	-18.0	4.3
France	-0.1	19.2	12.9	1.2	11.9	6.6
Germany	5.8	7.3	10.3	8.8	8.3	8.9
Greece	-91.6	303.5	56.4	174.1	57.0	17.4
Ireland	25.3	19.7	17.7	7.9	6.6	6.1
Italy	50.0	25.6	18.2	8.8	19.5	14.2
Netherlands	13.8	17.5	16.1	6.1	36.8	13.3
Norway	0.0	-4.5	11.5	-0.6	-19.5	10.0
Portugal	1,064.7	26.4	17.9	1.6	2.8	3.7
Spain	6.9	6.5	18.8	-4.8	-23.0	10.7
Sweden	-0.8	6.3	2.2	4.7	5.7	9.3
Switzerland	1.4	14.1	8.7	5.3	14.6	8.7
UK	0.8	1.5	13.6	5.5	15.4	7.1
EuroStoxx - Eurozone	7.7	14.8	13.4	4.9	6.2	9.5
Stoxx ex UK - Europe ex UK	5.8	13.8	11.8	5.0	7.2	9.6
Stoxx - Pan Europe	4.1	9.6	12.3	5.2	10.0	8.7

Source: Citi Research & DataStream. *Note: Country returns use MSCI index

Figure 41. Pan-European Country Ratings

As at Close 13 Jan 15	Price/Earnings				Net Dividend Yield			
Country	2013	2014E	2015E	2016E	2013	2014E	2015E	2016E
Austria	16.8	1837.8	11.1	9.3	2.64	2.46	4.71	5.08
Belgium	24.2	20.2	17.6	16.5	2.33	2.88	2.77	3.47
Denmark	25.5	21.3	17.1	14.6	1.61	1.94	2.20	2.71
Finland	36.5	19.6	18.0	16.2	2.92	4.34	3.56	3.71
France	16.9	16.9	14.2	12.5	3.35	3.39	3.79	4.04
Germany	14.7	13.9	12.9	11.7	2.67	2.90	3.15	3.43
Greece	4.8	57.4	14.2	9.1	0.87	2.39	3.76	4.41
Ireland	25.2	20.1	16.8	14.3	1.45	1.57	1.67	1.77
Italy	25.2	16.8	13.4	11.3	3.22	3.50	4.18	4.78
Netherlands	19.7	17.3	14.7	12.7	2.09	2.22	3.04	3.44
Norway	11.3	11.3	11.8	10.6	5.51	5.48	4.41	4.85
Portugal	212.0	18.2	14.4	12.2	4.04	4.11	4.22	4.38
Spain	17.3	16.2	15.2	12.8	5.26	5.01	3.86	4.27
Sweden	15.3	15.4	14.5	14.2	3.61	3.78	3.99	4.36
Switzerland	18.4	18.1	15.9	14.6	2.71	2.85	3.27	3.55
UK	15.2	15.1	14.8	13.1	3.36	3.55	4.10	4.39
EuroStoxx - Eurozone	17.4	16.1	14.1	12.4	3.14	3.29	3.49	3.83
Stoxx ex UK - Europe ex UK	17.5	16.5	14.5	13.0	3.07	3.22	3.45	3.79
Stoxx - Pan Europe	16.7	16.0	14.6	13.0	3.16	3.33	3.66	3.98

