

## Strategy Focus

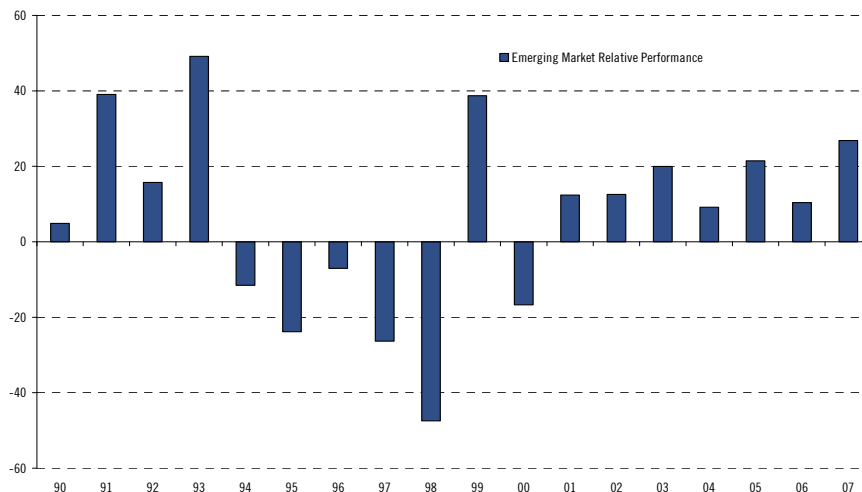
25 March 2008 | 24 pages

# Global Equity Strategist

## Thoughts From The Emerging Markets Strategy Roadshow

- **Outperformance** — After seven years of outperformance, we expect Emerging Markets to outperform again in 2008. However, market conditions will remain tough in the first half of the year.
- **Economic and Earnings Resilience** — Emerging Markets have stronger economic growth and earnings resilience than in the developed world.
- **Valuation bubble?** — Valuations are not as cheap as they were, but are still only trading at a small premium to global equities. They are nowhere near bubble territory yet.
- **Commodity Exporters vs Commodity Importers** — Our strategists are currently more optimistic on commodity exporters (CEEMEA, LatAm) than commodity importers (Asia ex Japan).
- **Preferred markets** — Our strategists like Korea, Taiwan, Hong Kong and Malaysia in Asia ex Japan, Mexico and Brazil in LatAm, and Russia, MENA and Turkey in CEEMEA.

Figure 1. Emerging Market Relative Performance (US\$ %)



Source: DataStream, Citi Investment Research

See Appendix A-1 for Analyst Certification and important disclosures.

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## Thoughts From The Emerging Market Strategy Roadshow

Emerging Market performance continues to hold up well against developed markets. This has been achieved against a backdrop of recessionary conditions in the US, severe liquidity constraints, and worrying increases in inflation. Can Emerging Markets continue to perform and perhaps even make further gains relative to developed markets? In this week's note we address these issues by highlighting some of the key takeaways from presentations given by our Global, Asian, LatAm and CEEMEA strategists during their recent Emerging Market strategy roadshow in Europe.

Globally, we remain positive on Emerging Markets. A combination of reasonable valuations, relative earnings resilience, good growth prospects, and supportive macro credentials keeps us Overweight. Also, we think emerging equities could be the beneficiary of much of the cheap money being supplied by central banks. Currently, we prefer CEEMEA and Emerging Asia to LatAm. Amongst our Emerging Market strategists, Andrew Howell in CEEMEA highlights the relative valuation attractions of the region. Russia, MENA and Turkey are his favoured markets. With LatAm at close to all time highs, our strategist Geoff Dennis is concerned valuations may not be sustainable in the near term. He prefers Mexico to Brazil. Both strategists expect earnings to be relatively resilient. Robust commodity prices remain important here.

Our Asia ex Japan strategist, Markus Rosgen, is more cautious. Valuations still look too high and earnings risk is significant. He expects the region to fall back to trend, a 10%+ decline from here. Failure to hold this trend would imply substantially greater downside potential. His preference is for cheap markets, such as Taiwan and Korea, where expectations are low.

### Global Emerging Market View

**Emerging Markets to Outperform for eighth consecutive year**

Emerging Markets have outperformed for seven consecutive years now and we think they can outperform again in 2008. Our bullish view is based on a number of drivers, including (1) relatively resilient economic and earnings growth, (2) valuations that suggest the region is not overly expensive, and (3) Emerging Markets are a likely beneficiary of much of the cheap money being pumped into the financial system right now. We discuss each of these drivers below.

For 2008, our economists forecast the slowest year of global growth (2.8%) since 2003. In comparison to the past 20 years, this would be a relatively mild downturn. Developed markets have seen the greatest downgrades to expectations. Over the last six months, 2008 GDP forecasts for the US have come down from 2.5% to 0.8%. Similar declines have been seen in Europe — the UK from 2.8% to 1.4% and the Euro zone from 2.3% to 1.3%. In comparison, the downgrades to Emerging Market GDP forecasts have been more modest. Six months ago our Emerging Market economists forecasted 2008 real GDP to grow by 6.9%. Now the forecast stands at 6.1%. This is broadly trend growth. While our economists do not subscribe to the decoupling argument, they do believe that Emerging Market economies are far better positioned to deal with a developed market slowdown than in previous cycles.

The supportive macro backdrop for Emerging Markets should ensure greater earnings resilience than elsewhere. IBES consensus expectations are for 14.8% earnings growth in 2008. While we suspect this will prove to be too high, the likely downgrades should be small compared to the earnings downgrades we forecast elsewhere.

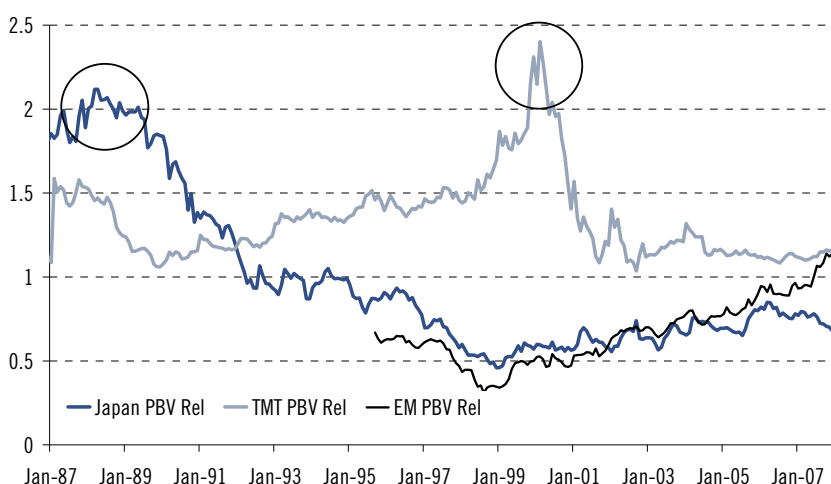
For example, consensus expectations are for US earnings to grow by almost 15% in 2008, whereas our top-down forecast is for earnings to contract by 1%. So while there is some earnings risk in Emerging Markets, we think the real risks are elsewhere.

