Citi Research

Equities

26 July 2012 │ 36 pages

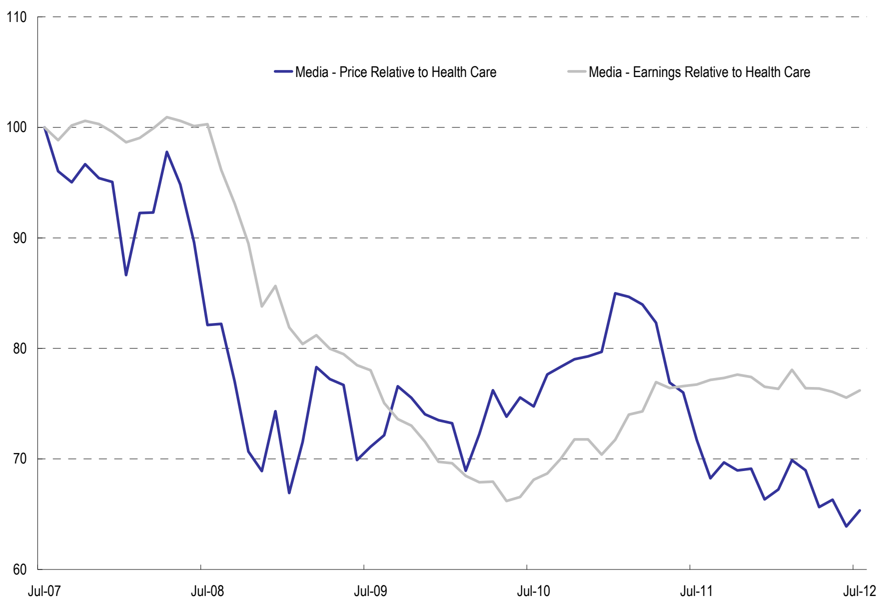
Equity Strategy (Citi)
Pan-Europe

European Portfolio Strategist

Pan-European — Media to Overweight

- **Ignore macro** — It is right to focus on macro risks. But, investors who have focused 100% on earnings will have enjoyed strong absolute and relative performance YTD.
- **Earnings mo wins** — Earnings momentum strategies have enjoyed excellent performance YTD at the country, sector, theme and stock level.
- **Win both ways** — Buying stocks with good earnings momentum has paid out, not unusual. Selling stocks with poor earnings momentum also paid out; more unusual.
- **Structural** — Earnings momentum supports our core strategies of World Champions, Defensive Growth, CDS-Adjusted Dividends. Stick with it structurally.
- **Tactical** — But, price and positioning once again suggests that some leadership reversal may happen within the market. Policy action could be the catalyst.
- **Media vs Health Care** — Media to O/weight, defensive growth at reasonable price. Health Care down to Neutral. Utilities up (Neutral). Oil & Gas down (U/weight).

Figure 1. Media vs Health Care: Earnings Sideways, Price Down = Big De-Rating = Opportunity



Source: Citi Research

- Equities

Adrian Cattley
+44-20-7986-4454
adrian.cattley@citi.com

Anna Esposito
+44-20-7986-4039
anna.z.esposito@citi.com

Jonathan Stubbs
+44-20-7986-4218
jonathan.stubbs@citi.com

András Vig
+44-020-7986-3940

Christine Jensen is on maternity leave.

July 19 — Zero Rates Means De-eq

July 17 — Yield ++

July 12 - Don't Give Up

July 05 — The Spain Trade, Part 3

June 28 — Risk & Opportunity

Contents

Pan-European — Media to Overweight

It's all about macro, right? Yes and no. Investors continue to focus on macro risks. However, an investor who has ignored all macro events, newsflow and speculation in 2012, and instead focused 100% on company earnings, would have enjoyed strong absolute and relative performance in Europe so far this year. Such an investor would have made money on the long and on the short side. So, it's all about micro, too. Schizophrenic markets.

This report shows how classic earnings momentum strategies have been successful YTD and how positive relative earnings trends support our strategy themes such as Europe's World Champions, Defensive Growth and CDS-Adjusted Dividends.

Structurally, we continue to back growth, earnings momentum and our core strategy themes in the coming 12-18 months. However, we can also see building support, once again[1], for a tactical shift in near-term performance within the market.

We observe two of our four Ps in place for such a tactical shift — Price and Positioning. The market appears primed for a tactical shift to risk/value. Supportive near-term Policy and/or Political developments could drive this shift. Given the lack of natural appetite for European equities, such a shift could be part-funded from within the market.

We make four sector changes: Media, Health Care, Utilities, and Oil & Gas. We raise Media to Overweight (from Underweight) and lower Health Care to Neutral (from Overweight). We, and our sector team, continue to like Health Care. It remains central to our structural themes such as Defensive Growth. But, we agree with Tom Singlehurst and our Media team that their sector also offers investors defensive growth exposure, and is trading close to 5-year cheaps compared to Health Care. We also raise Utilities to Neutral (from Underweight); this is the first time we have not been Underweight in the last 4 years. We lower Oil & Gas to Underweight (from Neutral) to fund the Utilities move. Both sectors look cheap, as we recently highlighted, but, outside Spain, our Utilities team sees reduced earnings risk across their sector over the next 12-months. The relative earnings trends for the sector have recently turned slightly positive. We are not going to fall in love with Utilities (we see it as still an ugly sector), but we see some valuation support.

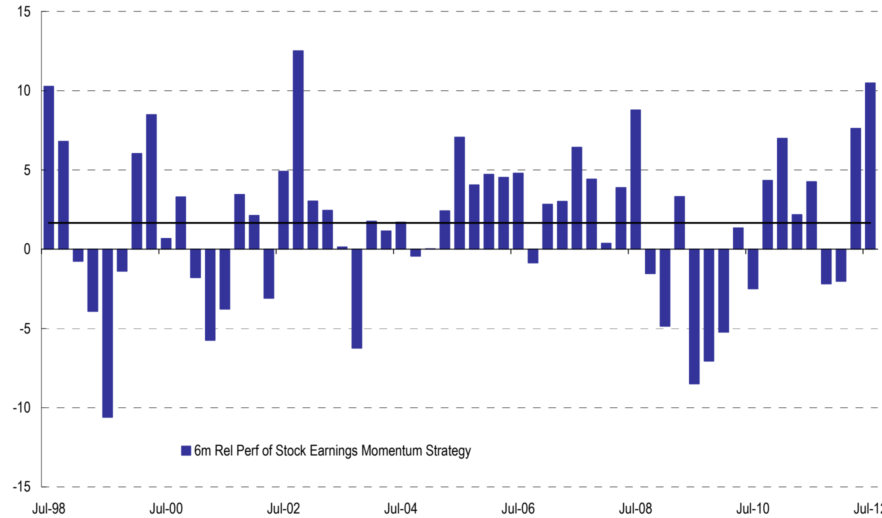
All about earnings

Earnings are important to share prices. But, not always. Figure 2 shows the performance of a disciplined earnings momentum strategy over the past 15 years. Each bar represents six months of performance. We buy stocks each quarter with 12-month forward earnings trends 8%+ better than the market and sell those with earnings trends 8%+ worse than the market to create a long/short earnings momentum basket. We measure each basket over the next six months.

Earnings momentum strategies have been very successful in the last two periods. The market has rewarded those companies with the strongest earnings trends and punished those with the weakest.

[1] European Portfolio Strategy — Edging Back to Risk — 31 May 2012.

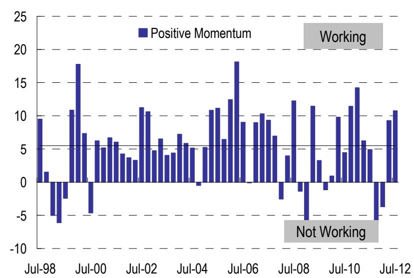
Figure 2. Performance of 6m Earnings Momentum Strategy



Source: Datastream & Citi Research

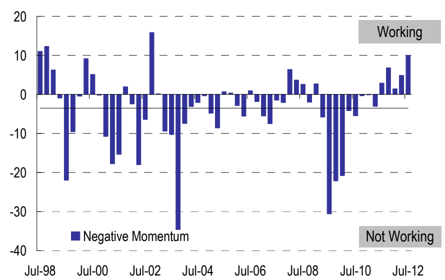
Figure 3 and Figure 4 show that earnings momentum strategies have been working on both the long and short side. Historically, long earnings momentum strategies have been a more consistent performance strategy. Underperformance tends to be restricted to major market or economic turning points.

Figure 3. Perf of Earnings Mo — Longs



Source: Datastream & Citi Research

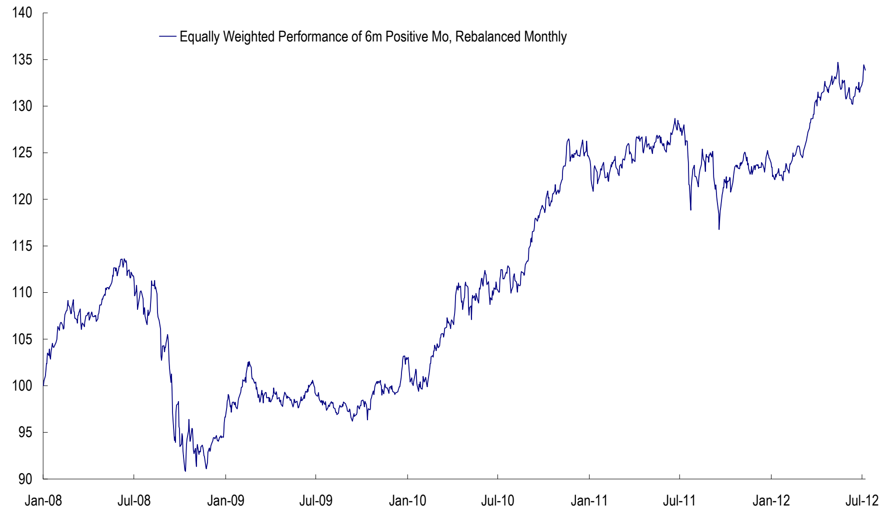
Figure 4. Perf of Earnings Mo — Shorts



Source: Datastream & Citi Research

Success of the short earnings momentum strategy has been less common over the past 15 years. This can be partly explained by corporate action, management action and the market efficiently pricing in six months of earnings weakness prior to entry into the short basket. The short side has worked better in the last 12-18 months due to the entrenched macro trends, which have provided a consistently negative feed to certain parts of the equity market, e.g. Financials, Utilities, and Telecoms.

