13 January 2014 | 17 pages

Western Europe

European Credit Outlook

The year of the Greater Fool's Game? (Positioning & Trades)

- **Tighter, but not enough to reach targets** – Based on our forecast of just 10-15% tightening, few people will meet their 2014 targets through alpha and primary alone.
- **Lever up prudently** – Most investors seem prepared to lever up further, but with underlying trends in credit deteriorating, we'd take incremental exposure with care.
- **Asymmetries & liquidity** – In aggregate, our strategies for 2014 revolve around exploiting asymmetries in risk / reward and taking that incremental exposure, where there is the liquidity to let you get out, even in a risk-off environment.
- **Cash strategies** – In the cash market, we prefer leverage through subordination to taking credit risk, leaving spread duration as our least preferred option. At the sectoral level, we expect financials to outperform non-financials further, but our focus would be on minimizing beta exposure taken per unit of carry.
- **Cash / CDS strategies** – Currently, the entry point is poor, but we expect the outperformance of CDS over cash that we saw late last year to be an ongoing theme in 2014. We think the best way to express that is by keeping spread duration short in cash and long in CDS.
- **CDS strategies** – We see most scope to enhance returns in 2014 in derivatives, outright and with RV trades. We like flatteners - for every 10bp of tightening in Main, 3s5s should flatten by 2.5-3bp. We also favour financial vs. non-financial compression, but β-adjusted Main and Crossover decompression.
- **Tranche & options strategies** – In tranche space, we expect mezzanine to outperform this year. In options, we favour selling straddles and using payer spreads to hedge generic exposure.

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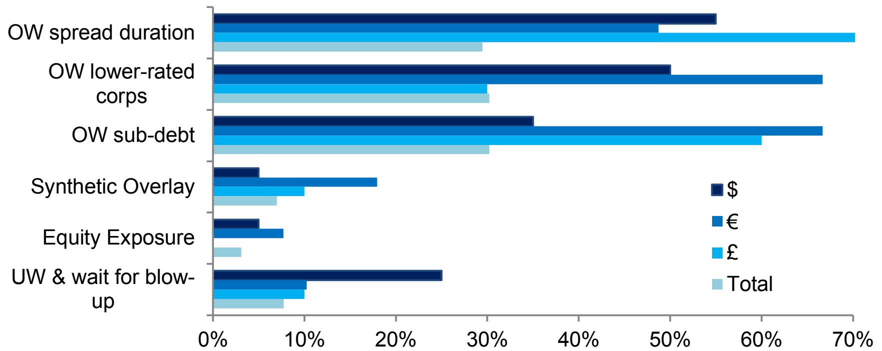
Figure 1. "How will you seek to enhance return prospects in 2014?"



Source: Citi Credit Survey, December 2013. Note: OW: Overweight. UW: Underweight

Positioning for 2014

Central scenario: "Take risk today, worry tomorrow"

In the accompanying *"The year of the Greater Fool's Game? (Strategies)"* note we argued that there is much not to like about the underlying trends in credit at the moment.

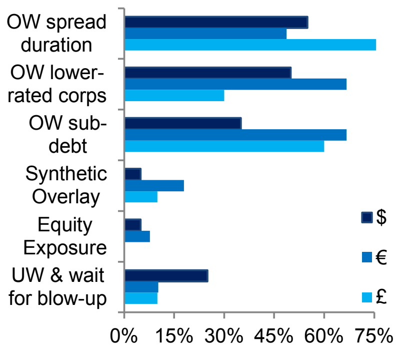
But equally, the major negative catalysts for 2014 aren't evident. And with central bank policies ensuring that there will still be a glaring imbalance between the supply of and demand for new securities across global financial markets, we reckon few investors will be able to wait for a better entry point.

Whereas equity performance should be supported by ongoing inflows, we suspect that much of the tightening in credit will be built on more fragile foundations.

In a variant of the Greater Fool's Game, we think most credit investors will end up levering their exposures further in one way or another. The implicit assumption seems to be that they'll get out when a negative catalyst appears or be in the same boat as everyone else, leaving central banks no option but to bail everyone out again.

In our December Credit Survey, we asked investors how they plan to enhance returns this year. The answer was clear: through spread duration, by moving down in credit quality and by overweighting sub-debt. Few said that they were planning to use synthetic overlays, but then again, judging by the performance of the CDS indices in Q4 *something* must be happening there too. So it looks like all the conventional ways of leveraging up are being employed (Figure 2).

Figure 2. "How will you seek to enhance return prospects in 2014?"



Source: Citi Credit Survey.

10-15% tighter in 2014

On that basis, we forecast spreads will tighten by 10-15% across the board (Figure 3) during the year. Indeed it is very possible that we overshoot during the year, but end off the lows as the market wakes up to the prospect of actual policy tightening into 2015.