Despite outperforming for seven consecutive years, Emerging Market valuations still remain reasonable, albeit not as attractive as they once were. On trailing PBV and PE measures, they trade at small premiums to the Global index. While some Emerging Markets, such as China and India, undoubtedly look expensive, the aggregate index is not in bubble territory as some investors have suggested. Figure 2 highlights this when comparing current relative valuations with previous equity market bubbles.

Valuations for Emerging Markets are not at bubble levels

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**Figure 2. Previous Equity Market Bubbles vs Emerging Markets Now**



Source: DataStream, Citi Investment Research

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Given the relative growth attractions, there is the potential for Emerging Markets to benefit from much of the liquidity currently being pumped into the financial system. Previously, when central banks have cut rates, the liquidity has helped create a bubble somewhere. The easy liquidity during the late 1980s, especially after the 1987 crash, helped fuel the Japanese bubble. Japan traded on a 100% premium to world equities. The easy liquidity during the late 1990s, especially after the LTCM/Russia default, helped fuel the TMT bubble. TMT peaked out at almost a 150% premium to world equities. Could cheap money help fuel a bubble in Emerging Markets this time?

## Asia ex Japan

### Long-term growth story priced in

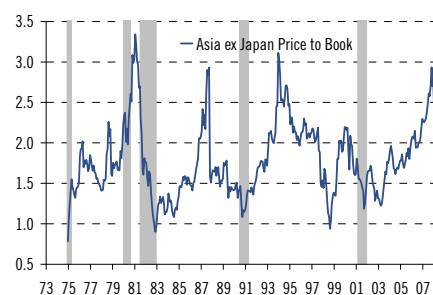
Our Asia ex Japan Strategist, Markus Rosgen, is cautious on his region. He likes the long-term growth story, but believes that this is already in the price. Valuations need to decline before he becomes more positive.

A good rule of thumb has been to sell the region when it hits 3x PBV (Figure 3). This is proving to be correct again. Even after the recent pullback, at 2.4x the PBV is still 46% above the average lows seen during the last two US recessions, when PBVs fell to 1.4x (1990/91) and 1.2x (2001). Downside risk on this measure remains.

### Valuations still high

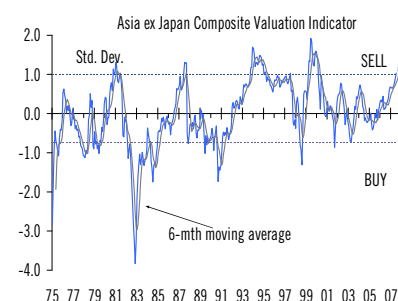
On a broader composite valuation measure, which includes an equally weighted index of trailing PBV, PE and dividend yields, a similar picture emerges. Not as expensive as it was, but still not at buy levels either (Figure 4).

Figure 3. Asia ex Jp PBV & US Recessions



Shaded periods mark US recessions.  
Source: NBER, Citi Investment Research

Figure 4. Asia ex Jp Composite Valuation



Source: MSCI, Citi Investment Research

On a normalised basis, using a return to the 10-year average ROE, Asia ex Japan PEs are close to 23x. This is almost 30% above the 10-year average (Figure 5). Within the region, markets looking most expensive on this measure are Indonesia, India, Malaysia and Hong Kong. The cheapest are Korea and Taiwan.

Figure 5. Implied PE vs 10-Year Average by Market

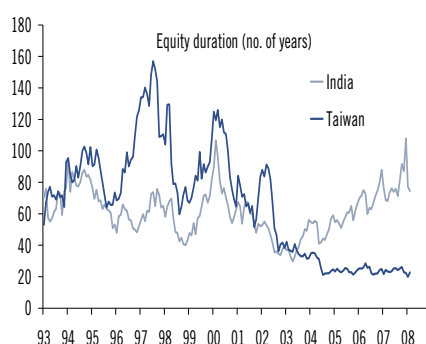
	Normalized P/E (implied by a return to 10Y avg ROE)	10-year average Normalized P/E*	Normalized P/E vs. 10-yr average (%)
Asia ex Jp	22.8	17.9	27.5
Australia	19.7	22	-10.2
China	32.8	n/a	n/a
HK	20.4	14.1	45
India	29.1	19.1	52.8
Indonesia	33.4	21.1	58.4
Korea	15.5	21	-26.2
Malaysia	28.1	19.1	46.9
Philippines	32.3	17.3	87
Singapore	21.6	19.4	11.3
Taiwan	20.3	19.3	5.3
Thailand	20	18.6	7.6

Source: MSCI, IBES, Citi Investment Research

At a sector level Technology, Telecoms and Banks look cheap. Real Estate, Industrials and Energy are expensive.

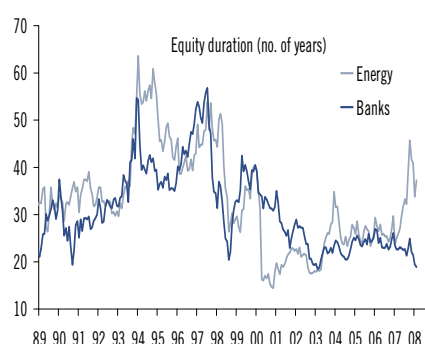
Using dividend duration (price to dividend ratio) as a valuation measure Markus highlights the attractions of markets / sectors where the pay-back period (assuming no growth in dividends or change in payout ratio) is short and therefore attractive. Taiwan's has fallen from 160 years to just 22 years, but India at just under 80 years is the highest in Asia (Figure 6). Hong Kong and Malaysia also look cheap on this measure. At the sector level, Energy has the highest dividend duration. Banks at less than 20 years are as low as they ever have been (Figure 7).

Figure 6. India & Taiwan Dividend Duration



Source: MSCI, IBES, Citi Investment Research

Figure 7. Energy & Banks Dividend Duration



Source: MSCI, IBES, Citi Investment Research

Markus also believes consensus earnings growth expectations are too high (10.6% in 2008E). An acceleration in downward revisions is expected in Q2 and Q3 as global growth slows. A major weight on profitability is the region's terms of trade. Rising commodity prices have meant that import prices are rising faster than output prices, which suggest margins could be squeezed.

**Focus on low expectation markets and sectors**

Overall, Markus favours markets and sectors where expectations are low and cashflows and dividend yields are high. Taiwan, Korea, Hong Kong and Malaysia are attractive on this basis. China, India, Singapore and Indonesia are to be avoided. At the sector level, Telecoms, Utilities, Consumer and Banks are favoured over more cyclical areas.

## Latin America

**Best performing EM region**

Geoffrey Dennis, our Latin American strategist, notes that his region has been the strongest performing of the Emerging Markets since the market peak in 4Q 2007, even hitting a new all-time high at the end of February. Robust commodity prices, improving macro fundamentals, strong domestic demand growth in Brazil, and perceived lower risk of earnings downgrades have supported LatAm. A continuation of these solid fundamentals means that the long-term prospects for the region remain positive. However, in the short term general uncertainty on the global economic outlook and higher valuations make the region vulnerable should global markets correct again.

