European Equity Strategy

Europe's Value Rally already over? Client feedback

We hit a tactical pause 9th Jan. But clients disagreed citing lots of value in Europe

Equity Strategy

Europe including UK

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Is Europe's Value Rally already over?

The 3 key crisis Value Rallies faltered due to a lack of follow-on earnings growth and politics: Mar 09, Jul 12 and 11 Feb of last year (fig 1,6). These differed from the long-standing 2003 rally - driven by earnings. This summer the Value Dispersion gap hit a new high Value gaps biggest globally and Value beat Growth by 20% so we suggested a pause on 9 Jan. The pushback: "too early; trade has only just begun after years of neglect," etc. Below we differentiate our Tactical vs Fundamental call. Europe is rich with Value IF trailing earnings finally turn and politics settle.

TACTICAL: Why we hit pause on the Value Rally? 4 reasons

1) Value beat growth by 20% - in line with prior crisis rallies that averaged 23% (fig 6); 2) Rising 10-yr US bond yields helped, but yields had paused below peak & UBS forecasts US 10-yr bonds at 2.25% (end 17); 3) 12m forward EPS has already turned the most since 2009 (fig 2) we still want proof on trailing earnings; 4) Political risk is rife with the Dutch (15 Mar) and French elections (23rd April/round 1). The recent failure of opinion polls to predict - increases Europe's risk premia. Political calendar on pg 5.

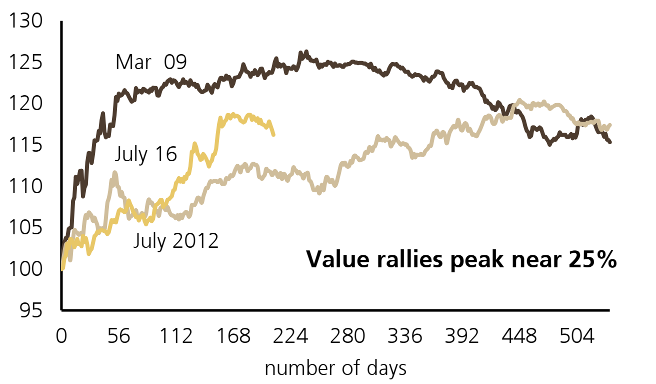
FUNDAMENTAL: Still unusually big Value Gaps 'within' Europe

Europe had a rich rally and excess dispersion gaps fell by 2/3rds -but we agree that Europe's value opportunity remains elevated & the biggest globally. Plus, profit growth is key and Europe offers one of the biggest Base-Effects globally with profits still 28% below 2007 levels (US is 28% above) married with EPS momentum that is turning UP. STOCKS: Value that LAGGED peers in the recent rally include: Vinci, Capgemini, ENI, Telenor, Daimler & Renault, page 16.

FUNDAMENTAL: Europe cheap vs Regions (US) & Assets (Bunds)

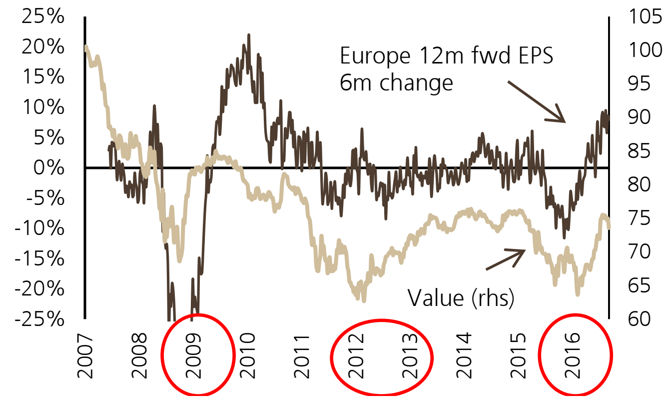
1) Europe vs US: Relative CAPE PE is now up from crisis lows, (fig 24,25). Plus US vs EU ETF Equity flows hit a record gap of €237bn see Trump could help Europe & page 9.
2) The Bund vs Equity Total Return Gap of 75% (92% in Nov 16) is wide but shrinking. It makes no sense if inflation/profits are up and tapering follows. These gaps already closed fully in the US and partly in Japan, pg 11.

Figure 1: Value performance - current rally paused mid Jan. Crisis rally ceiling seems to be 25%.



Source: UBS European Equity Strategy and IBES, Datastream

Figure 2: Earnings & Value: 12m fwd 6m change drove Value rally – biggest move since 09. But need proof.



Source: Thomson Datastream, UBS Quant and European Equity Strategy

Is European Value rally *already* over?

Background – Europe neither cheap nor expensive

Investors say:

Investing for long run, why pause

European Equities - under-owned

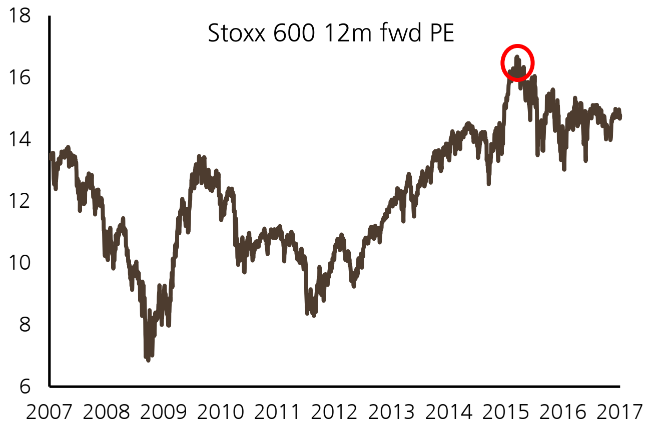
They don't look expensive

Before we move on to the value trade and valuation stretches 'within' Europe, the market as a whole doesn't look particularly cheap or expensive. The index is still roughly 10% below both 2007 and April 15 levels and the backdrop has improved. The problem is trailing earnings are still absent (page 7). Until they arrive the PE and markets are a bit stuck given its already above 15-yr average. This theme also resonates with the Value stretch and trade within sectors in Europe. The past decade's scarcity of earnings has driven investors to crowd around anything offering growth. Value rallies feed off earnings, as in 2003 (fig 28).

Figure 3: Stoxx 600 price Index –peaked in April 2015

Source: Thomson Datastream, UBS European Equity Strategy

Figure 4: Stoxx 600 - 12m fwd PE peaked near 17x in Apr 2015



Source: Thomson Datastream, UBS European Equity Strategy

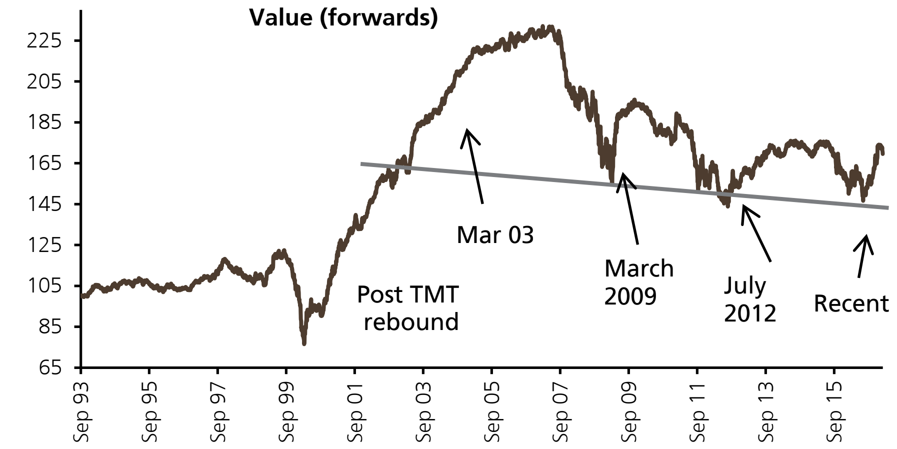
Value over long run & recent rally

We look at value rallies after the tech bubble, in March 2003 Value was up 45%, In March 2009 it was up 25% and in July 2012 c. 20%. The last two rallies didn't have the longevity that you get when the hope is combined with profits.

March 03 helped by profits

Next 3 faded – worries over profit growth & politics

Figure 5: LONG RUN Performance of Value (ex the tech bubble)



Source: UBS European Quant & Equity Strategy

Rallies:

Mar 03 – Profits

Mar 09 – TARP

July 12 – Draghi

Why we decided to pause – 4 reasons

In this paper we focus on valuation stretches 'within European sectors'. A good example would be looking at Italian versus Scandi banks through the crisis. In early January we hit pause on this trade. However, some investors were surprised (as were we). Incoming calls were as follows: "the value rally just got going after a decade of neglect; Europe still offers value vs the US/other assets; and it seems too early, especially if earnings are turning?" They were right to question and we don't disagree. We discuss our tactical reasons below and fundamental views after.

Why we paused?

See appx 2 for extreme stock & sector performance

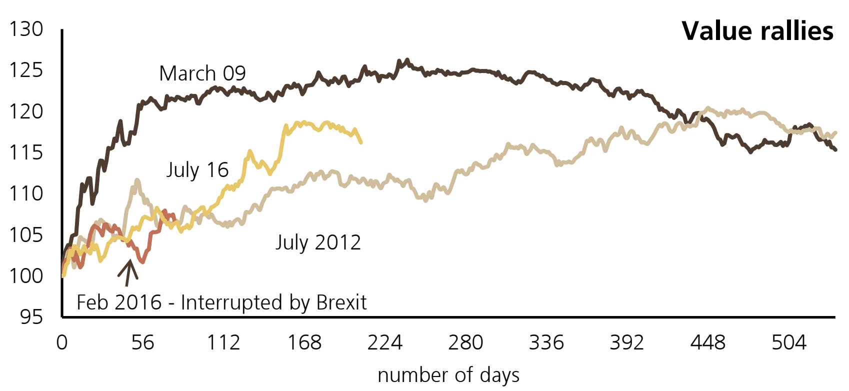
1. Tactical: a powerful rally

Value rally on par with prior rallies. Value beat Growth by 20% from 6th July to year end. The March 2009 TARP value rally peaked at a 25% beat and the July 2012 Draghi-induced rally peaked at c. 20%. After last year's 11 Feb market low, the US ISM index perked up and Value took off again, but stalled after an 8% beat and when Brexit fears re-ignited. A pretty full rally, in our view.