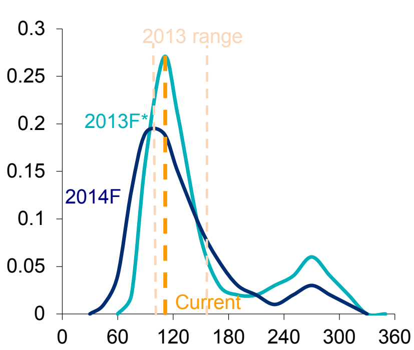
Figure 3. Citi 2014 forecasts

	Current	14F target	Excess return	Total return
iBoxx € Corp	105bp	90bp	1.5%	3%
iBoxx € HY	320bp	290bp	2.5%	4%
iTraxx Main	72bp	60bp	1.3%	-
iTraxx Xover	285bp	240bp	5.0%	-

Source: Citi Research

But the very fact that people are piling into the same consensus long-risk positions may also make 2014 more volatile than 2013. Without a major negative catalyst a proper tail-risk scenario seems less likely than we thought going into 2013, but we think periodic unwinds will lead to a wider range this year (Figure 4).

Figure 4. Stylised distribution of spread outcomes 14F vs. 13F* (Citi expectations)



Source: Citi Research. *: Perceived distribution of risk in 2013, as of January 2013.

"Trade the ranges in a contrarian fashion" sounds straightforward, but isn't in reality. Invariably, it implies selling risk when markets look good and buying risk when they look bad – and most likely without being able to see a tangible catalyst for change. So we'd look for the vulnerability rather than the trigger itself.

And at the moment we do see significant vulnerability. As discussed in our *Strategies* note, positions in credit are near a record long, inflows have diminished and investors have added significant amounts of beta since September. Large redemptions in January may top up depleted cash balances for now, but we suspect that new supply will bring them back down soon enough. So against the consensus bullishness (and our strategic overweight for the year), we are going into January with a neutral stance on a tactical basis.

Trade strategies for 2014

Cash-only strategies

Subordination > credit risk > duration risk

A fund manager sitting on a cash-only mandate would have to do extraordinarily well to generate sufficient excess returns in 2014 purely on new issue premia and alpha trades. As discussed above, s/he will almost inevitably end up taking beta through a combination of adding subordinated debt, moving down in credit quality and/or taking more spread duration. But which is preferable?

Subordination would be our first choice. The amount of credit risk or spread duration needed to generate the same spread on a subordinated bond seems disproportionate in our view.

For instance, there are single-B rated bonds of a similar maturity trading tight to the 215bp spread on the BBB+ rated EDF 2020 hybrids. Granted, the methodology changes from the rating agencies have left some investors out of pocket, when bonds suddenly became callable, but we think the methodology creep will slow significantly going forward.

In financials, the market is to our minds still underpricing the new bank bail-in regime, which has left senior unsecured in a much thinner and more junior slice of the capital structure than previously.

There is of course a caveat to that: supply. We expect the largest volume of subordinated debt issuance ever in 2014. We still like some of the longer-dated old-style T1 and T2 debt, which ought to be bought back or exchanged in the next 3-4 years, but if you are looking at new-style structures then we'd therefore focus on the primary market. We regard coupon deferral as a bigger risk than mandatory triggers and therefore tend to prefer T2-host CoCos to conventional AT1 issues. For the same reason, we have a clear preference for AT1 issues with dividend stoppers.

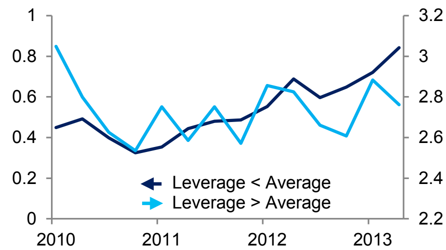
Credit risk would be our second choice. Generically, we expect default rates to remain low. S&P's projected 4% default rate on publically rated debt (from 2.2% currently) for end-2014 in Europe seems slightly on the high side to us in a gradual recovery with very low interest rates.

By moving down in credit quality, you are less exposed to the latent systemic issues on a risk-adjusted basis. Moreover, the companies that will be first to accelerate share buybacks or look at bolt-on acquisitions are those that have the strongest balance sheets and which therefore trade at very tight credit spreads currently.

As illustrated in Figure 5, in our sample of 258 non-financial companies in EuroStoxx, the leverage of companies that had less leverage than average has risen by half a turn over the last three years. The leverage of companies that had more leverage than average is essentially unchanged over the same period.

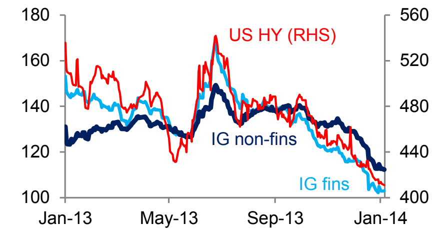
In the US, where these trends are more developed, we've seen IG non-financials underperform both financials and HY sharply in the latter part of 2013 (Figure 6).