Strong performance has pushed LatAm valuations into expensive territory relative to their history. The 12-month forward PE is now 12x, which is just over 10% above the historical average, but not too stretched if you factor in the lower cost of capital. Other valuation measures are less supportive. The forward EV/EBITDA at 7.4 times is roughly 40% higher than the historical average (Figure 8). Meanwhile the trailing P/BV is 3.3x, a 90% premium to its recent average (Figure 9). Even adjusting for high ROEs, it is still at a 10% premium. Any earnings downgrades will pull ROEs lower, warranting lower valuations. Earnings are clearly the key if these high valuations are to be justified. Current expectations are for 22% earnings growth in 2008E in LatAm, down from 29% in 2007, but still solid. Given high commodity prices and firmer domestic demand, Geoff sees limited earnings risk going forward, so long as there is not a prolonged, deep US recession and a sharp slowdown in global growth.

Figure 8. LatAm Fwd. EV/EBITDA



Source: Citi Investment Research

Figure 9. LatAm Trailing Price to Book



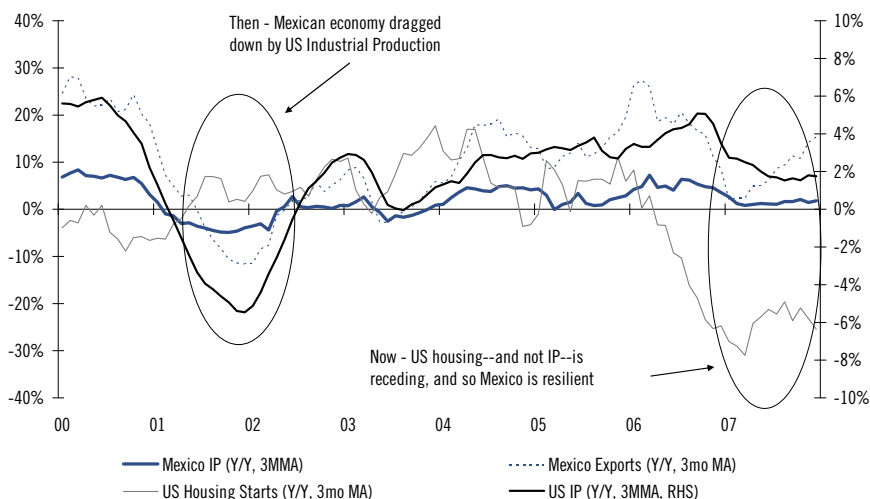
Source: IFC/S&P, MSCI, Citi Investment Research

### Mexico favoured

Mexico is the most favoured market within the region. It remains one of the highest exposed economies to the US — US exports as a share of GDP are 23% versus just 2.3% in Brazil. This is far higher than all other EM economies, except Malaysia, and was one of the reasons why the market performed poorly in 2007. Despite this, we believe there are a number of reasons why Mexico should do well from here.

First, the Mexican economy should be more resilient to the current US economic slowdown than in the last cycle. The present weakness in the US is being driven by the housing sector. The industrial sector, where Mexican companies are more exposed, remains sound. This is the opposite of what we saw in the early 2000s, when the US was in a manufacturing recession, but housing activity remained robust (Figure 10). This had a much bigger negative effect on the Mexican economy.

**Figure 10. Mexico Sensitivity to US Growth**



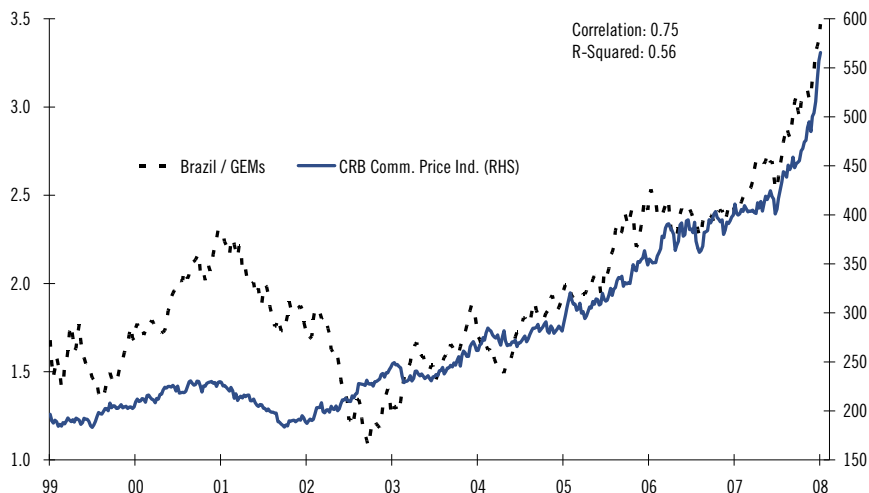
Source: DataStream, Citi Investment Research

Second, the Mexican currency has not appreciated vs the US, so the export sector has remained competitive. Finally, Mexican authorities can use counter-cyclical fiscal or monetary policy to help offset any weakness from a US recession. This is a real option now given a sound fiscal position and controlled inflation. Within the market, Consumer Staples, Industrials and Telecoms are the favoured sectors.

**Commodity prices key to Brazil**

Much of the strong performance of LatAm has come from Brazil, which makes up two-thirds of the region's market cap. The main driver of Brazilian performance has been commodity prices (Figure 11). The close correlation between Brazil and commodities is understandable given just under 60% of the index is in either the Energy or Materials sector. An obvious potential risk for Brazil and LatAm is a correction in commodity prices, particularly if the US\$ were to appreciate. However, over the medium term we believe commodity prices will remain strong. Coupled with a buoyant domestic economy, the longer-term prospects for the market remain sound. We remain Overweight, but less so than in Mexico. Preference within the market is for defensive domestic plays, such as Consumer Staples, Financials, Industrials and Utilities, over the commodity cyclical sectors.

Figure 11. Brazil Relative & Commodity Prices



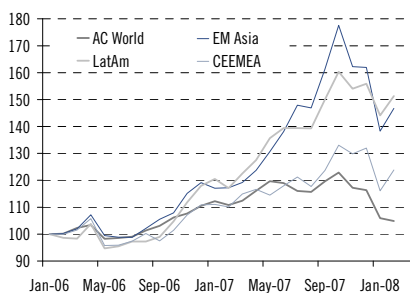
Source: MSCI, DataStream, Citi Investment Research

## CEEMEA

### The performance laggard

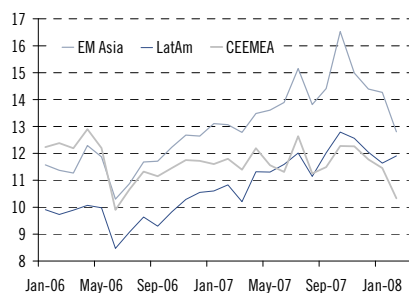
CEEMEA (Central & Eastern Europe, Middle East and Africa) has been the laggard Emerging Market region. It has underperformed LatAm and EM Asia by 27% and 23%, respectively, since the start of 2006 (Figure 12). Andrew Howell, our CEEMEA strategist, believes the region offers relative value within Emerging Markets. It is long commodities and less directly exposed to the US. Earnings are expected to be resilient.

