

European Portfolio Strategist

Bull Market — Re-rating, Restructuring & Recovery

- **Green shoots of recovery** — European macro risks continue to reduce. European growth prospects continue to improve. This is good news for European companies and European equity markets. Watch EM, US tapering and Middle East for macro risks.
- **PMIs lead earnings** — European PMIs = 50+ for the first time in over 2 years. US PMIs = in the mid-50s. PMIs have been a consistent lead for earnings over the past 30 years. PMIs suggest that European earnings have troughed on a year/year basis.
- **TOWIE** — The Only Way Is Equities = TOWIE. UK and US equity returns are ahead of bond returns over the past 1, 2, 3, 5, 10, 20 and 25 years. With risk-adjusted returns also improving, it is becoming harder for capital allocators to not buy equities.
- **Bull market** — Better DM macro, earnings trough, modest ratings, rising investor (flow) & corporate (deals) risk appetite support our ongoing bull case for European equities. We back further re-rating and target 15-20% returns over the coming 12-18 months.
- **Key investment themes** — We think investors should look for exposure to restructuring, recovery, quality, surplus cashflow and de-equitisation. Financials score strongly on restructuring, recovery and increasingly on potential for capital return.
- **The Citi Focus List Europe** — High conviction Citi's analysts' Buys combined with key strategy themes = ABInbev, adidas, Aviva, AXA, Barclays, BG, BNP, Compass, Essilor, Inditex, ING, Linde, Kering, Novartis, Reckitt Ben., Renault, Rio Tinto, Shire, Siemens.

■ De-Equitisation

Anna Esposito

+44-20-7986-4039
anna.z.esposito@citi.com

Jonathan Stubbs

+44-20-7986-4218
jonathan.stubbs@citi.com

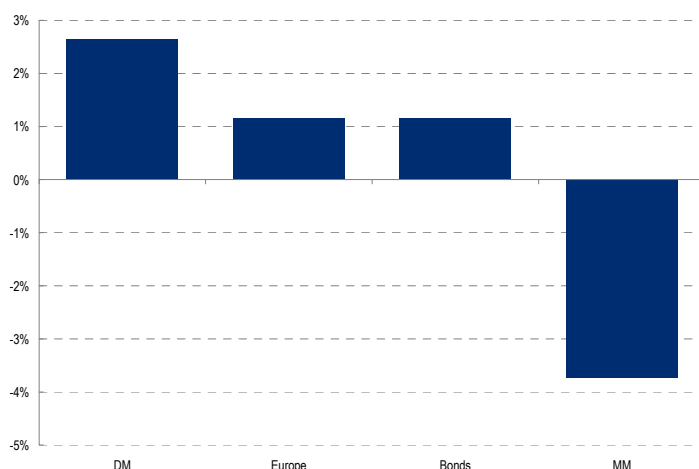
Beata M Manthey, PhD

+44-20-7986-4349
beata.manthey@citi.com

Ayush Tambi

+91-22-4277-5153
ayush.tambi@citi.com

Figure 1. Getting More Popular — Equity Inflows Ahead of Bonds YTD (% of Total Assets)



Source: EPFR

[29th Aug — European Recovery vs. Risk](#)
[15th Aug — The Citi Income Report](#)
[1st Aug — DG vs Fins vs Offensives](#)
[25th July — How to Play Recovery in EU](#)
[18th July — Capital Allocators are Coming](#)
[4th July — Head-to-Head: Value vs Quality](#)
[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](#)

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

Citi Research is a division of Citigroup Global Markets Inc. (the "Firm"), which does and seeks to do business with companies covered in its research reports. As a result, investors should be aware that the Firm may have a conflict of interest that could affect the objectivity of this report. Investors should consider this report as only a single factor in making their investment decision.

Contents

RRR = Re-rating, Restructuring & Recovery	3
Macro — Green Shoots of Recovery	3
Market — Re-rating	7
Key Themes — Restructuring & Recovery	16
European Sector & Country Strategy	32
Strategy outlook	35
Valuation Tables	37
Appendix A-1	50

RRR = Re-rating, Restructuring & Recovery

We stay bullish and target c15% returns from European equities to mid-2014. We continue to 'buy the dips' as we have done twice this year already. Key supports for our view include: 1) reasonable (absolute) to cheap (relative) valuations, 2) improving regional macro conditions likely to bring end of earnings downgrade cycle, and 3) pick-up in investor (flow) and corporate (M&A) risk appetite. We continue to back a further re-rating of equities as capital allocators raise their exposure to the asset class and as (European) macro risks reduce further. Further afield, the slowdown in emerging market (EM) growth, US tapering and Middle East tension are important for investors to keep an eye on. We have the first two of these risks as factors in our sector and country models.

Within the market our thematic focus has broadened over the past year. The exclusive earnings (and price) leadership of Defensive Growth has come to an end, which is why we continue to back our barbell approach to European equities. In particular, there is increasing competition from stocks and sectors with exposure to 'recovery'. We think Financials is the best way for investors to position for this. Importantly, European Financials have moved from being earnings laggards to earnings leaders in the past 2-3 quarters. We are Overweight all three Financial sectors.

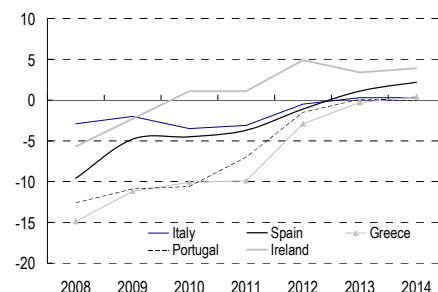
Despite our preference for Financials, we remain reluctant to back a wholesale value skew within the market, given: 1) the re-rating of value in the past 6-12 months, 2) the likely modest/uneven nature of economic recovery across Europe, and 3) the paucity of growth and FCF in 'cheap' sectors such as Utilities and Oil & Gas. Elsewhere, in a world of low growth and high margins, corporate restructuring remains a key support of profitability and, in our view, a key driver of alpha for investors. This covers both operational and financial restructuring. De-equitisation also remains a key theme for us. Last, we think that income and cashflow will remain in the spotlight. We like companies, which are generating plenty of surplus FCF and those which fit our various income strategies, such as CDS-adjusted DY*G.

Macro — Green Shoots of Recovery

Last summer, and for much of the last few years, investors in all regions and in all asset classes would have highlighted Greece and the Euro Area sovereign debt crisis as the key risk facing financial markets. That is changing.

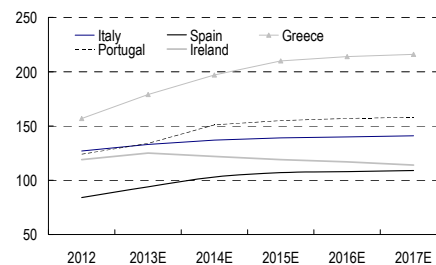
European macro risks have not disappeared, but they have reduced significantly over the past 6-12 months. Policy action and tough medicine, ie austerity, have combined to reasonable effect.

Figure 2. Periphery Current Account Deficits



Source: Haver

Figure 3. Government Debt (% of GDP)



Source: Haver

There are signs of modest improvement across peripheral economies, eg current account balances (Figure 2), selective falls in relative unit labour costs (Spain, Ireland) and the benign reaction of peripheral bond yields to the back-up in US bond yields. But, debt restructuring and funding challenges also remain (Figure 3).

While recent data confirms an economic improvement across Europe, the balance of risk continues to shift from Europe, and from developed markets (DM) more broadly, towards EM.

Overall, Citi's economists back a modest pick-up in global growth over the coming 1-2 years. Figure 4 shows their GDP growth and CPI forecasts for 2012-2015E. Led by a pick-up in DM growth from 1% to c2% in 2014-15E, global GDP growth is expected to rise from 2.4% this year to 3.2% in 2014E and 3.5% in 2015E. This backdrop would likely be supportive for corporate profits, would likely bring an end to the current earnings downgrade cycle of the past 12-18 months and would likely be supportive of positive returns from equities.

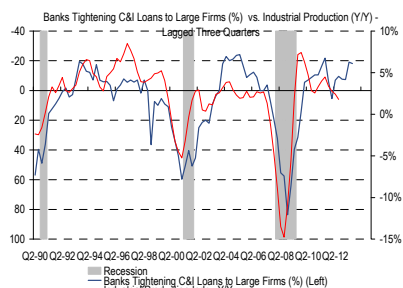
Figure 4. Citi GDP Growth & Inflation Forecasts

Region	GDP Growth (%)				CPI Inflation (%)				GDP + CPI (%)			
	2012	2013E	2014E	2015E	2012	2013E	2014E	2015E	2012	2013E	2014E	2015E
Global	2.6%	2.4%	3.2%	3.5%	2.9%	2.6%	3.0%	3.1%	5.5%	5.1%	6.2%	6.6%
Industrial Countries	1.4%	1.0%	1.9%	2.1%	1.8%	1.3%	1.8%	1.4%	3.2%	2.4%	3.7%	3.6%
Emerging Markets	4.7%	4.6%	5.0%	5.3%	4.6%	4.7%	4.6%	4.6%	9.2%	9.3%	9.6%	9.9%
US	2.8%	1.6%	2.7%	3.2%	1.8%	1.3%	2.0%	2.1%	4.6%	2.9%	4.7%	5.3%
Japan	2.0%	2.0%	2.0%	1.0%	0.0%	0.0%	2.1%	0.7%	2.0%	2.0%	4.1%	1.7%
Euro Area	-0.5%	-0.5%	0.6%	0.9%	2.5%	1.5%	1.4%	1.3%	2.0%	1.0%	2.0%	2.2%
Germany	0.9%	0.6%	1.7%	1.6%	2.0%	1.7%	1.9%	1.9%	2.9%	2.3%	3.5%	3.5%
France	0.0%	0.2%	0.8%	0.9%	2.2%	1.1%	1.7%	1.4%	2.3%	1.3%	2.5%	2.3%
Italy	-2.4%	-1.6%	-0.1%	0.1%	3.3%	1.5%	1.3%	0.7%	0.9%	-0.1%	1.3%	0.7%
Spain	-1.4%	-1.4%	-0.2%	0.5%	2.4%	1.8%	0.9%	0.7%	1.0%	0.4%	0.7%	1.2%
UK	0.1%	1.1%	2.1%	2.7%	2.8%	2.6%	2.0%	2.1%	3.0%	3.7%	4.1%	4.8%
Asia	6.2%	6.2%	6.3%	6.4%	3.9%	3.5%	3.7%	4.1%	10.1%	9.7%	10.0%	10.5%
Latin America	2.4%	2.4%	2.9%	3.0%	5.8%	7.2%	6.7%	5.9%	8.2%	9.7%	9.6%	8.9%
Central/East Europe	2.3%	2.1%	3.0%	3.5%	5.1%	5.2%	4.8%	4.5%	7.4%	7.3%	7.8%	8.0%
Australia	3.6%	2.5%	3.1%	3.0%	1.8%	2.1%	2.8%	2.8%	5.4%	4.5%	5.8%	5.8%
China	7.8%	7.4%	7.1%	7.0%	2.6%	2.7%	3.0%	3.5%	10.4%	10.1%	10.1%	10.5%

Source: Citi Research

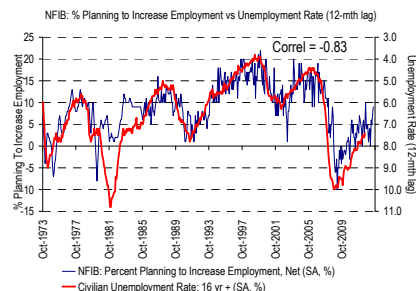
Our economists see the US recovery weathering the worst of the fiscal headwinds. Housing, capex, car sales and jobs are on healthy upswings. Falling fiscal deficits may also see the impetus for major budget reform wane. With the pace of growth likely to pick-up in coming quarters, attention will be on Fed action and QE tapering. Sharply higher US interest rates would present risks to the recovery and to financial markets. With inflation pressures low, our economists and rate strategists think this is unlikely. For equity markets, US economic improvement outweighs rising interest rate expectations for now, in our view.

Figure 5. Bank Lending Standards vs Capex



Source: Haver Analytics, Factset, Citi Research

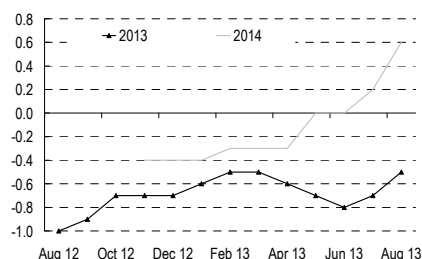
Figure 6. NFIB: Planning to Increase Jobs



Source: Haver Analytics, Factset, Citi Research

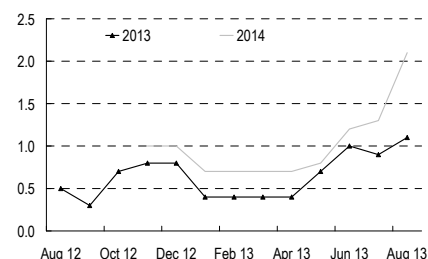
Our US strategy colleague, Tobias Levkovich highlights US bank lending standards and NFIB hiring intentions as important supports for the pick-up in US growth. These also make clear contrasts to the Euro Area where credit availability is poor and where our economists expect unemployment to remain elevated over the next couple of years.

Figure 7. Eurozone — GDP Growth Forecasts



Source: Citi Research

Figure 8. UK — GDP Growth Forecasts



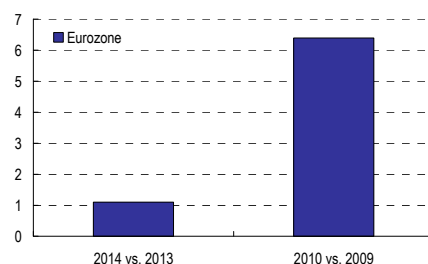
Source: Citi Research

Nevertheless, while the US economic outlook continues to firm and, it is Europe that has seen the biggest improvement in the past few months. PMIs for both the Euro Area and the UK have risen sharply. Our economists have raised their GDP growth forecasts for 2013-14E, by around 1% for 2014E in both the UK and the Euro Area. Some evidence of re-stocking and positive contribution from net trade has supported the recent improvement in data for the Euro Area.

While we would not overplay the pace of recovery in the Euro Area and structural growth headwinds remain, this does suggest that downside risks continue to reduce. Our economists believe that “the recovery is probably here to stay”. We see these developments as supportive broadly for corporates, risk appetite, equity markets and Financials.

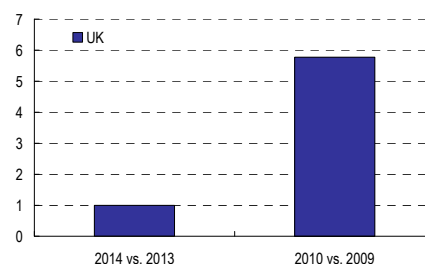
Our economists now expect the UK economy to grow by over 2% in 2014E. The upturn in housing, consumer spending and exports are supportive of a stronger growth backdrop. Without inflation or clear risks of financial instability, and with the fall in the jobless rate likely to be steady and progressive, Michael Saunders, our UK economist, expects the MPC to keep UK policy rates on hold for next few years. Even with activity data picking up, policy makers across DM are unlikely to turn off the liquidity taps in a hurry.

Figure 9. Eurozone — GDP Growth Delta



Source: Citi Research

Figure 10. UK — GDP Growth Delta



Source: Citi Research

While the improvement in economic conditions in Europe is encouraging and should be supportive of European equities, investors should not get too carried away. First, and as mentioned above, structural risks remain. Debt levels remain elevated in many economies so nascent recoveries are vulnerable to higher interest rates and external shocks. Second, Figure 9 and Figure 10 show that the GDP growth delta for both the Euro Area and the UK is likely to be small compared to previous cycles. For example, the c1% expected pick-up in growth between 2014E and 2013E pales compared to the c6% improvement that happened between 2009-10.

Shifting risks

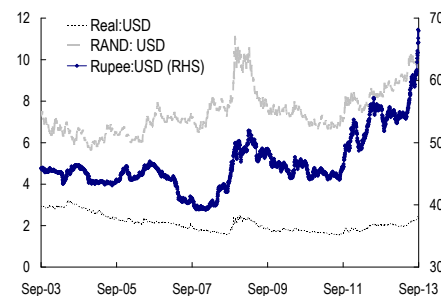
Europe has presented the key macro risk to investors in the post-financial crisis era. Now, it is slowing growth in EM, US tapering and Middle East tension that present greatest risk to financial markets. Equity market performance within Europe supports this with Greece and Ireland as the leading two equity markets in the region year to date.

Figure 11. US 10 Year Bond Yields



Source: Datastream

Figure 12. EM Exchange Rates

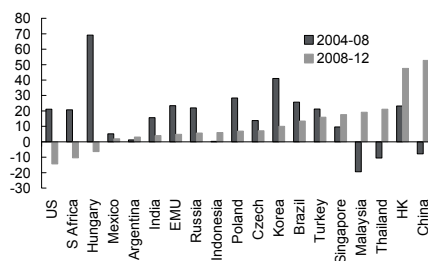


Source: Datastream

The prospect of US tapering has had a clear impact on the bond market. Figure 11 shows that US 10-year bond yields have almost doubled from their lows, with much of that move concentrated into the last few months. Our economists expect US financial conditions to remain supportive even post-tapering tightening.

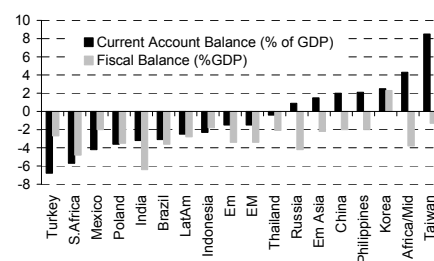
Overall equity market performance has been resilient against this backdrop. However, other markets have been less fortunate. In particular, selective EM equity, bond and FX markets have sold off, such as India.

Figure 13. US, EMU and EM: Change in Private Debt/GDP Ratios, 2004-12



Source: Citi Research, BIS. Note: Private debt is the sum of gross unconsolidated debt of the household and non-financial corporate sectors.

Figure 14. Current Account and Fiscal Balances in EM, Citi 2014 Forecasts



Source: Citi Research

Our economists have been lowering their EM growth forecasts for almost 2 years now. So, the EM growth slowdown is not a new theme for investors. But, EM risks have also risen in this time. Our economists highlight common factors such as sluggish export growth to DM, the deterioration in private sector balance sheets (Figure 13) and China's slowdown.

There also appears to be limited scope for various EM economies to revive growth given worsening current account and fiscal balances (Figure 14). While risks to growth are still probably to the downside, we think that much of this is already reflected in EM equity markets, which trade on sub-10x on a 12-month forward P/E basis. This is a key reason why we are Overweight EM equities in our global regional allocation. But, it is also important for investors to be selective within EM, both in terms of direct and indirect exposure.

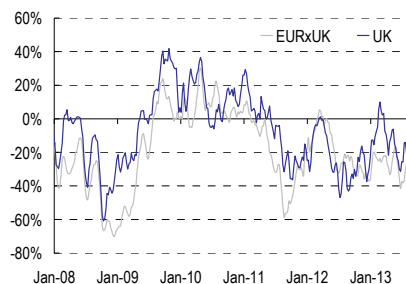
Market — Re-rating

Improving macro conditions across Europe and the rest of DM coupled with ongoing support from policy makers are important pillars of our bull case for European equities over the coming 12-18 months. Reasonable to cheap valuation, an improving earnings backdrop and the ongoing pick-up in corporate and investor risk appetite are the other pillars.

Earnings downgrades...

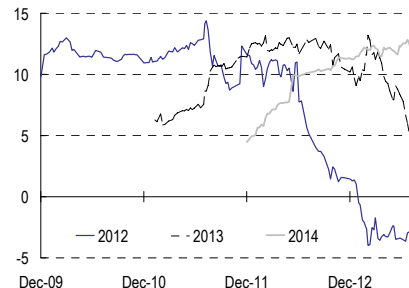
European earnings growth expectations have been falling for almost 2 years. This is shown in Citi's Earnings Revision Index (Figure 15). This has been an extended downgrade cycle already. But, the overall impact on growth rates has also been relative limited. For example, 2012 earnings growth expectation moved from +10% to -3% over the last 12-18 months. This is a modest fall in earnings expectations compared to 2008-09 when market earnings fell 50-60%. The corporate sector has been reasonably successful at defending profitability in the past couple of years.

Figure 15. ERI (4 Week Rolling Average)



Source: Factset

Figure 16. European EPS Growth Forecasts



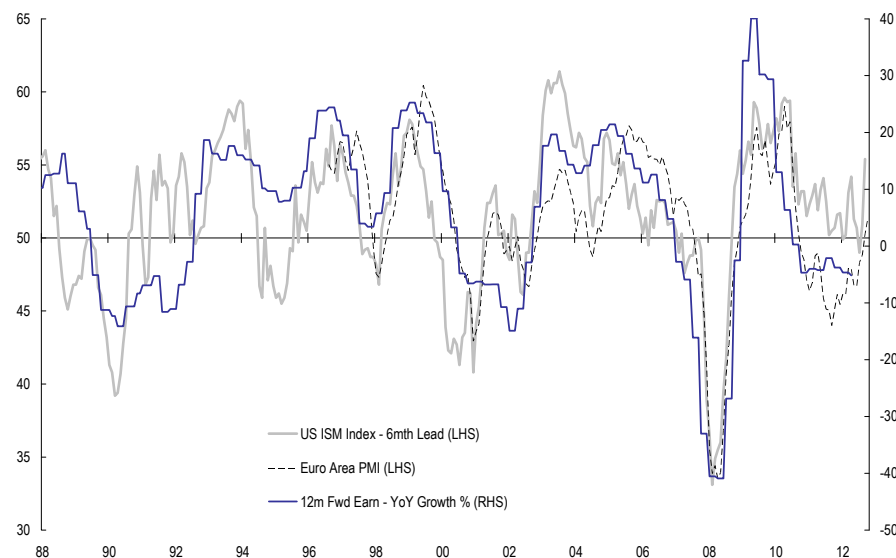
Source: Datastream & Citi Research

The main drag on earnings in 2012 came from 4 European sectors — Banks, Miners, Telecoms and Technology. Miners and Telecoms are likely to see negative earnings growth again this year and have suffered further downgrades YTD. Tech was stock specific. But, there has been an inflection for Bank sector earnings. Importantly, this has happened ahead of any real improvement in the European economy. This suggests that the recovery in Bank earnings is bottom-up led and the result of self-help and restructuring.

...heading for trough

Earnings downgrades in commodity sectors and more selectively in EM-exposed stocks have been a recent drag on overall market earnings growth expectations in Europe, but we think it is hard to see a repeat of last year's growth rate unless European macro improvements are in fact a false dawn or unless the slowdown in EM snowballs to contagious crisis. Our economists think both scenarios are unlikely.

Figure 17. PMI & European Earnings Momentum



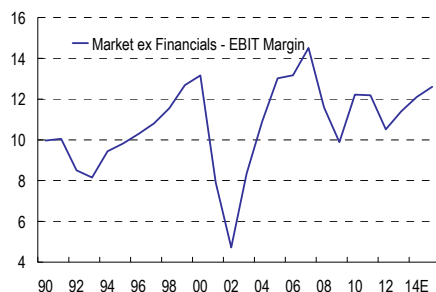
Source: Datastream & Citi Research

Figure 17 shows the reasonable relationship between leading economic indicators (PMIs) and year-on-year earnings growth, based on 12-month forward earnings. The pick-up in DM PMIs over the past 6-12 months would be consistent with our analysts' current earnings growth expectations for the coming 12-18 months. Both

suggest that we could be in the last stages of the current earnings downgrade cycle and that earnings growth has already troughed on a year-on-year basis.

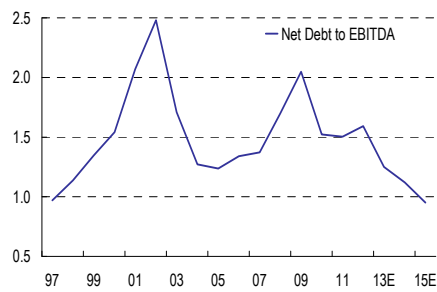
It is unlikely that an extended upgrade cycle follows in the next 1-2 years, but given modest equity valuations, we believe that 5-10% earnings growth is likely to be more than enough to sustain double-digit annualised returns from equity markets in the next couple of years.

Figure 18. Europe — EBIT Margin



Source: Datastream & Citi Research

Figure 19. Europe — Net Debt/EBITDA



Source: Datastream & Citi Research

Figure 18 and Figure 19 suggest that the European listed corporate sector is in decent shape. EBIT margins are high, although Citi's analysts expect modest margin expansion in the coming 12-18 months. Corporate balance sheets are in reasonable shape too.

Looking for leverage

Given that equity markets generally reward leverage in the good times and vice-versa in less good times, and under the assumption that our macro views are broadly correct, this suggests that investors should be looking to raise exposure to companies that can benefit from leverage in the coming 12-18 months.

This leverage can be top-down (economic), operational (margin) or financial (balance sheet). Overall, we think that this cycle presents lower and fewer leverage opportunities than in the 2003-07. We also think that is a good thing.

Economic growth is likely to be lower and less consistent than it was between 2003-07. The growth delta is also likely to be smaller. There is less room for margin expansion given current margin levels. Companies are likely to be less keen to over-extend balance sheets. This is why we think that leverage opportunities are selective rather than widespread and why this means that investors should not abandon quality and defensive growth, even if recovery generally suggests broader investment opportunities in other parts of the market, eg Financials.

This is also why self-help, restructuring and de-equitisation are likely to remain key sources of alpha over the coming 12-18 months.