Figure 5. Net debt/EBITDA for leveraged & less leveraged non-financials in EuroStoxx600



Source: Citi Research, Bloomberg.

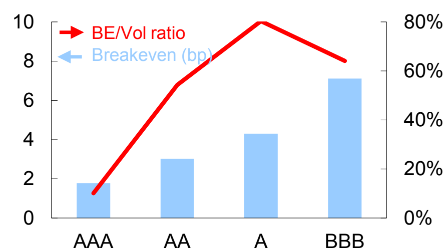
Figure 6. US IG & HY OAS spreads to Libor, bp



Source: Citi Research, YieldBook

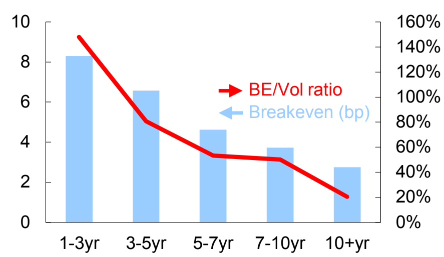
Another way to look at it is in terms of how well the carry is protected. The breakeven (spread divided by duration) tells you how much spread widening the carry over a certain period compensates you for. Realised vol says something about how likely it is that actual spread movements exceed that amount. So the breakeven-to-vol ratio is a simple metric of how well your carry is protected. Figure 7 shows that on this metric also, you are better off further down the credit quality spectrum[1].

Figure 7. iBoxx non-fins breakeven vs BE/vol ratio by rating, 3mth



Source: Citi Research, MarkIt

Figure 8. iBoxx non-fins breakeven vs BE/vol ratio by duration, 3mth



Source: Citi Research, MarkIt

Spread duration is our least preferred way of taking beta in € cash credit[2] because cash curves are so flat already. The breakeven-to-vol chart (Figure 8) illustrates this clearly: the additional carry further out the curve is not enough to compensate for the additional price sensitivity and volatility.

We're not saying that we would be short spread duration (remember, we're still bullish on spreads on a strategic horizon), but relative to the risk you are taking, we think it is the least attractive way of adding beta here.

Take carry with less beta

Another simple way of looking at the issue of how to generate excess returns without taking excessive risk is just to look at the carry relative to the historical beta.

[1] Obviously carry is not the principal consideration in a rallying market, where you want spread duration to profit from tightening spreads. Equally, when you are bearish, you don't want risk at all. We use the BE/vol ratio when spreads seem to be at the tighter end of the range (so we are not bullish), but when we don't have a specific negative catalyst either – that's when focus tends to be on carry.

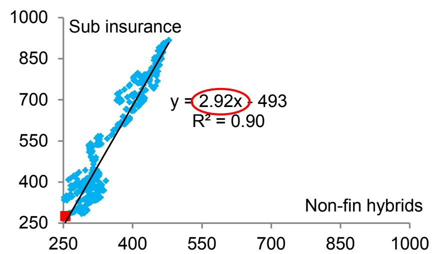
[2] Note that in $ credit it's a different story: ALM-driven demand for long-dated credit is likely to keep the very long-end very well underpinned.

For instance, compare non-financial hybrids with sub insurance (Figure 9). A simple regression over the last couple of years illustrates that sub insurance has traded in a range of 280-950bp, while the hybrids have traded in a range of 260-500bp. Put differently, sub insurance has moved nearly 3bp for every basis point hybrids have moved. Both sectors are now at the tights of the range, so the difference in carry is negligible. Why then sit in something that has historically been three times as volatile?

Now, we hear you that past history may not be relevant for sub insurance in the post-sovereign- and-financial-crisis world, but you can have a lot of structural change before that historical relative volatility inverts. You could also make the case that the technical in hybrids has been anything but good with so much issuance. But we'd argue that the technical in financial sub debt should be equally impacted by supply this year. To us, you're still taking a more downside risk in sub insurance than in hybrids, for virtually no incremental carry and a debatable fundamental argument.

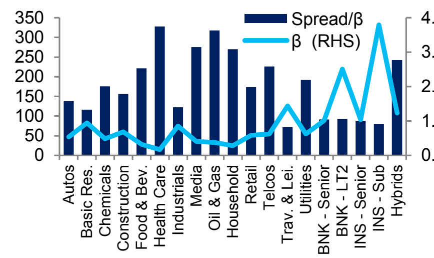
Looking across the market (Figure 10), we see comparatively large divergences in spread to beta ratios. While there may be good fundamental reasons for some of the discrepancies, we'd take a good look at whether the exposures in our portfolio really generate enough carry to compensate for the historical market sensitivity.