Hit the ceiling of prior crisis rallies

Except for 2003, when EPS growth present

Figure 6: Look at prior Value rallies – even Mar 09 peaked at 25,



Source: UBS Quant and European Equity Strategy

Excess value stretch closes by 2/3rd: At peaks you get above-average pay-backs for buying value. They peak because scarcity of profits drives crowding around perceived growth in a sector and the rest gets left behind.

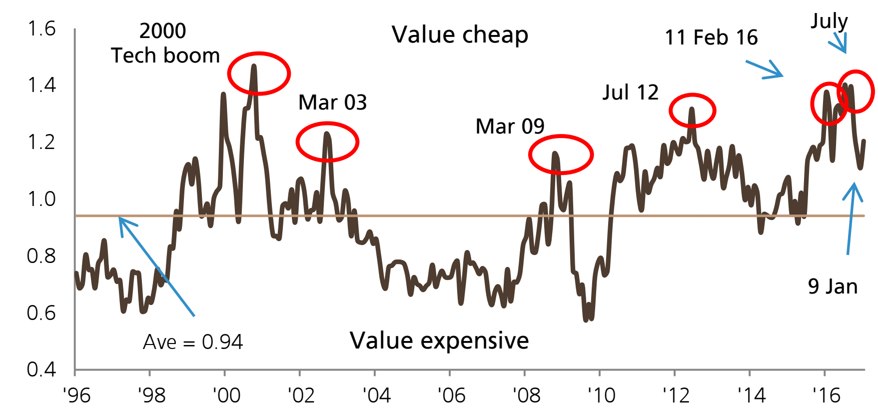
Gaps at peak = time to buy value

Excess gap fell by 2/3rds

Value gaps - sector neutral

Gap between Top & Bottom 3rd of sector - rebalanced monthly

Figure 7: Europe Value gap. Value gaps fell 2/3rd from July to early January



Source: UBS Quant and European Equity Strategy

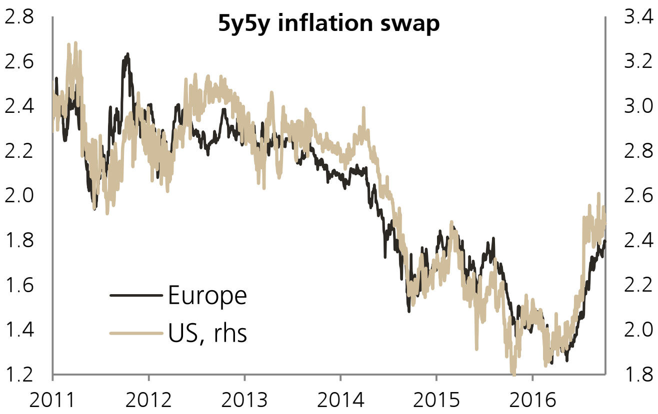
2. Tactical: pause in rise in US bond yields

The rally kicked off when bond yields moved up from their 6th July lows and Trump accentuated that given he promised the things a more cyclical Europe needs: fiscal spending and capex, plus 20% of EU sales are to the US and a pick up global growth helps. All great news, but will it happen in a straight-line? Plus how much of the inflation boost is Energy price base effects (Spain's 3% HICP, pg 11)

Yields paused

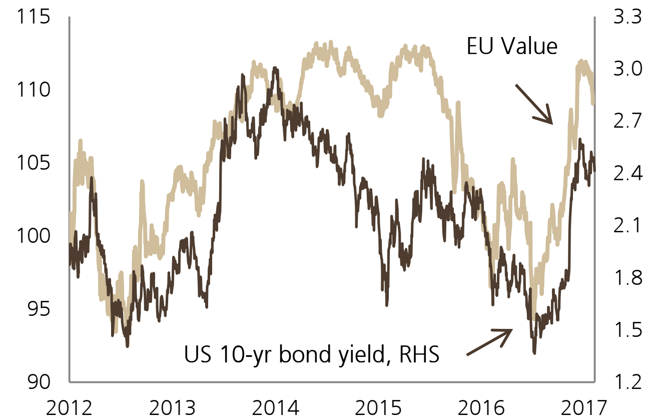
UBS forecast US 10-yr bonds: 2.3% end 17

Figure 8: EU & US… Inflation leads to higher rates & eventual support for the Banks



Source: Bloomberg, UBS European Equity Strategy

Figure 9: Value vs 10-Yr Treasuries. EU Value beat Growth by 20% from 6th July to year end. Fading now?



Source: Thomson Datastream, UBS Quant and European Equity Strategy

3. Tactical: forward EPS turning – but need more proof

Value is linked to profit growth and yes the below is exciting - the recent 6m change in EPS is the most powerful since 2009! But we still need more proof. The 09 rally and 2012 rally were exciting but lost their way as profits disappointed (fig 1). When oil prices took a dive (2014) profits and value were both hit hard to mid-16: Oil drives 'Value gap' to near tech bubble extreme.

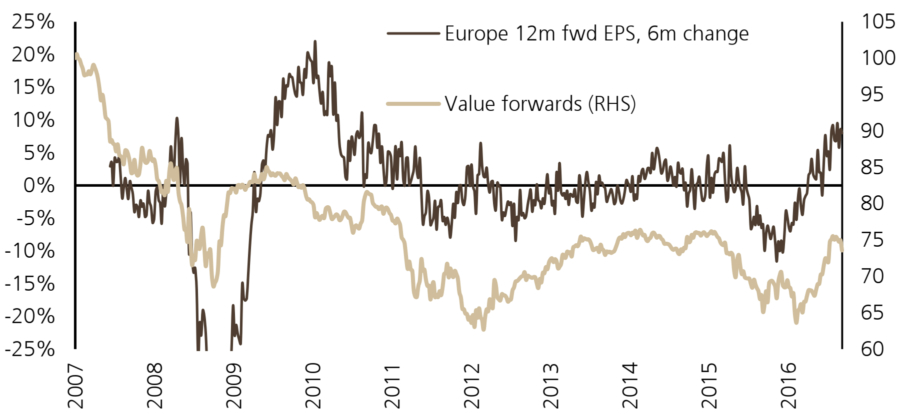
12m fwd turned & drove enthusiasm

Strongest jump since 2009

Now need hard evidence via trailing EPS

Left: turned up in May & went positive in Sept

Figure 10: 6m change - 12m forward Earnings turn most since 2009 to drive Value



Source: Thomson Datastream, UBS Quant and European Equity Strategy

4. Tactical: Political risk is upon us

The **recent failings of opinion polls have boosted Europe's Risk Premia** ahead of elections. The opinion polls failed to predict the outcome of Brexit, a Trump victory and gave us little indication about the extent of the NO vote in the 4th Dec Italian Referendum on senate reform. See the table below for upcoming political events & elections.

More uncertainty

Value dislikes uncertainty

11th Feb value rally (post market low) was halted by Brexit risk

- Dutch Election 15th May
- France First round 23rd April 2017 and second round 7th May 2017;
- Germany 24th September 2017

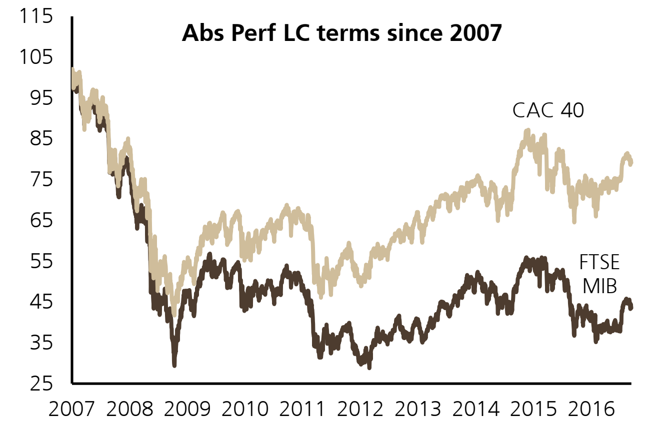
Figure 11: Event Calendar

Month	FOMC meetings	BoE MPC meetings	ECB MPC meetings	Political Elections
Feb	-	2	-	Germany*, Italicum
Mar	14-15	16	9	Dutch election, 15th May
Apr	-	-	27	France Presidential (Round 1)- 23rd
May	2-3	11	-	France Presidential (Round 2) – 7
Jun	13-14	15	8	France (Parliament elections) – 17/18
Jul	25-26	-	20	India*
Aug	-	3	-	Singapore (president)
Sep	19-20	14	7	German Federal election , 27th France (senate) - 24
Oct	31-1	-	26	Germany (parliament)
Nov	-	2	-	Slovenia (president)
Dec	12-13	14	14	South Korea (president)

Source: UBS European Equity Strategy, BBC, FT, Google News - *President (by Parliament)

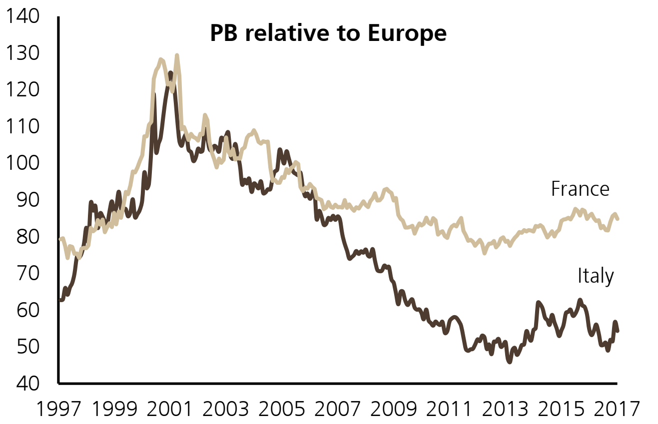
Is France priced for potential election disappointment – like Italy was?