Valuation — fair value (absolute) vs cheap (relative)

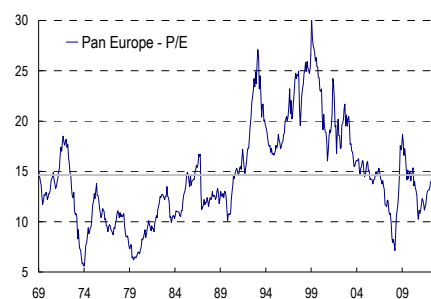
European equities have re-rated significantly over the last 1-, 2- and 5-years. Figure 20 shows that European equities are back to long-run average levels on a trailing P/E basis, 15x compared to 10x in 2H12. Prices up, earnings down. On trailing DY, European equities trade a bit under long-run average levels. If these averages represent some notion of fair value, then it appears that European equities are there or thereabouts. But, it is also clear that equity markets rarely remain at fair value for

long. Historically, share prices have tended to over- or under-shoot. This is what made the 2003-07 period relatively unusual. P/E multiples were relatively stable during this time. Equity markets moved higher broadly in line with earnings growth.

We see two scenarios as most likely over the coming 1-2 years: 1) repeat of 2003-07 with stable multiples and equity gains in line with earnings gains, or 2) equities moving to above fair value multiples as capital allocators continue to shift into the asset class.

In our view, the bears need a collapse in earnings. This would probably need another global recession. We think this is unlikely.

Figure 20. Europe — Trailing P/E



Source: Datastream

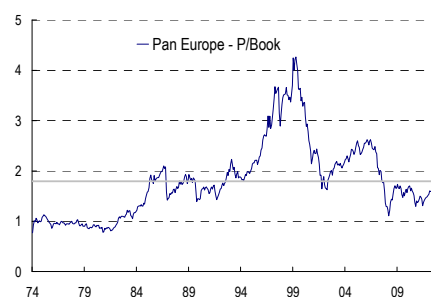
Figure 21. Europe — Dividend Yield



Source: Datastream

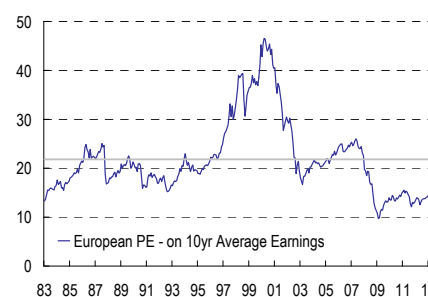
Other absolute valuation measures show European equities as looking more attractive. On a price/book basis, European equities are towards the top of their 5-year range but still c10% below the long-run average and towards the bottom of a post-1985 average. Excluding financials would take price/book to around long-run average levels.

Figure 22. Europe — P/Book



Source: Datastream

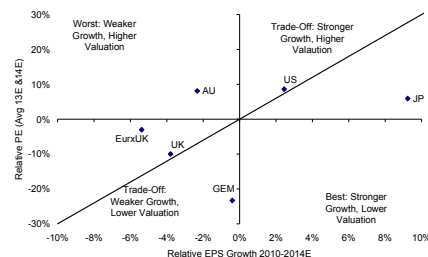
Figure 23. Europe — CAPE



Source: Datastream

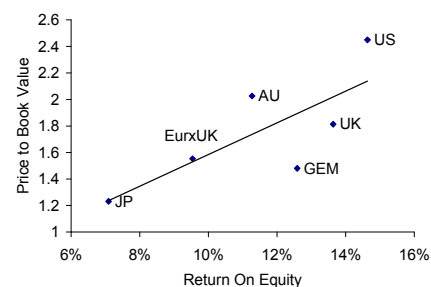
Figure 23 shows European equities on a cyclically-adjusted P/E basis. Along with price/book, this showed equities to be more extended in 2007-08 than P/Es did. The European CAPE remains close to 30-year lows. Buying markets with low CAPEs and selling with high CAPEs tends to work very well for long-term investors (10-year investment horizon). Greece, Ireland, Austria and Italy have the lowest CAPEs.

Figure 24. Region — P/E Rel vs EPS Growth



Source: Factset

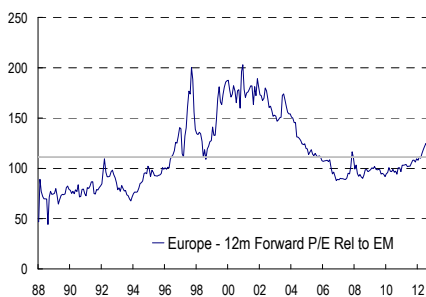
Figure 25. Region — P/Book vs RoE



Source: Factset

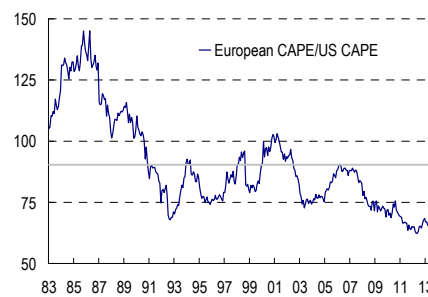
Figure 24 and Figure 25 compare European equities to other regions. Europe ex-UK and UK both trade at a small P/E discount to global equities, but EM equities are cheaper and have a better 2010-14E earnings growth profile. A simple comparison of price/book and RoE the UK looks reasonably attractive, as does EM. We are Overweight both regions in our global regional allocation.

Figure 26. Europe vs EM — 12m Fwd P/E



Source: Datastream

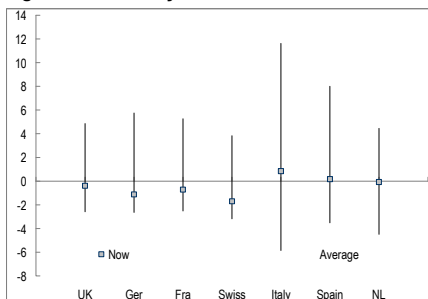
Figure 27. Europe vs US — CAPE



Source: Datastream

Figure 26 confirms the value opportunity in EM equities relative to the next cheapest region, ie Europe. EM equities do not need good news to perform better, in our view. A lack of bad news or a trough in GDP downgrades would likely be supportive. Figure 27 suggests that long-term investors should be looking to Europe ahead of the US with relative CAPEs around 30-year cheaps.

Figure 28. Country Bond Yield Less DY



Source: Datastream & Citi Research

Figure 29. European Corporate EYR



Source: Datastream & Citi Research

We think absolute valuations are supportive of our bull case for European equities. But, it is relative valuations that continue to show equities in best light. Equities look very cheap relative to cash, credit and government bonds. This continues to suggest that investors need to have a bearish macro outlook (eg end cycle or return to crisis) to not consider equities. The recent pick-up in bond yields has not meaningfully changed the relative attraction of equities, in our view.

The capital allocators are coming

Improving macro (DM), the prospect of earnings growth and an end to downgrades, reasonable valuations. Check, check, check. Despite 100%+ European equity returns over the last 4-5 years, the outlook for corporates and for share prices looks reasonably healthy.

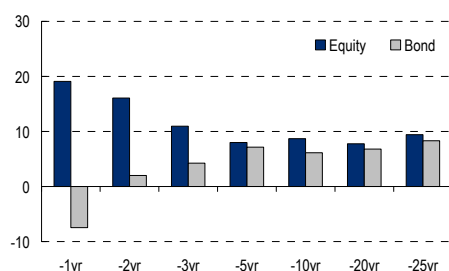
We expect capital allocators to continue to warm to the asset class. We continue to argue that rising risk appetite from investors and corporates will drive a further re-rating of equities. The combination of an increasingly impressive return profile and reducing (economic and market) volatility makes this outcome more likely.

Equities 7, Bonds 0

Take your pick. UK and US equity returns have beaten bond returns over the past 1-, 2-, 3-, 5-, 10-, 20- and 25-years. The return gap between these two key asset classes has grown considerably in the past few years.

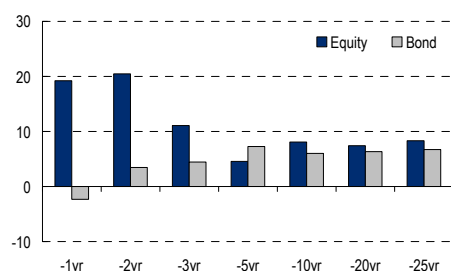
Importantly, bond returns are also negative over the past year in both the UK and US, and over the past 2-years in the US. Two-way risk in the bond market will make investors think harder about their exposures.

Figure 30. UK Annualised Returns



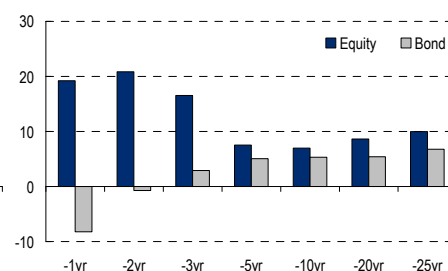
Source: DataStream and Citi Research

Figure 31. Germany Annualised Returns



Source: DataStream and Citi Research

Figure 32. US Annualised Returns



Source: DataStream and Citi Research

Investors often get judged on returns but most investment processes attempt to maximise the risk/reward. This is why we prefer to look at risk-adjusted returns when thinking about how capital allocators are likely to behave.

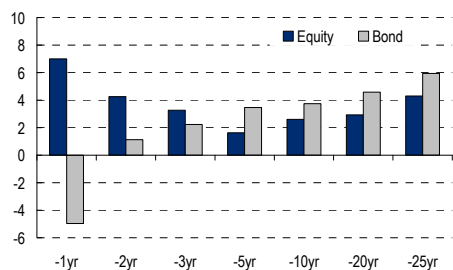
For equities to be fully embraced by capital allocators, they need to deliver on a risk- or volatility-adjusted return basis. Capital allocators want to maximise returns *and* minimise risk/volatility. That is the foundation of strong long-term performance

On straight returns, equities are beating bonds in all time periods we look at in the UK and the US. On a risk-adjusted basis, in Figure 33 to Figure 35, we score: 1) UK equities 3, UK bonds 4, 2) German equities 2, German bonds 5, and 3) US equities 5, US bonds 2.

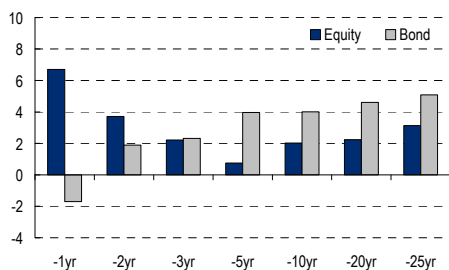
For each period we divide return with volatility to derive a score. US equities score best on this basis and make the strongest 'buy' case to capital allocators. Bond returns look more attractive in Europe, on this basis.

However, with risk-adjusted returns improving for equities and deteriorating for bonds, it is not hard to see why the [net equity outflows of the past few years have reversed YTD](#).

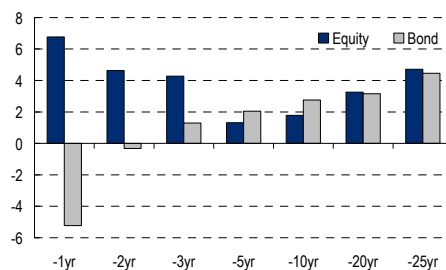
Figure 33. UK Annualised Risk Adjusted Returns Figure 34. German Ann. Risk Adjusted Returns Figure 35. US Annualised Risk Adjusted Returns



Source: DataStream and Citi Research



Source: DataStream and Citi Research



Source: DataStream and Citi Research

Capital allocators come in different flavours. Hence, there is no magic time period that drives capital allocators to act. Some groups may be more sensitive to short-term risk-adjusted returns. Others may be more sensitive to medium- or long-term returns. What is clear, however, is that should equities extend their current risk-adjusted return profile, then it is likely that an increasing amount of capital does get allocated back to equity.

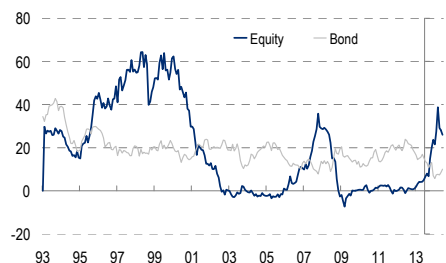
Figure 36. UK Annualised Risk Adjusted Returns Figure 37. German Ann. Risk Adjusted Returns Figure 38. US Annualised Risk Adjusted Returns



Source: DataStream and Citi Research



Source: DataStream and Citi Research



Source: DataStream and Citi Research

Figure 36 to Figure 38 show what happens to 5-year rolling risk-adjusted returns if we look forward keeping bonds stable and equity markets on a trajectory following our mid-2014 targets. Over the next couple of quarters, the 5-year risk-adjusted return for equities moves above that for bonds. The investment case for equities, on this basis, is set to get stronger from here.

Ya boo. . .

The cynics out there will look at this analysis and suggest that the late-1990s and 2007-08 were not great times to be putting fresh capital to work into equity markets. Surely, this means that equity risk-adjusted returns moving above bond risk-adjusted returns is a clear sell signal for equities?

It is certainly true, by definition, that this confirms that this is not the start of the equity market cycle. But, a big difference between now and the previous two occasions when this happened is valuation, both absolute and relative. UK/European equities are much cheaper now than on the previous occasions, on CAPEs and price/book ratios, and relative to government and corporate bonds.

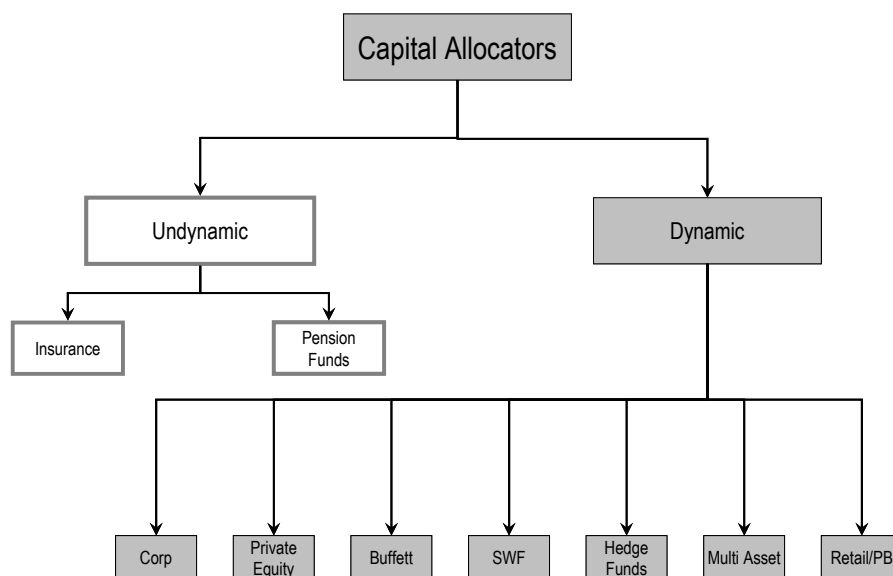
Additionally, the late-1990s and 2007-08 also marked the end-cycle periods for the global economy with the TMT bust and financial crisis respectively. Corporate earnings collapsed. From here, equity returns are not going to be great should we hit another end-cycle air pocket. We do not know that won't happen, but our

economists' base case is for a modest mid-cycle acceleration in global growth over the next 1-2 years, led by an improving US economy, rather than end-cycle bust. We agree and expect mid-cycle (positive) earnings growth in the next 1-2 years rather than end-cycle earnings recessions.

The capital allocators

So, who are these capital allocators and what are they doing? It is important to differentiate between the various capital allocator groups and for equity investors to understand what they want. If the marginal buyers want something different to a conventional equity investor then share prices may dance to a slightly different beat.

Figure 39. Capital Allocators — Dynamic vs Undynamic



Source: Citi Research

We break capital allocators into two groups — undynamic and dynamic (Figure 39). The former are represented by pension funds and insurance companies. The latter group includes corporates, private equity, multi-asset, hedge funds, sovereign wealth funds, retail investors/private banks, significant individuals (eg Buffett, Slim).

Regulators, consultants and actuaries effectively control the capital allocation of the undynamic investor group. Liability matching and solvency requirements rule the roost. This has guided undynamic capital allocators to sell down equity exposure and build up bond exposure since the early 2000s.

Effectively both pension funds and insurance companies allocate capital based on rolling risk-adjusted returns. To us, this is a very limited model and completely ignores two key components of any investment process, namely valuation and forward risk. This is why these investors bought record amounts of equities at record prices and valuations in the late 1990s and why they have done likewise with bonds in the last couple of years.

Insurance companies and pension funds are the most likely source of the 'Great Rotation' from bonds to equity and perhaps even re-birth of the cult of equity. But, it is premature to expect this to happen soon or quickly. Equity risk-adjusted returns need to improve further before that. However, there appears to be increasing pressure on some undynamic investors to consider equity as an investment rather than as a divestment.

Our Insurance analyst, Farooq Hanif, suggests to us that the 'Great Equity Sell-Down' could be nearing an end for many Insurance companies and that some may even be thinking about dipping a toe back into the equity market. This is backed up by our own anecdotal evidence. A combination of improving capital positions, a dearth of investment alternatives and a possible easing of the regulatory environment could combine in the coming 12-18 months and see more demand for equities from Insurance companies.

Dynamic capital allocators operate with less restriction than undynamic ones. Their actions will tend to be driven more by market forces. Even though risk-adjusted returns remain important to some groups, valuation will tend to play a bigger role in their allocation process.

For example, corporates and private equity both look for a combination of operational and funding opportunities at the right price. Given the record low debt funding opportunity for corporates and the record wide de-equitisation arbitrage, we believe all CEOs/CFOs and all private equity firms should be investigating what opportunities these bring.

The animal spirits appear to be warming up. Four years after the bumpy economic and market cycle started, the corporate cycle appears to have been kick-started.

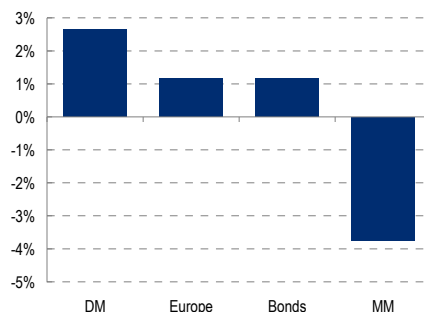
In addition to the relative de-rating of equity and attractive cost of funding for many corporates, there are two other factors which we see behind the recent pick-up in corporate activity, which has largely been US led: 1) the sharp fall in US macro fears compared to last summer and 2) the sharp fall in US political risk. While the US is undoubtedly the lead engine here, we expect Europe to join in at some point. Recent activity suggests European companies are involved, albeit as targets rather than predators. Excluding a macro melt-down, the maths are also too compelling in Europe for this not to continue, in our view.

Other dynamic capital allocators are either returning to equity or are raising equity exposure. For example, it will be harder and harder for multi-asset funds to meet their total return mandates without reasonable equity exposure. This has been one of the fastest growing investor communities in the past few years, in terms of funds under management.

Build it and they will come...

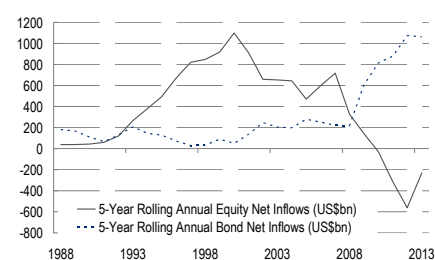
Retail investors are another good example. Figure 40 shows YTD net inflows for global and European equity, bond and money market funds. As we suggested earlier this year, it appears that [capital's exclusive relationship](#) with the bond market has ended. In the previous five years, capital wanted capital protection and found this in bonds rather than equities. There is no evidence here of a 'Great Rotation', but there is clear evidence of the end of this exclusive relationship. Equity now has a foot in the door with retail investors.

Figure 40. YTD Flows



Source: EPFR

Figure 41. US 5yr Rolling Net Flows



Source: Haver Analytics

Overall, while capital allocators are not flooding to equities, we see enough evidence from enough of the various investor groups to suggest that there has been a real shift in sentiment and behaviour in the past couple of quarters. Figure 40 shows inflows to equity funds ahead of inflows to bond funds for the first time in a very long time. Fuel for the equity bulls. All behavioural shifts that we can observe should be positive for share prices and could drive a further re-rating for equities. This has only just begun in our view.

Key Themes — Restructuring & Recovery

Within the market our thematic focus has broadened over the past year. The exclusive earnings (and price) leadership of Defensive Growth has come to an end, which is why we continue to back our barbell approach to European equities. In particular, there is increasing competition from stocks and sectors with exposure to 'recovery'. We think Financials is the best way for investors to position for this.

Overall, we think investors should think about the following themes: 1) recovery and changing earnings leadership, 2) self-help/restructuring, 3) value vs quality, 4) income and surplus FCF, and 5) de-equitisation.

How to play European recovery

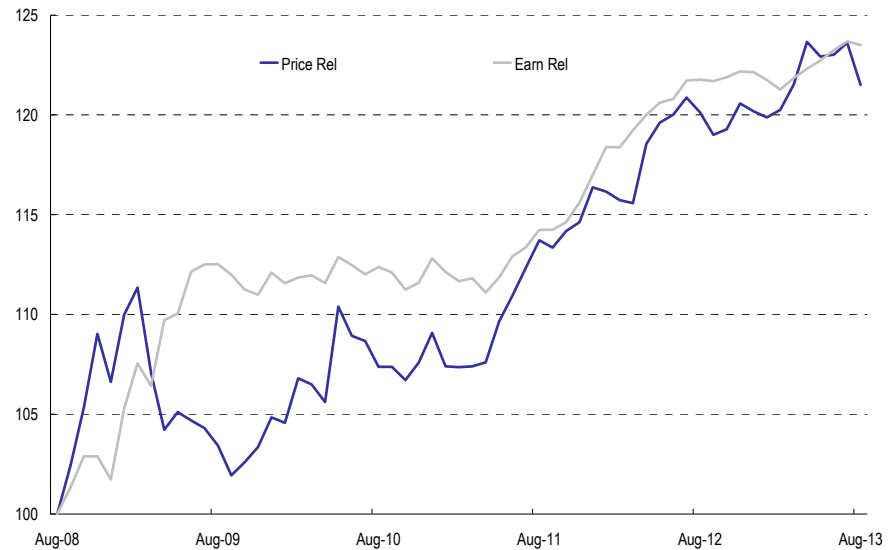
European macro data is firming. Euro Area PMIs are above 50 for first time since mid-2011. UK data is stronger too. Our economists expect end of recession and return to positive (just) GDP growth in 2014E. There appears to be light at the end of the tunnel. We also expect a pick-up in US growth in the next 6-12 months.

Improving GDP growth across DM should be supportive for equities. We have previously suggested 6 recovery trades for investors: 1) US recovery, 2) Financials, 3) selective domestic recovery, 4) selective UK recovery, 5) deep value & 6) quant sensitivity.

With the macro recovery likely to be modest, we are reluctant to chase a broad recovery strategy at the expense of everything else. Similarly, with value not looking that cheap, we are reluctant to chase a broad value strategy. However, we think that investors should have selective exposure to both.

We would prefer to take this exposure through companies which are geared to improving macro but which are already delivering in terms of earnings. Improving macro is likely to be an additional positive for such stocks. We find plenty of such companies with high US sales exposure and Financial are broadly represented.

Figure 42. US Exposure — Price & Earnings Relative



Source: Datastream & Citi Research

Figure 42 shows the price and earnings relative to European companies with at least 20% sales exposure to the US. This group has provided earnings leadership within the market over the past 12-18 months. Our economists expect the same pick-up in GDP growth, ie 1%, in the US as in Europe over the coming 12-18 months. With the US delivering higher growth and with the European outlook carrying more uncertainty, we think the quality of the recovery in the US is higher than in Europe.

Figure 43. High US Exposure & High Beta

Stock	RIC	Mkt Cap, Em	-6m Rel Earn Mo	Beta
ING Groep	ING.AS	31725	-1	1.71
Prudential	PRU.L	32270	15	1.53
Aegon	AEGN.AS	9711	1	1.47
Credit Suisse R	CSGN.VX	34405	8	1.43
CRH	CRH.L	11615	-2	1.40
UCB	UCB.BR	5147	12	1.40
Wolseley	WOS.L	10383	3	1.40
UBS R	UBSN.VX	52526	21	1.36
Fiat	FIA.MI	4966	2	1.36
Skanska B	SKAb.ST	5464	4	1.32
ARM Holdings	ARM.L	14337	26	1.26
Delhaize Group	DELB.BR	4895	9	1.22
GKN	GKN.L	6390	13	1.18
Weir Group	WEIR.L	5424	6	1.16
Cobham	COB.L	3599	5	1.13
Ashtead Group	AHT.L	3809	41	1.13
WPP	WPP.L	17793	10	1.12
Essilor Intl.	ESSI.PA	17399	5	1.10
Informa	INF.L	3585	4	1.10
Luxottica	LUX.MI	6264	7	1.10
Schneider Electric	SCHN.PA	32159	6	1.09
Grifols Ord Cl A	GRLS.MC	4561	10	1.08
Ahold Kon.	AHLN.AS	11606	9	1.06
Philips Electronics	PHG.AS	21268	-5	1.04
Securitas B	SECUB.ST	2540	2	1.04
Melrose Industries	MRON.L	4375	4	1.02
BAE Systems	BAES.L	16648	4	1.02

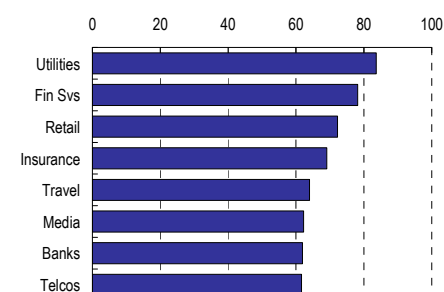
Source: Datastream & Citi Research

Figure 43 shows those European companies with high US sales exposure and with a beta above 1 (to focus on the more cyclical companies). This is a sensible shopping list for investors, in our view.

