Global
Equity Strategy (Citi)

Equities

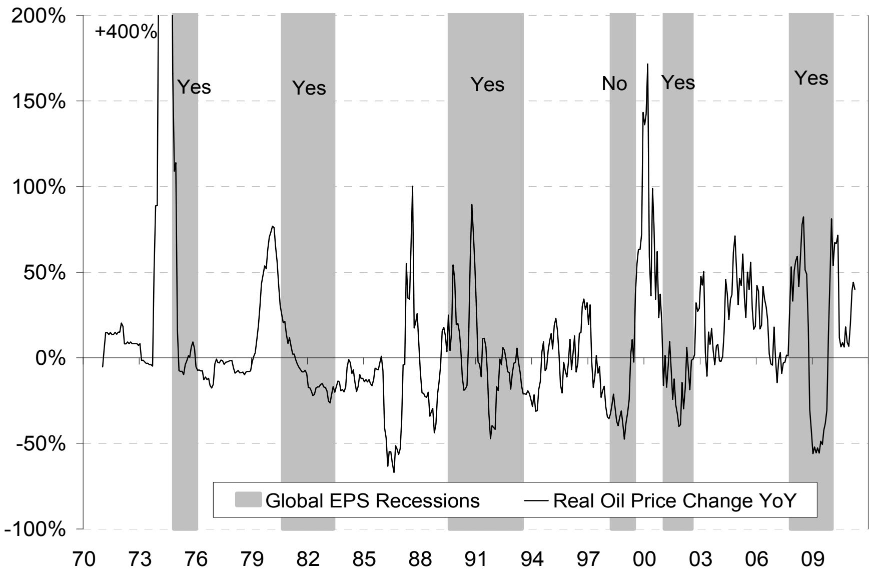
30 March 2011 | 24 pages

Global Equity Strategist

Commodity Risk

- **Big Oil** — Oil prices have rallied by more than 40% over the last 12 months. Investors are clearly worried. Previous global earnings downturns have been preceded by big increases in oil.
- **Earnings Risk** — It is not only crude prices rising. Metals prices are up 30% in the last year, food prices have increased more than 40%. Compounding investor worries further is that analysts' earnings revisions have turned negative.
- **Better Predictors** — Those worried about a serious earnings downturn should watch out for unsustainably high RoEs, tight labour markets and high real interest rates. None of these are apparent now. By themselves, a spike in commodity prices is unlikely to drive down global corporate profits.
- **Regions and Sectors** — Further increases in commodity prices should be positive for Emerging Markets, especially the large oil producers like Russia. Other cyclical sectors, in addition to the commodity producers, should also perform well. Consumer-focused companies may struggle.

Figure 1. Real Oil Price (YoY Chg) and Global Earnings Recessions.
Was a global earnings downturn preceded by a 50% spike in oil prices?



Source: Datastream, MSCI, CIRA

- Equity Strategy

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Commodity Risk

Commodity prices are on the rise

Global oil prices are up by more than 40% over the last 12 months. This is worrying many investors. Previous global earnings recessions have been preceded by big increases in oil prices. Compounding concerns is that other commodity prices, like Metals and Food, are also high. The outlook for corporate profits looks to have deteriorated.

In this week's report we find that, investors should keep an eye on rising commodity prices, but high commodity prices alone have not been enough to drive an earnings downturn in the past. Investors worried about global profits should be on the lookout for unsustainably high RoEs, tight labour markets and higher real rates. None of these are apparent at the moment. We expect global EPS and stock prices to remain robust. Therefore, we also highlight ways investors can profit from commodity price moves within the equity market.

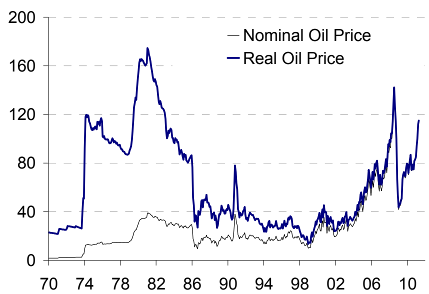
Big Oil

The oil price has increased by more than 40% over the last year and is back above $100. Last time it was at these levels was in 2008 — just before the global economy and equity market began to crumble. The issues driving higher oil prices now are a little different to those we had back then. While global demand remains strong, it is now being accompanied by supply concerns. Political tensions in the Middle East may mean major supply disruptions. Furthermore, governments are re-thinking nuclear energy generation after the disaster in Japan. The anti-nuclear Greens are gaining power. Any reduction in nuclear energy supply could also boost oil demand.

Our Global Energy team have recently raised their 2011 and 2012 oil price forecasts to an average Brent rate of $105/bbl and $100/bbl, respectively, compared with a current Brent price of $114. However, they believe the threat of further supply disruptions warrant a premium price for the commodity in the nearer term. They forecast a mid-cycle price of $80[1].

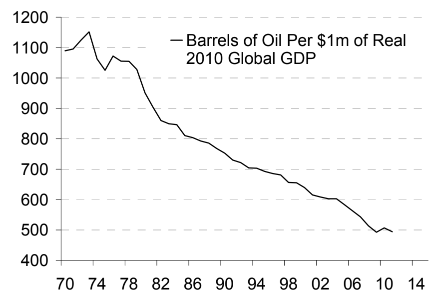
Crude prices have increased but the world has become less oil-intensive

Figure 2. Oil Price (Nominal vs Real*)



* Real prices deflated by OECD CPI. Current = Spot.
Source: Datastream, OECD, CIRA

Figure 3. Global Oil Intensity



Source: BP Statistical Review, IMF, CIRA

For a number of reasons we believe the recent increase in the oil price will have a modest impact on the global economy. There is less dependence on oil now than before. Since 1970 the number of barrels of oil consumed has grown by 1.6% per year while global real GDP has grown by 3.5% per year. It will take about 500 barrels of oil to produce $1m worth of real global GDP this year. The

[1] Oil price Perspective, Raising 2011 Brent Estimate to $105 and 2012 to $100, 6 March 2011, Mark Fletcher et al.

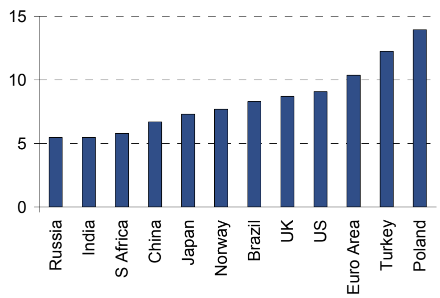
equivalent of $1m of GDP would have required more than 1000 barrels of oil in 1970 (Figure 3).

Saudi Arabia is committing to $70bn of additional fiscal spend

Our economists note an increase in the oil price does not necessarily destroy aggregate spending power but redistributes wealth from oil consumers to producers[2]. Oil producers have made it clear they will spend more of this new-found wealth. Recently the Saudi monarchy announced a number of decrees that will commit the country to about $70bn of additional spend in 2011[3]. This is equivalent to 15% of Saudi GDP or 0.1% of global GDP. Meanwhile, we believe governments in some oil-consuming countries will use expansionary fiscal measures to cushion the pain for consumers.

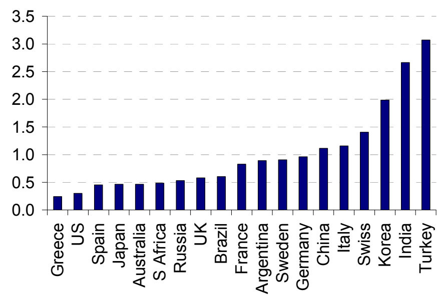
Despite these factors limiting the effect of high oil prices on overall economic growth, there could be substantial cross-country variation. Emerging economies are more energy-intensive. They use more oil per unit of GDP and some have a higher energy weight in their CPI baskets (Figure 4). So a rise in the oil price could have a more direct effect here than in developed economies. Meanwhile, the recycling of petro-dollars into increased demand could benefit exporters to the Middle East (Figure 5).