Figure 5. Buying Stocks with >8% Rel Earn Mo (previous 6m), Rebalanced Monthly



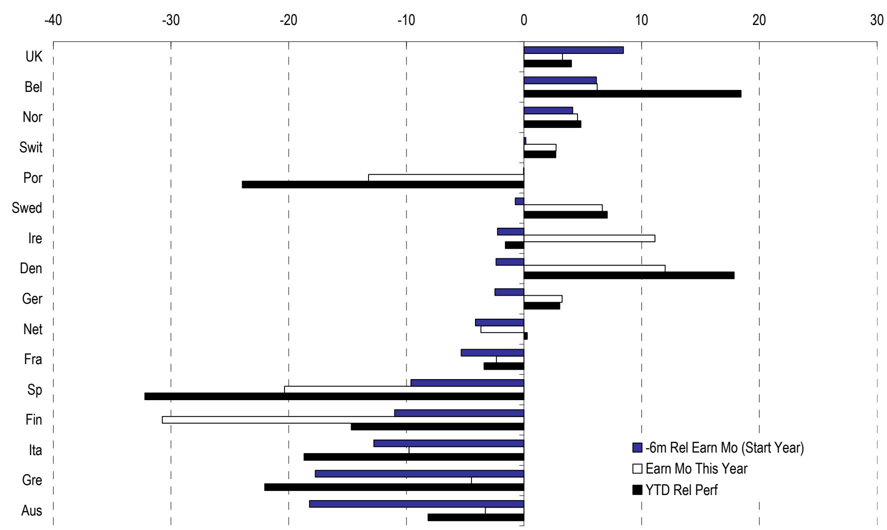
Source: Datastream & Citi Research

Figure 5 shows the performance of the long-only earnings momentum strategy with a monthly rebalance, starting in 2008. Earnings momentum strategies struggled in early 2H08, but have generally done well since.

Country earnings mo

Earnings momentum has worked at all levels in Europe YTD — country, sector, theme, stock. Figure 6 shows the start-year six-month earnings momentum score for each country, i.e. where start-year 12-month forward relative earnings for each country were compared to six-months previously, as well as how 12-month forward relative earnings have moved YTD and price performance YTD.

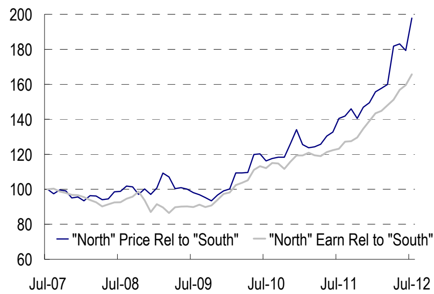
Figure 6. Country Earnings Momentum Trends vs Performance



Source: Datastream & Citi Research

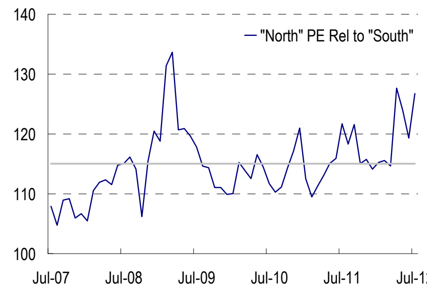
Earnings momentum investors would have been buying the UK, Belgium, Norway and Switzerland at the start of the year. All four countries have outperformed YTD. Earnings momentum strategies would have been short Austria, Greece, Italy, Finland, Spain and France. All of those countries have underperformed YTD.

Figure 7. "North" Price & Earn Rel to "South"



Source: Datastream & Citi Research

Figure 8. "North" P/E Rel to "South"



Source: Datastream & Citi Research

Expectations of stronger relative earnings have played a large role in our post-2010 structural bias of North over South in Europe. Figure 7 shows how the North has enjoyed both earnings and price outperformance over the South over the past couple of years. Figure 8, however, suggests that the recent re-rating of the North has returned close to levels from a couple of months ago when we last suggested a tactical opportunity to reduce Underweights in the South[2]. We reversed this tactical call a few weeks ago[3]. But, very quickly, it appears that another tactical opportunity has emerged to reduce Southern Underweights. Tread carefully.

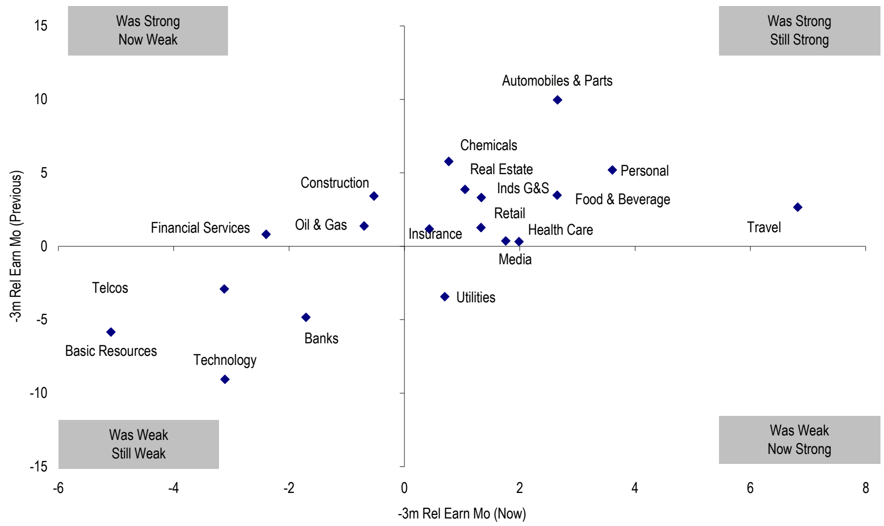
Sector earnings mo

Earnings momentum strategies have been equally successful at a sector level in 2012. Only one of the six sectors with the best earnings momentum at the start of this year — Oil & Gas — has underperformed YTD. It was sixth best. Earnings momentum has also done well on the short side, e.g. Banks and Basic Resources.

[2] European Equity Strategy — The Spain Trade, Part 2 — 25 April 2012.

[3] European Equity Strategy — The Spain Trade, Part 3 — 5 July 2012.

Figure 9. Current vs Previous Earnings Momentum By Sector



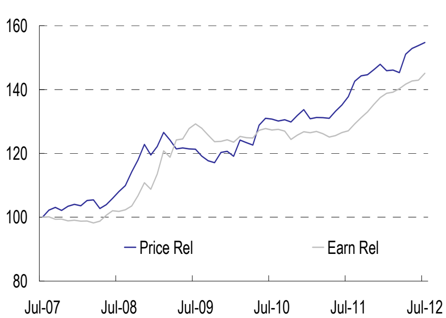
Source: Datastream & Citi Research

Figure 9 compares current relative earnings momentum over the past 3-months to the previous 3-months. Sectors like Banks and Basic Resources still have weak relative earnings trends. Sectors like Food & Beverage and Chemicals still have positive relative earnings trends. Utilities has edged up to strong from weak. Oil & Gas and Financial Services have edged the other way. We will return to this in our sector changes section of this report.

Thematic earnings mo

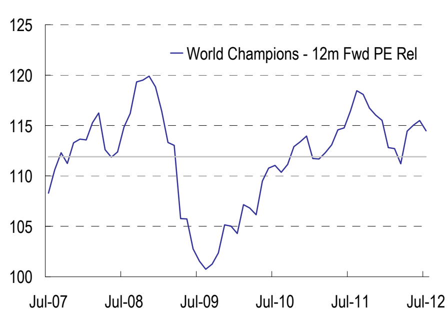
Earnings momentum has also supported our thematic biases through this year. We continue to back the structural re-rating of strong credit, growth, quality and secure income in a de-leveraging and lower growth world. This is why we back Europe's "World Champions", Defensive Growth and CDS-Adjusted Dividends[4].

Figure 10. World Champ P & E Rel to Market



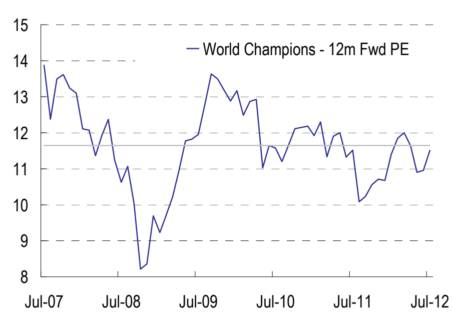
Source: Datastream & Citi Research

Figure 11. World Champions P/E Rel to Market



Source: Datastream & Citi Research

Figure 12. World Champions Absolute P/E



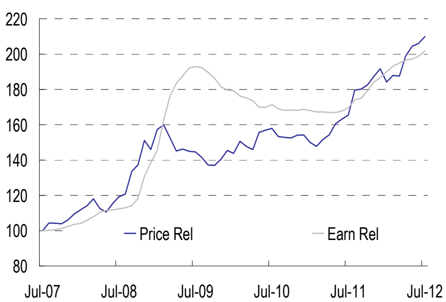
Source: Datastream & Citi Research

Figure 10 shows the price and earnings relative trends for the World Champions. Both trends have been positive over the past few years. We think that this group will continue to enjoy earnings, and therefore price, outperformance over the next couple of years as well. Figure 11 and Figure 12 shows that relative valuations (12-

[4] European Equity Strategy — Don't Give Up — 12 July 2012.

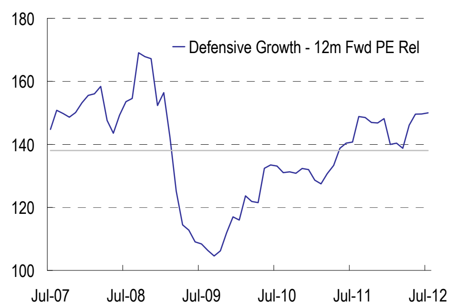
month forward P/E relative) look a little stretched and that absolute ratings have moved higher in the last month or two, but do not look stretched.

Figure 13. Defensive Growth P & E Rel to Market



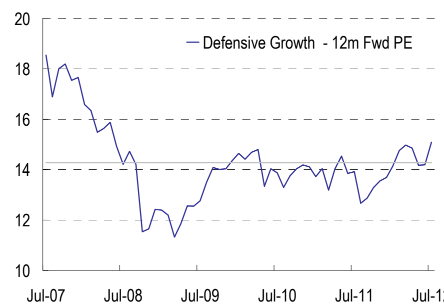
Source: Datastream & Citi Research

Figure 14. Defensive Growth P/E Rel to Market



Source: Datastream & Citi Research

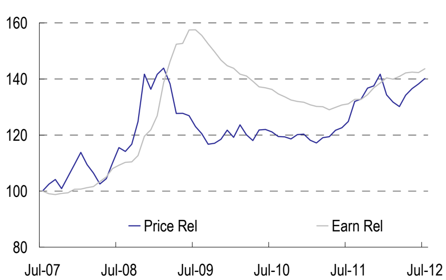
Figure 15. Defensive Growth Absolute P/E



Source: Datastream & Citi Research

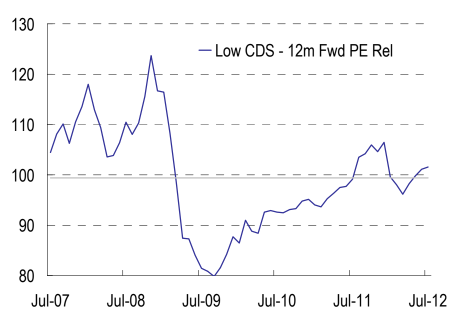
Figure 13 shows price and earnings relative trends for our Defensive Growth theme[5]. Similar to World Champions, we back Defensive Growth stocks to enjoy superior earnings than the market over the next couple of years. We still see this strategy as a "have your cake and eat it" one where downside protection and upside participation are mixed in a quasi earnings call option. Relative valuation for Defensive Growth looks reasonably stretched, at a 50% premium to the market, but is no more expensive on this basis than 5 years ago. Absolute ratings, on a simple 12-month forward P/E, are poking up to post-2009 highs and slightly above 5-year average levels. Not alarming, but undoubtedly more expensive. This is part of the structural re-rating of growth that we have long called for.