Figure 9. Sub insurance vs non-fin hybrid spreads in iBoxx 2012-13, bp



Source: Citi Research, MarkIt

Figure 10. iBoxx – spread per unit of β, bp



Source: Citi Research, MarkIt. Note: Beta is measured in levels relative to the iBoxx € Corp index from 2010

Cash & CDS strategies

Stay liquid: long CDS over cash

If most of the trends from the last couple of years carry over to 2014, then we reckon the cash-CDS basis is the exception to the rule. All the excess liquidity sloshing around in credit has generally been putting a premium on funded assets, keeping the basis unusually positive. Yet on a strategic horizon we would now position for a more negative basis.

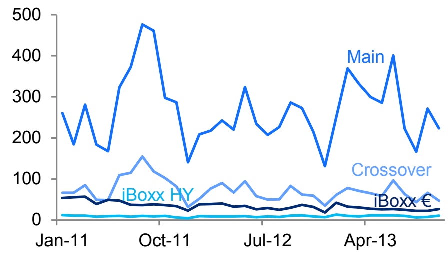
In 2014, where inflows are smaller and there is more supply, the relative bid for cash should weaken. Moreover, as investors look at new ways of enhancing returns, the bid for synthetic leverage will rise. It's just simpler for hedge funds to sell protection on iTraxx or even a mezz tranche of iTraxx, than to buy IG cash bonds on margin with a likelihood that haircuts will suddenly rise exactly at the point where the mark-to-market is underwater.

However, the best reason to take incremental exposure through CDS rather than in cash is liquidity. The volume of iTraxx Main and Crossover traded has consistently been a multiple of the total volume traded of bonds in the iBoxx IG and HY (Figure 11). In a year where we are ultimately increasingly uneasy about the underlying

currents in credit, we'd be considerably more comfortable in the knowledge that at least we have scope to reposition, if we see a downside scenario unfolding.

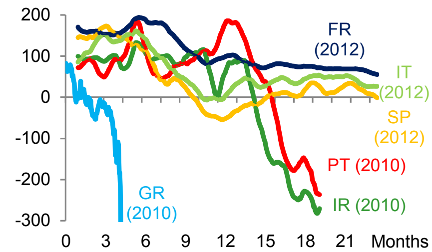
As ever, there is a catch though. Positive basis trades may make a nice tail hedge (Figure 12) but in moderate selloffs CDS is more volatile than cash in part because the iTraxx indices are such a convenient overlay to hedge short-term volatility.

Figure 11. Monthly CDS index vs cash bond turnover volumes, €bn



Source: Citi Research, MarkIt, Xtrakter

Figure 12. Sovereign CDS-cash basis during periods of stress (start year in brackets), bp

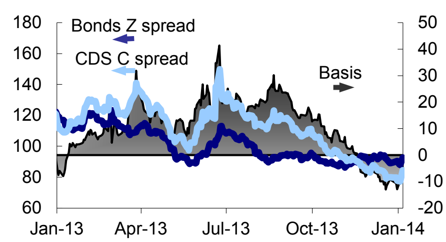


Source: Citi Research, MarkIt

And right now we think the entry point on the positive basis trade is poor – CDS rallied strongly in Q4 (presumably for the very reasons outlined above), while in cash only high-beta credit performed. As such, the basis has dropped about 40bp since September (Figure 13). We now think there are a fair amount of longs in the CDS indices that would be taken off quickly in a market reversal.

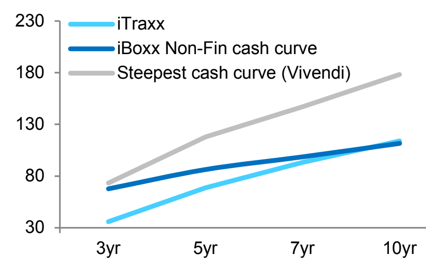
So on a tactical horizon, we would be scaling back rather than adding to index longs (risk) here. But beyond that we would be sellers of the basis on dips, expecting the basis to move another 20bp or lower during the year.

Figure 13. € iBoxx cash-CDS basis, bp



Source: Citi Research, MarkIt

Figure 14. iTraxx & iBoxx credit curves, bp



Source: Citi Research, MarkIt

Take duration through CDS rather than in cash

As we'll discuss below, the steepness of CDS curves presents one of the best trading opportunities for 2014. By comparison, the cash curve is extremely flat. In Figure 14 we have compared the iTraxx curve to an average of 48 individual cash curves to illustrate the difference in steepness.

If you take the steepest single cash curve (which was Vivendi) you can just about get the same absolute spread pickup by moving out in duration as you do on the iTraxx index. But relative to the spread level it is still significantly less, which means that the DV01-neutral position is less attractive.

So adding various elements together, we'd be long long-dated risk through CDS, while holding cash exposure at the short end, where the carry is better protected.