Domo stocks

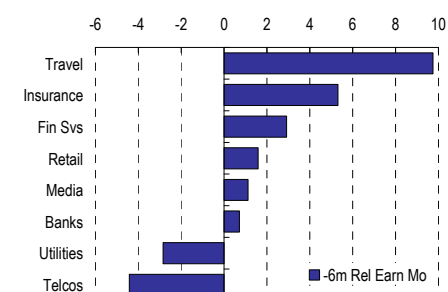
If European macro risks are reducing and modest recovery is around the corner, then there should be more opportunities in domestically exposed European companies. Many of these have struggled over the past few years. We would continue to tread carefully in this space. This is not a monster macro recovery which is going to 'float all boats' or 'fill all kettles', in our view.

Figure 44. Domestic Sales Exposure



Source: Citi Research

Figure 45. Earnings Momentum



Source: Datastream & Citi Research

We would look to those companies which have positive earnings trends despite the poor macro backdrop. An improving macro backdrop is likely to be an additional support to many of these companies.

Figure 45 makes this point at a sector level. Those domestic sectors with the best earnings momentum include Financials and Travel & Leisure.

Figure 46. Domo — High Domestic Exposure & Strong Earnings Mo

Stock	RIC	>€5bn Mkt Cap	+ve -6m Rel Earnings Mo
Allianz	ALVG.DE	49035	10
Lloyds Banking Group	LLOY.L	36464	41
Tesco	TSCO.L	32757	1
BT Group	BT.L	31116	6
Nordea Bank	NDA1V.HE	23099	7
			2
Assicurazioni Generali	GASI.MI	19373	6
SSE	SSE.L	17573	4
Unibail-Rodamco	UNBP.AS	16141	4
Swedbank A	SWEDa.ST	15996	2
Svenska Handbkn	SHBa.ST	15961	1
Legal & General	LGEn.L	12846	8
SEB A	SEBa.ST	11992	8
Danske Bank	DANSKE.CO	11014	6
DNB	DNB.OL	10751	6
Kingfisher	KGF.L	10663	4
Ryanair Holdings	RYA.I	9558	13
BSKyB	BSY.L	9497	4
Next	NXT.L	9213	8
Marks & Spencer Group	MKS.L	8859	1
Credit Agricole	CAGR.PA	8429	5
Land Securities Group	LAND.L	8222	6
Capita	CPI.L	7473	8
Julius Bar Gruppe	BAER.VX	7464	17
Snam	SRG.MI	7357	1
Geberit R	GEBN.VX	7149	2
Kabel Deutschland Hldg.	KD8Gn.DE	7130	1
ITV	ITV.L	7023	17
Whitbread	WTB.L	6430	7
Sainsbury (J)	SBRY.L	6291	5
EDF	EDF.PA	5938	6
United Utilities Group	UU.L	5424	3
Ferrovial	FER.MC	5144	33
Ziggo	ZIGGO.AS	5101	10

Source: Datastream & Citi Research

Figure 46 show those high domestic exposure companies with positive earnings momentum. Financials show well, as do various UK consumer related companies such as Next, Marks & Spencer, ITV, Whitbread and BSKyB.

Broadening Leadership

One consequence of improving DM and deteriorating EM macro data is further support for the broadening of earnings leadership within the market. The biggest change over the past 12-months has been the improvement in Financials' relative earnings trends.

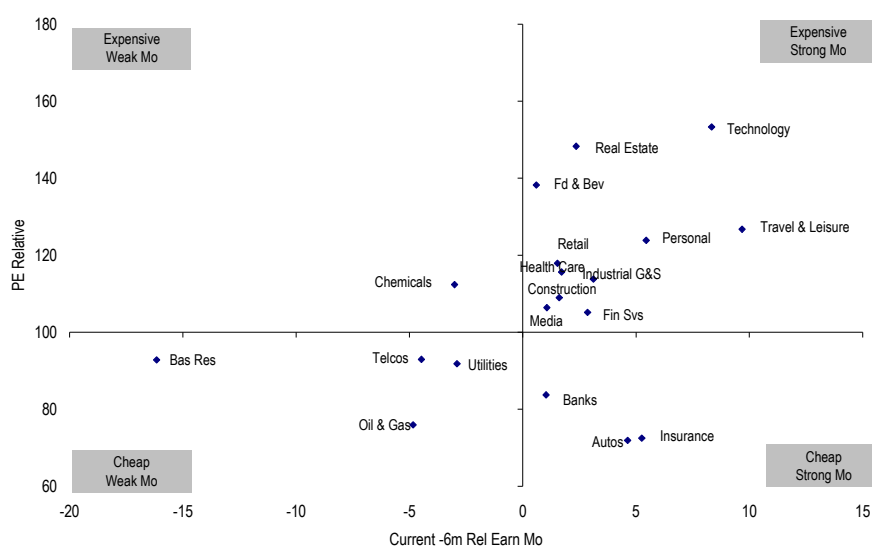
Figure 47. Earnings Momentum — The Improvers...

Sector	Rel. Earn. Mo. (Last 6m)	Rel. Earn. Mo. (Feb-Aug 2012)	Difference
Technology	8.3	-8.3	16.6
Banks	1.0	-7.3	8.3
Financial Services	2.9	-4.3	7.1
Insurance	5.3	1.0	4.3
Construction & Materials	1.6	-0.7	2.3
Telecommunications	-4.5	-5.2	0.7
Travel & Leisure	9.7	9.6	0.1
Real Estate	2.4	2.8	-0.5
Utilities	-2.9	-2.2	-0.7
Media	1.1	1.8	-0.8
Health Care	1.7	3.4	-1.7
Retail	1.5	3.4	-1.8
Industrial Goods & Services	3.1	5.0	-1.9
Personal & Household Goods	5.4	8.8	-3.4
Basic Resources	-16.2	-11.8	-4.3
Oil & Gas	-4.8	0.2	-5.0
Food & Beverage	0.6	6.6	-6.0
Automobiles & Parts	4.6	11.1	-6.4
Chemicals	-3.0	7.2	-10.2

Source: Datastream & Citi Research

Figure 47 shows the difference between European sector earnings relative trends in the past six months and the previous six months to that. Tech is high due to Nokia. Next, it is the three Financial sectors which have seen the biggest improvement in relative earnings trends in the past 6-12 months. Other sectors with a higher skew to Europe, such as Telecoms and Construction also show a positive delta. Commodity and sectors with higher EM exposure have seen a negative delta.

Figure 48. Valuation (P/E Rel, Y-Axis) vs Earnings Trends By Sector (X-Axis)



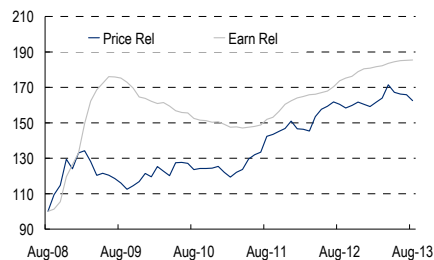
Source: Datastream & Citi Research

Figure 48 compares European sectors on a P/E relative and earnings momentum basis. This suggests that investors who are looking for cheap recovery exposure with positive earnings momentum should focus on Financials (and Autos).

Defensive growth — hanging in there

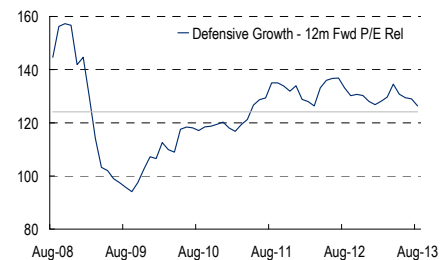
Defensive Growth has been one of the big thematic success stories of the past few years. Earnings outperformance has been strong in the past couple of years, although the rate of earnings outperformance has been reducing progressively in the past 6-9 months as earnings have stabilised within other parts of the market, notably Financials.

Figure 49. Defensive Growth — P & E Rel



Source: Datastream & Citi Research

Figure 50. Defensive Growth — P/E Rel



Source: Datastream & Citi Research

In October last year we suggested that “the only growth trade in town”, ie Defensive Growth, was going to face increasing competition from US recovery and from the (selective) rise in corporate leverage.

We also suggested that investors pay greater attention to valuation (with one eye rather than two), when looking within Defensive Growth.

We have since added modest domestic recovery to that list of challenges. Additionally, slowing EM growth is a negative for Defensive Growth generally. Over the past 6-12 months we have: 1) taken on more recovery exposure, eg Financials, 2) become more selective in Defensive Growth, eg prefer Health Care to Food & Beverage, and 3) have switched EM Defensive Growth exposure to DM Defensive Growth exposure, eg prefer Media to Defensive Growth.

Figure 49 and Figure 50 suggest that Defensive Growth does not look outrageously expensive. The group trades on a P/E relative below 130. Earnings momentum trends continue to be positive despite selective EM headwinds.

Figure 51 shows those large-cap stocks which qualify as Defensive Growth stocks as their peak-to-trough earnings fall in 2008-09 was less than 20% and 2-year earnings CAGR is greater than 8%.

Figure 51. Defensive Growth Screen — Large Caps

Stock	RIC	>10bn Mkt Cap, Em	>-20% Peak to Trough Fall	>8% 2yr Annual Earnings Growth	Rel Performance, YTD	P/E Now	Min	Max	Percentile (Abs)	Percentile (Rel)
SAP	SAPG.DE	53029	-13	13	-16	16	12	18	0.64	0.00
Shire	SHP.L	15613	-15	10	12	15	12	19	0.47	0.14
Novo Nordisk B	NOVOB.CO	51743	3	15	-5	19	14	23	0.58	0.25
Syngenta	SYNN.VX	27632	-16	12	-9	16	8	17	0.82	0.25
Ahold Kon.	AHLN.AS	11606	-2	11	14	13	9	13	0.97	0.28
Fresenius Med.	FMEG.DE	10215	-15	8	-13	18	12	19	0.76	0.31
Bayer	BAYGn.DE	69497	-18	13	9	14	8	14	0.98	0.32
Roche	ROG.VX	132632	-14	10	15	15	9	16	0.91	0.33
Novartis R	NOVN.VX	149347	-15	11	11	14	9	14	0.94	0.35
Danone	DANO.PA	32931	-11	10	4	18	11	18	1.00	0.35
Hennes & Mauritz	HMB.ST	26237	-19	8	0	22	13	22	0.95	0.40
Fresenius	FREG.DE	11739	-2	12	-4	15	8	17	0.78	0.41
Unilever Certs.	UNc.AS	44715	-9	8	-8	18	10	19	0.84	0.42
Pearson	PSO.N.L	12182	-18	12	-5	16	10	16	1.00	0.45
Unibail-Rodamco	UNBP.AS	16141	-6	8	-13	17	9	19	0.82	0.49
			-19	11	-2	18	10	18	0.98	0.52
SABMiller	SAB.L	36386	-14	9	-3	19	9	20	0.84	0.53
Unilever (UK)	ULVR.L	37025	-11	8	-8	18	10	19	0.85	0.54
Inditex	ITX.MC	21231	-19	11	-10	23	10	25	0.87	0.55
Compass Group	CPG.L	18301	-6	10	5	17	10	18	0.92	0.56
Kone B	KNEBV.HE	11863	-14	13	5	20	8	24	0.73	0.57
Essilor Intl.	ESSI.PA	17399	-6	14	0	27	14	27	0.95	0.60
Pernod-Ricard	PERP.PA	18212	-15	8	-8	17	8	18	0.88	0.62
Experian	EXP.N.L	13568	-20	8	3	19	8	20	0.97	0.69
Seadrill	SDRL.OL	12364	-13	25	19	13	2	13	1.00	0.75
Heineken	HEIN.AS	11209	-19	9	-5	17	9	17	0.97	0.80
Sanofi	SASY.PA	87599	-4	10	-6	13	7	14	0.92	0.88

Source: Datastream & Citi Research

For non-benchmark investors, we continue to think that this is one of a few drawdown protection strategies which make sense in the equity market. #

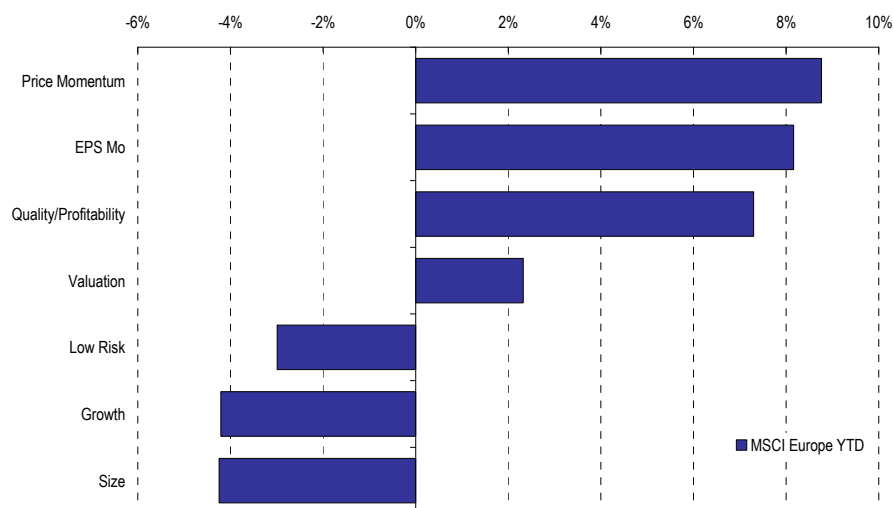
For benchmark investors, we think that it is right to be more selective in Defensive Growth now than a couple of years ago. Something has to pay for higher exposure to recovery plays such as Financials.

We would be more tempted by cheaper Defensive Growth. There are five stocks whose P/E relative is in the bottom 30% of its range over the past 5 years — SAP, Shire, Novo Nordisk, Syngenta and Ahold.

Value vs Quality

Buy low, sell high. That is what most investors try to do. Buying cheap is an appealing strategy and in the long-run tends to work pretty well. However, there is also a time and a place for buying value and that depends of the cycle and the price of value itself. We suggested value opportunity within European equity markets last summer (LINK) and we have raised exposure to value in our sector strategy over the past 6-12 months. But, we remain selective, preferring to look for a mix between value (or risk) and quality (or growth) rather than a strong skew either way. We do not think the economic cycle is aggressive enough for that.

Figure 52. Style Performance Across Market YTD



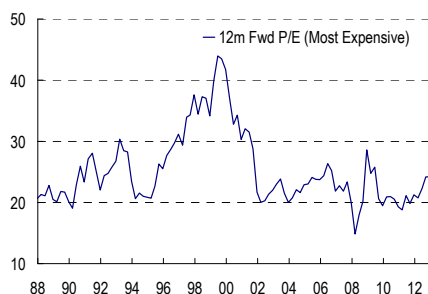
Source: Factset, Citi Research

Figure 52, from the Citi Quant team, shows the performance of various styles in Europe YTD. Momentum strategies, both price and earnings, have been most successful so far this year. Not trying to be a hero has worked well. Value strategies have performed a little better in the past month or so, but have still lagged quality YTD. What should investors do now? We continue to back earnings momentum. Our barbell approach would look to balance value and quality.

Cheap is not cheap

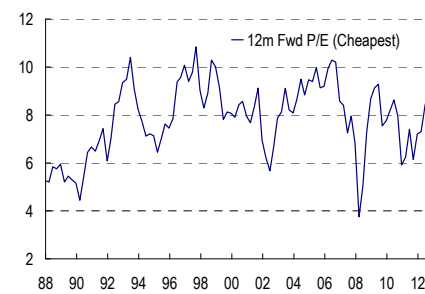
Figure 54 shows one reason why investors should not get too carried away with the cheaper part of the European equity market. The cheapest quintile in Europe is actually not that cheap relative to its own history over the past 25 years. This group has traded in a c5-10x P/E range in this period. Cheap looked cheap in summer 2011 and summer 2012 at 6x, but trades above 9x now.

Figure 53. Most Expensive Quintile — Fwd PE



Source: Datastream & Citi Research

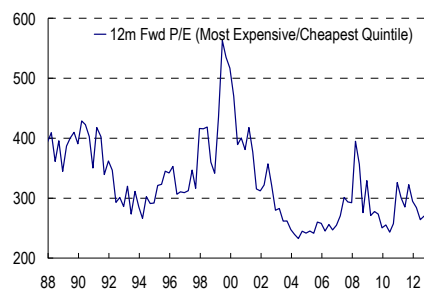
Figure 54. Cheapest Quintile — Fwd PE



Source: Datastream & Citi Research

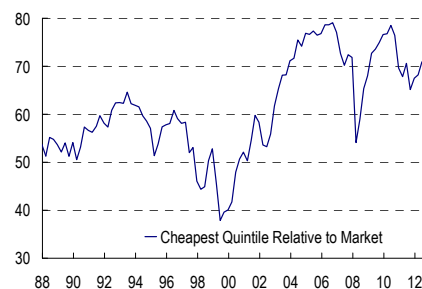
Much of the re-rating for this group appears to be behind us now unless we break out into a new valuation range. This suggests that those cheap stocks which can deliver on earnings are more likely to see share prices supported. Broadly, this makes us favour Financials over Commodities.

Figure 55. Most Expensive Quintile vs Cheapest



Source: Datastream & Citi Research

Figure 56. Cheapest Quintile — Fwd PE Relative



Source: Datastream & Citi Research

Figure 55 and Figure 56 add to this argument. The latter shows that the cheapest quintile is not too far from peak relative P/Es over the same period. The 2006-07 peak was at the end of the leverage boom. The 2009-10 peak was the trash rally following the market trough in 2009. These 'lofty' ratings make us slightly nervous.

Figure 55 compares the cheapest quintile to the most expensive quintile in Europe, still using 12-month forward P/Es. We have used this chart over the past few years to see when the opportunity in value looks most attractive. For example, in July 2012, this spread headed close to 400 (chart above shows monthly data so does not pick up intra-month readings) and suggested that investors had an excellent valuation entry point into value stocks.

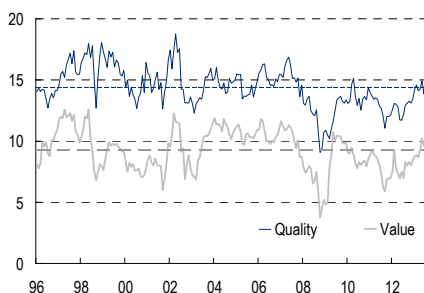
Now, the spread is close to 25 year lows. To us, this suggests that earnings delivery, ie earnings momentum strategies, will be important in determining price performance over the coming 12-18 months. Earnings momentum is likely to come from a range of industries and companies. Earnings momentum is not likely to just come from 'cheap' or just from 'expensive' stocks/sectors.

Be selective is the conclusion, which fits in well with the conclusion of a recent report we wrote globally on the [importance of stock-picking](#).

Value is not cheap

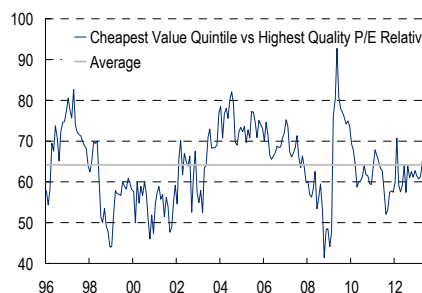
More data from our quant team back up our quintile analysis. Figure 57 shows the 12-month forward P/E of the cheapest value quintile from their style analysis and the highest quality quintile. The latter is based on RoE, balance sheet quality etc.

Figure 57. Value & Quality P/E



Source: Citi Research, MSCI, IBES, Worldscope

Figure 58. Value P/E Relative to Quality



Source: Citi Research, MSCI, IBES, Worldscope

This shows that both value and quality have been re-rated in the past 12 months. Both achieved similar multiple expansion in terms of P/E points, but the relative expansion for value is much higher as it came from a much lower base.

Part of this multiple expansion will have come from falling earnings, which has had a bias to value rather than quality. This helps explain why quality has still managed to outperform value YTD. Figure 58 shows that the relative re-rating of value against quality has taken value above long-run average levels in the past few months. Value is no longer cheap. Further support for the 'be selective' argument.

Quality Street

Despite improving DM economic prospects, we still live in a low growth world. To us, this means that companies with RoE, FCF, earnings and balance sheet advantages can continue to do well in equity markets.

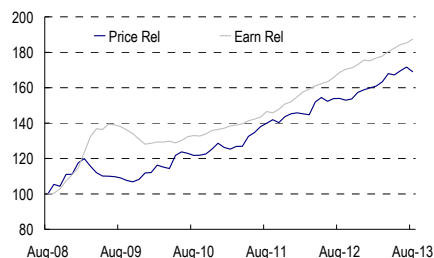
Figure 59. Quality Street Screen

		>E5bn	>0%	>15	>0				<0
Stock	RIC	Mkt Cap, €m	-6m Abs Earn Mo	Stock ROE 2013	Sector RoE13	Stock Less Sector RoE	Stock ND/ EBITDA 2013	Sector ND/ EBITDA 2013	Stock Less Sector ND/EBITDA
Roche	ROG.VX	132632	3	89	25	65	0.27	0.6	-0.29
Bayer	BAYGn.DE	69497	4	26	17	9	0.72	1.2	-0.45
Siemens	SIEGn.DE	66622	3	19	18	1	0.74	0.9	-0.12
Novo Nordisk B	NOVOB.CO	51743	9	64	25	39	-0.43	0.6	-0.99
ABB	ABBN.VX	37597	5	19	18	0	0.21	0.9	-0.66
Richemont	CFR.VX	37533	10	22	22	0	-1.29	0.6	-1.85
Unilever (UK)	ULVR.L	37025	1	29	18	12	0.62	1.3	-0.69
Reckitt Benckiser	RB.L	33744	6	31	22	9	0.45	0.6	-0.10
BT Group	BT.L	31116	5	1494	14	1481	1.19	2.1	-0.92
Syngenta	SYNN.VX	27632	1	23	17	6	0.40	1.2	-0.78
Rolls-Royce	RR.L	24450	10	20	18	1	-0.52	0.9	-1.38
EADS	EAD.PA	24369	20	22	18	4	-1.51	0.9	-2.37
Centrica	CNA.L	23571	4	23	10	13	1.36	2.9	-1.58
ASML Hldg	ASML.AS	23563	24	23	12	12	-1.29	-0.8	-0.50
BMW	BMWG.DE	22917	2	17	12	5	-1.09	1.6	-2.74
Inditex	ITX.MC	21231	2	31	13	17	-1.10	1.0	-2.12
Compass Group	CPG.L	18301	8	26	13	12	0.84	1.3	-0.43
SSE	SSE.L	17573	3	20	10	10	2.31	2.9	-0.63
BAE Systems	BAES.L	16648	4	36	18	17	0.40	0.9	-0.47
Shire	SHP.L	15613	9	33	25	8	-0.92	0.6	-1.48
ARM Holdings	ARM.L	14337	26	22	12	10	-2.03	-0.8	-1.24
Safran	SAF.PA	12777	14	19	18	1	0.50	0.9	-0.37
Kone B	KNEBV.HE	11863	7	38	18	20	-0.92	0.9	-1.79
Continental	CONG.DE	11428	6	26	12	14	0.96	1.6	-0.68
Telenor	TEL.OL	11302	2	19	14	5	1.07	2.1	-1.03
Reed Elsevier	REL.L	11086	7	52	19	33	1.48	1.7	-0.19
Assa Abloy B	ASSAb.ST	10702	1	19	7	12	1.00	2.3	-1.29
Ryanair Holdings	RYA.I	9558	13	19	13	6	-0.29	1.3	-1.56
BSKyB	BSY.L	9497	4	100	19	81	0.78	1.7	-0.89
Reed Elsevier (Ams)	ELSN.AS	9326	3	52	19	33	1.48	1.7	-0.19
Next	NXT.L	9213	8	179	13	165	0.52	1.0	-0.50
Burberry Group	BRBY.L	7890	11	33	22	11	-0.66	0.6	-1.22
SKF B	SKFb.ST	7498	2	20	18	1	0.74	0.9	-0.13
Geberit R	GEBN.VX	7149	2	29	7	22	-0.95	2.3	-3.24
ITV	ITV.L	7023	17	47	19	28	0.09	1.7	-1.57
Whitbread	WTB.L	6430	7	22	13	8	0.87	1.3	-0.40
GKN	GKN.L	6390	13	27	12	15	0.87	1.6	-0.78
Dassault Systemes	DAST.PA	6306	4	19	12	7	-1.85	-0.8	-1.05
Smiths Group	SMIN.L	5896	1	36	18	18	0.86	0.9	-0.01
IMI	IMI.L	5379	8	42	18	24	0.25	0.9	-0.62

Source: Datastream & Citi Research

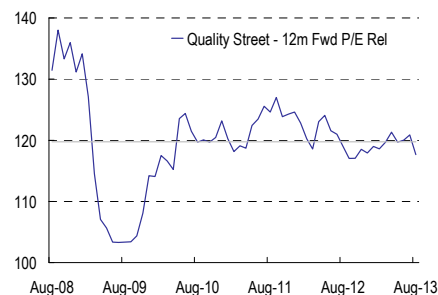
Figure 59 refreshes our Quality Street screen. We look for companies with the following characteristics: 1) positive absolute earnings over past 6m, 2) higher than 15% RoE, 3) higher than sector RoE, 4) stronger than sector balance sheet.

Figure 60. Quality Street — P & E Rel



Source: Datastream & Citi Research

Figure 61. Quality Street — P/E Rel



Source: Datastream & Citi Research

Figure 60 and Figure 61 show the price and earnings relative and the P/E relative of this group. Earnings momentum has been strong over the past 5 years. In fact, it has been stronger than that of Defensive Growth, although there is a fair amount of overlap between the two approaches. Quality Street trades on less than a 20% P/E premium to the market and so is also cheaper than Defensive Growth. We think this theme will remain a happy hunting ground for investors in an earnings momentum rewarding market.

