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Strategy
Western Europe

European Portfolio Strategist

ECB to Extend Search for European Yield

- **Global liquidity put remains** — Since the 2008-09 financial crisis, there has been a central bank-sponsored global liquidity put. This has restricted economic downside risks and helped to drive asset price inflation via a widespread search for yield/income. Following the end of QE3 in the US, Citi economists expect the BoJ and the ECB to provide the global liquidity put from here. Post-meeting language from ECB does not change our view, with reference to 2012 balance sheet retained.

- **ECB to extend search for yield/income** — Incremental ECB liquidity is likely to provide regional liquidity/nominal GDP put & to extend the search for yield/income. Our rate and credit strategy colleagues expect further spread tightening in their asset classes. We see stocks/sectors offering "reasonable and secure" yield as attractive: 1) high DY with strong balance sheets, 2) high DY with surplus FCF, 3) high DY*G and dividend cover, 4) surplus FCF with strong balance sheets.

- **Reasonable and secure yield** — Oil & Gas = highest DY and strong balance sheets. Sector near post-1990 DY cheap vs market. Our analysts see capex and balance sheet flexibility to defend dividends. Insurance/Telecoms offer high DY and surplus FCF. Signs of operational improvements in Telecoms. Banks = highest DY*G and robust dividend cover; surplus capital drives capital return in next 1-2 years. Tech best on surplus FCF & strong balance sheets = plenty of firepower.

- **Delivery strategies also important** — Global liquidity put has supported asset price inflation and helped to drive re-rating of equity. It has become harder for investors to find value in all asset classes, including equity, eg only 10-15% of European stocks have traded below 1x price/book in the last few months vs 55-60% above 2x price/book. Fewer value opportunities and valuation convergence mean that delivery strategies such as DY*G or earnings momentum = more important.

- **Yield meets delivery...what do you get?** — We look for stocks which meet both our "reasonable and secure" yield and delivery at a reasonable price criteria: DY >3%, DY*G >30, dividend cover >1.5x, positive 6-month relative earnings momentum, lower half of 5-year P/E relative range. Additionally for non-financials we look for surplus FCF and strong balance sheets. The final screen only has 9 stocks including just 1 non-financial = KBC, Aegon, SEB, Saint Gobain, Generali, Swiss Re, Nordea, AXA, HSBC. If investors want yield, delivery and are not afraid to back the ECB, then financials = key focus for coming months and quarters.

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ECB to Extend Search for European Yield

Liquidity has dominated financial markets since the financial crisis. Post-2009 central bank actions have played the central role in: 1) protecting economies from exaggerated downside risk, and 2) driving broad asset price inflation. Investors have been well rewarded for not fighting the resulting global liquidity put.

Central banks have hogged the limelight in recent weeks too – end of QE3 in the US, early and unexpected action last week from the BoJ, ongoing speculation over timing and detail of prospective ECB actions (ECB retained reference to balance sheet size of early 2012 in today's press conference). Despite changing central bank liquidity dynamics, we continue to back our "Goldilocks in a strait-jacket" view of the world, ie ongoing global liquidity put. What does all of this mean for equity investors?

First the central bank global liquidity baton is being passed currently from the Fed to the BoJ and the ECB. Recent BoJ action has driven significant moves in both Yen (lower) and Japanese equities (higher). ECB actions are likely to result in similar moves in Europe, in our view, although probably on a more modest scale. This is partly why we are Overweight both Japan and Europe ex-UK in our global regional allocation, which we run on a local currency basis.

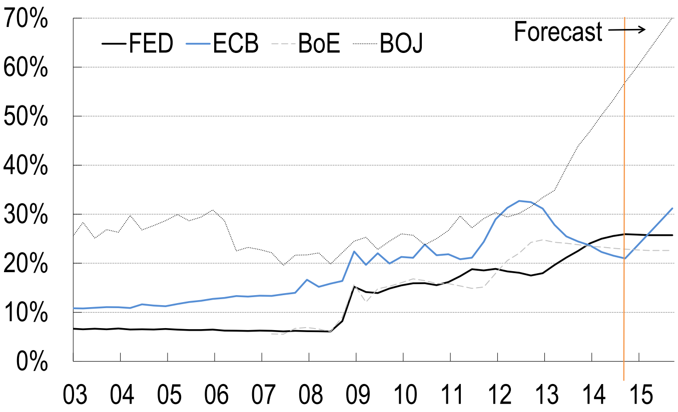
Second, we maintain that incremental ECB liquidity support will continue to drive a search for yield/income in Europe. We highlight four equity yield/income strategies in this report for investors to consider: 1) high DY with strong balance sheets, 2) high DY with high surplus FCF, 3) high DY*G with high dividend cover, 4) surplus FCF with strong balance sheets. All four strategies are looking for ways of getting exposure to "reasonable and secure yield", which is essentially what has been consistently re-rated in the last few years.

Third, given the liquidity-assisted re-rating of equities, it is increasingly important for investors to focus on 'delivery' strategies, eg earnings momentum. We looked in at where investors can find exposure to earnings momentum at a reasonable price in Europe in a report two weeks ago.

ECB QE = extending search for yield/income

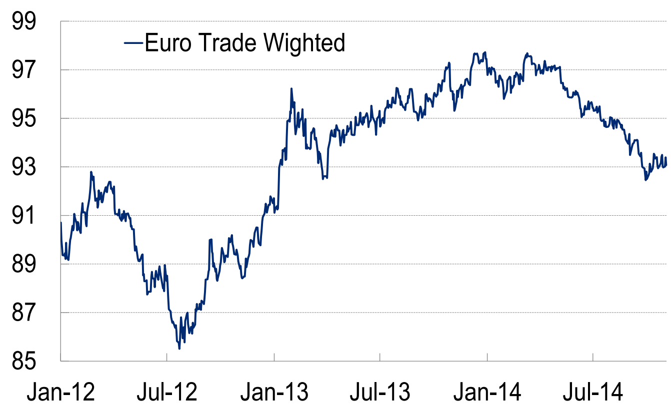
The ECB has allowed its balance sheet to shrink significantly over the last 1-2 years. Over the same time, other major central banks have been growing their balance sheets via asset purchases. Until recently, this had contributed to a strong euro and to an additional headwind to a region struggling to emerge from a double-dip recession.

Figure 1. Central Banks' Balance Sheets



Source: Haver, Citi Research

Figure 2. Trade Weighted Euro



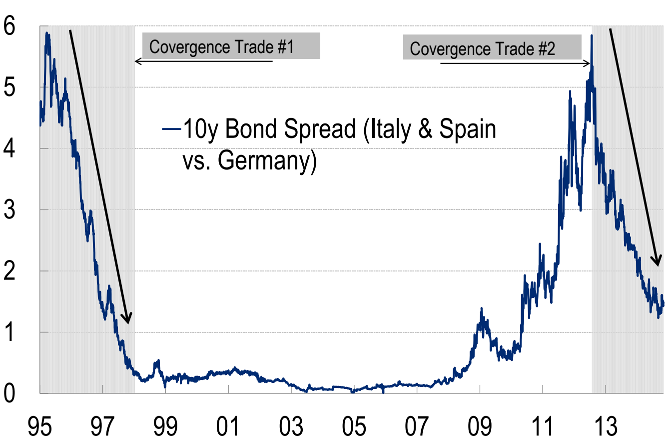
Source: DataStream, Citi Research

Following actions in recent months to lower interest rates (deposit) below zero and to initiate new private asset purchase programs (ABS, covered bonds), ECB President Draghi has made it clear that the ECB's balance sheet is likely to grow significantly in coming months and quarters. Citi's base case remains the announcement of full QE, ie public and private asset purchases, around year-end.

These actions are likely to achieve two things, in our view: 1) nominal GDP put, 2) extend cross market search for yield/income.

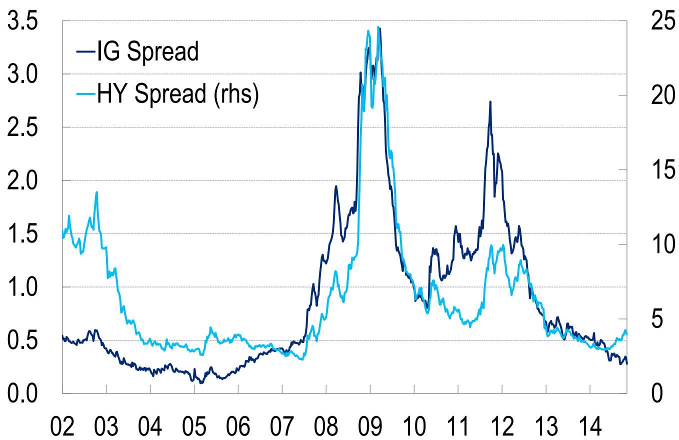
First, they are likely to contribute to an effective nominal GDP put in the Euro Area, with ECB actions driving further weakness in the euro, supporting progressive improvement in Euro Area bank lending and credit demand, and helping to underpin low levels of confidence across the economy.

Figure 3. Convergence Trades, Part I & II



Source: DataStream, Citi Research

Figure 4. Yield Spreads



Source: DataStream, Citi Research

Second, we think ECB actions are likely to extend the cross-market search for yield/income. Our rate strategy colleagues continue to back further peripheral spread narrowing in coming months. In credit, our strategy colleagues Hans Lorenzen and Matt King expect ECB actions to drive narrower spreads still in European corporate credit.

In equity, we see stocks and sectors which appear to offer investors "reasonable and secure yield" as being beneficiaries of central bank liquidity. We suggest four such approaches 1) high DY with strong balance sheets, 2) high DY with high surplus FCF, 3) high DY*G with high dividend cover, 4) surplus FCF with strong balance sheets.

High DY with strong balance sheet

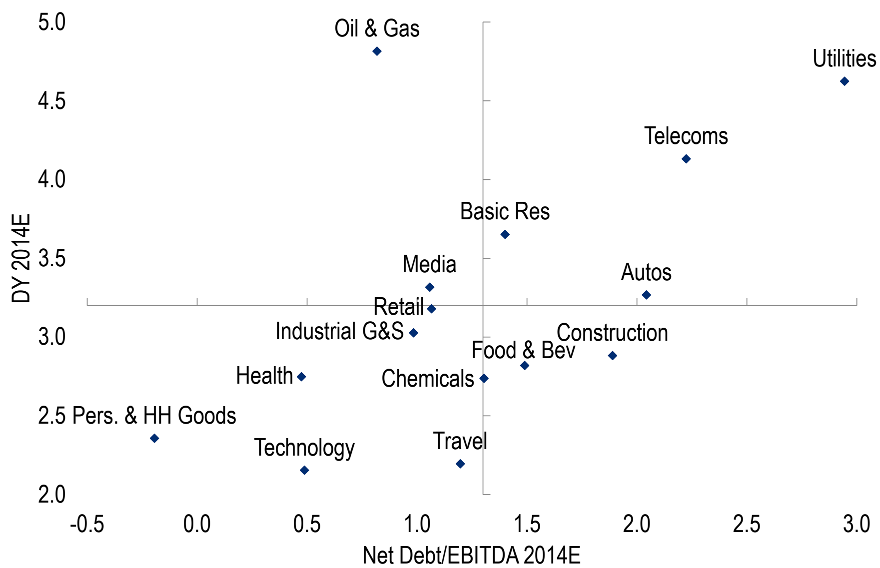
We showed in the most recent Citi Income Report that yield strategies had outperformed in 2014, albeit with significant assistance from sharp falls in 10-year government bond yields.