CDS trades

Flatteners – the reluctant bull trade of 2014

The flattener was probably been the most 'misunderstood ' trade of 2013 in our opinion. Curves were seen to be too steep to the historical relationship to spread levels (Figure 15), but failed to correct because the principal buyers of short-dated protection, bank CVA desks, were absent in an environment with fewer systemic risks. Moreover, as spreads were at the point where the relationship with the curve is least directional (around the inflection point of the 'bell'), we saw the flattener mostly as a cheap tail-hedge.

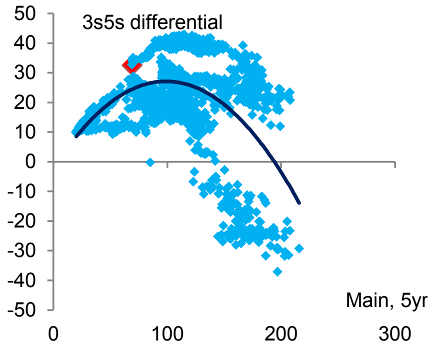
But to reluctant bulls like us, the flattener is the most obvious trade for 2014. Quite simply, spreads are getting to a level where people will almost invariably get forced into longer maturities if the tightening continues. In absolute terms the curve flattening started some time ago, but in relative terms the ratio between 3- and 5-year spreads is about as high as we have ever seen (Figure 16). For every 10bp of tightening in 5yr Main, we'd expect the 3s5s curve to flatten by 2.5-3bp.

Conversely, if spreads were to widen then the same arguments against further steepening that people have been using all year still apply.

That asymmetry in risk/reward looks inherently attractive to us, at a point in time where many people are grappling with how to get longer, when they are still ultimately worried about both valuations and fundamentals.

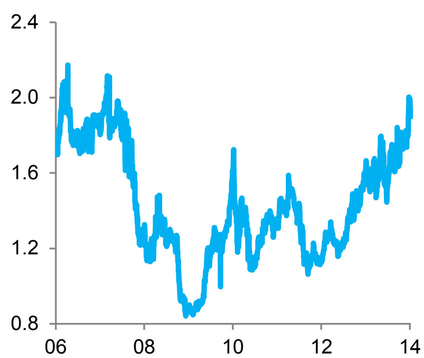
We think it is far more attractive to put on the flattener in 3s5s space, because the carry and roll is positive over time. In 5s10s space, the carry and roll is still negative over time. Among the indices, we would use iTraxx Main. The carry and roll on the Crossover 3s5s is not quite as attractive and the Main is more liquid.

Figure 15. iTraxx Main 3s5s spread differential vs iTraxx Main 5yr, bp



Source: Citi Research, MarkIt

Figure 16. iTraxx Main 5yr / 3yr ratio



Source: Citi Research, MarkIt

Long Main vs. Xover (Abel Elizalde)

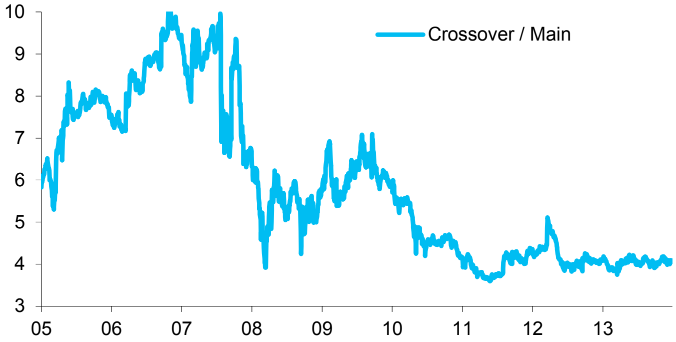
Over the last few years the ratio between Main and Crossover has been comparatively stable at a much lower multiple that we saw from 2005-07. As Figure 17 shows, the ratio of Crossover to Main spreads has spent most of the past two years at around 4x, a level which in a historical context looks too low when compared to the currently tight spread levels (Figure 18).

Assuming spreads tighten further or stabilize this year, we reckon that the market dynamics will gradually revert to something more similar to that which we saw before the crisis. Granted, the quality of the Crossover index has improved, but in a low volatility environment we believe investors will be more inclined to look for carry by levering up IG spreads than by venturing further into high yield, where valuations look increasingly stretched.

We believe the downside on this trade is limited if we widen and the upside is significant if we continue tightening.

