Deutsche Bank
Research

European Equity Strategy

Strategy snapshot: A month of monetary madness

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Passion to Perform

A month of monetary madness

- **Monetary policy, a key driver of equity markets over the past years, is set to go into rollercoaster mode in December,** with the ECB likely to announce further easing measures on December 3, November's non-farm payrolls report (a key determinant of the Fed's next policy steps) coming out on December 4 and the Fed then likely to hike interest rates for the first time since 2006 on December 16. Our European economists expect the ECB to announce a six-month extension of its QE program as well as a 10bps cut to its policy rates (the deposit rate, refinancing rate and the marginal lending rate; see their report *Fraternité*, Nov 20). Our US economists project a 140k gain in non-farm payrolls – and think the Fed will raise their policy rate by 25bps in December, followed by a further two 25bps hikes in H1 2016 (*Getting ready for a December rate hike*, Nov 19).

- **Why are markets so calm?** The two months before the Fed's September meeting when it was last expected to start hiking rates were marked by significant market turmoil, partly as a consequence of the PBoC's decision to devalue the RMB ahead of a Fed decision that was likely to put further upside pressure on the dollar (and, hence, on the Chinese currency pegged to it). Outflows out of EM equity funds accelerated to a seven-year high, EM sovereign bond spreads rose by 90bps and US HY credit spreads by 75bps, while the oil price fell 15% and equity markets by 6%. Compared to that earlier experience, the market now is a paragon of tranquillity: since the upside surprise to payrolls in early November, EM sovereign spreads have tightened, the VIX has remained at around 15% and the S&P 500 is within 2% of its all-time high. The only indicators registering stress are US HY bond spreads, which have risen by 55bps, and the oil price, which is down 11% since early November. Does this mean that the Fed can now start its policy normalization without negatively impacting asset prices? We doubt it!

- **A more plausible explanation is that the ECB is doing whatever it can to facilitate a December Fed lift-off**, as the likely resulting euro weakness versus the dollar would help in its fight against disinflation in the Euro-area. The only two factors we think would prevent the Fed from hiking in December are a sharp deterioration in US macro data or a bout of financial stress of the kind that deterred the Fed from hiking in September. There is little sign of the former – and the ECB's unusually blunt signals of dovishness ahead of its December meeting ensure that financial markets remain calm, removing the last remaining obstacles for a December Fed lift-off.

A month of monetary madness

- **While we see around 10% upside for European equities by end-2016, we believe a 5% to 10% correction in global equity markets is likely when the Fed hikes rates**. Following the first Fed rate hikes in 1994 and 2004, US equities corrected by 7% over two months, as P/Es dropped by 12% and 18% respectively on the back of rising 2-year note yields (yet, that impact was blunted by strong earnings growth). While rates are set to rise less sharply than on those earlier occasions, EPS growth now is weak and the unwinding of the $6tn pile of EM FX reserves as well the more fragile state of the US HY credit market are set to add to the financial stress at the start of this tightening cycle (see our report *Stress transmission,* Nov 17, for more details). If the Fed hikes now, we expect the dollar to appreciate (our FX strategists see 8% upside by end-2016), commodity prices to fall (as these move inversely to the dollar), EM asset prices to sink (as Fed policy is the main determinant of EM capital flows) and credit spreads to widen (given elevated corporate leverage, weak EPS growth and an increased sensitivity to oil, with 20% of the HY space accounted for by energy companies).

- **How could we be wrong?** There are two ways in which our correction scenario could fail to materialize – (a) *ECB easing outweighs Fed tightening*: if the ECB surprises on the dovish side, this might be sufficient to help risk assets stomach the well-flagged Fed rate hike. We're not convinced by this scenario, given that there is some evidence that USD-liquidity matters more to the USD-based global financial system than euro-liquidity, that market expectations for the ECB meeting already run high (which means there is some risk of disappointment) and that the incremental ECB easing now is likely to be less significant than at the start of its QE program in March, when European equities dropped by 15% over the following six months; (b) *a "dovish hike" means there is limited downside for asset prices*. Again, we think this is unlikely: equities have continued to move inversely to real bond yields, which move in line with expectations for future monetary policy – and these have tended to rise when policy tightening has appeared to become more likely.

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- **What is defensive?** While we continue to think that banks and cyclicals are set to outperform over the next 12 months, we think it makes sense to focus on sectors that should do well during a Fed-induced market correction in the near term. Among European defensives, health care looks the best placed to perform strongly in such a scenario, while telecoms, consumer staples and utilities are likely to struggle:

    - **Health care:** we want to focus on sectors that are defensive, export-focused (to benefit from a weaker euro) and have significant US exposure (to benefit from a stronger dollar). Health care fits the bill: the sector ranks top on our European defensiveness scorecard (based on 10-year net income volatility, 10-year return volatility, beta with the equity market and correlation with economic lead indicators), derives 80% of sales from outside Continental Europe (compared to 55% for the market) and has 35% sales exposure to the US (compared to 15% for the market). On our valuation scorecard, health care is the best ranking defensive sector after utilities, relative EPS has continued to be revised up, our analysts highlight that concerns about patent expiries have abated and our US strategists point out that health care will benefit from ageing and increasing efforts to treat clinical conditions with drugs (see their report *2016 S&P EPS growth to surge to 5%*, Nov 20). The key risk for the sector is greater political focus on pricing in the run-up to the presidential election.

    - **Telecoms:** the sector's fundamentals are clearly improving (telecom inflation in the Euro-area has just turned positive for the first time in six years and relative EPS, which has fallen by 50% between 2010 and 2014, has now stabilized). However, the sector has already re-rated significantly (the P/E relative is close to a 10-year high and the relative free cash-flow yield has turned negative for the first time since 2008), as a domestic sector it is less likely to benefit from a weaker currency and high leverage means it might suffer from rising credit spreads.

    - **Consumer staples** have a strong track record of low return volatility – and should benefit from a weaker currency. However, emerging market exposure is high and while the staples have reported good results in EM so far this year, we think further pressure on EM via higher US rates and lower commodity prices makes all EM plays vulnerable. Furthermore, European consumer staples appear to be priced for a significant fall in US 10-year bond yields, which is an unlikely to materialize if the Fed hikes. Lastly, with a dividend yield of 2.9% and low projected dividend growth, the sector ranks near the bottom of our European sector dividend scorecard.

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A month of monetary madness

- **What is defensive?**
  - **Utilities** ranks among the top three on our European sector valuation scorecard. However, the sector's pricing moves in line with the oil price (and, hence, suffers if a stronger dollar further pushes down the oil price), its domestic focus means it is unlikely to benefit meaningfully from a weaker currency and its high leverage makes it sensitive to rising credit spreads.
- **Which sectors look vulnerable?** In spite of years of underperformance and the fact that both rank close to the top of our European valuation scorecard, we think that energy and basic resources have further downside in a Fed-induced correction scenario. With the dollar remaining the main determinant of commodity prices (explaining 75% of the variance in the oil price over the past decade), the European resource sectors have tended to move inversely with the dollar – and we expect the dollar to strengthen further if the Fed hikes. Energy and mining offer the highest 12-month forward consensus dividend yield among European sectors – yet, given high pay-out ratios and low expected dividend growth, both nonetheless rank towards the bottom of our dividend scorecard.
  - **Energy**: the tight correlation of the oil price with the dollar suggests if our FX strategists are right in projecting a further 8% upside for the USD trade-weighted index by end-2016, there is a risk of the oil price dropping to $30/bbl (compared with the consensus forecast of $50/bbl by end-2016). While leverage for the European energy names is not particularly high, the sector has tended to underperform during periods of rising credit spreads over the past five years.
  - **Basic resources**: in spite of the sharp decline since 2011, real metal prices have only just returned to their 30-year average. Furthermore, leverage among the European basic resources stocks is elevated, suggesting there is scope for additional financial pressure in case of a further rise in credit spreads.

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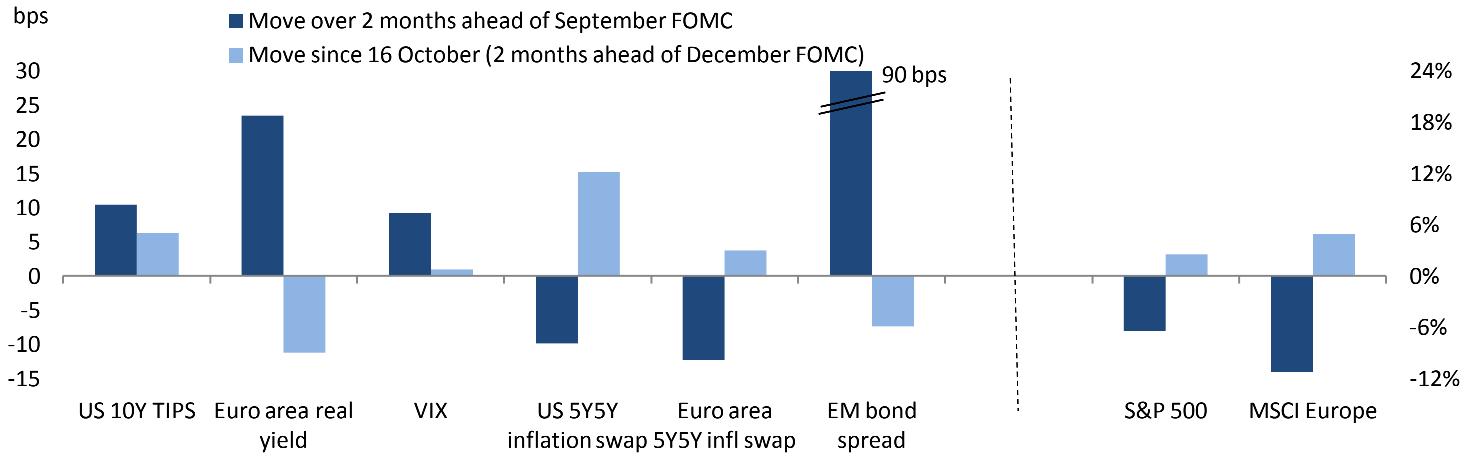
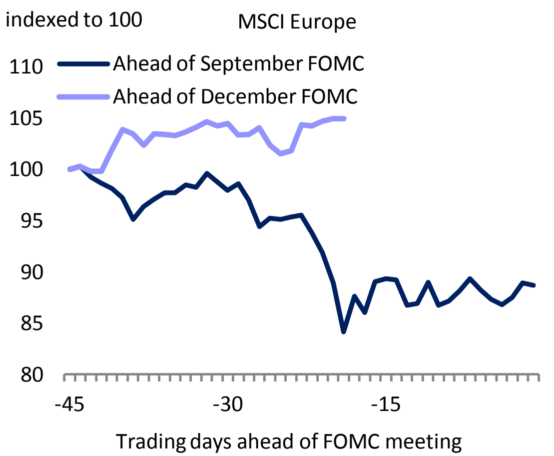
Markets appear to be calmer than in the run-up to the Sep FOMC meeting

