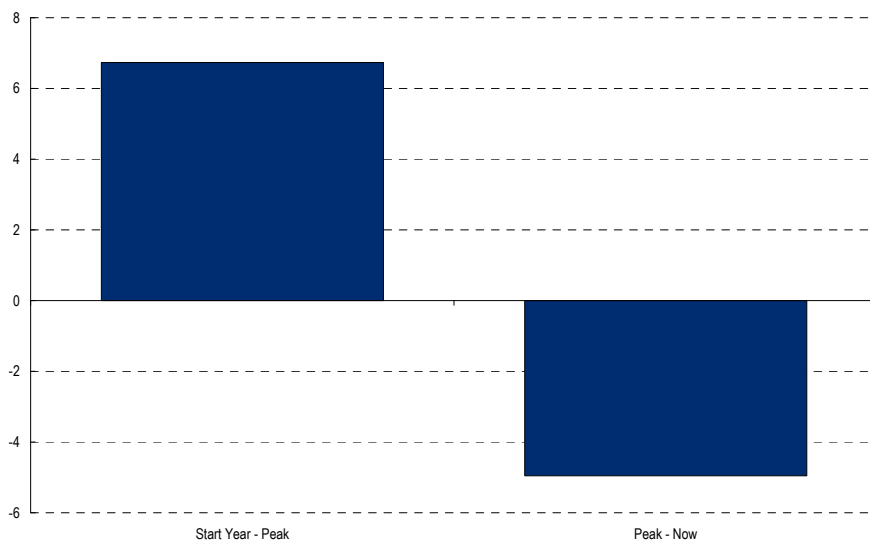


## European Portfolio Strategist

### Pause. Think. Reload.

- **Value of defensive growth** — Once again, recent market moves have confirmed the value of a defensive growth strategy. Strong start to the year for a key theme of ours.
- **Pause** — European equities have fallen 5% in the past few weeks on soggy global economic data, ongoing Euro Area concerns and unexciting earnings data.
- **Think** — Valuation remains supportive unless GDP/earnings cliff, policy put fails or rates charge higher. Equity super cheap vs credit. Earnings soggy but no disaster.
- **Reload** — Capital allocators will still drive re-rating. Stay bullish. Our index targets suggest c15% upside to end-13. Pull-back is healthy and a reload opportunity.
- **Reload strategies** — We run 3: 1) skew market-wide stock model to top 3 factors (US, earnings, balance sheet), 2) surplus cashflow, 3) strong financials with income.
- **5 stocks** — 4 non-fins on both screens = Ericsson, Novo Nordisk, WPP & Siemens. For Fins: HSBC, SEB, Axa & Munich Re score on balance sheet, income & earnings.

Figure 1. Pull-Back Provides Reload Opportunity



Source: Datastream

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[14th Mar — The Value of Cash](#)

[7th Mar — Better Than Bonds & Buffett](#)

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

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## Pause. Think. Reload.

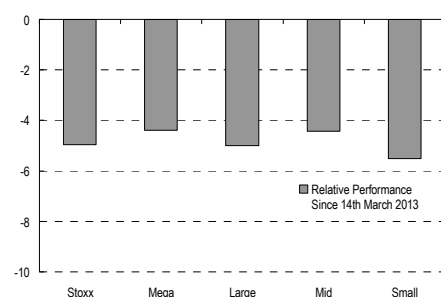
Tired investors, tired brokers, tired markets. All very tiring in equity markets right now. European equities have fallen 5% in the past few weeks. Soggy global economic data, ongoing concerns across the Euro Area and unexciting earnings data have oiled the pull-back. Given the 28% uninterrupted (ie no 5%+ pull-back) rise from the summer 2012 lows, the current pullback is unsurprising.

We think this provides investors with an opportunity to reload. We suggest three strategies: 1) we skew our stock attribution model (STAM) towards our three key model factors, ie earnings momentum, balance sheet strength, US exposure, 2) high surplus cashflow stocks with strong balance sheets, and 3) European Financials with strong capital positions and attractive income characteristics.

## Down, but not out

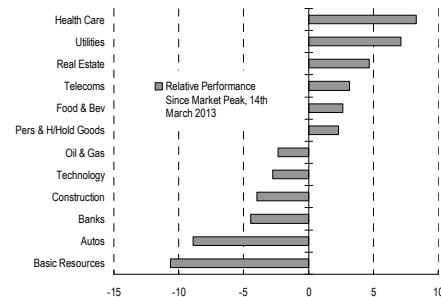
European equities had a strong start to the year, rising 7% to March highs and extending the rally from last summer's lows to 28%. It has been an impressive move up in share prices. Policy actions reduced macro risks and helped to drive an equity re-rating. Since mid-March, European equities have fallen 5%, a small pull-back. We think this is healthy and presents a reload opportunity for investors.

Figure 2. YTD Moves in European Equities (%)



Source: Citi Research

Figure 3. Sector Performance in Pull-Back (%)



Source: Citi Research

Figure 2 shows that the sell-off has been evenly distributed across size indices. Mega-caps have sold off the same as large- and mid-caps. Small-caps have fared slightly worse. Spain has been the worst country performer, down almost 10% in the past few weeks despite Spanish 10y bond yields now trading at 3-month lows. Germany and France, both down 6%, are not too far behind.

At a sector level, Figure 3 shows that defensive sectors have outperformed. Basic Resources and Autos have been the worst two sectors in the pull-back. Classic pull-back performance.

Once again, the recent pull-back has shown the value of a defensive growth strategy (Figure 4). We first suggested this approach in mid-2009 and have backed this "have your cake and eat it" strategy ever since.

Defensive growth companies are those with a proven earnings stop-loss in previous downturns, but which we also expect to grow earnings faster than the market in the next couple of years. We continue to back defensive growth, although we are well aware of the risks to this long-running theme. This is why, for example, we have US exposure as the biggest weight in our stock and sector models. Recent performance from defensive growth may also present some rotation opportunities for other parts of the market.

**Figure 4. Defensive Growth — The Only Growth Trade in Town**



Source: Datastream & Citi Research

Despite the pull-back, our market view is unchanged. We maintain our bullish stance on European equities and retain our "stay long, buy dips" approach to the market. Modest growth expectations and rising risk appetite from capital allocators and corporates should drive share prices higher through the next 1-2 years. We still target 330 at end-13 for the Stoxx and 7000 for FTSE 100, both c15% upside. While share prices could continue to be soggy near-term, genuine bears need a GDP/earnings cliff or sharply higher interest rates. We see neither.

We expect modest economic and earnings growth in 2013-14E. Our economists expect around average global GDP growth over the next couple of years, including an extended, but mild, recession in the Euro Area. We think that their nominal GDP growth forecasts of 5.3% and 6.1% for 2013E and 2014E can support modest earnings growth for European companies of around 5% this year and slightly higher in 2014E.

Most importantly, however, we expect dynamic capital allocators to raise risk appetite progressively over the next couple of years. We include corporates, private equity, retail investors, SWFs, hedge funds, multi-asset and significant individuals in this 'dynamic' group. These investors are most likely to respond to a near record valuation/funding gap between credit and equity. YTD investor flows, as well as recently announced mega-deals in the US, provide evidence of this emerging trend.

## Inside pullbacks

Equity markets go up, go down and go sideways. That's life. Pull-backs in rising markets are as normal as bounces in falling markets. By themselves, they should not be cause for concern. But, they are cause to kick the tyres. We kick in three ways: 1) analysis of previous pull-backs, 2) valuation, and 3) earnings.

## Previous pull-backs

We think that equity markets will remain in an uptrend over the next couple of years. We think only a sharp GDP/earnings cliff or sharply higher interest rates will prevent this. Evidence from the past 20 years shows that pull-backs are normal in periods of rising markets (Figure 5).

Pre-2009, it was rare for a bull market (whisper it) pull-back to exceed 10%. It happened just three times since 1995, and toward the end of the bull rally rather than at the start. Since 2009, however, the 10% pull-back has become more common. This has coincided with greater macro uncertainty. Even since the summer 2011 market correction, there have been two painful 10%+ pull-backs.

We think the prospect of another 10%+ pull-back is less likely now given the reduction in systemic/tail risks as a result of determined policy action from several central banks. We, therefore, see 5% as a good reload level and would be buyers into recent weakness. Further weakness would make us more aggressive.

Comparing the rise and fall of European equities since early 2009 with previous bull rallies shows that the average rally phase is the same as the previous two periods. 1995-98 stands out with much higher average rallies between pull-backs (those were the days...). We also show the price/book and trailing P/E for European equity at the pull-back trough. This shows that re-rating that European equities have enjoyed since the last pull-back in 2Q12. That pull-back troughed with a sub-11x trailing P/E compared with 14x now. European equities, in P/E terms anyway, are close to their 2003-07. Not expensive but not cheap. That bull rally ended with the 2008-09 financial crisis and a massive GDP and earnings cliffs. Another GDP/earnings cliff now would likely have similar impact on share prices. We just do not think it is a likely outcome.

