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Strategy
North America

North America Road Ahead 2014

Expect a Bumpier Ride in 2014

Equity Strategy

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See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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Equity Strategy

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Expect a Bumpier Ride in 2014

After a better-than-expected 2013, it is likely that the markets will be a bit choppy in the coming year, but the long-term Raging Bull thesis is intact. Volatility is expected to pick up entering 2014 after a rather smooth ascendant market this past year, but short-term indicators intimate that the environment will be somewhat less calm in coming months. Indeed, even the resumption of taper talk in 1Q14 could be disruptive, not to mention probable earnings estimate reductions during the January/February EPS release period given that consensus bottom-up numbers are too high.

Earnings growth should be the primary driver for equity index appreciation, with support from credit conditions that typically lead economic activity and S&P 500 sales trends. S&P 500 EPS should climb near 7% in 2014 to $117.50 helped along by better global GDP growth and some very slight margin improvement, but this profit growth element most likely will be the key factor in stock price gains. The P/E multiple is unlikely to get that much better in an environment where investors witness the end of a super-accommodative Fed.

Multiple expansion seems improbable due to tapering but valuation still argues for further share price gains, even as sentiment metrics generate near-term concerns. At current valuation levels, there is respectable empirical evidence for further upside, given outcomes generated by a normalized earnings yield gap analysis and even base P/E levels. However, sentiment metrics such as the Panic/Euphoria Model and intra-stock correlation argue for some tactical caution nearer term.

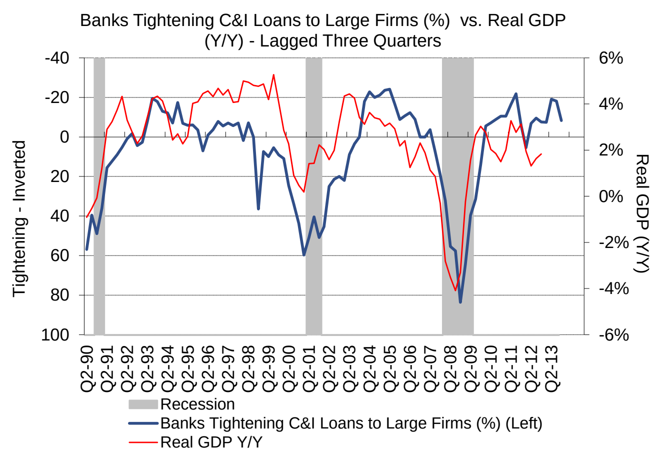
Style investing favoring large caps and growth should generate handsome rewards while themes such as tech capital spending acceleration beneficiaries and share shrinkers look attractive. Given expected volatility, high margins and valuation differentials as well as lead indicators, both large cap stocks and growth stocks should outperform next year. Moreover, double-digit growth in IT sector capital investment suggests good demand for tech companies while the share shrinker approach has been rewarding for a while and should continue.

There are always risks in any forecast. Some of the risks can be negative ones such as disappointing GDP growth in the US and internationally as well as margin pressures and geopolitical events, not to mention discord in Washington. There are also potential positive developments including a “grand bargain” in Washington or excessive money flows into stocks as investors think that there is no alternative investment option other than equities. Yet, these have not been incorporated into the 2014 outlook.

Foresight into Fourteen

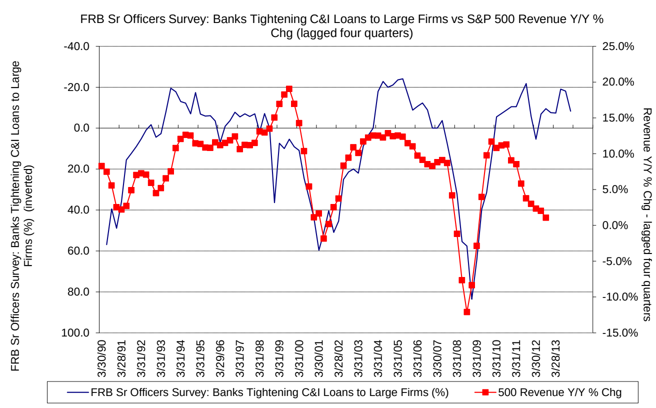
When laying out an equity market outlook for the coming year, it is necessary to incorporate different influences on stocks including liquidity, sentiment, valuation, and earnings growth while considering the validity of underlying assumptions such as GDP estimates. Citi's economists anticipate that the US economy will accelerate to 2.7% in 2014 after generating only 1.4% expansion in 2013. Moreover, the lead indicators from credit conditions on both GDP and S&P 500 sales (see Figures 1 and 2) seem to confirm the pattern being foreseen. At the same time, liquidity dynamics are intriguing as well. If one combines stock mutual funds and ETF net issuance, stock funds have gathered almost $270 billion of inflows this year through the end of October after suffering around $14 billion of outflows year-to-date in 2012 (see Figure 3). Only about $40 billion exited from bond funds over the same time period, so the Great Rotation has not occurred despite protestations that it has – the money for stocks has come from cash funds and Americans are sitting on more than $9 trillion of household deposits currently earning a negative real yield (see Figure 4).

Figure 1.



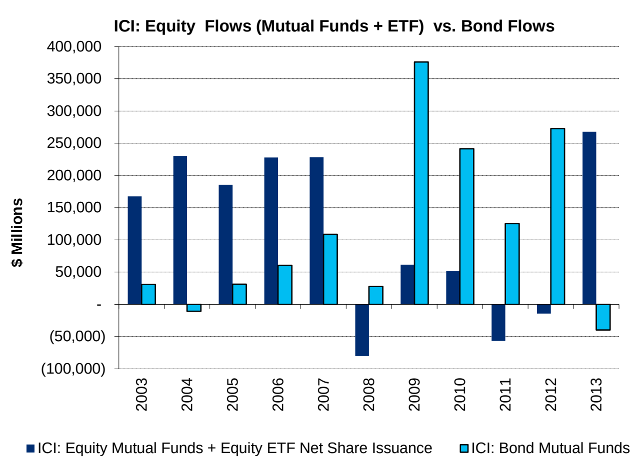
Source: Haver Analytics and Citi Research – US Equity Strategy

Figure 2.



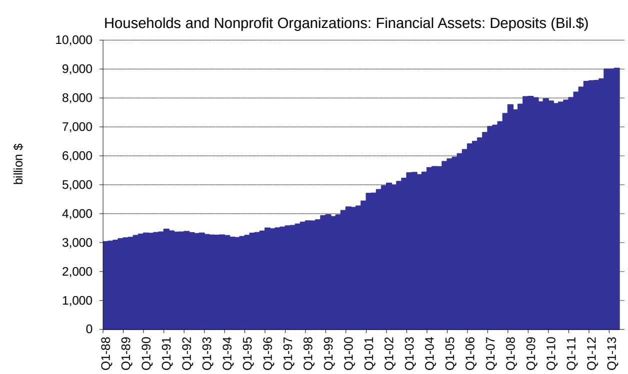
Source: FactSet, Haver Analytics and Citi Research – US Equity Strategy

Figure 3.



Source: ICI, Haver Analytics and Citi Research – US Equity Strategy

Figure 4.

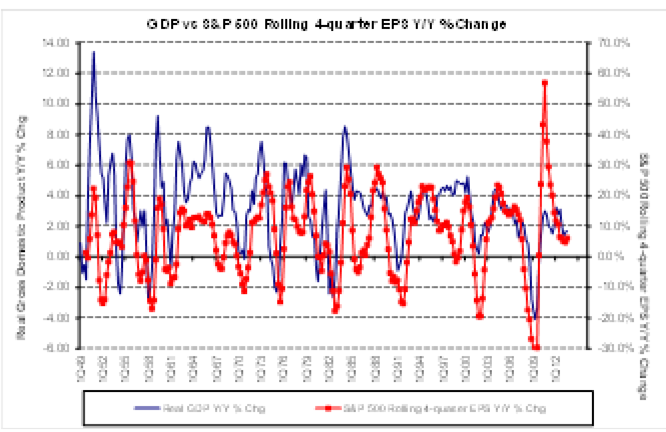


Source: Haver Analytics and Citi Research – US Equity Strategy

Valuation is also still attractive for equities but not in a traditional sense. Our normalized earnings yield gap work generates a better than 90% probability of gains with the average gain being roughly 11% one year later, while our P/E Bulls Eye measure would argue for a 5%-9% gain. Other metrics argue for less and some for more. But, the key issue now is that the Fed's delay of tapering implies that some of 2014's appreciation potential got pulled forward into late 2013 and earnings may be the only real driver for 2014, especially if the full quantitative easing program ends by December of next year as is currently projected. Admittedly, a large deal in Washington that seriously addresses fiscal imbalances would go a long way towards pushing valuation higher, in our opinion, but we are skeptical about such an agreement being forged given the partisanship currently on both sides of the aisle. Thus, it comes down to earnings, in our opinion.

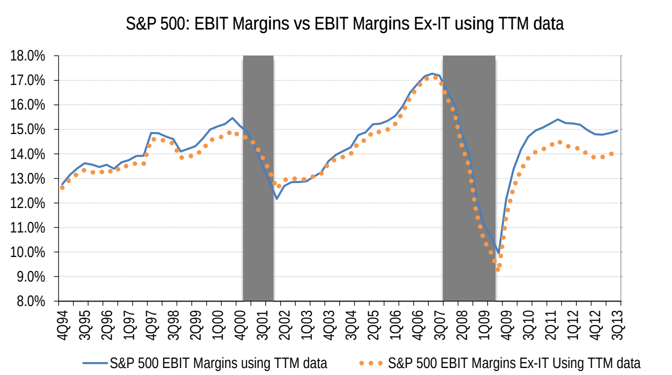
We estimate 2014 EPS at $117.50 versus $110.10 in 2013, which reflects better GDP trends (see Figure 5) as well as the potential for EBIT margins to improve (see Figure 6) as top-line growth ensues. Keep in mind that eight of the 10 S&P 500 sectors are producing EBIT margins below their 2007 highs such that there is room for expansion with better sales. We have stated many times in the past that the best linkage between markets and stocks is earnings with a high degree of correlation (see Figure 7) and there is no reason to think otherwise now, though pre-announcements are a bit worrisome (see Figure 8).

Figure 5.



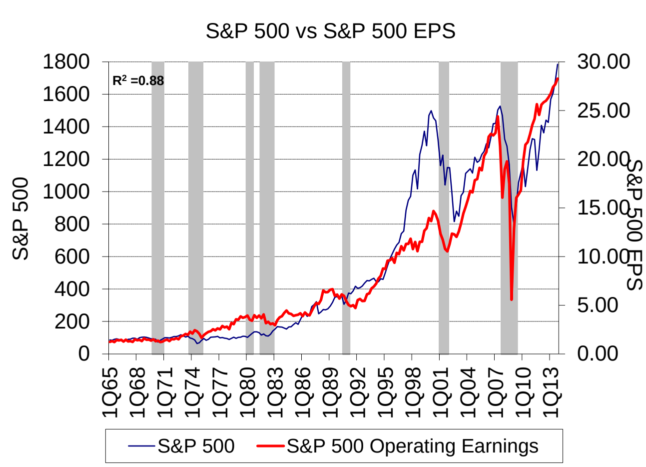
Source: Haver Analytics and Citi Research – US Equity Strategy

Figure 6.



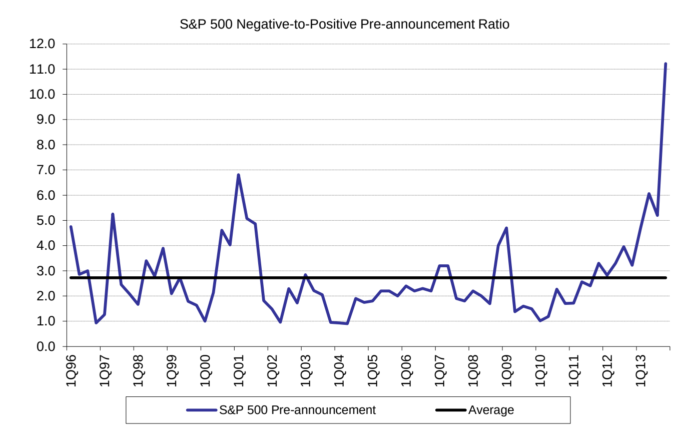
Source: FactSet and Citi Research – US Equity Strategy

Figure 7.



Source: Haver Analytics and Citi Research – US Equity Strategy

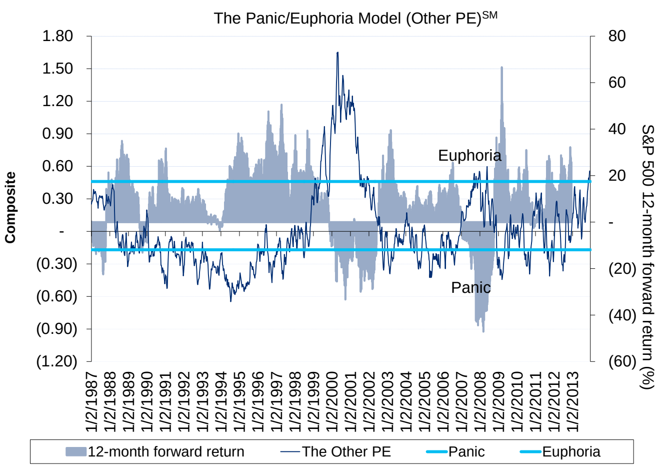
Figure 8.



Source: Haver Analytics and Citi Research – US Equity Strategy

The one clear problem we see is overly enthusiastic sentiment currently (see Figure 9) which makes us cautious nearer term especially if investors worry about tapering beginning in 1Q14, earnings estimate cuts and possible political wrangling again around budgets and debt ceilings. Notably, empirical evidence from the VIX argues for an 88% change of gains in markets over the next 12 months with readings in the 10-15 range (see Figure 10). Thus, the preponderance of the evidence is not indicating a major correction (10%+) but rather a more 5%-7% like pullback when it occurs.

Figure 9.



Source: Haver Analytics and Citi Research – US Equity Strategy

Figure 10.

Buckets of 5 for VIX - S&P 500 Fwd Performance

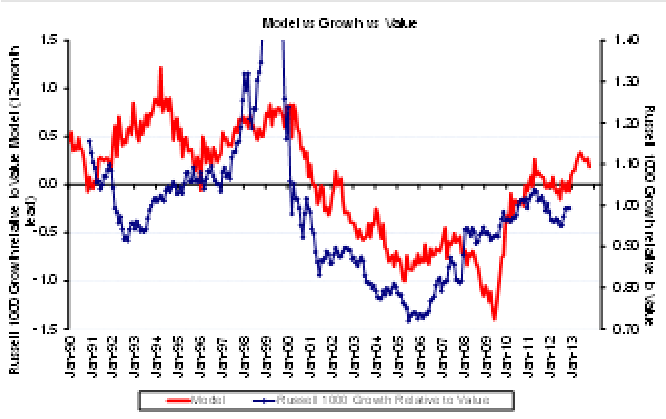
	10-15			15-20			20-25		
	3-mth	6-mth	12-mth	3-mth	6-mth	12-mth	3-mth	6-mth	12-mth
Average	2.7%	5.5%	10.8%	1.00%	2.93%	10.05%	0.7%	0.3%	1.8%
Median	2.6%	4.9%	9.4%	1.97%	4.68%	10.13%	2.0%	2.5%	7.7%
Up	1282	1401	1387	1148	1248	1525	807	775	839
Down	427	238	188	667	530	231	583	613	548
Total	1709	1639	1575	1815	1778	1756	1390	1388	1387
% Up	75.0%	85.5%	88.1%	63.25%	70.19%	86.85%	58.1%	55.8%	60.5%

	25-30			Random Outcomes		
	3-mth	6-mth	12-mth	3-mth	6-mth	12-mth
Average	2.7%	4.8%	3.6%	2.0%	4.2%	8.6%
Median	3.6%	7.0%	10.4%	2.7%	5.1%	10.3%
Up	442	412	421	4128	4379	4699
Down	220	250	241	2051	1734	1284
Total	662	662	662	6179	6113	5983
% Up	66.8%	62.2%	63.6%	66.8%	71.6%	78.5%

Source: Haver Analytics and Citi Research – US Equity Strategy

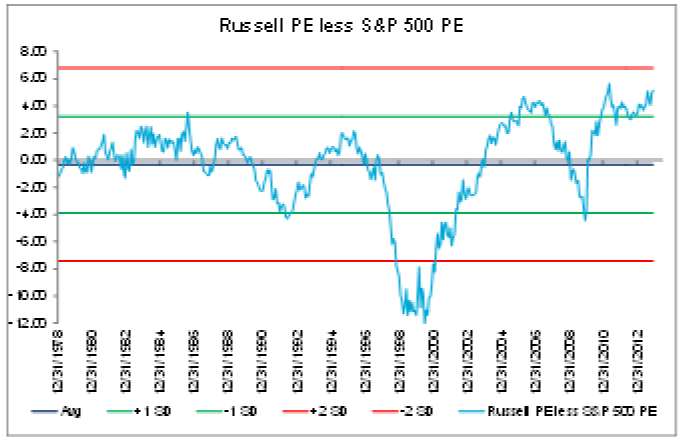
Positioning should be much more important in 2014 and style investing favors large caps and growth. Our proprietary lead indicator model clearly argues for growth (see Figure 11), while large caps versus small cap valuation differentials (see Figure 12) contend that there is a 72% chance that bigger cap names outperform. Given our concerns that volatility will pick up in 2014 looking at past indications (see Figure 13); a somewhat less risky portfolio makes sense as well. Bear in mind that share shrinkers have proven to be a great source of wealth accumulation (see Figure 14) and we continue to seek out companies that shrink their share count annually and not just engage in occasional buyback activity. Furthermore, capital spending intentions show a 13% increase in tech company capital investment plans for 2014 which should result in demand for the products and services tech companies provide. Thus, with still attractive valuation and good sales prospects, we perceive this sector as an area to provide outperformance potential next year, though we also like Financials and Utilities.

Figure 11.



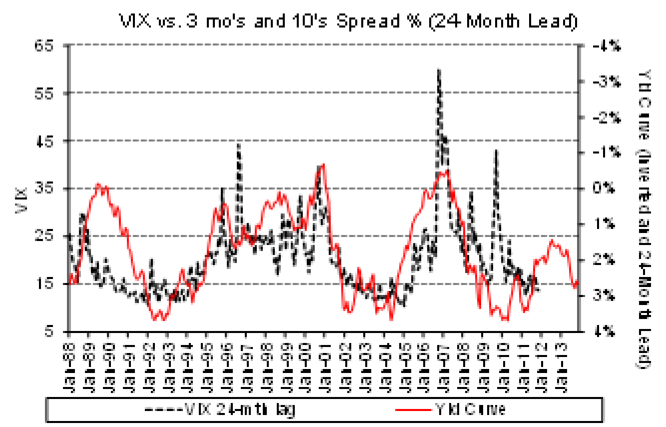
Source: Haver Analytics and Citi Research – US Equity Strategy

Figure 12.



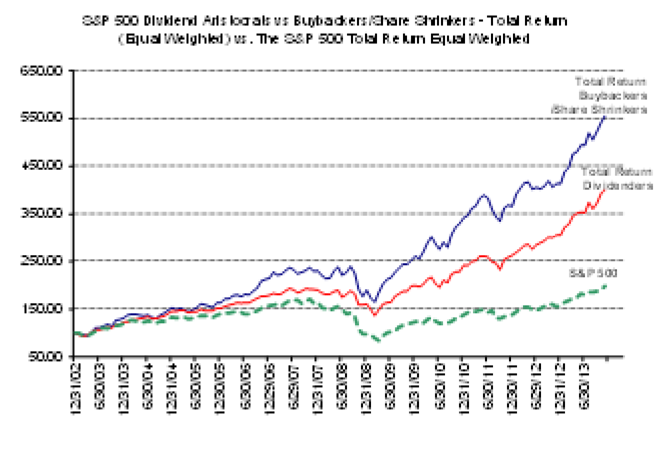
Source: Russell, Haver Analytics and Citi Research – US Equity Strategy

Figure 13.



Source: Haver Analytics and Citi Research – US Equity Strategy

Figure 14.



Source: FactSet, Haver Analytics and Citi Research – US Equity Strategy

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Economics

The Outlook for 2014: Cyclical Forces Take Charge

With diminishing headwinds and ongoing support from Fed accommodation, the US economic expansion is expected to continue over the next couple of years. Over the two-year horizon, we expect above-trend growth averaging roughly 2¾% (year-to-year basis) with unemployment declining to less than 6% by late 2015[1]. Although the recovery is now in its fifth year, it still has the upside of significant cyclical headroom in substantial labor and resource slack. Moreover, it does not show evidence of the sectoral imbalances that often doom mature cycles. A key hurdle is that policy uncertainties at times have undermined business and consumer confidence: Fed communications fumbles have compounded the effects of a dysfunctional fiscal policy process. Nonetheless, financial conditions now are extremely accommodating and the short-term fiscal outlook is shifting from considerable drag to an almost neutral stance in 2014.

The transition to a new Fed Chair and the fate of budget sequestration are two pressing issues in the immediate outlook. Janet Yellen's nomination to succeed Ben Bernanke is on track. With Fed policy missing on both ends of its dual mandate, the main challenge next year will likely focus on efforts to sustain a highly accommodative stance by anchoring short-rate expectations while phasing out asset purchases.

On fiscal policy, chances of major tax and budget reforms appear remote at best, and both sides are seeking minimal ways to undo some of the constraints on discretionary spending. We don't think another shutdown or debt limit crisis is likely but it may be too much to expect that reliance on continuing resolutions will be overcome next year. We expect fiscal drag of less than a half point and would not rule out something closer to zero if the remaining $20 billion of sequester-related drag in calendar 2014 is offset.

Ever since the Fed hesitated to taper QE in September, market participants have been unsure about the key policy drivers. The FOMC cited higher rates, downside risks from fiscal policy and reduced confidence in sustained labor market improvement, but on all three counts events so far hint that officials' concerns may be overdone. In particular, financial conditions are looser despite higher rates and solid job growth has been reaffirmed in typical revisions to soft summer data, followed by healthy gains through November. Policymakers seem willing to err on the side of ease and may be waiting for especially compelling signs of a virtuous cycle of self-sustaining demand, employment and growth that can withstand modestly higher bond yields.

Our base case is that tapering will be announced possibly as early as December but no later than March and that the balance sheet expansion will peak next September, followed by initial rate hikes in 3Q 2015 as unemployment nears 6%. In the lead-up to this forecast round, rate markets have been more accepting of the Fed's assertions that tapering is not tightening and that unwinding QE does not imply an earlier normalization of short rates. Rates out to five years have held more or less in check in the period following more favorable payroll gains, in part on signs that inflation has remained well below the Fed's 2% target and closer to 1%. We think forward guidance will emphasize that overnight rates are unlikely to rise until

[1] For a full discussion of the outlook see U.S. Macro Focus: The Outlook for 2014: Cyclical Forces Take Charge, December 1, 2013.

unemployment is considerably below 6½% or as long as inflation is expected to remain below target for some time.

Unlike previous years in the current upturn, Fed policy in 2013 can claim notable successes in promoting highly accommodative financial conditions. The Citi FCI has averaged plus one sigma or better for a year running, the most favorable backdrop since the late 1990s. Bank credit terms and standards have traced a similar pattern with all major loan categories looser, including a modest net improvement in mortgage credit availability in the two most recent quarterly surveys. The sudden back up in mortgage rates combined with sharply higher home prices has dulled the housing rebound and the sector's revival seems impeded in part by limited inventory that may be slow to normalize. We still expect solid growth in residential investment, especially as employment and income continue to gain, but we have trimmed back how much this sector is likely to contribute to overall expansion.

Although unemployment is still relatively high, job growth is very broad-based (six-month diffusion at 66%) and more than adequate to bring down the jobless rate now that housing-related and state and local employment are rebounding. The combination of improved hiring surveys, slowing productivity and better than average profit margins suggests payroll gains should remain close to or better than 2013's 189,000 pace. Along with slightly faster wage gains, the job recovery is expected to bolster household income and spending, in turn lifting business investment at a faster rate.

We expect inflation to remain below the Fed's 2% medium-term target near term with some modest firming as the expansion matures and global growth picks up. The recent slowing in inflation has been dominated by a relative price shock in commodities as rents, medical care, transportation and other core services are rising at a 2½% pace. Nominal income and demand are well supported, unit labor costs are accelerating modestly and household surveys as well as business pricing intentions all suggest that risks of an undesirable disinflation or worse are very low.

Figure 1. U.S. Economic Outlook Highlights (Annualized Percent Change Unless Noted), 2013-15F

	2013F	2014F	2015F	2013		2014				2015	
	4Q/4Q	4Q/4Q	4Q/4Q	3Q	4QF	1QF	2QF	3QF	4QF	1QF	2QF
Real GDP	2.0 %	3.1 %	3.0 %	3.6 %	1.0 %	3.3 %	2.8 %	3.0 %	3.2 %	3.2 %	3.0 %
Domestic Demand	1.7	3.2	3.0	1.8	2.0	3.2	3.1	3.3	3.3	3.3	3.0
Consumer Spending	2.0	3.1	3.0	1.4	2.7	2.9	3.0	3.2	3.3	3.2	3.0
Housing	12.1	15.2	10.1	13.0	8.7	13.4	16.2	17.6	13.5	13.0	11.4
Investment	1.8	5.0	4.5	3.5	4.0	4.7	5.0	5.2	5.2	4.9	4.4
Exports	3.6	4.2	4.6	3.7	4.2	4.2	4.5	3.9	4.2	4.5	4.4
Imports	3.2	4.5	4.2	2.7	2.6	2.6	5.1	4.6	4.6	4.7	4.4
Government	1.8	0.1	0.2	0.4	-3.0	-3.0	-0.5	-0.3	-0.2	0.3	0.2
Inventory (Contrib.)	0.2	0.0	0.0	1.7	-1.2	0.1	-0.1	-0.1	0.1	0.0	0.1
Net Exports (Contrib.)	-0.1	-0.2	-0.1	0.1	0.1	-0.1	-0.2	-0.2	-0.2	-0.1	-0.1
Unemployment Rate (Pct.)	7.3	6.4	5.9	7.3	7.1	6.9	6.8	6.6	6.4	6.3	6.2
PCE Deflator	0.9	1.8	1.8	2.0	0.7	1.8	1.9	1.8	1.6	1.9	1.7
Core PCE Deflator	1.2	1.7	1.8	1.5	1.2	1.6	1.8	1.8	1.6	1.9	1.8
Fed Funds Target	0.25	0.25	0.75	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
Ten-Year Treas. Yld. (Avg.)	2.80	3.25	4.00	2.71	2.80	2.80	2.95	3.15	3.25	3.40	3.50

Sources: Bureau of Economic Analysis, Bureau of Labor Statistics, and Citi Research.

Small/Mid Cap Strategy

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SMID 2014 Outlook: Staying on the Side Roads

- **Staying on the Side Roads** — During 2014, the “road ahead” should keep investors on the side roads, as 2013’s broader market influence gives way to increased company specific differentiation according to earnings growth and other thematic drivers.

- **Growth vs. Valuation Face Off** — Following strong 2013 performance, the SMID indices now trade at valuations near the high end of historical ranges. Yet, both trailing and forward earnings growth rates are near historical lows. Thus, the most critical dynamic facing SMID investors during 2014 will be a growth vs. valuation face off.

- **Targets** — We maintain 2014 targets set in September. These imply base case appreciation in the mid to upper single digits. A bull case scenario reflects a contrarian view toward stronger than expected earnings growth. A lower probability bear case is a function of less than expected improvement in underlying macros.

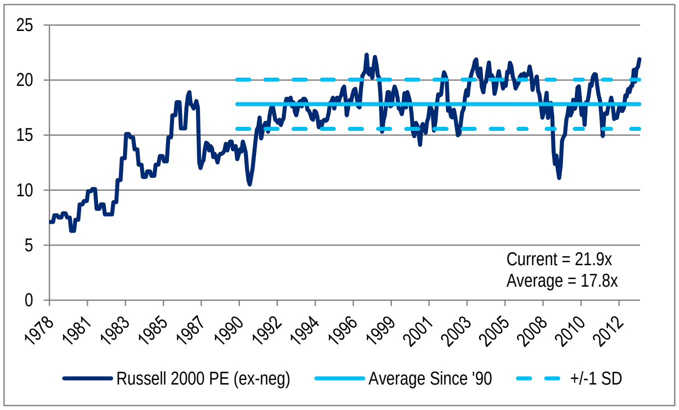
- **Styles and Sectors** — Our “investment focus” headed into 2014 shifts from “economic sensitivity” to “growth”. However, we maintain a style box call in favor of Value, reflecting its earnings growth improvement opportunity, but with more attractive valuations. Consumer Discretionary remains our primary Overweight, with a corresponding Health Care Underweight. We expect stock differentiation to supersede sector influences.

- **Macro Considerations** — The linkage between SMID performance and macro conditions is critical to our view. The connection is straightforward. Indicators such as the ISM have a strong correlation to SMID returns. Similarly, SMID performance has also shown a strong relationship to earnings growth. Thus, Citi’s view toward improving economic growth should benefit SMID’s inherent economic sensitivity.

- **Technicals** — Generally, SMID technicals reflect investor complacency. Volatility remains low, but implied has begun to tick higher. Similarly, correlations are low, but show early signs of inflecting higher. We suspect that ETF volumes imply an uptick in hedging activity. This is consistent with our expectation for some consolidation early in 2014.

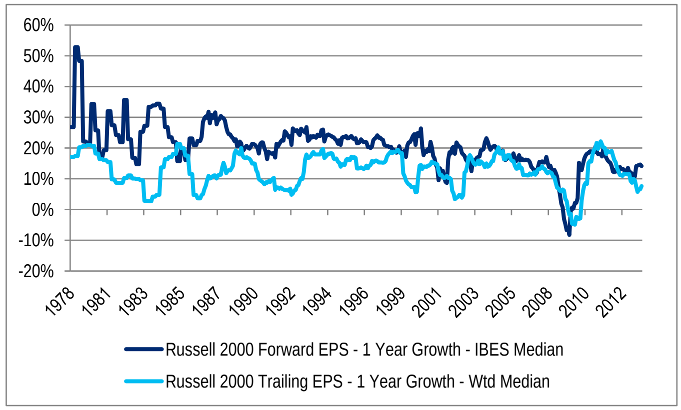
- **Stocks** — With stock selection according to growth characteristics key to our 2014 outlook, we screen for both “positive revisions” and “quality growth”. Additionally, we continue to emphasize our Value Creators SMID Focus list, which includes a number of well positioned SMID stocks, many of which are also included on the screens. The list has returned over 50% on an equal-weighted basis YTD.

Figure 1. Russell 2000 Trailing PE (ex-neg)



Source: Russell, FactSet

Figure 2. Russell 2000 Trailing and Forward EPS Growth



Source: Russell, FactSet

"Value Creators" Focus List

	YTD Through December 6, 2013	
		Recent Changes:
Russell 2500 Performance	31.15%	*QLIK was added after the close on 11/4/2013. See call note for details.
Russell 2500 Total Return	32.92%	*AXLL and MOH were removed after the close on 11/1/2013. See call note for details.
		*SUNE was added after the close on 9/30/2013. See call note for details.
		List changes are announced via a call note posted on Velocity and other internal research systems;
Value Creators List Index Equal Weighted Performance	51.57%	
Value Creators List Index Equal Weighted Total Return	53.24%	*FA's with questions, please contact MSSB Equity Sales at 914-225-7000.*

	Statistical Overview							Analyst Ratings, Targets & Estimates						Attributes	
	Date Added	Price Added	Price 12/6/2013	Perf. Since Added	Mkt. Cap (mil)	2013 Perf. YTD	Fiscal Year End	Rating	Price Target	EPS Estimates 2014	EPS Estimates 2013	P/E 2014	P/E 2013	5-Year Beta	Div. Yield
CONSUMER DISCRETIONARY															
American Axle & Manufacturing Holdings (AXL)	12/19/2011	$9.06	$20.00	120.75%	$1,511.30	78.57%	Dec	1	$23.00	$2.50	$1.54	8.0	13.0	2.35	0.0%
Steven Madden, Ltd. (SHOO)	12/19/2011	$22.47	$36.78	63.66%	$2,492.82	30.52%	Dec	1	$47.00	$2.40	$2.04	15.3	18.1	1.63	0.0%
Carter's Inc (CRI)	11/26/2012	$52.42	$70.25	34.01%	$3,830.44	26.24%	Dec	1	$80.00	$3.82	$3.39	18.4	20.7	0.88	0.0%
Goodyear Tire Rubber Co (GT)	2/19/2013	$14.09	$22.56	60.11%	$5,570.00	63.36%	Dec	1H	$28.00	$3.10	$2.54	7.3	8.9	2.57	0.0%
Brookfield Residential Properties (BRP)	4/29/2013	$24.05	$22.06	-8.27%	$2,625.72	22.97%	Dec	1	$28.00	$1.41	$1.13	15.6	19.6	2.17	0.0%
CONSUMER STAPLES															
TreeHouse Foods (THS)	11/12/2012	$51.48	$71.16	38.23%	$2,591.25	36.50%	Dec	1	$85.00	$3.67	$3.13	19.4	22.7	0.17	0.0%
ENERGY															
Tidewater Inc (TDW)	5/21/2013	$58.67	$58.15	-0.89%	$2,883.32	30.15%	Mar	1	$70.00	$5.74	$3.89	10.1	14.9	1.36	1.7%
FINANCIALS															
Post Properties Inc (PPS)	10/22/2012	$48.44	$46.15	-4.73%	$2,501.13	-7.61%	Dec	1	$58.00	$2.77	$2.99	16.7	15.4	1.39	1.8%
PennyMac Mortgage Investment Trust (PMT)	7/15/2013	$22.07	$22.01	-0.27%	$1,550.68	-12.97%	Dec	1	$25.00	$3.20	$2.94	6.9	7.5	0.53	8.9%
HEALTH CARE															
Medivation Inc (MDVN)	3/25/2013	$43.29	$62.20	43.68%	$4,693.33	21.58%	Dec	1	$70.00	-$0.47	-$0.71	-132.1	-88.2	0.64	0.0%
Cynosure Inc (CYNO)	9/11/2013	$23.36	$24.85	6.38%	$556.50	3.07%	Dec	1	$41.00	$1.25	$0.89	19.9	27.8	1.64	0.0%
INDUSTRIALS															
Con-Way Inc (CNW)	7/29/2013	$40.57	$41.46	2.19%	$2,358.70	49.03%	Dec	1	$46.00	$2.60	$1.81	16.0	23.0	2.12	1.0%
INFORMATION TECHNOLOGY															
Silicon Labs (SLAB)	9/6/2012	$38.57	$40.56	5.16%	$1,749.01	-2.96%	Dec	1	$47.00	$2.40	$1.98	16.9	20.5	1.06	0.0%
Advanced Energy Industries Inc (AEIS)	6/10/2013	$18.32	$22.43	22.43%	$896.85	62.43%	Dec	1H	$25.00	$1.70	$1.41	13.2	15.9	1.78	0.0%
AOL Inc. (AOL)	8/12/2013	$37.41	$44.44	18.79%	$3,487.30	50.08%	Dec	1	$49.00	$2.29	$2.06	19.4	21.6	0.93	0.0%
SunEdison (SUNE)	9/30/2013	$7.97	$13.23	66.00%	$3,527.17	312.15%	Dec	1H	$21.00	$1.08	$0.06	12.3	239.3	1.73	0.0%
Qlik Technologies (QLIK)	11/4/2013	$26.21	$24.96	-4.77%	$2,215.28	14.92%	Dec	1	$33.00	$0.37	$0.26	68.0	95.6	1.74	0.0%
UTILITIES															
Great Plains Energy (GXP)	5/21/2012	$19.90	$24.23	21.76%	$3,727.19	19.30%	Dec	1	$26.00	$1.73	$1.58	14.0	15.3	0.79	3.5%

Note: Portfolio performance based on daily index level as calculated by Russell indices; index performance incorporates historical constituent changes and is measured using daily close prices. Price added is prior day's close when stock is added b/f market open. Price added is same day close when stock is added after market open. Methodology generally mirrors that used to calculate the S&P equal weighted index. A full history of changes to our model portfolio is available upon request. No transaction costs are assumed. Past performance not indicative of future performance. FFOPS used instead of EPS for REITs. Calendarized data used.

Source: Citi Research, S&P Global Indices, Bloomberg, FactSet, Russell

Political Analysis

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2014 Global Political Outlook: Between Polarization and Populism

Political developments dominated the headlines in 2013: the election stalemate in Italy; the death of Hugo Chavez in Venezuela; mass protests in Brazil, India and Turkey, more recently in Ukraine and Thailand; a military takeover in Egypt; the first government shutdown in seventeen years in the United States; elections in Germany; the threat of US military intervention in Syria; and periodic spikes in security tensions between China and Japan, and on the Korean Peninsula. Yet thanks largely to accommodative policy from the Federal Reserve and European Central Bank, coupled with signs of economic recovery, these developments generated minimal market jitters rather than significant destabilization.

Given that neither liquidity nor modest economic growth will reverse the underlying causes of political risk, in our view *Vox Populi* risk — the notion that shifting and more volatile public opinion represents a new and powerful risk to the business & investment environment — remains a significant force.

Political risk to hamper economic governance, business confidence

International system struggles to build consensus to address geopolitical challenges

Slow growth, persistent unemployment means that political pressures continue

'Muddling through' policymaking still the rule

The combination of polarized electorates more prone to either protest or turning to non-mainstream political alternatives; weak political leadership, and limited international consensus on addressing global challenges remains potent. At the forefront for 2014 will be US midterm elections, a spate of elections in EM middle-income democracies (many of which saw major protests this year), European Parliament elections, and ongoing geopolitical challenges in the Middle East and Asia.

Figure1. Political Signposts for 2013-2014

December 13, 2013	Deadline for "Son of Supercommittee" budget panel (United States)
January 5, 2014	Bangladeshi general election
January 15	United States budget deadline, approximate sequestration date
February 7	United States debt ceiling deadline
March 23	French municipal elections (second round on March 30)
March 30	Turkish local elections
April	Algerian presidential election
April 5	Afghanistan presidential election
April 9	Indonesian legislative election
May	Last date for Hungarian parliamentary election
May 22-25	European Parliament elections
May 25	Belgian federal election
May 25	Colombian presidential election
May-June	Last date for Indian federal election
July	Last date for South African general election
July 9	Indonesian presidential election
September 14	Swedish general elections
September 18	Scottish independence referendum
October 5	Brazilian general elections (runoff on October 26)
November	Lebanese parliamentary election (tentative)
November 4	United States midterm election
December	Last date for Romanian presidential election

Source: Citi Research

Even so, the probability that political risk will generate systemically-significant disruptions remains comparatively moderate in the year ahead, given the small number of elections or planned changes in government in systemically significant markets and the shift toward diplomacy over military conflict. But longstanding

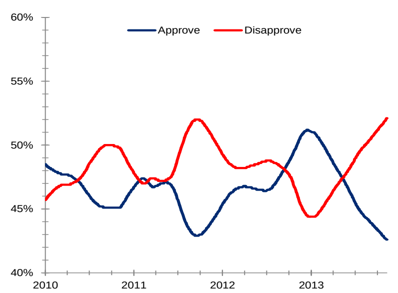
political risks will continue to surface periodically until the next major election cycle, hampering economic governance and business confidence in the process.

In our view, given persistently high unemployment, the modest growth pickup in DM will not reverse the trend toward fractured policies and anti-reform pressures. In EM, new middle classes are likely to continue to demand more from their leaders, even where they have been delivering growth and improving living standards. At the same time, the international system will struggle to address geopolitical challenges, as the focus on narrow domestic considerations collides with less room for maneuver for leaders constrained by low approval ratings and weak mandates.

Taken together, the global political outlook suggests an ongoing fragile equilibrium, with last-minute, piecemeal policymaking that may prevent the worst-case outcomes yet nonetheless continues the pattern of periodic heart attacks. In an era marked by a high degree of distrust of elites and dissatisfaction with politics, we find limited prospect for the improved economic governance that markets and corporates expect, keeping the pressure high on already "super-empowered" central banks. With Citi Research's global growth forecast at 3.1% next year and 0.9% in the eurozone, slow growth and high unemployment will mean that political risks continue to occupy center stage in the years to come.

Key Themes for 2014

Figure 2. President Obama's Approval Rating Ties For the Lowest Of His Presidency



Sources: Huffington Post/Pollster.com and Citi Research

***Lather, Rinse, Repeat* budget fights continue**

Obama approval ratings, concerns over health care law implementation, should pressure Democrats

Outlook for US midterm elections. Partisan polarization and demographic shifts have created conditions where many US politicians have more to fear from opponents from within their own party in primary contest than from the opposition party in a general election, a phenomenon which heightens polarization by hollowing out the political center and further reduces the political space for moderates. Where moderates remain in office, regardless of their party affiliation, pressure to avoid compromise is high. Consequently, short-term agreements have become the rule. The cyclical nature of these battles, which we call *Lather, Rinse, Repeat*, are likely to be replayed at regular intervals. Indeed we expect 2-3 more budget showdowns before midterm elections in November 2014. The US budget expires on January 15 and both sides are positioning themselves for next fight: sequestration. This highly partisan, disruptive cycle will continue until one party takes control of both houses of Congress, a scenario which is unlikely for some years according to current polling trends.