Figure 12: Italy lags France since 2007 by 35%



Source: Thomson Datastream, UBS European Equity Strategy

Figure 13: Italy vs France Price to Book relative to Europe



Source: Thomson Datastream, UBS European Equity Strategy

Fundamental: more to go for 'within' Europe

1. Europe's value gap still biggest in world (after rally)

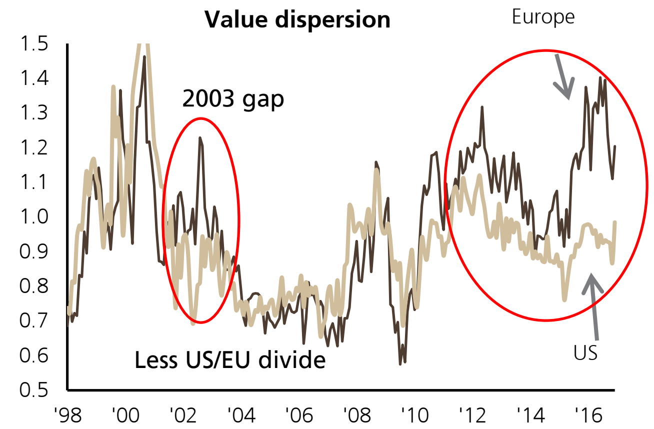
Fundamental view

EU gaps still biggest in world

See appendix 4

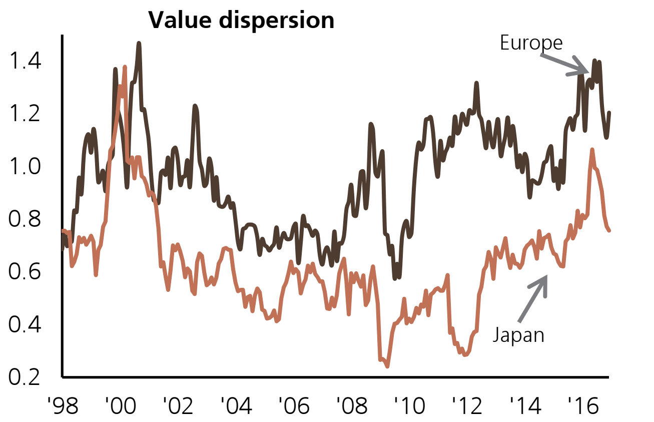
The value dispersion gaps are bigger than the Developed and Emerging World (see appendix 4). More specifically, see the gap versus the US below. This gap opened when Europe could not shake off persistent earnings disappointment. The last time we had this magnitude of a gap was in 2003, right before Europe's profit growth sped past the US helped by base effect, profit growth had lagged the US by 21% in 01/02)

Figure 14: Value gaps: Europe vs US – see 2003 gap too



Source: UBS Quant and European Equity Strategy

Figure 15: Value gaps: Europe vs Japan – wider in crisis



Source: UBS Quant and European Equity Strategy

The last time European profits sped past the US when in 2003, right after the opening of the above gap, see figure 28.

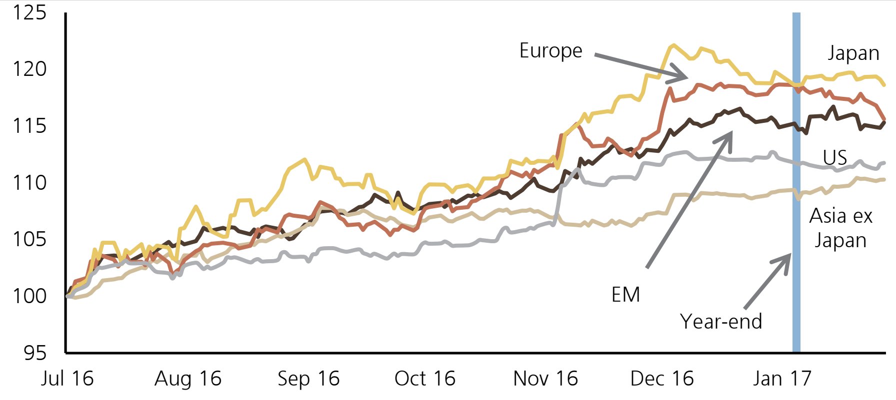
Global value rally – allows Europe to stay in top spot

Europe started off with the highest dispersion gaps before the global value rally. So after the event, with all regions participating, Europe still had the biggest gaps. Europe and Japan were both tied with value up 20% by year end.

Value rallied everywhere…

…so Europe still has biggest gap

Figure 16: Value performances for each region from 6th July



Source: UBS Quant and European Equity Strategy

2. Earnings drive Value & Europe offers BASE effect

Europe has ironically got a better chance for faster earnings growth because earnings had been so poor right through the crisis.

It's all about the BASE

- We have seen 1m earnings momentum for Europe turn up in November, December and January. This is a positive sign and the first time in 7 months: [Cyclical Rotation: Time for a Pause?]

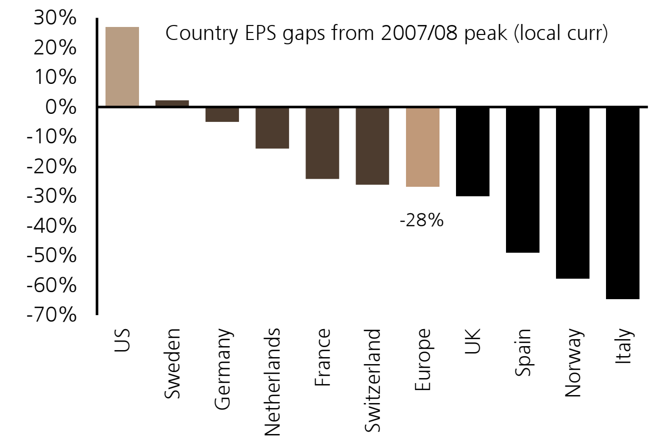
- The chart below shows where the base effect is concentrated. US earnings are 28% above levels seen a decade ago with Europe 28% below. Spain and Italy are near the bottom at 50% & 65% below their 2007 level. On a 'decade ago' earnings Italy and Spain trade on 4.6x and 6.7x respectively. Europe on 10.8x and the US would trade on 22.4x

On a decade-ago EPS Europe trades on 10.8x PE

Italy - 4.6x

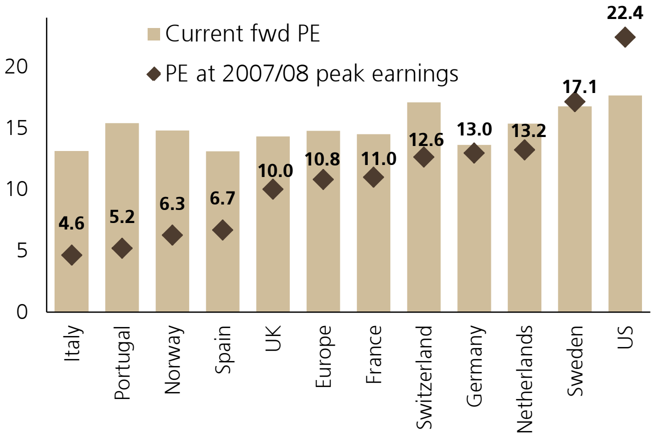
US - 22.4x PE

Figure 17: BASE EFFECT: Profits vs 2007 (a decade ago) - US profits up close to 30% - Europe down c. 28%



Source: Thomson Datastream, UBS European Equity Strategy

Figure 18: Country PE - if countries got back to EPS they earned a decade ago

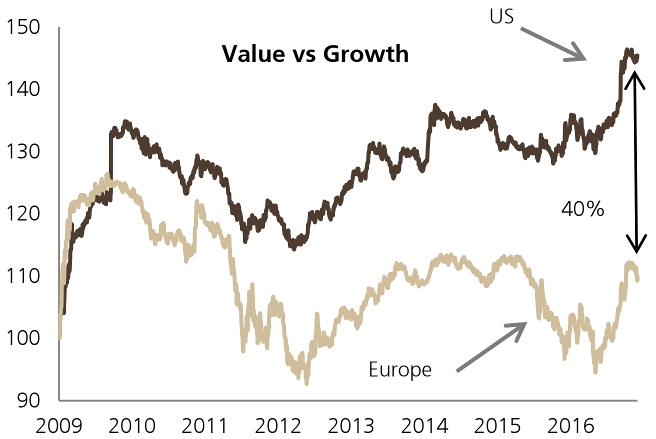


Source: Thomson Datastream, UBS European Equity Strategy

- **US Value Rally last decade – supported by profits & beat EU by 40%**

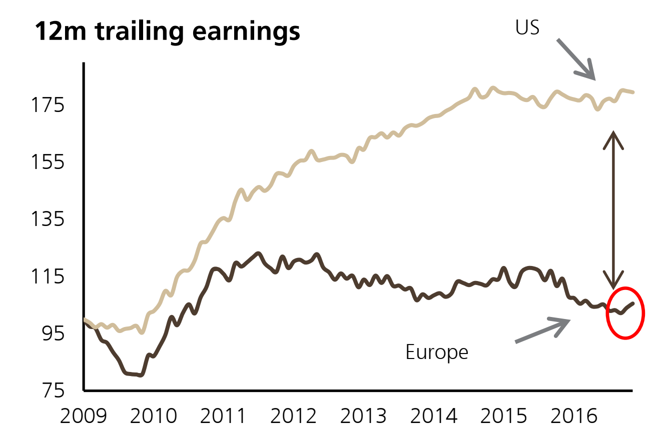
In the US it seemed everyone was a winner, investors bought more stocks within a sector and the valuation dispersion fell (hence the US having very low dispersion today as shown above). The US value rally was 40% more powerful because Europe was unable to generate profits which drove a crowd mentality within sectors.

Figure 19: Europe vs US Value Performance gap



Source: UBS Quant and European Equity Strategy

Figure 20: Europe vs US Trailing EPS gap = 56%



Source: Thomson Datastream, UBS European Equity Strategy

Further upside – look at 2003 value rally

The crisis value rallies stalled

The rallies during the crisis lacked longevity due to EPS disappointment.