Figure 5. Pullbacks During Rising Markets

	Start Rally	Peak	Trough	Mkt Perf During Rally	Mkt Perf During Pullback	Mkt P/Book (Trough)	Mkt Trailing P/E (Trough)
<b>Rally: Mar-95 to Jul-98</b>							
#1	Mar-95	Apr-96	Jul-96	29	-5	1.7	14.6
#2	Jul-96	Mar-97	Apr-97	35	-5	2.0	16.9
#3	Apr-97	Oct-97	Oct-97	27	-12	2.2	17.7
#4	Oct-97	Apr-98	Apr-98	43	-7	2.8	21.3
#5	Apr-98	Jul-98		13			
Average				29	-7	2.1	17.6
<b>Rally: Oct-98 to Mar-00</b>							
#1	Oct-98	Nov-98	Dec-98	31	-7	2.6	19.8
#2	Dec-98	Jan-99	Jan-99	15	-7	2.5	20.8
#3	Jan-99	Feb-99	Feb-99	6	-5	2.5	20.7
#4	Feb-99	May-99	May-99	13	-5	2.6	21.6
#5	May-99	Jul-99	Aug-99	9	-10	2.6	21.4
#6	Aug-99	Sep-99	Oct-99	9	-7	2.6	21.2
#7	Oct-99	Dec-99	Jan-00	28	-7	2.7	24.4
#8	Jan-00	Mar-00		15			
Average				16	-7	2.6	21.4
<b>Rally: Mar-03 to Jun-07</b>							
#1	Mar-03	Mar-03	Mar-03	18	-8	1.5	12.5
#2	Mar-03	Jun-03	Jul-03	19	-6	1.7	14.1
#3	Jul-03	Sep-03	Sep-03	12	-7	1.8	14.7
#4	Sep-03	Mar-04	Mar-04	19	-6	1.9	15.6
#5	Mar-04	Apr-04	May-04	7	-7	1.9	15.3
#6	May-04	Jun-04	Aug-04	6	-7	1.8	13.7
#7	Aug-04	Oct-05	Oct-05	33	-6	2.0	14.6
#8	Oct-05	May-06	Jun-06	21	-12	1.9	13.7
#9	Jun-06	Feb-07	Mar-07	26	-8	2.1	14.3
#10	Mar-07	Jun-07		13			
Average				17	-7	1.9	14.3
<b>Rally: Mar-09 - Now</b>							
#1	Mar-09	Jun-09	Jul-09	36	-8	1.2	10.8
#2	Jul-09	Oct-09	Nov-09	26	-6	1.4	15.0
#3	Nov-09	Jan-10	Feb-10	11	-9	1.3	15.4
#4	Feb-10	Apr-10	May-10	15	-13	1.3	13.6
#5	May-10	May-10	May-10	8	-10	1.3	12.8
#6	May-10	Jun-10	Jul-10	11	-8	1.3	12.8
#7	Jul-10	Aug-10	Aug-10	11	-6	1.3	13.5
#8	Aug-10	Feb-11	Mar-11	18	-10	1.4	12.9
#9	Mar-11	May-11	Jun-11	8	-7	1.4	12.3
#10	Jun-11	Jul-11	Sep-11	4	-22	1.1	9.7
#11	Sep-11	Oct-11	Nov-11	16	-12	1.1	9.9
#12	Nov-11	Mar-12	Jun-12	24	-14	1.2	10.9
#14	Jun-12	Mar-13	Apr-13	28	-5	1.4	14.1
Average				17	-10	1.3	12.6
<b>Average For All Periods</b>				<b>18</b>	<b>-8</b>	<b>1.8</b>	<b>15.5</b>

Source: Datastream & Citi Research

Given underlying economic, political and policy conditions are so different now compared to previous periods, we should perhaps concentrate our attention on the most recent pull-backs to see how this one compares.

Figure 6. Within The Recent Pullbacks

	Peak - Date	Trough Date	Stoxx Perf	Trough Trailing P/E	Trough Corp EYR	Top Sectors	Bottom Sectors	Δ Ger 10yr (bps)	Δ Italy 10yr (bps)	Δ Spain 10y (bps)
#1	02/05/2011	22/09/2011	-24	10	0.64	Health, Fd & Bev, Personal	Construction, Insurance, Banks	-153	96	3
#2	16/03/2012	04/06/2012	-14	11	0.64	Health, Fd & Bev, Travel	Autos, Insurance, Banks	-83	70	123
#3	18/10/2012	16/11/2012	-5*	13	0.54	Tech, Travel, Personal	Basic Res, Telcos, Utils	-30	11	49
Now	14/03/2013	17/04/2013	-5	14	0.52	Health Care, Utils, Real Estate	Banks, Autos, Basic Res	-23	-36	-18

Source: Datastream & Citi Research; \* =

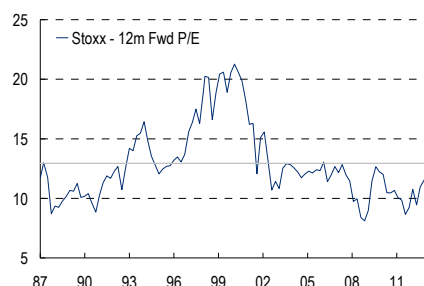
Figure 6 looks at the last three. We include the near but sub-5% pull-back we saw in 3Q12. What does this show? Three things: 1) while the trough P/E now is higher than the recent pull-backs the trough corporate bond EYR, ie equity vs credit, is lower, 2) sector leaders and laggards are broadly similar in each period, and 3) this is the only pull-back which has happened against backdrop of falling, not rising, Italian and Spanish bond yields.

The first point suggests that there is more support for the de-equitisation trade than following other recent pull-backs. Dynamic capital allocators should see excellent value even if equity investors do not. The last point suggests that the pull-back has not been directly driven by rising Euro Area crisis concerns. Instead, European equities have been performing more in line with high frequency economic data and Citi's Euro Area Economic Surprise Index (Figure 10).

## Valuation

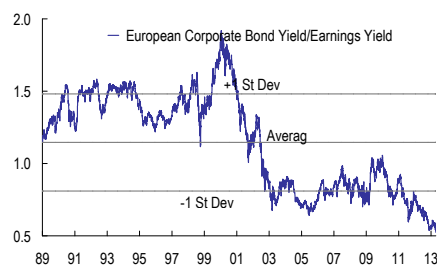
European equities continue to look fair value to a little cheap on a variety of absolute valuation metrics such as P/Es, price/book, median DY, EV/EBITDA, CAPE etc. Our view remains that earnings need to collapse to undermine the value case for the asset class. There is ongoing risk to current earnings expectations, but those risks, in our view, are modest and we see an end to earnings downgrades as the global economy picks up modestly in 2H13 and into 2014. Our top-down earnings growth forecast for 2013E is 5% vs just over 10% bottom-up.

Figure 7. 12m Forward P/E



Source: Datastream & Citi Research

Figure 8. European Corporate EYR



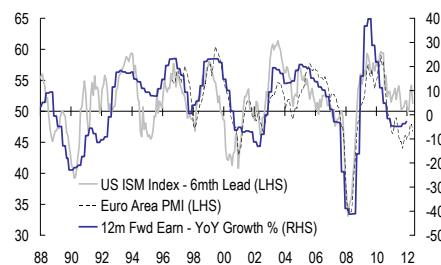
Source: Datastream & Citi Research

Figure 8 confirms the attraction of equity vs credit. European equities are trading at decade cheaps versus investment grade European corporate bond yields. Additionally, European equities have been aggressively de-rated in the past 12-18 months vs credit. We think this de-rating is more important than the absolute re-rating shares have enjoyed over the same period. To equity investors, shares have become more expensive (and therefore less attractive). To capital allocators, shares have become a lot cheaper (and therefore more attractive). We think capital allocators will drive the further re-rating of equities in the coming 12-18 months.

## Earnings

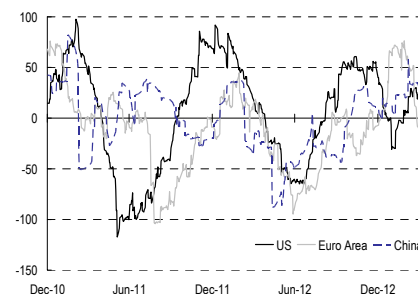
Kicking the tyres on earnings shows that downgrades continue to come through, but at a modest pace. Our global strategy team show that we have seen over 50 consecutive weeks of net downgrades. Globally, however, earnings growth estimates for 2012E still remain positive, just. So, earnings have not collapsed. Nor do we think they will. Earnings estimates in Europe have fallen further, but even here current bottom-up earnings growth estimates for 2012E show -4%.