Figure 16. CDS Adj Div P & E Rel to Market



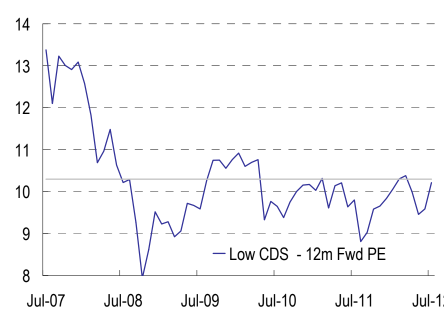
Source: Datastream & Citi Research

Figure 17. CDS Adj Div P/E Rel to Market



Source: Datastream & Citi Research

Figure 18. CDS Adj Div Absolute P/E



Source: Datastream & Citi Research

Figure 16 shows that even our CDS-Adjusted Dividend strategy has the support of positive relative earnings momentum[6]. Valuation looks more attractive here than for World Champions and Defensive Growth.

Structural vs tactical

Nothing has happened to alter our medium-term views on the market. De-leveraging should remain the key macro mega-trend. That means investors should expect a world of lower and more divergent economic growth. Interest rates will stay

[5] European Portfolio Strategist — Eating Cake — 29 March 2012.

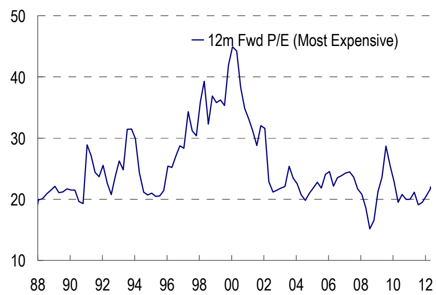
[6] The Citi Income Report — Yield ++ — 18 July 2012.

low and policy makers (and hopefully politicians too) will continue to intervene to reduce downside risks, in our view. In turn, this means that our core strategy themes should continue to be supported and that earnings momentum strategies should continue to pay out.

However, we also continue to highlight to investors the importance of tactical positioning. We did this at the start of the year by suggesting a 3Bs (beta, balance sheet strength, big) strategy to run with policy easing. We did this again at the end of May when suggesting investors take on more risk.

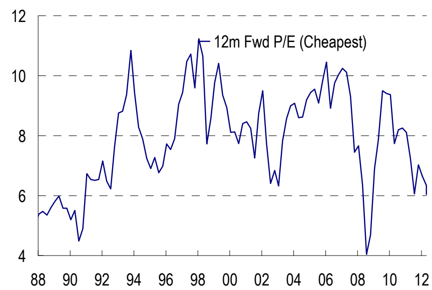
Overall, we see the risk-on/off cycle being driven by policy action and political developments and being most extreme when prices and positioning within the market are themselves at extremes. So, what do we see now?

Figure 19. Most Expensive Quintile — PE



Source: Citi Research & Datastream.

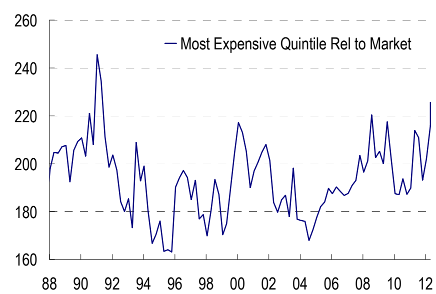
Figure 20. Cheapest Quintile — PE



Source: Citi Research & Datastream.

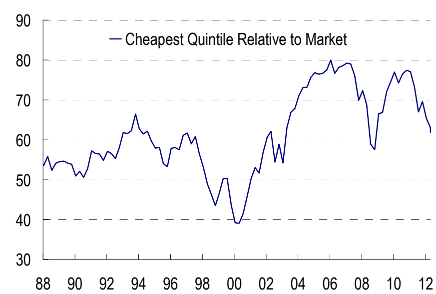
Figure 19 and Figure 20 refreshes our analysis of the most expensive and cheapest quintiles in the Europe, on a 12-month forward P/E basis. The most expensive quintile has enjoyed a small re-rate in the past few months. The cheapest quintile has been de-rated back to start-year lows, only cheaper in 2008-09 and the early-1990s of the past 25 years.

Figure 21. Most Expensive — PE Rel to Mkt



Source: Citi Research & Datastream.

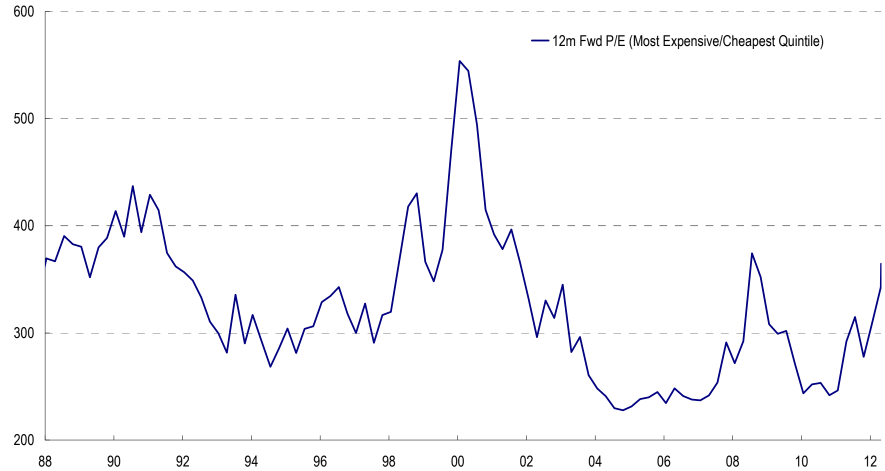
Figure 22. Cheapest — PE Rel to Mkt



Source: Citi Research & Datastream.

Figure 21 and Figure 22 show respective quintiles relative to the market. The most expensive has only been more expensive in the early 1990s. The cheapest continues its relative de-rating and has now almost unwound the re-rating of the 2003-07 "leverage" years. Expensive getting more expensive. Cheap getting cheaper. This is similar to what is happening in European sovereign bond markets. This is similar to what is happening in European real estate markets. The valuation gap between prime and non-prime has gotten a lot wider. But, everything has a price…eventually.

Figure 23. Most Expensive Relative to Cheapest Quintile (12m Forward P/E Relative)



Source: Citi Research & Datastream.

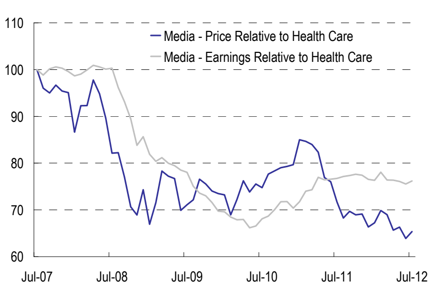
Figure 23 compares the two quintiles to each other. We are now around the wides of the past 10 years. The spread has only been exceeded in the early 1990s and in the late 1990s. While we continue to expect outperformance of the expensive (growth) over the next couple of years, it does appear that performance trends within the market could be more balanced, or even reverse, should policy action or political developments follow.

In this light, comments from ECB President Draghi today, future ECB rate cuts and multi-year LTROs, potential Fed action to support a weakening growth environment in the US, and various ongoing easing measures across EM could combine to support broader market performance despite a backdrop of Euro Area sovereign debt crisis, slowing global economic growth, and moderating earnings expectations.

Sector changes

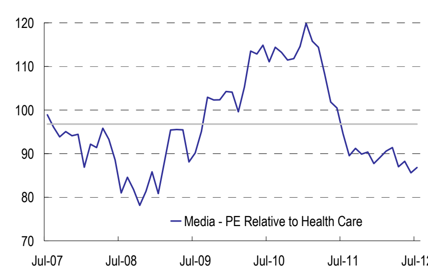
With this tug-of-war between structural and tactical influences on intra-market performance in mind, we make four sector changes to our European sector strategy. We raise Media to Overweight (from Underweight) and lower Health Care to Neutral (from Overweight). Media, in our view, offers exposure to defensive growth at a reasonable price.

Figure 24. Media Sector P & E Rel to Health



Source: Datastream & Citi Research.

Figure 25. Media Sector P/E Rel to Health Care

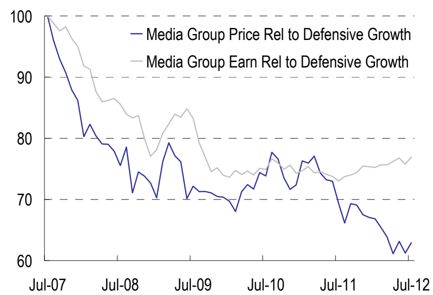


Source: Datastream & Citi Research.

We continue to like Health Care and it remains central to our structural themes such as Defensive Growth. But, we agree with Tom Singlehurst and our Media team that

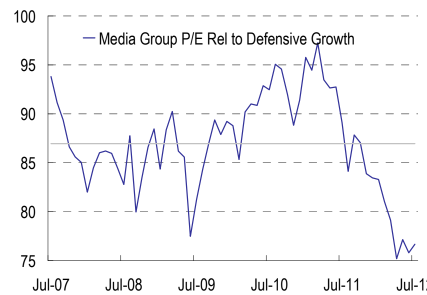
their sector also offers investors defensive growth exposure[7], and is trading close to 5-year cheaps compared to Health Care (Figure 25). Figure 24 shows that Media sector earnings have performed in line with Health Care over the past 12-15 months. Price performance has lagged. We think there is an opportunity for that relative performance to reverse somewhat in coming months.

Figure 26. Media Gp P & E Rel to Def Growth



Source: Datastream & Citi Research.

Figure 27. Media Gp P/E Rel to Def Growth



Source: Datastream & Citi Research.