Figure 12. MSCI EM Performance



Source: MSCI, Citi Investment Research

Figure 13. EM 12 Month Forward PE



Source: IBES, Citi Investment Research

### Valuation discount

CEEMEA's 12 month forward PE is 10.3x versus 11.9x in LatAm and 12.8x in Asia ex Japan. The region has suffered a dramatic de-rating relative to its peers, having traded at a premium to both as recently as mid 2006 (Figure 13). The de-rating of CEEMEA has been broad based. In early 2006 all of the major sectors were trading at a premium to their Emerging Market peers. Now, just one, Materials, is trading at a premium. Telecom valuations are in line, while Industrials, Financials and Energy all trade at sizeable discounts.

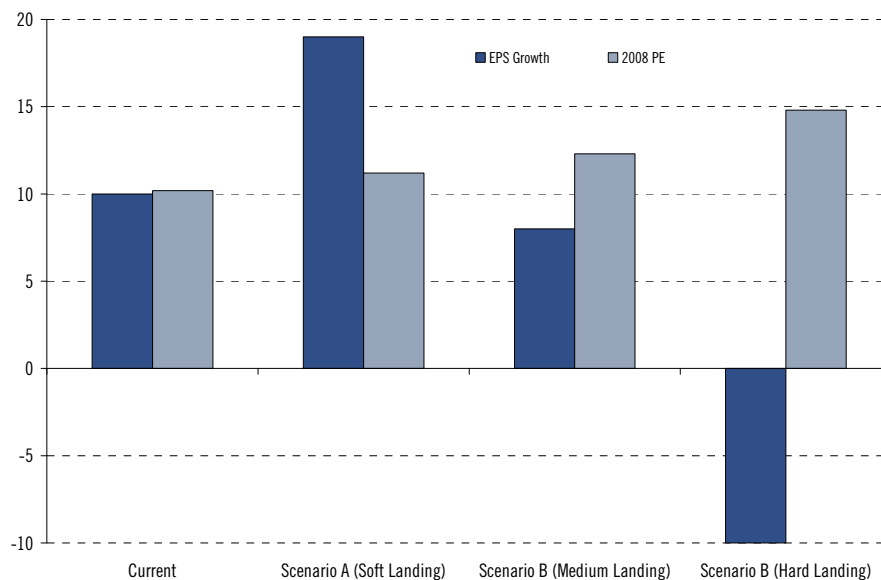
Perhaps a reason why CEEMEA has underperformed is because the region lacks a marketable name. Investors know where LatAm and Asia are, but are not quite sure where CEEMEA is. Certainly the region has seen fewer investment inflows than its peers. More recently, widening credit spreads, current account deficits (especially in E.Europe), inflation concerns, and Russian oil sector taxation have all weighed on sentiment towards the region.

Exposure to the US is low compared to other emerging regions. For example, US exports make up about 3% of Emerging European GDP, 7% of Middle East GDP, and 8% of African GDP. This compares to almost 9% for Asia and over 11% for all of LatAm. The lack of exposure to the US should support relatively resilient earnings. Another support for earnings is commodity prices. 40% of CEEMEA market cap is in commodity related sectors. We think commodity prices will remain robust and so should provide support to earnings.

**Limited earnings risk?**

Our analysts' earnings assumptions were tested to see how sensitive they are to different economic scenarios (Figure 14). At the moment, our analysts expect 2008 earnings to grow by 10%. In a scenario where the US flirts with recession in the first half and recovers during the rest of the year, while commodity prices remain higher than currently forecast, our analysts would have to upgrade their growth expectations to 19%. In a second scenario, it was assumed that the US economy does not recover and Europe slows more markedly but avoids recession. The global economy only begins to recover in 2009. If this was to occur, our analysts would have to downgrade their forecast to 8%. The final scenario assumed recession in the US and Europe for much of 2008, lower commodity prices, and slower emerging market GDP growth. Against this backdrop, our analysts believe earnings could fall by 10%.

**Figure 14. CEEMEA 2008E Earnings Growth and PE Under Different Scenarios**



Source: Citi Investment Research

Even under the worst-case scenario, with a 10% fall in earnings, the region does not look terribly expensive at less than 15x 2008E PE.

### Prefer Russia, MENA and Turkey

At the market level, Andrew likes Russia, MENA (Middle East & North Africa) and Turkey. Russia has been held back recently because of a heavy IPO pipeline, with over \$30bn raised in 2007. This looks to be clearing, which should remove an impediment to performance. The political outlook has been clarified and earnings should be robust so long as commodity prices remain high. It is largely insulated from the global credit crunch. Despite this, it remains easily the cheapest of the BRIC markets.

MENA remains one of the least correlated equity markets with the MSCI ACWI. Much of this is due to the closed nature of many of these markets. However, this is changing. MSCI has introduced a Frontiers index, which includes most of these markets. As markets open up, we should see larger international flows into MENA. Although performance has been good recently, valuations remain attractive and considerably cheaper than in 2006. Strong domestic economies (especially amongst the oil producers), low real interest rates, and solid earnings growth are additional supports for the region. Preferred markets are UAE, Qatar and Egypt.

Andrew is also Overweight in Turkey, but feels there is no rush to buy the market at the moment. It has been the worst performer in his region over the past 12 months. Although the economy is vulnerable to a European slowdown and the geopolitical background remains volatile, this looks to be priced in. Turkey trades at a PBV of less than 2x, its cheapest since 2005, yet profitability is high with ROEs of more than 20%.

## Summary

Globally we expect Emerging Markets to continue to outperform. A combination of reasonable valuations, relative earnings resilience, good growth prospects, and supportive macro credentials drives this view. Also, we think emerging equities could be the beneficiary of much of the cheap money being supplied by central banks. Near term, uncertainties on the economic and earnings outlook and continuing liquidity problems in financial markets may well weigh on absolute performance during the first half of this year. But as these uncertainties unwind, the scene should be set for a more positive outlook later in the year for Emerging Markets and equities in general. Within Emerging Markets, we prefer CEEMEA and Emerging Asia to LatAm.

Our Emerging Market strategists are more optimistic on those regions that are exporters of commodities — CEEMEA and LatAm — than those that are importers — Asia ex Japan. Earnings are expected to remain more resilient in the former, so long as commodity prices remain strong. Valuations, an extended period of underperformance, and lower exposure to the US economy favours CEEMEA over LatAm near term. Markus Rosgen is more cautious on Asia ex Japan. While the long-term growth story remains intact, valuations still look too high and earnings risk is significant.