Figure 9. ISM & PMI vs Earnings Mo



Source: Datastream & Citi Research

Figure 10. Citi Economic Surprise Index



Source: Datastream

Figure 9 is a quick sense check on earnings given the good relationship between leading economic indicators and European earnings growth over the years. European earnings are unlikely to track either European or US lead indicators, but more likely a blend of the two. This blend would suggest that 12-month forward earnings growth for European companies will be running a little over 0%, which is broadly consistent with our top-down estimate. Bottom-line = PMIs need to fall sharply to give us an earnings cliff. Unlikely say Citi's economists.

Figure 10 shows that US, Euro Area and China's CESIs have been heading lower over the past few weeks. This has coincided with weaker equity market performance. In the last couple of years, CESIs hit -100 two times as the global economy slowed sharply. Our economists see less risk of this now, partly because of clear cyclical improvements in the US economy ([Market and Policy Comments - Financial Boom Meets Fiscal Drag](#)) and partly due to the aggressive worldwide liquidity put provided by various central banks. Using CESIs alone would suggest that now is a better time to be buying equities than a few weeks ago.

## Reload strategies

Ok, so we retain our bullish market view. We see the pull-back as a reload opportunity. Where should investors look? We suggest three strategies: 1) we skew our stock attribution model (STAM) towards our three key model factors, ie earnings momentum, balance sheet strength, US exposure, 2) high surplus cashflow stocks with strong balance sheets, and 3) European Financials with strong capital positions and attractive income characteristics.

### US, earnings & balance sheet

Our first reload strategy equally weights the three key factors in our stock and sector models (STAM & SAM), ie US sales exposure, earnings momentum and balance sheets (strong).



**Figure 11. Balance Sheet, Mo & US Exp Large Cap STAM — Top 30**

Adidas	ADSGn.DE	Experian	EXP.N.L	Shire	SHP.L
ARM Holdings	ARM.L	Infineon Technologies	IFXGn.DE	Siemens	SIEGn.DE
Atlas Copco A	ATCOa.ST	L'Oreal	OREP.PA	Smith & Nephew	SN.L
Burberry Group	BRBY.L	Muenchener Rueckver	MUVGn.DE	Sodexo	EXHO.PA
Cap Gemini	CAPP.PA	Novo Nordisk B	NOVOB.CO	Swatch B	UHR.VX
Credit Suisse R	CSGN.VX	Philips Electronics	PHG.AS	Swiss Re	SRENH.VX
CRH	CRH.L	Publicis Groupe	PUBP.PA	Syngenta	SYNN.VX
EADS	EAD.PA	Rolls-Royce Holdings	RR.L	Tenaris	TS.N
Ericsson B	ERICb.ST	Safran	SAF.PA	Wolseley	WOS.L
Essilor Intl.	ESSI.PA	SAP	SAPG.DE	Wpp	WPP.L

Source: Datastream & Citi Research

Figure 11 shows the 30 top large-cap stocks. Figure 12 shows the 20 top mid-cap stocks using the same methodology.

**Figure 12. Balance Sheet, Mo & US Exp Mid Cap STAM — Top 20**

Actelion	ATLN.VX	Luxottica	LUX.MI
Alfa Laval	ALFA.ST	MTU Aero Engines	MTXGn.DE
Ashtead Group	AHT.L	Novozymes	NZYMb.CO
BIC	BICP.PA	Qiagen	QGEN.O
Bilfinger Berger	GBFG.DE	Skanska B	SKAb.ST
Brenntag	BNRGn.DE	Sonova N	SOON.VX
Coloplast 'B'	COLOb.CO	STMicroelectronics	STM.PA
Dassault Systemes	DAST.PA	Tgs-Nopec Geophs.	TGS.OL
Icti.HtIs.Gp.	IHG.L	UCB	UCB.BR
Lindt & Sprungli R	LISN.S	Zodiac Aerospace	ZODC.PA

Source: Datastream & Citi Research

## Cashflow

Our second reload strategy looks for stocks which have well covered dividends and strong balance sheets. Figure 13 shows stocks with average 2012-14E FCF yields at least 200 basis points above average 2012-14E DY and with 2013E net debt/EBITDA less than 1x. There are a lot of Health Care stocks in this screen, not many Utilities. We remain Overweight the former and Underweight the latter.

Figure 13. Balance Sheet Strength & FCF Support

Stock	RIC	>€10bn	>2			FCF			>2	<1x
		Market Cap, €m	DY 2012	DY 2013	DY 2014	FCF 12	FCF 13	FCF 14	Average FCF - DY	ND/EBITD A 2013
ABB	ABBN.VX	39539	3.26	3.51	3.74	4.95	6.87	7.92	3.07	-0.05
Ahold Kon.	AHLN.AS	11692	3.62	4.03	4.51	5.59	7.02	9.24	3.23	0.41
AstraZeneca	AZN.L	48245	5.64	5.50	5.54	10.55	10.78	10.48	5.04	0.15
Atlas Copco A	ATCOa.ST	13632	2.99	3.37	3.67	4.86	5.43	5.99	2.08	0.11
BAE Systems	BAES.L	14818	5.29	5.17	5.31	20.24	-2.74	6.06	2.60	0.40
Bayer	BAYGn.DE	67024	2.34	2.57	2.75	2.70	6.63	6.23	2.63	0.52
Ericsson B	ERICb.ST	28011	3.12	3.55	3.56	5.75	10.66	4.33	3.50	-0.98
Kone B	KNEBV.HE	11413	2.94	2.43	2.52	5.16	4.12	4.95	2.12	-0.94
LVMH	LVMH.PA	33737	2.30	2.57	2.89	3.90	5.38	6.17	2.56	0.43
Michelin	MICP.PA	11047	3.95	4.46	4.96	9.16	5.78	8.69	3.42	0.34
Novartis R	NOVN.VX	150807	3.42	3.43	3.70	6.42	7.06	7.72	3.55	0.36
Novo Nordisk	NOVOb.CO	53616	1.89	2.29	2.72	3.90	4.87	5.59	2.49	-0.48
Philips	PHG.AS	20550	3.32	3.32	3.32	8.31	9.88	9.55	5.93	0.12
PPR	PRTp.PA	12465	2.25	2.55	3.04	3.55	4.32	6.01	2.01	0.67
Reckitt	RB.L	35516	3.05	3.00	3.21	5.32	6.32	6.60	2.99	0.43
Roche	ROG.VX	131833	3.25	3.53	3.91	5.93	6.14	6.69	2.69	0.28
Sanofi	SASY.PA	99240	3.33	3.65	4.31	6.99	7.91	8.08	3.90	0.35
Schneider	SCHN.PA	30161	3.40	3.55	3.82	6.92	6.50	7.12	3.25	0.86
Siemens	SIEGn.DE	65799	3.86	4.08	4.49	4.54	7.27	10.05	3.14	0.54
Unilever (UK)	ULVR.L	42359	3.01	3.23	3.54	5.29	5.46	5.53	2.17	0.57
Unilever	UNc.AS	49466	3.09	3.32	3.64	5.44	5.62	5.69	2.23	0.57
Volvo B	VOLVb.ST	15665	3.62	3.97	4.21	6.11	5.88	6.79	2.33	-1.28
Wpp	WPP.L	15491	2.92	3.02	3.18	8.75	8.45	8.99	5.69	0.79

Source: Datastream & Citi Research

## Financials

Our final reload strategy looks at Financials. They have sold off aggressively since early-year euphoria. It is interesting to see previous correlations with peripheral bond yields break down. It appears that European bank share prices have become much more correlated with the Eurozone CESI instead.

Figure 14. European Financials — Strong Balance Sheet & Income

	Mkt Cap, €m	RIC	Balance Sheet	DY 2013	Cover 2013	2y Divi Growth	-3m Rel Earn Mo	DY*G
<b>Banks</b>								
HSBC Holdings	145236	HSBA.L	14%	4.33	2.38	10	3.4	41
Nordea Bank	23339	NDA1V.HE	15%	4.04	2.24	9	5.9	37
Svenska Handbkn	16360	SHBa.ST	22%	4.11	1.90	8	4.6	34
SEB A	12253	SEBa.ST	18%	4.86	1.82	12	10.1	59
<b>Insurance</b>								
Allianz	48492	ALVG.DE	197%	4.57	2.56	4	3.0	20
AXA	27527	AXAF.PA	233%	5.98	2.58	11	2.5	64
Muenchener Rueckver	24388	MUVGn.D E	225%	4.88	2.27	5	4.8	27

Source: Datastream & Citi Research

Figure 14 shows Banks and Insurance companies which jump through the following hoops: 1) strong balance sheet (Tier 1 > 14% for banks, solvency > 190% for insurers), 2) DY > 4%, 3) dividend cover > 1.5x (most have more than 2x), 4) positive 2-year dividend CAGR, 5) positive earnings mo, 6) DY\*G > 20.