US political drama takes place against a background of strikingly dismissive public opinion in the United States. As of this writing, Congress's approval rating is in the single digits, and President Barack Obama's approval rating ties for the lowest of his presidency. Setbacks in implementing the health care law, regarded as the signature achievement of his presidency, will weigh further on the president's support and worry Democrats heading into the midterm elections.

In November 2014, the entire House and one-third of the Senate will be up for election. In the House, Democrats need seventeen (17) seats to take control. However, leading US election prognosticators only see only 44-52 competitive seats in the entire country, with 24-26 already held by Democrats.[2] This means Democrats would have to win more than two-thirds of all competitive Republican seats, the type of sweep only seen in wave elections. In the Senate, Republicans need six (6) seats to take control. According to the current polling data, taking at least three seats are possible (potentially Montana, South Dakota and West Virginia, and perhaps Arkansas as well). But the next three seats look far more

[2] *The Cook Political Report*, Larry Sabato's Crystal Ball, *The Rothenburg Political Report*. Accessed November 14, 2013.

difficult, with well-established Democratic incumbents in Alaska, Louisiana, North Carolina.

Weakening EM economic & fiscal conditions

Renewed social unrest possible in run-up to elections, "flash mob" democracy

Key EM elections. Next year will see elections in key emerging market economies: Turkey, Indonesia, India, South Africa and Brazil. Over the past year, all of them have seen among the largest mass protests or labor unrest in their recent history. All five have longstanding incumbent governing parties, ranging from ten years (India and Indonesia) up to 20 years (South Africa) in office. History suggests that long-tenured leaders often face significant challenges in the run-up to elections, especially in weakening economic and fiscal conditions. A key indicator for protest activity is a recent history of protests, suggesting that further mass protests in the run-up to the polls in these countries is highly likely.

Mass demonstrations have long been a major feature of country risk, but the scale of the 2013 protests in EM middle-income democracies suggested a new variation, fuelled by new middle classes and enabled by access to technology. Nevertheless, major demonstrations do not necessarily mean a change of government, especially where the opposition is weak. Only Indonesia and India are likely to produce opposition victories based on current polling trends. But the new manifestation of "flash mob" democracy could mean episodic disruptions to local markets, even after elections have taken place, and greater tendency for fiscal loosening and populism in an attempt to placate a restive public.

Figure 3. *Vox Populi* Risk in 2014: Key EM Elections

	Likely Date	Citi GDP2014F	Poltical Snapshot
Turkey	March	3.5%	Local elections provide first test for Recep Tayyip Erdogan's AKP government after the Gezi Park protests.
Indonesia	April, July	5.3%	Susilo Bambang Yudhoyono leaves office in the wake of fuel price protests, falling equity markets and a currency crisis. Newcomer Jakarta governor Joko Widowo leads in the presidential polls.
India	May	5.6%	Pro-business Narendra Modi leads the BJP opposition against Congress's 11-year government as the economy sputters.
South Africa	April-July	2.8%	Jacob Zuma's ANC will win re-election, but faces labor unrest, high unemployment, and growing challenges on both the left and right.
Brazil	October	2.0%	Dilma Rousseff remains favored for re-election after the Salad Revolution, but environmentalist Marina Silva cuts into her base.

Source: Citi Research

Snap elections in Greece & Italy possible in 2014

European Parliament elections will pressure national governments, EU budget targets, influence domestic policy debate

Separatist & secessionist referendums unlikely to succeed, but highlight tensions

Slow growth Europe faces European Parliament elections, fragmentation risk. Weak coalition governments in Greece and Italy still face the threat of snap elections, making these a key eurozone political risk for 2014, as coalition partners are faced with tough choices. European Parliamentary elections are in May, providing an opportunity to test the support of populist NEAP's — the new, extreme or alternative parties that have seen a significant increase in support over the past two years. Amid persistently high unemployment, austerity fatigue and rising euroskepticism, particularly in the creditor countries, NEAPs could win big at the European Parliamentary level. In the hopes of blunting support for non-mainstream parties, Brussels will continue to apply less pressure on budget targets. European Parliamentary elections will be closely watched ahead of the national election cycle in the eurozone that will resume in 2015 as a leader indicator of public sentiment. Typically ignored by markets, these elections will likely get greater focus in the wake of recent attempts to pass the financial transactions tax and limit portfolio managers' pay.

Risks to European Union cohesion and rising separatism will also feature in 2014, with September's Scottish independence referendum as well as the continued tensions between Madrid and Spain's autonomous regions. As the European crisis evolves, secessionism, euroskepticism, and willingness to experiment with non-mainstream parties have grown (although notably most contemporary secession

movements are ardently pro-EU). In both the Scottish and Spanish cases secession falls short of a majority in the polling data, but is sufficient to suggest continued pressure on central governments and cloud the policymaking outlook, increasing the risks of populism.

Likelihood of Western intervention low

Iran deal pressures US relationship with Saudi, Israel

Persistent security problems in Libya, Iraq

China-Japan tensions on the rise

Arab Spring realignments and geopolitical risk in Asia. Despite the military intervention in Egypt and raging civil war in Syria, diplomatic efforts on Syria's chemical weapons and the interim agreement between Tehran and the P5+1 Iran nuclear negotiations have significantly reduced the risk of Western military intervention, thereby lowering the geopolitical risk temperature. The Iran diplomatic breakthrough, which will see Iran's nuclear program "frozen" in exchange for limited sanctions relief, reduces the likelihood of military action in Iran, a longstanding geopolitical risk that has worried markets. Yet the potential for improved US-Iran relations has strained the Saudi-US relationship as well as US-Israel ties. Further, worries of an eventual Iranian nuclear weapons capability could spark a regional WMD arms race over the longer-term. More significant for global energy supplies are the persistent security problems in Libya and Iraq, which show little prospect of subsiding.

In Asia, China-Japan tensions over the Senkaku islands continue, most recently illustrated in China's effort to create a new air zone over the disputed islands. Though neither side wants a military conflict to disrupt regional stability or commercial relations, friction is likely to continue sporadically, increasing the risk of an accidental conflict. US-China relations remain in a holding pattern, with the Obama administration maintaining a commitment to the Asia pivot even as attention is drawn back to the Middle East—and domestic concerns in Washington.

Conclusion

***Vox Populi* still a force to be reckoned with**

No sign of slowing in demand for democracy, civil rights & liberties

As more and more governments face intense pressure to be responsive to popular discontent and to produce sustainable economic benefits for the whole society, the Vox Populi will remain a force to be reckoned with and an important risk factor for the foreseeable future.

Some suggest that democracy is in decline in the aftermath of the global financial crisis, with various indicators of democratic freedoms going into reverse. Yet demand for political alternatives and accountability of leaders, the spike in protest activity and the flexibility, if lack of muscularity, found in the world's democracies over the course of the post-crisis period refute this argument. Demand for democracy, civil rights and liberties shows no signs of slowing, nor do the pressures and opportunities of globalization. It will be the ability of leaders to respond to public concerns while anticipating the shifts in the global system that will largely determine the shape of things to come.

USA Quantitative Strategy

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Value via Cheap Quality

- **Strong Value Performance…** Year to date, Value is up 7.2% in the US, significantly outperforming all other styles. Once Value is purged of other unintended style exposures (Pure factor performance in Figure) performance increases to 13.2%. The strong outperformance of Value emphasizes the 'Risk on' nature of US markets in 2013 with the market re-rating from 12x to 16x on 12 month forward earnings.

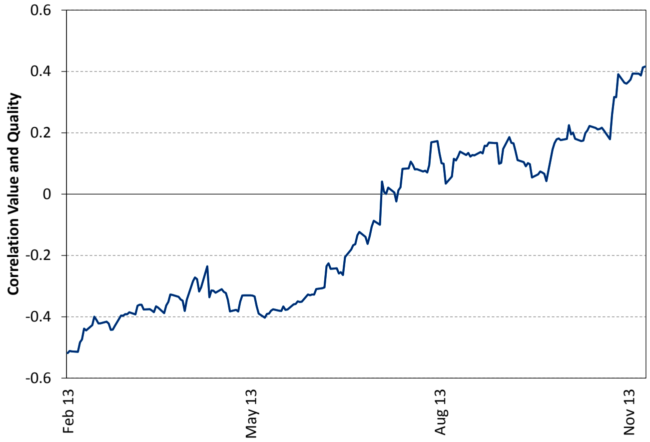
- **…Has made the Style Expensive** - Strong Value performance through 2013 has made the style expensive relative to history; the PE spread of Cheap/ Expensive stocks is around 1 standard deviation (Figure 1). While there is still a small amount of upside to Value according to this metric, we think the market re-rating due to an improved macro environment has broadly finished. Stock selection will be back on the agenda for 2014 requiring selective Value exposure.

- **Cheap Quality can provide Upside…** In contrast to Value, high Quality names look cheap (Figure 2). Forward PE spreads for high Quality/Junk are also extended around 1 standard deviation and, interestingly, a high correlation (0.4) between Cheap and high Quality portfolios highlights the significant Value exposure within Quality at this juncture.

- **…Whilst offering Macro Insulation -** Another benefit of Quality is the styles low volatility. While we are broadly positive on the US market for 2014 there are clear macro challenges such as the fiscal cliff and Fed tapering which are likely to cause short term volatility. Selecting Quality as our key factor for 2014 reduces exposure to Macro news volatility whilst providing upside through Value exposure.

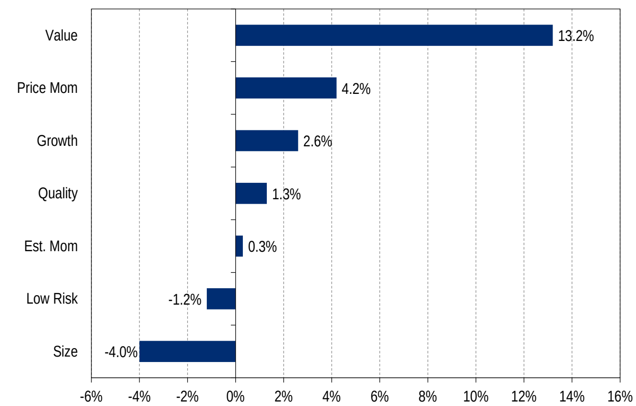
- **All about Earnings** The last 12 months has rewarded stocks regardless of earnings delivery. This has led to the overvaluation of Low versus high Quality providing real Value in high Quality names. Now the market has re-rated and improved macro expectations have been baked into numbers, we expect stocks to be rewarded for earnings delivery over sentiment. We continue to back earnings leadership and see this coming through Quality. We are consequently positive on US Quality going into 2014.

Figure 1. Style Correlation, Value and Quality, MSCI USA



Source: Citi Research

Figure 2. Pure Style Performance YTD 2013, MSCI USA



Source: Citi Research

Equities

Aerospace & Defense

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Aero Has Wings and Defense Has Cash

- **Buy Aero and Defense** — We see buying opportunities across our space as commercial aerospace continues to benefit from strong order activity, record backlogs, and rising production rates. Higher sales and operating leverage create significant cash flow growth over the next few years. And even though the defense demand environment is shaken by an uncertain budget situation, stocks still offer attractive cash flow dynamics. Bizjets are a mixed market with no recovery in sight for the low end of the market.

- **Aero Production Rates Increasing Through 2020** — Boeing and Airbus continue to go beyond already record production rates, driven largely at this point by new programs (787 and A350) and 737 stepping to 42/month in 1Q14. As a result, the two major OES will be producing more aircraft in 4Q14 vs. 4Q13. Furthermore, Boeing has already announced that 737 rates will go to 47/month in 2017, and that 787 will be at 14/month by the end of the decade (from ~10/month in 1Q14). Add to this the A350 ramp and 777X content announcements, and we're set up for yet another attractive year for companies sin the OE supply chain even though orders likely slow. As we've previously argued, these stocks can work during periods of "backlog burn" as the OEs execute on a record amount of work (6-8 years of backlog). We have Buys on Boeing (BA), Spirit Aerosystems (SPR), B/E Aerospace (BEAV), Precisions Castparts (PCP), and Wesco Aircraft (WAIR)

- **Civil Aftermarket Set for Rebound** — We expect civil aftermarket to re-couple with air traffic growth in 2014 after a relatively soft 2013 which was largely driven by airlines' careful cash and capacity management. We also see more aircraft rolling off warranty in 2014 as well as airspace modernization mandates providing a further boost. Offsetting these positive trends are higher aircraft scrap rates flooding the market with used parts.

- **Bizjets Still Bifurcated** — High-end large-cabin business jets still see relatively stable demand due to a relatively inelastic customer base (multi-nationals and high net-worth individuals). Specifically, General Dynamics (GD) benefits from G650 production rates picking up and associated margin upside as the company moves down the learning curve. On the other hand, we do not see a recovery in the small-cabin bizjet market anytime soon due to the significant overhang from the over-deliveries of the mid/late 2000s, as well as capacity demand competition from re-manufactured jets and fractional/charter business models. We like GD, and we're Neutral on Textron (TXT).

- **February Budget Proposal Helps Clarify Focus on Modernization, but There's Still Budget Uncertainty** — The US macro picture has been improving and Citi economists expect growth trends to modestly firm up and for already stronger cyclical forces to take charge. Regardless of this relatively positive fundamental backdrop, the US Congress still can't agree on a budgetary framework to help mitigate sequester. We're in a Continuing Resolution until January 15, with various plans floating around which could involve some sequester relief. We'll likely see some volatility between now & then, but we expect the President's February budget proposal to highlight the importance of modernization even amidst this budget environment. We have Buys on Huntington Ingalls (HII), Raytheon (RTN), Lockheed Martin (LMT), and Northrop Grumman (NOC).

- **Defense Cash Is Key** — We expect the defense primes to grow cash flows ~6.5% over the next few years due to resilient margins and positive pension dynamics. Defense stocks are relatively cheap from an EV/EBITDA perspective which we believe is the right way to look at these stocks on a historical basis.

- **Risks** — The aero supply chain ramping to record levels creates some risk that companies will not be able to keep up, potentially creating delays or financial hardship. We haven't seen appreciable pressure to date, but the OEs are paying more attention than ever to the health of the supply chain. Another recession would also likely bite into aero backlogs as airlines lose money and/or decide they can fly profitably with older equipment due to lower oil prices (likely brought on by recession). There is also plenty of risk around US defense budgets given on-going Congressional debates, with sequester set to persist into its second year with DoD reportedly having less flexibility to offset cuts.

- **Catalysts** — **(1)** Congressional action (or inaction) to deal with sequester and/or create a long-term budget framework; **(2)** Seamless production ramps at Boeing and A350 progress at Airbus benefit the supply chain; **(3)** Presidential defense budget proposal in early/mid-February likely highlights the importance of modernization programs (we're hosting a DC Bus Tour Feb 11-12); **(4)** GD, RTN, and NOC all likely boost their dividend in March-May timeframe, suggesting persistently strong CF activity and s/h returns; **(5)** Farnborough Air Show (July) generates more orders, although we probably won't see any new program introductions.

  Other companies mentioned: B/E Aerospace (BEAV.O; US$85.80; 1); General Dynamics Corp. (GD.N; US$90.74; 1); EADS (EAD.PA; €49.99; 1)

Aerospace & Defense: Top Buys

	Ticker	Rating	Price (12/9)	Target Price	Yield (%)	ETR (%)	2014E P/E	2014E P/BV	2014E ROE
Top Buys									
Spirit Aerosystems	**SPR**	**Buy**	32.99	39	0.00	18.2%	12.3x	1.9x	17.4%
Classic turnaround story with new management ready to execute more effectively on 6Y backlog. Re-initiated 2014 guidance on 4Q call & asset sale are likely catalysts									
Boeing	**BA**	**Buy**	134.68	142	2.34	7.0%	16.9x	11.2x	59.1%
Higher production rates & new variant intros set up for better margins, strong cash generation & shareholder returns. Resilient defense biz anchored by international demand.									
Precision Castparts	**PCP**	**Buy**	253.64	274	0.06	8.1%	20.9x	3.3x	17.2%
Higher aero production rates & energy markets drive PCP toward FY16 EPS target of ~$16 via higher volumes and/or operating leverage.									
Huntington Ingalls	**HII**	**Buy**	81.48	118	0.23	45.8%	12.1x	3.6x	32.2%
Margin expansion & cash growth driven by delivery of final underperforming ship in 1Q14 & positive pension dynamics. Avondale decision could also be a catalyst.									
Lockheed Martin	**LMT**	**Buy**	138.93	155	4.50	15.4%	13.5x	21.1x	200.2%
Industry-leading dividend yield & strong repurchase program supported by positive cash dynamics. F-35 exposure likely allows for faster growth vs. industry.									
Northrop Grumman	**NOC**	**Buy**	109.94	132	3.18	22.4%	13.1x	4.6x	20.8%
Strong margin performance & attractive portfolio (unmanned, electronics, fighters) supports early 2013 commitment to repurchase 25% of company by 2015.									
Raytheon	**RTN**	**Buy**	86.85	97	3.47	14.4%	13.9x	3.0x	21.7%
Industry-leading margins and international exposure supports balanced cash returns strategy (dividend and repurchase).									

Source: Citi Research

Apparel/Footwear/Textile Manufacturers

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Global Secular Growth Stories Will Continue to Drive Higher Multiples; Buy RL

- **Global Secular Growth Stories Should Gain Momentum In 2014 With Improvement in Europe and China** — While consumers remain cautious and selective buyers, apparel & footwear manufacturers are well positioned for 2014, in our view. We think growth could accelerate based on the brands' global appeal, the white space opportunity for growth, and the improvement in the macro environment in Europe and in China. Near-term catalysts for the sector include: 1) The ICR conference (January 13 – 15, 2014 in Orlando, FL) where we expect to hear preliminary projections for 2014, and 2) Year-end earnings in February, with potential upside to management expectations primarily from slightly better top line expectations.

- **We Expect Supply Chain to Become a Bigger Theme in 2014; Driving Gross Margins Higher** — A key theme emerging in the apparel/footwear industry over the past few quarters is a renewed focus on the supply chain, which we view as a response to multiple factors, including double-digit wage increases in China (still the largest global supplier of footwear and apparel) and other key manufacturing markets, volatility in commodity costs, and weather/retailers/fashion trends driving demand for faster speed to market, etc. Companies in our universe are getting more flexible & creative with how they are approaching the supply chain. Newer strategies include: 1) **lean manufacturing** – reducing dependence on labor and material inefficiencies; 2) **shifting sourcing** outside of China and/or bringing manufacturing closer to market; and 3) **going direct** (direct sourcing/in-house production). Overall, as manufacturing gets increasingly difficult/complex, we favor global companies that can stay nimble and ahead of the curve, enabling them to better service retailers and consumers while also maintaining control over their gross margins.

- **Top Line Growth and Margin Expectations** — On average we are expecting 10.5% top line growth in 2014 and +30bps gross margins expansion y/y, following 15% top-line growth and +120bps forecasted gross margin expansion in 2013 (with 2013 gross margins benefiting from lower cotton costs y/y). Those companies with above average growth include UA, FNP, SHOO, and HBI. Those companies with above average margin expansion include FNP, PVH, CRI, NKE, FL, and VFC.

- **Athletic Apparel Momentum Likely to Continue** — We expect the pickup in athletic apparel momentum beginning 2H13 to continue into 2014, driven by a continued consumer shift in athletic apparel as a lifestyle trend, improving assortments and head-to-toe hookups from key vendors, and an increased emphasis by retailers on premium product.

- **Cash Usage Likely Toward OmniChannel Investment and Share Repurchases** – We expect capital expenditures to increase an average of 7% y/y in 2014, below average double-digit growth over the last 3 years, as the industry has focused on building out direct-to-consumer and international businesses. Going forward, we expect continued investments in omni-channel expansion/integration as well as continued cash returns to shareholders via dividends and share repurchases.

- **Buy RL: Improving Top Line and Gross Margins Should Drive Growth and Multiple Expansion for 2014** — We reiterate our Buy rating on Ralph Lauren.

While the retail environment has been challenging, management expressed confidence from strong Q2 performance across channels/regions (especially luxury accessories), contributions from new DTC, share gains, & Asia (+DD in Q2 ex-Japan). RL's integration of the Chaps/Australia/NZ licenses and multi-year SAP rollout are also on track. We reiterate our Buy as our long-term thesis on RL's global secular growth remains intact, driven by international expansion, DTC, and category growth.

Other companies mentioned. Carter's Inc. (CRI.N; US$70.24; 1); Foot Locker Inc (FL.N; US$39.09; 1); Fifth & Pacific Companies Inc (FNP.N; US$33.19; 2); Hanesbrands, Inc. (HBI.N; US$68.19; 1); Nike Inc (NKE.N; US$78.39; 1); PVH Corp. (PVH.N; US$132.97; 1); Steven Madden, Ltd. (SHOO.O; US$35.85; 1); Under Armour Inc (UA.N; US$84.31; 2H); VF Corp (VFC.N; US$231.30; 1)

Apparel & Footwear: Top Buys

	Ticker	Rating	Price (12/9)	Target Price	Yield (%)	ETR (%)	2014E P/E	2014E P/BV	2014E ROE
Top Buys									
Ralph Lauren	**RL**	**Buy**	**$171.18**	**$205**	**1.0%**	**20.7%**	**20.6x**	**3.9x**	**20.8%**
Near-term potential upside from improving performance across channels/regions, contributions from new DTC, share gains, & Asia. RL's integration of the Chaps/Australia/NZ licenses & multi-year SAP rollout are also on track. Our long-term thesis on RL's global secular growth remains intact, driven by international expansion, DTC, and category growth.									
DSW	**DSW**	**Buy**	**$42.87**	**$52**	**1.1%**	**22.4%**	**22.2x**	**4.6x**	**21.0%**
We see increased momentum going into 2014 from: an extended boot season into Q1 (positive mix impact), benefit from DSW's recent charge-send rollout, early signs of a turnaround in the struggling dress shoe category, and guidance of 35 new stores. Longer term we still like the story based on the potential to double the projected store base, a strong balance sheet which could result in a share buyback in the next year or so, & its value message for consumers.									

Source: FactSet and Citi Research

Auto Manufacturers & Suppliers

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Can the Auto Run Continue in 2014?

- **Can the Auto Run Continue in 2014?** — 2013 will likely go down as yet another strong year for U.S. auto stocks on the back of strengthening end-markets (U.S. pickups, stabilizing EU, China), solid incremental margins and shareholder friendly actions. So what's 2014 going to look like? Fundamentally, we still see a favorable cyclical backdrop as the Citi Global Autos Team forecasts 2014 global light vehicle sales rising 4.4% YoY (vs. +1.9% in '13E). Here in the U.S., we remain upbeat about our 2015 SAAR inflection thesis based on our past scrap-age work—implying over 1 million units of additional upside by 2015E towards a 16.5 million SAAR (vs. YTD 15.4). We also remain upbeat about our "Go Long" pickup truck thesis, which should support mix and pricing for domestic automakers & suppliers. Away from cyclical dynamics, we also see a continuation of secular stories driven by a global technology evolution that's seeing new "must-have" content show up in cars like never before — active safety, connectivity and fuel economy. Lastly, improving pension positions should allow companies to maintain steady shareholder return postures without jeopardizing balance sheets. Sentiment remains positive but we haven't heard overly ambitious global demand forecasts or timetables for a European sales recovery.

- **What About Valuation?** — Clearly, we remain constructive on the group going into 2014. However, we're also mindful that two strong years for returns have restored historical valuation ranges (on '13-14#s). Thus, a more selective posture is appropriate at this stage. We've heard and actually concur with the view that improved auto fundamentals may warrant a moderately higher re-rating to something a bit closer to Industrial peers. However, having lived through both ends of the auto sentiment spectrum, we are reluctant to base an entire thesis simply on multiple-expansion unless there's a clear and quantifiable cause. Rather, we prefer to screen for companies with below auto-peer P/Es who have "transformation" stories that can eventually justify peer group multiples.

- **The 2014 Transformation Theme** — Such transformations can happen a number of ways: (1) De-leveraging (Goodyear, Axle); (2) Changing business mix (Lear EPMS) and new revenue streams (BorgWarner stop/start); and (3) Self-help restructuring/repositioning (Goodyear, Johnson Controls, Magna, Meritor, F). All the while, we look to screen these transformational themes against our highest-conviction cyclical ideas (pickups, 1st replacement tires, and eventual EU recovery), the secular trends touched upon above and our views of where sentiment is low & misguided.

- **Stocks We like Heading Into 2014** — With the screens applied above, we remain positive on US OEMs headed into 2014 on low valuation coupled with European restructuring tailwinds coming into view, pickup exposure and shareholder friendly postures. For suppliers, we highlight Goodyear, Lear, American Axle, Delphi and BorgWarner, followed by Tower.

- **What Could Go Wrong** — Besides obvious macro & geo-political shocks, we're watching the U.S. pricing environment carefully to assess competitive incentive activity. Although our data suggests that the pricing environment remains steady, higher off-lease volume and a weak Yen pose some risk. In addition, we're monitoring the financing environment as it pertains to the availability of longer-length auto loans and lease penetration—which have supported pricing to date. We're also watching Europe carefully through our proprietary European dealer surveys, which continue to paint a stable, albeit mixed, industry environment.

- **Top Cyclical Themes: Pickup Trucks & Tires** — Despite strong YTD performance for the full-size pickup truck segment, we believe we're still early in our "Go Long" pickup truck thesis, which argues that every (yes, every) pent-up demand indicator screens more robustly for pickups than the overall market. For newer investors, the pickup truck segment is of utmost importance to domestic auto companies thanks to high profit margin and Detroit's dominant position in the segment. Though strong YTD sales have warmed investors up to the segment, our analysis suggests that there's plenty more recovery left. Interestingly, some of the same misconceptions that led to widespread bearishness on pickups may also have led to bearish views on the U.S. tire replacement market. We therefore like positioning for an expected tire volume recovery in the U.S. and particularly in companies that can benefit from 1st replacement sales that today probably reflect the bottom of the 2008-10 SAAR downturns but should soon start benefiting from the 2011-YTD SAAR recovery.

- **Top Secular Themes: The Rise of the (Safe & Green) Connected Car** — Good content-per-vehicle (CPV) stories are often regulatory driven. Great CPV stories are often driven by technologies consumers want and are willing to pay for. In the fuel economy world, that means technologies offering a quick payback and fun-to-drive experience—think GDI/turbo & stop/start systems, or even electric vehicles at the high-end of the market where quick payback is less critical. In the safety world, that means active sensor/radar technology that can avert accidents and provide greater situational awareness to the driver. In the related connectivity world, that means seamless driver/passenger connectivity that can save consumers time and money. We like Delphi for exposure to all three trends (at a reasonable valuation) and BorgWarner for its well-known engine/drive train technology but also less known exposure to stop/start.

Other companies mentioned: Ford Motor Co (F.N; US$16.54; 1); Johnson Controls Inc (JCI.N; US$50.53; 2); Lear Corporation (LEA.N; US$81.20; 1); Meritor Inc (MTOR.N; US$7.62; 1H); Tower International, Inc. (TOWR.N; US$20.97; 1); Delphi Automotive PLC (DLPH.N; US$58.51; 1)

Auto Manufacturers and Suppliers: Top Buys and Sells

	Ticker	Rating	Price (12/9)	Target Price	Yield (%)	ETR (%)	2014E P/E	2014E P/BV	2014E ROE
Top Buys									
BorgWarner	**BWA**	**Buy**	**$107.92**	**$118**	**0.9%**	**10.3%**	**16.7**	**2.8**	**19.4**
Strong margins, resilient cash flow, even with European exposure, and LT growth attributes remain very robust on global fuel economy regulations									
American Axle	**AXL**	**Buy**	**$19.46**	**$23**	**-**	**18.2%**	**7.8**	**7.9**	**nm**
Direct leverage to "Go Long" pickups; high truck exposure (~80%), little Europe exposure, strong backlog, consistent margin execution									
Goodyear Tire & Rubber	**GT**	**Buy**	**$22.45**	**$28**	**0.9%**	**25.6%**	**7.3**	**2.6**	**48.4**
Lower raw materials, potential to capitalize on looming pent-up tire demand and first replacement cycle, more defensive product									
Top Sells									
Magna International	**MGA**	**Sell**	**$80.80**	**$77**	**1.6%**	**-3.1%**	**10.4**	**1.6**	**16.6**
Though we remain constructive long term, our Sell thesis predicated on: valuation relative to supplier group; FCF conversion; EM penetration relative to peers									

Source: Citi Research

Banks and Brokers – U.S.

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Risk/Reward Slightly Skewed to upside

Few catalysts to drive performance in 2014 – Banks are up 32% YTD vs 27% for the S&P, with bank outperformance driven by lower risk being priced in and a move to buy the banks ahead of the eventual rise in rates signaled by tapering. With sub-3% growth expected next year, the macro environment is unlikely to provide a significant tailwind to bank earnings. Multiples are near historic averages with our coverage group trading at 12x 2014 earnings and a 20% discount to the S&P while the implied cost of equity has trended down to 10.9% on average from 11.3% at mid-year. With implied betas at 1.3 for capital market names (near pre-crisis levels) vs 1.2 for the regionals, we prefer the regionals' risk-reward and believe BBT presents the best opportunity to invest in the space while we are Sell rated on NYCB. Among the capital market names, JPM is our top pick. Among the Trust Banks, we are Buy-rated on STT and BK.

1) 2014 fundamentals look challenged as slow growth, low rates continue and credit tailwinds subside. . . While 2014 consensus estimates have moved up 1-2% on average over the past year (in line with the S&P), consensus PTPP estimates have fallen roughly 5% and were more than offset by better credit. We see modest downside to consensus estimates reflecting low rates, mortgage headwinds, sluggish loan growth, and continued NIM compression weighing on bank fundamentals. For the capital market names, regulation on fixed income trading (SEF, Volker) will weigh on earnings, although this could be partially offset by better equity trading and investment banking. With limited potential for positive EPS revisions, 2014 outperformance will likely need to be driven by multiple expansion. On balance, we see slightly more upside than downside in the space, and are looking for 10% or so total return for the group.

- **Low rates and slow economic growth will likely lead to flattish top line growth –** Revenue growth should remain challenged in 2014 as we see little chance for a substantial rise in short term rates. Upward moves in the long end of the curve have already stifled mortgage refinancing activity, dampening our mortgage banking outlook. Thus we see a challenging environment for growing revenue in 2014 absent a large move up in short term rates and we see median fees and NII growing by ~2% and ~1.5% respectively in 2014. Loan growth may pick up slightly on a marginally better macro environment but we don't see a catalyst for a large acceleration of loan growth as the slow recovery of the U.S. economy continues. Additionally, C&I growth, which has been relatively strong in the recovery thus far, appears to be slowing and may pose an additional headwind for the banks. We see median loan growth at 3.8% next year vs 3.3% in 2013.

- **. . .while credit and expense upside has played out . . .** 2013 profitability benefitted from better than expected credit with large reserve releases more than offsetting weaker core pre-tax pre provision earnings. We believe we are unlikely to see the same level of reserve releases in 2014 and although net charge offs may continue to trend lower, they have reached more normalized levels. Thus, we see a 10% increase in provision expense next year. While 2014 may see some slight improvements in efficiency as banks adjust their mortgage segments to lower volumes, this would be offset by increased regulatory and compliance costs. Thus, we see few levers to pull for additional reductions in expenses.

- **. . .But longer term, higher rates and cyclical expansion should drive upside –** We see normalized ROTE at 17% vs 12% currently and we believe investors will begin to price this earnings power into the stocks should the U.S. economy begin to accelerate in 2014. The acceleration of the U.S. economy and higher rates should drive earnings growth longer term. Benefits from loan growth and balance sheet re-pricing will eventually benefit the regional players while more robust economic growth and business optimization in the broker space should lift earnings, driving better long-term returns.

2) . . .And with relatively low earnings risk, the key to stock performance will be the outlook for multiples, and we have a slight positive bias on regional bank multiples – Although we see a lack of catalysts to drive earnings, we note that multiples could continue to stretch higher as investors seek to hold the banks for their stability of earnings and upside leverage to an improving economy. We believe the regional banks have a more attractive risk-reward from here due to their lower regulatory overhang and a larger cushion for further multiple expansion as implied betas come down to pre-crisis levels. Among the trust banks we see cheap optionality on higher short term rates due to their asset sensitive nature.

- **Capital Markets names are challenged given regulatory overhangs and slow growth –** Regulation of derivatives trading and the Volker rule will likely weigh on fixed income trading, and our 2014 estimates are ~3.5% below consensus. The key to the stocks is whether the market can see a path to mid-teen returns, and with MS and GS trading at premiums to tangible book despite having returns below their cost of equity, we view the risk/reward as skewed more to the downside.
- **Regional Bank valuations are fair given the rate environment –** At 13x 2014 earnings and 1.5x tangible book, regional bank valuations seem full given the expected timing of rate hikes implied by the forward curve. That being said, the risk to the downside is deflation and the risk to the upside is the market pricing in a premium due to the stability of earnings and the potential for the market to anticipate rate hikes, and we believe this implies a slight upward bias to current multiples.

3) We are neutral on the space and JPM and BBT are our top picks – With valuations back to historical levels and lackluster economic activity, we are Neutral rated on most of our coverage. We see JPM as among the most attractively valued banks in the capital markets space given its industry leading franchises, strong management team, and underappreciated long-term earnings power. We see BBT as having the most room for multiple expansion as its trades at a discount to other banks with similarly high returns (WFC MTB). Additionally we think BBT may benefit from expense tailwinds in 2H14 due to lower pension costs related to higher rates. We are Buy-rated on BK and STT as we believe they are especially levered to an increase in rates. We are Sell-rated on NYCB on concerns over its dividend.

Other companies mentioned: M&T Bank Corp (MTB.N; US$113.90; 2); Wells Fargo & Co (WFC.N; US$43.92; 2)

U.S. Banks Top Buys and Sells

	Ticker	Rating	Price (12/9)	Target Price	Yield (%)	ETR (%)	2014E P/E	2014E P/BV	2014E ROE
Top Buys									
JP Morgan Chase & Co	**JPM**	**Buy**	**$56.51**	**$66.00**	**2.90**	**19.7%**	**9.3**	**1.0**	**11.02%**
JPM provides an attractive near-term opportunity to buy a bank generating strong mid-teens ROTE at a modest 1.3x multiple to TBV									
BB&T	**BBT**	**Buy**	**$34.84**	**$40.00**	**2.81**	**17.6%**	**11.7**	**1.2**	**9.36%**
We like BBT's above-average profitability and growth, strong balance sheet and risk discipline and view it as a solid long-term investment									
Bank of New York Mellon Co	**BK**	**Buy**	**$33.65**	**$34.00**	**1.96**	**3.0%**	**13.1**	**1.0**	**8.33%**
We believe the stock is pricing in a draconian impact from SLR and rising rates while simultaneously not pricing in the earnings benefit from higher rates.									
State Street Corp	**STT**	**Buy**	**$71.82**	**$78.00**	**1.82**	**10.4%**	**13.7**	**1.5**	**11.97%**
STT will likely show the greatest earnings leverage among the trust banks during the interim between the current rate environment and the next rate cycle									
Top Sells									
New York Community Bancorp	**NYCB**	**Sell**	**$16.38**	**$12.50**	**3.82**	**(19.9%)**	**16.7**	**1.2**	**7.50%**
We think NYCB's dividend is at risk of being cut and believe its dividend policy may come under new scrutiny in the 2014 CCAR process.									

Source: Citi Research

Beverages

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2013 Was Tough in Terms of Both Underlying Fundamentals and Investor Sentiment…We Think 2014 Will Be Better

- **Headwinds Persist, Though We Expect Improvement in 2014** — After the group delivered generally strong EPS growth in 2011 (median of 14%, range of -15% to +35%), the group delivered slower EPS growth in 2012 (median of 3%, range of -13% to +45%). While one quarter of results is yet to be reported, we expect the group will again show slower results in 2013 (median of 6%, range of -30% to +24%). Some of this slowdown over the last two years can be explained by continued f/x headwinds (which were expected to be more moderate in 2013, but became stronger over the course of the last nine months due to currency weakness in countries such as Argentina, Brazil, India, Japan, and Venezuela). However, even on a local currency basis, we believe that growth in the Beverages group has slowed, owing to a combination of (i) the slow-to-recover global consumer, (ii) anemic CSD volumes, in part owing to heightened health & wellness concerns, and (iii) poor weather (mostly in 1H13). That said, we are optimistic that volume growth can improve in 2014 as we begin to lap easier YoY comps and as the companies continue to push ahead with more innovation and marketing. Further, we expect that solid productivity/cost savings programs and a relatively benign commodity and f/x environment should help insulate EPS growth in 2014. Overall, for 2014, we expect median EPS growth of 10%, with a range of +6% to +39%).

- **Recap of Stock Price Performance** — We saw mixed relative performances in 2012 for the Beverage names, with the three major U.S. beverage companies each trailing the S&P 500's +13% performance in 2012 (KO, PEP and DPS) while our 5 other stocks under coverage each outperformed the S&P for the full year (SODA, COT, CCE, MNST and COKE). Thus far in 2013, seven of our eight beverage companies have *underperformed* the S&P 500's +27% appreciation, with only CCE (+33%) outperforming the S&P YTD.

- **Pricing & Promos Had Been Rational…But Got Less So Over the Last Few Months** — While the U.S. Beverage industry has been marked for years by aggressive pricing and promotional activity, we would characterize the environment over the last 12-18 months as having been relatively rational. That said, we did see some increased promotional activity in the late Summer months, lasting into September (with aggressive promotional spending mostly led by KO). While KO has said that this heightened level of competitive activity was temporary – and was aimed at lifting volumes after a weaker, early Summer period (when weather was poor) – we fear that this step-up in competitive activity could persist for some time. Indeed, given the prevalent health/wellness concerns among consumers (which continue to pressure volumes in CSDs and energy drinks), we expect that the beverage manufacturers may continue to be aggressive in their marketing in an attempt to bring consumers back to the CSD and energy drink categories. Also, the beverage companies are eager to persuade consumers that they are helping to fight the obesity epidemic by offering more low- or zero-calorie drink options (including naturally sweetened options), making drink labels more transparent, discontinuing or altering their marketing efforts towards children, and supporting physical activity programs.

- **EPS Growth Should Accelerate in 2014** — As stated above, we expect EPS growth to improve in 2014 from the levels seen in 2013. Currently, we are

forecasting median EPS growth of 10% for our beverage companies. While developing markets will still likely drive top line growth for both KO and PEP (particularly in Asia, Middle East, and Africa), we will be curious to see if these markets recover from recent macro slowdowns which have negatively impacted consumer spending. Also, we'll be looking out for whether mature market volumes improve given the easier YoY comparisons – partially attributable to poor weather in 1H13. We also expect MNST to benefit from easier YoY comparisons (recent Nielsen data has already shown this) and continued distribution (and local production) gains in various international markets (including Latin America and Asia). That said, we expect that MNST's results will remain tempered by negative PR concerns surrounding the safety of energy drinks (especially for children) and execution hurdles faced in new overseas markets (which have put a damper on overseas profits thus far).

- **Valuation** — Today, the Beverages group is trading at an average of 18x our 2014 EPS estimate, or a 18% premium to the S&P 500 (vs. an average 17x and 22% premium six months ago). This compares with an average historical relative premium of 18%. This year's relative underperformance by the beverage companies is likely due to: (i) a rotation out of the consumer staples sector (+24% YTD vs. +27% S&P 500) and of more concern, (ii) persistent category headwinds in the form of regulation (ie. soda taxes), negative PR (ie. drinking soda makes you fat) and changing consumer preferences (skewing more and more towards the ongoing health/wellness trend).

- **Conclusions** — We continue to favor KO and DPS as our preferred traditional beverage stocks, given what we perceive to be solid levels of current innovation and strong go-to-market execution, supported by meaningful cost savings and productivity initiatives. We also believe that investors can look forward to KO taking a step forward in 2014 with regard to refranchising some or all of its U.S. bottling network, which when completed, should lead to KO posting overall faster growth, higher margins and stronger returns (as the slower growth, lower margin part of the business becomes a smaller piece of the portfolio). We also still think that SODA is attractively valued given the outsized EPS growth (expecting ~24% in 2013 and ~29% in 2014) that we expect the company to deliver. In terms of stocks we are less enthusiastic about currently, we remain concerned about the recent slowdown in MNST's revenue growth rate in the U.S. and its level of profitability in its newer international markets.

