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Goldman Sachs

'Fat & Flat' with a Resurgence of Divergence

Portfolio Strategy Research

European equities: Market and themes for 2016

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Fat & Flat

The bull market since 2010 has been driven almost entirely by multiple expansion. We think valuations are now stretched and the European market trades at a 12-month forward P/E of 16.8x ex financials, similar to the US (at 17.4x) and we expect no further increase in P/E multiples from here. Profit growth is in Europe likely to be 8% in 2016 and 10% in 2017, supported by a weak euro and better domestic and global GDP growth. Our 12-month (end 2016) index targets are 400 for the SXXP and 3650 for the SX5E. For the SXXP this implies a return of 7.5% in euro and negligible returns in USD.

The need to differentiate

This year has been dominated by the underperformers (EM and commodities) rather than the outperformers. These themes remain in play but sustained underperformance and some moderation in fundamentals (softening imbalances in some EM and cost adjustments in oil) mean that greater differentiation within sectors and the themes is now required.

Five themes for 2016

We focus on differentiation within: 1) Commodities (we prefer oil to mining), 2) Industrials (we prefer opex to capex), 3) Consumer (we prefer cyclicals to staples), 4) Income (we prefer income with growth to staples), and 5) EM (we prefer Consumers to Industrials)

Sectors and baskets

Our favoured sectors are Media, Insurance, Telecoms, Technology, Travel & Leisure, Healthcare and Banks. Our Underweight sectors are Basic Resources, Food & Beverages, Tobacco, Industrial Goods & Services, and Chemicals. We recommend some relative value positions: long General Retail versus Food Retail (GSSBGERE vs GSSBFORE); long opex Industrials vs capex Industrials (GSSBOPEX vs GSSBCAPX); and long Household Products vs. Tobacco (GSSBHOU vs GSSBTOBA). For our thematic baskets, we prefer high yield with growth (GSSTHIDY) and companies with European cyclical exposure (GSSTEUGR).

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Summary – our views on one page

1) Our economists expect global GDP growth to edge up from 3.1% in 2015 to 3.5% in 2016, although the improvement largely reflects stabilization in some of the hardest-hit EM economies. Elsewhere, we see more modest changes, including a small acceleration in Europe and Japan. **That said, we expect above-trend GDP growth in Europe through to 2019.**

2) Our economists also expect US interest rates to rise faster and peak at a higher level than current forwards imply. Rising US rate expectations should push US bond yields higher. Market-implied inflation expectations seem too low for both the US and Europe according to our bond strategists.

3) This combination should push the USD higher; we continue to expect USD strength versus the EUR, however the ECB meeting did not show the commitment to extending QE that we and the market had expected. Given this, our FX strategists have put their targets under review (see *FX Views: Dry Powder, Lost Credibility,* December 3, 2015). A weaker EUR, even if it's not as weak as we had previously forecast, should help boost returns in local currencies and also help companies with high USD revenues.

4) The past four years have seen a significant increase in stock prices (43% in the SX5E and 55% in the SXXP since December 2011). This increase has been largely driven by valuation expansion as interest rates have fallen and QE began. **We believe this re rating has completed and the market is fully valued**.

5) Earnings should be the driver of the market. European profit margins languish close to a record 300 bp behind those in the US, but we do not expect a major catch up. We believe much of the gap can be explained by sector differences and by the high weight of technology in the S&P 500 vs the SXXP. We expect moderate rises in European profits overall (8% in 2016 and 10% in 2017). Coupled with a stable P/E multiple, over the next 12 months we forecast a rise in the SXXP to 400 (+7.5%) and in the SX5E to 3650 (+9.2%).

6) Consequently, we describe the index trajectory in **2016 as 'Fat and Flat' — a wide trading range but with little absolute index return, at least in USD terms**.

7) In 2015 we focused on three major trends: 1) the outperformance of DM-exposed assets relative to EM; 2) the outperformance of consumer versus industrial capex exposure; and 3) the underperformance of commodity stocks. In 2016 we expect more differentiation.

8) Our key themes for 2016 are: 1) **Commodity differentiation**; a more positive view on Oil stocks, but we remain negative on Basic Materials; 2) **Industrial differentiation**; a more positive view on opex-facing companies while we remain negative on capex-facing; 3) **Consumer differentiation**; a positive view on Consumer Cyclicals but we remain negative on Consumer Staples, and a positive view on European cyclical recovery via our basket (GSSTEUGR); 4) **Income differentiation;** negative on defensive yield and positive on yield plus growth (we recommend our basket GSSTHIDY), and 5) **EM differentiation**; stay positive on EM consumer vs. EM industrial exposure (GSSTBRCC vs. GSSTBRCI).

European Indices Long-Term Forecasts

Price level	Current	End of 2016	End of 2017	End of 2018
STOXX 600	372	400	420	440
Euro STOXX 50	3343	3650	3900	4100

Source: Goldman Sachs Global Investment Research

Our Key Targets and Recommendations in one page

Key Themes for 2016

1) **Commodity differentiation:** Positive on Oil, negative on resources
2) **Industrial differentiation:** Positive on Opex, negative on Capex
3) **Consumer differentiation:** Positive on consumer cyclicals, negative on consumer staples
4) **Income differentiation:** Positive on yield plus dividend growth, positive on european recovery, negative on Bond Proxies'
5) **EM differentiation:** Positive on EM Consumers, negative on EM Industrials

Relative Value & Thematic Trade Recommendations

Thematic Baskets

Long High Dividend Yield and Growth (GSSTHIDY vs. SXXP)

Long Euro Area Growth Basket (GSSTEUGR vs. SXXP)

Relative Value

Long EM Consumers vs. EM Industrials (GSSTBRCC vs. GSSTBRCI)

Opex Industrials vs. Capex Industrials (GSSBOPEX vs. GSSBCAPX)

General Retail vs. Food Retail (GSSBGERE vs. GSSBFORE)

Oil & Gas vs. Basic Resources (SXEP vs. SXPP)

Household & Personal Products vs. Tobacco (GSSBHOUS vs. GSSBTOBA)

Strategy Sector and Subsector Recommendations

Overweight	Neutral	Underweight
Banks (SX7P)	Autos & Parts (SXAP)	Basic Resources (SXPP)*
Healthcare (SXDP)	Construct. & Mat. (SXOP)	Chemicals (SX4P)
Insurance (SXIP)	Financial Services (SXFP)	Food & Beverage (SX3P)
Media (SXMP)	Oil & Gas (SXEP)*	Indus. Gds & Svs (SXNP)
Technology (SX8P)	Personal & HH Goods (SXQP)	Capex Industrials (GSSBCAPX)*
Telecoms (SXKP)	Real Estate (SX86P)	Food Retail (GSSBFORE)*
Travel & Leisure (SXTP)	Retail (SXRP)	Tobacco (GSSBTOBA)*
Civil Aerospace (GSSBCIVA)	Utilities (SX6P)	
Business Services - Staffing (GSSBSTAF)		
Building materials (GSSBSBUIL)		
Opex Industrials (GSSBOPEX)*		
General Retail (GSSBGERE)*		
Household & Personal Products (GSSBHOUS)*		

* denotes long/short trade

Source: Goldman Sachs Global Investment Research

Our Key Stocks

Key criteria: We screen for companies within our recommended sectors and baskets that have are rated Buy by our equity analysts and on the Conviction List.

Exhibit 1: Our key recommended stocks

Our Key Stocks			
Company	**Basket/ Sector**	**Currency**	**Price**
Arm Holdings	Information Technology	£	1122.0
Banca Ppo.Emilia Romagna	Banks	E	7.2
Barclays	Banks	£	230.3
Britvic Plc	High Dividend Yield and Growth Basket	£	696.5
Burberry Group	EM Consumers Basket	£	1199.0
Credit Suisse Group	Banks	SF	22.3
Deutsche Telekom	Telecommunication Services & Euro Area Growth Basket	£	16.4
Easyjet	Euro Area Growth Basket	E	1630.0
Erste Group Bank	Banks	E	28.1
Grifols	Insurance	E	32.0
Heidelbergcement Ag	Building Materials	E	70.4
Hera Spa	High Dividend Yield and Growth Basket	£	2.4
Imperial Tobacco	High Dividend Yield and Growth Basket	E	3562.0
Inditex SA	General Retail	SF	33.4
Julius Baer Group	Banks	£	50.0
Just Eat	Information Technology	E	456.2
Koninklijke Philips Electronics	H/H and Personal Products & Opex Industrials Basket	£	24.6
Man Group	High Dividend Yield and Growth Basket	E	163.7
Nokia	Information Technology	E	6.9
Orange	Telecommunication & High Dividend Yield and Growth Basket	£	15.7
Prudential	Insurance	E	1505.5
Randstad	Business services - Staffing & Euro Area Growth Basket	SF	57.2
Roche Holding	Health Care & High Dividend Yield and Growth Basket	E	272.6
Safran SA	Civil Aerospace	NK	65.9
Schibsted	Euro Area Growth Basket	E	301.9
Smurfit Kappa Group Plc	Euro Area Growth Basket	DK	25.7
TDC	Telecommunication & High Dividend Yield and Growth Basket	E	35.1
Total SA	High Dividend Yield and Growth Basket	E	44.5
Unipol Gruppo Finanziari	Insurance	E	4.5
Vivendi	Media	E	19.7
Wienerberger	Euro Area Growth Basket	E	16.6
Wirecard	Information Technology	E	45.5
Zalando SE	General Retail	E	34.6

Share prices as at December 3, 2015; Source: Goldman Sachs Global Investment Research

The Return of Low Return

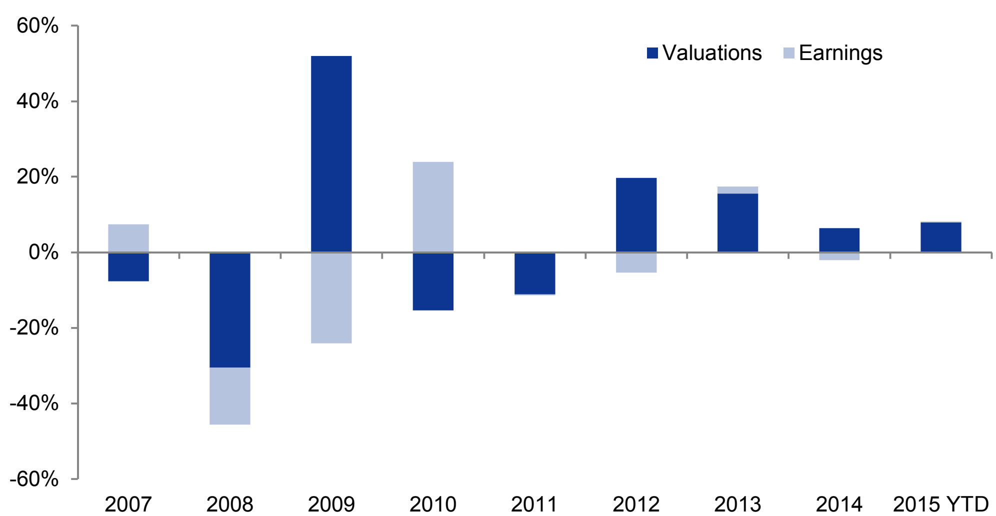
In *The Long Good Buy; the case for equities, Global Strategy Paper No. 4* (March 21, 2012) we argued that, despite the financial crisis, valuations in the market had fallen to such low levels (and risk premia had reached such high levels) that the equity market had entered the best buying opportunity for a decade. In 2013, in *The Long Good Buy II; 18 months on…The case for Equities continues, GOAL – Global Strategy paper* (September 11, 2013), we argued the market was likely to enjoy a steady upward trend, or a 'skinny & strong' market, driven by rising valuations.

Equity prices have recovered strongly since their lows in 2009 and, in Europe in particular, from its second low in 2011. But this recovery has come despite weak economic and earnings growth.

The main driver of higher equity prices has therefore been valuation expansion. The contributors to the return in the market over the past five years can be seen clearly in Exhibit 2 which breaks down the aggregate return (of the STOXX Europe 600) into changes in valuations and changes in earnings.

This also helps us to see how the classical 'cyclical' evolution of the market has been distorted – or at least interrupted by the financial crisis and the policy response to weak growth and deflationary fears. In most historical cycles we can identify four distinct phases in the equity market, which we describe as 'Despair', 'Hope', 'Growth', and 'Optimism. Europe, along with most markets, entered a classic 'Despair' phase around the US stage of the crisis and the global economic downturn of 2008 as stock prices fell sharply and valuations collapsed. This was followed by a powerful 'Hope' phase as QE triggered optimism in the recovery; valuations moved sharply higher. But the 'Recovery' phase in Europe was knocked off track by the bank crisis. There was a new mini 'Despair' phase in 2011 as fears of a Euro area collapse reached a peak. But the commitment to 'do whatever it takes' by the ECB triggered a recovery. **What is most striking is that the rise in equity prices over the subsequent four years has been almost entirely driven by multiple expansions. The 12m forward P/E for the Eurostoxx 50, for example, went from a low of 6.9x to the current 14.2x over this period**.

Exhibit 2: Recent equity gains have been driven by valuation expansion
Change (yoy) for STOXX Europe 600 EPS and 12-month fwd P/E (on I/B/E/S consensus)



Source: Datastream, Goldman Sachs Global Investment Research

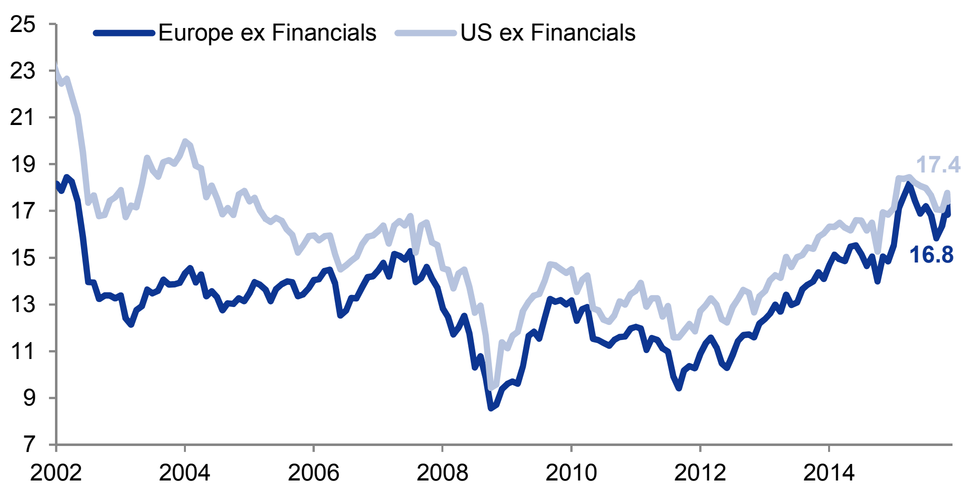
This year, however, the sustainability of the bull market has come into question as problems in emerging economies and renewed deflationary fears have dominated market sentiment. To us, these developments mark the 'Third Wave' of the financial crisis. The First Wave started in the US with the housing market collapse which spread into a broader credit crunch and ended with the Lehman Brothers collapse and the start of TARP and QE. **The Second Wave** had its epicentre in Europe, where high exposure of banks to leveraged losses in the US spread into a sovereign crisis, given the lack of a debt sharing mechanism across the Euro area. It ended with the Outright Monetary Transactions (OMT) promises to 'do whatever it takes', and finally the introduction of QE. But, just as Europe started to emerge from its crisis**, Wave 3; the EM phase,** became the key focus alongside a sharp fall in commodity prices. **This wave has had a big impact on European equities, holding back the overall index while pushing down stocks with high exposure to EM and commodity markets.**

Where to from Here? The Return of Low Return

As we embark on the first rise in US interest rates for around a decade, we are moving into a new phase. Our bond strategists expect higher US bond yields as duration risk is increasingly priced in. From an asset allocation perspective, we prefer equities where the prospect for returns on a relative basis is better.

But, having now seen the market achieve strong returns at the index level over the past four years, we think the valuation expansion is broadly complete. Valuations for the market are now high, particularly excluding the bank sector (see Exhibit 3). Overall P/Es excl. financials are 16.8x for Europe, very similar to the US on a comparable basis at 17.4x

Exhibit 3: Europe, no longer cheap
12m fwd PE for Europe ex financials and the US ex financials (on I/B/E/S consensus)

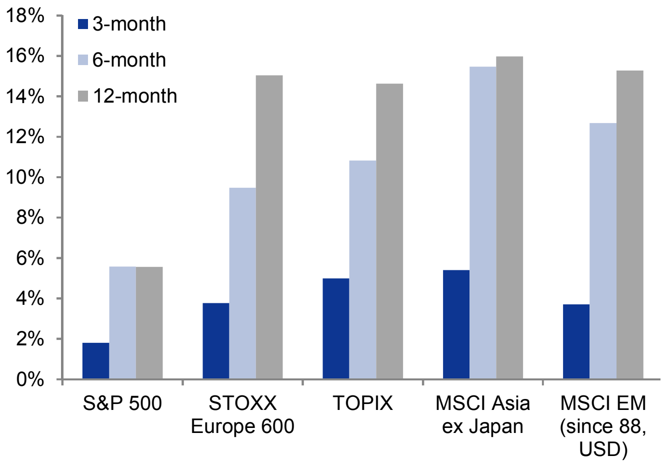


Source: I/B/E/S, Datastream, Goldman Sachs Global Investment Research

This means that earnings are likely to be the key driver of returns. Despite the lag of European profit margins relative to the US, much of this reflects the absence of technology and the high weight in banks in Europe. Excluding these sectors shows that margins are high by historical standards and not very different from the US (for more details see *Strategy Matters: Marginal Differences: Can Europe catch up with the US?,* November 10, 2015). Consequently **we expect profits to rise, but moderately, with 8% earnings growth in 2016 for the STOXX 600 and 10% in 2017.**

Our relative call, in local currency terms, is positive on Europe (as we have had this year) but foreign investors may want to hedge currency risk. As the exhibits below show, US equities have generally underperformed other developed equity markets such as Europe and Japan after the first Fed rate hike.

Exhibit 4: Non-US equity markets tend to outperform after the first Fed rate hike
Average total return after first Fed rate hike (since 1976, local)



Source: Datastream, Goldman Sachs Global Investment Research.

Exhibit 5: Europe outperformed the US in the 12 months after the first Fed rate hike (except in 1986 and 1994)
Europe vs. US relative performance around Fed rate hikes

	Total relative return Europe vs. US					
	-12m	-6m	-3m	+3m	+6m	+12m
20/04/1976	7%	7%	4%	-2%	-5%	10%
30/11/1976	-2%	-5%	2%	11%	21%	29%
07/08/1980	-3%	-1%	-4%	7%	8%	8%
29/04/1983	-11%	-1%	5%	5%	3%	24%
15/12/1986	0%	0%	-8%	-8%	-3%	-11%
28/03/1988	-3%	-6%	-1%	4%	6%	15%
03/02/1994	31%	14%	8%	-1%	-4%	-13%
29/06/1999	-13%	1%	1%	5%	10%	13%
29/06/2004	4%	5%	2%	1%	-2%	10%
Average	**1%**	**2%**	**1%**	**2%**	**4%**	**9%**
Median	**-2%**	**0%**	**2%**	**4%**	**3%**	**10%**

Source: Datastream, Goldman Sachs Global Investment Research.