There has also been a significant narrowing of yield spreads across European equities, which we have also noted previously. For example, Utilities and Telecoms had the highest prospective DY relatives at the end of 2012, with DYs c60%+ higher than the market; this compares to the c30% prospective DY premium enjoyed currently by Europe's three highest yielding sectors – Oil & Gas, Banks, Insurers.

This means two things to us: 1) dividend growth, ie delivery, should become more important in driving future returns; this is why we like DY*G strategies, and 2) high DY stocks have become scarcer.

The growing scarcity of yield is a feature of the post-financial crisis QE landscape in all asset classes, ie secure yield is in high demand from a variety of capital allocators and savers. This has been a key input into our thinking for some time, eg an inflection in FCF in the Utilities in 2014-16E vs 2011-13 drove our upgrade of the sector at the start of this year and Vodafone getting close to a 6% DY in late summer was behind our "Buy Vodafone" report and supported the addition of the stock to the Citi Focus List at the same time.

Figure 5. High Dividend Yield & Strong Balance Sheet

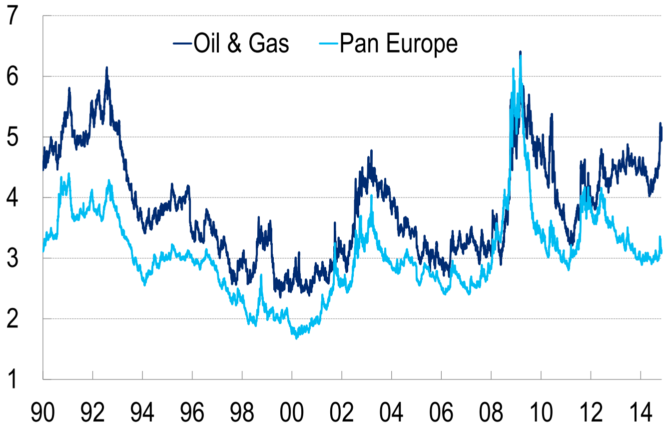


Source: Citi Research

Figure 5 plots European sectors' 2014E DY against 2014E net debt/EBITDA. Only two sectors have both stronger-than-market balance sheets and higher-than-market DYs – Media (just) and Oil & Gas. Financial sectors are missing from this analysis as we don't have comparable net debt/EBITDA metrics. However, given the strong improvement in European bank balance sheets/capital positions and the enhanced capital/solvency positions of the Insurance sector, we would also argue that investors can find attractive DY stocks with strong balance sheets in both sectors.

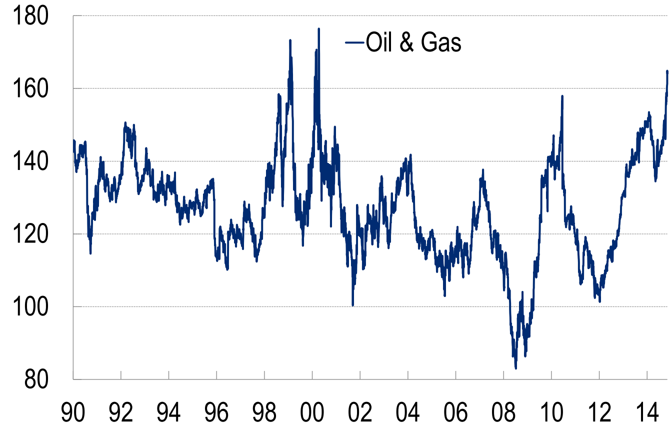
Figure 6 and Figure 7 show that the sector has rarely been this cheap on an absolute or relative DY basis since 1990. The sector trades at similar DY relative highs to the late 1990s and the Tech bubble. Then, it also didn't help that oil prices were cUS$10. So, if sector dividends are defendable at these levels, then Oil & Gas appears to be offering investors an increasingly rare value opportunity in equity markets.

Figure 6. DY – Absolute



Source: DataStream, Citi Research

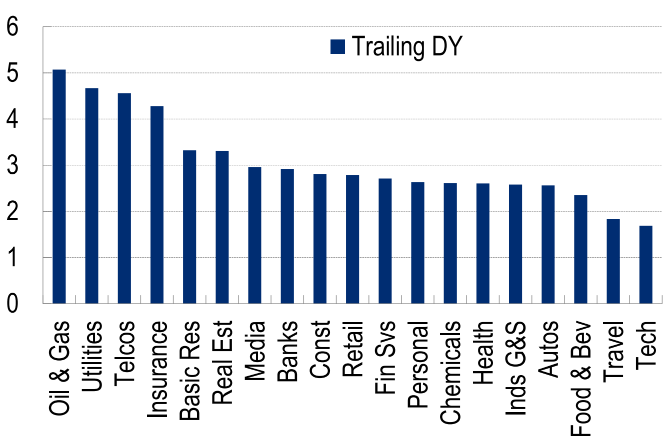
Figure 7. DY – Relative



Source: DataStream, Citi Research

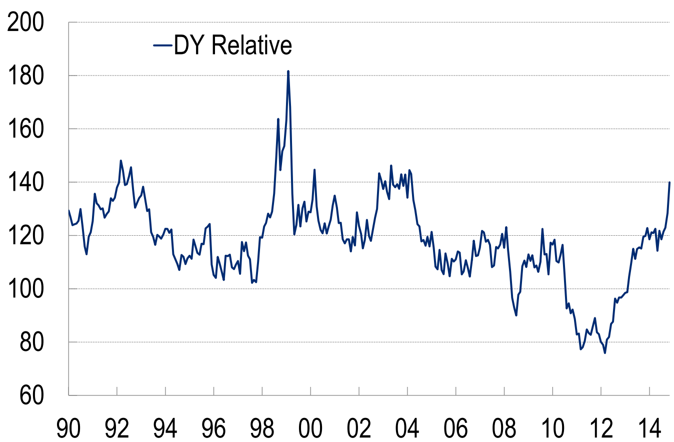
Figure 8 confirms that the sector has the highest 2014E (and 2015E) DY in Europe. Figure 9 shows that Oil & Gas has been significantly de-rated relative to big European defensive sectors and back towards highest (cheapest) DY relative levels since 1990. Not shown, but Oil & Gas is currently around cheapest DY relative to Food & Beverage since 1990 and approaching similar levels relative to Health Care, as well as back to a DY premium relative to Utilities. Again, if the sector can defend these DY's then they look increasingly attractive versus defensive DY opportunities elsewhere, on this basis.

Figure 8. Sector DY – Absolute



Source: DataStream, Citi Research

Figure 9. Oil & Gas DY Relative to Defensives



Source: DataStream, Citi Research

So, what do the experts think? Alastair Syme and our Oil & Gas team also see value emerging in their sector. Recent oil price action and 3Q14 results have been negative, but our team highlights the flexibility which their sector has to defend dividends, which if successful would present a good case for offering investors rare and "secure" yield.

Alastair and team believe that the industry will sacrifice growth to defend income with lower capex, renewed cost-cutting and using strong balance sheets as the industry's first line of defense.

In a recent report, they highlighted that the industry has a capex to dividend ratio of 3.5:1 and that in a lower cash flow scenario it will be investment that gives first. Importantly, the team see spending flexibility to rise from 10% in 2015 to 30% in 2016 and 50% in 2017. The industry's second line of defense is the delivery of new and higher-return growth projects in 2016-17. Their preferred stocks in Europe are BG (future FCF, low cost growth), BP and Total.

Figure 10. Reasonable & Secure Yield Strategy *1 – High DY and Strong Balance Sheet

RIC	Stock	> €10bn Market Cap	>4.5% DY 14E	<1 NetDebt/EBITDA 14E
TOTF.PA	Total	112781	5.17	0.9
RDSa.L	Royal Dutch Shell	112353	4.97	0.4
BP.L	BP	105570	5.18	0.7
ENI.MI	ENI	45866	6.59	0.7
BLT.L	BHP Billiton	43950	4.58	0.8
NOK1V.HE	Nokia	24941	5.17	-2.6
STL.OL	Statoil	19034	4.82	0.3

Source: DataStream, Citi Research

Figure 10 screens for those European stocks with a market cap above €10bn, a 2014E DY above 4.5% and 2014E net debt/EBITDA below 1x. Nokia is the only non-commodity stock featured, with 5 Oil and 1 Mining stock completing this exclusive screen.

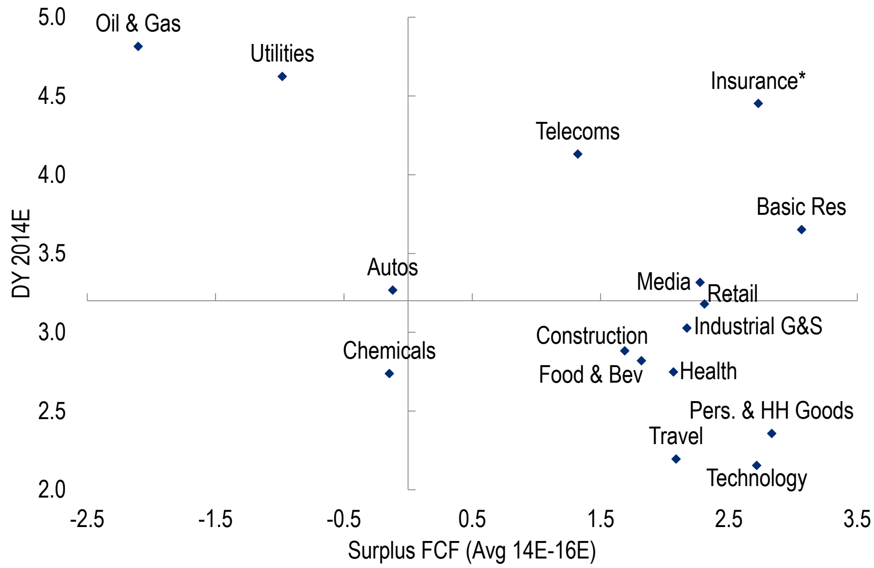
High DY with high surplus FCF

Our second “reasonable and secure” yield strategy is to look for stocks/sectors with high DY and also surplus FCF. This focuses attention on other parts of the market, away from Oil where surplus FCF remains a longer-term project for most stocks.

Figure 11 plots European sectors’ 2014E DY against 2014-16E average surplus FCF, which we calculate as the difference between the 2014-16E FCFY and DY for each sector. There are four European sectors with higher-than-market 2014E DYs and better-than-market 2014-16E surplus FCF – Telecoms, Insurance, Media (just) and Basic Resources. In theory, the surplus FCF, if delivered, should defend (and pay) these attractive DYs.

For Insurance we take the 2015E holding company FCF yields, as calculated by Farooq Hanif and our Insurance team, in the sector's equivalent surplus FCF calculation.

Figure 11. High Dividend Yield & Surplus Free Cash Flow



Source: Citi Research

Of the four highest yielding sectors featured here, two look more attractive than the others on this basis. Oil & Gas may have a high DY and a strong balance sheet, but it does not have surplus FCF, on current forecasts, to cover dividends in 2014-16E. This is why it will be important for the sector to demonstrate capex and balance sheet flexibility, most likely, in coming quarters.