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# Macro Out-takes

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*We provide brief summaries of our colleagues' most recent work. Please let us know if you would like more detail.*

## Regional Strategy

Latin America  
Geoffrey Dennis  
24-Mar-08

### Latin America Strategy Notebook: "The Infrastructure Opportunity"

Ambitious infrastructure programs have been announced across Latin America, supported by the strength of the commodity cycle. The total annual size of regional infrastructure spending is now running at \$35-\$40 billion and rising, which should help boost GDP growth in Latin America at a time when the global economic cycle seems vulnerable. Beneficiaries, over time, should include Mexican construction and materials stocks ICA, Cemex, PASA, Mexichem and IDEAL, and Colombia's Cementos Argos. Brazilian toll road companies and utilities are in what we call the "wait-and-see" camp, with the benefits depending on the economics of each specific project. Finally, Mexican airports Asur and GAP would likely lose out long term if competing airports cannibalize their territories. Latin American markets are (just about) retaining their outperformer status. Overall, the current corrective phase in global markets is unlikely to be over yet; we still look for a global low around mid-2008. Latin America, while exhibiting some ability to "de-couple" (such as Brazil's economy), will remain hostage to global events.

Japan  
Patrick Mohr  
21-Mar-08

### Incredible: "Market, styles, currencies buffeted by credit market convulsions"

The Fed's indirect bailout of Bear Stearns reflects extreme measures for extreme times. Ironically, Japanese bank stock performance vs. TOPIX during the crisis was positive. We retain our overweight view of the bank sector. The yen/dollar rate hit a 12 year low, while correlation of TOPIX with the yen/dollar rate is near a record high. In local terms Japan is again one of the worst performing markets year to date (as of March 18). Four categories of style outperformance are being observed: solvency (balance sheet quality), price/free cashflow (attractively valued cash generation), high individual shareholding levels (avoid foreign selling), and earnings revision styles (reward positive revisions). We continue to believe Japan should benefit from a rebound of global equity markets in the second half of the year, but in the near term we expect more credit market dislocations. In light of the credit crunch and yen strength we are trimming export exposure and increasing exposure to net cash and free cashflow. We add Fuji Television and remove Mazda from our model portfolio.

US  
Tobias Levkovich  
20-Mar-08

### Monday Morning Musings: "The Case for Crumbling Commodities"

The investment community might be in the process of recognizing some disquieting factors about commodities-focused portfolios that may have been overlooked as momentum-driven strategies dominated the past several months. Powerful performance in commodities over the last couple of years raises the plausibility that aggressive assumptions have further driven up prices that appear to be on the verge of correcting meaningfully as de-leveraging in various asset classes continues to play out. Moreover, industries including related resource extraction equipment and engineering services, which are appropriately perceived as significant beneficiaries, also face downward revaluation potential.

Europe  
Jonathan Stubbs  
19-Mar-08

## UK/European Equity Strategy: “Crisis of Confidence”

Fed-sponsored bail-outs are synonymous with the spectre of systemic risks. LTCM in 1998. Bear Stearns in 2008. At the root of crisis in financial markets is too much leverage and too little liquidity. Against some instruments, e.g. index-linked and short-dated government debt, it is hard to see equities offering anything but good value to an investor with a reasonable investment horizon. Against other asset classes, such as cash and benchmark bonds, equities also appear to offer investors a decent investment opportunity at the moment, but not by the same extreme measures. We stick with our knitting and continue to advocate an investment strategy that attempts: first, to avoid (or short) leverage, and second, to look for exposure to growth. This has been our investment mantra over the past 6-9 months: “short leverage/long growth”. We also continue to back the free-rider strategy.

## Economics

Economics  
Lewis Alexander  
20-Mar-08

### Global Economic Outlook and Strategy

Broad and deep deleveraging in core financial markets is generating significant volatility and generally higher risk premia. Tighter financial conditions will be a significant drag on the U.S. and other economies for some time. Aggressive actions by the Fed should help to limit the U.S. slowdown, but the outlook is subject to heightened uncertainty. We expect the Fed to continue easing aggressively, taking the funds rate down to 1%. Emerging economies are also expected to slow in coming quarters, but policy offsets should limit the impact of the U.S. led slowdown on the emerging world. We have revised down markedly our growth forecast for 2008-09, reflecting slower global growth and the persistent tightening of financial conditions. The U.S. recession is likely to be deeper than previously expected, with growth staying below trend until late 2009. European growth is likely to slow below trend this year, with little or no recovery in 2009 unless financial conditions improve sharply. Emerging Markets growth remains likely to outperform industrial countries by a wide margin in 2008 and 2009. This will cushion the industrial country slowdown, but also reduces the extent to which the slowdown will yield the usual disinflationary windfall of large commodity price declines. Our forecasts for industrial country growth are lower almost everywhere, with U.S. growth now expected to be a little below 1% year over year in both 2008 and 2009, versus previous forecasts of 1.6% and 2.1%, respectively. Our forecasts for growth in the Euro area, the United Kingdom, and Japan are marked down by similar amounts, with growth in all main industrial countries converging to about 1% next year. If our forecasts are correct, 2008 and 2009 will be the first years in over three decades in which every G7 country has fallen short of 2% growth. We further revised down Asian forecasts, and now expect GDP growth to be 9.8% in China and 7.7% in India, compared with our forecasts of 11% and 9.3%, respectively, at the start of the year.

## Market Outlook

We expect the direction of equity markets in 2008 to reflect the conflict between two contradictory forces — potentially substantial earnings downgrades and increasingly attractive valuations. We think that valuations should win out (just) over the course of the year, but that economic and earnings headwinds may mean that markets may struggle to find a floor in the first half of the year. The impact of aggressive monetary easing and more realistic earnings expectations should set the scene for better performance in the second half. However, it will continue to be a volatile ride for investors.

GDP	2007	2008E	2009E
Global	3.9	2.7	2.6
Euro zone	2.6	1.3	1.1
US	2.2	0.8	0.9
EM	7.2	6.1	5.8
Japan	2.1	1.7	1.0
Asia	8.7	7.5	7.4

CPI	2007	2008E	2009E
Global	3.0	3.8	2.8
Euro zone	2.0	2.0	1.7
US	2.9	3.7	1.9
EM	5.2	6.5	5.2
Japan	0.0	0.7	0.2
Asia	4.1	5.1	3.4

Interest Rates	Current	2Q08	4Q08
ECB	4.00	3.75	3.25
US Fed Funds	2.25	1.50	1.00
UK Base	5.25	4.75	4.25
Japan Call	0.50	0.50	0.50

10Yr Yield	Current	2Q08	4Q08
Euro zone	3.85	3.75	3.85
US	3.50	3.50	3.80
UK	4.37	4.30	4.40
Japan	1.26	1.40	1.30

Ex Rates	Current	2Q08	4Q08
US\$/€	1.55	1.60	1.60
US\$/£	1.99	1.96	1.92
€/£	1.28	1.22	1.20
¥/US\$	101	98	95

Source: Factset, Citi Investment Research

## Regional Strategy

We are Overweight Emerging Markets and Europe ex UK, which, in our view offer the best combination of relative earnings momentum, valuation attractions, and exposure to growth. We remain Neutral on UK and Japan. We are Underweight US and Developed Asia Pac.

## Sector Strategy

At a sector level, we are Overweight sectors that exhibit the combination of strong growth and low risk. Or preferred sectors are Energy, Materials and Telecoms. Our Underweights are dominated by expensive defensives Consumer Staples and Utilities and the over-leveraged Financial sector.