Figure 62. QARP — E10bn+ Market Cap, Ranked by Current 12m Forward P/E vs 5-Year Range

Stock	RIC	Mkt Cap, €m	>E10bn	>6	>14	<1.5x	PE (Now)	Min	Max	Percentile (Abs)	Percentile (Rel)
Sandvik	SAND.ST	11232		6.20	22.19	1.23	13.5	6.4	65.4	0.1	0.03
Michelin	MICP.PA	13175		6.40	18.07	0.38	9.0	5.8	18.9	0.2	0.10
Continental	CONG.DE	11428		6.52	28.20	0.96	10.5	4.4	26.9	0.3	0.22
ABB	ABBN.VX	37597		6.16	18.39	0.21	14.1	6.3	20.0	0.6	0.28
BAE Systems	BAES.L	16648		7.00	33.23	0.40	10.6	6.1	12.2	0.7	0.36
Reckitt Benck	RB.L	33744		6.25	33.11	0.45	16.6	12.8	17.9	0.8	0.12
BAT	BATS.L	73335		7.33	60.01	1.43	14.7	10.5	15.7	0.8	0.27
Roche	ROG.VX	132632		6.22	86.55	0.27	15.3	9.0	15.9	0.9	0.33
Novartis R	NOVN.VX	149347		7.05	19.30	0.37	14.0	8.8	14.3	0.9	0.35
Reed Elsevier	REL.L	11086		8.83	59.10	1.48	14.4	9.2	14.7	0.9	0.41
WPP	WPP.L	17793		6.28	14.83	1.12	13.7	6.6	14.0	0.9	0.73
Ahold Kon.	AHLN.AS	11606		7.32	16.07	-0.08	13.2	8.7	13.3	1.0	0.28
BT Group	BT.L	31116		7.32	1,448.66	1.19	12.4	4.9	12.5	1.0	0.91
Centrica	CNA.L	23571		8.35	24.72	1.36	13.4	9.9	13.5	1.0	0.29
AstraZeneca	AZN.L	46583		10.83	29.44	-0.16	10.1	6.2	10.1	1.0	0.40
Deutsche Bo.	DB1Gn.DE	10239		6.31	20.31	0.17	13.6	8.1	13.6	1.0	0.48

Source: Datastream & Citi Research

Figure 62 runs one of our other quality strategies — Quality At a Reasonable Price (QARP). This looks for high RoE, strong balance sheet and high FCF yields.

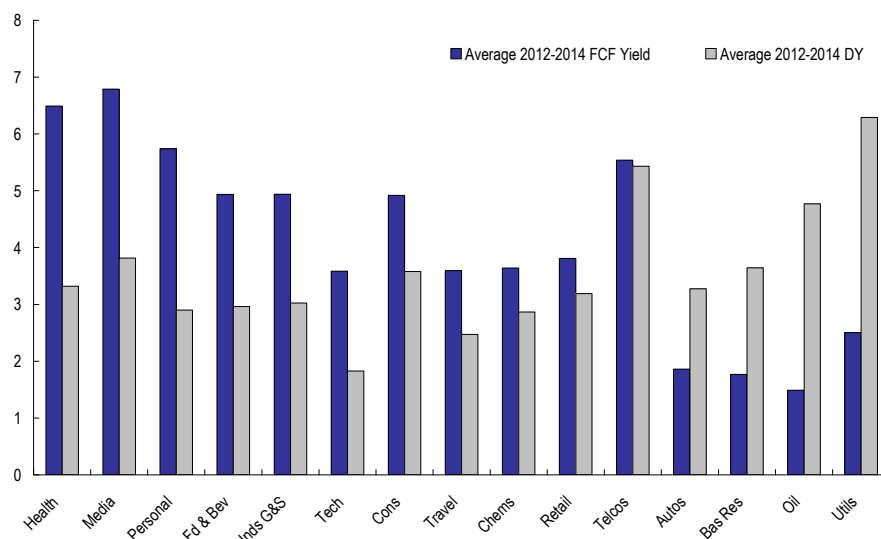
Surplus Cash & Income Growth

Quality and Defensive Growth have been successful performance strategies over the past few years. Recovery and value has become more competitive more recently. However, none of these have had the success of income in terms of raising capital for fund managers over the past 5 years. Income has been an important performance strategy within the market too during this time, providing investors have looked for income rather than have tried to maximise DY opportunities. The latter strategy would have resulted in lots of value traps.

In a low growth world, we think that, like quality, companies offering sustainable and growing income to investors will remain attractive. This is partly why [buyback strategies are being so successful](#).

Figure 63 shows one of our favourite starting places for seeking income opportunities. We look for FCY-DY gaps. Healthcare and Media have the most 'surplus' FCF on this basis. Utilities and Oil & Gas have the least.

Figure 63. Sector — FCF Yield – Dividend Yield (Average 2012-2014E)

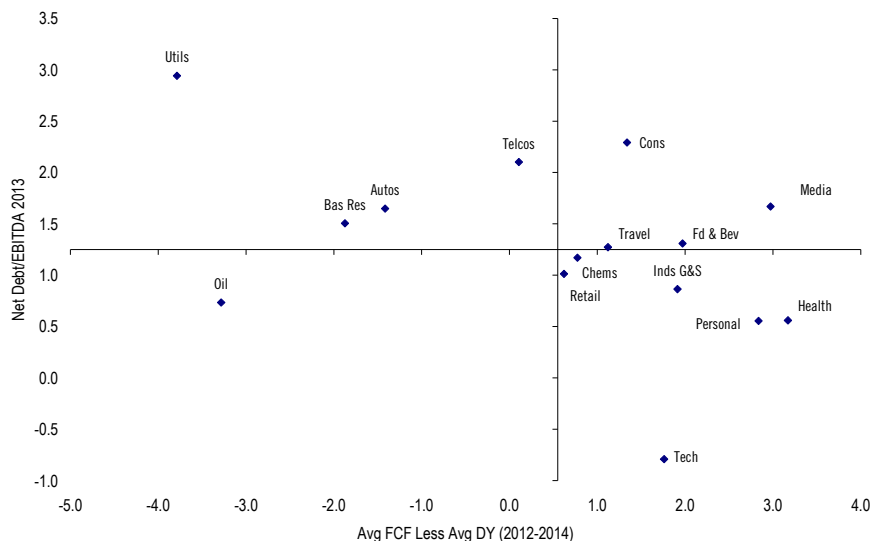


Source: Datastream & Citi Research

This shows the capital return flexibility and opportunity for the former and the challenges facing the latter two sectors. We are Overweight Health Care and Media. Companies in sectors towards the right hand side of this chart need to find ways of paying their dividends. Unless existing capex is to deliver strong growth in the next few years then it is likely that FCF will have to be supported by reduced or more effective investment plans. This is what has started to happen in some Mining companies. This is the challenge for Oil and Utility companies.

Figure 64 adds a further dimension by comparing the FCFY-DY gap and balance sheets. Technology, Health Care and Personal & Household Goods have the most attractive mix of high and positive surplus FCF and strongest balance sheets. Utilities looks least attractive on both. Figure 65 shows those large-cap stocks which also have a large FCF gap and strong balance sheets. This is an attractive combination and should also bring significant optionality to CEOs in terms of capital returns. Figure 66 shows the sub-€10bn market stocks which fit the bill.

Figure 64. Sector — FCF-Dividend Gap vs Balance Sheet



Source: Datastream & Citi Research

Figure 65. Big-Caps: FCF Surplus & Strong Balance Sheets

Stock	RIC	>E5bn Market Cap, €m	DY 2012	DY 2013	DY 2014	FCF 12	FCF 13	FCF 14	>150 Avg FCF Yield Less Average DY (BPS)	<1x ND/EBITDA 2013
Novartis R	NOVN.VX	149347	3.46	3.46	3.54	6.49	6.88	7.77	356	0.37
Roche	ROG.VX	132632	3.23	3.51	4.03	5.89	6.01	6.75	263	0.27
Sanofi	SASY.PA	87599	3.81	3.81	4.46	7.91	9	8.49	444	0.39
Bayer	BAYGn.DE	69497	2.26	2.41	2.77	2.6	6.16	4.85	206	0.72
Siemens	SIEGn.DE	66622	3.81	4.03	4.43	3.96	5.13	8.05	162	0.74
SAP	SAPG.DE	53029	1.52	1.7	1.88	4.67	4.11	5.62	310	-0.01
Novo Nordisk B	NOVOB.CO	51743	1.91	2.26	2.59	3.58	4.73	5.37	231	-0.43
AstraZeneca	AZN.L	46583	5.84	5.7	5.68	10.63	12.52	9.33	509	-0.16
Unilever Certs.	UNc.AS	44715	3.42	3.68	3.92	6.02	5.93	5.99	231	0.62
ABB	ABBN.VX	37597	3.43	3.69	3.92	5.21	6.16	7.11	248	0.21
Richemont	CFR.VX	37533	1.01	1.15	1.28	3.34	4.26	5.24	313	-1.29
Unilever (UK)	ULVR.L	37025	3.37	3.62	3.87	5.93	5.84	5.91	227	0.62
LVMH	LVMH.PA	35421	2.19	2.41	2.72	3.72	4.91	5.85	239	0.74
Reckitt Benckiser Group	RB.L	33744	3.21	3.1	3.26	5.6	6.49	6.67	306	0.45
Schneider Electric	SCHN.PA	32159	3.23	3.37	3.63	6.57	6.03	6.73	303	0.83
L'Oreal	OREP.PA	30095	1.82	2.02	2.22	3.42	3.71	4.11	172	-0.62
Ericsson B	ERICb.ST	27084	3.23	3.58	3.53	5.95	8.29	4.23	271	-1.28
ASML Hldg	ASML.AS	23563	0.8	0.92	1.06	1.88	2.09	5.8	233	-1.29
Philips Electronics	PHG.AS	21268	3.21	3.21	3.21	8.03	8.69	9.05	538	0.15
Compass Group	CPG.L	18301	2.63	2.87	3.16	4.28	4.35	4.99	166	0.84
Essilor Intl.	ESSI.PA	17399	1.08	1.15	1.28	3.14	2.61	4.85	237	0.09
BAE Systems	BAES.L	16648	4.71	4.61	4.75	18.02	-2.45	5.42	231	0.4
Shire	SHP.L	15613	0.16	0.46	0.71	5.78	4.99	6.91	545	-0.92
Swatch B	UHR.VX	13445	1.28	1.42	1.59	1.84	4.27	4.24	202	-0.68
Atlas Copco A	ATCOa.ST	13192	3.09	3.4	3.63	5.02	5.6	5.77	209	0.09
Michelin	MICP.PA	13175	3.32	3.16	4.11	7.68	3.78	7.73	287	0.38
Henkel Pref.	HNKG_p.DE	13059	1.3	1.42	1.54	16.36	13.39	14.86	1345	0.54
Kering	PRT.PA	12806	2.19	2.37	2.75	3.46	3.55	4.98	156	0.88
Kone B	KNEBV.HE	11863	2.83	2.99	3.07	4.97	3.84	4.68	153	-0.92
Ahold Kon.	AHLN.AS	11606	3.65	3.78	3.91	7.35	6.78	7.83	354	-0.08
Continental	CONG.DE	11428	1.97	2.63	3.2	7.46	4.04	8.05	392	0.96

Source: Datastream & Citi Research

Figure 66. Mid-Caps: FCF Surplus & Strong Balance Sheets

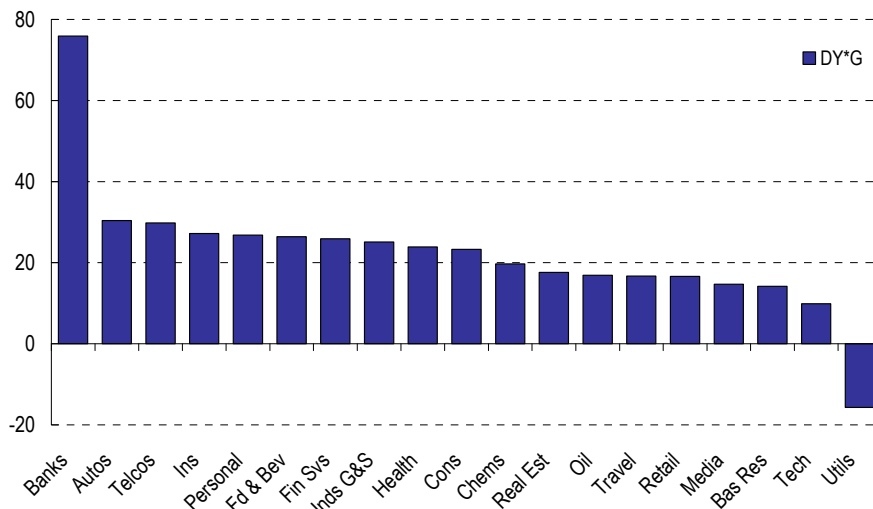
Stock	RIC	Market Cap, €m	>E5bn			FCF 12	FCF 13	FCF 14	Avg FCF Yield Less Average	>150 ND/EBITDA 2013 (BPS)	<1x
			DY 2012	DY 2013	DY 2014						
Ryanair Holdings	RYA.I	9558	0.00	0.00	0.00	7.95	8.06	8.17		806	-0.29
BSKyB	BSY.L	9497	3.38	3.63	3.81	7.59	7.15	6.65		353	0.78
Legrand	LEGD.PA	9496	2.61	2.87	2.87	6.33	6.08	6.53		354	0.92
Next	NXT.L	9213	2.22	2.37	2.63	6.56	6.82	7.19		445	0.52
Burberry Group	BRBY.L	7890	1.89	2.11	2.35	5.17	5.53	7.03		380	-0.66
Smith & Nephew	SN.L	7869	2.31	2.22	2.41	7.66	4.56	4.15		315	0.29
Merck KGAA	MRCG.DE	7428	1.48	1.59	1.72	8.58	7.44	8.25		649	0.21
ITV	ITV.L	7023	1.66	2.54	2.72	5.19	4.53	5.26		269	0.09
Adecco R	ADEN.VX	6845	3.15	3.30	3.47	5.05	6.68	6.74		285	0.74
Cap Gemini	CAPP.PA	6635	2.41	2.65	2.90	7.73	1.64	6.03		248	-0.49
Sodexo	EXHO.PA	6545	2.46	2.71	2.98	6.41	5.79	7.40		382	0.89
Beiersdorf	BEIG.DE	6498	1.07	1.22	1.43	2.11	2.81	4.08		176	-2.79
GKN	GKN.L	6390	2.31	2.52	2.90	1.76	5.45	6.74		207	0.87
Dassault Systemes	DAST.PA	6306	0.83	0.93	1.03	4.31	3.70	3.95		305	-1.85
Luxottica	LUX.MI	6264	1.24	1.47	1.52	3.27	3.38	3.87		210	0.94
Smiths Group	SMIN.L	5896	2.95	3.07	3.19	5.70	6.29	6.93		324	0.86
Actelion	ATLN.VX	5868	1.61	1.74	1.83	7.35	0.92	6.06		305	-1.59
Yara International	YAR.OL	5430	5.81	5.59	5.37	15.42	9.78	10.56		633	0.27
GEA Group	G1AG.DE	5403	1.80	2.12	2.30	5.82	1.93	3.51		169	0.42
IMI	IMI.L	5379	2.38	2.45	2.61	3.68	4.92	5.67		228	0.25
Kuehne+Nagel Intl.	KNIN.VX	5289	3.08	3.36	3.85	2.79	5.16	10.81		282	-1.17
Alfa Laval	ALFA.ST	5102	2.46	2.66	2.79	4.78	6.35	6.31		318	0.25

Source: Datastream & Citi Research

The search for income growth

In addition to surplus FCF, we suggest that investors also seek balance between income and income growth. We do this in our DY*G approach, which is the product of the current DY and the 2-year dividend CAGR.

Figure 67. 2013E DY * 2013-15E Dividend CAGR



Source: Datastream & Citi Research

Figure 67 shows that Banks is the stand-out in Europe. This means that income investors can no longer ignore European banks. The sector has already repaired its dividend and now yields a market yield. But, our analysts expect c20% compound dividend growth over the next 2-years as capital repair across the sector leads to

enhanced capital returns. Keen regulators will probably limit distribution to a certain extent through tougher capital requirements. Nonetheless, **surplus capital is fast becoming a nice problem for an increasing number of banks in Europe.**

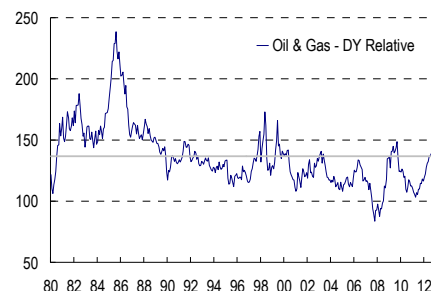
Figure 68. CDS Adjusted DY*G

Stock	RIC	Low	>3%	CDS Adj Div Score	>4%	Avg 2012-2014E FCF Less Avg 2012-2014E DY	DY*G	>0.3 DY*G/CDS
		CDS	2014 DY		2yr Ann. Div Growth			
Nordea Bank	NDA1V.HE	68	7.37	10.85	26.67	Fin	135	1.99
Credit Suisse R	CSGN.VX	95	4.85	5.11	53.00	Fin	149	1.57
Telenor	TEL.OL	40	6.13	15.52	11.31	0.1	59	1.50
Anheuser-Busch Inbev	ABI.BR	53	4.00	7.55	22.15	3.4	65	1.23
Sanofi	SASY.PA	44	4.46	10.13	13.08	4.4	50	1.13
Roche	ROG.VX	39	4.03	10.47	12.61	2.6	43	1.12
BT Group	BT.L	67	3.72	5.52	23.50	4.0	74	1.10
Volkswagen Pref.	VOWG.DE	73	3.38	4.62	31.51	5.3	77	1.06
Siemens	SIEGn.DE	52	4.43	8.58	13.69	1.6	54	1.05
Unilever Certs.	UNc.AS	31	3.92	12.72	7.65	2.3	27	0.89
British American Tobacco	BATS.L	48	4.77	9.88	7.30	2.8	32	0.67
Michelin	MICP.PA	89	4.11	4.62	16.71	2.9	54	0.60
Nestle R	NESN.VX	29	3.69	12.50	5.00	0.9	17	0.59
Compass Group	CPG.L	50	3.16	6.36	10.22	1.7	29	0.57
Imperial Tobacco Gp.	IMT.L	84	6.01	7.17	7.90	2.5	43	0.52
GlaxoSmithKline	GSK.L	49	5.05	10.41	5.14	0.4	24	0.50
Reed Elsevier	RELL	58	3.47	6.04	7.95	5.6	25	0.43
Svenska Handbkn	SHBa.ST	63	4.31	6.85	6.52	Fin	26	0.42
Unibail-Rodamco	UNBP.AS	96	5.59	5.81	7.71	Fin	39	0.41
SEB A	SEBa.ST	95	5.14	5.41	8.40	Fin	39	0.41
Centrica	CNA.L	60	4.77	8.02	5.15	3.8	23	0.39
Allianz	ALVG.DE	70	4.69	6.73	5.14	Fin	23	0.33
Atlas Copco A	ATCOa.ST	60	3.63	6.10	5.48	2.1	18	0.30
Muenchener Rueckver	MUVGn.DE	63	5.44	8.69	3.43	Fin	18	0.28

Source: Bloomberg, Datastream & Citi Research

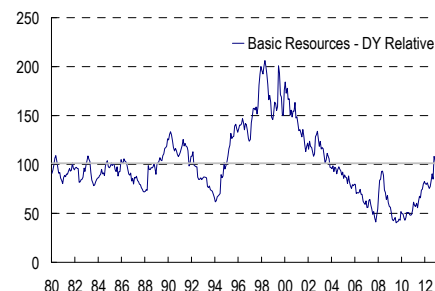
Figure 68 shows attractive DY*G stocks with an additional CDS hurdle. This shows the best risk- and growth-adjusted income stocks in Europe. There are plenty of Financial stocks here despite Banks and Insurers generally running with higher CDS than non-financials. This is reasonably representative of our barbell strategy.

Figure 69. Oil — Trailing DY



Source: Datastream

Figure 70. Basic Resources — Trailing DY



Source: Datastream

Commodity sectors tend not to show well on surplus FCF or DY*G. Indeed, it has been right for income and generalist PMs to stay clear of this part of the market for much of the last 2-3 years. We are now Neutral on both sectors but continue to watch the moves in their respective DY relative to the market. There appears to be value emerging in both sectors. With commodity prices unlikely to come to CEOs'

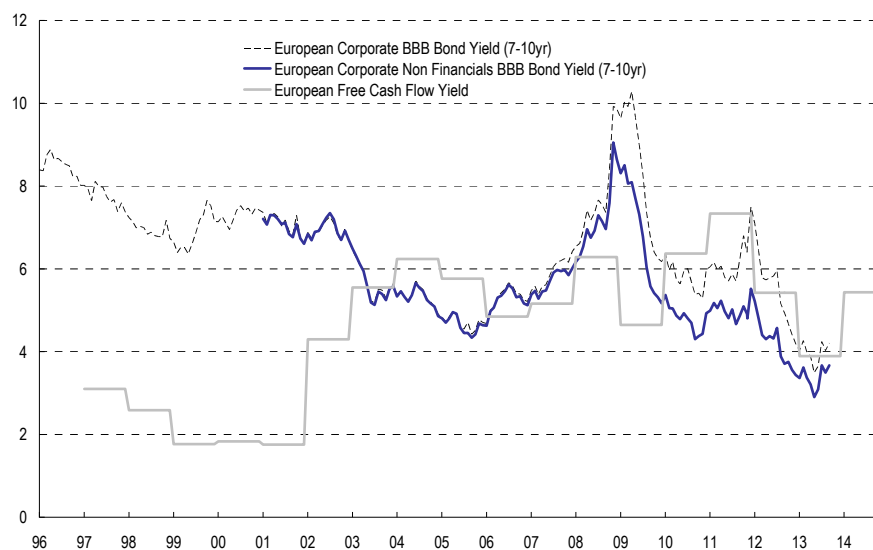
rescues, ie no super cycle return, the onus is with CEOs themselves to run strategies that enhance FCF, profitability and returns, and enable the companies to pay and hopefully grow their dividends. Until that happens, and perhaps it is [closer in Miners than in Oils](#), we would prefer to take income and market exposure in similarly cheap Financials. They offer growth supported by self help and restructuring.

Animal Spirits & Re-structuring

We have argued for a pick-up in investor and corporate animal spirits over the last 12-18 months. We think there are increasing signs that this is happening.

For companies, we think that the financial and economic logic of corporate action is compelling. As we said in our February report on [Animal Spirits](#), “CEOs have been cautious since 2008-09. Debt pay-down, dividends & buybacks ahead of capex and M&A. Now, conditions are in place for a pick-up in corporate activity. More broadly, we expect corporate re-leveraging to pick-up. This remains a key part of our re-rating call for equities. Overall, we think we are at the start, not the end, of an M&A and re-leveraging cycle. We note with interest events in the US at Dell and Heinz in recent weeks. Deal size suggests this could get interesting.” Recent activity involving Vodafone and Verizon does nothing to change our view.

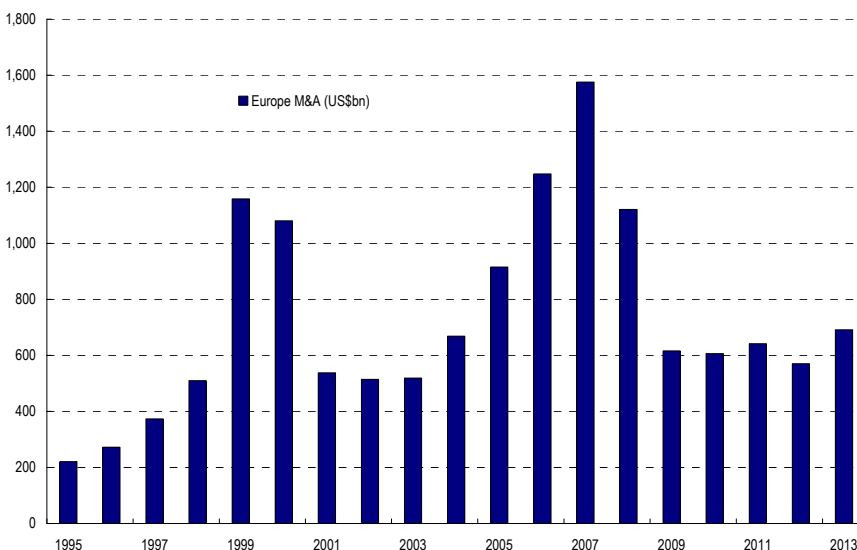
Figure 71. European FCF Yield vs European Corporate Bond Yield



Source: Datastream & Citi Research

The financial logic for a pick-up in corporate activity comes from the arbitrage between the cost of debt and equity funding. It makes plenty of sense for companies to use cash or cheap debt funding to buy equity, either their own or someone else's.

Figure 72. European M&A



Source: Dealogic.
Note: 2013 number is annualised

There has not yet been a meaningful pick-up in corporate actions. We are early cycle in this respect. But, on an annualised basis (and not including anything for the Vodafone/Verizon deal), this year is seeing the first pick-up in five years.

