

European Portfolio Strategist

Head-to-Head: Value vs Quality

- **Value vs Quality** — This has been a key battle within European equities over the past decade. Supported by leverage, value won out between 2003-07. Quality has been the clear winner since 2008, but the risk on/off trade has made it a bumpy ride. What next?
- **Cheap but...avoid value traps** — European equities are cheap vs global equities. But EM equities are the stand-out value trade, on sub-10x P/E. In Europe, be selective in value since value \neq cheap. Financials & surplus FCF = value. Offensives \neq value.
- **Financials & surplus FCF** — Financials = cheap, self/help, restructuring, improving capital/cashflow, +ve earnings trends, positive correlation to rising (US) bond yields. Surplus FCF, plus balance sheet optionality, = sectors such as Health Care.
- **Avoid the 'Offensives'** — Stocks/sectors with structural challenges = big Oil, Utilities, Food Retail, Telecoms. Generally, low/no FCF/returns/growth, high capex, unhelpful legacy positions and, selectively, weak balance sheets & high European exposure.
- **Stick with quality** — Quality (& Defensive Growth) are one-part of our barbell strategy. Quality winning YTD and over last few years. Two key risks to leadership: 1) strong global recovery, 2) broad re-leveraging surge. Both risks unlikely. Stick with quality.
- **Three quality strategies** — 1) Quality Street = stocks with better than sector RoE & balance sheets with +ve earnings trends, eg Roche, Siemens, BT, Compass, Inditex, Ryanair, ITV; 2) QARP = stocks with high FCFY, high RoE and strong balance sheets, eg Ryanair, Novartis, BATs, Ahold, Next, Alstom; 3) QUARI = the new income strategy from Chris Montagu and our Quant team.

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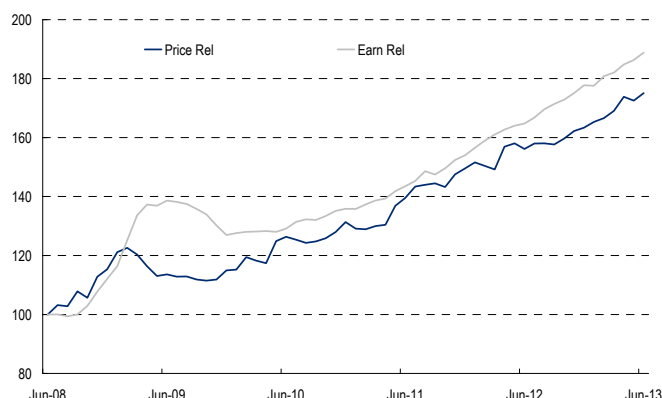
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Figure 1. Quality Still Winning — Stick With It (Price and Earnings Relative for Quality Street)



Source: Citi Research

- [27th Jun — Buy the Dip](#)
- [20th Jun — UK Equity Strategy](#)
- [13th Jun — Pan-Europe Road Ahead 2013](#)
- [6th Jun — US Rates & European Equities](#)
- [30th May — The Citi Income Report](#)
- [23rd May — Mid-Cycle = Earnings Mo](#)
- [16th May — European Earnings](#)
- [9th May — Buying European Banks](#)
- [2nd May — Equity Re-Rating](#)
- [25th Apr — The Drugs Do Work](#)
- [18th Apr — Pause.Think.Reload.](#)

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

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Head-to-Head: Value vs Quality

Value vs quality. That has been a key battle within European equities over the past decade. Supported by the leveraging up of the corporate sector, value won out between 2003-07. Quality has been the clear winner since 2008, but it has often been a bumpy ride due to the risk on/off trade.

European equities look cheap relative to global equities. But, we argue that investors should be wary of widespread value hunting (EM could be better for this). Economic recovery remains distant, eg our economists expect 0.0% Euro Area GDP growth in 2014. There are plenty of (relative) value traps to be found. Many of these traps, we believe, are in the 'offensives'.

The offensives are 'defensive' sectors with structural challenges — big Oil, Utilities, Food Retail, Telecoms. There are exceptions within all of these sectors of course, but generally these sectors suffer from low/no growth, low returns, high capex, low FCF, unhelpful legacy positions and, more selectively, weak balance sheets and high exposure to domestic growth.

There is a time and a place for value. [Last summer](#) presented a good opportunity for investors to take on more value. Now, we believe that investors should be more selective.

This is why we back our barbell strategy of quality/defensive growth and (acceptable) risk. This has led us to favour Financials (since end-2011¹ and US recovery [since October 2012](#)) as the risk part of the barbell, alongside stocks with various attributes across high returns, strong balance sheet and surplus FCF. We see the real value opportunities in Europe in surplus FCF sectors, such as [Health Care](#), and in cheap sectors with self-help/restructuring support, eg [Financials](#).

Last, we have run specific strategies with a quality bias in recent years, eg [World Champions](#), strong (companies) in strong (countries), Quality Street, QARP. In this report, we focus on the last two of our quality strategies — Quality Street & QARP. Overall, we continue to back these strategies in the coming 12-18 months and retain a selective approach to value.

Cheap, but...

European equities look decent value to us in absolute terms (eg sub-12x 12m forward P/E) and excellent value in relative terms versus other asset classes (eg credit). European equities also continue to look reasonably cheap relative to global equities (Figure 2 & Figure 3), although our colleagues in GEM and global strategy argue that EM equity, on sub-10x 12m forward P/E, offers a [more interesting value trade](#) following the YTD sell-off.

Figure 2. Regional 2014E P/E

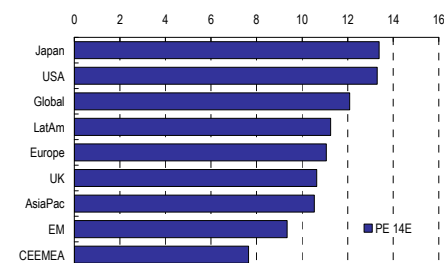
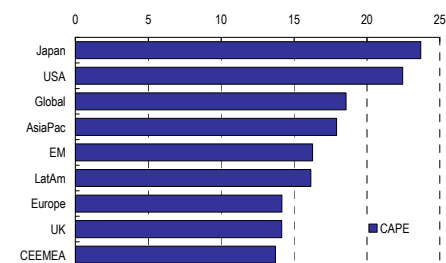


Figure 3. Regional CAPE



Source: Citi Research, Worldscope, MSCI, Factset

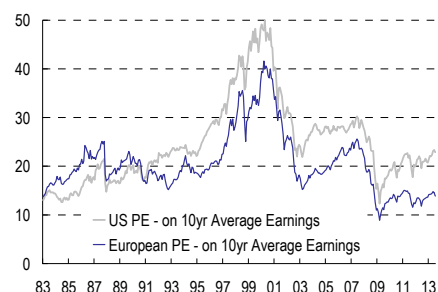
Source: Citi Research, Worldscope, MSCI, Factset

¹ 2012 European Market Outlook: Barbell – 1 Dec 2011

So, European equities looking cheap vs global equities is a reflection of being cheap relative to US equities. Figure 4 and Figure 5 show this on a cyclically-adjusted P/E (CAPE) basis. We do not think valuation alone, in this case, is a compelling reason to bang the table for Europe ahead of the US.

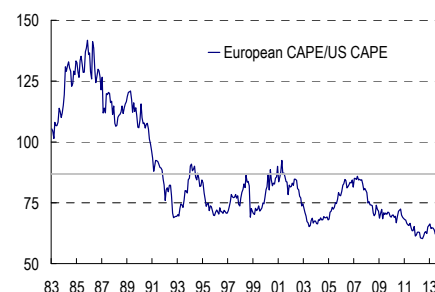
Equally, we would not be surprised were European equity returns to match US returns in the coming 12-months as the US economic recovery firms and as Europe emerges (slowly) from recession.

Figure 4. Europe & US CAPE



Source: Datastream, Citi Research

Figure 5. Europe/US CAPE



Source: Datastream, Citi Research

Despite European equities looking cheap, we suggest that global investors should avoid the siren call of value in Europe and not buy cheap stocks blindly. We see both plenty of value traps and plenty of better opportunities elsewhere in the region. The better opportunities we suggest are in quality (broadly) and value (selectively).

...avoid value traps

We see 6 core value groups in European equities: 1) mega-caps, 2) periphery, 3) financials, 4) commodities, 5) domestic defensives, 6) FCF generators. We believe the best value opportunities are in financials and in FCF generators.

The former look cheap and have self-help and restructuring driving higher returns. They also have positive relative earnings trends over the past 6-months, unlike most other sub-market P/E sectors, and should be positively correlated to rising US bond yields.

We showed earlier this year that while value has struggled in recent years as a strategy using [FCF has worked well](#). We continue to like FCF generators. In particular, those companies and sectors with a FCFY-DY gap, preferably with strong balance sheets too, look attractive to us (see Figure 13 in "[Buy the Dip — Insurance to Overweight](#)", 27 June 2013).

Mega-caps, excluding value traps, are likely to be more competitive with total market returns in the next couple of years especially should capital allocators increasing allocate [towards equity](#). We remain selective in the periphery, and would not take on excessive peripheral risk and prefer the '[misnomers](#)'.

Offensive

In the final two groups, commodities and domestic defensives, we see plenty of offensives. These are companies or sectors which suffer from low/no growth, low returns, high capex, low FCF, unhelpful legacy positions and, more selectively, weak balance sheets and high exposure to domestic growth. We would highlight big Oil, Utilities, Food Retail, Telecoms.

Arguably, Basic Resources (eg Miners) could also be grouped here. However, there is also some early evidence that the Miners are changing their spots in terms of addressing their surplus capex problem. Mining CEOs need to [transform a surplus capex problem into a surplus FCF one](#). Time will tell if they are able to deliver. But, this is why we have Rio Tinto on our European Focus List.