Figure 4. Energy Weight in CPI (%)



Source: OECD, BLS, Eurostat, CIRA

Figure 5. Exports to Middle East (% of GDP)



Source: IMF, CIRA

So our economists believe the increase in the oil price will not have a material effect on global economic growth. Rather, it will re-distribute spending from the oil consumers to oil producers. The net effect will probably be that GDP growth is slower than expected in some regions but faster in others.

Earnings Risk

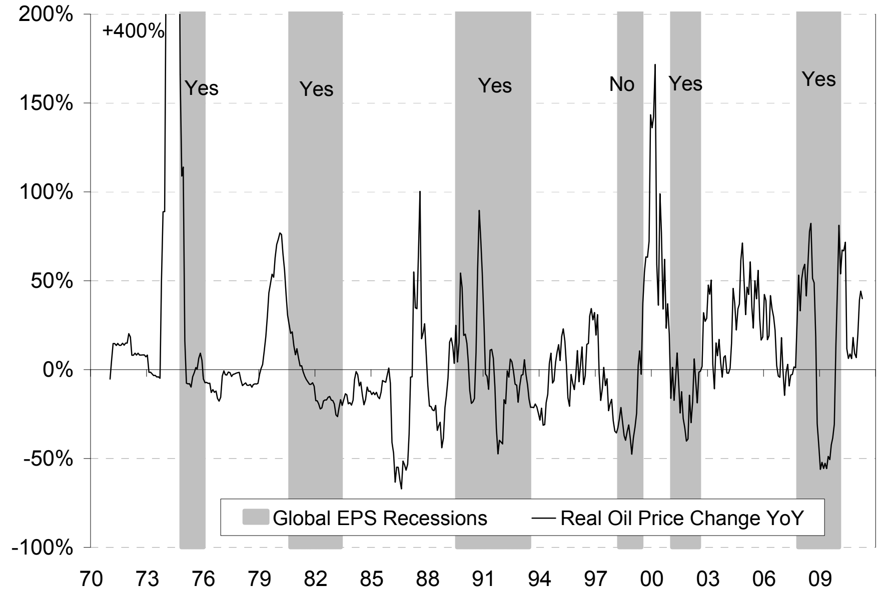
While our economists are comfortable with the recent rise in the oil price, a clear concern for investors is that previous oil price spikes have preceded serious corporate earnings downturns and stock market losses. Of the six global earnings recessions since 1970, five occurred around the time when real oil prices rose by at least 50% in a year (Figure 6)[4].

[2] Global Economic Outlook and Strategy — March 2011, 23 March 2011.

[3] Emerging Markets Daily, CEEMEA Edition, "Focus on Saudi Arabia – Inflation Risks on the rise", 28 March 2011, David Lubin, Farouk Soussa.

[4] Our Global Macro Strategy team found a 50% increase in oil prices also preceded US economic recessions. See Global Macro Strategy — Ad Hoc Comments: Do Higher Oil Prices cause/precede US recessions?, 21 March 2011, Jeremy Hale, Jeff Amato, Guillermo Felices, Maximilian Moldaschi.

Figure 6. Real Oil Price (YoY Chg) and Global Earnings Recessions. Was a global earnings downturn preceded by a 50% spike in oil prices?

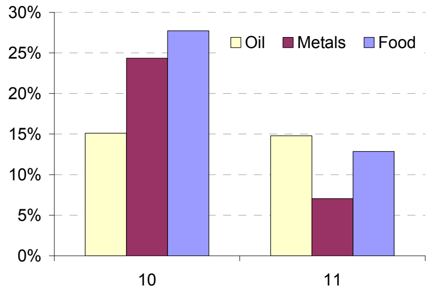


Source: Datastream, MSCI, CIRA

The earnings outlook seems to be deteriorating

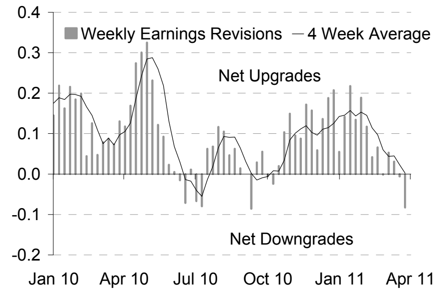
Real oil prices are now up by more than 40% YoY. Compounding investor concerns is that other commodities have also rallied with oil. Metals prices are up almost 10% year to date, while food prices have rallied 12% (Figure 7). All of these commodities add to consumer price inflation and increase corporate costs. And it looks like analysts are beginning to take notice (Figure 8). Our weekly global earnings revisions measure has recently turned negative — analysts are putting through more downgrades than upgrades (the 4-week average, which provides more stable readings, has yet to turn negative).

Figure 7. Oil, Metals and Food Price Change



Source: Datastream, CRB, CIRA

Figure 8. Global Earnings Revisions



Source: Factset, CIRA

So will high commodity prices be too much for corporate earnings? By themselves? Unlikely. In Figure 9 we look at the success of a number of indicators in forecasting earnings recessions. We rank the factors according to their success. Some of these indicators are from work we did on the profits

cycle last year[5]. Others have become apparent from on-going analysis of global earnings.

Figure 9. Success of Various Indicators in Forecasting Global Earning Recessions

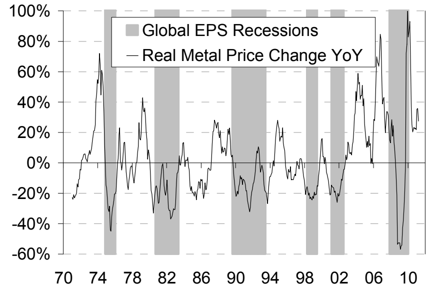
Rank	Indicator	Global Earnings Recessions							Factor Analysis		
		Early 1970s	Early 1980s	Early 1990s	Late 1990s	Early 2000s	2008-09	Now	Success Rate	Proportion of False Signals	Score*
1	**Global RoE** > 1 st dev higher than 2 cycle avg	n.a	Y	Y	Y	Y	Y	N	1.0	0.0	1.00
2	**Labour Market Tightness** US Unemployment Rate < NAIRU	Y	Y	Y	Y	Y	Y	N	1.0	0.1	0.93
3	**Global Government Yield Curve** Inverted	Y	Y	Almost	Y	Y	Y	N	0.9	0.2	0.84
4	**Global Real Policy Rates** >3%	Y	Y	Y	Y	Y	N	N	0.8	0.2	0.75
5	**Earnings Revisions** Falling 4 Week Average	n.a	n.a	Y	Y	Y	Y	N	1.0	0.6	0.68
6	**Oil Prices** Real YoY % Chg > 50%	Y	Y	Y	N	Y	Y	N	0.8	0.4	0.65
7	**Inventories** US ISM New Orders < Inventories	Y	Y	Y	N	Y	N	N	0.7	0.5	0.42
8	**Food Prices** Real YoY % Chg > 20%	Y	N	N	N	Y	Y	Y	0.5	0.3	0.38
9	**Metals Prices** Real YoY % Chg > 20%	Y	Y	N	N	N	Y	Y	0.5	0.6	0.19

* Score is equal to Success Rate less (Proportion of False Signals/2)
Source: Citi Investment Research and Analysis

While oil prices have had some success in forecasting earnings recessions, they have also provided a number of false signals. For example, the real oil price rose by more than 70% by the end of 2004, but earnings continued to grow. However, oil has been the most successful commodity in helping investors forecast earnings downturns. Metal prices sometimes fall and sometimes rise leading up to an earnings downturn. They have not been very helpful. There was no significant increase in food prices before half of the profits downturns.