Figure 73. Capital Structure Arbitrage Screen (Smaller Caps)

Adecco R	ADEN.VX	Easyjet	EZJ.L	Next	NXT.L	Thales	TCFP.PA
Aggreko	AGGK.L	Edenred	EDEN.PA	OMV	OMVV.VI	TNT	TNTE.AS
Alfa Laval	ALFA.ST	Electrolux B	ELUXb.ST	Ryanair	RYA.I	Tui Travel	TT.L
AMEC	AMEC.L	Givaudan N	GIVN.VX	Sage Group	SGE.L	Umicore	UMI.BR
Andritz	ANDR.VI	GKN	GKN.L	Smiths Gp	SMIN.L	Utd Int	UTDI.DE
Atos	ATOS.PA	IMI	IMI.L	Sodexo	EXHO.PA	Valeo	VLOF.PA
Berkeley	BKGH.L	ITV	ITV.L	Spectris	SXS.L	Yara	YAR.OL
BSKyB	BSY.L	Kuehne+Nl.	KNIN.VX	Spirax-Sarco	SPX.L		
Burberry	BRBY.L	Lagardere	LAGA.PA	Sulzer R	SUN.VX		
Colruyt	COLR.BR	Legrand	LEGD.PA	Symrise	SY1G.DE		
Delhaize	DELB.BR	Merck KGAA	MRCG.DE	Tate & Lyle	TATE.L		

Source: Datastream & Citi Research

It is always hard to screen for M&A stocks, but we often run Figure 73, which looks at those mid-cap stocks that have high FCF yields and strong balance sheets. In theory, this is more of a capital arbitrage screen, but both attributes should also be attractive to predator companies.

European Sector & Country Strategy

We plug our macro, market and thematic views into our sector (SAM) and country (CAM) models to guide our allocations. We positively skew towards US and European exposure to catch improving macro conditions in DM. We negatively skew to EM given ongoing risks to growth forecasts. Elsewhere we balance earnings momentum and valuation, as well as looking for surplus cash and balance sheet strength. Last, we also account for rising US bond yield risks. Figure 74 shows the outcome.

Figure 74. SAM — Sector Attribution Model

	EM Exp	US Exp	EU Exp	Earn Mo	P/B	Abs P/E Rel to History	B/S	DY*G	FCF-DY	US BY	Overall Rank
Factor Weight	5%	10%	10%	15%	10%	5%	10%	10%	15%	10%	100%
Insurance	2	11	5	4	1	13	-	4	-	6	5.4
Automobiles & Parts	12	5	14	3	9	1	6	2	12	2	6.5
Travel & Leisure	6	4	6	2	19	5	9	14	8	12	7.3
Banks	11	14	8	12	6	2	-	1	-	5	7.3
Personal & Household Goods	16	12	15	5	17	3	3	5	3	15	7.4
Industrial Goods & Services	13	8	11	6	16	8	4	8	5	3	7.4
Media	5	2	7	7	13	17	12	16	2	13	7.5
Real Estate	1	19	1	8	7	7	-	12	-	11	7.5
Health Care	7	1	19	8	14	19	6	9	1	19	7.6
Construction & Materials	8	10	10	8	5	10	13	10	7	4	8.0
Technology	19	6	18	1	8	18	1	18	6	8	8.0
Financial Services	3	15	3	12	10	15	-	7	-	7	8.2
Oil & Gas	10	3	12	18	4	4	2	13	14	9	8.9
Retail	9	16	4	8	12	12	5	15	10	16	9.0
Food & Beverage	17	7	16	14	15	11	11	6	4	18	9.6
Utilities	4	17	2	15	2	6	14	19	15	14	10.4
Chemicals	14	9	13	16	18	9	9	11	9	10	10.9
Telecommunications	15	18	9	17	11	14	14	3	11	17	11.2
Basic Resources	18	13	17	19	3	16	6	17	13	1	12.1

Source: Citi Research

Our actual European sector strategy (Figure 75) is close to our model, with a couple of exceptions. Autos is top of SAM and Basic Resources in bottom. We are Neutral both sectors. We like Autos but have plenty of risk, value and beta exposure through Financials, which also have less direct EM exposure than Autos. We had been Overweight Basic Resources through the summer until we lowered to Neutral last week. We think the combination of valuation (DY) support and signs of behavioural change (reducing capex) should combine to make the sector competitive with the market.

Otherwise, we have a clear bias to earnings momentum and surplus FCF in our sector strategy. We prefer our recovery exposure through Financials (domestic) and Media, Travel & Leisure & Tech (US).

Figure 75. European Sector Strategy

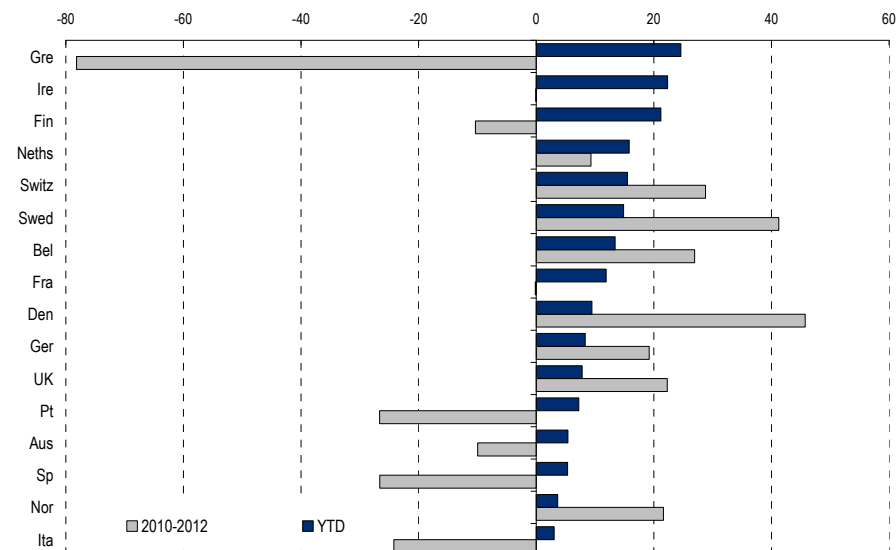
Overweight	Neutral	Underweight
Banks	Autos	Chemicals
Financial Services	Basic Resources	Construction
Healthcare	Food & Bev	Industrial G&S
Insurance	Oil & Gas	Real Estate
Media		Retail
Personal & Household Goods		Telecoms
Technology		Utilities
Travel & Leisure		

Source: Citi Research

Country strategy

We have downplayed the importance of country strategy this year given reduced macro risks across Europe, but retained a preference for the GUNS (Germany, UK, Netherlands, Scandi & Switzerland).

Figure 76. Country Performance 2010-12 & YTD



Source: Datastream

Figure 76 shows country performance for 2010-12 and YTD, ranked by YTD. A GUNS (Germany, UK, Netherlands, Scandinavia & Switzerland) strategy has worked reasonably well. But, it is also interesting to see Greece and Ireland leading the performance charge. It helps that the Financial weighting in both countries has pretty much disappeared. But, it also suggests that the equity market agrees that the worst of the European crisis is over.

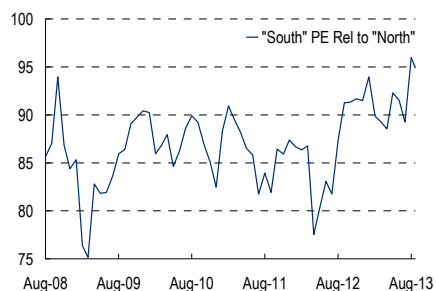
Figure 77. CAM — Country Attribution Model

	EM Exp	US Exp	EU Ex	Earn Mo	P/B	Abs P/E Rel to 5yr History	DYG	CDS Adj DY	Corporate B/S	Spread Vs Bunds	Macro	Overall Rank
	5%	10%	10%	10%	15%	10%	5%	5%	10%	5%	15%	100%
Norway	3	13	2	14	10	5	2	1	3	11	1	6.2
Germany	6	8	8	4	9	4	13	4	9	2	4	6.5
Ireland	2	3	6	1	6	1	15	15	11	12	10	6.8
Switz	5	2	16	4	14	12	7	6	1	1	2	6.9
Finland	13	11	4	3	3	9	16	2	4	4	14	7.4
Sweden	10	7	11	8	13	6	8	3	1	8	5	7.5
Denmark	14	9	10	2	16	2	5	8	7	3	5	7.7
Austria	16	14	12	10	2	13	3	5	4	6	7	8.2
France	7	10	5	6	7	11	6	10	10	7	12	8.6
Netherland	9	4	13	8	11	15	12	9	7	5	3	8.6
Italy	4	6	7	12	1	10	9	13	14	13	13	9.0
UK	11	5	14	11	12	8	11	7	4	10	8	9.2
Greece	1	16	1	14	8	3	1	16	12	16	16	9.9
Belgium	8	1	15	7	15	14	4	11	13	9	8	10.1
Portugal	12	15	3	16	4	7	14	14	16	15	15	11.3
Spain	15	12	9	12	5	16	10	12	15	14	11	11.4

Source: Citi Research

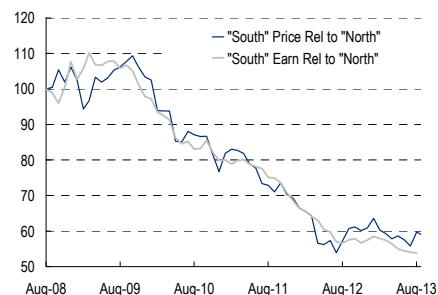
Figure 77 shows our country model, which follows the tilts of our sector model but has an additional macro skew. It still generally backs the GUNS countries. Ireland is also in the top 3 countries for the first time in a very long time. The spread of scores between top and bottom countries is also relatively small. We would prefer to focus on themes, stocks and sectors in that order ahead of country skews.

Figure 78. South vs North — P/E



Source: Datastream & Citi Research

Figure 79. South vs North — P & E Rel



Source: Datastream & Citi Research

Figure 78 and Figure 79 show the price and earnings relative and P/E relative of the North vs South in Europe. Similar to our analysis of value and cheap earlier in this report, the South does not actually look that cheap on a P/E basis. It actually trades at 5-year highs relative to the North. There has been strong correlation between price and earnings trends in the last 5 years at a country level. There are signs that the earnings underperformance of the South is nearing an end. But, it is difficult for us to see a move to strong earnings leadership without strong domestic recoveries. We think that is unlikely so continue to resist any call to make a big call on peripheral equity markets. We would prefer to take risk through Financials.

Strategy outlook

European macro risks continue to reduce & economic prospects are improving. This should end earnings downgrades. European equities = fair value on P/E's & DYs, but cheap relative to other asset classes. Rising risk appetite from investors (flows) and corporates (deals) to drive further re-rating. This supports our 15-20% total return targets over the coming 12-18 months. We think investors should look for exposure to restructuring, recovery, Financials, surplus cashflow and de-equitisation.

This page is intentionally left blank

Valuation Tables

Figure 80. Pan-European Sector Weightings & Returns

As at Close 30 Aug 13 Sector (No of Stocks)	Mkt Cap (Euros m)	% of DJ Stoxx	Return Relative to DJ Stoxx				Absolute Return			
			1m	3m	12m	Ytd	1m	3m	12m	Ytd
Oil & Gas (32)	505,473	8.3	3	0	-14	-6	2	0	0	2
Chemicals (24)	304,153	5.0	0	-3	0	-4	-1	-4	18	5
Basic Resources (23)	214,123	3.5	6	1	-21	-23	6	0	-7	-16
Construction & Materials (21)	131,381	2.2	-1	-1	6	0	-2	-1	24	9
Industrial G&S (102)	660,552	10.8	0	1	5	2	0	0	23	11
Automobiles & Parts (14)	170,485	2.8	-2	4	14	9	-2	3	34	18
Food & Beverage (30)	524,281	8.6	-2	-2	-8	-3	-2	-3	8	5
Personal & H'hold Goods (30)	360,464	5.9	-2	-3	-3	1	-2	-4	14	10
Health Care (35)	705,886	11.6	0	-2	-2	5	-1	-2	15	15
Retail (26)	202,714	3.3	1	3	3	4	0	3	20	14
Media (27)	153,283	2.5	-1	8	11	9	-1	7	30	19
Travel & Leisure (21)	88,775	1.5	-3	1	8	5	-3	0	27	14
Telecommunications (23)	308,656	5.1	3	7	-8	6	3	6	9	16
Utilities (26)	242,656	4.0	-1	-1	-10	-6	-1	-2	6	3
Banks (47)	779,629	12.8	0	-1	17	1	0	-1	37	10
Insurance (35)	367,957	6.0	-3	0	16	4	-3	-1	37	13
Real Estate (29)	83,360	1.4	-4	-5	-9	-8	-4	-6	7	0
Financial Services (31)	94,005	1.5	0	1	14	9	-1	0	34	19
Technology (24)	195,960	3.2	1	2	7	3	1	1	25	12
Stoxx - Pan Europe (600)	6,093,792	100.0	—	—	—	—	-1	-1	17	9
Pan Euro - Large Cap	4,929,989	80.9	0	-1	-1	-1	-1	-1	16	8
Pan Euro - Mid Cap	808,736	13.3	1	3	5	4	1	2	24	13
Pan Euro - Small Cap	355,068	5.8	1	2	5	2	0	2	23	11
Stoxx ex UK - Europe ex UK (419)	4,056,620	66.6	—	—	—	—	-1	-1	21	10
EuroStoxx - Eurozone (298)	2,728,003	44.8	—	—	—	—	-1	0	22	9

Source: Citi Research & DataStream

Figure 81. Pan-European Sector Relative Ratings

As at Close 30 Aug 13 Sector	P/E Relative to DJ Stoxx				Yield Relative to DJ Stoxx			
	2012	2013E	2014E	2015E	2012	2013E	2014E	2015E
Oil & Gas	64	76	81	87	131	129	124	118
Chemicals	106	111	115	113	80	79	78	78
Basic Resources	90	105	95	88	106	98	95	94
Construction & Materials	105	112	106	101	98	97	96	95
Industrial Goods & Services	110	113	112	113	80	83	83	83
Automobiles & Parts	60	72	69	66	90	90	90	94
Food & Beverage	132	132	137	139	78	81	82	82
Personal & H'hold Goods	123	122	124	125	76	81	80	82
Health Care	103	109	111	113	92	91	91	90
Retail	116	121	125	128	90	86	84	83
Media	105	110	111	112	111	100	98	95
Travel & Leisure	145	136	116	109	72	65	64	67
Telecommunications	77	87	95	99	142	145	139	137
Utilities	74	83	98	103	186	170	153	139
Banks	136	90	81	76	99	107	122	132
Insurance	77	69	72	74	117	118	116	113
Real Estate	137	138	147	155	122	120	115	110
Financial Services	118	103	106	106	110	102	103	103
Technology	237	193	136	131	55	47	47	48
Stoxx - Pan Europe	100	100	100	100	100	100	100	100
Pan Euro - Large Cap	93	95	97	97	103	104	104	104
Pan Euro - Mid Cap	132	123	116	114	88	82	84	84
Pan Euro - Small Cap	192	132	118	110	85	83	83	84
Stoxx ex UK - Europe ex UK	106	103	101	99	98	99	99	99
Stoxx Eurozone - Eurozone	103	99	96	96	101	101	101	100

Source: Citi Research & DataStream

Figure 82. Pan-European Sector Growth

As at Close 30 Aug 13 Sector	Earnings Growth %			Net Dividend Growth %		
	2013E	2014E	2015E	2013E	2014E	2015E
Oil & Gas	-12.3	6.5	3.6	1.9	4.3	4.1
Chemicals	-0.5	8.6	13.3	2.8	7.3	8.8
Basic Resources	-11.2	25.3	19.9	-4.9	5.6	7.8
Construction & Materials	-2.4	19.4	16.0	3.0	7.3	8.0
Industrial Goods & Services	1.2	13.9	10.4	7.7	8.5	9.3
Automobiles & Parts	-14.2	18.1	16.0	4.1	8.6	13.7
Food & Beverage	4.3	9.1	9.7	7.2	10.0	9.0
Personal & H'hold Goods	5.4	10.9	10.6	9.6	8.2	12.0
Health Care	-2.2	10.9	9.6	3.3	8.7	8.2
Retail	0.0	9.5	8.8	-0.8	6.2	8.1
Media	-0.4	11.5	10.0	-7.1	6.9	6.0
Travel & Leisure	11.2	32.6	18.6	-6.5	8.0	13.5
Telecommunications	-7.2	3.2	6.8	5.7	4.4	7.6
Utilities	-7.1	-3.4	5.7	-5.1	-2.0	-1.4
Banks	58.4	24.9	18.4	11.9	24.6	18.5
Insurance	16.5	8.0	7.4	4.7	6.8	6.8
Real Estate	4.0	5.6	5.8	1.5	4.5	4.6
Financial Services	18.9	9.7	11.3	-3.3	9.6	8.6
Technology	28.1	60.8	15.6	-11.9	8.6	10.8
Sbxx - Pan Europe	4.2	13.0	11.2	3.6	8.9	9.1
Pan Euro - Large Cap	1.8	11.4	10.4	4.7	8.6	9.1
Pan Euro - Mid Cap	11.2	19.9	13.3	-3.3	11.2	9.1
Pan Euro - Small Cap	51.6	26.7	19.0	1.0	9.5	9.5
Sbxx ex UK - Europe ex UK	7.5	15.8	12.4	4.1	9.0	9.6
Sbxx Eurozone - Eurozone	7.9	16.2	12.2	3.5	8.0	8.9

Source: Citi Research & DataStream

Figure 83. Pan-European Sector Ratings

As at Close 30 Aug 13 Sector	Price/Earnings				Net Dividend Yield			
	2012	2013E	2014E	2015E	2012	2013E	2014E	2015E
Oil & Gas	9.1	10.4	9.7	9.4	4.62	4.71	4.91	5.11
Chemicals	15.0	15.1	13.9	12.3	2.82	2.90	3.11	3.38
Basic Resources	12.7	14.3	11.4	9.5	3.74	3.56	3.76	4.05
Construction & Materials	14.8	15.2	12.7	11.0	3.43	3.54	3.80	4.10
Industrial Goods & Services	15.5	15.4	13.5	12.2	2.82	3.04	3.30	3.60
Automobiles & Parts	8.4	9.8	8.3	7.2	3.16	3.29	3.58	4.07
Food & Beverage	18.8	18.0	16.5	15.0	2.76	2.96	3.26	3.55
Personal & H'hold Goods	17.5	16.6	15.0	13.5	2.68	2.94	3.18	3.56
Health Care	14.6	14.9	13.4	12.2	3.22	3.33	3.62	3.91
Retail	16.5	16.5	15.1	13.8	3.17	3.14	3.34	3.61
Media	14.9	14.9	13.4	12.2	3.92	3.64	3.89	4.13
Travel & Leisure	20.6	18.6	14.0	11.8	2.53	2.36	2.55	2.90
Telecommunications	10.9	11.8	11.4	10.7	4.99	5.28	5.51	5.93
Utilities	10.6	11.4	11.8	11.1	6.54	6.21	6.09	6.00
Banks	19.3	12.2	9.8	8.3	3.47	3.88	4.84	5.73
Insurance	10.9	9.4	8.7	8.1	4.11	4.30	4.60	4.91
Real Estate	19.5	18.7	17.7	16.8	4.30	4.37	4.56	4.77
Financial Services	16.7	14.0	12.8	11.5	3.86	3.73	4.09	4.44
Technology	33.7	26.3	16.4	14.2	1.94	1.71	1.86	2.06
Sbxx - Pan Europe	14.2	13.6	12.1	10.8	3.52	3.65	3.97	4.33
Pan Euro - Large Cap	13.2	13.0	11.7	10.6	3.62	3.79	4.12	4.49
Pan Euro - Mid Cap	18.7	16.8	14.0	12.4	3.11	3.01	3.34	3.65
Pan Euro - Small Cap	27.2	18.0	14.2	11.9	3.00	3.03	3.31	3.63
Sbxx ex UK - Europe ex UK	15.1	14.0	12.1	10.8	3.46	3.60	3.92	4.30
Sbxx Eurozone - Eurozone	14.6	13.5	11.6	10.4	3.57	3.70	3.99	4.35

Source: Citi Research & DataStream

Figure 84. 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	26,367	0.4	4	3	10	-4	4	4	29	6
Belgium	95,564	1.6	-2	1	0	2	-2	2	17	13
Denmark	115,872	1.9	-1	1	-6	-1	-1	2	11	10
Finland	83,319	1.4	9	9	17	10	9	11	37	22
France	913,075	15.0	-1	0	3	1	-2	2	21	12
Germany	787,959	13.0	-2	-2	2	-2	-2	-1	20	9
Greece	7,233	0.1	5	15	22	13	5	17	43	25
Ireland	47,220	0.8	2	7	9	10	2	8	28	22
Italy	212,491	3.5	0	-3	-7	-8	0	-2	9	2
Netherlands	251,148	4.1	0	4	5	5	0	5	23	16
Norway	83,918	1.4	1	-2	-12	-6	1	-1	3	4
Portugal	17,632	0.3	3	-2	1	-3	2	0	19	7
Spain	269,098	4.4	-1	1	0	-4	-1	2	17	6
Sweden	291,583	4.8	1	0	5	4	0	2	23	15
Switzerland	837,244	13.8	-1	-1	6	5	-1	1	24	16
UK	2,037,172	33.5	1	0	-5	-2	1	1	11	9
Stoxx - Pan Europe	6,076,896	100								

Source: Citi Research & DataStream

Figure 85. Pan-European Country Relative Ratings

Country	Price/Earnings				Net Dividend Yield			
	2012	2013E	2014E	2015E	2012	2013E	2014E	2015E
Austria	95	108	82	83	75	82	89	92
Belgium	119	116	122	120	98	92	102	101
Denmark	135	125	119	113	52	60	68	71
Finland	156	132	121	121	142	109	104	98
France	111	98	94	94	99	102	104	105
Germany	79	88	90	90	95	89	86	90
Greece	44	94	110	93	105	22	76	135
Ireland	150	163	139	130	44	45	44	42
Italy	106	104	95	92	104	103	101	105
Netherlands	111	108	102	101	73	70	73	71
Norway	82	86	85	87	135	131	133	137
Portugal	1377	195	102	83	135	100	104	106
Spain	124	101	105	104	150	176	166	153
Sweden	105	119	116	116	105	109	108	109
Switzerland	120	111	111	108	88	89	91	93
UK	90	95	99	101	103	103	102	101
EuroStoxx - Eurozone	103	99	96	96	101	101	101	100
Stoxx ex UK - Europe ex UK	106	103	101	99	98	99	99	99
Stoxx - Pan Europe	100	100	100	100	100	100	100	100

Source: Citi Research & DataStream

Figure 86. Pan-European Country Growth

As at Close 30 Aug 13		Earnings Growth %			Dividend Growth %		
Country	2013E	2014E	2015E	2013E	2014E	2015E	
Austria	-8.4	48.5	9.7	13.5	17.5	13.3	
Belgium	7.0	8.1	12.5	-2.4	20.0	8.2	
Denmark	13.0	18.9	16.5	19.6	23.3	13.7	
Finland	23.3	23.6	11.1	-20.4	3.9	2.9	
France	18.1	17.7	11.9	7.0	10.4	10.0	
Germany	-6.8	10.7	11.3	-2.5	5.1	13.2	
Greece	-50.8	-3.2	30.6	-78.3	276.2	95.0	
Ireland	-3.8	32.6	18.5	6.8	6.0	5.7	
Italy	5.8	24.2	14.2	2.5	7.2	12.9	
Netherlands	7.6	19.3	11.8	-0.5	14.0	5.6	
Norway	-1.1	14.9	8.7	0.5	10.5	12.1	
Portugal	634.6	117.2	36.4	-23.1	13.2	11.1	
Spain	27.9	8.4	12.3	21.0	3.1	0.2	
Sweden	-8.0	16.4	10.9	7.9	7.4	9.7	
Switzerland	12.3	13.5	13.3	4.1	11.8	11.2	
UK	-1.2	8.0	8.9	2.6	8.7	8.1	
EuroStoxx - Eurozone	7.9	16.2	12.2	3.5	8.0	8.9	
Stoxx ex UK - Europe ex UK	7.5	15.8	12.4	4.1	9.0	9.6	
Stoxx - Pan Europe	4.2	13.0	11.2	3.6	8.9	9.1	

Source: Citi Research & DataStream

Figure 87. Pan-European Country Ratings

As at Close 30 Aug 13		Price/Earnings				Net Dividend Yield			
Country	2012	2013E	2014E	2015E	2012	2013E	2014E	2015E	
Austria	13.4	14.7	9.9	9.0	2.64	2.99	3.52	3.98	
Belgium	17.0	15.8	14.7	13.0	3.45	3.37	4.04	4.37	
Denmark	19.2	17.0	14.3	12.3	1.84	2.20	2.72	3.09	
Finland	22.2	18.0	14.6	13.1	5.00	3.98	4.14	4.26	
France	15.8	13.4	11.4	10.2	3.49	3.74	4.12	4.54	
Germany	11.2	12.0	10.8	9.7	3.35	3.26	3.43	3.88	
Greece	6.3	12.8	13.2	10.1	3.69	0.80	3.01	5.86	
Ireland	21.3	22.1	16.7	14.1	1.53	1.64	1.74	1.83	
Italy	15.0	14.1	11.4	10.0	3.67	3.76	4.03	4.55	
Netherlands	15.8	14.6	12.3	11.0	2.56	2.55	2.91	3.07	
Norway	11.6	11.7	10.2	9.4	4.76	4.78	5.29	5.93	
Portugal	195.4	26.6	12.2	9.0	4.74	3.64	4.13	4.59	
Spain	17.6	13.8	12.7	11.3	5.29	6.40	6.60	6.61	
Sweden	14.9	16.2	13.9	12.6	3.69	3.99	4.28	4.70	
Switzerland	17.0	15.1	13.3	11.8	3.11	3.23	3.61	4.02	
UK	12.7	12.9	11.9	11.0	3.64	3.74	4.06	4.39	
EuroStoxx - Eurozone	14.6	13.5	11.6	10.4	3.57	3.70	3.99	4.35	
Stoxx ex UK - Europe ex UK	15.1	14.0	12.1	10.8	3.46	3.60	3.92	4.30	
Stoxx - Pan Europe	14.2	13.6	12.1	10.8	3.52	3.65	3.97	4.33	