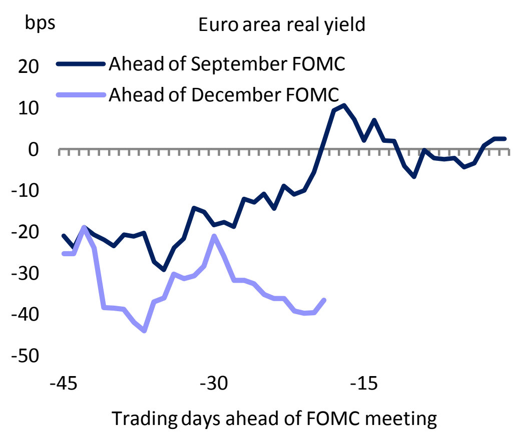
While financial stress was rising ahead of the September FOMC, they have so far been much better behaved this time round



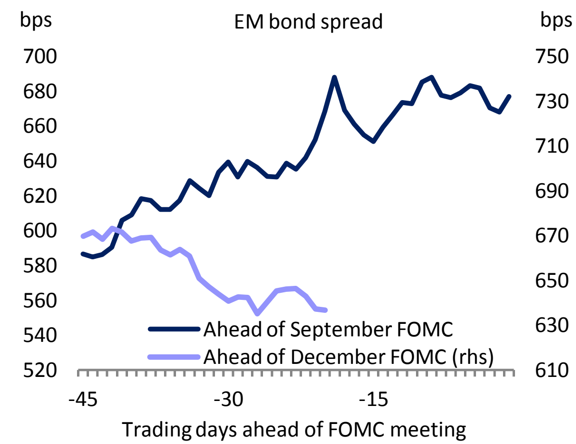
Despite the looming Fed hike in December, equity markets have risen…



…financial conditions have eased, as indicated by lower real yields…



…and EM sovereign bond spreads have tightened



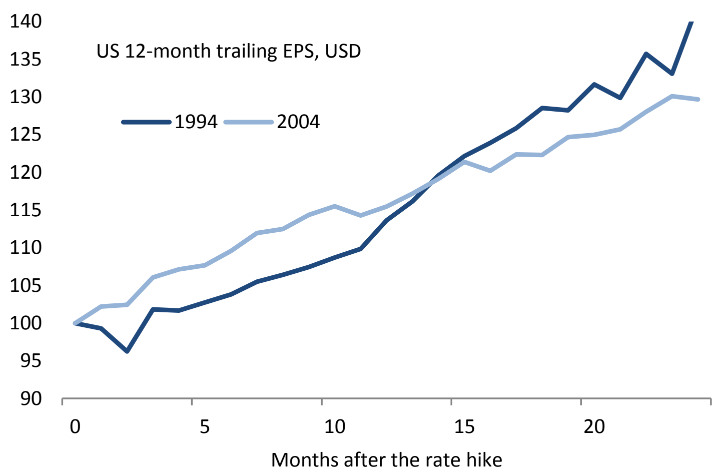
Source: Bloomberg Finance LP, Haver, Datastream, Deutsche Bank

At the start of the past two Fed hiking cycles: (1) US P/Es fell as 2-year note yields rose; (2) US EPS increased sharply; (3) the market troughed after two months

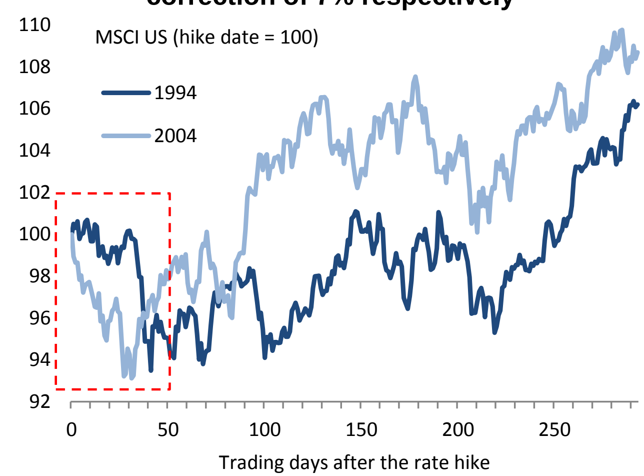
After the 1994 rate hike, the US market de-rated by 12% over a year as the 2-year note yields rose by 340bps

After the 2004 rate hike, the US market de-rated by 18% over two years as the 2-year note yield rose by 260bps

But earnings rose strongly during the same period...



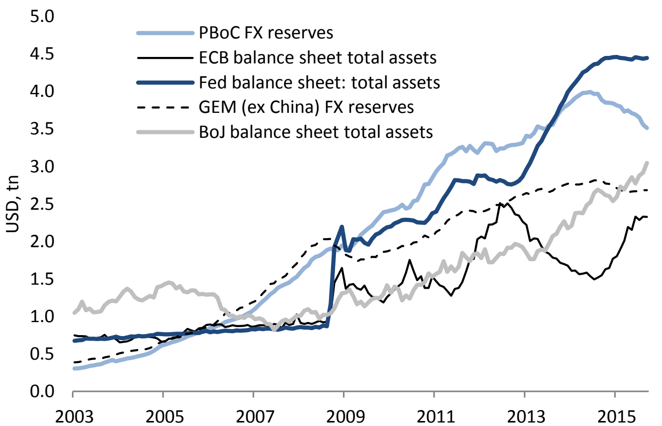
... allowing the market to trough after two months and a correction of 7% respectively



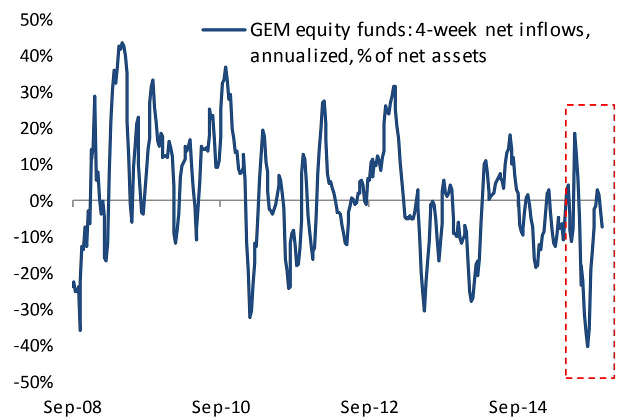
Source: Bloomberg Finance LP, Datastream, Deutsche Bank

The Fed-induced tightening of financial conditions is set to be magnified by a further fall in EM FX reserves and rising credit spreads

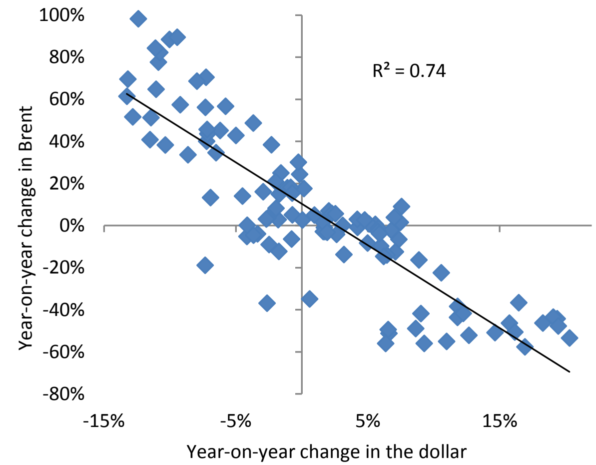
EM FX reserves, at around $6tn, are significantly higher than at the start of previous Fed rate cycles



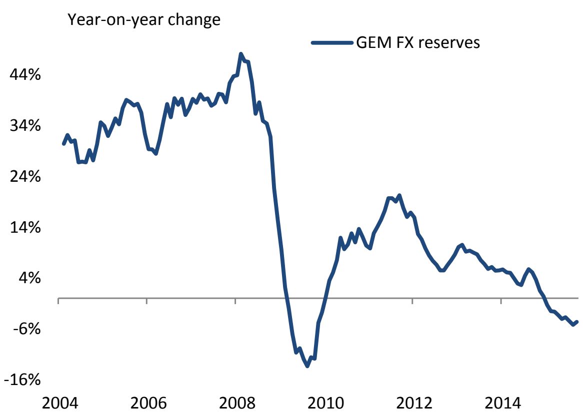
EM capital outflows are set to re-accelerate once the Fed hikes



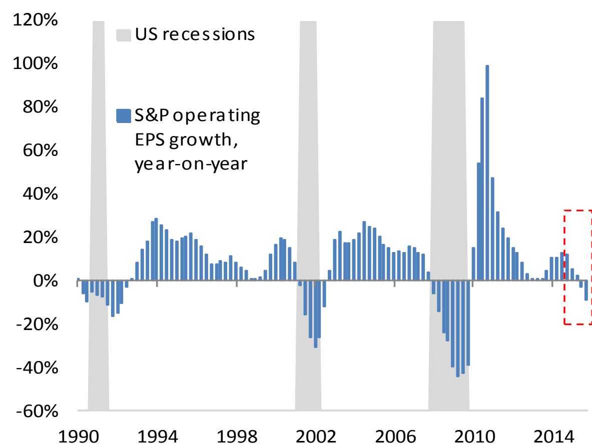
Over the past 10 years, the dollar has explained 74% of the changes in the oil price



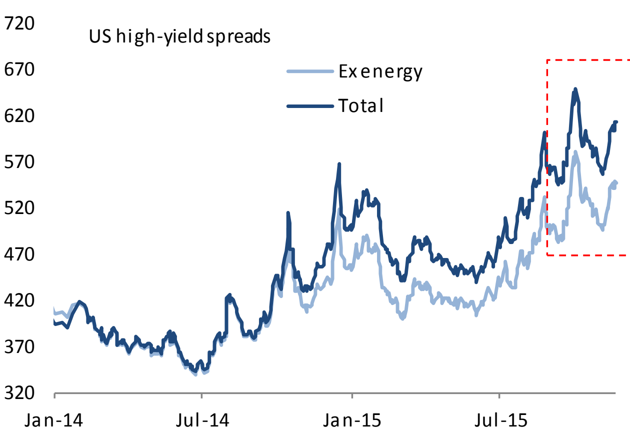
EM capital outflows and a lower oil price is set to translate into further Quantitative Tightening



S&P 500 operating EPS growth has turned negative – something that typically only happens in recessions



US high-yield credit spreads have risen by around 50bps since the start of November



Source: Datastream, Deutsche Bank

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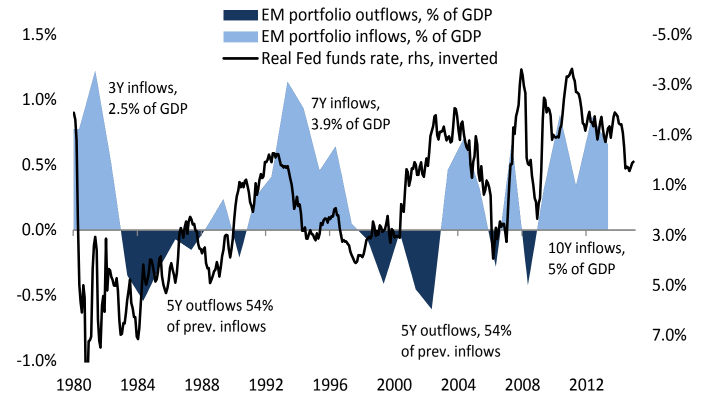
A Fed rate hike is likely to translate into further downside for EM and commodity plays