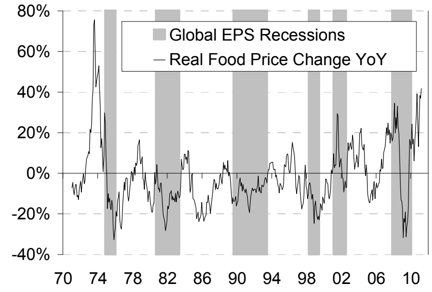
Metals and Food have not been helpful

Figure 10. Metals Price and EPS Recessions



Source: Citi Investment Research and Analysis

Figure 11. Food Price and EPS Recessions



Source: Citi Investment Research and Analysis

The Fantastic Four

Instead Figure 9 suggests the best indicators in forecasting future profits collapses are (1) unsustainably high RoEs, (2) labour market tightness, (3)

[5] Global Equity Strategist, Rollover, Not Recession, 30 June 2010

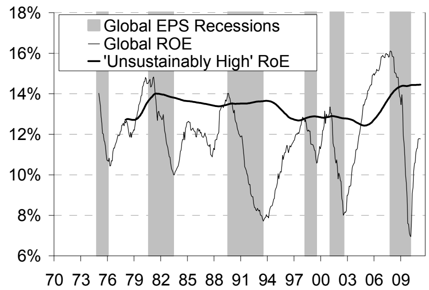
inverted global yield curves and (4) high real policy rates. These factors have correctly signaled an oncoming profits downturn and have not provided many false signals. We discuss each below.

1. Unsustainably High RoEs

Here we compare the current global RoE to the two-cycle average + 1 standard deviation. This factor has correctly signaled all of the last five recessions (we didn't have RoE data in the early 1970s). Sometimes the signal has been timely, at other times it has been 1-2 years early. At the moment, global RoE is below 12%. The level that we think is unsustainable is 14.5%. So this factor appears some way off from suggesting a profits downturn is imminent.

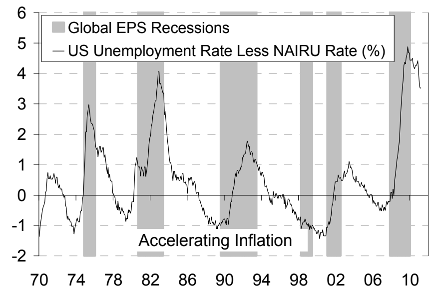
A high starting point is needed for an earnings collapse

Figure 12. Global RoEs and Global EPS Recessions



Source: Citi Investment Research and Analysis

Figure 13.US Labour Market and Global EPS Recessions



Source: Citi Investment Research and Analysis

2. Tight Labour Markets

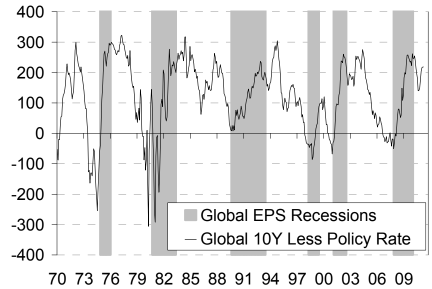
The biggest corporate cost

Labour is the biggest cost for companies. Our measure in Figure 13 compares the current US unemployment rate to the Non-Accelerating Inflation Rate of Unemployment (NAIRU) as estimated by OECD economists. When the line is below zero it is a period when labour markets are tight and employees have more bargaining power. When the line is above zero it suggests the labour market is slack and employees have less bargaining power. The OECD currently estimates NAIRU in the US to be 5.6%. The unemployment rate is 8.9%. Our economists forecast it to fall to 8.4% by the middle of next year. Labour markets are far from being tight right now.

3. Inverted Global Yield Curve

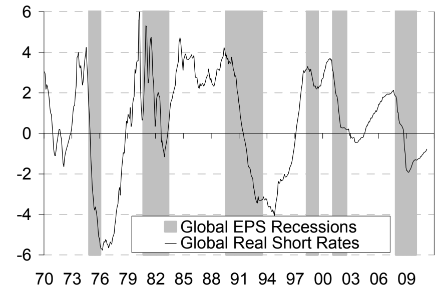
Here we look at the spread between the equity market cap weighted global 10-year bond yield less the weighted policy rate. An inverted yield curve has almost always preceded an earnings downturn and this indicator has only provided one false signal. With real rates close to zero in most major economies, there has been much debate on how appropriate the yield curve is in forecasting the profits cycle now. We agree, the signal will not be as 'strong', given where short rates are. This is perhaps another reason why investors should not rely on a single factor to highlight possible oncoming earnings recessions. Rather a bouquet of factors are more appropriate. At the moment the global 10-year yield is 3.4% and policy rates are 1.2%.

Figure 14. Global Yield Curve and Global EPS Recessions



Source: Citi Investment Research and Analysis

Figure 15. Global Real Rates and Global EPS Recessions



Source: Citi Investment Research and Analysis

4. Real Global Policy Rates

Real global policy rates above 3% have preceded five out of six profit recessions. The exception was the most recent earnings downturn when they reached only 2%. To measure real rates we take 3-year moving average global inflation from global policy rates. At the moment real rates are negative. They have been negative since the end of 2008.

Oil price spikes by themselves are less important

So sharply higher oil has preceded previous global earnings recessions. But only when oil spikes have been accompanied by unsustainably high RoEs, tight labour markets, inverted yield curves and/or high real rates. None of these factors are apparent right now. This keeps us positive on the direction of global earnings and share prices. While we think the current level of global equity markets will only provide only modest returns from here to year-end, we don't think investors should take a bearish view on corporate earnings or stock markets because of rising oil prices. If EPS remains robust, which we think they will, then we would also expect share prices to remain robust.

Regions and Sectors

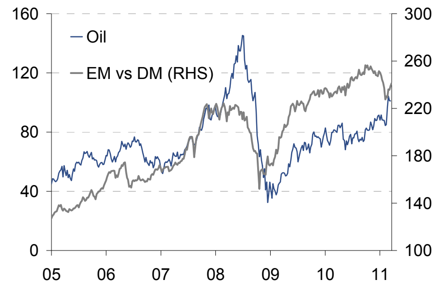
So we think the recent commodity price increases, are not enough to de-rail the global profits recovery. However, different sensitivities to commodity prices create trading opportunities at the region and sector level. Below we discuss commodity price scenarios and ways we think investors can profit from them.

Oil Price

Rising oil prices have previously been consistent with Emerging Markets outperformance (Figure 16). Our Global Emerging Markets Strategist, Geoffrey Dennis, suggests this is due in part to Emerging Markets being overweight Energy stocks relative to Developed Markets[6]. Within Emerging Markets the biggest oil-producing region is CEEMEA, with almost a 30% weight in the sector. And here, Russia is the biggest oil producer. Perhaps the biggest oil-consuming region in the developed world is Japan (with just a 2% weight in Energy stocks). It is no surprise, then, that a long Russia, short Japan trade has previously performed well during periods of rising oil prices (Figure 17).

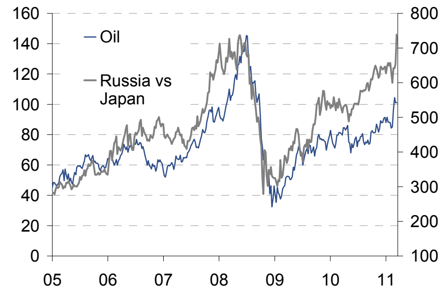
[6] Global Emerging Markets Strategy, Gimme Shelter, 28 February 2011, Geoffrey Dennis and Jason Press.

