

European Equity Strategy - Thematic

Peak European profit gap to US: set to close

Equity Strategy

Europe including UK

US & European profit gap = 46% & near peak, but not for long...

First markets: The US equity market is 35% above its 07 market peak and Europe is 17% below (in USD). Plus Europe's share of Global Market Cap, relative to the US, is at a 25 year low. Why? Europe missed its economic and profit cycle. Profits are travelling in the slowest lane in 50 years and the Profit Recovery Gap to the US is still 46% (vs 50% in our Nov 14 publication). THE CAUSE: 33% is sector composition; lack of QE (until now); strong euro (until now), buy-backs (small impact), anaemic lending growth (until now) and a European ROE that is at a decade low vs the US (involving 18 sectors). Things are improving as the outlook for US profits worsens for Q1 (page 5).

SECTORS where profits lag the US 'and' are cheaper than US peers

If we look at each sector's EPS versus last cycle peaks, there are 18 out of 28 sectors in Europe that are well behind the US. This is not just about the Financials – those earnings are down in both regions. The sectors with lagging earnings and that also look cheap relative to the US on Price to Book include: Transport, Media, Food & General Retail, Telecoms, Utilities, Banks, Div Fins and Chemicals, many are domestic (pg 13).

US earns 4.9% more ROE & sits on a 46% P/B premium - buy Europe here

The ROE and Price to Book valuation gap sound about right if you don't think Europe's ROE is going to improve. We think the gap will close. Why? 1) in 2005-07 US & Europe had similar ROEs; 2) European ROE normally breaks away from the US in cyclical downturns and then equalises by mid/end cycle (see 1992/2003) Plus, Price to Book valuations today point to 20% outperformance over the next two years – if history is any guide. We continue buying into a recovering Europe. See page 10.

Invest in 42 stocks: collapsed ROE (post 07), laggards & cheap vs peers

We list 42 stocks whose ROE has collapsed since 2007, have underperformed markets since 2007 and YTD and look cheaper than local & US peers. The short-list on page 2 includes: Bouygues, Soc Gen, Vivendi, TF1 & St Gobain. Long list is on page 16-17.

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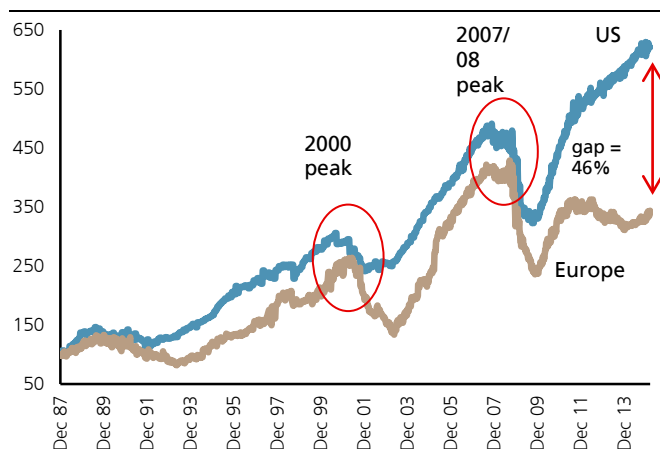
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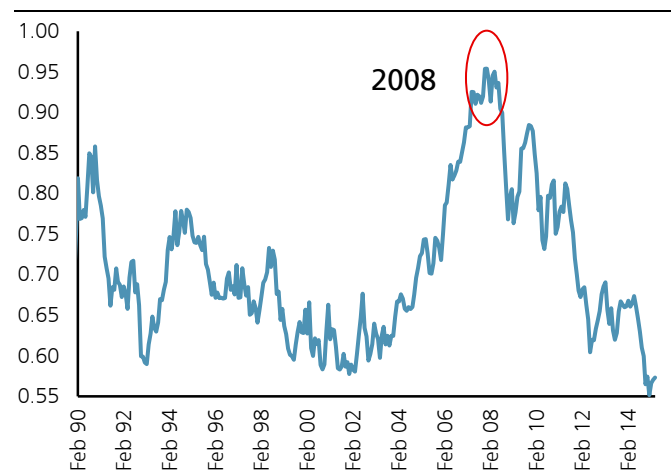
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Figure 1: US and Europe trailing 12m EPS in local currency



Source: UBS, Thomson Datastream

Figure 2: Share of GLOBAL market cap: Ratio of Europe's share over US share. Today at 25 year low



Source: UBS, Thomson Datastream

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Europe vs US profits: buy as gap closes

Gap unprecedented & still at peak

European profits started to lag US profits end 2010 and the gap eventually grew to an unprecedented level. We think we are at a turning point and that the gap will start to materially close. Why? There have been many improvements in the Eurozone: announcement of QE (22nd Jan), a weaker euro, lower oil price (Eurozone imports), an end to fiscal drag and credit (demand & supply) is rising from a low base. We think profit growth will be stronger in 2015/16 than in the past 7/8 years. Last month, the Eurozone had the first earnings upgrade (using IBES) in 4 years. In this note, we do the following:

- Review the current profit gap with the US and look at 5 causes.
- Find the sectors where post crisis earnings recovery is lagging US peers
- Dissect the ROE gap which is at a decade high
- Suggest sectors in a game of catch-up.
- Suggest companies in a game of catch-up. See a short-list below of our wider list on page 16-17.

5 key reasons for gap

Sectors responsible

Sectors and stocks to play on closure

How to play an earnings recovery
– see also page 15

Invest in an earnings catch-up via ROE recovery plays

These companies' ROE collapsed post 2007 and have underperformed YTD and since 2007. They also look cheaper than their local and US peers on our estimates (see 42 stocks and more detail in table on pages 16-17).

Figure 3: Stocks with depressed ROEs who largely underperformed since May 2007 and YTD

Stock Name	Sector	Rating	Change in ROE since 2007 (%)	PB rel to sector 2015	Rel Perf to Mkt since May 07 %	Rel Perf (YTD) %
Bouygues	Cap Goods	Neutral	-83%	59	-43	5
Vivendi	Media	Neutral	-79%	42	-25	-4
William Hill	Cons Svcs	Buy	-78%	61	-17	-6
Telefonica	Telecoms	Neutral	-73%	112	-21	-5
Lafarge	Const Mat	Neutral	-71%	85	-43	-7
Nokia	Tech Hard	Neutral	-66%	104	-65	-7
Tate & Lyle	Food Prod	Buy	-62%	38	-2	-3
GDF Suez	Utilities	Neutral	-61%	62	-49	-16
Orange	Telecoms	Neutral	-59%	77	-32	-6
BNP Paribas	Banks	Neutral	-56%	82	-37	-4
TF1	Media	Buy	-53%	55	-37	11
Soc Gen	Banks	Buy	-50%	76	-65	9
Iberdrola	Utilities	Buy	-49%	48	-43	-9
St. Gobain	Const Mat	Neutral	-48%	96	-44	-2
HSBC	Banks	Neutral	-41%	93	-31	-10
EDP	Utilities	Buy	-40%	88	-16	-6
EDF	Utilities	Neutral	-39%	79	-66	-15
Husqvarna	Cons Dur	Neutral	-39%	93	-33	-11
OERLIKON	Cap Goods	Buy	-35%	67	-78	-6
UBM	Media	Buy	-32%	82	-21	5
OTE	Telecoms	Neutral (CBE)	-26%	89	-68	-30
Ericsson	Tech Hard	Neutral	-22%	88	-18	-2

Source: UBS estimates

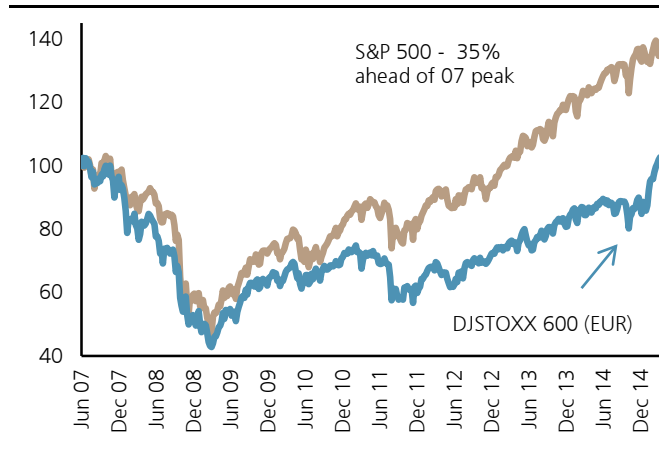
Performance since *last cycle peak* - big lag

The US is 35% ahead of its last cycle market peak and Europe is only 5% ahead. The gap today is 30% - the peak gap was 50%. But so much of this closure is currency based. If we run European performance using US\$, it is still 17% below its prior peak. YTD European Equities have outperformed US equities by c. 20% (and c. 6% in USD). However, this comes after 7 years of sustained underperformance. If we are in a structural shift, this is early days.

US is 35% above 2007 market peak

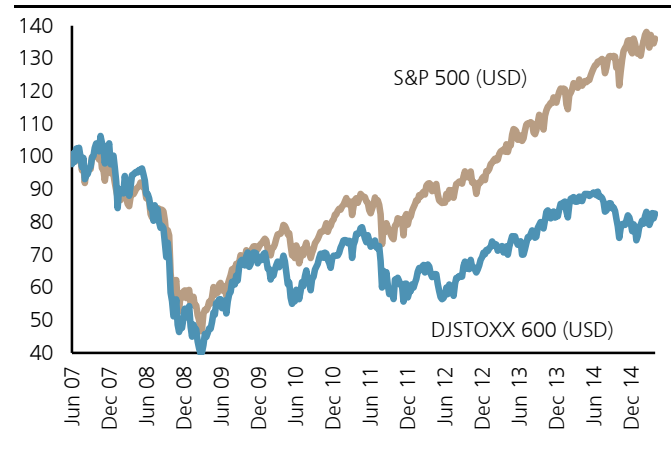
Europe is 17% 'below' in USD.

Figure 4: US vs Europe Performance from 2007 peak in local currency. US 35% ahead



Source: UBS, Thomson Datastream

Figure 5: US vs Europe Performance from 2007 peak in (US\$). Europe is 17% below 2007 peak in USD



Source: UBS, Thomson Datastream

Cyclically adjusted PE gap is c. 90% of its peak

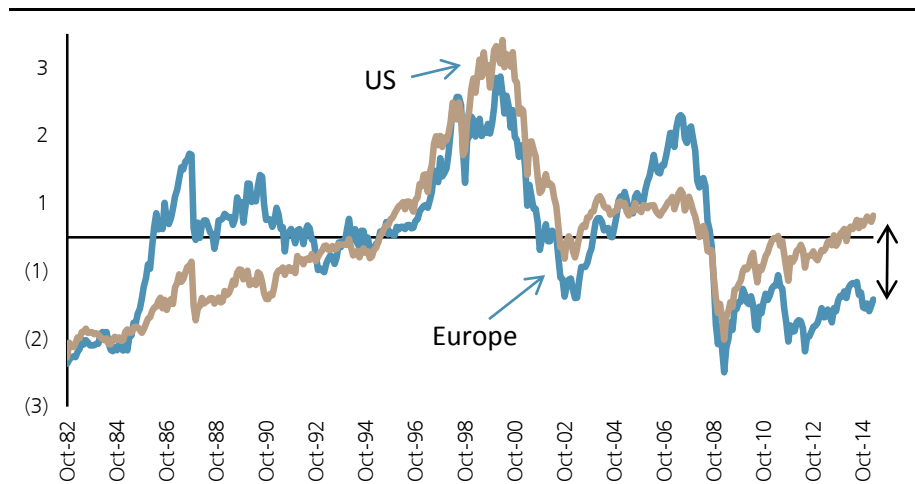
The chart looks at the standard deviation of the CAPE Pe for each region versus its long run average. The US is close to 1 standard deviation above, and Europe is c. 2 standard deviations below. This is the PE over each market's 10 year rolling average of earnings (smooths out the cycle).

US c. 1 standard deviation above

Europe c. 2 standard deviation below

Gap unprecedented over past 33 years

Figure 6: Cyclically adjusted PE – Above or Below average? Number of s.d's away from mean - gap is 90% of peak gap



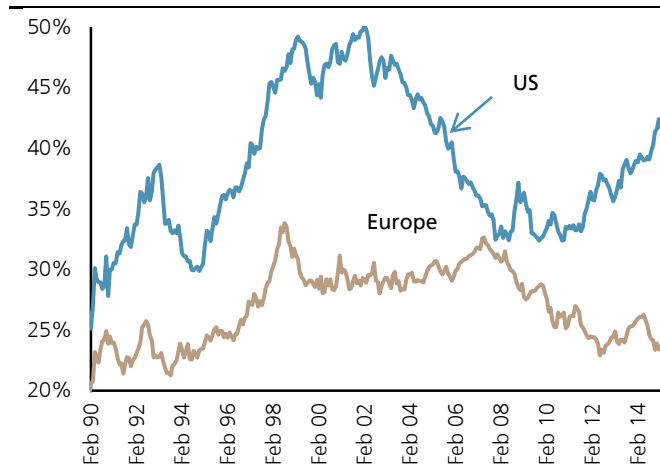
Source: UBS, Thomson Datastream

Europe's share of GLOBAL equity market

Europe and the US were on more equal footing in 2007 with a similar share of world market cap. Now on a relative basis, Europe is c. half that and its share sits at a 25 year low. It is not just about the US market rising (as the chart left shows). The ratio today looks like the recessionary lows seen in 1992 and 2002/03.

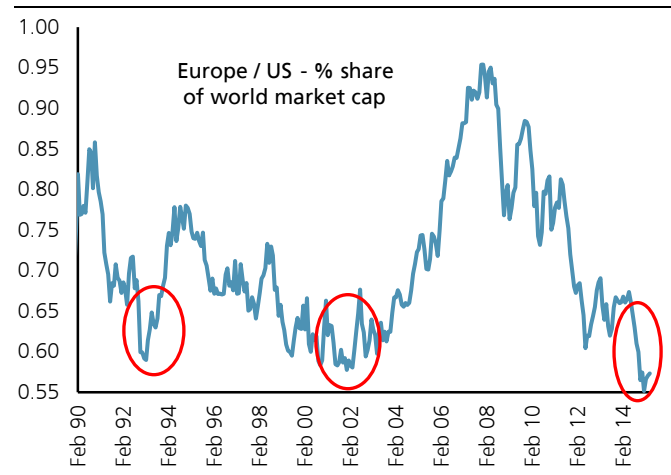
Europe's share of world market has halved relative to US share

Figure 7: US and Europe market capitalisation share of the world



Source: UBS, Thomson Datastream

Figure 8: Share of Global market cap: Ratio of Europe over US. Today at 25 year low!