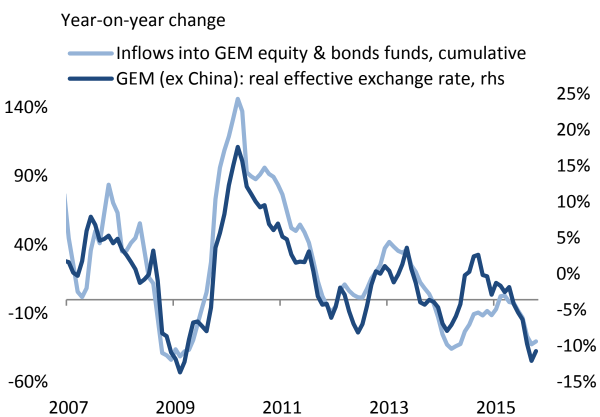
Commodity prices have moved inversely to the dollar over the past decade

EM GDP growth has slowed to 4.5% - and lead indicators point to further downside

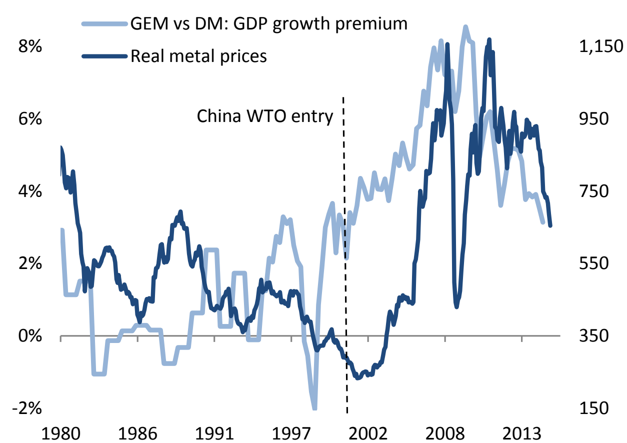
The Fed policy cycle has been the main driver of EM portfolio flows over the past 40 years – suggesting the scope for further outflows if the Fed starts hiking



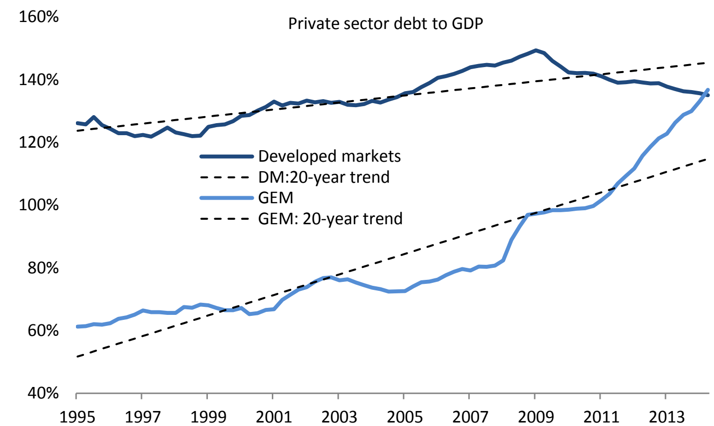
Renewed capital outflows are likely to translate into further FX weakness



GEM GDP growth premium is set to slow further if commodity prices continue to fall



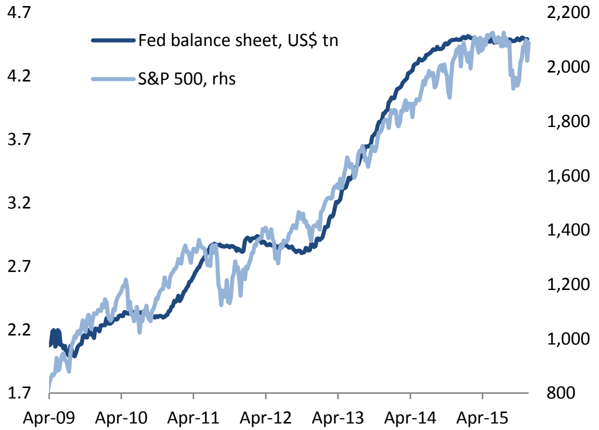
The EM private sector debt to GDP ratio is above that in developed markets for the first time



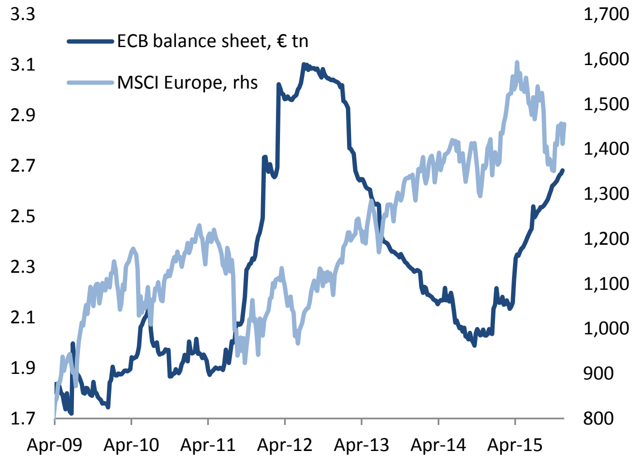
Source: Bloomberg Finance LP, EPFR Global, Datastream, Deutsche Bank

There is some evidence that USD-liquidity has been more important for asset prices than euro-liquidity

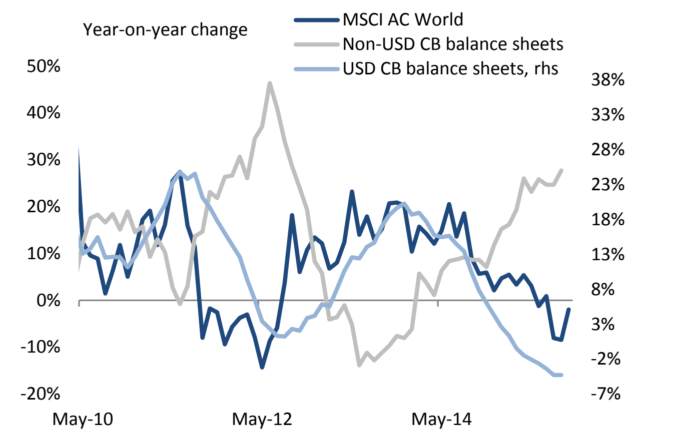
The US equity market has followed the trajectory charted by the Fed balance sheet...



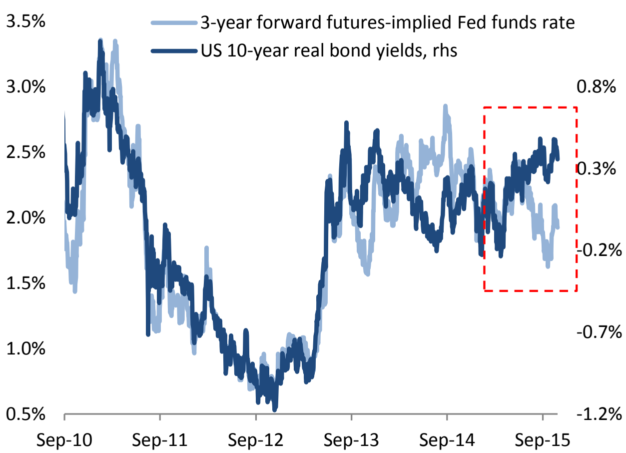
... while the same relationship does not hold between equities and the ECB balance sheet



Global asset prices have moved in line with the size of the balance sheets of the CBs buying USD-denominated assets

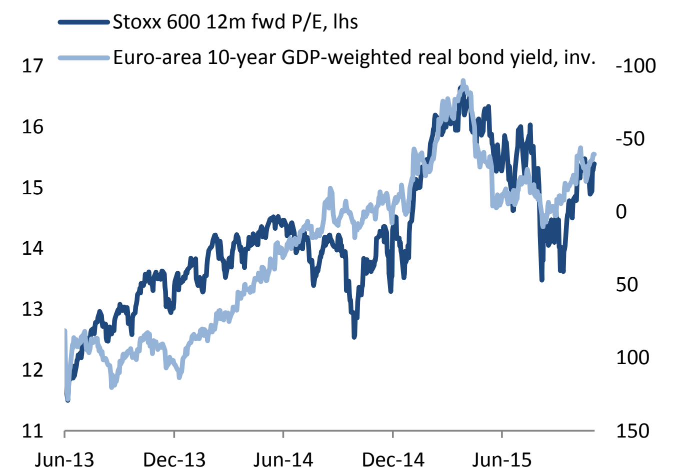


A Fed hike would likely push up the 3y forward Fed funds rate, the key driver of US real bond yields



Euro-area real bond yields tend to move in line with those in the US

If Euro-area bond yields were to rise, this would likely lead to a de-rating of the European equity market



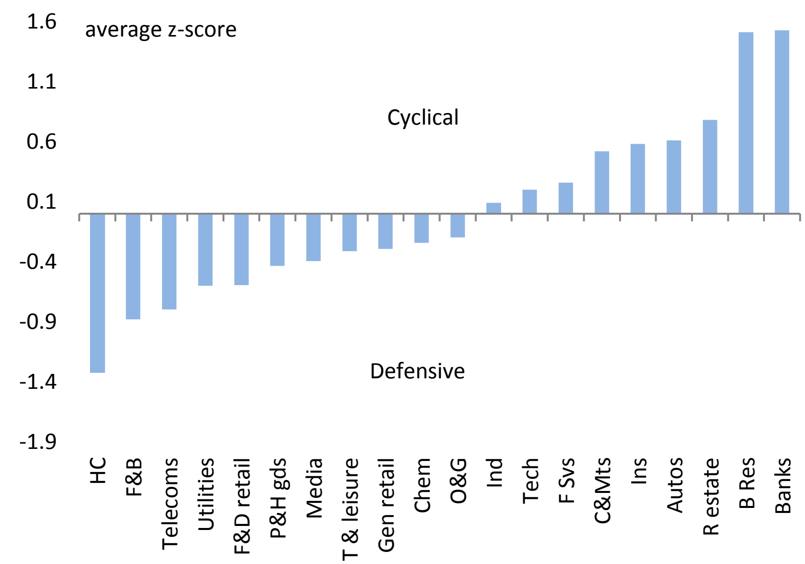
Source: Bloomberg Finance LP, Datastream, Deutsche Bank

What is defensive? Health care, food & beverage, telecoms and utilities are the most defensive among European sectors

Our European sector defensiveness scorecard is based on net income volatility, performance volatility, correlation with PMI and 5y sector beta