Source: Citi Research & DataStream

Figure 42. UK Sector Weightings & Relative Returns

As at Close 13 Jan 2015	Mkt Cap £m	% of AllShare	% of Group	Relative return 1m	3m	12m	Qtd	Ytd
OIL & GAS (21)	249,343	12.2		-1	-13	-16	-4	-4
Oil & Gas Producers (14)	241,468	11.8	97	-1	-13	-15	-4	-4
Oil Equip, Serv and Distrib (7)	7,875	0.4	3	-8	-31	-31	-10	-10
BASIC MATERIALS (29)	142,993	7.0		-1	-12	-9	-3	-3
Chemicals (7)	15,183	0.7	11	4	22	8	3	3
Forestry & Paper (1)	3,970	0.2	3	1	7	9	3	3
Industrial Metals (2)	832	0.0	1	7	8	8	-4	-4
Mining (19)	123,008	6.0	86	-2	-16	-11	-4	-4
INDUSTRIALS (114)	201,032	9.8		1	3	-6	0	0
Construction & Materials (13)	16,495	0.8	8	2	12	-7	0	0
Aerospace (9)	43,419	2.1	22	3	-1	-9	0	0
General Industrials (6)	13,299	0.6	7	2	2	-11	2	2
Electronic & Electrical Equip (12)	10,023	0.5	5	3	15	-10	0	0
Industrial Engineering (14)	16,960	0.8	8	0	-6	-14	-2	-2
Industrial Transportation (8)	5,705	0.3	3	0	3	-14	-1	-1
Support Services (52)	95,129	4.6	47	0	4	-1	0	0
CONSUMER GOODS (40)	301,289	14.7		1	4	13	2	2
Automobiles & Parts (1)	5,811	0.3	2	6	18	-7	4	4
Beverages (6)	83,669	4.1	28	-2	1	0	1	1
Food Producers (10)	17,634	0.9	6	0	17	16	1	1
Household Gds & Home Cons (13)	56,437	2.8	19	1	6	15	-1	-1
Leisure Goods (2)	406	0.0	0	-4	1	-10	-1	-1
Personal Goods (6)	41,970	2.1	14	1	4	6	3	3
Tobacco (2)	95,362	4.7	32	2	3	27	3	3
HEALTH CARE (20)	180,169	8.8		0	0	17	3	3
Health Care Equip & Services (9)	14,749	0.7	8	5	13	35	-1	-1
Pharmaceuticals & Biotech (11)	165,420	8.1	92	0	-1	16	4	4
CONSUMER SERVICES (96)	234,795	11.5		3	13	1	2	2
Food & Drug Retailers (7)	30,006	1.5	13	15	17	-26	8	8
General Retailers (30)	48,655	2.4	21	1	13	6	0	0
Media (24)	70,658	3.5	30	1	8	5	2	2
Travel & Leisure (35)	85,476	4.2	36	2	16	10	1	1
TELECOMMUNICATIONS (8)	101,398	5.0		1	11	0	2	2
Fixed-Line Telecoms (6)	37,074	1.8	37	-2	5	4	0	0
Mobile Telecoms (2)	64,324	3.1	63	2	15	0	3	3
UTILITIES (8)	80,425	3.9		-2	-1	14	-1	-1
Electricity (3)	16,745	0.8	21	-11	-8	5	-7	-7
Gas, Water & Multi-Utilities (5)	63,680	3.1	79	1	2	17	1	1
TECHNOLOGY (22)	31,194	1.5		1	15	4	1	1
Software & Computer Serv (14)	12,795	0.6	41	1	13	6	1	1
Technology Hardware & Equip (8)	18,399	0.9	59	2	16	4	0	0
TOTAL NON-FINANCIAL (358)	1,522,638	74.4		0	0	0	0	0
FINANCIALS (283)	524,560	25.6		-1	0	0	0	0
Banks (7)	221,658	10.8	42	-4	-7	-12	-2	-2
Non-Life Insurance (12)	23,818	1.2	5	5	5	13	4	4
Life Insurance (12)	97,986	4.8	19	-1	4	9	0	0
Real Estate Investment Svs (25)	13,503	0.7	3	1	5	-2	2	2
REITS (20)	42,405	2.1	8	2	11	24	3	3
Financial Services (29)	49,852	2.4	10	2	13	10	0	0
FTSE ALL SHARE (641)	2,047,198	100.0		0	0	0	0	0
FTSE 100 (100)	1,662,557	81.2		0	-1	0	0	0
Mid 250 (250)	315,320	15.4		1	6	1	0	0
Small Cap (291)	69,321	3.4		0	2	-1	1	1