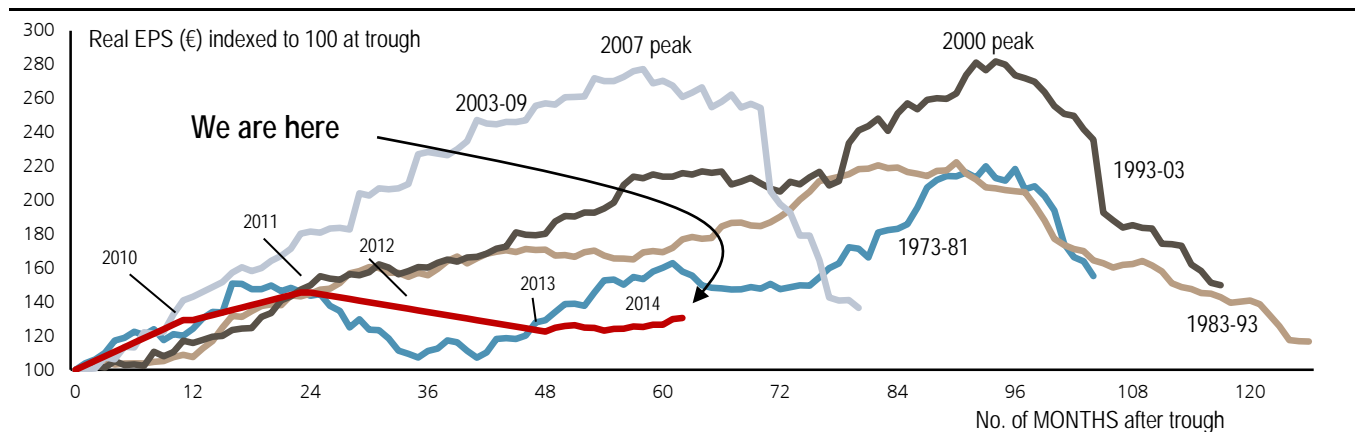
Source: UBS, Thomson Datastream

What's the problem? Missing a profit recovery

Before we look at the gap to the US, let's review Europe versus its own history. The chart below looks at profit cycles from the trough of each of the last cycles. Today's profit cycle (red line) is the slowest in 50 years – but has just started to turn. Profits are still sitting where they were in February 2011 – so four years of nothing. This shows that it is not just about the US profits being strong, but Europe in its own right.

Travelling in the slowest profit cycle in 50 years

Figure 9: Europe: Profit cycle paths for last 50 years: rebased to 100 at last cycle trough & length of cycle (months on x axis)



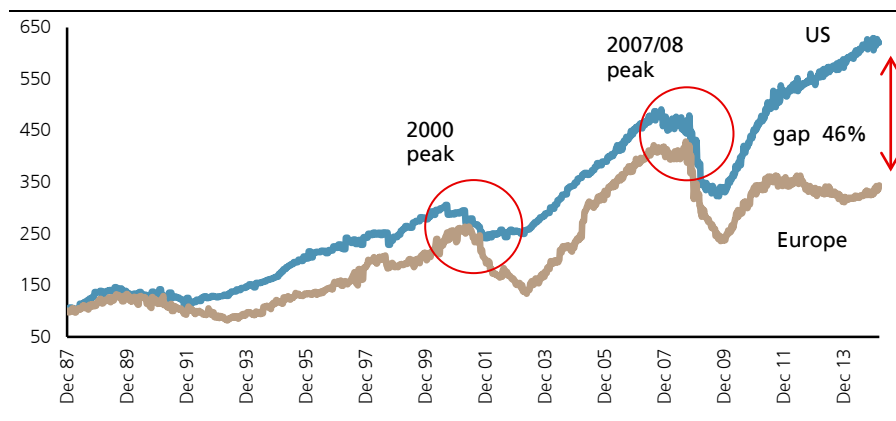
Source: UBS Thomson data stream

Profit gap: Europe vs US

Today, the US is 27% above its 2007 peak profits and Europe is 19% below. The Europe and US profit cycle broke away in 2010/2011 when the Eurozone fell back into recession and the US carried on recovering. This post crisis profit gap was *and still is* unprecedented (albeit it is just starting to close as below). The normal stage of events is for the US cycle/profit recovery to lead by 8-10 months. But this time it has been over 4 years.

In the race to surpass last cycle's peak – the US wins by almost 50%

Figure 10: Gap between European & US earnings = 46%



Source: UBS, Thomson Datastream

US 27% ahead & Europe 19% below

What would US and Europe's PE be at last cycle peak earnings?

The above uses trailing MSCI numbers, so let's look at trailing PEs. The US sits on 17.9x trailing PE and Europe on 17.8. If we take today's price and put the US and Europe back on their last cycle peak earnings, the US PE rises to 22.5x and Europe falls to 14.7x. It should not be a 'big ask' for Europe to get back to a level of earnings it earned 8 years ago – that would mean it stood still for 8 years!

Let's put both regions at last cycles peak

Europe trades on 14.7x and the US on 22.5x

US earnings comment from US equity strategy

What is the outlook for US 2015E eps growth? For S&P 500 earnings to grow by 0.7%, lower than the 8% growth expected at the start of the year. The decline in growth expectations can be attributed to energy prices and dollar strength.

For 2015E expect only 0.7% growth

How does that compare to the last few years? Consensus growth expectations are well below 2013 and 2014 growth (5.7% in 2013 and 8.3% in 2014). Ex-energy, S&P 500 consensus growth is 6.1%, which is more in-line with prior years.

Energy and USD biggest drags

What are you expecting for Q1? For Q1, consensus estimates expect a decline in S&P 500 earnings of 4.1%, driven in large part by YoY declines in the energy, materials and utilities sectors (-64.7%, -6.7% and -7.7% respectively). Ex-energy, Q1 earnings are expected to grow by 1.5. While a stronger US dollar is likely to weigh on earnings, the biggest headwind remains the decline in oil prices. However, the favourable comp relative to last year's weather-impacted first quarter could support Q1 earnings.

What's behind the profit gap?

In the following section we look at 5 of the items behind the gap.

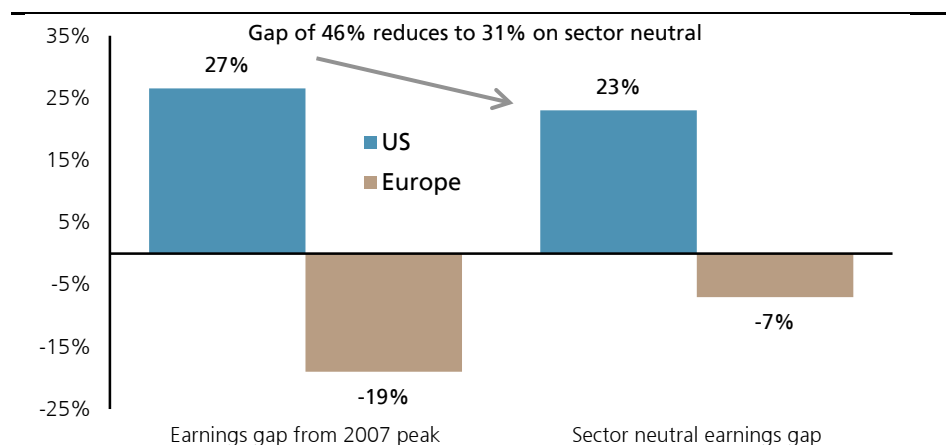
1. Sector composition = 33%

We run our sector composition analysis in Appendix 1 which shows that roughly one-third of the profit gap is due to the fact that Europe is overweight some pretty miserable sectors (at least post the crisis). See figure 12 for sectors that are more relevant to Europe versus their relevance in the US, such as Construction, Mining and Utilities and Banks.

One-third is due to European sector weights vs those in US

See appendix 1

Figure 11: Earnings gap – actual vs a sector neutral gap. 15pp of 46pp gap is due to sector composition.



Source: UBS, Thomson Datastream

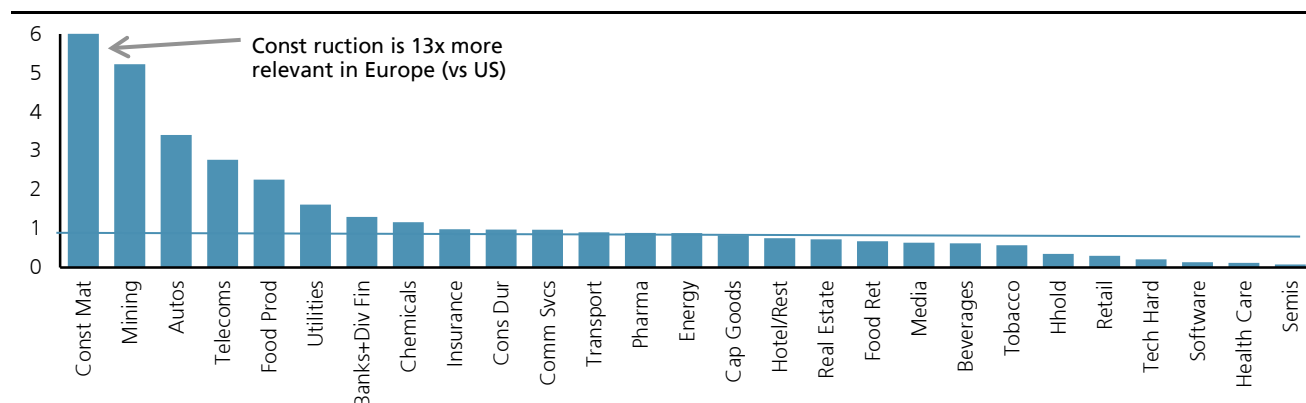
Which sectors are more relevant for Europe than for the US?

Many of the sectors more relevant to Europe have been pretty awful since 2007. The less relevant sectors (software, hardware, Household Goods and Consumer Staples) have done well but it has been level relevant.

Construction is 13x more relevant in Europe than it is to US

Tech Hardware is 1/5th as relevant

Figure 12: Relevance of European sectors in Europe vs US sectors in US– Ratio of sector earnings weight in Europe and US. (European sector earnings / European market earnings // US sector earnings/US market earnings)



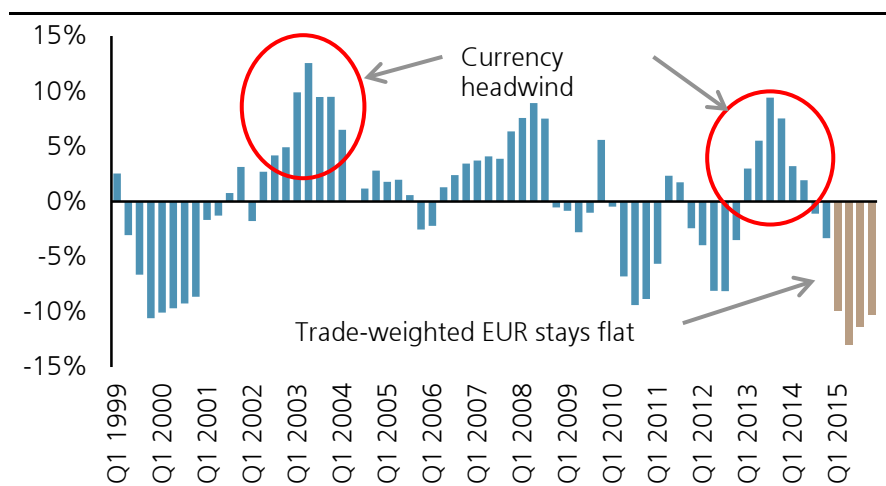
Source: UBS, Thomson Datastream

2. Currency strength: Start of 2014 EUR/USD was €1.40

The euro's strength frustrated profits for most of the post crisis period. In Q1 and Q2 of 2014 Europe had record revenue misses due to a strengthening trade-weighted euro. Today, the trade-weighted euro is down by 14% from the start of 2014. We roughly assume that every 10% fall in the trade-weighted euro boosts profits by 4-5%. We have some tail-winds to come if QE can keep the lid on a rising euro.

Trade-weighted euro down 14% since end 2013

Figure 13: Trade-weighted euro Quarterly (YoY) head/tail wind



Source: Datastream, UBS

3. QE weakens euro but also boosts lending – Europe's turn

The US had QE immediately after the crisis unfolded. Below we look at US versus Europe net easing below and how that helped feed not only positive credit growth in the US but market performance too. Given these are diffusion indices and refer to whether credit availability is improving or deteriorating, they do not tell us whether the Eurozone is operating with the same *level* of credit availability as the US, but they do tell us the direction. The below is taken from Reinhard Cluse's write-up on the latest ECB bank lending survey (see right).

22nd Jan 2015 QE announced - €60bn a month support

April's ECB Bank Lending Survey (BLS) for Q1 2015 conveyed a broadly encouraging message: Eurozone credit conditions continue to improve, although they remain tight by historical standards. Conducted on the 6th to 23rd March, the BLS shows that credit demand continued to recover across the board in Q1, a trend that is expected to continue in Q2. Banks eased lending standards for loans to non-financial corporates and for consumer loans, and expect to do the same in Q2.

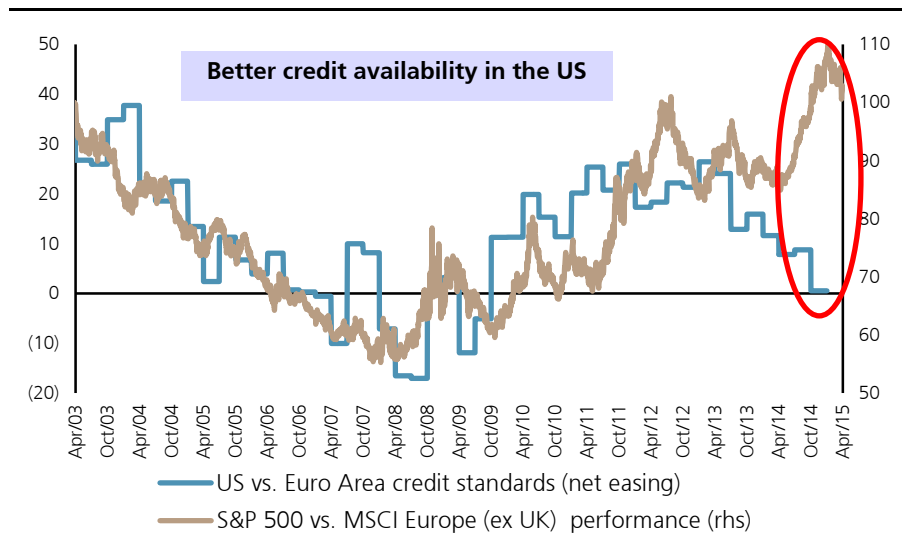
Latest ECB Bank Lending Survey – shows QE is helping

See Reinhard Cluse 14 April note: ECB: further improvements in credit conditions

The ECB concludes that QE seems to be effective in supporting lending to the Eurozone economy, as banks used their improved liquidity position to grant loans. The slower recovery in European credit extension relative to the US has been one of the key reasons for the underperformance of European equities versus the US – but this is now gradually turning.

Figure 14: Better improvement in Credit Availability in the US drove the outperformance of the US over Europe...but signs this may be turning...

But Europe is now starting to catch up...