Source: Citi Research & DataStream

Figure 88. UK Sector Weightings & Relative Returns

As at Close 30 Aug 2013	Mkt	% of	% of	Relative return				
	Cap £m	AllShare	Group	1m	3m	12m	Qtd	Ytd
OIL & GAS (25)	292,520	14.9		0	-2	-16	-2	-7
Oil & Gas Producers (17)	280,612	14.3	96	0	-2	-16	-3	-6
Oil Equip, Serv and Distrib (7)	11,819	0.6	4	1	1	-15	4	-9
BASIC MATERIALS (36)	159,497	8.1		6	1	-16	9	-23
Chemicals (8)	14,497	0.7	9	4	6	-2	2	-1
Forestry & Paper (1)	3,652	0.2	2	5	16	55	17	35
Industrial Metals & Mining (4)	1,004	0.1	1	18	-9	-50	13	-55
Mining (23)	140,344	7.1	88	6	0	-18	9	-25
INDUSTRIALS (109)	194,683	9.9		1	2	10	1	8
Construction & Materials (11)	15,151	0.8	8	2	3	7	1	1
Aerospace (9)	46,501	2.4	24	-1	-1	16	0	15
General Industrials (6)	13,419	0.7	7	0	-1	9	-1	3
Electronic & Electrical Equip (13)	9,783	0.5	5	5	4	8	8	3
Industrial Engineering (12)	20,240	1.0	10	5	5	19	5	9
Industrial Transportation (7)	2,814	0.1	1	8	15	31	9	23
Support Services (51)	86,775	4.4	45	0	2	5	1	6
CONSUMER GOODS (37)	265,859	13.5		-2	-4	-3	-4	-1
Automobiles & Parts (1)	5,342	0.3	2	-3	11	32	5	30
Beverages (4)	80,571	4.1	30	0	0	-1	-1	-1
Food Producers (11)	42,905	2.2	16	-4	-6	0	-8	-3
Household Goods & Home Const (13)	44,594	2.3	17	-3	-4	17	-7	9
Leisure Goods (2)	465	0.0	0	4	20	94	3	41
Personal Goods (4)	8,760	0.4	3	3	10	4	11	12
Tobacco (2)	83,221	4.2	31	-3	-8	-16	-7	-8
HEALTH CARE (13)	146,446	7.4		0	-1	1	-1	9
Health Care Equip & Services (5)	7,906	0.4	5	-1	-1	-2	-2	-1
Pharmaceuticals & Biotech (8)	138,540	7.0	95	1	-1	1	-1	9
CONSUMER SERVICES (83)	208,775	10.6		0	6	13	3	10
Food & Drug Retailers (7)	45,544	2.3	22	2	3	-1	5	2
General Retailers (22)	39,052	2.0	19	1	9	26	6	17
Media (22)	59,688	3.0	29	0	9	13	3	11
Travel & Leisure (32)	64,491	3.3	31	-2	3	18	-1	11
TELECOMMUNICATIONS (8)	132,674	6.7		5	12	6	4	22
Fixed-Line Telecoms (6)	29,262	1.5	22	0	9	26	2	23
Mobile Telecoms (2)	103,411	5.3	78	7	12	1	5	22
UTILITIES (7)	75,858	3.9		-1	1	-2	0	0
Electricity (2)	17,782	0.9	23	3	8	5	4	5
Gas, Water & Multi-Utilities (5)	58,076	3.0	77	-2	-1	-4	-2	-1
TECHNOLOGY (23)	30,160	1.5		1	-4	10	1	2
Software & Computer Serv (14)	14,033	0.7	47	1	3	9	-1	7
Technology Hardware & Equip (9)	16,127	0.8	53	1	-9	11	3	-1
TOTAL NON-FINANCIAL (341)	1,506,471	76.6		1	1	-3	0	0
FINANCIALS (260)	460,616	23.4		-2	-2	12	-1	0
Banks (6)	228,617	11.6	50	-3	-3	15	-1	-2
Non-Life Insurance (11)	18,608	0.9	4	-3	-1	-4	-7	-4
Life Insurance (10)	74,858	3.8	16	-3	0	15	0	6
Real Estate Inv. Servs (22)	9,393	0.5	2	-2	4	21	2	17
REITS (16)	28,324	1.4	6	-4	-3	-4	-3	-5
Financial Services (26)	37,985	1.9	8	-2	-1	21	1	12
FTSE ALL SHARE (601)	1,967,088	100.0		0	0	0	0	0
FTSE 100 (100)	1,638,251	83.3		0	-1	-2	0	-1
Mid 250 (250)	279,255	14		1	3	11	2	6
Small Cap (251)	49,582	3		3	5	15	3	8

Source: Citi Research & DataStream

Figure 89. UK Relative Ratings

As at Close 30 Aug 2013	P/E Relative				Yield Relative			
	2012E	2013E	2014E	2015E	2012E	2013E	2014E	2015E
OIL & GAS	71	76	77	80	116	119	113	107
Oil & Gas Producers	70	75	76	80	118	121	114	108
Oil Equip, Serv and Distrib	108	97	91	90	74	79	84	85
BASIC MATERIALS	86	105	99	89	96	94	92	92
Chemicals	136	136	137	136	63	63	63	66
Forestry & Paper	134	114	107	113	66	75	79	75
Industrial Metals & Mining	-51	-69	-	-117	34	16	15	14
Mining	81	100	95	84	100	98	96	96
INDUSTRIALS	123	122	120	118	74	76	72	72
Construction & Materials	121	161	129	111	111	109	102	98
Aerospace	109	103	108	110	79	79	77	76
General Industrials	104	103	101	101	86	86	87	86
Electronic & Electrical Equip	135	133	132	131	57	58	57	58
Industrial Engineering	138	129	127	128	61	61	60	59
Industrial Transportation	130	121	115	114	84	83	80	77
Support Services	131	129	127	124	68	72	67	68
CONSUMER GOODS	129	123	122	121	87	91	90	93
Automobiles & Parts	95	91	86	83	63	68	72	77
Beverages	154	146	144	141	64	65	65	66
Food Producers	141	134	133	132	85	89	87	88
Household Goods & Home Const	134	125	120	118	67	84	80	89
Personal Goods	177	160	153	153	50	53	56	57
Tobacco	106	103	104	104	126	128	126	128
HEALTH CARE	91	102	108	112	119	118	113	109
Health Care Equip & Services	119	122	122	120	61	58	58	59
Pharmaceuticals & Biotech	90	101	107	112	123	122	116	112
CONSUMER SERVICES	119	117	115	115	84	81	78	77
Food & Drug Retailers	91	100	110	120	110	106	99	92
General Retailers	130	125	121	119	69	70	69	70
Media	119	117	115	113	79	84	81	81
Travel & Leisure	142	126	113	112	77	69	67	67
TELECOMMUNICATIONS	102	106	107	108	139	124	117	116
Fixed-Line Telecoms	103	104	99	94	88	92	96	123
Mobile Telecoms	102	106	110	112	153	133	122	113
UTILITIES	109	113	115	117	141	137	131	128
Electricity	102	113	113	111	145	134	128	128
Gas, Water & Multi-Utilities	111	113	116	118	140	138	132	128
TECHNOLOGY	196	183	173	165	37	37	40	42
Software & Computer Serv	145	145	142	139	53	55	56	57
Technology Hardware & Equip	283	236	214	199	22	22	26	29
TOTAL NON-FINANCIAL	99	104	104	104	101	100	97	95
FINANCIALS	102	87	87	87	97	98	113	119
Banks	99	80	79	78	85	92	118	127
Non-Life Insurance	83	78	82	84	170	140	135	143
Life Insurance	88	89	90	91	111	111	111	111
Real Estate Inv. Servs	212	209	205	206	50	53	52	52
REITS	178	182	184	187	105	103	98	94
Financial Services	125	90	97	95	107	97	101	103
FTSE ALL SHARE	100	100	100	100	100	100	100	100
FTSE 100	97	97	97	98	104	104	104	104
Mid 250	121	120	121	118	79	74	74	75
Small Cap	135	125	109	101	72	69	69	68

Source: Citi Research & DataStream

Figure 90. UK Sector Growth

As at Close 30 Aug 2013	Earnings Growth %			Net Dividend Growth %		
	2013E	2014E	2015E	2013E	2014E	2015E
OIL & GAS	-3.0	6.9	4.0	9.4	3.0	2.5
Oil & Gas Producers	-3.5	6.7	3.8	9.3	2.6	2.3
Oil Equip, Serv and Distrib	15.2	15.8	10.2	13.1	15.6	10.1
BASIC MATERIALS	-14.8	15.1	21.0	4.3	6.9	8.5
Chemicals	3.0	8.1	9.9	7.9	8.5	12.4
Forestry & Paper	21.7	15.0	3.1	20.5	15.0	3.1
Industrial Metals & Mining	-22.6	-	-	-48.7	-0.4	0.0
Mining	-16.5	15.2	21.9	3.9	6.6	8.3
INDUSTRIALS	4.8	10.2	10.5	8.5	3.8	7.8
Construction & Materials	-22.3	35.8	25.7	4.7	2.3	3.3
Aerospace	9.6	3.7	7.2	6.3	6.3	6.5
General Industrials	4.9	11.0	8.5	7.0	9.9	7.2
Electronic & Electrical Equip	5.4	9.4	9.3	8.5	8.0	8.8
Industrial Engineering	10.9	10.5	8.0	6.3	7.0	7.0
Industrial Transportation	11.4	14.0	9.5	5.9	4.0	4.5
Support Services	5.3	10.5	11.2	11.8	0.7	10.0
CONSUMER GOODS	8.6	9.4	10.1	12.0	7.4	11.4
Automobiles & Parts	7.8	15.1	12.0	15.0	15.0	15.0
Beverages	9.5	9.8	11.3	7.4	9.4	10.1
Food Producers	8.8	9.1	9.6	11.7	7.0	8.8
Household Goods & Home Cor	11.5	12.4	10.9	34.7	2.8	21.2
Personal Goods	14.5	13.7	9.2	14.4	13.6	10.8
Tobacco	6.4	7.2	8.9	7.8	7.6	9.6
HEALTH CARE	-8.1	3.1	4.6	5.3	4.3	4.1
Health Care Equip & Services	0.7	9.0	10.3	1.8	8.5	9.6
Pharmaceuticals & Biotech	-8.5	2.8	4.3	5.4	4.2	3.9
CONSUMER SERVICES	5.7	10.5	8.0	3.8	4.7	6.3
Food & Drug Retailers	-5.2	-1.8	0.3	1.7	1.6	1.0
General Retailers	7.4	11.8	10.5	7.0	8.2	8.8
Media	5.2	9.9	10.6	12.8	4.9	8.5
Travel & Leisure	17.1	21.1	9.9	-4.6	5.7	7.8
TELECOMMUNICATIONS	-0.1	7.1	8.5	-4.6	2.3	7.1
Fixed-Line Telecoms	2.5	14.5	14.3	11.6	13.7	38.6
Mobile Telecoms	-0.8	4.9	6.7	-7.3	0.1	0.1
UTILITIES	-0.1	6.2	7.5	3.0	4.5	5.3
Electricity	-6.4	8.0	10.9	-2.2	4.3	8.1
Gas, Water & Multi-Utilities	2.0	5.7	6.5	4.7	4.6	4.5
TECHNOLOGY	11.2	14.6	13.7	8.0	16.7	13.4
Software & Computer Serv	3.5	11.0	11.0	9.9	11.2	9.1
Technology Hardware & Equip	24.2	19.7	17.1	4.2	28.7	21.5
TOTAL NON-FINANCIAL	-1.1	8.6	8.8	5.9	4.6	6.5
FINANCIALS	21.6	8.4	8.7	8.4	25.2	13.5
Banks	28.9	9.8	9.4	16.0	39.2	16.7
Non-Life Insurance	10.5	3.3	5.9	-12.2	4.7	14.9
Life Insurance	1.4	8.3	6.7	6.1	9.1	8.0
Real Estate Inv. Servs	5.2	10.3	8.4	13.5	8.1	8.0
REITS	1.4	7.2	7.3	3.7	3.8	4.1
Financial Services	43.4	1.5	10.6	-4.2	14.2	9.4
FTSE ALL SHARE	3.6	8.6	8.8	6.4	8.9	8.1
FTSE 100	3.4	8.6	8.3	7.2	8.8	8.0
Mid 250	4.4	7.0	11.9	0.1	9.5	9.5
Small Cap	11.9	24.8	17.2	2.7	7.7	8.0

Source: Citi Research & DataStream

Figure 91. UK Sector Ratings

As at Close 30 Aug 2013	Price/Earnings				Net Dividend Yield			
	2012E	2013E	2014E	2015E	2012E	2013E	2014E	2015E
OIL & GAS	9.4	9.7	9.0	8.7	4.04	4.41	4.55	4.66
Oil & Gas Producers	9.2	9.6	9.0	8.6	4.10	4.48	4.60	4.70
Oil Equip, Serv and Distrib	14.3	12.4	10.7	9.7	2.57	2.91	3.36	3.70
BASIC MATERIALS	11.4	13.4	11.6	9.6	3.32	3.46	3.70	4.01
Chemicals	17.9	17.4	16.1	14.7	2.17	2.34	2.54	2.85
Forestry & Paper	17.7	14.5	12.6	12.3	2.28	2.75	3.16	3.26
Industrial Metals & Mining	-6.8	-8.8	-	-12.6	1.17	0.60	0.60	0.60
Mining	10.7	12.8	11.1	9.1	3.47	3.61	3.85	4.17
INDUSTRIALS	16.3	15.5	14.1	12.8	2.58	2.80	2.91	3.13
Construction & Materials	16.0	20.6	15.2	12.1	3.85	4.03	4.12	4.25
Aerospace	14.5	13.2	12.7	11.9	2.74	2.91	3.10	3.30
General Industrials	13.8	13.2	11.9	10.9	2.97	3.18	3.50	3.75
Electronic & Electrical Equip	17.9	17.0	15.5	14.2	1.97	2.13	2.31	2.51
Industrial Engineering	18.3	16.5	14.9	13.8	2.11	2.25	2.41	2.58
Industrial Transportation	17.2	15.4	13.5	12.4	2.91	3.08	3.20	3.34
Support Services	17.4	16.5	14.9	13.4	2.38	2.66	2.67	2.94
CONSUMER GOODS	17.1	15.7	14.4	13.1	3.01	3.38	3.63	4.04
Automobiles & Parts	12.5	11.6	10.1	9.0	2.20	2.52	2.90	3.34
Beverages	20.4	18.6	17.0	15.2	2.23	2.40	2.62	2.89
Food Producers	18.6	17.1	15.7	14.3	2.93	3.28	3.51	3.82
Household Goods & Home Co	17.8	15.9	14.2	12.8	2.31	3.11	3.20	3.88
Personal Goods	23.5	20.5	18.0	16.5	1.73	1.97	2.24	2.48
Tobacco	14.0	13.1	12.3	11.3	4.38	4.72	5.08	5.57
HEALTH CARE	12.0	13.1	12.7	12.1	4.14	4.37	4.55	4.74
Health Care Equip & Services	15.7	15.6	14.3	13.0	2.11	2.15	2.33	2.56
Pharmaceuticals & Biotech	11.9	13.0	12.6	12.1	4.26	4.49	4.68	4.86
CONSUMER SERVICES	15.7	14.9	13.5	12.5	2.90	3.01	3.15	3.35
Food & Drug Retailers	12.1	12.8	13.0	13.0	3.83	3.90	3.96	4.00
General Retailers	17.2	16.0	14.3	12.9	2.40	2.57	2.78	3.02
Media	15.7	14.9	13.6	12.3	2.76	3.11	3.26	3.54
Travel & Leisure	18.9	16.1	13.3	12.1	2.68	2.56	2.70	2.91
TELECOMMUNICATIONS	13.5	13.5	12.6	11.6	4.81	4.59	4.69	5.03
Fixed-Line Telecoms	13.6	13.3	11.6	10.2	3.05	3.41	3.87	5.36
Mobile Telecoms	13.5	13.6	12.9	12.1	5.31	4.92	4.92	4.93
UTILITIES	14.4	14.4	13.6	12.6	4.91	5.06	5.28	5.57
Electricity	13.5	14.4	13.3	12.0	5.05	4.94	5.15	5.56
Gas, Water & Multi-Utilities	14.7	14.4	13.6	12.8	4.86	5.09	5.33	5.57
TECHNOLOGY	25.9	23.3	20.4	17.9	1.27	1.38	1.61	1.82
Software & Computer Serv	19.2	18.5	16.7	15.0	1.85	2.03	2.26	2.47
Technology Hardware & Equip	37.4	30.1	25.2	21.5	0.77	0.81	1.04	1.26
TOTAL NON-FINANCIAL	13.2	13.3	12.2	11.3	3.50	3.71	3.88	4.13
FINANCIALS	13.5	11.1	10.3	9.4	3.35	3.63	4.55	5.16
Banks	13.1	10.2	9.3	8.5	2.94	3.41	4.75	5.54
Non-Life Insurance	11.0	9.9	9.6	9.1	5.90	5.17	5.42	6.22
Life Insurance	11.6	11.4	10.6	9.9	3.85	4.08	4.45	4.81
Real Estate Inv. Servs	28.1	26.7	24.2	22.3	1.72	1.95	2.11	2.28
REITS	23.6	23.2	21.7	20.2	3.66	3.79	3.94	4.10
Financial Services	16.5	11.5	11.4	10.3	3.72	3.57	4.07	4.46
FTSE ALL SHARE	13.2	12.8	11.8	10.8	3.47	3.69	4.02	4.35
FTSE 100	12.9	12.4	11.5	10.6	3.59	3.85	4.19	4.52
Mid 250	16.0	15.3	14.3	12.8	2.73	2.73	2.99	3.28
Small Cap	17.9	16.0	12.8	10.9	2.49	2.56	2.76	2.98

Source: Citi Research & DataStream

Figure 92. Stocks Mentioned

Stock Name	RICs	Price	Rating	Currency	Stock Name	RICs	Price	Rating	Currency
ABB	ABBN.VX	20.65	2		CHF Legrand	LEGD.PA	39.65	2	EUR
Actelion	ATLN.VX	63.10	2		CHF Lloyds Banking Group	LLOY.L	0.75	2	GBP
Adecco R	ADEN.VX	61.20	3		CHF L'Oreal	OREP.PA	125.00	2	EUR
Aegon	AEGN.AS	5.55	2		EUR Luxottica	LUX.MI	38.85	1	EUR
Aggreko	AGGK.L	15.99	1		GBP LVMH	LVMH.PA	135.15	1	EUR
Ahold Kon.	AHLN.AS	12.51	1		EUR Marks & Spencer Group	MKS.L	4.94	1	GBP
Alfa Laval	ALFA.ST	146.90	2		SEK Melrose Industries	MRON.L	3.03	1	GBP
Allianz	ALVG.DE	111.55	1		EUR Merck KGAA	MRCG.DE	112.50	2	EUR
AMEC	AMEC.L	10.57	2		GBP Michelin	MICP.PA	75.18	1	EUR
Andritz	ANDR.VI	43.47	1		EUR Muenchener Rueckver	MUVGn.DE	136.65	2	EUR
Anheuser-Busch Inbev	ABI.BR	72.22	1		EUR Nestle R	NESN.VX	61.00	1	CHF
ARM Holdings	ARM.L	8.93	1		GBP Next	NXT.L	50.53	1	GBP
Ashtead Group	AHT.L	6.53	1		GBP Nokia	NOK1V.HE	3.99	2H	EUR
ASML Hldg	ASML.AS	67.90	1		EUR Nordea Bank	NDA1V.HE	9.01	1	EUR
Assa Abloy B	ASSAb.ST	291.80	3		SEK Novartis R	NOVN.VX	70.40	1	CHF
Assicurazioni Generali	GASI.MI	14.45	3		EUR Novo Nordisk B	NOVOB.CO	931.00	1	DKK
AstraZeneca	AZN.L	31.43	2		GBP OMV	OMV.VI	35.77	2	EUR
Atlas Copco A	ATCOa.ST	180.70	3		SEK Pearson	PSON.L	12.85	2	GBP
Atos	ATOS.PA	57.11	1		EUR Pernod-Ricard	PERP.PA	87.71	2	EUR
BAE Systems	BAES.L	4.46	2		GBP Philips Electronics	PHG.AS	24.56	3	EUR
BAT	BATS.L	32.58	1		GBP Prudential	PRU.L	11.24	1	GBP
Bayer	BAYGn.DE	84.16	1		EUR Reckitt Benck	RB.L	43.87	1	GBP
Beiersdorf	BEIG.DE	64.16	1		EUR Reed Elsevier	REL.L	8.03	2	GBP
Berkeley	BKGH.L	21.10	2		GBP Reed Elsevier (Ams)	ELSN.AS	14.00	2	EUR
BMW	BMWG.DE	76.05	2		EUR Richemont	CFR.VX	91.15	1	CHF
British American Tobacco	BATS.L	32.58	1		GBP Roche	ROG.VX	233.60	1	CHF
BSKyB	BSY.L	8.52	1		GBP Rolls-Royce	RR.L	11.32	1	GBP
BT Group	BT.L	3.42	1		GBP Ryanair	RYA.I	6.04	1	EUR
Burberry	BRBY.L	15.70	2		GBP SABMiller	SAB.L	30.48	1	GBP
Cap Gemini	CAPP.PA	42.02	1		EUR Safran	SAF.PA	43.08	1	EUR
Capita	CPI.L	9.82	2		GBP Sage Group	SGE.L	3.51	1	GBP
Centrica	CNA.L	3.94	2		GBP Sainsbury (J)	SBRY.L	3.88	3	GBP
Cobham	COB.L	2.96	2		GBP Sandvik	SAND.ST	91.40	2	SEK
Colruyt	COLR.BR	42.41	1		EUR Sanofi	SASY.PA	72.85	1	EUR
Compass Group	CPG.L	8.53	1		GBP SAP	SAPG.DE	53.46	2	EUR
Continental	CONG.DE	120.00	1		EUR Schneider Electric	SCHN.PA	60.71	3	EUR
Credit Agricole	CAGR.PA	7.78	1		EUR Seadrill	SDRL.OL	282.20	1	NOK
Credit Suisse R	CSGN.VX	27.91	1		CHF SEB A	SEBa.ST	69.60	2	SEK
CRH	CRH.L	14.12	3		GBP Securitas B	SECUB.ST	72.90	2	SEK
Danone	DANO.PA	55.71	1		EUR Shire	SHP.L	24.07	1	GBP
Danske Bank	DANSKE.CO	114.00	1		DKK Siemens	SIEGn.DE	84.03	1	EUR
Dassault Systemes	DAST.PA	95.91	1		EUR Skanska B	SKAb.ST	121.70		SEK
Delhaize	DELB.BR	46.00	1		EUR SKF B	SKFb.ST	180.00	3	SEK
Deutsche Bo.	DB1Gn.DE	54.57	2		EUR Smith & Nephew	SN.L	7.67	2	GBP
DNB	DNB.OL	95.40	2		NOK Smiths Group	SMIN.L	13.26	3	GBP
EADS	EAD.PA	45.09	1		EUR Snam	SRG.MI	3.53	3	EUR
Easyjet	EZJ.L	12.36	1		GBP Sodexo	EXHO.PA	68.05	1	EUR
Edenred	EDEN.PA	23.21	1		EUR Spectris	SXS.L	23.30	1	GBP
EDF	EDF.PA	21.35	2		EUR Spirax-Sarco	SPX.L	30.48	1	GBP
Electrolux B	ELUXb.ST	177.10	1		SEK SSE	SSE.L	15.75	3	GBP
Ericsson B	ERICb.ST	83.65	1		SEK Sulzer R	SUN.VX	142.10	2	CHF
Essilor Intl.	ESSI.PA	80.55	1		EUR Svenska Handbkn	SHBa.ST	286.40	2	SEK
Experian	EXPN.L	11.51	1		GBP Swatch B	UHR.VX	549.00	2	CHF
Ferrovial	FER.MC	12.68	1		EUR Swedbank A	SWEDa.ST	153.80	2	SEK
Fiat	FIA.MI	5.78	3		EUR Symrise	SY1G.DE	33.07	3	EUR
Fresenius	FREG.DE	90.00	1		EUR Syngenta	SYNN.VX	371.00	1	CHF
Fresenius Med.	FMEG.DE	48.83	2		EUR Tate & Lyle	TATE.L	7.97	1	GBP
GEA Group	G1AG.DE	29.59	1		EUR Telenor	TEL.OL	130.90	2	NOK
Geberit R	GEBN.VX	234.50	3		CHF Tesco	TSO.L	3.66	3	GBP
Givaudan N	GIVN.VX	1,299.00	2		CHF Thales	TCFP.PA	40.30	1	EUR
GKN	GKN.L	3.43	1		GBP TNT	TNTE.AS	6.81	2	EUR
GlaxoSmithKline	GSK.L	16.51	2		GBP Tui Travel	TT.L	3.35	2	GBP
Grifols Ord Cl A	GRLS.MC	30.00	1		EUR UBS R	UBSN.VX	18.77	1	CHF

Heineken	HEIN.AS	51.63	2	EUR UCB	UCB.BR	43.74	2	EUR
Henkel Pref.	HNKG_p.DE	73.29	2	EUR Umicore	UMI.BR	35.36	2	EUR
Hennes & Mauritz	HMB.ST	247.20	2	SEK Unibail-Rodamco	UNBP.AS	169.35		EUR
IMI	IMI.L	14.55	1	GBP Unilever (UK)	ULVR.L	24.39	2	GBP
Imperial Tobacco Gp.	IMT.L	22.34	2	GBP Unilever Certs.	UNC.AS	28.38	2	EUR
Inditex	ITX.MC	103.80	1	EUR United Utilities Group	UU.L	6.80	2	GBP
Informa	INF.L	5.26	1	GBP Utd Int	UTDI.DE	26.55	2	EUR
ING Groep	ING.AS	8.35	1	EUR Valeo	VLOF.PA	60.29	1	EUR
ITV	ITV.L	1.75	1	GBP Verizon	VZ.N	47.43	1	USD
Julius Bar Gruppe	BAER.VX	44.16	2	CHF Vodafone	VOD.L	2.10	1	GBP
Kabel Deutschland Hldg.	KD8Gn.DE	85.96	2	EUR Volkswagen Pref.	VOWG.DE	167.20	2	EUR
Kering	PRTP.PA	173.00	1	EUR Weir Group	WEIR.L	22.41	2	GBP
Kingfisher	KGF.L	4.01	1	GBP Whitbread	WTB.L	31.64	2	GBP
Kone B	KNEBV.HE	63.30	3	EUR Wolseley	WOS.L	33.63	1	GBP
Kuehne+Nagel Intl.	KNIN.VX	117.80	1	CHF WPP	WPP.L	12.44	2	GBP
Lagardere	LAGA.PA	23.50	2	EUR Yara	YAR.OL	241.40	1	NOK
Land Securities Group	LAND.L	8.81		GBP Ziggo	ZIGGO.AS	30.29	2	EUR
Legal & General	LGEN.L	1.91	2	GBP				

Source: Citi Research

Notes

Notes

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.