Our sector teams have written on the structural challenges facing the 'offensives' in the last few weeks (we are Underweight all of these sectors):

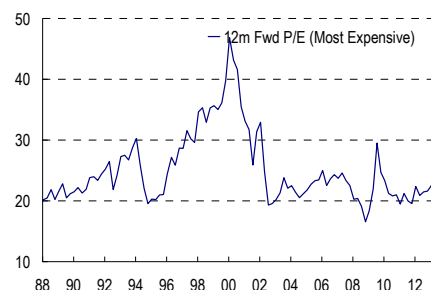
- Food Retail — [From Ritz to the Rubble](#), Al Johnston et al — “In real terms, sector earnings are 12% lower today than ten years ago: we expect real-terms decline to continue, or intensify, as space growth diminishes and macro-economic conditions remain harsh. We pare back our Buy recommendations to the four companies (Ahold, Booker, Colruyt, Jeronimo Martins) we believe will prosper long-term in all market circumstances. Investing in the sector on the basis of easy monetary conditions and low high-yield bond yields no longer seems, in our opinion, to make so much sense...The UK sector stands out for its capital largesse. All three UK companies are still leveraging up² in the context of a stagnant market in which their collective share is shrinking. We are not supportive of these strategic decisions.”
- Big Oil — [Same Old Issues on Spending and Returns](#), Alastair Syme et al — “Rolling 12-month ROCE is forecast at c9%, likely dropping below previous lows (4Q09/3Q02). We see low profitability as a function of the way in which the industry has invested/chased the cost-curve. Cashflow constraints continue. On a rolling 12-month basis we peg organic capex at 96% of cash flow, and dividends another 20% on top of that. The industry has previously shown little sign of reducing capex commitments, although in the face of a somewhat stagnant macro environment and poor profitability we sense that the market is looking for some change in direction.”
- Utilities — [The Lost Decade: What Next?](#), Sofia Savvantidou et al — “The addressable market in volume terms has scope to halve within 2 decades as energy efficiency measures are accelerated and renewables continue to take away market share. The Utilities Industry should expand to include new downstream services, where however traditional Utilities, with little experience on business model innovation, will face intense competition from other industries and available returns likely won't match those historically delivered by conventional generation. The earnings base of the listed utilities is likely to remain under pressure over this timeframe in this context...The listed Utilities sector is slashing capex. Against this backdrop and we expect further cuts in the coming 2-3 years. However, we show that levels expected to be reached in 2015 should be near the trough and therefore further downward pressures on Op.Cash Flow cannot easily be matched by further capex cuts.”
- Telecoms — [Still Under Pressure](#), Simon Weeden et al — We expect the organic EBITDA decline for the sector to worsen further to -2.7% 2Q13 from -1.9% 1Q13. Though we do forecast an improvement in organic revenue decline to -1.7% 2Q13 from -2.7% 1Q13.

² Looked at holistically, embracing on- and off-balance sheet debt (the way the credit rating agencies look at them).

Cheap = not cheap

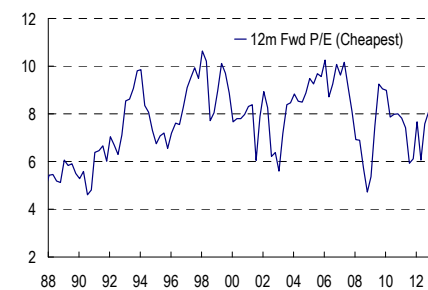
A final point we often make on value in Europe is that the price is important. Last summer, we highlighted [the tactical opportunity in value](#). At that point, the cheapest quintile in Europe relative to the most expensive quintile hit 2008-09 valuation cheaps (Figure 8). Now that is not the case.

Figure 6. Most Expensive 5th — 12m Fwd P/E



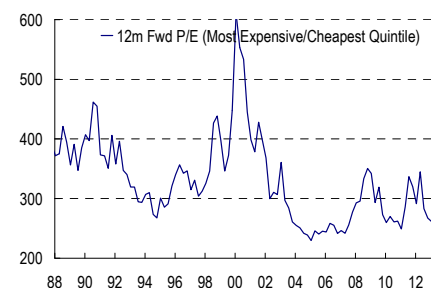
Source: Datastream, Citi Research

Figure 7. Cheapest 5th — 12m Fwd P/E



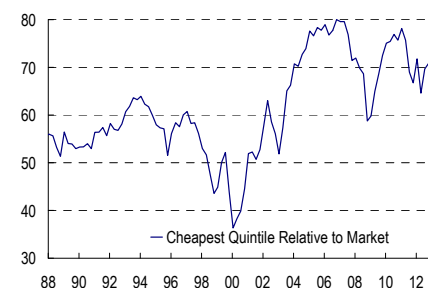
Source: Datastream, Citi Research

Figure 8. Most Expensive Vs Cheapest



Source: Datastream, Citi Research

Figure 9. Cheapest — 12m Fwd P/E Rel



Source: Datastream, Citi Research

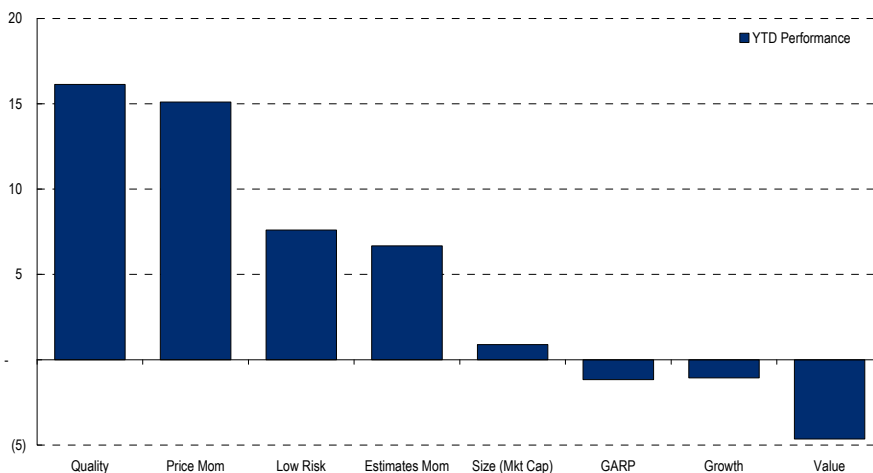
In fact, despite the re-rating of the most expensive quintile group (Figure 6), expensive stocks have been de-rated relative to cheap stocks because the re-rating of the cheapest quintile (from 6x 12m forward P/E to 9x) was more aggressive. Figure 7 shows that the cheapest stocks in Europe are trading closer to the top than bottom of their 25-year range. Figure 8 shows that the cheapest quintile does not look that cheap relative to the market. Sure, cheap was more highly rated relative to the market at end-2007 and end-2009 but that reflected the end of the leverage cycle and the post-2009 recovery trade respectively. It is unlikely that we head back to those levels in a hurry. Apart from those two periods, the cheapest quintile group in Europe has not been this expensive in the last 25 years. Cheap is not cheap, it seems.

Quality winning

So, if we remain reluctant to dive into a European value trade, unless selectively, where do we see opportunity for investors in Europe? This takes us to the other side of our barbell and to quality and defensive growth. (There is often overlap between both groups).

Our Quant team, Chris Montagu & co, show that [quality continues to be a strong performer YTD](#) at a style level. The rationale for investors retaining a quality skew in portfolios remains high, in our view. Similar to defensive growth, the two biggest risks to ongoing leadership from quality are: 1) strong global recovery, 2) broad re-leveraging surge. We see selective recovery and selective re-leveraging rather than strong and broad. So, in a world with enduring macro risks, we continue to back quality companies to deliver in terms of earnings, returns and share prices.

Figure 10. Year To Date Returns, Various Quant Styles



Source: IBES, Worldscope, Factset & Citi Research

In addition, Figure 11 and Figure 12 show the 10-year performance of our Quant team's quality and value styles. These reflect the performance of a top vs bottom quintile in each style group.

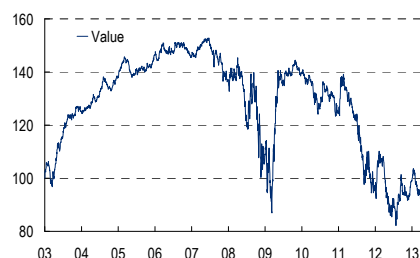
Quality has been a strong performer since 2008. The first leg of outperformance came in the 2008-09 bear market as quality stocks held up better. In the 2009 recovery rally, quality gave up most of its 2008 gains. The second leg of outperformance for quality has been delivered in both rising and falling markets since then, including strong performance YTD.

Figure 11. Quant Style — Quality (Long/Short)



Source: IBES, Worldscope, Factset & Citi Research

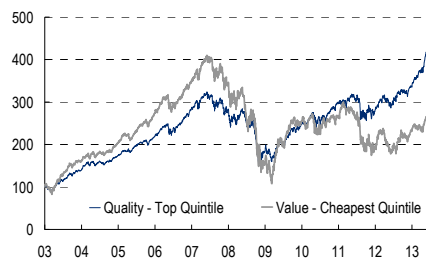
Figure 12. Quant Style — Value (Long/Short)



Source: IBES, Worldscope, Factset & Citi Research

Figure 12 shows that value enjoyed excellent performance from 2003-07. But, performance collapsed in 2008-09, recovered sharply after March 2009 and then collapsed again in summer 2011 and last summer. Performance since last summer has been better following Draghi's "whatever it takes" remarks.