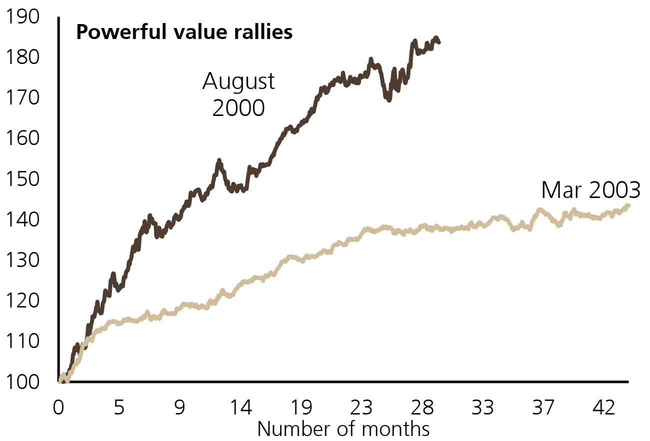
EPS growth pushed 2003 rally higher

But the rally in 2003 saw value beat growth by 31% in the first 18m and c. 45% within 3.5 years. However, this was helped along by EPS growth of 110% from 2003 to 2007. We have had almost zero growth in a decade. While we aren't expecting a BRIC based profit boom, given the dearth of profits (figure 1, 17, 26) and a decade of downgrades - we could get some growth surprises from here.

Base effect helps - figs 17 / 28.

The tech bubble was just that, a bubble. We don't choose to focus on the post tech value rally. But from August 2000 value beat growth by 60% over the next 18m and over 80% in total after a world famous 'growth love-in' that had little to do with profits.

. Figure 21: 2000 and 2003 rallies



Source: UBS Quant and European Equity Strategy

Figure 22: The fall before the 2000 post bubble Value rally

Source: UBS Quant and European Equity Strategy

Performance of Value and Quality after value dispersion peaks.

Figure 23: VALUE outperforms post a crisis

Value performance	6m later return	9m later return	12m later return	18m later return
Aug-2000	31%	36%	48%	**60%**
Mar-2003	15%	17%	21%	**31%**
Mar-2009	24%	**25%**	23%	15%
July-2012	13%	11%	17%	**19%**

Source: Thomson Datastream. UBS Quant and European Equity Strategy

Figure 24: QUALITY usually underperforms post a crisis

Quality performance	6m later return	9m later return	12m later return	18m later return
Aug-2000	5%	6%	10%	14%
Mar-2003	-23%	-23%	-23%	-20%
Mar-2009	-28%	-27%	-26%	-22%
July-2012	-13%	-8%	-14%	-24%

Source: Thomson Datastream. UBS Quant and European Equity Strategy

- **Below we move on to two other value plays: versus regions and other assets (bunds)**

Fundamental value vs regions: EU vs US

While the excess dispersion gaps *within* Europe closed by 2/3rds (by 9th Jan), the gap with the US market is even wider today - supported by the Trump impact. Ironically we think Trump could help EU profits too.

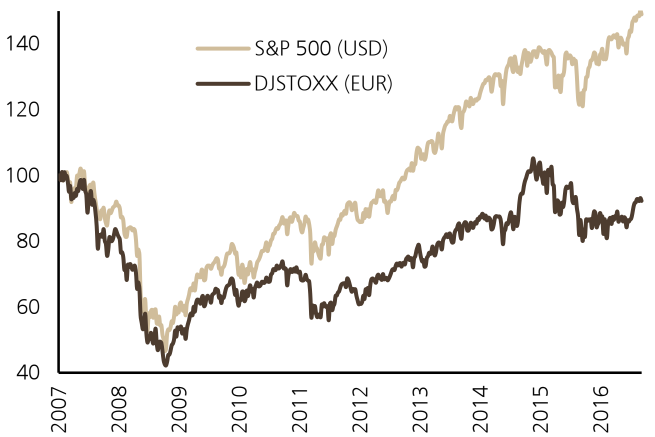
Still near crisis gaps, but starting to turn

- EU craves inflation/higher rates given it is more cyclical. Financials and Energy dividends make up 40% of the European market (double that in the US).

If there is Trump driven capex - easier to piggy-back off of

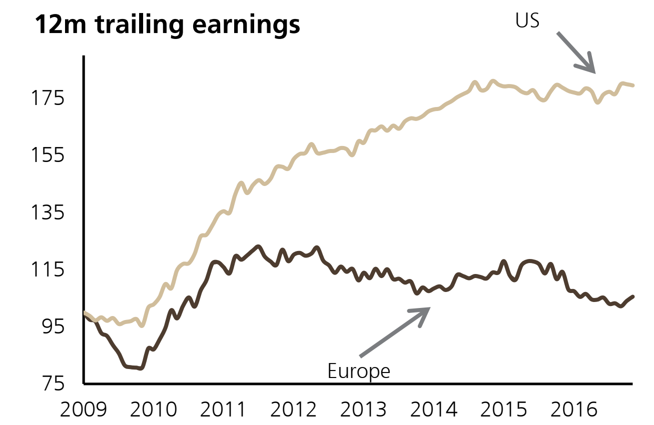
- 20% of European companies' sales are to the U.S. (subject to any tariffs). European profits used to be positively correlated to S&P profits (with lags), but it broke down in 09.

Figure 25: Europe vs US performance gap 55%



Source: UBS Quant and European Equity Strategy

Figure 26: Profit gap



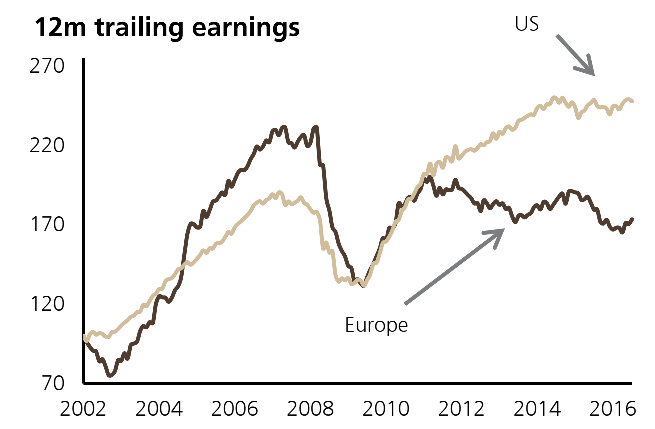
Source: Thomson Datastream, UBS European Equity Strategy

Base effect: US versus Europe, profit gaps don't last forever

The last time Europe's profits lagged those in the US, its EPS growth rate eventually outpaced the US. While the gap was smaller and followed by a BRIC boom, it is still worth considering.

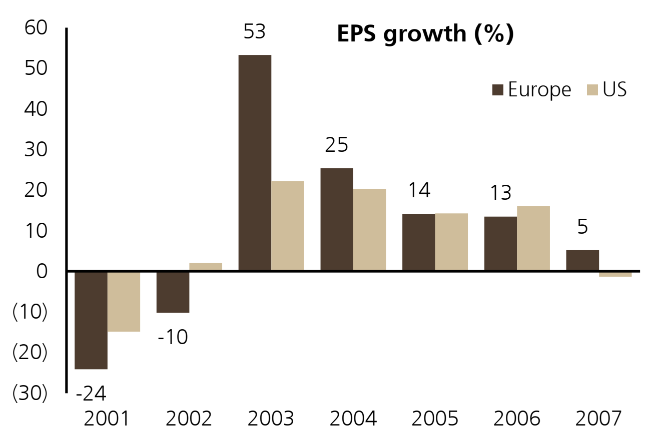
Lags followed by spurts?

Figure 27: Europe and US 12m trailing earnings



Source: Thomson Datastream, UBS European Equity Strategy

Figure 28: Europe and US annual earnings growth



Source: Thomson Datastream, UBS European Equity Strategy

Valuation Gap – still near crisis highs

To avoid simplified comparisons we look at:

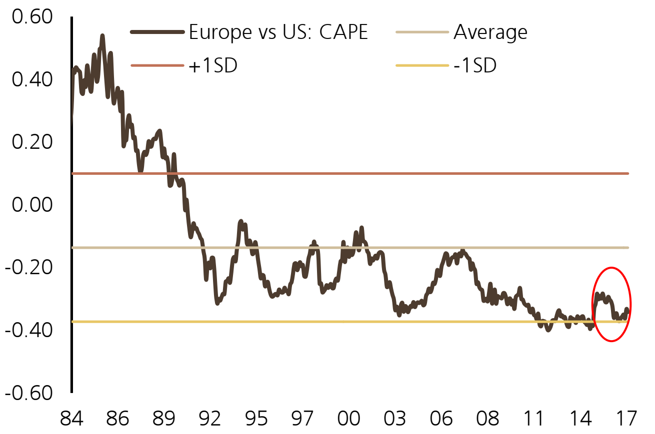
CAPE PE - EU 1 std dev cheap

- **A cyclically adjusted PE** where we use today's price over smoothed (10-yr ave) earnings for each. This actually supports the US and pushes its PE lower (it had healthy EPS growth since 2007, unlike Europe). And, still Europe is cheaper by c. 1 standard deviation.

Sector adj P/Book – EU at crisis levels

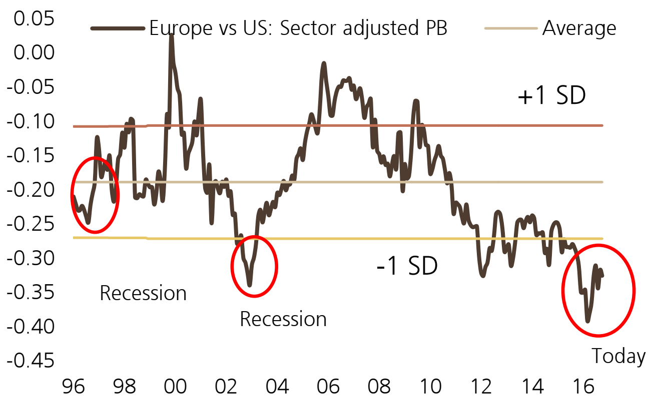
- **A sector-adjusted Price to Book** – where the US and Europe are both given Global MSCI sector weights for the valuation. Therefore, Europe is not disadvantaged by having less Technology and more Construction, for example. Here Europe is still valued near crisis level

Figure 29: Cyclically adjusted PE gap near crisis low & 1 std dev'n cheap (today's price /10-yr moving ave EPS)



Source: Thomson Datastream, UBS European Equity Strategy

Figure 30: Europe is more than 1SD cheap versus US on PB



Source: Thomson Datastream, UBS European Equity Strategy

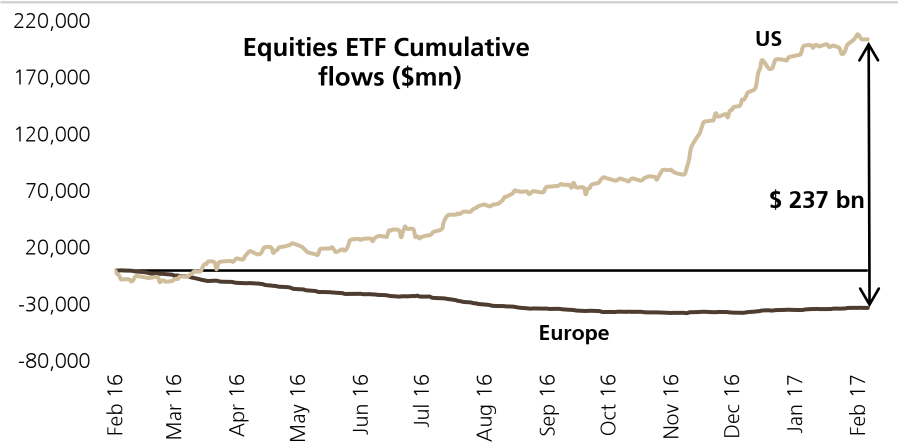
ETF flows near breaking point?