IMPORTANT DISCLOSURES

Citigroup Global Markets Inc. owns a position of 1 million USD or more in the debt securities of Nordea Bank AB

An employee of Citigroup Global Markets or its affiliates is chairman of the audit committee and Non-Executive Director of Smiths Group.

Citigroup Global Markets Limited is currently acting as advisor to Assicurazioni Generali Spa (the company) in the announced sale of the company's US Life Reinsurance Business (Generali U.S.) to Scor SE

Citigroup Global Markets Inc. owns a position of 1 million USD or more in the debt securities of Verizon Communications Inc

Citigroup Global Markets Inc. owns a position of 1 million USD or more in the debt securities of Svenska Handelsbanken AB

Citigroup Global Markets Inc. owns a position of 1 million USD or more in the debt securities of Pernod Ricard SA

An employee of Citigroup Global Markets or its affiliates is the Non-Executive Chairman of the Legal & General Group PLC.

Citigroup Global Markets Inc. owns a position of 1 million USD or more in the debt securities of Skandinaviska Enskilda Banken AB

A seat on the Supervisory Board of Heineken NV is held by an employee of Citigroup Global Markets or its affiliates.

Citigroup Global Markets Inc. owns a position of 1 million USD or more in the debt securities of Prudential PLC

Citigroup Global Markets Inc. owns a position of 1 million USD or more in the debt securities of Vodafone Group PLC

An employee of Citigroup Global Markets or its affiliates is a Chairman of the Audit Committee and a Board member of L'Oreal SA.

Citigroup Global Markets Inc. owns a position of 1 million USD or more in the debt securities of Danske Bank A/S.

Citigroup Global Markets Ltd is currently acting as advisor to Allianz SE in relation to the recent announcement of Allianz SE's acquisition of Yapi Kredi Sigorta AS.

Citigroup Global Markets Inc. owns a position of 1 million USD or more in the debt securities of Koninklijke Philips NV

The Chairman of Citi serves as a director of Roche Holding AG.

Citigroup Global Markets Inc. owns a position of 1 million USD or more in the debt securities of AstraZeneca PLC

Citigroup Global Markets Inc. owns a position of 1 million USD or more in the debt securities of ING Groep NV

Citigroup Global Markets Ltd is acting financial advisor to TNT Express NV in connection with the announced intention of the company to divest its Brazilian business.

Citigroup Global Markets Inc. owns a position of 1 million USD or more in the debt securities of Nokia Oyj

Citigroup Global Markets Inc. owns a position of 1 million USD or more in the debt securities of Electricite de France SA

Citigroup Global Markets Limited is currently mandated as advisor to Lloyds Banking Group Plc in relation to the announced disposal of the Groups UK bank branches.

An employee of Citigroup Global Markets or its affiliates is a Sales Consultant of Next Retail Ltd.

Adrian Cattley, Strategist, holds a long position in the securities of Prudential Plc.

Citigroup Global Markets Inc. or its affiliates beneficially owns 1% or more of any class of common equity securities of Vodafone Group PLC, Kabel Deutschland. This position reflects information available as of the prior business day.

Within the past 12 months, Citigroup Global Markets Inc. or its affiliates has acted as manager or co-manager of an offering of securities of Fiat SpA, Nordea, Verizon Communications Inc, Skandinaviska Enskilda Banken AB, Edenred, Heineken, BT Group PLC, Novartis AG, Swedbank AB, Credit Agricole SA, Imperial Tobacco Group PLC, Prudential Plc, Nestle, Sanofi SA, GlaxoSmithKline PLC, Ferrovial, S.A., Aggreko PLC, Snam SpA, Danske Bank A/S, Siemens, Continental AG, Allianz SE, Aegon NV, Credit Suisse, British American Tobacco PLC, ING Groep NV, BMW AG, SABMiller, EADS, Volkswagen AG, Fresenius SE, Nokia Oyj, Unilever PLC, Seadrill, Danone, Electricite de France, Thales, Deutsche Boerse AG, Atlas Copco.

Citigroup Global Markets Inc. or its affiliates has received compensation for investment banking services provided within the past 12 months from WPP PLC, Fiat SpA, SAP AG, Nordea, Pearson PLC, Smiths Group, Assicurazioni Generali SpA, Verizon Communications Inc, Svenska Handelsbanken AB, Yara International, Pernod-Ricard, Legal & General, Skandinaviska Enskilda Banken AB, Lagardere Groupe, Tesco, Edenred, CRH PLC, Heineken, EasyJet, BT Group PLC, Essilor, Electrolux, Novartis AG, AB-InBev, Swedbank AB, Credit Agricole SA, Imperial Tobacco Group PLC, Prudential Plc, Bayer AG, Sage Group PLC, Nestle, UBS, Sanofi SA, Vodafone Group PLC, GlaxoSmithKline PLC, SKF, Ferrovial, S.A., Sodexo, Valeo SA, Compass Group, L'Oréal,

Skanska, Snam SpA, Danske Bank A/S, Siemens, Securitas, Ryanair, Henkel, Continental AG, Allianz SE, Aegon NV, OMV AG, Michelin, Munich Re, Credit Suisse, Roche Holding AG, Capita Group PLC, Tate and Lyle, British American Tobacco PLC, LVMH, Fresenius Medical Care, Rolls Royce, Assa Abloy, Safran, Shire Pharmaceuticals, Reed Elsevier PLC, ING Groep NV, BMW AG, Unilever NV, SABMiller, EADS, Reed Elsevier NV, GKN Plc, DNB ASA, Volkswagen AG, Fresenius SE, ABB, Nokia Oyj, Unilever PLC, Seadrill, Danone, Luxottica Group SpA, Julius Baer Gruppe AG, Givaudan AG, Electricite de France, Thales, Marks and Spencer Group PLC, Ashtead Group Plc, Merck KGaA, Lloyds Banking Group PLC, BAE Systems, Deutsche Boerse AG, TUI Travel Plc, Atlas Copco, Syngenta AG, Telenor ASA, Centrica PLC, Wolseley PLC.

Citigroup Global Markets Inc. or its affiliates expects to receive or intends to seek, within the next three months, compensation for investment banking services from Fiat SpA, Assicurazioni Generali SpA, Skandinaviska Enskilda Banken AB, Tesco, BT Group PLC, Electrolux, Credit Agricole SA, Sage Group PLC, Nestle, UBS, GlaxoSmithKline PLC, Snam SpA, Siemens, Henkel, Allianz SE, Aegon NV, IMI, Rolls Royce, BMW AG, Unilever NV, Reckitt Benckiser, TNT Express, Ericsson LM, GKN Plc, Volkswagen AG, Nokia Oyj, Unilever PLC, Seadrill, Danone, Electricite de France, Lloyds Banking Group PLC, TUI Travel Plc, Telenor ASA, Centrica PLC.

Citigroup Global Markets Inc. or an affiliate received compensation for products and services other than investment banking services from Verizon Communications Inc, WPP PLC, Fiat SpA, SAP AG, Swatch Group AG, SSE PLC, Nordea, Pearson PLC, Land Securities, Informa PLC, Smiths Group, Assicurazioni Generali SpA, Svenska Handelsbanken AB, Yara International, Pernod-Ricard, Legal & General, Skandinaviska Enskilda Banken AB, Lagardere Groupe, Tesco, Edenred, CRH PLC, Heineken, EasyJet, Hennes & Mauritz AB, Richemont, Kone, BT Group PLC, GEA Group, Essilor, Electrolux, Novartis AG, AB-InBev, Swedbank AB, Credit Agricole SA, Adecco, Imperial Tobacco Group PLC, Prudential Plc, Bayer AG, Sage Group PLC, Nestle, UBS, Sanofi SA, Vodafone Group PLC, GlaxoSmithKline PLC, SKF, Ferrovial, S.A., Melrose, Sodexo, Aggreko PLC, Valeo SA, Compass Group, L'Oréal, Skanska, Snam SpA, Danske Bank A/S, Siemens, Capgemini SA, Andritz AG, Securitas, Grifols S.A., Ryanair, Henkel, Continental AG, Allianz SE, Legrand, Philips, Experian, Alfa Laval, Ahold, Aegon NV, OMV AG, Michelin, Cobham, Munich Re, Beiersdorf, Credit Suisse, Roche Holding AG, IMI, Dassault Systemes SA, Capita Group PLC, British Sky Broadcasting Group PLC, Tate and Lyle, Schneider Electric, ITV PLC, Inditex, British American Tobacco PLC, Sandvik, AstraZeneca PLC, Kabel Deutschland, LVMH, Fresenius Medical Care, Rolls Royce, Assa Abloy, Safran, Symrise AG, Shire Pharmaceuticals, Reed Elsevier PLC, ING Groep NV, BMW AG, Unilever NV, Reckitt Benckiser, TNT Express, SABMiller, Ericsson LM, EADS, Delhaize, Reed Elsevier NV, Kering, GKN Plc, DNB ASA, AMEC, Volkswagen AG, Fresenius SE, ABB, Nokia Oyj, UCB SA, Unilever PLC, Spirax-Sarco, Ziggo N.V., Seadrill, Actelion Ltd, Danone, Luxottica Group SpA, Julius Baer Gruppe AG, Givaudan AG, Electricite de France, Thales, Sainsbury, Kuehne & Nagel International, Marks and Spencer Group PLC, Ashtead Group Plc, Sulzer AG, Merck KGaA, Spectris, Lloyds Banking Group PLC, BAE Systems, ARM Holdings PLC, Deutsche Boerse AG, TUI Travel Plc, Atlas Copco, Syngenta AG, Next Group PLC, Telenor ASA, Novo Nordisk A/S, United Internet AG, Umicore NV/SA, ATOS, Centrica PLC, Wolseley PLC in the past 12 months.

Citigroup Global Markets Inc. currently has, or had within the past 12 months, the following as investment banking client(s): Verizon Communications Inc, ING Groep NV, Roche Holding AG, Heineken, Marks and Spencer Group PLC, WPP PLC, Fiat SpA, SAP AG, Nordea, Pearson PLC, Smiths Group, Assicurazioni Generali SpA, Svenska Handelsbanken AB, Yara International, Pernod-Ricard, Legal & General, Skandinaviska Enskilda Banken AB, Lagardere Groupe, Tesco, Edenred, CRH PLC, EasyJet, BT Group PLC, Essilor, Electrolux, Novartis AG, AB-InBev, Swedbank AB, Credit Agricole SA, Imperial Tobacco Group PLC, Prudential Plc, Bayer AG, Sage Group PLC, Nestle, UBS, Sanofi SA, Vodafone Group PLC, GlaxoSmithKline PLC, SKF, Ferrovial, S.A., Sodexo, Valeo SA, Compass Group, L'Oréal, Skanska, Snam SpA, Danske Bank A/S, Siemens, Securitas, Ryanair, Henkel, Continental AG, Allianz SE, Aegon NV, OMV AG, Michelin, Munich Re, Credit Suisse, IMI, Capita Group PLC, Tate and Lyle, British American Tobacco PLC, LVMH, Fresenius Medical Care, Rolls Royce, Assa Abloy, Safran, Shire Pharmaceuticals, Reed Elsevier PLC, BMW AG, Unilever NV, Reckitt Benckiser, TNT Express, SABMiller, Ericsson LM, EADS, Reed Elsevier NV, GKN Plc, DNB ASA, Volkswagen AG, Fresenius SE, ABB, Nokia Oyj, Unilever PLC, Seadrill, Danone, Luxottica Group SpA, Julius Baer Gruppe AG, Givaudan AG, Electricite de France, Thales, Ashtead Group Plc, Merck KGaA, Lloyds Banking Group PLC, BAE Systems, Deutsche Boerse AG, TUI Travel Plc, Atlas Copco, Syngenta AG, Telenor ASA, Centrica PLC, Wolseley PLC.

Citigroup Global Markets Inc. currently has, or had within the past 12 months, the following as clients, and the services provided were non-investment-banking, securities-related: IMI, ITV PLC, Pearson PLC, Verizon Communications Inc, WPP PLC, Fiat SpA, SAP AG, Swatch Group AG, SSE PLC, Nordea, Land Securities, Smiths Group, Assicurazioni Generali SpA, Svenska Handelsbanken AB, Yara International, Pernod-Ricard, Legal & General, Skandinaviska Enskilda Banken AB, Lagardere Groupe, Tesco, Edenred, CRH PLC, Heineken, EasyJet, Hennes & Mauritz AB, Richemont, Kone, BT Group PLC, GEA Group, Essilor, Electrolux, Novartis AG, Burberry Group PLC, AB-InBev, Swedbank AB, Credit Agricole SA, Adecco, Imperial Tobacco Group PLC, Prudential Plc, Bayer AG, Sage Group PLC, Nestle, UBS, Sanofi SA, Vodafone Group PLC, GlaxoSmithKline PLC, SKF, Ferrovial, S.A., Melrose, Sodexo, Aggreko PLC, Valeo SA, Compass Group, L'Oréal, Skanska, Snam SpA, Danske Bank A/S, Siemens, Capgemini SA, Andritz AG, Securitas, Ryanair, Henkel, Continental AG, Allianz SE, Legrand, Weir Group, Philips, Experian, Alfa Laval, Ahold, Aegon NV, OMV AG, Michelin, Munich Re, Beiersdorf, Credit Suisse, Roche Holding AG, Capita Group PLC, British Sky Broadcasting Group PLC, Smith & Nephew PLC, Tate and Lyle, Schneider Electric, Inditex, British American Tobacco PLC, Sandvik, AstraZeneca PLC, Kabel Deutschland, LVMH, Fresenius Medical Care, Rolls Royce, Assa Abloy, Safran, Symrise AG, Shire Pharmaceuticals, Reed Elsevier PLC, ING Groep NV, BMW AG, Unilever NV, Reckitt Benckiser, TNT Express, SABMiller, Ericsson LM, EADS, Delhaize, Reed Elsevier NV, Kering, GKN Plc, DNB ASA, AMEC, Unibail-Rodamco SE, Volkswagen AG, Fresenius SE, ABB, Nokia Oyj, UCB SA, Unilever PLC, Spirax-Sarco, Seadrill, Actelion Ltd, Danone, Luxottica Group SpA, Julius Baer Gruppe AG, Givaudan AG, Electricite de France, Thales, Sainsbury, Kuehne & Nagel International, Marks and Spencer Group PLC, Ashtead Group Plc, Sulzer AG, Merck KGaA, Spectris, Lloyds Banking Group PLC, BAE Systems, ARM Holdings PLC, Deutsche Boerse AG, TUI Travel Plc, Atlas Copco, Syngenta AG, Telenor ASA, Novo Nordisk A/S, United Internet AG, Umicore NV/SA, ATOS, Centrica PLC, Wolseley PLC.

Citigroup Global Markets Inc. currently has, or had within the past 12 months, the following as clients, and the services provided were non-investment-banking, non-securities-related: Pearson PLC, Lagardere Groupe, Verizon Communications Inc, ITV PLC, WPP PLC, Fiat SpA, SAP AG, Swatch Group AG, SSE PLC, Nordea, Land Securities, Informa PLC, Smiths Group, Assicurazioni Generali SpA, Svenska Handelsbanken AB, Yara International, Pernod-Ricard, Legal & General, Skandinaviska Enskilda Banken AB, Tesco, Edenred, CRH PLC, Heineken, EasyJet, Hennes & Mauritz AB, Richemont, Kone, BT Group PLC, GEA Group, Essilor, Electrolux, Novartis AG, AB-InBev, Swedbank AB, Credit Agricole SA, Adecco, Imperial Tobacco Group PLC, Prudential Plc, Bayer AG, Sage Group PLC, Nestle, UBS, Sanofi SA, Vodafone Group PLC, GlaxoSmithKline PLC, SKF, Ferrovial, S.A., Melrose, Sodexo, Aggreko PLC, Valeo SA, Compass Group, L'Oréal, Skanska, Snam SpA, Danske Bank A/S, Siemens, Capgemini SA, Andritz AG, Securitas, Grifols S.A., Ryanair, Henkel, Continental AG, Allianz SE, Legrand, Philips, Experian, Alfa Laval, Ahold, Aegon NV, OMV AG, Michelin, Cobham, Munich Re, Beiersdorf, Credit

Suisse, Roche Holding AG, IMI, Dassault Systemes SA, Capita Group PLC, Tate and Lyle, Schneider Electric, Inditex, British American Tobacco PLC, Sandvik, AstraZeneca PLC, LVMH, Fresenius Medical Care, Rolls Royce, Assa Abloy, Safran, Symrise AG, Shire Pharmaceuticals, Reed Elsevier PLC, ING Groep NV, BMW AG, Unilever NV, Reckitt Benckiser, TNT Express, SABMiller, Ericsson LM, EADS, Delhaize, Reed Elsevier NV, Kering, GKN Plc, DNB ASA, AMEC, Volkswagen AG, Fresenius SE, ABB, Nokia Oyj, UCB SA, Unilever PLC, Spirax-Sarco, Ziggo N.V., Seadrill, Actelion Ltd, Danone, Luxottica Group SpA, Julius Baer Gruppe AG, Givaudan AG, Electricite de France, Thales, Kuehne & Nagel International, Marks and Spencer Group PLC, Ashtead Group Plc, Sulzer AG, Merck KGaA, Spectris, Lloyds Banking Group PLC, BAE Systems, Deutsche Boerse AG, TUI Travel Plc, Atlas Copco, Syngenta AG, Next Group PLC, Telenor ASA, Novo Nordisk A/S, United Internet AG, Umicore NV/SA, ATOS, Centrica PLC, Wolseley PLC.

Citigroup Global Markets Inc. or an affiliate received compensation in the past 12 months from Pearson PLC, ITV PLC, Verizon Communications Inc.

Analysts' compensation is determined based upon activities and services intended to benefit the investor clients of Citigroup Global Markets Inc. and its affiliates ("the Firm"). Like all Firm employees, analysts receive compensation that is impacted by overall firm profitability which includes investment banking revenues.

The Firm is a market maker in the publicly traded equity securities of Fiat SpA, SSE PLC, Yara International, Pernod-Ricard, Legal & General, Tesco, Heineken, Hennes & Mauritz AB, Swedbank AB, Imperial Tobacco Group PLC, Bayer AG, Sage Group PLC, Nestle, Sanofi SA, Vodafone Group PLC, SKF, Sodexo, Valeo SA, Compass Group, L'Oréal, Danske Bank A/S, Capgemini SA, Grifols S.A., Ryanair, Henkel, Continental AG, Allianz SE, Experian, Ahold, Munich Re, Roche Holding AG, IMI, Dassault Systemes SA, Tate and Lyle, Sandvik, LVMH, Rolls Royce, United Utilities PLC, Shire Pharmaceuticals, BMW AG, SABMiller, Ericsson LM, GKN Plc, Volkswagen AG, Danone, Sainsbury, Marks and Spencer Group PLC, ARM Holdings PLC, Kingfisher PLC, Deutsche Boerse AG, Atlas Copco, Telenor ASA, Centrica PLC, Wolseley PLC, ASML Holding NV.

For important disclosures (including copies of historical disclosures) regarding the companies that are the subject of this Citi Research product ("the Product"), please contact Citi Research, 388 Greenwich Street, 28th Floor, New York, NY, 10013, Attention: Legal/Compliance [E6WYB6412478]. In addition, the same important disclosures, with the exception of the Valuation and Risk assessments and historical disclosures, are contained on the Firm's disclosure website at https://www.citivelocity.com/cvr/eppublic/citi_research_disclosures. Valuation and Risk assessments can be found in the text of the most recent research note/report regarding the subject company. Historical disclosures (for up to the past three years) will be provided upon request.

Citi Research Equity Ratings Distribution

Data current as of 30 Jun 2013

Citi Research Global Fundamental Coverage

% of companies in each rating category that are investment banking clients

12 Month Rating			Relative Rating		
Buy	Hold	Sell	Buy	Hold	Sell
48%	40%	12%	6%	88%	6%
53%	50%	45%	58%	51%	49%

Guide to Citi Research Fundamental Research Investment Ratings:

Citi Research stock recommendations include an investment rating and an optional risk rating to highlight high risk stocks.

Risk rating takes into account both price volatility and fundamental criteria. Stocks will either have no risk rating or a High risk rating assigned.

Investment Ratings: Citi Research investment ratings are Buy, Neutral and Sell. Our ratings are a function of analyst expectations of expected total return ("ETR") and risk. ETR is the sum of the forecast price appreciation (or depreciation) plus the dividend yield for a stock within the next 12 months. The Investment rating definitions are: Buy (1) ETR of 15% or more or 25% or more for High risk stocks; and Sell (3) for negative ETR. Any covered stock not assigned a Buy or a Sell is a Neutral (2). For stocks rated Neutral (2), if an analyst believes that there are insufficient valuation drivers and/or investment catalysts to derive a positive or negative investment view, they may elect with the approval of Citi Research management not to assign a target price and, thus, not derive an ETR. Analysts may place covered stocks "Under Review" in response to exceptional circumstances (e.g. lack of information critical to the analyst's thesis) affecting the company and / or trading in the company's securities (e.g. trading suspension). As soon as practically possible, the analyst will publish a note re-establishing a rating and investment thesis. To satisfy regulatory requirements, we correspond Under Review and Neutral to Hold in our ratings distribution table for our 12-month fundamental rating system. However, we reiterate that we do not consider Under Review to be a recommendation.

Relative three-month ratings: Citi Research may also assign a three-month relative call (or rating) to a stock to highlight expected out-performance (most preferred) or under-performance (least preferred) versus the geographic and industry sector over a 3 month period. The relative call may highlight a specific near-term catalyst or event impacting the company or the market that is anticipated to have a short-term price impact on the equity securities of the company. Absent any specific catalyst the analyst(s) will indicate the most and least preferred stocks in the universe of stocks under consideration, explaining the basis for this short-term view. This three-month view may be different from and does not affect a stock's fundamental equity rating, which reflects a longer-term total absolute return expectation. For purposes of NASD/NYSE ratings-distribution-disclosure rules, most preferred calls correspond to a buy recommendation and least preferred calls correspond to a sell recommendation. Any stock not assigned to a most preferred or least preferred call is considered non-relative-rated (NRR). For purposes of NASD/NYSE ratings-distribution-disclosure rules we correspond NRR to Hold in our ratings distribution table for our 3-month relative rating system. However, we reiterate that we do not consider NRR to be a recommendation.

Prior to October 8, 2011, the firm's stock recommendation system included a risk rating and an investment rating. **Risk ratings**, which took into account both price volatility and fundamental criteria, were: Low (L), Medium (M), High (H), and Speculative (S). **Investment Ratings** of Buy, Hold and Sell were a function of the Citi Research expectation of total return (forecast price appreciation and dividend yield within the next 12 months) and risk rating. Additionally, analysts could have placed covered stocks "Under Review" in response to exceptional circumstances (e.g. lack of information critical to the analyst's thesis) affecting the company and/or trading in the company's securities (e.g. trading suspension). Stocks placed "Under Review" were monitored daily by management and as practically possible, the analyst published a note re-establishing a rating and investment thesis. For securities in developed markets (US, UK, Europe, Japan, and Australia/New Zealand), investment ratings were: Buy (1) (expected total return of 10% or more for Low-Risk stocks, 15% or more for Medium-Risk stocks, 20% or more for High-Risk stocks, and 35% or more for Speculative stocks); Hold (2) (0%-10% for Low-Risk stocks, 0%-15% for Medium-Risk stocks, 0%-20% for High-Risk stocks, and 0%-35% for Speculative stocks); and Sell (3) (negative total return). For securities in emerging markets (Asia Pacific, Emerging Europe/Middle East/Africa, and Latin America), investment ratings were: Buy (1) (expected total return of 15% or more for Low-Risk stocks, 20% or more for Medium-Risk stocks, 30% or more for High-Risk stocks, and 40% or more for Speculative stocks); Hold (2) (5%-15% for Low-Risk stocks, 10%-20% for Medium-Risk stocks, 15%-30% for High-Risk stocks, and 20%-40% for Speculative stocks); and Sell (3) (5% or less for Low-Risk stocks, 10% or less for Medium-Risk stocks, 15% or less for High-Risk stocks, and 20% or less for Speculative stocks).