Source: UBS, Haver, MSCI

4. Share buy-backs = < 5% of profit gap

While buybacks increase the EPS of individual companies *within the S&P 500*, they do not increase overall net income for the firm as a whole. The S&P EPS calculation determines the index earnings for each issue in USD, based on the specific issues' index shares, index float, and EPS – which negates most of the share count change. Therefore, when looking at S&P index EPS, the effect of share buybacks do not seem to make up a significant part (if any) of the profit gap with Europe.

Comment from our US strategy team

S&P EPS growth is not boosted by buy-backs

We use MSCI above and the profit picture looks similar to that for the S&P 500. We also take some comfort from the fact that while buy-backs in the US made up 2.7% of market cap (on average since start 2011 when gap opens), in Europe they made up about 1.5%. So the difference is not that material ($2.7 - 1.5\% \times 4 \text{ years} = 4.8\%$).

5. Europe still on depressed ROE – 4.9% below the US

The ROE gap between the US and Europe is at a decade high more commonly found in recessionary times. Today US companies earn 4.9% more ROE than European companies. Europe should see some revenue growth from a Eurozone recovery, better lending momentum and support from the currency (amongst other things). The ROE gap tends to close to c. zero when the Eurozone enters a recovery.

Europe ROE at a decade gap to US – it won't sit here forever

See page 10 for more detail

Sector EPS comparison with US

Here we do a deep dive in the sectors to find whose profits are lagging the most and then later we look at sector ROEs. This is not just about the Financials.

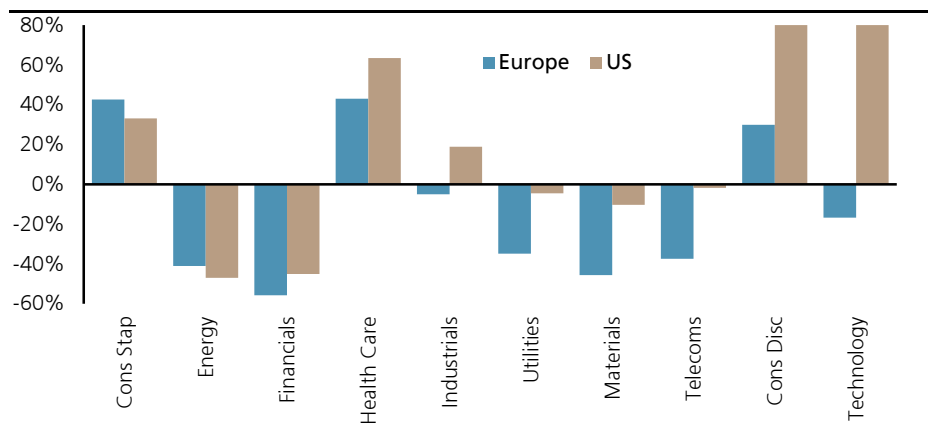
Deep dive into sectors

Europe vs US profits: Level 1 sectors - Europe lags in 8

Which sectors are heading back to (or beyond) the last cycle's peak more quickly? The below chart shows the earnings level today versus the sectors peaks in the last cycle (07/08). Europe is behind in 8 out of 10 sector groups.

Sector earnings vs last cycle peak?
Europe ahead in Consumer Staples & Energy

Figure 15: Level 1 Sector earnings gap from 2007 – 2008 peak – US vs Europe



Source: UBS, Thomson Datastream

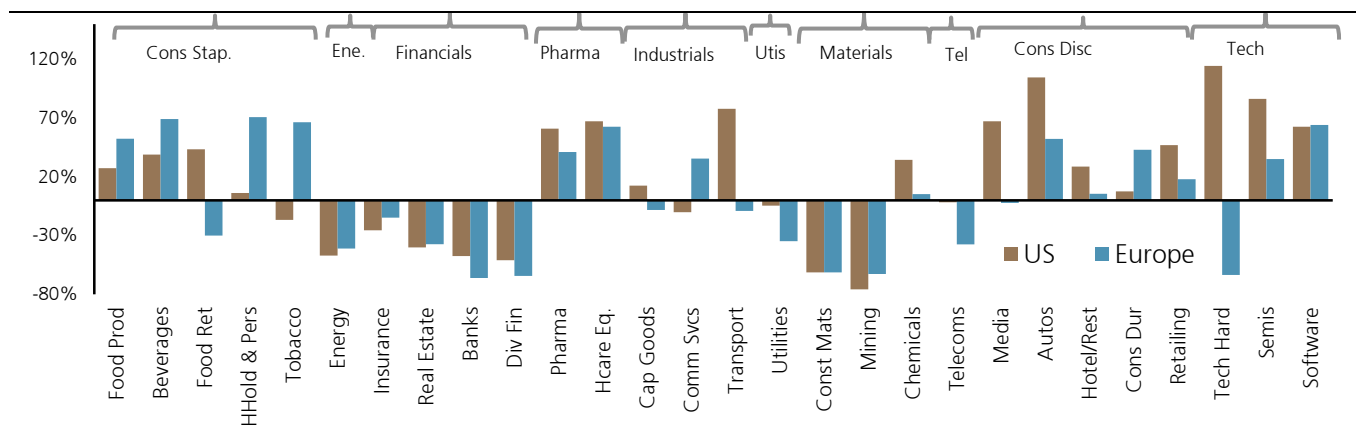
Dig deeper into Level 2 – 18 sectors lag the US

Europe behind in 18 sectors

And in level two, 18 sectors are behind the US in the race to get back to the last cycle's peak. Some interesting findings

- Financials, Construction and Mining do poorly in both regions
- Consumer defensives are Europe's strong point
- Domestic sectors lag the most: Telecoms, Utilities, Food Retail, General retail

Figure 16: Level 2 Sector earnings gap from 2007 – 2008 peak – US vs Europe



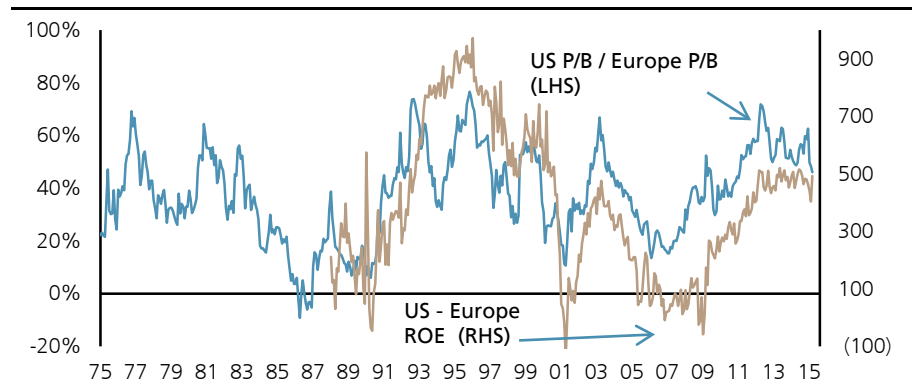
Source: UBS, Thomson Datastream

ROE: Europe versus US

The ROE and Price to Book gap are still extreme.

The US trades at a 46% Price to Book premium to Europe ex-UK. The excess ROE being earned in the US versus Europe is 4.9%. This gap is similar to 2003 and for the next 3-4 years profit growth in Europe surpassed profit growth in the US. We don't expect a repeat of a 2003 to 2007 boom, but the starting point is similar.

Figure 17: US ROE is 4.9% higher, and US trades at 46% P/B premium



Source: UBS, datastream. Europe = Europe ex-UK

ROE gap at decade high

US Price to Book on 46% premium to Europe

Post 2003 European EPS growth sped past US growth

The gap opens up in recessions and closes as cycle heats up

Price to Book – good indicator of returns 2 years out

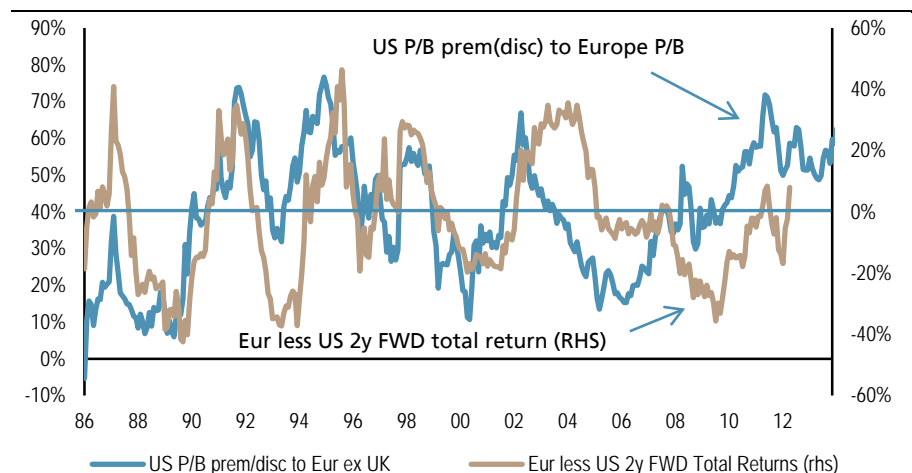
The chart below looks at the Price to Book gap between US and Europe and subsequent performance. Each point on the brown line gives you the total return in the market 2 years on so if you bought Europe and sold the US in 2010 then over the next two years you would have received c. -40%. Based on history, when the gap between Europe and the US price to book is at today's level, it points to roughly 20% outperformance over the next two years.

Price to Book gaps can trigger long run outperformance

Still in opportune territory

Today suggests 20% out-performance over next 2 yrs

Figure 18: US vs Europe PB entry point and subsequent performance

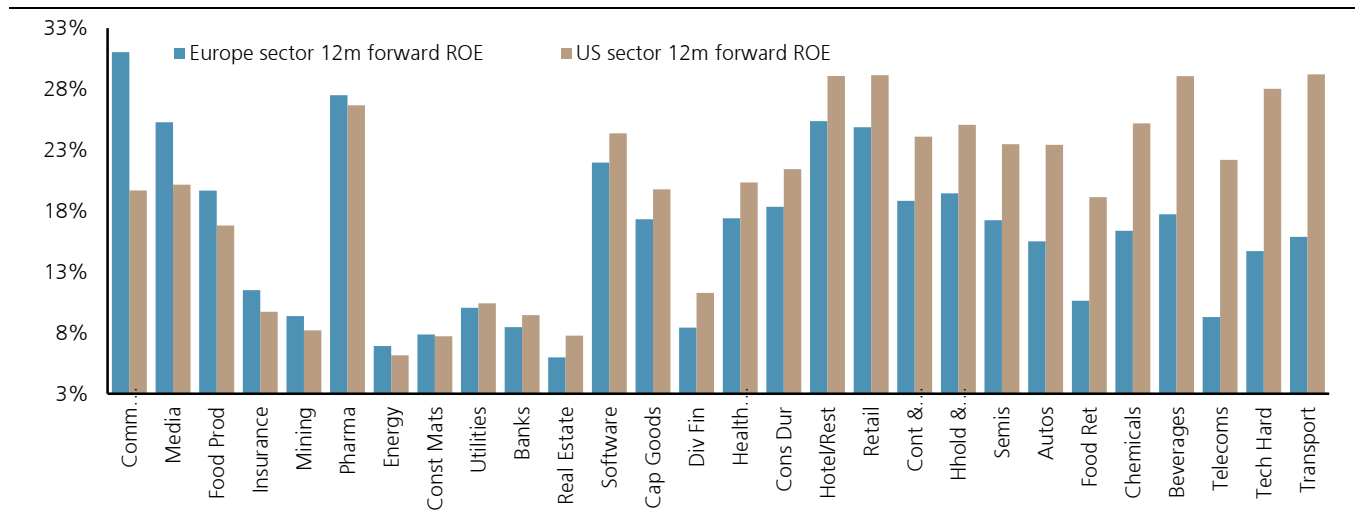


Source: UBS, datastream. Europe = Europe ex-UK

European sector ROE - 20 sectors below US peers

Today there are a number of sectors in Europe with an ROE much below the US. **20 sectors have lower ROE than US peer group**
This is not normal and happens when at a cyclical low. With the Eurozone starting to improve (from November 2014) we think these gaps will start to close.

Figure 19: TODAY: European sector ROE vs US sector ROE – 20 out of 30 sectors have lower ROE in Europe



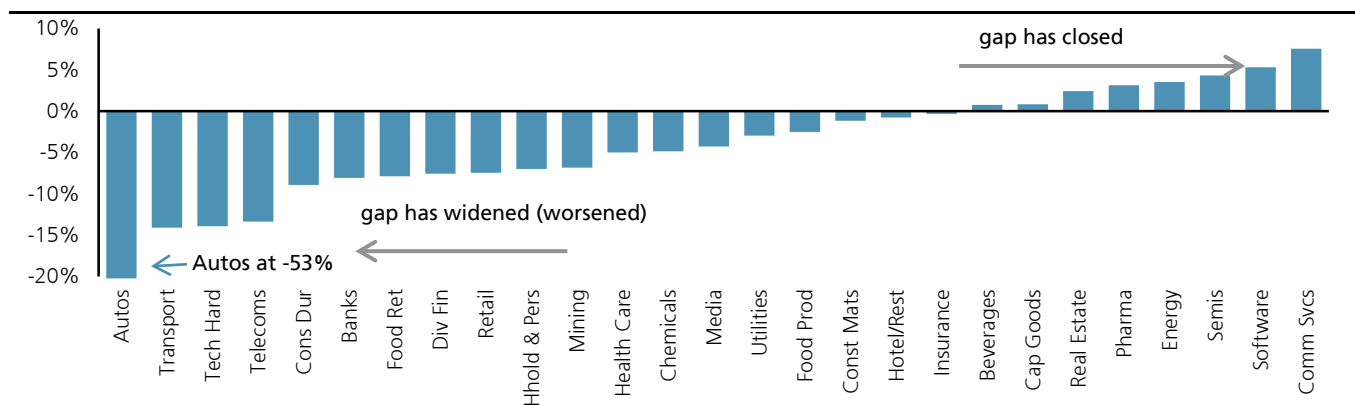
Source: UBS, Thomson Datastream

ROE: how the gap has changed since March 2008

Today it is much worse than 2008

The chart below shows the where the ROE gap has widened (gotten worse) and closed (improved) since 2008. Financials and domestics suffer such as: Transport, Telecoms, Banks, Food Retail/Gen Retail. The gap has closed for 8 sectors including Software, Energy and Pharma.