Figure 26 compares the key "defensive growth" stocks in Media (BSkyB, Reed Elsevier, Pearson, Wolters Kluwer, Informa) to our overall Defensive Growth basket. Media's defensive growth comes from exposure to professional publishers, platform/pay TV and marketing services. This makes up nearly 80% of sector market cap, according to our Media team.

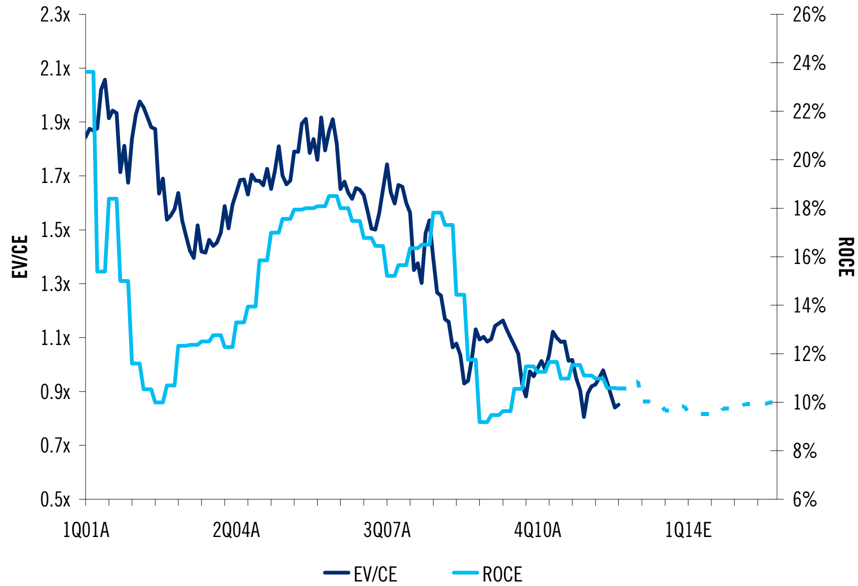
These five Media stocks have enjoyed better earnings momentum than Defensive Growth over the past 12-months but have lagged in price terms. This has delivered a sharp de-rating (Figure 27). We think this presents an interesting investment opportunity to investors. Tom and team's favoured Media stocks are BSkyB, which is also in The Citi Focus List Europe, Reed Elsevier, ITV, TF1 and Informa.

We also raise Utilities to Neutral (from Underweight); this is the first time we have not been Underweight in the last 4 years. We lower Oil & Gas to Underweight (from Neutral) to fund the Utilities move. Both sectors look cheap, as we recently highlighted[8]. Outside Spain, our Utilities team sees reduced earnings risk across their sector over the next 12-months and relative earnings trends for the sector have recently turned positive. We are not going to fall in love with Utilities (we see it as still an ugly sector) but we see some valuation support. Alastair Syme and our Oils' team continue to see an uninspiring combination of low growth and low returns (Figure 28).

[7] European Media — Breaking Up is Hard to Do (But Let's Talk About it Anyway) — Thomas Singlehurst & crew, 9 July 2012.

[8] European Portfolio Strategist — Value Hunter — 14 June 2012.

Figure 28. Oil Sector: Low Growth and Low Returns Expected Over Next Few Years



Source: Citi Research & Company Reports

Strategy outlook

European equities have delivered positive returns YTD, competitive with US equity returns. Within the market, investors will have been very well-served by backing earnings momentum strategies. Our structural strategy themes are well-aligned with earnings momentum trends as well.

In the medium-term, we would continue to back earnings momentum trends and our core strategy themes. However, we are once again raising a flag on some potential tactical opportunities presented by the market. We think that it could be sensible for investors to slightly reduce their commitment to YTD successful strategies and consider acceptable risk and value opportunities within the market. We do not think that risk (e.g. Financials) or value (e.g. Utilities) will enjoy sustained outperformance as that would require a structural shift in the Euro Area economic cycle or in the Euro Area sovereign debt crisis. Neither is likely at the moment. But, we continue to see policy makers fighting hard with words and with actions to try to reduce downside risks. We continue to back the policy put.

We have made a few sector changes to reflect some of these themes. Media moves up to Overweight and Utilities to Neutral. We are more committed to the former than the latter. Health Care moves to Neutral, from Overweight, even though we would expect outperformance from the sector on a medium-term view. Last, Oil & Gas is lowered to Underweight.

Market Outlook & Citi Research

Market Outlook

Despite some small positive steps at the 28th post-2008 EU Summit, the EA crisis is enduring and likely to get worse before better with banking sector strains and deficit overshoots. Our economists' base case is 90% probability of Grexit over the next 12-18 months and believe the most likely date is in the next 2-3 quarters. Over the next few years, the EA end game is likely to be a mix of EMU exit (Greece), a significant amount of sovereign debt and bank debt restructuring and only limited fiscal burden sharing. There's plenty of news for investor's to digest.

GDP	2011	2012E	2013E
Euro zone	1.5	-0.6	-0.9
UK	0.7	-0.5	0.3
Global	3.0	2.5	2.8
US	1.7	1.9	2.0
Japan	-0.7	2.7	2.1
CPI	**2011**	**2012E**	**2013E**
Euro zone	2.7	2.3	1.8
UK	4.5	2.5	1.8
Global	3.6	2.7	2.7
US	2.5	1.7	1.6
Japan	-0.3	0.2	-0.1
Interest Rates		**3Q12E**	**3Q13E**
ECB		0.50	0.25
UK Base		0.50	0.50
US Fed Funds		0.25	0.25
Japan Call		0.10	0.10
10Yr Yield		**3Q12E**	**3Q13E**
Euro zone		1.15	1.50
UK		1.40	1.75
US		1.45	2.35
Japan		0.80	1.10
Ex Rates		**3Q12E**	**3Q13E**
US$/€		1.22	1.18
US$/£		1.56	1.53
€/£		1.28	1.29
Y/US$		78	82
End Year Targets	**Now**	**End-12E**	**Return**
Stoxx	250	275	10
FTSE 100	5498	6000	10

Source: Reuters and Citi Research

Macro – worsening trends

Global growth prospects are worsening, according to our economists, reflecting the ongoing Euro Area crisis and slowing growth in EMs. They have recently cut their GDP growth forecasts to 2.5% for 2012E.This includes Euro Area recession in both years. Overall, they still expect soft, not hard, landing for the global economy but growth will be sluggish over the next 12-18m and risks are downside skewed.

Flat earnings

A slowdown of the global economy is likely to put ongoing pressure on corporate profits. Domestic European growth headwinds should remain stronger than international headwinds. We stick with our top-down earnings growth estimate of 0% for 2012E. This is broadly in-line with weakened US and Euro Area PMI data. We think European earnings growth will hit 0-10% in 2013E. Bottom-up earnings growth expectations are heading lower but still look too high.

Valuation – support

European equity valuations look reasonably to very attractive to us. In absolute terms, Europe trades on a 12-month forward P/E of 10x. This is 20% below its 25-year average. On an EV/EBITDA basis, ie balance sheet adjusted, UK and European equities have not looked this cheap in the last 20 years. We continue to argue that earnings (or margins) need to collapse to undermine the broad valuation support for European equities. This probably needs a global recession, which we think is unlikely in the next couple of years. But, it is also difficult to argue for a re-rating of equities in the near-term unless various macro risks recede

Themes

While there are plenty of macro risks across all regions, we see clear and stable macro mega-trends in what is often an unclear and unstable world: 1) de-leveraging, 2) lower growth, 3) divergence, and 4) low interest rates. We think that these trends are embedded for the next few years. Our investment strategy continues to be guided by this macro framework.

Sector Strategy

Our sector Overweights have an international and strong balance sheet bias. Our sector Underweights have a domestic and more levered tilt.

Figure 29. European Sector Strategy

Overweight	Neutral	Underweight
Basic Resources	Autos	Construction
Chemicals	Banks	Real Estate
Food & Bev	Financial Services	Retail
Insurance	Industrial G&S	Travel & Leisure
Personal & Household Goods	Technology	Oil & Gas↓
Media↑	Telecoms	
	Health Care↓	
	Utilities↑	

Source: Citi Research

Macro Highlights

Citi Economics

Jürgen Michels +44-20-7986-3294

Euro Economics Weekly — 6 Months On: Reiterating Our Bearish Case

Although some progress has been made by euro area governments at the EU summit of 28/29 June, the biggest challenge ahead remains the lack of growth – and in some cases the likelihood of extended recessions – as many euro area member states jointly pursue aggressive fiscal tightening programmes.

Michael Saunders +44-20-7986-3299

Sovereign Ratings Outlook — July 2012

Citi economists and strategists continue to expect further near-term rating downgrades in the euro area, and a broader range of downgrades over the longer term including the US, UK and Japan. We do not expect any upgrades among advanced economies, other than a technical one for Greece exiting from expected default status.

US Economics

Portfolio Economics — Event Study: Both Pain and Gain in U.S. Fiscal Tightening

Historical evidence suggests chronic deficit spending crowds out private investment, weakening productivity, wages and long-term output in the process. Looking forward, these are economic costs beyond a potential confidence crisis that might eventually be in store for the sovereign. But in tightening fiscal policy, U.S. experience suggests short-term transition costs can't be avoided.

Citi Rates

Mark Schofield +44-20-7986-9224

The ongoing yield shortage – but what to grab?

Core EMU yields have risen for the past three days. We think this is not driven by positioning and a loss of momentum in the "reach for yield" trade. If we are correct then there are a number of trades looking potentially overstretched: Bobls and Bunds could pull back to about 0.5% and 1.5%, respectively, and this would imply a re-steepening of 5s10s of about 15bp. We think that France may also underperform the other core markets, having been the most notable beneficiary of the reach for yield.

Citi Credit

Hans Lorenzen +44-20-7986-3568

European Credit Weekly — La France Vive!

The impact of the 0% deposit rate and low yields is having a growing impact on credit. Companies in France and the other 'softer core' countries are benefiting in particular. We think this will continue in the near term, but expect a correction in the medium term.

Citi Equity Strategy

Tobias M Levkovich +1-212-816-1623

Washington Watch — Three Months to Go and to Know

The elections are roughly three months away and the race remains tight. President Obama's approval ratings have improved but still shy of the elusive 50%. History suggests that a challenger's win is better for the S&P 500 in the subsequent year. Credit conditions argue for a better economy late in 2012 and into 2013 but near-term pressures are in place. The fiscal cliff continues to be a Sword of Damocles hanging over 2013 EPS.