Nevertheless, in 'common currency' or USD terms, we expect overall index returns to be fairly muted. The trading range may be wide ('fat') but we expect the returns to be low ('flat').

In our view, this puts us in a market that can be described as 'Fat & Flat' with fewer beta opportunities but more alpha opportunity.

Our returns forecasts for Europe are shown in Exhibit 6 below. We have slightly upgraded our forecasts, but this is largely rolling on from our last forecast change in October.

Exhibit 6: Summary of our target price changes
Price levels and returns for the STOXX Europe 600, FTSE 100 and EURO STOXX 50

European Indices Forecasts						
	STOXX 600		FTSE 100		EURO STOXX 50	
Price level	**Old**	**New**	**Old**	**New**	**Old**	**New**
3 months	365	380	6250	6350	3300	3450
6 months	375	385	6400	6500	3450	3500
12 months	400	400	6700	6700	3700	3650
Expected	**STOXX 600**		**FTSE 100**		**EURO STOXX 50**	
Price Return	**Old**	**New**	**Old**	**New**	**Old**	**New**
3 months	-1.9	2.1	-0.4	1.2	-1.3	3.2
6 months	0.8	3.5	2.0	3.6	3.2	4.7
12 months	7.5	7.5	6.8	6.8	10.7	9.2
Total Return 12m (%)		***11.2***		***10.9***		***13.0***

Source: Datastream, Goldman Sachs Global Investment Research

We keep valuations roughly flat over the next 12 months to reflect the higher rate environment in the US. This implies a price return of 7.5% and total return of 11.4%.

Given our view on a recovery in the Euro area and wider US vs Euro area bond spreads, we expect a slightly higher acceleration in performance for the Eurostoxx 50 on a 12-month horizon. We expect a similar trend for the FTSE 100 due to the recovery in the commodity markets and the fact that the UK will have had time to digest the BoE rates hike that we expect in 2Q 2016. Overall, we forecast that in 12 months the Eurostoxx 50 and the FTSE will reach 3800 and 6700, implying returns of around 5% and 8%, respectively.

The prospect for low returns in common currency applies across equities as Exhibit 7 illustrates. While Japan and Europe are likely to perform best amongst the major markets, we forecast all will deliver flat price returns in USD terms.

Exhibit 7: Global equity forecasts – Low returns in USD terms*

		12-month						Long-term forecast		
			Price Return		Div.	Total return		Level		CAGR to
	Current	Level	Local	USD	Yield	Local	USD	2016	2017	2017 (local)
STOXX Europe 600	372	400	**7 %**	(6)%	4 %	11 %	**(0)%**	400	420	**6 %**
TOPIX	1602	1800	**12 %**	6 %	2 %	14 %	**8 %**	1800	1900	**9 %**
MSCI Asia Pac ex Japan	416	425	**8 %**	2 %	4 %	12 %	**6 %**	425	440	**3 %**
S&P 500	2050	2100	**2 %**	2 %	2 %	5 %	**5 %**	2100	2200	**3 %**

Source: Datasteam, Bloomberg, Goldman Sachs Global Investment Research

Note: Our Currency forecasts are still under review.*

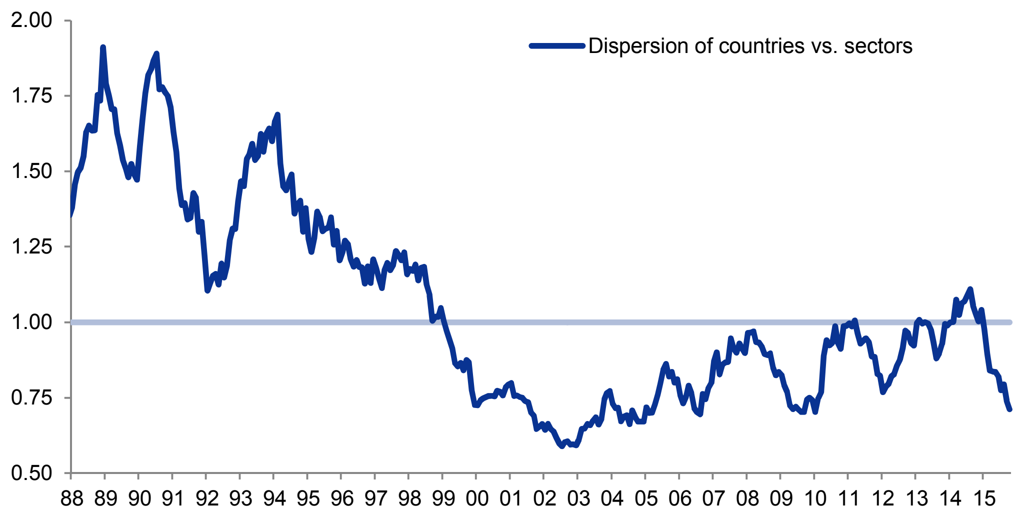
The Reversion of Dispersion – Less beta but more alpha

While we do not expect to see significant index progression, it is likely that there will still be significant investment opportunities within the market and we have already seen increased dispersion throughout this year – a trend that we expect to continue.

We note two interesting developments:

1) **Sector returns are becoming more important than country returns in driving the market**. This is an interesting shift because it reflects a new phase for the market as concerns about a collapse in the Euro system or differences between the 'core' and the 'periphery' have largely moderated. Instead, as a result of the 'Third Wave', the main differences in the market have been driven by other considerations, in particular weakness of commodities and EM exposure. This is why, in Exhibit 8, we can see how country dispersion of returns has fallen relative to sectors since the start of QE.

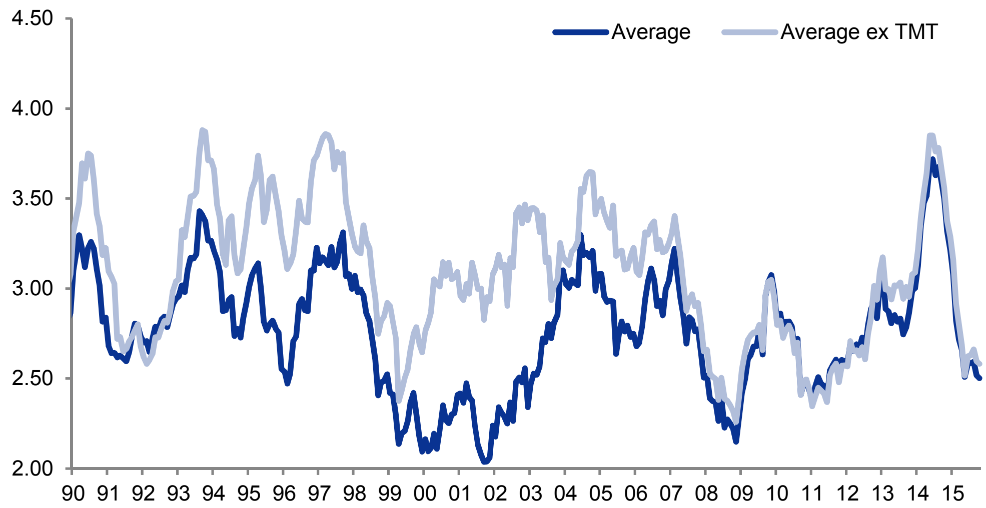
Exhibit 8: Sectors becoming more important than countries again
Ratio of 12-month rolling average for standard deviation of monthly returns



Source: Datastream, Goldman Sachs Global Investment Research

Equally notable throughout this year is how differences in returns *across* sectors have dominated returns *within* sectors. This is another manifestation of the dominance of key macro themes driving market returns.

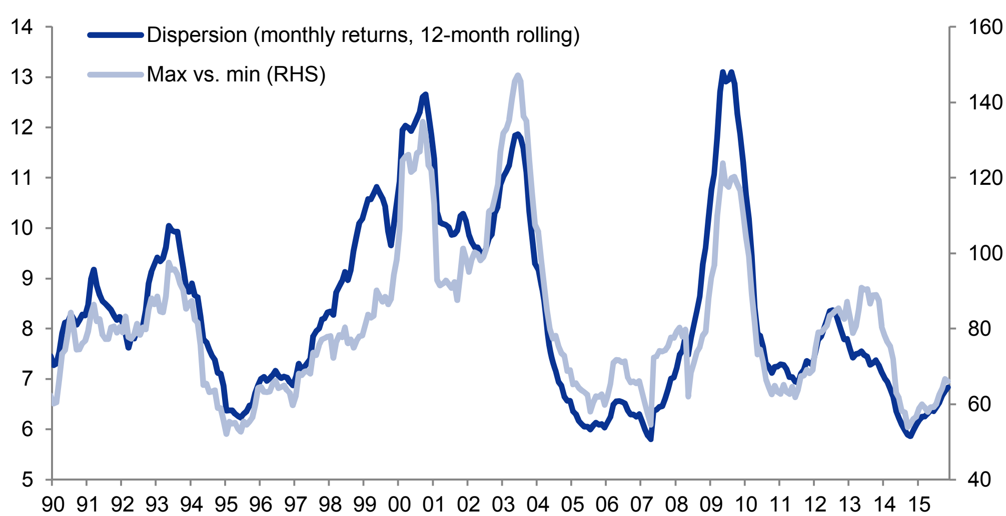
Exhibit 9: Sector differences more important than stocks differences
Ratio of within-sector relative to across-sector dispersion max vs. min return (12-month rolling average, monthly returns)



Source: Datastream, Goldman Sachs Global Investment Research

2) Nevertheless, despite the strong impact of macro themes (commodities, DM v EM etc.) we have started to see the early signs of stock alpha contributions picking up. From close-to-record-low dispersion of returns across stocks (as beta moves in the index have been a more dominant driver) there has been a nascent rebound in stock-specific factors driving returns. We think that this will continue to become more important through 2016.

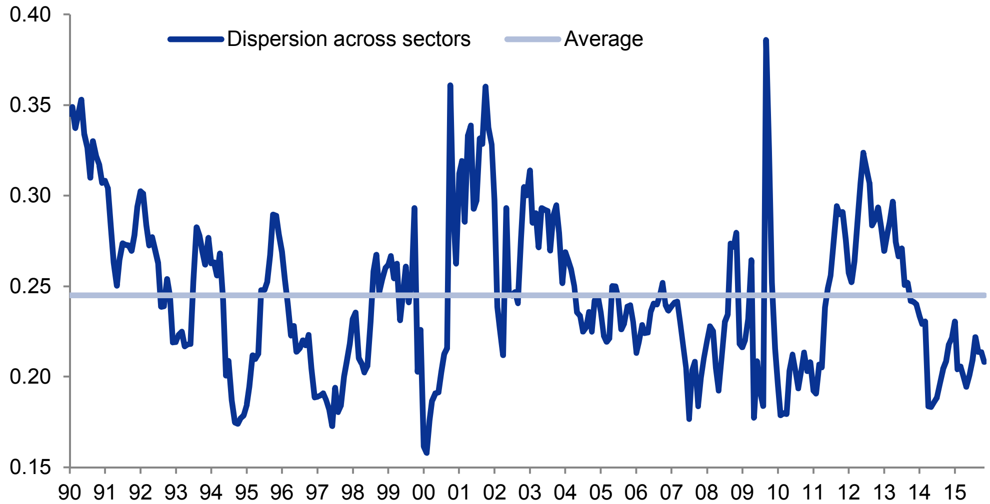
Exhibit 10: Stocks starting to drive alpha – from a record low
Dispersion for STOXX Europe 600



Source: Datastream, Goldman Sachs Global Investment Research

Alongside this, we are also seeing a modest rise in valuation dispersion form record low levels.

Exhibit 11: We are seeing a modest rise in valuation dispersion form record low levels.
Standard deviation of 12-month forward P/E for total market European sectors



Source: Datastream, Goldman Sachs Global Investment Research

A Resurgence of Divergence; what changes and what's new

This year we have focused on three key themes in 2015 – all of which have become very dominant in driving returns within the market. Our view is that each of these still has relevance but in a more select form. Divergence within themes and sectors is likely to be a crucial factor in driving alpha in 2016.

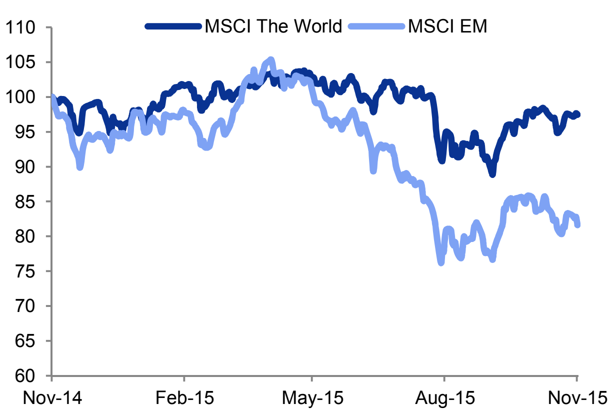
In 2015 the three dominant themes have been:

1) DM/EM exposure;
2) commodity underperformance; and
3) industrial/capex underperformance and consumer outperformance, especially staples.

The reason we expect more divergence of return moving forward is that all of these themes have already played out meaningfully.

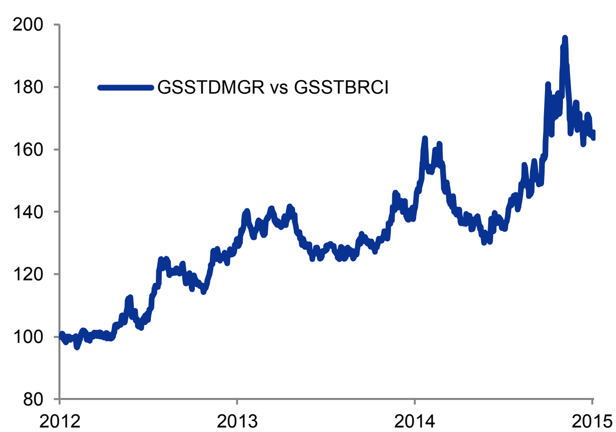
1) EM-exposed assets have significantly underperformed DM assets. We can see this by comparing global index returns (Exhibit 12) and by using our baskets that slice the market into different exposures. Exhibit 13 shows our DM cyclical exposure basket (GSSTDMGR) versus our EM industrial exposure basket (GSSTBRCI, the subset of EM-exposed stocks that have weakened the most).

Exhibit 12: MSCI The World and MSCI EM performance
November 2014 = 100



Source: Datastream, Goldman Sachs Global Investment Research

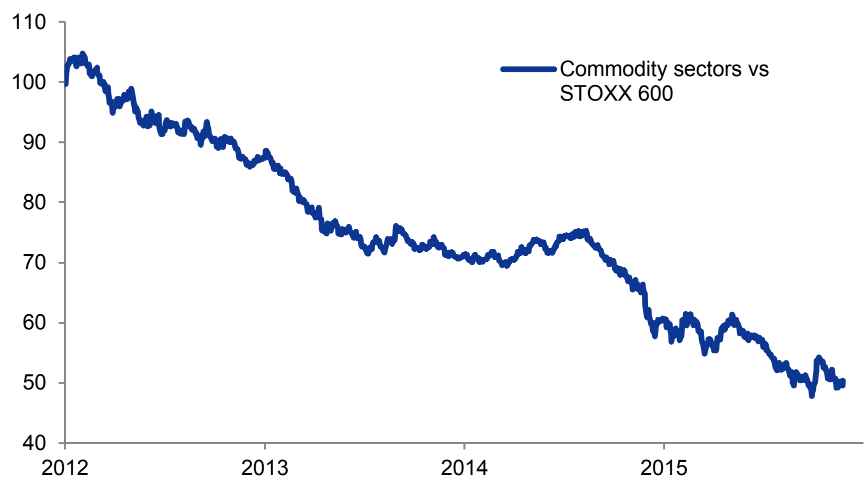
Exhibit 13: EM-exposed assets have significantly underperformed DM assets
Developed market Growth basket vs EM Industrials basket, 2012 = 100



Source: Goldman Sachs Global Investment Research

2) Second, commodity sectors have underperformed substantially and underlying conditions are stabilizing, at least within the Oil sector.

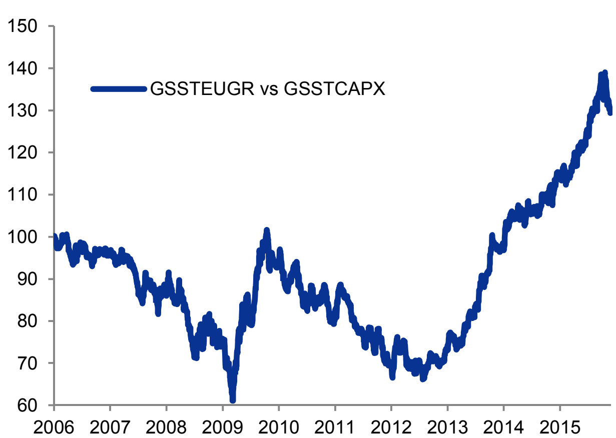
Exhibit 14: Commodity sectors have substantially underperformed the market
STOXX 600 Basic Resources and Oil & Gas vs STOXX 600, 2012 = 100



Source: Datastream, Goldman Sachs Global Investment Research

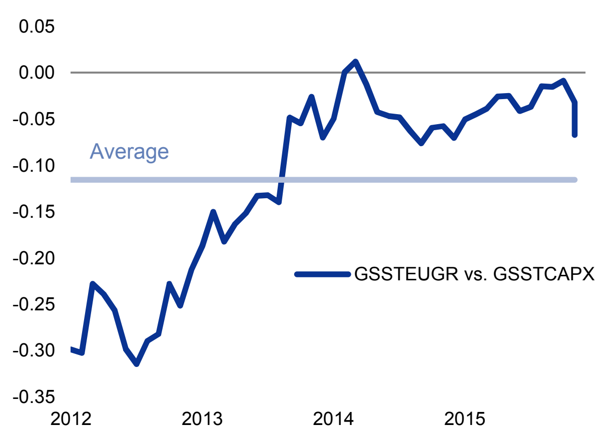
3) EM-exposed industrial and capex-related companies have weakened significantly given both the weakness in commodity capex spend and also weak EM end market demand. This underperformance has been particularly strong relative to European-exposed consumer names. We see this using our European exposure basket.