Figure 16. EM vs DM and Oil Price



Source: MSCI, CIRA

Figure 17. Russia vs Japan

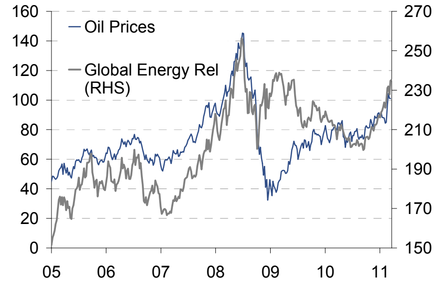


Source: MSCI, CIRA

Higher oil = long Russia

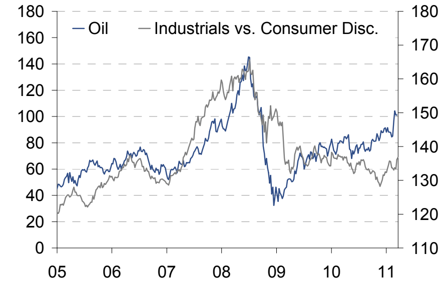
The obvious sector trade when oil prices are rising is long Energy (Figure 18). Less intuitively, another sector that tends to rally with higher oil prices is Industrials. This includes the major capital goods companies, which not only sell to the industrialising consumers of oil but are also major suppliers to oil producers. A sector that typically suffers from higher oil prices is Consumer Discretionary. Our US Economist notes that a rise in the oil price acts like a tax on the US consumer, who spends 3.5% of his disposable income on gasoline[7]. Perhaps this is why a long Industrials, short Consumer Discretionary position has worked during previous oil price rises (Figure 19).

Figure 18. Energy Relative and Oil Price



Source: MSCI, CIRA

Figure 19. Indus. vs Cons Disc. and Oil



Source: MSCI, CIRA

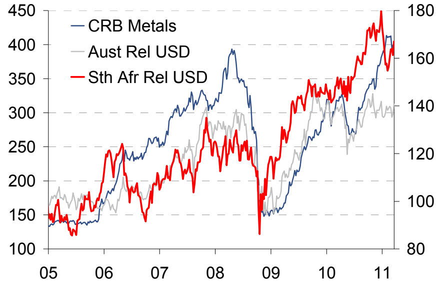
Metals prices

Higher Metals prices = long AUD and ZAR

Higher metals prices are, of course, good for the miners. Two markets that have a heavy weight in mining companies include Australia and South Africa. Both have performed well during periods of rising metals prices. However, much, if not all, of the performance has been in the currency, not local stock prices. For example, since 2009 metals prices have rallied more than 250%. During this period the Australia and South African stock markets have outperformed by 40-60% when measured in US dollars (Figure 20). But both markets have underperformed when measured in local currency (Figure 21).

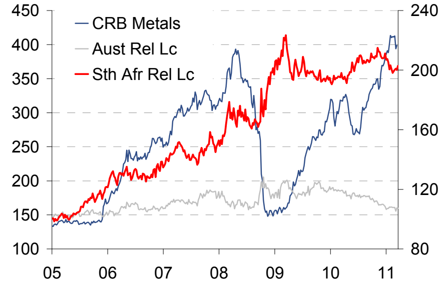
[7] Monday Morning Comments, Indirect Impacts of oil Price Spike: This Time, They're Smaller, 14 March 2011.

Figure 20. Metals, Australia & Sth Afr (USD)



Source: MSCI, CIRA

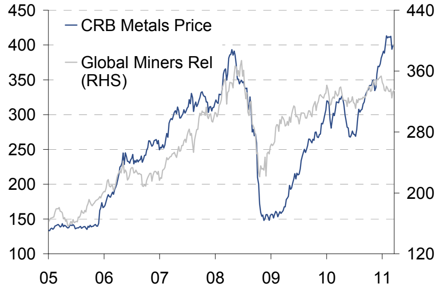
Figure 21. Metals, Australia & Sth. Afr (Lc)



Source: MSCI, CIRA

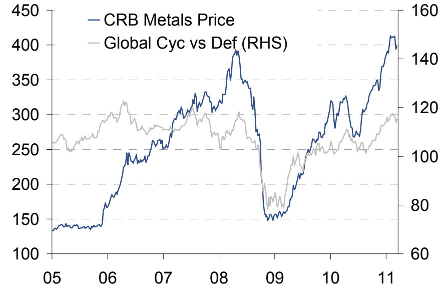
It is not only the miners that have performed well during periods of rising metals prices (Figure 22). As rising prices have previously been consistent with a strong economic backdrop, we have found that many cyclicals tend to outperform (Figure 23).

Figure 22. Metals Price and Miners Rel



Source: MSCI, CIRA

Figure 23. Metals Prices Cyc. vs Defensives



Source: MSCI, CIRA

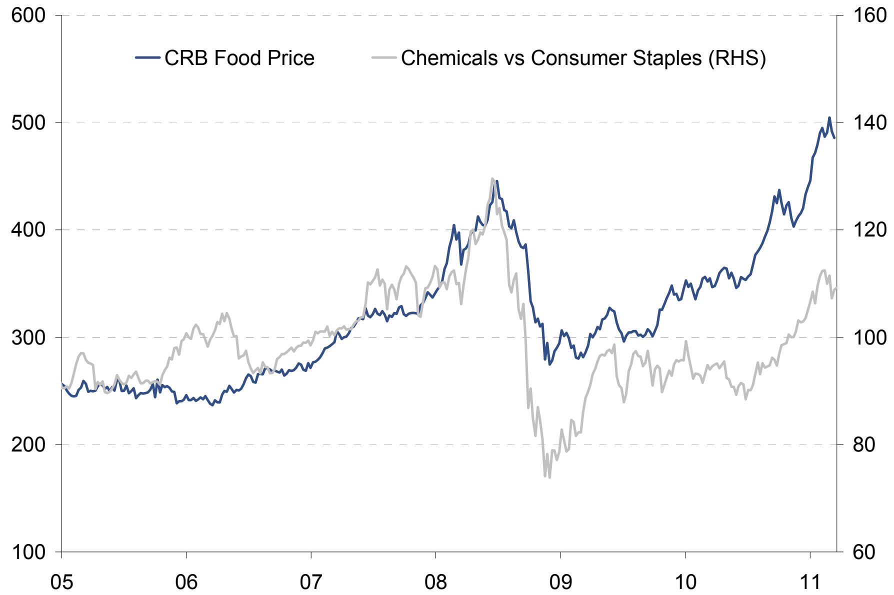
Food Prices

Higher food prices = long Chemicals

At the sector level, perhaps the most obvious way to benefit from rising food prices is to be long Chemicals companies and short Consumer Staples (Figure 24). This leaves investors' long cyclicals with increasing pricing power and short defensives suffering margin pressure. The Chemicals industry is where we find many of the fertilizer manufacturers. Meanwhile, Consumer Staples have traditionally found it hard to pass on rising food costs, at least in the short term.

For those who would rather a more focused exposure to rising food prices, Citi has a structured product that is a basket of the major agricultural chemical companies in North America and Europe. Please check out CGDOAGRI Index on Bloomberg.

Figure 24. Chemicals Relative to Consumer Staples



Source: MSCI, CIRA

Overall, rising commodity prices have been associated with positive cyclical sector performance. It seems that the additional demand typically offsets any input cost increase. Rising commodity prices seem to be worse news for consumer goods companies. Higher prices sometimes act as a tax on consumption, which makes it harder for companies to pass through cost increases. Below we summarise the different ways investors can look to profit from higher commodity prices.