Utilities offers a high DY, but neither has a strong balance sheet nor is expected to generate surplus FCF. This could make it harder for the sector to protect its dividends, especially if structural risks from alternative energy continue to build. Having moved more positive on the sector at the start of the year, we recently moved back to Underweight.

Insurance and Telecoms both look more attractive on a surplus FCF basis. On Insurance, Farooq Hanif and team remain positive on the sector due to: 1) attractive valuation, 2) ongoing strategic change which is improving business models through what our team calls the 'Four Forces' of strong capital, improved focus, growth opportunities and monetisation (or greater cash flow clarity), and 3) positive catalysts from clarity on sector capital (Solvency 2), upside through restructuring and supportive macro. Being a potential direct and indirect beneficiary of incremental ECB actions as well keeps us Overweight the sector.

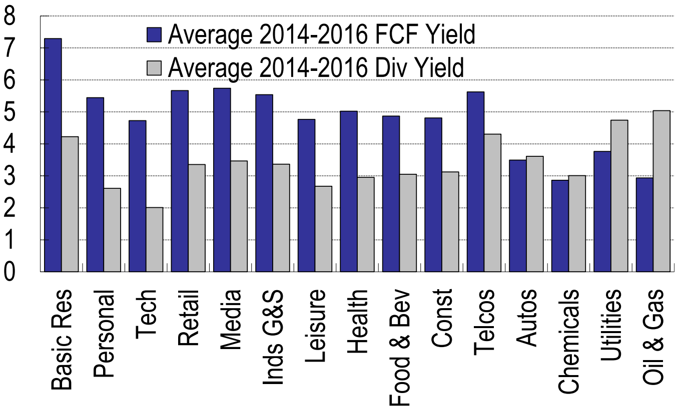
Telecoms is the non-financial sector in Europe with the highest DY and also expected surplus FCF for 2014-16E. While the sector's balance sheet does not look that strong, current dividend should be covered by FCF. For us, that makes the sector more attractive than Utilities.

The latter has outperformed YTD due to much lower bond yields in Europe and globally, as well as capex reduction led FCF inflection. Falling bond yields may provide ongoing support for Utility shares, but our rate strategists expect rising 10-year bond yield in the US and also in Europe (even with ECB QE) over the next 12-18 months.

Telecoms look like they would be better prepared for this outcome and would also likely be beneficiaries of a further reduction in bond yields, providing that collapsing European growth and a return of Euro Area systemic risk was not the cause.

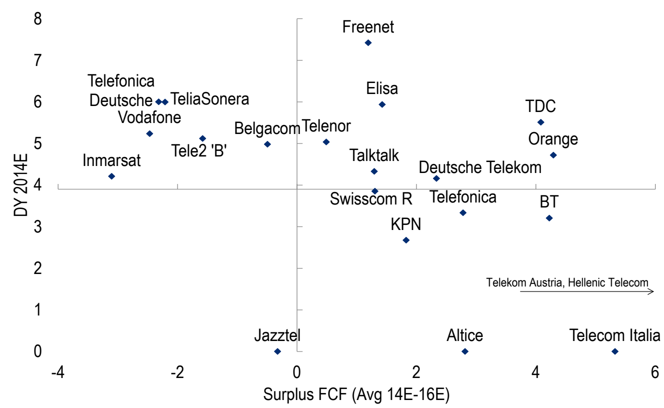
Simon Weeden and our Telecoms team highlight the improving fundamental backdrop for their sector. Beyond the plentiful corporate actions across the sector, there are increasing signs that operational performance is picking up. The current results season is a good example of that with most stocks beating analysts' estimates. The team prefers those stocks which are investing and have capacity to improve growth and grow FCF and dividends longer-term. They back incumbents which have stepped up investment in either fibre local network or 4G or both, eg Vodafone (Citi Focus List), DT, BT, Swisscom, TeliaSonera and OTE.

Figure 12. Surplus Free Cash Flow



Source: Citi Research

Figure 13. Surplus Free Cash Flow & DY – Telecoms



Source: Citi Research

Figure 12 shows the 2014-16E average DY and FCFY for each sector. It is encouraging that most sectors are expected to generate surplus FCF. To us, this suggests that providing the ECB can help to protect against downside nominal GDP risks in the Euro Area and that the rest of the world does not initiate global recession, the corporate sector is in reasonable shape to pay dividends and still have additional cash to enhance distributions or to invest in growth as appropriate. Figure 12 also shows why Telecoms stands out relative to other high DY sectors due to much stronger (and surplus) FCF. Figure 13 plots Telecom stocks using 2014E DYs against 2014-16E surplus FCF; those with high DYs and surplus FCF are in the top-right quadrant, including Swisscom/DT from our team's preferred names.

Broadening the search beyond Telecoms, Figure 14 shows those large-cap European stocks with high DYs and surplus FCF. A broad spread of sectors are represented here, hence should be a reasonably well-balanced strategy.

Figure 14. Reasonable & Secure Yield Strategy *2 – High DY and Surplus FCF

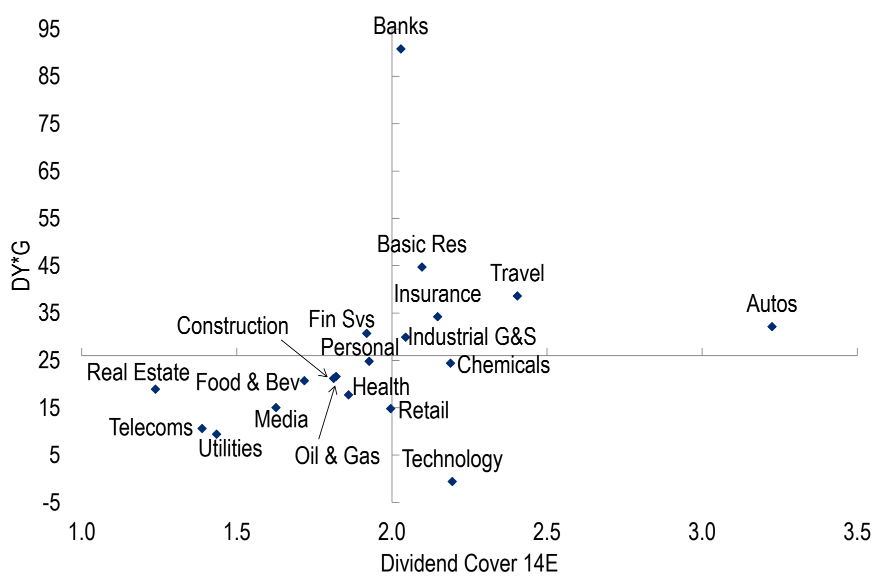
RIC	Stock	> €10bn Market Cap	>200bps Surplus FCF (Avg 14E-16E)	>3.5% DY 14E
SASY.PA	Sanofi	88613	2.10	3.87
SIEGn.DE	Siemens	74458	2.47	3.95
DAIGn.DE	Daimler	61823	2.21	3.87
UNc.AS	Unilever Certs.	48329	3.02	3.68
RIO.L	Rio Tinto	47154	2.36	4.36
BLT.L	BHP Billiton	43950	3.95	4.58
ULVR.L	Unilever (UK)	42058	2.91	3.55
ABBN.VX	ABB	40427	2.72	3.86
DTEGn.DE	Deutsche Telekom	37235	2.34	4.16
ERICb.ST	Ericsson B	28556	2.66	3.52
ORAN.PA	Orange	24607	4.29	4.72
AAL.L	Anglo American	23626	2.23	3.80
PHG.AS	Philips Electronics	21324	2.81	3.59
VOLVb.ST	Volvo B	13875	2.37	3.60
RWEG.DE	RWE	13643	3.05	3.54
CRH.L	CRH	13064	2.38	3.54
MICP.PA	Michelin	12903	2.78	3.92
AHLN.AS	Ahold Kon.	11931	4.12	3.60

Source: Citi Research

High DY*G with high dividend cover

Our third “reasonable and secure” strategy looks at a yield strategy with a growth (or rising bond yield) hedge, which is backed by robust dividend cover. Figure 15 shows European sectors; DY*G score versus 2014E dividend cover.

Figure 15. High DY*G & High Dividend Cover



Source: DataStream, Citi Research

Our DY*G score aims to find stocks/sectors with a healthy balance between income and growth; this strategy should do better than a straight high DY one in an environment of rising bond yields, which is our base case over the coming 12-18 months. We calculate DY*G as the product of current DY and 2-year compound dividend growth.

There are six sectors with better-than-market DY*G and 2014E dividend cover -- Banks, Autos, Basic Resources, Industrials, Insurance and Travel & Leisure. We are Overweight all except Industrials (Neutral) since we have: 1) progressive/modest improvement in European and global macro/nominal GDP in coming 12-18 months, and 2) higher bond yields, in our base case. We think both will support stronger relative returns from stocks and sectors which offer some exposure to growth.

We would note that both Utilities and Telecoms score poorly on both measures, ie little growth expected and limited dividend cover.

Figure 16. Reasonable & Secure Yield Strategy *3 – High DY*G and Robust Dividend Cover

RIC	Stock	> €10bn Market Cap	>30 DY*G	>2x Dividend Cover 14E
BAYGn.DE	Bayer	93817	34.2	2.70
ALVG.DE	Allianz	57839	48.7	2.47
LLOY.L	Lloyds Banking Group	52791	126.0	8.42
BARC.L	Barclays	50494	131.6	2.97
UBSN.VX	UBS R	49836	123.0	2.66
RIO.L	Rio Tinto	47154	55.9	2.30
BLT.L	BHP Billiton	43950	33.2	2.00
AXAF.PA	AXA	38262	42.6	2.38
BT.L	BT Group	38247	48.3	2.37
ISP.MI	Intesa Sanpaolo	32756	155.7	2.13
CSGN.VX	Credit Suisse R	32334	159.5	3.54
DBKGn.DE	Deutsche Bank	32316	39.3	4.99
CRDI.MI	Unicredit	32077	83.1	2.73
BMWG.DE	BMW	27376	35.3	3.08
VOWG.DE	Volkswagen Pref.	26236	53.9	4.42
STAN.L	Standard Chartered	24275	43.3	2.28
GASI.MI	Assicurazioni Generali	22071	54.0	2.50
AV.L	Aviva	19609	36.1	3.18
CONG.DE	Continental	16919	39.1	3.67
DANSKE.CO	Danske Bank	14973	117.7	3.22
MAERSKb.CO	A P Moller - Maersk B	13937	31.6	3.67
DNB.OL	DNB	13390	93.6	3.64
CAGR.PA	Credit Agricole	13231	129.7	3.13
INVEb.ST	Investor B	12979	31.9	3.70
MICP.PA	Michelin	12903	40.6	2.87
RENA.PA	Renault	12259	34.6	3.79
AEGN.AS	Aegon	12035	45.8	2.79
ISPA.AS	Arcelormittal	10545	135.3	2.45
KBC.BR	KBC Groupe	10522	87.6	2.07