## Risk

The biggest risk to our strategy is a deeper, broader and more sustained slowdown in the global economy than the market is currently discounting. Even after recent falls, equities would be vulnerable if such a scenario was to unfold. Valuations, however, provide a considerable degree of downside protection if this was to occur.

Figure 15. Regional And Global Sector Recommendations

Overweight	Neutral	Underweight
Emerging Markets	UK	US
Europe ex-UK	Japan	Developed Asia Pac
<b>Overweight</b>	<b>Neutral</b>	<b>Underweight</b>
Energy	Industrials	Financials
Materials	Health Care	Consumer Staples
Telecoms	Consumer Disc.	Utilities
	IT	

Source: Citi Investment Research

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# Market Intelligence

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Figure 16. Market Intelligence by Region

21 Mar 08	Free MC US\$bnn	Wgt %	P/E			EPS YoY %			P/B	ROE	Div Yld	EV/ Sales	EV/ EBITDA	Perf % (local)						
			07E	08E	09E	07E	08E	09E						08E	08E	08E	07	07	Weekly	YTD
<b>Global</b>	<b>28,301</b>	<b>100</b>	<b>13.4</b>	<b>12.2</b>	<b>10.9</b>	<b>4.9</b>	<b>10.6</b>	<b>12.5</b>	<b>2.0</b>	<b>15.3</b>	<b>3.2</b>	<b>1.7</b>	<b>8.7</b>	<b>0.2</b>	<b>-13.8</b>					
Developed World	25,182	89.0	13.4	12.3	11.0	3.6	10.1	12.3	2.0	15.1	3.2	1.7	8.8	0.6	-13.7					
Emerging World	3,119	11.0	13.5	11.8	10.4	18.6	14.8	14.5	2.2	16.9	3.1	1.8	7.9	-3.0	-15.1					
<b>North America</b>	<b>13,151</b>	<b>46.5</b>	<b>15.3</b>	<b>13.8</b>	<b>12.1</b>	<b>-0.5</b>	<b>14.3</b>	<b>14.9</b>	<b>2.3</b>	<b>16.3</b>	<b>2.6</b>	<b>1.9</b>	<b>9.4</b>	<b>2.4</b>	<b>-9.3</b>					
USA	12,105	42.8	15.5	13.9	12.2	-1.0	14.6	15.3	2.4	16.2	2.6	1.9	9.4	3.0	-9.5					
Canada	1,046	3.7	13.2	12.0	11.0	6.7	10.0	10.2	2.1	17.3	2.9	2.4	8.8	-3.5	-7.4					
<b>Europe</b>	<b>8,313</b>	<b>29.4</b>	<b>11.2</b>	<b>10.3</b>	<b>9.4</b>	<b>6.1</b>	<b>7.4</b>	<b>10.1</b>	<b>1.8</b>	<b>16.1</b>	<b>4.3</b>	<b>1.5</b>	<b>8.0</b>	<b>-2.1</b>	<b>-17.6</b>					
United Kingdom	2,598	9.2	11.3	10.3	9.5	6.5	4.5	8.2	2.0	17.0	4.3	1.5	7.8	-2.4	-14.9					
Europe ex UK	5,716	20.2	11.1	10.4	9.4	5.9	8.7	11.0	1.7	15.8	4.3	1.5	8.0	-2.0	-18.9					
France	1,282	4.5	11.0	10.1	9.2	1.2	10.8	9.9	1.6	14.6	4.2	1.2	7.7	-1.5	-18.8					
Germany	1,083	3.8	10.7	10.4	9.3	21.6	4.2	13.0	1.6	14.8	3.9	1.3	7.2	-2.4	-21.6					
Switzerland	862	3.0	13.6	11.7	10.5	-13.7	26.6	11.9	2.1	17.8	3.5	2.2	10.8	-1.9	-17.5					
Spain	530	1.9	11.7	10.4	9.3	18.1	12.9	12.0	2.0	18.7	4.9	2.4	10.5	0.0	-15.5					
Italy	454	1.6	9.6	9.0	8.3	3.1	6.7	8.8	1.3	13.9	6.2	1.6	5.6	-4.2	-21.9					
Netherlands	342	1.2	10.3	10.2	9.3	8.3	0.7	9.9	1.7	16.8	4.4	1.4	8.2	-0.3	-16.3					
Sweden	282	1.0	10.9	10.6	9.7	-2.3	1.5	8.5	1.9	16.8	4.9	1.5	9.7	-3.6	-16.8					
Finland	209	0.7	12.3	11.3	10.4	49.7	-8.8	8.6	2.5	21.8	4.2	1.4	12.3	-6.6	-23.4					
Belgium	154	0.5	9.4	9.1	8.2	-6.7	2.9	11.8	1.3	13.5	5.5	1.0	7.8	-0.5	-13.4					
Norway	123	0.4	10.9	10.4	9.2	-9.6	4.6	12.9	2.0	19.1	4.1	1.6	6.9	-2.7	-19.7					
Denmark	119	0.4	15.2	13.6	12.0	14.1	11.7	13.7	2.4	17.5	1.9	1.8	8.6	-1.3	-12.2					
Ireland	86	0.3	7.4	8.4	8.1	11.1	4.2	4.1	1.2	17.1	4.9	1.1	9.1	5.2	-9.1					