Figure 25. Potential Equity Trades Under Rising Commodity Price Scenarios

Rising Oil Price	EM vs DM Russia vs Japan Industrials vs Consumer Discretionary Energy
Rising Metals Price	Australia (currency un-hedged) Sth Africa (currency un-hedged) Miners Cyclical Sectors vs Defensive
Rising Food Prices	Chemicals vs Consumer Staples CGDOAGRI Index*

Source: Citi Investment Research and Analysis

Strategy Outlook

While sharp increases in commodity prices have led many of the previous global earnings downturns, we don't think the most recent rise will have a materially negative impact on corporate profits. Our analysis shows that other factors are more important indicators of a downturn in profits, including unsustainably high RoEs, tight labour markets and high real rates. None of these suggest investors should be overly bearish on profits now.

We think further increases in commodity prices should be a positive for Emerging Market equities, especially the oil-producing markets like Russia. Commodity-producing sectors and other cyclicals should also benefit. Meanwhile higher commodity prices will likely be less positive for Developed Market equities, consumer stocks and defensives.

Macro Out-takes

We provide brief summaries compiled by Bruce Rolph in The Globaliser presenting our colleagues' most recent work. Please let us know if you would like more detail.

Regional Strategy

Asia Pacific
Markus Rosgen
28-Mar-11

Asia ex Japan: The "It's Different (Not) and Growth Worry" Edition

'No signs of a double dip here for the moment', soothes Asian Strategist Markus Rosgen, 'despite the recent wall of worries: ie. DM vs EM, inflation, rate fears, oil price fears, a Japanese earthquake… as our LEI continues to improve, signaling better – not worse - times are ahead for the economy… beside, there is always a growth deceleration at this stage of the cycle – and it would be unusual for it not to happen… furthermore, year 3 of a cycle is always tough – this cycle no different… importantly, valuations today are exactly where they are on average in year 3… and earnings revisions remain above mean… as such, we still prefer cyclicals and are underweight consumer, utilities and telecoms'.

Australia & New Zealand
Tony Brennan
Richard Schellbach
28-Mar-11

Australian Equity Strategy: The Market Should Begin to Make Gains Again

'The Australian market should do better', determines Strategist Tony Brennan, 'after a disappointing past 18 months, with the prospect now of a pause in interest rate increases… more confidence in earnings too should help, as business conditions stabilise… furthermore, the market's valuation looks undemanding, at a PE of ~12x forward earnings – levels that generally has delivered good returns in ensuing years... overall, we continue to think that more supportive domestic conditions can enable the ASX200 to finally push above 5,000 and move toward 5,500 over the year'.

US
Tobias Levkovich
25-Mar-11

Monday Morning Musings: The Backstop Buyers

'The risk/reward ratio still favors the S&P500', argues Strategist Levkovich, 'given large money pools that can be and have been tapped on pullbacks… including pension funds' likely asset allocation shifts from bonds to stocks… strategic buyers also have every reason to be more aggressive in the M&A world particularly when high yield financing costs are so attractive relative to corporate cash flow and corporate cash balances have grown to almost ~$2 trillion… in addition, buyback activity is beginning to rebound too... that all said, one should only expect moderate stock market gains by year-end (with 7% left towards achieving our full-year target)… given corporate margin pressures, government budget woes and the likelihood of slowing industrial economic momentum'.

Europe
Jonathan Stubbs & Adrian Cattley
24-Mar-11

European Portfolio Strategist: De-Megatisation

'Big is not beautiful in European equity markets', muses the European Portfolio Strategist, 'for mega-cap companies have endured more than a decade of underperformance… conditions should become less negative for mega-caps over the next 2-3 years - fading operating leverage across the market and rising appetite for equity should help… but, rather than wait and hope, we suggest action now: many CEOs have the opportunity to unlock value and deliver higher share prices by being more shareholder friendly and improving return on capital… either by getting better, smaller, or both… e-equitisation and demegatisation: 2 ugly words, but 2 powerful and important investment themes'.

CEEMEA
Andrew Howell
22-Mar-11

CEEMEA Strategy: Egypt

‘Egypt market set to reopen, but uncertainties abound’, cautions Strategist Andrew Howell, ‘to be sure, exchange and local authorities have taken actions encouraging Egyptians to support the market… however many local investors are sitting on losses and a rush to exit cannot be ruled out… some foreign investors too, may exit the market given the uncertain political outlook and challenges of the past 2 months… also, regardless of how and when stability is established in the political arena, the economic outlook could take a clear populist turn with negative consequences for investors… so while Egypt is trading at an 18% PB discount to the broader emerging markets index, for now, it’s still too early to search for bargains… the risks outweigh any potential reward - and we remain Egypt underweight within CEEMEA and MENA portfolios’.

Latin America
Jason Press
21-Mar-11

Latin American Equity Strategy: Growing Up

‘Latin American equities are well positioned‘, maintain Strategists Press & Hickman, ‘to benefit from the ongoing global recovery… there’s a general sense of unease due to global events and EM fund outflows of $25bn over 2 months; but we are buyers ahead of a change in investor sentiment… improving fundamentals over the past 10 years, along with the region’s stability and pursuit of generally orthodox policy through the ‘great recession’, give us a high degree of confidence multiple rerating will continue… we see year-end dollar returns of 25%-30%… Brazil though is our sole Overweight… growth deceleration is good for that market… we look for the rolling over of inflation expectations as a potential catalyst… and, our year-end target for the Bovespa is 87,500 - aggressive yet achievable’.

Economics Analysis

Economics
Willem Buiter
23-Mar-11

Global Economic Outlook and Strategy: March 2011

‘Twin shocks: oil and earthquake’, regales Willem Buiter’s “Global Economic Outlook & Strategy”, ‘have clouded the outlook… however, these shocks do not greatly alter global growth prospects for 2011 and 2012… global growth will remain strong in the year ahead… and while the increase in oil prices has been large – more than 200% from late 2008 to now – the effect will be modest for 4 reasons: rising demand for oil has been the main driver this time around; a rise in prices does not destroy aggregate spending power but rather redistributes it; in some countries fiscal offsets will be used; and the effect on oil-intensive processes is slow moving’.

Market Outlook

GDP	2010F	2011F	2012F
Global	4.0	3.6	3.9
US	2.9	2.9	3.3
Euro zone	1.6	1.7	1.3
Japan	3.9	1.1	2.6
EM	7.2	6.2	6.2
Asia	9.0	7.7	7.8
CPI	**2010F**	**2011F**	**2012F**
Global	2.7	3.7	3.2
US	1.6	2.6	1.8
Euro zone	1.6	2.7	2.2
Japan	-0.7	0.6	0.5
EM	5.3	6.2	5.6
Asia	4.2	5.1	4.5
Interest Rates	**Current**	**4Q11**	**2Q12**
US Fed Funds	0.25	0.25	0.75
ECB	1.00	1.50	2.00
UK Base	0.50	1.25	1.75
Japan Call	0.10	0.10	0.10
10Yr Yield	**Current**	**4Q11**	**2Q12**
US	3.49	3.60	3.85
Euro zone	3.35	3.70	3.90
UK	3.56	4.10	4.35
Japan	1.24	1.40	1.80
Ex Rates	**Current**	**4Q11**	**2Q12**
US$/€	1.41	1.44	1.43
£/US$	1.60	1.69	1.73
€/£	0.87	0.85	0.83
US$/¥	82	84	87

Source: Factset, Citi Investment Research

Having ground out a double-digit return in 2010, global equities will do the same in 2011, we believe. The recent rally has brought global equities back into line with previous experience, but they are not yet in overshoot territory. We remain constructive on equity markets and see prospects for further gains from here. We target 360 for end-2011 on the MSCI AC World (331 at the end of 2010). This is in-line with our EPS growth projections of 12% in 2011, following 35%-40% in 2010. Our forecasts conservatively assume no re-rating of global equities, which trade on only 12x 2011E EPS, so the risks to our targets probably remain to the upside. That still looks cheap relative to history and ultra-low interest rates. We expect more de-equitisation (M&A/buybacks) as a result.

