

European Portfolio Strategist

The Only Growth Trade in Town

- **Defensive Growth** — Cyclical and levered growth led performance before 2008-09. In the de-leveraging era, Defensive Growth has enjoyed structural leadership.
- **Question** — Strong multi-year performance scares many. We hear cries of “too expensive” or “over-owned”. Is it time to call time on the Defensive Growth theme?
- **Answer** — No. Broad global recovery or widespread corporate leverage is needed to end Defensive Growth leadership. Both unlikely over next 12-18 months.
- **And** — Defensive Growth has de-rated in the past few months. Entry opportunity for earnings outperformance strategy. SAP, Bayer, Syngenta, BATs, Inditex feature.
- **Risks to Defensive Growth outperformance** — We see three: 1) stabilisation of Chinese growth, 2) 2H13 pick-up in US growth, 3) selective corporate leverage.
- **Asian plays** — With our economists seeing signs of Chinese growth leveling off, we screen for Asian exposed stocks with beta >1. ABB, ARM, BHP, LVMH feature.

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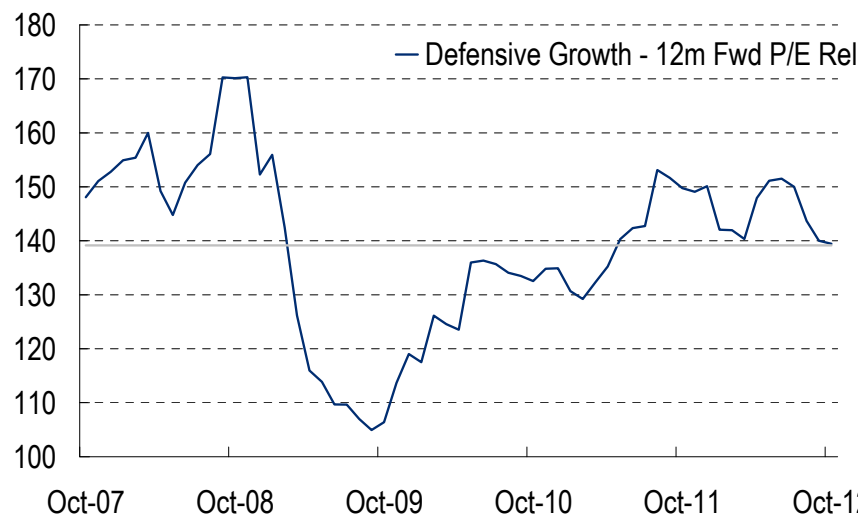
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Figure 1. Defensive Growth De-rating — Back to 12-Month Relative Cheaps (P/E Rel)



Source: Datastream and Citi Research

[Oct 18 – World Champions Revisited](#)

[Oct 11 – Investor Survey](#)

[Oct 04 – Buyers for Equity Found](#)

[Sep 27 – Earnings Mo to Carry On](#)

[Sep 20 – The Hokey Cokey](#)

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

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The Only Growth Trade in Town

We have backed Defensive Growth since mid-2009¹. It is an investment theme which always generates a lot of investor debate. Few investors counter the fundamental strength of most companies with Defensive Growth characteristics. But, many investors carry valuation and (over) ownership concerns.

Defensive Growth has been a key beneficiary of widespread de-leveraging over the past few years. As cyclical and levered growth has become scarcer, Defensive Growth has become the "only growth trade in town". The outperformance of Defensive Growth has been supported by superior earnings trends over the past few years. This report considers the threat to ongoing Defensive Growth earnings and performance leadership from broad economic recovery (cyclical growth) and the reversal of de-leveraging (levered growth).

We conclude that it is too early to walk away from our long-held backing of Defensive Growth and that the recent de-rating provides investors with another good entry point². We expect selective, rather than widespread, threats to Defensive Growth from stock specific disappointments, economic recovery and re-leveraging over the next 12-18 months. The stabilisation of Chinese growth, a 2H13 pick-up in US growth and the rise in corporate leverage present the biggest threats, in our view. Investors should also continue to assess individual business models for signs of potential weakness and keep one eye (not two) on valuation.

Defensive Growth

We have viewed Defensive Growth as a "[have your cake and eat it](#)" investment theme for investors in recent years³. We think that it offers downside protection and upside participation, at the same time. We like that.

Defensive growth has outperformed

Figure 2. European Defensive Growth Relative to Market



Source: Datastream & Citi Research

¹ European Portfolio Strategist — The Case for the Defence — 2 July 2009.

² European Portfolio Strategist — Hokey Cokey — 20 September 2012.

³ European Portfolio Strategist — Eating Cake — 29 March 2012.

We have also described Defensive Growth as an "earnings call option". Our criteria for finding stocks to fit this theme play to this. We want companies which had a proven earnings stop-loss in the 2008-09 crisis (peak to trough earnings fall less than 20% vs market earnings down c50%) and which are also expected to deliver decent earnings growth over the next couple of years (8%+ 2-year compound growth for big-caps, 10%+ for others).

Figure 2 shows the relative performance of the 60-65 European stocks which qualify as Defensive Growth on our criteria. Defensive Growth was a slow-burn underperformer between 2002-07. We put this down to one thing — leverage. Leverage generated "artificial" returns and growth, for corporates and across economies too. This presented a formidable competitor to organic returns and growth. Leverage 1, Defensive Growth 0.

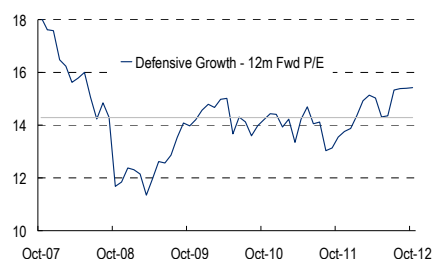
Defensive Growth has been a strong performer through and since the 2008-09 global financial crisis. De-leveraging and lower global growth have removed the previous competitor to organic returns and growth. There have been brief periods of policy-led underperformance, such as this summer, but otherwise Defensive Growth has delivered strong performance over the past 4-5 years. Leverage 0, Defensive Growth 3. It is this outperformance which is the starting point for investor concern.

Valuation

But, what about valuation? Like investors, we don't like over-paying for shares, but we have also aggressively downplayed valuation in our investment process and in our structural themes over the past 2-3 years. Instead of value, we have focused on attributes such as quality, growth and secure income. Structurally, we continue to do so. But, we are also happy to tactically raise exposure to value when the time is right. We last did this, for example, in June this year ([Value Hunter](#)).

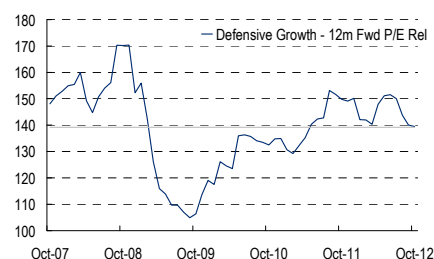
Relative de-rating offers entry point

Figure 3. Defensive Growth — P/E Abs, 5yr



Source: Datastream & Citi Research

Figure 4. Defensive Growth — P/E Rel, 5yr



Source: Datastream & Citi Research

Figure 3 and Figure 4 show the 12-month forward P/E and P/E relative of our Defensive Growth stocks. In absolute terms, these stocks have re-rated since summer 2011 lows, from c13x to c15x. Not cheap, but only one P/E point above the 5-year average and bang in-line with the 10-year average (not shown). Absolute valuation shows Defensive Growth as fair value (10-years) to slightly expensive (5-years). Relative valuation suggests fair value on 5- and 10-years. Defensive Growth trades on its average 12-month forward P/E relatives for both periods. Figure 4 also shows the de-rating in the past couple of months. We think this de-rating provides another good entry point for investors.

Outperformance driven by earnings

Figure 5. Defensive Growth — Price & Earnings Relative, 5yr



Source: Datastream & Citi Research

Figure 5 breaks down the P/E relative into price and earnings relative for Defensive Growth. This is the key chart for us. It shows that the outperformance of the past 5 years has been entirely supported by earnings outperformance. This is why the P/E relative for Defensive Growth has not risen during this time. In fact, it has fallen from 150 to 140, a small relative de-rating.

The biggest threat to ongoing outperformance from Defensive Growth, in our view, is the end of earnings leadership. We see three possible ways this could happen: 1) economic recovery, 2) re-leveraging, 3) earnings weakness across Defensive Growth but not across rest of market.

We pretty much dismiss the third option. It is not impossible that earnings expectations soften for individual Defensive Growth stocks or for the whole Defensive Growth group. Indeed, we have seen profit disappointments in recent weeks from stocks such as Danone, Nestle and Aggreko. But, widespread earnings weakness is unlikely without a further sharp slowdown in the global economy. In this scenario, cyclicals and financials are likely to face greater downside risks to earnings, as was the case in 2008-09.

So, it seems very unlikely that earnings weakness in this group exceeds earnings weakness of the rest of the market for a prolonged period of time. Earnings underperformance is more likely to happen because earnings across the rest of the market are recovering strongly. We discuss that scenario in the next section.

Risks to Defensive Growth — 1, 2, 3

Broad global economic recovery is unlikely, according to our [economists](#). They expect global GDP growth of 2.5% this year and 2.6% next year⁴, with Euro Area GDP growth likely to remain negative until 2015. This is not an environment which is likely to broadly challenge the earnings leadership from Defensive Growth. But, there may be more specific risks from the stabilisation of Chinese growth expectations in the coming months or pick-up of US growth in 2H13-2014.

Overall, we see three main risks to Defensive Growth from economic recovery and re-leveraging: 1) the stabilisation of Chinese growth, 2) a 2H13 pick-up in US growth and 3) the selective rise in corporate leverage.