	Z-score				
	Net income volatility	Performance volatility	Correlation with PMI	5y Beta	average z-score
Health Care	-0.87	-1.68	-1.31	-1.43	**-1.32**
Food & Beverage	-0.66	-1.41	0.06	-1.52	**-0.88**
Telecommunications	0.48	-0.80	-2.11	-0.77	**-0.80**
Utilities	-0.55	-0.62	-1.00	-0.23	**-0.60**
Food & drug retail	0.10	-0.96	-0.84	-0.68	**-0.60**
Personal & Household Goods	-0.79	-0.75	0.34	-0.54	**-0.44**
Media	-0.42	-0.61	-0.14	-0.41	**-0.40**
Travel & Leisure	-0.43	-0.07	-0.21	-0.54	**-0.31**
Gen retail	-0.95	0.15	-0.09	-0.28	**-0.29**
Chemicals	-0.65	0.14	-0.72	0.26	**-0.24**
Oil & Gas	-0.06	0.10	-1.18	0.34	**-0.20**
Industrial Goods & Services	-0.80	0.24	0.62	0.30	**0.09**
Technology	-0.13	0.13	0.86	-0.06	**0.20**
Financial Services	0.48	-0.37	1.51	-0.59	**0.26**
Construction & Materials	-0.50	0.86	0.80	0.92	**0.52**
Insurance	0.22	0.73	0.32	1.05	**0.58**
Automobile	0.31	0.85	-0.39	1.68	**0.61**
Real Estate	3.49	-0.10	0.77	-1.03	**0.78**
Basic Resources	0.93	2.48	0.88	1.77	**1.51**
Banks	0.80	1.70	1.84	1.77	**1.53**

Healthcare, food & beverage, telecoms, and utilities rank as most defensive sectors in the European market



Source: Datastream, Deutsche Bank

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Energy, banks, utilities and basic resources rank top on our European sector valuation scorecard

Our European sector valuation scorecard is based on the deviations of P/E, P/B and dividend yield relatives to the market from their 20-year average

Sector name	12m fwd P/E			P/B			Dividend yield			Average of σ from LTA
	Absolute	Relative to market	Relative, deviation from LT average (σ)	Absolute	Relative to market	Relative, deviation from LT average (σ)	Absolute	Relative to market	Relative, deviation from LT average (σ)	
Oil & Gas	15.3	-2%	0.96	0.91	-51%	-2.62	5.5%	2.7%	-2.99	-1.5
Banks	10.7	-32%	-1.49	0.83	-55%	-1.46	3.6%	0.8%	-0.26	-1.1
Utilities	14.4	-8%	-0.48	1.38	-25%	-1.21	4.7%	2.0%	-0.94	-0.9
Basic Resources	14.9	-5%	0.67	0.86	-53%	-1.80	4.3%	1.6%	-1.13	-0.8
Insurance	11.3	-28%	-0.52	1.43	-22%	-0.31	4.1%	1.4%	-1.25	-0.7
Technology	19.2	23%	-0.72	3.66	98%	0.14	1.5%	-1.3%	-0.49	-0.4
Automobile	10.4	-33%	-0.39	1.42	-23%	0.78	2.5%	-0.3%	-0.17	0.1
Media	18.4	17%	-0.39	3.29	79%	1.21	3.0%	0.2%	-0.57	0.1
Health Care	19.0	22%	-0.20	4.72	156%	1.40	2.5%	-0.3%	-0.32	0.3
Industrial Goods & Services	16.1	3%	0.00	2.88	56%	1.65	2.5%	-0.3%	-0.29	0.5
Financial Services	16.4	5%	-0.35	1.42	-23%	1.46	2.5%	-0.2%	0.41	0.5
Telecommunications	19.9	27%	0.36	2.92	58%	1.52	3.9%	1.1%	-0.27	0.5
Real Estate	19.7	26%	-0.23	1.32	-28%	1.57	3.0%	0.2%	0.79	0.7
Chemicals	16.6	6%	0.43	3.03	64%	1.78	2.4%	-0.4%	0.28	0.8
Personal & Household Goods	19.2	23%	0.30	4.62	151%	2.40	2.4%	-0.4%	-0.16	0.8
Construction & Materials	15.7	0%	0.38	1.92	4%	1.17	2.5%	-0.3%	1.03	0.9
Travel & Leisure	14.6	-7%	-0.70	3.27	78%	3.07	1.8%	-0.9%	0.99	1.1
Food & Beverage	22.1	41%	1.29	3.28	78%	1.95	2.2%	-0.5%	0.16	1.1
Retail	19.7	26%	1.04	2.97	61%	2.39	2.1%	-0.6%	0.99	1.5

Source: Bloomberg Finance LP, Datastream, Deutsche Bank

Mining, energy, telecoms and food & beverage rank towards the bottom of our European dividend scorecard

Our European dividend scorecard is based on the 12-month forward dividend yield, 12-month forward payout ratio, and 2015-17 consensus dividend growth

		Values			Rank		
Rank	Sector	12m fwd dividend yield	12m fwd payout ratio	2015-17 cons div growth	12m fwd dividend yield	12m fwd payout ratio	2015-17 cons div growth
1	Div Fins	3.6%	45%	16%	9	7	1
2	Autos	3.2%	31%	11%	11	2	8
3	Banks	4.9%	51%	10%	4	13	9
4	Transport	3.3%	47%	11%	10	10	7
5	Cons Durables	2.7%	46%	13%	20	8	2
6	Construction materials	2.5%	42%	13%	21	6	3
7	HC equipment	1.3%	31%	11%	26	1	5
8	Semis	1.4%	33%	11%	25	4	6
9	Software	1.7%	32%	10%	24	3	10
10	Com Services	3.0%	50%	8%	14	12	13
11	Retail	2.8%	57%	12%	16	19	4
12	Cons Services	2.7%	49%	10%	18	11	11
13	Tech HW	2.7%	47%	10%	19	9	12
14	Food retail	2.5%	42%	7%	22	5	14
15	Insurance	4.7%	53%	5%	5	16	20
16	Capital goods	3.2%	51%	5%	13	14	16
17	Chemicals	3.0%	51%	6%	15	15	15
18	Real Estate	3.7%	82%	5%	8	23	17
19	Media	3.8%	67%	5%	7	21	21
20	Pharma	3.2%	55%	5%	12	18	19
21	Utilities	5.0%	73%	-6%	3	22	26
22	Mining	6.0%	88%	0%	1	26	24
23	Energy	5.8%	85%	-3%	2	25	25
24	Telecoms	4.2%	85%	4%	6	24	23
25	Food & bev	2.8%	61%	5%	17	20	18
26	HH products	2.4%	55%	5%	23	17	22

Source: Datastream, Deutsche Bank

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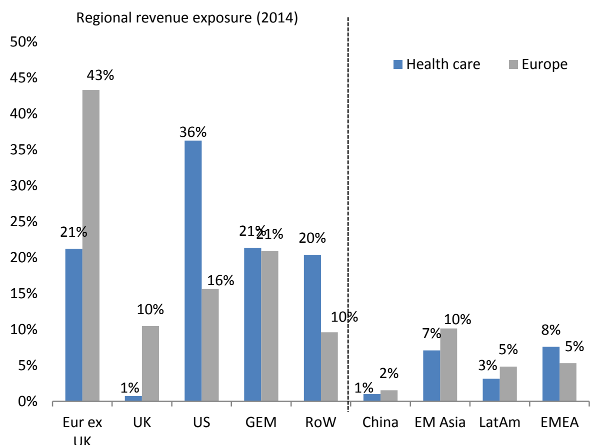
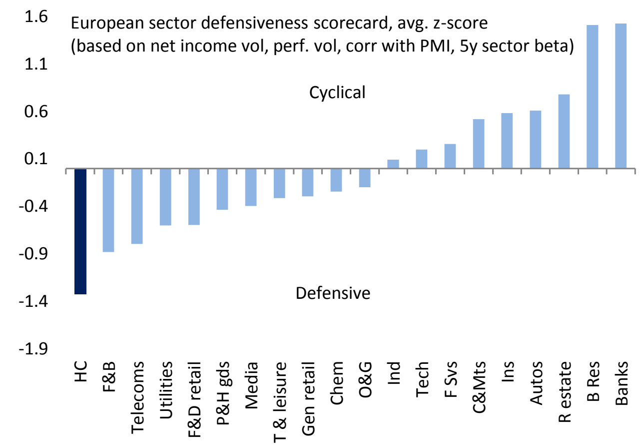
Health care should do well in a Fed-induced equity market correction

Around 40% of sales for the European health care sector come from the US

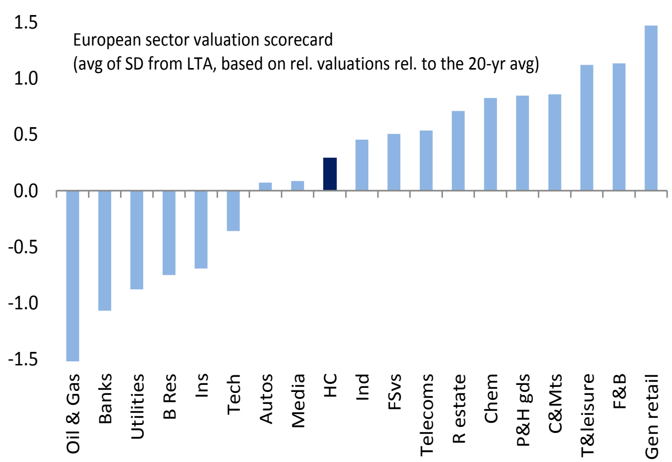


Health care's relative performance should benefit if the dollar strengthens

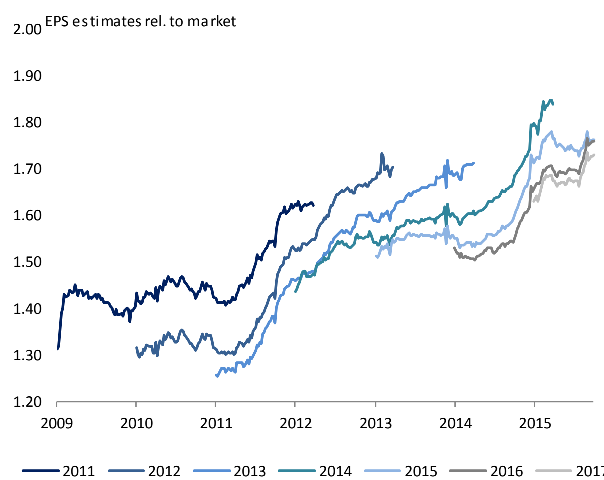
Health care ranks top on our European defensiveness scorecard



Health care is the best ranking defensive sector on our valuation scorecard after utilities