Source: Citi Research & DataStream

Figure 43. UK Relative Ratings

	P/E Relative				Yield Relative			
As at Close 13 Jan 2015	2013	2014E	2015E	2016E	2013	2014E	2015E	2016E
OIL & GAS	71	69	106	99	143	141	137	133
Oil & Gas Producers	71	70	109	101	143	141	138	133
Oil Equip, Serv and Distrib	57	58	55	58	132	137	135	131
BASIC MATERIALS	77	89	89	78	112	110	113	116
Chemicals	139	133	121	127	57	62	60	62
Forestry & Paper	104	94	84	91	73	82	83	86
Industrial Metals	-71	64	41	40	41	88	167	156
Mining	72	85	87	74	121	117	121	123
INDUSTRIALS	113	111	99	102	79	77	73	73
Construction & Materials	152	148	117	107	104	92	81	79
Aerospace	90	94	88	94	88	87	81	81
General Industrials	98	93	86	92	108	98	91	89
Electronic & Electrical Equip	124	125	112	118	59	63	60	61
Industrial Engineering	114	107	98	106	74	75	71	70
Industrial Transportation	108	98	79	78	75	108	116	120
Support Services	124	119	105	107	69	66	64	66
CONSUMER GOODS	127	126	115	119	84	87	84	83
Automobiles & Parts	89	90	82	87	62	65	64	65
Beverages	141	143	132	137	66	67	62	62
Food Producers	128	141	130	131	50	53	52	55
Household Gds & Home Cons	132	117	99	102	75	86	89	81
Personal Goods	146	147	137	144	85	86	78	79
Tobacco	111	113	105	111	113	114	109	110
HEALTH CARE	111	119	114	120	102	99	92	88
Health Care Equip & Services	164	150	131	133	54	43	43	45
Pharmaceuticals & Biotech	108	117	113	119	106	104	96	91
CONSUMER SERVICES	107	113	104	108	79	71	69	71
Food & Drug Retailers	54	97	111	115	178	83	60	63
General Retailers	123	114	103	108	66	73	68	71
Media	117	114	103	111	79	81	75	76
Travel & Leisure	134	117	103	104	53	58	68	69
TELECOMMUNICATIONS	134	152	148	139	112	116	109	109
Fixed-Line Telecoms	112	101	91	95	79	87	88	94
Mobile Telecoms	152	215	231	190	131	132	121	118
UTILITIES	106	110	104	115	136	137	126	122
Electricity	86	89	89	100	159	154	143	139
Gas, Water & Multi-Utilities	113	118	109	119	131	133	122	117
TECHNOLOGY	192	174	145	146	37	41	43	47
Software & Computer Serv	141	133	116	119	57	63	63	67
Technology Hardware & Equip	251	219	174	172	23	26	30	34
TOTAL NON-FINANCIAL	101	104	108	107	101	100	96	95
FINANCIALS	96	88	80	81	97	101	114	117
Banks	79	74	68	67	102	105	134	141
Non-Life Insurance	124	83	85	91	135	134	113	110
Life Insurance	102	95	85	88	90	99	99	101
Real Estate Investment Svs	192	168	151	154	37	55	53	53
REITS	217	201	179	191	80	82	76	75
Financial Services	111	105	92	94	90	97	95	94
FTSE ALL SHARE	100	100	100	100	100	100	100	100
FTSE 100	98	98	100	100	104	103	104	104
Mid 250	118	114	101	104	78	81	79	79
Small Cap	88	89	86	85	69	77	75	81