Regional Strategy

Our key regional and global sector recommendations are summarised in Figure 26. Reasonable valuations and decent earnings momentum mean that we favour EM and UK equities. Stabilisation in the yen should help Japanese equities to benefit from their traditional cyclical characteristics. Improving earnings momentum means that we maintain the US at Neutral. A weaker EPS outlook means that we Underweight Europe ex-UK. We remain Underweight Developed Asia (70% Australia) where valuations look expensive and earnings momentum is uninspiring.

Sector Strategy

Our belief in the ongoing global EPS recovery means that our sector strategy still has a cyclical tilt. We think it is too early to give up on the recovery trade. Our Overweights (Consumer Disc, Materials, Industrials) should benefit from a continued recovery in the global economy. Our Underweights now look more mixed. We are Underweight Financials given lacklustre earnings momentum and ongoing, dilutive equitisation. Energy may be cheap but earnings momentum is disappointing. The sector is also overweight mega-caps. Utilities remains our least preferred classic defensive.

Risk

The biggest risk to our outlook is that the emerging evidence of an economic and earnings recovery proves to be just a false dawn.

Figure 26. Regional And Global Sector Recommendations (Arrows show recent changes)

Overweight	Neutral	Underweight
UK	US	Europe ex-UK
Global Emerging Markets		Developed Asia
Japan		
Overweight	**Neutral**	**Underweight**
Consumer Disc.	Consumer Staples	Financials
Materials	IT	Utilities
Industrials	Health Care	Energy
	Telecoms	

Source: CIRA

Global Market Intelligence

Figure 27. Global Market Intelligence by Region

25 Mar 11	Free MC	Wgt	P/E			EPS YoY %			P/B	ROE	Div Yld	EV/ Sales	EV/ EBITDA	Perf % (local)	
	US$bn	%	10E	11E	12E	10E	11E	12E	11E	11E	11E	09	09	Weekly	YTD
Global	**29,124**	**100**	**14.4**	**12.4**	**11.0**	**42.7**	**16.2**	**13.3**	**1.7**	**13.7**	**2.7**	**1.5**	**8.2**	**3.0**	**1.8**
Developed World	25,195	86.5	14.6	12.6	11.2	43.7	15.9	13.3	1.7	13.4	2.7	1.5	8.2	2.9	2.3
Emerging World	3,929	13.5	13.3	11.3	9.9	37.7	17.9	13.3	1.8	15.7	2.8	1.6	7.8	3.3	-1.4
North America	**13,842**	**47.5**	**15.9**	**13.7**	**12.0**	**40.7**	**16.2**	**14.0**	**2.1**	**15.0**	**1.9**	**1.8**	**8.5**	**2.6**	**4.5**
USA	12,440	42.7	15.7	13.6	11.9	43.1	15.3	14.0	2.1	15.3	1.9	1.7	8.4	2.7	4.4
Canada	1,402	4.8	19.0	15.1	13.2	18.6	26.2	14.2	1.9	12.9	2.3	2.7	9.4	1.6	4.6
Europe	**7,445**	**25.6**	**12.4**	**10.9**	**9.7**	**36.3**	**13.9**	**12.6**	**1.5**	**13.9**	**3.8**	**1.3**	**7.6**	**3.6**	**1.3**
United Kingdom	**2,430**	**8.3**	**12.3**	**10.4**	**9.3**	**33.4**	**18.6**	**11.3**	**1.7**	**16.1**	**3.7**	**1.3**	**8.5**	**3.1**	**0.3**
Europe ex UK	**5,014**	**17.2**	**12.5**	**11.2**	**9.9**	**37.7**	**11.6**	**13.3**	**1.5**	**13.0**	**3.9**	**1.3**	**7.2**	**3.8**	**1.9**
France	1,152	4.0	12.2	10.7	9.6	46.8	13.4	12.0	1.3	11.8	4.2	1.1	7.1	4.2	4.0
Germany	962	3.3	11.8	10.8	9.5	72.5	9.2	14.1	1.4	13.4	3.5	1.2	6.7	4.1	-0.1
Switzerland	894	3.1	13.4	12.2	10.9	14.0	9.3	12.2	2.0	16.6	3.5	2.1	10.3	4.2	-1.3
Spain	416	1.4	10.6	10.0	8.7	-0.9	6.3	13.9	1.4	13.8	6.2	1.9	6.5	3.6	8.5
Sweden	363	1.2	13.0	13.0	11.7	48.6	0.5	11.1	2.1	16.5	3.7	1.7	11.3	3.5	-2.5
Italy	333	1.1	12.4	10.3	8.9	15.2	19.4	16.5	0.9	8.9	4.4	1.4	5.0	3.5	8.4
Netherlands	305	1.0	11.9	10.3	9.5	110.6	15.8	8.1	1.6	15.3	3.2	1.3	7.9	4.0	3.9
Denmark	123	0.4	18.8	15.7	12.7	88.5	20.0	23.4	2.2	13.8	1.7	1.7	7.1	-0.6	0.9
Finland	123	0.4	13.8	12.9	11.4	18.4	7.3	12.8	1.7	13.0	4.8	1.0	8.0	3.9	-5.0
Belgium	107	0.4	14.1	12.6	11.4	11.7	11.9	10.6	1.3	10.6	3.0	2.1	8.5	3.6	0.5
Norway	106	0.4	13.4	10.9	9.6	38.1	23.4	12.5	1.6	15.2	4.2	1.3	5.3	2.3	1.5
Austria	39	0.1	13.3	10.4	8.8	13.8	27.4	18.2	1.1	10.5	3.3	1.2	7.3	3.3	-0.1
Greece	33	0.1	12.4	11.3	8.5	-43.2	9.7	32.9	0.9	8.1	2.8	1.1	4.9	0.8	16.5
Portugal	32	0.1	14.4	13.3	11.5	1.1	7.8	16.4	1.3	9.7	4.7	1.9	7.0	0.3	4.0
Ireland	28	0.1	25.6	31.9	13.0	83.4	179.8	145.4	1.3	3.9	2.6	1.0	9.2	3.7	3.0
Japan	**2,335**	**8.0**	**15.6**	**12.7**	**11.3**	**174.9**	**22.7**	**13.1**	**1.0**	**7.9**	**2.3**	**1.0**	**8.5**	**2.9**	**-4.9**
Asia Pac ex Jp	**3,750**	**12.9**	**14.5**	**12.4**	**11.0**	**35.4**	**16.4**	**13.4**	**1.8**	**14.4**	**3.2**	**1.5**	**8.6**	**3.5**	**-1.3**
Pacific ex Jp	**1,489**	**5.1**	**15.3**	**13.2**	**11.9**	**20.3**	**16.3**	**11.4**	**1.7**	**13.1**	**4.0**	**2.2**	**9.8**	**2.9**	**-0.9**
Australia	979	3.4	15.3	12.4	11.2	19.0	23.0	11.1	1.8	14.9	4.5	2.3	9.1	2.4	0.3
Hong Kong	310	1.1	16.0	16.0	14.1	26.9	0.1	12.9	1.5	9.3	2.8	2.5	15.7	3.2	-2.6
Singapore	189	0.6	14.8	13.7	12.5	19.1	7.5	10.2	1.7	12.0	3.4	1.9	12.0	4.9	-3.8
New Zealand	11	0.0	15.4	13.8	11.7	-4.3	11.5	17.7	1.6	11.3	5.4	1.4	6.2	1.1	2.6
Em Asia	**2,260**	**7.8**	**13.9**	**12.0**	**10.4**	**46.3**	**16.4**	**14.7**	**1.8**	**15.4**	**2.6**	**1.4**	**8.1**	**3.8**	**-1.6**
China	688	2.4	13.5	11.6	10.1	39.3	16.5	15.1	1.9	16.6	2.9	1.5	8.8	4.7	1.1
Korea	553	1.9	11.4	9.8	8.6	57.3	16.6	13.0	1.4	14.3	1.4	0.8	5.5	3.4	0.3
Taiwan	433	1.5	14.7	13.1	11.3	78.8	13.0	14.8	1.8	13.9	4.2	1.7	8.9	2.6	-4.1
India	290	1.0	19.6	16.0	13.3	21.1	22.5	19.6	2.6	16.3	1.3	2.5	12.6	5.1	-8.3
Malaysia	113	0.4	16.8	14.5	13.2	26.3	15.8	9.9	2.1	14.7	3.5	2.4	11.2	1.2	-0.2
Indonesia	94	0.3	17.4	14.2	12.1	17.0	22.8	17.6	3.4	24.0	2.9	2.5	8.3	4.8	-0.9
Thailand	68	0.2	14.0	12.4	10.8	32.6	12.2	15.5	2.1	16.9	3.4	1.2	7.3	4.0	3.0
Philippines	21	0.1	14.6	13.7	12.7	43.8	6.7	7.9	2.4	17.5	3.3	2.5	7.9	1.7	-9.5
Latin America	**913**	**3.1**	**14.2**	**11.7**	**10.3**	**26.1**	**20.6**	**13.8**	**1.9**	**16.3**	**3.0**	**2.2**	**7.9**	**2.4**	**-2.9**
Brazil	624	2.1	12.5	10.5	9.3	32.1	18.9	12.7	1.7	16.1	3.3	2.1	7.1	1.7	-1.6
Mexico	174	0.6	20.8	15.8	13.2	-1.0	31.6	17.7	2.6	16.4	2.2	2.2	10.4	3.8	-4.6
Chile	60	0.2	18.5	16.5	14.3	21.9	11.9	15.7	2.4	14.4	2.6	2.8	10.7	6.5	-6.5
Colombia	31	0.1	22.1	19.8	16.1	34.0	11.3	23.4	2.4	15.1	2.8	3.6	15.7	-0.5	-2.8
Peru	24	0.1	17.7	12.0	10.5	29.0	46.7	14.5	3.8	31.2	3.8	9.4	17.7	2.2	-12.6
CEEMEA	**755**	**2.6**	**10.9**	**9.2**	**8.4**	**30.7**	**18.8**	**9.9**	**1.5**	**15.8**	**3.1**	**1.6**	**6.3**	**2.7**	**1.4**
Russia	292	1.0	8.4	7.1	6.7	48.0	16.8	6.6	1.1	15.3	2.0	1.4	4.9	3.0	8.8
South Africa	290	1.0	14.9	11.7	10.1	22.1	27.4	15.8	2.1	17.7	3.7	1.7	8.4	4.0	-2.6
Poland	67	0.2	14.0	11.1	10.4	20.2	25.7	6.7	1.5	13.7	4.1	1.8	6.7	1.3	2.5
Turkey	56	0.2	10.4	10.1	9.1	12.6	2.5	10.9	1.6	16.1	3.2	1.5	8.1	0.7	-4.8
Hungary	17	0.1	11.9	9.7	8.4	9.0	22.8	14.8	1.2	12.6	3.3	1.1	5.8	4.2	8.6
Czech Republic	14	0.0	10.7	11.4	11.0	-3.0	-6.1	3.2	2.0	17.3	6.3	2.6	5.2	3.0	6.0
Egypt	13	0.0	9.5	8.7	7.6	-9.3	8.9	14.4	1.2	14.1	4.8	2.0	6.4	-11.6	-29.7
Morocco	6	0.0	16.5	14.6	14.1	8.5	13.0	4.8	3.9	26.6	4.8	4.4	7.6	-1.8	1.2
Israel	**84**	**0.3**	**12.0**	**10.6**	**9.3**	**19.1**	**13.2**	**11.0**	**1.8**	**17.2**	**3.1**	**2.6**	**9.7**	**2.9**	**-4.7**