Exhibit 15: Capex-related companies have underperformed relative to strongly European-exposed names
Relative price performance for Euro Growth (GSSTEUGR) vs Capex beneficiaries (GSSTCAPX), 2006 = 100



Source: Goldman Sachs Global Investment Research

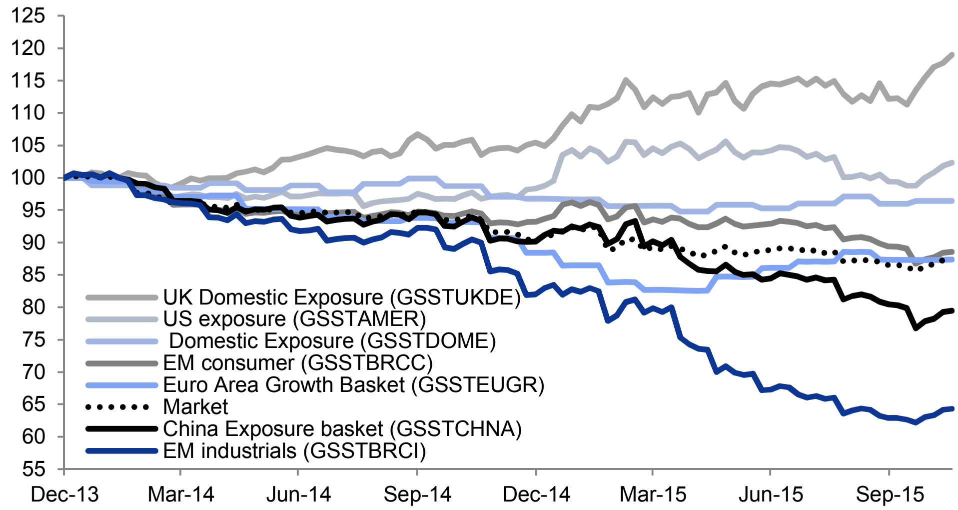
Exhibit 16: Capex exposure still trades at a premium to European consumer exposure
Relative 12-month fwd P/E (on I/B/E/S consensus)



Source: Datastream, Goldman Sachs Global Investment Research

These relative moves can be largely explained by divergence in consensus earnings revisions. While overall revisions have decreased, the more domestic and consumer facing parts of the market have seen upgrades. EM industrial names, meanwhile, have seen substantial downgrades (see Exhibit 17).

Exhibit 17: Earnings revisions have driven relative returns
2015 EPS consensus estimates, December 2013 = 100



Source: Factset, I/B/E/S, Goldman Sachs Global Investment Research

Of course the powerful performance of some of these themes does not mean that they cannot continue, particularly since these have reversed very persistent trends. But **some of the fundamentals that have supported the themes of 2015 are changing or at least evolving, which implies a more selective approach moving forward.** There are three important shifts that, at the margin, we think are likely to impact these themes.

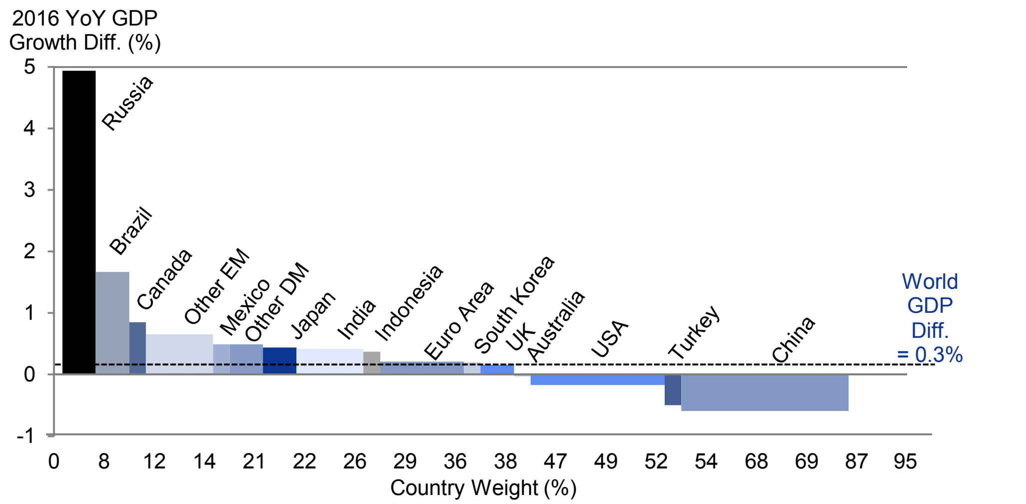
1) EM imbalances have started to unwind, reducing the risk of EM underperformance;

2) the collapse in commodity prices is well advanced and we see oil prices in line with the forwards (although we see more risks to lower metal prices); and

3) industrial weakness has been significant and may bottom out at a weak level.

1. EM growth moderation – The need for selectivity

We have long argued that EM assets would underperform. However, we think investors now need to be more selective. In many cases significant currency devaluations have reduced the size of external imbalances, and current account deficits in particular. The credit deleveraging that has slowed growth in EM is decelerating at least outside of China and some EM are likely to enjoy a strong turnaround in growth in 2016 (see Exhibit 18).



Source: IMF, Goldman Sachs Global Investment Research

2. Commodity prices — the prospect of more divergence

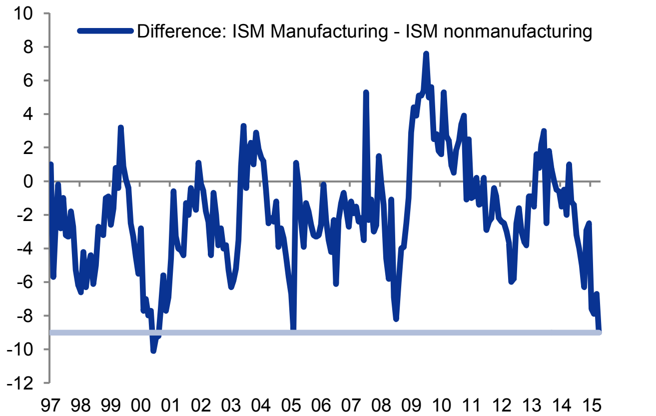
While our commodity strategists believe that supply adjustments to date are still insufficient to move prices higher and demand has done too little to offset this slow supply adjustment, **China's efforts to rebalance demand from investment to consumption should reduce demand for capex-exposed commodities (metals) much more than it reduces demand for opex-exposed commodities (oil).**

Reflecting this shift, we are less negative on oil companies, which are continuing to find ways to drive improved efficiency and push costs out of the business as they aim to recalibrate for a lower oil price. Unit costs are decreasing for many producers, whereas we see further declines in prices in the metals space and expect more underperformance in Basic Resources equities. **We think the prospects for commodity exposures within the market are becoming more nuanced.**

3. Industrial cycle — the divergence between opex and capex

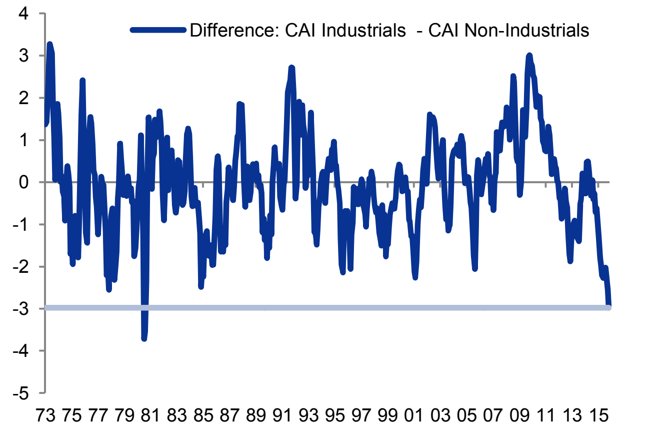
In aggregate, over the last six months, OECD industrial production has contracted sharply, declining around 50-75 basis points on an annualized basis. The weakness in the US has been particularly severe, with the manufacturing ISM now 9 index points below the ISM nonmanufacturing index, nearly the widest such gap on record (see Exhibit 19). **Being short industrial and particularly EM industrial companies appears to have made sense.**

Exhibit 19: One of the largest divergences between the ISM manufacturing and ISM nonmanufacturing on record
ISM manufacturing – ISM nonmanufacturing indices. July 97-Oct 15



Source: Haver Analytics, Goldman Sachs Global Investment Research

Exhibit 20: Our Current Activity Indicator (CAI) currently shows the largest spread between US industrials & non-industrial economic data in 35 years
January 1973 – October 2015



Source: Goldman Sachs Global Investment Research

However, we see risks as more balanced now as we think it is possible the industrial sector slowdown moderates. We remain negative on broad commodity and industrial capex exposure, but we again would be more nuanced in how to position for this. **We would advocate a more selective approach within the industrial space and among areas most exposed to EM. In our view, differentiation is once again the watch word. Within industrials we have been focused on a long in opex-related companies rather than capex related**.

A note on value traps

Another reason to moderate some of the strong views (particularly underweight views) we have had this year is simply by how and for how long many of these have underperformed. In our study of momentum and value traps we looked at some historical long underperforming value traps – secular underperformers that look cheap *(Strategy Matters: Momentum, rotation and value traps,* October 15 2015). The average length of the underperformance of these sectors was around 24 days, with aggregate underperformance of 15%. The Commodities and Utilities sectors matched this average pattern. Of course this is no reason why they should recover. We found in past cycles these secular underperformers needed to experience a bottoming out of fundamentals (dividends and/or ROE for example) before recovering. But we think the risks are now more balanced, particularly for Oil.

Exhibit 21: Previous lengths of 'value traps' in Europe

Sector	Value trap end date	Relative PE	Relative DY
Basic Resources	18/11/1992	1.2	1.1
Con & Mat	15/08/2012	1.0	1.1
Auto & Parts	03/11/1993	1.7	0.6
Food & Bev	08/12/1999	0.8	1.2
Health Care	14/05/2008	1.3	0.8
Media	01/06/2005	1.4	0.9
Technology	23/04/2008	1.2	0.7
Telecom	26/06/2002	1.2	1.0
Telecom	20/02/2013	0.8	1.8
Banks	10/06/1992	0.7	1.3
Banks	25/07/2012	0.9	1.1
Insurance	08/01/1997	1.1	0.8
Insurance	20/10/2004	0.7	1.2
Oil & Gas	recent trough*	0.9	1.8
Basic Resources	recent trough**	0.7	1.4
Utilities	recent trough***	0.8	1.6
Avg.		**1.1**	**1.0**

** 26/08/2015, ** 30/09/2015, *** 01/07/2015*

Source: Datastream, Goldman Sachs Global Investment Research

The conclusion to all of this is that, while the index returns slow, the simple split within the market of long DM vs EM and long consumer vs industrial may become more nuanced.

Our key themes for 2016: Differentiate to Accumulate

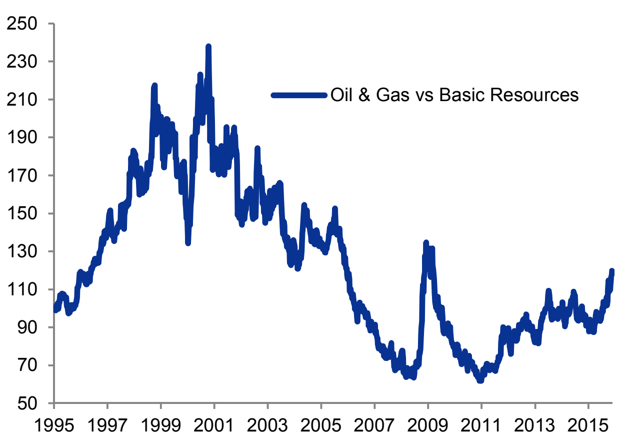
Some of the themes mentioned above are still relevant but **now we tend to be more selective about the way we implement them**. For example, taking a negative view on all EM exposure is, in our view, becoming more risky. Equally, while there remain significant downward risks in some parts of the commodity space (e.g. Basic Resources), we think the Oil sector's prospects appear more balanced. There are some themes that we think are still very much worth focusing on in Europe for 2016.

1) **Commodity differentiation**: Positive on Oil, negative on Basic Resources
2) **Industrial differentiation:** Positive on opex exposure, negative on capex exposure
3) **Consumer differentiation:** Positive on Consumer Cyclicals, negative on Consumer Staples
4) **Income differentiation:** Positive on yield plus dividend growth, negative on bond proxies.
5) **EM differentiation:** Positive on EM consumers, negative on EM Industrials.

Theme 1: Commodity differentiation – Oil & Gas vs Basic Resources

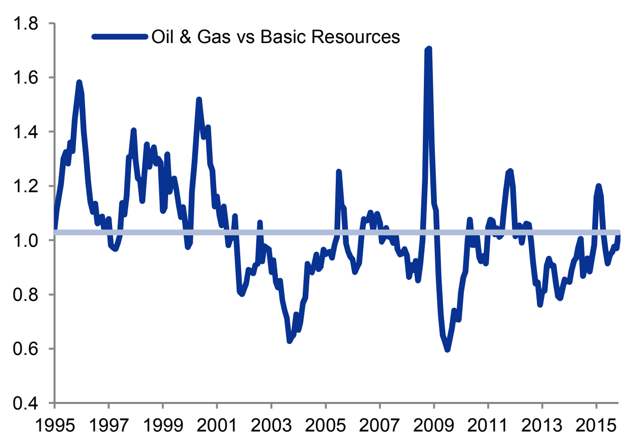
We still think that parts of the commodity complex are at risk. In particular we remain negative on Basic Resources. The prospect for oil companies is less negative. We would not differentiate more by being long Oil relative to Basic Resources. As Exhibit 22 shows**, while this has already played out over recent months, we believe we are in the early stages of a likely further re-balancing between the two sectors**.

Exhibit 22: Oil vs Basic Resources trend has only partially reversed…
Relative price performance, STOXX 600 sectors, 1995 = 100



Source: Datastream, Goldman Sachs Global Investment Research

Exhibit 23: … while valuations are roughly the same
Relative 12 month fwd P/E (on I/B/E/S consensus)



Source: Datastream, Goldman Sachs Global Investment Research

Theme 2: Industrial differentiation – Prefer opex exposure to capex exposure

We have maintained a negative view on the Industrials throughout 2015. This has worked both because many of these stocks are sensitive to decreasing commodity-related capex and also because they are facing weaker end demand in many emerging economies where we are seeing broad deleveraging. In general, we expect this process to continue.

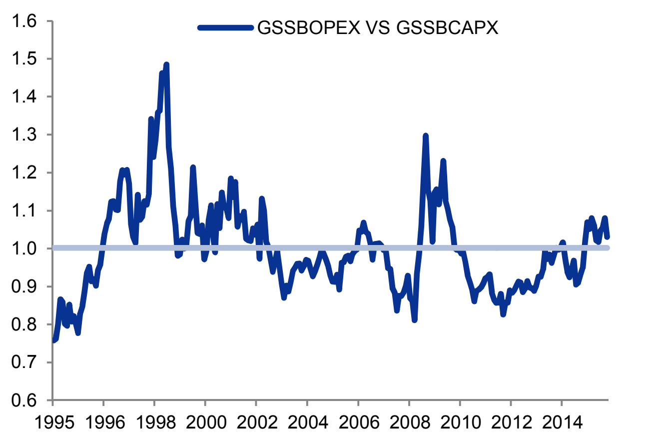
Along the lines above, while we prefer the Consumer and Services sectors relative to Industrials, we have a relative preference for opex-sensitive Industrial companies rather than those that are capex exposed.

We reflect this view via our relative basket trade idea; we have already been recommending this since September– (See *Strategy Espresso: Long Opex Industrials (GSSBOPEX) vs Capex Industrials (GSSBCAPX),* September 24, 2015). **While the opex basket trades at about a 12% premium to capex on 12m fwd P/E, this is not extreme by an historical comparison.**

Exhibit 24: Opex relative to capex, reversing a long term trend…
Relative price performance of opex-exposed Industrials vs capex-exposed Industrials subsector baskets, 1999 =100

Source: Goldman Sachs Global Investment Research

Exhibit 25: …Opex is only marginally more expensive
Relative 12 month fwd P/E (on I/B/E/S consensus)

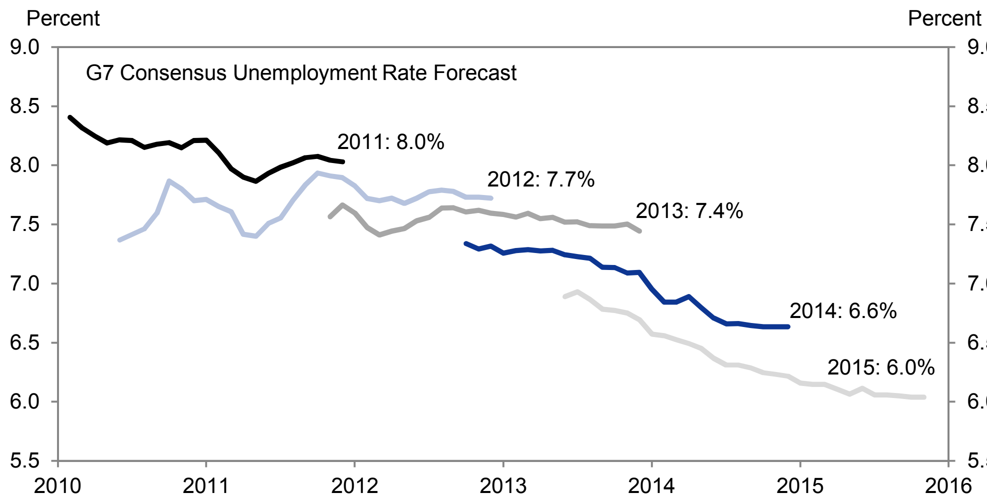


Source: Datastream, Goldman Sachs Global Investment Research

Theme 3: Consumer differentiation; Cyclicals against Consumer Staples & European domestic growth potential

We have argued that the headwinds that consumers have faced in recent years – tighter fiscal policy, high unemployment, falling real incomes and adjustment in household balance sheets – are starting to become tailwinds. As our economists point out, while overall economic growth has been disappointing, the labour market has started to improve.

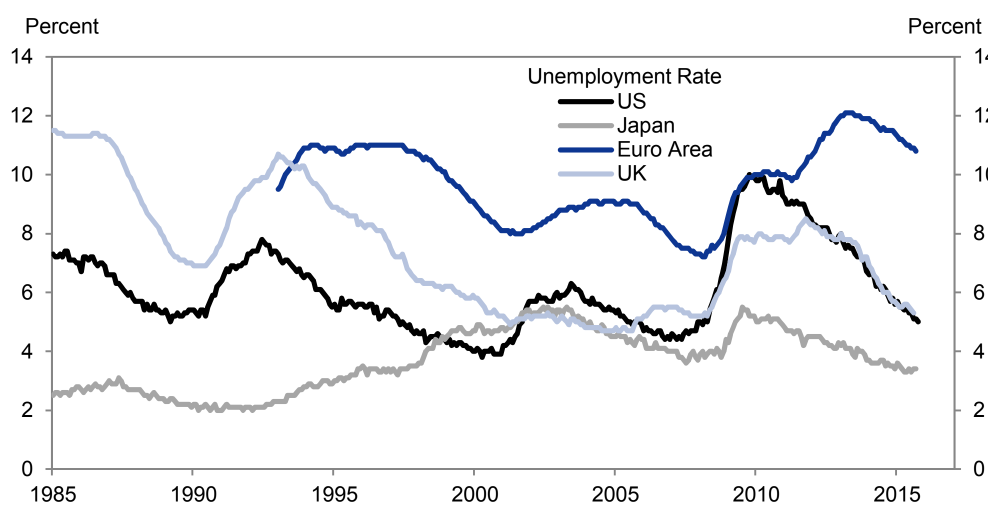
Exhibit 26: Unemployment has fallen faster than expected



Source: Bloomberg, Goldman Sachs Global Investment Research.

With improved labour markets and higher real incomes in export markets like the US and the UK, many European companies are well positioned, particularly with a weaker EUR. In the case of Europe, unemployment rates remain high and there is plenty of slack in the economy – which is likely to keep interest rates low – but even across Europe unemployment is falling and generally real incomes are rising.