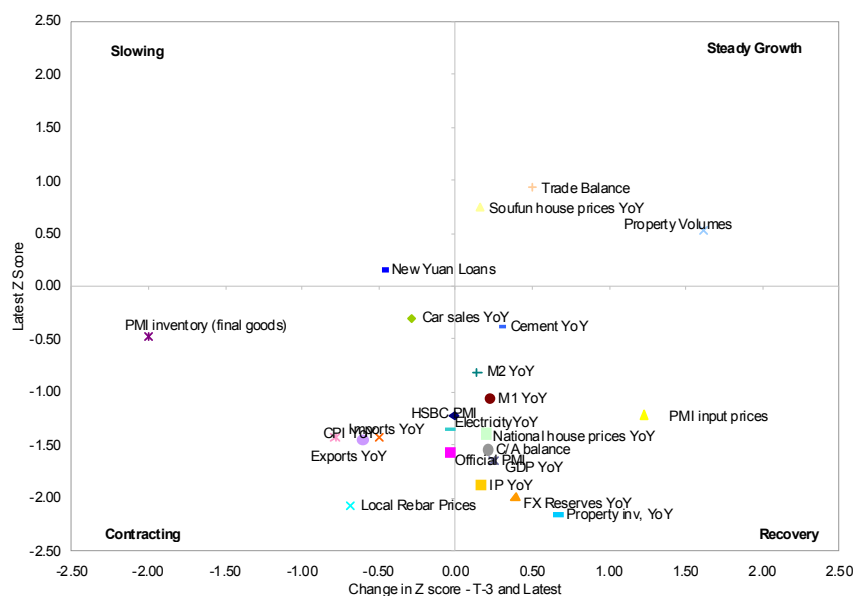
1. Stabilisation of Chinese growth

Chinese growth has slowed over the past 12-18 months. Our economists have cut 2012-13E GDP growth forecasts. They now expect 7.7% GDP growth this year and 7.6% next year compared to 8.7% and 8.5% 12 months ago. But, there are some tentative signs in recent data that China's economy is leveling off and perhaps even rebounding a little. Our economists cite credit growth, which continues to grind higher, import growth turning positive in September and stronger export data in some other Asian economies.

Expectations for stabilising Chinese growth are further supported by official monetary and fiscal stimulus, ample liquidity and catch-up industrialisation and [urbanisation](#). Minggao Shen and our Chinese economics team see urbanisation playing a critical role in rebalancing the Chinese economy and in sustaining the next stage of growth.

Chinese macro data getting less bad

Figure 6. China Quadrant — Breaking Down Chinese Economic Data



Source: Citi Research

⁴ Global Economic Outlook and Strategy — Willem Buiter et al, 24 October 2012.

Figure 6 borrows a chart from Citi's Global Macro Strategy team. They score various Chinese economic variables on a z-score basis and compare current scores to 3-month ago levels to see whether a variable is suggesting steady growth, slowing, contracting or recovery. At the moment, recovery is the most populated quadrant. This means that current z-scores are still negative, but less so than 3-months ago. This supports the economists' view of a leveling of growth.

Chinese stabilisation screen

Figure 7. China Growth Stabilisation Screen — Asia Sales > 20%, Mkt Cap >€5bn, Beta >1

Stock	RIC	>€5bn Mkt Cap, Em	>20% Asia Sales Exp	>1 Beta	Rel Perf YTD	12m Fwd P/E	Net Debt/EBITDA 2012E
ASML	ASML.AS	17004	70	1.1	14	13.5	-1.15
Standard Chart	STAN.L	35251	70	1.0	-2	10.2	
BHP Billiton	BLT.L	52045	45	1.5	-1	11.3	0.80
Restricted			45	1.5	-7	10.9	1.51
Richemont	CFR.VX	25265	44	1.3	13	13.7	-1.25
Swatch B	UHR.VX	9675	41	1.2	-1	13.0	-0.92
Prudential	PRU.L	26464	41	1.3	24	11.5	
Rio Tinto	RIO.L	48308	40	1.6	-6	8.3	1.00
Holcim R	HOLN.VX	11920	40	1.2	16	15.5	2.66
Infineon Tech	IFXGn.DE	5667	39	1.9	-18	19.6	-2.02
Nokia	NOK1V.HE	7677	38	1.3	-50	-27.1	-23.06
HeidelbergCem	HEIG.DE	5730	36	1.9	12	11.3	3.00
Antofagasta	ANTO.L	6034	34	1.6	-3	14.2	-0.51
ING Groep	ING.AS	25905	29	2.4	10	6.1	
Ericsson B	ERICb.ST	20702	28	1.2	-22	12.1	-1.55
Akzo Nobel	AKZO.AS	9764	28	1.1	0	12.2	1.29
LVMH	LVMH.PA	32708	27	1.1	2	16.0	0.51
ARM Holdings	ARM.L	10829	27	1.0	1	35.0	-1.61
ABB	ABBn.VX	33890	26	1.2	-9	12.6	0.03
A P Moller	MAERSKb.CO	7307	26	1.4	-4	9.1	1.44
Kone B	KNEBV.HE	10608	24	1.1	26	21.1	-1.13
Anglo American	AAL.L	32117	24	1.5	-27	10.3	1.05
Johnson Matthey	JMAT.L	5768	23	1.2	14	13.7	0.66
Koninklijke DSM	DSMN.AS	6420	21	1.0	-2	11.3	0.85

Source: Datastream & Citi Research

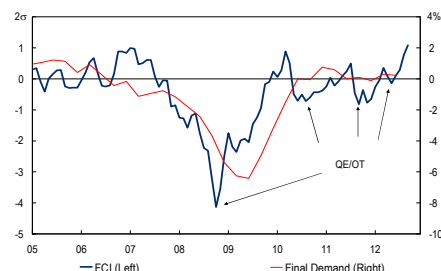
If the stabilisation of Chinese growth is confirmed in the coming months, this could provide a near-term boost to Chinese and Asian exposed stocks. Given expectations in some quarters for further slowdown in Chinese growth, or even hard landing, such a confirmation would likely provide the biggest boost to high beta Asian stocks. Figure 7 shows some of those stocks that could be a beneficiary of this scenario. These are €5bn+ market cap European stocks with at least 20% sales/profit exposure to Asia and with a beta greater than one. Miners, Asian financial stocks, luxury, tech and chemicals dominate.

2. 2H13 US growth pick-up

The second economic risk to Defensive Growth, in our view, is the potential pick-up in US economic growth in 2H13 and 2014.

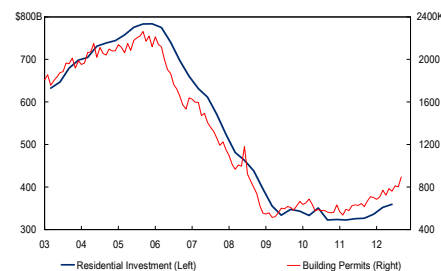
Supports for US growth

Figure 8. US Final Domestic Demand, YoY %



Sources: BEA, Congressional Budget Office, CIRA.

Figure 9. US Private Residential Investment



Sources: BEA and Census Bureau.

Our US economists have recently highlighted Citi's Financial Conditions Index (FCI) at its highest level for a few years (Figure 8). They believe that final demand is reasonably well supported at this point. Improvements in the residential housing market (Figure 9) also provide support.

Overall, our economists are not getting carried away and believe that US GDP growth will remain around 2% in 2013. This is similar to this year's growth rate. But, they also expect weaker growth in 1H13 to be replaced by stronger growth in 2H13 as consumption and business investment picks up following resolution of the US fiscal cliff in the coming months.

Failure to address the US cliff would be [disaster](#), for the US and the global economy⁵. Recent developments in the US election could also have raised the risks relating to the US fiscal cliff⁶, according to [Tina Fordham](#), Citi's chief political analyst.

US growth pick-up screen

⁵ US Macro Focus — The Fiscal Cliff: Assessing the Policy Risks — 21 September 2012.

⁶ Global Political Insights — Poll Position: Uncertainty on the Rise in Close US Election — 25 October 2012.

Figure 10. 2H13 US Growth Pick-Up Screen — US Sales > 20%, Mkt Cap >€5bn, Beta >1

Stock	RIC	>€5bn Mkt Cap, Em	>20% US Sales Exp	>1 Beta	Rel Perf YTD	12m Fwd P/E	Net Debt/EBITDA 2012E
Wolseley	WOS.L	9196	53	1.3	16	14.4	0.14
CRH	CRH.L	9801	50	1.6	-20	15.3	2.08
Swiss Re	SRENH.VX	18507	46	1.1	25	9.6	
Aegon	AEGN.AS	7428	46	1.8	30	7.0	
ING Groep	ING.AS	25905	43	2.4	10	6.1	
ARM Holdings	ARM.L	10829	38	1.0	1	35.0	-1.61
Deutsche Bank	DBKGn.DE	31077	37	1.9	3	7.8	
Prudential	PRU.L	26464	37	1.3	24	11.5	
Tenaris	TS.N	6877	35	1.6	-6	12.3	-0.09
WPP	WPP.L	12804	35	1.0	14	10.6	1.14
Michelin	MICP.PA	11643	34	1.7	28	7.2	0.52
Assa Abloy B	ASSAb.ST	8232	30	1.1	17	14.0	1.66
Muenchener Re	MUVGn.DE	20122	29	1.2	20	8.2	
Schneider Electric	SCHN.PA	26267	28	1.6	7	11.8	1.23
Standard Life	SL.L	8265	27	1.1	30	13.4	
Porsche Pref.	PSHG_p.DE	7224	26	1.6	4		-575.33
Daimler	DAIGn.DE	37153	25	1.8	2	7.2	0.73
Johnson Matthey	JMAT.L	5768	25	1.2	14	13.7	0.66
Fiat Industrial	FI.MI	6422	25	1.7	8	8.7	5.45
Rio Tinto	RIO.L	48308	25	1.6	-6	8.3	1.00
Ericsson B	ERICb.ST	20702	24	1.2	-22	12.1	-1.55
Bayer	BAYGn.DE	54471	24	1.4	21	12.2	0.83
Barclays	BARC.L	30191	24	1.7	24	6.5	
ASML	ASML.AS	17004	23	1.1	14	13.5	-1.15
HeidelbergCement	HEIG.DE	5730	22	1.9	12	11.3	3.00
LVMH	LVMH.PA	32708	22	1.1	2	16.0	0.51
Akzo Nobel	AKZO.AS	9764	21	1.1	0	12.2	1.29
Siemens	SIEGn.DE	64002	21	1.1	-5	11.9	0.39
BASF	BASFn.DE	57445	20	1.5	6	11.3	0.86

Source: Citi Research

But, it is still likely that US politicians turn the cliff into a slope. When this happens, then investors will be able to look forward with greater confidence to an improving economic landscape in the US. Importantly, downside risks, assuming no cliff, will also have sharply reduced.