Figure 13. Quality & Value Abs Returns



Source: IBES, Worldscope, Factset & Citi Research

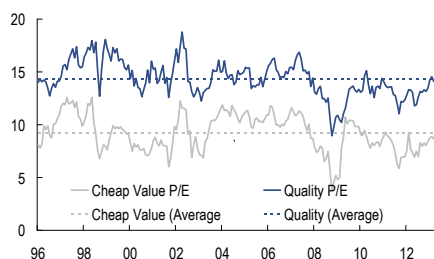
Figure 14. Quality & Value Rel Returns



Source: IBES, Worldscope, Factset & Citi Research

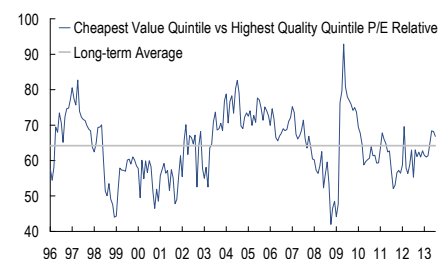
Figure 13 and Figure 14 shows the returns of the highest quality quintile and the cheapest value quintile in absolute terms and relative to each other over the past 10 years. Again, this shows how value beat quality in 2003-07, but has struggled since, bar the 2009 recovery trade and various iterations of the risk on trade since then. Performance has been broadly the same over the past 12-months, which suggests rewards for a more balance approach to European equities.

Figure 15. Value & Quality P/E



Source: Citi Research, MSCI, IBES, Worldscope

Figure 16. Value P/E Relative to Quality



Source: Citi Research, MSCI, IBES, Worldscope

Figure 15 shows the P/E of these quintiles. Both are close to long-run average levels. Not extreme. Cheap value is cheaper, but it always is. Quality does not look particularly expensive. Run earnings delivery to see which group performs best from here seems a reasonable conclusion.

Figure 16 shows the P/E relative of the cheapest value quintile relative to the highest quality quintile. The re-rating of value over the past 1-, 2- and 5-years means that cheap value is now back above its long-term P/E relative compared to quality. Value does not appear especially cheap on this basis. Again, support for a selective view absent a strong and consistent macro driver for a value trade, such as stronger than expected economic recovery or full blown QE. We think that we have good exposure to these risks with our Financials Overweight.

Three Quality Strategies

So, the case for broad value ownership in Europe is not compelling. We remain happier with broad backing of quality companies with high returns, strong balance sheets and decent earnings delivery. Here, we highlight three quality strategies: 1) Quality Street, 2) Quality At a Reasonable Price (QARP), 3) Quality with a Reliable Income (QUARI). The first two are updates to strategies we have been running for some time. The third strategy is new from our Quant team and looks for an optimized income strategy.

Quality Street

Figure 17 shows those European companies that fulfill 5 criteria: 1) greater than €5bn market cap, 2) >0% absolute 6-months earnings momentum, 3) >15% 20013E RoE, 4) better than sector RoE, and 5) strong than sector 2013E balance sheets.

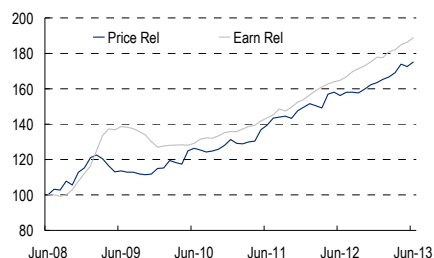
Figure 17. Quality Street Screen

Stock	RIC	>€5bn Mkt Cap, €m	>0% -6m Abs Earn Mo	>15 Stock RoE 2013	>0 Sector RoE13	>0 Stock Less Sector RoE	Stock ND/EBITDA 2013	Sector ND/EBITDA 2013	<0 Stock Less Sector ND/EBITDA	EM Exposure
Roche	ROG.VX	125238	2	89	25	64	0.3	0.5	-0.3	18
Bayer	BAYGn.DE	65354	3	27	18	9	0.5	1.1	-0.6	34
Siemens	SIEGn.DE	63569	7	20	19	2	0.7	0.8	-0.1	33
Novo Nordisk B	NOVOB.CO	47854	10	63	25	38	-0.4	0.5	-1.0	26
ABB	ABBN.VX	37341	7	20	19	1	0.2	0.8	-0.6	45
Reckitt Benckiser	#N/A	35513	6	32	22	10	0.4	0.5	-0.1	36
BT Group	BT.L	29290	1	1493	15	1479	1.2	2.1	-1.0	2
Syngenta	SYNN.VX	27046	5	24	18	7	0.4	1.1	-0.7	32
Rolls-Royce Holdings	RR.L	24842	5	20	19	1	-0.5	0.8	-1.3	32
EADS	EAD.PA	22771	23	22	19	3	-1.5	0.8	-2.3	43
BMW	BMWG.DE	21191	2	17	12	5	-1.1	1.8	-2.9	21
Inditex	ITX.MC	19972	3	31	13	18	-1.1	1.0	-2.1	10
Compass Group	CPG.L	17757	3	26	14	12	0.8	1.2	-0.4	14
Shire	SHP.L	13259	7	33	25	8	-0.7	0.5	-1.3	0
ARM Holdings	ARM.L	12934	24	22	14	8	-2.0	-0.9	-1.1	27
Kone B	KNEBV.HE	11633	7	38	19	19	-0.9	0.8	-1.7	32
Reed Elsevier	REL.L	10205	1	50	19	31	1.3	1.5	-0.2	13
Ryanair Holdings	RYA.I	10117	16	19	14	5	-0.3	1.2	-1.5	0
Continental	CONG.DE	9708	2	23	12	11	1.0	1.8	-0.8	17
SGS N	SGSN.VX	9236	6	34	19	15	0.2	0.8	-0.6	38
Next	NXT.L	8552	3	177	13	164	0.5	1.0	-0.5	1
Reed Elsevier (Ams)	ELSN.AS	8473	2	50	19	31	1.3	1.5	-0.2	13
Geberit R	GEBN.VX	7214	6	30	8	22	-0.9	2.2	-3.1	12
Burberry Group	BRBY.L	6761	5	33	22	11	-0.7	0.5	-1.2	20
Whitbread	WTB.L	6177	2	22	14	7	0.9	1.2	-0.4	2
Dassault Systemes	DAST.PA	6057	1	19	14	4	-2.0	-0.9	-1.2	27
ITV	ITV.L	5725	10	46	19	28	0.0	1.5	-1.5	0
GKN	GKN.L	5721	4	27	12	15	0.9	1.8	-0.9	0
IctL.HtIs.Gp.	IHG.L	5607	3	131	14	117	1.0	1.2	-0.2	27

Source: Datastream & Citi Research

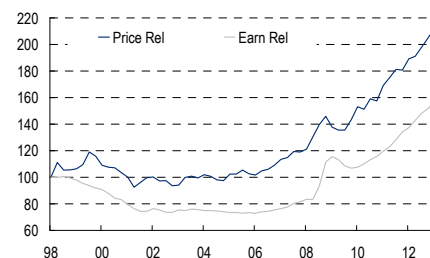
Siemens, Syngenta, Reckitt Benckiser, Inditex and Compass are all on the European Focus List. There are also few stocks from the 'offensive' sectors here. BT Group is an exception.

Figure 18. Quality Street — P & E Rel, 5yr



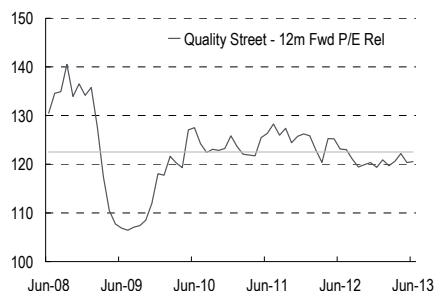
Source: Datastream & Citi Research

Figure 19. Quality Street — P & E Rel, 15yr



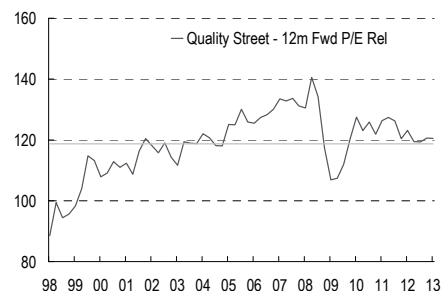
Source: Datastream & Citi Research

Figure 20. Quality Street — P/E Rel, 5yr



Source: Datastream & Citi Research

Figure 21. Quality Street — P/E Rel, 15yr



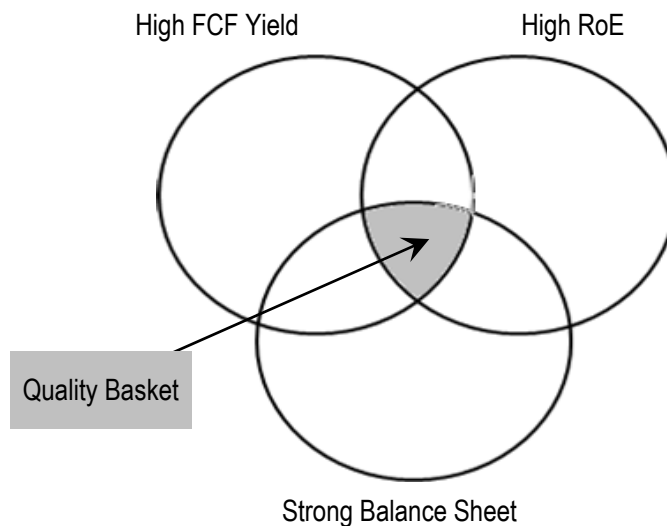
Source: Datastream & Citi Research

Figure 18 to Figure 21 show the 5- and 15-year history for the Quality Street stocks in Figure 17 for price and earnings relative trends and also P/E relative. Quality Street stocks trade in line with their 5- and 15-year P/E relative average levels and are a strong positive earnings momentum trade. The big risk to Quality Street strategy is the end of earnings leadership. Strong European and global economic recovery is the most likely source of this. Our economists, and ourselves, think this scenario, however, is unlikely. Modest, not strong, recovery is our base case.

QARP

Our second quality strategy is QARP. This combines valuation with quality. We look for companies with an average 2012-14E FCF yield of over 6% as well as high RoE and strong balance sheets.