Exhibit 27: Unemployment rates in the US, the Euro area, Japan, and the UK



Source: Department of Labour, Eurostat, Office for National Statistics, Ministry of Health, Labour & Welfare.

The prospects for the consumer cyclicals favour sectors such as Travel & Leisure, Telecoms, Media, General Retail, parts of Technology, Banks, and also Employment Agencies.

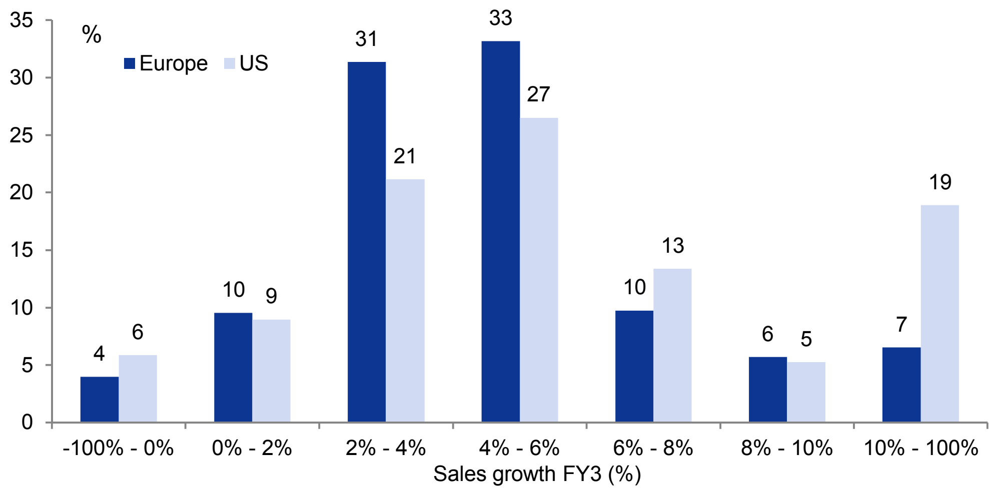
We are long General Retail (GSSBGERE) versus Food Retail (GSSBFORE) and long our Staffing subsector basket (GSSBSTAF) we are also long Household Products (which tend to be the more cyclical part of the Personal & Household Goods sector) (GSSBHOUS).

At the same time we believe the more 'defensive' Consumer Staples are too expensive.

Staples have been seen as a proxy for growth visibility …

In Europe, the absence of a meaningful Technology sector means that high-growth companies are even scarcer than they are in the US. As Exhibit 28 shows, the issue with the European market is not that it has many more slower growing companies compared with the US (in fact the proportion is similar in the US), rather it has a much smaller proportion of growth companies.

Exhibit 28: Europe's scarcity of high growth companies
Market cap weights for FY3 sales growth bands, STOXX 600 (on I/B/E/S consensus)



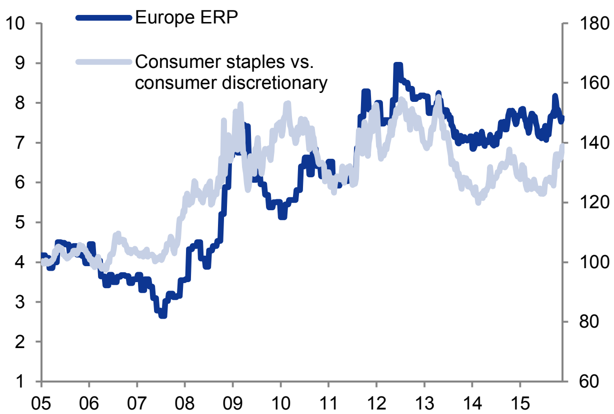
Source: Datastream, Goldman Sachs Global Investment Research

The scarcity of European growth companies and the low level of interest rates, together with a high ERP and increased preference for top-line growth over cyclical growth, have led to a significant boost in the value of defensive 'bond proxies' – sectors with a predictable top line that also offer income.

… and the risk premium

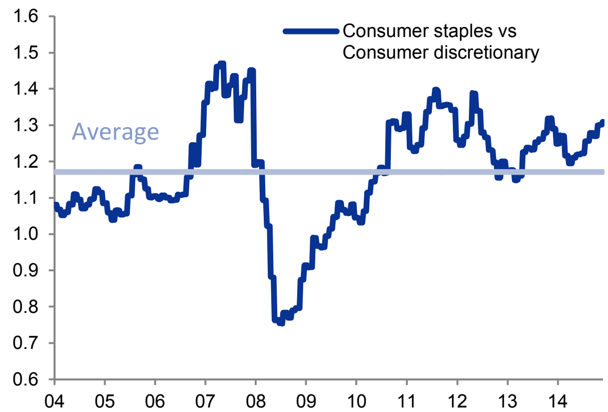
We also find that the outperformance of Consumer Staples versus Consumer Cyclicals can be related to the equity risk premium (ERP). This makes sense. The higher the macro uncertainty, the more investors are prepared to buy Staples with more predictable top-line growth than Consumer Cyclicals with earnings that are dependent on margins and the economic cycle. A gradual improvement in macro conditions should help to bring the ERP down further and support the Consumer Cyclicals at the expense of the Staples.

Exhibit 29: Top-line growth outperforms Cyclicals with higher uncertainty
Relative price performance for STOXX 600 sectors with European market-implied ERP



Source: Datastream, Goldman Sachs Global Investment Research

Exhibit 30: Relative valuation for Consumer Staples vs Consumer Discretionary
Relative 12 month fwd P/E (on I/B/E/S consensus)

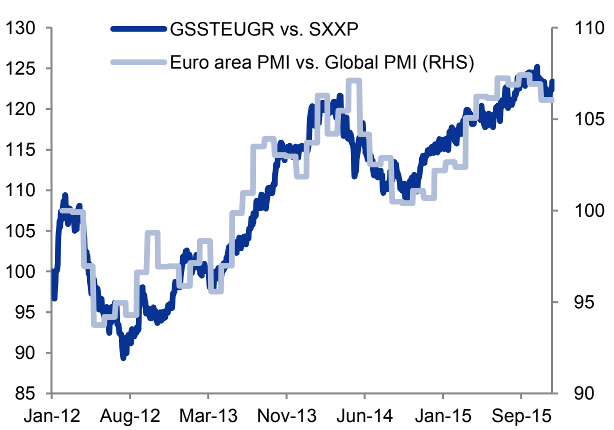


Source: Datastream, Goldman Sachs Global Investment Research

We also continue to like our European basket with cyclical European exposure (GSSTEUGR). See *Strategy Matters: Where to find Euro area cyclical exposure* (September 18, 2015). Growth in Europe is supported by strong consumer confidence, lower fiscal drag, falling commodity prices (supporting real incomes), low rates, and declining unemployment. The latest PMI data continues to show Euro area expansion and M3 growth is running at 5.3% yoy. See *European Economics Analyst: Europe's outlook: Resilient growth, weak inflation, easy policy* (November 19, 2015).

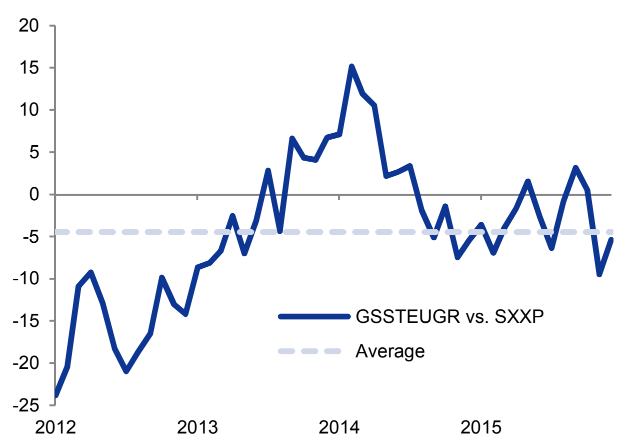
One frequent question we are asked by investors is how to get exposure to domestic growth; so much of the large-cap universe is international. Also, many domestic names have low gearing to growth. In our European cyclical growth basket (GSSTEUGR) we have screened for stocks with high Europe ex-UK exposure and a high beta of EBIT growth to GDP.

Exhibit 31: Our European cyclical growth basket trades in line with improvements in Euro area manufacturing …



Source: Markit, Haver Analytics, Goldman Sachs Global Investment Research.

Exhibit 32: … and at a small discount to the market
12m forward P/E (on I/B/E/S consensus)

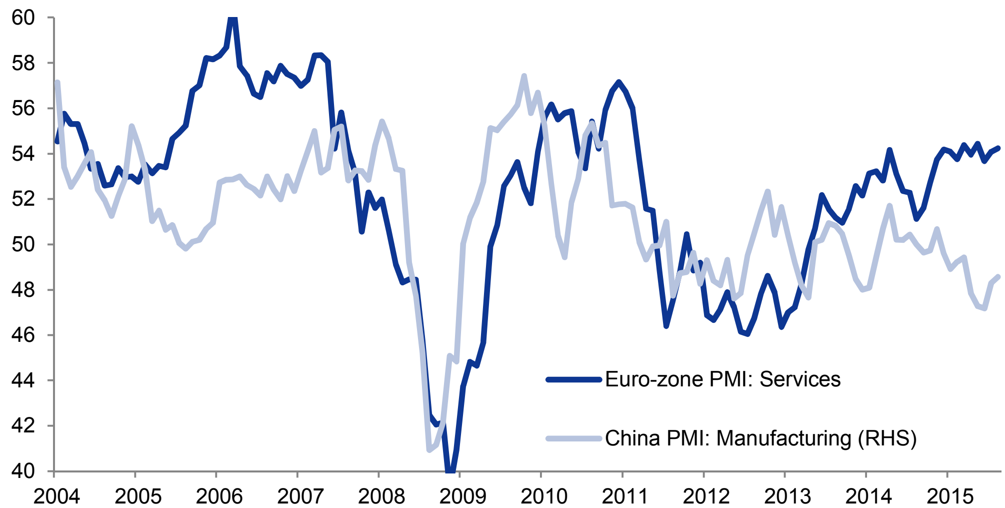


Source: I/B/E/S, Datastream, Goldman Sachs Global Investment Research.

This environment should support the performance of domestic cyclically exposed companies, especially Consumer stocks. The difference between domestic Euro area exposure (measured below by the Euro area Services PMI) and China manufacturing, for example, is stark and widening.

Exhibit 33: The widening gap between Euro area services and Chinese manufacturing is stark

Euro area Services PMI vs. Chinese Manufacturing PMI



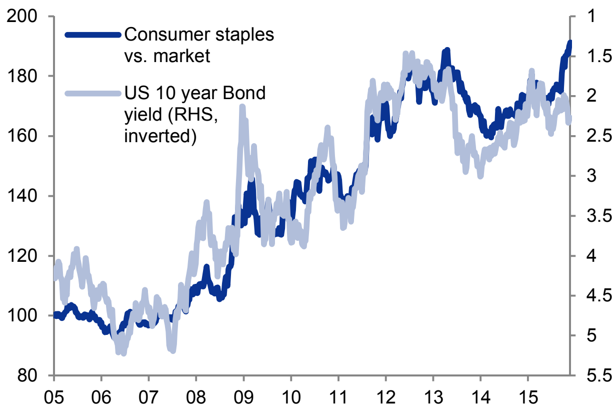
Source: Markit, Caixin, Haver Analytics, Goldman Sachs Global Investment Research.

Theme 4: Income Differentiation; the value of growth with yield

Alongside the scarcity of growth, we have also experienced scarcity of income. Even with gradual increases in bond yields in 2016, the yield advantage of European equities is material and likely to remain so over the coming years as real bond yields remain very low – so the attraction of companies with high dividend yields is likely to remain. In Europe's case, just as the scarcity of growth has favoured the defensive sectors and Staples in particular (given a lack of alternatives), so the search for yield has also benefited these parts of the market.

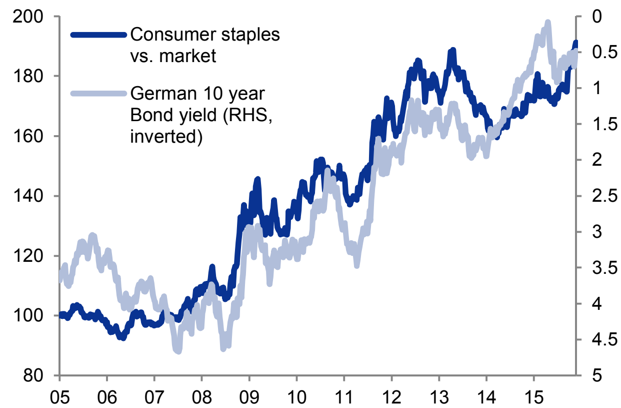
As Exhibits 34 and 35 show, Staples have benefited a lot from falling bond yields and lower inflation expectations. **But the relative performance has even exceeded what this relationship has recently implied. We think they are vulnerable to a reassessment of inflation expectations, bond yields and growth**.

Exhibit 34: Staples have benefited from lower bond yields
Relative price performance for STOXX 600 sector with US 10Y bond yield



Source: Datastream, Goldman Sachs Global Investment Research

Exhibit 35: Staples have also benefited from lower inflation expectations
Relative price performance for STOXX 600 sector with German 10Y bond yield

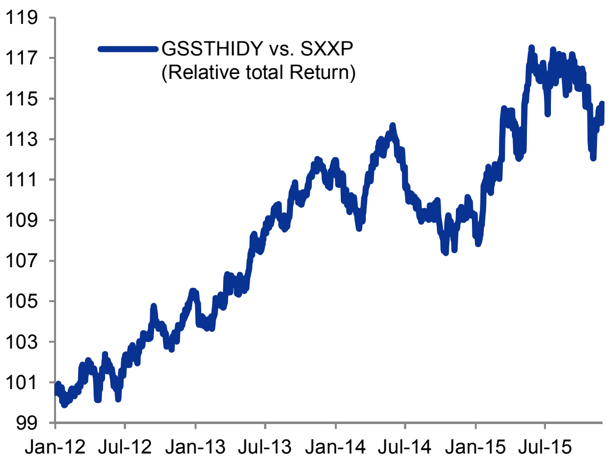


Source: Datastream, Goldman Sachs Global Investment Research

Our preference is to focus on companies across the market that have high dividend yields but also potential for dividend growth backed by strong balance sheets. We screen for payout ratios, free cash flow cover as well as leverage and exclude companies where dividend swaps are pricing a dividend cut or those with high CDS. **Our preferred implementation is still our high dividend yield plus growth basket (GSSTHIDY)**. As with higher bond yields, the search for yield will ease and investors need to focus even more on dividend growth. European high dividend yield stocks often have the lowest expected dividend growth, increasing the risk of picking 'dividend yield traps'. Higher dividend yields often come at the expense of dividend growth, and dividends are more at risk of cuts. The GSSTHIDY-basket offers an only slightly lower dividend yield than the European top-quartile dividend yield stocks but has much better dividend growth.

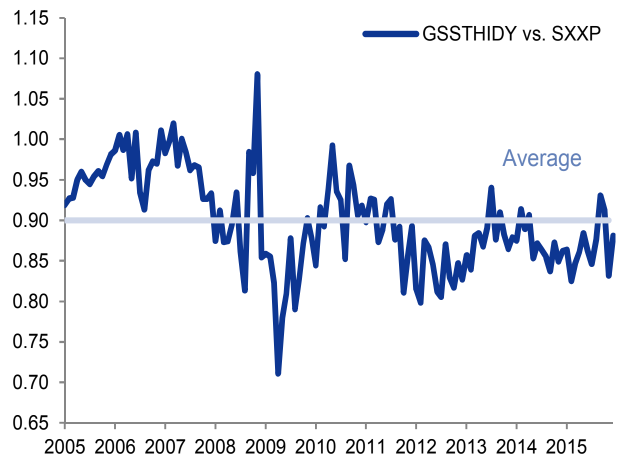
Our GSSTHIDY-basket has been a steady outperformer since inception in 2012 (Exhibit 36). This year to date is has outperformed the STOXX 600 by 300 bp. However, in 3Q it has underperformed the market, which has mainly been due to some cyclicals that have missed earnings. We have lowered our minimum growth threshold from 10% cumulative over the next two years to 5% to reduce the cyclical exposure slightly.

Exhibit 36: Our preferred implementation is our yield plus dividend growth basket GSSTHIDY.
High Dividend Yield and Growth basket vs STOXX 600, 2012 = 100



Source: Bloomberg, Goldman Sachs Global Investment Research

Exhibit 37: Relative valuation for High Dividend Yield and Growth basket vs STOXX 600
Relative 12 fwd P/E (on I/B/E/S consensus)



Source: Datastream, Goldman Sachs Global Investment Research

The basket has some sector skews – it is overweight Insurance and Financial Services and underweight expensive, quality defensive sectors such as Food & Beverage and Healthcare as well as commodity-linked sectors such as Chemicals and Oil & Gas. It has a pro-cyclical bias partly and thus the basket should be resilient if bond yields are rising and growth picks up. The basket has a beta below 1. But, despite having better dividend growth, stronger balance sheets, and lower CDS than the market, it does currently trade at a discount of close to 20% to the market on 12m fwd P/E on I/B/E/S consensus.

Exhibit 38: GSSTHIDY is overweight Financials and underweight expensive defensive sectors
Basket sector composition and skews relative to benchmark

	GSSTHIDY	STOXX Europe 600	Deviation
Food & Beverage	**2.3%**	7.5%	**-5.3%**
Chemicals	**0.0%**	5.0%	**-5.0%**
Health Care	**9.1%**	12.6%	**-3.5%**
Industrial Goods & Services	**9.1%**	10.8%	**-1.7%**
Real Estate	**0.0%**	1.7%	**-1.7%**
Oil & Gas	**4.5%**	6.0%	**-1.4%**
Technology	**2.3%**	3.6%	**-1.4%**
Automobiles & Parts	**2.3%**	3.1%	**-0.8%**
Retail	**2.3%**	3.1%	**-0.8%**
Construction & Materials	**2.3%**	2.4%	**-0.2%**
Travel & Leisure	**2.3%**	2.1%	**0.2%**
Basic Resources	**2.3%**	1.8%	**0.5%**
Utilities	**4.5%**	3.9%	**0.6%**
Banks	**13.6%**	12.9%	**0.8%**
Personal & Household Goods	**9.1%**	7.9%	**1.2%**
Telecommunications	**6.8%**	4.8%	**2.0%**
Media	**6.8%**	3.2%	**3.7%**
Financial Services	**6.8%**	1.9%	**5.0%**
Insurance	**13.6%**	7.0%	**6.7%**

Source: Bloomberg, Goldman Sachs Global Investment Research.