At this juncture, companies with exposure to US growth are likely to find decent support. We screen for some of these in Figure 10. These are €5bn+ market cap European stocks with more than 20% sales/profit exposure to the US and with a beta above one.

Early resolution of the US fiscal cliff could accelerate support for this group. Our economists and political analysts suspect that is likely to be later not sooner.

3. Corporate leverage

The third risk to Defensive Growth is from corporate leverage. Broad take-up of leverage across companies and economies between 2003-07 presented the major headwind to Defensive Growth before the financial crisis. It is the absence of leverage, and de-leveraging, which has been a core factor behind Defensive Growth's subsequent outperformance. What now?

We continue to highlight the arbitrage opportunity on offer to many companies between cheap debt funding and expensive equity funding. This is the classic de-equitisation trade. Borrow cheaply in the bond market. Buy cheaply in the equity market.

De-equitisation screen

Figure 11. Large Cap Arbitrage Screen

Stock	RIC	>10bn Market Cap €m	>4.4 Avg FCFY	<1x Net Debt/EBITDA 12E
Novartis R	NOVN.VX	128856	8.8	0.4
Roche	ROG.VX	105817	6.8	0.8
Royal Dutch Shell A	RDSa.L	96005	6.1	0.3
Total	TOTF.PA	85393	4.4	0.6
GlaxoSmithKline	GSK.L	85332	7.4	1.0
Sanofi	SASY.PA	79621	9.1	0.7
Siemens	SIEGn.DE	64002	5.1	0.4
BASF	BASFn.DE	57445	5.7	0.9
Bayer	BAYGn.DE	54471	6.7	0.8
ENI	ENI.MI	46185	7.6	0.5
Unilever Certs.	UNc.AS	43307	5.6	1.0
Daimler	DAIGn.DE	37153	10.1	0.7
Unilever (UK)	ULVR.L	36428	5.6	1.0
ABB	ABBN.VX	33890	8.2	0.0
LVMH	LVMH.PA	32708	5.9	0.5
Reckitt Benckiser Group	RB.L	29302	6.6	0.6
Richemont	CFR.VX	25265	6.1	-1.3
L'Oreal	OREP.PA	23060	5.2	-0.4
Ericsson B	ERICb.ST	20702	6.1	-1.6
Rolls-Royce Holdings	RR.L	19680	4.4	-0.6
Philips Electronics	PHG.AS	18255	8.3	0.2
ASML	ASML.AS	17004	4.7	-1.2
Compass Group	CPG.L	15402	5.1	0.7
Essilor Intl.	ESSI.PA	14550	4.6	0.4
Volvo B	VOLVb.ST	14327	5.9	-1.2
Deutsche Post	DPWGn.DE	14146	4.5	0.1
BAE Systems	BAES.L	12259	7.9	0.4
Shire	SHP.L	12158	7.0	-0.3
Pearson	PERSON.L	11972	6.4	0.5
Michelin	MICP.PA	11643	6.7	0.5
Atlas Copco A	ATCOa.ST	11282	5.7	0.5
Henkel Pref.	HNKG_p.DE	10895	15.5	0.3
Kone B	KNEBV.HE	10608	4.4	-1.1

Source: Datastream & Citi Research

As macro risks reduce over coming quarters, eg post US fiscal cliff and with confirmation of Chinese growth stabilisation, we expect an increasing number of companies to take advantage of the de-equitisation arbitrage. We wrote about this in more detail in a [recent report](#) and we refresh the large-cap arbitrage screen from that report in Figure 11. This shows strong balance sheet €10bn+ market cap stocks with average 2012-13E free cashflow yields above BBB-rated European corporate bond yields.

Actually, there is reasonable overlap between this screen and our Defensive Growth universe. Some of the companies we believe are best positioned to take advantage of balance sheet strength and cheap debt funding are Defensive Growth stocks.

Defensive Growth opportunities

While we see some emerging risks to Defensive Growth earnings and performance leadership, these appear to be selective rather than widespread. It will take broad global economic recovery or widespread take-up of leverage by the corporate sector to put an end to the structural outperformance of this investment theme, in our view. We do not see that happening in the next 12-15 months.

Figure 12. Large Cap Defensive Growth — Market Cap >€10bn, 2yr Annualised Earnings Growth >8%, Fall EPS in Last Cycle <20%

Stock	RIC	>10bn Mkt Cap, Em	>-20% Peak to Trough Fall	>8% 2yr Annual Earnings Growth	Rel Perf, YTD	P/E Now	Min	Max	Percentile (Abs)	Percentile (Rel)
Nestle R	NESN.VX	159814	-9	8	2	17	12	18	0.81	0.59
Roche	ROG.VX	105817	-14	8	5	13	9	17	0.48	0.27
British American Tobacco	BATS.L	78760	-1	10	-3	14	11	17	0.59	0.44
Bayer	BAYGn.DE	54471	-18	14	21	12	8	17	0.48	0.31
Restricted			-19	11	16	17	10	18	0.82	0.64
Novo Nordisk B	NOVOB.CO	53235	3	18	33	23	14	24	0.85	0.67
SAP	SAPG.DE	48861	-13	16	18	16	12	21	0.44	0.19
Unilever Certs.	UNc.AS	43307	-9	8	-6	16	10	17	0.94	0.55
Unilever (UK)	ULVR.L	36428	-11	8	-2	17	10	18	0.88	0.72
SABMiller	SAB.L	32472	-14	13	8	16	9	20	0.64	0.56
Air Liquide	AIRP.PA	28107	-10	9	-6	17	12	19	0.67	0.46
Imperial Tobacco Gp.	IMT.L	28095	-18	9	-12	11	9	17	0.23	0.28
Danone	DANO.PA	27815	-11	8	-14	14	11	20	0.35	0.22
Syngenta	SYNN.VX	26605	-16	10	15	15	8	21	0.57	0.32
Hennes & Mauritz B	HMb.ST	24909	-19	10	-3	20	13	23	0.76	0.60
L'Oreal	OREP.PA	23060	-13	8	9	20	14	25	0.53	0.50
Inditex	ITX.MC	20277	-19	12	38	23	10	24	0.94	0.91
Pernod-Ricard	PERP.PA	17401	-15	13	7	16	8	18	0.79	0.72
Compass Group	CPG.L	15402	-6	8	3	15	10	18	0.58	0.57
Essilor Intl.	ESSI.PA	14550	-6	13	14	23	14	25	0.80	0.56
Experian	EXP.N.L	13680	-20	12	16	19	8	19	1.00	0.95
Shire	SHP.L	12158	-15	11	-26	14	12	28	0.10	0.07
Fresenius	FREG.DE	11883	-2	9	17	16	8	18	0.76	0.63
Fresenius Med. Care	FMEG.DE	11854	-15	9	0	19	12	20	0.88	0.60
Seadrill	SDRL.OL	10827	-13	21	8	12	2	18	0.63	0.67
Restricted			-19	14	21	15	9	18	0.72	0.80

Source: Datastream & Citi Research

Figure 12 re-runs our large-cap Defensive Growth screen, based on criteria described earlier in this report. Recent results from these companies contain some good numbers (eg SAP, Unilever, Syngenta) and some less good numbers (eg Danone, Nestle).

Our analysts highlight incremental weakness from Western European consumer demand for Tobacco and Food companies, but only see modest downside risks to aggregate consensus earnings growth estimates over the next couple of years because of this. Given the growth challenges elsewhere in the market, we think that these risks are unlikely to disrupt the ongoing earnings leadership from across the Defensive Growth group. We remain Overweight both Tobacco and Food & Beverage sectors in our European sector strategy.

Other analysts, such as our Health Care team, see a stable backdrop with potential upside risks as well. For example, Andrew Baum and team highlight that the proposed initiatives in the recently published President's Council of Advisors on Science and Technology (PCAST) report could have a significantly positive impact on industry R&D productivity⁷. We remain Overweight Health Care in our European sector strategy. Sanofi, Bayer and Novo Nordisk remain our team's key picks.

⁷ White House Calls for FDA to take More Risk — R&D ROI will double; sector remains materially undervalued — Andrew Baum, 1 October 2012.