Relative EPS have continued to be revised up



Health care's relative earnings revisions are close to a 3-year high

Source: Datastream, Deutsche Bank

European health care screen

Buy-rated European health care companies with attractive valuations

Company name	Price (local) 22/11/15	DB recommendation	3m % change in 12m fwd EPS	3m net earnings rev (%)	12m fwd PE (x)	12m fwd PE (pre/disc to market)	12m fwd PE rel to market sd from LTA	12m trl PB (x)	12m trl PB (pre/disc to market)	12m trl PB rel to market sd from LTA	12m trl DY (%)	12m trl DY (pre/disc to market)	12m trl DY rel to market sd from LTA*	Avg of sd from LTA	Reco rel to market rel to history (percentile rank)
BTG plc	2,863	Buy	-0.3%	-76.9%	26.0	69.0%	-1.1	3.2	70.7%	-0.5	0.0%	-3.4%	-0.3	-0.6	73%
Coloplast	23,275	Buy	2.3%	-39.3%	29.3	90.7%	1.0	na	na	na	2.6%	-0.8%	-1.8	-0.4	72%
Indivior	164	Buy	-8.3%	73.9%	12.9	-16.5%	-0.2	na	na	na	3.4%	0.0%	-1.9	-1.1	90%
Qiagen	331	Buy	0.1%	-63.0%	22.5	46.5%	-0.7	2.3	25.1%	-0.5	0.0%	-3.4%	-0.2	-0.5	11%
Smith & Nephew	22,236	Buy	-0.9%	-28.0%	18.7	21.3%	-0.5	3.6	93.7%	-0.8	1.8%	-1.6%	-0.7	-0.7	80%

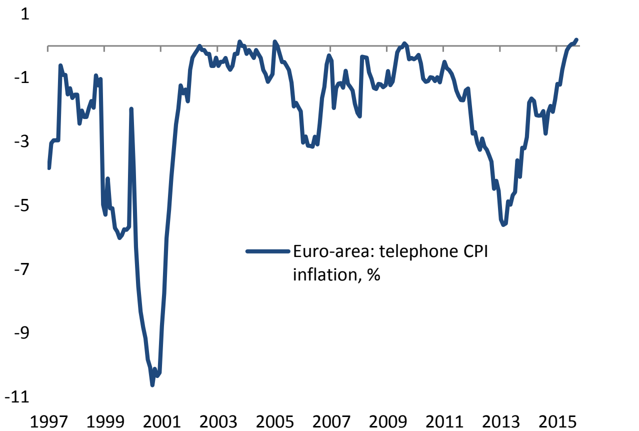
* inverted the sign for comparison purpose

Source: Datastream, Deutsche Bank

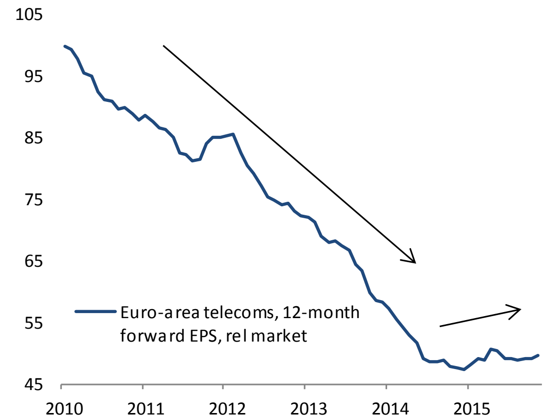
Sebastian Raedler +44-20754-18169; Wolf von Rotberg +44-20754-52801; Andreas Bruckner +49-69910-32787

Telecoms: fundamentals are improving – but valuations are demanding and the sector underperformed sharply when credit spreads spiked in September

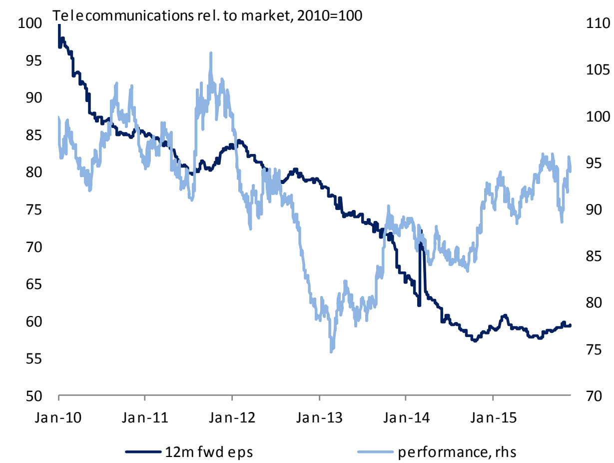
Euro-area telecoms inflation is now at a 20-year high



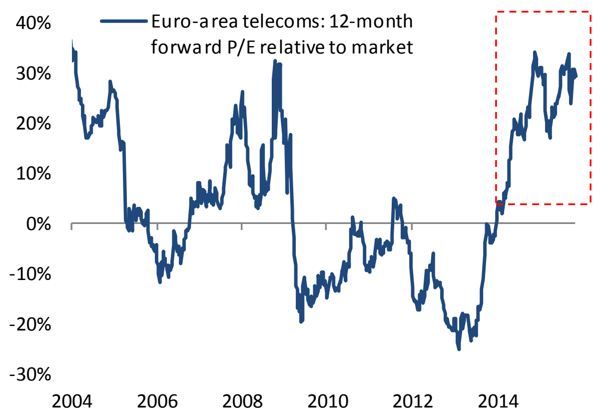
The fall in relative EPS has come to a halt…



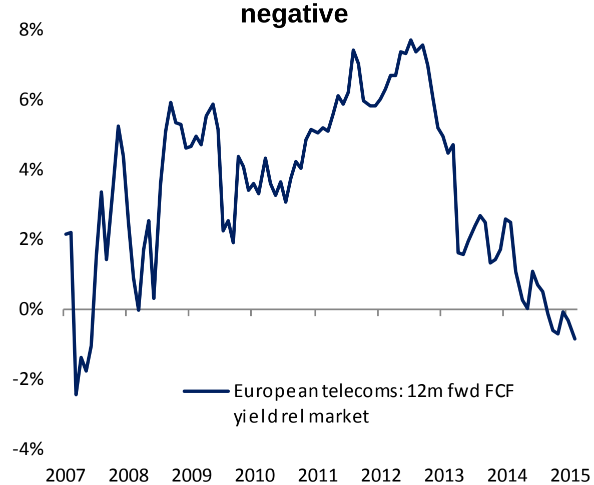
… yet, relative performance has already run ahead of the earnings recovery



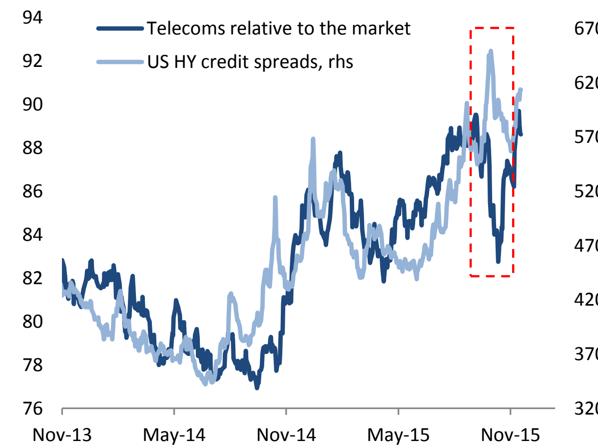
Telecoms are trading on a 30% P/E premium to the market



Telecoms' relative FCF yield has turned negative



Telecoms typically move in line with credit spreads – but when they spiked in Sep, telecoms underperformed



Source: Datastream, Deutsche Bank

European telecoms screen

Sell- and hold-rated European telecommunication companies with high valuations

Company name	Price (local) 22/11/15	DB recommendation	3m % change in 12m fwd EPS	3m net earnings rev (%)	12m fwd PE (x)	12m fwd PE (pre/disc to market)	12m fwd PE rel to market sd from LTA	12m trl PB (x)	12m trl PB (pre/disc to market)	12m trl PB rel to market sd from LTA	12m trl DY (%)	12m trl DY (pre/disc to market)	12m trl DY rel to market sd from LTA*	Avg of sd from LTA	Reco rel to market rel to history (percentile rank)
BT Group PLC	539	Hold	1.6%	9.8%	15.3	-0.4%	0.2	na	na	na	2.7%	-0.7%	1.3	0.7	64%
Elisa Corporation	170	Hold	2.6%	68.1%	22.3	45.1%	1.1	6.2	234.6%	2.9	3.9%	0.5%	0.8	1.6	35%
Freenet AG	127	Hold	-0.5%	-65.5%	16.1	4.5%	0.8	3.1	69.7%	1.9	5.0%	1.6%	0.1	0.9	46%
Proximus NV	130	Hold	0.1%	60.0%	18.6	21.0%	1.4	3.6	94.9%	0.0	4.7%	1.3%	1.2	0.9	82%
Swisscom	167	Hold	-1.3%	-57.3%	16.6	7.8%	0.7	4.7	152.3%	0.8	4.2%	0.8%	0.6	0.7	26%
Tele2	450	Hold	-15.0%	-56.4%	22.3	44.7%	0.5	2.1	13.0%	0.2	6.0%	2.6%	-0.3	0.2	23%
Telefonica Deutschland	121	Hold	20.0%	34.4%	na	na	na	1.5	-16.4%	1.7	4.5%	1.1%	1.6	1.6	3%
Telenor ASA	394	Hold	0.3%	-18.3%	13.9	-9.4%	-0.3	3.6	93.1%	2.1	5.0%	1.6%	-1.0	0.3	8%

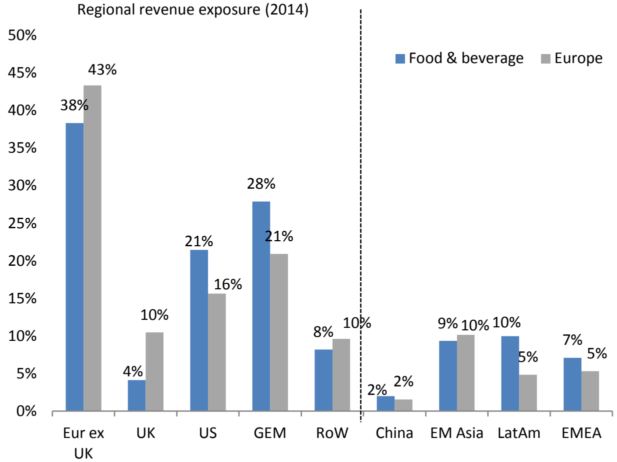
* inverted the sign for comparison purpose

Source: Datastream, Deutsche Bank

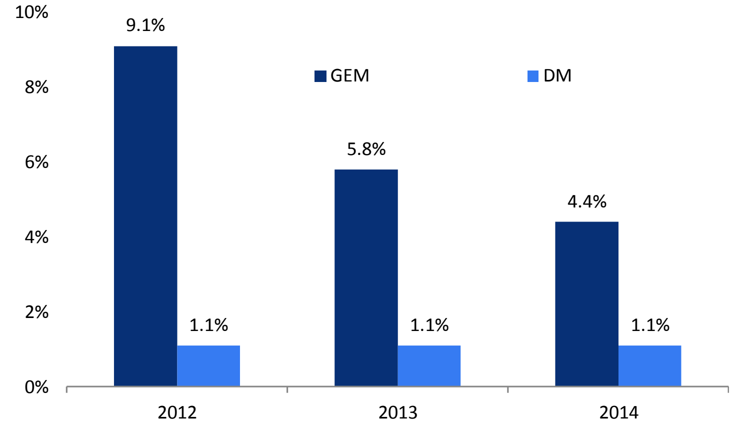
Sebastian Raedler +44-20754-18169; Wolf von Rotberg +44-20754-52801; Andreas Bruckner +49-69910-32787