Figure 22. QARP — Better Than Market FCF Yield, Better Than Market RoE & Strong B/S



Source: Citi Research

There is more of a sector bias in this approach since we are not looking for “better than sector” metrics. Five Health Care stocks show how strongly the sector scores on a QARP basis. BT Group, Siemens and Reckitt Benckiser appear again, as they did on the Quality Street screen.

Figure 23. QARP — €10bn+ Market Cap, Ranked by Current 12-Month Forward P/E vs 5-Year Range

Stock	RIC	>€10bn Mkt Cap, €m	>6 Avg FCFY (2012-14)	>14 Avg ROE (2012-2014)	<1.5 ND/EBITDA 2013	PE (Now)	Min	Max	Percentile (Abs)	Percentile (Rel)
Sandvik	SAND.ST	10410	6.8	22	1.2	11.9	6.4	65.4	0.1	0.0
Ryanair Holdings	RYA.I	10117	7.5	20	-0.3	15.5	9.8	47.1	0.2	0.1
Michelin	MICP.PA	12243	7.2	19	0.3	7.9	5.8	18.9	0.2	0.1
Shire	SHP.L	13259	7.1	34	-0.7	13.3	12.0	18.8	0.2	0.1
TeliaSonera	TLSN.ST	10830	6.5	15	1.5	10.1	7.9	12.8	0.5	0.2
ABB	ABBN.VX	37341	6.6	19	0.2	13.4	6.3	20.0	0.5	0.4
Siemens	SIEGn.DE	63569	7.0	21	0.7	11.3	6.7	15.1	0.5	0.1
BAE Systems	BAES.L	14898	7.8	33	0.4	9.5	6.1	12.2	0.6	0.3
British American Tobacco	BATS.L	75234	7.2	60	1.4	14.0	10.5	15.7	0.7	0.3
Atlas Copco A	ATCOa.ST	11648	6.2	39	0.1	14.3	6.5	18.1	0.7	0.4
Roche	ROG.VX	125238	6.6	87	0.3	14.3	9.0	15.9	0.8	0.4
Centrica	CNA.L	21556	9.4	24	1.2	12.7	9.9	13.5	0.8	0.3
Reckitt Benckiser Group	RB.L	35513	6.1	34	0.4	16.7	12.8	17.9	0.8	0.2
Novartis R	NOVN.VX	141747	7.8	19	0.3	13.2	8.8	14.4	0.8	0.4
Sanofi	SASY.PA	91130	8.3	14	0.4	12.4	6.7	13.7	0.8	0.9
Volvo B	VOLVb.ST	15097	6.3	17	-1.3	14.5	-438.5	115.3	0.8	0.8
Reed Elsevier	REL.L	10205	9.4	53	1.3	13.3	9.2	14.0	0.8	0.4
AstraZeneca	AZN.L	45112	11.5	30	-0.2	9.4	6.2	10.0	0.8	0.4
WPP	WPP.L	16030	7.0	15	1.1	12.9	6.6	13.6	0.9	0.8
BT Group	BT.L	29290	7.8	1447	1.2	11.5	4.9	12.2	0.9	1.0
Ahold Kon.	AHLN.AS	10908	7.2	16	-0.1	12.3	8.7	12.4	1.0	0.3

Source: Datastream, Citi Research

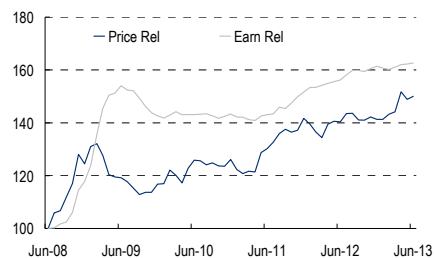
Figure 24. QARP — Between €5bn & €10bn+ Market Cap, Ranked by Current 12-Month Forward P/E vs 5-Year Range

Stock	RIC	<€10bn Mkt Cap, €m	>6 Avg FCFY (2012-14)	>14 Avg ROE (2012-2014)	<1.5 ND/EBITDA 2013	PE (Now)	Min	Max	Percentile (Abs)	Percentile (Rel)
Alstom	ALSO.PA	5535	6.2	21	1.2	8.1	6.8	19.6	0.1	0.0
Continental	CONG.DE	9708	7.5	27	1.0	9.1	4.4	26.9	0.2	0.2
BSkyB	BSY.L	8811	7.3	106	0.7	12.9	10.6	18.6	0.3	0.1
Adecco R	ADEN.VX	6184	6.6	15	0.7	13.7	7.7	28.0	0.3	0.2
Actelion	ATLN.VX	5018	7.4	24	-1.4	14.3	8.8	22.1	0.4	0.2
Yara International	YAR.OL	5462	11.3	20	0.2	8.0	2.9	13.8	0.5	0.3
Burberry Group	BRBY.L	6761	6.9	32	-0.7	16.8	6.0	23.6	0.6	0.3
Weir Group	WEIR.L	5305	8.6	25	0.8	13.1	4.8	16.8	0.7	0.4
Smiths Group	SMIN.L	5806	6.4	33	0.9	12.7	8.6	14.5	0.7	0.4
Legrand	LEGD.PA	8758	6.8	17	0.9	16.6	8.0	18.8	0.8	0.7
Sodexo	EXHO.PA	6247	6.8	19	0.9	18.2	12.0	19.4	0.8	0.6
Reed Elsevier (Ams)	ELSN.AS	8473	9.9	54	1.3	12.3	8.8	12.8	0.9	0.4
Assa Abloy B	ASSAb.ST	9655	6.1	20	1.0	16.5	7.8	17.5	0.9	0.9
Next	NXT.L	8552	7.4	188	0.5	13.7	5.9	14.3	0.9	1.0
Publicis Groupe	PUBP.PA	9161	8.0	16	-0.2	14.5	7.7	15.0	0.9	0.7
Merck KGAA	MRCG.DE	7431	7.9	17	0.2	13.8	7.8	13.8	1.0	0.7

Source: Datastream, Citi Research

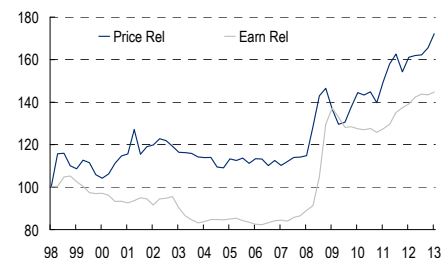
Figure 24 repeats QARP for stocks between €5bn and €10bn market cap. Media stocks are quite well represented on both QARP screens — WPP, Reed, Publicis, BSKyB. Continental and Michelin represent the Auto sector.

Figure 25. QARP — P & E Rel, 5yr



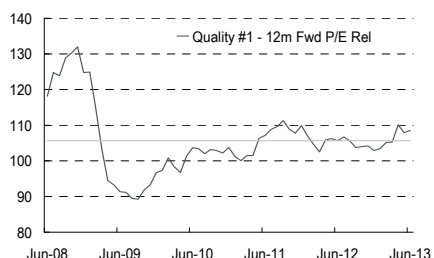
Source: Datastream & Citi Research

Figure 26. QARP — P & E Rel, 15yr



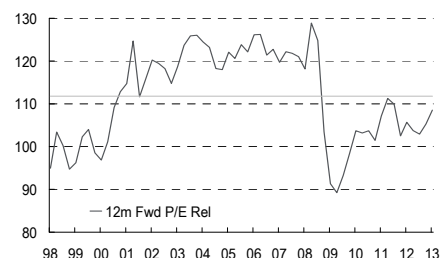
Source: Datastream & Citi Research

Figure 27. QARP — P/E Rel, 5yr



Source: Datastream & Citi Research

Figure 28. QARP — P/E Rel, 15yr



Source: Datastream & Citi Research

Figure 25 to Figure 28 show the 5- and 15-year history for the QARP stocks for price and earnings relative trends and also P/E relative. QARP trades on a c10% discount to Quality Street and has had less consistent support from earnings and weaker performance over the past few years. But, earnings momentum trends are still supportive and the combination of high FCF yields, high RoEs and strong balance sheets generally looks appealing for many of these companies.

QUARI

The third quality strategy, [QUARI](#), is from our Quant team, headed by Chris Montagu. Our Quant colleagues have concluded that “high yield is not enough”. We completely agree, especially in a new regime of rising (US) bond yields. Most of the income strategies in our regular [Citi Income Report](#) publication are DY+ strategies.

What exactly is QUARI? It is a “6-step process where the goal is to achieve a more optimal income stream through trading-off yield for a more acceptable level of risk and downside protection”. In our Quant team’s back-test, the QUARI strategy has delivered above benchmark yield but with low correlation to a generic DY strategy. Please read the recent report from our colleagues for full details.

Strategy outlook

Value vs quality = key battle in the past decade. Value won 2003-07. Quality won since 2008. Investors should remain selective in value as plenty of value traps, eg the ‘Offensives’ = Oil, Utilities, Food Retail, Telecoms. Instead, we see value in Financials & surplus FCF (eg Health Care). We continue to back quality over value. Two quality strategies = Quality Street & QARP. Roche, Siemens, ABB, Reckitt Benckiser, BT, Shire, Reed, Ryanair, Continental, Next & Burberry on both screens.