Figure 20: How the gap has changed today compared to March 2008. Gap is widened, Europe worse today than in 2008. Where gap has closed Europe has roe improved relative to the US



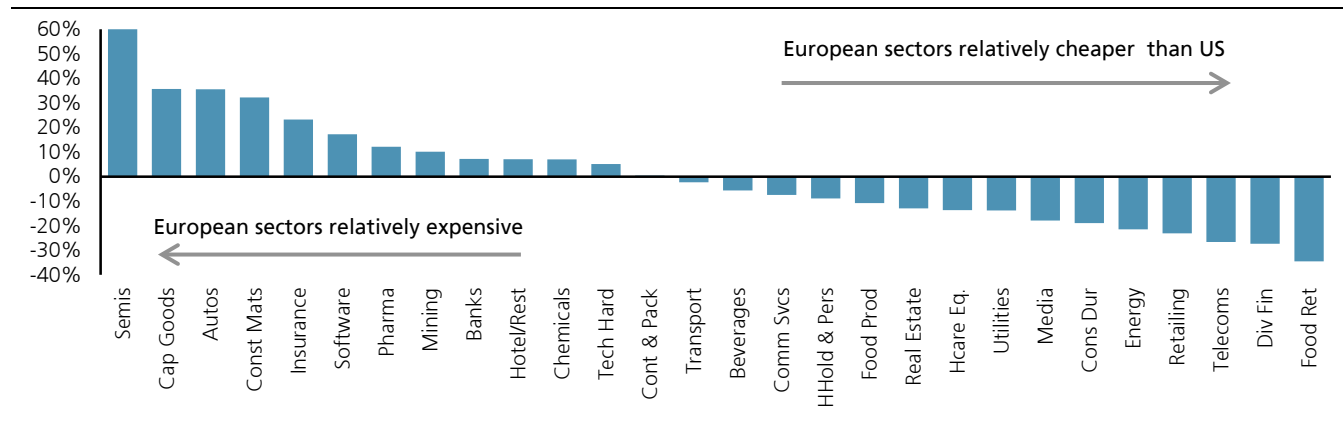
Source: UBS, Thomson Datastream

Price to Book: where are European sectors cheaper than US?

Many of the sectors that are cheaper than the US are also troubled. Those that can't seem to get themselves back to the prior peak even after 7 years look right.

Cheaper include: Telecoms, Div Fins, Food Retail, Utilities, Media

Figure 21: European sector relative P/B vs US sector relative P/B (premium/discount to 10 year average)



Source: UBS, Thomson Datastream

Summary: Earnings versus Valuation gap

Here we create a scatter chart to show which sectors are lagging the US in the return to prior cycle peak earnings and which ones are cheaper too?

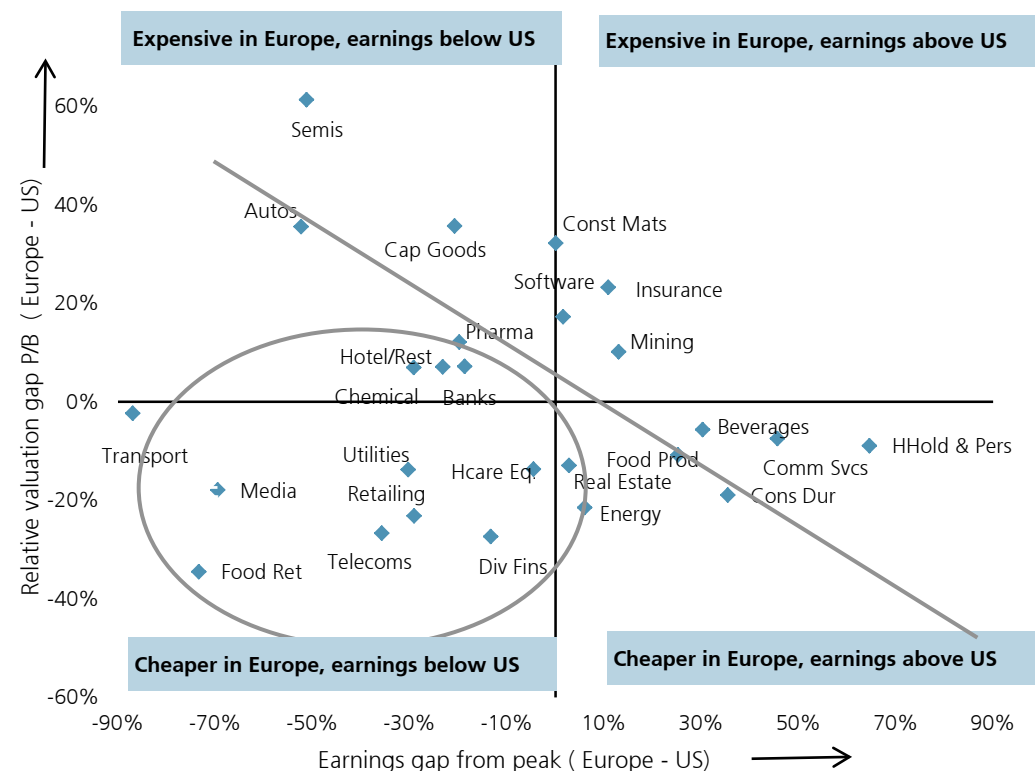
Sector EPS gap (vs US) & Valuation gap

In this chart we summarise the earnings and valuation gap between the two regions. By earnings we look at the gap to each sector's 2007/08 peak. The lower left quartile is where sectors are cheaper in Europe and where earnings have still not caught up to their 2007 levels **and are well behind the US's catch up**. The upper right is more expensive and earnings are ahead. Insurance is one.

Lower left box: EPS has lagged the US & cheaper than US

Tech HW off map (180% EPS lag)

Figure 22: EUROPE versus US: profit gap (vs catch up to last peak) & valuation gap (Price to Book)



Source: UBS

Sector Conclusions

- Those lagging US sector peers in EPS recovery and cheaper (rel to US) are largely domestic: Food Retail, Telecoms, Financials, Retail, Utilities and Media
- Construction and Energy do poorly in both – so no big profit gap to US
- Consumer defensives do better than US: Beverages & Household & Personal
- Tech Hardware falls off the map as lagging US profits by close to 200%

You need to buy the lower left corner if playing a recovery

Food Retail, Telecoms, Financials, Retail, Utilities and more...

SEE PAGE 20 FOR LONG RUN SECTOR PROFIT CHARTS

Conclusion – Keep buying Europe vs US

Europe has rallied by c. 20% YTD in euros, but only 6% in USD. We understand the temptation to take profits or pause, but overall we think the rally has much further to run. As shown in the table below, Europe is in better shape than it was at the end of 2013. European profit growth has disappointed for 7 of the past 8 years. We think this is about to change. As mentioned earlier, European profits had upgrades last month for the first time in 48 years.

- QE brings confidence
- QE brings weaker euro – start of 2014 EUR/USD closer to €1.40 and since then trade-weighted down 14%
- Oil price has halved and the Eurozone is a net importer (so gets a bigger boost to GDP than the US). Even \$80 still produces a GDP boost as assume \$20 of fall is supply driven.
- Fiscal drag ending (for the first time in c. 6 years)
- Banks provisions are stabilising like US's did post 2010 – will lending growth catch up to US?
- ECB bank lending survey was the best in 7 years with both supply and credit gaining momentum to the upside.
- With US unemployment at 5.5% (versus 6.7% end 2013) there is more traction for Europe to tap into as a time when currency is helping.

Figure 23: Fundamental changes since end 2013

<i>Indicator</i>	<i>Today</i>	<i>End 2013</i>	<i>Good for Europe</i>	<i>Comments</i>
Euro / USD	1.06	1.37	✓	Positive for profits
Oil price	c. 60	111.4	✓	Avoid oil price deflation line of fire and a positive
HICP Inflation	negative	0.8	mixed	But not about falling wages
Real wage growth	1.6	1.1	✓	near a 5 year high
Chance of QE	Done	Less likely	✓	60 bn EUR monthly
Fiscal Drag ending	No More Drag	Fiscal Drag	✓	Fiscal drag ended 1 st time in 6 years
Single Banks regulator	ECB the regulator	National regulators	✓	More influence over Banks
Stress test	Done	Lurking	✓	Had big provisions ahead of AQR/stress tests
Bank provisions & lending growth	Provisions stabilising	Ongoing	✓	ECB survey best in 7 years: now to follow US?
US unemployment	5.5%	6.7%	✓	US economy gains traction
Political risk: Russia / Greece / China	Bigger worry today	Lower	✗	Global political risk seems heightened

Source: UBS

ROE recovery – stocks to invest in

To invest in a depressed ROE for Europe (versus the US and history) we screen for European companies with a depressed ROE versus their own 2007 peak. We expect some improvement over the next 12 to 24m as the Eurozone economy gains momentum. Eight years is a long time to be sitting around on post 2007 collapsed ROEs. We are not saying they revert to 2007 levels, we just expect some improvement.

Our list includes companies that have:

- Largely underperformed the market since 2007 peak and Year to Date;
- Suffered a collapse in ROE from 2007 to-date of over 10% (almost half are still down by 50% or more);
- Company is cheaper than its European sector peers on DY and PB (other than a few exceptions that we think are justified);
- Company is cheaper than its US peers - on at least 2 of the 3 valuation variables (PE relative, PB relative and DY relative).

See our two-page stock list below – an extension of the shorter list in the front section.

How to play an earnings recovery?

Buy good quality names with depressed ROE ahead of a recovery

Stocks are underperformers!

Suffered massive collapse in ROE

Cheaper than US peers

Figure 24: Stocks that have suffered biggest FALL in ROE from peak of 2007 (sorted by change in ROE), underperformed and offer value vs local & US peers

Stock Name	Mkt Cap (EUR b)	Sector	Price	Upside to PT(%)	Rating	Rel Perf to Mkt since May 07 %	Rel Perf (YTD) %	Rel Perf since Jan 22nd %	Change in ROE since 2007 (%)	Change in Margins since 2007 (%)	PB rel to sector 2015	DY rel to sector 2015	Cheaper than US on parameters (#)	Developed Sales Exp (%) (US+ Europe + UK)
Bouygues	12.0	Cap Goods	38	-19%	Neutral	-43	5	5	-83%	-81%	59	152	2	88%
Vivendi	32.4	Media	24	-16%	Neutral	-25	-4	1	-79%	-50%	42	137	2	75%
William Hill	4.6	Cons Svcs	377	10%	Buy	-17	-6	-5	-78%	-30%	61	143	3	NA
Telefonica	61.9	Telecoms	14	4%	Neutral	-21	-5	-5	-73%	-48%	112	136	2	46%
Lafarge	18.2	Const Mat	65	4%	Neutral	-43	-7	-5	-71%	-51%	85	91	3	42%
BBVA	43.3	Banks	9	-4%	Buy	-51	0	5	-66%	-41%	119	108	2	39%
Nokia	27.6	Tech Hard	7	-7%	Neutral	-65	-7	-7	-66%	-17%	105	120	2	41%
ING	54.1	Banks	14	3%	Buy	-46	7	6	-64%	127%	102	92	3	95%
Tate & Lyle	4.3	Food Prod	652	-6%	Buy	-2	-3	-8	-62%	7%	38	165	3	NA
GDF Suez	46.3	Utilities	19	-1%	Neutral	-49	-16	-10	-61%	-47%	62	114	3	65%
Marks & Spencer	12.9	Retailing	568	10%	Buy	-26	7	13	-61%	-37%	69	115	3	89%
Sulzer	3.8	Cap Goods	110	-3%	Neutral	12	2	0	-60%	-28%	54	105	2	NA
Orange	41.7	Telecoms	16	0%	Neutral	-32	-6	-8	-59%	-43%	77	93	2	74%
BNP Paribas	71.0	Banks	56	-12%	Neutral	-37	-4	1	-56%	-38%	82	107	2	87%
Randstad	10.4	Comm Svcs	56	2%	Neutral	-8	18	13	-56%	-28%	69	108	3	91%
CS Group	42.2	Div Fin	27	-4%	Neutral	-54	5	17	-56%	-36%	83	114	3	91%
TF1	3.6	Media	17	10%	Buy	-37	11	9	-53%	-4%	55	119	2	NA
Mediaset	5.4	Media	5	-9%	Buy	-43	10	5	-52%	-73%	100	170	2	NA
Soc Gen	36.3	Banks	46	9%	Buy	-65	9	6	-50%	-19%	76	140	3	89%
Iberdrola	37.8	Utilities	6	4%	Buy	-43	-9	-9	-49%	-38%	48	96	3	85%
St. Gobain	23.4	Const Mat	41	-16%	Neutral	-44	-2	-4	-48%	-38%	96	139	3	82%

Source: UBS

Figure 25: Stocks that have suffered biggest FALL in ROE from peak of 2007 (sorted by change in ROE) underperformed and offer value vs local & US peers

Stock Name	Mkt Cap (EUR b)	Sector	Price	Upside to PT(%)	Rating	Rel Perf to Mkt since May 07 %	Rel Perf (YTD) %	Rel Perf since Jan 22nd %	Change in ROE since 2007 (%)	Change in Margins since 2007 (%)	PB rel to sector 2015	DY rel to sector 2015	Cheaper than US on parameters (#)	Developed world Sales Exp (%) (US+ Europe + UK)
Icade	6.1	Real Estate	81	2%	Neutral	-41	2	-3	-46%	43%	91	139	3	NA
HSBC	165.6	Banks	607	-3%	Neutral	-31	-10	-9	-41%	16%	93	144	2	44%
EDP	13.5	Utilities	4	3%	Buy	-16	-6	-9	-40%	-17%	88	109	3	83%
EDF	43.5	Utilities	23	4%	Neutral	-66	-15	-11	-39%	-28%	79	118	3	83%
Husqvarna	3.8	Cons Dur	60	-16%	Neutral	-33	-11	-3	-39%	2%	93	134	3	NA
OERLIKON	4.0	Cap Goods	12	16%	Buy	-78	-6	0	-35%	40%	67	94	3	NA
CASA	35.5	Banks	14	-1%	Buy	-53	7	7	-35%	-13%	75	90	2	93%
UBM	3.5	Media	561	3%	Buy	-21	5	0	-32%	9%	82	125	3	NA
Vinci	31.4	Cap Goods	57	-1%	Buy	-3	4	3	-30%	11%	71	112	3	85%
Allianz	76.8	Insurance	166	7%	Buy	0	1	2	-29%	NA	105	98	2	83%
Inchcape	5.4	Retailing	834	-19%	Neutral	-18	3	11	-27%	24%	58	89	3	NA
OTE	3.8	Telecoms	8	42%	Neutral (CBE)	-68	-30	-21	-26%	-4%	89	125	3	NA
Carnival Plc	35.5	Cons Svcs	3232	15%	Buy	14	0	-2	-25%	-27%	35	97	2	85%
Accor	11.2	Cons Svcs	49	7%	Buy	7	10	4	-23%	5%	68	98	2	78%
Klepierre	14.7	Real Estate	46	-6%	Neutral	0	7	2	-23%	8%	119	106	3	91%
Intesa SanPaolo	51.9	Banks	3	6%	Buy	-43	7	6	-23%	-21%	118	99	2	94%
Fraport	5.3	Transport	58	3%	Buy	3	1	-4	-22%	11%	54	88	2	NA
Ericsson	40.3	Tech Hard	109	-12%	Neutral	-18	-2	-2	-22%	-30%	88	162	2	43%
A.P.Moller-Maersk	41.3	Transport	14080	-3%	Neutral	4	-5	-5	-16%	37%	52	95	3	25%
Lagardere	3.7	Media	29	-23%	Neutral	-53	12	5	-13%	-50%	52	153	3	NA
Barratt Dev.	7.5	Cons Dur	530	8%	Buy	-31	1	11	-12%	-5%	50	211	3	NA

Source: UBS

Appendix 1 – sector composition table

We give each market global sector weights and then look at the profit gap between the last earnings peak and today. This is the gap that would exist if sectors were the same – the gap would be around 31% - instead the gap is 46%. The bigger gap grows due to sector composition.