Exhibit 39: GSSTHIDY has a beta <1
Comparison of basket current fundamentals to the market

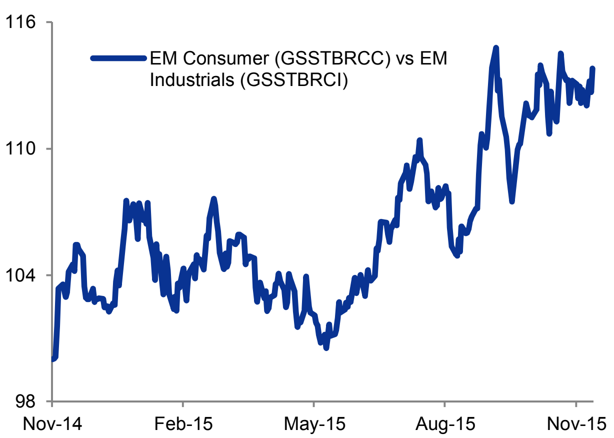
	GSSTHIDY	STOXX Europe 600
Dividend yield (FY1)	4.4%	3.0%
P/E (FY1)	14.1x	17.5x
Dividend growth (FY2/FY1)	10.5%	6.4%
Dividend growth (FY3/FY2)	7.2%	8.0%
Payout ratio (FY1)	63%	50%
Net debt/ EBITDA (FY1)	1.0x	1.5x
FCF cover (FY1)	1.5x	1.6x
5 year CDS	61 bps	71 bps
Beta	**0.82**	**1.00**

Source: Datastream, Bloomberg, Goldman Sachs Global Investment Research.

Theme 5: EM Differentiation; Prefer EM consumer exposure to EM industrial

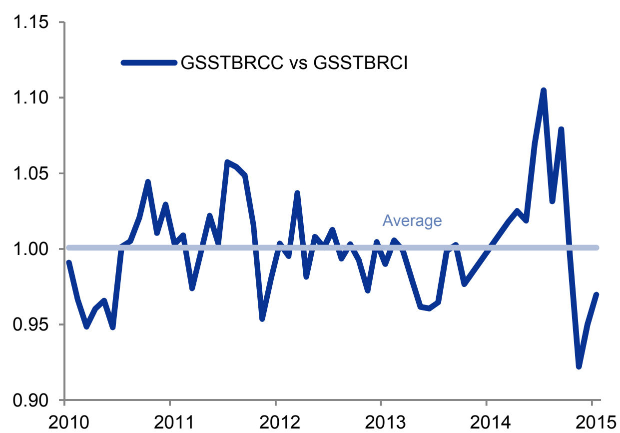
We continue to prefer EM Consumer companies (GSSTBRCC) to EM Industrial (GSSTBRCI). This trade has performed well over the last year and we expect this to continue as China, in particular, shifts its economy away from the infrastructure and more towards the consumer. As discussed above, we expect many of the Industrial names with EM exposure to be hit by continued cuts to capex. While the EM Consumer basket has outperformed, the valuation premium to the Industrial basket remains very small.

Exhibit 40: We continue to prefer EM Consumer companies (GSSTBRCC) to EM industrial (GSSTBRCI)
EM Consumer basket vs EM Industrials, Nov 2014 = 100



Source: Goldman Sachs Global Investment Research.

Exhibit 41: Relative valuation of EM Consumer to EM Industrials
Relative 12-month forward P/E (on I/B/E/S consensus)



Source: Datastream, Goldman Sachs Global Investment Research

European earnings: Rising from the ashes (but not much)

We continue to expect moderate earnings growth of 8% for 2016 for the STOXX 600, as we expect stabilization in the commodity and emerging markets. We upgrade our 2017 forecast to 10% (from 8% previously) and introduce a 5% forecast for 2018.

2016 earnings: Rising from the ashes

We expect 2016 earnings growth to be fueled by two factors of different relative importance in our top-down forecast model:

(i) Our economists expect the Euro area economy to expand by 1.7% in 2016, above trend and slightly better than in 2015, and expect global GDP to rise to 3.5% next year, after having hit what we think will prove to be a post-crisis low of 3.2% in 2015. We see our sales-weighted GDP growth measure (GDP weighted by the revenue exposure of the STOXX Europe) as the single most important driver of earnings. We estimate that a 1pp improvement in global sales-weighted GDP would boost earnings by a little over 10%. Further growth is supported by lower oil prices, which have fallen by 46% from the 2014 average, and a weaker EUR which has depreciated by 17% against the USD. Our economists estimate that the biggest impact on growth from these two factors tends to occur with a 3 to 6 quarter lag, suggesting that there is room for a boost in 2016. Besides, loose policy conditions, easing credit standards and less fiscal drag are likely to continue to fuel growth over the next year.

(ii) We estimate that each 10% move in the EUR/USD boosts EPS growth by around 2%. Most of this boost is likely to come via sales (we estimate that they increase by 3.7% for a 10% depreciation of the EUR), especially in the Oil & Gas and Aeronautic sectors as USD sales are translated back into EUR.

Exhibit 42: We expect double-digit earnings growth in Europe through 2017
STOXX EUROPE 600 Earnings Forecasts

STOXX EUROPE 600 EARNINGS FORECAST						
	2014	2015E	2016E	2017E	2018E	Peak
Net income growth (%)	**1**	**0**	**8**	**10**	**5**	
EPS Level (EUR)	**23.2**	**23.2**	**25.1**	**27.6**	**28.9**	**27.9**
Breakdown:						
Net income growth ex financials (%)	**-1**	**-6**	**8**	**10**	**3**	
Sales growth (%)	14.9	-8.9	5.4	9.6	2.5	
Net income margin (level, %)	5.6	5.7	5.9	5.9	5.9	8.4
Change in net income margin (%)	*-14*	*3*	*2*	*0*	*0*	
Change in net income margin (bp)	*-87*	*17*	*12*	*2*	*1*	
Financials net income growth (%)	**7**	**17**	**9**	**10**	**10**	
Net income growth ex commodities (%)	**1**	**8**	**13**	**5**	**5**	
Commodity sectors net income growth (%)	**0**	**-45**	**-21**	**40**	**7**	

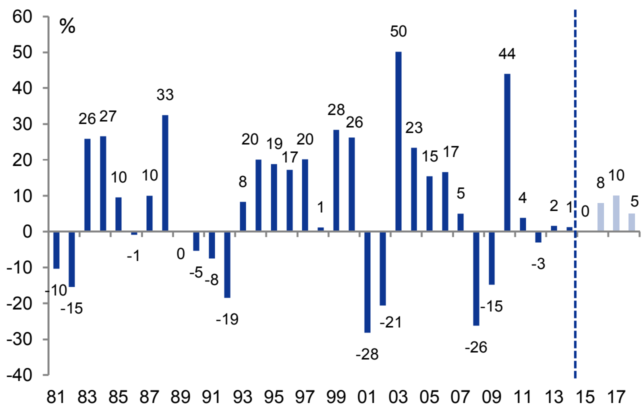
Source Goldman Sachs Global Investment Research.

Sharp sales growth and modest margin improvement 'in the pipeline'
We expect sales of non-financial companies to grow by 5.4% and a modest net income margin improvement of 12bp in 2016. There is strong evidence that financial conditions are easing as bank lending rates to companies are falling and credit supply has eased. Additionally, in the context of Euro area recovery, stabilisation in EM and rising commodity prices, we see less deflationary risks in Europe, which leaves the door open for the emergence of greater firm pricing power and higher margins. That said, as we have recently highlighted, the gap in margins between the US and Europe is somewhat an illusion (see *Strategy Matters, Marginal Differences: Can Europe catch up with the US?*, November, 10, 2015). Once we adjust for differing sector weights and take out the Technology sector, the gap between the US and Europe is no longer different to the long-term average margin differential, reducing the probability that margin improvement will be a big driver of profits in Europe.

Double-digit 2017 earnings growth fueled by recovery in the Commodity market
We upgrade our 2017 earnings growth to 10% (8% previously); we expect a strong recovery in the Commodity sector along with increasing commodity prices. We expect average 2017 oil prices to rise for the first time since 2013. When analysing the historical correlation between STOXX 600 earnings growth and oil prices, we find a slightly positive relationship, due to the heavy weight of resources companies within the index: a 10% increase in oil prices boosts EPS growth by 1.1%. Our expectation of double digit earnings growth in 2017 mainly reflects the recovery of profits in the Commodity sector, which we expect to grow by 40%.

External risks, CNY devaluation and commodity prices main threats to our forecasts
We view economic uncertainty in Asia and a prolonged fall in Commodity markets as the most important risks to our modest profits outlook. Our economists appreciate the challenges posed by the rapid accumulation of domestic debt in China and consider that the risk of a more disruptive slowdown and a one-off RMB devaluation remains. Such a scenario would be deflationary for European companies which would face again tighter financial conditions and compressed net income margins. A delayed lift-off in commodity prices would compromise the recovery of companies from the Resources sector and put a drag on 2017 earnings.

Exhibit 43: We expect positive but mild earnings growth compared to history
STOXX 600 price performance



Source: Datastream, Goldman Sachs Global Investment Research

Exhibit 44: We expect a recovery in the EPS level close to the previous peak
EPS level for the STOXX 600

Source: Datastream, Goldman Sachs Global Investment Research

Sector views for 2016

Our sector views are designed to fit with the general themes we see as playing out in 2016, a weaker EUR, modestly better global growth, a rise in bond yields and weak metals prices. See Exhibit 45 for our sector weights and specific relative pairs.

Exhibit 45: Our Key sector and sub-sector recommendations

Strategy Sector and Subsector Recommendations

Overweight	Neutral	Underweight
Banks (SX7P)	Autos & Parts (SXAP)	Basic Resources (SXPP)*
Healthcare (SXDP)	Construct. & Mat. (SXOP)	Chemicals (SX4P)
Insurance (SXIP)	Financial Services (SXFP)	Food & Beverage (SX3P)
Media (SXMP)	Oil & Gas (SXEP)*	Indus. Gds & Svs (SXNP)
Technology (SX8P)	Personal & HH Goods (SXQP)	Capex Industrials (GSSBCAPX)*
Telecoms (SXKP)	Real Estate (SX86P)	Food Retail (GSSBFORE)*
Travel & Leisure (SXTP)	Retail (SXRP)	Tobacco (GSSBTOBA)*
Civil Aerospace (GSSBCIVA)	Utilities (SX6P)	
Business Services - Staffing (GSSBSTAF)		
Building materials (GSSBSBUIL)		
Opex Industrials (GSSBOPEX)*		
General Retail (GSSBGERE)*		
Household & Personal Products (GSSBHOUS)*		

* denotes long/short trade

Source: Goldman Sachs Global Investment Research

Sector sensitivity to FX

The ECB meeting did not show the commitment to extending QE that we and the market had been expecting, given this our FX strategists have put their targets under-view (see *FX Views: Dry Powder, Lost Credibility,* December 3, 2015). However, a weaker EUR – even if it's not as weak as we previously forecast –should help boost returns in local currencies and also help companies with high USD revenues.

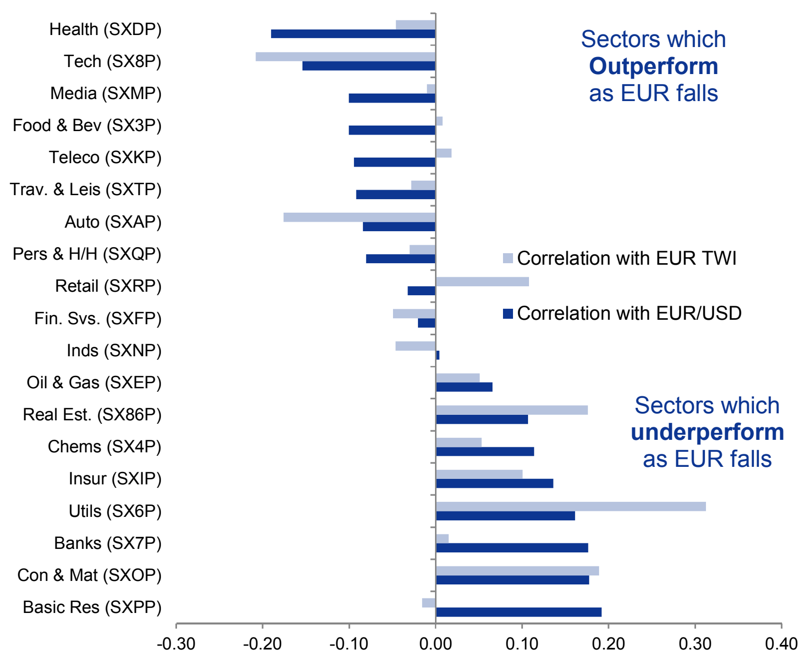
There is no perfect measure for sensitivity to currency; so much depends on what is driving the moves that the pure impact on company profitability is frequently swamped by other factors. For example, in 2012 and 2013 a strong EUR was correlated positively with equity market returns in Europe – because the alterative, a weak EUR, was at the time associated with rising risk of the Euro area breaking apart. When Euro area break-up was less of a risk the EUR rose and high beta sectors generally outperformed; this had nothing to do with their FX exposure but was more a function of their sensitivity to changing risk perception. Given this, we are always cautious about interpreting sector correlations with FX moves. However, when correlations also fit with regional exposures we can be more confident they represent to some degree a real FX effect. Similarly, when correlations are taken over longer periods we find them to be more reliable.

Since 1990 we show sector performance correlations with moves in the EUR/USD and moves in the trade-weighted EUR.

- **The sectors with the highest negative correlations to the EUR/USD are Healthcare, Technology, Media, Food & beverages. Autos tend to be more sensitive to the trade-weighted EUR** – which makes sense given its more global exposure. Healthcare is chiefly USD-sensitive.
- **Inversely the sectors which would be hit by a falling EUR on a relative basis tend to be more domestic – Banks, Utilities Insurance, Real Estate.** There are some exceptions, the commodity sectors tend to underperform with a weak EUR; this could be because a strong USD tends to be associated with lower commodity prices (which are priced in USD).

We also show sales exposures by sector in Exhibit 46. In some cases these tally well with FX sensitivity – so Healthcare and Tech are both very non-European in their exposures and have high FX sensitivity, Real Estate and Utilities are more domestic businesses and tend to outperform as the EUR rises. But for other sectors such as Basic Resources, other factors, are often more crucial in determining performance than FX moves.

Exhibit 46: Correlations with exchange rate moves
Correlation of monthly relative sector performance with moves in the exchange rate since 1990



Source: Datastream, Goldman Sachs Global Investment Research

Exhibit 47: Geographical breakdown of sales exposure by sector
STOXX 600 sectors

Sector	Europe	Non- Europe	Americas	Emerging Markets ex Asia	Asia	Others
STOXX 600	**54%**	**46%**	**18%**	**9%**	**11%**	**8%**
Health Care	28%	72%	38%	16%	10%	8%
Basic Resources	31%	69%	23%	6%	38%	2%
Personal & Household Goods	37%	63%	23%	15%	14%	11%
Technology	41%	59%	27%	5%	19%	8%
Food & Beverage	42%	58%	22%	19%	7%	9%
Chemicals	45%	55%	21%	11%	18%	4%
Oil & Gas	46%	54%	21%	6%	12%	15%
Industrial Goods & Services	48%	52%	22%	6%	14%	11%
Automobiles & Parts	48%	52%	25%	6%	16%	5%
Travel & Leisure	56%	44%	20%	9%	4%	11%
Construction & Materials	56%	44%	15%	10%	7%	11%
Financial Services (Supersector)	57%	43%	14%	15%	11%	3%
Media	60%	40%	23%	8%	4%	5%
Retail	65%	35%	8%	11%	6%	10%
Insurance	67%	33%	17%	4%	8%	4%
Telecommunications	68%	32%	1%	15%	5%	10%
Banks	69%	31%	11%	11%	7%	2%
Utilities	83%	17%	6%	6%	1%	4%
Real Estate	95%	5%	0%	5%	0%	0%

Source: Worldscope, Datastream, Goldman Sachs Global Investment Research

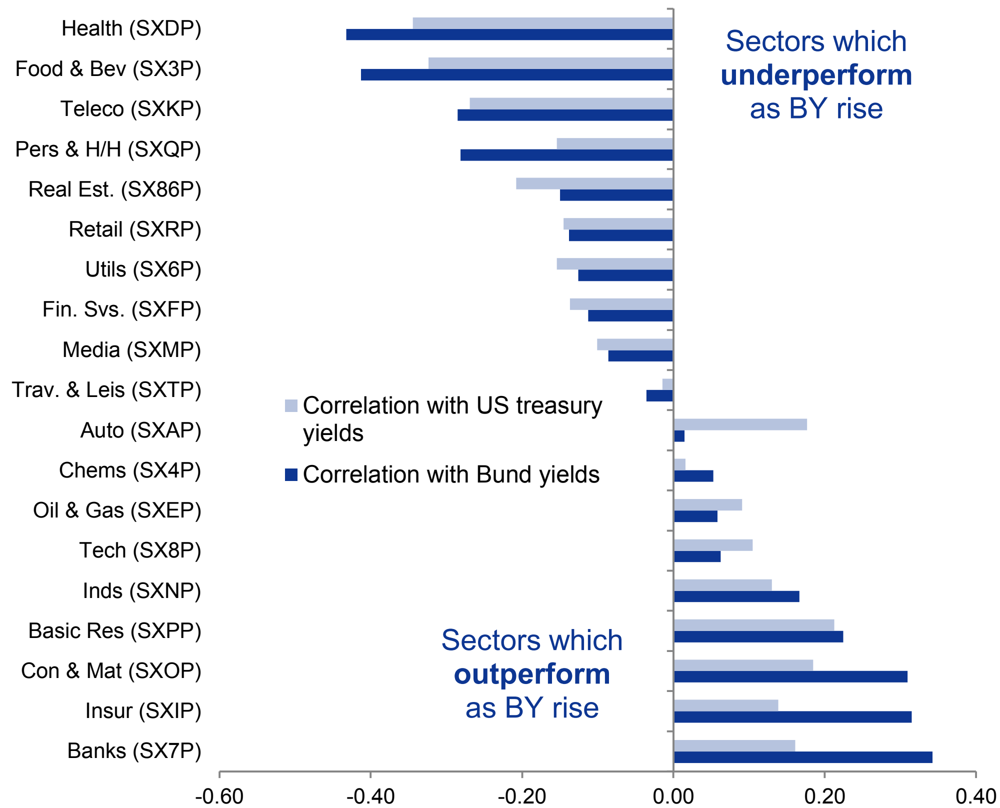
Sector sensitivity to bond yields

Similar to FX, there are too many moving parts to always be confident of being able to isolate the impact of bond yield moves on sectors with any precision. This is especially true at present when bond yields are diverging between Europe and the US. See *GOAL: Resurgence of divergence; trades & positioning ahead of ECB & Fed,* November 25, 2015.

We show below the correlation of relative sector performance with bond yield moves based on weekly changes since 2008. We have taken data only back to 2008 given the emphasis on QE in monetary policy since then. That said, largely the same sectors are bond proxies prior to the GFC as have been since:

- The sectors most negatively correlated with bond yields are Healthcare, Food & Beverages, Telecoms, Personal & Household Goods and Real Estate. All defensive sectors with relatively stable cash flow streams.
- The ones that would benefit from a rise in bond yields would be Banks, Insurance, Construction & Materials, Basic Resources and Industrials. These either directly benefit (Banks, Insurance) or indirectly via the causes of higher bond yields, better growth and higher inflation.