Source: Citi Investment Research and Analysis, MSCI, World scope, FactSet Consensus estimates

Figure 28. Global Market Intelligence by Sector

25 Mar 11	Free MC	Wgt	P/E			EPS YoY %			P/B	ROE	Div Yld	EV/ Sales	EV/ EBITDA	Perf % (local)	
	US$bn	%	10E	11E	12E	10E	11E	12E	11E	11E	11E	09	09	Weekly	YTD
Global	**29,124**	**100**	**14.4**	**12.4**	**11.0**	**42.7**	**16.2**	**13.3**	**1.7**	**13.7**	**2.7**	**1.5**	**8.2**	**3.0**	**1.8**
Level One															
Energy	3,641	12.5	14.0	11.8	10.5	35.6	18.3	12.4	1.7	14.7	2.4	1.2	6.8	3.6	10.6
Materials	2,624	9.0	15.7	11.5	10.1	81.6	37.4	12.7	1.9	16.2	2.2	1.9	9.1	3.5	-1.4
Industrials	3,183	10.9	16.6	13.9	12.0	47.2	19.2	16.0	2.0	14.6	2.3	1.4	9.9	3.6	2.9
Consumer Disc.	2,811	9.7	16.3	13.8	11.8	126.2	18.0	17.0	1.9	13.6	2.0	1.2	8.3	3.0	-0.4
Consumer Staples	2,621	9.0	15.9	14.5	13.1	11.7	9.6	11.2	2.6	18.2	3.2	1.4	9.7	2.7	-1.6
Health Care	2,329	8.0	12.6	11.7	10.9	8.3	7.8	6.7	2.2	19.1	2.8	2.0	8.9	2.4	1.6
Financials	6,093	20.9	13.3	11.3	9.7	61.1	17.5	16.7	1.1	9.9	3.1	NA	NA	2.2	1.6
IT	3,383	11.6	15.1	13.1	11.6	65.1	14.7	12.8	2.5	19.0	1.4	1.8	8.3	3.7	0.8
Telecoms	1,339	4.6	13.0	12.2	11.2	5.1	6.8	8.6	1.7	14.2	5.4	1.9	5.9	3.3	1.3
Utilities	1,098	3.8	12.5	12.7	11.8	4.3	-1.5	7.5	1.3	9.8	4.6	1.7	7.4	2.0	-1.5
Level Two															
Energy	3,641	12.5	14.0	11.8	10.5	35.6	18.3	12.4	1.7	14.7	2.4	1.2	6.8	3.6	10.6
Materials	2,624	9.0	15.7	11.5	10.1	81.6	37.4	12.7	1.9	16.2	2.2	1.9	9.1	3.5	-1.4
Capital Goods	2,418	8.3	16.5	13.6	11.7	38.5	21.3	16.0	2.1	15.1	2.3	1.3	10.3	4.0	4.2
Comm Svc & Supp	202	0.7	18.4	16.4	14.3	15.5	12.4	14.7	2.5	15.2	2.6	1.3	9.4	3.6	1.2
Transport	564	1.9	16.1	14.4	12.3	127.1	12.1	16.7	1.8	12.4	2.3	1.7	8.9	2.0	-1.8
Autos	706	2.4	12.2	10.4	8.7	720.6	17.0	19.1	1.3	12.3	1.9	0.9	7.6	2.7	-2.1
Consumer Durables	419	1.4	20.1	15.3	12.8	119.4	31.9	19.4	1.6	10.6	1.9	1.2	9.0	3.1	-5.9
Consumer Services	375	1.3	19.3	16.8	14.7	22.8	14.8	14.2	3.0	18.2	2.3	2.3	11.4	3.2	-0.8
Media	648	2.2	17.1	14.4	12.4	20.7	19.1	15.7	1.9	13.9	2.3	1.9	7.5	2.9	6.9
Retailing	663	2.3	18.1	16.1	14.0	25.8	12.4	14.9	2.7	16.6	1.8	1.1	9.2	3.2	-1.4
Food & Staples	614	2.1	15.4	13.9	12.3	12.3	10.8	13.2	1.9	13.9	2.8	0.7	7.8	1.3	-2.7
Food Bev & Tobac.	1,590	5.5	16.0	14.5	13.1	12.3	10.0	10.6	2.9	19.9	3.4	2.1	10.3	3.4	-0.5
Household Products	417	1.4	16.6	15.6	14.2	8.6	6.0	10.3	3.4	21.7	3.0	2.1	10.7	2.2	-3.8
Health Care	606	2.1	15.0	14.3	12.6	15.9	4.7	13.3	2.3	16.0	1.1	1.2	8.6	2.6	7.0
Pharma & Biotech	1,723	5.9	11.9	11.0	10.4	6.3	8.7	4.9	2.2	20.1	3.4	2.5	9.0	2.3	-0.3
Banks	2,838	9.7	12.6	10.7	9.1	60.6	19.8	17.4	1.2	11.0	3.6	NA	NA	2.6	1.7
Div Financials	1,421	4.9	12.7	10.8	9.1	220.0	17.8	18.7	1.0	9.4	1.7	NA	NA	1.1	1.6
Insurance	1,151	4.0	12.5	11.1	9.8	7.7	12.0	13.9	1.1	9.7	3.2	NA	NA	2.6	2.6
Real Estate	684	2.3	21.9	18.9	16.8	24.8	16.0	12.6	1.2	6.6	3.5	NA	NA	1.7	-0.2
Software & Services	1,361	4.7	16.6	14.6	13.0	17.1	13.7	12.4	3.6	24.7	1.2	2.7	9.1	4.2	2.5
Tech	1,388	4.8	15.4	12.7	11.1	79.1	21.4	13.6	2.0	16.1	1.3	1.4	8.5	3.3	-1.3
Semi & Semi Equip	634	2.2	12.1	11.6	10.4	236.7	4.6	11.8	2.1	18.3	2.2	1.8	6.5	3.6	1.7
Telecom	1,339	4.6	13.0	12.2	11.2	5.1	6.8	8.6	1.7	14.2	5.4	1.9	5.9	3.3	1.3
Utilities	1,098	3.8	12.5	12.7	11.8	4.3	-1.5	7.5	1.3	9.8	4.6	1.7	7.4	2.0	-1.5