The gap has moved on from c. $145bn in November of last year to $237bn. Is this unusual? Yes, it is at record levels (albeit ETFs fairly new) in 2015 the flows into Europe were marginally bigger than flows into the US.

Gap now $237bn

In 2015 it when the other way with more flows into Europe

Figure 31: US and Europe cumulative flows since Feb 2016



Source: UBS Global Equity Finance

Fundamental vs other assets: Bond vs Equity gaps biggest in DM

As we wrote in November 2017: [Europe differs to World = 4 unique buy ideas,] one of the 4 key EU trades left coming out of a crisis was/is to buy Eurozone equities over Bunds. While it might sound obvious, it stuck right through the crisis. Now it is closing, it was 92% in November. There are two things that fully and partly closed the US and Japanese gaps below.

- **Return to profit growth** – we expect 8% growth this year. Japan's profit growth in 2013/14 drove some gap closure as did the US from 2010 to 2015.
- **Thoughts focus on ECB tapering**. With German HICP at a 3.5 year high (at 1.9%) and Spain hitting 3%, unless this is largely base-effect, tapering should soon become the topic de jour and eventually a reality. In the US, QE3 ended December 2013 and the gap closure sped up.

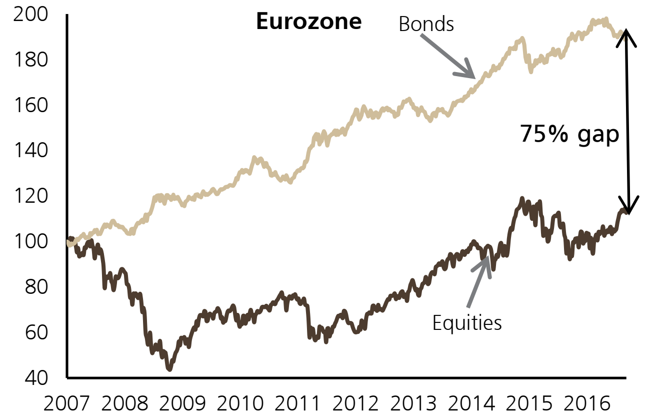
Eurozone -biggest opportunity in developed world

Gap was 92% in November

Today 75%

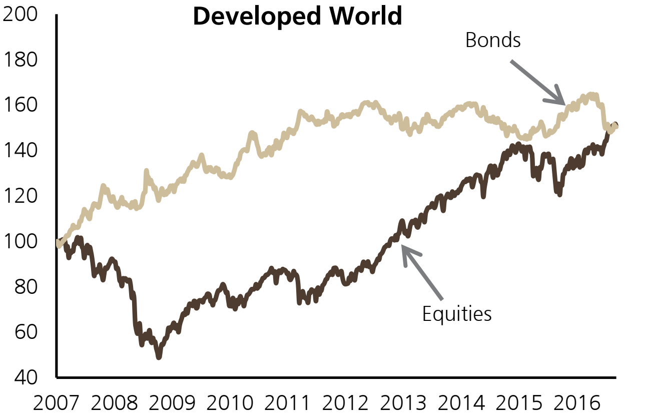
US closed fully

Figure 32: Eurozone Total Return Gap – 10 yr Bunds vs Equities



Source: Thomson Datastream, UBS European Equity Strategy

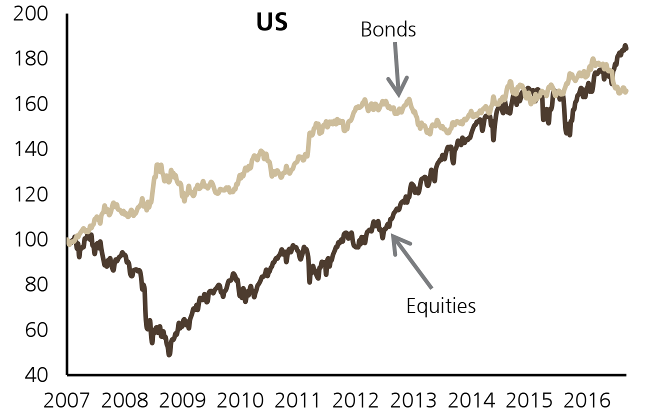
Figure 33: Developed World Total Return Gap: 10-yr Bonds vs Equities



Source: Thomson Datastream, UBS European Equity Strategy

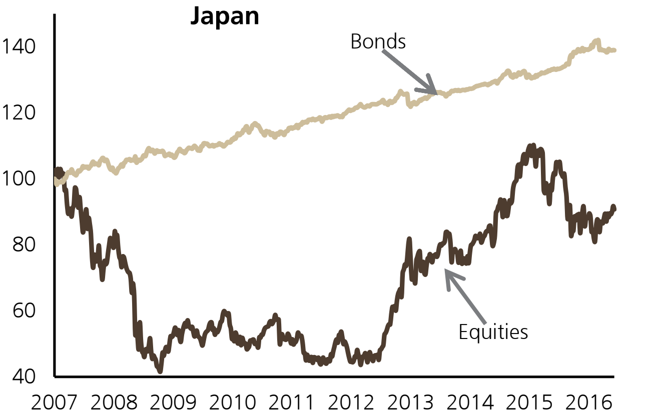
The US gaps closed with a return to profit growth (in 2011 it parted ways from Europe and kept going) and tapering, QE-3 ended Dec 2013. In Japan it was the earnings boom in 13/14. Europe is the last big gap standing in the DM.

Figure 34: U.S. Total Return Gap – 10-yr Bonds vs Equities (-19%)



Source: Thomson Datastream, UBS European Equity Strategy

Figure 35: Japan Total Return Gap – 10 yr bonds vs Equities (36% gap)



Source: Thomson Datastream, UBS European Equity Strategy

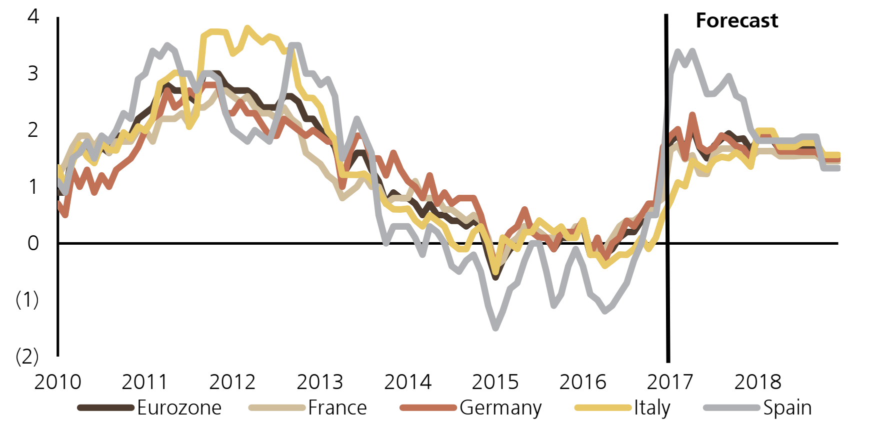
Inflation surprises support gap closure?

Spain's HICP hit 3% - something the hawks will latch onto?

Will the Hawks latch onto Spanish HICP

Spain's HICP print was 3% last week. But this might be due to more base effect than a genuine broad-based pick-up in inflation; the core was only 9%. Still it surprised many and might be something the hawks latch onto in any future QE or potential tapering discussions.

Figure 36: HICP year on year



Source: UBS Economics

What to watch

Earnings

- Consensus expectations: IBES EPS growth for 2017E is 14.2%, but not many investors we speak to believe it.
- Expectations: Our top-down view is 8% this year: Outlook 2017: No More Excuses…
- Analysts' over-promised EPS growth by 120% over the past decade (double the average). We need hard evidence that trailing earnings are decisively turning, the chart below shows that it is the first time current year revisions were up in January since 2010. See appendix 3.

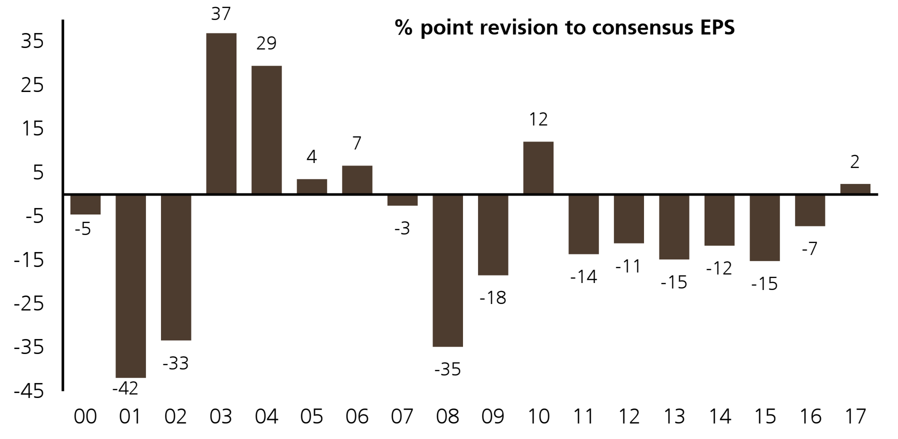
Consensus at 14% for 2017

Top down we expect 8%

Hope:

17E EPS revised up in January - 1st time since 2010

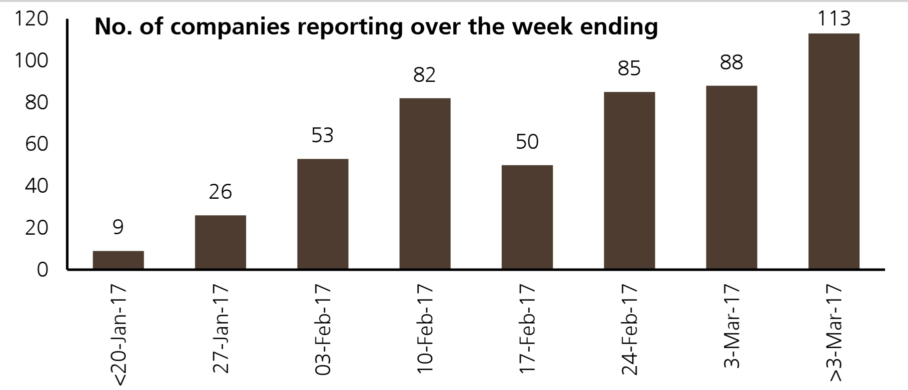
Figure 37: Earnings have been downgraded 9 out of 11 years since 2007. Have we paid our dues yet?