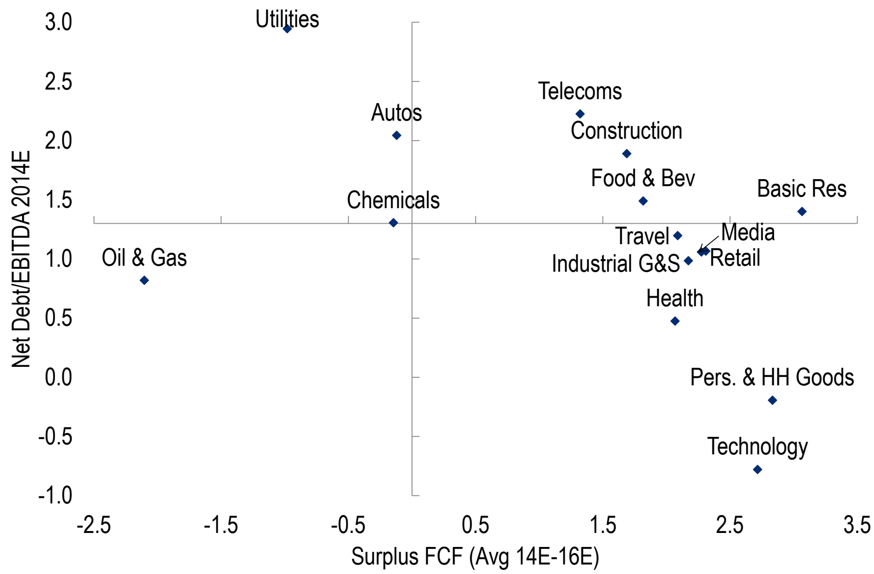
Source: DataStream, Citi Research

Figure 16 shows those large-cap stocks which offer both a high DY*G score (>30) and robust dividend cover (>2x). Banks and Insurers are well represented here; this is a big part of why we like both sectors into year-end and into 2015. Both sectors are likely to be key capital return sectors in Europe for investors over the coming 1-2 years, providing the ECB succeeds in providing an effective liquidity and nominal GDP put, ie Goldilocks stays intact.

High surplus FCF with strong balance sheet

Our fourth and final "reasonable and secure" yield strategy is to identify European stocks/sectors with high surplus FCF and strong balance sheets. Stocks with such characteristics have a wide-ranging tool-box to allow CEOs to "do something"; raise distributions, buyback stock, invest in growth or grow via acquisition.

Figure 17. Surplus Free Cash Flow & Strong Balance Sheet



Source: Citi Research

Figure 17 shows European sectors' 2014-16E surplus FCF against 2014E net debt/EBITDA. Technology, Personal & Household Goods and Health Care score most strongly on a combination of these two factors. Globally, Tech and Health Care also score strongest. It is not surprising, therefore, to see both sectors at the forefront of the pick-up in corporate actions, both M&A and capital returns, over the past several quarters. These sectors have several options and there are increasing signs of CEO confidence driving a pick-up in corporate activity around the world.

Figure 18. Reasonable & Secure Yield Strategy *4 – Surplus FCF and Strong Balance Sheet

RIC	Stock	>€10bn Market Cap	>200bps Surplus FCF (Avg 14E-16E)	<1 NetDebt/EBITDA 14E
SASY.PA	Sanofi	88613	2.10	0.9
SIEGn.DE	Siemens	74458	2.47	0.9
SAPG.DE	SAP	51575	3.98	0.1
RIO.L	Rio Tinto	47154	2.36	0.9
RB.L	Reckitt Benckiser Group	44235	2.64	0.4
BLT.L	BHP Billiton	43950	3.95	0.8
ABBN.VX	ABB	40427	2.72	0.0
LVMH.PA	LVMH	36795	2.30	0.8
CFR.VX	Richemont N	35042	3.10	-1.8
SHP.L	Shire	31790	2.94	-0.5
ASML.AS	ASML Hldg	30503	2.31	-1.4
OREP.PA	L'Oreal	30489	2.23	-0.8
ERICb.ST	Ericsson B	28556	2.66	-1.7
PHG.AS	Philips Electronics	21324	2.81	0.5
CONG.DE	Continental	16919	4.46	0.8
HNKG_p.DE	Henkel Pref.	14036	12.60	0.1
ASSAb.ST	Assa Abloy B	13936	2.50	0.5
MICP.PA	Michelin	12903	2.78	0.3
NXT.L	Next	12622	3.87	0.8
AHLN.AS	Ahold Kon.	11931	4.12	0.6
BSY.L	BSKyB	11826	3.21	0.0
LEGD.PA	Legrand	11370	2.92	0.9
RYA.I	Ryanair Holdings	10512	4.30	-0.2

Source: Citi Research

Figure 18 shows those stocks with apparent optionality via balance sheet actions or use of surplus FCF. Stocks which have come under recent pressure such as Sanofi and Shire show up here alongside stocks such as Next which have used surplus FCF to religiously retire equity and support EPS growth in recent years. Big-cap Tech and Mining is well represented.

Not featured, but if we also included stocks with a balance sheet which was strong versus that respective stock's balance sheet history over the last 10-years and still with high levels of surplus prospective FCF, stocks such as ABInbev, Danone, BT, CRH, Kering, Reed and even RWE would feature.

Reasonable and secure yield combo

Finally, we bring together all of these factors in Figure 19. Banks and Insurers dominate this screen. Very few non-financial stocks meet all criteria – BT, Rio Tinto, BHP Billiton, Siemens, Saint Gobain, VW and Michelin.

Figure 19. Combo #1 -- Stocks With High DY, High DY*G, Strong Balance Sheets, Robust Dividend Cover and Surplus FCF

RIC	Stock	>€10bn Market Cap	>3% DY 14E	>30 DY*G	ND/EBITDA 14E	ND/EBITDA 10y Avg	>1.5x Dividend Cover 14E	>150bps Surplus FCF (Avg 14E-16E)
HSBA.L	HSBC Holdings	155964	4.52	60.2	Fin	Fin	1.78	Fin
SIEGn.DE	Siemens	74458	3.95	76.1	1.2	0.9	1.79	2.5
ALVG.DE	Allianz	57839	4.74	48.7	Fin	Fin	2.47	Fin
BARC.L	Barclays	50494	3.44	131.6	Fin	Fin	2.97	Fin
RIO.L	Rio Tinto	47154	4.36	55.9	0.9	1.0	2.30	2.4
BLT.L	BHP Billiton	43950	4.58	33.2	0.8	0.5	2.00	4.0
AXAF.PA	AXA	38262	5.05	42.6	Fin	Fin	2.38	Fin
BT.L	BT Group	38247	3.21	48.3	1.0	1.5	2.37	4.2
NDA.ST	Nordea Bank	32579	5.38	91.5	Fin	Fin	1.59	Fin
DBKGn.DE	Deutsche Bank	32316	3.01	39.3	Fin	Fin	4.99	Fin
SOGN.PA	Societe Generale	30931	4.56	97.3	Fin	Fin	1.85	Fin
VOWG.DE	Volkswagen Pref.	26236	3.03	53.9	-0.6	-0.4	4.42	4.2
STAN.L	Standard Chartered	24275	4.66	43.3	Fin	Fin	2.28	Fin
SRENH.VX	Swiss Re	22112	5.43	50.0	Fin	Fin	1.90	Fin
GASI.MI	Assicurazioni Generali	22071	3.57	54.0	Fin	Fin	2.50	Fin
AV.L	Aviva	19609	3.08	36.1	Fin	Fin	3.18	Fin
LGEN.L	Legal & General	17455	4.39	59.9	Fin	Fin	1.56	Fin
SGOB.PA	Saint Gobain	17145	3.80	38.4	1.7	2.0	1.52	2.0
SEBa.ST	SEB A	16041	4.85	55.3	Fin	Fin	1.93	Fin
INVEb.ST	Investor B	12979	3.48	31.9	Fin	Fin	3.70	Fin
MICP.PA	Michelin	12903	3.92	40.6	0.1	1.2	2.87	2.8
OML.L	Old Mutual	12120	4.58	47.0	Fin	Fin	1.94	Fin
AEGN.AS	Aegon	12035	3.73	45.8	Fin	Fin	2.79	Fin
KBC.BR	KBC Groupe	10522	4.68	87.6	Fin	Fin	2.07	Fin

Source: DataStream, Citi Research

Overall, this suggests to us that investors, who have limited or no exposure to European Financials should expect either: 1) the ECB to either be unable or unwilling to attempt to defend its inflation mandate, ie perennial disappointments on policy response, 2) the ECB's response to be insufficient to avoid a triple-dip in the Euro Area economy, or 3) a global downturn driven from outside Europe. None of these three scenarios is our base case. Consequently, we are happy to back European Financials and expect both Banks and Insurance to outperform over coming quarters.

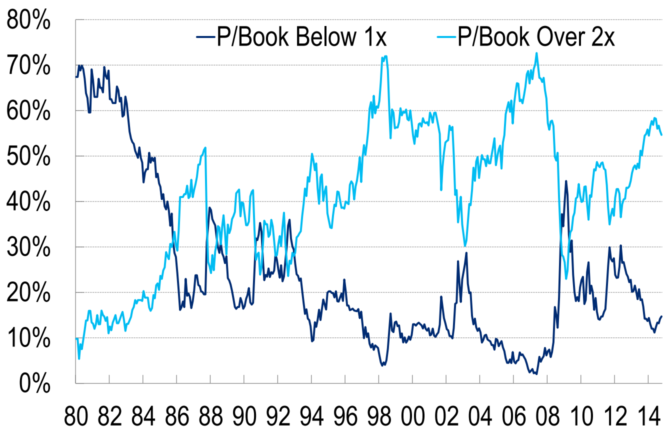
Re-rating = focus on 'Delivery' strategies

Central bank liquidity has provided downside protection to economic activity over the past few years and has helped to ward of high levels of systemic risk across the financial system. The extraordinary post-financial crisis liquidity response from central banks has also restricted net supply of all global financial securities and, in turn, and in combination with their role in the reduction of systemic risk, contributed to a widespread reduction in yield and compression in spreads across global financial markets.

In short, asset prices have been reflated and re-rated and it has become harder for investors to find attractive yield and value opportunities in many asset classes.

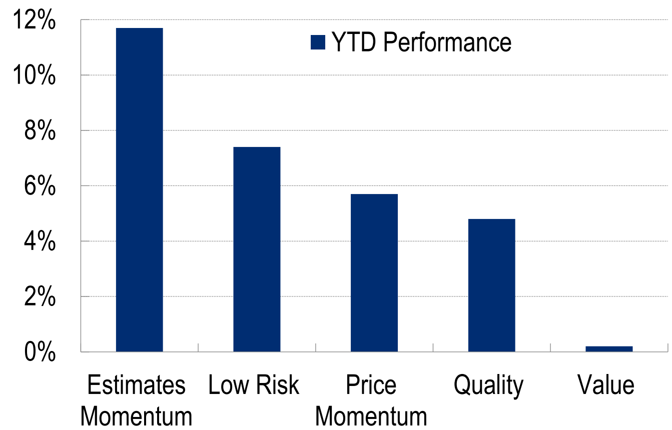
The previous section shows that we think there are still attractive yield opportunities for investors in European equities, providing our base case of an extension of the central bank liquidity put successfully warding off significant economic downside risk. But, given the re-rating of equities in the past couple of years, it is also becoming increasingly important for investors to focus on delivery strategies. Our DY*G approach is one such delivery strategy, featuring dividend growth. Earnings momentum is another delivery strategy.