Figure 13. Sub €10bn Defensive Growth — Market Cap <€10bn, 2yr Annualised Earnings Growth >8%, Fall EPS in Last Cycle <20%

Stock	RIC	<10bn Mkt Cap, Em	>-20% Peak to Trough Fall	>8% 2yr Annual Earnings Growth	Rel Perf, YTD	P/E Now	Min	Max	Percentile (Abs)	Percentile (Rel)
Ahold Kon.	AHLN.AS	9164	-2	8	-17	9	9	17	0.08	0.08
SGS N	SGSN.VX	9022	-4	14	17	21	11	21	1.00	0.82
Randgold Resources	RRS.L	8315	-11	20	6	17	12	48	0.15	0.09
Publicis Groupe	PUBP.PA	7295	-14	9	5	12	8	15	0.62	0.41
Smith & Nephew	SN.L	6982	-14	13	-4	13	11	21	0.23	0.22
Aggreko	AGGK.L	6669	-8	8	-6	19	8	22	0.75	0.59
Swedish Match	SWMA.ST	6166	-7	13	-1	17	12	18	0.77	0.53
Capita	CPI.L	5964	-16	9	8	13	12	24	0.13	0.00
Sodexo	EXHO.PA	5837	-5	8	-2	17	12	18	0.82	0.49
Kerry Group A	KYGa.I	5835	0	13	30	15	9	15	1.00	0.78
Snam	SRG.MI	5647	-3	28	-9	12	11	18	0.23	0.07
Intertek Group	ITRK.L	5487	-2	15	29	20	10	21	0.91	0.72
Dassault Systemes	DAST.PA	5161	-16	14	19	22	12	22	0.98	0.77
Gemalto	GTO.PA	4940	-11	20	58	19	8	21	0.87	0.74
Petrofac	PFC.L	4767	8	13	0	13	5	19	0.56	0.49
Getinge	GETIb.ST	4539	-14	14	8	15	10	19	0.51	0.49
G4S	GFS.L	4519	-9	9	-10	10	9	16	0.19	0.19
Bureau Veritas Intl.	BVI.PA	4373	-1	12	34	20				
Actelion	ATLN.VX	4353	-6	22	28	15	9	22	0.47	0.28
AMEC	AMEC.L	4276	-16	15	11	12	9	25	0.23	0.02
Bunzl	BNZL.L	4157	-16	8	8	14	9	15	0.79	0.58
Red Electrica Corpn.	REE.MC	4004	1	8	2	10	8	21	0.16	0.06
Tele2 B	TEL2b.ST	4000	-14	17	-21	10	8	24	0.12	0.08
Elektro B	EKTab.ST	3848	-4	20	13	22	11	23	0.92	0.70
Casino Guichard	CASP.PA	3816	-13	12	-5	12	8	14	0.61	0.51
Sonova N	SOON.VX	3793	-8	17	-12	18	10	28	0.48	0.31
Grifols	GRLS.MC	3781	-11	32	77	21	11	28	0.59	0.51
Coloplast B	COLOb.CO	3719	0	14	37	20	15	23	0.60	0.48
Serco Group	SRP.L	3455	-1	10	12	13	11	21	0.24	0.03
Aryzta N	ARYN.S	3438	-13	10	-9	10				
Vopak	VOPA.AS	3159	7	13	19	18	6	19	0.97	0.79
Qiagen	QGEN.O	3114	-14	10	14	16	12	28	0.24	0.11
Jeronimo Martins	JMT.LS	2951	-14	23	-2	19	12	23	0.60	0.34
Admiral Group	ADML.L	2790	-16	10	21	12	9	21	0.27	0.10
Colruyt	COLR.BR	2675	1	9	5	14	12	18	0.30	0.14
ADP	ADP.PA	1877	-10	16	3	16	14	32	0.12	0.00

Source: Datastream & Citi Research

Figure 13 shows European Defensive Growth stocks with a market cap under €10bn.

Strategy outlook

We first highlighted our preference for Defensive Growth in mid-2009 and argued that "consumer defensive companies in Food, Beverages, Tobacco, HPC and perhaps Health Care are more likely to fit the bill rather than Telecoms and Utilities". We broadly stick with our mid-2009 conclusions in late-2012. But, we continue to look for sources of earnings underperformance for Defensive Growth. It is this, in our view, which is key to the durability of this theme.

For now, we see selective risks from the stabilisation of Chinese growth, from a better US growth environment in 2H13-2014 and from increasing evidence of corporate leverage. Unlike 2003-07, when Defensive Growth underperformed, this is not broad global economic recovery or widespread adoption of corporate leverage. This is why we continue to back Defensive Growth and see the recent de-rating as an opportunity for investors.

Last, we return both Utilities and Telecoms to Underweight, from Neutral, in our European sector strategy. We had raised both for tactical reasons in the past couple of months to try to catch some benefits from falling European political and sovereign risks. Results have been mixed on that count. We see growth, capex and political challenges for both sectors. In addition, in the case of meaningful downside macro risks in Europe, we doubt these sectors are that defensive.

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Market Outlook & Citi Research

Market Outlook

Overall, global growth is likely to remain sluggish. Risks are probably skewed to the downside, but policy support should limit damage. Growth is likely to be weakest in the euro area with recession this year and next. With plenty of macro risk showing across all regions, it is easy to behave like “rabbits dazzled by bright macro headlights”. Despite risks, we see stable macro mega-trends: 1) de-leveraging, 2) lower growth, 3) divergent growth, 4) low interest rates. These trends look embedded for the next few years and our investment strategy remains guided by this.

Macro

GDP	2011	2012E	2013E
Euro zone	1.5	-0.4	-0.7
UK	0.9	-0.3	0.7
Global	3.0	2.5	2.6
US	1.8	2.1	1.8
Japan	-0.8	2.0	0.9

CPI	2011	2012E	2013E
Euro zone	2.7	2.6	2.3
UK	4.5	2.7	2.1
Global	3.8	2.8	2.9
US	2.4	1.8	1.9
Japan	-0.3	0.1	-0.1

Interest Rates	4Q12E	4Q13E
ECB	0.50	0.25
UK Base	0.50	0.50
US Fed Funds	0.25	0.25
Japan Call	0.1	0.1

10Yr Yield	4Q12E	4Q13E
Euro zone	1.50	1.50
UK	1.80	1.75
US	1.65	2.55
Japan	0.95	1.30

Ex Rates	4Q12E	4Q13E
US\$/€	1.31	1.22
US\$/£	1.61	1.56
€/£	1.23	1.30
Y/US\$	79	79

End Year Targets	Now	End-12E	Return
Stoxx	270	275	1.9
FTSE 100	5805	6000	3.3

Source: Reuters and Citi Research estimates

Our economists expect *Grexit* (probability recently lowered from 90% to 60%) over the coming 12-18 months, with the most likely timing for this to happen being H1 2014. However, contagion risks from any Grexit should be more limited given progress in building a suitable firewall. The EFSF/ESM, ECB secondary market purchases and further LTRO programmes can help to provide temporary funding to “at risk” countries over the next couple of years. Near-term euro disintegration risks have been reduced, according to our economists. It is likely that financial markets focus more on US elections and fiscal concerns into year-end. Our US economists think that the “fiscal cliff” will be avoided, while downside risks have pushed the Fed to further easing. In China, growth continues to slow.

Weak earnings

We find it hard to see a big acceleration in profit growth in 2013 without a strong economic recovery in Europe and the global economy. Our economists think that is unlikely. We target 0-10% earnings growth top-down in 2013E. An earnings or margin collapse seems unlikely to us without broader recession beyond Europe.

Valuation – support

European equities continue to look decent value. Not rock-bottom prices, but not expensive unless earnings collapse, in our view. We expect European equities to trade in a range of c9.5x-12x over the next year and a bit.

Themes

We continue to back the structural re-rating of strong credit, growth, quality and secure income. The global economy is long debt/short growth. We think investors should position oppositely, ie overweight growth/underweight debt. Our core themes such as Defensive Growth, World Champions and various income strategies (CDS, Diamonds) play to this. De-equitisation and earnings momentum strategies should be backed too, in our view. Investors also need to take advantage of tactical opportunities when the 4Ps (policy, politics, price, positioning) are lined up.

Sector Strategy

Our sector Overweights have an international and strong balance sheet bias. Our sector Underweights have a domestic and more levered tilt.

Figure 14. European Sector Strategy

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

Source: Citi Research

Valuation Tables

Figure 15. Pan-European Sector Weightings & Returns

As at Close 23 Oct 12	Mkt Cap	% of	Return Relative to DJ Stoxx				Absolute Return			
Sector (No of Stocks)	(Euros m) / J Stoxx	J Stoxx	1m	3m	12m	Ytd	1m	3m	12m	Ytd
Oil & Gas (33)	517,912	9.6	-1	-4	-7	-10	-4	3	8	2
Chemicals (25)	271,474	5.0	-3	1	8	8	-5	8	26	22
Basic Resources (28)	236,386	4.4	0	0	-8	-11	-3	8	7	1
Construction & Materials (21)	112,897	2.1	-3	0	-8	-5	-5	8	7	8
Industrial G&S (104)	563,580	10.4	0	1	5	4	-2	8	22	17
Automobiles & Parts (14)	128,778	2.4	-3	1	-2	8	-5	8	14	22
Food & Beverage (28)	487,772	9.0	1	-5	8	4	-1	2	26	18
Personal & H'hold Goods (31)	317,727	5.9	1	-7	4	2	-2	0	20	16
Health Care (36)	622,646	11.5	2	-5	7	1	-1	2	25	14
Retail (24)	171,395	3.2	-1	-2	-6	-5	-4	5	10	7
Media (27)	126,925	2.3	-1	-2	2	0	-3	5	18	13
Travel & Leisure (21)	70,698	1.3	0	-2	9	8	-3	5	27	22
Telecommunications (19)	276,313	5.1	-5	-8	-14	-13	-7	-1	0	-1
Utilities (25)	242,591	4.5	0	2	-10	-5	-3	9	4	8
Banks (46)	647,115	12.0	2	17	0	6	-1	26	16	19
Insurance (33)	304,480	5.6	2	11	9	14	0	19	26	29
Real Estate (29)	78,529	1.5	4	-2	3	10	1	5	20	24
Financial Services (30)	72,073	1.3	-1	1	-2	3	-4	8	14	17
Technology (26)	154,491	2.9	-2	-2	-8	-3	-5	5	7	9
Stoxx - Pan Europe (600)	5,403,780	100.0	—	—	—	—	-3	7	16	13
Pan Euro - Large Cap	4,428,646	82.0	0	0	0	-1	-3	7	16	12
Pan Euro - Mid Cap	681,748	12.6	-1	1	1	2	-3	8	17	16
Pan Euro - Small Cap	293,386	5.4	1	2	2	4	-1	9	18	18
Stoxx ex UK - Europe ex UK (420)	3,521,937	65.2	—	—	—	—	-3	10	15	13
EuroStoxx - Eurozone (298)	2,365,859	43.8	—	—	—	—	-3	12	11	12