Source: Citi Research & DataStream

Figure 44. UK Earnings Growth

As at Close 13 Jan 2015	Earnings Growth % 2014	2015E	2016E	Net Dividend Growth % 2014	2015E	2016E
OIL & GAS	0.1	-35.8	21.9	0.5	9.2	3.2
Oil & Gas Producers	0.3	-37.4	22.9	0.3	9.2	3.2
Oil Equip, Serv and Distrib	-4.5	5.0	7.3	5.5	10.2	4.0
BASIC MATERIALS	-14.2	-2.3	30.2	0.1	15.3	9.2
Chemicals	3.2	7.1	8.7	10.7	9.4	9.6
Forestry & Paper	7.7	10.0	5.3	15.3	14.0	10.1
Industrial Metals	-210.2	53.5	16.0	119.3	112.3	0.0
Mining	-17.1	-3.9	33.1	-1.1	15.2	9.2
INDUSTRIALS	0.1	9.6	10.0	-0.5	6.3	7.9
Construction & Materials	0.9	24.2	23.6	-10.1	-0.6	4.0
Aerospace	-6.4	4.6	6.5	1.6	4.1	6.9
General Industrials	2.7	6.2	6.1	-8.3	4.9	4.3
Electronic & Electrical Equip	-2.2	8.9	8.3	9.1	7.2	7.3
Industrial Engineering	5.0	6.4	5.3	3.4	5.7	5.4
Industrial Transportation	8.3	20.7	15.4	45.9	19.9	11.4
Support Services	2.5	11.0	11.1	-2.2	8.3	10.1
CONSUMER GOODS	-1.1	7.5	9.3	5.2	7.7	5.7
Automobiles & Parts	-2.5	6.7	7.5	6.3	10.0	10.0
Beverages	-3.3	5.7	10.0	2.6	4.0	7.2
Food Producers	-11.1	5.6	12.8	6.7	10.8	11.9
Household Gds & Home Cons	10.8	15.6	10.2	16.5	16.0	-2.8
Personal Goods	-3.1	5.1	8.7	2.1	2.6	7.6
Tobacco	-3.2	5.1	7.9	2.9	7.2	7.7
HEALTH CARE	-8.6	2.5	7.5	-0.7	4.0	1.8
Health Care Equip & Services	7.0	12.2	11.8	-17.9	11.3	12.2
Pharmaceuticals & Biotech	-9.5	1.9	7.2	0.0	3.8	1.4
CONSUMER SERVICES	-6.4	6.3	9.2	-8.5	9.0	9.3
Food & Drug Retailers	-45.3	-14.0	10.0	-52.6	-18.3	12.1
General Retailers	6.0	8.2	8.8	12.4	4.5	12.3
Media	0.6	9.2	5.4	4.9	4.2	7.7
Travel & Leisure	12.9	11.2	12.6	12.0	31.8	8.5
TELECOMMUNICATIONS	-13.7	0.9	21.0	5.5	5.5	7.3
Fixed-Line Telecoms	8.2	8.7	9.4	12.0	13.5	14.1
Mobile Telecoms	-30.9	-8.6	37.9	3.2	2.5	4.5
UTILITIES	-5.7	3.6	3.4	2.5	3.1	3.4
Electricity	-5.0	-2.6	1.5	-1.0	4.3	3.9
Gas, Water & Multi-Utilities	-5.9	5.8	4.1	3.6	2.7	3.3
TECHNOLOGY	8.0	17.5	13.1	13.8	18.0	17.8
Software & Computer Serv	4.2	12.5	10.8	12.7	11.7	14.1
Technology Hardware & Equip	12.4	22.9	15.4	15.6	28.2	22.8
TOTAL NON-FINANCIAL	-4.6	-5.2	14.0	0.6	8.0	5.7
FINANCIALS	6.7	7.0	12.7	7.0	25.7	10.6
Banks	5.0	6.2	15.0	4.7	42.4	13.3
Non-Life Insurance	46.3	-3.6	5.4	1.0	-5.3	4.4
Life Insurance	4.8	9.6	10.3	12.3	11.7	8.8
Real Estate Investment Svs	12.2	8.9	11.2	53.4	6.9	8.2
REITS	6.2	9.8	6.8	4.5	5.0	5.1
Financial Services	3.9	11.6	10.9	10.4	10.1	5.2
FTSE ALL SHARE	-1.9	-2.0	13.7	2.0	12.1	7.0
FTSE 100	-2.4	-3.7	14.0	1.3	12.6	6.8
Mid 250	1.5	10.0	11.3	6.3	8.1	7.9
Small Cap	-2.5	1.2	15.1	13.6	9.1	16.3