Figure 26: Sector contribution to earnings gap

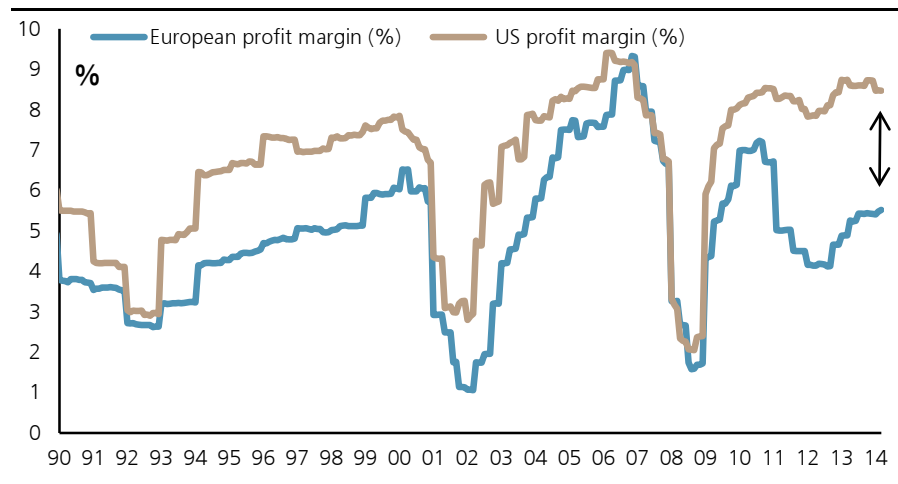
US sector contribution to earnings growth		Europe sector contribution to earnings gap	
Tech Hard	6.1%	Pharma & Biotech	3.4%
Pharma	4.7%	Autos & Parts	1.9%
Autos	4.6%	Software Svcs	1.8%
Media	3.3%	Food Producers	1.5%
Cons Dur	2.7%	Health Care	1.4%
Software	2.2%	Beverages	1.2%
Cap Goods	2.0%	HHold & Personal	1.1%
Transpo	1.8%	Tobacco	1.0%
Health Care	1.6%	Consumer Dur	0.8%
Chemicals	1.6%	Retailing	0.8%
Food Retail	1.3%	Semis	0.6%
Food Producers	1.1%	Chemicals	0.4%
Retailing	1.0%	Comm Services	0.3%
Beverages	0.9%	Hotel/Rest/Leis	0.2%
Semis	0.9%	Media	0.1%
Tobacco	0.7%	Insurance	0.0%
Hotel/Rest/Leis	0.5%	Transportation	0.0%
Utilities	0.4%	Cap Goods	-0.1%
HHold & Personal	0.3%	Construction Mats	-0.3%
Telecoms	0.3%	Real Estate	-0.4%
Comm Services	0.0%	Food/Staples Ret	-0.5%
Construction Mats	-0.3%	Utilities	-1.3%
Real Estate	-0.5%	Telecoms	-1.6%
Insurance	-1.8%	Metals & Mining	-2.2%
Energy	-2.5%	Tech Hardware	-2.4%
Metals & Mining	-2.7%	Energy	-5.0%
Banks + Div Fin	-7.5%	Banks + Div Fin	-10.6%
US	23.1%	Europe	-7.4%

Source: UBS, Thomson Datastream

Appendix 2: Extra charts on profits

Net income profit margin is catching up

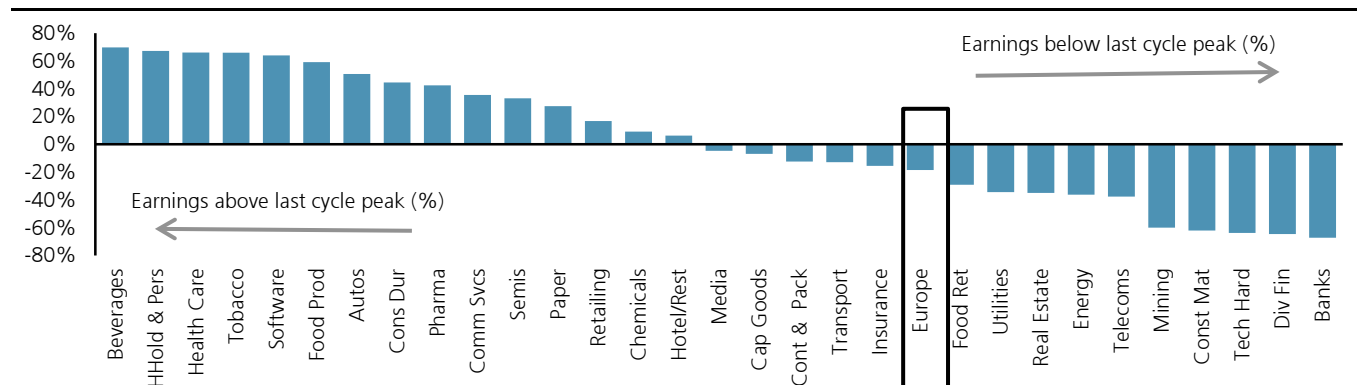
Figure 27: US vs Europe NIMs



Source: UBS, datastream.

European earnings versus their 2007 peak - sector laggards

Figure 28: European sector earnings gap from 2007 peak



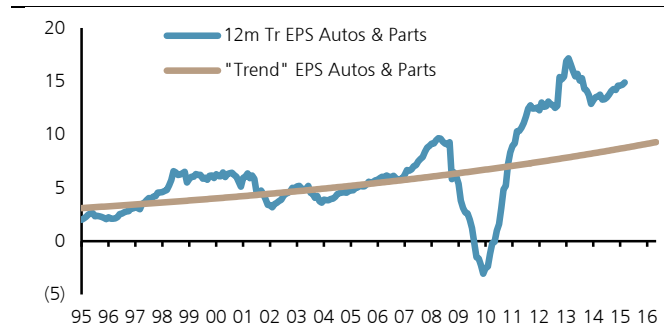
Source: UBS, Thomson Datastream

Appendix 3 – sector profit history

The below offers a long run snap-shot of sector profits and a mid cycle PEs

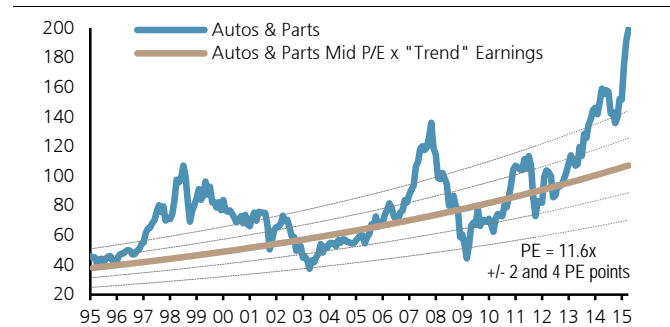
Automobile & Parts:

Figure 3: Historical trend earnings



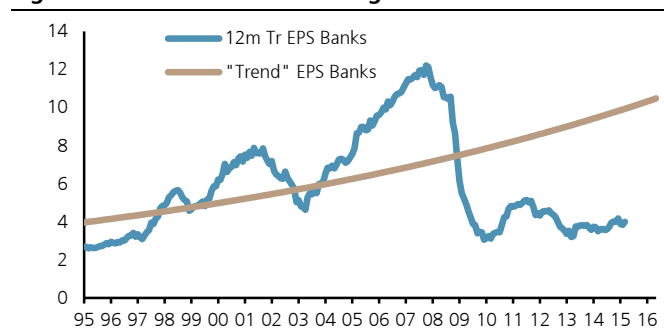
Source: IBES, Datastream, UBS European Market Map

Figure 4: "mid x mid" valuations



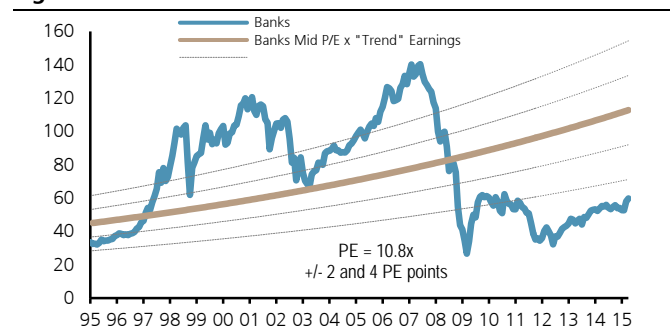
Banks:

Figure 5: Historical trend earnings



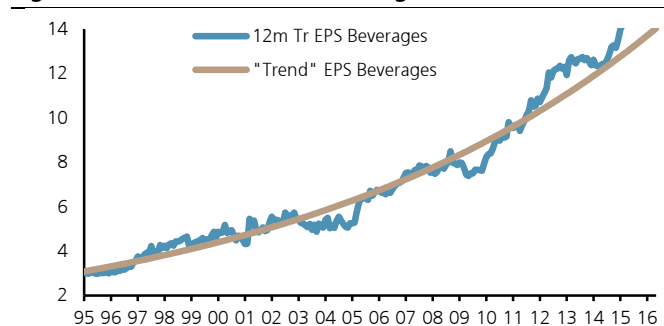
Source: IBES, Datastream, UBS European Market Map

Figure 6: "mid x mid" valuations



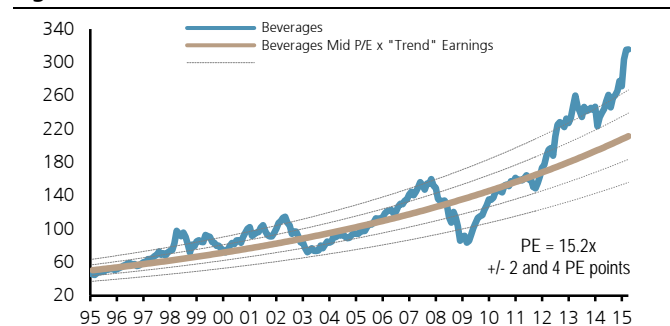
Beverages:

Figure 729: Historical trend earnings



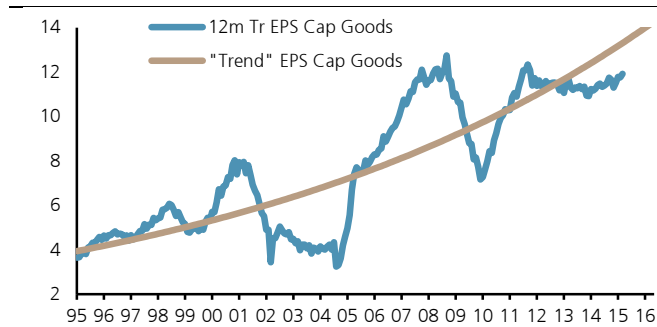
Source: IBES, Datastream, UBS European Market Map

Figure 8: "mid x mid" valuations



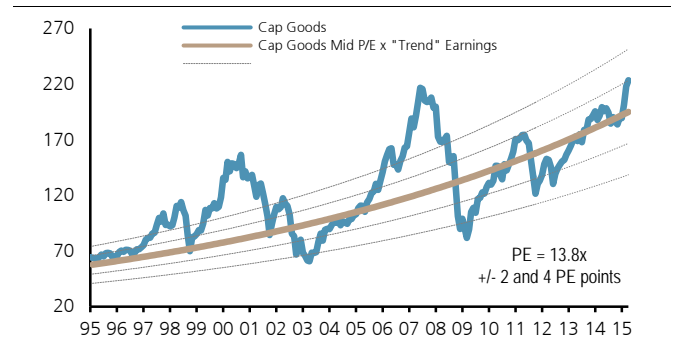
Capital Goods:

Figure 930: Historical trend earnings



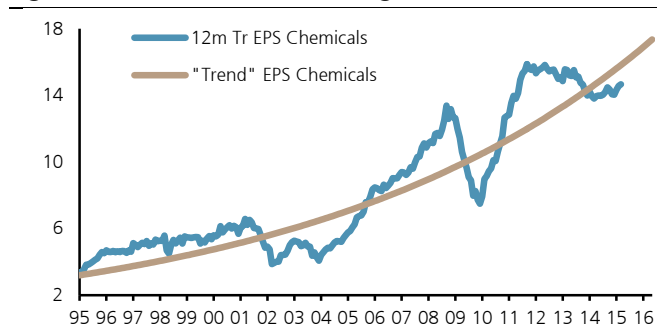
Source: IBES, Datastream, UBS European Market Map

Figure 10: "mid x mid" valuations



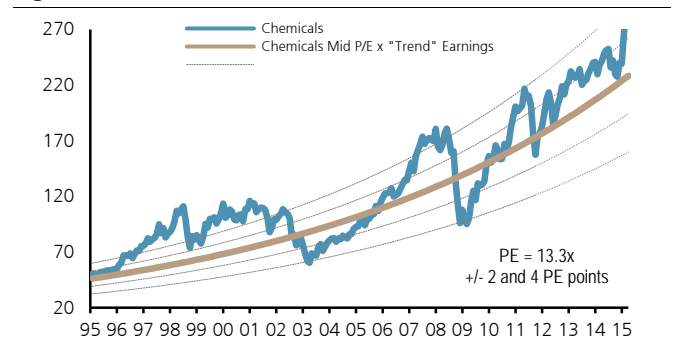
Chemicals:

Figure 11: Historical trend earnings



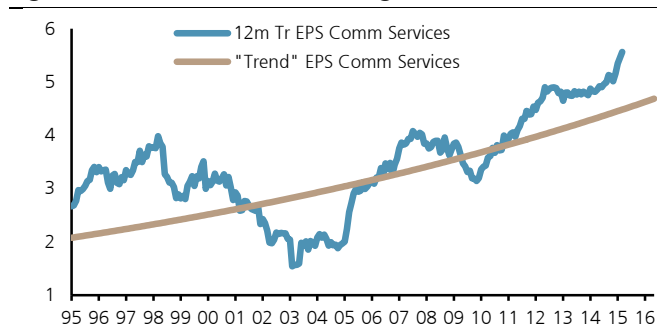
Source: IBES, Datastream, UBS European Market Map

Figure 1231: "mid x mid" valuations



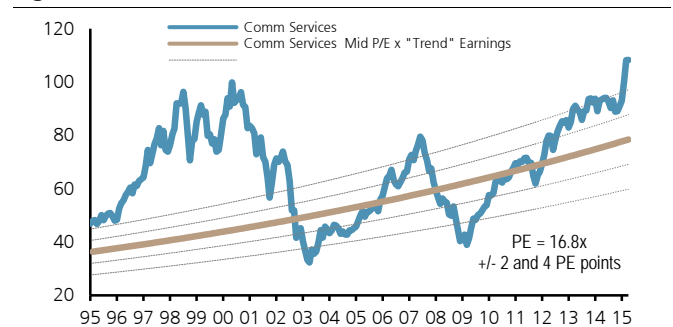
Commercial Services:

Figure 13: Historical trend earnings



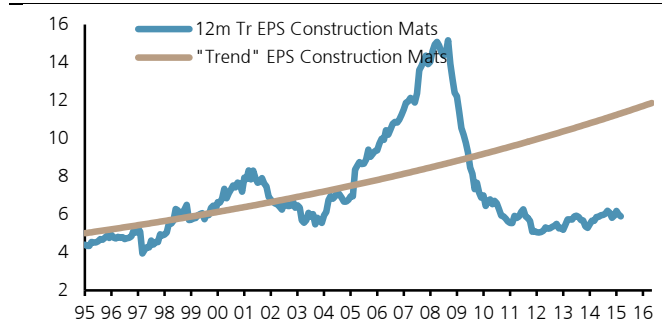
Source: IBES, Datastream, UBS European Market Map

Figure 14: "mid x mid" valuations



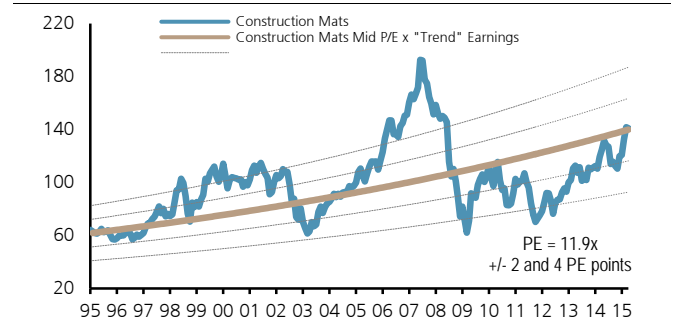
Constructions & Materials:

Figure 15: Historical trend earnings



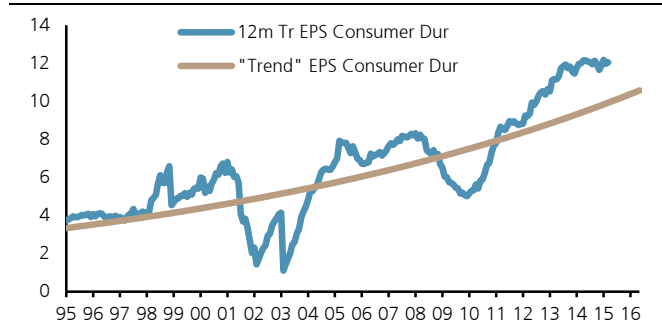
Source: IBES, Datastream, UBS European Market Map

Figure 16: "mid x mid" valuations



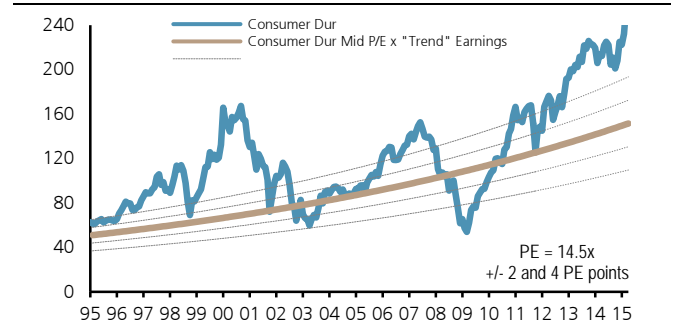
Consumer Durables:

Figure 17: Historical trend earnings



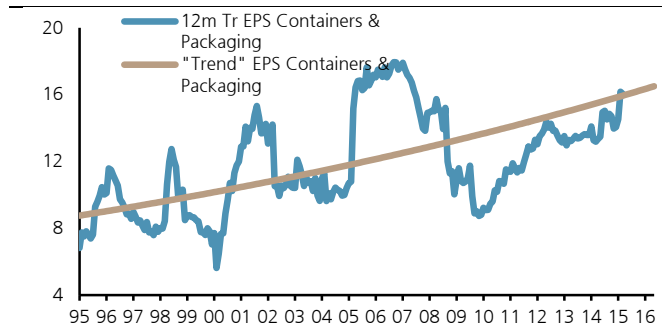
Source: IBES, Datastream, UBS European Market Map

Figure 18: "mid x mid" valuations



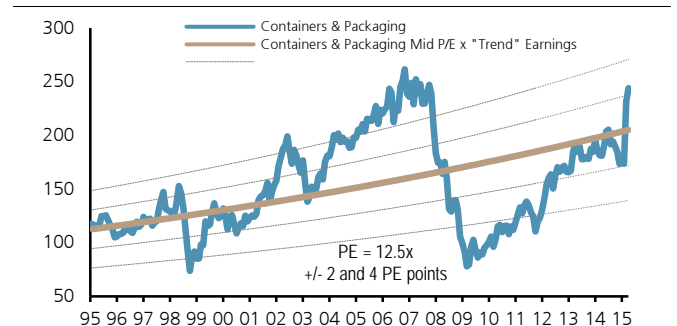
Containers & Packaging:

Figure 19: Historical trend earnings



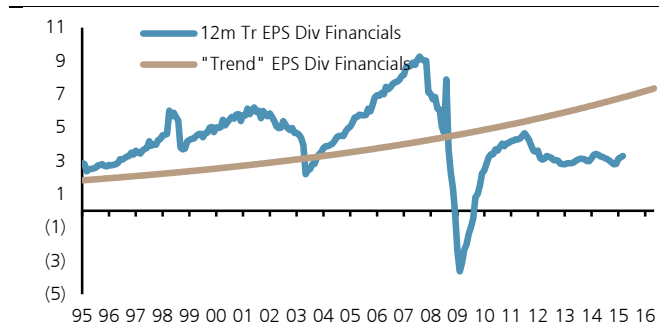
Source: IBES, Datastream, UBS European Market Map

Figure 20: "mid x mid" valuations



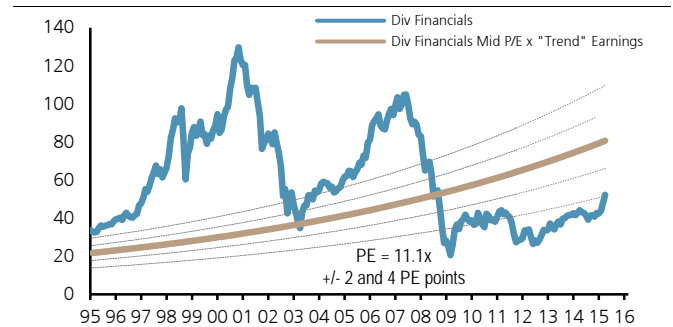
Diversified Financials:

Figure 21: Historical trend earnings



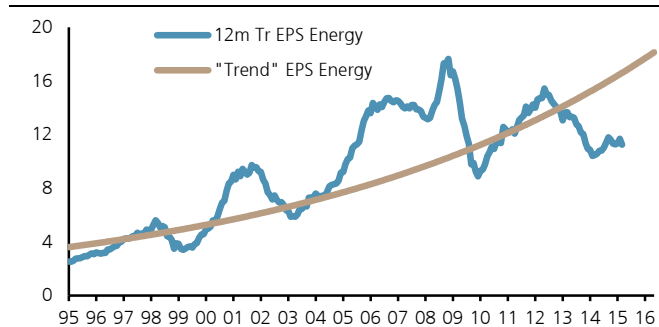
Source: IBES, Datastream, UBS European Market Map

Figure 22: "mid x mid" valuations



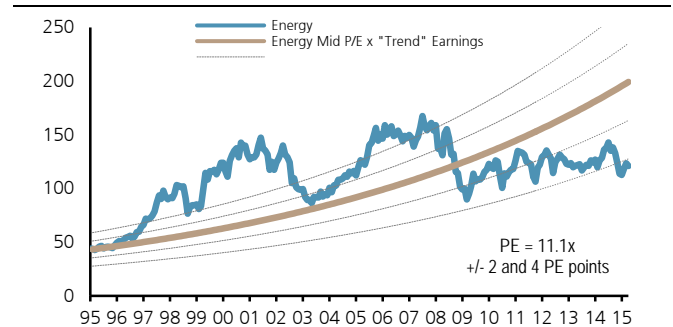
Energy:

Figure 23: Historical trend earnings



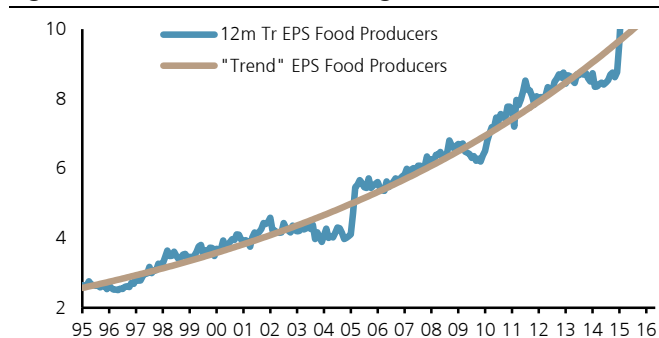
Source: IBES, Datastream, UBS European Market Map

Figure 24: "mid x mid" valuations



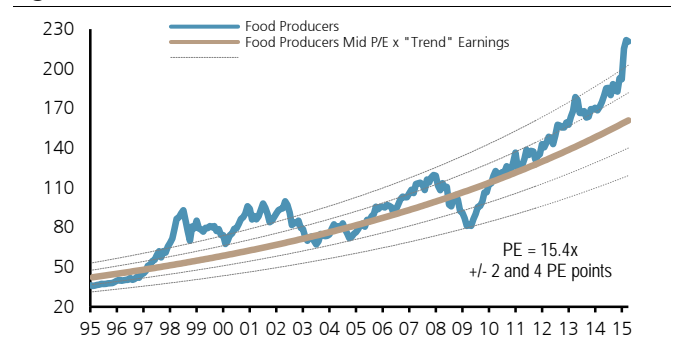
Food Producers:

Figure 25: Historical trend earnings



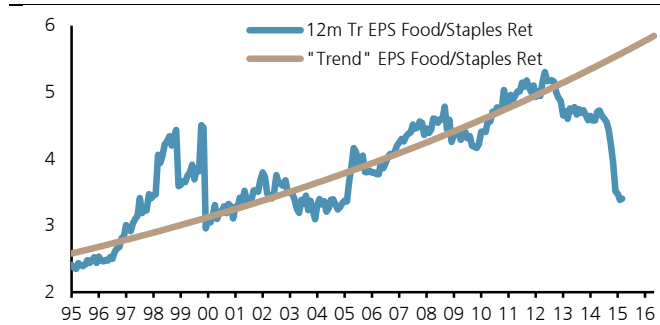
Source: IBES, Datastream, UBS European Market Map

Figure 26: "mid x mid" valuations



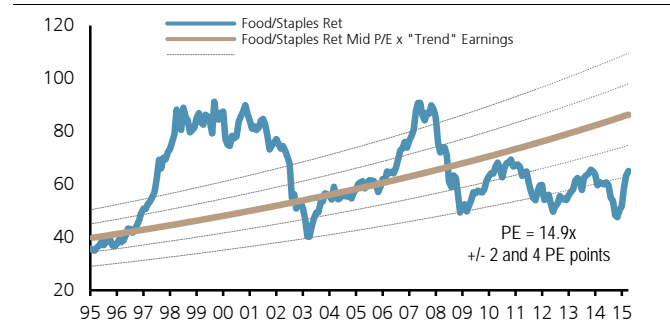
Foods & Staples Retail:

Figure 2732: Historical trend earnings



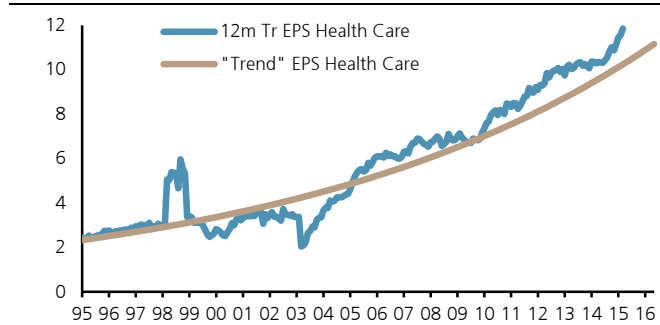
Source: IBES, Datastream, UBS European Market Map

Figure 338: "mid x mid" valuations



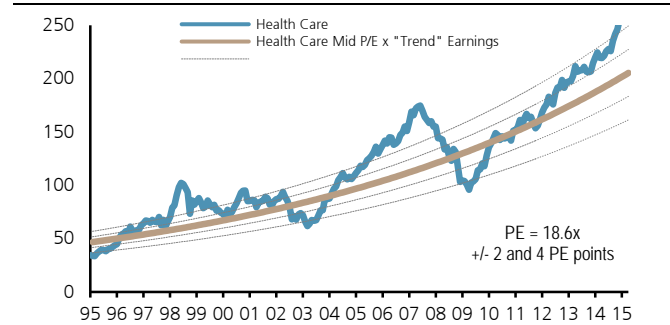
Health Care Equip:

Figure 29: Historical trend earnings



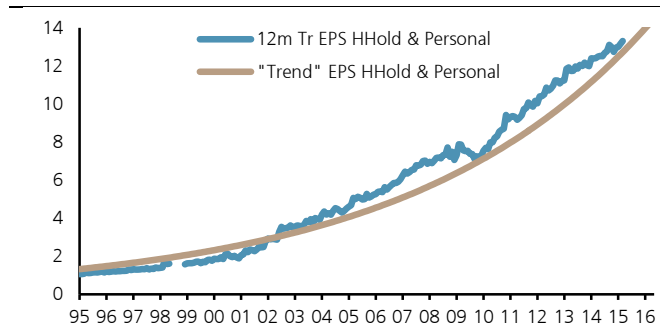
Source: IBES, Datastream, UBS European Market Map

Figure 30: "mid x mid" valuations



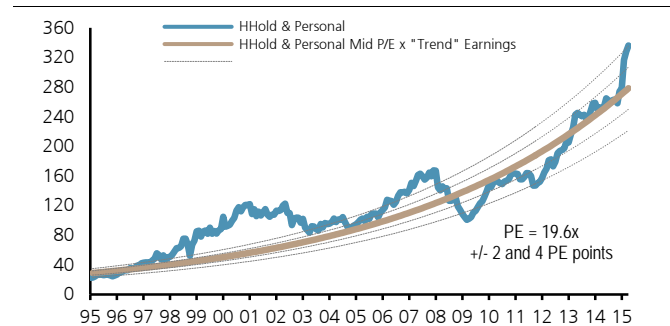
Household & Personal:

Figure 31: Historical trend earnings



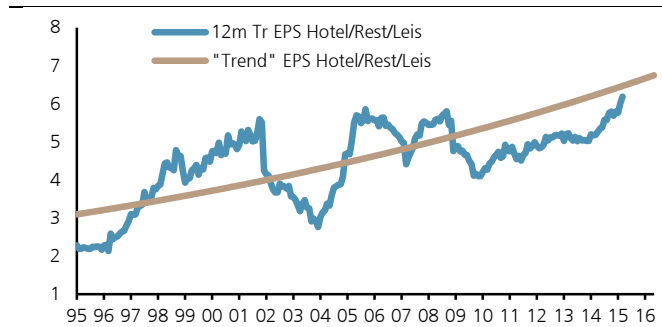
Source: IBES, Datastream, UBS European Market Map

Figure 32: "mid x mid" valuations



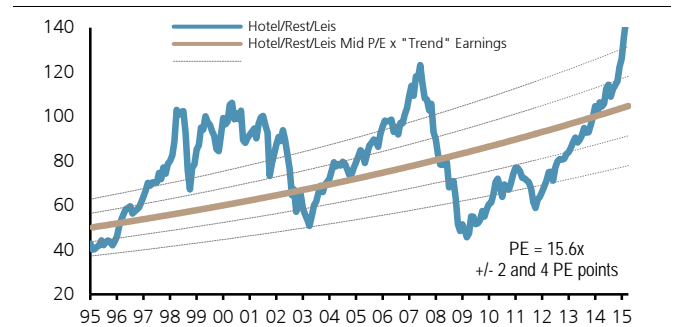
Hotel/Restaurant/Leisure:

Figure 33: Historical trend earnings



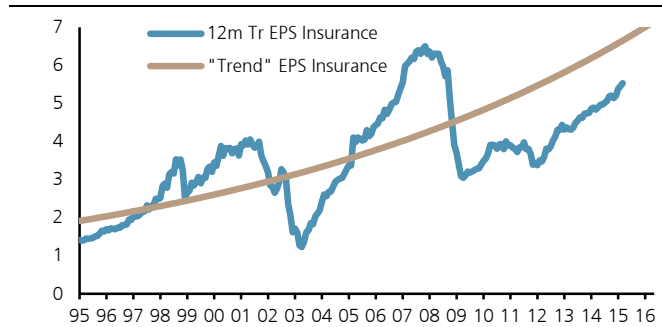
Source: IBES, Datastream, UBS European Market Map

Figure 34: "mid x mid" valuations



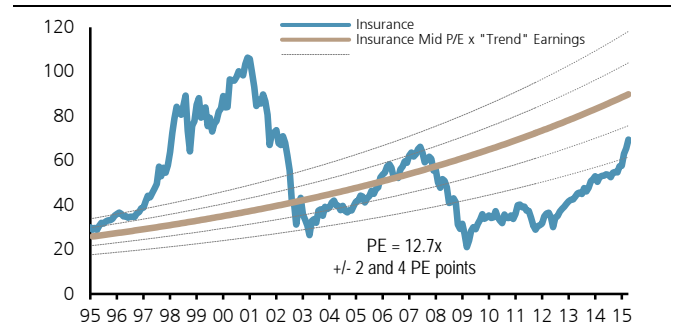
Insurance:

Figure 35: Historical trend earnings



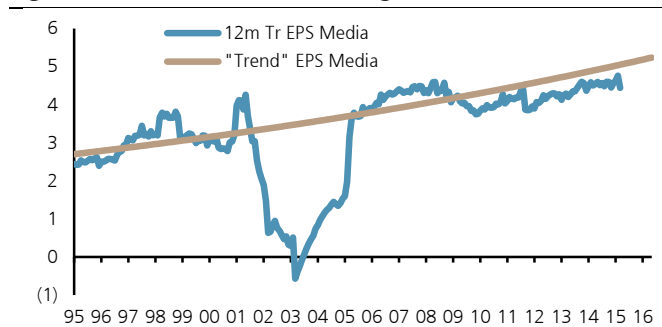
Source: IBES, Datastream, UBS European Market Map

Figure 36: "mid x mid" valuations



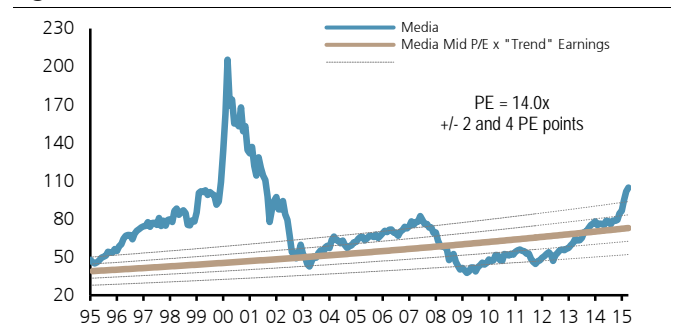
Media:

Figure 37: Historical trend earnings



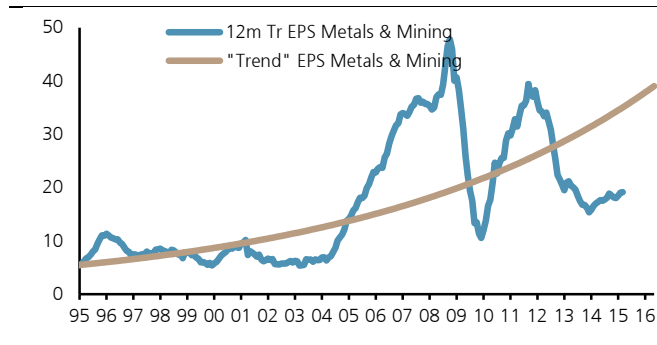
Source: IBES, Datastream, UBS European Market Map

Figure 38: "mid x mid" valuations



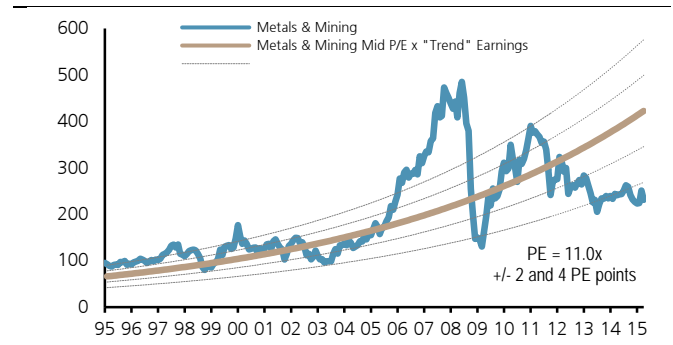
Metals & Mining:

Figure 39: Historical trend earnings



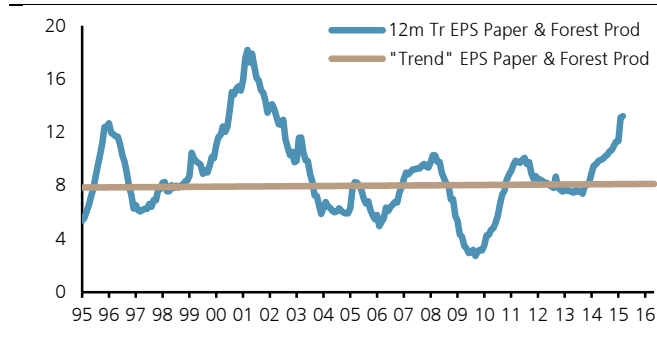
Source: IBES, Datastream, UBS European Market Map

Figure 40: "mid x mid" valuations



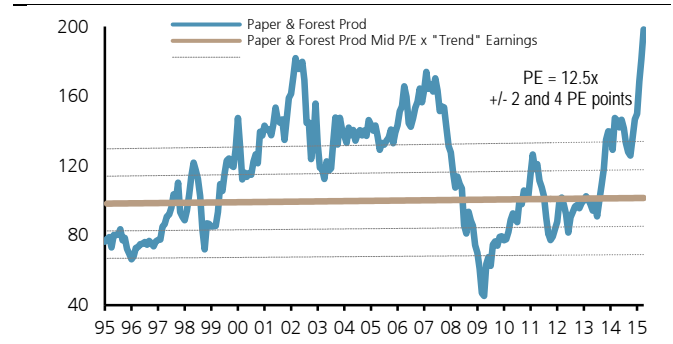
Paper & Forest Products:

Figure 41: Historical trend earnings



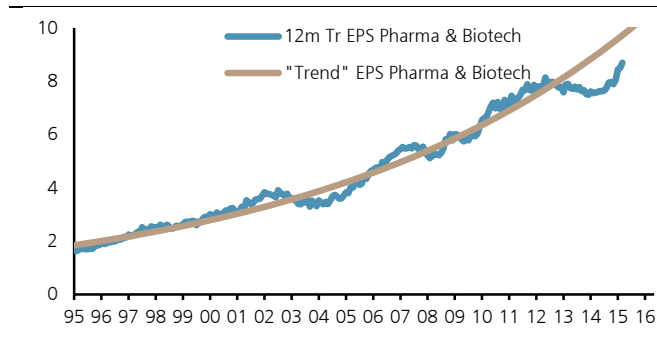
Source: IBES, Datastream, UBS European Market Map

Figure 42: "mid x mid" valuations



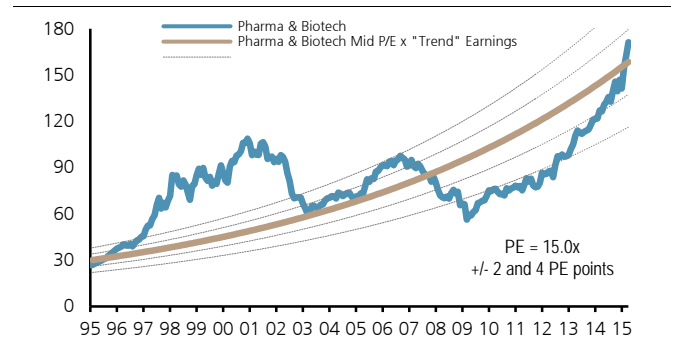
Pharmaceuticals & Biotech:

Figure 43: Historical trend earnings



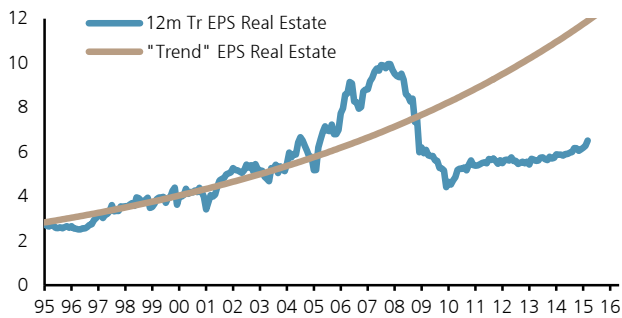
Source: IBES, Datastream, UBS European Market Map

Figure 44: "mid x mid" valuations



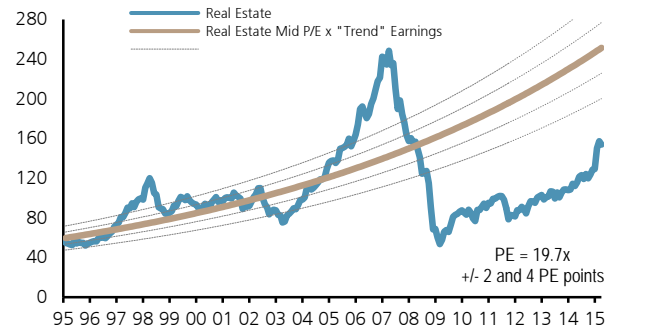
Real Estate

Figure 34: Historical trend earnings



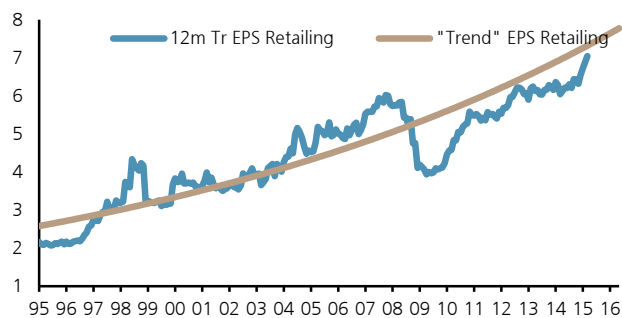
Source: IBES, Datastream, UBS European Market Map

Figure 35: "mid x mid" valuations



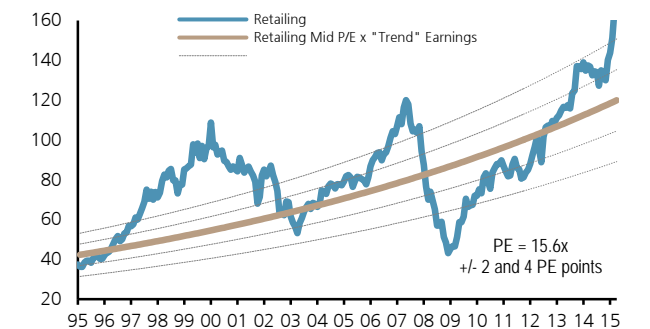
Retailing:

Figure 47: Historical trend earnings



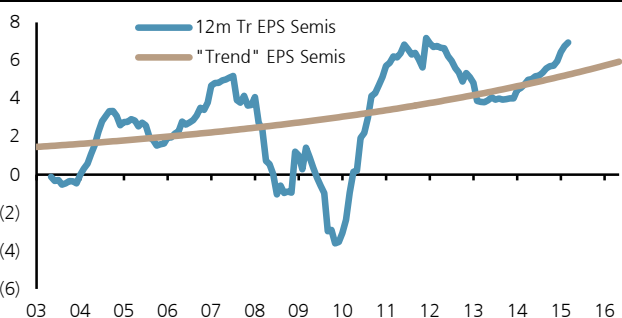
Source: IBES, Datastream, UBS European Market Map

Figure 48: "mid x mid" valuations



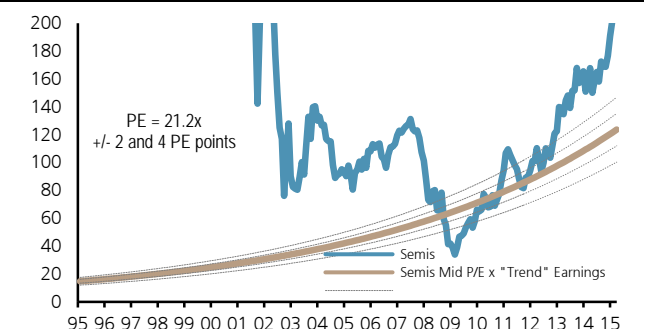
Semiconductor & Equipment:

Figure 49: Historical trend earnings



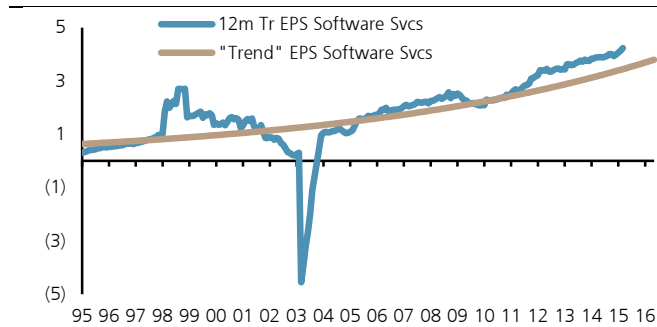
Source: IBES, Datastream, UBS European Market Map