Upside for consumer staples is limited by the high exposure to EM which are set to come under further pressure if the Fed hikes rates

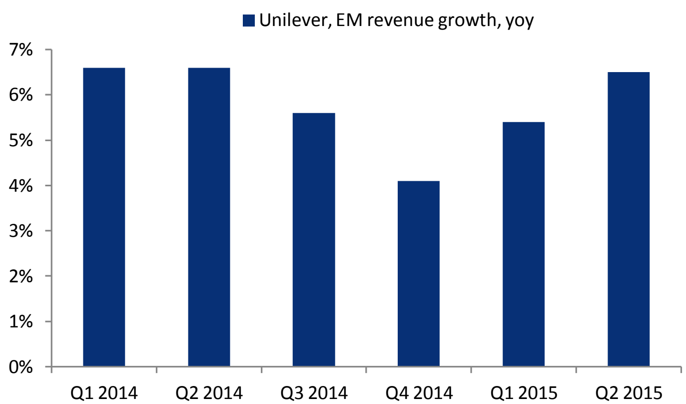
30% of European consumer staples revenues come from emerging markets (45% for food & beverage, according to our analysts)



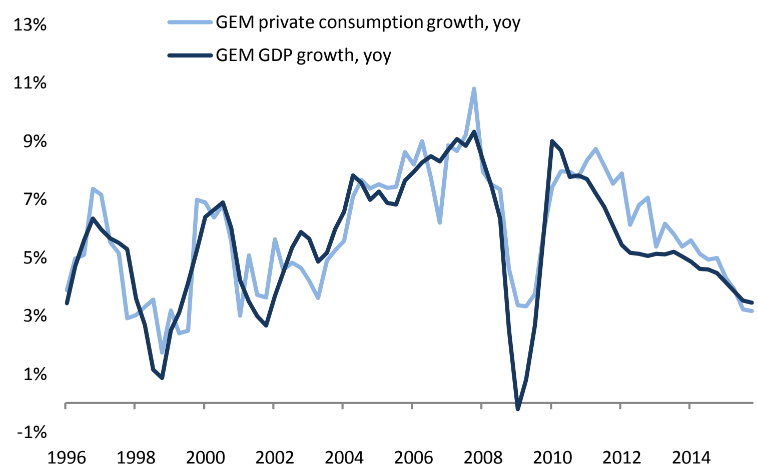
The EM slowdown has translated into lower EM revenue growth for European consumer staples



There have been some signs of improving EM revenue growth momentum for consumer staples this year



Yet, if EM GDP growth slows further, EM real consumption growth is unlikely to hold up well



Source: Datastream, Deutsche Bank

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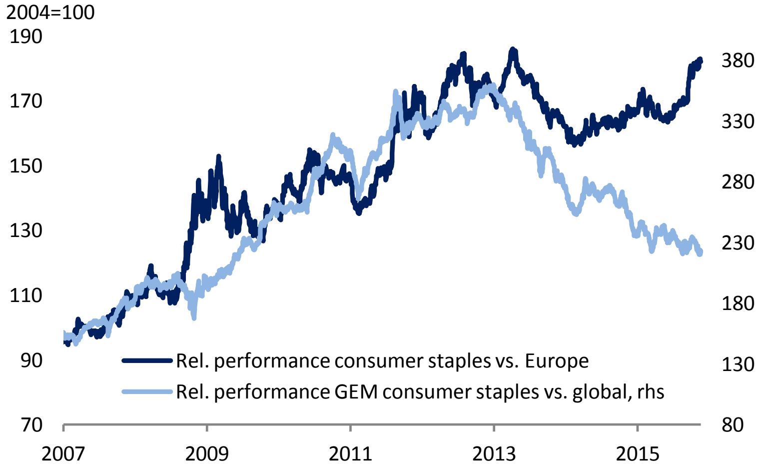
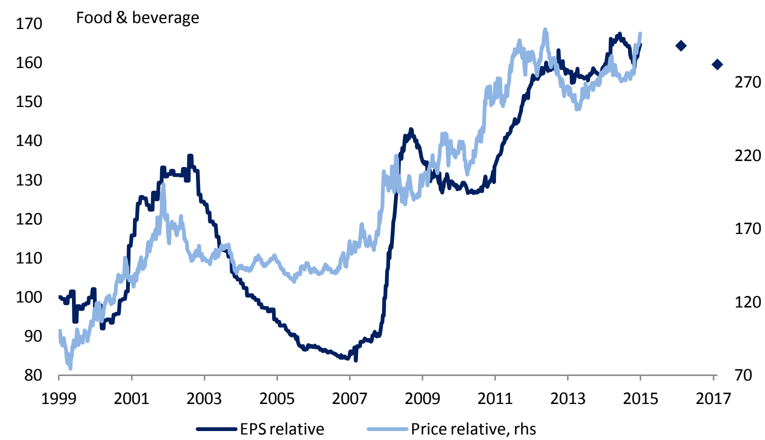
Upside for consumer staples is limited by the high exposure to EM which are set to come under further pressure if the Fed hikes rates

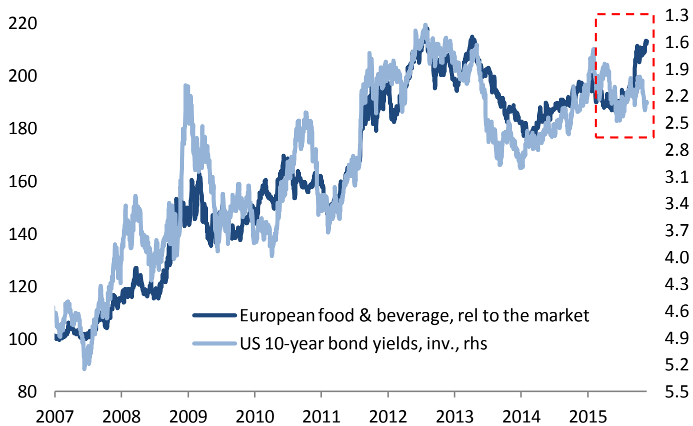
European consumer staples have held up better than their EM counterparts



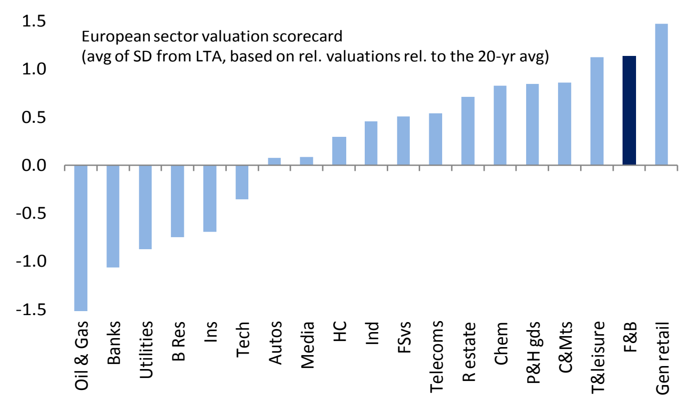
The price relative has risen to a 15-year high, due to strong relative EPS growth – but consensus now expects relative EPS to decline



The sector has outperformed in line with falling US bond yields – but is now priced for an implausibly low yield scenario



Food & beverage is the second most expensive sector on our European valuation scorecard



Source: Datastream, Deutsche Bank

European consumer staples screen

Sell- and hold-rated European consumer staples companies with high valuations

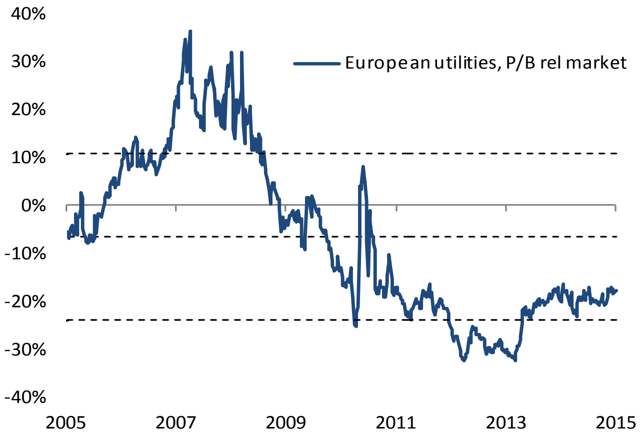
Company name	Price (local) 22/11/15	DB recommendation	3m % change in 12m fwd EPS	3m net earnings rev (%)	12m fwd PE (x)	12m fwd PE (pre/disc to market)	12m fwd PE rel to market sd from LTA	12m trl PB (x)	12m trl PB (pre/disc to market)	12m trl PB rel to market sd from LTA	12m trl DY (%)	12m trl DY (pre/disc to market)	12m trl DY rel to market sd from LTA*	Avg of sd from LTA	Reco rel to market rel to history (percentile rank)
A B Foods	22,087	Hold	-0.2%	19.2%	33.9	120.4%	2.7	4.3	134.0%	2.8	1.0%	-2.4%	1.5	2.3	61%
Carlsberg	3,282	Sell	-5.6%	-71.3%	18.7	21.4%	0.6	1.7	-5.3%	1.0	1.4%	-2.0%	-0.3	0.4	8%
Coca-Cola Hellenic	93	Hold	4.2%	10.8%	25.4	64.7%	1.0	2.9	56.9%	1.9	1.6%	-1.8%	1.1	1.3	0%
Danone	3,456	Hold	0.2%	-53.5%	21.0	36.2%	0.2	3.1	70.1%	0.3	2.4%	-1.0%	-0.1	0.1	75%
Nestle	3,272	Hold	-1.4%	-52.7%	21.9	42.1%	0.7	3.5	87.0%	0.1	2.9%	-0.5%	-0.2	0.2	33%
Pernod-Ricard	8,364	Hold	-5.2%	-45.9%	19.7	28.0%	0.6	2.1	15.8%	-0.4	1.7%	-1.7%	0.2	0.1	78%
Remy Cointreau	211	Hold	0.2%	-75.2%	28.4	84.8%	0.8	3.0	61.8%	0.4	2.3%	-1.1%	0.5	0.6	98%
Bellway	7,678	Hold	11.0%	94.4%	8.9	-42.1%	-0.4	1.7	-10.2%	1.6	3.3%	-0.1%	-0.4	0.3	68%
Henkel	1,134	Hold	1.1%	-42.2%	20.9	35.9%	1.0	3.3	78.8%	1.1	1.3%	-2.1%	0.5	0.9	68%
L'Oreal	18,750	Hold	0.3%	-52.4%	25.8	67.7%	-0.5	4.4	136.5%	1.2	1.8%	-1.6%	-0.2	0.2	29%
Luxottica	372	Hold	1.4%	3.3%	30.5	97.9%	1.2	5.9	217.1%	2.5	1.6%	-1.8%	0.2	1.3	0%
Pandora	315	Hold	8.6%	15.6%	18.0	16.8%	0.6	16.6	800.6%	2.3	1.4%	-2.0%	0.9	1.2	70%
Persimmon	9,156	Hold	3.4%	67.6%	10.8	-29.9%	-0.2	2.4	31.1%	1.9	5.4%	2.0%	-0.8	0.3	4%