Other companies mentioned: Coca-Cola Enterprises (CCE.N; US$41.92; 2); Coca-Cola Bottling Co. Consolidated (COKE.O; US$69.47; 2); Dr Pepper Snapple Group (DPS.N; US$48.63; 1); Monster Beverage Corp (MNST.O; US$63.00; 2); PepsiCo (PEP.N; US$82.81; 2); Cott Corp (COT.N; US$8.34; 1)

Beverages: Top Buys

	Ticker	Rating	Price (12/9)	Target Price	Yield (%)	ETR (%)	2013E P/E	2013E P/BV	2013E ROE
Top Buys									
The Coca-Cola Company	**KO**	**Buy**	**$40.40**	**$47.00**	**2.8%**	**19%**	**19.3x**	**5.2x**	**27.0%**
We expect KO will meet its target of HSD EPS growth over the long term, driven by strong innovation and heavy marketing support fueling market share gains in both developed and emerging markets.									
SodaStream International	**SODA**	**Buy**	**$55.76**	**$77.00**	**0.0%**	**38%**	**21.4x**	**3.5x**	**18.5%**
We still think SODA is attractively valued given the outsized EPS growth that we expect the company to deliver (fueled by growing consumer acceptance of and preference for at-home carbonation alternatives).									

Source: Citi Research

Biotechnology

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Constructive on Lg-Cap but Moderating on SMID-Cap

- **Sector Fundamentals Are Solid So Performance Should Continue —** Large-cap biotech is trading at a P/E premium to the S&P500 (25x vs.15x) as the momentum in the sector continues to gather steam. We believe that the fundamentals are very attractive and anticipate that EPS estimates will continue to be revised upward driven by new product launches (BIIB's Tecfidera for MS, Gilead's Sovaldi for hepC, CELG's Pomalyst and apremilast). Both the S&P500 EPS and lg-cap biotech groups estimates are getting revised upwards (~50% vs. ~70% of revisions are upwards) highlighting the positive fundamentals of both. But the EPS growth outlook for biotech is clearly better as we anticipate a 22% EPS y/y growth in 2014 vs. S&P500's 9%.

- **Can Outperformance Continue? —** Biotech has outperformed the market for 3 years in a row (Fig.4). However, historically the group rarely outperforms for 3 years in a row. In 2013, large-cap biotech's PE multiple have been on an upward swing due to upcoming new product launches, deep pipelines, stable pricing environment, and improving FDA dynamics. In addition, biotech has been defensive macro play with relatively manageable exposure to Europe. As a result, stocks continued their upward trajectory and the lg cap group has YTD posted +70% returns vs. +25% for the S&P500.

- **Investor Sentiment Is Shifting Towards Lg-Cap Biotechs Partially At Expense of SMID Stocks —** Our quarterly investor survey is showing that investors are continuing to shift from small/mid-cap to lg-cap stocks and their bullishness on the lg cap group is now at all-time highs (Fig.1& 2). Their optimism on the SMID group is at lower levels relative to historical. This is because the lg cap group offers plenty of opportunity allowing generalist investors to derive attractive returns without having to dive into lower market caps.

- **Biotech Valuation Models Are Now Bearish—** Tobias Levkovich's, Citi's Equities Strategists, biotech valuation model has been tracking higher into over-bought territories (Fig.3). These indicate that the sector is due for a correction at some point in the future and may leg the broader S&P500. As expectations are high, valuations for lg cap biotechs are now trading at or above their DCF valuations, and P\E multiples are now approaching their 10-year highs, this raises some caution. While we concede that the valuations for the large-cap group are not cheap, they seem reasonable and we like them for their strong fundamentals and robust growth profiles. But for the small-/mid-cap stocks where valuations are broadly stretched and the Street is overly optimistic of the chances for pipeline success, we would be selective of stocks to own, balancing the risks involved with the potential rewards.

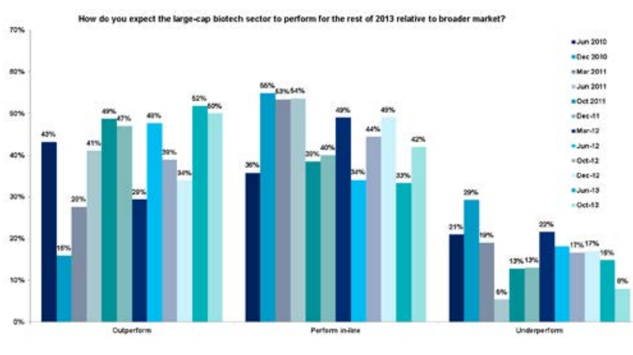
- **Upward Revisions Key for Performance —** Our analysis suggests that the large cap biotech stock performance correlates with upward EPS revisions. This bodes well since we are expecting upward EPS revisions for several companies driven by new drug launches, stock buybacks and solid fundamentals. So as long as the main ongoing and upcoming multi-billion dollar drug launches do not disappoint (Biogen's Tecfidera, Gilead's Sovaldi, Celgene's apremilast, and JNJ/Pharmacyclics' Imbruvica) and ph 3 studies do not disappoint (Vertex's CF combo), we expect that interest in the group will remain strong given the lackluster growth in the overall market.

Biotechnology: Top Buys and Neutral

	Ticker	Rating	Price (12/9)	Target Price	Yield (%)	ETR (%)	2014E P/E	2014E P/BV	2014E ROE
Top Buys									
Alkermes	**ALKS**	**Buy**	**$39.94**	**$48**	**0.00**	**20.2%**	**36.2**	**6.2**	**1.5%**
ALKS's is an unique SMID-cap opportunity offering positive and growing cash flows and a broad Late-stage pipeline creating a favorable risk profile. We continue to see upside for ALKS' pipeline with multiple blockbuster opportunities.									
Celgene	**CELG**	**Buy**	**$170.01**	**$204**	**0.00**	**20.0%**	**21.8**	**4.6**	**25.7%**
The MM-020 study recently yielded positive results and should clarify Revlimid EU approval. We believe that the Street is under estimating the potential magnitude of treatment duration expansion for both Revlimid and Pomalyst over the long-term. We anticipate a strong launch for Pomalyst and Abraxane. Apremilast launch in psoriasis/PsA should also drive multiple expansion. We view the long-term financial guidance as conservative.									
Gilead	**GILD**	**Buy**	**$75.19**	**$87**	**0.00**	**15.7%**	**20.1**	**6.4**	**43.1%**
Gilead HepC franchise is on a solid footing and should provide strong tailwinds driven by positive ph 3 results and material upside to Sovaldi's sales estimates. As Idelalisib for iNHL/CLL should also surprise to upside, the P/E multiple should continue to expand.									
MDVN	**MDVN**	**Buy**	**$61.65**	**$70**	**0.00**	**13.5%**	**NA**	**NA**	**NA**
We are bullish on outlook for Xtandi in prostate cancer as Xtandi should beat estimates in US driven by share gains and market expansion into pre-chemo. We anticipate solid launch in EU and Japan in post-chemo. We expect positive data from STRIVE & TERRAIN studies in M0 early stage prostate cancer setting leading to compendia listing and modest usage									
Top Neutral									
Sarepta	**SRPT**	**Neutral**	**$17.86**	**$NA**	**NA**	**NA**	**NA**	**6.2**	**NA**
FDA notified Sarepta that it is premature to file eteplirsen for approval. The path forward is unclear and we believe that approval will now be delayed to 2017/18. Sarepta requires significant cash to complete development and ph 3 trial design remains unclear.									

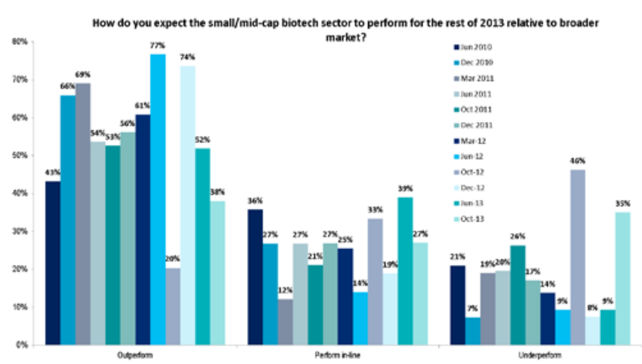
Source: Citi Research

Figure 1. Lg-Cap Biotech Investor Sentiment



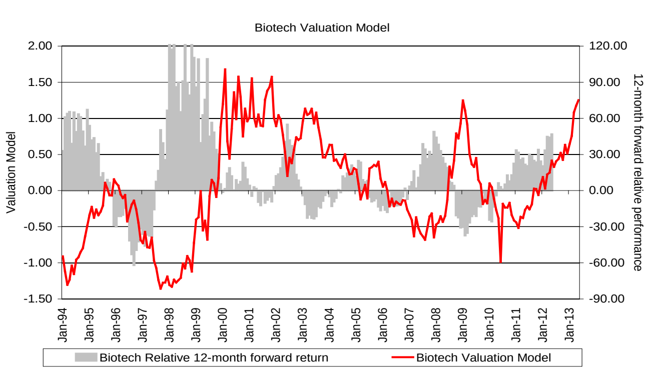
Source: Citi Research-Biotech Survey

Figure 2. Small/Mid-Cap Biotech Investor Sentiment



Source: Citi Research-Biotech Survey

Figure 3. Biotech Valuation Model



Source: Citi Research– US Equity Strategy

Figure 4. Biotech Relative Performance

	1-Jan-09	12/5/2013	Total Return
BTK	$647.17	$2,268.59	251%
NBI	$729.54	$2,299.07	215%
DRG	$272.84	$457.40	68%
Nasdaq	$1,577.03	$4,033.17	156%
S&P 500	$903.25	$1,785.03	98%
Russell 2000	$499.45	$1,122.47	125%

Source: Citi Research and DataCentral

Broker Dealers & Asset Managers

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Realizations, Retail Rotation & (FCF) Return; BX, IVZ, & LPLA Top Picks

- **Overview** — We enter 2014 constructive across our three sub-sectors of coverage though more price sensitive following broad-based price appreciation and P/E multiple expansion in 2013. We remain most constructive on Alternative Managers but prefer to "buy the dips" for Traditionals and Broker Dealers generally. Our top picks are BX, IVZ, and LPLA.

- **Five themes for 2014** — *First,* we expect realization activity to drive further multiple expansion for the Alternatives. *Second,* we expect further retail rotation back to equity mutual funds, perhaps led by further sustained pick up in domestic flows. We also expect retail alternatives to be a major theme for 2014. We see room for both active and passive wins. *Third,* we expect further retail re-engagement around trading. *Fourth,* we expect rate dynamics to influence all three sectors, but focus now will shift to short end trends. Here, consensus seems adamant ST rates remain anchored, so any shift in this expectation could catalyze Broker Dealers and FII. *Fifth,* we see strong year ahead for return of capital, likely led by LPLA, FXCM, and AMG – the latter via possible deals.

- **Watch lists and dark horse plays** — We want more “equity play” exposure but most equity-centric names have appreciated to/beyond ST fair value, in our view. Here, we look for pullbacks in AMG, BLK, APAM and WDR, while we maintain our Buy on TROW as we expect the flow outlook to improve as Other Portfolio redemption pressures ease. Among our Neutrals, AB, LM and FII could be surprise names to the upside, but we see 2014 as the breakout year for IVZ and expect BEN to be more resilient than commonly expected.

- **Alternatives** — We see best sector upside for 2014 on the combo of sustained realization activity, likely further allocation gains, market share wins, and moderate multiple expansion. In order, we like BX and OZM, with KKR perhaps assuming leadership into 2H14.

- **Traditionals** — We see Traditionals as mostly at fair value, with IVZ, BEN and TROW as our favored names. We affirm our IVZ/EV pair trade and Sell rating on JNS. While rising markets are clearly helping JNS, underlying fundamentals remain problematic, in our view.

- **Broker Dealers** — LPLA is our top pick as we expect a step function in capital management in concert with the 4Q13 earnings call.

Top Picks

BX - Assuming Realization Leadership

- Three factors should drive another year of outperformance. *First,* we expect the realization outlook to steadily improve, led by Real Estate but also more broadly across the franchise. Management has argued for ~$2.50 in typical annual distribution potential, and we see 2014 shaping up toward this level. *Second,* we believe visibility for BCP V to move above the high water mark will play out, setting the stage for sizeable ENI catch up benefit into 2015, and providing further valuation support as investors roll through 2014. *Third,* we look for

outsized retail flow gains, which should help drive another year of strong/superior asset gathering.

IVZ - The Year Of Multiple Expansion

- IVZ remains our overall top pick, and on the US focus list. Five factors fuel our enthusiasm. *First,* we believe UK related attrition is already heavily discounted and investors under appreciate flow power elsewhere. *Second,* we look for further fee rate improvement and upside margin surprise to consensus, even should UK attrition pick up temporarily. *Third,* we see best upside to 2014 and 2015 adjusted EPS expectations, excluding deal impact. *Fourth,* we believe better than expected capital return will play out. *Fifth,* we believe the relative PE gap will narrow considerably.

LPLA - Big Time Capital Management Outcome In February Awaits

- We like LPLA for several key reasons. *First,* we see LPLA as a solid play on further retail re-engagement, FA growth, and FA productivity gains, including improving flow mix. *Second,* we see improving operating leverage. *Third,* and most impactful, we expect management will either craft a bank or return significant FCF via buy back and stepped up dividend payout, either driving substantial value - see also our 11/4 report, Bank or Buyback? “Win Win” Scenarios, But We Think Buyback. Here, we believe it is less likely management will craft a bank and instead will look to pick up buy back. Investors may be hesitant to purchase the stock ahead of the decision in fear management needs to raise capital. Regardless, we see a step function in value creation, with less probability for the bank creation scenario.

Other companies mentioned: AllianceBernstein Holding LP (AB.N; US$21.74; 2); Affiliated Managers Group (AMG.N; US$198.96; 2); Artisan Partners Asset Management (APAM.N; US$62.63; 2); Franklin Resources Inc (BEN.N; US$53.78; 1); BlackRock Inc (BLK.N; US$292.32; 2); Federated Investors, Inc (FII.N; US$25.66; 2); FXCM Inc (FXCM.N; US$16.52; 1); Legg Mason Inc (LM.N; US$40.60; 2); Och-Ziff Capital Management (OZM.N; US$14.08; 1); T Rowe Price Group Inc (TROW.O; US$78.61; 1); Waddell & Reed Financial, Inc (WDR.N; US$61.21; 2)

Broker Dealers & Asset Managers: Top Buys

	Ticker	Rating	Price (12/9)	Target Price	Yield (%)	ETR (%)	2014E P/E	2014E P/BV	2014E ROE
Top Buys									
Blackstone Group L.P.	**BX**	**Buy**	**$28.51**	**$33.00**	**6.0%**	**21.7%**	**10.6x**	**10.8x**	**51.6**
Top Alternative pick around: 1) realizations; 2) visibility into BCP V reaching high water mark; and, 3) strong asset gathering.									
Invesco Ltd	**IVZ**	**Buy**	**$35.67**	**$44.00**	**2.9%**	**26.3%**	**14.2x**	**21.2x**	**12.0**
Top Traditional and on the US Focus List around: 1) increasingly constructive flow dynamics; 2) rising margins + FCF return; and, 3) positive upside surprise, in our view.									
LPL Financial Holdings Inc	**LPLA**	**Buy**	**$44.00**	**$52.00**	**1.9%**	**20.1%**	**15.7x**	**14.1x**	**22.5**
LPLA is our top Broker Dealer as we see as: 1) solid play on retail re-engagement; 2) strong FCF repatriation story with optionality; and, 3) improving operating leverage.									

Source: Citi Research

Chemicals & Ag

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Ringing the Register, Ethane Exports and Portfolio Activism

- **Committed to "Ringing the Register"** — The shale gas bonanza has led to significant free cash flows and improved balance sheets, most notably for US commodity chemical producers like LYB. We think the next leg up in the US commodity cycle will be driven by this cash deployment before the demand-led recovery kicks in. Thus, the ongoing focus for many commodity companies will be on how this excess cash will be deployed. Besides a robust capex program totaling ~$100B in the chemical industry due to shale gas, we have also seen dividend increases announced by LYB, EMN, AXLL, CF and Westlake.

- **Cheap Ethane Buoys Margins, Export Debate Interest** — With ethane prices remaining low this year, the "Shale Supremacy" is clearly alive and well. In essence, steadily growing ethane supply has reduced the ethane price premium over natural gas. As a result, the US ethylene outlook is positive with another year of record high margins (~29c/lb) benefiting DOW and LYB. Ethane prices are likely to remain near natural gas parity with excess supply reaching 450k-700k bpd by 2020 according to Enterprise Products Partners. This has rekindled interest in ethane exports, although the chemical industry prefers PE exports and have noted European naphtha cracker conversion costs to ethane is high.

- **Portfolio Repositioning Accelerates** — Chemical companies are actively pruning their portfolios through spin-offs, acquisitions and divestitures like DOW, DD, PPG, HUN and EMN. However, others with strong balance sheets such as paint companies are looking to add to their portfolios. The ultimate goal for many of these companies is to tilt their portfolios towards high-multiple specialty chemicals rather than lower-multiple commodity chemicals. This year, we have also seen activist involvement in companies including DD, APD, CF and Ashland.

- **Selective in Ag** — Our sense is that there is currently less interest in Ag and fertilizer stocks going into 2014 due to: 1) Lower grain prices; 2) Uncertainty regarding the RFS mandate and US production of ethanol; and 3) Lack of clarity regarding any future cooperation of FSU potash producers and the impact on potash pricing. One of the biggest new data points from our recent Basic Materials conference was Buy-rated CF's announcement that it is evaluating a MLP type structure. We think this could make sense for the company's new plants that come online in 2015/16. We also like MON and the opportunity in "big data" following the acquisition of Climate Corporation, although the earnings impact from its precision farming platform is still a couple years away.

Other companies mentioned: Air Products and Chemicals Inc (APD.N; US$107.60; 2); Axiall Corporation (AXLL.N; US$46.68; 2); E I du Pont de Nemours and Co (DD.N; US$60.52; 1); Dow Chemical Co (DOW.N; US$41.36; 1); Eastman Chemical Co (EMN.N; US$74.84; 1); Enterprise Products Partners LP (EPD.N; US$61.67; 1); PPG Industries Inc (PPG.N; US$182.67; 1)

Chemicals & Ag: Top Buys

	Ticker	Rating	Price (12/9)	Target Price	Yield (%)	ETR (%)	2014E P/E	2014E P/BV	2014E ROE
Top Buys									
Huntsman	**HUN**	**Buy**	**$23.62**	**$28.00**	**2.1**	**20.7**	**10.5x**	**2.5x**	**22%**
Preferred way to play the recovery in TiO2; mgmt.forecasts EBITDA benefits of ~$800mm through 2017 from restructuring, growth projects and acquisitions.									
LyondellBasell	**LYB**	**Buy**	**$76.80**	**$85.00**	**2.6**	**13.3**	**10.8x**	**3.4x**	**32%**
Beneficiary of low-cost ethane and propane, with excess cash flow allocated to share buybacks.									
CF Industries	**CF**	**Buy**	**$231.59**	**$240.00**	**1.7**	**5.4**	**11.7x**	**2.1x**	**21%**
We think nitrogen fertilizer markets are bottoming, CF is poised to continue returning cash to shareholders with buybacks; first-mover in major new nitrogen capacity in 2016									
Monsanto	**MON**	**Buy**	**$111.65**	**$122.00**	**1.5**	**10.3**	**18.5x**	**3.7x**	**21%**
Strong growth opportunities in Latin America corn and soybeans; mgmt transforming the company with two precision agriculture platforms									

Source: Citi Research

Comm Equipment and Data Networking

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Look for Restructuring and Secular Opportunities in a Choppy Spending Environment

- **We believe Qualcomm is the main beneficiary of the global 4G LTE adoption cycle** — Global LTE adoption is in its early days: Gartner estimates just 12% of the total worldwide smartphones shipped in 2013 are LTE, with LTE penetration rising to 31% by 2017. With global LTE penetration still in its infancy, fewer LTE baseband players than there were 3G/UMTS baseband vendors, and prices on LTE devices generally higher than on 3G devices, we expect QCOM to benefit from the higher volumes and mix shift throughout this upgrade cycle.

- **China LTE: A Big Opportunity for Qualcomm** — China Mobile, China's largest carrier with 760M subscribers, including 176M 3G subs, will be the first carrier in China to launch LTE in early 2014. We expect vendors to ship roughly 40M TD-LTE devices into China Mobile in 2014 creating ~40M TD-LTE subs out of a 280M total 3G/4G subscriber pool. By 2018, we expect China Mobile's TD-LTE base to get close to 300M driving LTE unit shipments of 160M/yr and, we conservatively calculate, incremental annual revenue of over $1.6B for Qualcomm assuming it retains 75% baseband chip share at just $8 per chipset. Given Qualcomm's still dominant market share of LTE basebands - we estimate Qualcomm held close to 95% of the market in 2013, per Strategy Analytics - we expect the growth of LTE in China to begin driving QCT "chipments" in the June and September quarters. We believe the impending LTE launch at China Mobile, where Qualcomm has no share today, should drive QCT chipment unit volume and margin in H2'FY14 with minimal negative impact to QTL (royalties).

- **A Lumpy Capex Environment; North America Appears to be Peaking** — We expect carrier capex spending to be lumpy as the carrier capex cycle in North America appears to be peaking, potentially negatively impacting carrier-focused names including ERIC, NOK, CIEN and JNPR. North America is more concentrated than others regions with AT&T and Verizon accounting for 62% of capex dollars in the region which itself accounts for 26% of global capex spend, versus 7 carriers in Europe accounting for a similar concentration, a region representing a similar 23% of global capex. While APAC and Latin America are both just as concentrated as North America – the two largest carriers account for 58% of spend in Latin America and the 3 largest carriers account for 60% in APAC, LatAm accounts for just 9% of global capex spend while much of China, which accounts for nearly 60% of Asia spend, is beginning to rely more on local vendors such as Huawei. Meanwhile, we expect to see a pick-up in spending in APAC and EMEA over the next few quarters as China emerges from its government transition and rolls-out LTE networks and the European macro environment recovers. However, given the lower carrier concentrations in these regions we believe there's a greater risk that spending could be lumpy and less predictable, and therefore negative for stock valuation.

- **"Carrier-fication" of the Enterprise** — We see risk to enterprise-focused companies as enterprises increasingly outsource data center functions to public cloud operators, resulting in what historically has been a fragmented enterprise customer base becoming a more concentrated carrier customer base. As this "carrier-fication" of the enterprise occurs, we also expect pricing to decline rapidly, as cloud providers increasingly turn to white box switch vendors (Quanta, Accton, etc) to keep costs low, pressuring pricing across the industry, and features and functions that had been deployed via stand-alone appliances (i.e, ADCs, WAN optimization, or security) are deployed by these cloud providers as

virtual instances. Specifically, within the Ethernet switching market, the growth is concentrated in the data center segment, and within the data center segment, most of the growth is in the public cloud, a segment many of our coverage companies may be challenged to sell into. We expect data center switching to grow at a 10% CAGR through 2016 to $11.6B from $8.8B in 2013 driven by the transformation to 10G from 1G, and to spine and leaf architectures from 3-layer hierarchies, while the non-data center piece of the market remains flat over the same period. Within data center switching, we forecast public cloud growing at a 25% CAGR to 39% of the market in 2016, up from 5% in 2013, leaving the private cloud segment flat over the same period at $7B.

- **Software Defined Networking (SDN) is For Real, but Too Soon to Gauge Impact** — While we believe SDN could change the complexion of several of the hardware markets (e.g., switches, routers, application delivery controllers, WAN optimization solutions), we believe it is premature to gauge the impact to specific companies in contrast to the recent hype cycle. Based on our experience, architectural changes in carrier and enterprise networks take years to transpire – it has taken nearly 15 years for carriers to finally deploy IMS from their hype cycle in the late 1990s! We do expect the SDN architectural changes to occur more quickly this time, and we believe that many enterprises and carriers are actively considering how SDN fits into their organizations. Ultimately we believe it could take another 1-2 years to have a clearer view on the impact to earnings and strategic positioning for individual companies.

Other companies mentioned: Ciena Corporation (CIEN.O; US$21.99; 2); Juniper Networks, Inc (JNPR.N; US$20.97; 2)

Communications Equipment and Data Networking: Top Buys and Sells

			Price	Target	Yield	ETR	2014E		
	Ticker	Rating	(12/9)	Price	(%)	(%)	P/E	P/BV	ROE
Top Buys									
Nokia	**NOK1V-FI**	**Buy**	**€5.77**	**€7.00**	**0.00**	**18.4%**	**21.4X**	**3.1X**	**2.1%**
With €8B in net cash post Devices sale, Nokia's fundamentals should allow it to engage in capital returns as fundamentals stabilize; China Mobile and Sprint to drive FY14									
F5 Networks	**FFIV**	**Buy**	**$85.18**	**$100.00**	**0.00**	**17.3%**	**15.7X**	**4.4X**	**24.9%**
Data Center world is becoming more application centric and moving towards F5's competencies of load balancing and application layer control									
Qualcomm	**QCOM**	**Buy**	**$73.37**	**$88.00**	**2.10**	**17.4%**	**14.5X**	**3.45X**	**19.4%**
China Mobile's LTE launch is a catalyst into H2'FY14, driving QCT volume / margin. QCOM's early lead in LTE put it ahead of comps as tech complexity increases									
Top Sells									
Cisco Systems	**CSCO**	**Sell**	**$21.22**	**$18.00**	**3.70%**	**-11.5%**	**10.9X**	**2.0X**	**19.5%**
Revenue growth slows to 3-5% from current 5-7% LT guidance as key markets reach saturation; multi-platform strategies in DC switching and routing likely result in share loss									
Brocade Communications	**BRCD**	**Sell**	**$8.59**	**$8.00**	**0.00%**	**-6.9%**	**11.0X**	**1.6X**	**15.1%**
Operating margin topping out following significant restructuring; revenue growth impacted by storage convergence and focus on more competitive data center switching market									
Blackberry	**BBRY**	**Sell**	**$5.75**	**$4.00**	**0.00%**	**-30.4%**	**NM**	**0.4X**	**NM**
Wind-down costs and purchase commitments make winding down BBRY expensive yet as subs decline, services rev should follow; Remaining in HW leads to more losses									

Source: Citi Research

Computer Services & IT Consulting

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Look for Steady Upward Trajectory in 2014

- **Secular Shifts Continue to Benefit Processors** — The ongoing mix-shift to electronic payments from cash and checks should benefit essentially all of our processing names under coverage. We expect the highest growth areas in payment processing will remain Online, Mobile, and Prepaid. Disintermediation fears will continue to be weighed as investors assess the success of new entrants' competing initiatives. For the core processing side of our coverage, we continue to like the relative stability that these companies offer – i.e., revenues under long-term contract, margin expansion, and buybacks/ deleveraging lead to low-to-mid single digit revenue growth and double digit EPS growth.

- **Flat IT Budgets the New Norm; Still Growth Opportunities** — In IT services, the trend of flattish IT budgets for 2014 is the most likely outcome. In this environment, cost control and demand for flexibility remain the focus of clients, which favors outsourcing in our opinion. That said we do have some true drivers of new demand for the first time in many years in the areas of Mobility, Analytics, and Social Media. Also, we look for continued strengthening in BPO demand. We continue to note that tech spending beyond the CIO continues to pick up, with the CMO, business heads and the COO/CFO.

- **Buy TSS** — We believe TSS can continue to outperform based on strong organic execution and accelerated growth from NetSpend. Execution on the Bank of America conversion is key and we have confidence it will help results in 2H14.

- **Buy CTSH** — CTSH has recovered recently due to solid operating performance and Congressional inaction on the immigration reform in the US. We believe 2014 sets up nicely as solid growth could continue.

- **Buy WNS** — Despite a strong 2013, WNS' valuation is still attractive. We believe WNS has the ability to accelerate top-line growth while delivering bottom-line improvement, which is rare amongst BPO companies.

- **Buy FIS** — FIS should be a 'steady eddy' for 2014 given its solid execution and healthy return of cash to shareholders. Look for modest upward surprises on top-line growth to drive outperformance.

- **Buy DOX** — DOX underperformed the market despite steady results in 2013. We look for outperformance to resume as results improve on the back of client M&A.

- **Buy ACN** — ACN underperformed in 2013 with weaker-than-expected revenue growth. We look for a recovery in 2014, though it likely will be back-end loaded.

- **Buy EXLS** — Many of the causes for 2013 underperformance (FX headwinds, loss of large client, slow transformation biz) will pressure 2014 results. That said, expectations are low, so solid execution could create a recovery opportunity.

- **Buy VNTV** — While 2013 revenue growth was below expectations, it is still better than that of its peers. We believe solid 2014 guidance and execution on the WMT win should drive good gains next year.

- **Sell PAYX** — While PAYX benefited from an employment recovery and modest interest rate increases, the stock's 2013 outperformance will be difficult to repeat based on the current growth profile and a premium valuation vs. peak levels.

Other companies mentioned: Accenture Ltd (ACN.N; US$74.40; 1); ExlService Holdings Inc (EXLS.O; US$26.15; 1); Fidelity National Info Svcs, Inc (FIS.N; US$50.50; 1); Vantiv, Inc. (VNTV.N; US$29.80; 1)

Computer Services & IT Consulting: Top Buys and Sells

			Price	Target	Yield	ETR	2014E		
	Ticker	Rating	(12/9)	Price	(%)	(%)	P/E	P/BV	ROE
Top Buys									
Total Systems	**TSS**	**Buy**	**$30.92**	**$34.00**	**1.3%**	**11.3%**	**15.3x**	**3.8x**	**24.9%**
Good organic momentum, help from NetSpend and Bank of America conversion should drive interest / acceleration.									
Cognizant	**CTSH**	**1**	**$94.80**	**$101.00**	**0.0%**	**6.5%**	**19.9x**	**4.4x**	**22.1%**
Strong growth in 2014 could cause a re-rating of the multiple higher.									
WNS Holdings	**WNS**	**1**	**$20.58**	**$23.50**	**0.0%**	**14.2%**	**14.4x**	**3.8x**	**26.4%**
We believe 2014 could see an accelerating revenue growth profile that translates well to earnings – a rarity in BPO.									
Fidelity Info. Services	**FIS**	**1**	**$50.86**	**$53.50**	**1.8%**	**7.0%**	**16.0x**	**2.0x**	**12.8%**
Steady eddy performer that could outperform based on upside to revenue expectations.									
Top Sells									
Paychex	**PAYX**	**3**	**$43.49**	**$36.00**	**3.3%**	**(13.9%)**	**24.9x**	**8.3**	**33.3%**
Solid company, but strong 2013 performance unlikely to be repeated given middling growth rate and premium valuation.									

Source: Citi Research

Consumer Finance

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Remain Constructive on Card Sector Heading Into 2014

- **Sector Outlook** — Despite another year of strong performance, we continue to have a positive outlook for the card sector in 2014. Fundamentals remain favorable including: 1) benign credit, 2) healthy global spend largely driven by affluent spending, and 3) robust capital returns. This is counter balanced with still tepid industry loan growth and signs of emerging competition from issuers such as WFC and BAC. We believe the current regulatory environment is manageable with key items to look out for in 2014 being the Fed debit appeal and European interchange legislation. For the card sector, we see very little fundamental impact from rising long term rates, though could lead to rotation to more rate sensitive stocks such as banks. Our top pick remains AXP on accelerating revenue growth (especially if GDP growth surprises to the upside) and we see downside protected by a large share repurchase plan.

- **No Expected Turn in Credit Trends** — The card sector has benefited from 3+ years of steady credit improvement despite elevated unemployment and a choppy macro environment. While credit improvement is clearly stabilizing, we do not expect a negative turn in credit trends in 2014 apart from normal seasonality. Though we note that lower recoveries of previously charged off receivables should have some ongoing impact. However, we do not view this has a sign of deteriorating credit, but rather a function of a smaller pool of charged off loans as we move further from the credit crisis. Finally, we believe we are near or at the end of reserve releases.

- **Healthy Global Spend** — Global spend growth rates have generally remained at healthy levels in 2013 and we expect that to continue into 2014. Despite the uneven macro recovery, global spend has been buoyed by affluent spend given rising equities and housing prices. Though we are keeping an eye on some recent mixed data points for US spend. In general, there was a moderation in growth rates in September around the government shut down, but it has bounced back somewhat in October and November. Though this trend appears uneven by the major networks with V seeing the larger negative impact with more relative stability at AXP and MA.

- **Robust Capital Positions** — Card stocks continue to benefit from their strong excess capital positions. In 2014, we expect equal or better payout ratios for the card sector. We expect AXP to screen well as investors focus on the Q1'14 Fed CCAR. For the first time DFS will officially be part of the CCAR in 2014 however we expect them to submit a strong capital return request. While COF did not request a share repurchase in their original 2013 CCAR request, they did commence in Sept a $1B share repo plan from the capital freed up from the sale of the Best Buy card portfolio. COF management has stated that they expect a total pay out in 2014 to be well above other strong banks (i.e. 50%+). In terms of the card networks (V and MA) we expect further strong capital returns in 2014 with both paying out the majority of their earnings in the form of share repurchases and dividends.

- **Tepid Loan Growth** — Overall card industry loan growth remains lackluster (~+1% y/y per Fed's G-19 revolving consumer debt data). Though we have seen outsized market share gains from DFS and AXP and generally declines at some of the larger banks (though this has shown some signs of recent stabilization

particularly at BAC). The lack of industry card growth is being driven by a combination of cautious consumers and banks. Looking ahead into 2014 we believe improving consumer confidence could drive modestly better loan growth, up +1-2% next year. On the risk side, the lack of loan growth and high returns in card issuance could drive increased competition, and we are seeing some early signs of that develop. For instance, WFC has been vocal about wanting to increase the credit card penetration to their customers to 40-50% from 36% today. Plus they recently inked a deal with AXP where WFC will issue cards on the American Express network, which will target the affluent consumer. We have also seen players such as BAC show signs of becoming more active. BAC had 1M+ (highest level since 2008) of new accounts in Q3, up 22% y/y.

- **Regulatory Risk** — We view the card sector as high risk from a regulatory standpoint. However, we view current regulatory risk as manageable, though we are watching potential events in 2014 particularly around: 1) Fed's debit appeal in the US, and 2) European interchange cuts. Oral arguments are expected to begin on Jan 17th for the Fed debit appeal. In terms of European interchange cut legislation, our industry contacts suggest that it is unlikely that the European Parliament will look at the interchange legislation before 2H'14 given recess in February and elections in May.

Other companies mentioned: Bank of America Corp (BAC.N; US$15.28; 2); Visa Inc. (V.N; US$205.37; 2); Wells Fargo & Co (WFC.N; US$43.80; 2)

Consumer Finance: Top Buys

	Ticker	Rating	Price (12/9)	Target Price	Yield (%)	ETR (%)	2014E P/E	2014E P/BV	2014E ROE
Top Buys									
American Express	**AXP**	**Buy**	**$85.75**	**$88**	**1.10%**	**3.7%**	**15.7x**	**4.2x**	**28.2%**
Leveraged to high end consumer spending and corporate T&E buoyed by sizable share buy backs.									
MasterCard	**MA**	**Buy**	**$758.86**	**$835**	**0.36%**	**10.4%**	**24.5x**		
Benefitting from global secular migration towards electronic payments, robust capital returns and manageable regulatory risk									
Discover Financial	**DFS**	**Buy**	**$53.47**	**$56**	**1.57%**	**6.3%**	**10.7x**	**2.1x**	**21.9%**
Attractive risk/reward as fundamentals remain strong including credit, sector leading loan growth and excess capital.									
Capital One	**COF**	**Buy**	**$73**	**$76**	**1.85%**	**6.0%**	**10.7x**	**1x**	**9.1%**
Attractive valuation for high return card business anchored by a top tier deposit franchise.									

Source: Citi Research

Food Manufacturers

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2014 Grain Deflation to Drive Robust Packaged Food Earnings

- **Food Input Cost Deflation to Take Effect in January 2014 and Drive Above Average EPS Growth in Large Cap US Food** — Following nine years of above average inflation, the US packaged food manufacturers are in store for input cost deflation in 2014 from falling grain prices, driven by the large US crop harvested in the fall of 2013. Our historical analysis on deflation is conclusive and shows that manufacturers' margins, volumes, and EPS are positively correlated with deflation's effects – i.e. lower costs, drive higher margins and better volumes. Further, we would point out, that while this concept seems rather straight forward to us, consensus 2014 estimates show zero positive effect from deflation, and are projecting 2014 EPS growth in line with the packaged food group's long term targets of high single digits. Thus, our 2014 packaged food EPS estimates are generally ahead of consensus, as we believe consensus estimates are too low.

- **Biggest Grain Exposed Companies with the Strongest Brands Have the Most Benefit**— We view the companies with the largest exposures to the grain complex as benefitting the most from grain deflation in 2014. Within our group, Kellogg, Smucker (declining coffee bean costs), Mondelez, and General Mills all have significant composure to the grain complex. Moreover, these companies have strong brands, as witnessed by their above average gross margin structures, which should allow them to hold onto a meaningful portion of the deflation benefits in 2014.

- **Flat or Declining 2014 Food Prices Should Jump Start Volume Growth, Following Negative Growth in 2013** — 2013 food volumes were down across the grocery store due to the cumulative effect of 8 years of food inflation, which has been compounded by a soft economy and depressed wages. Thus, we believe that food manufacturers are likely to give back a portion of the benefits from lower input costs in 2014 to consumers in the form of lower prices. We believe this will provide much needed relief to consumers, and should combine with an improving macro-economic environment to drive food at home volumes higher.

- **Valuations Are OK; Thus Stock Appreciation Is Oriented Toward EPS Growth Rather Than Multiple Expansion** — Valuation across the large cap packaged food sector is currently approximately in line with the group's 15 year historical average at ~17x forward earnings, utilizing consensus estimates. However, we believe the stocks in the sector have room for good appreciation in 2014, as consensus estimates appear low, in our opinion, and are failing to incorporate the benefits of input cost deflation. Thus, we see earnings growth as the principal driver of large cap packaged food stocks in 2014, as we are forecasting strong double digit earnings growth for the group over the next twelve months.

2014 Outlook for Agricultural Processors Mixed

- **2014 Oilseeds Outlook Bullish; But Corn Sweetener Outlook Appears Challenged** — We have a mixed outlook for the Agricultural Processing sub-segment of the Food group, as we are positive on the outlook for oilseeds in 2014, but see challenges for corn sweeteners. Specifically, oilseed processors should benefit in 2014 from growing global demand for animal protein and from increased demand stemming from declining oilseed prices, which should in turn

tighten global oilseed processing operating rates and strengthen margins. However, the outlook for corn sweeteners appears challenged, as corn sweetener volumes are likely to continue being pressured by competition from low sugar prices. Thus, in accordance with our views on the oilseed processing and corn sweetener markets, we hold a positive view on Buy-rated Bunge (the leading global processor of oilseeds), and are Neutral on corn sweetener producer Ingredion. Meanwhile, we are also Neutral on Archer Daniels Midland, as we forecast good oilseed and ethanol results at the firm over the next twelve months, but see shares as being fairly valued at current prices.

Other companies mentioned: Archer-Daniels-Midland Company (ADM.N; US$40.66; 2); General Mills Inc (GIS.N; US$49.68; 1); Ingredion Inc (INGR.N; US$66.22; 2); Mondelez International Inc (MDLZ.O; US$33.82; 1); The J.M. Smucker Company (SJM.N; US$101.59; 1); Bunge Limited (BG.N; US$80.17; 1)

Food Manufacturers: Top Buys

			Price	Target	Yield	ETR	2014E		
	Ticker	Rating	(12/9)	Price	(%)	(%)	P/E	P/BV	ROE
Top Buys									
Mead Johnson	**MJN**	**Buy**	**$85.49**	**$95.00**	**1.6%**	**12.7%**	**23.3x**	**20.2x**	**115.4%**
Emerging market exposure and benefits from competitor recalls in the Chinese infant nutrition market to drive robust 2014 EPS growth.									
TreeHouse	**THS**	**Buy**	**$71.79**	**$85.00**	**0.0%**	**18.4%**	**19.5x**	**1.8x**	**9.7%**
Momentum from the company's entrance into the single serve coffee market, cost savings, and grain deflation to power strong 2014 results.									
Hershey	**HSY**	**Buy**	**$96.97**	**$110.00**	**2.0%**	**15.4%**	**23.6x**	**11.1x**	**53.1%**
Hershey continues to expand market share within chocolate—one of the strongest food categories—while benefitting from a favorable input cost environment.									
Kellogg	**K**	**Buy**	**$61.94**	**$76.00**	**2.9%**	**25.6%**	**14.6x**	**6.0x**	**44.1%**
Kellogg possesses some of the most significant exposure to the grain complex in packaged food, and as such is set up nicely to benefit from grain deflation in 2014									

Source: Citi Research

Healthcare Facilities

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Obamacare or Bust

- **We Think 2014 Could be Another Great Year for "Enrollment Plays"** — All hospitals and emergency room staffing stocks materially outperformed the markets in 2013 on the heels of Obama's election victory and prospect for implementation of Obamacare. Despite the foreseeable noise and volatility, we remain bullish on insurance enrollment over 2014-2016 driving improved fundamentals, valuations and equity returns.

- **It's All About Enrollment** — The last great unknown piece of the Obamacare thesis is "how many will enroll"? We can identify no other single factor that will have as much impact on hospital and ER stock valuations as the Street's evolving enrollment expectations. Subsidized enrollment of previously uninsured individuals drives the majority of consensus EBITDA growth over 2014-16.

- **There's Some Wiggle Room on Timing**— If the Federal insurance exchange website continues to impede enrollment, a material portion of 2014 EBITDA and EPS growth could shift from 2014 into 2015. As long as the market perceives this as a temporary technology issue, the stocks endure.