Source: Citi Research & DataStream

Figure 16. Pan-European Sector Relative Ratings

As at Close 23 Oct 12	P/E Relative to DJ Stoxx				Yield Relative to DJ Stoxx			
Sector	2011	2012E	2013E	2014E	2011	2012E	2013E	2014E
Oil & Gas	81	76	84	88	108	113	108	104
Chemicals	105	105	109	108	74	76	75	75
Basic Resources	67	101	97	89	78	82	80	85
Construction & Materials	97	106	105	101	105	102	101	100
Industrial Goods & Services	116	110	113	112	86	86	85	83
Automobiles & Parts	61	62	60	59	98	111	117	119
Food & Beverage	155	142	146	146	71	75	77	78
Personal & H'hold Goods	144	125	129	128	71	77	81	83
Health Care	108	107	113	114	90	94	94	95
Retail	117	111	119	123	91	95	94	92
Media	97	97	102	105	111	104	103	102
Travel & Leisure	135	160	129	122	75	75	73	74
Telecommunications	75	80	90	95	220	164	172	163
Utilities	89	82	98	102	168	162	152	146
Banks	96	111	81	78	93	96	102	112
Insurance	95	67	72	74	115	123	122	119
Real Estate	155	152	162	170	118	116	112	107
Financial Services	113	103	96	94	124	129	119	117
Technology	112	165	131	121	65	68	62	62
Stoxx - Pan Europe	100	100	100	100	100	100	100	100
Pan Euro - Large Cap	96	96	98	99	102	103	103	102
Pan Euro - Mid Cap	124	121	110	107	91	88	89	91
Pan Euro - Small Cap	127	131	108	104	87	85	87	88
Stoxx ex UK - Europe ex UK	101	102	100	99	103	99	99	100
Stoxx Eurozone - Eurozone	94	97	95	94	111	103	103	102

Source: Citi Research & DataStream

Figure 17. Pan-European Sector Growth

As at Close 23 Oct 12 Sector	Earnings Growth %			Net Dividend Growth %		
	2012E	2013E	2014E	2012E	2013E	2014E
Oil & Gas	7.6	2.1	5.1	8.6	3.3	3.9
Chemicals	1.3	8.9	10.8	6.6	5.9	7.9
Basic Resources	-32.3	17.6	19.7	10.4	4.7	15.6
Construction & Materials	-7.1	14.0	14.3	1.1	6.7	8.1
Industrial Goods & Services	6.9	9.5	11.1	3.6	6.5	6.9
Automobiles & Parts	0.0	15.9	11.5	17.6	14.0	10.4
Food & Beverage	11.3	9.2	10.5	10.1	10.9	9.9
Personal & H'hold Goods	16.3	9.5	10.5	12.9	12.8	11.6
Health Care	2.6	5.9	10.1	8.8	7.4	9.4
Retail	6.7	5.4	6.5	8.5	5.9	6.8
Media	1.7	6.5	7.5	-3.2	6.8	6.9
Travel & Leisure	-14.1	38.8	16.6	3.0	5.3	10.8
Telecommunications	-5.5	0.0	4.6	-22.4	12.6	3.5
Utilities	10.3	-5.9	6.0	0.3	0.8	4.2
Banks	-12.6	53.5	15.3	6.6	14.9	18.7
Insurance	43.5	5.0	6.4	11.2	6.2	6.4
Real Estate	3.1	5.7	5.5	2.3	3.8	4.3
Financial Services	12.0	20.9	12.3	8.2	-0.7	6.5
Technology	-30.9	41.6	19.4	8.5	-2.5	8.9
Sbxx - Pan Europe	1.4	12.4	10.3	3.8	7.6	8.7
Pan Euro - Large Cap	1.3	9.8	9.8	4.4	7.4	8.2
Pan Euro - Mid Cap	3.9	24.7	12.5	0.3	8.2	11.7
Pan Euro - Small Cap	-1.8	36.6	15.0	1.5	10.7	9.7
Sbxx ex UK - Europe ex UK	0.7	14.5	10.9	-0.8	8.1	9.2
Sbxx Eurozone - Eurozone	-1.8	14.7	10.9	-3.7	7.3	8.6

Source: Citi Research & DataStream

Figure 18. Pan-European Sector Ratings

As at Close 23 Oct 12 Sector	Price/Earnings				Net Dividend Yield			
	2011	2012E	2013E	2014E	2011	2012E	2013E	2014E
Oil & Gas	10.0	9.3	9.1	8.7	4.03	4.38	4.52	4.70
Chemicals	13.0	12.9	11.8	10.7	2.78	2.96	3.14	3.39
Basic Resources	8.4	12.3	10.5	8.8	2.90	3.20	3.35	3.87
Construction & Materials	12.0	13.0	11.4	9.9	3.91	3.95	4.21	4.55
Industrial Goods & Services	14.3	13.4	12.2	11.0	3.20	3.32	3.54	3.78
Automobiles & Parts	7.5	7.5	6.5	5.8	3.66	4.30	4.90	5.41
Food & Beverage	19.3	17.3	15.8	14.3	2.64	2.91	3.23	3.55
Personal & H'hold Goods	17.8	15.3	14.0	12.6	2.65	3.00	3.38	3.77
Health Care	13.4	13.1	12.3	11.2	3.37	3.66	3.94	4.30
Retail	14.5	13.6	12.9	12.1	3.40	3.69	3.91	4.18
Media	12.0	11.8	11.1	10.3	4.16	4.03	4.31	4.61
Travel & Leisure	16.8	19.5	14.1	12.1	2.81	2.89	3.05	3.37
Telecommunications	9.3	9.8	9.8	9.4	8.20	6.36	7.17	7.42
Utilities	11.0	10.0	10.6	10.0	6.27	6.29	6.34	6.61
Banks	11.9	13.6	8.8	7.7	3.48	3.71	4.26	5.06
Insurance	11.7	8.2	7.8	7.3	4.30	4.78	5.07	5.40
Real Estate	19.2	18.6	17.6	16.7	4.39	4.50	4.67	4.87
Financial Services	14.1	12.6	10.4	9.3	4.62	5.00	4.96	5.29
Technology	13.9	20.1	14.2	11.9	2.43	2.64	2.57	2.80
Sbxx - Pan Europe	12.4	12.2	10.9	9.9	3.73	3.88	4.17	4.54
Pan Euro - Large Cap	11.9	11.7	10.7	9.7	3.82	3.98	4.28	4.63
Pan Euro - Mid Cap	15.4	14.9	11.9	10.6	3.41	3.43	3.71	4.14
Pan Euro - Small Cap	15.8	16.0	11.7	10.2	3.24	3.29	3.64	4.00
Sbxx ex UK - Europe ex UK	12.5	12.4	10.9	9.8	3.86	3.83	4.14	4.52
Sbxx Eurozone - Eurozone	11.6	11.8	10.3	9.3	4.14	3.99	4.28	4.65

Source: Citi Research & DataStream

Figure 19. 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	22,296	0.4	3	8	-7	-1	0	15	8	12
Belgium	84,831	1.6	0	0	20	17	-3	7	39	33
Denmark	103,825	1.9	3	0	27	16	1	7	48	31
Finland	71,639	1.3	1	6	-14	-7	-2	14	0	5
France	773,435	14.3	-1	3	-3	0	-3	10	13	13
Germany	701,999	13.0	-1	4	4	8	-4	12	21	22
Greece	6,567	0.1	17	8	-30	-13	14	16	-18	-2
Ireland	33,442	0.6	-4	-12	0	-12	-7	-6	17	-1
Italy	198,586	3.7	0	14	-12	-5	-3	22	2	7
Netherlands	222,397	4.1	1	0	-1	0	-2	7	15	13
Norway	84,203	1.6	-3	-4	1	2	-6	3	17	15
Portugal	14,697	0.3	1	10	-21	-12	-1	18	-9	-1
Spain	235,971	4.4	-3	18	-18	-14	-5	27	-5	-3
Sweden	251,062	4.6	-3	-6	3	0	-6	1	19	13
Switzerland	716,989	13.3	3	-1	4	2	0	7	20	16
UK	1,881,843	34.8	0	-5	1	-2	-3	2	18	11
Stoxx - Pan Europe	5,403,780	100								

Source: Citi Research & DataStream

Figure 20. Pan-European Country Relative Ratings

Country	Price/Earnings				Net Dividend Yield			
	2011	2012E	2013E	2014E	2011	2012E	2013E	2014E
Austria	198	89	87	85	82	93	92	97
Belgium	134	123	126	122	75	72	73	75
Denmark	192	158	145	131	40	48	57	63
Finland	98	170	125	114	145	142	120	114
France	91	93	92	92	106	106	106	108
Germany	96	89	94	95	93	93	92	91
Greece	218	1449	281	116	101	97	67	76
Ireland	145	152	146	137	53	53	52	46
Italy	88	83	85	82	109	105	105	106
Netherlands	99	91	99	98	85	81	75	80
Norway	99	90	91	88	127	117	123	128
Portugal	103	93	93	91	178	135	138	130
Spain	76	144	92	93	219	147	158	153
Sweden	105	105	111	114	99	107	105	101
Switzerland	122	116	112	112	87	88	89	92
UK	98	97	100	101	94	102	101	101
EuroStoxx - Eurozone	94	97	95	94	111	103	103	102
Stoxx ex UK - Europe ex UK	101	102	100	99	103	99	99	100
Stoxx - Pan Europe	100	100	100	100	100	100	100	100