Greece	81	0.3	11.0	9.9	8.3	27.0	11.5	18.7	2.0	18.5	4.6	1.7	8.8	-3.3	-27.2					
Austria	69	0.2	9.4	8.5	8.1	9.2	10.4	11.4	1.6	12.8	3.5	1.4	6.8	-5.1	-21.5					
Portugal	40	0.1	13.2	12.2	11.1	-7.3	8.3	10.1	2.2	14.8	5.0	2.6	9.5	-1.2	-23.1					
<b>Japan</b>	<b>2,558</b>	<b>9.0</b>	<b>13.6</b>	<b>12.8</b>	<b>11.7</b>	<b>8.6</b>	<b>8.9</b>	<b>9.0</b>	<b>1.3</b>	<b>9.7</b>	<b>2.0</b>	<b>1.2</b>	<b>8.6</b>	<b>1.8</b>	<b>-18.1</b>					
<b>Asia Pac ex JP</b>	<b>2,791</b>	<b>9.9</b>	<b>13.9</b>	<b>12.8</b>	<b>11.3</b>	<b>16.0</b>	<b>7.5</b>	<b>13.9</b>	<b>2.1</b>	<b>15.5</b>	<b>3.6</b>	<b>1.8</b>	<b>8.9</b>	<b>-1.6</b>	<b>-19.4</b>					
Pacific ex JP	1,159	4.1	13.6	13.2	11.7	11.4	-1.2	12.5	2.0	14.6	4.5	2.9	11.2	-1.9	-20.2					
Australia	753	2.7	13.6	12.5	11.1	6.2	9.0	12.0	2.2	17.1	4.9	3.0	11.5	-1.4	-19.2					
Hong Kong	256	0.9	14.5	16.2	13.9	27.0	-25.4	15.4	1.7	9.6	3.4	3.1	10.5	-4.5	-24.8					
Singapore	135	0.5	12.6	12.9	11.5	17.9	-4.6	11.8	1.8	13.1	4.1	2.0	11.6	0.1	-16.8					
EM Asia	1,632	5.8	14.2	12.5	11.0	20.1	14.7	14.9	2.1	16.1	2.9	1.6	8.1	-1.3	-18.8					
Korea	425	1.5	12.4	10.9	9.6	9.3	12.8	12.9	1.6	13.9	2.0	0.8	5.7	3.6	-12.8					
China	405	1.4	15.3	13.0	11.2	29.6	18.8	16.3	2.4	18.0	2.9	2.1	9.1	-8.4	-31.9					
Taiwan	381	1.3	13.4	12.6	11.5	25.6	8.3	13.5	2.0	16.1	4.6	1.5	7.4	4.6	-1.0					
India	219	0.8	18.9	16.3	13.3	16.0	20.0	23.4	3.0	18.5	1.3	2.6	10.4	-5.9	-28.9					
<b>Latin America</b>	<b>708</b>	<b>2.5</b>	<b>13.7</b>	<b>12.0</b>	<b>10.3</b>	<b>13.9</b>	<b>14.3</b>	<b>15.8</b>	<b>2.6</b>	<b>19.5</b>	<b>3.5</b>	<b>2.4</b>	<b>8.0</b>	<b>-4.9</b>	<b>-9.0</b>					
Brazil	450	1.6	13.1	11.3	9.7	15.4	13.0	16.6	2.5	20.9	3.3	2.4	7.6	-6.8	-11.9					
Mexico	158	0.6	14.4	12.9	11.3	12.0	14.5	14.5	3.7	16.9	3.9	2.3	9.1	-0.5	-3.3					
Chile	44	0.2	19.4	15.8	13.5	10.8	29.8	17.0	1.9	11.9	3.2	2.4	10.2	0.0	-6.1					
Peru	23	0.1	13.4	11.6	12.1	8.8	15.8	-4.7				4.9	10.1	-6.2	4.2					
Argentina	17	0.1	10.9	9.1	7.0	7.9	16.7	24.1	1.6	18.0	1.8	1.6	5.5	-7.0	-1.5					
Colombia	14	0.1	22.9	16.6	14	19.6	38.1	17.9			3.6	3.6	16.3	-0.7	-13.3					
<b>CEEMEA</b>	<b>779</b>	<b>2.8</b>	<b>12.3</b>	<b>10.5</b>	<b>9.2</b>	<b>19.1</b>	<b>15.2</b>	<b>12.8</b>	<b>2.0</b>	<b>17.3</b>	<b>3.1</b>	<b>2.0</b>	<b>7.4</b>	<b>-4.5</b>	<b>-11.9</b>					
Russia	312	1.1	11.4	9.8	9.0	19.9	16.5	9.0	1.8	18.2	1.9	2.5	7.0	-5.5	-16.1					
South Africa	200	0.7	13.2	10.6	9.1	19.7	24.0	17.5	2.6	15.1	4.0	1.8	7.7	-5.9	-1.3					
Israel - Domestic	70	0.2	15.2	13.6	10.2	3.9	11.8	12.7	1.9	16.6	4.8	1.9	11.1	-2.5	-13.4					
Poland	53	0.2	11.5	11.1	10.6	15.4	0.1	15.3	2.2	16.6	4.2	1.1	6.4	-0.3	-18.1					
Turkey	42	0.1	8.7	7.7	6.5	48.5	5.4	18.7	1.5	17.5	3.9	1.1	6.4	-7.1	-29.1					
Egypt	30	0.1	17.5	14.2	15.8	42.1	-0.2	19.3	3.6	22.3	3.3	3.3	8.5	-3.4	2.3					
Czech Republic	27	0.1	16.8	14.4	12.9	42.2	16.5	12.0	2.8	19.3	4.1	2.9	7.8	1.6	-12.0					
Hungary	23	0.1	9.6	8.8	8.3	-13.9	8.4	5.9	1.7	19.8	4.0	1.5	6.4	0.4	-18.5					
Morocco	13	0.0	29.3	23.3	19.4	27.4	25.6	0.5	9.7	49.8	5.1	2.4	9.2	-0.7	24.8					
Israel - Non Domestic	6	0.0	15.7	14.1	12.5	26.0	11.8	12.7	3.0	18.0	7.0	6.3	10.4	3.1	1.0					
Jordan	3	0.0	19.4			-7.9						1.2	7.5	-2.0	1.9					