* inverted the sign for comparison purpose

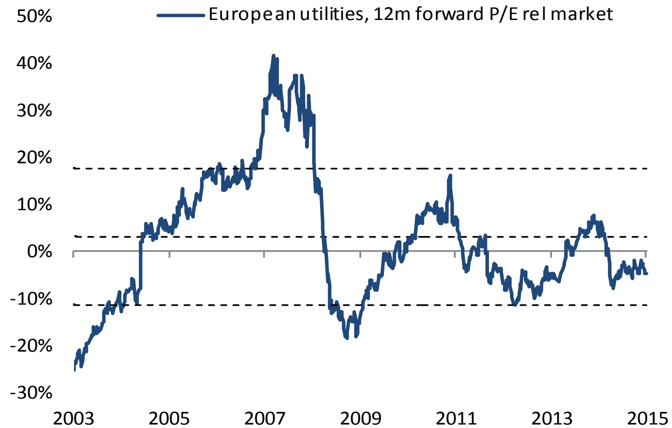
Source: Datastream, Deutsche Bank

Utilities: the sector is cheap, but performance is negatively impacted by falling oil and power prices. High leverage makes it vulnerable to rising credit spreads

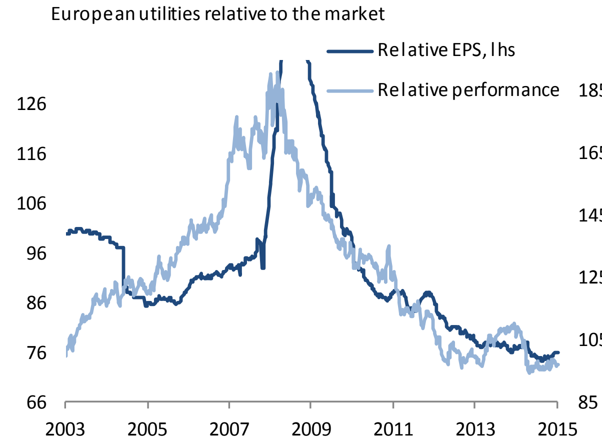
European utilities are trading on 18% P/B discount to the market



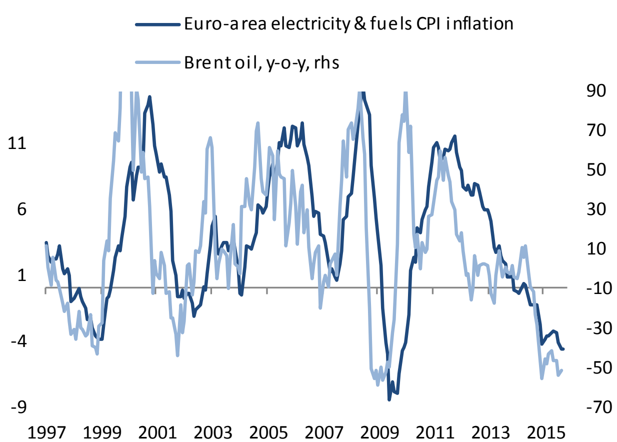
The sector is trading on a 5% 12-month forward P/E discount to the market



The sector has been underperforming for seven years on the back of falling relative EPS

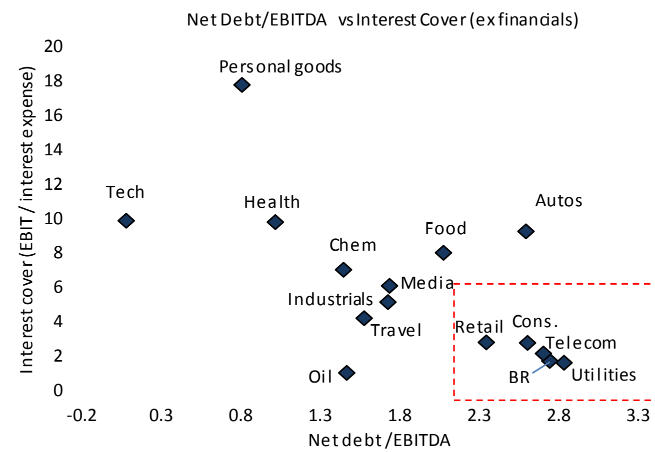


Utilities' pricing is negatively impacted by the falling oil price



Utilities' relative performance has been negatively impacted by falling power prices

Utilities is among the most highly leveraged sectors in the market



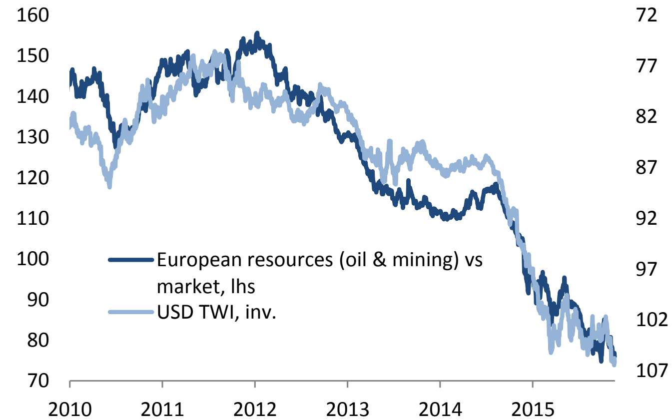
Sebastian Raedler +44-20754-18169; Wolf von Rotberg +44-20754-52801; Andreas Bruckner +49-69910-32787

Source: Datastream, Deutsche Bank

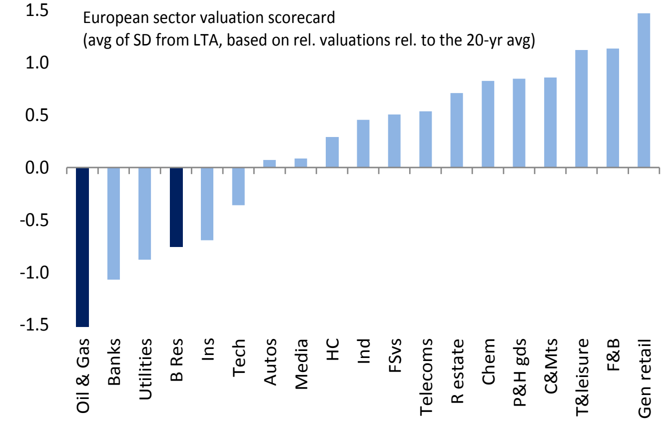
European commodity stocks should see further downside if the dollar continues to strengthen

The oil price moves closely in line with the USD

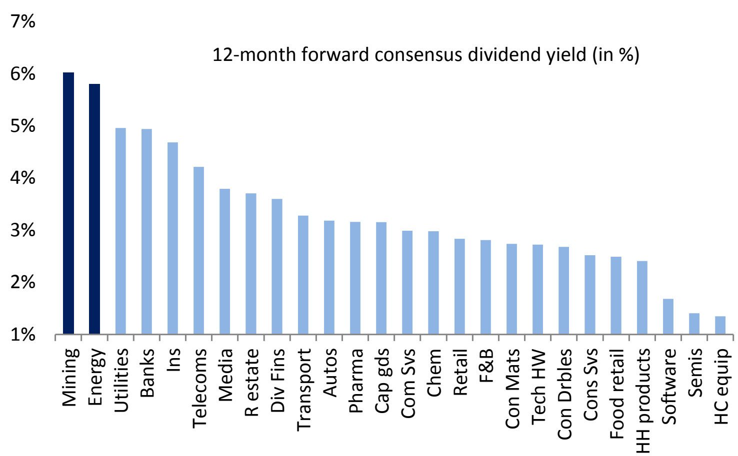
European resources’ relative performance tends to move in line with the dollar



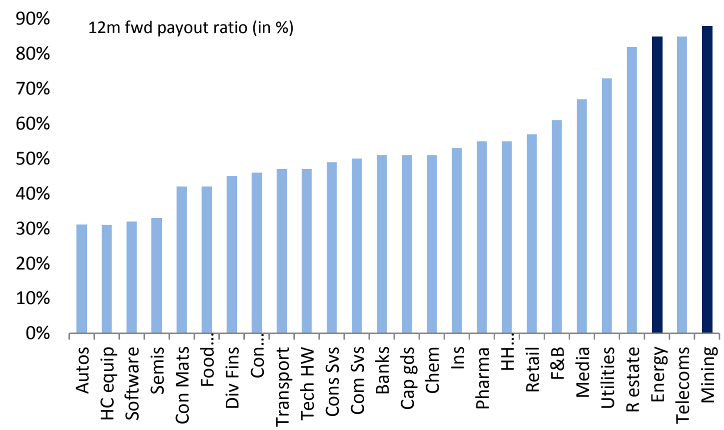
European commodity stocks trade on low relative valuations



Oil & mining have the highest dividend yields among European sectors …



… yet payout ratios raise doubts about the sustainability of the dividend



Source: Datastream, Deutsche Bank

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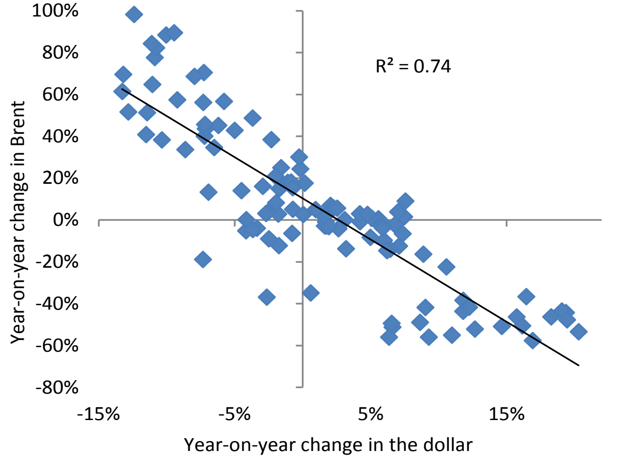
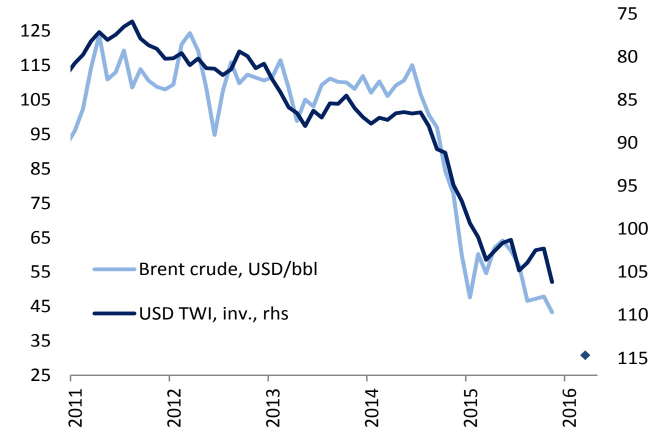
We see more downside for the European energy sector