Exhibit 48: The correlation of relative sector returns and bond yields
Correlation based on weekly changes since 2008

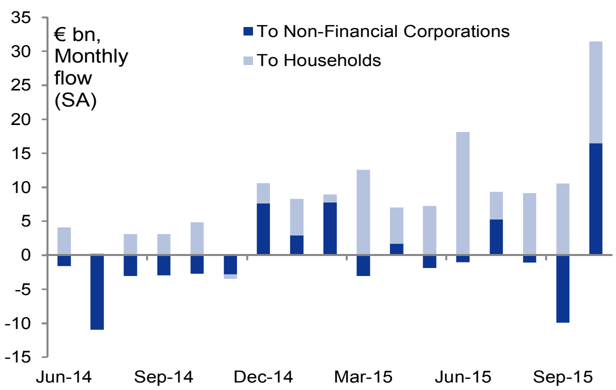


Source: Datastream, Goldman Sachs Global Investment Research

Financials: Overweight Banks and Insurance

- 3Q was a weak earnings season for the banks – hit by lower net interest margins, reduced fee income on assets, and weaker EM markets for those with exposure. In addition, those banks with energy exposure have increased provisions in the area. However, most disappointing has been loan growth which has failed to pick up in the way that had been hoped for at the outset of the year. Exhibits 49 and 50 show lending to households and non-financial corporates, it's picked-up since the start of 2014.
- But in a longer term context it is still low and the stock of overall loans (on which banks make their money) has barely moved.
- Provisioning is coming down in the periphery which is supportive and should continue. Given the lack of a strong sector-wide catalyst, particularly loan growth, our analysts prefer restructuring stories. In particular they prefer Banca Ppo. Emilia Romagna, Barclays, Credit Suisse Group, Erste Group and Julius Baer Group.
- Banks are now on the lowest relative valuation for 20 years and the market has been acutely aware of the issues they face with a lack of lending growth and margin pressure with low rates.
- The banks sector performance has been closely tied to bond yields and increasingly so to the shorter rather than the longer end of the curve. With inexpensive valuation and less aggressive easing by the ECB than many expected, there is potential for some outperformance **we remain Overweight the Banks sector.**
- **We remain Overweight the Insurance sector.** Despite low and falling bond yields in 2015 the sector has been resilient and we think this will continue.
- Downgrades this year have been very small (far less than the market even ex commodities) and the sector has outperformed. We continue to see this sector as attractive on a dividend yield basis, with the current DY of 4.2% well covered by earnings with a payout ratio of around 50%.
- The current DY is 100bp above the market and continues to offer more yield than Banks (despite the underperformance) and considerably more yield than **real estate, where we stay Neutral**. See Exhibit 54.
- Real Estate tends to underperform as bond yields rise; however, there are a number structural positives for the sector. Most of the markets are under-supplied given a lack of new construction in recent years; there is also large demand for real estate exposure from pension and insurance funds hungry for yield and from overseas investors looking for a combination of yield and safety. On the flipside demand for retail space could be hit by the move to online spend – but we emphasize that the listed sector tends to own the highest quality 30% of retail space, and we see this as relatively protected from the move to online.

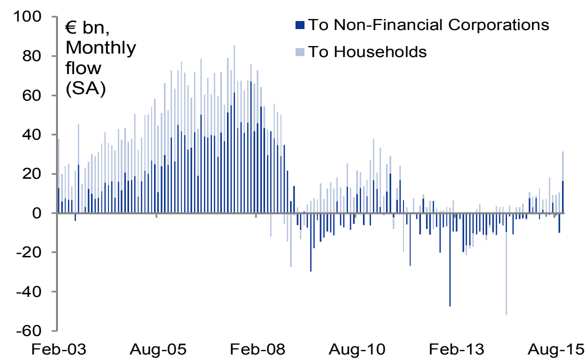
Exhibit 49: Euro area MFI Loans to NFCs and households show a rise...



Source: Haver Analytics, Goldman Sachs Global Investment Research.

Exhibit 50: ...but the rise is modest in a longer term context

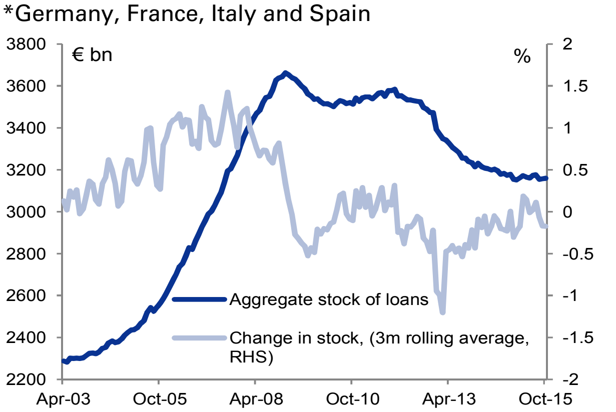
Euro area MFI Loans to NFCs and households



Source: Haver Analytics, Goldman Sachs Global Investment Research.

Exhibit 51: Aggregate stock and flows of Euro area MFI loans to NFCs*

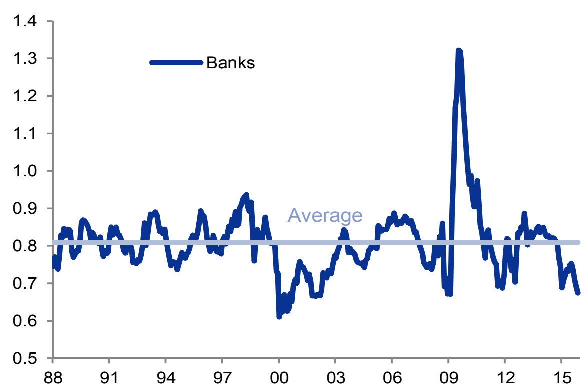
*Germany, France, Italy and Spain



Source: Haver Analytics, Goldman Sachs Global Investment Research.

Exhibit 52: Banks relative valuation is below that in 2012

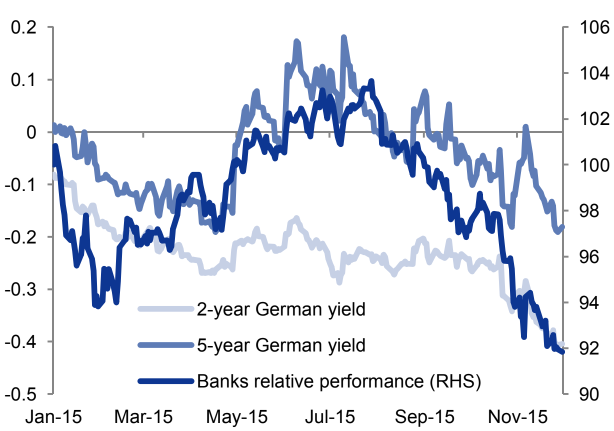
12m forward I/B/E/S consensus P/E relative to the SXXP



Source: I/B/E/S, Datastream, Goldman Sachs Global Investment Research.

Exhibit 53: Banks performance increasingly tied to the shorter end of the yield curve

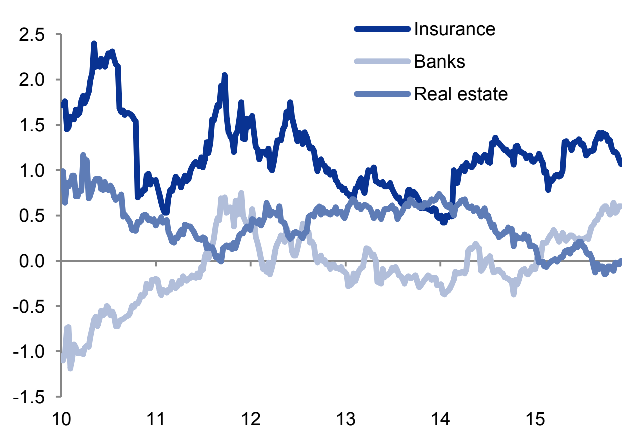
Price performance relative to the SXXP



Source: Datastream, Goldman Sachs Global Investment Research.

Exhibit 54: Insurance continues to offer the best dividend yield in the financials

12m trailing DY compared with the European market (% difference)

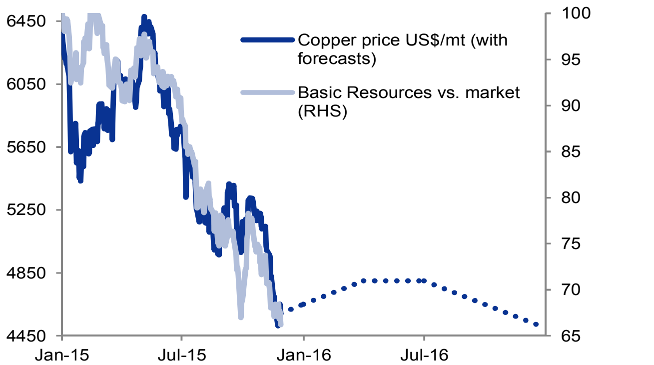


Source: Datastream, Goldman Sachs Global Investment Research.

Resources: Prefer Oil & Gas to Basic Resources

- **We remain Underweight Basic Resources; we see cost deflation, over supply and the stronger USD all as negatives for metals prices**. Several companies have suspended their dividends and others may need to cut. Capex has already been cut sharply by the mining companies, but the amount further they can reduce this is limited according to our analysts given that eventually it will eat into current production and hence cash flows.
- Our analysts' forecasts are significantly below consensus on 2016 earnings; our analysts expect EPS to fall by another 33% in 2016 after halving in 2015 while the consensus expects EPS to be down only 3% next year.
- The 12m forward P/E consensus number is also not compelling, with the sector trading close to in line with the market and in line with its longer-term average relative valuation. On P/BV the sector is cheaper; however, we question the validity of book values when much of the assets were capitalized at much higher price levels for commodities. In addition, our analysts estimate that around half of our sector coverage needs to raise capital.
- **We are more sanguine on the oil price, expecting it to remain roughly flat in the next few months and then rise towards to middle of next year** as we are coming towards a period when the oil market is in balance as US production declines. Non-OPEC investment has collapsed and this should reduce capacity next year. There are downside risks especially in the near term if it is a warm winter. But those not withstanding, we think oil prices should rise through most of 2016.
- We noted in *Strategy Matters: Momentum, rotation and value traps* (October 15, 2015) that the most important thing for seeing a sector recover after a period of being a value trap is a trough and stabilization in returns on capital. We find for the Oil sector returns are very linked to oil prices and as these trough and improve we expect the sector to at least perform in line with the market in 2016.
- The sector has a current DY of around 5.5%compared to the market at around 3%. Typically oil & gas offers a higher dividend – but normally about 50-100 bp above the market. We estimate that roughly a one-third-cut in sector dividends is discounted by the market. **We upgrade the sector to Overweight from Neutral.**
- We consider the Oil Services sub-sector (GSSBOILS) to still be very structurally challenged; the main problem we see is that there is unlikely to be an improvement in oil capex until 2018. However, the sector has underperformed sharply and unless there is a much more significant problems for the oil majors we no longer take a negative view on the sub-sector and have taken off our Underweight recommendation.
- **We remain Neutral on Utilities**. The sector has underperformed sharply and offers a current yield significantly above the market at c.4.6% with good cash flow cover. Also there is some evidence of a softening by the regulators, the Italian regulator recently increased the returns allowed on regulated assets. Moreover, the large German names are divesting and restructuring businesses which we expect to unlock value. On the flipside, natural gas prices are likely to remain weak in the view of our commodities team and this would still mean the sector struggles to grow.

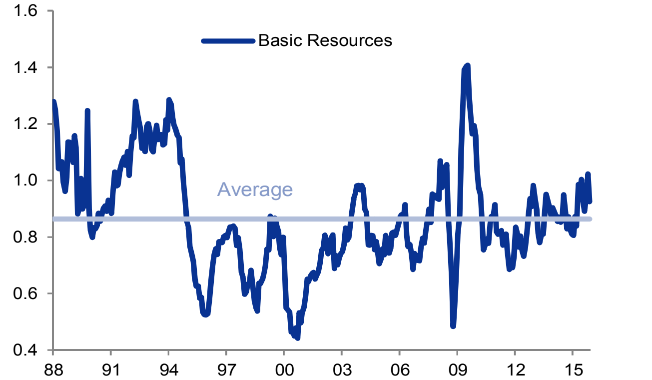
Exhibit 55: Expect copper prices to be flat to down in 2016



Source: Datastream, Goldman Sachs Global Investment Research.

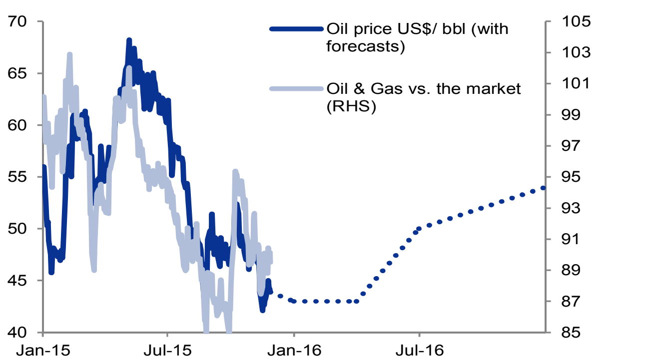
Exhibit 56: Basic Resources on consensus estimates is on a small premium to the market

12m forward I/B/E/S consensus P/E relative to the SXXP



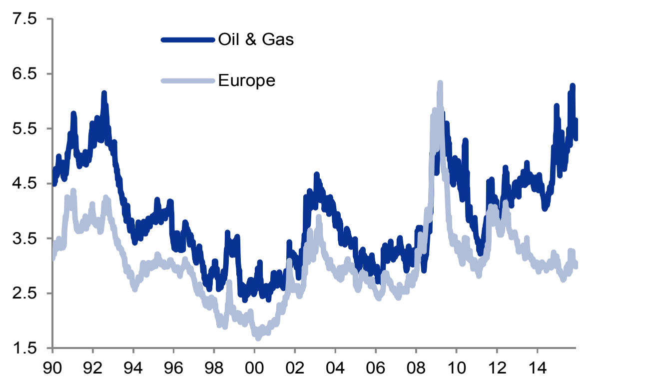
Source: I/B/E/S, Datastream, Goldman Sachs Global Investment Research.

Exhibit 57: Oil price set to trough and rise in 2016; we upgrade the Oil sector to Neutral



Source: Datastream, Goldman Sachs Global Investment Research.

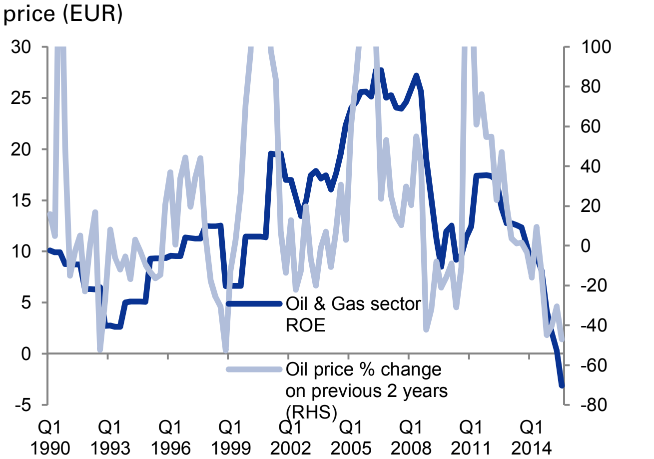
Exhibit 58: Dividend yield for the Oil & Gas sector now c.6%



Source: Datastream, Goldman Sachs Global Investment Research.

Exhibit 59: Oil sector ROE tends to be a function of medium-term moves in oil prices

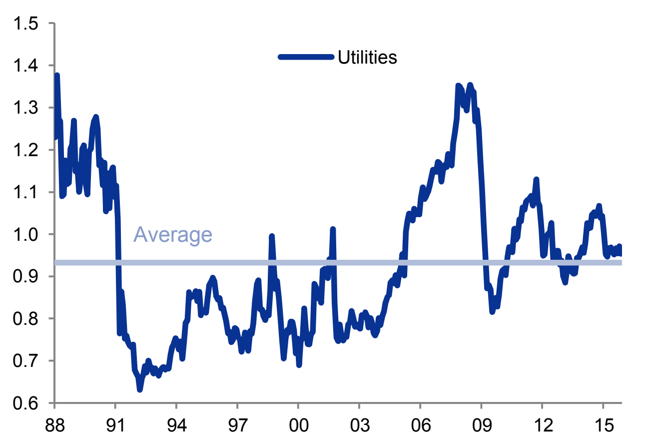
Sector 4Q trailing ROE compared with 2-year % change in oil price (EUR)



Source: Datastream, Goldman Sachs Global Investment Research.

Exhibit 60: Utilities are trading at their average

12m forward I/B/E/S consensus P/E relative to the market

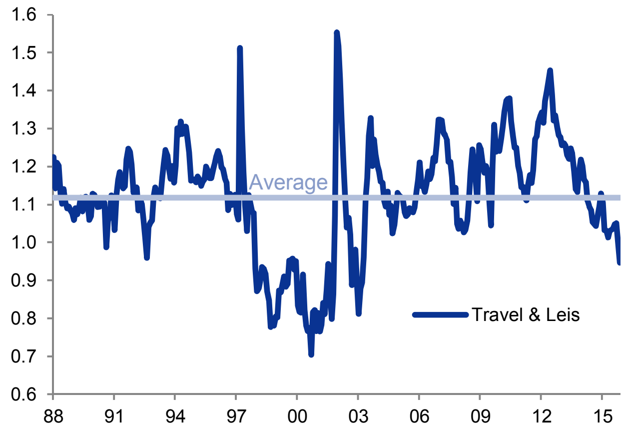


Source: I/B/E/S, Datastream, Goldman Sachs Global Investment Research.

Consumer Cyclicals: Prefer Media, Travel & leisure, General retail

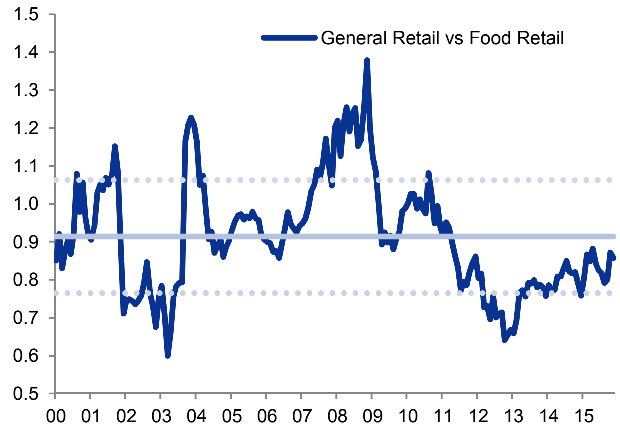
- **We continue to like the Media sector and upgrade to Overweight** (from Neutral) – we had previously expressed a preference for Media via our Ad Agencies sub-sector basket (GSSBMEAD) but now we upgrade the sector as a whole. It should benefit from the rising USD, from better economic growth and especially more consumer-orientated growth. In addition, valuation is not stretched on a 12-month forward P/E of 18.1x versus the market ex financials at over 17x.
- The big shift to digital away from TV has hit some of the US names in the sector but our analysts see European TV as structurally different. For example, pay TV is less expensive in Europe and often packaged together with broadband and phone. The development of the online classified industry is also creating opportunity and growth in large parts of the sector.
- **We remain Neutral Retail, within Retail we prefer General Retail (GSSBGERE) to Food Retail (GSSBFORE).** Better disposal income growth in Europe should be supportive of the General Retailers. And, while there have been a number of disruptive shifts in the sector, the companies are increasingly improving their online and multi-channel presence.
- For the Food Retailers, especially the UK ones we continue to see loss of market share to online and the hard discounters. They are seeing both deflationary industry pressure combined with rises in wages.
- **We continue to Overweight Travel & Leisure,** it is positively correlated with the USD in terms of relative sector performance. The sector should benefit from fiscal easing in Europe and generally loose monetary policy supporting the consumer. Lower commodity prices should also be a direct benefit to some of the names. Finally, this sector has seen the most positive consensus earnings revisions this year with upgrades of 4% year-to-date – only one other sector (Media) has seen upgrades through 2015.
- Given the improved earnings picture, but relatively weak share price performance we think the sector represents an opportunity. The relative valuation has fallen to 13-year lows.
- **Autos, we remain Neutral on the sector**, despite the obvious benefits from any falls in the USD. Our analysts argue that structural changes in the industry remain a headwind, and we expect roughly flat car sales volumes in 2016. Incentives in the US are at an all-time high and we think volumes will slow, similarly in Europe volumes have been growing fast and are in our view likely to slow next year. In China incentives are directed at the smaller local end of the car market.
- We also regard a devaluation in the CNY as a large risk (not our core view) for 2016 and the autos sector with high exposure to China would be one of the more sensitive to this move.