Source: Citi Research & DataStream

Figure 21. Pan-European Country Growth

As at Close 23 Oct 12 Country	Earnings Growth %			Dividend Growth %		
	2012E	2013E	2014E	2012E	2013E	2014E
Austria	125.2	15.3	12.7	17.4	7.3	13.9
Belgium	10.4	9.6	14.3	-0.1	9.4	11.8
Denmark	23.5	22.0	22.5	25.6	26.8	20.2
Finland	-41.8	53.3	20.3	1.7	-8.9	2.8
France	-0.1	13.2	10.7	4.7	7.6	10.1
Germany	9.1	6.6	9.0	3.6	7.0	6.8
Greece	-84.7	480.4	168.0	-0.2	-26.1	23.2
Ireland	-3.3	17.4	17.8	3.9	4.2	-2.6
Italy	6.9	10.7	13.7	0.2	6.9	10.3
Netherlands	10.3	4.1	11.3	-1.0	0.3	15.1
Norway	11.7	10.9	13.9	-3.9	12.8	13.2
Portugal	12.4	11.8	13.5	-21.1	9.7	2.8
Spain	-46.0	75.3	9.5	-30.2	15.6	5.3
Sweden	1.8	5.7	8.2	11.6	5.5	5.6
Switzerland	7.0	16.5	10.3	5.4	9.6	11.3
UK	2.8	8.9	9.2	13.2	6.9	7.9
EuroStoxx - Eurozone	-1.8	14.7	10.9	-3.7	7.3	8.6
Stoxx ex UK - Europe ex UK	0.7	14.5	10.9	-0.8	8.1	9.2
Stoxx - Pan Europe	1.4	12.4	10.3	3.8	7.6	8.7

Source: Citi Research & DataStream

Figure 22. Pan-European Country Ratings

As at Close 23 Oct 12 Country	Price/Earnings				Net Dividend Yield			
	2011	2012E	2013E	2014E	2011	2012E	2013E	2014E
Austria	24.6	10.9	9.5	8.4	3.06	3.59	3.85	4.39
Belgium	16.6	15.0	13.7	12.0	2.79	2.78	3.04	3.40
Denmark	23.8	19.3	15.8	12.9	1.50	1.88	2.38	2.86
Finland	12.1	20.8	13.6	11.3	5.41	5.50	5.01	5.16
France	11.3	11.3	10.0	9.1	3.94	4.13	4.44	4.89
Germany	11.9	10.9	10.2	9.4	3.48	3.60	3.86	4.12
Greece	27.1	177.1	30.5	11.4	3.77	3.76	2.78	3.42
Ireland	18.0	18.6	15.9	13.5	1.99	2.07	2.16	2.10
Italy	10.9	10.2	9.2	8.1	4.08	4.09	4.37	4.82
Netherlands	12.3	11.2	10.7	9.6	3.16	3.13	3.13	3.61
Norway	12.3	11.0	9.9	8.7	4.73	4.54	5.12	5.80
Portugal	12.7	11.3	10.1	8.9	6.64	5.24	5.74	5.90
Spain	9.5	17.6	10.0	9.1	8.16	5.69	6.58	6.93
Sweden	13.0	12.8	12.1	11.2	3.71	4.14	4.36	4.60
Switzerland	15.2	14.2	12.2	11.0	3.23	3.41	3.73	4.15
UK	12.2	11.9	10.9	10.0	3.50	3.96	4.23	4.57
EuroStoxx - Eurozone	11.6	11.8	10.3	9.3	4.14	3.99	4.28	4.65
Stoxx ex UK - Europe ex UK	12.5	12.4	10.9	9.8	3.86	3.83	4.14	4.52
Stoxx - Pan Europe	12.4	12.2	10.9	9.9	3.73	3.88	4.17	4.54

Source: Citi Research & DataStream

Figure 23. UK Sector Weightings & Relative Returns

As at Close 23 Oct 2012	Mkt	% of	% of	Relative return				
	Cap £m	AllShare	Group	1m	3m	12m	Qtd	Ytd
OIL & GAS (25)	297,194	17.1		-1	-6	-10	-1	-13
Oil & Gas Producers (18)	285,180	16.4	96	-1	-6	-10	-1	-13
Oil Equip, Serv and Distrib (7)	12,014	0.7	4	-4	1	5	-4	3
BASIC MATERIALS (37)	174,950	10.1		0	6	-10	2	-9
Chemicals (7)	11,595	0.7	7	-8	1	15	-7	17
Forestry & Paper (1)	2,422	0.1	1	8	16	36	4	38
Industrial Metals & Mining (4)	1,362	0.1	1	-12	5	-40	-5	-36
Mining (25)	159,571	9.2	91	0	6	-11	2	-11
INDUSTRIALS (109)	155,019	8.9		-2	1	11	-2	8
Construction & Materials (11)	12,352	0.7	8	-7	-4	-4	-5	-8
Aerospace (9)	35,092	2.0	23	-2	-4	8	-2	6
General Industrials (6)	12,323	0.7	8	2	0	16	2	15
Electronic & Electrical Equip (12)	7,298	0.4	5	-5	0	16	-4	14
Industrial Engineering (12)	15,146	0.9	10	-4	5	5	-3	-2
Industrial Transportation (8)	2,044	0.1	1	5	7	6	3	11
Support Services (51)	70,764	4.1	46	0	5	14	-1	12
CONSUMER GOODS (35)	235,623	13.6		0	-4	5	-1	4
Automobiles & Parts (2)	3,392	0.2	1	-9	-4	3	-6	5
Beverages (4)	69,677	4.0	30	0	-2	14	-2	13
Food Producers (11)	37,546	2.2	16	1	0	3	1	0
Household Goods & Home Const (11)	34,161	2.0	14	3	4	7	2	15
Leisure Goods (1)	117	0.0	0	5	29	-10	2	-8
Personal Goods (4)	6,394	0.4	3	9	-12	-16	11	-10
Tobacco (2)	84,336	4.9	36	-2	-10	1	-2	-4
HEALTH CARE (13)	126,922	7.3		-1	-8	-7	-3	-9
Health Care Equip & Services (5)	6,772	0.4	5	-3	-6	3	-5	-3
Pharmaceuticals & Biotech (8)	120,150	6.9	95	-1	-8	-7	-3	-9
CONSUMER SERVICES (85)	162,759	9.4		-1	1	1	-1	2
Food & Drug Retailers (6)	38,301	2.2	24	-5	-5	-20	-5	-20
General Retailers (22)	28,821	1.7	18	6	11	12	6	21
Media (23)	47,822	2.8	29	-2	0	8	-2	6
Travel & Leisure (34)	47,815	2.8	29	0	2	11	0	11
TELECOMMUNICATIONS (8)	108,911	6.3		-2	-7	0	-2	-4
Fixed-Line Telecoms (6)	20,142	1.2	18	-5	-4	13	-6	10
Mobile Telecoms (2)	88,770	5.1	82	-1	-8	-3	-2	-6
UTILITIES (7)	69,079	4.0		1	-1	4	0	8
Electricity (2)	15,344	0.9	22	3	1	-1	1	5
Gas, Water & Multi-Utilities (5)	53,734	3.1	78	0	-1	5	0	8
TECHNOLOGY (25)	25,059	1.4		1	6	10	1	10
Software & Computer Serv (15)	12,233	0.7	49	-3	-3	11	-4	13
Technology Hardware & Equip (10)	12,826	0.7	51	6	16	9	6	5
TOTAL NON-FINANCIAL (344)	1,355,518	78.1		-1	-2	-2	-2	-3
FINANCIALS (252)	380,376	21.9		3	9	8	7	14
Banks (6)	192,526	11.1	51	4	15	10	5	17
Non-Life Insurance (9)	14,992	0.9	4	1	3	7	0	16
Life Insurance (9)	58,683	3.4	15	2	9	16	2	18
Real Estate Inv. Servs (23)	6,281	0.4	2	2	0	6	-1	8
REITS (17)	24,882	1.4	7	4	-1	4	2	14
Financial Services (27)	29,351	1.7	8	1	9	4	2	13
FTSE ALL SHARE (596)	1,735,894	100.0		0	0	0	0	0
FTSE 100 (100)	1,470,493	84.7		0	-1	-1	-1	-2
Mid 250 (250)	226,421	13		0	3	7	4	10
Small Cap (246)	38,980	2		2	4	8	4	11