Market Outlook

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

Macro

GDP	2012	2013E	2014E
Euro zone	-0.5	-0.8	0.0
UK	0.3	1.0	1.2
Global	2.5	2.6	3.2
US	2.2	1.9	2.9
Japan	1.9	2.2	1.9
CPI	2012	2013E	2014E
Euro zone	2.5	1.4	1.2
UK	2.8	2.7	2.3
Global	2.9	3.0	3.2
US	1.8	1.1	1.9
Japan	0.0	0.0	2.0
Interest Rates	3Q13E	4Q13E	2Q14E
ECB	0.50	0.25	0.25
UK Base	0.50	0.50	0.50
US Fed Funds	0.25	0.25	0.25
Japan Call	0.10	0.10	0.10
10Yr Yield	3Q13E	4Q13E	2Q14E
Euro zone	1.50	1.50	1.50
UK	2.10	2.15	2.35
US	2.25	2.50	2.90
Japan	0.90	0.90	0.60
Ex Rates	3Q13E	4Q13E	2Q14E
US\$/€	1.37	1.36	1.37
US\$/£	1.60	1.58	1.59
€/£	0.85	0.86	0.86
Y/US\$	102	106	110
End Year Targets	Now	End-13E	Return
Stoxx	285	330	16
FTSE 100	6230	7000	12

	Now	Mid-14	Return
Stoxx	285	340	19
FTSE 100	6230	7200	16
	Now	End-14	Return
Stoxx	285	345	21
FTSE 100	6230	7300	17

Source: Datastream and Citi Research estimates

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

2014 looks better than 2013 for earnings

Modest nominal global GDP growth including a 2H13 pick-up in US growth and a pick-up in EPS-boosting M&A and buybacks could support modest single-digit earnings growth in 2013E. But, recession in the EA and near-record margins suggest that big earnings gains are unlikely. Citi's analysts expect 10% earnings growth in 2013E and 2014E. Our top-down base case is 0-5% & 10%, respectively.

Equities look fair value to super-cheap

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

Sector Strategy

We continue to run a barbell strategy, with a preference for growth leaders in a low growth world & cheap (acceptable) risk. We also back restructuring and re-leveraging as key alpha drivers in 2013-14.

Figure 29. European Sector Strategy

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

Source: Citi Research

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Valuation Tables

Figure 30. Pan-European Sector Weightings & Returns

As at Close 28 Jun 13 Sector (No of Stocks)	Mkt Cap (Euros m)	% of Stoxx	Return Relative to Stoxx				Absolute Return			
			1m	3m	12m	Ytd	1m	3m	12m	Ytd
Oil & Gas (32)	479,211	8.2	-1	-2	-16	-7	-6	-4	3	-4
Chemicals (24)	300,666	5.1	0	1	3	-1	-5	0	26	3
Basic Resources (23)	188,886	3.2	-8	-15	-29	-29	-12	-17	-13	-26
Construction & Materials (21)	126,354	2.2	-1	0	3	0	-6	-2	27	4
Industrial G&S (101)	624,536	10.7	0	-1	2	1	-5	-3	25	5
Automobiles & Parts (14)	155,355	2.7	-1	10	6	4	-6	9	31	8
Food & Beverage (30)	525,187	9.0	2	-6	-3	1	-3	-8	19	5
Personal & H'hold Goods (30)	359,771	6.2	1	0	0	5	-5	-1	22	9
Health Care (35)	706,661	12.1	3	2	5	10	-3	1	29	15
Retail (26)	186,618	3.2	0	-1	0	0	-6	-3	22	5
Media (27)	143,854	2.5	6	3	11	6	0	1	36	11
Travel & Leisure (21)	88,602	1.5	5	3	13	9	-1	2	39	14
Telecommunications (23)	287,069	4.9	4	3	-10	3	-1	1	10	8
Utilities (26)	237,600	4.1	1	3	-10	-4	-4	1	10	0
Banks (47)	716,593	12.3	-5	1	12	-4	-10	-1	37	0
Insurance (35)	356,322	6.1	1	7	22	5	-4	6	50	9
Real Estate (29)	83,042	1.4	-1	2	-3	-4	-6	1	20	0
Financial Services (31)	88,325	1.5	-1	1	13	7	-6	0	39	11
Technology (25)	188,049	3.2	2	0	6	3	-3	-1	31	7
Stoxx - Pan Europe (600)	5,842,701	100.0	—	—	—	—	-5	-2	23	4
Pan Euro - Large Cap	4,753,578	81.4	0	0	0	0	-5	-2	22	4
Pan Euro - Mid Cap	757,514	13.0	1	0	2	1	-5	-1	25	5
Pan Euro - Small Cap	331,609	5.7	0	0	0	0	-5	-2	23	4
Stoxx ex UK (418)	3,884,282	66.5	—	—	—	—	-5	-1	27	5
EuroStoxx - Eurozone (297)	2,594,031	44.4	—	—	—	—	-5	1	27	3

Source: Citi Research & DataStream

Figure 31. Pan-European Sector Relative Ratings

As at Close 28 Jun 13 Sector	P/E Relative to Stoxx				Yield Relative to Stoxx			
	2011	2012E	2013E	2014E	2011	2012E	2013E	2014E
Oil & Gas	69	63	71	77	125	132	131	125
Chemicals	110	108	115	115	71	77	78	76
Basic Resources	49	81	82	78	105	116	109	107
Construction & Materials	101	107	111	105	94	97	98	96
Industrial Goods & Service	125	107	112	110	76	81	84	83
Automobiles & Parts	68	56	71	70	87	94	96	94
Food & Beverage	156	138	140	143	71	75	77	78
Personal & H'hold Goods	155	127	131	133	66	73	77	76
Health Care	115	106	117	115	85	88	88	90
Retail	118	111	119	123	91	94	89	86
Media	107	102	111	112	99	114	101	99
Travel & Leisure	150	151	137	119	73	69	62	61
Telecommunications	71	81	84	94	241	148	150	142
Utilities	78	77	91	101	192	182	164	150
Banks	91	130	88	79	94	103	111	125
Insurance	107	78	71	75	111	116	117	114
Real Estate	152	143	146	154	115	118	115	111
Financial Services	127	115	103	104	109	112	106	108
Technology	128	232	168	138	58	55	48	47
Stoxx - Pan Europe	100	100	100	100	100	100	100	100
Pan Euro - Large Cap	97	94	96	97	102	102	103	103
Pan Euro - Mid Cap	115	130	121	115	91	91	86	87
Pan Euro - Small Cap	127	191	126	116	95	88	85	84
Stoxx ex UK	103	106	103	101	102	98	99	100
EuroStoxx - Eurozone	95	103	98	96	111	102	103	102

Source: Citi Research & DataStream

Figure 32. Pan-European Sector Growth

Sector	Earnings Growth %			Net Dividend Growth %		
	2012E	2013E	2014E	2012E	2013E	2014E
Oil & Gas	6.3	-4.1	3.4	10.3	2.4	4.7
Chemicals	-1.8	1.7	12.1	13.1	4.4	6.9
Basic Resources	-41.5	7.7	17.3	15.1	-1.6	7.2
Construction & Materials	-9.2	5.1	18.8	7.8	5.0	6.9
Industrial Goods & Services	13.2	3.4	14.0	11.2	7.3	8.6
Automobiles & Parts	17.2	-14.0	13.7	13.9	5.3	7.6
Food & Beverage	9.1	6.4	9.7	10.3	7.0	10.7
Personal & Household Goods	17.7	5.3	10.3	16.4	9.5	8.3
Health Care	4.8	-1.3	14.0	7.9	4.0	12.3
Retail	3.0	0.6	8.6	7.3	-1.2	5.7
Media	1.7	-0.7	11.8	19.3	-7.8	6.9
Travel & Leisure	-4.1	18.8	29.2	-1.1	-6.0	7.1
Telecommunications	-15.5	3.8	0.9	-36.1	5.7	2.9
Utilities	-2.0	-8.5	0.7	-1.4	-6.2	-0.5
Banks	-32.1	59.9	24.9	14.1	12.5	23.1
Insurance	32.3	19.3	6.7	9.0	4.9	6.1
Real Estate	3.0	6.1	6.0	6.3	2.2	4.7
Financial Services	6.5	20.7	11.0	7.1	-1.3	10.7
Technology	-46.5	49.2	36.9	0.1	-10.7	9.0
Stoxx - Pan Europe	-3.4	8.3	12.3	4.3	4.0	9.1
Pan Euro - Large Cap	-0.2	5.5	11.0	4.8	5.0	9.0
Pan Euro - Mid Cap	-14.6	16.2	18.2	3.9	-1.6	10.1
Pan Euro - Small Cap	-35.7	64.0	22.0	-3.3	-0.2	8.6
Stoxx ex UK	-6.5	11.9	14.5	0.8	4.4	9.9
EuroStoxx - Eurozone	-10.9	13.1	14.6	-3.6	4.4	8.7

Source: Citi Research & DataStream

Figure 33. Pan-European Sector Ratings

Sector	Price/Earnings				Net Dividend Yield			
	2011	2012E	2013E	2014E	2011	2012E	2013E	2014E
Oil & Gas	9.1	8.6	9.0	8.7	4.42	4.87	4.99	5.22
Chemicals	14.5	14.8	14.6	13.0	2.52	2.85	2.97	3.18
Basic Resources	6.5	11.1	10.3	8.8	3.69	4.25	4.18	4.48
Construction & Materials	13.3	14.7	14.0	11.8	3.32	3.58	3.76	4.02
Industrial Goods & Services	16.5	14.6	14.1	12.4	2.68	2.98	3.20	3.48
Automobiles & Parts	9.0	7.7	8.9	7.9	3.05	3.47	3.66	3.93
Food & Beverage	20.6	18.9	17.7	16.2	2.49	2.75	2.94	3.26
Personal & Household Goods	20.5	17.4	16.6	15.0	2.31	2.69	2.95	3.19
Health Care	15.3	14.6	14.7	12.9	2.98	3.22	3.35	3.76
Retail	15.6	15.1	15.0	13.9	3.21	3.44	3.40	3.59
Media	14.2	14.0	14.1	12.6	3.50	4.18	3.85	4.12
Travel & Leisure	19.8	20.6	17.4	13.4	2.56	2.53	2.38	2.55
Telecommunications	9.3	11.0	10.6	10.5	8.50	5.43	5.74	5.91
Utilities	10.3	10.5	11.5	11.4	6.78	6.68	6.27	6.24
Banks	12.1	17.8	11.1	8.9	3.31	3.77	4.25	5.23
Insurance	14.2	10.7	9.0	8.4	3.90	4.26	4.47	4.74
Real Estate	20.1	19.5	18.4	17.4	4.06	4.32	4.41	4.62
Financial Services	16.7	15.7	13.0	11.7	3.84	4.11	4.05	4.49
Technology	17.0	31.7	21.3	15.5	2.03	2.03	1.82	1.98
Stoxx - Pan Europe	13.2	13.7	12.6	11.3	3.53	3.68	3.82	4.17
Pan Euro - Large Cap	12.8	12.8	12.1	10.9	3.59	3.76	3.95	4.30
Pan Euro - Mid Cap	15.2	17.8	15.3	12.9	3.21	3.34	3.29	3.62
Pan Euro - Small Cap	16.8	26.1	15.9	13.0	3.35	3.24	3.23	3.51
Stoxx ex UK	13.6	14.6	13.0	11.4	3.59	3.62	3.78	4.15
EuroStoxx - Eurozone	12.5	14.1	12.4	10.9	3.91	3.76	3.93	4.27