Figure 17. Ratio of Xover to Main spreads

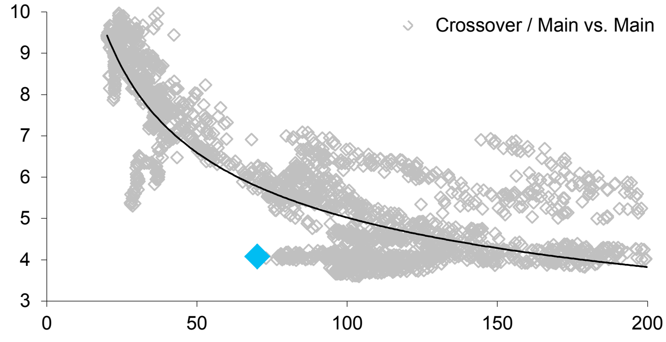
5y on-the-run indices.



Source: Citi Research.

Figure 18. Ratio of Xover to Main spreads vs. Main spreads

Y-axis: spread ratio. X-axis: Main 5y spreads, in bp.



Source: Citi Research. Using on-the-run indices. Daily data since 2005.

Long Senior Financials vs. Main (Abel Elizalde)

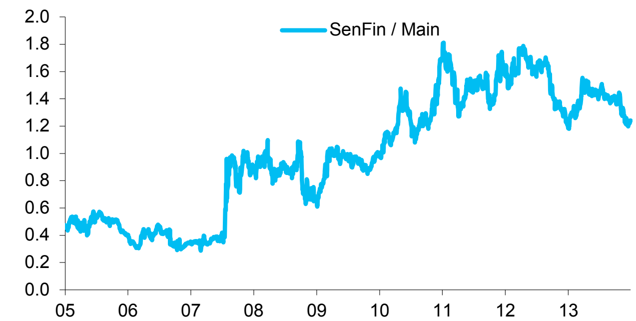
In the sector strategies below we argue for further outperformance of financials this year. This applies in CDS also.

The outperformance of financials is another trend we expect to continue playing out in 2014 as investors adjust to a new world of tight spreads, where every basis point counts. As we highlighted in early November,[3] the comparatively high ratio between financials and non-financials, proxied by Senior Fins to Main, has been tempting investors into compression trades.

Although the trade has started to play out, we still believe it has room to run further, albeit at a slower pace. We expect to see Senior Financial spreads trading inside Main in 2014 – currently spreads are 88bp vs. 71bp; see Figure 19 and Figure 20.

Figure 19. Ratio of Senior Financials to Main spreads

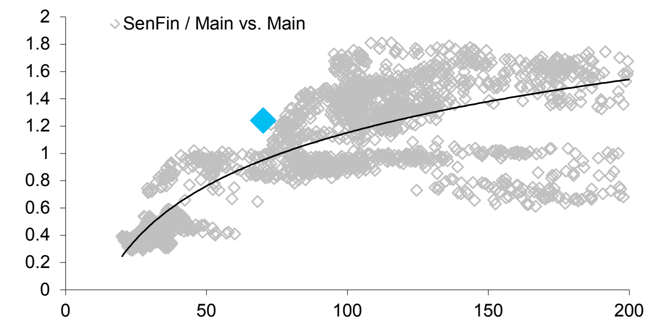
5y on-the-run indices.



Source: Citi Research.

Figure 20. Ratio of Senior Financials to Main spreads vs. Main spreads

Y-axis: spread ratio. X-axis: Main 5y spreads, in bp.



Source: Citi Research. Using on-the-run indices. Daily data since 2005.

[3] See Long risk Senior Fins. vs. short risk Main, A Elizalde, 5 Nov.

Tranche & option trades

Mezzanine tranches in IG portfolios should outperform (Abel Elizalde)

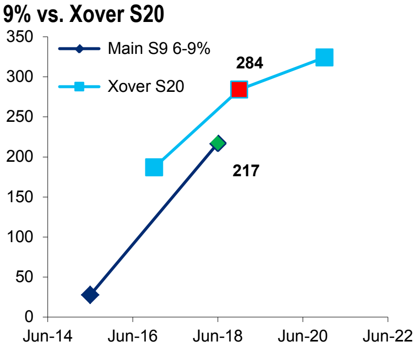
The tranche market over the past 4 years was for specialists – investors happy to sell equity tranche protection and manage the default risk. In a low-default environment, they've enjoyed the very high roll down on equity tranches.

However, given that the 0-3% tranche is now very stretched pricing-wise and also has exposure to first loss risk, going forward we reckon levering up non-equity tranches is a more attractive way to run a high-risk / high-return profile – and without exposure to first losses.

Many of the potential entrants to the tranche market will probably not want to take default risk, in our view, and will more likely look at mezzanine tranches. They still pay a multiple of the underlying index.[4] As an example, the Jun-18 3-6% / 6-9% / 9-12% tranches in iTraxx Series 9 have spreads of around 382 / 217 / 142bp.

For relative value investors, we particularly like a relative value trade that is long risk the 6-9% tranche, but short iTraxx Crossover – see Figure 21.

Figure 21. Current spread curves: Main S9 6-9% vs. Xover S20



Source: Citi Research, Markit. Mid-spreads, in bp, shown.