## Strategy outlook

Equity markets have looked tired of late. Soggy global economic data has helped European equities down 5%. Valuation still looks reasonable (absolute) to super attractive (relative). Earnings risk remain modest, in our view, without a GDP cliff which our economists think is unlikely. So, for us, the pull-back is a reload opportunity. We suggest three ways to reload: 1) US & earnings, 2) cashflow, 3) Financials. Ericsson, Novo Nordisk, WPP, Siemens, HSBC, Munich Re all show up.

## Market Outlook

Our Chief Economist and team expect another year of modest global growth in 2013. De-leveraging should cap growth. Policy action should (successfully, in our view) defuse systemic growth bombs. Despite macro risks, we have argued that the macro framework remains pretty certain and embedded. It consists of five elements: 1) de-leveraging, 2) lower growth, 3) divergent growth, 4) 0% policy rates, and 5) QE. It is this framework that gives us a world of low growth and low rates and is the basis for our ongoing preference for growth and income-biased strategies.

### Macro

<b>GDP</b>	<b>2012E</b>	<b>2013E</b>	<b>2014E</b>
Euro zone	-0.5	-0.6	-0.3
UK	0.3	0.4	0.7
Global	2.5	2.6	3.1
US	2.2	1.9	2.8
Japan	2.0	1.3	1.4
<b>CPI</b>	<b>2012E</b>	<b>2013E</b>	<b>2014E</b>
Euro zone	2.5	1.6	1.3
UK	2.8	2.9	2.7
Global	2.9	2.7	3.0
US	1.8	1.3	2.1
Japan	0.0	0.1	1.9
<b>Interest Rates</b>	<b>2Q13E</b>	<b>4Q13E</b>	<b>2Q14E</b>
ECB	0.50	0.25	0.25
UK Base	0.50	0.50	0.50
US Fed Funds	0.25	0.25	0.25
Japan Call	0.10	0.10	0.10
<b>10Yr Yield</b>	<b>2Q13E</b>	<b>4Q13E</b>	<b>2Q14E</b>
Euro zone	1.40	1.30	1.40
UK	1.90	2.10	2.30
US	1.86	2.38	2.83
Japan	0.50	0.70	0.50
<b>Ex Rates</b>	<b>2Q13E</b>	<b>4Q13E</b>	<b>2Q14E</b>
US\$/€	1.31	1.25	1.23
US\$/£	1.51	1.43	1.41
€/£	0.86	0.88	0.87
Y/US\$	107	105	105
<b>End Year Targets</b>	<b>Now</b>	<b>End-13E</b>	<b>Return</b>
Stoxx	284	330	16
FTSE 100	6244	7000	12

Source: Datastream and Citi Research estimates

Modest global growth is the outcome in 2012, but investors have had to deal with Chinese hard landing fears, US stall speed concerns and ongoing uncertainty in the Euro Area. By end-1H13, no Chinese hard landing and no US fiscal cliff should contribute to a world of reduced macro risks. From Europe, Spain (and possibly Italy) in a funding program and getting safely beyond Italian elections could also bring some temporary stability. Lower macro risk in 2013 is one support of our re-rating case and should also present a better platform for corporates to be heard.

### 2014 looks better than 2013 for earnings

Modest nominal global GDP growth including a 2H13 pick-up in US growth and a pick-up in EPS-boosting M&A and buybacks could support modest single-digit earnings growth in 2013E. But, recession in the EA and near-record margins suggest that big earnings gains are unlikely. Citi's analysts expect 10-15% earnings growth in 2013E and 2014E. Our top-down base case is 5% & 10%, respectively. Ongoing downgrades to 2013E estimates likely to be modest.

### Equities look fair value to super-cheap

European equities look fair value on trailing P/E and price/book multiples, in-line with long-term averages. Balance sheet adjusted multiples (EV/EBITDA) suggest that shares are cheaper than fair value, as does the cyclically adjusted P/E for Europe (CAPE). Based on post-1980 data, current DY, P/E, price/book and CAPE multiples all suggest 10%+ compound returns over the next 10 years. While, in the absence of an earnings collapse, absolute valuations look supportive of further 2013 gains for European equities, it is relative valuations that continue to show equities as looking particularly cheap. In the UK, dividends have not looked this cheap vs UK gilts in the last 100 years. European equities are trading at record cheaps relative to investment grade credit.

### Sector Strategy

We continue to run a barbell strategy, with a preference for growth leaders in a low growth world & cheap (acceptable) risk. We also back restructuring and re-leveraging as key alpha drivers in 2013-14. We are currently net long Financials with an Overweight on Banks. Here, our analysts see improving capital, higher potential returns, restructuring and regulatory forbearance as supporting a positive stance. We are broadly Neutral on cyclicals, have a positive skew to defensive growth and are Underweight Utilities, Telecoms and Oil & Gas.

Figure 15. European Sector Strategy

<b>Overweight</b>	<b>Neutral</b>	<b>Underweight</b>
Banks	Autos	Construction
Food & Bev	Basic Resources	Oil & Gas
Healthcare	Chemicals	Real Estate
Industrial G&S	Financial Services	Retail
Media	Insurance	Telecoms
Personal & Household Goods	Travel & Leisure	Utilities
Technology		

Source: Citi Research

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## Valuation Tables

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Figure 16. Pan-European Sector Weightings & Returns

As at Close 16 Apr 13 Sector (No of Stocks)	Mkt Cap (Euros m)	% of Stoxx	Return Relative to Stoxx				Absolute Return			
			1m	3m	12m	Ytd	1m	3m	12m	Ytd
Oil & Gas (32)	483,118	8.3	-2	-8	-18	-7	-4	-6	-4	-4
Chemicals (24)	301,679	5.2	-1	0	2	-2	-4	2	20	2
Basic Resources (29)	208,606	3.6	-10	-17	-27	-21	-12	-16	-15	-18
Construction & Materials (21)	125,126	2.1	-3	-1	-1	-2	-6	1	16	2
Industrial G&S (103)	624,487	10.7	-2	1	0	0	-5	3	18	4
Automobiles & Parts (14)	139,240	2.4	-7	-9	-8	-8	-9	-8	7	-5
Food & Beverage (28)	550,240	9.4	2	8	8	7	-1	9	26	11
Personal & H'hold Goods (29)	357,270	6.1	1	3	0	3	-2	4	17	7
Health Care (35)	713,423	12.2	7	11	11	11	4	13	30	15
Retail (24)	189,338	3.2	3	4	2	2	0	6	20	6
Media (27)	142,527	2.4	1	4	9	3	-1	6	28	7
Travel & Leisure (21)	82,884	1.4	0	4	12	4	-3	5	31	8
Telecommunications (23)	289,468	4.9	2	2	-8	3	-1	4	7	7
Utilities (26)	243,091	4.2	6	0	-9	-3	3	2	6	1
Banks (46)	708,128	12.1	-3	-8	6	-3	-6	-6	25	1
Insurance (33)	336,939	5.8	0	1	13	0	-3	2	33	4
Real Estate (29)	84,377	1.4	4	1	5	-2	1	3	23	2
Financial Services (30)	87,052	1.5	0	5	8	7	-2	7	27	11
Technology (26)	184,846	3.2	-4	0	3	0	-6	2	20	4
Stoxx - Pan Europe (600)	5,851,839	100.0	—	—	—	—	-3	2	17	4
Pan Euro - Large Cap	4,775,333	81.6	0	0	0	0	-3	1	17	4
Pan Euro - Mid Cap	753,372	12.9	0	1	0	0	-3	3	17	4
Pan Euro - Small Cap	323,134	5.5	-1	-1	0	0	-4	1	17	4
Stoxx ex UK (418)	3,887,976	66.4	—	—	—	—	-3	2	20	5
EuroStoxx - Eurozone (297)	2,563,285	43.8	—	—	—	—	-4	-1	17	1