Figure 20. % of Stocks with P/Book <1x & >2x



Source: DataStream, Citi Research

Figure 21. Quant Style Performance



Source: Citi Research

Figure 20 updates a chart we used in a mid-year report called "Looking for Value in a Valueless World". It shows the proportion of European stocks trading below 1x price/book (10-15% in past few months) or above 2x price/book (55-605 in past few months). This makes the point that it has become harder for investors to find value. Only the late 1990s and 2007 presented less value opportunities to investors, and we know what happened next both times.

This is why delivery strategies matter now and why they matter much more than 2-3 years ago when there were plenty of value opportunities across the market. It is also fair to say that this could make genuine value opportunities now more attractive given their increasing scarcity. This is also partly why we are attracted to European Financials, which offer one of the last few value trades to investors, in our view.

Figure 21, from our Quant team, shows which style factors have worked YTD. Estimates momentum, which captures earnings, sales and cashflow revisions has been the most successful style strategy in Europe YTD. This is clear delivery strategy. Our Quant team, like ourselves, continues to back this strategy from here.

Figure 22. Combo #2 -- "Reasonable & Secure" Meets "Delivery"

RIC	Stock	>€10bn Market Cap	>3% DY 14E	>30 DY*G	ND/EBITDA 14E	ND/EBITDA 10y Avg	>1.5x Dividend Cover 14E	>150bps Surplus FCF (Avg 14E-16E)	Curr P/E Rel in 5y Range	6m Earn Rel Mo
HSBA.L	HSBC	155964	4.52	60.2	Fin	Fin	1.78	Fin	1	5.2
AXAF.PA	AXA	38262	5.05	42.6	Fin	Fin	2.38	Fin	26	1.0
NDA.ST	Nordea Bank	32579	5.38	91.5	Fin	Fin	1.59	Fin	3	0.1
SRENH.VX	Swiss Re	22112	5.43	50.0	Fin	Fin	1.90	Fin	7	4.8
GASI.MI	Assicu. Generali	22071	3.57	54.0	Fin	Fin	2.50	Fin	9	3.0
SGOB.PA	Saint Gobain	17145	3.80	38.4	1.7	2.0	1.52	2.0	23	0.0
SEBa.ST	SEB A	16041	4.85	55.3	Fin	Fin	1.93	Fin	2	2.9
AEGN.AS	Aegon	12035	3.73	45.8	Fin	Fin	2.79	Fin	25	0.9
KBC.BR	KBC Groupe	10522	4.68	87.6	Fin	Fin	2.07	Fin	49	0.1

Source: DataStream, Citi Research

Figure 22 attempts to combine our “reasonable and secure” yield combo strategy with a delivery strategy. We add two more factors to the original combo screen (Figure 19) – 6-month relative earnings momentum needs to be positive and each stock needs to be in the bottom-half of its 5-year P/E relative range. This adds delivery at a reasonable price to the final screen. There are only 9 stocks, with just Saint Gobain representing non-Financials.

Strategy outlook

There has been a global liquidity put since the financial crisis, provided by central banks around the world. The end of QE3 in the US has concerned some investors that this liquidity put has ended. Others are concerned that the additional and extraordinary liquidity efforts of central banks have not impacted the real economy.

We think that the BoJ and the ECB will combine to continue to provide what remains effectively a global liquidity (and nominal GDP) put. In Europe, this week’s post-meeting ECB language continues to point to a significant expansion of balance sheet over coming months and quarters.

This liquidity put is likely to continue to drive a global search for yield and income, as it has done in recent years. At the same time, the re-rating of equity markets suggests that investors should also focus more on delivery strategies.

This report identifies four “reasonable and secure” yield strategies across European equities: 1) high DY with strong balance sheets, 2) high DY with high surplus FCF, 3) high DY*G with high dividend cover, 4) surplus FCF with strong balance sheets. Oil & Gas, Telecoms/Insurance, Banks and Technology are the stand-out sectors in the respective strategies. Overall, Financials dominate the combo strategy, which combines all strategies. They also have positive relative earnings trends, trade in the bottom half of 5-year relative valuation ranges and (Banks) have had an encouraging results season.

Overall, this suggests to us that investors, who have limited or no exposure to European Financials should expect either: 1) the ECB to either be unable or unwilling to attempt to defend its inflation mandate, ie perennial disappointments on policy response, 2) the ECB’s response to be insufficient to avoid a triple-dip in the Euro Area economy, or 3) a global downturn driven from outside Europe. None of these three scenarios is our base case. Consequently, we are happy to back European Financials and expect both Banks and Insurance to outperform over coming quarters.

Figure 23. Stocks Mentioned in the Report

RIC	Stock	Price	Rating	Currency	RIC	Stock	Price	Rating	Currency
MAERSKb.CO	A P Moller - Maersk B	13,060.00	2	DKK	LLOY.L	Lloyds Banking Group	0.77	2	GBP
ABBN.VX	ABB	21.56	1	CHF	OREP.PA	L'Oreal	127.35	2	EUR
AEGN.AS	Aegon	6.57	2	EUR	LVMH.PA	LVMH	135.30	1	EUR
AHLN.AS	Ahold Kon.	13.62	1	EUR	MICP.PA	Michelin	70.67	1	EUR
ALVG.DE	Allianz	126.65	1	EUR	NXT.L	Next	64.85	1	GBP
ATCE.AS	Altice	50.90	3	EUR	NOK1V.HE	Nokia	6.64	1	EUR
AAL.L	Anglo American	13.29	2	GBP	NDA.ST	Nordea Bank	91.90	1	SEK
ABI.BR	Anheuser-Busch Inbev	88.41	1	EUR	OML.L	Old Mutual	1.93		GBP
ISPA.AS	Arcelormittal	9.88	1	EUR	ORAN.PA	Orange	12.57	2	EUR
ASML.AS	ASML Hldg	82.00	1	EUR	PHG.AS	Philips Electronics	22.63	1	EUR
ASSAb.ST	Assa Abloy B	389.70	3	SEK	RB.L	Reckitt Benckiser Group	52.25	1	GBP
GASI.MI	Assicu. Generali	16.37	2	EUR	REL.L	Reed Elsevier	10.33	1	GBP
AV.L	Aviva	5.27	1	GBP	ELSN.AS	Reed Elsevier (Ams)	18.55	1	EUR
AXAF.PA	AXA	18.33	1	EUR	RENA.PA	Renault	60.40	1	EUR
BARC.L	Barclays	2.36	1	GBP	CFR.VX	Richemont N	80.50	1	CHF
BAYGn.DE	Bayer	114.50	1	EUR	RIO.L	Rio Tinto	29.68	1	GBP
BCOM.BR	Belgacom	29.79	3	EUR	RDSa.L	Royal Dutch Shell	21.79	2	GBP
BG.L	BG Group	10.26	1	GBP	RWEG.DE	RWE	28.91	3	EUR
BLT.L	BHP Billiton	16.28	1	GBP	RWEG.DE	RWE	28.91	3	EUR
BMWG.DE	BMW	84.38	2	EUR	RYA.I	Ryanair Holdings	8.55	1	EUR
BP.L	BP	4.36	1	GBP	SGOB.PA	Saint Gobain	34.86	1	EUR
BSY.L	BSKyB	8.85	1	GBP	SASY.PA	Sanofi	73.60	2	EUR
BT.L	BT Group	3.71	1	GBP	SAPG.DE	SAP	54.39	1	EUR
CONG.DE	Continental	158.20	1	EUR	SEBa.ST	SEB A	93.60	2	SEK
CAGR.PA	Credit Agricole	10.99	1	EUR	SHP.L	Shire	42.09	1	GBP
CSGN.VX	Credit Suisse R	25.00	1	CHF	SIEGn.DE	Siemens	91.03	1	EUR
CRH.L	CRH	14.11	1	GBP	SOGN.PA	Societe Generale	37.07	1	EUR
DAIGn.DE	Daimler	62.97	2	EUR	STAN.L	Standard Chartered	9.60	1	GBP
DANO.PA	Danone	54.60	1	EUR	STL.OL	Statoil	149.80	2	NOK
DANSKE.CO	Danske Bank	162.00	1	DKK	SRENH.VX	Swiss Re	78.10	2	CHF
DBKGn.DE	Deutsche Bank	24.68	1	EUR	SCMN.VX	Swisscom R	563.50	1	CHF
DTEGn.DE	Deutsche Telekom	12.03	1	EUR	TALK.L	Talktalk	2.96	2	GBP
DNB.OL	DNB	122.30	1	NOK	TDC.CO	TDC	44.78	1	DKK
ELI1V.HE	Elisa	22.15	1	EUR	TEL2b.ST	Tele2 'B'	95.55	2	SEK
ENI.MI	ENI	16.49	2	EUR	TLIT.MI	Telecom Italia	0.88	3	EUR
ERICb.ST	Ericsson B	88.70	2	SEK	TEF.MC	Telefonica	12.00	2	EUR
FNTGn.DE	Freenet	21.67	2	EUR	O2Dn.F	Telefonica Deutsche	3.92	1	EUR
OTEr.AT	Hellenic Telecom	9.46	1	EUR	TELA.VI	Telekom Austria	5.85	2	EUR
HNKG_p.DE	Henkel Pref.	80.36	2	EUR	TEL.OL	Telenor	150.40	2	NOK
HSBA.L	HSBC	6.36	2	GBP	TLSN.ST	TeliaSonera	51.05	1	SEK
ISA.L	Inmarsat	6.99	1	GBP	TOTF.PA	Total	46.52	1	EUR
ISP.MI	Intesa Sanpaolo	2.24	1	EUR	UBSN.VX	UBS R	16.60	1	CHF
INVEb.ST	Investor B	265.80	1	SEK	CRDI.MI	Unicredit	5.69	1	EUR
JAZ.MC	Jazztel	12.75	2	EUR	ULVR.L	Unilever (UK)	25.20	2	GBP
KBC.BR	KBC Groupe	41.87	1	EUR	UNc.AS	Unilever Certs.	31.07	2	EUR
PRTP.PA	Kering	157.95	1	EUR	VOD.L	Vodafone Group	2.07	1	GBP
KPN.AS	KPN	2.55	2	EUR	VOWG.DE	Volkswagen Pref.	174.35	1	EUR
LGEN.Linbev	Legal & General	2.37	2	GBP	VOLVb.ST	Volvo B	85.05	1	SEK
LEGD.PA	Legrand	40.90	2	EUR					

Source: Citi Research. Prices as of 5th November.