Source:

- Below is the reporting schedule for European Earnings

Figure 38: European earnings calendar – gains momentum this week



Source: Bloomberg, UBS European Equity Strategy

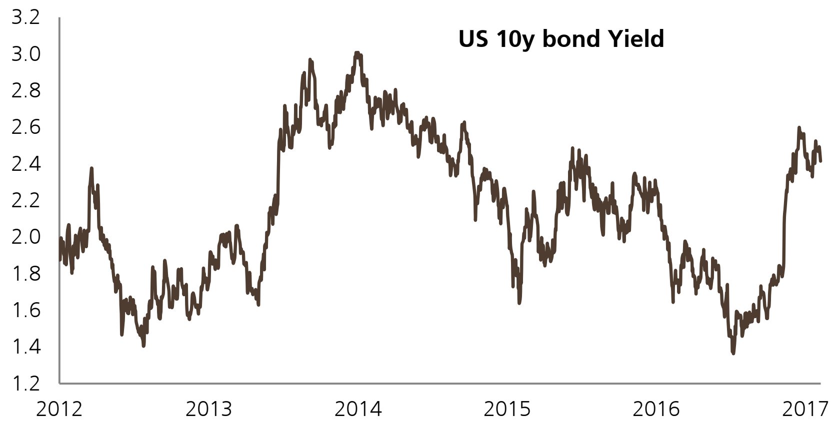
Watch 10 year US bond yields

- UBS view is for US 10-year treasuries to end 2017 at 2.25%. The value and Cyclical trade has been linked to bond yields rising and higher growth/inflation expectations.

Gone too far? UBS global view is 2.25%

Today at 2.41%

Figure 39: 10-Yr U.S. treasury yield



Source: Thomson Datastream, UBS European Equity Strategy

Political calendar

- Political risk halted the 11th February attempted value rally as Brexit risk re-ignited. So we watch this space, calendar on page 5.
- As flagged above the inability of opinion polls to predict the outcome of key recent political events has thrown into question their use to reduce risk when investing around elections. Therefore many of the following events could disrupt a risk-on trade either within Europe or versus other regions.

Other Research that might be relevant

- Italy: A step towards earlier elections 27 Jan 17
- Markets focus on the French elections 23 Nov 16
- Tactical Q-Trades: A Quality sell-off 17 Jan17
- Macro Keys: EU Value Gap closes 2/3rds, consider lagged Quality 16 Jan 17
- Cyclical Rotation: Time for a Pause? 12 Jan17
- Market Temperature - 60% more bullish than a year ago 9 January 2017
- Macro Keys - Could Trump help EU more than US? 4 ways 5 December 2016
- Value gaps within Europe - biggest in World 2 August 2016

Appendix 1: Value ideas that lagged

We repeat the list from our 15th November note (right). Mediaset, Societe Generale and SKF have outperformed their peers by 22%, 14% and 9% respectively, so we removed from the list as analysts have downgraded them to a Sell.

Others include: Vinci, CapGemini, ENI and Renault, these have all lagged peers since the value rally commenced on 6th July.

From our November 15 note:

Europe differs to World = 4 unique buy ideas

Figure 40: Value list published in November – European msci

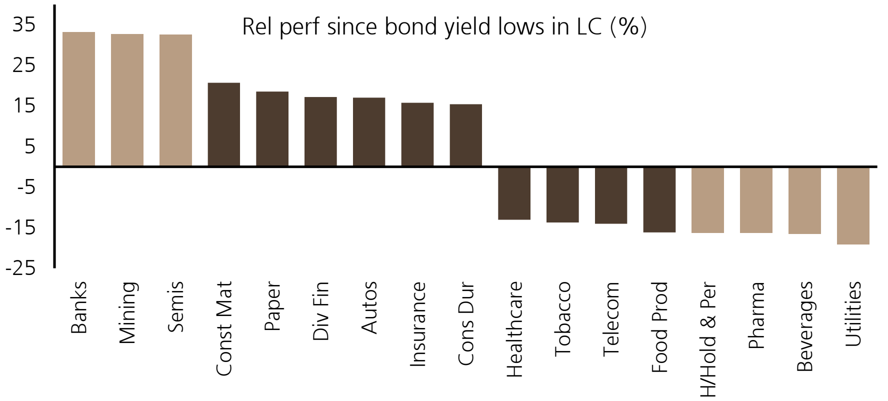
Name	Sector	M Cap EUR bn	Price	Upside to PT (%)	Rating	Rel perf peers since July 16 (%)	Rel perf mkt since May 07 (%)	PE 2017E	PE 2017E rel sector	PB 2017E	PB 2017E rel sector	DY 2017E	DY 2017E rel sector
Engie	Utilities	28	11	9	Neutral	(15)	(67)	12.4	92	0.6	43	6.0	117
Vinci	Cap Goods	37	66	17	Buy	(13)	29	14.4	84	2.2	82	3.4	123
CapGemini	Software	13	76	32	Buy	(13)	53	13.8	73	1.8	50	2.2	129
Vodafone	Telecoms	59	193	37	Buy	(12)	6	35.1	222	0.8	55	6.5	133
Travis Perkins	Cap Goods	4	1467	18	Buy	(9)	(20)	12.4	72	1.2	44	3.2	115
ENI	Energy	56	14	19	Buy	(6)	(39)	17.0	113	1.1	88	5.1	90
Telenor	Telecoms	22	131	11	Buy	(4)	17	12.2	74	3.6	226	6.1	129
Shell	Energy	213	2175	15	Buy	(4)	3	12.1	80	na	n/a	6.8	120
Renault	Autos	23	84	31	Buy	(3)	(11)	5.8	67	0.7	60	4.5	132
Daimler	Autos	76	67	26	Buy	(2)	11	7.8	91	1.4	119	5.3	158
UniCredit	Banks	16	12	8	Neutral (CBE)	(2)	(93)	12.3	105	0.5	64	2.0	42
AstraZeneca	Pharma	63	4388	14	Buy	0	44	14.1	93	4.2	124	5.2	152
Ladbrokes	Cons Svcs	3	123	30	Buy	2	(69)	11.9	65	1.5	43	4.2	159
Icade	Real Estate	5	66	6	Buy	5	(45)	14.7	75	0.8	86	6.1	143
Sanofi	Pharma	101	76	3	Neutral	8	19	13.3	88	1.6	48	4.8	141
Alstom	Cap Goods	6	27	13	Buy	11	(48)	18.1	105	1.6	60	0.0	0
ENEL	Utilities	39	4	22	Buy	9	(42)	12.5	92	1.2	85	5.0	98
EDP	Utilities	10	3	24	Buy	10	(29)	10.4	77	0.9	64	6.8	133
Britvic	Beverages	2	629	13	Buy	12	42	12.3	61	5.1	168	4.2	146
Taylor Wimpey	Cons Dur	6	170	12	Buy	13	(56)	8.7	46	1.8	67	8.3	306
CS Group	Div Fins	30	15	17	Buy	14	(71)	13.9	91	0.7	67	2.6	80
Gas Natural	Utilities	18	18	10	Buy	15	(43)	12.4	92	1.2	80	5.7	110
Generali	Insurance	21	15	7	Buy	16	(47)	7.9	72	1.0	93	6.6	133
Leonardo	Cap Goods	8	12	16	Buy	18	(35)	11.5	67	1.6	60	1.7	62
Wacker Chemie	Chemicals	6	108	3	Buy	22	(18)	19.1	103	2.4	94	2.6	92
BPER	Banks	3	5	2	Neutral	34	(67)	15.1	129	0.5	62	2.6	55
G4S	Comm Svs	4	256	12	Buy	37	3	13.6	82	2.3	45	3.8	127

Source: Thomson Datastream, UBS European Equity Strategy

Appendix 2: extremes performance

The below is from 6th Jul 2016 to 2nd Feb. We look at sectors and stocks.