Exhibit 61: Travel & Leisure relative P/E at a large discount to where it has traded in recent years
12m forward I/B/E/S consensus P/E relative to the SXXP



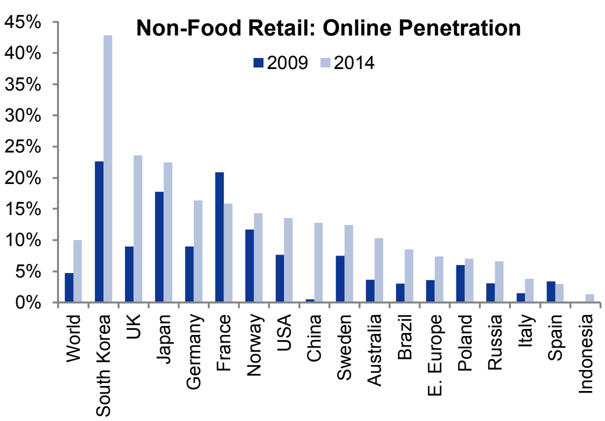
Source: I/B/E/S, Datastream, Goldman Sachs Global Investment Research.

Exhibit 62: General Retail has re-rated vs. Food Retail but still only at average relative PE
12m forward relative I/B/E/S consensus P/E



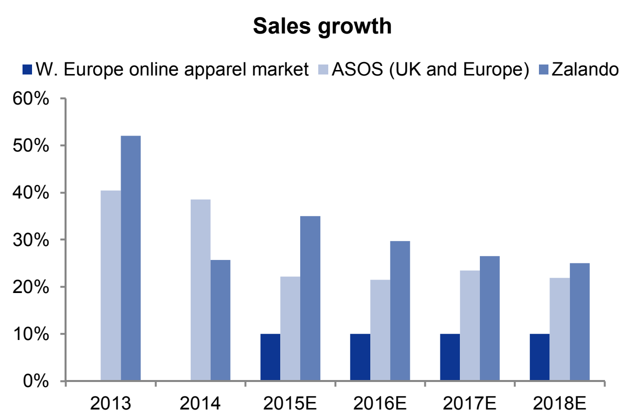
Source: I/B/E/S, Datastream, Goldman Sachs Global Investment Research.

Exhibit 63: European retail online penetration >10%
Online penetration by geography



Source: Euromonitor.

Exhibit 64: Retail aggregators continue to take share
Pure play online aggregators sales growth vs online

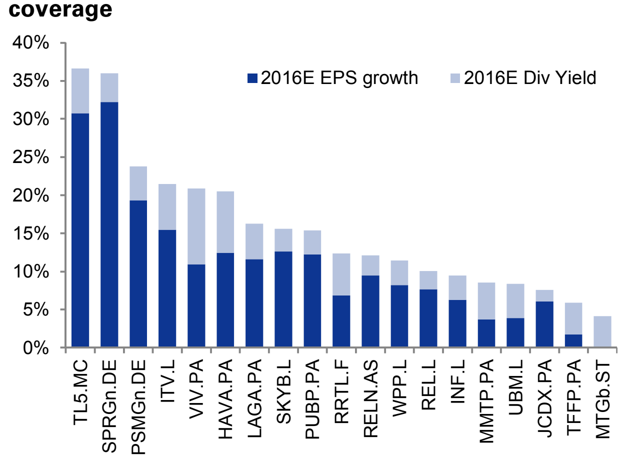


Source: Euromonitor, Company data, Goldman Sachs Global Investment Research.

Exhibit 65: We expect a slight pick-up in global advertising growth…

Source: MagnaGlobal, Goldman Sachs Global Investment Research.

Exhibit 66: …and see attractive growth across our Media coverage

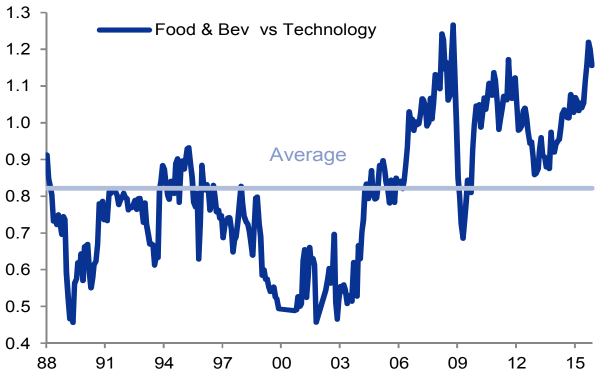


Source: Goldman Sachs Global Investment Research.

Defensives: Prefer Healthcare & Telecoms to Staples

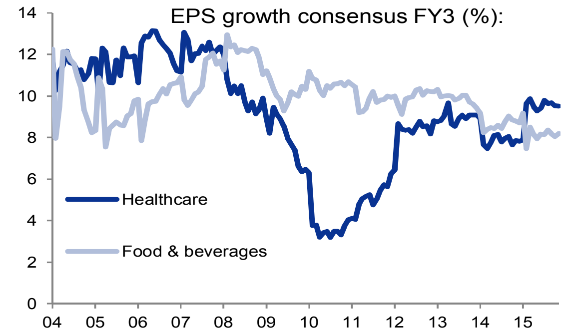
- We remain Underweight the Consumer Staples areas of the market, with an **Underweight views in Food & Beverages, and an Underweight recommendation on our Tobacco** sub-sector basket (GSSTOBA).
- Despite very weak earnings revisions through the last year Food & Beverages has outperformed and now trades on a P/E on a 12 month forward consensus earnings of over 23x. Its relative P/E to the market is high, not as high as during the GFC or the sovereign crisis, but the highest outside those periods.
- Clearly falling bond yields have been a large driver of this sector and the other bond proxy areas of the market – see Exhibit 69. But, in our view, as the European economy starts to reflate next year, we see room for these bond proxy areas to underperform.
- In addition, the sector has not proved as defensive in terms of earnings as many others, with consensus EPS revisions -11% for 2016 so far this year. The sector is facing losing market share in Asia to local producers, and in many western markets still suffering from price deflation.
- In contrast, the Healthcare sector, which has also similar defensive characteristics, in our view looks much less stretched – see Exhibit 71**. We upgrade Healthcare to Overweight (from Neutral).**
- The Healthcare sector trades on around a 20% premium to the European equity market – roughly at its long-term average. Our analysts' forecasts are above consensus for 2016 and they expect relatively robust sales CAGR of 4%-5% for the sector over the next 4-5 years, with EPS growth running in the high single digits through this period.
- R&D productivity has improved markedly, a function of faster FDA approval and the sector starting to reap the advantages of the improved knowledge of diseases achieved over the last decade.
- The sector should also be one of the main beneficiaries of a rise in the USD (although that is also true to some extent for the Food & Beverages sector). The key risk we see with the Healthcare sector is concerns on pricing going into a US election year.
- **We remain Overweight Telecoms.** We still believe that fixed-line network owners have the best growth outlook in European telecoms given better positioning for convergence and in light of greater regulatory scrutiny over mobile consolidation. We believe new technologies raise the attractiveness of incumbents, bringing them highly competitive speed vs. cable for the first time, and should enable them to return to top-line growth, narrowing the gap vs. cable. See *Future of fixed, The incumbent catch-up,* October 20, 2015.

Exhibit 67: Defensive vs. Cyclical – getting to extreme valuations
Relative 12m fwd P/E for General retail (GSSBGERE) vs. Food retail (GSSBFORE)



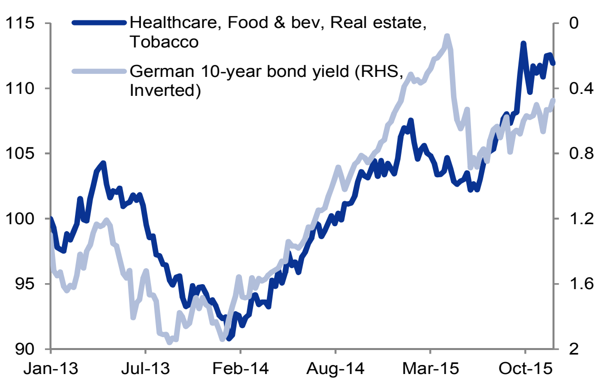
Source: I/B/E/S, Datastream, Goldman Sachs Global Investment Research.

Exhibit 68: Healthcare earnings starting to grow strongly



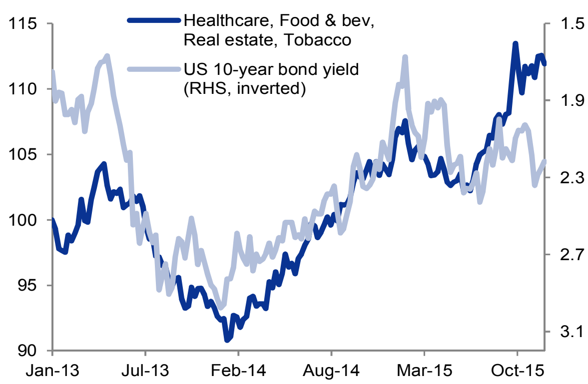
Source: I/B/E/S, Datastream, Goldman Sachs Global Investment Research.

Exhibit 69: Bond proxy sectors have outperformed as bund yields have fallen...



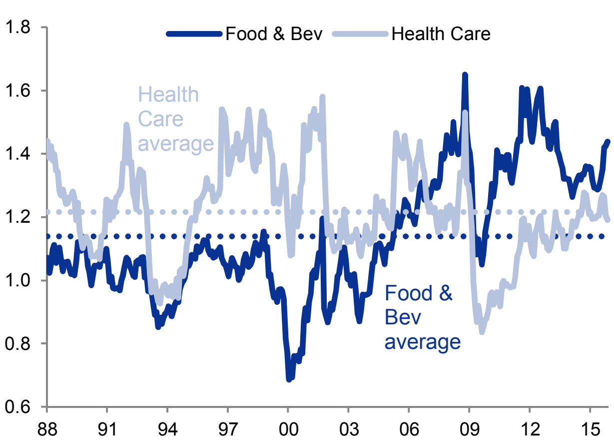
Source: Goldman Sachs Global Investment Research.

Exhibit 70: ... and seemed to have shrugged off US yield rises



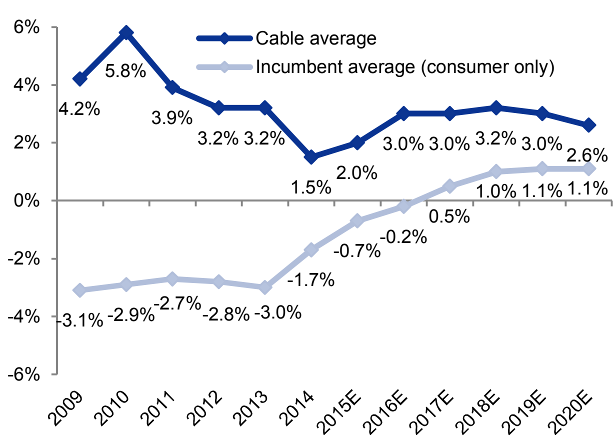
Source: Goldman Sachs Global Investment Research.

Exhibit 71: Healthcare relative P/E remains near the long-term average
12m forward I/B/E/S consensus P/E relative to the market



Source: I/B/E/S, Datastream, Goldman Sachs Global Investment Research.

Exhibit 72: New technology to close the growth gap
European fixed-line revenue growth yoy



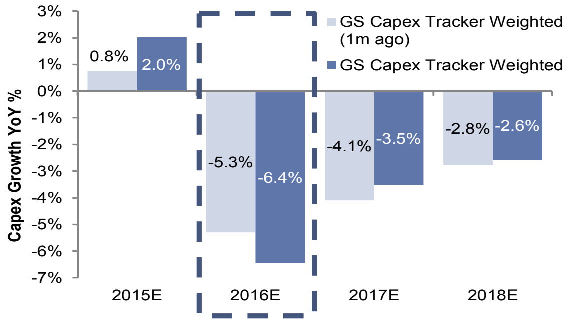
Source: Company data, Goldman Sachs Global Investment Research.

Industrials & Technology: Selective in Industrials, overweight Tech

- Industrial Goods & Services (SXNP) is a very broad sector, with everything from staffing and logistics to capital goods, **we downgrade Industrial Goods & Services to underweight**, but have very distinct views within this group.
- **We prefer opex-exposed Industrials (GSSBOPEX) and would recommend a long vs capex-exposed industrials (GSSBCAPX).** The headwinds for the latter remain strong; weak investment recovery globally, declines in commodity-related capex, declines in China infrastructure demand and growth.
- Opex-exposed industrials meanwhile should benefit from better cyclical growth in developed markets.
- **We also like the Staffers (GSSBSTAF)** and we recommend a long position in our sub-sector basket. Growth in staffing in continental Europe is starting to improve as data from the Netherlands and France show (see Exhibit 74).
- We also **remain long the Civil Aerospace sub-sector (GSSBCIVA)** this group has performed well, but we expect this to continue given a stronger USD versus the EUR. Aircraft order growth has slowed but orders remain high out to 2025.
- The Tech sector is relatively small in Europe with many separate sub-sectors. But overall it tends to be economy-sensitive and also benefit from weaker European currencies. It's second only to Healthcare in terms of seeing outperformance as the EUR falls versus the USD and is the most sensitive sector to moves in the trade weighted EUR.
- We expect a combination of slightly higher bond yields, better global growth and stronger USD to be **supportive of European Technology and we remain Overweight.**
- As an extreme contrast, we show the relative valuation of Food & Beverages (safe, defensive) with Technology (cyclical) both are very internationally exposed but the preference of premium for defensive international exposure has in our view reached extreme levels. We expect 2016 to see more of a tilt towards cyclicals such as technology.
- We **remain Underweight Chemicals**; our analysts argue many upstream markets remain oversupplied amid intensifying Asian competition. This drives their cautious views on Evonik, BASF, Lanxess and K+S (all rated Sell, Evonik is also on the CL). We believe the downstream companies are in a better position to grow given low raw material costs and margin improvement. But overall our analysts see limited upside.
- We **remain Neutral on Construction & Building Materials (SXOP)** but within this group we have a **long recommendation on the Building Materials stocks (GSSBBUIL).** The sector should benefit from a cyclical recovery in residential construction in Europe and at present there is low capacity utilization and high operational leverage.

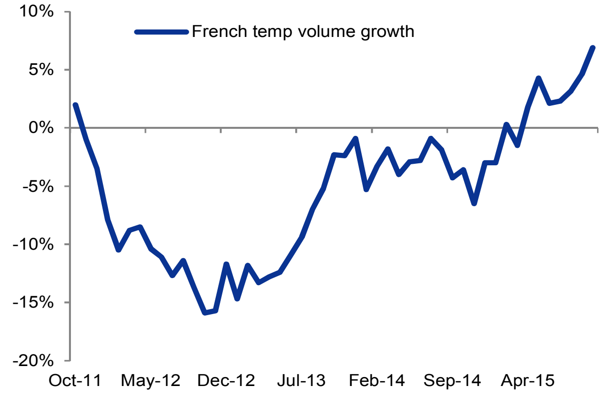
Share prices as at December 3, 2015: Evonik €30.84; BASF €27.87; Lanxess €45.20; K+S €24.43.

Exhibit 73: Capex tracking even lower for 2016
Growth in capex for the GS universe of >2,500 cos



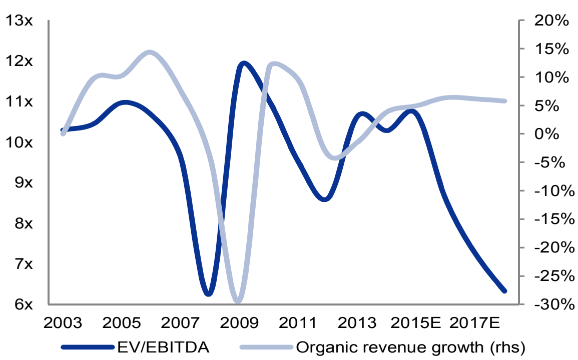
Source: Goldman Sachs Global Investment Research.

Exhibit 74: Temp staff volume growth has started to improve



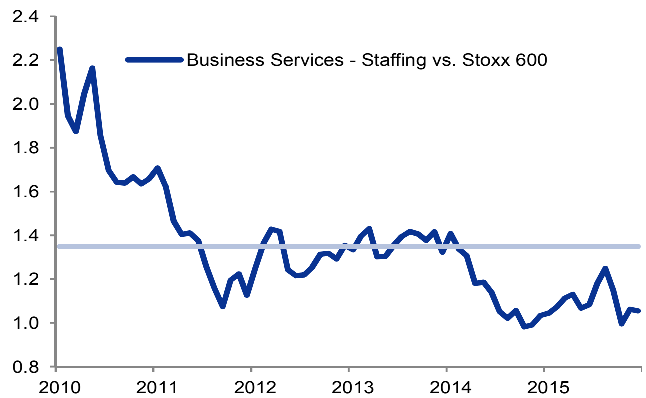
Source: prism'emploi, Goldman Sachs Global Investment Research.

Exhibit 75: Compared to growth, valuations remain reasonable for our European Staffing sector coverage



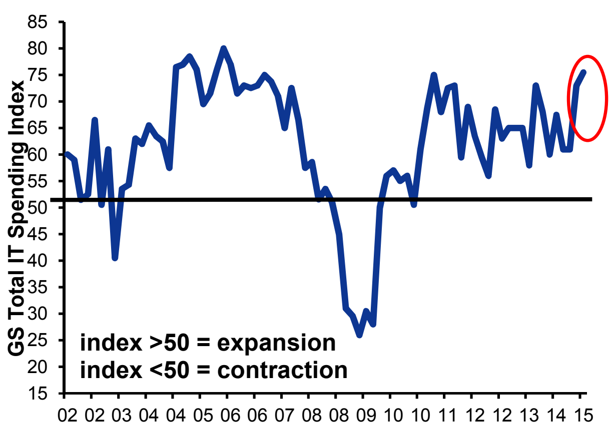
Source: Company Data, Goldman Sachs Global Investment Research.