Valuation Tables

Figure 24. Pan-European Sector Weightings & Returns

As at Close 31 Oct 14	Mkt Cap	% of	Return Relative to Stoxx				Absolute Return			
Sector (No of Stocks)	**(Euros m)**	**Stoxx**	**1m**	**3m**	**12m**	**Ytd**	**1m**	**3m**	**12m**	**Ytd**
Oil & Gas (33)	529,191	7.5	-7	-9	-8	-7	-9	-8	-2	-2
Chemicals (25)	338,460	4.8	1	0	-1	-4	-1	1	6	1
Basic Resources (19)	217,757	3.1	-3	-12	-7	-4	-5	-11	0	1
Construction & Materials (20)	158,326	2.3	1	-4	-3	-3	0	-3	5	2
Industrial G&S (108)	732,092	10.4	0	-1	-6	-7	-2	0	1	-3
Automobiles & Parts (14)	200,804	2.9	3	-4	-5	-7	2	-3	2	-2
Food & Beverage (27)	590,255	8.4	2	4	3	5	0	5	11	10
Personal & H'hold Goods (29)	400,804	5.7	3	2	-1	1	1	3	6	6
Health Care (35)	866,103	12.3	-2	4	14	14	-4	5	23	19
Retail (27)	197,947	2.8	0	-6	-17	-14	-2	-5	-11	-10
Media (28)	180,427	2.6	2	3	-1	-3	0	3	6	2
Travel & Leisure (21)	106,435	1.5	2	4	9	3	0	4	17	8
Telecommunications (24)	315,764	4.5	2	2	1	0	1	3	8	5
Utilities (26)	314,517	4.5	1	1	11	13	-1	1	20	19
Banks (49)	1,004,336	14.3	-1	0	-4	-2	-3	1	3	3
Insurance (38)	425,579	6.1	2	5	6	3	0	6	13	8
Real Estate (25)	106,634	1.5	5	3	10	13	3	4	18	19
Financial Services (31)	114,371	1.6	4	1	5	0	2	2	13	6
Technology (21)	220,364	3.1	-2	-1	-3	-5	-4	0	4	0
Stoxx - Pan Europe (600)	7,020,166	100.0	—	—	—	—	-2	1	7	5
Pan Euro - Large Cap	5,654,207	80.5	0	0	0	0	-2	1	8	6
Pan Euro - Mid Cap	944,668	13.5	1	-1	1	0	-1	0	8	5
Pan Euro - Small Cap	421,292	6.0	1	-2	-3	-4	-1	-2	4	1
Stoxx ex UK - Europe ex UK (415)	4,753,970	67.7	—	—	—	—	-2	1	7	5
EuroStoxx - Eurozone (294)	3,204,915	45.7	—	—	—	—	-3	0	4	2

Source: Citi Research & DataStream

Figure 25. Pan-European Sector Relative Ratings

As at Close 31 Oct 14	P/E Relative to Stoxx				Yield Relative to Stoxx			
Sector	**2013**	**2014E**	**2015E**	**2016E**	**2013**	**2014E**	**2015E**	**2016E**
Oil & Gas	73	75	81	79	142	140	133	126
Chemicals	105	110	113	111	80	80	79	79
Basic Resources	91	86	80	76	108	106	111	112
Construction & Materials	112	112	109	105	93	94	89	89
Industrial Goods & Services	110	107	106	106	85	88	88	88
Automobiles & Parts	83	62	64	62	88	96	96	95
Food & Beverage	129	137	140	143	81	81	79	78
Personal & H'hold Goods	113	115	117	119	84	87	86	84
Health Care	115	121	128	130	87	85	81	80
Retail	96	104	110	111	105	92	87	86
Media	114	123	122	125	105	96	88	88
Travel & Leisure	132	119	106	101	62	67	74	76
Telecommunications	90	114	127	130	142	122	113	108
Utilities	86	99	113	124	148	135	125	117
Banks	98	89	76	72	99	106	128	140
Insurance	74	69	74	79	126	130	127	125
Real Estate	143	143	152	161	108	109	103	99
Financial Services	66	94	89	114	102	106	102	104
Technology	188	138	133	125	50	63	51	50
Stoxx - Pan Europe	100	100	100	100	100	100	100	100
Pan Euro - Large Cap	96	97	98	99	103	103	103	103
Pan Euro - Mid Cap	135	118	109	107	88	88	88	87
Pan Euro - Small Cap	105	112	108	106	91	89	87	89
Stoxx ex UK - Europe ex UK	104	103	100	100	98	97	96	97
Stoxx Eurozone - Eurozone	104	101	96	95	100	99	98	98

Source: Citi Research & DataStream

Figure 26. Pan-European Sector Growth

As at Close 31 Oct 14	Earnings Growth %			Net Dividend Growth %		
Sector	2014E	2015E	2016E	2014E	2015E	2016E
Oil & Gas	2.8	5.5	13.5	4.4	5.5	3.3
Chemicals	1.3	10.4	12.7	5.0	10.3	8.3
Basic Resources	12.0	22.7	16.7	4.1	16.3	9.5
Construction & Materials	6.5	16.2	15.6	6.9	4.7	9.3
Industrial Goods & Services	8.9	14.8	11.0	8.6	11.3	9.0
Automobiles & Parts	41.3	10.6	14.7	15.2	11.9	7.0
Food & Beverage	-0.3	11.0	9.0	6.1	8.4	6.8
Personal & H'hold Goods	4.5	11.3	9.7	8.2	10.9	5.7
Health Care	1.0	7.7	8.9	3.0	5.9	7.0
Retail	-2.3	7.9	9.5	-7.3	4.7	7.1
Media	-2.2	14.7	8.4	-3.8	2.8	8.5
Travel & Leisure	17.1	27.6	16.3	13.3	22.5	12.0
Telecommunications	-15.7	1.7	8.6	-9.5	3.3	4.2
Utilities	-8.4	-0.6	1.1	-3.9	2.7	2.4
Banks	16.8	32.2	17.7	13.1	33.8	18.6
Insurance	14.3	4.8	5.1	8.6	8.9	6.4
Real Estate	6.5	6.1	5.1	6.4	5.8	4.2
Financial Services	-25.5	20.4	-13.0	9.4	6.7	10.8
Technology	44.4	18.1	18.5	33.6	-10.4	7.6
Stoxx - Pan Europe	6.1	13.4	11.4	5.4	11.2	8.7
Pan Euro - Large Cap	4.8	11.9	11.0	5.5	11.4	8.8
Pan Euro - Mid Cap	21.4	22.7	13.0	6.1	11.0	6.7
Pan Euro - Small Cap	-1.2	17.6	13.5	3.0	9.4	10.9
Stoxx ex UK - Europe ex UK	7.2	16.6	11.3	5.0	10.3	9.7
Stoxx Eurozone - Eurozone	9.4	18.4	12.7	4.3	9.9	9.7

Source: Citi Research & DataStream

Figure 27. Pan-European Sector Ratings

As at Close 31 Oct 14	Price/Earnings				Net Dividend Yield			
Sector	2013	2014E	2015E	2016E	2013	2014E	2015E	2016E
Oil & Gas	11.8	11.5	10.9	9.6	4.59	4.79	5.05	5.22
Chemicals	17.0	16.8	15.2	13.5	2.59	2.72	3.01	3.25
Basic Resources	14.7	13.2	10.7	9.2	3.48	3.62	4.21	4.62
Construction & Materials	18.2	17.1	14.7	12.7	3.01	3.22	3.37	3.68
Industrial Goods & Services	17.8	16.4	14.2	12.8	2.75	2.99	3.33	3.63
Automobiles & Parts	13.4	9.5	8.6	7.5	2.84	3.27	3.66	3.91
Food & Beverage	20.9	21.0	18.9	17.4	2.61	2.77	3.01	3.21
Personal & H'hold Goods	18.4	17.6	15.8	14.4	2.73	2.95	3.27	3.46
Health Care	18.7	18.5	17.2	15.8	2.82	2.90	3.07	3.29
Retail	15.6	15.9	14.8	13.5	3.39	3.15	3.29	3.53
Media	18.4	18.8	16.4	15.2	3.39	3.26	3.36	3.64
Travel & Leisure	21.3	18.2	14.3	12.3	2.01	2.28	2.80	3.13
Telecommunications	14.6	17.4	17.1	15.7	4.58	4.15	4.29	4.47
Utilities	13.9	15.1	15.2	15.1	4.79	4.60	4.73	4.84
Banks	15.8	13.6	10.3	8.7	3.21	3.63	4.86	5.76
Insurance	12.0	10.5	10.0	9.5	4.08	4.44	4.83	5.14
Real Estate	23.2	21.8	20.5	19.5	3.48	3.71	3.92	4.08
Financial Services	10.7	14.4	12.0	13.8	3.30	3.61	3.85	4.27
Technology	30.5	21.1	17.9	15.1	1.62	2.16	1.93	2.08
Stoxx - Pan Europe	16.2	15.3	13.5	12.1	3.24	3.41	3.79	4.12
Pan Euro - Large Cap	15.5	14.8	13.2	11.9	3.32	3.50	3.90	4.25
Pan Euro - Mid Cap	21.8	18.0	14.7	13.0	2.84	3.02	3.35	3.57
Pan Euro - Small Cap	17.0	17.2	14.6	12.8	2.94	3.03	3.31	3.67
Stoxx ex UK - Europe ex UK	16.9	15.8	13.5	12.2	3.16	3.32	3.66	4.01
Stoxx Eurozone - Eurozone	16.8	15.4	13.0	11.5	3.23	3.37	3.70	4.06

Source: Citi Research & DataStream

Figure 28. Pan-European Country Weightings & Returns

	Mkt Cap (Euros m)	% of Stoxx	Relative Return to Stoxx 1m	3m	12m	YTD	Absolute Return 1m	3m	12m	YTD
Austria	22,259	0.3	2	-5	-25	-21	3	-4	-20	-17
Belgium	122,210	1.7	1	4	7	7	1	6	15	12
Denmark	164,220	2.3	-3	0	21	16	-3	1	30	22
Finland	102,242	1.5	2	3	7	7	2	5	15	13
France	1,034,591	14.8	-2	-2	-4	-4	-1	0	3	1
Germany	891,973	12.7	1	0	-4	-7	2	2	3	-2
Greece	14,355	0.2	-11	-15	-24	-22	-10	-14	-18	-18
Ireland	50,630	0.7	1	5	3	4	1	7	11	9
Italy	273,030	3.9	-4	-4	-2	2	-4	-2	6	7
Netherlands	303,287	4.3	1	6	1	0	1	7	8	5
Norway	85,693	1.2	-6	-10	-7	-2	-6	-8	0	3
Portugal	19,077	0.3	-8	-14	-29	-25	-8	-12	-23	-22
Spain	371,261	5.3	-3	-2	3	3	-3	-1	10	8
Sweden	320,405	4.6	2	2	2	0	2	4	10	6
Switzerland	972,576	13.9	2	5	6	7	2	7	14	13
UK	2,266,196	32.3	0	-2	0	1	1	0	8	6
Stoxx - Pan Europe	7,014,005	100								

Source: Citi Research & DataStream

Figure 29. Pan-European Country Relative Ratings

As at Close 31 Oct 14 Country	Price/Earnings 2013	2014E	2015E	2016E	Net Dividend Yield 2013	2014E	2015E	2016E
Austria	110	1021	74	72	83	78	119	118
Belgium	137	122	124	129	84	93	79	91
Denmark	154	128	127	120	51	57	58	65
Finland	239	122	129	129	92	131	96	92
France	101	105	95	94	105	102	100	100
Germany	84	84	88	89	88	89	89	90
Greece	32	344	112	79	25	66	93	100
Ireland	134	118	111	108	52	53	51	50
Italy	150	109	95	90	93	97	104	109
Netherlands	116	104	103	102	71	70	82	87
Norway	75	78	83	85	150	153	148	149
Portugal	-	137	116	110	108	105	97	92
Spain	111	110	105	100	157	140	130	127
Sweden	92	102	102	112	115	114	110	112
Switzerland	109	113	113	116	88	88	90	90
UK	92	94	99	99	105	106	107	105
EuroStoxx - Eurozone	104	101	96	95	100	99	98	98
Stoxx ex UK - Europe ex UK	104	103	100	100	98	97	96	97
Stoxx - Pan Europe	100	100	100	100	100	100	100	100