Source: Citi Research & DataStream

Figure 24. UK Relative Ratings

As at Close 23 Oct 2012	P/E Relative				Yield Relative			
	2011E	2012E	2013E	2014E	2011E	2012E	2013E	2014E
OIL & GAS	81	78	84	88	99	99	96	92
Oil & Gas Producers	80	77	83	88	100	101	98	93
Oil Equip, Serv and Distrib	142	119	109	103	60	62	68	73
BASIC MATERIALS	69	103	94	87	73	74	77	80
Chemicals	134	128	131	129	64	66	66	69
Forestry & Paper	98	125	107	99	92	84	93	87
Industrial Metals & Mining	81	-166	-	1196	12	11	10	9
Mining	67	100	91	84	74	75	78	82
INDUSTRIALS	119	112	112	111	78	80	81	78
Construction & Materials	113	120	116	112	128	117	111	106
Aerospace	102	96	97	99	92	92	92	91
General Industrials	107	101	99	98	89	87	88	90
Electronic & Electrical Equip	124	118	117	116	49	51	52	54
Industrial Engineering	119	110	112	114	70	70	71	72
Industrial Transportation	97	105	102	100	109	103	99	95
Support Services	134	124	122	120	64	70	74	69
CONSUMER GOODS	145	130	129	128	85	85	89	92
Automobiles & Parts	81	67	61	62	78	87	94	96
Beverages	171	152	148	145	63	65	67	68
Food Producers	149	136	136	138	88	84	84	84
Household Goods & Home Const	144	124	128	127	71	67	80	87
Personal Goods	170	149	143	137	55	59	63	67
Tobacco	129	119	118	117	110	111	115	118
HEALTH CARE	88	92	99	100	131	124	122	120
Health Care Equip & Services	122	118	112	109	46	62	64	64
Pharmaceuticals & Biotech	86	91	98	99	136	128	126	123
CONSUMER SERVICES	106	106	108	110	95	89	89	87
Food & Drug Retailers	91	91	100	111	119	109	101	93
General Retailers	110	108	110	110	85	82	83	85
Media	114	105	106	108	93	89	91	90
Travel & Leisure	110	123	115	113	82	79	80	81
TELECOMMUNICATIONS	97	95	99	103	175	185	181	175
Fixed-Line Telecoms	88	80	84	87	113	113	119	125
Mobile Telecoms	100	98	104	107	189	201	194	186
UTILITIES	120	113	120	125	137	135	131	126
Electricity	108	103	117	121	149	144	134	127
Gas, Water & Multi-Utilities	124	117	121	126	134	133	130	126
TECHNOLOGY	199	178	162	159	38	41	42	43
Software & Computer Serv	150	136	129	130	55	57	59	59
Technology Hardware & Equip	288	250	214	203	22	25	26	28
TOTAL NON-FINANCIAL	97	100	102	103	100	100	100	98
FINANCIALS	113	98	91	89	100	100	100	106
Banks	105	94	85	81	86	87	90	101
Non-Life Insurance	193	83	87	90	166	149	145	142
Life Insurance	94	87	86	89	119	125	124	122
Real Estate Inv. Servs	259	219	192	176	51	55	59	61
REITS	190	190	199	203	104	101	98	95
Financial Services	148	113	94	91	120	120	110	111
FTSE ALL SHARE	100	100	100	100	100	100	100	100
FTSE 100	96	99	99	99	103	103	103	103
Mid 250	149	114	109	109	82	77	79	80
Small Cap	88	94	87	84	84	78	81	81

Source: Citi Research & DataStream

Figure 25. UK Sector Growth

As at Close 23 Oct 2012	Earnings Growth %			Net Dividend Growth %		
	2012E	2013E	2014E	2012E	2013E	2014E
OIL & GAS	1.8	1.1	3.9	6.9	3.8	3.2
Oil & Gas Producers	1.4	0.6	3.6	6.8	3.5	2.8
Oil Equip, Serv and Distrib	17.3	18.7	15.2	9.9	17.2	15.7
BASIC MATERIALS	-34.0	19.2	17.8	8.2	11.3	11.9
Chemicals	3.0	6.5	10.4	9.6	7.8	11.4
Forestry & Paper	-22.6	26.4	18.6	-2.8	18.4	0.3
Industrial Metals & Mining	-147.8	-101.6	908.0	1.3	-0.8	0.0
Mining	-34.6	19.2	18.1	8.4	11.4	12.1
INDUSTRIALS	4.1	9.0	9.9	9.4	8.6	3.8
Construction & Materials	-7.4	11.7	14.1	-2.7	2.0	2.7
Aerospace	4.8	7.5	6.9	7.1	6.1	6.3
General Industrials	3.5	10.8	10.5	5.0	8.2	9.3
Electronic & Electrical Equip	3.3	9.2	10.0	10.0	9.5	10.1
Industrial Engineering	5.9	6.7	7.8	7.8	7.7	9.2
Industrial Transportation	-8.9	11.5	11.7	0.2	3.1	3.3
Support Services	6.4	9.6	11.4	17.1	12.5	-0.2
CONSUMER GOODS	9.2	9.3	10.5	6.3	11.8	11.2
Automobiles & Parts	18.7	18.6	8.1	20.0	15.0	10.0
Beverages	10.4	11.3	12.2	8.6	10.2	10.4
Food Producers	7.5	7.8	8.4	1.9	6.9	7.3
Household Goods & Home Cor	14.5	4.8	10.0	0.4	28.4	17.2
Personal Goods	11.8	12.9	14.5	14.5	14.2	14.7
Tobacco	6.5	9.4	10.3	7.7	10.0	11.0
HEALTH CARE	-6.4	1.0	8.4	1.2	5.0	5.2
Health Care Equip & Services	1.2	14.7	12.6	45.3	9.0	7.9
Pharmaceuticals & Biotech	-6.7	0.4	8.2	0.3	4.9	5.2
CONSUMER SERVICES	-2.5	7.2	6.7	0.8	5.9	5.5
Food & Drug Retailers	-2.0	-1.5	-1.3	-2.5	-0.8	-1.5
General Retailers	-0.5	7.1	9.4	3.1	8.0	9.2
Media	6.4	7.7	7.2	1.3	9.0	7.4
Travel & Leisure	-12.6	16.1	11.7	2.8	8.7	8.2
TELECOMMUNICATIONS	0.8	3.2	5.7	12.7	4.3	4.0
Fixed-Line Telecoms	7.4	3.8	5.4	7.3	11.9	13.0
Mobile Telecoms	-0.9	3.0	5.7	13.4	3.3	2.8
UTILITIES	3.6	2.5	5.1	5.2	3.3	3.8
Electricity	2.9	-4.5	5.7	3.5	-1.2	1.8
Gas, Water & Multi-Utilities	3.8	4.7	4.9	5.7	4.7	4.3
TECHNOLOGY	9.9	18.8	11.3	13.5	10.2	11.1
Software & Computer Serv	8.3	14.2	8.8	11.0	8.9	8.8
Technology Hardware & Equip	12.8	26.7	15.1	19.5	13.1	15.9
TOTAL NON-FINANCIAL	-4.9	6.4	8.4	6.5	6.6	6.1
FINANCIALS	12.3	17.0	12.3	7.3	6.9	13.9
Banks	8.9	19.7	14.7	7.7	10.0	21.0
Non-Life Insurance	127.3	3.7	5.7	-4.2	4.2	5.3
Life Insurance	5.7	9.4	6.3	11.9	5.8	5.6
Real Estate Inv. Servs	16.0	23.6	19.3	16.3	13.0	11.2
REITS	-2.1	3.5	7.5	3.5	3.3	4.1
Financial Services	28.4	31.2	13.2	6.6	-2.1	8.4
FTSE ALL SHARE	-1.9	8.5	9.3	6.7	6.6	7.6
FTSE 100	-4.3	7.9	9.1	7.4	6.5	7.4
Mid 250	28.2	12.7	9.8	0.5	8.3	9.2
Small Cap	-7.9	17.1	13.7	-0.4	10.4	7.7

Source: Citi Research & DataStream

Figure 26. UK Sector Ratings

As at Close 23 Oct 2012	Price/Earnings				Net Dividend Yield			
	2011E	2012E	2013E	2014E	2011E	2012E	2013E	2014E
OIL & GAS	9.3	9.2	9.1	8.7	3.66	3.91	4.06	4.19
Oil & Gas Producers	9.1	9.0	9.0	8.7	3.72	3.97	4.11	4.23
Oil Equip, Serv and Distrib	16.3	13.9	11.7	10.2	2.24	2.46	2.88	3.33
BASIC MATERIALS	8.0	12.1	10.1	8.6	2.70	2.92	3.25	3.64
Chemicals	15.4	15.0	14.1	12.8	2.37	2.60	2.80	3.12
Forestry & Paper	11.3	14.6	11.5	9.7	3.42	3.33	3.94	3.95
Industrial Metals & Mining	9.3	-19.4	-	118.0	0.43	0.43	0.43	0.43
Mining	7.7	11.7	9.8	8.3	2.73	2.96	3.30	3.70
INDUSTRIALS	13.6	13.1	12.0	10.9	2.88	3.15	3.42	3.55
Construction & Materials	13.0	14.0	12.6	11.0	4.73	4.61	4.70	4.82
Aerospace	11.7	11.2	10.4	9.8	3.40	3.65	3.87	4.11
General Industrials	12.3	11.8	10.7	9.7	3.28	3.45	3.73	4.08
Electronic & Electrical Equip	14.2	13.8	12.6	11.5	1.83	2.02	2.21	2.43
Industrial Engineering	13.7	12.9	12.1	11.2	2.58	2.78	2.99	3.27
Industrial Transportation	11.2	12.3	11.0	9.8	4.05	4.06	4.19	4.32
Support Services	15.4	14.4	13.2	11.8	2.36	2.77	3.11	3.11
CONSUMER GOODS	16.6	15.2	13.9	12.6	3.15	3.35	3.74	4.16
Automobiles & Parts	9.3	7.8	6.6	6.1	2.88	3.46	3.98	4.37
Beverages	19.7	17.8	16.0	14.3	2.35	2.55	2.81	3.10
Food Producers	17.1	15.9	14.7	13.6	3.24	3.30	3.53	3.79
Household Goods & Home Co	16.6	14.5	13.8	12.6	2.62	2.63	3.38	3.96
Personal Goods	19.5	17.4	15.4	13.5	2.03	2.32	2.65	3.04
Tobacco	14.8	13.9	12.7	11.5	4.07	4.39	4.83	5.36
HEALTH CARE	10.1	10.8	10.7	9.8	4.86	4.91	5.16	5.43
Health Care Equip & Services	14.0	13.9	12.1	10.7	1.69	2.46	2.68	2.89
Pharmaceuticals & Biotech	9.9	10.6	10.6	9.8	5.03	5.05	5.30	5.57
CONSUMER SERVICES	12.1	12.4	11.6	10.9	3.50	3.53	3.74	3.95
Food & Drug Retailers	10.4	10.7	10.8	11.0	4.41	4.30	4.26	4.20
General Retailers	12.6	12.7	11.8	10.8	3.16	3.26	3.52	3.84
Media	13.1	12.3	11.4	10.7	3.46	3.50	3.82	4.10
Travel & Leisure	12.6	14.4	12.4	11.1	3.03	3.11	3.38	3.66
TELECOMMUNICATIONS	11.1	11.1	10.7	10.1	6.48	7.30	7.62	7.92
Fixed-Line Telecoms	10.1	9.4	9.0	8.6	4.17	4.48	5.01	5.66
Mobile Telecoms	11.4	11.5	11.2	10.6	6.99	7.93	8.19	8.42
UTILITIES	13.7	13.3	12.9	12.3	5.09	5.35	5.53	5.73
Electricity	12.4	12.0	12.6	11.9	5.51	5.71	5.64	5.74
Gas, Water & Multi-Utilities	14.2	13.7	13.0	12.4	4.97	5.25	5.49	5.73
TECHNOLOGY	22.8	20.8	17.5	15.7	1.42	1.61	1.77	1.97
Software & Computer Serv	17.3	15.9	14.0	12.8	2.04	2.27	2.47	2.69
Technology Hardware & Equip	33.0	29.3	23.1	20.1	0.82	0.98	1.11	1.28
TOTAL NON-FINANCIAL	11.2	11.7	11.0	10.2	3.71	3.95	4.21	4.46
FINANCIALS	12.9	11.5	9.8	8.8	3.69	3.96	4.23	4.82
Banks	12.0	11.0	9.2	8.0	3.19	3.43	3.78	4.57
Non-Life Insurance	22.2	9.7	9.4	8.9	6.14	5.88	6.13	6.45
Life Insurance	10.8	10.2	9.3	8.8	4.42	4.94	5.23	5.52
Real Estate Inv. Servs	29.7	25.6	20.7	17.3	1.88	2.19	2.47	2.75
REITS	21.8	22.3	21.5	20.0	3.85	3.98	4.12	4.29
Financial Services	17.0	13.3	10.1	8.9	4.44	4.74	4.64	5.03
FTSE ALL SHARE	11.5	11.7	10.8	9.9	3.70	3.95	4.21	4.53
FTSE 100	11.0	11.5	10.7	9.8	3.80	4.08	4.34	4.66
Mid 250	17.1	13.3	11.8	10.8	3.04	3.06	3.31	3.61
Small Cap	10.1	11.0	9.4	8.2	3.11	3.10	3.42	3.68