Source: Citi Research & DataStream

Figure 17. Pan-European Sector Relative Ratings

As at Close 16 Apr 13 Sector	P/E Relative to Stoxx				Yield Relative to Stoxx			
	2011	2012E	2013E	2014E	2011	2012E	2013E	2014E
Oil & Gas	69	63	74	78	125	132	131	127
Chemicals	110	107	115	115	72	78	78	77
Basic Resources	55	92	91	86	97	104	96	96
Construction & Materials	99	106	107	102	96	99	101	100
Industrial Goods & Service	119	107	111	110	77	82	85	85
Automobiles & Parts	60	42	67	64	98	106	103	103
Food & Beverage	164	144	147	148	67	71	76	78
Personal & H'hold Goods	150	124	129	129	68	75	80	81
Health Care	115	106	119	120	85	88	88	90
Retail	120	114	121	125	90	93	90	89
Media	105	100	109	111	101	116	106	103
Travel & Leisure	146	143	127	118	72	69	67	68
Telecommunications	72	84	87	93	236	146	144	137
Utilities	80	79	95	102	187	177	160	150
Banks	93	144	80	75	96	103	111	118
Insurance	103	72	70	73	114	121	120	118
Real Estate	153	146	151	159	114	116	114	111
Financial Services	128	113	108	104	113	115	109	111
Technology	125	225	150	125	56	58	50	51
Stoxx - Pan Europe	100	100	100	100	100	100	100	100
Pan Euro - Large Cap	96	94	96	97	102	102	103	102
Pan Euro - Mid Cap	117	132	118	113	92	88	88	90
Pan Euro - Small Cap	128	168	124	115	97	92	86	87
Stoxx ex UK	103	106	102	100	102	99	99	99
EuroStoxx - Eurozone	94	101	95	94	112	103	104	102

Source: Citi Research & DataStream

Figure 18. Pan-European Sector Growth

As at Close 16 Apr 13 Sector	Earnings Growth %			Net Dividend Growth %		
	2012E	2013E	2014E	2012E	2013E	2014E
Oil & Gas	6.2	-5.1	4.9	10.3	2.5	4.7
Chemicals	-1.5	3.9	11.7	13.1	4.0	6.9
Basic Resources	-42.8	13.4	17.9	11.3	-3.5	8.0
Construction & Materials	-9.6	10.4	17.5	7.8	5.4	7.3
Industrial Goods & Services	7.4	7.2	12.3	11.3	7.5	8.0
Automobiles & Parts	37.3	-29.5	16.5	13.5	0.4	8.0
Food & Beverage	9.9	8.8	11.1	11.5	10.4	11.1
Personal & H'hold Goods	17.3	7.0	10.9	14.6	11.2	9.6
Health Care	4.9	-0.5	10.5	7.9	4.4	9.5
Retail	1.8	4.4	8.1	8.3	0.5	6.4
Media	1.9	1.7	9.5	19.0	-5.1	4.7
Travel & Leisure	-1.3	25.0	19.7	0.0	0.7	9.6
Telecommunications	-17.5	7.2	4.8	-35.7	2.5	2.8
Utilities	-2.1	-7.9	3.6	-1.4	-6.3	1.4
Banks	-37.4	100.2	18.2	11.1	11.7	14.8
Insurance	38.3	14.2	6.4	10.4	3.3	6.1
Real Estate	1.4	7.6	5.4	5.8	2.4	4.6
Financial Services	8.9	16.2	15.9	6.8	-2.1	10.1
Technology	-46.7	67.7	33.4	7.0	-10.1	9.9
Stoxx - Pan Europe	-3.6	11.3	11.5	4.2	3.9	7.9
Pan Euro - Large Cap	-1.1	8.4	10.5	5.1	4.2	7.5
Pan Euro - Mid Cap	-14.4	25.0	15.8	-0.3	4.6	10.1
Pan Euro - Small Cap	-26.5	50.6	21.0	-1.0	-3.6	10.1
Stoxx ex UK	-6.3	16.0	13.1	0.8	4.7	8.0
EuroStoxx - Eurozone	-10.6	18.3	12.8	-3.6	4.0	6.3

Source: Citi Research & DataStream

Figure 19. Pan-European Sector Ratings

As at Close 16 Apr 13 Sector	Price/Earnings				Net Dividend Yield			
	2011	2012E	2013E	2014E	2011	2012E	2013E	2014E
Oil & Gas	9.3	8.7	9.2	8.8	4.35	4.80	4.92	5.15
Chemicals	14.6	14.9	14.3	12.8	2.50	2.82	2.94	3.14
Basic Resources	7.3	12.8	11.3	9.6	3.38	3.76	3.63	3.92
Construction & Materials	13.3	14.7	13.3	11.3	3.34	3.60	3.80	4.07
Industrial Goods & Services	15.9	14.8	13.8	12.3	2.68	2.98	3.21	3.46
Automobiles & Parts	8.1	5.9	8.3	7.2	3.40	3.86	3.88	4.19
Food & Beverage	21.9	19.9	18.3	16.5	2.32	2.58	2.85	3.17
Personal & H'hold Goods	20.1	17.1	16.0	14.4	2.37	2.72	3.02	3.31
Health Care	15.4	14.7	14.8	13.4	2.96	3.19	3.33	3.65
Retail	16.0	15.7	15.1	13.9	3.12	3.38	3.40	3.61
Media	14.1	13.8	13.6	12.4	3.53	4.21	3.99	4.18
Travel & Leisure	19.5	19.8	15.8	13.2	2.50	2.50	2.52	2.76
Telecommunications	9.6	11.7	10.9	10.4	8.22	5.28	5.41	5.56
Utilities	10.7	10.9	11.8	11.4	6.51	6.42	6.02	6.10
Banks	12.4	19.9	9.9	8.4	3.36	3.73	4.17	4.79
Insurance	13.7	9.9	8.7	8.2	3.98	4.39	4.54	4.82
Real Estate	20.5	20.2	18.8	17.8	3.98	4.21	4.31	4.51
Financial Services	17.0	15.7	13.5	11.6	3.92	4.19	4.10	4.52
Technology	16.7	31.2	18.6	14.0	1.96	2.10	1.89	2.07
Stoxx - Pan Europe	13.4	13.9	12.4	11.2	3.48	3.63	3.77	4.07
Pan Euro - Large Cap	12.9	13.0	12.0	10.9	3.54	3.72	3.87	4.16
Pan Euro - Mid Cap	15.7	18.3	14.7	12.7	3.19	3.18	3.32	3.66
Pan Euro - Small Cap	17.1	23.3	15.5	12.8	3.38	3.35	3.23	3.55
Stoxx ex UK	13.7	14.7	12.6	11.2	3.55	3.57	3.74	4.04
EuroStoxx - Eurozone	12.5	14.0	11.8	10.5	3.90	3.75	3.90	4.15

Source: Citi Research & DataStream

Figure 20. Pan-European Country Weightings & Returns

	Mkt Cap (Euros m)	% of Stoxx	Relative Return to Stoxx*				Absolute Return*			
			1m	3m	12m	YTD	1m	3m	12m	YTD
Austria	25,129	0.4	-2	-5	1	-4	-6	-5	14	-2
Belgium	96,878	1.7	2	6	15	5	-2	6	29	8
Denmark	111,259	1.9	0	-1	0	3	-4	-1	13	6
Finland	78,594	1.3	1	-3	-2	1	-3	-3	10	3
France	842,212	14.4	-2	-3	1	-3	-6	-3	14	0
Germany	754,876	12.9	-2	-2	-1	-3	-6	-3	11	-1
Greece	7,130	0.1	-7	6	-6	7	-11	5	7	9
Ireland	43,090	0.7	-2	11	-6	5	-6	10	6	7
Italy	196,628	3.4	0	-13	-8	-9	-5	-14	4	-7
Netherlands	232,054	4.0	2	1	6	1	-2	0	20	3
Norway	86,691	1.5	-1	-4	-8	-3	-5	-4	4	-1
Portugal	17,178	0.3	-1	-6	-2	-1	-5	-6	11	2
Spain	252,558	4.3	-5	-9	1	-5	-9	-10	14	-3
Sweden	292,957	5.0	-1	6	5	5	-5	6	19	7
Switzerland	833,784	14.3	2	7	10	9	-2	6	24	12
UK	1,963,864	33.7	2	1	-4	-1	-3	0	9	1
Stoxx - Pan Europe	5,834,883	100								

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

Figure 21. Pan-European Country Relative Ratings

As at Close 16 Apr 13 Country	Price/Earnings				Net Dividend Yield			
	2011	2012E	2013E	2014E	2011	2012E	2013E	2014E
Austria	224	96	107	88	77	88	94	101
Belgium	147	137	133	127	68	93	88	92
Denmark	186	138	134	124	45	51	59	70
Finland	98	151	116	101	144	147	111	108
France	90	100	92	92	104	103	108	109
Germany	96	78	93	93	96	96	89	88
Greece	163	-28	210	90	62	47	38	65
Ireland	153	141	145	135	48	49	50	49
Italy	81	99	88	87	119	109	110	111
Netherlands	123	110	102	100	79	74	74	78
Norway	95	86	88	86	115	131	129	134
Portugal	82	741	146	109	165	133	123	122
Spain	71	145	86	90	228	150	170	146
Sweden	115	105	116	116	91	103	106	104
Switzerland	130	123	119	117	81	85	86	90
UK	95	90	97	100	97	103	101	101
EuroStoxx - Eurozone	94	101	95	94	112	103	104	102
Stoxx ex UK - Europe ex UK	103	106	102	100	102	99	99	99
Stoxx - Pan Europe	100	100	100	100	100	100	100	100