Source: Citi Research & DataStream

Figure 30. Pan-European Country Growth

As at Close 31 Oct 14	Earnings Growth %			Dividend Growth %		
Country	2014E	2015E	2016E	2014E	2015E	2016E
Austria	-88.6	1,470.8	13.4	-1.6	71.2	7.6
Belgium	19.2	11.9	6.9	16.7	-5.7	25.3
Denmark	28.0	14.7	17.5	18.5	13.5	21.8
Finland	107.6	7.4	11.3	49.2	-18.1	3.9
France	2.6	24.7	12.6	1.5	9.7	8.1
Germany	6.6	7.9	10.5	7.1	10.4	10.1
Greece	-90.0	246.8	59.2	176.2	57.6	17.3
Ireland	20.2	20.9	13.6	7.2	7.1	6.0
Italy	45.4	31.0	17.2	10.7	19.6	13.3
Netherlands	17.7	15.4	12.1	4.5	31.0	15.0
Norway	1.0	7.1	8.9	7.5	7.3	9.3
Portugal	-	33.6	17.9	2.1	2.7	3.6
Spain	6.3	19.0	16.7	-5.7	3.3	5.8
Sweden	-4.3	13.5	1.4	5.1	7.3	10.1
Switzerland	3.0	12.9	9.0	6.3	13.4	8.2
UK	4.0	7.3	11.6	6.2	13.0	6.8
EuroStoxx - Eurozone	9.4	18.4	12.7	4.3	9.9	9.7
Stoxx ex UK - Europe ex UK	7.2	16.6	11.3	5.0	10.3	9.7
Stoxx - Pan Europe	6.1	13.4	11.4	5.4	11.2	8.7

Source: Citi Research & DataStream

Figure 31. Pan-European Country Ratings

As at Close 31 Oct 14	Price/Earnings				Net Dividend Yield			
Country	2013	2014E	2015E	2016E	2013	2014E	2015E	2016E
Austria	17.8	156.0	9.9	8.8	2.69	2.65	4.53	4.88
Belgium	22.3	18.7	16.7	15.6	2.73	3.19	3.01	3.77
Denmark	25.0	19.6	17.1	14.5	1.64	1.95	2.21	2.70
Finland	38.7	18.7	17.4	15.6	2.99	4.45	3.65	3.79
France	16.4	16.0	12.8	11.4	3.41	3.46	3.80	4.11
Germany	13.7	12.8	11.9	10.8	2.84	3.05	3.36	3.70
Greece	5.3	52.5	15.1	9.5	0.81	2.24	3.53	4.14
Ireland	21.7	18.0	14.9	13.1	1.68	1.80	1.93	2.05
Italy	24.3	16.7	12.7	10.9	2.99	3.31	3.96	4.49
Netherlands	18.8	15.9	13.8	12.3	2.28	2.38	3.12	3.59
Norway	12.1	12.0	11.2	10.3	4.87	5.23	5.62	6.14
Portugal	-	20.9	15.6	13.3	3.51	3.58	3.68	3.81
Spain	17.9	16.9	14.2	12.2	5.08	4.79	4.94	5.23
Sweden	14.9	15.6	13.8	13.6	3.71	3.90	4.18	4.61
Switzerland	17.8	17.2	15.3	14.0	2.84	3.01	3.41	3.70
UK	14.9	14.3	13.4	12.0	3.40	3.61	4.07	4.35
EuroStoxx - Eurozone	16.8	15.4	13.0	11.5	3.23	3.37	3.70	4.06
Stoxx ex UK - Europe ex UK	16.9	15.8	13.5	12.2	3.16	3.32	3.66	4.01
Stoxx - Pan Europe	16.2	15.3	13.5	12.1	3.24	3.41	3.79	4.12

Source: Citi Research & DataStream

Figure 32. UK Sector Weightings & Relative Returns

As at Close 31 Oct 2014	Mkt Cap £m	% of AllShare	% of Group	1m	3m	12m	Qtd	Ytd
				Relative return				
OIL & GAS (22)	283,611	14.0		-5	-7	-2	-5	-3
Oil & Gas Producers (15)	273,494	13.5	96	-5	-7	-1	-5	-4
Oil Equip, Serv and Distrib (7)	10,117	0.5	4	-7	-7	-14	-7	-2
BASIC MATERIALS (31)	153,309	7.6		-4	-12	-8	-4	-5
Chemicals (7)	13,079	0.6	9	5	4	0	5	-7
Forestry & Paper (1)	3,867	0.2	3	5	3	-3	5	4
Industrial Metals & Mining (2)	781	0.0	1	-5	16	-6	-5	-5
Mining (21)	135,582	6.7	88	-5	-14	-9	-5	-5
INDUSTRIALS (115)	195,164	9.6		-1	-1	-7	-1	-8
Construction & Materials (14)	15,872	0.8	8	-3	-3	-10	-3	-10
Aerospace (9)	41,546	2.0	21	-5	-5	-12	-5	-13
General Industrials (6)	12,731	0.6	7	-3	-2	-11	-3	-14
Electronic & Electrical Equip (12)	9,084	0.4	5	0	-2	-10	0	-18
Industrial Engineering (14)	18,347	0.9	9	-3	-5	-9	-3	-7
Industrial Transportation (8)	5,873	0.3	3	8	5	-12	8	-9
Support Services (52)	91,712	4.5	47	1	1	-3	1	-3
CONSUMER GOODS (38)	291,829	14.4		2	5	5	2	8
Automobiles & Parts (1)	5,179	0.3	2	0	-5	-13	0	-13
Beverages (6)	84,982	4.2	29	4	8	-1	4	1
Food Producers (10)	15,860	0.8	5	4	1	4	4	4
Household Goods & Home Const (12)	54,175	2.7	19	2	6	11	2	12
Leisure Goods (2)	402	0.0	0	-1	-6	-9	-1	-3
Personal Goods (5)	38,996	1.9	13	-1	6	-3	-1	-3
Tobacco (2)	92,235	4.5	32	3	5	10	3	17
HEALTH CARE (19)	171,833	8.5		-2	2	15	-2	13
Health Care Equip & Services (9)	13,372	0.7	8	4	6	35	4	25
Pharmaceuticals & Biotech (10)	158,460	7.8	92	-2	1	14	-2	12
CONSUMER SERVICES (97)	210,524	10.4		1	1	-6	1	-6
Food & Drug Retailers (7)	25,001	1.2	12	-3	-23	-44	-3	-39
General Retailers (30)	43,668	2.2	21	1	2	-2	1	2
Media (25)	65,541	3.2	31	0	3	-2	0	-2
Travel & Leisure (35)	76,314	3.8	36	3	8	11	3	4
TELECOMMUNICATIONS (8)	92,403	4.6		1	3	-5	1	-10
Fixed-Line Telecoms (6)	34,416	1.7	37	-2	-2	0	-2	-2
Mobile Telecoms (2)	57,987	2.9	63	2	6	-7	2	-12
UTILITIES (8)	82,167	4.0		3	6	13	3	14
Electricity (3)	18,177	0.9	22	2	7	14	2	14
Gas, Water & Multi-Utilities (5)	63,990	3.2	78	4	6	12	4	14
TECHNOLOGY (22)	28,063	1.4		0	5	-3	0	-8
Software & Computer Serv (14)	11,512	0.6	41	1	2	2	1	-2
Technology Hardware & Equip (8)	16,551	0.8	59	-1	7	-6	-1	-13
TOTAL NON-FINANCIAL (360)	1,508,903	74.3		-1	-1	0	-1	-1
FINANCIALS (283)	521,182	25.7		3	4	1	3	2
Banks (7)	231,740	11.4	44	2	2	-7	2	-4
Non-Life Insurance (12)	22,847	1.1	4	1	4	6	1	7
Life Insurance (12)	95,508	4.7	18	3	5	11	3	10
Real Estate Inv. Servs (25)	12,572	0.6	2	1	1	-1	1	-3
REITS (20)	39,544	1.9	8	7	8	18	7	19
Financial Services (29)	46,352	2.3	9	5	5	9	5	4
FTSE ALL SHARE (643)	2,030,085	100.0		0	0	0	0	0
FTSE 100 (100)	1,659,683	81.8		0	0	0	0	0
Mid 250 (250)	302282	15		2	2	2	2	0
Small Cap (293)	68,121	3		0	0	1	0	0

Source: Citi Research & DataStream

Figure 33. UK Relative Ratings

As at Close 31 Oct 2014	P/E Relative 2013E	P/E Relative 2014E	P/E Relative 2015E	P/E Relative 2016E	Yield Relative 2013E	Yield Relative 2014E	Yield Relative 2015E	Yield Relative 2016E
OIL & GAS	81	77	82	81	125	122	116	112
Oil & Gas Producers	81	77	83	81	127	123	116	112
Oil Equip, Serv and Distrib	80	84	75	75	91	94	97	98
BASIC MATERIALS	84	90	81	76	105	103	103	105
Chemicals	122	121	117	120	66	69	69	71
Forestry & Paper	101	95	91	96	75	84	87	90
Industrial Metals & Mining	-	75	59	50	43	93	113	110
Mining	80	87	79	74	110	107	107	108
INDUSTRIALS	110	110	105	106	81	80	77	78
Construction & Materials	133	127	108	100	109	107	95	94
Aerospace	86	91	95	99	92	91	85	85
General Industrials	95	93	90	94	112	100	97	95
Electronic & Electrical Equip	114	117	114	116	65	69	68	68
Industrial Engineering	124	118	114	118	69	70	68	69
Industrial Transportation	113	106	91	89	72	102	111	117
Support Services	121	119	112	111	71	69	69	70
CONSUMER GOODS	125	125	122	125	86	90	89	87
Automobiles & Parts	80	83	85	90	70	72	72	74
Beverages	144	150	148	151	65	67	66	68
Food Producers	119	136	134	134	59	61	58	61
Household Goods & Home Const	131	112	104	106	76	86	93	79
Personal Goods	137	143	141	145	91	91	85	86
Tobacco	109	112	110	114	115	118	115	116
HEALTH CARE	108	122	125	132	106	102	95	91
Health Care Equip & Services	155	146	136	136	56	46	46	48
Pharmaceuticals & Biotech	105	120	124	131	110	107	99	94
CONSUMER SERVICES	99	103	100	103	87	82	79	80
Food & Drug Retailers	48	71	81	84	202	119	94	89
General Retailers	110	104	99	102	75	79	77	78
Media	111	111	106	112	84	86	81	82
Travel & Leisure	125	113	103	103	59	69	73	76
TELECOMMUNICATIONS	113	137	149	142	122	126	120	120
Fixed-Line Telecoms	87	93	97	102	84	92	95	100
Mobile Telecoms	138	191	218	187	145	145	135	132
UTILITIES	109	116	118	124	133	133	125	122
Electricity	95	101	106	108	144	139	134	134
Gas, Water & Multi-Utilities	114	121	122	130	130	131	122	118
TECHNOLOGY	176	165	149	146	40	43	47	52
Software & Computer Serv	130	126	117	119	61	66	68	72
Technology Hardware & Equip	231	208	182	173	25	29	33	38
TOTAL NON-FINANCIAL	101	104	104	104	101	100	96	95
FINANCIALS	96	89	89	89	96	100	112	116
Banks	82	76	79	76	98	101	127	134
Non-Life Insurance	122	83	87	90	139	126	122	120
Life Insurance	100	96	92	95	92	98	98	98
Real Estate Inv. Servs	183	164	154	149	38	58	59	62
REITS	206	196	189	198	85	86	82	81
Financial Services	104	104	100	102	97	104	99	99
FTSE ALL SHARE	100	100	100	100	100	100	100	100
FTSE 100	98	98	99	99	104	103	103	103
Mid 250	111	112	105	105	78	84	84	85
Small Cap	101	101	94	93	67	78	74	77