- **But No Wiggle Room on Premise** — If weak enrollment is perceived to be driven by the undesirability of subsidized coverage, sector valuations will crater.

- **Ultimately "Who" Enrolls is More Important than "How Many" Enroll** — 75% of uninsured healthcare utilization is driven by a small subset (15-20%) of the uninsured population. Therefore, enrolling 10m "frequent fliers" is worth infinitely more than enrolling 30m "young invincibles". This phenomenon may create one last buying opportunity in the stocks.

- **Underlying Hospital Fundamentals Remain Uninspiring** – Outside of the Obamacare thesis, we see little opportunity. Regulatory pressure and evolving payment models continue to threaten patient utilization and profitability.

- **Hospitals Remain our Favorite 12month Play**— Although ER stocks offer compelling enrollment leverage, organic growth and lower reimbursement risk, hospital stocks offer a more compelling opportunity for further valuation **expansion.**

- **HCA Remains our Favorite Large-Cap Stock —** Large and liquid will remain in favor if our bullish hospital sector call turns out to be correct. In addition, HCA's high prevailing market share drives preferred pricing and higher sustainable margins (i.e. we like the assets). HCA's FCF generation will continue to support a stream of shareholder friendly dividends and share repurchase.

- **LifePoint is our Favorite Small-Cap Stock —** Obamacare promises to cover a large portion of LPNT's uninsured mix and we estimate could boost EBITDA by 15-20% by 2016. LPNT's Duke JV affiliation is yielding the industry's most robust acquisition pipeline. LPNT has the cheapest 2015 EV/EBITDA multiple in the group.

Hospital Valuation, Pro-Forma for Estimated Healthcare Reform Benefit

Ticker	Price	2013 P/E	2014 P/E	2014 P/E, ProForma for Reform	2013 EV/EBITDA	2014 EV/EBITDA	2014 EV/EBITDA, ProForma for Reform
CYH	$41.23	25.6x	19.2x	13.6x	8.2x	7.6x	6.7x
CYH/HMA pf	$41.23	25.6x	20.1x	13.3x	7.6x	6.8x	5.9x
HCA	$47.24	15.7x	13.6x	11.1x	8.4x	8.0x	7.2x
HMA	$13.08	119.0x	76.9x	59.5x	11.3x	10.7x	9.4x
LPNT	$51.24	25.6x	21.5x	17.0x	8.4x	7.6x	6.7x
THC	$42.70	35.6x	26.9x	17.5x	11.8x	8.1x	6.8x
UHS	$82.91	19.5x	16.5x	14.5x	10.0x	9.0x	8.3x
Acute Hospital Median		**25.6x**	**19.1x**	**12.2x**	**8.4x**	**7.2x**	**6.3x**

Source: Citi Research, Factset, Company Filings

Healthcare Facilities: Most and Least Favorites

	Ticker	Rating	Price (12/9)	Target Price	Yield (%)	ETR (%)	2014E P/E	2014E P/BV	2014E ROE
Top Buys									
HCA Inc	**HCA**	**Buy**	**$47.10**	**$55.00**	**0%**	**16.8%**	**8.0x**	**na**	**na**
We estimate Obamacare could increase EBITDA by 15% over 2014-2016 and we have highest confidence in underlying run-rate earnings power.									
Lifepoint Hospitals	**LPNT**	**Buy**	**$51.12**	**$56.50**	**0%**	**10.5%**	**21.5x**	**1.1x**	**5%**
We estimate Obamacare could increase EBITDA by 20% over 2014-2016 and LPNT has the cheapest 2015 multiple in the group.									
Universal Health Services	**UHS**	**Buy**	**$83.00**	**$84.00**	**0.3%**	**1.5%**	**16.5x**	**2.6x**	**17%**
We estimate Obamacare could increase EBITDA by 11% over 2014-2016 and we believe the behavioral business is worth a premium valuation.									
Team Health	**TMH**	**Buy**	**$48.02**	**$51.00**	**0%**	**6.2%**	**21.3x**	**15.6x**	**46%**
We estimate Obamacare could increase EPS by $1.00/share over 2014-2016. TMH has underlying non-acquired growth and low reimbursement risk..									
Neutrals									
Kindred Healthcare	**KND**	**Neutral**	**$17.42**	**$13.00**	**3.0%**	**-25%**	**12.0x**	**0.8x**	**6%**
We are concerned that in April 2014 CMS will propose LTAC patient criteria that materially impair run-rate earnings power.									
DaVita HealthCare Partners	**DVA**	**Neutral**	**$62.17**	**$57.50**	**0%**	**-7.5%**	**17.8x**	**3.1x**	**16%**
Given headwinds in both businesses, we see little earnings growth in 2014 and 2015, suggesting the stock won't trade a premium valuation.									
Quest Diagnostics	**DGX**	**Neutral**	**$60.21**	**$59.00**	**2.0%**	**-3.0%**	**13.3x**	**2.4x**	**16%**
Industry lab headwinds on price and volume are creating a difficult environment to deliver a turnaround in company execution.									

Source: Citi Research

Home and Personal Care

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Lots of Good "Story Stocks" Drove Outperformance in 2013; We Expect More of the Same in 2014

- **The HPC Stocks Are Up 29% YTD** — The HPC group of stocks has outperformed the market by roughly 200 bps through December 9, 2013. Within the group, we have had some particularly strong stocks (ENR +41%, NWL +39%, and CLX +31%), and we have had some particularly good "stories"—of restructuring programs, of new strategies and of new managements. We think these company-specific stories are generally what have driven the stocks up this year, as opposed to any particular macro factor.

- **Though the Stocks Have Appreciated Faster than EPS Growth This Year** — Interestingly, every stock in our group has appreciated more than the rate of EPS growth we forecast for calendar 2013 for the given company (with the average appreciation of 29% considerably better than the average EPS growth of 7%). Indeed, all of our companies' share price appreciation exceeds its EPS growth by 10 pts or more, with the biggest gaps being at ENR and NWL (whose stocks are each up nearly 40% this year, though we expect calendar 2013 EPS growth with of only ~7% and ~8%, respectively).

- **We Are Optimistic EPS Growth Will Accelerate in 2014** — Overall, the five "C's"—of Currency, Commodities, Cost Cutting, Consumer, and Cash—have been generally favorable for our group this year. Looking ahead, we think that each factor will continue to be positive and should lead to an acceleration in EPS growth in 2014, as outlined below:

  - **Currency** — The trade-weighted U.S. dollar is currently ~1% stronger on average YTD vs. the same period of 2012, with the pressure from f/x in the last few months of 2013 being less than expected at the start of the Summer. What's more, looking ahead, the pressure from f/x looks to be less-than-onerous, especially in calendar 1H14. And, importantly, our companies will anniversary the 32% devaluation of the Venezuelan bolivar in February 2014, which will benefit EPS growth.

  - **Commodities** — For the most part, the increases that we saw in commodity prices in 2013 were relatively immaterial, with the exception being natural gas. And, the outlook for the overall commodity environment in 2014 seems generally benign as well.

  - **Cost Savings** — Nearly every one of our HPC companies has a large-scale restructuring program in place, with most having been announced during 2012. While no new, big programs were announced in 2013, AVP and PG have foreshadowed that they have potential program expansions on the horizon (for the U.S. for AVP and for the European supply chain for PG). The big deal, in our opinion, is that *nearly every company's program resulted in faster-than- expected initial savings in 2013*, such that savings are running ahead of plan. These programs are (i) funding higher levels of reinvestment in the ever-more intensely competitive emerging markets and (ii) enabling managements to have some "flex" in terms of opting for how much they drop to the bottom line to meet their earnings guidance.

  - **Cash** — Whether it's being used for healthy dividends (the HPC stocks are offering an average yield of ~2% today, though CLX and KMB are each offering ~3% yields or higher) or healthy buybacks (we forecast the average

share count will be going down ~1%-2% in 2014), the HPC companies are relatively cash-rich, and they are being selective about making acquisitions.

– **Consumer** — For the HPC companies, the key markets of the U.S., Western Europe, China, and Brazil all were under real pressure in 2012, and while for the most part they stabilized in 2013, in the last couple of months we've seen a slowdown in growth in certain emerging markets. While we are still optimistic that developed markets continue to strengthen as we enter 2014, generally, we would characterize the global consumer spending environment as fragile.

- **Where Do We Go from Here? We Think Higher, but Not By Much on a Relative P/E Basis** — The HPC group is trading at an average of ~19x our CY14 EPS estimate, or a 21% premium to the market multiple. This compares to an average relative premium of 14% over the last 10 years or so. While we suspect the stocks can head a bit higher as we believe there could be some room for upside to our estimates for 2013, one caveat we offer is that we still believe that the long-term future EPS growth for the group will remain at levels below that which we have seen at times historically (in the low/mid teens).

  We Have Lots of Buy Recommendations — Going into 2014, we like (i) AVP for the continued turn-around that we expect will play out next year, (ii) CLX for its strong dividend yield and balanced top-and-bottom line growth, (iii) ENR for the cost savings flowing through from the restructuring program and focus on cash flow improvements, (iv) EL for its best-in-class revenue growth (driven by a robust new product pipeline and distribution expansion), (v) NWL for its continued strong execution against its productivity and growth initiatives, and (vi) PG for the acceleration in EPS growth owing to stronger innovation and stronger cost savings realization.

Other companies mentioned: Avon Products Inc (AVP.N; US$17.07; 1); The Clorox Co (CLX.N; US$94.88; 1); Kimberly-Clark (KMB.N; US$105.80; 2); Newell Rubbermaid Inc (NWL.N; US$31.03; 1)

Home and Personal Care: Top Buys

	Ticker	Rating	Price (12/9)	Target Price	Yield (%)	ETR (%)	2013E P/E	2013E P/BV	2013E ROE
Top Buys									
Energizer	**ENR**	**Buy**	**$113**	**$120**	**1.8**	**8**	**16.6**	**2.9**	**19.4%**
ENR is one of our top picks for the cost savings flowing through from the restructuring program and focus on cash flow improvements.									
Estee Lauder	**EL**	**Buy**	**$74**	**$78**	**1.1**	**7**	**29.8**	**8.8**	**34.5%**
EL is one of our top picks for its best-in-class revenue growth (driven by a robust new product pipeline and distribution expansion).									
Procter & Gamble	**PG**	**Buy**	**$85**	**$95**	**2.8**	**15**	**21.2**	**3.6**	**17.6%**
PG is one of our top picks for the acceleration in EPS growth we expect owing to stronger innovation and stronger cost savings realization.									

Source: Citi Research

Homebuilding & Building Products

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Buy the Builders into Spring. For the Full Year, We Want to Own Under-Appreciated Names

'Tis the Season...to Get Long the Builders – While we haven't been overly bullish on the builders in the past year (unlike consensus), we are now – for 4 reasons despite tapering concerns. First, sentiment appears to be bottoming, and the builder stocks have been shrugging off recent negative order and other data points, which is consistent with our view, first discussed in September. Second, our Private Homebuilder Perspectives survey showed unadjusted November orders ahead of the seasonal trend (i.e. flat MoM vs. historically -10% MoM) and net pricing and forward year demand expectations are also favorable. Further, we continue to hear from larger private builders that traffic is up meaningfully (YoY) but conversion-to-order rates slowed down since last June as consumers adjust to less but still historically favorable affordability metrics. We believe conversion rates will pick up in the less discretionary Spring Selling Season period when new homebuyers would need to sign contracts in order to move into their new gems in time for the next school year. Other external data sources also show demand ahead of the seasonal trend. Third, since 1982, builder shares tend to outperform the S&P 500 by ~19% (avg) in December through April years when MoM monthly (avg) annualized New Home Sales strengthens into/through the April-end. Fourth, even if the pace of the recovery may have slowed in past months, investors will likely want to gain exposure to the builder stocks following the homebuilder index (RUF) underperforming the S&P 500 by nearly 30% YTD. We would note that if we are experiencing the economic recovery that the S&P 500 reflects, housing historically should lead the recovery as potential homebuyers are typically the easiest economic pocket to impact.

Demand Outlook Remains Favorable — Last year, in our Road Ahead report excerpt, we highlighted potential constraints to a rapid rise in 1-family housing starts (i.e. shortage of developed lots, labor, and rising material prices), and our thesis came to fruition on a gradual, not rapid, supply chain recovery. While demand expectations have been volatile over the past year with the pace of the recovery slowing in 3Q13, a recent pick up in traffic and order activity reaffirm our view that housing starts can return to a normalized pace over the next 2 years. We forecast total housing starts of 1.1M units in 2014 and to return to a (demographics-based) mid-cycle level of 1.4M by 2015. We believe there are good demographic drivers to spur this recovery including: (1) adult/working age persons per household currently ~6%/4% more dense than the 1980-2000 (avg) ; (2) marginal loosening in mortgage standards on the edges; and (3) and housing affordability 23% better than median since the '80s, mostly on sub-7% 30-year mortgage rates. However, household income growth remains paramount absent mortgage rates holding at ~6% or less versus currently ~4.5%.

Our 3 Differentiated Picks for 2014: Buy BRP, DHI, & AWI — Among land developers and builders, BRP and DHI are our favored names for the Road Ahead. BRP's land position includes 20 years of forward supply, we believe there in a potential for a near double in stock valuation if the housing market accelerates and upside to $28 in the current state (Revisiting the Long Thesis: Top Pick for 2014), and it's an undiscovered value story with limited coverage that should outperform the cycle as it becomes discovered. Among larger builders, DHI exhibits greater operating leverage versus peers, as a function of management's laser focus on costs, which positions it well to generate above average margins in a recovery. Also, the builder’s healthy lot position and exposure to recovering lower ASP buyers

should provide for share gains going forward. In building products, we favor AWI's attractive valuation, which prices in no earnings growth and we expect the company to benefit from its US nonres exposure as the 2nd of its 3 earnings growth engines fires.

Sell KBH & BZH — We believe investors will start to differentiate between the "haves" and "have nots" post the run in higher beta builders. These 2 companies likely will underperform as result of: (1) possessing the highest leverage among covered builders, (2) needing to more aggressively invest in lots after a run in prices or recover at a slower pace than peers (i.e. lower relative margins), and (3) likely requiring additional equity to reduce cash interest drag, risk associated with excess leverage, and to scale up inventory.

Homebuilding & Building Products: Top Buys and Sells

	Ticker	Rating	Price (12/9)	Target Price	Yield (%)	ETR (%)	2014E P/E	2014E P/BV	2014E ROE
Top Buys									
Brookfield Residential	**BRP**	**Buy**	**$22.21**	**$28.00**	**0.0%**	**26.1%**	**15.8x**	**1.6x**	**11.0%**
Hidden value story set to unlock as the company monetizes its 20-year lot supply with a low cost basis.									
D.R. Horton	**DHI**	**Buy**	**$19.45**	**$25.00**	**0.8%**	**29.3%**	**15.4x**	**1.5x**	**11.3%**
Greater operating leverage versus peers, lower net debt to capital, and focus on cost controls									
Armstrong World Industries	**AWI**	**Buy**	**$54.20**	**$65.00**	**0.0%**	**19.9%**	**16.7x**	**3.8x**	**25.8%**
Trades at an attractive valuation, which prices in no earnings growth. We expect AWI to benefit from US nonres exposure									
Top Sells									
KB Homes	**KBH**	**Sell/High Risk**	**$17.49**	**$13.00**	**0.7%**	**-25.0%**	**25.3x**	**2.5x**	**12.0%**
Expensive valuation despite high leverage relative to peers. KBH also needs to more aggressively invest in lots.									
Beazer Homes	**BZH**	**Sell/High Risk**	**$20.79**	**$14.00**	**0.0%**	**-32.7%**	**NM**	**2.6x**	**-3.3%**
Possesses high leverage among peers, and likely requires additional equity to reduce risk associated with excess leverage and to scale up inventory.									

Source: Citi Research

Internet

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Selection & Themes Are Key

- **During the Last Year, Returns Were Robust** — Over the past 12 months, U.S. Internet equities have performed very well. Our Internet index of 74 companies (65 of which have YTD data) is up 118% YTD through 12/9/13, as compared with +35% for the NASDAQ Comp. 54 of the 65 in our index are up YTD and 40 of the 65 are up greater than 35%. While upward EPS revisions have been a driver, the entire sector benefitted from multiple expansion. The multiple expansion stemmed from 1) a change in sentiment as investors began to acknowledgement that mobile represented more of a positive and accelerator vs. a risk to growth for the group; and, 2) investors giving some companies credit for entering or executing against large, adjacent and new markets (e.g., LinkedIn's Sales Navigator or Amazon's AWS). Going forward, however, robust returns are apt to be less broad based. As such, we believe selection is key and that a focus on key growth themes is important.

- **Key Themes to Watch** — With this backdrop, we are focused on five key themes over the next year: 1) Mobile – the proliferation of mobile Internet devices and increasing mobile Internet usage as an incremental revenue opportunity or as a potential competitive disrupter; 2) Social/Data – the opportunity to leverage new sources of data (namely, "social" data) to enhance ad targeting and personalization; 3) International – opportunities to expand addressable markets outside of the core U.S. market; 4) AdTech – growth opportunities from the adoption of new adtech and other ad automation platforms; and, 5) B2B/Platform Optionality – opportunities to expand addressable markets outside of core B2C markets into B2B or platform markets (e.g., Amazon in AWS).

- **Key Theme #1: Mobile** — In only a handful of years, the emergence of mobile Internet devices (i.e., smartphones and tablets) has had a material impact on the Internet sector. Today, it is not uncommon to hear of established Internet companies generating 20-30% of their revenues from the mobile channel and of mobile growth in excess of 50% y/y. However, as is often the case with significant new platform shifts, mobile can represent both an opportunity and also a risk for incumbents as in some cases new entrants with a mobile-only approach could gain share. Within Internet, the shift to greater mobile device Internet consumption should be a meaningful net positive, with particular beneficiaries in our coverage being Facebook and Google, and to a lesser degree Yelp, LinkedIn and OpenTable.

- **Key Theme #2: Social/Data** — The term "social" is often bandied about, but a key practical implication of the increased use of social networks like Facebook is the emergence of a data asset that is arguably more robust than the legacy cookie-based approach. We refer to this as online identities or profiles, and with the increased adoption of social log-in or registration services we see social or identity-based personalization and targeting only increasing. We believe the benefits of social or identity-based data are far-reaching, but would highlight Facebook, LinkedIn, Yelp and Amazon as key beneficiaries.

- **Key Theme #3: International** — Sales outside the U.S. (primarily Europe/UK) for our coverage universe today represent roughly 47% of total revenue and are growing at a rate that is, on average, about twice as fast as the growth of their U.S. businesses (i.e., 66% vs. 34%). Given that our estimates of the addressable markets outside the U.S. are at least as large as in the U.S. and that some U.S.-based Internet companies have had success in replicating their success in the U.S. overseas (e.g., Google, LinkedIn, etc.), we believe growth and expansion

outside the U.S. will continue to represent a key growth theme for U.S. Internet companies. That said, not all U.S. companies have been successful (e.g., OpenTable), so some conservatism is likely prudent. As it relates to companies with potential to meaningfully expand their footprint or enhance their monetization outside the U.S., we are paying particular attention to Yelp, Netflix and Facebook.

- **Key Theme #4: AdTech/Advertising Automation** — Outside of search, most other categories of Internet advertising (e.g., display, video, etc.) have used rather manual processes for the buying and selling of inventory. In recent years, that has begun to change as large and small publishers and ad agencies adopt new real-time automated platforms such as ad exchanges. Often referred to as "programmatic" advertising, we expect this segment to continue to take significant share and post above-average growth because of its superior targeting and ROI characteristics. Within our universe, companies well positioned to benefit from the continued shift toward programmatic channels include Google, Rocket Fuel and AOL.

- **Key Theme #5: B2B/Platform Optionality** — One of the most significant yet still under-appreciated trends in the consumer Internet sector over the past five years, in our view, has been the development of new B2B or platform services by several of the large Internet companies. Examples include Amazon's launch of AWS and 3P marketplace services, Google's AdSense and other adtech solutions, and eBay's Enterprise business, among others. Within Internet, we believe Amazon.com is the best positioned to continue to benefit from the opportunities in B2B/platform services, while Facebook has the greatest potential to develop such solutions over the next year (e.g., an ad network).

Figure 15. Top Internet Buys

Company	Ticker	Rating	Price (12/9)	Target Price	ETR %	2014E Rev	2014E EBITDA	2014E EV/Rev	2014E EV/EBITDA	13/14e Rev Chg
Facebook	FB	1	$48.84	$57	17%	$9,743	$5,511	11.8x	20.8x	28%
Large global audience online. Largest mobile app. First-party profile data, not cookies. Monetization still early.										
Google	GOOG	1	$1,078.14	$1,190	10%	$18,419	$6,271	5.8x	12.4x	15%
Consistent execution & innovation. Diversified rev base with leadership in key growth segments (mobile, video, etc.)										
Amazon	AMZN	1	$384.89	$381	-1%	$91,449	$6,619	1.9x	25.9x	23%
Consistent execution & innovation. Margin expansion potential from mix shift to AWS & 3P plus N.A. retail leverage.										
Yahoo!	YHOO	1	$38.87	$39	0%	$54,362	$25,133	3.9x	11.6x	16%
Significant opportunity to unlock Asian asset value. Core turnaround underway. Strong balance sheet, buybacks.										
eBay	EBAY	1	$43.91	$49	12%	$1,897	$494	1.9x	7.1x	3%
Among most attractive valuations in large-cap Internet. Stable Marketplace growth + PayPal momentum = catalysts.										

Source: Citi Research

Other companies mentioned: AOL Inc. (AOL.N; US$42.95; 1); Rocket Fuel Inc. (FUEL.O; US$46.65; 1); LinkedIn Corp (LNKD.N; US$234.46; 2); Netflix, Inc (NFLX.O; US$366.26; 2); OpenTable, Inc (OPEN.O; US$80.71; 3); Yelp Inc. (YELP.N; US$64.34; 2)

IT Hardware & Technology Supply Chain

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IT Hardware As a Service Continues Momentum; Connectors Add the Value

- **Investment thesis** – Given a tepid IT spending environment in 2014 (Gartner and IDC forecast IT Spending to grow by 5% in constant currency in 2014 vs 4% in 2013), we continue to favor hardware companies that are transforming themselves to lead revenue growth from services and software. Service revenues tend to be more resilient and drive more annuity type revenue structure. Our Top Picks are HPQ and XRX.

- **Sector Theme** — Our investment framework is entitled "IT Hardware Flexing Service Muscles". This theme has several aspects which consensus is not considering, such as 1) Obamacare (Patient Protection and Affordable Care Act is the official name) set to roll out next year and with many states grasping for healthcare solutions, this should provide a positive for both HP and Xerox in 2014 and beyond. HP & Xerox are the two largest healthcare claims & payment processing companies, 2) HP and Xerox have been restructuring their services business and 2014 is set to show acceleration in service sales (Xerox) or material improvement in profit margins (HPQ).

- **Services Led Transformation at XRX** — Xerox now derives ~55% of their revenues from outsourcing services (print, IT and business process). This compares with ~20% pre the ACS acquisition in 2010. With print hardware revenues under pressure from muted IT spending, XRX's services led transformation should drive revenue stability while growth will come from implementation of health care reform (XRX is the largest health care claims processing and payment companies) and continued momentum in outsourcing in the public and commercial sector. Additionally recent restructuring efforts coupled with pruning of non core business (paper) should enable higher operating margins in 2014 and 2015. On capital allocation, XRX remains committed to returning at least 40% of FCF to shareholders via dividends and buybacks.

- **HP Stabilizing Biz Via Restructuring and Reinvestments** — HP is a classic case of a company that has propped up profitability for several years by essentially milking the business dry. This has led to a deterioration of innovation, and a product portfolio and sales organization poorly positioned to compete in a rapidly changing IT environment. After Meg Whitman became CEO two years ago, the company embarked on a lengthy journey to stabilize and reinvest into the company. A massive 10% of the workforce has been cut (expected to generate $3.2B of cost savings), with a significant portion being reinvested in "growth" areas. The company has also rebuilt its balance sheet and has achieved a net cash position (excluding financing biz) in the most recent quarter. This has allowed the company to commit to a meaningful shareholder return (50% of FCF in share repo or dividends) in the recent investor day.

- **Technology Supply Chain** - Within Tech Supply Chain, while y/y growth appears to have stabilized, there is little confidence in overall technology growth. We remain cautious on the Supply Chain until we are able to identify meaningful growth which would translate into increased OEM orders & additional outsourcing opportunities. We continue to favor the connector industry which has a much more diversified customer base, stronger cash flow, margins, dividends, stock buybacks, & accretive M&A opportunities.

- **Valuation** – Both HP and XRX trade at a sharp discount to their US IT Hardware peers. Revenue stabilization and margin improvement should yield earnings upside, improved investor sentiment, and multiple expansion. TEL trades at a discount to APH.

- **Risks** – Risks to earnings include execution missteps and price aggression that could derail margin improvements, macro factors that pressure revenues, and acquisition integration risks. Acquisitions remain important to services growth.

IT Hardware & Technology Supply Chain: Top Buys and Sells

			Price	Target	Yield	ETR		2014E	
	Ticker	Rating	12/9/2013	Price	(%)	(%)	P/E	P/BV	ROE
Top Buys									
Hewlett Packard	**HPQ**	**Buy**	**27.21**	**32.00**	**2.1%**	**20%**	**7.0**	**1.7**	**20.5%**
Business stabilizing via restructuring and reinvesting									
Xerox	**XRX**	**Buy**	**11.4**	**12.00**	**2.0%**	**7%**	**9.9**	**1.0**	**9.7%**
Services led growth to offset secular declines in print; healthcare opportunities are key catalyst									
TE Connectivity	**TEL**	**Buy**	**53.73**	**64.00**	**1.9%**	**21%**	**13.7**	**2.3**	**17.8%**
Increasing electronic content in autos, attractive valuation levels									
Amphenol	**APH**	**Buy**	**86.13**	**93.00**	**0.9%**	**9%**	**21.1**	**4.5**	**22.8%**
M&A to drive eps growth given best in class integrator									
Top Sells									
Lexmark	**LXK**	**Sell**	**35.56**	**29.00**	**3.4%**	**-15%**	**9.6**	**1.5**	**17.0%**
Heightened competitive intensity and Inkjet exit remain a significant headwind for operating income growth post 2014									

Source: Citi Research

Leisure and Restaurants

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High End Consumer Remains Resilient

- **High-End Consumer Likely to Continue to Spend on High-End Restaurants and Natural/Organic Food; Underlying Fundamentals Remain Solid in Leisure** — Some general themes we're seeing are that the higher income consumer is buying bigger ticket items like Harley Motorcycles, as well as affordable luxuries like $4 Cappuccinos at Starbucks, likely due to an improving economy, rebounding housing prices, and a rising stock market. We believe overall restaurant sales are slow but that those restaurants that cater to the higher end consumer are holding up fairly well. Natural/organic food trends should also continue to remain strong given resiliency in the high-end consumer. The key risks to our thesis is a significant decline in macro-economic conditions resulting in a pullback in spend by high-end consumers due to concerns over unemployment/underemployment or lower wealth.

- **Leisure Vehicles Are a Leading Indicator for Consumer** — Leisure vehicles in general are a leading indicator for consumer. Most sectors turned negative back in 2006 and 2007 when the consumer first began getting tapped out. Sales started to rebound from '09 through 2Q11, but it stalled in 3Q as trends in 3Q11 were for the most part slower relative to 2Q in leisure. Trends picked up again in 4Q11 and were strong through 1H'12 until weather/ elections/ concerns about fiscal cliff impacted trends later in the year and into early 2013. Sales then accelerated into 3Q13. Recreational vehicles (which can be a leading indicator for the leisure vehicle industry) have shown strength consistently in 2013, which is a promising sign for leisure vehicles in 2014. A risk going forward is further economic uncertainty may delay big ticket leisure purchases, but market share gainers such as PII may be able to overcome sluggish industry demand. Additionally, Harley's August new product launch, along with the company's recent introduction of its Street 750/500 motorcycles, should benefit the company over the next few quarters and retail sales should remain strong.

- **Quick Service Restaurants Should Improve with Less Unemployment of Young People** — Looking at quick service restaurants, we believe the biggest factor affecting this segment is unemployment of young people, which has improved somewhat, but still is higher than prerecession levels. In our view, while any sustained improvement in employment of young people would provide a nice tailwind, we have only started to see some signs of improvement in 2H13. Our checks indicate that competition remains fierce and that there continues to be a focus on value.

- **Casual Dining Could Be Impacted By Middle-Income Consumer; High End Concepts Should Benefit** — In casual dining, we historically see similarities to some of the leisure segments that we follow, which tend to be more closely tied into consumer sentiment. As such, casual dining is much more discretionary than QSR. As we look ahead, we believe casual diners with a middle-income focus may be challenged. Casual dining SSS was flat in October and down approximately 2.5% in 3Q. The primary issue includes a challenged middle income consumer. However our checks indicate the higher-income consumer is holding up well, which should benefit high-end concepts such as Starbucks. We expect sluggish demand in 2013 to continue for the category unless macro conditions improve, particularly for the middle-income consumer.

- **Natural/Organic Food Trends Likely Remain Strong** — As it relates to the natural products/organic food category, we sense trends there remain solid. In

our view, core customers to this segment tend to be higher end/higher income individuals, who have remained quite resilient throughout 2010-2012. Based on recent trends, we're currently seeing strength in the organic food segment YTD 2013 and expect continued strength in 2014, despite macroeconomic uncertainty. We think category strength is being driven by higher end consumer spending and secular growth of organic food. There is also an increasing willingness to pay more for natural/organic products due to the health benefits. Finally, we don't believe WFM's SSS slowdown to 5.8% in the first 5 weeks of calendar 4Q and 5.9% in calendar 3Q from 7.5% in calendar 2Q is broad-based, rather, it is likely WFM specific. In calendar 3Q, HAIN posted an acceleration in consumption to 11.1% the latest 12 weeks vs. 6.7% in the prior 12 weeks; STKL posted an acceleration in organic sales growth to 8% vs. 6% in 2Q; and UNFI posted organic sales growth of 12.9% in calendar 3Q vs. 12.2% in calendar 2Q, also their management mentioned November remained strong and was consistent with strong sales growth in the quarter.

- **Top Restaurant Pick: SBUX** — Our top pick in restaurants is Starbucks. For SBUX, we believe the U.S. segment should continue benefiting from a resilient high end consumer, while International continues to progress on its turnaround and Channel Development and recent acquisitions provide growth potential.

- **Top Leisure Picks: HOG and PII** — We believe Polaris should continue to pick up market share at least over the next year and should significantly outpace the broader ATV industry. This is driven by new product innovations and growth in international markets. Regarding HOG, the company's August new product launch, along with the recent introduction of its Street 750/500 motorcycles, should benefit the company over the next few quarters and retail sales should remain strong.

- **Top Natural/Organic Pick: HAIN** — Our top pick in natural/organic is HAIN. HAIN should benefit in the near-term and long-term from strong industry demand in natural/organic as well as increasing SKU offerings at its retail customers. The company also appears on track to achieve long-term EBITDA margins of 14-17% driven by continued sales momentum, improved efficiencies/productivity, and managing costs.

Other companies mentioned: United Natural Foods Inc (UNFI.O; US$68.71; 1); Whole Foods Market Inc (WFM.O; US$56.44; 2); SunOpta Inc. (STKL.O; US$8.72; 1)

Leisure & Restaurants: Top Buys

			Price	Target	Yield	ETR	2014E		
	Ticker	Rating	(12/9)	Price	(%)	(%)	P/E	P/BV	ROE
Top Buys									
Starbucks	**SBUX**	**Buy**	**$79.73**	**$93**	**1.3%**	**17.9%**	**28.7x**	**8.4x**	**30.6%**
Should benefit from continued resiliency of the high end consumer, as well as continued progression on the company's multi-tiered turnaround plan and CPG initiatives.									
Hain Celestial Group	**HAIN**	**Buy**	**$84.12**	**$104**	**0.0%**	**23.6%**	**25.9x**	**3.0x**	**11.6%**
Should continue to benefit from strong underlying demand in natural/organic food.									
Polaris	**PII**	**Buy**	**$138.80**	**$156**	**1.2%**	**13.6%**	**22.0x**	**7.4x**	**38.7%**
Should continue to pick up market share at least over the next few quarters and should significantly outpace a sluggish ATV industry given strong product innovations.									
Harley Davidson	**HOG**	**Buy**	**$68.95**	**$79**	**1.2%**	**15.8%**	**18.1x**	**5.3x**	**26.0%**
Should benefit from continued strong demand following its August new product launch and recent introduction of its Street 750/500 motorcycles.									

Source: Citi Research

Life Insurance

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Life's Been Great and It's Not Over Yet

- **Life Still Looks Good —** In 2013, the U.S. life insurance group is up 65% as the sector has benefited from a more favorable macro environment, easing concerns about low interest rates and variable annuity exposures, and positive earnings revisions. Consensus estimates for 2014 are up about 3-4% from the beginning of the year, so most upside has been driven by multiple expansion. While valuations are no longer depressed, we still see room for modest upside as interest rates rise and fundamental trends continue to improve. In addition, our conversations with investors suggest there is room for further rotation into the sector. We believe investors should have some exposure to life insurance stocks and would look to use any pullbacks as buying opportunities.

- **Sector in the Macro Sweet Spot** — Life insurance stocks are levered to both rising equity markets and higher interest rates, so Citi's macro forecasts are supportive of further upside for the group in 2014. In addition, we view the group as largely "taper proof" as it should benefit if a pullback in bond buying results in higher long-term interest rates. We expect the group to continue trading with high correlation to interest rates until the 10-year gets to the 3.5% area.

- **ROEs Trending Higher** — We forecast the median sector ROE to expand from ~11% in 2013 to 11.2% in 2014 and 11.4% in 2015. Our estimates do not assume a material increase in rates, so we see upside if yields rise. At the same time that returns are improving, we also forecast the cost of equity to continue declining as a result of ongoing business mix shifts and lower perceived balance sheet and earnings risks. We view the long-term cost of equity for the sector to be ~10% and forecast most companies to generate positive "excess" returns (ROE – cost of equity) in 2014, warranting valuations above 1x book value.

- **Sales Tepid but Improving; Pricing Environment Remains Constructive** — Sales growth for most products has been muted in recent years due to the weak economy, low interest rates, higher prices, and a pullback by competitors in select products (notably variable annuities and universal life). However, we are starting to see an uptick in demand for individual life, group benefits, and defined contribution retirement. In addition, production for both fixed and variable annuities appears to have bottomed and should increase in 2014 (especially if interest rates rise). Pricing trends are generally favorable as companies continue to increase premiums/fees and make guarantees less generous, and competition in most markets appears rational. As a result, we believe most companies are earning attractive margins on new business, which should help lift returns.

- **Healthy Balance Sheets Support Ongoing Capital Return** — Based on our estimates, most of our coverage companies have deployable excess capital. In addition, on average our companies produce free cash flow of ~60% of operating earnings (prior to dividends). This provides considerable flexibility for share repurchases, dividend increases, or potential M&A. Given the rise in stock prices, we expect slightly less focus on buybacks in 2014, potentially leading to greater emphasis on dividend increases. In our view, there could also be a modest uptick in M&A activity, especially as valuation multiples have recovered. We expect deal activity to remain focused on blocks of business, bolt-on transactions that add scale or distribution, and international properties.

- **Increased Regulation, Macro Deterioration Are Key Risks** — PRU was recently named a non-bank systemically important financial institution (SIFI), and

MET is likely to be deemed a SIFI shortly. In 2014, we anticipate greater clarity on the prudential standards and capital rules to which these companies will be subject. While we expect new requirements to be manageable and have modest impact on ROEs and capital return, it is hard to argue that additional regulation is a positive. Regulators are also likely to finalize new rules for captive reinsurance entities over the next few months, and we expect ongoing debate about principles based reserving and potential accounting changes for insurance contracts. In our view, the black box nature of the sector, regulatory uncertainty, and high macro leverage will continue to drive an above-average beta and cost of equity for the sector.

- **Valuations No Longer Depressed, but Not Expensive Either** — The life group currently trades at median multiples of 1.15x book value (ex. AOCI) and 10.6x 2014E EPS. On a P/BV basis, we believe the group could revalue to the 1.2-1.3x range over the next year given our forecast of 11-12% ROEs and a 10% cost of equity. On P/E, the group is trading at about a 30% discount to the S&P 500, close to the historical average (ex. the financial crisis). However, the group trades at among the lowest multiples of any financials, so many investors view life stocks as a “cheap” way to get exposure to higher interest rates.

- **PRU and HIG Are Our Favorite Names** — PRU has strong operating momentum across most of its businesses, and we believe the company’s mix should enable it to sustain a superior ROE over time. In our view, the current P/E discount vs. the group (9.5x vs. 10.6x) should close over time, particularly as regulatory clarity improves. HIG is one of the few self-help stories remaining in the group with catalysts outside of the macro improvement. We expect its valuation to continue to re-rate higher as core business returns improve, the runoff annuity block shrinks, and the pace of capital return accelerates. In our view, the company’s runoff life blocks (Talcott Resolution) remain an under-appreciated source of value, and we estimate they are worth >$12 per share.

- **We Would Be Buyers If the Group Pulls Back** — Our ratings have become less bullish in recent months as some stocks have reached our target levels, but we continue to believe the group offers both absolute and relative upside. All things being equal, if the sector pulls back, the Neutral-rated names that we are most positive on are MET and VOYA. We currently have no Sell ratings as our targets do not imply material negative expected total returns in 2014, but some stocks are approaching fair value. Our outlook is most cautious for RGA as we believe it faces structural headwinds that will limit growth and preclude material multiple expansion.

Other companies mentioned: MetLife Inc. (MET.N; US$51.75; 2); Reinsurance Group of America (RGA.N; US$74.56; 2); ING U.S., Inc. (VOYA.N; US$33.88; 2)

Life Insurance: Top Buys

	Ticker	Rating	Price (12/5)	Target Price	Yield (%)	ETR (%)	2014E P/E	2014E P/BV	2014E ROE
Top Buys									
Hartford Financial	**HIG**	**Buy**	**35.38**	**39.00**	**1.7%**	**10.3%**	**10.0**	**0.85**	**8.8%**
Attractive turnaround story with improving core business results, increased capital flexibility, and potential to unlock value in its runoff VA business.									
Prudential Financial	**PRU**	**Buy**	**89.15**	**94.00**	**2.4%**	**7.9%**	**9.7**	**1.45**	**15.4%**
An improving ROE and strong organic growth should drive modest multiple expansion. Most attractive business mix among the large multi-line life insurers.									

Source: Citi Research

Life Science Tools & Diagnostics

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Cautious into 2014: Accelerating Organic Growth Needed to Support Valuations

- **Mixed Outlook Heading into 2014 as Organic Growth Profiles Will Need to Improve to Support Current Valuation Levels** — Thus far in 2013, the Life Science Tools & Diagnostics (LST/Dx) sector has outperformed the S&P – up +43% YTD vs. +26% for the S&P – driven by low management expectations coming into the year, M&A activity (LIFE/TMO) and a lack of noticeable end market deterioration despite continued pressure in lab budgets. However, while revenue comps are easier heading into 2014 (YTD 2013 organic revs at +1%), relative valuations have noticeably expanded and are near 5-year highs (NTM P/E relative to S&P to 1.44; 5-year avg. of 1.29; High 1.53). Given the last time valuation levels were at this level (2010), organic growth was roughly +8-10% and we expect organic growth will need to meaningfully accelerate in 2014 to support current levels, which could be challenging given that end-markets' dynamics remain mixed overall.

- **Easier Comps Though Relative Valuations Approaching Five Year Highs…**— Organic growth was challenged in 2013 through the first three quarters with the group average at +1% vs. +5% in 2012, and +8% in 2011 though continued cost-cutting, operational improvements, minimal pricing pressure and share buybacks helped to drive EPS growth. Valuations levels have increased throughout 2013 (currently NTM relative P/E to S&P is at 1.44 vs. 1.28 at end of 2012) and while revenue comps are easier and margin expansion opportunity and stock repurchases should continue into 2014, we would expect (absent an uptick in M&A activity) organic growth would need to accelerate to mid/high single digit levels to justify current levels (see Fig. 2).

- **….With End Market Dynamics Remaining Mixed.** — Not surprisingly, end-market dynamics heading into 2014 still remained mixed. While improving global ISM indexes should lead to improvements in the Industrial markets and US hospital volumes may benefit from implementation of the Affordable Care Act (ACA), academic/government funding budgets remain tight and pharma trends, a growth driver in 2013, have shown early signs of slowdown as large pharma restructuring in 2H13 could begin taking effect. Hospital capex remains challenged and with the uncertainty surrounding political/fiscal issues showing no signs of dissipating, overall, while there are puts and takes, end markets look to remain mixed as we head into 2014.

- **Top Tools & Dx/ Medtech Stocks (TMO, A, CFN, EW, SPNC)** — Given this backdrop, we remain positive on companies with new product stories such as **CFN** (Pyxis ES), **EW** (Sapien XT/3, Intuity Elite) and **SPNC** (in-stent restenosis approval) as well as companies building scale and expanding margins including **TMO** (acquisition of **LIFE**) and **Agilent** (strategic spin-off). Given the tough growth environment, companies with continued cost cutting opportunities such as **IART** and **CFN** should continue to support EPS growth.