Hedges? Payer spreads to beat outright index shorts (Abel Elizalde)

In terms of running costs, payer spreads[5] comfortably beat outright index shorts in 2013 as a hedge – see Figure 22.

Without any “major” sell-off and with a clear tightening trend (especially during the second half of the year), payer spreads were at their best: protection for very large widenings was not needed and the losses in tightening environments were limited.

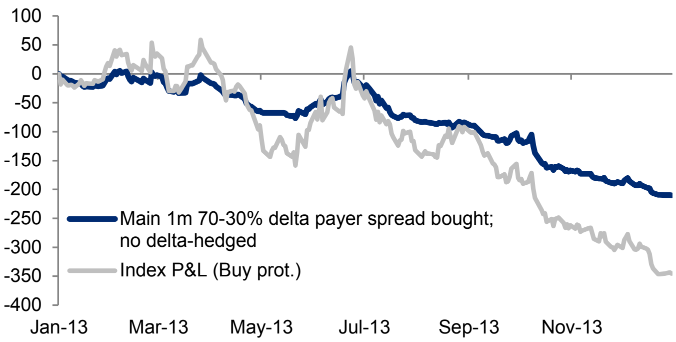
We recommend that investors looking for hedges in 2014 continue using payer spreads. While we see scope for the range to be somewhat wider this year, on a strategic horizon, we expect corrections to be moderate and short-lived.

If our constructive view of the world for 2014 materializes, payer spreads should suffer less than outright index shorts. Our hedging strategy for 2014 combines payer spreads for moderate widenings plus protection against large sell-offs via flatteners and (for real-money investors) replacing bond longs with synthetic longs.

[4] See Mezz may be back next year ... though nowhere near 2004-7, A Elizalde, 15 Nov.

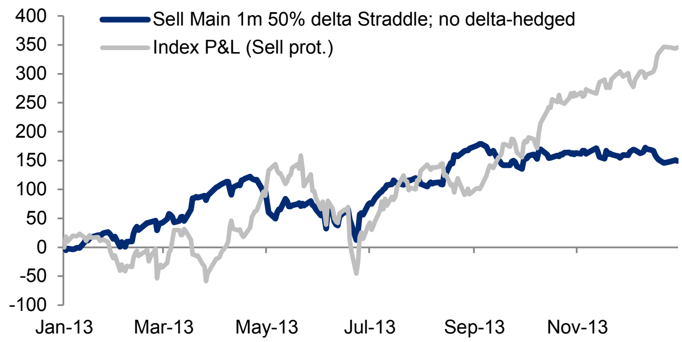
[5] Buy a low strike payer and sell a high strike payer. As an example, see the payoff profile of a 70-85bp Main payer spread (February expiry) in our online Options Pricing Tool.

Figure 22. Payer spreads vs. Index short – 2013 cumulative P&L
In cents of notional traded (100c = 1%).



Source: Citi Research. Using mids.

Figure 23. Selling no-delta straddles – 2013 cumulative P&L
In cents of notional traded (100c = 1%).



Source: Citi Research. Using mids.

Continue selling the range via 1m straddles

2014 should see spreads trade range-bound, like most of 2013. We are expecting realized volatility to remain low for most of the year and with trending periods comparatively short lived.[6]

Without major macro triggers, we'd expect demand for credit to pick up on any correction. At the same time, although our view for 2014 is constructive, CDS indices are already tight, limiting the upside from here.

That combination suggests that the P&L of selling ranges, via no-delta 1m ATM straddles, should be positive and a very good complement to long risk portfolios – as Figure 23 shows for 2013.

As an example, a 70bp February straddle in Main generates breakeven spreads of around 62/78bp (at expiry).

For more details on our options views and trades, please our latest iTraxx Options Views & Trades.

[6] See Credit Options - What did investors do in 2013?: What will they do in 2014?, A. Elizalde, 4 Dec.

Sector strategies (Teresa Cascino)

Long financials

One of the big questions for 2014 is whether the dramatic rerating of financials versus non-financials can continue. The spread differential between the two is already at a post-crisis low of 22bp. Indeed, the debate about whether the two can cross over again is surfacing.

On the one hand, even without the AQR there are still the usual asset quality concerns and significant regulatory uncertainty, not least about the application of the bail-in regime. On the other, the banking sector should continue to delever in 2014, while non-financial leverage is likely to rise further as shareholders are rewarded.

For the near term, we are a little worried about the concentration of longs in financials and a perception of tight valuations after the strong performance last year. That tempers our bullishness on financial spreads early in the year.

However, over time **we expect the compression to non-financials to continue** – the best guide is probably to look at what happened in the US last year, where financial spreads passed through non-financial spreads without any discernible drama. So on a strategic horizon we would continue to be long financials.