Source: Citi Research & DataStream

Figure 34. Pan-European Country Weightings & Returns

	Mkt Cap (Euros m)	% of Stoxx	Relative Return to Stoxx*				Absolute Return*			
			1m	3m	12m	YTD	1m	3m	12m	YTD
Austria	23,493	0.4	-4	-2	1	-10	-11	-4	22	-6
Belgium	91,717	1.6	-1	-3	4	2	-8	-5	25	6
Denmark	108,218	1.9	0	-3	-4	-2	-7	-5	16	2
Finland	78,641	1.3	0	2	10	2	-7	0	32	6
France	864,170	14.8	0	4	6	1	-7	2	27	6
Germany	770,483	13.2	2	4	9	1	-6	2	30	5
Greece	6,234	0.1	2	-9	12	1	-5	-10	34	5
Ireland	45,052	0.8	3	-3	-8	6	-5	-5	10	10
Italy	193,151	3.3	-6	2	-7	-11	-13	0	12	-7
Netherlands	236,804	4.1	1	3	7	3	-6	2	28	7
Norway	80,231	1.4	-3	-5	-8	-7	-10	-6	11	-3
Portugal	16,952	0.3	-1	1	5	-2	-8	-1	26	1
Spain	251,661	4.3	-2	0	0	-8	-9	-2	19	-4
Sweden	275,286	4.7	-2	-5	3	1	-9	-6	23	5
Switzerland	826,516	14.2	3	0	7	9	-4	-1	29	13
UK	1,958,419	33.6	-1	-2	-9	-2	-8	-3	10	2
Stoxx - Pan Europe	5,827,029	100								

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

Figure 35. Pan-European Country Relative Ratings

As at Close 28 Jun 13 Country	Price/Earnings				Net Dividend Yield			
	2011	2012E	2013E	2014E	2011	2012E	2013E	2014E
Austria	211	91	101	80	81	89	99	104
Belgium	139	132	125	122	72	97	89	100
Denmark	180	131	125	115	48	54	61	71
Finland	102	134	125	114	138	140	115	110
France	93	110	96	95	101	100	105	106
Germany	102	80	92	92	95	93	87	87
Greece	47	40	87	107	171	135	43	62
Ireland	165	152	162	139	42	43	44	43
Italy	76	99	91	88	122	110	110	108
Netherlands	120	110	105	100	85	76	71	74
Norway	90	80	83	85	123	139	135	135
Portugal	78	1373	157	105	166	136	125	124
Spain	69	137	102	106	225	154	181	169
Sweden	110	101	111	114	95	107	108	104
Switzerland	130	123	117	114	81	86	85	90
UK	95	89	95	98	96	103	102	101
EuroStoxx - Eurozone	95	103	98	96	111	102	103	102
Stoxx ex UK - Europe ex UK	103	106	103	101	102	98	99	100
Stoxx - Pan Europe	100	100	100	100	100	100	100	100

Source: Citi Research & DataStream

Figure 36. Pan-European Country Growth

As at Close 28 Jun 13 Country	Earnings Growth %			Dividend Growth %		
	2012E	2013E	2014E	2012E	2013E	2014E
Austria	124.7	-2.8	41.4	14.8	15.3	14.8
Belgium	2.0	14.2	14.9	40.3	-4.5	21.7
Denmark	32.8	13.9	21.5	17.7	18.2	27.2
Finland	-26.3	16.6	23.2	6.0	-14.9	4.6
France	-18.1	23.4	14.1	3.9	8.8	10.0
Germany	22.8	-5.8	12.2	2.4	-2.5	9.5
Greece	13.7	-50.3	-8.9	-17.9	-66.5	55.7
Ireland	5.0	1.8	30.6	6.2	7.1	7.3
Italy	-25.8	18.1	16.0	-6.0	3.9	7.7
Netherlands	5.1	13.3	17.9	-7.0	-2.6	13.6
Norway	7.7	4.6	10.4	18.1	0.7	9.1
Portugal	-94.5	849.8	67.4	-14.3	-4.7	8.0
Spain	-51.4	45.5	8.1	-28.7	22.3	1.9
Sweden	5.8	-2.0	9.6	17.5	5.1	5.3
Switzerland	1.9	13.5	15.6	9.6	3.7	14.5
UK	2.2	2.3	8.2	11.5	3.1	7.7
EuroStoxx - Eurozone	-10.9	13.1	14.6	-3.6	4.4	8.7
Stoxx ex UK - Europe ex UK	-6.5	11.9	14.5	0.8	4.4	9.9
Stoxx - Pan Europe	-3.4	8.3	12.3	4.3	4.0	9.1

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

Figure 37. Pan-European Country Ratings

As at Close 28 Jun 13 Country	Price/Earnings				Net Dividend Yield			
	2011	2012E	2013E	2014E	2011	2012E	2013E	2014E
Austria	27.9	12.4	12.8	9.0	2.86	3.28	3.78	4.34
Belgium	18.4	18.0	15.8	13.7	2.55	3.57	3.41	4.15
Denmark	23.8	17.9	15.7	13.0	1.68	1.98	2.33	2.97
Finland	13.5	18.4	15.7	12.8	4.87	5.16	4.39	4.59
France	12.3	15.0	12.1	10.6	3.55	3.69	4.01	4.41
Germany	13.4	10.9	11.6	10.3	3.33	3.41	3.33	3.64
Greece	6.2	5.5	11.0	12.1	6.02	4.95	1.66	2.58
Ireland	21.8	20.8	20.4	15.6	1.48	1.57	1.68	1.81
Italy	10.1	13.6	11.5	9.9	4.29	4.04	4.20	4.52
Netherlands	15.9	15.1	13.3	11.3	2.99	2.78	2.71	3.08
Norway	11.9	11.0	10.5	9.5	4.33	5.11	5.15	5.61
Portugal	10.3	187.9	19.8	11.8	5.86	5.02	4.78	5.17
Spain	9.1	18.8	12.9	11.9	7.94	5.66	6.92	7.05
Sweden	14.6	13.8	14.1	12.8	3.34	3.93	4.13	4.35
Switzerland	17.1	16.8	14.8	12.8	2.87	3.15	3.26	3.74
UK	12.5	12.2	12.0	11.1	3.40	3.79	3.90	4.21
EuroStoxx - Eurozone	12.5	14.1	12.4	10.9	3.91	3.76	3.93	4.27
Stoxx ex UK - Europe ex UK	13.6	14.6	13.0	11.4	3.59	3.62	3.78	4.15
Stoxx - Pan Europe	13.2	13.7	12.6	11.3	3.53	3.68	3.82	4.17