Source: Citi Research & DataStream



**Figure 22. Pan-European Country Growth**

As at Close 16 Apr 13 Country	Earnings Growth %			Dividend Growth %		
	2012E	2013E	2014E	2012E	2013E	2014E
Austria	124.7	0.4	35.3	19.2	11.4	15.7
Belgium	3.3	14.4	16.6	42.3	-1.7	12.6
Denmark	29.8	14.5	21.2	17.9	19.6	27.9
Finland	-37.5	44.4	28.8	6.0	-21.4	5.0
France	-13.1	21.5	11.7	3.6	8.9	9.2
Germany	19.5	-6.7	11.1	4.0	-3.7	7.2
Greece	-671.1	-114.6	160.3	-20.8	-15.8	83.2
Ireland	4.6	7.9	20.0	6.6	6.6	5.6
Italy	-21.0	25.2	13.4	-4.8	5.1	8.8
Netherlands	7.3	20.3	14.5	-1.6	3.9	13.3
Norway	7.3	8.8	13.8	18.1	2.3	12.1
Portugal	-89.4	466.0	48.5	-16.2	-4.1	7.3
Spain	-52.7	87.1	7.1	-31.7	18.0	-7.4
Sweden	5.3	0.5	11.8	17.5	6.7	6.4
Switzerland	2.2	15.0	13.5	9.2	5.6	12.3
UK	1.4	3.6	8.6	11.1	2.4	7.7
EuroStoxx - Eurozone	-10.6	18.3	12.8	-3.6	4.0	6.3
Stoxx ex UK - Europe ex UK	-6.3	16.0	13.1	0.8	4.7	8.0
Stoxx - Pan Europe	-3.6	11.3	11.5	4.2	3.9	7.9

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

**Figure 23. Pan-European Country Ratings**

As at Close 16 Apr 13 Country	Price/Earnings				Net Dividend Yield			
	2011	2012E	2013E	2014E	2011	2012E	2013E	2014E
Austria	30.0	13.3	13.3	9.8	2.67	3.18	3.54	4.10
Belgium	19.6	19.0	16.6	14.2	2.38	3.39	3.33	3.75
Denmark	24.8	19.1	16.7	13.8	1.58	1.86	2.23	2.85
Finland	13.0	20.9	14.4	11.2	5.02	5.32	4.18	4.39
France	12.1	13.9	11.4	10.2	3.61	3.74	4.07	4.45
Germany	12.8	10.7	11.5	10.4	3.34	3.47	3.34	3.59
Greece	21.8	-3.8	26.2	10.1	2.16	1.71	1.44	2.64
Ireland	20.4	19.5	18.1	15.1	1.66	1.77	1.89	2.00
Italy	10.8	13.7	11.0	9.7	4.16	3.96	4.16	4.53
Netherlands	16.4	15.3	12.7	11.1	2.74	2.70	2.80	3.17
Norway	12.7	11.8	10.9	9.6	4.02	4.75	4.85	5.44
Portugal	10.9	102.6	18.1	12.2	5.75	4.82	4.62	4.96
Spain	9.5	20.1	10.7	10.0	7.95	5.43	6.41	5.93
Sweden	15.3	14.6	14.5	13.0	3.17	3.73	3.98	4.23
Switzerland	17.4	17.0	14.8	13.1	2.82	3.08	3.26	3.66
UK	12.7	12.5	12.1	11.1	3.36	3.73	3.82	4.12
EuroStoxx - Eurozone	12.5	14.0	11.8	10.5	3.90	3.75	3.90	4.15
Stoxx ex UK - Europe ex UK	13.7	14.7	12.6	11.2	3.55	3.57	3.74	4.04
Stoxx - Pan Europe	13.4	13.9	12.4	11.2	3.48	3.63	3.77	4.07

Source: Citi Research & DataStream

Figure 24. UK Sector Weightings & Relative Returns

As at Close 16 Apr 2013	Mkt	% of	% of	Relative return				
	Cap £m	AllShare	Group	1m	3m	12m	Qtd	Ytd
OIL & GAS (24)	288,378	15.1		-2	-6	-16	-1	-6
Oil & Gas Producers (17)	276,895	14.5	96	-1	-6	-16	-1	-6
Oil Equip, Serv and Distrib (7)	11,484	0.6	4	-7	-12	-21	-4	-9
BASIC MATERIALS (38)	160,000	8.4		-10	-17	-25	-5	-20
Chemicals (8)	13,420	0.7	8	-4	-2	-7	-4	-7
Forestry & Paper (1)	3,160	0.2	2	1	16	34	-2	18
Industrial Metals (4)	1,068	0.1	1	-33	-43	-60	-19	-41
Mining (25)	142,352	7.5	89	-11	-19	-27	-4	-21
INDUSTRIALS (109)	181,412	9.5		-1	5	6	-1	5
Construction & Materials (11)	14,290	0.7	8	-7	4	-1	-3	1
Aerospace (9)	43,735	2.3	24	4	11	12	0	11
General Industrials (6)	12,547	0.7	7	-4	-1	2	-1	-1
Electronic & Electrical Equip (12)	8,858	0.5	5	-5	3	2	-4	-1
Industrial Engineering (12)	18,526	1.0	10	-6	3	5	-3	3
Industrial Transportation (8)	2,285	0.1	1	3	7	3	3	3
Support Services (51)	81,171	4.3	45	0	4	6	0	5
CONSUMER GOODS (35)	276,261	14.5		2	6	7	0	6
Automobiles & Parts (2)	4,130	0.2	1	-4	2	10	-2	3
Beverages (4)	82,185	4.3	30	-1	6	12	-3	5
Food Producers (11)	46,397	2.4	17	4	9	19	1	8
Household Gds & Home Cons (11)	45,002	2.4	16	5	12	24	1	14
Leisure Goods (1)	181	0.0	0	-3	18	50	4	18
Personal Goods (4)	7,252	0.4	3	-8	-10	-25	-3	-4
Tobacco (2)	91,114	4.8	33	2	4	-5	2	3
HEALTH CARE (13)	143,101	7.5		8	9	2	4	9
Health Care Equip & Services (5)	7,755	0.4	5	1	1	6	-1	0
Pharmaceuticals & Biotech (8)	135,346	7.1	95	9	9	1	4	9
CONSUMER SERVICES (85)	189,719	9.9		1	4	11	0	3
Food & Drug Retailers (7)	45,797	2.4	24	3	7	4	2	4
General Retailers (22)	32,244	1.7	17	5	3	9	2	-1
Media (23)	53,875	2.8	28	0	2	10	-1	2
Travel & Leisure (33)	57,803	3.0	30	0	5	18	-1	5
TELECOMMUNICATIONS (8)	121,999	6.4		6	12	5	3	12
Fixed-Line Telecoms (6)	25,394	1.3	21	4	9	17	1	9
Mobile Telecoms (2)	96,605	5.1	79	6	13	2	3	13
UTILITIES (7)	76,638	4.0		9	5	5	4	3
Electricity (2)	17,020	0.9	22	7	3	2	4	1
Gas, Water & Multi-Utilities (5)	59,617	3.1	78	10	6	6	5	3
TECHNOLOGY (25)	29,874	1.6		-3	-1	13	-3	2
Software & Computer Serv (15)	13,813	0.7	46	-1	0	11	-1	0
Technology Hardware & Equip (10)	16,061	0.8	54	-5	-2	14	-4	3
TOTAL NON-FINANCIAL (344)	1,467,382	76.9		0	0	-3	0	0
FINANCIALS (252)	441,266	23.1		-1	-2	12	0	0
Banks (6)	220,627	11.6	50	-3	-5	12	-1	-2
Non-Life Insurance (10)	17,339	0.9	4	0	0	8	0	-3
Life Insurance (9)	69,863	3.7	16	-2	2	20	1	3
Real Estate Investment Svs (21)	7,684	0.4	2	5	8	15	4	6
REITS (16)	27,854	1.5	6	6	0	9	6	-2
Financial Services (27)	36,753	1.9	8	1	7	19	3	10
Equity Inv. Instruments (163)	61,146	3.2	14	1	2	1	1	2
FTSE ALL SHARE (596)	1,908,649	100.0		0	0	0	0	0
FTSE 100 (100)	1,601,075	83.9		0	0	-1	0	0
Mid 250 (250)	263,583	13.8		0	3	7	2	2
Small Cap (246)	43,991	2.3		1	1	6	2	2