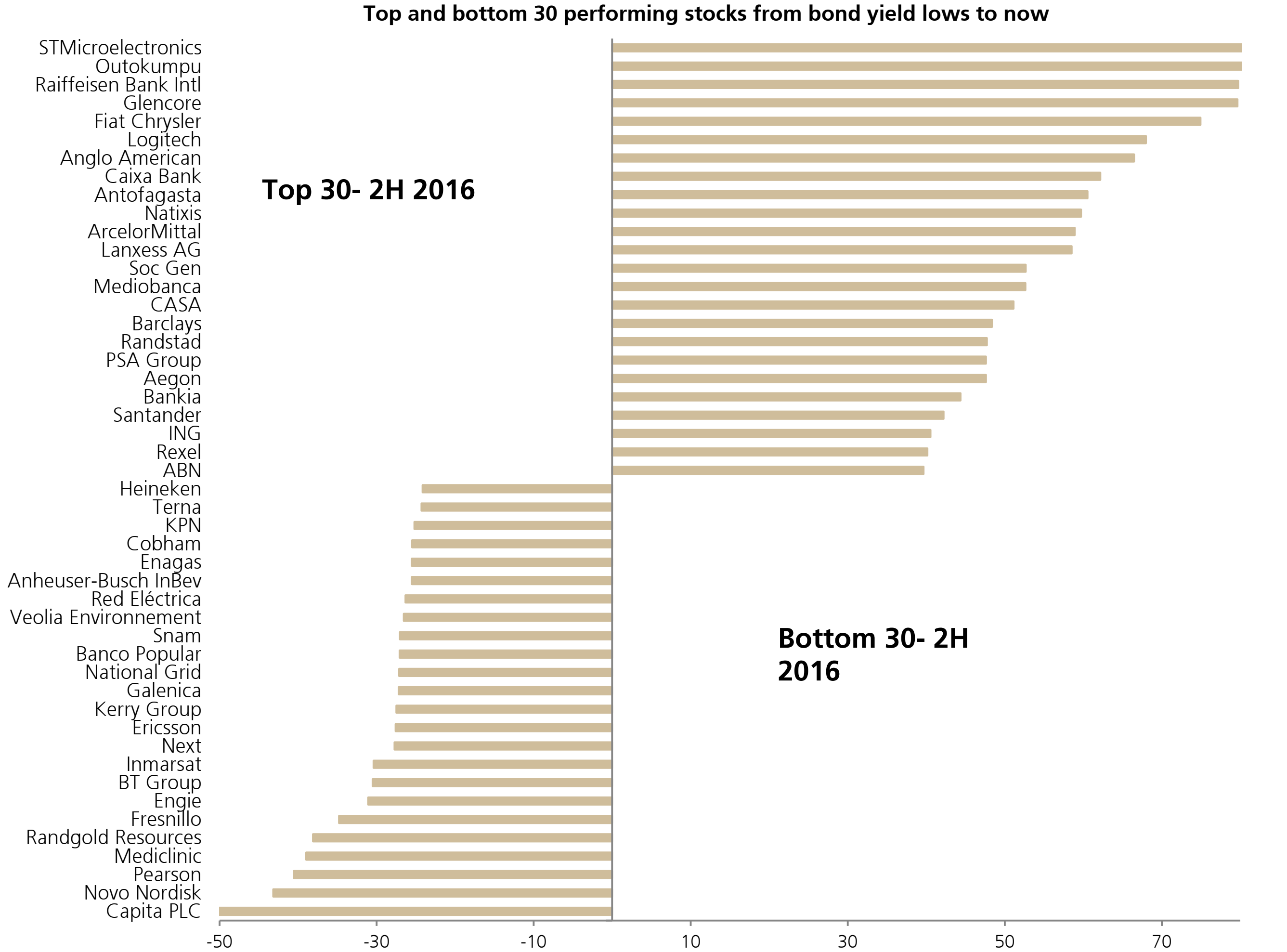
Figure 41: Big performance gaps within sectors – 56% gap Mining vs Utilities



Source: Thomson Datastream, UBS European Equity Strategy

Stocks: 5 cyclical names up over 75% from 6th July to now

Figure 42: Sample of stock extremes

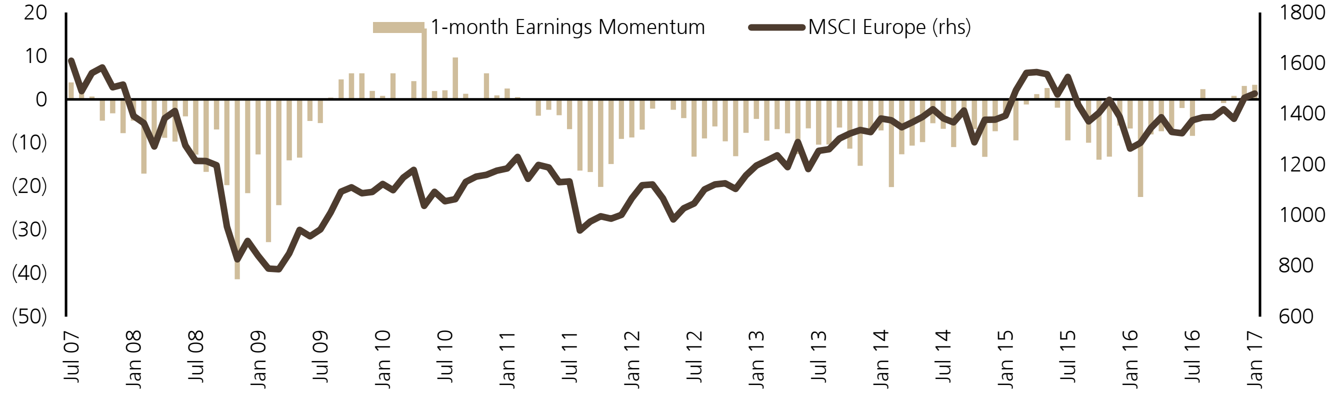


Source: Thomson Datastream, UBS European Equity Strategy

Appendix 3 – Profit backdrop

We look at market and sector EPS momentum and it's looking positive.

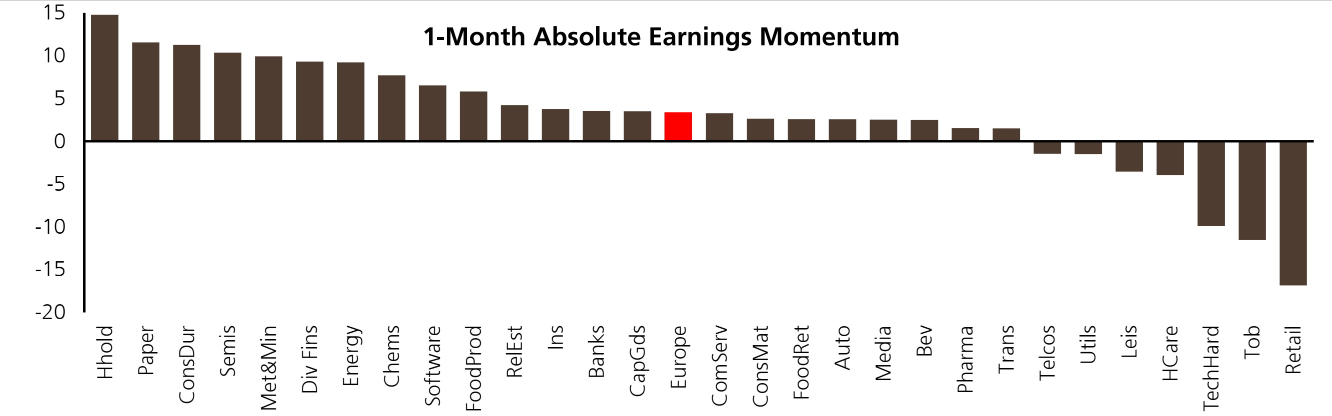
Figure 43: European EPS momentum - up 3m in a row & first time since end 2010



Source: Thomson Datastream, UBS European Equity Strategy

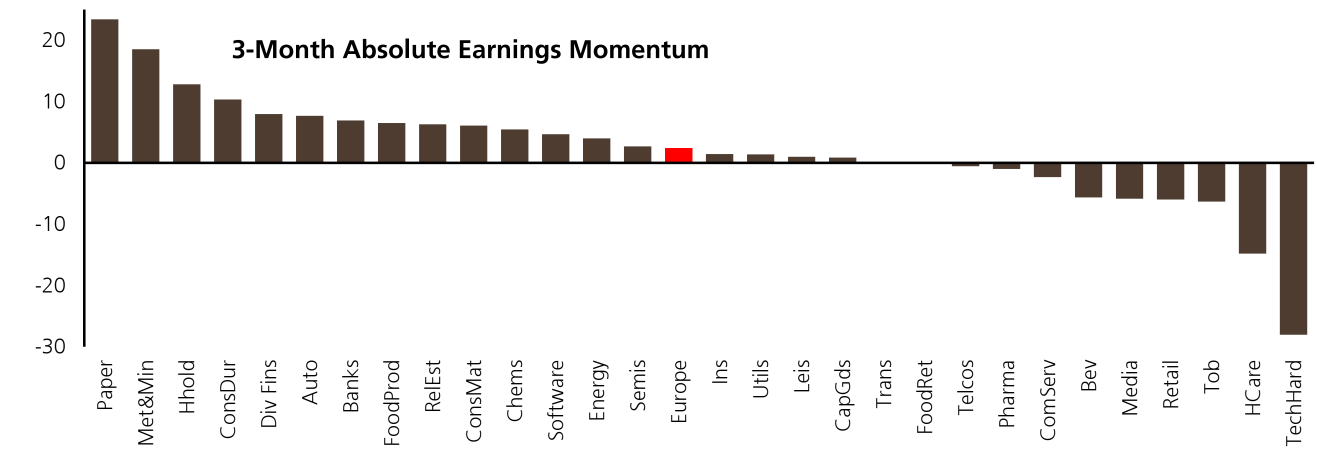
Cyclical sectors appear to be holding up over 3m and 1m EPS momentum.

Figure 44: Sectors: 1- month absolute earnings momentum



Source: Thomson Datastream, UBS European Equity Strategy

Figure 45: Sectors' 3 month absolute earning momentum



Source: Thomson Datastream, UBS European Equity Strategy

BASE EFFECT

EPS gaps from 2007 peak to date. They are still very big and do offer exceptional base-effect even if they partly close. See countries and sectors.