E = I/B/E/S estimates Source: I/B/E/S, Worldscope, MSCI, Citi Investment Research

Figure 17. Market Intelligence by Sector

21 Mar 08	Free MC US\$bn	Wgt %	P/E			EPS YoY %			P/B	ROE	Div Yld	EV/ Sales	EV/ EBITDA	Perf % (local)	
			07E	08E	09E	07E	08E	09E						08E	08E
<b>Global</b>	<b>28,301</b>	<b>100</b>	<b>13.4</b>	<b>12.2</b>	<b>10.9</b>	<b>4.9</b>	<b>10.6</b>	<b>12.5</b>	<b>2.0</b>	<b>15.3</b>	<b>3.2</b>	<b>1.7</b>	<b>8.7</b>	<b>0.2</b>	<b>-13.8</b>
<b>Level One</b>															
Energy	3,259	11.5	11.8	10.3	9.8	5.1	13.8	5.2	2.2	20.8	2.5	1.4	6.6	-5.4	-13.8
Materials	2,376	8.4	12.2	11.3	10.3	11.8	8.2	10.0	2.1	17.7	2.7	1.9	8.7	-6.2	-10.2
Industrials	3,207	11.3	14.5	13.1	11.7	16.7	10.5	12.3	2.2	16.1	2.6	1.6	10.2	-0.5	-13.7
Consumer Disc.	2,608	9.2	13.7	12.6	11.1	17.2	13.3	15.9	1.7	12.6	2.9	1.3	8.0	2.2	-13.6
Consumer Staples	2,503	8.8	18.5	16.7	14.9	8.3	10.0	12.0	3.1	18.1	2.7	1.4	11.3	1.6	-7.5
Health Care	2,299	8.1	14.8	13.7	12.3	10.4	8.6	11.5	2.8	19.7	3.0	2.6	10.7	2.1	-12.3
Financials	6,245	22.1	11.0	10.2	8.9	-8.6	10.0	15.1	1.4	12.7	4.4	NA	NA	4.3	-16.0
IT	3,003	10.6	17.2	14.9	13.0	12.4	16.7	17.0	2.8	16.8	2.0	1.9	10.3	1.7	-16.1
Telecoms	1,497	5.3	13.6	12.6	11.2	12.7	5.9	12.2	1.9	14.4	4.7	2.4	7.1	-0.6	-18.8
Utilities	1,303	4.6	15.8	15.1	13.4	8.0	4.4	12.5	1.9	12.2	3.8	2.1	8.6	-1.5	-13.1
<b>Level Two</b>															
Energy	3,259	11.5	11.8	10.3	9.8	5.1	13.8	5.2	2.2	20.8	2.5	1.4	6.6	-5.4	-13.8
Materials	2,376	8.4	12.2	11.3	10.3	11.8	8.2	10.0	2.1	17.7	2.7	1.9	8.7	-6.2	-10.2
Capital Goods	2,441	8.6	14.5	13.0	11.5	17.9	12.0	13.0	2.2	16.5	2.6	1.5	10.7	-0.8	-15.0
Comm Svc & Supp	178	0.6	15.3	14.1	12.8	9.4	9.1	10.5	2.3	15.4	2.7	1.3	9.3	0.3	-7.9
Transport	589	2.1	14.3	13.2	12.0	13.8	4.8	10.1	2.0	14.5	2.5	1.7	8.8	0.7	-9.8
Autos	627	2.2	10.5	9.5	8.4	17.8	9.2	16.7	1.3	13.0	3.0	1.0	6.7	3.4	-16.7
Consumer Durables	462	1.6	14.4	13.1	11.8	19.0	29.9	18.5	1.7	11.6	2.3	1.1	8.6	0.9	-16.6
Consumer Services	337	1.2	17.0	15.7	13.9	22.6	7.6	13.1	2.8	15.6	3.1	2.4	11.4	0.8	-10.9
Media	642	2.3	15.6	14.2	12.5	15.0	14.2	15.4	1.7	11.2	2.9	2.3	8.2	0.9	-12.0
Retailing	540	1.9	15.5	14.4	12.8	11.0	7.8	13.0	2.4	14.4	3.2	1.0	8.6	4.7	-10.8
Food & Staples	624	2.2	18.1	15.7	13.8	7.5	15.0	13.7	2.1	13.3	2.2	0.7	9.7	3.1	-7.3
Food Bev & Tobac.	1,456	5.1	17.9	16.5	14.8	7.5	7.4	11.4	3.5	20.6	2.9	2.1	11.9	0.5	-7.6
Household Products	423	1.5	21.1	18.6	16.6	13.2	13.8	11.9	3.5	18.7	2.2	2.4	12.1	2.9	-7.5
Health Care	598	2.1	16.8	15.1	13.2	14.0	11.4	14.5	2.7	17.3	1.0	1.6	11.3	1.2	-15.8
Pharma & Biotech	1,702	6.0	14.2	13.3	12.0	9.4	7.7	10.6	2.9	20.7	3.6	3.4	10.5	2.4	-11.0
Banks	2,794	9.9	10.4	9.5	8.4	-5.3	9.3	14.1	1.4	13.7	5.1	NA	NA	3.2	-15.7
Div Financials	1,582	5.6	12.0	10.6	8.9	-28.9	27.8	19.6	1.4	12.6	4.0	NA	NA	7.7	-17.0
Insurance	1,267	4.5	9.6	9.4	8.4	4.2	-1.0	11.8	1.3	13.2	3.6	NA	NA	3.5	-15.1
Real Estate	602	2.1	17.4	17.7	15.8	16.9	-2.2	16.6	1.4	7.0	3.9	NA	NA	2.2	-16.1
Software & Services	984	3.5	20.0	17.0	14.7	23.8	17.9	15.2	3.8	22.1	1.7	3.6	12.1	2.3	-17.3
Tech	1,485	5.2	16.0	13.7	12.0	17.9	18.3	13.7	2.4	15.6	2.0	1.4	10.6	0.4	-16.6
Semi & Semi Equip	533	1.9	16.1	15.2	13.0	-14.2	9.7	32.7	2.4	14.4	2.4	2.3	8.0	4.0	-12.4
Telecom	1,497	5.3	13.6	12.6	11.2	12.7	5.9	12.2	1.9	14.4	4.7	2.4	7.1	-0.6	-18.8
Utilities	1,303	4.6	15.8	15.1	13.4	8.0	4.4	12.5	1.9	12.2	3.8	2.1	8.6	-1.5	-13.1

E = I/B/E/S estimates Source: I/B/E/S, Worldscope, MSCI, Citi Investment Research

Figure 18. 2008 P/E Estimates by Sector and Region

21 Mar 08 P/E 08E	World	US	Eur ex UK	UK	Japan	Dev Asia	Em Asia	Lat Am	CEEMEA
<b>Region</b>	<b>12.2</b>	<b>13.9</b>	<b>10.4</b>	<b>10.3</b>	<b>12.8</b>	<b>13.2</b>	<b>12.5</b>	<b>12.0</b>	<b>10.5</b>
Energy	10.3	10.8	8.5	9.1	10.3	16.7	11.5	9.9	8.9
Materials	11.3	14.2	11.1	10.5	10.3	11.7	10.5	10.0	11.0
Capital Goods	13.0	14.6	11.8	11.7	10.1	17.3	14.7	14.8	12.4
Comm Svc & Supp	14.1	13.4	11.6	14.2	18.9	17.2	15.0		
Transport	13.2	15.6	11.6	9.0	13.3	12.8	11.0	15.7	6.2
Autos & Components	9.5	14.2	8.9	8.4	9.6		9.8		6.4
Consumer Durables	13.1	14.4	12.6	7.4	13.9	13.7	10.9	14.2	10.5
Consumer Services	15.7	17.7	13.1	11.5	23.9	16.7	14.2		22.3
Media	14.2	15.4	11.1	14.4	20.4	13.4	18.3	16.4	13.3
Retailing	14.4	16.3	14.2	9.4	16.0	16.5	16.8	21.5	7.1
Food & Staples Retailing	15.7	16.0	14.7	14.1	15.7	18.6	19.2	20.1	12.7
Food Bev & Tobacco	16.5	16.7	16.4	15.4	23.1	14.4	15.0	18.7	11.4
Household Products	18.6	18.1	19.1	19.6	23.3		21.8	13.6	
Health Care Equip & Svc	15.1	14.6	17.9	20.7	16.5	19.0		29.0	12.2
Pharma & Biotech	13.3	13.6	13.6	10.4	13.3	26.6	18.8		17.1
Banks	9.5	14.3	7.8	7.7	10.4	10.9	11.5	10.3	9.3
Div Financials	10.6	12.3	7.4	9.8	12.4	11.4	13.0	18.5	7.9
Insurance	9.4	9.6	7.6	7.7	25.2	11.3	19.5		8.3
Real Estate	17.7	27.3	11.6	18.9	18.4	15.1	12.7	16.4	9.0
Software & Services	17.0	17.0	14.9	10.8	19.9	20.8	16.2	19.7	14.3
Tech Hardware & Equip	13.7	15.2	10.8	10.6	14.4	8.7	10.0		12.7
Semi & Semi Equip	15.2	16.4	11.1	14.1	18.2	15.0	13.6		
Telecom	12.6	13.4	11.1	11.2	12.9	14.4	14.9	13.1	13.6
Utilities	15.1	14.9	14.1	13.3	28.8	16.6	13.4	12.1	18.5

E = I/B/E/S estimates Source: I/B/E/S, Worldscope, MSCI, Citi Investment Research

**Notes**

## Appendix A-1

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