Source: Citi Investment Research and Analysis, MSCI, World scope, FactSet Consensus estimates

Figure 29. 2011E P/E Estimates by Region and Sector

25 Mar 11 P/E 11E	Global	DM	GEM	US	Eur ex UK	UK	Jap	Dev Asia	Em Asia	Lat Am	CEEMEA
Region	**12.4**	**12.6**	**11.3**	**13.6**	**11.2**	**10.4**	**12.7**	**13.2**	**12.0**	**11.7**	**9.2**
Level One											
Energy	11.8	12.6	9.1	13.3	9.7	9.7	8.4	23.2	11.4	12.4	6.5
Materials	11.5	11.9	10.2	13.8	12.8	8.2	12.0	11.1	11.6	8.8	10.8
Industrials	13.9	14.1	12.3	15.5	13.8	12.4	11.3	15.8	11.8	19.0	9.9
Consumer Disc.	13.8	14.0	11.8	15.5	11.6	12.8	13.4	15.8	11.1	13.6	14.2
Consumer Staples	14.5	14.3	18.0	14.3	14.6	12.6	16.5	15.0	16.2	20.1	18.2
Health Care	11.7	11.6	18.5	12.0	11.0	9.3	14.4	17.8	21.1	20.7	13.2
Financials	11.3	11.4	11.2	12.5	9.0	10.8	12.6	12.6	11.6	11.3	10.2
IT	13.1	13.3	12.5	13.1	13.9	25.0	14.0	17.7	12.4	13.6	10.4
Telecom Services	12.2	12.4	11.6	17.4	10.4	10.3	11.4	11.1	11.7	11.7	11.3
Utilities	12.7	12.8	12.3	12.9	11.6	12.0	15.9	15.2	14.3	11.4	11.0
Level Two											
Energy	11.8	12.6	9.1	13.3	9.7	9.7	8.4	23.2	11.4	12.4	6.5
Materials	11.5	11.9	10.2	13.8	12.8	8.2	12.0	11.1	11.6	8.8	10.8
Capital Goods	13.6	13.8	12.1	15.3	13.7	11.3	10.8	15.7	12.0	18.1	10.1
Comm Svc & Supp	16.4	16.4	15.1	16.9	16.5	15.1	15.2	18.2	15.1		
Transport	14.4	14.6	12.8	16.0	13.1	8.1	13.2	15.6	11.1	19.8	7.0
Autos & Components	10.4	10.5	9.8	10.4	8.8		12.1		9.8		
Consumer Durables	15.3	16.4	9.9	15.8	16.1	20.8	17.9	10.7	11.8	8.2	9.3
Consumer Services	16.8	16.9	15.3	18.0	14.6	13.2	15.0	16.6	14.4	23.3	
Media	14.4	14.2	18.6	15.3	11.1	13.3	16.9	12.4	18.7	19.6	18.1
Retailing	16.1	16.1	16.8	16.6	18.1	10.4	14.0	17.0	16.7	25.4	12.0
Food & Staples Retailing	13.9	13.3	21.2	13.5	12.3	11.2	16.3	14.9	17.1	24.8	21.1
Food Bev & Tobacco	14.5	14.4	16.1	14.4	15.0	13.0	15.8	15.2	14.7	18.4	14.1
Household Products	15.6	15.3	22.7	15.0	16.5	13.5	19.2		24.2	20.5	
Health Care Equip & Svc	14.3	14.2	20.6	13.7	17.3	14.8	17.9	17.5	32.6	20.7	12.2
Pharma & Biotech	11.0	10.9	17.6	11.2	10.4	9.1	13.9	18.0	19.5		13.6
Banks	10.7	10.7	10.6	13.1	8.9	10.8	9.6	11.3	10.8	10.6	10.1
Div Financials	10.8	10.7	12.8	11.0	8.6	9.6	19.2	17.8	13.2	17.2	10.2
Insurance	11.1	10.8	15.5	11.3	9.1	9.7	18.6	13.1	17.8	10.9	10.4
Real Estate	18.9	20.6	10.5	35.7	16.8	20.6	19.7	14.3	10.1	20.7	10.4
Software & Services	14.6	14.2	20.6	14.0	15.8	16.3	19.0	16.3	22.5	13.6	10.4
Tech Hardware & Equip	12.7	12.7	12.7	12.7	14.0		13.0	217.3	12.7		
Semi & Semi Equip	11.6	12.4	10.4	11.9	11.2	51.6	18.1	13.0	10.4		
Telecom	12.2	12.4	11.6	17.4	10.4	10.3	11.4	11.1	11.7	11.7	11.3
Utilities	12.7	12.8	12.3	12.9	11.6	12.0	15.9	15.2	14.3	11.4	11.0

Source: Citi Investment Research and Analysis, MSCI, World scope, FactSet Consensus estimates

Appendix A-1

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