Source: Citi Research & DataStream

Figure 45. UK Sector Ratings

As at Close 13 Jan 2015	Price/Earnings 2013	2014E	2015E	2016E	Net Dividend Yield 2013	2014E	2015E	2016E
OIL & GAS	10.0	10.0	15.6	12.8	5.10	5.12	5.59	5.78
Oil & Gas Producers	10.1	10.1	16.1	13.1	5.11	5.13	5.60	5.78
Oil Equip, Serv and Distrib	8.0	8.4	8.0	7.5	4.71	4.97	5.47	5.69
BASIC MATERIALS	11.0	12.8	13.1	10.0	4.00	4.01	4.62	5.04
Chemicals	19.7	19.1	17.9	16.4	2.03	2.25	2.46	2.70
Forestry & Paper	14.7	13.6	12.4	11.7	2.59	2.98	3.40	3.74
Industrial Metals	-10.1	9.2	6.0	5.2	1.46	3.21	6.81	6.81
Mining	10.2	12.3	12.8	9.6	4.31	4.26	4.91	5.36
INDUSTRIALS	16.0	16.0	14.6	13.2	2.80	2.79	2.97	3.20
Construction & Materials	21.5	21.3	17.2	13.9	3.70	3.33	3.31	3.44
Aerospace	12.7	13.5	13.0	12.2	3.12	3.17	3.30	3.53
General Industrials	13.8	13.4	12.7	11.9	3.86	3.54	3.72	3.88
Electronic & Electrical Equip	17.6	18.0	16.5	15.2	2.11	2.30	2.46	2.64
Industrial Engineering	16.2	15.4	14.5	13.7	2.64	2.73	2.88	3.04
Industrial Transportation	15.3	14.1	11.7	10.1	2.69	3.92	4.70	5.24
Support Services	17.5	17.1	15.4	13.9	2.47	2.41	2.61	2.88
CONSUMER GOODS	18.0	18.2	16.9	15.5	3.01	3.16	3.41	3.60
Automobiles & Parts	12.6	12.9	12.1	11.3	2.21	2.35	2.59	2.85
Beverages	19.9	20.6	19.5	17.7	2.37	2.43	2.53	2.71
Food Producers	18.0	20.3	19.2	17.0	1.80	1.92	2.12	2.38
Household Gds & Home Cons	18.6	16.8	14.5	13.2	2.67	3.11	3.61	3.51
Personal Goods	20.6	21.3	20.2	18.6	3.04	3.11	3.19	3.43
Tobacco	15.8	16.3	15.5	14.3	4.02	4.14	4.44	4.78
HEALTH CARE	15.7	17.2	16.8	15.6	3.64	3.61	3.76	3.82
Health Care Equip & Services	23.2	21.7	19.3	17.3	1.92	1.57	1.75	1.97
Pharmaceuticals & Biotech	15.3	16.9	16.6	15.5	3.78	3.78	3.93	3.98
CONSUMER SERVICES	15.2	16.2	15.3	14.0	2.83	2.59	2.82	3.08
Food & Drug Retailers	7.7	14.0	16.3	14.8	6.34	3.01	2.46	2.75
General Retailers	17.5	16.5	15.2	14.0	2.36	2.65	2.77	3.11
Media	16.6	16.5	15.1	14.3	2.81	2.95	3.07	3.31
Travel & Leisure	19.0	16.8	15.1	13.4	1.87	2.09	2.76	2.99
TELECOMMUNICATIONS	19.0	22.0	21.8	18.0	3.99	4.21	4.44	4.77
Fixed-Line Telecoms	15.8	14.6	13.4	12.3	2.83	3.17	3.60	4.10
Mobile Telecoms	21.5	31.1	34.0	24.7	4.66	4.81	4.93	5.15
UTILITIES	15.0	15.9	15.4	14.9	4.86	4.98	5.14	5.31
Electricity	12.1	12.8	13.1	12.9	5.65	5.59	5.83	6.06
Gas, Water & Multi-Utilities	16.0	17.0	16.1	15.5	4.66	4.82	4.95	5.12
TECHNOLOGY	27.1	25.1	21.4	18.9	1.30	1.48	1.75	2.06
Software & Computer Serv	20.0	19.2	17.1	15.4	2.03	2.29	2.55	2.92
Technology Hardware & Equip	35.5	31.5	25.6	22.2	0.82	0.95	1.21	1.49
TOTAL NON-FINANCIAL	14.3	15.0	15.9	13.9	3.60	3.62	3.91	4.13
FINANCIALS	13.5	12.7	11.8	10.5	3.44	3.68	4.62	5.11
Banks	11.2	10.6	10.0	8.7	3.65	3.82	5.44	6.16
Non-Life Insurance	17.6	12.0	12.5	11.8	4.81	4.86	4.60	4.81
Life Insurance	14.4	13.8	12.6	11.4	3.22	3.61	4.03	4.39
Real Estate Investment Svs	27.1	24.2	22.2	20.0	1.31	2.01	2.15	2.33
REITS	30.8	29.0	26.4	24.7	2.84	2.96	3.11	3.27
Financial Services	15.7	15.1	13.6	12.2	3.20	3.53	3.88	4.09
FTSE ALL SHARE	14.1	14.4	14.7	13.0	3.56	3.63	4.07	4.35
FTSE 100	13.9	14.2	14.7	12.9	3.71	3.76	4.23	4.51
Mid 250	16.7	16.4	14.9	13.4	2.78	2.96	3.20	3.45
Small Cap	12.5	12.8	12.7	11.0	2.45	2.78	3.03	3.53

Source: Citi Research & DataStream

Notes

Notes

Appendix A-1

Analyst Certification

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