Richard Schellbach +27-11-944-0085

South African Strategy Wrap — Foreign Equity Investors are Changing the Domestic Market

South Africa | Equity Strategy

Non-domestic investors have noticeably increased their presence in the South African equity market over recent years, now owning 43% of the MSCI South Africa index. We believe this increased level of foreign ownership has contributed to the markets re-rating relative to global equities. The gap, and diverging trend, between the proportion of foreign trade volumes versus foreign ownership suggests that international investors into South African equities are increasingly of the longer-horizon "buy & hold" investment approach.

GEMS Strategy — Breakdown? – Lower Rates and EM Equities

Geoffrey Dennis +1-212-816-8391

Breakdown? The role of monetary policy is being questioned around the world. Are developed economies in a liquidity-trap? Similar concerns exist in certain emerging markets (China, Brazil?). The worry for investors and equity strategists is why lower interest rates are not pushing equity markets higher. We would 'stay the course'; as EM monetary easing broadens, we expect equity markets to rally.

Julio R. Zamora +1-212-816-6039

Mexico Equity Strategy - Too hot? Or is there further to go?

Are Mexico equities fully valued yet? — The question we most often hear these days is what we still like in Mexico. The scenario we'll be living in a year's time could justify valuations or drive a reversion to mean valuations. There are many unknowns; we go through two (opposite) extreme scenarios. The valuation of the Mexican market is beginning to show, with above average P/E's and greater interest in smaller capitalization names.

The Point — Top Calls

Europe ex-UK

Antonella Bianchessi +39-02-8906-8715

Atlantia (ATL.MI) — A levered play on Italy – we prefer Snam

Italy | Infrastructure | Neutral

Initiating coverage with a Neutral rating and €10 target price. Atlantia is Europe's largest toll road player. Despite a recent reorganisation of the group's Latam presence, 80% of group EBITDA is still linked to the Italian economy, where poor growth and deflation could dent adjusted net earnings. We expect adjusted EPS to decline over the next two years (-2.9% in 2012 and -2.8% in 2013) implying a further 6-7% downside to consensus earnings. With an ETR of only 1.6%, we see better value and lower risk in Italian fully regulated names, particularly in Snam.

ABB Ltd (ABBN.VX) — Buy – Low Expectations Present Opportunity

Mark Fielding +44-20-7986-4018

Switzerland | Engineering | Buy

ABB is our top large-cap pick in the sector and is included in the "Citi Focus List Europe". ABB reports its 2Q results on Thursday 26 July. Against a recent backdrop of disappointment from many of the European capital goods companies we see consensus forecasts at ABB as more conservative suggesting relative resilience supporting our Buy case. 2013E EPS may have upside risks driven by improvement in Chinese Rail and Nuclear, the end of destocking in Italy, and a stabilisation of power pricing.

Henrik Christiansson +44-20-7986-4100

Nordic Banks - Strong 2Q12 Delivery, Nordea & Swedbank Show Strength

Sweden, Norway, Denmark, Finland | Banks

The Nordic banks reported so far have delivered strong numbers. With the banks continuing to deliver solid results and the domestic economies being relatively stronger the banks have lived up to their safe haven status so far. We expect the banks will continue to do relatively better as they benefit from strong capitalization, good access to funding markets, and better macro in core markets.

UK

Next Group PLC (NXT.L) — Business As Usual

Richard Edwards +44-20-7986-4006

United Kingdom | Retailing - Broadlines | Buy

Ahead of the 2Q IMS due on 1 August, we strike a £242m 1H PBT forecast, assuming 1H Next Brand sales +2.5% (broadly in the mid-point of the group's +1-4% 1H guidance), a stable gross margin and some modest operating cost leverage within the Directory. As a consequence of this robust 1H earnings forecast agenda, we modestly raise our FY13 PBT forecast to £593mn (from £588mn). As we are approaching 2H FY13 we roll forward our valuation reference year to FY15. Applying an 11x target January 2015E PE multiple we derive a 3700p target price (from 3300p). Buy rating maintained.

Michael E Flitton +44-20-7986-3943

China Rebalance - The Impact On Steel

United Kingdom | Metals - Steel

Consensus expectations are for China's steel industry to produce >1bt by 2025, with Citi's base case a more conservative 820mt in 2020F. Citi economists recently published the GPS report China is about to rebalance. How will EM be affected?, 16 July, arguing for an imminent rebalancing towards consumer-led growth. With China representing 45% of world steel demand, any adjustment in the intensity of China's investment profile is likely to have wide-ranging ramifications for the global industry. In this note we test the impact of this transition; our analysis highlights a possible 2020 production range of 480-720mt.

Weir Group PLC (WEIR.L) — Don't Expect the Answers Until Later in the Year

Mark Fielding +44-20-7986-4018

United Kingdom | Engineering | Neutral

We upgraded Weir to Neutral from Sell in June as we believed that most of the risks are now captured in the valuation. However, we noted at the time that we still saw significant uncertainties over the 2H12/2013 outlook for profits in the shale oil & gas business. We still see further consensus EPS downside risk and for 2013 we are c7% below consensus. However, 1H12 results are unlikely to provide the resolution of such concerns. We would not expect to get a clearer picture until 4Q.

Aquarius Platinum Ltd (AQP.L) — Model Update on June-Q Data

Jon H Bergtheil +44-20-7986-4453

United Kingdom | Precious Metals | Neutral

We update our model for the June-quarter data and for management forward looking comments in that release. Our 2012E EPS forecast moves from a loss of 5.4c to a loss of 10.3c, our 2013E EPS improves from 2c to 3.7c and our 2014E EPS from 3.9c to 7.0c. Our base case NPV for AQP of £0.51 is derived from a DCF model that assumes a discount rate of 9%. We set our target price at 0.8x NPV, deriving our new target price of $0.41. We set this level in recognition of the high risk of expropriation of a key asset, Mimosa. Rated Neutral.

Report of the Week

Global Economic Outlook & Strategy – July 2012

Willem Buiter +44-20-7986-5944

- We make only modest changes to our growth forecasts this month, and expect global growth of 2.5% in 2012 and 2.8% in 2013 at current exchange rates (versus 2.6% and 2.7% respectively last month). Our forecast remains well below those of the consensus and IMF, reflecting in particular a much weaker outlook for the euro area and a modestly weaker outlook for many emerging markets.
- Within this subpar global outlook, we remain gloomy on the euro crisis. Our base case is for prolonged economic weakness and financial market strains in periphery countries, spilling over into renewed recession for the euro area as a whole this year and the next. We now believe the probability that Greece will leave EMU in the next 12-18 months is about 90%, up from our previous 50-75% estimate, and believe the most likely date is in the next 2-3 quarters. As before, for the sake of argument, we assume that "Grexit" occurs on 1 January 2013, but we stress this is an assumption rather than a forecast of the precise date. Even with the Spanish bank bailout, we continue to expect that both Spain and Italy are likely to enter some form of Troika bailout for the sovereign by the end of 2012. Over the next few years, the EA end-game is likely to be a mix of EMU exit (Greece), a significant amount of sovereign debt and bank debt restructuring (Portugal, Ireland and, eventually, perhaps Italy, Spain and Cyprus) with only limited fiscal burden-sharing.
- Major central banks are likely to keep policy loose or ease further, with the ECB likely to cut the refi rate to 0.25% (and to cut the deposit rate below zero) in the next 2-3 quarters. Predicated on economic weakness in the periphery plus "Grexit", we expect a wide series of ratings downgrades among EMU countries in the next 2-3 quarters, with at least a one-notch downgrade by at least one major agency for Austria, Belgium, France, Germany, Greece, Ireland, Italy, the Netherlands, Portugal and Spain. We continue to expect a one-notch downgrade for both the US and Japan over the next 2-3 years. In addition, with economic weakness and fiscal slippage, we believe the UK also may lose its AAA sovereign rating over the next 2-3 years.

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Valuation Tables

Figure 30. Pan-European Sector Weightings & Returns

As at Close 24 Jul 12	Mkt Cap	% of	Return Relative to DJ Stoxx				Absolute Return			
Sector (No of Stocks)	(Euros m)	DJ Stoxx	1m	3m	12m	Ytd	1m	3m	12m	Ytd
Oil & Gas (34)	505,976	10.1	3	0	6	-6	5	0	1	-2
Chemicals (23)	247,396	4.9	3	0	2	7	4	0	-3	12
Basic Resources (30)	222,488	4.4	-2	-11	-22	-11	-1	-11	-26	-6
Construction & Materials (23)	108,807	2.2	-3	-2	-11	-5	-1	-2	-15	0
Industrial G&S (103)	524,618	10.4	2	-2	-1	4	4	-2	-6	9
Automobiles & Parts (14)	114,602	2.3	1	-7	-20	7	3	-7	-23	12
Food & Beverage (28)	479,520	9.5	4	6	26	9	6	6	20	15
Personal & H'hold Goods (31)	321,397	6.4	3	4	20	11	5	4	15	16
Health Care (35)	604,412	12.0	3	7	23	6	4	7	17	12
Retail (25)	166,580	3.3	0	3	6	-3	1	3	1	2
Media (28)	120,963	2.4	4	6	8	3	6	6	2	8
Travel & Leisure (21)	68,360	1.4	1	5	13	11	3	5	7	16
Telecommunications (20)	282,162	5.6	-2	3	2	-7	0	3	-3	-2
Utilities (25)	218,130	4.3	-5	-3	-11	-8	-4	-3	-15	-3
Banks (46)	500,540	10.0	-10	-10	-28	-11	-9	-10	-31	-6
Insurance (32)	252,471	5.0	-3	-2	-5	2	-1	-2	-9	7
Real Estate (25)	70,160	1.4	5	8	5	13	6	8	0	19
Financial Services (30)	66,933	1.3	0	0	-8	3	2	0	-13	9
Technology (27)	150,289	3.0	1	0	0	0	2	0	-4	5
Stoxx - Pan Europe (600)	5,025,806	100.0	—	—	—	—	2	0	-5	5
Pan Euro - Large Cap	4,130,787	82.2	0	0	1	0	2	0	-4	5
Pan Euro - Mid Cap	623,832	12.4	0	-2	-3	2	1	-2	-7	7
Pan Euro - Small Cap	271,186	5.4	-1	-1	-4	3	1	-1	-8	8
Stoxx ex UK - Europe ex UK (417)	3,163,539	62.9	—	—	—	—	1	-1	-11	2
EuroStoxx - Eurozone (299)	2,069,319	41.2	—	—	—	—	-1	-3	-18	-1