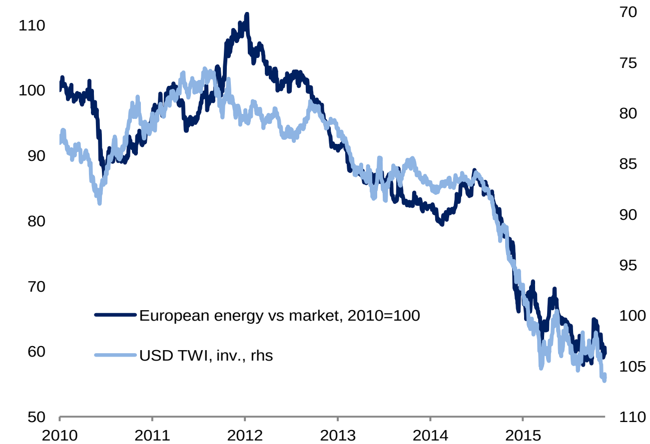
Over the past 10 years, the dollar has explained 74% of the changes in the oil price



Our FX strategists expect a further 8% USD decline until YE'16 , which could put Brent at 30 USD/bbl

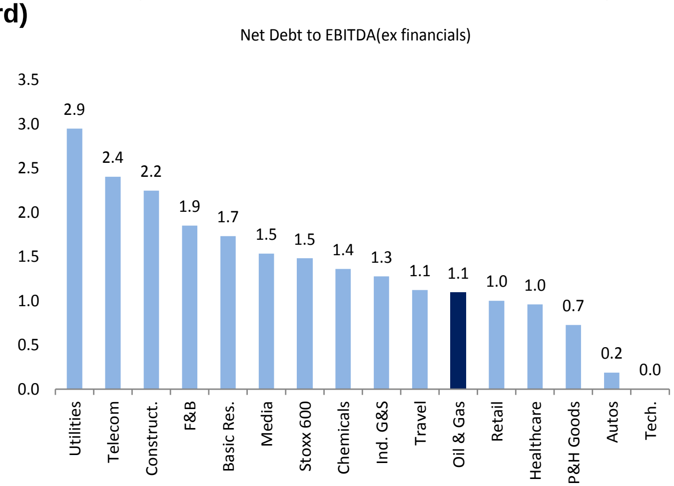


Further dollar strength would likely be associated with further underperformance by energy stocks



The dividend yield is at a 27-year (yet the div. cover is low, resulting in a low rank on our dividend scorecard)

Leverage for the sector is not particularly high…



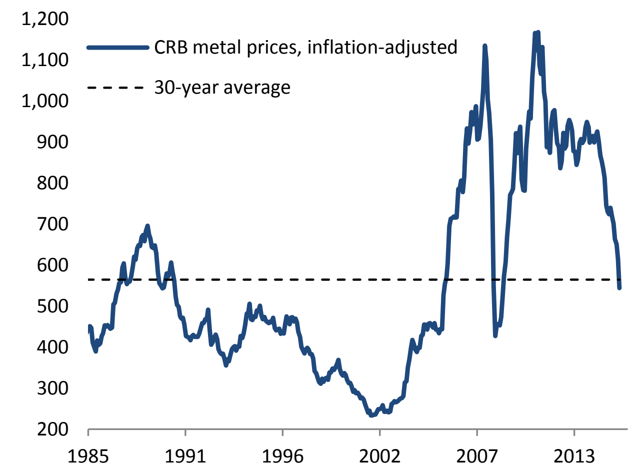
… yet it has tended to underperform during periods of rising credit spreads over the past five years

Periods of credit spreads rising >100 bps Start		End	Credit spread rise (in bps)	Relative performance energy vs market (annualized, in %)
Jan 2010	-	Feb 2010	103	-19.8%
Apr 2010	-	May 2010	193	-25.3%
Apr 2011	-	Jun 2011	126	-23.4%
Jul 2011	-	Oct 2011	294	1.0%
Oct 2011	-	Nov 2011	139	23.3%
Mar 2012	-	Jun 2012	148	-13.3%
May 2013	-	Jun 2013	101	-9.7%
Jun 2014	-	Dec 2014	223	-48.8%
Jun 2015	-	Oct 2015	203	-16.7%
Average rel. performance energy vs market (annualized)				-14.8%
Underperformance vs market % of times				78%

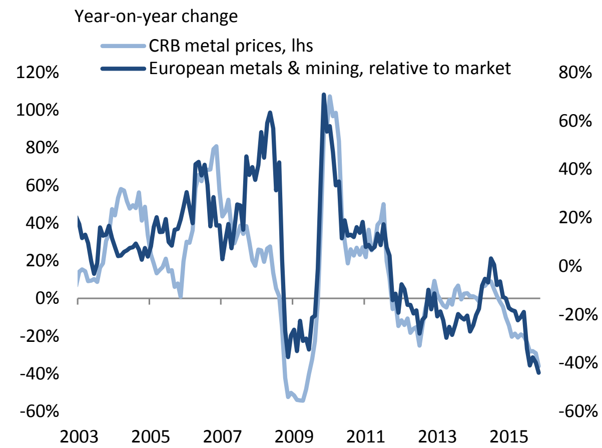
Source: Datastream, Deutsche Bank

Mining: valuations are depressed – but the sector is set to underperform as long as metal prices are falling and emerging markets hurting

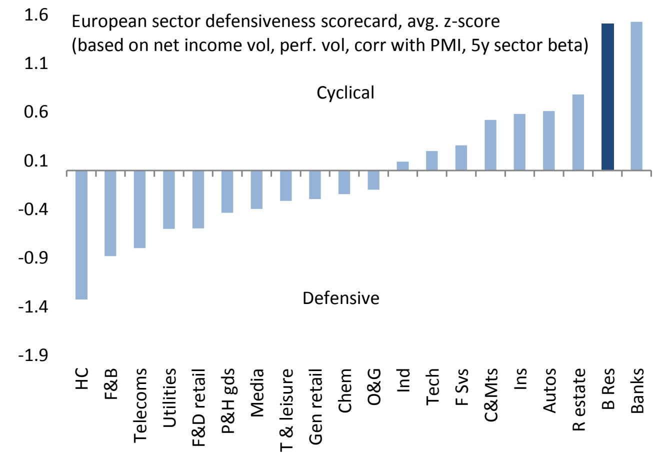
Real metal prices have fallen by 50% since 2011 – but are still only just back to their 30-year average



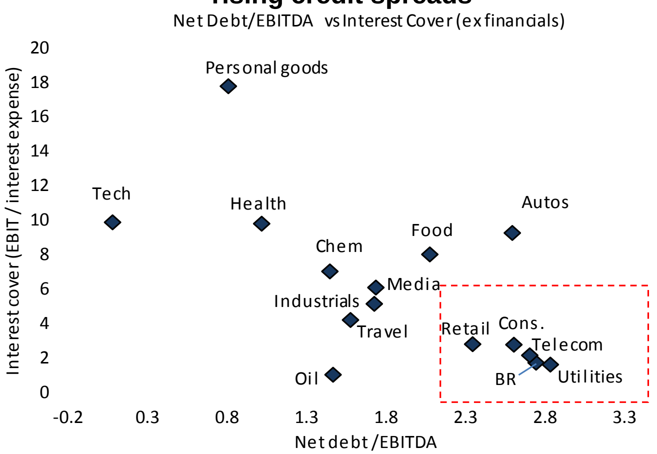
Mining is likely to continue underperforming as long as metal prices are falling



Mining is among the most cyclical sectors in the market

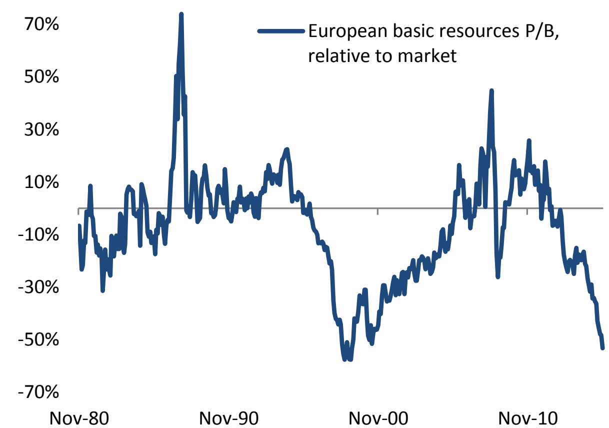


High leverage levels make the sector vulnerable to rising credit spreads



Mining has continued to move in line with emerging markets over the past decade

The sector is trading on a 50% discount on P/B, close to the 35-year record discount of 60% in 1999



Source: Datastream, Deutsche Bank

European commodities screen

Sell- and hold-rated European commodity stocks (oil & gas, basic resources) with high valuations

Company name	Price (local) 22/11/15	DB recommendation	3m % change in 12m fwd EPS	3m net earnings rev (%)	12m fwd PE (x)	12m fwd PE (pre/disc to market)	12m fwd PE rel to market sd from LTA	12m trl PB (x)	12m trl PB (pre/disc to market)	12m trl PB rel to market sd from LTA	12m trl DY (%)	12m trl DY (pre/disc to market)	12m trl DY rel to market sd from LTA*	Avg of sd from LTA	Reco rel to market rel to history (percentile rank)
Antofagasta PLC	65,003	Hold	-24.6%	-40.6%	21.2	37.7%	1.5	1.1	-38.9%	-2.0	2.0%	-1.4%	1.0	0.2	43%
Boliden AB	98	Hold	-19.4%	-42.9%	11.8	-23.5%	0.4	1.6	-11.9%	0.3	2.3%	-1.1%	0.4	0.4	97%
ENI	279	Hold	-23.6%	-71.4%	23.9	55.1%	4.3	0.9	-50.5%	-1.7	5.8%	2.4%	-0.1	0.8	3%
Lundin Petroleum	4,113	Sell	32.4%	-42.4%	34.0	120.9%	0.4	15.9	759.5%	4.0	0.0%	-3.4%	0.2	1.5	3%

* inverted the sign for comparison purpose

Source: Datastream, Deutsche Bank

Appendix 1
Important Disclosures
Additional Information Available upon Request

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Buy: Expected total return (including dividends) of 10% or more over a 12-month period

Hold: Expected total return (including dividends) between -10% and 10% over a 12-month period

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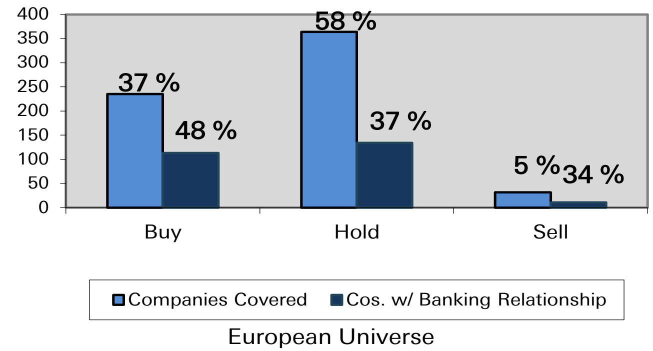
Equity Rating Dispersion and Banking Relationships



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