Exhibit 76: Staffing relative valuation
Relative 12 month fwd P/E (on I/B/E/S consensus)



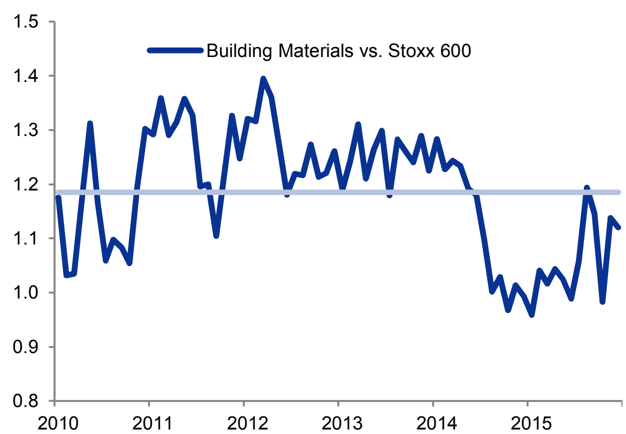
Source: I/B/E/S, Datastream, Goldman Sachs Global Investment Research.

Exhibit 77: GS IT spending survey – highest reading since Feb 2006



Source: Goldman Sachs Global Investment Research.

Exhibit 78: Building materials sub-sector basket
Relative 12 month fwd P/E (on I/B/E/S consensus)



Source: I/B/E/S, Datastream, Goldman Sachs Global Investment Research.

Appendix

Exhibit 79: Revisions to our subsector baskets

STOXX sector	GSSB Name	GSSB Ticker	GSSB Currency	Company name	Bloomberg	SEDOL	RIC	Weight STOXX	Weight GSSB	Volume	Price (US$)	Market cap. (US$, mn)	3M ADV (US$, mn)
SXNP	Business Services - Cyclical	GSSBBUSC	EUR	Bunzl PLC	BNZL LN	B0744B3	BNZL.L	1.1%	10.0%	606373	28.3	9,476	17
				Amadeus IT Holding SA	AMS SM	B3MSM28	AMA.MC	NA	10.0%	1689587	39.6	17,399	67
				Brenntag Aktiengesellschaft	BNR GY	B4YVF56	BNRGn.DE	1.9%	10.0%	296740	53.4	8,253	16
				Compass Group PLC	CPG LN	BLNN3L4	CPG.L	17.7%	10.0%	3238159	16.3	26,755	53
				Deutsche Post AG	DPW GY	4617859	DPWGn.DI	3.1%	10.0%	4057895	28.5	34,502	116
				Experian Finance PLC	EXPN LN	B19NLV4	EXPN.L	2.1%	10.0%	2283762	17.9	17,370	41
				G4S PLC	GFS LN	B01FLG6	GFS.L	0.6%	10.0%	4355029	3.2	5,023	14
				Rentokil Initial PLC	RTO LN	B082RF1	RTO.L	0.5%	10.0%	2307647	2.3	4,264	5
				Securitas AB	SECUB SS	5554041	SECUb.ST	0.5%	10.0%	1264633	15.0	5,474	19
				Sodexho Alliance SA	SW FP	7062713	EXHO.PA	6.0%	10.0%	289605	96.3	15,139	28
	Business Services - Outsourcing	GSSBBSOT	EUR	Capita Group PLC/The	CPI LN	B23K0M2	CPI.L	1.4%	33.3%	1078958	18.5	12,299	20
				Serco Group PLC	SRP LN	0797379	SRP.L	0.2%	33.3%	4085651	1.5	1,702	6
				Babcock International Group PLC	BAB LN	0969703	BAB.L	0.4%	33.3%	1034100	15.6	7,865	16
	CAPX	GSSBCAPX	EUR	ABB Ltd.	ABBN VX	7108899	ABBN.VX	4.8%	9.1%	7302369	18.7	43,178	136
				Intertek Group PLC	ITRK LN	3163836	ITRK.L	0.7%	9.1%	368816	40.2	6,481	15
				SGS SA	SGSN VX	4824778	SGSN.VX	1.1%	9.1%	20385	1842.7	14,414	38
				Bureau Veritas SA	BVI FP	B28DTJ6	BVI.PA	0.6%	9.1%	869162	20.2	8,956	18
				Alfa Laval AB	ALFA SS	7332687	ALFA.ST	0.6%	9.1%	1385109	17.7	7,408	24
				Atlas Copco AB	ATCOA SS	BXC8BS7	ATCOa.ST	1.9%	9.1%	2711772	26.1	31,225	71
				Wartsila OYJ Abp	WRT1V FH	4525189	WRT1V.HE	0.7%	9.1%	465216	44.5	8,787	21
				Metso OYJ	MEO1V FH	5713422	MEO1V.HE	0.3%	9.1%	702166	24.1	3,631	17
				Weir Group PLC	WEIR LN	946580	WEIR.L	0.4%	9.1%	1188597	17.0	3,638	20
				Kone OYJ	KNEBV FH	B09M9D2	KNEBV.HE	1.9%	9.1%	943326	42.0	22,046	40
				Siemens AG	SIE GY	5727973	SIEGn.DE	8.8%	9.1%	2386371	100.7	88,679	240
SXOP	Building materials	GSSBBUIL	EUR	Buzzi Unicem SpA	BZU IM	5782206	BZU.MI	NA	16.7%	1001306	18.0	3,441	18
				Cie de Saint-Gobain	SGO FP	7380482	SGOB.PA	10.6%	16.7%	2180477	42.7	24,148	93
				CRH PLC	CRH ID	0182704	CRH.I	11.6%	16.7%	980916	28.6	23,522	28
				Wienerberger AG	WIE AV	5699373	WBSV.VI	NA	16.7%	291336	17.3	2,028	5
				HeidelbergCement AG	HEI GY	5120679	HEIG.DE	5.3%	16.7%	616383	77.6	14,575	48
				LafargeHolcim Ltd.	LHN VX	7110753	LHN.VX	11.3%	16.7%	1757366	52.8	32,021	93
SXAP	Auto Components	GSSBAUCO	EUR	Compagnie Generale des Etablissements I	ML FP	4588364	MICP.PA	7.0%	14.3%	633537	98.4	18,355	62
				Continental AG	CON GY	4598589	CONG.DE	9.7%	14.3%	482853	230.7	46,145	111
				Faurecia	EO FP	4400446	EPED.PA	0.8%	14.3%	818840	36.8	4,600	30
				GKN PLC	GKN LN	3064650	GKN.L	2.9%	14.3%	5037924	4.4	7,568	22
				Nokian Renkaat OYJ	NRE1V FH	B07G378	NRE1V.HE	1.9%	14.3%	697208	37.7	5,072	26
				Rheinmetall AG	RHM GY	5334588	RHMG.DE	0.9%	14.3%	257899	62.3	2,713	16
				Valeo SA	FR FP	4937579	VLOF.PA	4.6%	14.3%	530931	150.0	11,921	80

Source: Goldman Sachs Global Investment Research

Exhibit 80: Constituents of GSSTHIDY

HIGH DIVIDEND YIELD AND GROWTH BASKET (GSSTHIDY)																
Company name	Market cap (€Bn)	Beta (6 month)	Dividend yield 2015E	2016E	DPS growth (forecast) 2015E	2016E	2014-16E	DPS growth (implied) 2015	2016	Payout ratio 2015E	2016E	Free cash flow cover 2015E	2016E	Net debt/EBITDA 2015E	2016E	5 year CDS
Automobiles & Parts																
Daimler AG	87.7	1.42	4.0%	4.9%	32.7%	23.1%	63.3%	8.9%	19.0%	41%	38%	0.3x	2.0x	-1.2x	-1.1x	66 bps
Banks																
BNP Paribas	69.6	1.30	4.9%	5.1%	84.1%	4.0%	91.4%	0.0%	47.3%	28%	47%					67 bps
HSBC	148.7	0.58	6.2%	6.5%	9.7%	5.6%	15.9%	10.5%	-6.9%	57%	63%					
Intesa Sanpaolo	52.5	1.61	4.7%	5.7%	108.9%	21.1%	153.0%	40.0%	100.0%	103%	71%					86 bps
Nordea	41.9	0.99	6.6%	6.8%	12.1%	3.3%	15.7%	51.6%	2.0%	72%	73%					
Svenska Handelsbanken	24.0	0.81	5.6%	6.0%	11.4%	7.7%	20.0%	6.1%	-2.2%	75%	81%					46 bps
UBS Group AG	66.4	0.59	4.1%	4.6%	6.7%	12.5%	20.0%			80%	59%					47 bps
Basic Resources																
UPM-Kymmene	9.5	1.17	4.5%	4.5%	14.3%	0.0%	14.3%	16.7%	3.6%	59%	61%	2.3x	1.6x	2.8x	2.4x	92 bps
Construction & Materials																
Skanska	7.6	1.00	4.9%	5.0%	25.9%	0.5%	26.6%	8.0%	0.3%	71%	71%	1.1x	1.2x	0.1x	-0.2x	
Financial Services																
Azimut Holding	3.4	1.37	4.2%	4.8%	27.3%	14.9%	46.4%	11.4%	48.8%	62%	58%			-1.5x	-1.4x	
ICAP plc	4.6	0.67	4.5%	4.9%	4.2%	8.1%	12.6%	42.9%	-4.4%	75%	74%			0.2x	-0.1x	
Man Group	4.0	1.11	4.6%	5.8%	20.5%	26.5%	52.4%	33.5%	6.0%	41%	60%	3.3x	1.8x	-1.3x	-1.3x	
Food & Beverage																
Britvic Plc	2.5	0.51	3.3%	3.5%	8.9%	7.4%	17.0%	9.5%	4.5%	51%	51%	1.5x	1.3x	2.0x	1.7x	
Health Care																
AstraZeneca	89.2	0.68	4.0%	4.1%	7.6%	1.6%	9.3%	9.4%	-0.9%	65%	65%	1.8x	-0.3x	0.7x	1.6x	36 bps
GlaxoSmithKline	94.1	0.72	7.3%	5.8%	25.0%	-20.0%	0.0%	0.0%	13.8%	84%	133%	0.9x	0.8x	2.7x	3.2x	
Roche	217.3	0.51	3.2%	3.7%	11.0%	15.2%	27.8%	2.6%	4.6%	56%	60%	1.9x	1.9x	1.1x	0.8x	
Sanofi	111.0	1.24	4.1%	4.3%	4.0%	4.0%	8.2%	1.8%	4.6%	64%	61%	1.4x	1.3x	0.6x	0.5x	33 bps
Industrial Goods & Services																
BAE Systems	23.9	0.69	4.1%	4.4%	5.0%	7.0%	12.4%	2.0%	-4.5%	54%	53%	1.5x	0.8x	0.5x	0.8x	64 bps
Royal Mail Group	7.0	0.30	4.4%	4.6%	4.6%	5.0%	9.9%			54%	48%	1.6x	1.4x	0.2x	0.0x	
Siemens AG	81.9	1.08	3.7%	3.9%	6.5%	7.6%	14.7%	10.0%	6.1%	47%	55%	1.6x	1.5x	0.3x	0.8x	38 bps
Weir Group	3.6	0.55	3.8%	4.4%	2.3%	16.7%	19.3%	-8.7%	-5.2%	31%	54%	1.8x	2.8x	1.3x	2.2x	
Insurance																
Allianz SE	75.8	1.11	4.3%	4.4%	5.1%	2.8%	8.0%	29.2%	6.5%	50%	50%					35 bps
Aviva Plc	20.9	0.89	4.2%	4.9%	20.0%	15.0%	38.0%	24.6%	7.0%	39%	47%					59 bps
AXA	57.9	1.27	4.4%	4.5%	18.4%	2.4%	21.3%	17.3%	8.4%	49%	50%					52 bps
Legal & General Group	22.8	0.74	5.0%	5.4%	20.0%	8.0%	29.6%	20.4%	10.4%	66%	68%					
SCOR	6.7	0.89	4.1%	4.4%	7.1%	6.7%	14.3%	7.7%	3.6%	51%	47%					70 bps
UnipolSai SpA	6.7	1.10	7.6%	7.9%	5.8%	3.8%	9.8%			65%	70%					
Media																
ITV plc	14.7	0.83	5.3%	6.1%	27.9%	16.3%	48.7%			80%	87%	1.1x	0.9x	0.9x	1.1x	113 bps
ProSiebenSat.1	10.8	1.23	3.8%	4.5%	15.3%	19.4%	37.7%			84%	84%	1.4x	1.4x	1.9x	2.1x	
UBM plc	1.7	0.69	5.4%	4.5%	26.7%	-16.8%	5.5%	0.5%	-5.0%	56%	70%	1.7x	1.6x	2.5x	1.3x	
Oil & Gas																
BP plc	102.4	0.63	6.7%	6.8%	9.7%	1.6%	11.4%	10.3%	-23.1%	60%	116%	1.1x	0.3x	1.0x	2.6x	89 bps
TOTAL SA	107.3	1.13	5.2%	5.5%	0.7%	4.9%	5.7%	0.8%	-7.1%	58%	61%	0.4x	0.1x	1.0x	1.3x	51 bps
Personal & Household Goods																
Barratt Developments	8.3	0.89	4.7%	5.7%	55.4%	21.6%	89.0%	143.7%	12.8%	46%	54%	1.2x	0.9x	-0.2x	-0.3x	
British American Tobacco	102.3	0.74	4.0%	4.3%	4.0%	7.9%	12.3%	3.5%	-3.1%	71%	73%	1.0x	1.3x	2.0x	2.8x	48 bps
Imperial Tobacco	48.9	0.71	4.0%	4.4%	10.0%	10.2%	21.1%	51.0%	-20.7%	64%	66%	1.5x	1.6x	3.2x	3.8x	74 bps
Taylor Wimpey	8.7	0.91	5.8%	7.5%	17.9%	30.0%	53.3%	321.8%	-14.8%	83%	71%	0.6x	1.2x	0.1x	0.0x	
Retail																
Next	16.7	0.44	4.9%	5.1%	31.2%	4.3%	36.9%	30.7%	-1.6%	71%	88%	1.4x	1.3x	0.7x	0.5x	46 bps
Technology																
Ericsson	29.8	0.87	4.1%	4.7%	14.8%	14.5%	31.5%	13.3%	-3.7%	68%	79%	1.2x	-0.1x	-0.9x	-0.2x	56 bps
Telecommunications																
Orange	43.6	1.36	3.6%	4.2%	0.0%	16.7%	16.7%			170%	59%	2.3x	2.6x	2.9x	3.0x	53 bps
TDC A/S	3.9	0.52	6.7%	3.5%	-2.3%	-48.6%	-49.8%			57%	67%	1.6x	1.9x	3.5x	3.3x	120 bps
TeliaSonera	19.9	0.60	7.0%	7.4%	0.0%	5.0%	5.0%	0.0%	-7.5%	74%	79%	2.3x	3.8x	1.7x	1.6x	67 bps
Travel & Leisure																
TUI AG	9.2	0.70	3.8%	4.0%	34.9%	5.4%	42.2%			33%	59%	8.6x	0.9x	1.0x	0.8x	114 bps
Utilities																
Gas Natural	20.5	0.80	4.7%	4.8%	6.2%	2.3%	8.6%	1.2%	-5.1%	72%	62%	1.3x	1.2x	3.2x	2.8x	103 bps
Hera SpA	3.4	0.65	3.8%	4.2%	0.0%	11.1%	11.1%			79%	71%	1.6x	1.8x	3.0x	2.9x	
Median	**21.8**	**0.82**	**4.4%**	**4.8%**	**10.5%**	**7.2%**	**16.8%**	**10.0%**	**2.0%**	**63%**	**62%**	**1.5x**	**1.3x**	**1.0x**	**1.2x**	**61 bps**

Source: Bloomberg, Goldman Sachs Global Investment Research.

Exhibit 81: Constituents of GSSTEUGR

Euro Area Growth (GSSTEUGR)											
Name	Weight	Market Cap (EUR Bn)	Beta to GDP	Europe ex. UK Exposure (%)	NTM P/E (x)	Name	Weight	Market Cap (EUR Bn)	Beta to GDP	Europe ex. UK Exposure (%)	NTM P/E (x)
Automobiles & Parts	**2.9%**					**Media**	**11.8%**				
Peugeot	2.9%	12.8	13.4	62	9.6	Mediaset Espana Comunicacion	2.9%	2.3	19.5	100	20.7
Banks	**20.6%**					Mediaset S.p.A.	2.9%	7.8	9.2	100	75.9
Bank of Ireland	2.9%	50.3	13.1	60	11.1	Schibsted	2.9%	4.6	14.1	99	38.6
Bankinter	2.9%	17.4	2.6	100	11.8	Television Francaise 1	2.9%	3.8	9.0	100	17.8
Commerzbank	2.9%	12.9	18.5	65	10.1	**Oil & Gas**	**5.9%**				
ING Groep	2.9%	6.1	14.4	51	13.9	Eni	2.9%	8.6	7.0	56	12.1
Intesa Sanpaolo	2.9%	22.7	0.7	79	10.5	OMV	2.9%	54.2	7.1	76	25.8
KBC Groupe	2.9%	11.3	12.7	69	12.8	**Real Estate**	**8.8%**				
NATIXIS	2.9%	52.1	29.3	53	13.9	Gecina	2.9%	2.1	10.7	100	15.2
Basic Resources	**2.9%**					Unibail-Rodamco	2.9%	23.6	14.6	98	21.3
UPM-Kymmene	2.9%	9.4	17.1	52	12.6	Wereldhave	2.9%	7.0	17.3	60	18.8
Construction & Materials	**2.9%**					**Retail**	**2.9%**				
Wienerberger	2.9%	1.9	1.1	55	24.4	METRO	2.9%	9.5	7.2	66	16.0
Financial Services	**2.9%**					**Technology**	**5.9%**				
Intermediate Capital Group	2.9%	2.7	11.9	65	13.3	Atos	2.9%	9.8	6.3	59	22.2
Industrial Goods & Services	**14.7%**					United Internet	2.9%	7.6	6.2	89	11.9
Adecco	2.9%	10.4	15.6	52	15.3	**Telecommunications**	**5.9%**				
DSV	2.9%	5.8	7.8	62	16.4	Deutsche Telekom	2.9%	15.5	8.3	54	22.2
ISS	2.9%	6.7	8.5	61	21.1	Telecom Italia	2.9%	78.1	3.5	85	20.3
Randstad	2.9%	10.9	10.6	63	13.4	**Travel & Leisure**	**11.8%**				
Smurfit Kappa Group	2.9%	5.8	5.7	66	11.0	Accor	2.9%	18.3	12.6	63	13.6
						Deutsche Lufthansa	2.9%	6.0	12.0	53	5.0
						EasyJet	2.9%	9.0	11.3	54	10.5
						Ryanair	2.9%	9.1	8.9	75	18.7
Median		**9.2**	**10.6**	**64**	**14.6**						

Source: I/B/E/S, FactSet, Goldman Sachs Global Investment Research.

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