Figure 50: "mid x mid" valuations



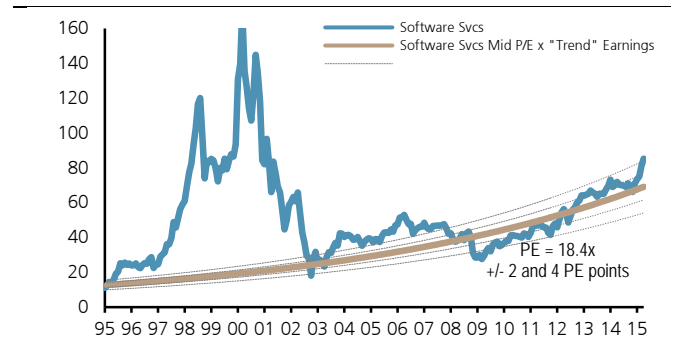
Software & Services:

Figure 51: Historical trend earnings



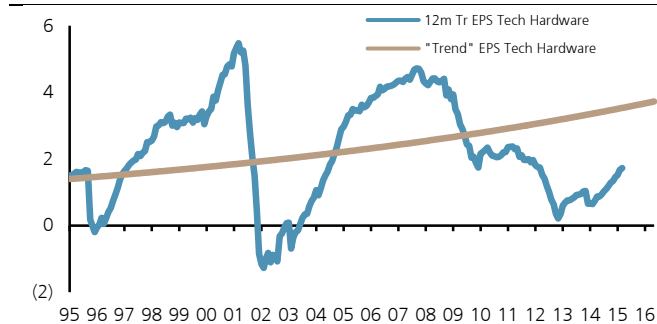
Source: IBES, Datastream, UBS European Market Map

Figure 52: "mid x mid" valuations



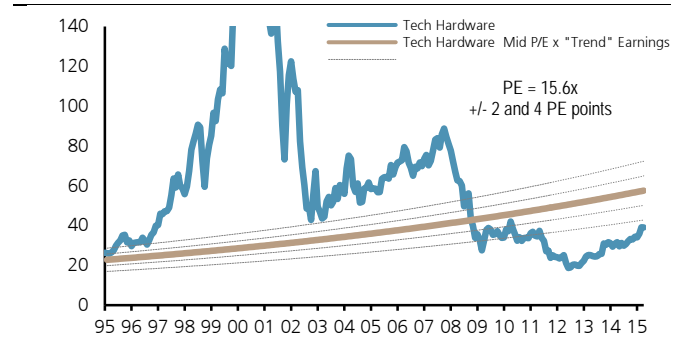
Tech Hardware:

Figure 53: Historical trend earnings



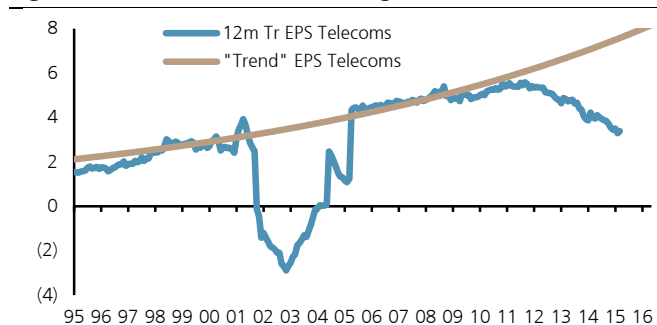
Source: IBES, Datastream, UBS European Market Map

Figure 54: "mid x mid" valuations



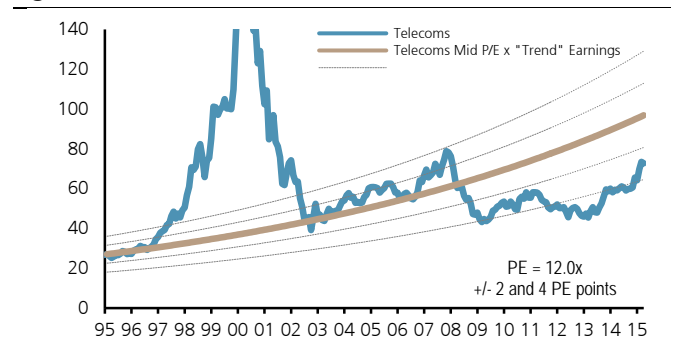
Telecommunications:

Figure 55: Historical trend earnings



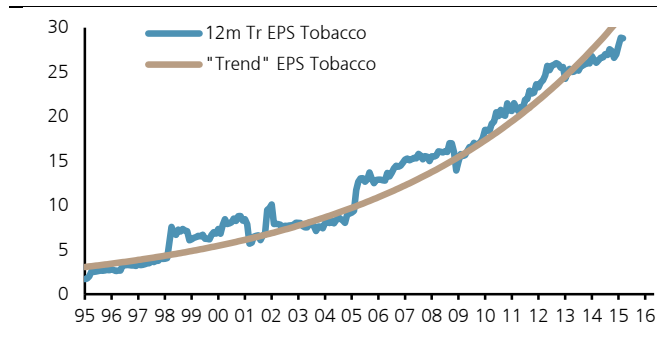
Source: IBES, Datastream, UBS European Market Map

Figure 56: "mid x mid" valuations



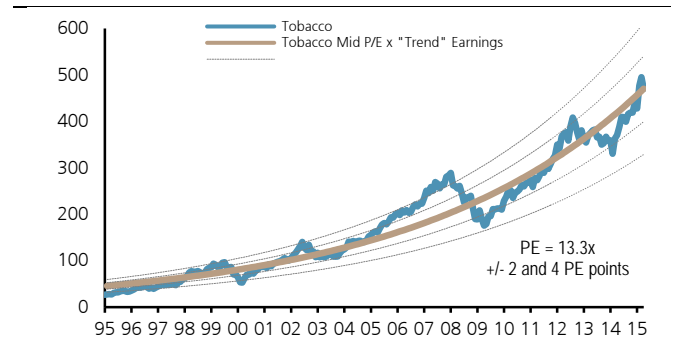
Tobacco

Figure 57: Historical trend earnings



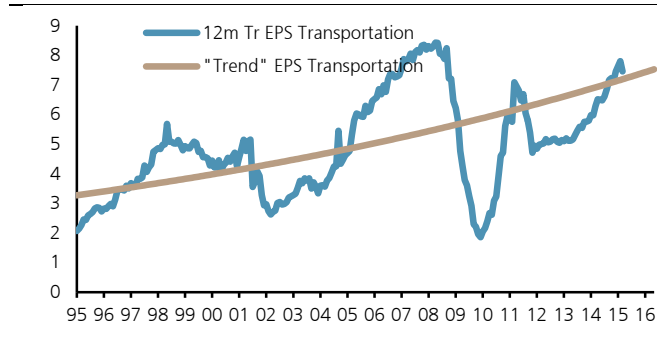
Source: IBES, Datastream, UBS European Market Map

Figure 58: "mid x mid" valuations



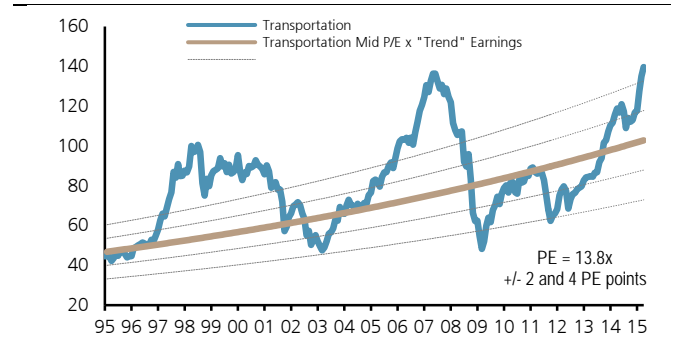
Transport:

Figure 59: Historical trend earnings



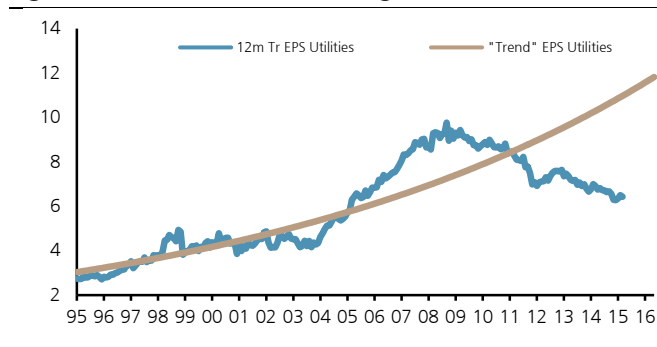
Source: IBES, Datastream, UBS European Market Map

Figure 60: "mid x mid" valuations



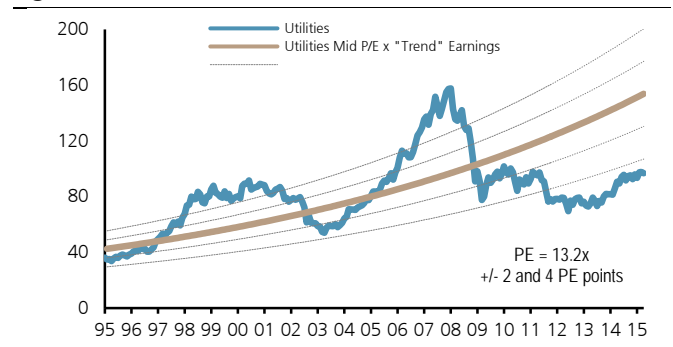
Utilities:

Figure 36: Historical trend earnings



Source: IBES, Datastream, UBS European Market Map

Figure 37: "mid x mid" valuations



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

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Neutral	FSR is between -6% and 6% of the MRA.	43%	33%
Sell	FSR is > 6% below the MRA.	12%	20%
Short-Term Rating	Definition	Coverage ³	IB Services ⁴
Buy	Stock price expected to rise within three months from the time the rating was assigned because of a specific catalyst or event.	less than 1%	less than 1%
Sell	Stock price expected to fall within three months from the time the rating was assigned because of a specific catalyst or event.	less than 1%	less than 1%

Source: UBS. Rating allocations are as of 31 March 2015.

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A.P.Moller-Maersk	MAERSKb.CO	Neutral	N/A	DKr13,800.00	17 Apr 2015
Accor ^{2, 4, 5}	ACCP.PA	Buy	N/A	€49.40	17 Apr 2015
Allianz S.E ⁵	ALVG.DE	Buy	N/A	€161.25	17 Apr 2015
Barratt Developments ¹³	BDEV.L	Buy	N/A	531p	17 Apr 2015
BBVA ^{2, 4, 5, 16b}	BBVA.MC	Buy	N/A	€9.20	17 Apr 2015
BNP Paribas ^{4, 5}	BNPP.PA	Neutral	N/A	€55.11	17 Apr 2015
Bouygues	BOUY.PA	Neutral	N/A	€37.00	17 Apr 2015
Carnival Plc ^{2, 5, 6b, 7, 14, 16b}	CCL.L	Buy	N/A	3,217p	17 Apr 2015
Crédit Agricole SA ^{2, 4, 5}	CAGR.PA	Buy	N/A	€13.40	17 Apr 2015
Credit Suisse Group ^{5, 16b}	CSGN.VX	Neutral	N/A	CHF26.61	17 Apr 2015
EDF	EDF.PA	Neutral	N/A	€22.92	17 Apr 2015
Energias de Portugal ^{4, 5, 6a}	EDP.LS	Buy	N/A	€3.60	17 Apr 2015
Ericsson ^{16b}	ERICb.ST	Neutral	N/A	SKr107.10	17 Apr 2015
Fraport AG	FRAG.DE	Buy	N/A	€56.05	17 Apr 2015
GDF Suez ^{4, 5}	GSZ.PA	Neutral	N/A	€19.32	17 Apr 2015
HSBC ^{2, 4, 5, 6a, 16a, 16b}	HSBA.L	Neutral	N/A	600p	17 Apr 2015
Husqvarna	HUSQb.ST	Neutral	N/A	SKr58.50	17 Apr 2015
Iberdrola ^{4, 5}	IBE.MC	Buy	N/A	€6.00	17 Apr 2015
Icade SA ⁵	ICAD.PA	Neutral	N/A	€79.64	17 Apr 2015
Inchcape ¹³	INCH.L	Neutral	N/A	832p	17 Apr 2015
ING ^{2, 4, 5, 16b}	ING.AS	Buy	N/A	€13.45	17 Apr 2015
Intesa SanPaolo ^{2, 4, 5}	ISP.MI	Buy	N/A	€2.98	17 Apr 2015
Klepierre SA ^{2, 4, 5, 18}	LOIM.PA	Neutral	N/A	€44.60	17 Apr 2015
Lafarge ^{3a, 3d, 3e, 4}	LAFP.PA	Neutral	N/A	€64.21	17 Apr 2015
Lagardere ⁴	LAGA.PA	Neutral	N/A	€28.58	17 Apr 2015
Marks & Spencer	MKS.L	Buy	N/A	564p	17 Apr 2015
Mediaset ^{3c}	MS.MI	Buy	N/A	€4.37	17 Apr 2015
Nokia ^{16b}	NOK1V.HE	Neutral	N/A	€7.15	17 Apr 2015
OERLIKON ^{2, 4, 5}	OERL.S	Buy	N/A	CHF11.85	17 Apr 2015
Orange ^{16b}	ORAN.PA	Neutral	N/A	€15.41	17 Apr 2015
OTE ²⁰	OTEr.AT	Neutral (CBE)	N/A	€7.50	17 Apr 2015
Randstad	RAND.AS	Neutral	N/A	€54.70	17 Apr 2015
Saint Gobain	SGOB.PA	Neutral	N/A	€40.61	17 Apr 2015
Société Générale ^{2, 4, 6a, 22}	SOGN.PA	Buy	N/A	€44.83	17 Apr 2015
Sulzer ^{4, 5}	SUN.S	Neutral	N/A	CHF107.50	17 Apr 2015
Tate & Lyle	TATE.L	Buy	N/A	653p	17 Apr 2015
Telefonica ^{1, 2, 3b, 3c, 3f, 4, 5, 16b, 22}	TEF.MC	Neutral	N/A	€13.48	17 Apr 2015
TF1	TFFP.PA	Buy	N/A	€16.53	17 Apr 2015
UBM ¹³	UBM.L	Buy	N/A	558p	17 Apr 2015
Vinci	SGEF.PA	Buy	N/A	€55.80	17 Apr 2015
Vivendi ¹³	VIV.PA	Neutral	N/A	€23.43	17 Apr 2015

Company Name	Reuters	12-month rating	Short-term rating	Price	Price date
William Hill ¹³	WMH.L	Buy	N/A	372p	17 Apr 2015

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

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