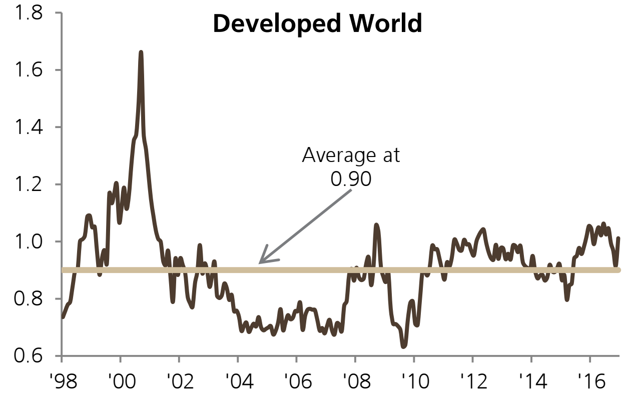
Figure 46: Country & Sector EPS gap from 2007-08 peak

	Europe	Denmark	France	Germany	Italy	Netherlands	Norway	Portugal	Spain	Sweden	Switzerland	UK
Cons Discr	43%	-42%	16%	92%	66%	-184%	-93%		67%	-1%	18%	26%
Cons Staples	22%	-15%	7%	42%		37%	6%	64%	18%	119%	24%	15%
Energy	-73%		-49%		-96%	-63%	-93%	-6%	-51%	-57%		-74%
Financials	-59%	-6%	-24%	-57%	-73%	-63%	-6%		-71%	-3%	-54%	-65%
Health Care	23%	221%	-11%	78%						-20%	31%	-10%
Industrials	-5%	-30%	-20%	20%	-40%	-26%			3%	15%	5%	-7%
IT	-11%		0%	103%		182%			21%	-62%		85%
Materials	-54%	-73%	-69%	-29%		-3%	-57%			-17%	4%	-69%
T/Cm Svs	-39%		-53%	-1%	-75%	-81%	-9%		-60%	-43%	-3%	-38%
Utilities	-42%		-61%	-84%	-39%			-2%	4%			-7%
Country Total	**-28%**	**61%**	**-24%**	**-5%**	**-64%**	**-17%**	**-58%**	**-66%**	**-48%**	**1%**	**-26%**	**-30%**

Source: Thomson Datastream, UBS European Equity Strategy

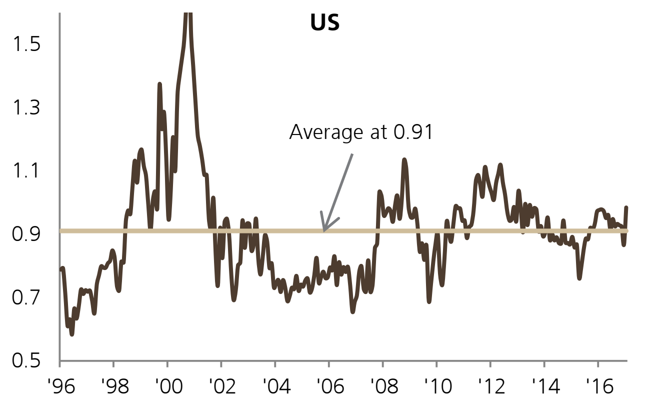
Appendix 4: Global Value gaps

Figure 47: Developed World Value gap



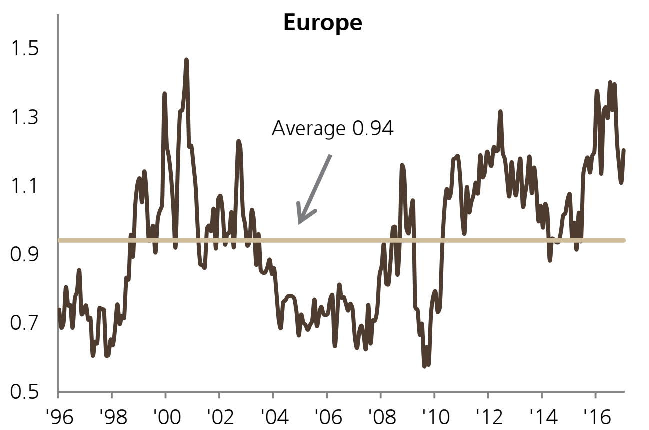
Source: UBS Quant and European Equity Strategy

Figure 48: US Value gap



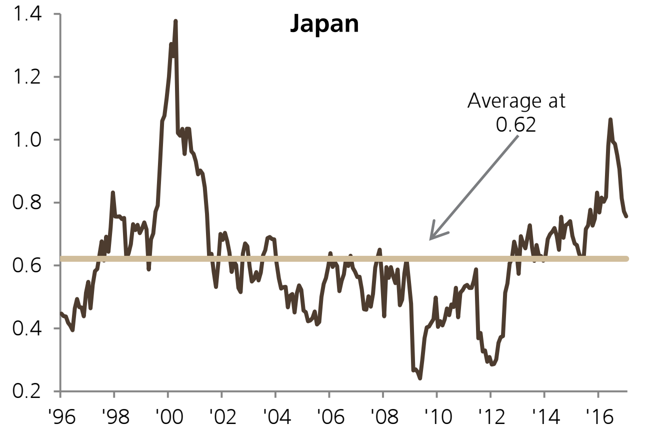
Source: UBS Quant and European Equity Strategy

Figure 49: Europe Value gap



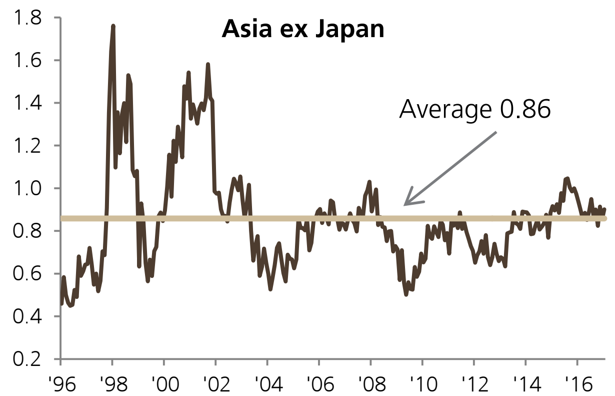
Source: UBS Quant and European Equity Strategy

Figure 50: Japan Value gap



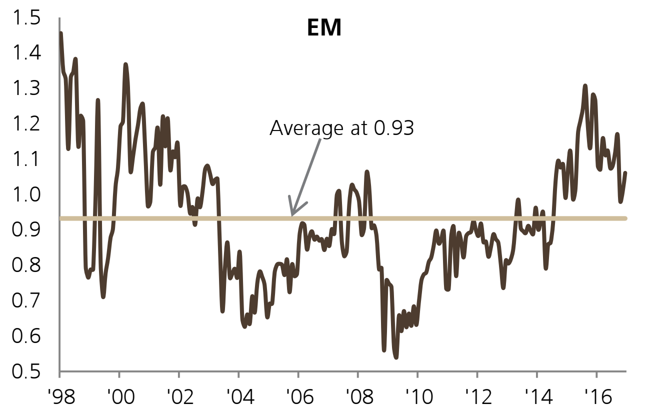
Source: UBS Quant and European Equity Strategy

Figure 51: Asia ex Japan Value gap



Source: UBS Quant and European Equity Strategy

Figure 52: EM value gap



Source: UBS Quant and European Equity Strategy

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Risks include macroeconomic variables (such as GDP growth rates and inflation), economic slowdown, a weakening currency, global economic events, and government policy changes.

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Buy	Stock price expected to rise within three months from the time the rating was assigned because of a specific catalyst or event.	<1%	<1%
Sell	Stock price expected to fall within three months from the time the rating was assigned because of a specific catalyst or event.	<1%	<1%

Source: UBS. Rating allocations are as of 31 December 2016.
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UBS Limited: Karen Olney, CFA; Nick Nelson; Joao Toniato; Andras Nagy, CFA.

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Company Name	Reuters	12-month rating	Short-term rating	Price	Price date
Alstom[7]	ALSO.PA	Buy	N/A	€26.74	07 Feb 2017
AstraZeneca[7, 16]	AZN.L	Buy	N/A	4,450p	07 Feb 2017
BPER[7]	EMII.MI	Neutral	N/A	€5.02	07 Feb 2017
Britvic	BVIC.L	Buy	N/A	634p	07 Feb 2017
Capgemini	CAPP.PA	Buy	N/A	€76.34	07 Feb 2017
Credit Suisse Group[5, 7, 16]	CSGN.S	Buy	N/A	CHF14.81	07 Feb 2017
Daimler	DAIGn.DE	Buy	N/A	€66.76	07 Feb 2017
Enel[4, 5, 7]	ENEI.MI	Buy	N/A	€3.87	07 Feb 2017
Energias de Portugal[5, 7]	EDP.LS	Buy	N/A	€2.69	07 Feb 2017
Engie[7]	ENGIE.PA	Neutral	N/A	€11.03	07 Feb 2017
Eni[7, 16]	ENI.MI	Buy	N/A	€14.20	07 Feb 2017
G4S	GFS.L	Buy	N/A	256p	07 Feb 2017
Gas Natural Fenosa	GAS.MC	Buy	N/A	€18.35	07 Feb 2017
Generali[2, 4, 5, 7]	GASI.MI	Buy	N/A	€14.55	07 Feb 2017
Icade SA	ICAD.PA	Buy	N/A	€67.03	07 Feb 2017
Ladbrokes Coral Group[4, 14]	LCL.L	Buy	N/A	124p	07 Feb 2017
Leonardo Finmeccanica[4, 14]	LDOF.MI	Buy	N/A	€12.08	07 Feb 2017
Mediaset SpA[20]	MS.MI	Sell (CBE)	N/A	€3.81	07 Feb 2017
Renault[7]	RENA.PA	Buy	N/A	€82.61	07 Feb 2017
Royal Dutch Shell[4, 5, 7, 16]	RDSa.L	Buy	N/A	2,154p	07 Feb 2017
Sanofi[7, 16]	SASY.PA	Neutral	N/A	€75.90	07 Feb 2017
SKF B	SKFb.ST	Sell	N/A	SKr169.50	07 Feb 2017
Société Générale[2, 4, 5, 6, 7, 22]	SOGN.PA	Sell	N/A	€43.64	07 Feb 2017
Taylor Wimpey[13]	TW.L	Buy	N/A	172p	07 Feb 2017
Telenor	TEL.OL	Buy	N/A	NKr131.30	07 Feb 2017
Travis Perkins	TPK.L	Buy	N/A	1,489p	07 Feb 2017
UniCredit[1, 3a, 3b, 4, 5, 7, 20, 22]	CRDI.MI	Neutral (CBE)	N/A	€12.27	07 Feb 2017
Vinci	SGEF.PA	Buy	N/A	€65.22	07 Feb 2017
Vodafone Group[1, 2, 4, 5, 7, 14, 16]	VOD.L	Buy	N/A	192p	07 Feb 2017
Wacker Chemie	WCHG.DE	Buy	N/A	€109.45	07 Feb 2017

Source: UBS. All prices as of local market close.
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