Investment ratings are determined by the ranges described above at the time of initiation of coverage, a change in investment and/or risk rating, or a change in target price (subject to limited management discretion). At other times, the expected total returns may fall outside of these ranges because of market price movements and/or other short-term volatility or trading patterns. Such interim deviations from specified ranges will be permitted but will become subject to review by Research Management. Your decision to buy or sell a security should be based upon your personal investment objectives and should be made only after evaluating the stock's expected performance and risk.

NON-US RESEARCH ANALYST DISCLOSURES

Non-US research analysts who have prepared this report (i.e., all research analysts listed below other than those identified as employed by Citigroup Global Markets Inc.) are not registered/qualified as research analysts with FINRA. Such research analysts may not be associated persons of the member organization and therefore may not be subject to the NYSE Rule 472 and NASD Rule 2711 restrictions on communications with a subject company, public appearances and trading securities held by a research analyst account. The legal entities employing the authors of this report are listed below:

Citigroup Global Markets Ltd

Anna Esposito; Jonathan Stubbs; Beata M Manthey, PhD; Mark Fielding; Natalia Mamaeva; Assad M Malic; Andrea Pistacchi; Jonathan Beake; Simon Weeden; Alastair A Johnston; Thomas A Singlehurst, CFA; Paul L Bradley; Toby McCullagh; Dominik Frauendienst; Richard Edwards; Philip Watkins; Amit B Harchandani; Aynsley Lammin; Farooq Hanif; Andrew Light; Thomas Chauvet; Andrew S Baum; Alastair R Syme; Joanne Jerman; Andrew Coombs; James Ainley; Hugo Mills; Florent Nitu; Adam Spielman; Roger Elliott; Kinner Lakhani; Robert Dickinson, CA; Robert Coates; Nese Guner; Laurie Fitzjohn-Sykes, CFA; Marc Van'T Sant; Ruchi Malaiya, CFA; Ronit Ghose; Antonella Bianchessi; Mauro Baragiola; Ed Steele; Andrew Benson; Dimitri Y Kallianiotis, CFA; Thomas Dorner; Ryan W Kauppila; Josh Lipman; Adrian Cattley; Sofia Savvantidou

Citigroup Global Markets India Private Limited

Ayush Tambi

Citigroup Global Markets Inc

Michael Rollins, CFA; Walter H Pritchard, CFA; Jim Suva, CPA; Liav Abraham

OTHER DISCLOSURES

Citigroup Global Markets Inc. and/or its affiliates has a significant financial interest in relation to SAP AG, Pearson PLC, Land Securities, Smiths Group, Verizon Communications Inc, Svenska Handelsbanken AB, Yara International, Pernod-Ricard, Legal & General, Skandinaviska Enskilda Banken AB, Lagardere Groupe, Tesco, Edenred, CRH PLC, Heineken, Kone, Essilor, Electrolux, AB-InBev, Swedbank AB, Credit Agricole SA, Adecco, Imperial Tobacco Group PLC, Prudential Plc, Bayer AG, Nestle, UBS, Sanofi SA, Vodafone Group PLC, GlaxoSmithKline PLC, SKF, Ferrovia, S.A., Sodexo, Valeo SA, Compass Group, L'Oréal, Snam SpA, Danske Bank A/S, Siemens, Securitas, Henkel, Continental AG, Allianz SE, Philips, Aegon NV, OMV AG, Credit Suisse, Roche Holding AG, Capita Group PLC, Tate and Lyle, Schneider Electric, Inditex, British American Tobacco PLC, Sandvik, AstraZeneca PLC, LVMH, Fresenius Medical Care, Rolls Royce, Assa Abloy, Safran, ING Groep NV, BMW AG, SABMiller, Ericsson LM, EADS, Volkswagen AG, Fresenius SE, Nokia Oyj, Seadrill, Danone, Luxottica Group SpA, Givaudan AG, Electricite de France, Thales, Ashtead Group Plc, Sulzer AG, Merck KGaA, Lloyds Banking Group PLC, BAE Systems, Deutsche Boerse AG, Syngenta AG, Telenor ASA, Novo Nordisk A/S, Centrica PLC. (For an explanation of the determination of significant financial interest, please refer to the policy for managing conflicts of interest which can be found at www.citiVelocity.com.)

Citigroup Global Markets Inc. or its affiliates beneficially owns 2% or more of any class of common equity securities of Kabel Deutschland.

For securities recommended in the Product in which the Firm is not a market maker, the Firm is a liquidity provider in the issuers' financial instruments and may act as principal in connection with such transactions. The Firm is a regular issuer of traded financial instruments linked to securities that may have been recommended in the Product. The Firm regularly trades in the securities of the issuer(s) discussed in the Product. The Firm may engage in securities transactions in a manner inconsistent with the Product and, with respect to securities covered by the Product, will buy or sell from customers on a principal basis.

Citigroup Global Markets Inc. or its affiliates acts as a corporate broker to Pearson PLC, Sage Group PLC, Vodafone Group PLC, GlaxoSmithKline PLC, Aggreko PLC, Ryanair, IML, Capita Group PLC, Tate and Lyle, Marks and Spencer Group PLC, Lloyds Banking Group PLC.

Securities recommended, offered, or sold by the Firm: (i) are not insured by the Federal Deposit Insurance Corporation; (ii) are not deposits or other obligations of any insured depository institution (including Citibank); and (iii) are subject to investment risks, including the possible loss of the principal amount invested. Although information has been obtained from and is based upon sources that the Firm believes to be reliable, we do not guarantee its accuracy and it may be incomplete and condensed. Note, however, that the Firm has taken all reasonable steps to determine the accuracy and completeness of the disclosures made in the Important Disclosures section of the Product. The Firm's research department has received assistance from the subject company(ies) referred to in this Product including, but not limited to, discussions with management of the subject company(ies). Firm policy prohibits research analysts from sending draft research to subject companies. However, it should be presumed that the author of the Product has had discussions with the subject company to ensure factual accuracy prior to publication. All opinions, projections and estimates constitute the judgment of the author as of the date of the Product and these, plus any other information contained in the Product, are subject to change without notice. Prices and availability of financial instruments also are subject to change without notice. Notwithstanding other departments within the Firm advising the companies discussed in this Product, information obtained in such role is not used in the preparation of the Product. Although Citi Research does not set a predetermined frequency for publication, if the Product is a fundamental research report, it is the intention of Citi Research to provide research coverage of the/those issuer(s) mentioned therein, including in response to news affecting this issuer, subject to applicable quiet periods and capacity constraints. The Product is for informational purposes only and is not intended as an offer or solicitation for the purchase or sale of a security. Any decision to purchase securities mentioned in the Product must take into account existing public information on such security or any registered prospectus.

Investing in non-U.S. securities, including ADRs, may entail certain risks. The securities of non-U.S. issuers may not be registered with, nor be subject to the reporting requirements of the U.S. Securities and Exchange Commission. There may be limited information available on foreign securities. Foreign companies are generally not subject to uniform audit and reporting standards, practices and requirements comparable to those in the U.S. Securities of some foreign companies may be less liquid and their prices more volatile than securities of comparable U.S. companies. In addition, exchange rate

movements may have an adverse effect on the value of an investment in a foreign stock and its corresponding dividend payment for U.S. investors. Net dividends to ADR investors are estimated, using withholding tax rates conventions, deemed accurate, but investors are urged to consult their tax advisor for exact dividend computations. Investors who have received the Product from the Firm may be prohibited in certain states or other jurisdictions from purchasing securities mentioned in the Product from the Firm. Please ask your Financial Consultant for additional details. Citigroup Global Markets Inc. takes responsibility for the Product in the United States. Any orders by US investors resulting from the information contained in the Product may be placed only through Citigroup Global Markets Inc.

The Citigroup legal entity that takes responsibility for the production of the Product is the legal entity which the first named author is employed by. The Product is made available in **Australia** through Citi Global Markets Australia Pty Ltd. (ABN 64 003 114 832 and AFSL No. 240992), participant of the ASX Group and regulated by the Australian Securities & Investments Commission. Citigroup Centre, 2 Park Street, Sydney, NSW 2000. The Product is made available in Australia to Private Banking wholesale clients through Citigroup Pty Limited (ABN 88 004 325 080 and AFSL 238098). Citigroup Pty Limited provides all financial product advice to Australian Private Banking wholesale clients through bankers and relationship managers. If there is any doubt about the suitability of investments held in Citigroup Private Bank accounts, investors should contact the Citigroup Private Bank in Australia. Citigroup companies may compensate affiliates and their representatives for providing products and services to clients. The Product is made available in **Brazil** by Citigroup Global Markets Brasil - CCTVM SA, which is regulated by CVM - Comissão de Valores Mobiliários, BACEN - Brazilian Central Bank, APIMEC - Associação dos Analistas e Profissionais de Investimento do Mercado de Capitais and ANBID - Associação Nacional dos Bancos de Investimento. Av. Paulista, 1111 - 11º andar - CEP. 01311920 - São Paulo - SP. If the Product is being made available in certain provinces of **Canada** by Citigroup Global Markets (Canada) Inc. ("CGM Canada"), CGM Canada has approved the Product. Citigroup Place, 123 Front Street West, Suite 1100, Toronto, Ontario M5J 2M3. This product is available in **Chile** through Banchile Corredores de Bolsa S.A., an indirect subsidiary of Citigroup Inc., which is regulated by the Superintendencia de Valores y Seguros. Agustinas 975, piso 2, Santiago, Chile. The Product is made available in **France** by Citigroup Global Markets Limited, which is authorised and regulated by Financial Services Authority. 1-5 Rue Paul Cézanne, 8ème, Paris, France. The Product is distributed in **Germany** by Citigroup Global Markets Deutschland AG ("CGMD"), which is regulated by Bundesanstalt fuer Finanzdienstleistungsaufsicht (BaFin). CGMD, Reuterweg 16, 60323 Frankfurt am Main. Research which relates to "securities" (as defined in the Securities and Futures Ordinance (Cap. 571 of the Laws of Hong Kong)) is issued in **Hong Kong** by, or on behalf of, Citigroup Global Markets Asia Limited which takes full responsibility for its content. Citigroup Global Markets Asia Ltd. is regulated by Hong Kong Securities and Futures Commission. If the Research is made available through Citibank, N.A., Hong Kong Branch, for its clients in Citi Private Bank, it is made available by Citibank N.A., Citibank Tower, Citibank Plaza, 3 Garden Road, Hong Kong. Citibank N.A. is regulated by the Hong Kong Monetary Authority. Please contact your Private Banker in Citibank N.A., Hong Kong, Branch if you have any queries on or any matters arising from or in connection with this document. The Product is made available in **India** by Citigroup Global Markets India Private Limited, which is regulated by Securities and Exchange Board of India. Bakhtawar, Nariman Point, Mumbai 400-021. The Product is made available in **Indonesia** through PT Citigroup Securities Indonesia. 5/F, Citibank Tower, Bapindo Plaza, Jl. Jend. Sudirman Kav. 54-55, Jakarta 12190. Neither this Product nor any copy hereof may be distributed in Indonesia or to any Indonesian citizens wherever they are domiciled or to Indonesian residents except in compliance with applicable capital market laws and regulations. This Product is not an offer of securities in Indonesia. The securities referred to in this Product have not been registered with the Capital Market and Financial Institutions Supervisory Agency (BAPEPAM-LK) pursuant to relevant capital market laws and regulations, and may not be offered or sold within the territory of the Republic of Indonesia or to Indonesian citizens through a public offering or in circumstances which constitute an offer within the meaning of the Indonesian capital market laws and regulations. The Product is made available in **Israel** through Citibank NA, regulated by the Bank of Israel and the Israeli Securities Authority. Citibank, N.A. Platinum Building, 21 Ha'arba'ah St, Tel Aviv, Israel. The Product is made available in **Italy** by Citigroup Global Markets Limited, which is authorised and regulated by Financial Services Authority. Via dei Mercanti, 12, Milan, 20121, Italy. The Product is made available in **Japan** by Citigroup Global Markets Japan Inc. ("CGMJ"), which is regulated by Financial Services Agency, Securities and Exchange Surveillance Commission, Japan Securities Dealers Association, Tokyo Stock Exchange and Osaka Securities Exchange. Shin-Marunouchi Building, 1-5-1 Marunouchi, Chiyoda-ku, Tokyo 100-6520 Japan. If the Product was distributed by SMBC Nikko Securities Inc. it is being so distributed under license. In the event that an error is found in an CGMJ research report, a revised version will be posted on the Firm's Citi Velocity website. If you have questions regarding Citi Velocity, please call (81 3) 6270-3019 for help. The Product is made available in **Korea** by Citigroup Global Markets Korea Securities Ltd., which is regulated by the Financial Services Commission, the Financial Supervisory Service and the Korea Financial Investment Association (KOFIA). Citibank Building, 39 Da-dong, Jung-gu, Seoul 100-180, Korea. KOFIA makes available registration information of research analysts on its website. Please visit the following website if you wish to find KOFIA registration information on research analysts of Citigroup Global Markets Korea Securities Ltd. <http://dis.kofia.or.kr/fs/dis2/fundMgr/DISFundMgrAnalystPop.jsp?companyCd2=A03030&pageDiv=02>. The Product is made available in Korea by Citibank Korea Inc., which is regulated by the Financial Services Commission and the Financial Supervisory Service. Address is Citibank Building, 39 Da-dong, Jung-gu, Seoul 100-180, Korea. The Product is made available in **Malaysia** by Citigroup Global Markets Malaysia Sdn Bhd (Company No. 460819-D) ("CGMM") to its clients and CGMM takes responsibility for its contents. CGMM is regulated by the Securities Commission of Malaysia. Please contact CGMM at Level 43 Menara Citibank, 165 Jalan Ampang, 50450 Kuala Lumpur, Malaysia in respect of any matters arising from, or in connection with, the Product. The Product is made available in **Mexico** by Acciones y Valores Banamex, S.A. De C. V., Casa de Bolsa, Integrante del Grupo Financiero Banamex ("Accival") which is a wholly owned subsidiary of Citigroup Inc. and is regulated by Comision Nacional Bancaria y de Valores. Reforma 398, Col. Juarez, 06600 Mexico, D.F. In **New Zealand** the Product is made available to 'wholesale clients' only as defined by s5C(1) of the Financial Advisers Act 2008 ('FAA') through Citigroup Global Markets Australia Pty Ltd (ABN 64 003 114 832 and AFSL No. 240992), an overseas financial adviser as defined by the FAA, participant of the ASX Group and regulated by the Australian Securities & Investments Commission. Citigroup Centre, 2 Park Street, Sydney, NSW 2000. The Product is made available in **Pakistan** by Citibank N.A. Pakistan branch, which is regulated by the State Bank of Pakistan and Securities Exchange Commission, Pakistan. AWT Plaza, 1.1. Chundrigar Road, P.O. Box 4889, Karachi-74200. The Product is made available in the **Philippines** through Citicorp Financial Services and Insurance Brokerage Philippines, Inc., which is regulated by the Philippines Securities and Exchange Commission. 20th Floor Citibank Square Bldg. The Product is made available in the Philippines through Citibank NA Philippines branch, Citibank Tower, 8741 Paseo De Roxas, Makati City, Manila. Citibank NA Philippines NA is regulated by The Bangko Sentral ng Pilipinas. The Product is made available in **Poland** by Dom Maklerski Banku Handlowego SA an indirect subsidiary of Citigroup Inc., which is regulated by Komisja Nadzoru Finansowego. Dom Maklerski Banku Handlowego S.A. ul.Senatorska 16, 00-923 Warszawa. The Product is made available in the **Russian Federation** through ZAO Citibank, which is licensed to carry out banking activities in the Russian Federation in accordance with the general banking license issued by the Central Bank of the Russian Federation and brokerage activities in accordance with the license issued by the Federal Service for Financial Markets. Neither the Product nor any information contained in the Product shall be considered as advertising the securities mentioned in this report within the territory of the Russian Federation

or outside the Russian Federation. The Product does not constitute an appraisal within the meaning of the Federal Law of the Russian Federation of 29 July 1998 No. 135-FZ (as amended) On Appraisal Activities in the Russian Federation. 8-10 Gasheka Street, 125047 Moscow. The Product is made available in **Singapore** through Citigroup Global Markets Singapore Pte. Ltd. ("CGMSPL"), a capital markets services license holder, and regulated by Monetary Authority of Singapore. Please contact CGMSPL at 8 Marina View, 21st Floor Asia Square Tower 1, Singapore 018960, in respect of any matters arising from, or in connection with, the analysis of this document. This report is intended for recipients who are accredited, expert and institutional investors as defined under the Securities and Futures Act (Cap. 289). The Product is made available by The Citigroup Private Bank in Singapore through Citibank, N.A., Singapore Branch, a licensed bank in Singapore that is regulated by Monetary Authority of Singapore. Please contact your Private Banker in Citibank N.A., Singapore Branch if you have any queries on or any matters arising from or in connection with this document. This report is intended for recipients who are accredited, expert and institutional investors as defined under the Securities and Futures Act (Cap. 289). This report is distributed in Singapore by Citibank Singapore Ltd ("CSL") to selected Citigold/Citigold Private Clients. CSL provides no independent research or analysis of the substance or in preparation of this report. Please contact your Citigold/Citigold Private Client Relationship Manager in CSL if you have any queries on or any matters arising from or in connection with this report. This report is intended for recipients who are accredited investors as defined under the Securities and Futures Act (Cap. 289). Citigroup Global Markets (Pty) Ltd. is incorporated in the **Republic of South Africa** (company registration number 2000/025866/07) and its registered office is at 145 West Street, Sandton, 2196, Saxonwold. Citigroup Global Markets (Pty) Ltd. is regulated by JSE Securities Exchange South Africa, South African Reserve Bank and the Financial Services Board. The investments and services contained herein are not available to private customers in South Africa. The Product is made available in **Spain** by Citigroup Global Markets Limited, which is authorised and regulated by Financial Services Authority. 29 Jose Ortega Y Gasset, 4th Floor, Madrid, 28006, Spain. The Product is made available in the **Republic of China** through Citigroup Global Markets Taiwan Securities Company Ltd. ("CGMTS"), 14 and 15F, No. 1, Songzhi Road, Taipei 110, Taiwan and/or through Citibank Securities (Taiwan) Company Limited ("CSTL"), 14 and 15F, No. 1, Songzhi Road, Taipei 110, Taiwan, subject to the respective license scope of each entity and the applicable laws and regulations in the Republic of China. CGMTS and CSTL are both regulated by the Securities and Futures Bureau of the Financial Supervisory Commission of Taiwan, the Republic of China. No portion of the Product may be reproduced or quoted in the Republic of China by the press or any third parties [without the written authorization of CGMTS and CSTL]. If the Product covers securities which are not allowed to be offered or traded in the Republic of China, neither the Product nor any information contained in the Product shall be considered as advertising the securities or making recommendation of the securities in the Republic of China. The Product is for informational purposes only and is not intended as an offer or solicitation for the purchase or sale of a security or financial products. Any decision to purchase securities or financial products mentioned in the Product must take into account existing public information on such security or the financial products or any registered prospectus. The Product is made available in **Thailand** through Citicorp Securities (Thailand) Ltd., which is regulated by the Securities and Exchange Commission of Thailand. 18/F, 22/F and 29/F, 82 North Sathorn Road, Silom, Bangrak, Bangkok 10500, Thailand. The Product is made available in **Turkey** through Citibank AS which is regulated by Capital Markets Board. Tekfen Tower, Eski Büyükdere Caddesi # 209 Kat 2B, 23294 Levent, Istanbul, Turkey. In the **U.A.E.**, these materials (the "Materials") are communicated by Citigroup Global Markets Limited, DIFC branch ("CGML"), an entity registered in the Dubai International Financial Center ("DIFC") and licensed and regulated by the Dubai Financial Services Authority ("DFSA") to Professional Clients and Market Counterparties only and should not be relied upon or distributed to Retail Clients. A distribution of the different Citi Research ratings distribution, in percentage terms for Investments in each sector covered is made available on request. Financial products and/or services to which the Materials relate will only be made available to Professional Clients and Market Counterparties. The Product is made available in **United Kingdom** by Citigroup Global Markets Limited, which is authorised and regulated by Financial Services Authority. This material may relate to investments or services of a person outside of the UK or to other matters which are not regulated by the FSA and further details as to where this may be the case are available upon request in respect of this material. Citigroup Centre, Canada Square, Canary Wharf, London, E14 5LB. The Product is made available in **United States** by Citigroup Global Markets Inc, which is a member of FINRA and registered with the US Securities and Exchange Commission. 388 Greenwich Street, New York, NY 10013. Unless specified to the contrary, within EU Member States, the Product is made available by Citigroup Global Markets Limited, which is regulated by Financial Services Authority. Pursuant to Comissão de Valores Mobiliários Rule 483, Citi is required to disclose whether a Citi related company or business has a commercial relationship with the subject company. Considering that Citi operates multiple businesses in more than 100 countries around the world, it is likely that Citi has a commercial relationship with the subject company.

Many European regulators require that a firm must establish, implement and make available a policy for managing conflicts of interest arising as a result of publication or distribution of investment research. The policy applicable to Citi Research's Products can be found at https://www.citivelocity.com/cvr/eppublic/citi_research_disclosures.

Compensation of equity research analysts is determined by equity research management and Citigroup's senior management and is not linked to specific transactions or recommendations.

The Product may have been distributed simultaneously, in multiple formats, to the Firm's worldwide institutional and retail customers. The Product is not to be construed as providing investment services in any jurisdiction where the provision of such services would not be permitted.

Subject to the nature and contents of the Product, the investments described therein are subject to fluctuations in price and/or value and investors may get back less than originally invested. Certain high-volatility investments can be subject to sudden and large falls in value that could equal or exceed the amount invested. Certain investments contained in the Product may have tax implications for private customers whereby levels and basis of taxation may be subject to change. If in doubt, investors should seek advice from a tax adviser. The Product does not purport to identify the nature of the specific market or other risks associated with a particular transaction. Advice in the Product is general and should not be construed as personal advice given it has been prepared without taking account of the objectives, financial situation or needs of any particular investor. Accordingly, investors should, before acting on the advice, consider the appropriateness of the advice, having regard to their objectives, financial situation and needs. Prior to acquiring any financial product, it is the client's responsibility to obtain the relevant offer document for the product and consider it before making a decision as to whether to purchase the product. With the exception of our product that is made available only to Qualified Institutional Buyers (QIBs) and other product that is made available through other distribution channels only to certain categories of clients to satisfy legal or regulatory requirements, Citi Research concurrently disseminates its research via proprietary and non-proprietary electronic distribution platforms. Periodically, individual Citi Research analysts may also opt to circulate research posted on such platforms to one or more clients by email. Such email distribution is discretionary and is done only after the research has been disseminated via the aforementioned distribution channels. Citi Research simultaneously distributes product that is limited to QIBs only through email distribution.

The level and types of services provided by Citi Research analysts to clients may vary depending on various factors such as the client's individual preferences as to the frequency and manner of receiving communications from analysts, the client's risk profile and investment focus and perspective (e.g.

market-wide, sector specific, long term, short-term etc.), the size and scope of the overall client relationship with Citi and legal and regulatory constraints. Citi Research product may source data from dataCentral. dataCentral is a Citi Research proprietary database, which includes Citi estimates, data from company reports and feeds from Reuters and Datastream.

© 2013 Citigroup Global Markets Inc. Citi Research is a division of Citigroup Global Markets Inc. Citi and Citi with Arc Design are trademarks and service marks of Citigroup Inc. and its affiliates and are used and registered throughout the world. All rights reserved. Any unauthorized use, duplication, redistribution or disclosure of this report (the "Product"), including, but not limited to, redistribution of the Product by electronic mail, posting of the Product on a website or page, and/or providing to a third party a link to the Product, is prohibited by law and will result in prosecution. The information contained in the Product is intended solely for the recipient and may not be further distributed by the recipient to any third party. Where included in this report, MSCI sourced information is the exclusive property of Morgan Stanley Capital International Inc. (MSCI). Without prior written permission of MSCI, this information and any other MSCI intellectual property may not be reproduced, disseminated or used to create any financial products, including any indices. This information is provided on an "as is" basis. The user assumes the entire risk of any use made of this information. MSCI, its affiliates and any third party involved in, or related to, computing or compiling the information hereby expressly disclaim all warranties of originality, accuracy, completeness, merchantability or fitness for a particular purpose with respect to any of this information. Without limiting any of the foregoing, in no event shall MSCI, any of its affiliates or any third party involved in, or related to, computing or compiling the information have any liability for any damages of any kind. MSCI, Morgan Stanley Capital International and the MSCI indexes are services marks of MSCI and its affiliates. The Firm accepts no liability whatsoever for the actions of third parties. The Product may provide the addresses of, or contain hyperlinks to, websites. Except to the extent to which the Product refers to website material of the Firm, the Firm has not reviewed the linked site. Equally, except to the extent to which the Product refers to website material of the Firm, the Firm takes no responsibility for, and makes no representations or warranties whatsoever as to, the data and information contained therein. Such address or hyperlink (including addresses or hyperlinks to website material of the Firm) is provided solely for your convenience and information and the content of the linked site does not in anyway form part of this document. Accessing such website or following such link through the Product or the website of the Firm shall be at your own risk and the Firm shall have no liability arising out of, or in connection with, any such referenced website.

ADDITIONAL INFORMATION IS AVAILABLE UPON REQUEST