Source: Citi Research & DataStream

Figure 25. UK Relative Ratings

As at Close 16 Apr 2013	P/E Relative				Yield Relative			
	2011	2012E	2013E	2014E	2011	2012E	2013E	2014E
OIL & GAS	72	71	78	79	111	115	119	114
Oil & Gas Producers	71	70	77	78	113	117	120	115
Oil Equip, Serv and Distrib	123	107	95	89	71	72	77	84
BASIC MATERIALS	57	88	91	87	90	92	92	94
Chemicals	131	124	133	132	62	62	65	66
Forestry & Paper	117	118	104	99	77	74	84	90
Industrial Metals	56	-74	-162	227	257	31	15	14
Mining	54	83	87	84	92	96	95	97
INDUSTRIALS	129	118	118	118	72	76	78	75
Construction & Materials	118	119	132	118	121	112	111	105
Aerospace	117	105	103	109	80	82	82	80
General Industrials	108	100	100	99	85	87	91	92
Electronic & Electrical Equip	136	128	130	130	46	47	48	49
Industrial Engineering	133	121	122	123	62	77	65	65
Industrial Transportation	101	107	103	99	81	80	81	78
Support Services	143	130	128	126	61	69	73	69
CONSUMER GOODS	155	136	133	131	79	81	87	88
Automobiles & Parts	90	74	74	72	70	80	86	92
Beverages	185	160	154	151	59	61	64	65
Food Producers	167	155	148	147	77	76	80	81
Household Gds & Home Cons	174	139	136	134	59	62	80	78
Personal Goods	177	151	145	138	53	57	60	64
Tobacco	128	116	114	114	111	114	118	120
HEALTH CARE	91	90	105	108	125	120	118	115
Health Care Equip & Services	126	119	120	118	44	60	61	62
Pharmaceuticals & Biotech	90	88	104	107	130	123	122	118
CONSUMER SERVICES	113	113	114	115	87	87	86	83
Food & Drug Retailers	99	100	110	122	110	107	101	94
General Retailers	112	109	108	107	83	82	82	83
Media	120	109	113	113	81	86	88	87
Travel & Leisure	122	136	123	115	76	76	73	72
TELECOMMUNICATIONS	100	96	98	98	170	148	133	126
Fixed-Line Telecoms	102	91	96	98	98	99	103	109
Mobile Telecoms	99	97	98	99	190	161	141	130
UTILITIES	121	115	121	125	136	136	132	128
Electricity	107	102	115	118	150	147	138	134
Gas, Water & Multi-Utilities	126	119	123	127	132	133	131	127
TECHNOLOGY	220	193	175	167	34	37	42	46
Software & Computer Serv	158	139	133	131	52	56	59	60
Technology Hardware & Equip	334	288	241	219	19	22	27	34
TOTAL NON-FINANCIAL	96	99	104	104	101	101	101	99
FINANCIALS	117	104	88	88	97	98	97	106
Banks	108	103	79	79	83	85	89	105
Non-Life Insurance	163	83	84	87	165	181	141	137
Life Insurance	101	87	90	93	119	114	109	108
Real Estate Investment Svs	294	197	201	195	55	55	58	60
REITS	189	182	192	196	104	103	100	96
Financial Services	169	128	102	96	106	108	100	107
FTSE ALL SHARE	100	100	100	100	100	100	100	100
FTSE 100	95	98	98	98	103	103	103	103
Mid 250	150	116	117	115	78	80	78	78
Small Cap	103	113	102	92	81	78	78	81

Source: Citi Research & DataStream

Figure 26. UK Earnings Growth

As at Close 16 Apr 2013	Earnings Growth %			Net Dividend Growth %		
	2012	2013E	2014E	2012	2013E	2014E
OIL & GAS	-1.9	-2.0	8.1	8.7	9.5	3.8
Oil & Gas Producers	-2.2	-2.6	7.8	8.8	9.4	3.4
Oil Equip, Serv and Distrib	11.5	21.0	16.7	6.8	12.4	18.3
BASIC MATERIALS	-37.1	3.9	14.4	7.4	6.0	9.9
Chemicals	2.1	1.0	10.1	5.0	10.7	9.9
Forestry & Paper	-3.8	22.1	15.3	0.7	20.9	15.3
Industrial Metals	-173.3	-51.0	-178.1	-87.3	-48.5	0.2
Mining	-38.0	3.3	13.8	9.6	5.6	9.8
INDUSTRIALS	5.3	8.0	9.7	12.1	8.0	4.2
Construction & Materials	-4.0	-2.7	22.4	-3.1	5.2	2.8
Aerospace	7.4	9.8	3.8	6.7	6.3	6.4
General Industrials	3.6	8.5	10.4	7.1	11.9	9.1
Electronic & Electrical Equip	2.9	6.2	9.4	8.6	9.1	9.8
Industrial Engineering	6.5	6.6	8.6	29.6	-9.1	7.1
Industrial Transportation	-8.8	11.7	13.6	4.4	7.3	4.1
Support Services	6.7	9.2	11.6	18.9	13.5	1.4
CONSUMER GOODS	9.8	10.8	10.7	8.1	14.4	9.4
Automobiles & Parts	16.9	7.9	12.8	20.0	15.0	15.0
Beverages	11.2	12.0	12.0	8.8	11.2	10.5
Food Producers	4.3	13.0	10.1	4.2	11.7	9.6
Household Gds & Home Cons	20.4	10.2	11.6	11.0	37.1	5.1
Personal Goods	13.0	12.7	14.9	13.3	12.3	15.3
Tobacco	6.6	9.5	9.2	7.8	10.9	9.9
HEALTH CARE	-2.0	-7.9	6.7	0.7	5.2	4.6
Health Care Equip & Services	2.8	6.8	11.3	45.3	6.8	10.6
Pharmaceuticals & Biotech	-2.2	-8.6	6.4	-0.2	5.1	4.4
CONSUMER SERVICES	-3.4	6.8	9.1	5.3	4.4	5.4
Food & Drug Retailers	-4.5	-2.5	-1.0	2.2	0.9	0.5
General Retailers	-0.4	8.3	10.4	3.3	7.1	8.5
Media	6.6	3.5	9.1	11.4	8.0	7.3
Travel & Leisure	-13.6	19.7	17.4	4.0	2.8	6.6
TELECOMMUNICATIONS	0.3	5.9	8.5	-8.4	-4.7	2.3
Fixed-Line Telecoms	8.9	2.0	7.2	6.4	11.2	13.7
Mobile Telecoms	-1.8	7.0	8.8	-10.4	-7.2	0.1
UTILITIES	2.0	2.5	6.0	5.1	3.5	4.5
Electricity	1.2	-4.5	6.9	2.9	0.0	4.5
Gas, Water & Multi-Utilities	2.3	4.9	5.7	5.8	4.7	4.6
TECHNOLOGY	10.3	18.8	14.8	14.9	18.5	18.9
Software & Computer Serv	9.4	13.2	11.1	13.4	11.8	10.8
Technology Hardware & Equip	11.9	28.7	20.5	18.4	33.2	33.7
TOTAL NON-FINANCIAL	-6.1	3.0	9.4	4.8	6.6	5.6
FINANCIALS	8.9	27.7	9.3	6.3	5.2	18.1
Banks	1.5	39.7	9.7	7.5	12.0	26.9
Non-Life Insurance	89.9	7.1	5.5	15.8	-17.0	5.0
Life Insurance	13.1	3.7	5.9	0.8	1.9	6.4
Real Estate Investment Svs	43.6	5.9	12.9	5.1	12.5	10.8
REITS	0.0	2.6	7.2	4.3	3.3	4.0
Financial Services	26.9	35.5	16.2	7.3	-1.3	15.5
FTSE ALL SHARE	-3.4	7.8	9.4	5.1	6.3	8.1
FTSE 100	-5.9	7.8	9.0	4.8	6.6	8.1
Mid 250	25.4	6.7	11.3	8.1	3.9	8.3
Small Cap	-12.3	19.2	21.8	1.3	5.9	12.6