Source: Citi Research & DataStream

Figure 34. UK Sector Growth

	Earnings Growth %			Net Dividend Growth %		
As at Close 31 Oct 2014	2014E	2015E	2016E	2014E	2015E	2016E
OIL & GAS	6.3	-1.9	13.3	0.2	4.2	3.3
Oil & Gas Producers	6.7	-2.6	13.3	0.0	4.0	3.1
Oil Equip, Serv and Distrib	-4.0	17.9	12.0	5.5	13.5	7.7
BASIC MATERIALS	-5.4	15.6	18.8	1.3	10.1	8.1
Chemicals	1.9	7.9	9.1	8.0	9.5	10.5
Forestry & Paper	7.5	9.4	5.9	15.0	13.5	10.9
Industrial Metals & Mining	-	31.6	32.7	-	34.4	3.3
Mining	-7.4	16.2	19.7	0.4	9.9	7.9
INDUSTRIALS	1.4	9.8	10.7	1.8	6.6	7.8
Construction & Materials	5.9	23.4	20.5	1.5	-2.3	5.5
Aerospace	-4.3	1.1	6.7	1.3	2.9	6.8
General Industrials	3.3	8.5	6.4	-8.7	7.4	4.6
Electronic & Electrical Equip	-1.4	7.6	9.6	9.0	7.9	7.5
Industrial Engineering	6.8	8.0	8.3	4.6	7.9	8.0
Industrial Transportation	7.6	22.5	13.8	44.4	20.5	12.0
Support Services	2.7	12.4	12.0	0.4	9.2	9.1
CONSUMER GOODS	0.7	7.7	8.9	6.6	9.1	5.1
Automobiles & Parts	-2.5	2.3	5.6	6.3	10.0	10.0
Beverages	-2.6	6.1	9.6	6.0	8.1	9.4
Food Producers	-11.7	6.4	12.1	5.6	6.1	12.4
Household Goods & Home Cor	18.1	13.3	9.2	16.4	18.6	-8.6
Personal Goods	-3.0	5.9	8.8	1.8	3.6	7.8
Tobacco	-2.2	6.7	8.0	4.7	7.4	7.7
HEALTH CARE	-10.6	2.0	6.1	-1.0	2.5	2.1
Health Care Equip & Services	7.8	12.3	12.2	-16.5	10.3	11.5
Pharmaceuticals & Biotech	-11.6	1.3	5.6	-0.4	2.2	1.8
CONSUMER SERVICES	-2.9	8.3	8.7	-3.1	5.8	8.3
Food & Drug Retailers	-30.9	-8.4	7.1	-39.3	-12.9	0.5
General Retailers	7.3	10.1	9.0	8.9	6.8	9.1
Media	0.9	9.7	5.7	5.1	4.4	8.2
Travel & Leisure	11.3	15.0	11.6	20.0	17.3	11.4
TELECOMMUNICATIONS	-16.5	-3.3	17.0	5.8	5.3	6.7
Fixed-Line Telecoms	-5.0	0.4	6.7	13.5	13.5	12.1
Mobile Telecoms	-27.2	-7.9	30.7	3.2	2.2	4.5
UTILITIES	-4.6	3.4	5.8	2.5	3.4	4.3
Electricity	-5.3	0.5	9.8	-1.0	5.9	7.4
Gas, Water & Multi-Utilities	-4.4	4.4	4.4	3.6	2.7	3.3
TECHNOLOGY	8.0	16.0	14.1	12.5	19.8	17.0
Software & Computer Serv	4.3	12.7	10.4	10.4	13.5	14.1
Technology Hardware & Equip	12.4	19.6	18.0	15.9	29.4	20.8
TOTAL NON-FINANCIAL	-1.5	5.3	11.4	1.7	6.1	5.5
FINANCIALS	9.1	4.2	12.3	6.3	24.0	10.5
Banks	8.9	2.0	14.9	5.8	38.8	13.1
Non-Life Insurance	48.5	0.2	7.2	-7.1	6.3	5.0
Life Insurance	5.5	8.7	8.2	9.3	9.6	7.5
Real Estate Inv. Servs	12.5	12.3	15.4	55.6	11.1	12.8
REITS	6.0	9.0	6.5	4.4	4.7	5.1
Financial Services	1.6	8.9	9.4	9.7	5.6	6.9
FTSE ALL SHARE	1.0	5.0	11.6	2.7	10.1	6.8
FTSE 100	1.0	4.0	11.6	1.7	10.1	6.5
Mid 250	0.8	11.9	11.5	9.4	10.7	8.4
Small Cap	0.8	12.9	12.6	19.5	5.1	9.9

Source: Citi Research & DataStream

Figure 35. UK Sector Ratings

As at Close 31 Oct 2014	2013E	2014E	2015E	2016E	2013E	2014E	2015E	2016E
OIL & GAS	11.3	10.7	10.9	9.6	4.47	4.48	4.67	4.82
Oil & Gas Producers	11.3	10.6	10.9	9.6	4.52	4.52	4.70	4.85
Oil Equip, Serv and Distrib	11.2	11.7	9.9	8.9	3.27	3.44	3.91	4.21
BASIC MATERIALS	11.8	12.4	10.8	9.1	3.74	3.79	4.18	4.51
Chemicals	17.1	16.8	15.5	14.2	2.35	2.54	2.78	3.07
Forestry & Paper	14.2	13.2	12.0	11.4	2.68	3.08	3.50	3.87
Industrial Metals & Mining	-	10.4	7.9	5.9	1.53	3.41	4.58	4.73
Mining	11.2	12.1	10.4	8.7	3.92	3.94	4.33	4.67
INDUSTRIALS	15.5	15.3	13.9	12.6	2.88	2.93	3.12	3.37
Construction & Materials	18.7	17.6	14.3	11.8	3.88	3.94	3.85	4.06
Aerospace	12.1	12.7	12.5	11.7	3.30	3.34	3.43	3.67
General Industrials	13.3	12.9	11.9	11.2	3.99	3.65	3.92	4.10
Electronic & Electrical Equip	16.0	16.2	15.0	13.7	2.32	2.53	2.73	2.94
Industrial Engineering	17.4	16.3	15.1	14.0	2.45	2.56	2.76	2.98
Industrial Transportation	15.8	14.7	12.0	10.5	2.59	3.74	4.50	5.04
Support Services	17.0	16.6	14.7	13.2	2.53	2.54	2.77	3.02
CONSUMER GOODS	17.5	17.4	16.2	14.8	3.08	3.29	3.58	3.77
Automobiles & Parts	11.2	11.5	11.3	10.7	2.48	2.64	2.91	3.20
Beverages	20.3	20.8	19.6	17.9	2.33	2.47	2.67	2.92
Food Producers	16.7	18.9	17.7	15.8	2.10	2.22	2.36	2.65
Household Goods & Home Co	18.3	15.5	13.7	12.6	2.71	3.15	3.74	3.42
Personal Goods	19.2	19.8	18.7	17.2	3.26	3.32	3.44	3.71
Tobacco	15.2	15.6	14.6	13.5	4.12	4.32	4.64	5.00
HEALTH CARE	15.1	16.9	16.6	15.6	3.78	3.74	3.84	3.92
Health Care Equip & Services	21.8	20.2	18.0	16.1	2.01	1.68	1.85	2.07
Pharmaceuticals & Biotech	14.7	16.7	16.4	15.6	3.92	3.91	4.00	4.07
CONSUMER SERVICES	13.9	14.3	13.2	12.2	3.11	3.01	3.19	3.46
Food & Drug Retailers	6.8	9.8	10.7	10.0	7.20	4.36	3.80	3.82
General Retailers	15.5	14.4	13.1	12.0	2.67	2.90	3.10	3.38
Media	15.5	15.4	14.0	13.3	2.98	3.14	3.27	3.54
Travel & Leisure	17.5	15.7	13.7	12.2	2.10	2.52	2.96	3.30
TELECOMMUNICATIONS	15.9	19.1	19.7	16.8	4.35	4.61	4.85	5.18
Fixed-Line Telecoms	12.2	12.9	12.8	12.0	2.98	3.39	3.84	4.31
Mobile Telecoms	19.3	26.6	28.9	22.1	5.17	5.33	5.45	5.70
UTILITIES	15.4	16.1	15.6	14.7	4.76	4.88	5.04	5.26
Electricity	13.3	14.1	14.0	12.7	5.14	5.09	5.40	5.80
Gas, Water & Multi-Utilities	16.1	16.8	16.1	15.4	4.65	4.81	4.94	5.11
TECHNOLOGY	24.8	22.9	19.8	17.3	1.41	1.59	1.90	2.22
Software & Computer Serv	18.2	17.5	15.5	14.0	2.18	2.41	2.73	3.12
Technology Hardware & Equip	32.4	28.8	24.1	20.4	0.90	1.05	1.35	1.63
TOTAL NON-FINANCIAL	14.2	14.4	13.7	12.3	3.61	3.67	3.89	4.11
FINANCIALS	13.4	12.3	11.8	10.5	3.43	3.65	4.53	5.01
Banks	11.6	10.6	10.4	9.1	3.48	3.69	5.12	5.79
Non-Life Insurance	17.1	11.5	11.5	10.7	4.97	4.62	4.91	5.16
Life Insurance	14.0	13.3	12.2	11.3	3.30	3.60	3.95	4.24
Real Estate Inv. Servs	25.7	22.8	20.4	17.6	1.37	2.13	2.37	2.67
REITS	28.9	27.2	25.0	23.4	3.03	3.16	3.31	3.48
Financial Services	14.7	14.4	13.2	12.1	3.46	3.80	4.01	4.29
FTSE ALL SHARE	14.0	13.9	13.2	11.8	3.57	3.67	4.04	4.31
FTSE 100	13.8	13.7	13.2	11.8	3.71	3.77	4.16	4.43
Mid 250	15.6	15.5	13.8	12.4	2.80	3.06	3.39	3.68
Small Cap	14.2	14.0	12.4	11.0	2.39	2.86	3.00	3.30

Source: Citi Research & DataStream

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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