Other companies mentioned: Edwards Lifesciences Corp (EW.N; US$61.90; 1); Integra Lifesciences Holdings Corp (IART.O; US$46.22; 1); Life Technologies Corp (LIFE.O; US$75.62; 2); Spectranetics Corp (SPNC.O; US$23.94; 1)

Life Science Tools & Diagnostics: Top Buys

	Ticker	Rating	Price (12/9)	Target Price	Yield (%)	ETR (%)	2014E P/E	2014E P/BV	2014E ROE
Top Buys									
Thermo Fisher	**TMO**	**Buy**	**$102**	**$103**	**0.60%**	**0%**	**17.7x**	**2.2**	**8.25%**
End market and product diversification, restructuring efforts and LIFE acquisition (EPS Accretion; strengthening position within labs) should drive TMO.									
Care Fusion	**CFN**	**Buy**	**$40**	**$42**	**N/A**	**6%**	**17.2x**	**1.6**	**7.33%**
New product introductions (Pyxis ES), continued organizational streamlining, M&A potential and Infusion share gain opportunity will continue into 2014.									
Agilent	**A**	**Buy**	**$55**	**$59**	**0.90%**	**8%**	**17.3x**	**3.8**	**13.83%**
Electronic Measurement (EMG) showing signs of stability, margin expansion opportunity within Life Science and new product introductions should drive Life Science as it awaits the EMG spin in late 2014.									

Source: Citi Research

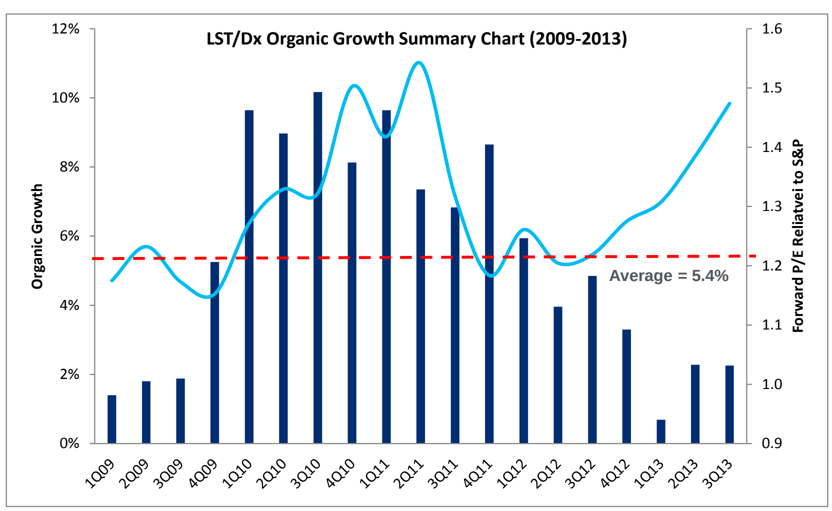
Figure 1. Life Science Tools End Market Mix

	Government/ Academic	Applied/ Industrial	Pharma/ Biotech	Hospital/ Healthcare
Illumina (ILMN)	80%	4%	16%	0%
Bruker (BRKR)	62%	30%	8%	0%
Affymetrix (AFFX)	45%	5%	40%	10%
Life Technologies (LIFE)	45%	15%	30%	10%
Qiagen (QGEN)	26%	7%	20%	47%
Sigma Aldrich (SIAL)	25%	35%	28%	12%
Thermo Fisher (TMO)	22%	27%	25%	26%
PerkinElmer (PKI)	21%	29%	21%	29%
Danaher (DHR) [(a)]	15%	10%	10%	65%
Waters (WAT)	13%	24%	63%	0%
Agilent (A)	8%	78%	14%	0%
Mettler Toledo (MTD)	4%	50%	46%	0%
Pall (PLL)	0%	56%	29%	15%
Average	**30%**	**26%**	**26%**	**17%**

Note: (a) Life Sciences & Diagnostic segment only (36% of DHR's total 2012 revenues)

Source: Citi Research

Figure 2. LST/Dx Organic Growth vs. Relative Valuation with S&P (2009-2013)



Source: Citi Research

Machinery

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Mixed Outlook; Selectivity Key in 2014

- **Initial Outlook for 2014 –** We remain selective in 2014 and prefer companies with favorable end-market exposure (U.S. non-residential is our favorite) along with company-specific catalysts (i.e. deal integration, synergies, capital deployment). Improving global growth (industrial production expected to be up ~3.8% in 2014) should help accelerate the general industrial capex cycle this year, benefiting names like PH. Despite the positive cycle momentum, we expect a tougher backdrop for companies with commodity-specific capex, including mining and agriculture. Amongst the major risks we see in 2014 include carry-over of the weakness in commodity prices, as well as inventory issues in certain key markets. Our top Buy rated ideas have significant leverage to an improving outlook for U.S. construction spending and related investment (URI and ETN) and global ag equipment (DE).

- **Positive U.S. Construction Outlook –** As with the broader economic recovery, the anticipated rebound of the U.S. non-residential construction industry has fallen short of expectations in 2013, beset by public sector weakness, heightened caution among private developers and businesses, and decelerating growth in global economies. That said, we see several indicators pointing to growth acceleration into 2014; improving credit conditions, declining vacancy rates, and follow-through from U.S. housing upturn. Residential construction spending, which was up ~17% in October y/y, continues to define the U.S. recovery, with housing starts expected to rise ~20% for 2014. Given the historical leading relationship, we expect this to carry-through to the non-residential markets in 2014 and beyond. The recovery will be segmented, and we expect new construction growth to remain muted in certain sectors, like Office and Retail, which are both contending with secular challenges. The outlook for the Industrial sector remains bright, supported by growth in e-commerce, improving prospects for the U.S. manufacturing sector and shale-related investment. We see equipment rental as the best way to leverage this growth, as narrow contractor margins and low visibility, significant emission-driven hikes in new equipment costs, and uneven credit availability are factors that we think will enable rental to far outpace end market growth.

- **Grain Prices Keep Sentiment Lower –** Record crop production and high ending stocks are expected to keep grain prices under pressure in 2014. Lower prices combined with uncertainty regarding major policy (relating to tax incentives, ethanol mandate, FINAME), have created a more uncertain sentiment than in past years. While it won't be the story like it was in 2013, it is also important to keep in mind the significant role that crop insurance plays in providing some protection from the recent correction in grain prices. Thus, we believe the strength of the farmer balance sheet and financial health will help to sustain sales at decent levels in 2014, but question marks loom regarding the sustainability beyond next year should grain prices persist near current levels.

- **Mining Equipment Remains Pressured** – In the post commodity "Supercycle" world, the picture is less promising for mining equipment companies, who (as a whole) are cutting capex budgets, which we expect to continue to weigh on equipment demand. Companies are lowering the capital intensity of production, partly through the combination of brownfield expansion and productivity gains, while at the same time deferring (in most cases) the development of greenfield mines. While the reduction in overall spending clearly represents a headwind for the equipment providers, we see this partly offset by the industry's shift to a

higher percentage of sustaining versus growth capex (the former tends to be much more equipment-intensive vs. the latter).

- **Mixed Outlook for Emerging Markets** – Brazil's truck market has rebounded sharply in 2013 from emissions-induced softness in 2012, on the back of a surging crop and a slew of favorable subsidies/incentives. The ag equipment market in Brazil also experienced strong growth in 2013 and benefited from favorable exchange and financing rates. The outlook for 2014 remains uncertain, with the development bank wanting to remove vehicles from the capital-goods subsidy Investment Support Program (or PSI) – though we believe other segments (like ag equipment) will remain. China's truck market is expected to see 15% growth in 2013, though the current forecast calls for a decline in 2014 given this year's pre-buy. We believe China's agricultural machinery policy support is a long-term story and should continue to drive equipment investment.

- **Valuations Have Some Opportunity for Growth —** The Machinery group on average is trading at roughly 14x 2014 expected EPS, or a roughly 8% discount to the S&P 500. This valuation has improved since last year at this time, when our coverage was trading at ~30% discount to the S&P 500. This improved valuation comes with renewed belief in the U.S. non-residential recovery story and improved operational performance of select companies. While lowered growth forecasts and an elevated risk profile account for some of the discount to the market, we believe certain stocks merit higher multiples at this stage.

Machinery: Top Buys

			Price	Target	Yield	ETR	2014E		
	Ticker	Rating	(12/9)	Price	(%)	(%)	P/E	P/BV	ROE
Top Buys									
United Rentals	**URI**	**Buy**	**$70.99**	**$75.00**	**0.0%**	**5.6%**	**10.9x**	**3.0x**	**30%**
Economic Uncertainty and US Construction Growth Favors Rental, Largest Player in Fragmented Industry									
Eaton	**ETN**	**Buy**	**$72.30**	**$78.00**	**2.4%**	**10.2%**	**14.5x**	**1.9x**	**13%**
Acquisition of CBE Provides Favorable Electrical End Market Exposure and Opportunity for Additional Synergy and Deleveraging									
Deere & Co.	**DE**	**Buy**	**$87.20**	**$97.00**	**2.2%**	**13.5%**	**9.8x**	**2.8x**	**31%**
Continued Equipment Needs and Strong Farmer Income in 2013									
Top Sells									
PACCAR Inc.	**PCAR**	**Neutral**	**$56.87**	**$58.00**	**1.4%**	**3.4%**	**15.6x**	**2.6x**	**17%**
Exposure to European Heavy-Duty Truck Market									

Source: Citi Research

Managed Care

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Health Insurers Face A Tougher 2014

- **It's hard for us to see the managed care stocks outperforming again in 2014** — In 2013, the average company in the group beat EPS expectations by 5%, with most of the stock improvement coming from multiple expansion. If the fundamental environment is similar in 2014, as we expect will be the case, the stocks would need to realize another year of meaningful multiple expansion. It's hard for us to see the health insurance industry sustainably trading at anything close to a market multiple, considering that margins are close to peak levels, a significant and growing portion of revenue depends on government reimbursement, while earnings will be negatively impacted by health reform in both 2014 and 2015.

- **Most insurers expect earnings to be flat to down in 2014** — The hope has been that 2014 would be a transition year because of health reform, with a return to 10-15% earnings growth in 2015. UnitedHealth has already suggested that won't be the case, as Medicare Advantage rates will continue to be difficult, while the impact of health reform will linger into 2015.

- **As is often the case, medical cost trend could have the biggest impact on stock prices** — If cost trend decelerates further in 2014, consensus estimates will prove conservative, enabling the stocks to do well. However, we doubt that scenario plays out next year, considering that that medical cost trend didn't really decelerate in 2013, while it appears the economy (which has a high correlation to medical spend) is improving.

- **The market is more optimistic on Medicare than anything else in the group right now** — The view is that while 2014 and 2015 will be tough, rates will begin to improve in 2016, and combined with 10% enrollment growth, earnings can rise 15% or more in 2016 and beyond. While possible, this scenario seems unlikely to us, considering that some companies, like Humana, are implementing a riskier strategy to offset 2014 rate reductions than has been the case historically (the company is relying on significant medical management savings, rather than cutting benefits), while it seems unlikely that nothing new will negatively impact Medicare reimbursement between now and April 2015, when the 2016 rates are set.

- **Sentiment is more mixed on the Medicaid stocks** — We really like the long-term earnings trajectory of the Medicaid plans, since each company can legitimately double or triple revenue over the next few years. However, it seems like there's a high probability of negative earnings surprises over the next six months, since plans are unlikely to completely offset the health insurance industry fee, the new lives added through Medicaid expansion will probably have pent up demand and utilize after gaining coverage, while plans are adding more new contracts in 2014. This helps the long-term revenue growth story, but nearly every new start-up Medicaid contract added over the last decade has been unprofitable initially.

- **The potential for publicly traded M&A is low right now** — After completing big deals over the last 12 months, most of the larger plans in the group have debt to capital ratios above 35%, so even if they wanted to pursue M&A, most don't have the capital flexibility at the moment. Once the debt levels drop, we think interest in consolidation will pick up, and will likely be focused on increasing scale in government business.

Managed Care: Top Buys and Sells

	Ticker	Rating	Price (12/9)	Target Price	Yield (%)	ETR (%)	2014E P/E	2014E P/TBV	2014E ROE
Top Buys									
Universal American	**UAM**	**Buy**	**$7.44**	**$12.00**	**0.0%**	**61.3%**	**37.4x**	**1.3x**	**(0.8%)**
Universal has a significant amount of cash on the balance sheet. The cash, plus the Houston HMO asset, seem to be worth more than the company's entire market cap now.									
Aetna	**AET**	**Buy**	**$66.82**	**$72.00**	**1.2%**	**9.0%**	**11.0x**	**19.2x**	**16.1%**
We think Aetna has the potential for EPS upside in 2014, driven primarily by accretion from the Coventry transaction.									
UnitedHealth Group	**UNH**	**Buy**	**$73.72**	**$77.00**	**1.5%**	**6.0%**	**13.0x**	**-28.8x**	**16.9%**
The potential monetization of the Optum asset will continue to come up in 2014, raising the question of whether United deserves to trade at even more of a premium valuation.									
Top Sells									
eHealth	**EHTH**	**Sell**	**$42.95**	**$12.00**	**0.0%**	**(72.1%)**	**121.7x**	**7.7x**	**5.1%**
The market is anticipating big earnings growth in 2014, and the company still has yet to sell a single health insurance exchange policy because of technical issues.									
Magellan	**MGLN**	**Sell**	**$61.01**	**$52.00**	**0.0%**	**(14.8%)**	**19.0x**	**1.5x**	**7.8%**
Magellan lost its two largest contracts, and the stock has actually gone up since. EBITDA will fall in 2014, and EBITDA is likely to be down again in 2015.									

Source: Citi Research

Other companies mentioned: Humana (HUM.N; US$101.93; 2)

Midstream Energy MLPs

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Growth Over Interest Rates

- **Rising Rates a Mild Headwind** — We expect midstream MLPs to generate a 2014 total return of 9.9% as a rising interest rate environment has the potential to partially offset relatively high yields and continued distribution growth. Midstream MLPs were fairly resilient throughout most of 2013 generating a total return of 22% as North American midstream fundamentals remained strong, while positive fund flows helped offset taper talk, record equity issuances, and increasing interest rates. However, MLPs started 2013 with a yield that was 485 bps above the 10-year Treasury (6.6% MLP Yield / 1.75% 10-year) compared to a historical median spread of 300 bps. Currently, this spread stands at 325 bps (6.1% MLP Yield / 2.85% 10-year) and we see less potential for MLPs to generate significant principal appreciation based on yield compression if interest rates indeed head higher. Our 12-month total return forecast takes into consideration the 10-year increasing to 3.25% by the end of 2014, in-line with the Citi Economic Outlook.

- **The Growth Counter Balance** — MLP growth capex hit an all-time high in 2013 at nearly $30 billion, which we estimate will drive distribution growth of 6.25% in 2014. Considering the capital intensity and long lead time needed to bring midstream infrastructure into service, we see recent spending and planned projects already under construction supporting growth of 4.7% through 2018. Taking this longer-term view into consideration, we estimate midstream MLPs will generate a 5-year IRR of 7.5% which assumes a 2018 10-Year Treasury yield of 4.5%. This might sound low compared to the annual total return of 18% over the last ten years, but remains fairly attractive considering we are discounting a rising interest rate environment throughout our forecast period.

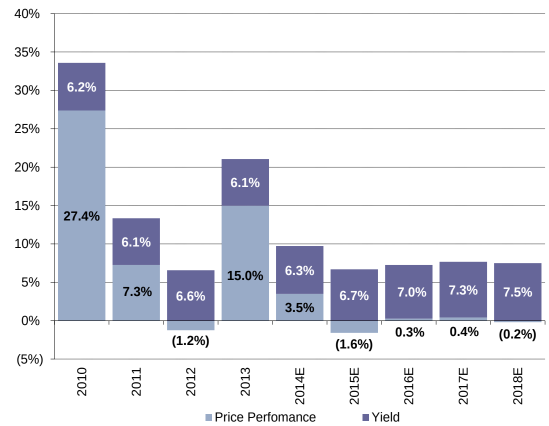
- **Further Spread Compression?** — Our estimated IRR assumes MLP yields trend back to the historical median spread of 300 bps to the 10-year Treasury, despite previous occasions when the sector traded at a much narrower spread during a rising rate environment. In our opinion, we believe this spread has further room to compress over the next few years as institutional acceptance of MLPs continues to expand and other fixed income investors look for growth to help offset a rising interest rate environment. MLPs performed extraordinarily well from May of 2003 to June of 2006 as the yield on the 10-year rose from 3.4% to 5.2%. During this time MLP yields actually decreased from 7.4% to 6.9%, while the spread decreased from 400 basis points to 170 basis points.

- **Uptick in M&A Expected** — Valuations among MLPs have continued to diverge over the last three years that we expect to drive an uptick in consolidation across the sector in 2014. MLPs that have growth and stable cash flows now trade at significantly lower yields compared to MLPs that are perceived by the market as higher risk with limited growth opportunities. While ±1 standard deviation from the average yield was 5.6% to 7.2% in 2011, this now stands at 4.4% to 9.6%. We view this as a positive indicator that consolidation will likely increase over the next few years especially if organic growth opportunities begin to dry up.

- **2014 Positioning** — The broader markets remained relatively calm throughout 2013 experiencing a pullback of only ~5% compared to gains that were five times that amount. MLPs on the other hand started the year off strong, but were range bound from June throughout the rest of the year as record equity issuances offset record fund flows. For 2014 we expect MLPs to once again rely heavily on the equity markets to fund expansion projects, but this could exaggerate MLP volatility if broader market conditions are not as accommodating. There are a number of identifiable catalysts that could trigger a more choppy broader market in 2014 such as budget disputes, midterm elections, and central bank policy decisions. In such

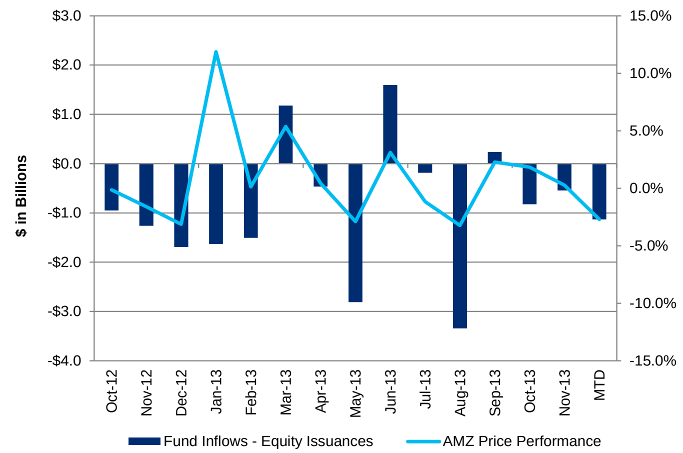
markets, MLPs with large capital budgets that require a lot of equity funding could experience above avg. volatility even if growth expectations are high. As a result, we favor MLPs with well-funded balance sheets, healthy distribution coverage, and/or higher-yield catalyst driven names.

Figure 1. Alerian MLP Index Total Return: 2010A – 2018E



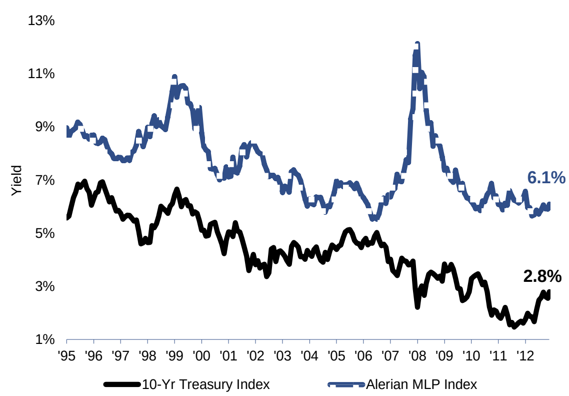
Source: Citi Research

Figure 2. Net Fund Flows vs. AMZ Price Performance



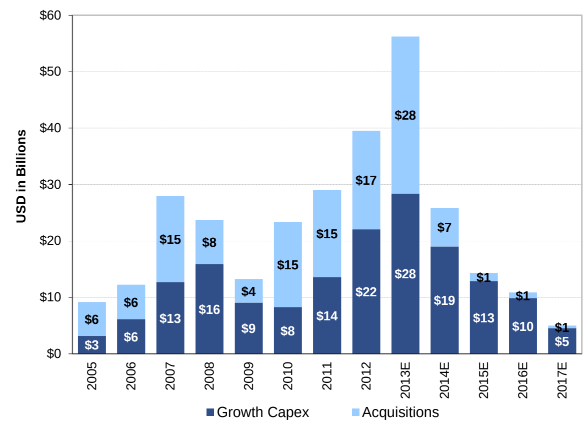
Source: Citi Research

Figure 3. Alerian MLP Index Yield vs. 10-Year Treasury



Source: Citi Research

Figure 4. MLP Capital Expenditure



Source: Citi Research

MLPs: Top Buys and Sells

	Ticker	Rating	Price (12/9)	Target Price	Yield (%)	ETR (%)	2014E EV/EBITDA	2014E Target Yld	2014E FTM Dist Grth
Enterprise Product Partners LP	**EPD**	**Buy**	**$62.52**	**$73.00**	**4.7%**	**21.9%**	**15.2x**	**4.0%**	**5.8%**
Core MLP holding, ideally positioned assets, attractive growth, strong distribution coverage, no IDRs and IG balance sheet.									
Targa Resources Partners LP	**NGLS**	**Buy**	**$49.85**	**$57.00**	**6.2%**	**21.8%**	**14.4x**	**5.5%**	**8.2%**
Strategically located NGL logistics assets in the Gulf Coast and gathering & processing plants in the Permian and Bakken. Interesting candidate for consolidation.									
Emerge Energy Services LP	**EMES**	**Buy**	**37.97**	**$42.00**	**10.6%**	**20.9%**	**9.4x**	**9.0%**	**11.7%**
Undervalued organic growth, flat capital structure conducive to accretive growth or consolidation, and high yield relative to peers.									
TC Pipelines LP	**TCP**	**Sell**	**$44.97**	**$43.00**	**7.2%**	**2.8%**	**13.7x**	**7.5%**	**0.0%**
Performance to remain volatile as Canadian gas imports seem likely to decline further; Possesses a more-levered BS following recent dropdowns.									

Source: Citi Research

Medical Supplies & Technology

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Horse Chases Cart

- **Summary** — From a fundamental perspective, 2013 has gone very much in line with our expectations for both organic sales growth (+3%) and EPS growth (+5%). We cannot say the same about the stock performance as the group is up 35% YTD vs. a 26% increase for the S&P. This move has pushed the relative valuation vs. the S&P up to a 10% premium vs. an in-line multiple a year ago. While we see a slightly better fundamental performance in 2014 – we estimate 4% sales growth and 8% EPS growth – we believe such an improvement is necessary in order to catch up to this year's relative multiple expansion.

- **The US Market Could See Modest Improvement** — The US market is expected to generate $151B in med tech sales in 2013, or 42% of the global total. The good news is the US appears to have improved modestly in 2013 with sales expected to rise 1.5% up from a relatively flat performance in 2012. Utilization appears to have ticked up slightly and downward pricing pressure looks to have moderated. While we expect a further improvement in 2014 – we continue to model 2.5% growth – recent hospital admission trends do suggest there could be some risk to our assumptions as lower admissions means less testing, which in turn should ultimately lead to less diagnosis and procedures.

- **Western Europe Likely to Remain the Weak Spot** — Austerity programs throughout most of Western Europe (26% of the global total) remained in place in 2013 and our estimate of roughly 1% cc growth is in line with the 2012 performance. We assume austerity pressures moderate a bit in 2014 and expect industry growth to rise to 2.5% cc, which may prove a bit optimistic.

- **EM Growth Is Now the Wildcard** — The past two years, emerging markets (20% of the global total) have driven most of the industry's overall growth, primarily in the BRIC region. We estimate growth in 2013 slowed down a tick to around 13% behind a modest overall slowdown in GDP growth (-50bp cc) and some uncorrelated and various corruption, regulatory, and reimbursement and austerity measures in the BRIC countries. We assume some of these issues carry over into 2014 and assume another modest step down in growth to 12%.

- **Belt Tightening and Return Cash Efforts Should Moderate** — In 2013, med tech faced the implementation of the medical device tax, which is on track to clip EPS growth by 300bp. With OM leverage difficult to come by, the industry responded by accelerating restructuring efforts in 2H12 and 1H13 and has largely offset this hit. Share repurchase has remained a sizable driver of EPS growth at +250bp. Dividend rates also moved up modestly faster than earnings with Abbott and Covidien leading the way with increases of 57% and 23%, respectively.

  In 2014, we expect a similar amount of share repurchase on a dollar basis but with shares up an average of 35%, the absolute share counts should decline at about half the prior rate as less shares can be repurchased per dollar and there is a more dilutive effect from options. Given that med tech generates a significant amount of cash overseas (we estimate the group average is 50%), we see limited ability for the industry overall to accelerate share repurchase (and/or raise dividends much above EPS growth) without meaningful increases in US debt levels. Hence, we only expect share repurchase to add 125bp to EPS growth in 2014. Overall, we expect EPS growth of 8% for the group in 2014, which would represent an improvement from 2013.

- **Street Estimates Look More Realistic vs. Optimistic** — Unlike prior years, the delta between our sales and EPS forecasts in 2014 vs. the consensus are less pronounced with sales on average in line and our EPS growth about 1-2% lower. The biggest deviations to the downside are Abbott, where our 2014 EPS forecast of $2.15 is $0.08 lower, and Baxter, where our EPS forecast of $4.88 is $0.16 lower. While we do believe that there is probably more downside risk than upside surprise to our 2014 forecasts (i.e., a delayed reaction to the current US admission trends, no relief from EU austerity measures, slower EM growth rates, a reduction in share repurchase), we don't see additional consensus risk.

- **Medtronic Should Have the Early Momentum** — Valuation spreads for both "cash" P/E (12.6-16.4x 2014) and EV/EBITDA (8.8-11.7x) and both sales and EPS growth rate spreads have tightened. Hence, we see fewer clear cut stock selection calls heading into 2014. We continue to prefer Medtronic as the stock still trades at a discount to its peers and should benefit from improved sentiment in 1Q14 with the US launch of Corevalve, additional data from the Corevalve pivotal trial, and the initial pivotal trial data for Symplicity (RDN). Johnson & Johnson has less room for relative valuation expansion, but with several product launch tailwinds in Pharma and some expected improvement in MD&D and Consumer, we see room for EPS upside. Within our small-cap coverage, Cynosure should benefit from strong growth in the US aesthetics market, cost synergies from the Palomar acquisition, the beginning of a shift to higher-margin consumable sales and several product launches in the AsiaPac region.

  We are most concerned about Abbott Labs, Hospira, and St. Jude Medical. For Abbott Labs, earnings quality and FCF remain disappointing, Street expectations for sales and EPS still look overly aggressive, and the stock is trading at a premium to the peer group. Hospira also has issues with earnings quality, FCF is down nearly $200MM YTD, FDA/quality issues will still take time to fix, and the valuation is above the peer group. St. Jude Medical has also seen earnings quality decline and the relative valuation move up (although the stock roughly trades in line with the group on most metrics). Our biggest concern is still Durata, where the negative news flow has admittedly died down the past several months, but is still an outstanding risk.

Other companies mentioned: Baxter International Inc (BAX.N; US$66.97; 2); Covidien Ltd (COV.N; US$66.25; 1)

Medical Supplies & Technology: Top Buys and Sells

	Ticker	Rating	Price (12/9)	Target Price	Yield (%)	ETR (%)	2013E P/E	2013E P/BV	2013E ROE
Top Buys									
Medtronic	**MDT**	**Buy**	**$58.14**	**$69.00**	**19.1%**	**20.8%**	**15.4x**	**3.3x**	**19.4%**
Rising visibility for Corevalve (US launch and new data) and Symplicity (new data) should dominate investor attention in 1H14, stock still trades at a discount to peers.									
Johnson & Johnson	**JNJ**	**Buy**	**$94.44**	**$102.00**	**13.4%**	**16.0%**	**16.4x**	**3.3x**	**22.6%**
Still in the middle innings of a renaissance in the Pharmaceutical business, MD&D and Consumer should join the party in 2014 and show some OP improvement.									
Cynosure	**CYNO**	**Buy**	**$24.85**	**$41.00**	**75.5%**	**75.5%**	**27.5x**	**2.1x**	**8.1%**
Strong underlying market growth in aesthetics, sizable cost leverage from the Palomar acquisition, an improving consumable model, and new product approvals in AsiaPac.									
Top Sells									
Abbott Labs	**ABT**	**Sell**	**$37.53**	**$34.00**	**-5.3%**	**-3.7%**	**17.9x**	**2.2x**	**12.9%**
Lower quality earnings than peer group based on recurring charges and FCF generation. Nutritionals business will face headwinds in 1H14 and Diagnostics should slow.									
St. Jude Medical	**STJ**	**Sell**	**$59.75**	**$41.00**	**-26.8%**	**-25.3%**	**15.0x**	**3.5x**	**24.8%**
Valuation no longer appears to reflect regulatory risk for the Durata lead which we believe is still an issue and carries significant P&L risk if removed from the market.									
Hospira	**HSP**	**Sell**	**$41.57**	**$31.00**	**-23.9%**	**-23.9%**	**19.5x**	**2.3x**	**-0.5%**
Timeline and risk around FDA/quality issues are likely to remain in 2014, generic launch of key product Precedex will now happen by 12/14, and cash flow remains depressed.									

Source: Citi Research

Media, Cable & Satellite

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Picking Our Spots

- **During the Last Year, Returns Were Robust** — Over the past 12 months, Media, Cable & Satellite equities have performed very well. While upward EPS revisions were rare, the entire sector benefitted from multiple expansion. The multiple expansion stemmed from: 1) Robust capital returns, 2) The ability to tap into new revenues streams (Netflix content fees, TV Everywhere, Targeted advertising), and 3) Tight cost controls resulting in healthy operating margins. Going forward, however, robust returns are apt to be less broad based. As such, we're picking our spots.

- **Key Themes to Watch** — With this backdrop, we are focused on three key themes over the next year: 1) Consolidation within the pay TV space, 2) Pay TV growth to contract (even as occupied housing units recover), and 3) Emerging broadband opportunities.

- **Key Theme #1: Pay TV Consolidation** — With the rapid rise in programming costs – typically rising 8-10% per sub per year – video margins are compressing. As such, we expect the US pay TV sector to consolidate over the next 12-24 months. Incremental scale – via consolidation - should help mitigate some of the margin pressure. Within cable, consolidation should benefit Time Warner Cable and Charter. It's also possible (though less likely) the two US DBS firms merge.

- **Key Theme #2: Pay TV Growth to Contract** — Between 2011 and 2013, many media firms licensed content to new web video providers (like Netflix and Hulu). So far, these content deals have resulted in new revenues from content licensing. But, these new revenues have been offset by lower cable network ad revenues (as consumers shift video consumption from traditional linear TV to on-demand, web-based services). Now, however, we are beginning to see subtle signs that the pay TV market is not keeping up with growth in household formation. In effect, with robust web video offerings, some customers are eliminating their pay TV subscription all together. Over the next 12-24 months, we expect pay TV subscriptions to contract more significantly. While this development poses a risk for most firms in our coverage universe, we think the pure-play Cable Networks are most at risk. Scripps is rated Neutral; Discovery is rated Sell.

- **Key Theme #3: Emerging Broadband Opportunities** — Over the past few years, the cable and telco firms benefitted from the mass-market adoption of broadband services. But, most of that growth is behind us. Over the next 12-24 months, however, we see a new set of opportunities dominating the broadband debate: 1) The potential growth in the connected car market (also known as telematics). We expect Sirius to be the biggest beneficiary, 2) The migration of home security firms – like ADT – into the connected home market with emerging services like Pulse (which allows consumers to control lights, temperature and door locks from a smart phone), 3) The growth next-generation satellite broadband services – like EchoStar's Jupiter satellite – should allow under-served (and non-served) broadband markets to receive faster Internet speeds. Sirius, ADT and EchoStar are all Buy-rated.

Other companies mentioned: Scripps Networks Interactive, Inc. (SNI.N; US$81.00; 3); Time Warner Cable Inc (TWC.N; US$131.50; 1)

Media, Cable & Satellite: Top Buys and Sells

	Ticker	Rating	Price (12/9)	Target Price	Yield (%)	ETR (%)	2014E P/E	2014E P/BV	2014E ROE
Top Buys									
Charter Communications	**CHTR**	**Buy**	**$128.16**	**$152.00**	**0%**	**19%**	**49.5x**	**-38.7x**	**-85%**
Significant tax assets. Expect TWC tie-up.28% Malone stake a positive.									
SiriusXM	**SIRI**	**Buy**	**$3.67**	**$5.00**	**0%**	**36%**	**36.7x**	**17.0x**	**49%**
Apt to materially shrink equity with more leverage. Telematics new growth opportunity.									
ADT	**ADT**	**Buy**	**$39.69**	**$48.00**	**1%**	**21%**	**20.4x**	**2.5x**	**12%**
Stable, recurring FCF; potential upside from levered capital return.									
EchoStar	**SATS**	**Buy**	**$48.50**	**$60.00**	**0%**	**24%**	**167.2x**	**1.3x**	**1%**
Hughes growth key for stock. Echo XVII and Echo XIX (1H16E launch date) should allow under-served (and non-served) broadband markets to receive faster speeds.									
Top Sells									
Discovery Communications	**DISCA**	**Sell**	**$85.41**	**$68.00**	**0%**	**-20%**	**21.3x**	**3.3x**	**23%**
Only firm with better TV ratings. Valuation seems full. Cable network firms (such as DISCA) may be negatively impacted by Pay TV consolidation.									

Source: Citi Research

Metals & Mining

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Stay Cautious and Selective, It's Me (Supply) Not You (Demand)

- **Supply Risks Persist** — Metals and Mining equities generally lagged the S&P for the third consecutive year. Despite improving demand indicators (global PMI), major commodity prices continue to average lower YoY with the exception of iron ore. In our view, the issue is growing supply following years of over investment which will take time to fix. Across the major commodity subgroups, we favor domestic steels the most given their leverage to recovering US construction spending. We see little downside risk in 2014 for coal and aluminum partly because prices have already dropped significantly and existing assets are facing closure, a sign of a market bottom. We are more neutral on gold and North American gold equities but expect greater price stability now that prices are tracking near our average 2014 forecast of $1,250/oz. We are most contrarian on copper and expect pricing to correct lower as the market surplus swells for two more years before falling back to a deficit.

- **Prefer EAF/Minimill Steelmakers** — We favor companies such STLD that have less direct exposure to steel pricing because of their variable cost business model, where scrap input costs can move in tandem with steel selling prices, potentially preserving margins. In addition, STLD's sell long-products have greater leverage to a recovering US non-residential construction market. Other steel producers with a similar business model as STLD include NUE and CMC.

- **Negative on FCX and Copper** — The global copper market surplus should peak in 2014 at 539kT as supply growth accelerates to +4.4% YoY. Lower pricing, cash flows and project spending should slow down the pace of supply growth in future years, but we believe it is too early to look past the valley until the copper market hits bottom. In our opinion, copper looks over valued at over ~$3.25/lb and is likely to average ~$3.00 next year. FCX with its historically high correlation to copper prices and increased balance sheet leverage following recent energy acquisitions looks especially vulnerable.

- **Coal Woes –** Based on Citi's natural gas price forecast of $3.75/MMBtu for 2014, domestic coal demand and pricing should stabilize vs the dramatic losses in 2012 and reversal/gains in 2013.Yet without a more meaningful recovery in gas prices, coal miners are unlikely to find pricing power due to excess capacity. For metallurgical coal, the weak AUD coupled with capacity growth is displacing higher cost US supply, perpetuating difficult times for domestic coal miners. On a relative basis, we prefer BTU due to their low cost thermal coal assets in the US and Australia mines that will benefit from a weak AUD. Our view is that seaborne met coal prices should recover in 2014 and average $160/tonne as high cost capacity idles, favoring met coal leveraged names such as WLT, TCK and BTU that operate at the low end of the cost curve.

- **Gold … Time for Select Equities to Outperform –** As miners reduce spending in a lower but stable ($1,250/oz) gold price environment, we believe low-cost companies with a better balance sheet that can continue to grow may outperform, namely GG. We continue to recommend ABX because of their lowest all-in-sustaining-cost position amongst the senior gold miners and valuation.

Metals and Mining: Top Buys and Sells

	Ticker	Rating	Price (12/9)	Target Price	Yield (%)	ETR (%)	2013E P/E	2013E P/BV	2013E ROE
Top Buys									
Steel Dynamics	**STLD**	**Buy**	**$19.04**	**$21**	**2.3%**	**12.7%**	**20.8x**	**1.8x**	**8.6%**
Highest margin US steel producer that has consistently generated positive free cash and offers leverage to lagging non-residential construction spend.									
Constellium	**CSTM**	**Buy**	**$21.48**	**$23**	**0.0%**	**7.1%**	**12.0x**	**NM**	**NM**
Mid/downstream aluminum convertor with exposure to growing auto and aero market.									
Peabody Energy	**BTU**	**Buy**	**$19.08**	**$23**	**1.8%**	**22.3%**	**76.4x**	**1.1x**	**0.6%**
Low cost US thermal coal and Australia thermal/met assets									
Goldcorp	**GG**	**Buy**	**$21.07**	**$28**	**2.8%**	**35.7%**	**24.9x**	**1.1x**	**NM**
Low cost senior gold miner with a healthy balance sheet and bite-sized growth projects where construction spending is nearly complete									
Top Sells									
Freeport McMoRan	**FCX**	**Sell**	**$34.63**	**$24**	**3.6%**	**-27.1%**	**13.9x**	**1.8x**	**13.0%**
We expect copper prices to correct down to $3/lb in 2014 as the market surplus grows. EPS sensitivity is roughly $0.03 for every $0.01/lb change in copper.									
Alpha Natural Resources	**ANR**	**Sell**	**$7.53**	**$5.10**	**0.0%**	**-32.3%**	**NM**	**0.4x**	**NM**
Largest Central Appalachia coal miner that will likely face strong earnings headwinds as met coal prices average an estimated $160/tonne in 2014.									
AK Steel	**AKS**	**Sell\High Risk**	**$5.86**	**$2.10**	**0.0%**	**-64.2%**	**NM**	**-1.3x**	**NM**
Unfunded pension/OPEB liabilities of $1.9 bln will make it difficult for the company to generate positive free cash flow in the foreseeable future.									

Source: Citi Research

Other companies mentioned: Barrick Gold (ABX.N; US$16.38; 1); Commercial Metals Co (CMC.N; US$19.45; 2); Nucor Corporation (NUE.N; US$51.45; 2); Walter Energy (WLT.N; US$14.92; 2H); Teck Resources (TCKb.TO; C$24.67; 2)

Multi-Industry & Electrical Equipment

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Still in the Sweet Spot of the Cycle

- **Favor "Control Your Own Destiny" Stories in Steady Growth Phase of Economic Cycle** — We continue to see the Multi-Industry sector as still in the sweet spot of the late-cycle/steady growth stage of the economic cycle. Recent improvements in US macro indicators, such as ISM, upticks in late-cycle businesses like nonresi and signs of stabilization in Europe all position the group favorably for another year of double-digit earnings growth in 2014. The Multi-Industry sector historically achieves absolute and relative outperformance at this stage of the cycle. Elevated sector valuations now suggest that upside from here will need to come more from better earnings growth in 2014 and less from multiple expansion. We continue to favor Control Your Own Destiny stories like GE (our top pick), PNR, ROP, UTX, DHR, and ETN, companies in the sector with more exposure to mid and late-cycle, and companies with higher earnings visibility.

- **Positioned for Another Year of Double-digit EPS Growth** — The sector looks well positioned for another year of solid earnings growth as US markets remain resilient, Europe shows signs of stabilization, and Emerging Market growth remains strong. Disciplined cost structures and restructuring savings should fuel another leg of margin expansion in 2014 even from elevated 2013 levels. We expect much of the 2014 growth to be driven by the mid and late-cycle markets that, in many cases, are still below prior peak levels. Residential and non-residential construction, in particular, should see recoveries accelerate into 2014. Large backlogs in commercial aviation support expectations for several years of robust growth, plus aftermarket should remain strong with airline profitability and flight hours. Oil & gas and process industries also have large backlogs of projects that should ramp through the year.

- **Capital Allocation Catalysts Boosted by a Spate of Activism** — We have seen a wave of capital allocation catalysts and portfolio simplification actions. Recent examples of spin-off/divestiture actions include General Electric (retail finance), ITW (industrial packaging), Dover (handset components), Ingersoll-Rand (locks), Emerson (embedded power), Actuant (electrical products), and Carlisle (Transportation Products). There has been a spate of activism in the sector and even the shadow of activism may be sufficient to move corporate boards to take action. In a watershed development, we arranged to have Relational Investors present at the Citi Industrials Conference in September 2013 to explain their investment approach and valuation methodologies. Please see our recap of this presentation in our conference report: Cautious Optimism Abounds.