Source: Citi Investment Research and Analysis & DataStream

Figure 31. Pan-European Sector Relative Ratings

As at Close 24 Jul 12	P/E Relative to DJ Stoxx				Yield Relative to DJ Stoxx			
Sector	2011	2012E	2013E	2014E	2011	2012E	2013E	2014E
Oil & Gas	85	79	90	94	102	105	102	97
Chemicals	104	112	115	113	75	75	72	72
Basic Resources	68	87	76	76	78	83	86	87
Construction & Materials	97	107	104	100	105	103	100	99
Industrial Goods & Services	118	114	115	114	86	84	83	83
Automobiles & Parts	60	65	63	61	98	107	118	124
Food & Beverage	165	156	159	159	67	73	73	74
Personal & H'hold Goods	155	142	142	141	65	70	73	76
Health Care	111	115	118	118	87	91	90	91
Retail	118	116	119	120	90	93	93	94
Media	101	102	108	112	119	106	103	102
Travel & Leisure	140	157	134	125	73	72	74	76
Telecommunications	81	87	94	99	202	168	173	164
Utilities	86	82	97	99	173	165	152	145
Banks	78	80	67	65	109	113	124	133
Insurance	84	63	66	68	128	135	131	129
Real Estate	152	159	170	177	117	115	107	103
Financial Services	114	103	95	91	126	132	123	123
Technology	126	163	137	134	63	58	52	53
Stoxx - Pan Europe	100	100	100	100	100	100	100	100
Pan Euro - Large Cap	96	97	98	99	102	103	102	102
Pan Euro - Mid Cap	119	119	111	108	91	88	89	90
Pan Euro - Small Cap	131	114	108	105	90	88	87	91
Stoxx ex UK - Europe ex UK	99	99	99	98	106	102	101	101
Stoxx Eurozone - Eurozone	89	92	91	90	117	109	107	107

Source: Citi Investment Research and Analysis & DataStream

Figure 32. Pan-European Sector Growth

As at Close 24 Jul 12	Earnings Growth %			Net Dividend Growth %		
Sector	2012E	2013E	2014E	2012E	2013E	2014E
Oil & Gas	14.8	-1.5	6.0	9.0	6.8	3.6
Chemicals	-0.7	9.2	12.3	5.6	6.1	8.1
Basic Resources	-16.9	28.2	10.8	12.9	13.8	10.0
Construction & Materials	-3.4	15.9	14.3	3.2	7.3	7.9
Industrial Goods & Services	11.0	11.6	10.7	4.4	8.5	8.2
Automobiles & Parts	-1.9	17.1	12.2	16.1	21.8	13.9
Food & Beverage	13.0	10.6	9.6	14.8	11.1	9.3
Personal & H'hold Goods	16.5	12.7	10.9	13.4	15.5	12.2
Health Care	3.1	9.8	10.1	9.6	10.1	9.0
Retail	9.0	9.7	9.2	9.9	10.6	9.3
Media	5.6	6.1	6.2	-5.6	7.5	6.9
Travel & Leisure	-5.0	32.0	18.1	5.0	13.4	10.8
Telecommunications	-0.6	3.7	4.4	-12.3	13.7	2.9
Utilities	11.9	-4.8	8.5	0.9	1.8	3.9
Banks	3.9	34.5	14.2	10.2	21.7	15.5
Insurance	41.6	8.0	7.0	11.4	7.1	6.5
Real Estate	1.7	5.2	5.9	3.4	3.4	4.1
Financial Services	18.0	21.7	14.5	10.6	3.3	8.4
Technology	-17.7	33.2	13.2	-2.5	-1.5	10.8
Stoxx - Pan Europe	6.8	12.4	10.0	5.8	10.6	8.3
Pan Euro - Large Cap	6.0	11.0	9.4	6.4	10.3	7.9
Pan Euro - Mid Cap	7.2	20.3	13.6	2.3	12.9	9.2
Pan Euro - Small Cap	22.6	19.6	12.8	3.2	9.8	13.5
Stoxx ex UK - Europe ex UK	6.0	13.4	10.9	1.0	9.8	8.6
Stoxx Eurozone - Eurozone	4.0	13.4	10.8	-1.8	8.8	7.6

Source: Citi Investment Research and Analysis & DataStream

Figure 33. Pan-European Sector Ratings

As at Close 24 Jul 12	Price/Earnings				Net Dividend Yield			
Sector	2011	2012E	2013E	2014E	2011	2012E	2013E	2014E
Oil & Gas	9.8	8.5	8.7	8.2	4.11	4.48	4.78	4.96
Chemicals	12.0	12.1	11.1	9.9	3.01	3.18	3.37	3.65
Basic Resources	7.8	9.4	7.3	6.6	3.14	3.55	4.04	4.44
Construction & Materials	11.2	11.5	10.0	8.7	4.24	4.37	4.69	5.06
Industrial Goods & Services	13.6	12.3	11.0	9.9	3.44	3.59	3.89	4.21
Automobiles & Parts	6.9	7.0	6.0	5.4	3.92	4.55	5.55	6.32
Food & Beverage	19.0	16.8	15.2	13.9	2.69	3.09	3.43	3.75
Personal & H'hold Goods	17.9	15.4	13.6	12.3	2.63	2.98	3.45	3.87
Health Care	12.8	12.4	11.3	10.3	3.51	3.85	4.24	4.62
Retail	13.7	12.5	11.4	10.5	3.60	3.96	4.38	4.79
Media	11.6	11.0	10.3	9.7	4.77	4.50	4.84	5.17
Travel & Leisure	16.1	17.0	12.8	10.9	2.93	3.07	3.49	3.86
Telecommunications	9.3	9.4	9.0	8.7	8.14	7.13	8.11	8.34
Utilities	10.0	8.9	9.4	8.6	6.94	7.00	7.12	7.40
Banks	9.0	8.7	6.4	5.6	4.36	4.81	5.85	6.75
Insurance	9.7	6.9	6.3	5.9	5.16	5.75	6.15	6.55
Real Estate	17.5	17.2	16.3	15.4	4.72	4.88	5.05	5.26
Financial Services	13.1	11.1	9.1	8.0	5.07	5.61	5.79	6.28
Technology	14.5	17.6	13.2	11.7	2.54	2.48	2.44	2.71
Stoxx - Pan Europe	11.5	10.8	9.6	8.7	4.02	4.25	4.70	5.09
Pan Euro - Large Cap	11.1	10.5	9.4	8.6	4.10	4.36	4.81	5.19
Pan Euro - Mid Cap	13.8	12.8	10.7	9.4	3.64	3.72	4.20	4.59
Pan Euro - Small Cap	15.1	12.4	10.3	9.2	3.62	3.73	4.10	4.65
Stoxx ex UK - Europe ex UK	11.4	10.7	9.5	8.5	4.28	4.32	4.74	5.15
Stoxx Eurozone - Eurozone	10.3	9.9	8.7	7.9	4.72	4.64	5.04	5.43

Source: Citi Investment Research and Analysis & DataStream

Figure 34. 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 (2)	19,976	0.4	-2	-9	-30	-8	1	-10	-33	-3
Belgium (10)	81,007	1.6	5	10	21	18	8	8	15	24
Denmark (14)	96,306	1.9	5	4	17	17	8	3	12	23
Finland (16)	63,117	1.3	-2	-13	-16	-12	1	-14	-20	-7
France (19)	689,114	13.8	-1	0	-10	-3	2	-2	-14	2
Germany (84)	624,088	12.5	1	-3	-8	4	5	-4	-12	9
Greece (67)	4,783	0.1	1	-19	-62	-21	4	-20	-64	-17
Ireland (3)	32,794	0.7	-3	-2	16	-4	1	-3	11	1
Italy (8)	157,955	3.2	-7	-10	-25	-18	-4	-11	-29	-13
Netherlands (30)	193,411	3.9	3	4	4	0	6	3	0	5
Norway (29)	80,566	1.6	7	2	11	6	11	1	5	12
Portugal (15)	12,091	0.2	-9	-14	-31	-24	-6	-15	-35	-20
Spain (5)	174,090	3.5	-11	-11	-31	-29	-8	-12	-34	-26
Sweden (28)	249,266	5.0	6	6	9	8	9	5	4	14
Switzerland (40)	668,081	13.3	1	2	6	3	4	1	2	9
UK (183)	1,862,267	37.2	0	3	14	3	3	2	9	8
Stoxx - Pan Europe	5,008,912	100								

Source: Citi Investment Research and Analysis & DataStream

Figure 35. Pan-European Country Relative Ratings

As at Close 24 Jul 12	Price/Earnings				Net Dividend Yield			
Country	2011	2012E	2013E	2014E	2011	2012E	2013E	2014E
Austria	176	90	77	72	84	89	104	102
Belgium	137	126	132	127	73	84	81	82
Denmark	202	166	151	135	40	47	55	60
Finland	108	148	121	123	151	130	106	102
France	88	91	93	92	110	109	108	108
Germany	95	89	92	93	97	96	94	93
Greece	171	220	94	66	129	138	152	161
Ireland	154	158	151	142	50	50	48	43
Italy	75	71	73	71	128	117	112	115
Netherlands	96	93	95	95	87	81	78	78
Norway	103	95	97	94	122	110	114	118
Portugal	91	82	83	84	199	149	149	142
Spain	63	94	74	76	265	195	202	195
Sweden	112	115	119	120	93	98	95	95
Switzerland	124	118	116	116	85	87	88	91
UK	102	101	103	104	89	97	98	98
EuroStoxx - Eurozone	89	92	91	90	117	109	107	107
Stoxx ex UK - Europe ex UK	99	99	99	98	106	102	101	101
Stoxx - Pan Europe	100	100	100	100	100	100	100	100

Source: Citi Investment Research and Analysis & DataStream

Figure 36. Pan-European Country Growth

As at Close 24 Jul 12	Earnings Growth %			Dividend Growth %		
Country	2012E	2013E	2014E	2012E	2013E	2014E
Austria	108.9	30.8	18.2	12.4	29.0	6.2
Belgium	16.4	6.9	14.6	20.8	6.9	9.5
Denmark	29.8	23.3	23.7	24.9	29.0	18.5
Finland	-22.1	37.1	8.3	-9.3	-10.0	4.4
France	2.9	10.5	11.4	4.4	9.7	8.7
Germany	14.1	8.1	9.3	5.2	7.7	7.3
Greece	-17.0	163.5	55.8	12.9	22.1	14.9
Ireland	4.0	17.0	17.4	3.8	6.6	-2.7
Italy	12.1	8.9	13.7	-3.5	5.7	10.9
Netherlands	10.3	9.9	9.7	-1.4	6.3	8.8
Norway	15.5	9.3	14.1	-5.3	15.2	11.9
Portugal	17.7	11.7	8.5	-20.5	10.3	3.0
Spain	-28.4	41.5	8.2	-22.3	14.7	4.6
Sweden	4.5	8.5	8.6	11.9	7.8	8.1
Switzerland	11.7	14.6	10.2	7.8	12.3	11.1
UK	8.2	10.7	8.5	15.4	11.9	7.8
EuroStoxx - Eurozone	4.0	13.4	10.8	-1.8	8.8	7.6
Stoxx ex UK - Europe ex UK	6.0	13.4	10.9	1.0	9.8	8.6
Stoxx - Pan Europe	6.8	12.4	10.0	5.8	10.6	8.3