Source: Citi Research & DataStream

Figure 38. UK Sector Weightings & Relative Returns

As at Close 28 Jun 2013	Mkt	% of	% of	Relative return				
	Cap £m	AllShare	Group	1m	3m	12m	Qtd	Ytd
OIL & GAS (25)	289,765	15.3		0	0	-14	0	-4
Oil & Gas Producers (17)	278,757	14.7	96	0	1	-14	1	-4
Oil Equip, Serv and Distrib (7)	10,910	0.6	4	-2	-8	-13	-8	-12
Alternative Energy (1)	99	0.0	0	-	-	-	-	-
BASIC MATERIALS (36)	141,494	7.5		-7	-15	-26	-15	-29
Chemicals (8)	13,608	0.7	10	4	0	0	0	-3
Forestry & Paper (1)	3,004	0.2	2	-1	-5	31	-5	15
Industrial Metals (4)	853	0.0	1	-20	-45	-65	-45	-60
Mining (23)	124,029	6.5	88	-9	-17	-28	-17	-31
INDUSTRIALS (110)	184,368	9.7		0	0	9	0	6
Construction & Materials (11)	14,303	0.8	8	2	-3	-4	-3	1
Aerospace (9)	44,621	2.4	24	-1	3	13	3	15
General Industrials (6)	13,012	0.7	7	0	4	10	4	4
Electronic & Electrical Equip (13)	8,729	0.5	5	-3	-8	1	-8	-5
Industrial Engineering (12)	18,420	1.0	10	-1	-2	15	-2	4
Industrial Transportation (7)	2,478	0.1	1	5	13	16	13	13
Support Services (52)	82,806	4.4	45	1	0	8	0	5
CONSUMER GOODS (37)	269,629	14.2		1	-2	3	-2	3
Automobiles & Parts (1)	4,907	0.3	2	6	18	44	18	23
Beverages (4)	78,776	4.2	29	1	-7	3	-7	0
Food Producers (11)	44,725	2.4	17	2	-2	10	-2	5
Household Gds & Home Cons (13)	46,341	2.4	17	3	3	31	3	17
Leisure Goods (2)	433	0.0	0	17	20	95	20	37
Personal Goods (4)	7,625	0.4	3	-1	3	-7	3	1
Tobacco (2)	86,822	4.6	32	-1	-2	-11	-2	-1
HEALTH CARE (13)	143,714	7.6		0	5	0	5	10
Health Care Equip & Services (5)	7,721	0.4	5	1	0	0	0	0
Pharmaceuticals & Biotech (8)	135,993	7.2	95	0	5	0	5	11
CONSUMER SERVICES (83)	194,076	10.2		3	4	12	4	7
Food & Drug Retailers (7)	41,445	2.2	21	-2	-5	-3	-5	-3
General Retailers (22)	35,263	1.9	18	2	13	21	13	10
Media (22)	55,532	2.9	29	5	4	13	4	7
Travel & Leisure (32)	61,836	3.3	32	4	6	20	6	12
TELECOMMUNICATIONS (8)	122,259	6.4		7	7	0	7	17
Fixed-Line Telecoms (6)	27,901	1.5	23	7	11	26	11	20
Mobile Telecoms (2)	94,358	5.0	77	7	6	-5	6	16
UTILITIES (7)	73,592	3.9		1	3	-3	3	1
Electricity (2)	16,935	0.9	23	4	4	-2	4	1
Gas, Water & Multi-Utilities (5)	56,656	3.0	77	0	3	-3	3	1
TECHNOLOGY (23)	28,638	1.5		-5	-3	16	-3	1
Software & Computer Serv (14)	13,645	0.7	48	4	7	12	7	8
Technology Hardware & Equip (9)	14,992	0.8	52	-12	-11	22	-11	-4
TOTAL NON-FINANCIAL (342)	1,447,535	76.3		0	-1	-3	-1	0
FINANCIALS (261)	448,963	23.7		-1	2	13	2	1
Banks (6)	223,621	11.8	50	-2	0	15	0	-1
Non-Life Insurance (11)	19,069	1.0	4	6	5	6	5	2
Life Insurance (10)	71,935	3.8	16	0	4	22	4	6
Real Estate Investment Svs (22)	8,698	0.5	2	3	12	23	12	15
REITS (16)	28,103	1.5	6	0	7	2	7	-2
Financial Services (26)	36,256	1.9	8	-2	3	20	3	11
Equity Inv Instruments (170)	61,280	3.2	14	1	0	2	0	1
FTSE ALL SHARE (603)	1,896,498	100.0		0	0	0	0	0
FTSE 100 (100)	1,587,447	83.7		0	0	-2	0	-1
Mid 250 (250)	262,489	13.8		1	2	10	2	4
Small Cap (253)	46,562	2.5		2	3	12	3	4

Source: Citi Research & DataStream

Figure 39. UK Relative Ratings

As at Close 28 Jun 2013	P/E Relative				Yield Relative			
	2011	2012E	2013E	2014E	2011	2012E	2013E	2014E
OIL & GAS	73	73	76	79	110	113	117	112
Oil & Gas Producers	72	72	75	79	111	115	118	113
Oil Equip, Serv and Distrib	118	103	93	88	75	78	81	85
Alternative Energy	300	219	199	191	24	24	26	26
BASIC MATERIALS	50	78	84	80	101	104	106	106
Chemicals	136	131	135	135	61	63	64	65
Forestry & Paper	113	114	100	94	81	77	87	93
Industrial Metals	38	-54	-112	1,361	426	38	19	17
Mining	46	73	80	76	104	110	111	111
INDUSTRIALS	132	122	122	120	71	75	76	73
Construction & Materials	119	121	152	125	121	111	109	103
Aerospace	121	109	106	111	78	79	79	78
General Industrials	113	107	106	104	81	84	86	86
Electronic & Electrical Equip	130	124	125	124	48	49	50	50
Industrial Engineering	143	131	125	123	62	65	64	64
Industrial Transportation	112	119	113	108	72	73	74	71
Support Services	144	131	129	126	61	69	73	68
CONSUMER GOODS	154	136	133	132	80	83	87	86
Automobiles & Parts	108	90	89	86	58	66	71	76
Beverages	179	157	151	149	61	63	65	65
Food Producers	164	150	144	143	77	78	81	81
Household Gds & Home Cons	179	145	140	136	57	62	78	74
Personal Goods	188	161	151	145	50	55	58	60
Tobacco	125	115	115	116	114	117	117	117
HEALTH CARE	93	92	108	107	123	117	116	112
Health Care Equip & Services	127	121	121	118	43	60	60	62
Pharmaceuticals & Biotech	91	91	107	107	128	121	119	115
CONSUMER SERVICES	116	115	116	115	87	87	83	81
Food & Drug Retailers	90	86	97	107	120	117	110	103
General Retailers	124	122	120	118	75	74	74	74
Media	127	115	117	115	78	82	84	84
Travel & Leisure	125	140	130	118	79	78	69	67
TELECOMMUNICATIONS	102	97	102	103	166	145	130	123
Fixed-Line Telecoms	113	100	103	98	81	88	93	98
Mobile Telecoms	99	97	102	105	190	162	140	130
UTILITIES	119	113	117	120	140	141	135	131
Electricity	107	101	115	116	150	147	134	129
Gas, Water & Multi-Utilities	122	117	118	121	138	139	136	131
TECHNOLOGY	218	186	178	172	35	39	43	47
Software & Computer Serv	161	137	146	146	51	56	57	59
Technology Hardware & Equip	321	274	223	204	21	23	30	36
TOTAL NON-FINANCIAL	96	99	103	103	101	101	101	98
FINANCIALS	119	103	90	89	95	95	97	107
Banks	109	101	82	80	82	84	91	109
Non-Life Insurance	173	87	85	90	155	155	132	128
Life Insurance	106	88	92	94	116	111	107	105
Real Estate Investment Svs	306	214	215	207	44	44	47	47
REITS	191	184	192	195	102	103	99	96
Financial Services	169	124	97	96	106	108	101	109
FTSE ALL SHARE	100	100	100	100	100	100	100	100
FTSE 100	95	98	98	98	103	103	104	104
Mid 250	153	117	118	117	79	79	75	77
Small Cap	107	127	112	99	83	79	77	76

Source: Citi Research & DataStream

Figure 40. UK Earnings Growth

As at Close 28 Jun 2013	Earnings Growth %			Net Dividend Growth %		
	2012	2013E	2014E	2012	2013E	2014E
OIL & GAS	-1.6	1.9	4.4	8.8	10.0	4.2
Oil & Gas Producers	-1.9	1.5	4.1	8.8	9.9	4.0
Oil Equip, Serv and Distrib	12.1	17.7	15.4	9.5	11.3	14.2
Alternative Energy	33.6	16.9	13.8	6.9	15.8	7.4
BASIC MATERIALS	-38.1	-0.7	14.2	8.0	8.5	8.6
Chemicals	0.7	3.1	9.0	7.4	10.1	8.5
Forestry & Paper	-3.8	21.7	15.3	0.7	20.5	15.3
Industrial Metals	-168.7	-49.3	-109.0	-90.5	-48.3	0.7
Mining	-38.7	-1.8	14.0	11.0	8.3	8.5
INDUSTRIALS	5.6	6.6	10.4	10.5	9.0	3.9
Construction & Materials	-3.7	-15.6	33.0	-3.0	4.6	2.3
Aerospace	7.8	9.6	3.7	6.8	6.3	6.3
General Industrials	3.1	6.4	11.1	8.2	9.5	8.9
Electronic & Electrical Equip	2.1	5.8	9.3	8.7	8.9	9.0
Industrial Engineering	6.9	11.3	10.2	9.5	6.7	7.0
Industrial Transportation	-8.1	11.3	14.1	6.1	7.7	4.3
Support Services	7.3	7.8	11.5	18.7	12.3	1.0
CONSUMER GOODS	10.0	8.8	9.7	8.8	12.1	7.7
Automobiles & Parts	16.5	7.8	12.8	20.0	15.0	15.0
Beverages	11.0	10.5	10.2	8.9	9.5	9.2
Food Producers	6.1	10.8	9.9	6.5	10.4	8.3
Household Gds & Home Cons	20.3	10.1	12.5	13.8	35.0	3.1
Personal Goods	14.3	12.8	13.3	15.8	12.8	12.8
Tobacco	6.5	6.2	7.5	7.8	7.6	7.9
HEALTH CARE	-2.1	-9.0	9.1	0.0	5.7	4.2
Health Care Equip & Services	2.6	6.0	11.7	45.5	7.3	11.2
Pharmaceuticals & Biotech	-2.3	-9.6	8.9	-0.9	5.7	4.0
CONSUMER SERVICES	-1.5	5.2	9.9	5.2	2.3	5.4
Food & Drug Retailers	1.8	-4.7	-2.0	2.6	0.6	1.1
General Retailers	-0.5	7.3	11.2	3.2	7.2	8.5
Media	7.5	4.8	10.2	11.0	9.1	8.3
Travel & Leisure	-13.3	15.0	19.4	3.6	-5.0	5.1
TELECOMMUNICATIONS	2.1	1.0	7.9	-7.8	-4.5	2.3
Fixed-Line Telecoms	10.3	2.6	14.5	13.6	13.1	13.8
Mobile Telecoms	0.0	0.6	6.0	-10.5	-7.2	0.1
UTILITIES	2.5	2.1	6.6	5.3	2.9	4.5
Electricity	3.9	-7.1	7.8	3.5	-2.6	4.1
Gas, Water & Multi-Utilities	2.0	5.3	6.2	5.8	4.7	4.6
TECHNOLOGY	14.3	10.7	13.1	16.1	18.9	18.8
Software & Computer Serv	14.4	-0.4	9.0	15.1	10.3	11.3
Technology Hardware & Equip	14.2	30.7	18.8	18.3	37.5	31.8
TOTAL NON-FINANCIAL	-5.9	2.2	8.6	4.9	6.5	5.3
FINANCIALS	12.6	22.2	10.0	5.8	8.9	19.5
Banks	5.1	31.1	11.5	7.5	17.1	28.7
Non-Life Insurance	94.1	8.2	3.3	4.8	-8.8	5.2
Life Insurance	17.4	1.4	6.6	1.2	2.4	7.0
Real Estate Investment Svs	39.0	6.1	13.1	6.0	13.4	9.8
REITS	1.4	1.9	7.1	6.0	3.8	4.0
Financial Services	32.7	35.4	10.9	7.6	-0.4	16.3
FTSE ALL SHARE	-2.6	6.3	8.9	5.1	7.0	8.2
FTSE 100	-5.0	6.3	8.6	5.1	7.7	7.9
Mid 250	27.4	4.7	9.9	5.5	0.7	11.3
Small Cap	-18.0	20.4	23.3	-0.8	5.1	6.6