- **Valuation Represents the Biggest Sector Risk at This Point** — In our view, the primary risk for the sector is valuation following the mostly multiple-driven 37% increase in the sector YTD 2013. Forward P/E of 17.8x is now at a premium to the ten-year and twenty-year averages of 16x, reducing the likelihood that further multiple expansion would be a meaningful contributor to sector performance in 2014.

Other companies mentioned: Actuant Corporation (ATU.N; US$38.16; 2); Carlisle Companies Inc. (CSL.N; US$73.86; 2); Danaher Corporation (DHR.N; US$74.33; 1); Dover Corp (DOV.N; US$89.58; 2); Emerson Electric Co. (EMR.N; US$66.30; 1); Eaton Corp (ETN.N; US$70.75; 1); Illinois Tool Works Inc. (ITW.N; US$78.41; 2); United Technologies Corporation (UTX.N; US$108.46; 1)

Multi-Industry & Electrical Equipment: Top Buys and Sells

	Ticker	Rating	Price (12/9)	Target Price	Yield (%)	ETR (%)	2014E P/E	2014E P/BV	2014E ROE
Top Buys									
General Electric	**GE**	**Buy**	**$27.19**	**$32**	**2.9%**	**20.6%**	**16.0x**	**NA**	**NA**
Balanced earnings outlook, $229 billion backlog; earnings shift towards Industrial drives multiple expansion; our top pick in the sector									
Roper Industries	**ROP**	**Buy**	**$130.15**	**$157**	**0.5%**	**21.1%**	**20.7x**	**4.0x**	**16.9%**
Shift to SaaS driving superior margins and cash flow, grouping ROP among the sector's highest-quality Primes; stock not expensive on P/FCF									
Pentair	**PNR**	**Buy**	**$71.24**	**$82**	**1.4%**	**17.1%**	**18.0x**	**2.2x**	**11.8%**
Transformational merger with Tyco Flow creates critical mass to key industrial markets, creates significant value									
Ametek	**AME**	**Buy**	**$49.38**	**$55**	**0.5%**	**11.9%**	**20.5x**	**5.2x**	**18.4%**
Among the best-in-class Multi-Industrials; M&A is the key value driver and the setup recently became attractive									
Top Sells									
SPX Corp.	**SPW**	**Sell**	**$95.05**	**$79**	**1.1%**	**-15.8%**	**17.0x**	**2.2x**	**10.7%**
Steep 2H13 EPS ramp, with no likely capital allocation catalysts; Thermal sale has been tabled pending more restructuring and no M&A. Valuation is not compelling.									

Source: Citi Research

Offshore Supply Vessel Companies

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Don't Panic

- **Sector Call: Stay the Course with the Boats in 2014** —The CY3Q13 earnings season raised more questions than answers in the minds of investors, but we remain steadfast in our positive call on the offshore supply vessel companies. We believe the sector's ~10% average pullback over the last six weeks provides a buying opportunity, particularly in the case of our top pick Hornbeck Offshore Services, Inc. (HOS). In our view, the fundamental indicators of vessel supply and demand remain healthy, and we believe that recent concerns regarding the Gulf of Mexico are overdone.

- **Driver: Rig Count Has Steadily Climbed for Two Years** — Working offshore rig counts continue to indicate a high level of vessel demand. The jackup rig count has increased from approximately 300 units in the beginning of 2011 to 405 units today. The floater rig count has increased from less than 200 units two years ago to 262 units today. These rig additions will drive demand for the type of high-spec vessels supplied by HOS, Tidewater Inc. (TDW), and GulfMark Offshore, Inc. (GLF).

- **Driver: Rig Orders Have Remained Strong in 2013** — The number of offshore rig orders has increased from 60 units in 2012 to 102 units so far in 2013, although the asset mix has shifted dramatically from floaters (declining from 38 in 2012 to 25 in 2013) to high-spec jackups (increasing from 22 in 2012 to 77 in 2013). The number of rigs under construction has grown from 199 a year ago to 234 currently. During this time, the vessel orderbook has stayed nearly flat from 241 vessels a year ago to 239 vessels on order today.

- **Driver: Deepwater Discoveries Bode Well for Vessel Activity** — The long-term vessel outlook is promising as a result of recent deepwater exploration successes. In 2012, operators announced 53 discoveries in water depths of at least 4,000 feet, compared to the previous record of 36 such discoveries. Another 27 deepwater discoveries have been announced so far in 2013. These exploration finds are likely to generate a healthy backlog of development projects requiring deepwater rigs and high-specification vessels.

- **Risk: Delayed Rig Start-Ups Could Impact 4Q13** — A potential concern is that the Gulf of Mexico is experiencing an influx of vessel deliveries in 4Q13 in advance of anticipated deepwater rig start-ups. Numerous vessels from HOS, TDW, Edison Chouest, and Bordelon Marine have been delivered or are scheduled for delivery in 2013 and are expected to precede the commencement of new deepwater rigs. If an "air pocket" of demand occurs in late 2013, we expect that any vessel availability would be absorbed once rig deliveries resume by early 2014.

- **Risk: Gulf of Mexico Rig Displacement Concerns Are Overdone —** Concerns have grown in recent weeks that net floater additions could be muted in the Gulf of Mexico in 2014. The uncertainty revolves around whether less capable floaters with contracts expiring in 2014 could be pushed out to make room for the sixth-generation rigs entering the region. However, we remain confident that deepwater rig activity will continue a healthy ascent and sustain an undersupplied or balanced vessel market in the GoM over at least the next two years. We anticipate that the inflow of deepwater rigs already contracted and additional contract announcements will be more than sufficient to negate the

impact of potential floater newbuild delays and any lower-spec floaters departing the region upon their contract expirations.

- **Valuation: Multiples Are Below Peaks** — As a result of stock price declines over the last six weeks, U.S.-based OSV peer group valuations have fallen from 7.5x to 7.1x on 2014 EV/EBITDA and from 1.5x to 1.3x on price/book. This compares to forward EV/EBITDA multiples of 9.0x at the current-cycle peak (in March 2011) and 12.7x at last cycle's peak (in November 2004). Price-to-book metrics are now below current-cycle peak levels of 1.5x (in October 2013) and last cycle's peak of 2.4x (in January 2006).

- **Game-Changer: Energy Reform Would Attract E&P Capital to Mexico** — The possibility that President Pena Nieto will be successful in reforming energy policy in Mexico could provide a further catalyst to offshore supply vessel companies with operations in the country. We believe that the greatest opportunities over the next decade to explore and develop abundant deepwater reserves in Mexico would accrue to HOS, which has been in Mexico since 2002, given the large number of high-spec vessels the company has working out of nearby Port Fourchon. In addition, TDW has long had operations in Mexico based out of Ciudad del Carmen, Campeche, and is also well positioned particularly to the extent that the new spending may initially target unexplored shallow-water prospects.

Offshore Supply Vessel Companies: Top Buys

			Price	Target	Yield	ETR	2014E		
	Ticker	Rating	(12/9)	Price	(%)	(%)	P/E	P/BV	ROE
Top Buys									
Hornbeck Offshore Services	**HOS**	**Buy**	**$50.13**	**$70.00**	**0.00%**	**39.6%**	**10.7x**	**1.40x**	**10.5%**
Hornbeck is a long-term call on the tightening spot market in the Gulf of Mexico in 2014 and 2015. We believe recent investor concerns provide an attractive entry point.									
Tidewater	**TDW**	**Buy**	**$57.82**	**$70.00**	**1.73%**	**22.8%**	**10.1x**	**1.08x**	**9.9%**
Tidewater is firing on all cylinders, but nobody appears to be noticing. New jackup rig construction could inflect the shallow-water vessel market sooner than anticipated.									
GulfMark Offshore	**GLF**	**Buy**	**$49.24**	**$59.00**	**2.03%**	**21.9%**	**11.7x**	**1.25x**	**9.5%**
GulfMark is well-positioned with a fleet across the Americas, North Sea, and Southeast Asia. All three regions have outperformed expectations over the last two quarters.									

Note: Tidewater estimates adjusted to reflect a December fiscal year end

Source: Citi Research

Oil and Gas Exploration & Production

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E&P "Goldilocks" Era To Persist, Although A Projected Drop In Oil Prices Could Yield Some Headwinds At Times

- **Goldilocks Is Still In The Building…** – Through the end of November, our market-weighted E&P index had lagged the S&P for the year with a 19.2% gain (vs. S&P +26.6%) despite domestic (WTI) oil prices up only ~1.0% and Brent prices essentially flat on the year while natural gas prices have averaged ~30% higher than last year. But this sharp gain was bolstered by the E&P sector more recently (i.e., in September-October) breaking from the strong correlation to domestic oil prices that existed from March 2012 through August due, in our opinion, to 1) broadly reduced reinvestment risk for many emerging resource plays, and 2) ongoing margin expansion at flat commodity prices. This also resulted in 'multiple' expansion for select names in our E&P coverage group through the year which we believe will persist or have yet to be realized by other select companies.

- **…As Resource Plays & Efficiencies Continue To Improve…** – A consistent theme this year has been the ongoing improvement in drilling efficiencies in the absence of any oil field services (OFS) cost pressure. In fact, we project that the group's RRE will be at 2.0x this year versus 1.7x in 2012. We expect that many resource plays will expand along with continued efficiency gains again in 2014 and we believe there will be minimal or no onshore North America OFS cost pressure again in 2014 (see Citi Oil Field Services analyst, Robin Shoemaker's 12/10 note). We do project E&P E&D capital spending will be up at least 6% next year but don't foresee the total U.S. rig count rising by anywhere close to 100 (currently 1,756) which is the level we believe would prompt some meaningful OFS cost increases.

- **…While Keeping An Eye On Commodity Prices** – In line with Citi's Commodities Team's recent revision (see their 11/18 note), we are lowering our 2014 Brent/WTI price projections to \$97.50/\$92.80 from \$107.50/\$105.30 per Bbl (and for 2015 to \$86.30/\$92.50 from \$99.25/\$102.50). The E&P team's 2014 composite spot natural gas price remains \$3.75/MMBtu although we previously noted that a 4% colder-than-normal winter could push this to \$4.10/MMBtu (Citi's Meteorological Team continues to call for a ~4% colder-than-normal winter).

- **Key E&P Share Performance Drivers Remain The Same** – The 'Haves' with clear resources already in hand, and which in most instances only appeared to get better through the year, led E&P sector performance in 2013 and we expect this will continue to be the case in 2014. Overall, we expect cash flow per debt-adjusted share (CF/DAS) growth along with Reserve Replacement Efficiency (RRE) will continue to be the mostly highly correlated metrics to E&P share performance.

- **Stick With The Winners** – Even though some companies will continue to look to forms of restructuring to capture value, and we foresee limited M&A in the space near term, we believe the greater upside potential still lies with the 'Haves' (absent a sharp drop in commodity prices) with **APC**, **COG**, **CXO**, **CHK**, **NBL**, **PXD**, and **WLL** among our top picks.

Oil and Gas Exploration & Production: Top Buys

	Ticker	Rating	Price (12/9)	Target Price	Yield (%)	ETR (%)	2014E P/E	2014E P/BV	2014E ROE
Top Buys									
Cabot Oil & Gas	**COG**	**Buy**	**$35.73**	**$45**	**0.22**	**26.1%**	**29.5**	**3.0**	**14.2%**
Top Pick Among Pure Gas-Leveraged E&P Names									
Chesapeake Energy	**CHK**	**Buy**	**$26.44**	**$35**	**1.32**	**33.5%**	**11.3**	**0.4**	**4.0%**
Production Growth To Accelerate With Better Capital Efficiency									
Concho Resources	**CXO**	**Buy**	**$98.12**	**$130**	**0.00**	**32.5%**	**81.1**	**2.8**	
Top Smid-Cap Pick: Capturing Value In The Delaware Basin									
Pioneer Natural Resources	**PXD**	**Buy**	**$176.43**	**$260**	**0.05**	**47.4%**	**27.5**	**1.7**	**8.3%**
Poised For More Permian Oil Growth									

Source: Citi Research

Other companies mentioned: Anadarko Petroleum Corp (APC.N; US$84.07; 1); Noble Energy Inc (NBL.N; US$67.80; 1); Whiting Petroleum Corp (WLL.N; US$58.54; 1)

Oil Services & Equipment

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Oil Service Stocks May Get a Boost from Rising Interest Rates

- **If Past Is Prologue, Oil Service Should Outperform** — With economic indicators strengthening, some investors have concluded that the road ahead leads to higher interest rates and they are screening for companies and sectors that would be likely to outperform in a rising interest rate environment. The oil service and equipment stocks have shown a clear historical pattern of positive performance, both absolute and relative, in periods of rising interest rates. Conversely, these stocks have tended to underperform in times of declining interest rates. Since 1970 oil service stocks have performed best when the Fed was tightening and worst when the Fed was easing.

- **Energy Demand Tied to Economic Activity** — The cycles of economic growth and decline since 1970 show a much stronger correlation with demand for oilfield services than do fluctuations in oil and gas prices (although the two are related in some important respects). Although uncertainty remains with respect to the pace of the global economic recovery, the macro-economic outlook offers more positive news lately. This is especially true in the U.S., the world's largest market for oilfield equipment and services. Investment in oil and gas drilling projects globally is positively correlated with strengthening economic activity.

- **The Road Ahead Leads to More Dividends** — The large dividend increases announced in 2013 by industry-leading companies—especially in the offshore drilling sector—was the most surprising development of the year. The companies that recently have expressed and demonstrated their commitment to returning cash to shareholders includes Halliburton, National Oilwell Varco, Ensco, Noble Corp., Transocean, and Helmerich & Payne. These companies joined and bolstered the ranks of high dividend payers led by Diamond Offshore and Seadrill Limited. They embraced capital disciple in a new and important way, compelling other industry players to consider higher payouts sooner or later. In 2014 we expect more companies to follow their lead, notably improving investors' perception of the oil and gas drilling services industry.

- **A Better Start for North America in 2014** — Although the North America market for oilfield services struggled with stagnant demand and highly competitive pricing in 2013, the outlook for 2014 is better in some important respects. It is true that pricing for hydraulic fracturing and coiled tubing services remains weak going into 2014, and excess capacity continues to be an impediment to pricing improvement. But in other respects 2014 is shaping up as a better year. There has been no year-end slump in drilling at the end of 2013 as there was at the end of 2012. Consequently the market is stronger going into 2014 and it appears that the first quarter will be better than the sluggish start to 2013. We also expect that various initiatives undertaken in 2013 to improve operating efficiency will boost margins and overall financial performance in 2014.

- **A Stronger Year Ahead in Latin America after a Disappointing 2013** — Although the oil service industry experienced double digit revenue growth and modest margin improvement in the international arena in 2013, Latin America was a notable exception to this trend. Mexico in particular slowed down as the national oil company (Pemex) reassessed its oil and gas drilling priorities and sharply curtailed investments in certain onshore basins that were not meeting targeted production levels. In Brazil there was a shift from drilling to completions in 2013 that reduced demand for drilling services and forced some oil service

providers to reduce their work force in a year that was expected to produce strong gains in revenue and profit. As of now it appears that Petrobras will continue to emphasize production growth through completions and workovers in 2014, a decision driven largely by budgetary constraints. Nonetheless, we expect the major oil service companies to benefit from stronger demand, led by Mexico, in 2014. Latin America is not expected to be a drag on international margins next year as it was this year.

- **Expect More Offshore Drilling Limited Partnerships** — The road ahead almost certainly will lead to the formation of more offshore drilling limited partnerships, starting with one to be created by Transocean in 2014. The first publicly traded limited partnership, Seadrill Partners, was formed at the end of 2012 and it performed strongly in 2013. The success of Seadrill Partners demonstrates that investors consider new, technologically advanced offshore rigs with high-margin multi-year contracts to be suitable assets for limited partnerships. Transocean has announced that it will be the second offshore drilling company to create a limited partnership comprised of economic interests in some of its highest earning assets. If the Transocean partnership offering is successful, other offshore drillers almost certainly will follow.

- **Expect Delayed Projects to Get Back on Track** — A final thought on the road ahead relates to the surprisingly large number of “big budget” investment projects that were delayed in 2013, preventing some oilfield equipment and service companies from booking as much new business as they anticipated at the start of the year. Many of these delayed projects are for the development of deepwater fields discovered in recent years in West Africa, the Gulf of Mexico, and the North Sea. An improving global economic backdrop in 2014 could provide the spark that leads to the sanctioning and commencement of at least some of these stalled investment projects. If and when this occurs, it would be a major positive catalyst for the shares of the oilfield equipment manufacturers.

Other companies mentioned: Helmerich & Payne (HP.N; US$79.39; 1); Transocean Ltd. (RIG.N; US$48.36; 2); Noble Corp (NE.N; US$36.61; 1); Seadrill Partners LLC (SDLP.N; US$30.36; 1)

Oilfield Services and Equipment: Top Buys

	Ticker	Rating	Price (12/9)	Target Price	Yield (%)	ETR (%)	2014E P/E	2014E P/BV	2014E ROE
Top Buys									
Halliburton	**HAL**	**Buy**	**$49.91**	**$59.00**	**1.20%**	**19.4%**	**12.5x**	**3.3x**	**22.4%**
Expected to deliver the strongest improvement in operating margins of the major diversified oil service companies in 2014.									
National Oilwell Varco	**NOV**	**Buy**	**$80.19**	**$95.00**	**1.30%**	**19.8%**	**12.9x**	**1.6x**	**11.4%**
Expected to deliver modest improvements in rig technology margins and to boost its dividend following the spinoff of its distribution services in mid-2014.									
Dresser-Rand	**DRC**	**Buy**	**$58.17**	**$66.00**	**0.00%**	**13.5%**	**16.6x**	**3.6x**	**18.8%**
Expected to succeed in reducing working capital in the year ahead, and to benefit from strong order inflows for compressors and turbines.									
Ensco International	**ESV**	**Buy**	**$59.78**	**$72.00**	**5.02%**	**25.5%**	**8.0x**	**1.1x**	**13.1%**
The stock seems deeply undervalued in the wake of several major dividend hikes, with good prospects for more to come.									

Source: Citi Research

Paper, Packaging & Forest Products

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Prefer Containerboard & Wood Products; Stay Selective on Packaging

- **We Prefer Containerboard & Wood Products in an Uneven Recovery** — We are most positive on containerboard and wood products producers heading into 2014. Homebuilding is one of the few end markets where we see sustained organic growth over the next 2+ years, while long-term secular shifts including the reduction of Canadian supply and rising Asian demand are favorable to US producer Plum Creek Timber (PCL). We believe PCL is also well-positioned to benefit from any up-tick in Southern log markets where prices are yet to recover to pre-recession levels, unlike the US West. In Paper, we prefer containerboard, where we see producers benefitting from balanced supply demand despite slightly elevated inventories the last 3 months. Moreover, recent capacity adds and export price weakness have shifted sentiment, presenting an attractive entry point as we believe the market will tighten in 1H '14 and producers trade at their cheapest relative EBITDA multiples over the last 2 years. We remain selective on Packagers where producers are mostly trading well above 10-year averages.

- **Four Strategies for 2014** — Preparing for another year of slow economic growth, we want investors to focus on the following strategies:

  – (1) **Buy timber and lumber producers with exposure to a multi-year US housing recovery**. Canadian supply reductions have begun to take hold in 2013 and should continue to tighten the North American market in 2014, while a recent pick up in traffic and order activity reaffirm our view that housing starts can return to a normalized pace over the next 2 years. We forecast US housing starts of 1.1M units in 2014 (+18% Y/Y) and a return to a mid-cycle level of 1.4M by 2015.

  – (2) **Containerboard valuations remain compelling while we believe elevated inventories and new capacity can be absorbed in 1H '14**. With price hikes fully flowing through, attention has turned to elevated inventories (4.1 weeks of supply vs. 3.8 week average) and recent capacity adds, which has caused reports of spot discounts by smaller producers in some geographies. We believe market leaders IP & RKT will continue to manage supply and work down excess supply by 1H '14. Producers IP, RKT and PKG are all trading below 10-year average EBITDA multiples with RKT and IP offering double-digit FCF yields.

  – (3) **Focus on rigid packaging producers with solid cash conversion (Top Pick BERY) or proven track records of capital allocation (BLL)** as we expect another year of sluggish economic growth. While we do see upside potential to food & beverage vols as commodity deflation from this year's robust crop harvest likely translates to lower retail prices (1% decrease in price = +1.5% vols), we believe stocks are already somewhat pricing this in with multiples well above 10-year averages. We are cautious on plastic packagers (SEE, BMS) and metal can producer SLGN given increased competitive pressures in their core end-markets.

  – (4) **Stay cautious on companies with high EM exposure,** including AVY, SEE, BMS & OI which all derive 20%+ of sales from developing regions. We saw several EM-related guidance cuts in 2013 & we are cautious further pressure could lead to a more meaningful earnings impact in 2014, especially with several companies coming up against challenging comps (SEE, AVY).

- **Positive on Containerboard Markets** — With elevated inventories and the ramp-up of new supply, investor attention has shifted to the supply side of

containerboard. We believe producers will tighten markets through either temporary downtime or potential capacity curtailments and see little downside risk to list prices. As such we believe this presents a buying opportunity for IP & RKT who are both trading at double-digit FCF yields, despite significantly de-risking their balance sheets the past 2 years which could enable stepped up cash return in 2014.PKG is our top-pick in containerboard as we do not believe the market has fully priced in the BZ deal which we estimate could be ~50% accretive to 2015 EPS.

- **Positive View on Wood Products Remains Non-Consensus** — Timber REIT PCL is poised to benefit as Canadian supply reductions start to take hold (could equate to ~400k housing starts worth of demand) forcing higher demand on US mills. This structural shift should benefit PCL as Southern lumber mills ramp up production which we expect to drive higher sawlog prices in the region where prices are yet to recover to pre-recession levels, unlike the US West. We think the Street is underestimating the potential for Southern sawlog price improvement as a return to 2000-10 average stumpage prices would provide 25%+ upside to our 2015 EBITDA estimate..

- **Tops Pick for 2014: BERY, PKG & PCL** — BERY is our Top Pick heading in 2014 as we see multiple catalysts to close the valuation gap with peers including improved execution and margin improvement in Flexibles (15% target vs. ~10% LTM), increased visibility into its new product pipeline and potential volume upside to management's guidance. PKG is our preferred containerboard producer as we expect the BZ acquisition to boost earnings in 2014-16, while the recent pull back in the stock offers investors an attractive entry point. Within wood products, PCL is our preferred name given high exposure to recovering Southern saw log markets (30%+ of sales) coupled with an attractive dividend yield (3.9%). Domtar is our least preferred name due to the company's leading position (~34% 2014E share, 64% of sales) in the secularly declining uncoated free sheet market as well as an expected pulp price downcycle in 2014. While we believe Domtar will benefit from IP's recent capacity closure, which will remove ~8% of N.A. freesheet capacity, we believe the good news is mostly priced in.

Paper, Packaging & Forest Products

	Ticker	Rating	Price (12/9)	Target Price	Yield (%)	ETR (%)	2014E P/E	2014E P/BV	2014E ROE
Top Buys									
Berry Plastics	**BERY**	**Buy**	**$22.00**	**$28.00**	**0.0%**	**27.2%**	**17.6X**	**NM**	**NM**
We see multiple catalysts to close valuation gap with peers in 2014; the company would be a primary beneficiary of any improvement in US food & bev vols									
Packaging Corp	**PKG**	**Buy**	**$59.87**	**$68.00**	**2.5%**	**14.1%**	**17.2X**	**4.5X**	**28.0%**
BZ deal to drive earnings growth in 2014-16 while recent pullback in the stock presents an attractive entry point									
Plum Creek Timber	**PCL**	**Buy**	**$44.84**	**$54.00**	**3.9%**	**24.4%**	**27.1X**	**5.8X**	**23.9%**
We think the street has underestimated the impact of recovering Southern sawlog markets and long-term structural changes to supply/demand									
Top Sells									
Domtar	**UFS**	**Neutral**	**$90.66**	**$94.00**	**2.4%**	**6.0%**	**11.5X**	**1.1X**	**9.4%**
We expect a softening pulp cycle to be a drag on earnings growth in 2014 while we believe the stock is pricing in favorable adjustments to uncoated freesheet markets									

Source: Citi Research

Other companies mentioned: Avery Dennison Corp (AVY.N; US$48.19; 2); Bemis Co Inc (BMS.N; US$38.83; 2); International Paper Co (IP.N; US$45.85; 1); Rock-Tenn Co (RKT.N; US$95.89; 1); Sealed Air Corp (SEE.N; US$31.45; 2)

Pharmaceuticals — Global

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Long-Term Growth Driven by Innovation; Immunotherapy Is a Key Theme

- **Positive Stance** — Despite the sharp re-rating in our key Buy-rated names in the US over the past few months, we continue to view the sector positively. Our stance is driven by the ability of the sector to improve R&D productivity through self-help, increasing externalization as well as the pro-science regulatory environment (especially in the US) allowing faster approvals of drugs. The reimbursement environment in the US is still relatively benign vis-à-vis other more capex-intensive sectors of the healthcare value chain (imaging / diagnostics, etc.). US pharma is trading at 15.4x 2015e EPS with a 9.7% 5 year EPS CAGR vs. EU pharma at 12.7x with a 9.5% CAGR, respectively. Our key Buy-rated names in the US are BMY and PFE. However, given greater relative valuation support, we have a strong preference for our Buy-rated EU names, namely Novartis, Roche and Bayer.

- **Immunotherapy Represents a $35bn Opportunity for the Industry** — Immunotherapy will become the treatment backbone of ~60% of cancers over the next decade (vs. 3% today), transforming many cancers into chronic diseases (see our report: **Immunotherapy – The Beginning of the End for Cancer**). We believe consensus estimates for immunotherapy, although rising, still reflect only a limited opportunity in the currently trialed indications (melanoma, renal and NSCLC). We see an opportunity of up to $24bn in revenue for checkpoint inhibitors, driven by: 1) expansion of indications to other solid tumors as well as to blood cancers; 2) increased market penetration with use of combination treatments (with other immunotherapies, small molecule TKIs, radiotherapy, chemotherapy); 3) increasing price per unit of therapy driven by combination pricing and 4) increasing treatment duration and potential for retreatment.

- **Shorter Development Time Has a Dramatic Impact on NPV** — A shorter development time leads to a 2x-3x higher EVA per drug. The unique characteristics of immunotherapy development are marked by: 1) faster development times due to accelerated FDA pathways, 2) lower attrition rates due to greater drug tolerability and efficacy and 3) smaller registration trials due to strong efficacy signal and use of biomarkers.

- **Winners in Immunotherapy** — We believe Bristol Myers and Roche are the best positioned in this emergent area, given their advanced portfolio of checkpoint agents and significant R&D expertise in oncology. We also like AZN's developing immunotherapy portfolio, which although early, appears inadequately reflected in the current stock price. Given the rapidly changing dynamics in this space, we advocate a basket approach to investing in this space. We have constructed an immunotherapy basket that can be found under the Bloomberg ticker CGRBIMMU.

Other companies mentioned: Pfizer (PFE.N; US$30.71; 1); AstraZeneca PLC (AZN.L; £34.33; 2)

Pharmaceuticals: Top Buys

	Ticker	Rating	Price (12/9)	Target Price	Yield (%)	ETR (%)	2014E P/E	2014E P/BV	2014E ROE
Top Buys									
Roche Holding AG	ROG.VX	Buy	SFr243.00	SFr280.00	3.3%	18.5%	14.4x	8.4x	57.7%
Potential for significant operating leverage from new product introductions, developing immunotherapy pipeline remains underappreciated.									
Novartis AG	NOVN.VX	Buy	SFr69.90	SFr83.00	3.6%	22.3%	13.7x	2.5x	14.4%
Restructuring/spin-off led shareholder value creation, underappreciated pipeline potential, especially LCZ696, CART19 and LEE011.									
Bayer AG	BAYGn.DE	Buy	€96.98	€110.00	2.2%	15.6%	14.8x	3.5x	19.2%
Operating leverage in pharma driven by new product introductions, continuing strength in crop science and return to profitability in MatScience									
Bristol Myers	BMY	Buy	$51.21	$55.00	2.8%	10.2%	24.5x	6.8x	26.0%
Dominant position in immunotherapy in the future given broad portfolio of checkpoint inhibitors. Major beneficiary through significant op leverage.									

Source: Citi Research

Pharmaceuticals — Specialty and Generic

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Strategic Change Remains Key Focus

- **Valuation Outlook Mixed** — While we remain bullish on the earnings growth potential for the industry, we note that current valuations have risen significantly, partly reflecting higher industry growth projections and also factoring in an M&A premium as assets are acquired. We favor companies that are undergoing strategic change and are focused on streamlining operations and value-enhancing business development. Specialty pharma trades at a '14 P/E of 16.7x (while offering a 0.3% dividend yield), while generic pharma trades at a '14 P/E of 13.6x (while offering a 0.7% dividend yield). We prefer Buy-rated Shire, Forest and Endo amongst the specialty pharma names, and Buy-rated Actavis and Teva amongst the generic pharma names.

- **We Have a Favorable Stance on the Multinational Generics Sector** – The industry should continue to diversify into higher value areas characterized by higher barriers to entry and limited competition, we believe, including complex generics, injectables, respiratory, biosimilars and specialty/branded products. We don't see any of the three US generics companies emerging as the clear "winner" with the respect to the incremental opportunities for diversification that lie ahead. We see each company as continuing to build scale in its core areas of competence, while opportunistically continuing to diversify in order to generate sustainable long-term growth as opportunities arise.

- **Generics Industry Valuation Reflects Transition into Higher Value Opportunities** – The re-rating of the sector over the past 12 months reflects the increase revenue and earnings momentum of the sector, we believe. The re-rating has been driven by a push by multinational generics into more complex products characterized by lower competition, as well as into higher margin, branded products. The sector trades at 13.6x forward earnings, vs. c.16x for the US large cap pharma sector. We see scope for a continued re-rating as diversification continues, however the discount vs. the pharma sector is justified, we believe, given the higher level of innovation, and consequently earnings growth of innovative pharma vs. generics.

- **Management Change Seen as a Positive Catalyst at Specialty Pharma Companies** – Investors have welcomed senior management changes at specialty pharma companies, which have typically been accompanied by strategic reevaluation leading to initiatives to drive down costs, accelerate business development efforts and engage in other shareholder-friendly measures. New management teams at Shire, Forest and Endo have refocused company efforts on enhancing profitability and accelerating growth. We believe this theme is likely to continue into 2014.

- **Cost Cutting Initiatives Drive Faster Earnings Growth in Spec Pharma Universe** – We project five-year (2013e-2018e CAGR) U.S. specialty pharma earnings growth of 9.9% growing faster than five-year sales growth of 6.0%, driven by ongoing measures to further cost and drive operating leverage. Shire, Forest and Endo have all announced cost-reduction initiatives, largely targeted at operating expenses.

- **Business Development an Important Growth Driver** – We continue to view business development as a meaningful growth driver for the industry, as companies continue to (i) seek growth opportunities; (ii) deploy excess cash and leverage the current low-cost financing environment. Specialty pharma

transactions are likely to target complementary therapeutic assets, augmentation of late-stage pipelines, and portfolio diversification to drive long-term growth, while the focus of generic pharma transactions is likely to involve more complex, higher barrier-to-entry generic assets and higher margin branded assets.

- **Tax Rate Restructuring Likely to Remain a Theme in the Global Specialty Pharma/Generics Space –** There has been an increased focus by pharma companies to restructure their tax rates recently. Recently, Actavis (in its acquisition of Warner Chilcott) and Endo (in its acquisition of Paladin Labs) have restructured their tax rates through all-stock deals and created an acquisition platform to plug in future assets into their lower tax structure. Additional companies in our coverage universe that could benefit from this structure include those with: (i) relatively high/increasing tax rates; (ii) a strategy that includes inorganic growth. Potential companies that fit these criteria include FRX (FY2014e effective tax rate of 23.2%), Mylan (2013e effective tax rate of 24.8%), and AGN (2013e effective tax rate of 27.0%).

Other companies mentioned: Allergan, Inc. (AGN.N; US$96.20; 2); Mylan Inc. (MYL.O; US$41.74; 2)

Pharmaceuticals — Specialty and Generic: Top Buys

	Ticker	Rating	Price (12/9)	Target Price	Yield (%)	ETR (%)	2014E P/E	2014E P/BV	2014E ROE
Top Buys (Specialty Pharma)									
Shire	**SHP.L**	**Buy**	**£27.31**	**£32.00**	**0.4%**	**17.6%**	**14.3x**	**11.4x**	**48.5%**
Continued re-rating justified as stock still trading at a discount to the peer growth (14.3x 2014e earnings vs. 16.7x for the peer group), despite above-average growth profile (8.4% and 13.8% 5-year sales and earnings CAGRs vs. 6.0% and 9.9% for the peer group).									
Forest	**FRX**	**Buy**	**$56.44**	**$70.00**	**0.0%**	**24.0%**	**38.9x**	**2.7x**	**4.4%**
Earnings potential from Project Rejuvenate and strategic upside not fully reflected in current valuation.									
Endo	**ENDP**	**Buy**	**$65.90**	**$70.00**	**0.0%**	**6.2%**	**15.1x**	**6.1x**	**32.7%**
Transformation to continue as the company poised to continue targeting accretive deals aggressively following recent Paladin acquisition and Irish redomicile.									
Top Buys (Generic Pharma)									
Actavis	**ACT**	**Buy**	**$166.16**	**$180.00**	**0.0%**	**8.3%**	**12.9x**	**5.7x**	**21.0%**
Earnings upside from substantial synergies from Actavis and Warner Chilcott acquisitions, in addition to execution on continued business development opportunities.									
Teva	**TEVA**	**Buy**	**$40.15**	**$47.00**	**3.2%**	**20.3%**	**8.3x**	**1.4x**	**12.4%**
Presents attractive risk – reward as floor valuation reflects CEO and Copaxone uncertainty and fails to fully value ex-Copaxone earnings potential.									

Source: Citi Research

Real Estate Investment Trusts (REITs)

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Losing Jet Fuel but Not All of the Sparks

- **The REIT Pullback Has Been Largely Interest Rate Driven** — REITs have long benefitted from declining interest rates driving cap rate compression, lifting NAVs and commensurate share prices. The recent rise in rates has caused REIT stocks to pull back ~15% since late May and considerably underperform the broad market. This has also led to some self-fulfilling beliefs that REITs simply "can't work" in a rising rate environment despite historical evidence to the contrary. With the backdrop of higher rates 12 months from now, generating interest for the group is increasingly difficult. **However, we believe REITs can still produce reasonable and positive total returns and withstand a moderate rise in rates, with a number of "sparks" that can lead to increased cash flows and value creation as discussed below.**

- **From a Property Sector Perspective** — We are overweight regional malls, multifamily, lodging, select CBD office and some "specialty" stocks. We are underweight healthcare, net lease, self-storage and shopping centers. Some of the key overweight positions in our REIT model portfolio include: **BXP, DFT, ELS, GGP, HME, HOT, HST, LHO, PPS, SKT, SPG** and **VNO**.

- **The Bull Case** — The bull case for REITs is underperformance on interest rate concerns is only temporary. Interest rates are likely to move higher, but this is well understood and factored into private market pricing. A stronger economy in 2014 would mean better real estate fundamentals (i.e. stronger rent growth) and greater availability of capital, both of which are positive for real estate and could mitigate the impact of higher rates.

- **The Bear Case** — The bear case is the stocks are leading indicators and are correctly pricing in what will be a rise in private market cap rates over the next 12-18 months. We tend to fall in the more bullish camp, as REITs have worked in prior tightening cycles (i.e. 2004-06), but recognize every cycle is different and understand rising rates can be a powerful force both in perception and reality.

- **Cap Rates Should Remain Sticky** — We agree that the cap rate compression portion of the real estate cycle is likely over and that, longer term, cap rates may have an upward bias. This view is implicitly shared by some well-respected management teams — who have become net sellers of assets — as well as the recent slew of IPOs. However, we also believe that current cap rates will be "sticky" for the foreseeable future, and that has certainly been the case since May. This should allow commercial real estate values to continue to rise, albeit at a slower pace than the last few years, as the benefits of an improving economy feed into results (i.e. higher rents, occupancies, development value creation, etc.). Looked at another way, we view the current environment as more akin to 2004 – when REITs were poised to benefit from an improving economy – than 1997 – when REITs were about to fall dramatically out of favor.

- **REITs Are More Than Just a Collection of Assets** — Most REITs operate dynamic businesses that can create value through improving operations, refinancing accretively, investing capital wisely and harvesting value when appropriate. All these remain "**sparks**" and tailwinds for the sector - even as interest rates rise. These include: (1) operating fundamentals remain solid across most sectors and we expect same store NOI growth of ~3.0-3.5% in 2014. (2) The average cost of REITs maturing debt over the next two years (at ~5%) remains higher than current and forecasted rates and offers the ability to refinance accretively, increasing cashflows. (3) REITs continue to create value from external growth with redevelopment and development investment opportunities. (4) The private market remains active, allowing companies to raise capital and take advantage of what are "stickier" cap rates. (5) Supply - while off

its lows - remains at extremely low levels and supportive of continued gains in occupancy and rental rates.

- **M&A Could Provide a Catalyst or at Least Backstop for Valuations** — We think REIT valuations have become increasingly attractive over the last several months. The stocks have dramatically underperformed on concerns over rising interest rates, with implied cap rates increasing. At the same time, private market cap rates have held relatively firm, particularly for higher quality assets. This has led to some compelling NAV discounts across a number of property sectors, begging the question, "when will capital step in and take advantage of the private/public arbitrage?" At the very least, NAVs help provide a backstop to weaker share prices, in our opinion.

- **Building Blocks to Positive Total Return** — We believe REITs could still produce a positive total return, even if cap rates were to expand – as REITs' NAVs grow from increases in retained free cash and net operating incomes (or NOI). Clearly changes in the macro environment remain a key risk, and with significant uncertainty with government stimulus/interest rates, economic growth, and unemployment – volatility is likely to continue.

- **Stock Selection Remains Key** — We believe stock selection is paramount in this phase of the cycle – and we recommend those stocks that we believe can create value absent a change in cap rates. Our model portfolio continues to have a bias toward the large caps and "blue chips" which continue to trade "cheap" to small and mid-caps relative to history. Some of the key overweight positions in our REIT model portfolio include: **BXP, DFT, ELS, GGP, HME, HOT, HST, LHO, PPS, SKT, SPG,** and **VNO**.

Other companies mentioned: DuPont Fabros Technology Inc (DFT.N; US$23.07; 1); Equity Lifestyle Properties Inc (ELS.N; US$35.74; 1); General Growth Properties (GGP.N; US$20.49; 1); Home Properties Inc (HME.N; US$53.69; 1); Starwood Hotels & Resorts (HOT.N; US$73.21; 1); LaSalle Hotel Properties (LHO.N; US$29.46; 1); Tanger Factory Outlet Centers Inc (SKT.N; US$31.85; 1); Vornado Realty Trust (VNO.N; US$87.35; 1)

REITs: Top Buys and Sells

			Price	Target	Yield	ETR	2014E		
	Ticker	Rating	(12/9)	Price	(%)	(%)	P/FFO	P/AFFO	Implied Cap Rate
Top Buys									
Boston Properties	**BXP**	**Buy**	**$102.00**	**$128**	**2.5**	**28**	**19.4**	**27.2**	**5.4**
We favor BXP based on attractive relative valuation and the potential for outsized growth through 2014, which seems underappreciated by the market.									
Host Hotels & Resorts	**HST**	**Buy**	**$18.55**	**$21**	**2.6**	**15.8**	**13.2**	**15.3**	**7.9**
We see HST as well positioned to outperform, based on reasonable valuation and positive lodging industry supply/demand dynamics. HST has historically outperformed during interest rate tightening cycles.									
Post Properties	**PPS**	**Buy**	**$46.16**	**$58**	**2.9**	**28.5**	**16.7**	**19.4**	**6.2**
We like PPS given its attractive valuation, solid growth, strong balance sheet and accretive development pipeline.									
Simon Property Group	**SPG**	**Buy**	**$153.74**	**$190**	**3.1**	**26.6**	**16.0**	**19.2**	**5.5**
We favor Simon's solid balance sheet, strong internal growth drivers, solid redevelopment pipeline, and discounted valuation.									
Top Sells									
Equity One	**EQY**	**Sell**	**$22.6**	**$21**	**3.9**	**-3.2**	**17.9**	**21.6**	**5.9**
Management has done a great job improving the quality of the portfolio, but we view the valuation as rich given more work to do.									
Realty Income	**O**	**Sell**	**$37.33**	**$27**	**5.8**	**-21.9**	**14.6**	**15.0**	**6.4**
Shares continue to trade at a large premium to NAV even as asset cap rates remain fairly steady and increasing cost of capital squeezes investment spreads.									