Source: Citi Research & DataStream

Figure 27. Companies Mentioned

RIC	Stock	Price	Rating	Currency	RIC	Stock	Price	Rating	Currency	RIC	Stock	Price	Rating	Currency
ABBN.VX	ABB	17.61	1	CHF	ERICb.ST	Ericsson	58.6	1	SEK	RRS.L	Randgold Resourc	74.39326	2	GBP
ATLN.VX	Actelion	45	2	CHF	ESSI.PA	Essilor	69.19	1	EUR	RDSa.L	RD Shell Class A	21.19712	2	GBP
ADML.L	Admiral Grp	11.07677	2	GBP	EXP.N.L	Experian	10.73708	1	GBP	RB.L	Reckitt Benckiser	37.7	1	GBP
AEGN.AS	Aegon	4.2	2H	EUR	FI.MI	Fiat Industrial	7.87	1	EUR	REE.MC	Red Electrica	37.165	1	EUR
ADP.PA	Aéroports Paris	60.18	1	EUR	FMEG.DE	Fresenius Med Care	57.39	2	EUR	CFR.VX	Richemont	58.6	1	CHF
AGGK.L	Aggreko	20.23	1	GBP	FREG.DE	Fresenius SE	92.15	1	EUR	RIO.L	Rio Tinto	31.325	2	GBP
AHLN.AS	Ahold	9.52	1	EUR	GFS.L	G4S	2.621206	1	GBP	ROG.VX	Roche	181.2	2	CHF
AIRP.PA	Air Liquide	90.37	2	EUR	GTO.PA	Gemalto	66.74		EUR	RR.L	Rolls-Royce	8.475	1	GBP
AKZO.AS	Akzo Nobel	41.07	2	EUR	GETIb.ST	Getinge	201.2		SEK	SAB.L	SABMiller	26.25	1	GBP
AMEC.L	AMEC	10.49	2	GBP	GSK.L	GlaxoSmithKline	14.1	1	GBP	SASY.PA	Sanofi	66.69	1	EUR
AAL.L	Anglo American	18.675	2	GBP	GRLS.MC	Grifols	25.81	1	EUR	SAPG.DE	SAP AG	55.59	1	EUR
ANTO.L	Antofagasta	12.76	3	GBP	HEIG.DE	HeidelbergCement	40.235	1	EUR	SCHN.PA	Schneider Electric	48.345	3	EUR
MAERSKb.CO	APM Maersk	40000	2	DKK	HNKG_p.DE	Henkel	61.28	2	EUR	SDRL.OL	Seadrill	230.6	1	NOK
ARM.L	ARM Hld	6.6	1	GBP	HMb.ST	Hennes & Mauritz	225.4	2	SEK	SRP.L	Serco	5.716178	1	GBP
ARYN.S	Aryzta	45.95		CHF	HOLN.VX	Holcim	63.15	3	CHF	SGSN.VX	SGS	1987	2	CHF
ASML.AS	ASML Hld	41.875	2	EUR	IMT.L	Imperial Tobacco	22.93067	2	GBP	SHP.L	Shire	17.78	1	GBP
ASSAb.ST	Assa Abloy	216.3	3	SEK	ITX.MC	Inditex	95.9	1	EUR	SIEGn.DE	Siemens	76.79	1	EUR
ATCOa.ST	Atlas Copco	156.7	3	SEK	IFXGn.DE	Infineon	5.242	2	EUR	SN.L	Smith & Nephew	6.47187	1	GBP
BAES.L	BAE Systems	3.078	2	GBP	ING.AS	ING	6.802	1	EUR	SRG.MI	Snam SpA	3.386	1	EUR
BARC.L	Barclays	2.2965	1	GBP	ITRK.L	Intertek	27.97668	1	GBP	EXHO.PA	Sodexo	59.67	2	EUR
BASFn.DE	BASF	62.41	2	EUR	JMT.LS	Jeronimo Martins	13.675	1	EUR	SOON.VX	Sonova Hld	93.95	1	CHF
BAYGn.DE	Bayer	66.27	1	EUR	JMAT.L	Johnson Matthey	22.12203	1	GBP	STAN.L	Standard Chartered	14.735	1	GBP
BLT.L	BHP Billiton	20.02	1	GBP	KYGa.I	Kerry Group	40.325		EUR	SL.L	Standard Life	2.853916	2	GBP
BATS.L	Brit Am Tobacco	31.43716	1	GBP	KNEBV.HE	Kone	55.35	3	EUR	UHR.VX	Swatch Grp	378.4	2	CHF
BNZL.L	Bunzl	10.2	2	GBP	OREP.PA	L'Oréal	97	2	EUR	SWMA.ST	Swedish Match	260.7	1	SEK
BVI.PA	Bureau Veritas	83.36	2	EUR	LVMH.PA	LVMH	121.85	1	EUR	SRENH.VX	Swiss Re	65.65	1	CHF
CPI.L	Capita Grp	7.294111	1	GBP	MICP.PA	Michelin	64.57	1	EUR	SYNN.VX	Syngenta	350.6	1	CHF
CASP.PA	Casino	67.18	1	EUR	MUVGn.DE	Munich Re	124.4	2	EUR	TEL2b.ST	Tele2	112.9	1	SEK
COLOb.CO	Coloplast	1247		DKK	NESN.VX	Nestle	60.2	2	CHF	TS.N	Tenaris	38.3		USD
COLR.BR	Colruyt	34.225	1	EUR	NOK1V.HE	Nokia	2.05	2H	EUR	TOTF.PA	Total	38.8	2	EUR
CPG.L	Compass Grp	6.845	1	GBP	NOVN.VX	Novartis	57.45	2	CHF	ULVR.L	Unilever	22.63	2	GBP
CRH.L	CRH	11.05414	3	GBP	NOVOb.CO	Novo-Nordisk	962	1	DKK	UNc.AS	Unilever NV	27.735	2	EUR
DAIGn.DE	Daimler	37.515	1	EUR	PERSON.L	Pearson	12.10465	2	GBP	VOLVb.ST	Volvo AB	88.5	2	SEK
DANO.PA	Danone	46.42	1	EUR	PERP.PA	Pernod-Ricard	84.33	1	EUR	VOPA.AS	Vopak	53.39		EUR
DAST.PA	Dassault Sys	82.04	1	EUR	PFC.L	Petrofac	15.73036	2	GBP	WOS.L	Wolseley	26.21	2	GBP
DBGn.DE	Deutsche Bank	33.58	2	EUR	PHG.AS	Philips	19.54	3	EUR	WPP.L	WPP	8.16	2	GBP
DPWGn.DE	Deutsche Post	15.795	1	EUR	PSHG_p.DE	Porsche	48.48	3H	EUR					
DSMN.AS	DSM	38.86	1	EUR	PRU.L	Prudential	8.414973	1	GBP					
EKTab.ST	Elektro	91		SEK	PUBP.PA	Publicis Groupe	41.405	3	EUR					
ENI.MI	Eni	17.45	1	EUR	QGEN.O	Qiagen	17.58		USD					

Source: Citi Research. Stocks Prices as at 23rd October 2012

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Appendix A-1

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