Source: Citi Investment Research and Analysis & DataStream

Figure 37. Pan-European Country Ratings

As at Close 24 Jul 12	Price/Earnings				Net Dividend Yield			
Country	2011	2012E	2013E	2014E	2011	2012E	2013E	2014E
Austria	20.3	9.7	7.4	6.3	3.38	3.80	4.90	5.21
Belgium	15.8	13.6	12.7	11.1	2.95	3.56	3.81	4.17
Denmark	23.3	17.9	14.5	11.8	1.59	1.99	2.57	3.04
Finland	12.4	15.9	11.6	10.7	6.08	5.51	4.96	5.17
France	10.1	9.9	8.9	8.0	4.42	4.62	5.06	5.51
Germany	10.9	9.6	8.9	8.1	3.89	4.09	4.41	4.73
Greece	19.7	23.8	9.0	5.8	5.18	5.84	7.13	8.19
Ireland	17.7	17.0	14.5	12.4	2.03	2.11	2.24	2.18
Italy	8.6	7.7	7.1	6.2	5.15	4.97	5.25	5.83
Netherlands	11.1	10.1	9.1	8.3	3.48	3.43	3.64	3.96
Norway	11.8	10.2	9.4	8.2	4.92	4.66	5.36	6.00
Portugal	10.4	8.9	7.9	7.3	7.99	6.35	7.01	7.21
Spain	7.2	10.1	7.1	6.6	10.66	8.28	9.50	9.94
Sweden	12.9	12.4	11.4	10.5	3.72	4.16	4.49	4.85
Switzerland	14.3	12.8	11.1	10.1	3.43	3.70	4.15	4.61
UK	11.8	10.9	9.9	9.1	3.58	4.13	4.62	4.98
EuroStoxx - Eurozone	10.3	9.9	8.7	7.9	4.72	4.64	5.04	5.43
Stoxx ex UK - Europe ex UK	11.4	10.7	9.5	8.5	4.28	4.32	4.74	5.15
Stoxx - Pan Europe	11.5	10.8	9.6	8.7	4.02	4.25	4.70	5.09

Source: Citi Investment Research and Analysis & DataStream

Figure 38. UK Sector Weightings & Relative Returns

As at Close 24 Jul 2012	Mkt Cap £m	% of AllShare	% of Group	Relative return 1m	3m	12m	Qtd	Ytd
OIL & GAS (26)	295,452	18.0		0	0	0	0	0
Oil & Gas Producers (19)	284,146	17.3	96	3	1	0	1	-8
Oil Equip, Serv and Distrib (7)	11,306	0.7	4	6	-11	-5	5	2
BASIC MATERIALS (38)	160,193	9.8		-4	-14	-30	-4	-14
Chemicals (7)	11,227	0.7	7	-2	-4	6	-1	18
Forestry & Paper (1)	1,989	0.1	1	-1	0	-5	0	20
Industrial Metals & Mining (4)	1,227	0.1	1	-20	-35	-65	-18	-40
Mining (26)	145,750	8.9	91	-4	-15	-31	-4	-16
INDUSTRIALS (110)	145,134	8.8		1	-1	7	0	7
Construction & Materials (11)	12,180	0.7	8	3	-1	-8	-5	-4
Aerospace (9)	34,547	2.1	24	2	4	19	2	10
General Industrials (6)	11,717	0.7	8	5	1	6	4	16
Electronic & Electrical Equip (12)	6,847	0.4	5	-4	-7	-5	-3	14
Industrial Engineering (12)	13,720	0.8	9	0	-10	-6	-1	-6
Industrial Transportation (8)	1,800	0.1	1	-4	-2	-8	-4	3
Support Services (52)	64,323	3.9	44	0	-1	9	0	8
CONSUMER GOODS (35)	233,790	14.2		3	5	21	3	9
Automobiles & Parts (2)	3,167	0.2	1	12	4	-9	12	9
Beverages (4)	67,687	4.1	29	5	7	31	3	15
Food Producers (11)	35,511	2.2	15	3	6	15	1	1
Household Goods & Home Const (11)	30,913	1.9	13	1	0	11	2	11
Leisure Goods (1)	86	0.0	0	-13	-15	-37	-11	-29
Personal Goods (4)	6,761	0.4	3	-4	-7	-18	-2	2
Tobacco (2)	89,663	5.5	38	3	6	25	3	7
HEALTH CARE (13)	130,551	8.0		0	4	12	2	-1
Health Care Equip & Services (5)	6,796	0.4	5	5	10	6	3	4
Pharmaceuticals & Biotech (8)	123,755	7.5	95	0	4	12	2	-2
CONSUMER SERVICES (84)	151,357	9.2		1	3	3	1	1
Food & Drug Retailers (6)	37,951	2.3	25	1	3	-8	3	-16
General Retailers (22)	24,393	1.5	16	-3	-1	3	-3	9
Media (23)	45,101	2.7	30	4	4	9	2	6
Travel & Leisure (33)	43,912	2.7	29	1	5	8	0	9
TELECOMMUNICATIONS (9)	110,228	6.7		1	10	20	1	3
Fixed-Line Telecoms (7)	20,665	1.3	19	5	7	17	3	14
Mobile Telecoms (2)	89,563	5.5	81	0	10	21	0	1
UTILITIES (7)	65,176	4.0		0	4	14	-1	8
Electricity (2)	14,778	0.9	23	-2	4	7	-2	4
Gas, Water & Multi-Utilities (5)	50,399	3.1	77	0	4	16	-1	9
TECHNOLOGY (27)	24,206	1.5		2	5	10	3	5
Software & Computer Serv (16)	13,607	0.8	56	5	12	24	5	17
Technology Hardware & Equip (11)	10,599	0.6	44	-1	-4	-6	1	-8
TOTAL NON-FINANCIAL (349)	1,316,087	80.2		1	1	3	1	-1
FINANCIALS (253)	325,660	19.8		-4	-3	-9	-5	4
Banks (6)	154,869	9.4	48	-10	-8	-16	-6	1
Non-Life Insurance (9)	13,985	0.9	4	2	6	-1	1	13
Life Insurance (9)	50,695	3.1	16	0	1	4	0	8
Real Estate Inv. Servs (23)	5,790	0.4	2	5	5	-1	4	8
REITS (17)	23,780	1.4	7	5	11	-2	4	17
Financial Services (27)	25,783	1.6	8	-2	-2	-14	-2	5
Equity Inv Instruments (162)	50,759	3.1	16	1	0	-4	1	2
FTSE ALL SHARE (602)	1,641,747	100.0		0	0	0	0	0
FTSE 100 (100)	1,394,372	84.9		0	0	0	0	-1
Mid 250 (250)	210392	13		1	0	-1	-1	7
Small Cap (252)	36,983	2		1	-1	-4	-1	7

Source: Citi Investment Research and Analysis & DataStream

Figure 39. UK Relative Ratings

	P/E Relative				Yield Relative			
As at Close 24 Jul 2012	2011E	2012E	2013E	2014E	2011E	2012E	2013E	2014E
OIL & GAS	87	81	92	95	93	95	94	91
Oil & Gas Producers	86	80	91	95	94	96	95	91
Oil Equip, Serv and Distrib	141	116	102	94	61	69	75	83
BASIC MATERIALS	67	85	75	74	77	79	82	85
Chemicals	138	132	129	126	63	64	65	67
Forestry & Paper	86	111	105	103	106	91	96	93
Industrial Metals & Mining	78	134	118	18366	12	56	17	10
Mining	64	82	73	71	78	81	84	87
INDUSTRIALS	119	113	112	111	78	78	77	77
Construction & Materials	120	123	116	109	121	109	102	98
Aerospace	108	103	104	108	88	87	85	84
General Industrials	105	100	99	99	88	90	91	92
Electronic & Electrical Equip	125	117	115	115	50	51	52	53
Industrial Engineering	116	105	109	111	72	74	74	73
Industrial Transportation	92	98	94	93	117	113	108	105
Support Services	130	123	119	117	66	66	67	69
CONSUMER GOODS	154	144	141	139	81	80	82	85
Automobiles & Parts	85	72	71	70	75	84	84	85
Beverages	180	166	160	157	61	62	62	62
Food Producers	150	142	144	145	87	83	79	79
Household Goods & Home Const	140	129	131	127	74	67	80	89
Personal Goods	192	169	155	144	49	54	59	64
Tobacco	146	139	136	134	99	99	101	104
HEALTH CARE	95	102	104	103	122	117	113	111
Health Care Equip & Services	132	130	126	127	43	45	45	46
Pharmaceuticals & Biotech	93	101	103	102	126	121	117	114
CONSUMER SERVICES	106	109	108	108	96	90	90	90
Food & Drug Retailers	97	98	101	103	114	107	104	102
General Retailers	100	101	99	98	95	91	90	92
Media	115	111	111	113	93	88	87	87
Travel & Leisure	110	126	117	113	83	79	80	81
TELECOMMUNICATIONS	105	106	110	115	163	171	164	159
Fixed-Line Telecoms	93	90	92	95	105	103	106	112
Mobile Telecoms	107	111	116	121	177	186	177	170
UTILITIES	122	119	124	127	136	133	127	123
Electricity	111	111	124	124	146	140	128	123
Gas, Water & Multi-Utilities	125	121	124	127	133	131	126	123
TECHNOLOGY	176	167	154	150	46	47	48	49
Software & Computer Serv	142	136	128	128	61	62	61	61
Technology Hardware & Equip	254	235	206	193	27	28	31	33
TOTAL NON-FINANCIAL	101	102	104	105	98	98	97	96
FINANCIALS	97	90	84	82	111	112	116	120
Banks	84	81	75	72	100	101	113	121
Non-Life Insurance	193	87	90	92	168	149	144	141
Life Insurance	87	84	82	84	130	135	132	129
Real Estate Inv. Servs	263	233	201	184	51	54	58	59
REITS	195	202	208	208	102	99	94	91
Financial Services	140	114	91	87	129	131	122	125
FTSE ALL SHARE	100	100	100	100	100	100	100	100
FTSE 100	96	99	99	100	102	103	103	103
Mid 250	144	113	108	106	84	78	78	80
Small Cap	90	88	82	81	85	82	83	86