Source: Citi Research & DataStream

Figure 41. UK Sector Ratings

As at Close 28 Jun 2013	Price/Earnings				Net Dividend Yield			
	2011	2012E	2013E	2014E	2011	2012E	2013E	2014E
OIL & GAS	9.1	9.3	9.1	8.7	3.75	4.08	4.49	4.68
Oil & Gas Producers	9.0	9.2	9.0	8.7	3.80	4.13	4.54	4.72
Oil Equip, Serv and Distrib	14.7	13.1	11.1	9.6	2.55	2.79	3.11	3.55
Alternative Energy	37.3	27.9	23.9	21.0	0.81	0.87	1.01	1.08
BASIC MATERIALS	6.2	10.0	10.1	8.8	3.47	3.74	4.06	4.41
Chemicals	16.8	16.7	16.2	14.9	2.09	2.25	2.48	2.69
Forestry & Paper	14.0	14.6	12.0	10.4	2.76	2.78	3.35	3.86
Industrial Metals	4.7	-6.8	-13.4	149.7	14.58	1.38	0.71	0.72
Mining	5.7	9.4	9.5	8.4	3.56	3.95	4.28	4.64
INDUSTRIALS	16.4	15.5	14.6	13.2	2.43	2.69	2.93	3.04
Construction & Materials	14.8	15.4	18.2	13.7	4.13	4.01	4.19	4.28
Aerospace	15.0	13.9	12.7	12.2	2.67	2.86	3.04	3.23
General Industrials	14.0	13.6	12.7	11.5	2.78	3.01	3.29	3.59
Electronic & Electrical Equip	16.1	15.8	15.0	13.7	1.63	1.77	1.93	2.10
Industrial Engineering	17.8	16.6	14.9	13.6	2.12	2.32	2.48	2.65
Industrial Transportation	13.9	15.1	13.6	11.9	2.47	2.63	2.83	2.95
Support Services	17.9	16.7	15.5	13.9	2.10	2.49	2.80	2.83
CONSUMER GOODS	19.1	17.3	15.9	14.5	2.73	2.97	3.33	3.59
Automobiles & Parts	13.4	11.5	10.7	9.4	1.99	2.39	2.75	3.16
Beverages	22.2	20.0	18.1	16.4	2.08	2.27	2.48	2.71
Food Producers	20.3	19.1	17.3	15.7	2.64	2.82	3.11	3.37
Household Gds & Home Cons	22.2	18.5	16.8	14.9	1.95	2.22	3.00	3.09
Personal Goods	23.4	20.4	18.1	16.0	1.71	1.98	2.23	2.52
Tobacco	15.5	14.6	13.7	12.8	3.89	4.20	4.51	4.87
HEALTH CARE	11.5	11.7	12.9	11.8	4.22	4.22	4.47	4.65
Health Care Equip & Services	15.8	15.4	14.5	13.0	1.49	2.16	2.32	2.58
Pharmaceuticals & Biotech	11.3	11.6	12.8	11.8	4.38	4.34	4.59	4.77
CONSUMER SERVICES	14.4	14.6	13.9	12.6	2.97	3.12	3.19	3.36
Food & Drug Retailers	11.2	11.0	11.6	11.8	4.11	4.21	4.24	4.28
General Retailers	15.4	15.5	14.4	13.0	2.57	2.66	2.85	3.09
Media	15.7	14.6	14.0	12.7	2.66	2.95	3.22	3.49
Travel & Leisure	15.5	17.9	15.6	13.0	2.70	2.80	2.66	2.80
TELECOMMUNICATIONS	12.6	12.4	12.2	11.3	5.67	5.22	4.99	5.10
Fixed-Line Telecoms	14.0	12.7	12.4	10.8	2.79	3.17	3.58	4.08
Mobile Telecoms	12.3	12.3	12.2	11.5	6.50	5.82	5.39	5.40
UTILITIES	14.7	14.4	14.1	13.2	4.81	5.06	5.21	5.44
Electricity	13.3	12.8	13.8	12.8	5.12	5.30	5.16	5.37
Gas, Water & Multi-Utilities	15.2	14.9	14.1	13.3	4.71	4.99	5.22	5.46
TECHNOLOGY	27.0	23.6	21.4	18.9	1.20	1.39	1.65	1.96
Software & Computer Serv	20.0	17.5	17.5	16.1	1.74	2.00	2.20	2.45
Technology Hardware & Equip	39.8	34.9	26.7	22.4	0.71	0.83	1.15	1.51
TOTAL NON-FINANCIAL	11.9	12.6	12.3	11.4	3.47	3.64	3.88	4.08
FINANCIALS	14.8	13.2	10.8	9.8	3.24	3.42	3.73	4.46
Banks	13.5	12.9	9.8	8.8	2.79	3.00	3.52	4.53
Non-Life Insurance	21.5	11.1	10.2	9.9	5.30	5.56	5.07	5.33
Life Insurance	13.1	11.1	11.0	10.3	3.96	4.00	4.10	4.39
Real Estate Investment Svs	37.9	27.3	25.7	22.7	1.50	1.59	1.80	1.98
REITS	23.7	23.4	22.9	21.4	3.48	3.69	3.82	3.98
Financial Services	21.0	15.8	11.7	10.5	3.63	3.90	3.89	4.52
FTSE ALL SHARE	12.4	12.7	12.0	11.0	3.42	3.60	3.85	4.16
FTSE 100	11.8	12.4	11.7	10.8	3.53	3.71	3.99	4.31
Mid 250	18.9	14.9	14.2	12.9	2.71	2.86	2.88	3.20
Small Cap	13.3	16.2	13.5	10.9	2.86	2.83	2.98	3.17

Source: Citi Research & DataStream

Figure 42. Stocks Mentioned In This Report*

Stock Name	RIC	Price	Rating	Currency
ABB	ABBN.VX	20.72	2	CHF
Actelion	ATLN.VX	57.95	2	CHF
Adecco R	ADEN.VX	54.00	3	CHF
Ahold Kon.	AHLN.AS	11.75	1	EUR
Alstom	ALSO.PA	24.86	1	EUR
ARM Holdings	ARM.L	8.37	1	GBP
Assa Abloy B	ASSAb.ST	265.80	3	SEK
AstraZeneca	AZN.L	31.92	2	GBP
Atlas Copco A	ATCOa.ST	158.40	3	SEK
BAE Systems	BAES.L	4.05	2	GBP
Bayer	BAYGn.DE	82.29	1	EUR
BMW	BMWG.DE	67.60	2	EUR
Booker	BOK.L	1.23	1	GBP
British American Tobacco	BATS.L	34.50	1	GBP
BSKyB	BSY.L	8.09	1	GBP
BT Group	BT.L	3.23	1	GBP
Burberry Group	BRBY.L	13.92	2	GBP
Centrica	CNA.L	3.70	2	GBP
Colruyt	COLR.BR	40.78	1	EUR
Compass Group	CPG.L	8.68	1	GBP
Continental	CONG.DE	107.30	1	EUR
Dassault Systemes	DAST.PA	96.61	1	EUR
EADS	EAD.PA	40.88	1	EUR
Geberit R	GEBN.VX	242.00	3	CHF
GKN	GKN.L	3.16	1	GBP
Icti.Htts.Gp.	IHG.L	18.77	1	GBP
Inditex	ITX.MC	97.29	1	EUR
ITV	ITV.L	1.51	1	GBP
Jeronimo Martins	JMT.LS	15.87	1	EUR
Kone B	KNEBV.HE	61.25	3	EUR
Legrand	LEGD.PA	36.54	2	EUR
Merck KGAA	MRCG.DE	117.80	2	EUR
Michelin	MICP.PA	71.55	1	EUR
Next	NXT.L	46.85	1	GBP
Novartis R	NOVN.VX	67.60	1	CHF
Novo Nordisk B	NOVOb.CO	907.00	1	DKK
Publicis Groupe	PUBP.PA	55.37	3	EUR
Reckitt Benckiser Group	RB.L	47.21	1	GBP
Reed Elsevier	REL.L	7.75	2	GBP
Reed Elsevier (Ams)	ELSN.AS	13.28	2	EUR
Rio Tinto	RIO.L	27.33	1	GBP
Roche	ROG.VX	239.40	1	CHF
Rolls-Royce Holdings	RR.L	11.73	1	GBP
Ryanair	RYA.I	7.48	1	EUR
Sandvik	SAND.ST	78.85	2	SEK
Sanofi	SASY.PA	78.43	1	EUR
SGS N	SGSN.VX	2,092.00	2	CHF
Shire	SHP.L	21.39	1	GBP
Siemens	SIEGn.DE	78.85	1	EUR
Smiths Group	SMIN.L	13.51	3	GBP
Sodexo	EXHO.PA	66.10	1	EUR
Syngenta	SYNN.VX	376.00	1	CHF
TeliaSonera	TLSN.ST	43.72	3	SEK
Volvo B	VOLVb.ST	87.75	2	SEK
Weir Group	WEIR.L	20.89	2	GBP
Whitbread	WTB.L	31.16	2	GBP
WPP	WPP.L	11.41	2	GBP
Yara International	YAR.OL	244.50	1	NOK

Source: Citi Research. *Prices as of 3 July 2013

Notes

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Appendix A-1

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