Source: Citi Research

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Retailing/Specialty Stores Softlines, & Luxury

Buy Expensive (KORS) or Defensive (TJX, LB) Specialty Retail Stocks

- **OC's Strategy for Making Money in 2014, Different Strokes for Different (Risk) Folks** — Choose your own adventure. We bucket our investment ideas into: (1) Expensive Buy stocks which we like: KORS and ULTA, (2) Defensive Buy stocks that we like: TJX and LB, and (3) Growth at a reasonable price and recovery opportunities: COH.
- **How to Choose It… Go Expensive for Sequential Momentum and Prime Differentiation, Go Defensive with Time-Tested Robust Business Models with Less Fashion Risk** — We like ULTA and KORS despite expensive valuations because we see differentiated retail ideas with impressive comps, and store growth which is better than normal apparel retailers, in our view (e.g.15-20% at ULTA vs. sector ~7-9%). We like defensive stories given volatility in weather, traffic, and promotional environment. We're particularly impressed by TJX, which has only had a single negative quarterly comp since 2007, and has utilized efficient buying platform to expand customer base. Finally, we view COH as a great GARPY stock with greater upside toward May/June but strong shareholder returns. We continue to be cautious about teen retailers ANF and AEO and also VRA given aggressive promotional environment, lack of store growth opportunities, and risk of notable margin deleverage.
- **A New Caution: More Retail Fears Coming in 1H with Higher Healthcare Premiums?** — Some retailers are concerned that a spike in healthcare premiums will directly and negatively impact discretionary spending in 1H, which we believe could have a widespread negative impact on many specialty retailers in our coverage. According to our Managed Care team, we expect premiums to rise ~2-3% as a result of the universal healthcare program in addition to the 3-4% regular premium increases over the past few years. Generally, employers have passed on a majority of the costs, and it's possible that this would negatively impact discretionary stocks. We do believe value oriented companies like ULTA, TJX, and LB are best positioned for a tough 1H14.
- **Buy Rated "Expensive" Growth Ideas, ULTA and KORS:**
  - **Elevated Risk But Still Generating 15+% Comps, Buy KORS** — Differentiated market position given designer styling but value pricing, high fashion credibility, and key item success continues to impress and informs our view of a 30%+ long-term EPS CAGR. Comps in FY2013 were 40% and we estimate they will be 22.4% in FY14. KORS management recently noted that Michael Kors brand fashion watches have the #1 market share, and is working toward having the #1 share in fashion jewelry. SLGs (small leather goods) are one of the biggest comp drivers (according to management) and we believe the competitive pricing vs. peers gives KORS leadership among a younger demographic.
  - **What Other Retailers Are Growing Square Footage at ~+15%? Buy ULTA** — We acknowledge valuation improvement may require time given elevated promotional environment, a new CEO, traffic volatility, and the execution of incremental promotion. However, we continue to feel that ULTA is a great growth concept that is benefitting both from a transition in beauty distribution, and also a growing beauty industry. We also have confidence that ULTA's new CEO has great initiatives including e-commerce growth from 2-3% currently to 8-10% over time, better targeted marketing through CRM, and

potentially expanding ULTA's salon business from current ~5% percent of revenue given the high profitability.

- **Defensive Buys, TJX a LB:**
  - **Buy Defensive TJX Which Offers Built In Value Ideas** — We continue to be very constructive on TJX given the consistent value messaging, growth of the e-commerce segment, strong comp performance & margin expansion possibilities in Europe & impressive store growth opportunities globally. We believe growth in Europe, margin expansion potential, and long term benefits are justification for a higher P/E multiple vs. competitors. Additionally, TJX continues to see positive traffic and comps despite a challenging environment.
  - **Consistent Positive Performance & Price Growth, Buy LB** — We view LB as an impressive, consistent performer. LB's comp has consistently outperformed many apparel retailers and continues to work on margin improvement, product innovation, supply chain efficiencies, and is rolling out a higher productivity sales model. We also see upside with LB's line extensions into PINK, VSX, and expansion of lingerie into more stores.
- **Our "Recovery" Stock Pick… Growth at a Reasonable Price Which Isn't a Value Trap, in Our View:**
  - **Buy COH, Growth Still at a Reasonable Price: We Do Believe COH Is on The Path To Improvement** — We believe better than expected comps will drive the stock higher during 2014. COH's recent push to transition the brand into a lifestyle brand will likely benefit the COH's LT positioning, and faster than we expected. The company has already launched footwear (increasing penetration from 4%- 8% in 1Q), trendy handbag silhouettes, and has started to reposition the watch selection with fashion watches at more competitive prices (~$100 less vs. prior). We believe COH's potential creative director will likely lead the brand in a new direction which will shape the new appearance.
- **Potential Risks** — Key questions for us: Will mall retailers ever lower promotional levels? Will teen retail continue to face intense competition from fast fashion? Will watches continue to grow? Is the Michael Kors brand a fad? Can Coach be a lifestyle brand? Are LB and TJX too expensive for additional growth?

Other companies mentioned: American Eagle Outfitters Inc. (AEO.N; US$14.14; 2)

Specialty Retail: Top Buys and Most Cautious Neutrals

	Ticker	Rating	Price (12/9)	Target Price	Yield (%)	ETR (%)	2013E P/E	2013E P/BV	2013E ROE
Top Buys									
Ulta Salon & Fragrance	**ULTA**	**Buy**	**$90.21**	**$123**	**N/A**	**28%**	**23.2x**	**6.2x**	**23%**
Margin Upside from Increased Prestige Product in Mix, E-comm Driving Topline Growth, & Greater Penetration in Salon Segment									
TJ Maxx Companies	**TJX**	**Buy**	**$62.06**	**$68**	**0.93%**	**9%**	**19.1x**	**10.7x**	**56%**
Positive Traffic Trends, Wide Demographic Appeal, Superior Inventory Mgmt. and Higher Marketing Spend Driving Share Gains									
Michael Kors	**KORS**	**Buy**	**$80.61**	**$95**	**N/A**	**19%**	**23x**	**11.9x**	**44%**
Healthy Growth and Performance Across All Segments, Strong Product Selection, $1.0Bn Opportunity in Europe and Men's									
Coach, Inc.	**COH**	**Buy**	**$56.06**	**$63**	**2.41%**	**11%**	**14.6x**	**6.6x**	**39%**
New Silhouettes, & Early Strength of Watch Repositioning are Positive Signs of Transition to a Lifestyle Brand for an Inexpensive Valuation									
L Brands, Inc.	**LB**	**Buy**	**$62.09**	**$67**	**1.93%**	**13%**	**17.4x**	**N/A**	**N/A**
Iconic Brands, Excellent Mgmt. Team, Strong Supply Chain, & Solid Shareholder Returns Make LB Appealing to Own									
Most Cautious Neutrals									
Abercrombie & Fitch	**ANF**	**Neutral**	**$34.10**	**$37**	**2.35%**	**6%**	**14.7x**	**1.55x**	**6%**
Heightened Competition/Promotions Hurting GM and Leading to Lower Comps, But Opportunity for Improvement in Women's Tops, Supply Chain and International Expansion									
Vera Bradley	**VRA**	**Neutral**	**$23.44**	**$20**	**N/A**	**-14%**	**14.4x**	**4.34x**	**26%**
Differentiated Brand with Uncertain Customer Traffic But Opportunities For New Product, Improved Inventory Management, and Rationalization of Indirect Chain									

Source: Citi Research

Retailing – Hardlines

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We Remain Bullish on Housing Exposure Names and Differentiated Retailers with Omni-Channel Capabilities

- **Current Sector View and Key Themes for 2014** — We remain cautiously optimistic on the hardline retailers against a slowly improving macroeconomic backdrop. In particular, we are selectively bullish on industry segments with secular growth: home furnishings, home improvement and sporting goods retail. While there has been square footage reduction to address excess capacity and consolidation within the office supply space in efforts to achieve synergies and cost reduction, most hardlines retailers continue to face secular challenges including competition from both brick & mortar (B&M) and online retailers, product commoditization, and still high excess square footage. We believe retailers that have 1) invested heavily in omni-channel capabilities, 2) differentiation through exclusive products, 3) strong balance sheets, and 4) exposure to housing are best positioned for outperformance in 2014.

- **Expecting Comps of +LSD (+3.6%) in 2014** — We are looking for SSS of +3.6% for the hardlines group driven mostly by retailers with housing exposure, partially offset by continued secular challenges in the office supply space and more price-conscious consumers. We expect home improvement and home furnishings retailers to achieve the highest SSS among hardlines at +6.9% and +6.2% on average, respectively. Our optimism is driven by the ongoing consumer trend of spending on the home (~furniture, kitchen) as the recovering housing market improves personal wealth. We are also constructive on sporting goods retail (DKS) with expectation of SSS +4.5% on trend right inventory, and contribution from accelerated growth in differentiated shop-in-shops, and e-commerce. We expect the mild summer and ongoing weakness of the low end consumer to weigh on automotive aftermarket retailers, with expectation for SSS growth of +2.7%. We have a more positive outlook for consumer electronics (BBY) with anticipation for comps of +1.5% on lapping of easy margin and comp comparisons, contribution from e-commerce, comp lift from shop-in-shops (~Samsung Experience Shop and Microsoft), and share gains in appliances. Despite the ODP/OMX merger and likely further store closures, we estimate SSS of (-0.4)% in 2014 for office supply retailers on 1) large box size and excess square footage, 2) lack of pricing power, and 3) loss of market share to both online and other B&M competition.

- **2014 Retailing/Hardlines Drivers** — In-line with recent trends, we expect industry growth drivers in 2014 to come from: 1) y/y improvement in housing market, 2) market share gains from product exclusivity and differentiation, and 3) return of shareholder capital through dividends and share repurchases.

- **Key Risks in 2014** — We believe risks to our outlook include: the health of the consumer who is becoming more price conscious, macro considerations like Obamacare, effectively competing with online retailers and the impact to margins, supply chain and integration issues.

- **New Product Cycle Could Be a Game Changer Within Consumer Electronics** – We think the recent launch of Xbox One and Playstation 4 could be the dawn of a new multi-year product cycle, likely to provide tailwind to sales and comps at consumer electronics retailers. Sony's Playstation 4 launched on November 15th and the company has reported over 1 million units sold on the

first day. Similarly, Microsoft launched its new Xbox One console this past Friday (Nov. 22nd) and has also reported selling 1 million units on launch day. The new console prices of $399 for PS4 and $499 for Xbox One compare against the previous launch prices of $499 (for a 20GB, $599 for a 60GB) PS3 and $299 (for a core, $399 for a "premium") Xbox 360.

Best Buy's recent problems relating to the steady chain of consecutive negative comp quarters relate to both an increase in online competition and the lack of a hot product to reinvigorate sales. In the near term, the release of the next generation video game consoles (Playstation 4, Xbox One) should provide a solid lift to BBY's video game category (although will not contribute much to gross margin). Looking at GameStop's (GME) new hardware and software sales per store over the last few years shows how depressed the video game industry was late into the Playstation 3/Xbox 360 cycle.

- **Top Picks: WSM and DKS** — We reiterate our Buy rating on WSM based on: 1) sooner than-expected turnaround in the WSM banner (~on product exclusivity/innovation, marketing, and customer engagement), 2) ongoing product differentiation and merchandising sales lift, 3) accretive impact of mix shift towards direct-to-consumer (~driven by growth of e-commerce), 4) an attractive long-term runway for international growth (WSM recently expanded into Australia and UK markets), and 5) a strong balance sheet with increasing cash returns to shareholders in the form of dividends and share repurchases (~2% dividend yield). As a reminder, WSM is on Citi's U.S. Focus List.

  We are also constructive on DKS due to: clean inventory, and contribution from accelerated growth in shop-in-shops, contribution from investments in e-commerce, potential normalized winter, and higher share repurchases.

Other companies mentioned: Best Buy Co Inc (BBY.N; US$40.11; 1); Office Depot Inc (ODP.N; US$5.26; 2); Sony (6758.T; ¥1,818; 2)

Hardlines: Top Buys and Sells

	Ticker	Rating	Price (12/9)	Target Price	Yield (%)	ETR (%)	2013E P/E	2013E P/BV	2013E ROE
Top Buys									
Williams-Sonoma, Inc.	**WSM**	**Buy**	**57.80**	**$67**	**2.1**	**15.9**	**20.1**	**5.4**	**24.4**
Exposure to an improving housing market, likely conservative guidance, and its longer term international growth story.									
Dick's Sporting Goods, Inc.	**DKS**	**Buy**	**55.60**	**$66**	**0.9**	**18.7**	**20.9**	**3.8**	**19.8**
Outperformance from trend right inventory, and differentiation and contribution from accelerated growth in shop-in-shops (Nike, Under Armour, Footwear Shared services), and e-erce									

Source: Citi Research

Semiconductor Capital Equipment

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Constructive on Record $36B +26% Y/Y C14 WFE Outlook; AMAT #1 & KLAC #2 Picks

- **Above Consensus C14 WFE View —** We maintain our C14 $36B WFE (+26% Y/Y) vs. Street's $33B (+16% Y/Y) view based on our top spender model entering 2014. Near-term, we believe improving 20nm foundry bookings led by TSMC and Samsung China Xian NAND fab ramp bodes well for strong +25% qq Dec-Q WFE with flat to up Mar-Q. Longer-term, we continue to believe ARM-Intel FinFET foundry competition and rising 3D NAND memory adoption sustains WFE spend at elevated +$30B levels. DRAM spending should remain stable on modest mobile DRAM growth and EUV adoption for 2015 volume production.

- **Higher C14 Spend Growth Supported by GDP Correlation Work —** Our regression analysis shows that global GDP change Y/Y shows strong correlation with semi capex spend or ~0.91 RSQ. Citi's 2013/14 global GDP of 2.4% /3.1%, implies semi capex could grow +26% Y/Y or in-line with our top spender WFE predicted growth.

- **Multiple Expansion:** Big three US equipment stocks (AMAT, KLAC, LRCX) are trading at 12x average P/E on our C14 EPS vs. historical 13-14x P/E range at prior peak WFE spend levels. We expect secular growth driven by higher device complexity (3D-NAND, FinFET etc) and 450mm wafer size migration to drive further multiple expansion for the group next year.

- **AMAT #1 Pick:** AMAT is our #1 semi cap pick as a) core semi business is poised to strengthen into 2014 on FinFET and 3D NAND technology inflections, and b) catalysts around the Tokyo Electron merger sets the stock up well next year. We expect investor attention to be on regulatory approval, closure timing, and analytics around the pro-forma earnings model, which call for $2.40 in '17, but could have upside. Our preliminary pro-forma analysis indicates C15 EPS of $1.63 or 6% / 17% above our/Street current EPS of $1.54/$1.39.

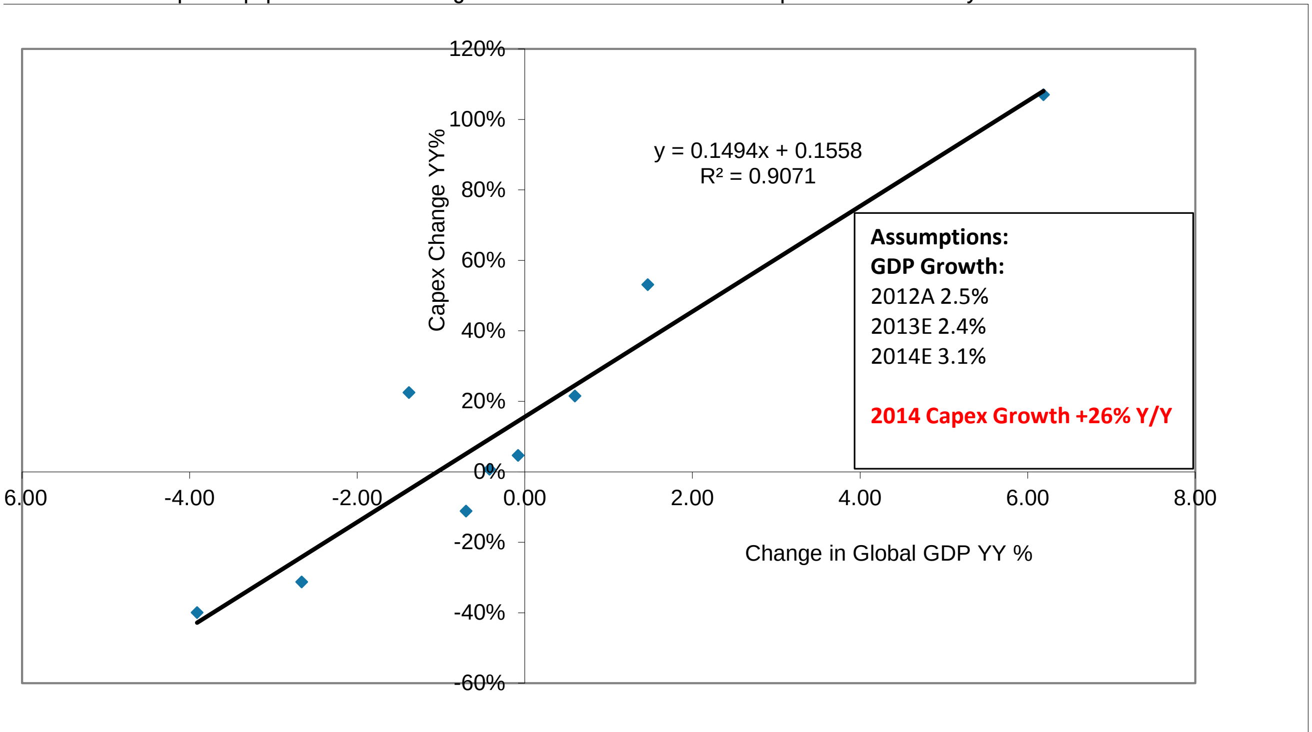
- **KLAC #2 Pick:** KLAC should outgrow the sector on higher share of WFE/segment helped by: a) outsized exposure to the foundry/logic driven capex spending in 2014, b) rising inspection equipment capital intensity at 20nm/16nm nodes driven by device shrink, complexity, and yield issues, and c) potential margin expansion from more software loaded yield enhancement solutions at leading edge technologies.

Semiconductor Capital Equipment Sector: Top Picks

	Ticker	Rating	Price 12/9/2013	Target Price	Yield %	ETR %	C2014E P/E	C2014E P/BV	C2014E ROE
Top Buys									
Applied Materials	**AMAT**	**Buy**	**$16.81**	**$20**	**2.3%**	**21%**	**13.6**	**2.4**	**19%**
Tokyo Electron deal catalysts like regulatory approval, closure, and analytics around pro-forma model should move the stock higher next year.									
KLA-Tencor	**KLAC**	**Buy**	**$62.62**	**$70**	**2.6%**	**14%**	**12.9**	**3.5**	**29%**
KLAC should outgrow the sector on higher inspection equipment spend per $ of wafer fab equipment spend.									

Source: Citi Research, FirstCall

Semiconductor Capital Equipment Sector: Change in Global GDP YY vs. Overall Capex Growth YY Analysis



Source: Citi Research, Company Reports

Semiconductors

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Remain Selective as Downside Risks to Estimates Exist

- **In the Midst of a Mid-cycle Correction** — Our takeaway during 3Q13 earnings season, and still now, is that the slope of the chip cycle is simply not as steep as consensus had originally anticipated. Further evidence of this came from press commentary by Morris Chang (the Chairman of Taiwan Semiconductor) in which he stated the inventory correction he had previously expected to end in 4Q13 would instead take another quarter to complete. While not altogether surprising (Citi's Roland Shu already models TSMC's utilization rates to fall in 1Q14), it underscores that the industry is in a mid-cycle correction. To be sure, we continue to expect positive growth for 2014 (Citi models 4.4% revenue growth across its coverage universe vs. consensus 7.9%), suggesting the cycle has not reversed.

- **Semi Estimates are Still at Risk…** — As we outlined in a recent note (see: The First Cut is the Deepest, but the Second One Still Stings), we are concerned that 4Q13 / 1Q14, as well as 2014 consensus estimates remain above seasonal. Specifically, 4Q13 semi consensus revenue growth (ex-memory) remains above normal seasonality by 1.8% - 2.7% q/q. Moreover, at +7.9% y/y, 2014 consensus revenue growth is above S&P 500 (+4.4%), information technology (+5.4%), and implied semi revenue growth based on seasonal patterns (+3.6%). Facing the prospect of further cuts in consensus estimates, it is difficult for us to imagine material upside for semi stocks relative to the broader market.

- **…Although Recent Commentary Turning Cautiously Optimistic** — At their regularly scheduled mid-quarter update, TI indicated order, geographic, and end-market trends are all tracking within expectations, and that channel inventories are not expected to change quarter-over-quarter. This echoes the cautiously optimistic tone in recent comments from other chipmakers that helps to ease our concerns somewhat.

- **We Remain Selective Within the Group** — When then considering that our dependable upward/total estimate revision ratio is sitting at 36.5%, within the 20% - 40% range that historically signals buy, we believe downward estimate revisions exiting 4Q13 may create opportunities in 1H14, particularly after factoring in seasonal performance patterns of the SOX. Within the group, we continue to favor names benefitting from long-term themes: MU (memory); ALTR, XLNX, FSL (wireless infrastructure). We are also constructive on INTC in light of the stabilizing commercial PC market which should provide a more solid footing to 2014 estimates. We continue to avoid BRCM, QCOM (smartphones) and AMD (heavy exposure to client PC's).

- **PC Demand Stabilizing** — We recently upgraded Intel to Buy from Neutral. Our upgrade reflects increasing evidence that corporate PC demand (49% of PC base) has stabilized, providing more limited downside to Intel estimates. And while consumer PC demand, particularly in emerging markets, remains a source of weakness, we believe Intel's guidance for 2014 is sufficiently conservative to minimize downside and even leave room for upside. This adds confidence to our cash flow estimate for Intel, creating potential for a dividend increase in 2014 (there was none in 2013). To be sure, with holiday sales still ahead, some risk to NT estimates exists. But with Intel's upward/total revision ratio at 31%, and the shares under-performing the S&P500 by 570bps since the 11/21 analyst day, we

suspect this is factored into the current share price. When considering Intel's 13% discount to the market multiple (again on firmer earnings), we are incrementally encouraged about the potential for share appreciation.

Other companies mentioned: Advanced Micro Devices (AMD.N; US$3.69; 2H); Broadcom Corporation (BRCM.O; US$28.04; 2); Freescale Semiconductor Holdings, I Ltd (FSL.N; US$14.33; 1H); Qualcomm Inc (QCOM.O; US$72.78; 1); Texas Instruments Inc (TXN.O; US$42.47; 1)

Semiconductors: Top Buys

	Ticker	Rating	Price (12/9)	Target Price	Yield (%)	ETR (%)	2014E P/E	2014E P/BV	2014E ROE
Top Buys									
Micron Technology Inc	**MU**	**Buy/High Risk**	**$23.12**	**$30.00**	**0.0%**	**29.8%**	**9.0**	**1.7**	**24.9%**
Consolidating industry trends make us positive on the near term pricing environment, particularly given our expectation for lower bit growth for both NAND and DRAM in 2014									
Xilinx Inc	**XLNX**	**Buy**	**$44.24**	**$52.00**	**2.3%**	**19.8%**	**19.7**	**3.3**	**19.8%**
Xilinx should benefit from 4G China wireless infrastructure spending. PLDs meaningfully outperformed the broader chip industry during the last 3G wireless build-out in China.									
Altera Corp	**ALTR**	**Buy**	**$31.85**	**$41.00**	**1.3%**	**30.0%**	**21.5**	**2.5**	**12.5%**
Altera should benefit from 4G China wireless infrastructure spending. PLDs meaningfully outperformed the broader chip industry during the last 3G wireless build-out in China.									
Intel Corp	**INTC**	**Buy**	**$24.93**	**$28.00**	**3.5%**	**15.8%**	**14.2**	**2.1**	**15.2%**
With increasing evidence that corporate PC demand is stabilizing, we believe Intel's guidance for 2014 is sufficiently conservative									

Source: Citi Research

Software

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Expecting the High Fliers to Set the Tone in 2014

- **Extreme 2013 leaves likely mixed 2014 set-up** — "Risk on" and "winners take all" sentiment in 2013 drove growth valuation to extremes while anything controversial was left as a loser. We expect investors will continue to reward growth and for those that can maintain growth at ~2013 levels, multiples will contract less than growth will compound, driving outperformance. Additionally, **if** US-led macro recovery continues (Citi 2014 US GDP +2.7% vs. 2013 at +1.7%), we expect "growth wealth" to be spread amongst those that share in its acceleration (CTXS well positioned here as are SAP and QLIK). If macro continues to bounce along the bottom with GDP below forecasted rates, then growth will likely remain scarce, and the narrow group of hyper-growers will continue to be rewarded (NOW, WDAY, etc.).

- **Do the legacy become even more legacy?** — 2014 is likely a critical year for the three mega caps (MSFT, ORCL, SAP), although all for different reasons. After two years of significant changes in the sales organization at Oracle, we expect more stability in FY14, driving more consistent results. This, combined with a new database, should be a catalyst for the stock. MSFT looks more binary to us with an outsider as a new CEO being a positive catalyst, although it may be overly simplistic to think an outsider would shed businesses or streamline the company in the near term. For SAP, the company is signaling that it will push more aggressively to cloud, although it is still not clear to us what that strategy is (other than SaaS acquisitions) and thus we expect investors may remain skeptical. If SAP can get through this transition and a reset of medium-term targets, the stock may set up better as its applications franchise is amongst the stickiest in enterprise tech.

- **Will valuation matter again in 2014?** — In 2013, the theme was growth at any price and 20x revenue became the new high watermark as several new companies saw their market caps eclipse former mid-caps. Valuation has escalated to the point we don't believe most investors understand the embedded expectations associated with 20x revenue and the law of large numbers will find victims in 2014 (WDAY would be our concern). We expect in 2014 a more narrow separation of companies that can justify hyper-premium valuation. We view GWRE as most vulnerable, although NOW and WDAY have to prove growth is sustainable as well.

- **SaaS is now mainstream, platform becomes greater focus** — SaaS is now gaining significant share of most packaged application categories. We still believe there is money to be made owning SaaS as adoption continues to escalate. At the same time, we expect the platform as a service (PaaS) market will see an uptick in adoption in 2014 and begin to take some share in the "customer-developed" (non-packaged) apps market. We expect the driver to be significant adoption of SaaS, which drags with it a platform that can be used in custom apps. We expect the winners here are CRM, NOW and MSFT. For MSFT, position in PaaS could help re-focus investors away from challenges in PC-exposed markets.

- **Public cloud debate turns to shades of gray** — In 2013, sentiment was "it is all going to the cloud". We think in 2014 there is more likely a debate around "what", "how" and "when / how fast". We expect the prevailing sentiment to remain that public cloud infrastructure takes significant share over the next 305 years with Amazon's AWS a winner. However, we expect investors to begin to appreciate more the complexity of moving existing applications to cloud architectures and the pace of this application migration will become more central to the cloud discussion. We expect the notion of "hybrid" architecture will move front and center putting into the spotlight Microsoft's Azure service. We expect

the debate around OpenStack traction to continue well into 2014 with still more discussion than deployment (RHT is levered to O/S). At the same time, VMware, which has been late to market with its hybrid architecture must deliver on-time with public cloud services (vCHS) in Q1.

- **On-prem infrastructure continues to commoditize and consolidate** — Compute has been well consolidated and has commoditized at the hands of x86 virtualization. In 2014 the software-defined network (SDN) battle will heat up with VMware NSX in the market and architecturally opposite to Cisco's ACI. Significant design wins for VMware would be a catalyst, while even this isn't likely to bring significant revenue. Security sits at the cross-roads here and we expect companies that have strong relationship with VMware (PANW) or software-based solution (CHKP) can benefit in terms of market share. Storage remains behind network in the eyes of most investors. However with an expected mid-year vVols API release from VMW that could change this market and enable VMware to drive revenue form software-defined storage, potentially faster than SDN.

- **Self-help stories continue as a focus** — As macro debate is unsettled, we expect investors will continue to gravitate towards companies that can drive earnings growth or visibility through improvements / optimization of business independent of the macro / market. Candidates here include ADBE, SYMC and CA, while MSFT may be added to the list. We believe ADBE is in later innings as we enter 2014, but with consensus underestimating FY16 earnings power, we believe shares can outperform. SYMC has significant potential to drive margins while CA faces more hard work to re-ignite growth. Previous "self help" story VeriSign has played out and we have some concern investor expectations around capital return and margin leverage are too high.

Other companies mentioned: Adobe Systems Inc. (ADBE.O; US$54.25; 1); Amazon.com, Inc. (AMZN.O; US$380.17; 1); CA Inc. (CA.O; US$32.44; 2); Cisco Systems, Inc. (CSCO.O; US$20.57; 3); Microsoft Corp. (MSFT.O; US$37.36; 1); Palo Alto Networks, Inc. (PANW.N; US$51.78; 2H); Red Hat, Inc. (RHT.N; US$46.32; 2); VMware, Inc. (VMW.N; US$85.42; 2); Verisign, Inc. (VRSN.O; US$56.34; 2); Workday Inc (WDAY.N; US$78.59; 2); Citrix Systems, Inc. (CTXS.O; US$57.26; 1); SAP AG (SAPG.DE; €58.80; 2); CheckPoint Software Technologies, Inc. (CHKP.O; US$59.84; 1)

Software: Top Buys and Sells

			Price	Target	Yield	ETR	2014E		
	Ticker	Rating	(12/9)	Price	(%)	(%)	P/E	P/BV	ROE
Top Buys									
Salesforce.com	**CRM**	**Buy**	**$53.68**	**$67**	**0.0%**	**24.95%**	**107.0x**	**10.0x**	**9.4%**
Best in universe secular growth driven by ample new product pipeline and larger deals. Revenue and margins should go higher in FY15									
Service-Now	**NOW**	**Buy**	**$51.63**	**$66**	**0.0%**	**28.11%**	**356.2x**	**22.9x**	**6.4%**
TAM underestimated, numbers look low based on this and expanded distribution									
Oracle	**ORCL**	**Buy**	**$35.60**	**$38**	**1.3%**	**8.00%**	**11.2x**	**2.9x**	**26.2%**
We believe 12c database release will drive some revenue re-acceleration and reversion to higher multiple									
Symantec	**SYMC**	**Buy**	**$22.58**	**$28**	**2.7%**	**26.80%**	**11.8x**	**2.3x**	**19.4%**
We see multiple scenarios for new CEO to drive value, including margins, cap. return, and growth									
Top Sells									
Guidewire	**GWRE**	**Sell**	**$46.01**	**$41**	**0.0%**	**-11.08%**	**178.3x**	**5.1x**	**2.8%**
Positive market and competitive view offset by valuation which overlooks vertical TAM limits and high services mix									

Source: Citi Research

Solar

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The Sun Should Continue to Shine in 2014

- **Show me the growth! US Solar in 2014 and beyond will continue to be driven by pure economics, a utility's need to diversify fuel mix, third party financing vehicles and legislative mandates**. Moreover, this growth looks set to continue for the long term, as solar takes an ever greater share of energy generation, helped by improving economics against fossil fuels, (which conversely are likely to get more expensive over time, assuming that the cheapest reserves have been utilized first) as well as a need for utilities to diversify away from gas and into other generation sources. So, besides pure economics, from a utility perspective the need to diversify is becoming crucial to remove the impact of volatility and potential eventual upward movement in gas prices over the longer term. Coupled with legislative mandates and the emergence of third party financing at the state level, solar growth will continue to escalate as it remains very early in the cycle - we remain in the early innings.

- **The "Substitution Effect": US solar growth not at the mercy of power demand/reserve margins which continue to remain weak for 2014.** Residential and commercial solar are essentially distributed generation which could be installed by household, company and utility displacing current supply. This "substitution effect" is a very strong attribute in the US given the very visible signs of tepid load growth and high reserve margins in 2014 and into the foreseeable future. Solar will grow regardless of where power supply/demand balance is. Case in point, at the utility scale level, future generation build will not include a material amount of coal or nuclear capacity given environmental rules and challenging economics at the current level of gas prices – in fact, many of these assets are set to be retired in 2014 and beyond. Solar will steal some share of this dynamic.

- **"Mindset Change" – the symbiotic relationship of solar versus gas: a peak shaver.** We continue to view solar as a complement to gas…not a supplement. The key takeaway is that the "real" role solar plays in the power stack is during the peak times of the day – ironically, when generators earn the most margins. So, we should not view the shale revolution as a demise of solar given their complementary roles. This relationship will continue to bear fruit in 2014.

- **The solar demand swing factor: the evolution/revolution of Distributed Generation (DG):** Distributed Generation is the next driver of growth in the US as utility scale solar spending normalizes in the near term. But, can solar providers and utilities reach a middle ground on adequate compensation for DG? We think so.

- **North America stock takeaways – we would continue to be buyers of US project developers in 2014 despite their material outperformance in 2013.** Buy-rated First Solar Inc. (ticker FSLR), SunPower Corp. (ticker SPWR) and, SunEdison (ticker SUNE) remain direct beneficiaries of our NA solar call for sizeable growth in 2014 and beyond from residential, commercial and utility scale solar. In the US, we anticipate a shift from project wins in traditional solar states to non-traditional solar states and regions that have the potential to grow rapidly in the coming years (i.e. SE US, Texas, Carolinas, Indiana, Kentucky).

Solar: Top Buys

	Ticker	Rating	Price (12/9)	Target Price	Yield (%)	ETR (%)	2014E P/E	2014E P/BV	2014E ROE
Top Buys									
First Solar Inc.	**FSLR**	**Buy**	**56.07**	**$63**	**0.0**	**12.4**	**16.6**	**1.0**	**6.7**
Our sector tilt is favorable towards solar downstream names versus the upstream manufacturers – FSLR is the bellwether in the downstream market									
SunPower Corp.	**SPWR**	**Buy**	**28.55**	**$32**	**0.0**	**12.1**	**19.1**	**2.7**	**16.7**
Total solar package because of industry leading efficiency panels, massive distribution channel, and global recognized brand/geographically diverse project pipeline									
SunEdison	**SUNE**	**Buy**	**12.82**	**$21**	**0.0**	**63.8**	**11.9**	**4.3**	**45.6**
Decision to spin off its Semi business through an IPO enables the refocus of management and board on its solar business - taking steps toward YieldCo, ABS market									
Advanced Energy Industries	**AEIS**	**Buy**	**22.44**	**$25**	**0.0**	**11.4**	**13.2**	**1.8**	**14.5**
A cash generating North American downstream solar holding well positioned to capitalize on the rapid growth of the US and Canadian commercial and utility scale solar									

Source: Citi Research

Specialty Payments & Business Services

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Stick with Top Growth Plays for 2014

- **Growth Worked in 2013, Likely to Repeat in 2014** — FLT was the top performer among the Specialty Payment Processors in 2013 and Grand Canyon Education was the leader in Education Services. We believe the industry leading growth provided by these two companies is sustainable and likely to drive continued outperformance in 2014. Buy FLT and LOPE.

- **Specialty Payments a Good Sub-Sector —** Specialty Payment Processors produced good returns in 2013 with three out of four companies beating the market with returns in excess of 30%. Good underlying secular growth and upside from M&A are likely to drive some outperformance in 2014 as well. FLT again led the group with a return of 120%+ making it the best stock in the broader payments universe for the second consecutive year. We believe a combination of strong organic trends and good upside potential from recent M&A will continue to drive FLT higher. ADS had another very good year as well, returning more than 70% YTD. While continued momentum in Private Label and building strength at Epsilon make the numbers achievable, we remain valuation sensitive given the lower level of absolute growth vs. peers. WEX also had a good 2013 with a couple of nice contract wins. That said, the level of growth also remains sub-par while valuation is a premium, which keeps us on the sidelines. PAY produced another year of losses in 2013, though the stock has recovered from its absolute lows earlier in the year. While we think the company can recover some of the market share it lost during this year, margins are likely to be below consensus, which keeps us cautious on the stock.

- **Stick with Good Growth in Education** — Stock performance in the Education Services sector was decidedly mixed with a high degree of volatility. Many stocks recovered from lows seen in 2012 and early in the year, while others continued to struggle on a fundamental basis. LOPE stood out yet again with another strong performance (up 80%+) given continued strength in enrollment growth and upside from better profitability. In 2014, we look for LOPE to continue to outperform based on building momentum in the online business despite lower enrollment headcount investment, continued expansion at the ground campus and potential upside from better margins. For APOL, much will depend on how new enrollment trends react to new scholarships offerings and tuition discounts – early results may prove encouraging, but we caution investors to look out for effects of lower planned marketing spending in 2014. Margins may continue to hold up better-than-expected and we may see a resumption of share buyback activity as well. Valuation remains discounted vs. the group but ongoing enrollment declines don't paint the prettiest picture, which keeps us on the sidelines. For the sector, we also note that regulatory actions could create ongoing volatility in the stocks with negotiated rulemaking on gainful employment ongoing and the recertification of the Higher Education Act still on the docket. We would stick the best positioned player in the space – Buy LOPE.

- **We Like MMI in Commercial Real Estate** — US commercial real estate drivers continue to trend well given an improving economy, rising rental rates, declining vacancy levels and still low interest rates. As broker, MMI is a pure play on the continued recovery in this sector and we believe additional upside exists from the company's plans to improve market share via a structured hiring approach. The stock is also attractive from a valuation perspective both on an absolute basis and relative to its peers. We believe good revenue growth in 2014 is likely and

that should translate well to strong EBITDA and EPS growth given the expense leverage inherent in the model. Buy MMI.

Other companies mentioned: Apollo Education Group, Inc. (APOL.O; US$24.77; 2)

Specialty Payments & Business Services: Top Buys

	Ticker	Rating	Price (12/9)	Target Price	Yield (%)	ETR (%)	2014E P/E	2014E P/BV	2014E ROE
Top Buys									
FleetCor Technologies	**FLT**	**Buy**	**$118.31**	**$128.00**	**0.0%**	**8.2%**	**24.2x**	**6.6x**	**27.3%**
Momentum with organic growth remains strong and backlog of recent M&A gives ample opportunity to drive accretion upside in 2014.									
Grand Canyon Education	**LOPE**	**Buy**	**$43.91**	**$50.00**	**0.0%**	**13.9%**	**20.9x**	**5.0x**	**23.9%**
Enrollment growth should remain robust both online and at its ground campus – margin upside is possible given the limited need to invest to support this growth.									
Marcus & Millichap	**MMI**	**Buy**	**$14.48**	**$16.50**	**0.0%**	**14.0%**	**14.5x**	**7.5x**	**51.9%**
Ongoing recovery in commercial real estate should be supportive and organic market share trends remain positive – valuation is discounted vs. peers.									

Source: Citi Research

Specialty Semiconductors

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Buy High Quality Core Analog Names – ADI and MCHP to Gain Cyclical Exposure; Also Favor High Growth Small Cap SMTC and SLAB

- **Analog Stance Favors Long-Tailed Cyclical Stocks** — Our analog sector stance favors long-tailed high quality core analog names with limited smartphone exposure – MCHP and ADI. We see analog stock in the midst of valuation dispersion where long-tailed stocks multiples could while customer concentration and seasonality drive multiple contractions amongst smartphone name in particular.

- **Analog Semi Cycle Peaking** — YY sales growth should remain healthy at to +6% to 7% in 2014. Margins and utilization should *decline slightly* in 1Q14E and then rebound into 2Q14E and 3Q14E. Inventory is set to remain flat at 95 days throughout 2014, down from 99 and 96 days in 2012 and 2013, respectively. With 4Q13E through 3Q14E y/y growth plateauing at 7%/7%/7%/6%, the defensive high yield attributes of core names ADI and MCHP appear comparatively favorable versus smartphone and commodity analog names.

- **Valuation Favors Core Analog vs Smartphone** — We position toward core high quality analog vs. smartphone to reflect our view valuation differentials could widen, rather than revert into 2014 reflecting: a) smartphone deceleration / commoditization getting worse before they get better, b) seasonal revenue and stock patterns that favor industrial analog vs non-industrial analog, and c) plateauing y/y growth favoring defensive vs high beta analog and d) high dividend yield and cash return dynamics.