In our opinion, senior unsecured spreads don't reflect the true risks associated with bail-in and depositor preference. Fundamentally, we therefore **prefer covered bonds to senior unsecured in the periphery**. However, we remain sceptical that the AQR or any other regulatory initiative will change that any time soon – especially in a year where senior unsecured outstanding should contract further.

New sub debt, which we explored in a primer late last year, will likely have to be attractively priced in order to generate sufficient demand to meet banks' desired issuance. As such, we believe the best opportunities will be in the primary market. Generically, **we prefer T2 structures (the CoCos) and US T1 structures over T1 structures issued under CRD IV.**

Capital optimization will remain in focus as Basel III draws closer. Specifically, this should imply further LME activity. From a valuation perspective, **old-style peripheral T1 bonds seem the best place to be to take advantage of LME activity**, being cheap to both core-based T1 and peripheral T2 debt in our view.

We are **neutral Insurers versus banks**. Spreads are tight, but not without justification: the capital position and the credit metrics of the sector remain strong and we see room for further improvement. Their profitability should continue improving, thanks to prudent underwriting and strong pricing trends. Apart from life insurers, which will have to compete with more attractive savings products, rising interest rates are likely to have a positive effect on the asset quality and returns of insurers' portfolios. The long timeline for the implementation of Solvency II requirements suggests that the impact on insurers' balance sheets will be minimal. As such, we'd look to **reinitiate a long in insurance over banks on any underperformance**.

Non Financials

Within the non-financials we expect the two main themes this year will be the move down in credit quality and the attempt to separate deleveragers from releveragers. Both are likely to have a significant bearing on relative sector performance.

In particular, **Utilities** are likely to see on-going weak demand growth. Some of it is cyclical; some is structural and due to increased efficiency and oversupply. Regulatory intervention (taxes, price controls) is also a challenge for cash flows. We'd **underweight core utilities**, which look particularly exposed, especially given their tight valuations. Peripherals look more attractive, in our view: capex reduction and cost cutting will continue to be in focus of next year; we will see more equity and hybrid issuance, asset disposals; and we don't expect transformational M&A. We would be **overweight the Italian utilities** in particular.

The challenges that have already rocked **Telcos** have not yet been resolved in our view. Although the modest recovery is likely to improve consumer telephone spending, competition remains stiff, and revenue growth remains subdued, in spite of capex growth. Although the sector as a whole enjoys good access to capital markets, event risk will remain high in a scenario of limited financial flexibility. Spreads look more or less in line with Industrials or Utilities, where we see less risk. The biggest players like BT and DT are the most likely to maintain – if not strengthen – their market position. We might see more equity and hybrid issuance, especially from KPN, Telekom Austria, Telecom Italia and Telefonica. However, away from these names we would be **slightly underweight** the sector.

We are neutral on **Basic Materials**, although valuations are currently comparatively wide versus the index. The glut of supply this sector is seeing is unlikely to clear this year, in spite of the global recovery. However, with capex and costs being aggressively cut, we expect an easing in the current earnings downgrade cycle. We **prefer the globally diversified miners** like Rio Tinto and Glencore, which are aggressively restructuring their business. We would be **underweight chemicals**, which suffer from the same issues but seem comparatively expensive.

Non-food retail, especially in the UK, is benefitting from a recovery in household spending power, which underpins the strong performance of the likes of Dixons and Next. We would remain comparatively more **cautious on the food retail** space. We see the first signs of stabilization, for instance in Casino and Carrefour, but credit metrics remain fragile with little flexibility should retail demand weaken from here. We also consider the potential for M&A and increased shareholder-friendly activity in some places, which we don't really find reflected in spreads.

We still like Industrials overall. Value has compressed significantly, but leverage is comparatively low and we think many companies in the sector are well-positioned to benefit from the modest global economic recovery this year. But obviously there are caveats. We would be cautious on companies that are exposed to capex in metals and mining and in utilities. While the dynamics in the Construction sector have improved somewhat, we still feel it is mostly in spreads already. We **prefer Civil Aerospace to Defence**, given the uninspiring outlook of military spending next year.

The outlook for **Oil & Gas** remains uninspiring and **we expect further underperformance**. Citi has recently downgraded its forecasts for Brent prices from $107.5/bbl to $97.5/bbl for 2014 and from $102.5/bbl to $92.5/bbl in 2015, reflecting a deteriorating supply picture and lower geopolitical risks. We also downgraded our EPS forecasts for European oil companies by around 10% in 2014 and 11% in 2015. In both years, we are much below consensus. Most Oil & Gas companies have started to bring down capex in light of the new pricing environment, but still, we think the low cost, most efficient producers will be better positioned.

For our latest specific picks and pans, please see the forthcoming edition of the European Credit Sector Recommendations.

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Appendix A-1

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