Source: Citi Investment Research and Analysis & DataStream

Figure 40. UK Sector Growth

As at Close 24 Jul 2012	Earnings Growth % 2012E	2013E	2014E	Net Dividend Growth % 2012E	2013E	2014E
OIL & GAS	9.9	-5.3	4.4	9.3	7.9	3.3
Oil & Gas Producers	9.6	-6.1	3.9	9.1	7.6	2.8
Oil Equip, Serv and Distrib	24.7	21.3	18.0	20.1	18.4	19.3
BASIC MATERIALS	-19.7	20.7	9.8	10.5	12.8	10.8
Chemicals	7.0	10.2	10.5	10.3	10.1	10.7
Forestry & Paper	-20.3	12.8	10.9	-8.2	15.3	4.2
Industrial Metals & Mining	-40.1	22.1	-99.3	397.3	-67.5	-36.1
Mining	-20.5	21.2	10.3	10.3	13.4	11.0
INDUSTRIALS	6.8	9.0	8.8	6.6	7.8	7.4
Construction & Materials	-0.1	13.5	15.2	-3.1	2.3	2.2
Aerospace	6.6	6.1	4.9	6.7	6.1	6.3
General Industrials	7.2	9.0	8.5	10.1	9.2	8.7
Electronic & Electrical Equip	8.8	8.9	8.5	10.2	9.8	9.8
Industrial Engineering	12.3	3.3	7.0	10.3	7.7	7.0
Industrial Transportation	-4.7	12.1	10.0	3.6	4.1	3.8
Support Services	7.2	11.3	10.5	8.0	10.3	9.5
CONSUMER GOODS	9.1	9.2	10.2	6.2	11.5	10.8
Automobiles & Parts	20.1	9.9	9.0	20.0	9.4	9.0
Beverages	10.5	11.4	10.5	8.3	8.8	8.7
Food Producers	8.5	5.5	7.6	2.1	3.9	6.7
Household Goods & Home Cor	10.7	5.6	12.3	-2.7	29.4	19.4
Personal Goods	16.1	17.0	17.2	19.8	17.4	17.7
Tobacco	6.9	10.2	9.8	8.1	10.8	10.4
HEALTH CARE	-5.7	6.1	9.5	3.3	5.2	5.1
Health Care Equip & Services	3.6	10.6	7.7	11.9	10.7	9.7
Pharmaceuticals & Biotech	-6.1	5.9	9.6	3.2	5.1	5.0
CONSUMER SERVICES	-1.1	8.8	8.4	1.4	7.8	7.4
Food & Drug Retailers	0.9	4.1	6.1	0.8	5.7	5.6
General Retailers	1.0	8.9	9.7	2.5	7.8	9.4
Media	5.8	7.2	6.7	0.8	8.3	6.7
Travel & Leisure	-11.0	15.7	11.7	2.1	9.9	9.1
TELECOMMUNICATIONS	0.5	3.2	4.2	12.5	4.2	4.1
Fixed-Line Telecoms	5.9	4.7	5.4	6.0	11.3	13.4
Mobile Telecoms	-0.9	2.8	3.9	13.4	3.3	2.8
UTILITIES	4.7	3.1	6.0	5.1	3.4	4.4
Electricity	2.6	-3.8	8.2	3.3	-0.7	3.5
Gas, Water & Multi-Utilities	5.4	5.3	5.4	5.7	4.7	4.6
TECHNOLOGY	7.6	16.5	11.0	9.8	11.0	9.1
Software & Computer Serv	6.3	13.8	8.6	9.0	8.4	6.5
Technology Hardware & Equip	10.4	22.6	15.9	12.3	18.1	15.9
TOTAL NON-FINANCIAL	0.2	5.7	7.6	7.3	7.7	6.5
FINANCIALS	10.4	14.5	12.2	8.1	12.9	11.4
Banks	6.4	15.3	14.3	8.9	21.0	15.5
Non-Life Insurance	126.2	4.2	5.7	-4.2	4.5	5.4
Life Insurance	6.1	8.8	6.7	11.6	5.7	5.6
Real Estate Inv. Servs	15.4	24.5	18.2	13.0	15.8	10.5
REITS	-1.5	4.4	8.8	3.5	3.6	4.5
Financial Services	25.2	35.2	13.1	9.0	1.7	9.7
FTSE ALL SHARE	2.0	7.4	8.5	7.4	8.7	7.5
FTSE 100	-0.3	6.7	8.4	8.2	8.7	7.2
Mid 250	29.8	13.3	9.8	0.1	9.3	9.7
Small Cap	4.7	15.0	9.9	3.6	10.5	10.4

Source: Citi Investment Research and Analysis & DataStream

Figure 41. UK Sector Ratings

	Price/Earnings				Net Dividend Yield			
As at Close 24 Jul 2012	2011E	2012E	2013E	2014E	2011E	2012E	2013E	2014E
OIL & GAS	9.3	8.5	9.0	8.6	3.66	4.00	4.32	4.46
Oil & Gas Producers	9.2	8.4	8.9	8.6	3.71	4.05	4.35	4.48
Oil Equip, Serv and Distrib	15.1	12.1	10.0	8.5	2.41	2.89	3.43	4.09
BASIC MATERIALS	7.1	8.9	7.4	6.7	3.03	3.35	3.78	4.19
Chemicals	14.8	13.9	12.6	11.4	2.46	2.72	2.99	3.31
Forestry & Paper	9.3	11.6	10.3	9.3	4.17	3.82	4.41	4.60
Industrial Metals & Mining	8.4	14.0	11.5	1,654.3	0.47	2.36	0.77	0.49
Mining	6.8	8.6	7.1	6.4	3.08	3.40	3.85	4.28
INDUSTRIALS	12.7	11.9	10.9	10.0	3.07	3.27	3.52	3.79
Construction & Materials	12.9	12.9	11.4	9.9	4.74	4.59	4.70	4.81
Aerospace	11.6	10.8	10.2	9.7	3.46	3.69	3.92	4.16
General Industrials	11.3	10.5	9.7	8.9	3.46	3.81	4.16	4.52
Electronic & Electrical Equip	13.4	12.3	11.3	10.4	1.95	2.15	2.36	2.59
Industrial Engineering	12.4	11.0	10.7	10.0	2.84	3.14	3.38	3.61
Industrial Transportation	9.8	10.3	9.2	8.4	4.60	4.77	4.96	5.15
Support Services	13.9	13.0	11.7	10.5	2.60	2.80	3.09	3.39
CONSUMER GOODS	16.5	15.1	13.8	12.5	3.18	3.38	3.77	4.17
Automobiles & Parts	9.1	7.6	6.9	6.3	2.94	3.52	3.85	4.20
Beverages	19.3	17.5	15.7	14.2	2.40	2.60	2.83	3.07
Food Producers	16.1	14.9	14.1	13.1	3.43	3.50	3.64	3.88
Household Goods & Home Co	15.0	13.6	12.8	11.4	2.92	2.84	3.68	4.40
Personal Goods	20.6	17.8	15.2	12.9	1.92	2.30	2.70	3.18
Tobacco	15.6	14.6	13.3	12.1	3.87	4.18	4.64	5.12
HEALTH CARE	10.1	10.8	10.1	9.3	4.78	4.94	5.20	5.46
Health Care Equip & Services	14.1	13.6	12.3	11.4	1.68	1.88	2.08	2.28
Pharmaceuticals & Biotech	10.0	10.6	10.0	9.2	4.95	5.10	5.36	5.63
CONSUMER SERVICES	11.3	11.5	10.5	9.7	3.76	3.81	4.11	4.42
Food & Drug Retailers	10.4	10.3	9.9	9.3	4.46	4.50	4.75	5.02
General Retailers	10.7	10.6	9.7	8.8	3.73	3.83	4.13	4.52
Media	12.4	11.7	10.9	10.2	3.67	3.70	4.00	4.27
Travel & Leisure	11.7	13.2	11.4	10.2	3.26	3.33	3.65	3.99
TELECOMMUNICATIONS	11.2	11.1	10.8	10.4	6.41	7.22	7.52	7.83
Fixed-Line Telecoms	10.0	9.4	9.0	8.6	4.12	4.36	4.86	5.51
Mobile Telecoms	11.5	11.6	11.3	10.9	6.93	7.86	8.12	8.35
UTILITIES	13.1	12.5	12.1	11.4	5.35	5.62	5.81	6.07
Electricity	11.9	11.6	12.1	11.2	5.73	5.92	5.87	6.08
Gas, Water & Multi-Utilities	13.4	12.7	12.1	11.5	5.24	5.53	5.80	6.06
TECHNOLOGY	18.8	17.5	15.0	13.5	1.81	1.98	2.20	2.40
Software & Computer Serv	15.2	14.3	12.5	11.5	2.38	2.60	2.82	3.00
Technology Hardware & Equip	27.2	24.6	20.1	17.3	1.06	1.20	1.41	1.64
TOTAL NON-FINANCIAL	10.8	10.8	10.2	9.5	3.84	4.11	4.43	4.72
FINANCIALS	10.4	9.4	8.2	7.3	4.36	4.72	5.32	5.93
Banks	9.0	8.5	7.4	6.5	3.92	4.27	5.16	5.96
Non-Life Insurance	20.7	9.1	8.8	8.3	6.58	6.30	6.59	6.94
Life Insurance	9.3	8.8	8.1	7.6	5.11	5.71	6.03	6.37
Real Estate Inv. Servs	28.2	24.4	19.6	16.6	2.02	2.28	2.64	2.92
REITS	20.9	21.3	20.4	18.7	4.02	4.16	4.31	4.50
Financial Services	15.0	12.0	8.9	7.8	5.06	5.52	5.61	6.15
FTSE ALL SHARE	10.7	10.5	9.8	9.0	3.93	4.22	4.59	4.93
FTSE 100	10.3	10.4	9.7	9.0	4.01	4.34	4.72	5.06
Mid 250	15.5	11.9	10.5	9.6	3.29	3.29	3.60	3.95
Small Cap	9.6	9.2	8.0	7.3	3.34	3.46	3.83	4.23

Source: Citi Investment Research and Analysis & DataStream

Figure 42. Companies Mentioned

Stock	RIC Code	Rating	Price	Currency
ABB	ABBN.VX	1	16.52	CHF
Aquarius Platinum Ltd	AQP.L	2	0.39	GBP
Atlantia	ATL.MI	2	10.02	EUR
BSkyB	BSY.L	1	7.07	GBP
Informa	INF.L	1	3.57	GBP
ITV	ITV.L	1	0.76	GBP
Next	NXT.L	1	32.12	GBP
Pearson	PSON.L	2	12.95	GBP
Reed Elsevier	REL.L	1	5.43	GBP
Snam Rete Gas SpA	SRG.IT	1	3.23	EUR
TF1	TFFP.PA	1	6.87	EUR
Weir Group	WEIR.L	2	15.97	GBP
Wolters Kluwer	WLSNc.AS	3	13.85	EUR

Note: Prices as at Close 25 July 2012. Source: Citi Research

Notes

Appendix A-1

Analyst Certification

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