Source: Citi Research & DataStream

Figure 27. UK Sector Ratings

As at Close 16 Apr 2013	Price/Earnings				Net Dividend Yield			
	2011	2012E	2013E	2014E	2011	2012E	2013E	2014E
OIL & GAS	9.0	9.2	9.4	8.7	3.78	4.11	4.50	4.67
Oil & Gas Producers	8.9	9.1	9.3	8.7	3.83	4.17	4.56	4.72
Oil Equip, Serv and Distrib	15.5	13.9	11.5	9.8	2.42	2.58	2.90	3.44
BASIC MATERIALS	7.2	11.4	11.0	9.6	3.06	3.29	3.49	3.83
Chemicals	16.5	16.2	16.0	14.5	2.12	2.22	2.46	2.70
Forestry & Paper	14.7	15.3	12.5	10.9	2.62	2.64	3.19	3.68
Industrial Metals	7.0	-9.6	-19.5	25.0	8.71	1.10	0.57	0.57
Mining	6.7	10.9	10.5	9.2	3.12	3.42	3.61	3.97
INDUSTRIALS	16.2	15.4	14.3	13.0	2.43	2.72	2.94	3.07
Construction & Materials	14.8	15.5	15.9	13.0	4.12	3.99	4.20	4.32
Aerospace	14.7	13.7	12.4	12.0	2.73	2.91	3.10	3.29
General Industrials	13.5	13.1	12.0	10.9	2.88	3.09	3.46	3.77
Electronic & Electrical Equip	17.1	16.7	15.7	14.3	1.54	1.68	1.83	2.01
Industrial Engineering	16.7	15.7	14.7	13.6	2.11	2.73	2.48	2.66
Industrial Transportation	12.7	13.9	12.5	11.0	2.74	2.86	3.06	3.19
Support Services	18.0	16.9	15.5	13.8	2.06	2.45	2.78	2.82
CONSUMER GOODS	19.5	17.7	16.0	14.5	2.68	2.89	3.31	3.62
Automobiles & Parts	11.3	9.7	9.0	7.9	2.37	2.84	3.27	3.75
Beverages	23.2	20.9	18.6	16.7	1.99	2.17	2.41	2.66
Food Producers	21.0	20.2	17.8	16.2	2.61	2.72	3.03	3.32
Household Gds & Home Cons	21.8	18.1	16.5	14.8	1.99	2.21	3.03	3.18
Personal Goods	22.2	19.7	17.4	15.2	1.79	2.03	2.28	2.63
Tobacco	16.1	15.1	13.8	12.6	3.76	4.05	4.49	4.93
HEALTH CARE	11.4	11.7	12.7	11.9	4.24	4.27	4.49	4.70
Health Care Equip & Services	15.9	15.4	14.5	13.0	1.48	2.15	2.30	2.54
Pharmaceuticals & Biotech	11.3	11.5	12.6	11.8	4.40	4.39	4.62	4.82
CONSUMER SERVICES	14.2	14.7	13.8	12.6	2.95	3.11	3.24	3.42
Food & Drug Retailers	12.4	13.0	13.3	13.4	3.72	3.80	3.83	3.85
General Retailers	14.1	14.2	13.1	11.8	2.82	2.91	3.12	3.38
Media	15.1	14.1	13.7	12.5	2.76	3.07	3.32	3.56
Travel & Leisure	15.3	17.7	14.8	12.6	2.59	2.70	2.77	2.96
TELECOMMUNICATIONS	12.5	12.5	11.8	10.9	5.78	5.29	5.05	5.16
Fixed-Line Telecoms	12.9	11.8	11.6	10.8	3.31	3.52	3.92	4.45
Mobile Telecoms	12.4	12.7	11.8	10.9	6.43	5.76	5.34	5.35
UTILITIES	15.2	14.9	14.6	13.8	4.61	4.85	5.02	5.25
Electricity	13.4	13.2	13.9	13.0	5.09	5.24	5.24	5.47
Gas, Water & Multi-Utilities	15.9	15.5	14.8	14.0	4.48	4.74	4.96	5.18
TECHNOLOGY	27.7	25.1	21.2	18.4	1.16	1.33	1.58	1.88
Software & Computer Serv	19.8	18.1	16.0	14.4	1.76	1.99	2.23	2.47
Technology Hardware & Equip	41.9	37.5	29.1	24.2	0.65	0.77	1.03	1.38
TOTAL NON-FINANCIAL	12.1	12.9	12.5	11.4	3.42	3.59	3.82	4.04
FINANCIALS	14.8	13.6	10.6	9.7	3.28	3.48	3.67	4.33
Banks	13.6	13.4	9.6	8.7	2.81	3.02	3.38	4.29
Non-Life Insurance	20.5	10.8	10.1	9.6	5.58	6.46	5.36	5.63
Life Insurance	12.7	11.3	10.9	10.3	4.04	4.07	4.15	4.41
Real Estate Investment Svs	36.9	25.7	24.2	21.5	1.87	1.97	2.21	2.45
REITS	23.7	23.7	23.1	21.6	3.52	3.67	3.79	3.94
Financial Services	21.2	16.7	12.3	10.6	3.58	3.84	3.79	4.38
FTSE ALL SHARE	12.6	13.0	12.1	11.0	3.39	3.57	3.79	4.10
FTSE 100	12.0	12.8	11.8	10.8	3.51	3.68	3.92	4.23
Mid 250	18.9	15.1	14.1	12.7	2.63	2.85	2.96	3.20
Small Cap	12.9	14.7	12.4	10.1	2.74	2.78	2.94	3.31

Source: Citi Research & DataStream

Figure 28. Stocks Mentioned (As at 17<sup>th</sup> April 2013)

Stock	RIC	Price	Rating	Currency	Stock	RIC	Price	Rating	Currency
ABB	ABBN.VX	20.23	1	CHF	Munich Re	MUVGn.DE	148.60	2	EUR
Actelion	ATLN.VX	53.30	2	CHF	Nordea	NDA1V.HE	8.63	2	EUR
Adidas	ADSGn.DE	76.19	1	EUR	Novartis	NOVN.VX	67.10	1	CHF
Ahold	AHLN.AS	11.71	1	EUR	Novo-Nordisk	NOVOb.C O	950.00	1	DKK
Alfa Laval	ALFA.ST	140.40	2	SEK	Novozymes	NZYMb.CO	203.00	3	DKK
Allianz	ALVG.DE	104.85	1	EUR	Philips	PHG.AS	21.87	3	EUR
ARM Hld	ARM.L	8.69	1	GBP	Publicis Groupe	PUBP.PA	50.60	3	EUR
Ashtead Group	AHT.L	5.92	1	GBP	Qiagen	QGEN.O	19.83	3	USD
AstraZeneca	AZN.L	33.31	2	GBP	Reckitt Benckiser	RB.L	46.76	1	GBP
Atlas Copco	ATCOa.ST	173.00	3	SEK	Roche	ROG.VX	225.90	2	CHF
AXA	AXAF.PA	12.89	1	EUR	Rolls-Royce	RR.L	11.32	1	GBP
BAE Systems	BAES.L	3.80	2	GBP	Safran	SAF.PA	34.41	2	EUR
Bayer	BAYGn.DE	79.00	1	EUR	Sanofi	SASY.PA	80.09	1	EUR
BIC	BICP.PA	84.66		EUR	SAP AG	SAPG.DE	59.55	2	EUR
Bilfinger	GBFG.DE	77.49		EUR	Schneider Electric	SCHN.PA	52.86	3	EUR
Brenntag	BNRGn.DE	123.95		EUR	SE Banken AB	SEBa.ST	63.95	2	SEK
Burberry Grp	BRBY.L	12.94	2	GBP	SHB	SHBa.ST	265.60	2	SEK
CAP Gemini	CAPP.PA	33.65	1	EUR	Shire	SHP.L	19.64	1	GBP
Coloplast	COLOb.CO	303.00		DKK	Siemens	SIEGn.DE	77.84	1	EUR
Credit Suisse	CSGN.VX	25.45	1	CHF	Skanska	SKAb.ST	105.40		SEK
CRH	CRH.L	13.22	3	GBP	Smith & Nephew	SN.L	7.18	1	GBP
Dassault Sys	DAST.PA	88.18	1	EUR	Sodexo	EXHO.PA	64.03	1	EUR
EADS	EAD.PA	38.80	1	EUR	Sonova Hld	SOON.VX	96.25	1	CHF
Ericsson	ERICb.ST	76.35	1	SEK	STMicroelectr onics	STM.PA	5.53	2	EUR
Essilor	ESSI.PA	82.50	1	EUR	Swatch Grp	UHR.VX	520.50	2	CHF
Experian	EXP.N.L	11.10	1	GBP	Swiss Re	SRENN.VX	69.60	2	CHF
HSBC	HSBA.L	6.65	2	GBP	Syngenta	SYNN.VX	394.50	1	CHF
Infineon	IFXGn.DE	5.58	2	EUR	Tenaris	TS.N	39.90		USD
Intercont Hotels	IHG.L	18.72	1	GBP	TGS	TGS.OL	207.30		NOK
Kering	P RTP.PA	162.75	1	EUR	UCB SA	UCB.BR	46.93	2	EUR
Kone	KNEBV.HE	58.70	3	EUR	Unilever	ULVR.L	27.55	2	GBP
Lindt Spruengli	LISN.S	42205.00	1	CHF	Unilever NV	UNc.AS	31.48	2	EUR
L'Oréal	OREP.PA	121.15	2	EUR	Volvo AB	VOLVb.ST	87.05	2	SEK
Luxottica Grp	LUX.MI	39.01	1	EUR	Wolseley	WOS.L	31.79	2	GBP
LVMH	LVMH.PA	120.80	1	EUR	WPP	WPP.L	10.29	2	GBP
Michelin	MICP.PA	59.20	1	EUR	Zodiac Aero	ZODC.PA	91.73		EUR
MTU Aero Engines	MTXGn.DE	74.19	2	EUR					

Source: Citi Research

# Appendix A-1

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