- **Analog F12M P/E Relative to the S&P500** — Analog F12M P/E relative to the SP500 decreased slightly to 1.04x from 1.05x since 1Q11. Segment performance varied heavily though: a) core high margin analog (ADI, LLTC, MCHP) increased 20% to 1.3x from 1.1x between 1Q11-4Q13, b) smartphone (AVGO, MXIM) remained flat at 1.0x, c) small cap growth (SMTC/SLAB) declined 9%, and d) lower margin value stocks (IRF, FCS, ONNN) decreased 11% to 0.7x from 0.8x

- **Top Large-Cap Picks** — **#1 MCHP:** 1) strong growth prospects, particularly in China; 2) consistent track record of accretive acquisitions, with the recent SMSC acquisition exceeding integration and synergy goals; 3) MCHP should benefit from positive funds flow as smartphone suppliers begin their seasonal downslope in 4Q13; and 4) above analog average dividend yield of 3.3%. **#2 ADI:** 1) ~70% industrial/auto exposure; 2) lack of customer concentration risk – no customer accounts for more than 4% of total sales; 3) increasing commitment to return 80% of free cash flow could drive multiple appreciation; and 4) above analog average dividend yield of 3.1%

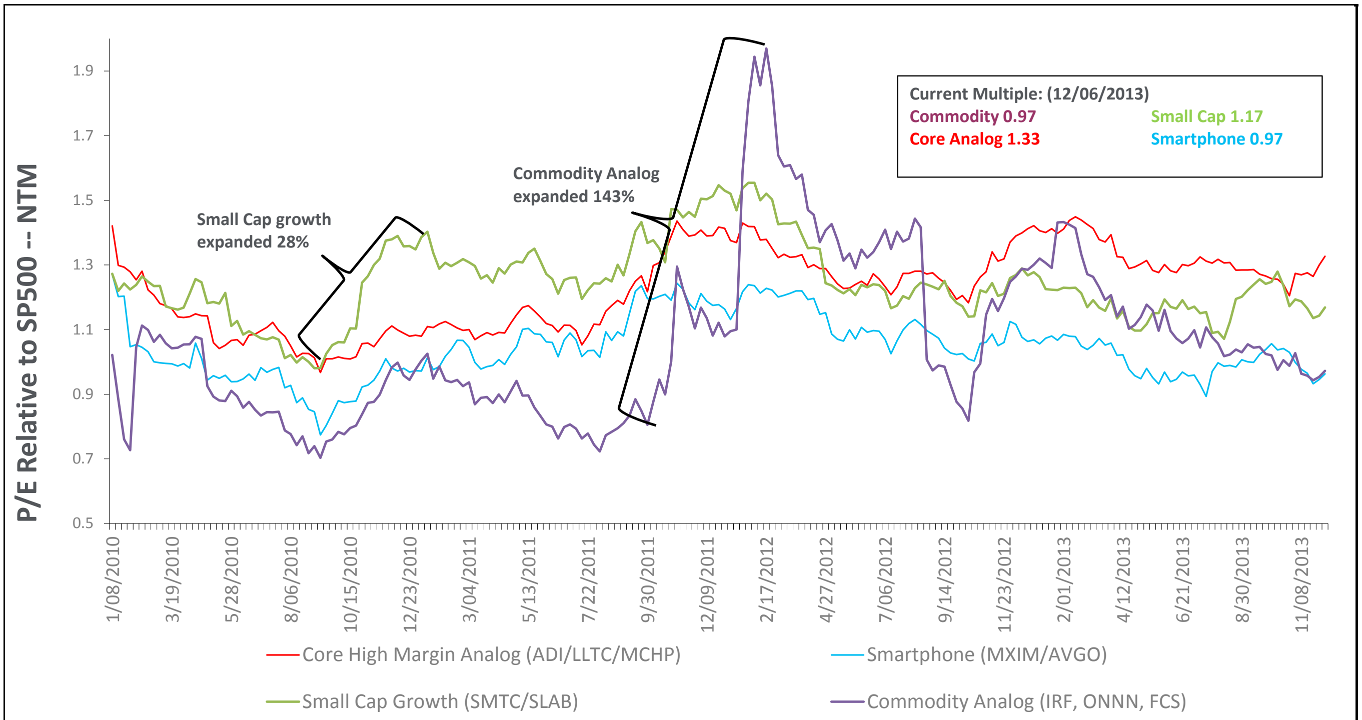
- **Top Small-Cap Picks** — **#1 SLAB:** 1) we see potential for 10-15% yy growth in 2014 vs Street's +8% driven by strength in all segments and end markets and 2) slowdown in legacy businesses already priced in. **#2 SMTC:** 1) above analog average communications growth in 2014, and 2) new handset ramps in 1H14 bodes well for protection business growth outlook.

Analog Sector: Top Buys and Sells

	Ticker	Rating	Price 12/9/2013	Target Price	Yield %	ETR %	C2014E P/E	C2014E P/BV	C2014E ROE
Top Buys: Mid-Cap									
Microchip	**MCHP**	**Buy**	**$43.31**	**$51**	**3.27%**	**21.0%**	**17.23**	**4.10**	**26.5%**
Solid Shareholder Return Coupled with Improved Margins; Broad Analog Appeal; Multiple Expansion on FCF Return									
Analog Devices	**ADI**	**BUY**	**$49.01**	**$56**	**3.10%**	**17.4%**	**20.90**	**2.27**	**14.4%**
Core Analog Defensive Holding; Broad Analog Appeal; Multiple Expansion on FCF Return									
Top Buys: Small-Cap									
Semtech	**SMTC**	**Buy**	**$29.41**	**$38**	**-**	**29.2%**	**18.25**	**2.30**	**12.6%**
Above Average Communications Growth in 2014; New Handset Ramps in 1H14 Bodes Well for Protection Business									
Silicon Laboratories	**SLAB**	**Buy**	**$41.35**	**$47**	**-**	**13.7%**	**23.07**	**2.08**	**12.1%**
Bright 2014 Growth Outlook across MCU (+19% C14E), Timing (+15% C14E), Video (+15% C14E), and Audio (+10% C14E)									
Top Sells									
Intersil	**ISIL**	**Sell**	**$11.05**	**$10**	**4.34%**	**-5.2%**	**18.20**	**0.66**	**3.7%**
OpEx reductions flattening out and baked into stock; High PC exposure will drag overall sales Y/Y starting in 2Q14									

Source: Citi Research

Analog Sector: NTM P/E Relative to the SP500 (1Q10-4Q13E)



	1Q10	2Q10	3Q10	4Q10	1Q11	2Q11	3Q11	4Q11	1Q12	2Q12	3Q12	4Q12	1Q13	2Q13	3Q13	4Q13 QTD	Compression 2Q12 - Current	4Q13 - QTD vs Trailing 8Q average
Core High Margin Analog	1.24	1.09	1.05	1.06	1.10	1.12	1.16	1.38	1.37	1.26	1.25	1.32	1.41	1.30	1.30	1.27	0%	-1%
Smartphone	1.07	0.97	0.89	0.94	1.01	1.05	1.10	1.19	1.21	1.11	1.07	1.06	1.06	0.97	0.98	0.99	-11%	-10%
Small Cap Growth	1.22	1.16	1.03	1.26	1.31	1.29	1.29	1.46	1.48	1.26	1.21	1.22	1.21	1.15	1.17	1.19	-5%	-9%
Commodity Analog	0.76	0.64	0.56	0.70	0.79	0.69	0.60	0.91	1.02	0.77	0.71	0.93	1.10	0.88	0.77	0.70	-9%	-10%
Analog Average	1.07	0.97	0.88	0.99	1.05	1.04	1.04	1.23	1.27	1.10	1.06	1.13	1.19	1.07	1.06	1.04	-6%	-7%

Source: Citi Research

Other companies mentioned: Avago Technologies (AVGO.O; US$45.95; 2); Fairchild Semiconductor (FCS.O; US$12.63; 1); International Rectifier (IRF.N; US$24.50; 2); Linear Technology (LLTC.O; US$43.57; 2); Maxim Integrated (MXIM.O; US$27.67; 2); ON Semiconductor (ONNN.O; US$7.42; 2)

Telecommunications Services

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Seeking Revenue Growth & Rising Shareholder Repatriation

- **Key Themes for the Telecom Sector** — For 2014, we enter the year favoring stocks that we believe should post solid revenue growth and have the ability to significantly increase cash repatriation to shareholders over time. We believe dividend sustainability remains a key focus for investors, and believe the ability for companies to show profitable revenue growth remains a key litmus test. With bit growth predicted to be roughly 25% in the U.S. during 2014 according to Cisco VNI, the telecom industry is still running on a treadmill with less than 2% revenue growth for 2014, based on our estimates. We believe telecom carriers increasingly need to address how the combination of innovation in their business models and investment can improve their revenue growth prospects. Wireless revenue growth is unfortunately continuing to decelerate as Smartphone penetration is rapidly approaching maturation. The jury is still out, in our view, as to whether or not tiered broadband pricing will work at driving meaningful revenue growth over the next few years, especially given the efforts by Sprint and T-Mobile to offer unlimited usage plans as a tool to acquire customers. Consumer wireline has been helped by a broader availability of facilities-based triple-play products, but the Business & Wholesale recovery has been sluggish as cable is taking share from the small business segment and the sales cycle remains elongated for larger business customers.

- **Innovate and Invest** — We expect companies to respond to the sluggish environment for industry revenue growth through innovation in their business models and investment. We believe Telcos will continue to try to add over-the-top applications and cloud-based services to their core network offerings for both the residential & business market. Companies are also likely to respond with an upward bias towards increasing broadband investments for both fixed and mobile networks to increase capabilities and capacity. We also expect companies to try to invest through further M&A and believe the wireless and enterprise segments are ripe for further activity.

- **Wireless Revenue Growth Is Likely to Decelerate** — We believe the wireless sector is in significant transition as revenue growth is slowing and further consolidation is needed to correct the misallocation of spectrum resources and improve scale for those carriers trying to effectively compete against Verizon and AT&T. We forecast wireless sector revenue growth is likely to decelerate in 2014 on the heels of: 1) slowing Smartphone penetration and BYOD trends, while cross-product cannibalization continues with broadband services taking share from traditional voice and text revenue; 2) Wireless needs to show spending elasticity as data caps become more popular for connected devices; & 3) Recent efforts by carriers to unbundle the service plan from device sales adds a new competitive risk and wrinkle to the longer-term return prospects for the industry.

- **Recovery in Business & Wholesale Spending on Telco Services Remains Sluggish** — We believe the Business & Wholesale segment within the Telco sector is still poised for a longer-term recovery, but the pace of recovery has been slowed by a lengthening of the sales cycle by larger enterprise customers over the last 3-6 months. The improving level of non-farm private sector employment remains a positive leading indicator for a rebound in B&W spending on telecom service, while companies continue to indicate favorable demand in the pipeline, despite an apparent slowdown in the decision making. We believe

product demand for data center services, cloud-based services, and metro-fiber access is showing greater durability.

- **Tower Industry Poised to Benefit from Near-Term LTE Deployments** — We believe the tower group should continue to be beneficiaries of incremental deployment of mobile broadband services (including LTE) on multiple-frequency bands during 2014. Tower companies have described that internal revenue growth is shifting from a high proportion of amendment activity towards a greater revenue contribution from site colocation as densification is becoming a big theme for coverage and capacity (especially ahead of VoLTE). We have learned that labor to deploy cell site equipment remains in short-supply from the combination of new colocation and amendment activity, while the amount of equipment deployment through amendments is exceeding the original specifications from amendment deals. On a longer-term basis, we believe the likelihood for further wireless industry consolidation represents a headwind on the pace of domestic revenue growth, while international revenue opportunities remain robust, however we view a declining probability related to the risk of further national carrier consolidation within the next 12-24 months.

- **Regulatory Environment Represents a Net Risk to Larger Wireless Carriers and Smaller Wireline Incumbents** — We believe the ongoing reform of Inter-Carrier Compensation (ICC) and the Universal Service Fund by the FCC are likely to dilute returns for incumbent wireline providers. We also expect the FCC to review policies regarding spectrum holdings that could lead to limitations on how some larger wireless carriers expand their spectrum inventory over time. Incumbent wireline providers may also a review of special access services with respect to pricing and availability.

Telecommunications Services: Top Buys and Sells

	Ticker	Rating	Price (12/9)	Target Price	Yield (%)	ETR (%)	2014E P/E	2014E FV/OIBDA	2014E FCF Yield
Top Buys									
American Tower	**AMT**	**Buy**	**$78.84**	**$89**	**1.7%**	**15.7%**	**30.3x**	**17.0x**	**4.5%**
Solid domestic colocation revenue growth prospects, upside potential from International and valuation									
Cogent	**CCOI**	**Buy**	**$38.68**	**$40**	**4.1%**	**7.5%**	**NM**	**14.6x**	**3.7%**
Opportunity to sustain solid revenue growth, significantly increase cash dividends to shareholders, & retain an opportunity to further accelerate returns.									
Equinix	**EQIX**	**Buy**	**$168.36**	**$225**	**2.7%**	**32.6%**	**NM**	**10.3x**	**NM**
Solid revenue growth prospects, potential tax efficiencies related to the pending REIT conversion (which remains the more likely outcome), and valuation.									
Interxion	**INXN**	**Buy**	**$20.83**	**$30**	**0.0%**	**41.5%**	**30.5x**	**9.5x**	**NM**
Durable demand for data center colocation from its Big-4 European markets, discretionary FCF growth, & valuation.									
SBA Communications	**SBAC**	**Buy**	**$87.32**	**$98**	**0.0%**	**12.5%**	**NM**	**19.6x**	**NM**
Favorable site leasing and AFFO per share growth prospects.									
Telephone & Data Systems	**TDS**	**Buy**	**$25.68**	**$35**	**33.5%**	**33.5%**	**NM**	**5.7x**	**13.9%**
Potential ability to unlock significant shareholder value by monetizing additional non-core assets, including spectrum/towers, & improving the fitness of its wireless operations.									
Verizon Communications	**VZ**	**Buy**	**$49.57**	**$53**	**4.3%**	**11.5%**	**13.9x**	**7.2x**	**6.5%**
Solid wireless growth, wireline cash flow should start to improve in '14, & Verizon Wireless can unleash new strategic explorations to improve its asset mix & value over time.									
Top Sells									
Consolidated Communications	**CNSL**	**Sell**	**$19.25**	**$14**	**8.1%**	**(19.2%)**	**21.3x**	**8.0x**	**9.2%**
Trading at a premium valuation, while retaining elevated financial leverage relative to its peers.									
Frontier Communications	**FTR**	**Sell**	**$4.57**	**$3.50**	**8.8%**	**(14.5%)**	**21.7x**	**5.6x**	**13.2%**
Erosion of high margin legacy revenue, elevated marketing costs to retain customers & improve broadband share, & increasing competition for fiber-to-the-tower deployments.									

Source: Citi Research

Tobacco

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We Remain Bullish on U.S. Tobacco, While Challenges Remain Internationally

- **We Remain Bullish on Tobacco** — Though the landscape for the tobacco industry remains challenging (both domestically and globally), we remain bullish on the sector heading into 2014 as tobacco manufacturers are expected to: (i) continue to consistently return value to shareholders via healthy dividend payouts and share buybacks, (ii) continue to capitalize on opportunities present in the industry (i.e. cost-cutting initiatives and next-generation tobacco innovation), and (iii) maintain pricing power. In addition, the major manufacturers have proven to be especially adept at addressing most headwinds.

- **U.S. Tobacco: E-cigarettes Remain a Point of Focus** — In early 2012, LO acquired blu eCigs for $135 million, essentially kicking off Big Tobacco's foray into the e-cigarette segment. LO has since expanded distribution of blu to 127,000 U.S. stores (up from 10,000 at the time of acquisition). Meanwhile, MO and RAI are now active in the segment as well (with the MarkTen and Vuse brands, respectively) and will be expanding their geographic presence over the coming months. While the e-cigarette category remains small (~1% of U.S. tobacco industry sales) and fragmented (with roughly 250 players currently competing), it presents a potential growth opportunity, with 2013 sales expected to reach $1.5 billion (triple that seen in 2012). And though it remains to be seen whether the growing popularity of e-cigarettes will significantly impact U.S. cigarette volumes, the products remain a point of focus in U.S. tobacco, along with pricing, taxation, regulation, and litigation.

  - **Pricing Continues to be Dependent on Consumer Recovery** — As expected, each of MO, RAI and LO recently implemented pricing adjustments for their cigarette brands (effectively increasing prices $0.07 pp, or +1.4% to +2.0%) and their MST brands (of $0.06 per can, or +2.2% to +3.3%). Encouragingly, these were the largest increases seen since 2011. Looking ahead, we expect another round of price hikes in mid-2014, though we note that the magnitude of the increases will be dependent on excise tax increases and the pace of the consumer recovery.

  - **Volume Trends Expected to Remain Stable** — YTD through 3Q13, cigarette volumes in the U.S. were down 4% YoY on an adjusted basis, while smokeless volumes were up roughly 5% (both in line with our full-year expectations). In 2014, we expect cigarette volumes to again decline 3% to 4% (in line with the historical average), while smokeless volumes should continue to grow by 4%-6%. That said, significant SET increases and/or draconian action by the FDA (both discussed below) have the potential to exacerbate declines.

  - **Regulatory Changes Could Be Seen in 2014** — The FDA continues to focus its efforts on: (i) substantial equivalence (SE) applications, (ii) menthol and (iii) deeming regulation. To date, the agency has issued 17 affirmative SE orders (including two LO cigarette products) and 13 not substantially equivalent orders. Meanwhile, the public comment period on the FDA's advance notice of proposed rulemaking for menthol has concluded such that we may see proposed rules in 2014. And while the government shutdown delayed the issuance of deeming regulation (which is expected to bring e-cigarettes under the agency's jurisdiction), we expect to see it in the coming months. Finally, we continue to keep our eyes on public place e-cig bans and regulation increasing the minimum purchase age for tobacco.

- **Taxation Environment Likely to Remain Manageable** — President Obama's proposed federal excise tax increase has failed to gain traction, while state excise tax increases have been muted in 2013, with MA, MN, NH, and OR the only states to approve increases year-to-date (such that the weighted-average nationwide SET rate will be up just six cents for the year). While the SET environment in 2014 is unlikely to be as benign in 2013 (particularly given the potential for a $1 pp tax increase in CA via a ballot initiative), we will closely monitor legislative proposals introduced in the first half of the year.

- **International Tobacco: A Number of Challenges Exist** — The weak macro environment in Europe has continued to weigh on the international tobacco industry in 2H13, while challenging trends in a number of markets in Asia and EEMA have exacerbated matters for the global players. Looking ahead to 2014, both the taxation and regulatory environments will remain in focus, as a number of notable changes have already been proposed and, in some cases, approved.

  - **Volume Trends Likely to be Mixed** — YTD volumes have declined notably in a number of EU markets (including France, Spain and Poland) such that the region is expected to experience a ~8% volume decline for the full-year 2013. Given the weak macro environment in the region, these declines are likely to continue into 2014. And while we look for certain non-OECD markets (most notably Indonesia) to act as offsets, we're also expecting to see significant tax-driven volume decreases in the Philippines and Russia such that global volumes excluding China should decline 2%-3% in 2014.

  - **Taxation Is A Key Concern** — A number of tax increases are to be enacted in 2014 in the major international cigarette markets (most notably in Japan, the Philippines, and Russia, but also in Brazil, France, Germany and Ukraine). While the international manufacturers have notable pricing power, we'll closely monitor the effects of these tax changes as they could result in further volume declines and/or down-trading from premium brands to value-priced brands.

  - **Regulatory Changes May Be Enacted** — From a regulatory perspective, plain packaging will continue to garner the most attention in 2014. Australia has already implemented plain packaging for tobacco products, while New Zealand and the U.K. are currently considering the issue. In addition, the EU is finalizing the revisions to its Tobacco Products Directive, with potential changes including: (i) ingredient bans (including menthol), (ii) enlarged graphic health warnings, (iii) a prohibition of packaging containing rounded or beveled edges, and (iv) restrictions on product descriptors. And while many countries continue to introduce public-place smoking bans and graphic warning labels for cigarette packaging, these changes have historically not had a significant effect on volumes.

  Other companies mentioned: Lorillard Inc. (LO.N; US$50.71; 2)

Tobacco: Top Buys

	Ticker	Rating	Price (12/9)	Target Price	Yield (%)	ETR (%)	2014E P/E	2014E P/BV	2014E ROE
Top Buys									
Altria Group	**MO**	**Buy**	**$37.69**	**$42.00**	**5.2%**	**16.6%**	**14.8x**	**23.9x**	**135.6%**
MO maintains a family of profitable brands across multiple tobacco segments, including Marlboro in cigarettes which brand should see further growth via innovation in menthol.									
Reynolds American	**RAI**	**Buy**	**$51.36**	**$58.00**	**5.0%**	**18.0%**	**14.8x**	**6.6x**	**41.5%**
RAI's 3-brand cigarette strategy & strong presence in the smokeless segment, as well as its innovative approach to next-gen products position the company for solid growth.									

Source: Citi Research

Transportation — Freight Transportation

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Transports Road to 2014 Leads to Cash Back

- **Bullish on Fundamentals, but Mixed on Valuation** — We are constructive on the fundamental outlook for the transportation sector as North American volumes remain strong, while 2014 could be a better recovery year for international markets and global trade. Citi economist Willem Buiter targets a solid 3.1% global real GDP growth rate in 2014, an acceleration from his 2.4% target for 2013. However, despite the positive domestic and international outlook, given that earnings multiples for the transport sector have increased 20% year-to-date, we believe that investors will need to become more selective heading into 2014. In our view, investors will be most rewarded for targeting companies that execute solid earnings growth, rather than companies whose performance is likely more leveraged to multiple expansion.

- **Rails Remain Favored Sector** — We continue to view the rails as our favored sector. In our view, the rails will continue to sustain inflation plus pricing, while multiple secular catalysts could drive volume growth above GDP. Solid domestic consumer trends coupled with market share gains from Truck should sustain intermodal volumes and pricing next year, crude-by-rail volumes will likely slow in growth but still remain among the fastest growing volume segments, a solid grain harvest this fall should sustain agriculture volumes, particularly in the first 9 months of the year given the easy drought comps, and petrochemical volumes are well positioned to benefit from oncoming capacity and increase in export demand. With good top line growth, we believe some additional margin can be attained, although leveraging shareholder returns (buybacks and dividends) is likely to play an increasing role in valuation going forward.

- **Capital Returns to Play a Bigger Role in Earnings Growth and Valuation** — With growing cash balances and margins at or approaching peak for many transportation companies/segments, we believe that shareholder returns will play an increasing role in valuation next year. Shareholder returns, namely higher dividends and buybacks, could accelerate for many companies with solid cash flow yields, but notably for Union Pacific [Free Cash Flow Story at Inflection Point] which we estimate will scale its free cash flow to over $10/share in the next three years (effectively double current levels). Additionally, we believe that both FedEx [Buyback Signals Important Shift; Buy], and Canadian Pacific [With New CFO, 2014 Should Include Cash Return Discussion] are best positioned to scale shareholder returns.

- **International Rebound to Aid Small Package and Export Rail Bulk Volumes** — We have become incrementally constructive on the small package sector given strong domestic volumes (driven by B2C) and the potential for international volumes and pricing to inflect more positively. Thus, we believe investors will benefit from additional exposure heading into 2014. Domestically, Ground business continues to trend at peak/above peak cycle earnings, which we think should continue due to B2C volume growth. Further, UPS and FedEx appear well positioned internationally, as they have cut Express/Next Day capacity in multiple lanes, which coupled with the economic re-acceleration in Asia and Europe could provide solid upside in shares given that investors remain skeptical on the earnings power of these segments. We like exposure to both FedEx and UPS, however, we favor FedEx given that it is more rich in catalysts, particularly with its restructuring program.

- **Favorite SMID Name Is Old Dominion** — We believe that Old Dominion will continue to outperform next year as fundamentals in the less-than-truckload space are constructive, and Old Dominion remains well positioned to continue to take market share. We believe that pricing remains rational in the sector, particularly as some of its competitors are downsizing their network footprints and overall volumes remain supportive. While valuation is elevated compared to

its LTL peers at 17.3x 2014 EPS, in-line with its peak cycle multiple of 17.4x, we believe that investors will continue to accumulate exposure and assign a premium to well positioned companies with secular catalysts in growth sectors. Old Dominion has done a good job of maintaining 10%+ revenue growth and 20%+ EPS growth in non-recession years, likely leading to multiple expansion as well as earnings growth.

- **Truckload and Truckload Brokerage Remain Pressured** — While the overall level of domestic volumes are solid, we believe that Truckload carriers will continue to face a less robust fundamental outlook than other transportation sectors, primarily due to continued market share loss to rails, productivity pressure from Hours of Service implementation, increasing costs, and higher utilization of brokers by customers which subsequently has increased the overall competitiveness of the Truckload business. We believe that these factors will continue to weigh on pricing, and with labor costs set to grow (in order to maintain driver retention) ahead of real pricing, the margin outlook for the industry remains challenged. Further, competition in the asset light space is likely to remain tight, which will pressure margins for truckload brokers.

- **Dry Bulk and LNG Outlook** — We remain constructive on LNG shipping, as the long term supply demand balance continues to favor ship owners. Rates have fluctuated above $75,000/day, but as we progress into 2015 and beyond, we believe a shortage of vessel supply could drive rates higher. On the dry bulk side, we believe that as the orderbook has becomes more rationalized (the orderbook as a % of the on water fleet has dropped from ~80% in 2007 to 18% in 2013) supply and demand have the chance to grow roughly at equal rates in 2014. This could drive a more sustained improvement in rates, which would greatly benefit shipping companies which did not compromise balance sheets during the recession. We continue to favor Safe Bulkers and Navios Maritime Partners as high quality ways to gain exposure to this segment of shipping.

Freight Transportation: Top Buys and Sells

			Price	Target	Yield	ETR	2014E		
	Ticker	Rating	(12/9)	Price	(%)	(%)	P/E	P/BV	ROE
Top Buys									
Canadian Pacific	**CP**	**Buy**	**$152.96**	**$170**	**1.5%**	**12.6%**	**15.9x**	**3.6x**	**20.9%**
Operational turnaround is taking shape, upside not fully reflected in current valuation									
Kansas City Southern	**KSU**	**Buy**	**$119.88**	**$120**	**0.7%**	**0.8%**	**23.3x**	**3.1x**	**14.2%**
Solid growth opportunities, particularly in Mexican intermodal franchise									
Union Pacific	**UNP**	**Buy**	**$164.50**	**$180**	**1.8%**	**11.2%**	**15.1x**	**2.8x**	**20.4%**
Solid freight mix levered to domestic retail consumer, Share buyback potential									
FedEx	**FDX**	**Buy**	**$139.81**	**$170**	**0.4%**	**22.0%**	**14.9x**	**1.9x**	**11.5%**
Potential earnings growth from company's Express restructuring, while Ground likely to continue outperforming									
Top Sells									
Eagle Bulk Shipping	**EGLE**	**Sell**	**$3.55**	**$0.50**	**0.0%**	**-85.9%**	**NM**	**0.1x**	**0.0%**
Weak industry backdrop depresses earnings power and ability to effectively service its debt load									
Genco Shipping & Trading	**GNK**	**Sell**	**$2.47**	**$0.50**	**0.0%**	**-79.8%**	**NM**	**0.1x**	**-2.9%**
Weak industry backdrop depresses earnings power and ability to effectively service its debt load									

Source: Citi Research

Other companies mentioned: Old Dominion Freight Line (ODFL.O; US$49.70; 1); United Parcel Service Inc. (UPS.N; US$101.05; 2); Safe Bulkers Inc (SB.N; US$7.91; 1H); Navios Maritime Partners L.P. (NMM.N; US$17.43; 1)

Utilities

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Be Selective

- **Key themes for 2014**: distributed generation, M&A, YieldCo, FERC Order 1000 transmission opportunities, and challenging merchant power markets with investors. We continue to question the viability of the integrated/hybrid utility model and further right-sizing of dividends will continue to be a topic in 2014.

- **Utilities are becoming true solar believers – we expect further utility scale solar announcements in 2014.** The large utilities across the country are beginning to understand the real threat that solar (including distributed generation) poses to the industry. We left 2013 with the view that regulators and management teams are looking at ways that they can be a part of the solution to encourage adoption rather than fight the rapidly-growing fuel source – whether true believers or not, most agreed that solar growth is here to stay.

- **Hybrid model becoming a dinosaur? M&A in 2014 will continue to be a key question in industry.** The integrated business model continued to be questioned in 2013 but the specifics of company situations seemed to reject most ideas around splitting up companies. Last year, PPL indicated that there were material synergies that could potentially be realized if their merchant assets were combined with another entity. In the regulated space, multiple CEOs and CFOs said that the industry trend of consolidation is logical and that there are too many regulated utilities in the country. Either way, following Duke and AEP's eventual exit out of Midwest generation, few hybrid models remain – most agree further consolidation will occur. 2014 should be a year when reality begins to set in.

- **We don't expect a material number of utilities to announce Yieldco's similar to NRG Energy; however, other public financing vehicles a potential but not a driver for the industry in 2014.** In 2013, all managers seemed to downplay the potential opportunity but were keenly aware of the structure and its variations and continue to monitor the public financing situation. For instance, at the EEI conference in 2013, Exelon seemed open to a private YieldCo structure and has looked into the ABS market in the past but seemed to decide against a public YieldCo.

- **How long will the challenging power markets continue and how to respond?** Items to watch for in 2014: FirstEnergy already sees a recovery but lowered expectations in 2014/2015 for their competitive business last year. Exelon continues to reiterate their analysis of higher power prices as coal retires. In response to these conditions, EXC mentioned the may shut down a couple nukes (Clinton, Quad City, and Ginna seem most vulnerable), FirstEnergy may eventually right-size its dividend, and PPL may spin or merger its Supply business. Entergy highlighted relative vulnerability of FitzPatrick due to soft Zone A NYISO pricing; however, the company sees potential for inflection in NE ISO pricing in 2016-2017 due to tightening supply/demand, which gives optionality to Pilgrim.

Other companies mentioned: American Electric Power Co Inc (AEP.N; US$46.17; 2); Entergy Corp (ETR.N; US$61.50; 2); Exelon Corp (EXC.N; US$28.12; 2); FirstEnergy Corp (FE.N; US$32.37; 2); NRG Energy Inc (NRG.N; US$28.19; Not Rated); PPL Corp (PPL.N; US$29.50; 2)

Utilities: Top Buys

	Ticker	Rating	Price (12/9)	Target Price	Yield (%)	ETR (%)	2014E P/E	2014E P/BV	2014E ROE
Top Buys									
Duke Energy	**DUK**	**Buy**	**69.81**	**83**	**5.6**	**24.5**	**15.1**	**1.2**	**7.9**
Strong and well-run utility warranting a premium to peers given above-average growth prospects, constructive rate settlements and removal of key overhangs.									
Edison International	**EIX**	**Buy**	**46.22**	**58**	**3.0**	**28.5**	**13.1**	**1.5**	**11.5**
EIX is a fundamentally strong utility in an attractive jurisdiction. In our view SONGS Phase 3 hearings in mid-2014 will result into a favorable outcome removing key overhang.									
PG&E Corp	**PCG**	**Buy**	**41.16**	**54**	**4.4**	**35.6**	**13.3**	**1.2**	**9.5**
We believe that discount embedded into PCG shares exceeds likely impact of San Bruno related exposure, and we view the upcoming resolution of San Bruno as a catalyst									
Great Plains Energy	**GXP**	**Buy**	**24.08**	**26**	**3.7**	**11.7**	**13.9**	**1.0**	**10.9**
We believe that the resolution of pending rate cases should help close current valuation gap with peers caused by recent tepid load data and regulatory treatment									

Source: Citi Research

3D Printing / Additive Manufacturing

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Expanding Market Opportunities Benefit Market Leaders; Accelerating Growth Justifies Valuations

- **The chase for TAM remains a priority, but looking for some proof points in 2014** — The entire 3D printing sector has benefitted from the belief that digital manufacturing is in its infancy but that the market was nearing a tipping point. Companies that were seen as being able to address the largest market opportunities (DDD, SSYS) saw valuations pushed to peak levels (35x CY15 EV/EBITDA). We believe the TAM mindset will extend into 2014, but with investors more in tune to data points such as printer sales and growth rates to help validate the long term growth trajectory. Advance manufacturing applications have bubbled up in niche markets such as medical, dental and aerospace, however we believe deeper usage and an expansion into other verticals will be necessary to sustain above market growth.

- **Will improving materials mix materialize?** — While top line growth remains a top priority, market leaders, 3D Systems and Stratasys have also highlighted margin expansion that will be largely fueled by growth in the companies' consumables revenue mix which carries 70% gross margins (vs. ~40% for systems). Strong sales of print systems in 2013 enabled management to fall back on the argument that "seeding" the market with printers will bear fruit long term. While we believe investors are willing to forego near-term profitability for 30%+ growth, we believe any deceleration in growth will be viewed negatively without a clear path to margin expansion. We do not believe investors are looking for margin expansion from Voxeljet as the company remains in early growth mode.

- **Is Consumer a real market?** — The market for personal desktop 3D printers I expected to double in 2013, however this growth is on the back of small numbers (40K units). 3D Systems has aggressively positioned itself to capitalize on broad consumer adoption by pushing down price points (currently $1,000, expecting $500 device) and growing its retail partner footprint from a few dozen to over 400. On the other hand, Stratasys with Makerbot has the most established brand, but has thus far taken the luxury car approach to the consumer market pricing. We believe mass adoption will hinge on price with our analysis of past consumer devices showing broad adoption is inversely related to price.

- **Valuation tied to growth** — In 2013, it appeared that the mindset was growth at any price as companies old (DDD, SSYS) and new (VJET) saw their market caps increase greatly. Valuations (35-80x CY15 EV/EBITDA) are now pricing in sustained hyper growth rates which we believe favor established companies (DDD, SSYS) with established brand recognition and balance sheets capable of pursuing market opportunities. We believe smaller vendors such as Voxeljet are likely to experience volatile quarterly results that could lead investors to question the company's growth trajectory.

- **New competitors more likely to be headline risks than financial; Consolidation should continue** — As to be expected in a fast growing market, new entrants have started to surface, the most notable being HP. Details remain limited around possible product offerings, but our conversations with industry players suggests there is likely to be little financial impact over the next 24 months. However, we would expect some headline risks over the coming quarters. We would also note that large technology vendors entering the market

has also amplified the chatter around M&A since the fastest path to market relevance would be with an acquisition. Neither we nor our colleague Jim Suva (Citi Hardware analyst) expects HP to take any action over the next twelve months, we believe valuations could see a bump from increased noise.

Other companies mentioned: Voxeljet AG (VJET.N; US$36.78; 2H)

3D Printing / Additive Manufacturing: Top Buys

	Ticker	Rating	Price (12/9)	Target Price	Yield (%)	ETR (%)	2014E P/E	2014E P/BV	2014E ROE
Top Buys									
Stratasys	**SSYS**	**Buy**	**$117.67**	**$135.00**	**NA**	**15%**	**50x**	**2x**	**1%**
Largest install base in the industry set up well to drive near term growth and sales of high margin materials									
3D Systems	**DDD**	**Buy**	**$75.96**	**$68.00**	**NA**	**-10%**	**60x**	**6x**	**12%**
Expansive product portfolio is best suited to capture all market segments from the consumer to industrial manufacturers									

Appendix A-1

Analyst Certification

The research analyst(s) primarily responsible for the preparation and content of this research report are named in bold text in the author block at the front of the product except for those sections where an analyst's name appears in bold alongside content which is attributable to that analyst. Each of these analyst(s) certify, with respect to the section(s) of the report for which they are responsible, that the views expressed therein accurately reflect their personal views about each issuer and security referenced and were prepared in an independent manner, including with respect to Citigroup Global Markets Inc and its affiliates. No part of the research analyst's compensation was, is, or will be, directly or indirectly, related to the specific recommendation(s) or view(s) expressed by that research analyst in this report.

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Boston Properties Inc, The Hartford Financial Services Group, Tower International, Inc., American Axle & Manufacturing Holdings Inc., Ingersoll-Rand plc, ING U.S., Inc., Realty Income Corp, Walter Energy, PPL Corp, Nokia Oyj, KB Home, Starbucks Corp, Marcus & Millichap, Kimberly-Clark, Sealed Air Corp, ADT Corporation, Entergy Corp, Rocket Fuel Inc., Armstrong World Industries Inc., Prudential Financial Inc., Berry Plastics Group, Bank of New York Mellon Corp, Coca-Cola Enterprises.

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Microchip Technology, OpenTable, Inc, Teck Resources, Deere & Company, LaSalle Hotel Properties, D.R. Horton, Foot Locker Inc, Commercial Metals Co, Pfizer, Mead Johnson Nutrition Company, Endo Health Solutions Inc., Procter & Gamble Co, Con-way Inc., Anadarko Petroleum Corp, GameStop Corp, Charter Communications, EchoStar Corporation, Simon Property Group Inc, Beazer Homes, Northrop Grumman Corp., Alpha Natural Resources, Mylan Inc., Lockheed Martin Corp., Targa Resources Corp., Avery Dennison Corp, Advanced Micro Devices, eBay Inc., Reinsurance Group of America, PerkinElmer Inc, Ford Motor Co, Stratasys Ltd, New York Community Bancorp Inc, SunEdison, T Rowe Price Group Inc, CF Industries Holdings Inc, Pentair Ltd., Wells Fargo & Co, VMware, Inc., Edwards Lifesciences Corp, Emerson Electric Co., Amazon.com, Inc., Texas Instruments Inc, Baxter International Inc, Palo Alto Networks, Inc., Archer-Daniels-Midland Company, Actuant Corporation, Adobe Systems Inc., Red Hat, Inc., Roper Industries, Inc., Goldcorp Inc, FirstEnergy Corp, Capital One Financial Corp., Aetna, Hospira, General Dynamics Corp., PVH Corp., Seadrill Partners LLC, Facebook, Inc, Meritor Inc, KLA Tencor Corp, Bemis Co Inc, American Express Co., Novartis AG, CA Inc., St Jude Medical Inc, Medtronic Inc, Coca-Cola Bottling Co. Consolidated, Universal American, Celgene Corp, Bayer AG, SunPower Corp., General Electric Company, Delphi Automotive PLC, LyondellBasell Industries, Exelon Corp, BlackRock Inc, Newell Rubbermaid Inc, Fidelity National Info Svcs, Inc, Altera Corp, Qiagen, Avago Technologies, Microsoft Corp., Constellium, American Electric Power Co Inc, Google Inc., Verisign, Inc., Consolidated Communications Holdings Inc, NRG Energy Inc, PACCAR Inc., Hershey Foods Corp, Hanesbrands, Inc., State Street Corp, SPX Corporation, Goodyear Tire & Rubber Co, Raytheon Co., Applied Materials Inc, Sirius XM Holdings Inc, Packaging Corp of America, HCA Holdings, Inc, Tidewater Inc., Intel Corp, CheckPoint Software Technologies, Inc., Lear Corporation, Johnson & Johnson Inc, PepsiCo, Host Hotels & Resorts, Harley-Davidson Inc, AK Steel Holding Corporation, Covidien Ltd, AstraZeneca PLC, Nike Inc, Reynolds American Inc, Discover Financial Services, Time Warner Cable Inc, Citrix Systems, Inc., Carlisle Companies Inc., Allergan, Inc., Transocean Ltd., Vornado Realty Trust, Johnson Controls Inc, Eaton Corp, Bunge Limited, Discovery Communications, Sigma-Aldrich Corp, Intersil Corporation, Xilinx Inc, Shire Pharmaceuticals, Abercrombie & Fitch Co., Illinois Tool Works Inc., VF Corp, Boston Properties Inc, Teva Pharmaceutical Industries Ltd., The Hartford Financial Services Group, TC PipeLines LP, CareFusion, Tower International, Inc., American Axle & Manufacturing Holdings Inc., Alkermes PLC, Ingersoll-Rand plc, ING U.S., Inc., Walter Energy, Universal Health Services, PPL Corp, Nokia Oyj, Fairchild Semiconductor, AMETEK, Inc., KB Home, Fifth & Pacific Companies Inc, BlackBerry, Affiliated Managers Group, Starbucks Corp, Waddell & Reed Financial, Inc, AOL Inc., Kimberly-Clark, International Rectifier, Peabody Energy, Sealed Air Corp, Life Technologies Corp, ADT Corporation, Ensco plc, Legg Mason Inc, Entergy Corp, Qualcomm Inc, United Technologies Corporation, MasterCard Inc., Equity One, Inc., Armstrong World Industries Inc., Federated Investors, Inc, Prudential Financial Inc., Berry Plastics Group, Bank of New York Mellon Corp, Ralph Lauren Corporation, Coca-Cola Enterprises in the past 12 months.

Citigroup Global Markets Inc. currently has, or had within the past 12 months, the following as investment banking client(s): Enterprise Products Partners LP, American Tower Corp, Equinix Inc, Frontier Communications Corp, SBA Communications Corp, Telephone & Data Systems Inc, Verizon Communications Inc, E I du Pont de Nemours and Co, Dow Chemical Co, Eastman Chemical Co, Huntsman Corp, Monsanto Co, PPG Industries Inc, Celgene Corp, Capital One Financial Corp., Accenture Ltd, WNS Holdings Ltd, ExlService Holdings Inc, Avago Technologies, Microsoft Corp., Qlik Technologies Inc., PepsiCo, Humana, FXCM Inc, Targa Resources Corp., Interxion Holding NV, Ensco plc, International Paper Co, Medtronic Inc, PennyMac Mortgage Investment Trust, Symantec Corp., Delphi Automotive PLC, Guidewire Software, Inc., ServiceNow, Inc., Vantiv, Inc., Palo Alto Networks, Inc., National Oilwell Varco Inc, Archer-Daniels-Midland Company, Berry Plastics Group, Aetna, Universal American, UnitedHealth, Seadrill Partners LLC, Navios Maritime Partners L.P., Artisan Partners Asset Management, FleetCor Technologies Inc, Emerge Energy Services LP, ING U.S., Inc., Constellium, Marcus & Millichap, Rocket Fuel Inc., Yahoo! 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	12 Month Rating			*Relative Rating*		
Data current as of 30 Sep 2013	Buy	Hold	Sell	Buy	Hold	Sell
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Citi Research Asia Quantitative Radar Screen Model Coverage	20%	60%	20%			
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